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ECONOMICS OF DEPENDENCE ON FOREIGN OIL-RISING GASOLINE PRICES

HEARING

BEFORE THE

SELECT COMMITTEE ON
ENERGY INDEPENDENCE
AND GLOBAL WARMING
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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HEARING ON ECONOMICS OF DEPENDENCE ON FOREIGN OIL—RISING GASOLINE PRICES

WEDNESDAY, MAY 9, 2007

HOUSE OF REPRESENTATIVES,
SELECT COMMITTEE ON ENERGY INDEPENDENCE
AND GLOBAL WARMING,
Washington, DC.

The Committee met, pursuant to call, at 2 p.m.., in room 2318, Rayburn House Office Building, Hon. Edward Markey (chairman of the Committee) presiding.

Present: Representatives Markey, Blumenauer, Inslee, Solis, Herseth, Cleaver, Hall, McNerney, Sensenbrenner, Shadegg, Walden, Sullivan, and Blackburn.

Chairman MARKEY. Ladies and gentlemen, welcome. This hearing is commenced on the economics of dependence on foreign oil, rising gasoline prices.

In 1973 Americans were shocked by a sudden increase in gasoline prices and supply shortage that were brought on by the Arab OPEC member states. And the price of the gasoline rose from 38 cents in May of '73 to .55 in June of 1974. Lines for refueling formed as supplies were constrained. But America responded. We largely moved away from the use of oil for electricity generation, going from 16 percent oil fired generation in '72 to 2.5 percent today.

We promoted energy efficiency and conservation, and most effectively in 1975 the Congress passed and President Ford signed a bill which doubled the fuel economy for the vehicle fleet in the United States from 13.5 miles per gallon to 27.5 miles per gallon, a doubling of fuel economy for the vehicles we drive in America in ten years. And what happened?

Well, the dependence on foreign oil in the United States dropped from 46.5 percent in 1977 to 27 percent in 1985, a precipitous drop in oil consumption in the United States. We backed out 4.3 million barrels a day of energy consumption as the fuel economy average for the American automotive fleet doubled in just ten years.

Well, today we are unfortunately faced with a similar crises. Because since 1986 what we are seeing is a dramatic rise in oil consumption, largely related to the fact that there has been an SUV-like truck exception that has seen the average for fuel economy go backwards since 1986 from 27 back to 25 miles per gallon, even as the United States has pretty much lead the way in deploying the internet around the world, cracked the human genome, here in auto mechanics we have actually gone backwards for the last 20

years. But with an increase from 27 percent to 60 percent our dependence upon imported oil.

If all we did in the United States was to improve our fuel economy average from 25 miles per gallon to 35 miles per gallon, we would back out all of the oil that the United States imports from the Persian Gulf states. Just an increase in ten miles per gallon. And we can do that.

As the price of gasoline now passes $3 and experts are predicting are $4 a gallon gasoline, this becomes an even more serious issue. Because not only are we spending all this money to import the oil, but the money which is then spent is used by many of these countries to finance the terrorism, to finance the hate which is then redirected back at the United States of America. It is the worst of all worlds for our country.

If you are a family only one car making $20,000 a year, $3 a gallon gasoline consumes almost 9 percent of the annual income of that family.

For a family making $40,000 a year, $3 a gallon gasoline costs them 4.5 percent of their annual budget.

So this issue becomes something that is very real for ordinary Americans. This is a lot of money. Increasingly, OPEC is able to tip consumers upside down and shake money out of their pockets because we do not have a national policy which is effective to protect the consumers in our country.

So this issue is something that is central to the American well-being. We have to increase the fuel economy of our cars and trucks. We have to increase the amounts of renewable, home grown biofuels. We have to prevent gasoline price gouging during times of tight supply and high demand. Gasoline prices are at $3 a gallon right now. Experts say that $4 a gallon is right around the corner for the American consumer.

I look forward to gaining the perspective of our witnesses on this issue. It is an issue that effects our economy. It effects our national security. It effects the very ability of our country to be able to deal with issues both domestic and international. And so I do not think there can be a more important subject. I think that it is critical for us to understand that the time has now arrived for the Congress and, hopefully, for the President to begin to do something about this outrageous high priced gasoline that consumers are forced to purchase and as a result, make other choices that deprive their families of what they need.

[The statement of Hon. Edward Markey follows:]

Representative Edward J. Markey (D-MA)
Opening Statement
Hearing, "Economics of Dependence on Foreign Oil - Rising Gasoline Prices"
Select Committee on Energy Independence and Climate Change
May 9, 2007, 2:00 PM, 2318 Rayburn House Office Building

In 1973, Americans were shocked by a sudden increase in gasoline prices and supply shortages brought on by Arab OPEC Member States' decision to embargo oil and cut back on production to protest American support for Israel during the Yom Kippur War. The price of gasoline went up from 38.5 cents a gallon in May 1973 to 55.1 cents a gallon in June 1974. Lines for refueling formed as supplies were constrained.

But America responded. We largely moved away from the use of oil for electricity generation – going from 16% oil-fired generation in 1972 to only 2.5% today. We promoted energy efficiency and conservation in our homes and offices. And most effectively, we mandated an increase in fuel economy from 13.5 miles per gallon to 27.5 miles per gallon – a doubling of fuel economy – in 10 years.

And what happened? Our dependence on foreign oil went from 46.5% in 1977, the year the new fuel economy law took effect, to 27% in 1985 when it was fully phased in. We took more than 4 million barrels of oil a day off the roads by making cars use less of it.

We now face a crisis similar to the crisis we faced in the 1970s. Fuel economy standards for cars have not been increased in 20 years, and because of the higher numbers of SUVs on the road that were not part of the original fuel economy law, the fuel economy of our fleet is actually LOWER now than it was in 1987.

Our oil dependence has skyrocketed to more than 60%. And gasoline prices have reached more than $3 a gallon – surpassing the level they reached the week after Hurricane Katrina hit.

It is no coincidence that gasoline prices continue their steady climb upward: 45 percent of the world's oil is located in Iraq, Iran and Saudi Arabia. What happens in those countries has a dramatic impact on oil prices – our foreign policy in this unstable region of the world is driven by our energy needs right here at home. And Americans increasingly believe that the human cost over there and the economic costs over here are simply too high in a war that to

many Americans is looking less and less like a struggle to prevent Saddam from getting Weapons of Mass Destruction and more and more like a struggle over oil and the terrorist groups funded out of Persian Gulf oil revenues.

But on top of the national security threat, it is important for Congress to be aware of the impacts on ordinary Americans. Today, we have invited witnesses to testify about the impacts rising gasoline prices have on their businesses and their lives. Each $1 increase in the price of gasoline adds $594 to the average consumer's annual transportation bill. For a family owning one car making $20,000 a year, $3 a gallon gasoline consumes almost 9% of its annual income. For a family making $40,000, $3 gasoline costs them 4.5% of its annual budget.

But the impacts on Americans do not end at the consumer level. Today we will hear from several business owners who can describe just how much higher fuel costs impact them. Farmers must pay for the fuel costs associated with operating farm equipment and for the costs of transporting their produce to purchasers. School districts have been forced to choose between providing school-bus service and the full range of planned curriculum and student activities. And small business owners who rely heavily on transportation have seen dramatic impacts to their bottom lines.

In just the FIRST THREE MONTHS of 2007, Exxon Mobil, Chevron, ConocoPhillips, Shell and BP collectively made $29.44 BILLION DOLLARS in profits. As soon as Democrats retook control of the House of Representatives, we passed legislation by a bipartisan vote of 264-163 to close some tax loopholes for large oil companies and recover royalties for oil and gas obtained from drilling in public waters. The $14 billion dollars obtained from these sources was then directed to a fund for energy efficient technologies and renewable energy. But the oil industry, many Congressional Republicans and the Bush Administration OPPOSED most provisions in this legislation – even as the oil industry made more than twice the amount of money Congress obtained from closing these loopholes in just **3 months.**

Instead, Republicans accuse Democrats of failing to support their so-called "solutions":

- Republican leadership and the Bush Administration say that we need to allow drilling on the Outer Continental Shelf or in the Arctic National Wildlife Refuge. Roughly 80 percent of the oil and gas resources in the Outer Continental Shelf are located in areas where drilling is already allowed! Moreover, of the 8,000 leases oil companies hold in the Gulf of Mexico, they are producing oil on fewer than 25 percent of them. The oil

companies should be drilling on the leases that they already have, where the majority of the oil is, not looking to place drill rigs off of each of America's beaches. The reality is that the United States sits on only 3% of the world's known oil reserves. We can't drill our way to lower gasoline prices or energy independence even if we drill on every last piece of environmentally sensitive land in the country.

- Republican leadership says that we need to enable the expansion of refinery capacity and streamline the permitting process. But the reality is that even as the oil industry itself made decisions to shut down refineries, refining capacity itself has been dramatically increased, and the permitting requirements for new refineries has never been shown to be a problem.
- And finally, Republican leadership says that we need to reduce the number of so-called "boutique fuels" required to meet clean air standards. But Republicans themselves added a section to last year's Energy Bill entitled "Reducing the Proliferation of Boutique Fuels" which was supposed to solve this problem.

I believe that the solutions to high gasoline prices and reducing our oil dependence MUST include:

- Increasing the fuel economy of our cars and trucks
- Increasing the amounts of renewable, home-grown biofuels
- And preventing gasoline price gouging during times of tight supply and high demand.

Gasoline prices are at $3 a gallon now, and experts say that $4 a gallon gasoline could be right around the corner. I look forward to gaining the perspective our witnesses can provide on what $3 a gallon means to them today, and what will happen if the experts predicting $4 a gallon are proved right.

Chairman MARKEY. The time for the opening comments by the Chair has expired. I turn to recognize the Ranking Member, the Gentleman from Wisconsin, Mr. Sensenbrenner.

Mr. SENSENBRENNER. Thank you, Mr. Chairman.

Contrary to popular belief this Select Committee is not just about global warming. Energy independence is also in this panel's title. And I am pleased that today we will be talking about America's dependence on foreign oil.

Nowhere do Americans feel our economy's reliance on foreign oil more than when filling up at the pump. Everyone who drives knows that the cost of gas has been rising. While some of us have almost become use to gasoline price fluctuations, most of us will never get used to the consequences of high gas prices.

Some of the reasons for these fluctuations are straight from the economics 101 textbook. Demand for oil is rising around the world and cartels like OPEC, which enforce production controls, are not doing much to help keep costs down.

Geo-political uncertainty is also doing its part to keep the value of a barrel of oil high.

If American drivers are going to see gas prices drop, we need to break our country's dependence on foreign oil. But we also need to break Washington's dependency on taxes and regulation. Lowering the cost of gas is about freeing drivers from regulations that keep prices high and about reducing dependency on foreign oil.

When crude oil gets to U.S. shores it must be processed into gasoline at domestic refineries. Today the U.S. has the ability to refine about 17 million barrels of oil a day into gasoline. Unfortunately, the average U.S. demand for gasoline is 21 million barrels a day. This gap is often met by importing gasoline that has been refined in other countries, further expanding our reliance on foreign sources of energy.

The residents of my District, which is the area surrounding Milwaukee, often experience the hidden fee cost by limited refinery capacity. While the national average for gasoline was reasonably reported to be $3.07 a gallon, the Milwaukee Journal Sentinel reported yesterday that my constituents are paying $3.28 a gallon. And why so high? Scheduled maintenance, a power failure and even a fire have reduced capacity at the refineries in Indiana and Minnesota that supply the Milwaukee area.

Mr. Felmy of API says the industry is working to increase refinery capacity, and that's very good. However, I also note that it has been 30 years since a new gasoline refinery has been built in the United States. An expensive and cumbersome permitting process has contributed to this trend.

Republicans last year tried to streamline this process in a way that will continue to protect the environment. But, unfortunately, we met too much opposition along the way.

As we hear from the panelists today, higher gas prices are felt nearly every corner of the economy from farmers to small businesses to school bus operators.

Mr. Michael Mitternight says in his testimony that gas prices are wrecking havoc on America's small businesses. Mr. Mitternight also rightly notes that onerous government regulations hit small businesses very hard.

As Congress looks for ways to address both global warming and energy independence issue, I am worried that the cure may be worse than the cough. The most recent report from the U.N. Intergovernmental Panel on Climate Change includes a proposal for a tax of $100 for each ton of carbon dioxide released into the atmosphere. The Washington Post reported last Saturday that that proposal could result in drivers paying up a $1 more for each gallon of gas they pump.

The testimony we will hear today shows that $4 a gallon gas would be a blow to the economy. Fortunately Mr. Mitternight also has many positive ideas on how to address these problems. He says that any government energy problem must focus on new technology, should use the power of markets and protect American jobs. And I agree. I will add that any energy or environmental policy must also produce tangible environment improvements and include international participation from countries like India and China.

I am pleased this panel is talking about energy independence. Let us hope that today's discussion helps us find way to free American drivers from both foreign oil and government regulators.

I thank the Chair and yield back the balance of time.

Chairman MARKEY. The Gentleman's time has expire.

The Chair recognizes the Gentleman from Oregon, Mr. Blumenauer.

Mr. BLUMENAUER. Thank you, Mr. Chairman.

I appreciate your setting the context in terms of how we rose to the challenge 30 years ago when we were facing this issue. The trends that you demonstrated in terms of failure for us to deal meaningfully with conservation, there is a very real issue in terms of refinery capacity. But it is not a case of tweaking, streamlining regulatory matter. I think the record will show that there has been a conscious effort to actually reduce the amount of refining capacity. There has been more consolidation. I look forward to being able to deal with some of the impacts that that has had in terms of the free market.

I know that there are other initiatives that are being examined to make sure that there is not collusion and unfair advantage being taken by people who are consumers. I think in any respect it is going to require a balanced approach in terms of dealing with supply, in terms of dealing with conservation, making sure that a market that is becoming less and less perfect both nationally and internationally, that we examine to see if there are ways that we can provide the protections to make sure that the market does in fact work.

I appreciate the breadth of opinions that are being offered. I had a chance to skim some of the testimony. I think it is going to be very useful for us to have as part of the record. And look forward to a conversation with people who are dealing with these consequences on an ongoing basis.

I know the people that I represent who are now looking at the third highest gasoline prices in the country, this is not an idol concern whether they are commuters, whether they are small business people or that they are people who are just breathing the air and wondering where we are going.

Thank you very much.

Chairman MARKEY. The Gentleman's time has expired.

The Chair recognizes the Gentleman from Arizona, Mr. Shadegg.

Mr. SHADEGG. Thank you, Mr. Chairman, for holding this hearing. And I will waive my opening statement and reserve.

Chairman MARKEY. The Gentleman reserves his time.

The Gentleman from Oregon, Mr. Walden.

Mr. WALDEN. Thank you, Mr. Chairman. I, too, would rather reserve my time and use it in questions.

Chairman MARKEY. The Gentlelady from California, Ms. Solis.

Ms. SOLIS. Thank you, Mr. Chairman.

And I am delighted to be here this afternoon to hear what our witnesses have to say. Every time I go home, and I go home just about every weekend here from Washington to visit my District in Los Angeles, the number one question that people tell me at any forum or any meeting is "When is the gas price going to go down, Hilda. I do not want to hear about anything else. I want to know when the gas prices are going to go down."

When you have working families suffering right now with other economic constraints on them, you hear about the price of gasoline nationally. Well, let me tell you, folks, in California and Los Angeles for the last two years it has been above $3. In fact, in my District in east Los Angeles, probably one of the poorest areas in the country, we are experiencing levels of $3.69 a gallon and sometimes even upwards on the west side of town, the higher income, maybe $4 and higher.

So we are talking about a real crunch on our pocketbook, but we are also talking about the cost of people who want to use public transportation. We are seeing proposals right now in my District where the Metropolitan Transportation District would like to increase their fees almost 80 percent. And the majority of those bus riders tend to be low income folks who do not have cars so they use alternative sources of transportation. But again because the high cost of gasoline and what have you, they are not going to be experiencing an increase from what is now at a $1.25 to up to $2. That is an 87 percent increase for the ridership. And many of constituents use those buses to get around town, to get to work, to see the doctor and what have you.

I am equally concerned also about our schools. And I know one of our witnesses will be talking about traveling on school buses. Well, I tend to represent one of the largest, second largest school district in the county, LA Unified School District. This was a question that I raised last year during the energy. Debate how we dealing with the high cost of fuel and fuel efficiency in trying to make sure that our students get to school on time and get home on time, and that they are safe. And believe me, there was not much discussion or concern at the time.

And, yes, I tend to agree with some of my colleagues here that costs that are being transferred onto the consumer are not transparent. And what I am trying to get to is that refineries and what have you, there is not a shortage of refineries. There is a shortage of political will.

So I look forward to hearing from our witnesses today.

Thank you, Mr. Chairman.

Chairman MARKEY. The Gentlelady's time has expired.

The Gentleman from Oklahoma, Mr. Sullivan.

Mr. SULLIVAN. Thank you, Mr. Chairman.

And thank you for holding this hearing today on an important issue of rising gas prices. I welcome this debate.

As you remember, in 2005 the Republican Majority in the House passed the Gasoline for America Security Act. The Gas Act helped bring greater quantities of fuel to the market by expanding domestic refining capacity and limiting the number of gasoline and diesel blends refineries must product. By increasing the quantity of fuel that makes it into American's neighborhood gas stations, we are able to help keep the price consumers pay per gallon from rising.

Additionally, by opening up the Outer Continental Shelf to new energy exploration, the House allowed for oil and natural gas exploration in an area holding 85 percent of America's Outer Continental Shelf energy, much of which was untapped because of a 25 year old ban on deep sea energy production.

Furthermore, if President Clinton had not vetoed ANWR legislation in 1995, the U.S. could be domestically producing 1 million barrels of oil from that area today. Having both these areas into play would allow the U.S. to have energy security through a more diverse supply.

I am submitting for the record a letter from the National School Transportation Association citing their support for past action on gas prices. This includes H.R. 5254, legislation from the 109th Congress which would have streamlined the permitting process to allow for new or expanded domestic refineries to be built. I, too, supported this legislation and was original sponsor. This noteworthy legislation would have helped meet America's increasing demand for gasoline by increasing domestic refining capacity. It is a shame that this legislation was not able to move past the Senate.

Thank you. And I yield back the balance of my time.

Chairman MARKEY. The Gentleman's time has expired.

The Chair recognizes the Gentleman from Missouri, Mr. Cleaver.

Mr. CLEAVER. Mr. Chairman, thank you for holding the hearing. I would reserve my time and use it to ask questions.

Chairman MARKEY. The Gentleman's time will be reserved.

The Chair recognizes the Gentleman from California.

Mr. MCNERNEY. Thank you, Mr. Chairman.

We all know that there are numerous factors impacting the price of a gallon of gasoline: World conflict, for example; refinery capacity as has been mentioned here earlier; weather changes such as Katrina can all contribute to fluctuating gas prices. However, we are now experiencing prices that are higher in California than the post-Katrina gouge. We are paying nearly 3.50 a gallon, as my colleague from California mentioned with reports from some stations in the Bay area just a nickel short of $4 a gallon. This kind of price hike is very bad for commuters and business alike.

We all know that we are going to experience even higher prices as the summer wears on and vacationers head out. Clearly if our cars and trucks had better fuel efficiency, lowering the demand for gasoline, the price of gas would be lower. The better the efficiency, the lower the price.

Moreover, wasteful consumption of gasoline does contribute to global warming, another very bad outcome.

So I am looking forward to hearing the testimony from today's witnesses. And I hope we can highlight just how devastating high prices can be on our small businesses.

Thank you, Mr. Chairman.

Chairman MARKEY. The Gentleman from California time has expired.

The Chair recognizes the Gentlelady from Tennessee.

Ms. BLACKBURN. Thank you, Mr. Chairman. Thank you for the hearing.

And I want to thank and welcome our witnesses. We are looking forward to the testimony today.

In many places in the U.S. energy prices for electricity and transportation fuel are increasing significantly. You are hearing that from us today as we are out there with our constituents in responding to what they tell us. It has effected many sectors of our economy and in my District we hear a lot about this from our small businesses and our logistic businesses in their work.

I believe that we can make America energy independent and free from all foreign sources of energy, but it is going to take serious actions to increase and diversify our supply of available energy. It is not going to be easy. We did not get here overnight and we are not going to get out of it overnight. We realize that.

The interesting thing is we do have vast resources of oil, gas and coal in our country that would meet our need for hundreds of years. But there is a group of people that do not want us to tap into these resources. Now, I have had some interesting conversations with some from this group. And when you ask them what they would recommend, sometimes you will get an answer that sounds like returning to the stone age or having a substandard quality of life and shutting down our coal plants because there is a perceived threat of global warming. And most often it does not include measures that incorporate conservation, innovation, deregulation, exploration, production or commercialism; all steps I feel are necessary to get us to energy independence.

What Americans want is reliable and affordable energy, but they do not want to sacrifice their way of life because of somebody's political agenda that is based on what they consider to be a faulty and unproven science. They want options that will allow them a continuance of a good quality of life and an available and affordable energy supply. And they want to continue to benefit from a robust economy.

America would rather have us here in Congress encourage the production of more energy right here in this country and not rely on foreign sources of oil that could increase prices with little notice.

Mr. Chairman, I thank you for the hearing today. I look forward to the comments from our witnesses.

Chairman MARKEY. Thank the Gentlelady.

And Mr. Inslee, you are the last Member if you wish to be recognized for an opening statement.

Mr. INSLEE. I just want to say briefly that there is a cause for optimism in this whole issue. I was walking over to be on C–SPAN's journal this morning and ran across a car that gets 150 miles a gallon runs 40 miles on electricity when you plug it in, and one day we are running ethanol and we ought to have optimism

and use technology to solve this problem. And I am glad this Committee is on the job to do it.

Chairman MARKEY. I thank the Gentleman very much.

I will note before we will hear from the witnesses. But for the Members there is a clock right in the middle of Mr. Teske right there. And that clock will move from green to yellow with one minute remaining, and then to red if anyone is interested in just keeping track of the time which you have.

So now we will turn to witnesses. And I would like to now recognize our first witness, Mr. Terry Thomas, President and CEO of the Community Bus Service, Incorporated in Youngstown, Ohio.

Welcome, sir.

STATEMENT OF TERRENCE V. THOMAS, PRESIDENT AND CEO, COMMUNITY BUS SERVICES, INCORPORATED

Mr. THOMAS. Thank you so much, Chairman Markey, Members of the Committee.

My name is Terry Thomas. I am President and CEO of the Community Bus Services. My company provides school bus service to 22 school districts and 7.000 students in northern Ohio.

I am past President of the National School Transportation Association, which represents private school bus contractors that operate one-third of the nation's 475,000 school buses.

I also serve on the Governing Committee of the American School Bus Council, which is a coalition of public and private operators, manufacturers, suppliers and State policymakers. We represent the entire school bus industry. And my remarks today are consistent with the entire school bus industry.

I appreciate the opportunity to share with you my concerns about the effect of energy dependence, rising fuel costs on my family, and I am the father of five children three of which ride the school bus everyday, my business, the school districts I serve and the entire school bus industry. According to the latest statistics from the U.S. Department of Education 56 percent of public school students in the United States depend on school bus to access their education. Twenty-five million public school children every day on a fleet of vehicles that is two and a half times the size of all other forms of mass transportation; that is transit buses, intercity business, commercial airlines and rail combined. School buses are far safer statistically than any other mode of travel with an average of 20 fatalities a year compared to 800 fatalities a year for students traveling to school by any other means. Teenagers are 44 times safer if they ride the bus rather than riding with their friends.

But when faced with the need to cut service, school districts are most likely to discontinue high school transportation, thereby encouraging or even forcing teenagers to high risk driving.

School buses play an important role in mitigating traffic congestion. Replacing an average of 50 personal automobiles for every school bus on the road. In addition, one school bus uses significantly less fuel than 50 cars and SUVs.

The Federal Government provides no funding source for routine home to school transportation or school activity transportation. Increasingly, a larger burden falls on the local school districts to support school transportation, and though it represents just four per-

cent of the total school budget, it is the first target hit when districts need to reduce expenditures.

From September 2004 to September 2005 the price of diesel fuel increased an average of 58 percent, a $1 a gallon. Though prices slipped back somewhat in 2006, they are on the rise again and in many areas have reached or exceeded the 2005 highs. Other transportation modes are better able to either absorb the costs or pass them on to the marketplace. The school bus operators literally have nowhere to go.

School districts have had to find other ways to respond, most of which now involve reduction of school bus service. For example, Troy, Michigan eliminated sports and activity trips. Massachusetts districts are charging parents for school bus service. Ohio eliminated, if you can believe this, 80,000 students from school transportation over the last two years. Tennessee and Georgia closed schools for two days last year and Kentucky went to four-day weeks for some schools just as a result of the cost of the fuel for the school buses.

Congestion, pollution, excessive fuel consumption, inconvenience to parents and employers, inconsistent attendance and interruptions in the educational progress, all of these result from reductions in school bus service. But the number one reason to ensure that school buses keep running is student safety.

We know Congress is tackling this issue on many fronts, and our industry has supported efforts to increase supply through more refinery capacity and reasonable exploration of oil and to protect consumers against price gouging. Additional steps that might help with fuel costs and congestion include: The use of Federal Highway Congestion Mitigation Funding for the purpose of new school buses and for a national public education campaign to encourage the greater use of school buses to cut down on the use of personal vehicles;

Federal assistance to school districts to offset the ever increasing cost of fuel, regardless of whether the districts operate it themselves or if they contract out for the service;

An investment tax credit or other incentives for bus manufacturers to encourage the production of energy efficient and alternative power vehicles;

Managing tax credit for school bus companies to encourage purchase of a cleaner, more energy efficient fleet, and;

Funding to assist Federal mandates to meet safety, environmental and security standards.

As fuel costs go up due to the increased cost of energy, everyone feels the burden including parents who pay for gas to drive their school children. Already schools are seeing a difference. Sixty percent of the districts reported an increase of ridership due to fuel prices.

I want to thank the Committee for this opportunity to provide some insight into our industry and share our concerns.

[The statement of Mr. Thomas follows:]

Testimony of
Terrence V. Thomas
before the
Select Committee on Energy Independence and Global Warming
May 9, 2007

Chairman Markey and Members of the Select Committee, my name is Terry Thomas and I am President and CEO of Community Bus Services in Youngstown, Ohio. My company provides school bus service under contract to 22 school districts in northern Ohio, transporting nearly 7,000 students daily, many of whom require specialized transportation services. Community Bus Service also operates the Niles-Trumbull Transit System, a demand-response public transportation service that provides door-to-door bus service to the transit-reliant citizens of Trumbull County, Ohio.

I am a past-president of the National School Transportation Association and currently serve as the Chairman of its Government Relations Committee. The NSTA represents private school bus contractors who operate one-third of the nation's 475,000 school buses. I also serve on the governing committee of the American School Bus Council, a coalition of all segments— public and private pupil transportation providers, manufacturers, and state policy leaders —of the school transportation industry. My remarks today are supported by all the members of ASBC.

I appreciate the opportunity to share with the committee my concerns about the effects of energy dependence and rising fuel costs on my family, my business, the school districts I serve, and the entire school bus industry.

The Role of School Buses in Education

Let me start by giving you a brief overview of school busing across the country. According to statistics from the U.S. Department of Education for school year 2002-2003 (the latest available), 56% of the 45 million public school students in the U.S. depend on school buses to access their education. That's 25 million children every school day—and that number does not include students who are not transported at public expense, such as many private and parochial school students. Public expenditures for pupil transportation in constant 2004 dollars totaled $16.4 billion in 2003, compared to $12.1 billion in 1990, when we were transporting 59% of our students. The per-pupil cost of transportation rose (again in constant dollars) from an average of $565 in 1990 to $654 in 2003. Note that these figures are for operating costs only; they do not include capital expenses, such as bus replacement. As you can see, transportation costs were rising steadily before the fuel crisis hit in 2005; they have spiked since then.

Each weekday approximately 475,000 yellow school buses travel the nation's roads. Our fleet is 2.5 times the size of all other forms of mass transportation—transit, intercity buses, commercial airlines and rail—combined. During the school year we make more than 50 million passenger trips daily, compared to public transportation's 32 million trips daily. And our buses are not idle

during the summer—we continue to transport students to and from summer school, specialized learning programs, summer camp, and other activities.

School buses not only ensure that children are able to access their education, but they also ensure that they travel to and from school safely. School buses are far safer statistically than any other mode of travel. Consider this: Among those 25 million students who ride the school bus, there are an average 20 fatalities a year. But among the 20 million students who go to school some other way, there are an average **800** fatalities a year. Teenagers are 44 times more likely to arrive at school alive if they ride the school bus than if they drive or ride with friends. But when faced with the need to cut service, school districts are most likely to discontinue high school transportation—thereby encouraging, or even forcing, teenagers into high-risk driving. We can't afford to put even more children at risk by cutting school bus service. On the contrary, for the sake of our children, public policy must support greater, not lesser, use of school buses.

The Role of School Buses in the Community

In addition to providing safe access to schools, school buses play an important role in mitigating traffic congestion and reducing pollution in their communities. If the average school bus represents 50 personal automobiles that are not being used to ferry children to and from school, imagine what would happen if a fleet of 25 buses in your town were suddenly pulled from service. More than a thousand more cars and trucks would flood the neighborhood streets and commuter highways during morning rush hour, clogging the roads, backing up traffic near schools, and spewing exhaust into the air. Multiply that by the larger numbers in larger cities, and you can see the important ways in which whole communities—not just parents and students—benefit from the use of school buses.

In addition, notwithstanding the poor mileage rating for school buses (8-11 mpg), one school bus uses significantly less fuel than 50 cars and SUVs. Given the size of the nation's school bus fleet, replacing even 25% with personal vehicles—that's 6 million more vehicles—would have a significant detrimental impact on the nation's fuel usage and energy dependence. The ramifications would be felt by all citizens, whether or not they have children in school.

School Transportation Funding

School transportation is funded almost entirely by state and local government. The federal government provides no funding source for routine home-to-school transportation or school activity transportation. (In fiscal year 2003, the first federal funds became available for school buses when the Environmental Protection Agency provided $5 million for grants to reduce diesel emissions as part of their Clean School Bus USA program; approximately $22 million has been distributed since then.)

States vary considerably in the percentage of transportation funding they provide to local school districts—from 0% to 100%. They also vary considerably in their funding mechanisms and their transportation requirements. Eleven states do not require school districts to provide transportation at all (with the exception of students with special needs), and of the others, some require it only for elementary students.

As state governments face their own cutbacks and decrease their expenditures, a larger burden falls on municipalities to support school transportation. Even though transportation represents just 4% of the total school budget on average, it is one of the first targets when districts must reduce expenditures, particularly in states where there is no mandate.

The Effect of Fuel Price Increases

From September 2004 to September 2005, the price of diesel fuel increased an average of 58%, almost a dollar a gallon. Though prices slipped back somewhat in 2006, they are on the rise again and in many areas, have reached or exceeded the 2005 highs. Also, contrary to past experience, diesel fuel prices are now more than 20 cents higher in most states than the price of regular gasoline. In addition, the industry is having to absorb the increased cost of the new ultra low sulfur diesel fuel and new clean diesel engines mandated under Federal law, which will greatly reduce harmful emissions from the Nation's diesel fleet but which add more than $6,000 to the cost a new school bus. While high fuel costs affect all modes of transportation, other transportation modes are better able either to absorb the costs or to pass them on in the marketplace. Neither school districts nor their transportation contractors are able to pass on the increased costs to the students they drive to and from school every day. That means that school districts have had to find other ways to respond, most of which now involve some reduction of service.

As this crisis has been going on now for almost three years, the industry has already implemented all of the fuel-saving tricks in our bag. Both private and public operations have eliminated unnecessary idling, rerouted buses for efficiency, consolidated bus stops, trained drivers in fuel-efficient driving practices, increased maintenance for fuel economy, and reduced deadheading. Many of us have changed the way we buy fuel—installing larger tanks for bulk purchase, for example, or even hedging fuel purchases.

When these tactics proved to be insufficient, schools turned to more drastic measures. Many, like the Troy, Michigan district, eliminated sports and activity trips. Others, like several districts in Massachusetts, began to charge parents for bus service. In Ohio, home-to-school transportation was eliminated for 80,000 students in large measure, though not exclusively, due to fuel costs. In Tennessee and Georgia, schools closed for two days to conserve energy and fuel. In Kentucky, some schools went to four-day weeks.

One of the more common responses has been to shift students from dedicated school bus service to public transit. Whatever the savings are when this occurs, they are much less than the increased risk to students when they are thrust into the uncontrolled environment of public transit. The superiority of school bus equipment as well as driver qualification, training and responsibilities, plus the exclusive nature of school bus service, combine to provide our children with a controlled environment that offers protection no public transit service can match. Parents understand this, and in many districts—such as New York City—they refuse to accept the adinistration's decision to exchange school buses for public bus passes.

Unfortunately, schools have few choices. They must either raise more money or cut expenses. In too many districts, there are no more easy cuts. So districts turn to local voters for relief, but voters are not always sympathetic. When voters in Randolf, Massachusetts, rejected the school budget, the district eliminated school bus service. In Pasadena, budget cuts are forcing elementary students to walk two miles along a busy highway to get to school. In Seneca Valley, Pennsylvania, the increased cost of fuel resulted in a bond issue that will cause a 4.26 jump in the mill rate; and in the Strasburgh-Franklin, Ohio, district, increased fuel costs requires a 7.7 mill emergency operating levy. If the levy fails, the board has decided to discontinue extracurricular and athletic supplemental activities, increase class sizes, cut seven teachers, and discontinue services such as a school nurse, special education coordinator, gifted coordinator and technical support.

The consequences of transportation cuts are serious. Without consistent, reliable, safe transportation, student attendance suffers. Many parents are not able to provide rides for their kids; their own jobs do not allow them the flexibility they need, particularly for afternoon pickups. Other parents simply leave their workplace in order to get their children to and from school—a practice that has ramifications for employers. Students who rely on the schools for breakfast rely on the bus to get them there; and without the bus, they also lose out on what may be their best meal of the day.

Congestion, pollution, excessive fuel consumption, inconvenience to parents and employers, inconsistent attendance and interruptions in educational progress—all of these result from reductions in school bus service. But the number one reason to ensure that school buses keep running—and in fact to increase the service—is student safety. It's those 800 kids a year who die because they did not take the bus. We in the industry and we as a society can't allow that number to increase, which it surely will if we don't preserve and maintain our school bus system.

What Can We Do?

Clearly the increase in fuel costs and our energy dependence affects more than school transportation. We know that Congress is tackling this issue on many fronts, and our industry has supported efforts to increase supply through more refinery capacity and reasonable exploration of oil, and to protect consumers against price gouging. The school bus industry has been one of the first to incorporate biodiesel as a way to reduce pollution and stretch diesel fuel. Our manufacturers are producing more alternative vehicles, including new hybrid buses. But these are long-term solutions; they are not realistic measures for school districts or contractors in the immediate future.

There are some possible relief measures, though, which I would like to suggest:

1) The Congestion Mitigation and Air Quality (CMAQ) Program, administered by FHWA, is a grant program to the states funded through the Highway Trust Fund. Our industry has asked FHWA to encourage states to include the purchase of new school buses in their grant programs. As I stated earlier, increasing school bus fleets, whether they are publicly or privately owned, is an effective way to reduce congestion and pollution. We have also asked FHWA to undertake a

national public education campaign to encourage greater use of school buses as a way to cut down on the use of personal vehicles.

2) We support Federal assistance to school districts to offset the increased cost of fuel, such as offered last year by Congressman Baca's bill (H.R. 4158) to provide up to $50 million per year in grants to our poorer school districts to help pay for school-related energy costs, including for transportation fuels. We understand that Rep. Baca is reintroducing his bill this week and we support its favorable consideration by the Congress. Such assistance must be available to all districts, whether they operate their own vehicles or contract for that purpose.

3) We propose that Congress enact an investment tax credit and other incentives for school bus manufacturers to encourage production of energy-efficient and alternative-power buses. We understand that the Senate Energy and Natural Resources Committee is moving legislation (S. 1115) that would allow vehicle manufacturers to take advantage of Federal grants and loan guarantees to assist in expanding energy-efficiency manufacturing.

4) We propose that Congress enact an energy tax credit for school bus companies to encourage purchase of cleaner, more energy-efficient fleets and the infrastructure necessary to operate them. The Energy Policy Act of 2005 contained tax incentives for a variety of alternative-fueled vehicles but did not address the overwhelming vehicle of choice in the school bus industry—diesel powered buses that provide the most reliable and durable vehicle at the lowest cost to school districts. The existing tax credits should be expanded to include diesel vehicles which are vastly improved over older models in terms of emissions, while providing the best fuel economy using the new cleaner burning ultra low sulfur fuel.

5) We encourage Congress to provide funding for Federal mandates on the school bus industry. New safety standards, environmental standards, and security standards, for example, create increased costs that make school transportation less affordable and contribute to reductions in service. The House has passed the Rail and Public Transportation Security Act (H.R. 1401) legislation that includes a provision to require that the Department of Homeland Security undertake a thorough threat assessment of the Nation's school bus fleet. This is the first step in providing access to Federal funds dedicated to addressing security threats. Thus far, the public and private school bus community have had to bear essentially all of the cost of increasing security needed to meet potential terrorist and other threats.

In closing, I would like to make one important point: As fuel costs go up due to the increased cost of energy, everyone feels the burden, including parents who pay for gas to drive their children to school. Already schools are seeing a difference; in a recent survey, 60% of districts reported an increase in ridership presumably due to fuel prices. The higher fuel prices go, the more attractive riding the bus becomes. Unfortunately, schools and their contractors are caught in a difficult financial irony: they are being asked to accommodate more students for the same reason that they are being forced to cut service. It's a situation that can't be resolved without additional resources.

Conclusion

On behalf of my colleagues in all sectors of school transportation, I want to thank the Committee for this opportunity to provide some insight into our industry and share our concerns. School buses are easily taken for granted in this country—until they are gone. The loss of school bus service affects more than our children; it affects our schools, our communities, and our nation with the resulting increased congestion, pollution, and energy use. But it affects our children the most. Without dedicated school buses, our children are at far greater risk of losing not only their access to education, but their lives.

We urge Congress to work with us to ensure that safe school transportation remains a viable option for all schools. States and local municipalities can no longer do this on their own; they need your help. We remind Congress that the nation's school buses comprise a larger mass transit system than public transportation, and is every bit as worthy of Federal financial support.

As a nation, we cannot continue to ignore the 800 children who die every year because they are not in a school bus; we certainly can't allow that number to increase. Help us find the means to keep yellow buses on the road.

Thank you for your attention and consideration. I will be happy to respond to questions from the Committee.

Chairman MARKEY. Thank you, Mr. Thomas, very much.

Our second witness, Mr. Michael Mitternight, is the owner of Factory Service Agency, Incorporated, a commercial air conditioning, construction and service company in Metairie, Louisiana. He has been nominated as a finalist for the 2007 Small Business Advocate of the year. After Hurricane Katrina he helped many New Orleans area businesses recover and resume operations.

Welcome, Mr. Mitternight.

STATEMENT OF MICHAEL MITTERNIGHT, OWNER FACTORY SERVICE AGENCY, INCORPORATED

Mr. MITTERNIGHT. Thank you, Chairman Markey and Ranking Member Sensenbrenner, Members of the Committee.

My name is Mike Mitternight. I am the owner of Factory Service Agency, the family owned small business established in 1975 located in the New Orleans of Metairie, Louisiana. My company specializes in commercial air conditioning service and installation throughout southeast Louisiana.

I am also a member of the National Small Business Association, which the Chairman just mentioned.

I would like to thank you for inviting me to testify today about the impact of rising gasoline prices on small businesses, particularly mine. I am very grateful that you are cognizant of the negative effect increasing gasoline prices are having on small business across the country and that you are seeking to address it. Whatever the cause, the volatile increase in price of gasoline is wreaking havoc on America's small businesses.

The day-to-day operation of my small business, I have as many as six service trucks and three management vehicles on the street at any one point in time. In order to carry the load of tools and service equipment necessary to provide the service for the equipment upon which we work, most of my service trucks are three quarter ton pickup trucks with a service body on the back. Obviously, these trucks fall into the category of nonfuel efficient vehicles. Unfortunately, there is no affordable alternative to this choice.

Currently the cost of gasoline in the metropolitan New Orleans area varies from $2.88 per gallon to 2.93 per gallon from a low of 1.98 late last year. This sudden and unpredictable 50-percent increase hits directly at the bottom line of my business, and countless others.

In my industry one major problem is that many of my service and maintenance contracts are fixed cost contracts with billable rates established well in advance, sometimes for a period of a year with no opportunity to recoup increased expenses. Although I routinely try to include an estimated escalation percentage in my pricing, the actual cost of gasoline is impossible to project. If I project too large an increase, I will lose the contract. If I project too small, I will lose money.

Direct impact on cash flow, the life blood of any business is seen when you compare a weekly operating cost for fuel from $325 in December of '06 to my current expense of $510 a week. This represents an increase of 60 percent in only five months.

A fellow contractor in my area provided me with the cost figures of his company showing an increase of 113 percent in fuel costs be-

tween '02 and '06. How in the world does a small business owner like me supposed to cope with this sort of a volatile and devastating price increase? How can I expect to formulate a viable business model with these sorts of wild price fluctuations? How can I grow my business? How can I add additional employees?

As summer months approach, fuel costs continue to rise, almost expidentially with the temperature. Unfortunately for my business the summer price surge occurs during a period of increased fuel consumption as a result of expanded service activity. I dare say that these numbers are typical for most businesses regardless of their geographic location.

In fact, 75 percent of respondents doing an NSBA survey last year reported their businesses had either been significantly or moderately effected by rising prices.

In order to maintain any level of profit in my operation I have no alternative but to pass the cost of rising gasoline prices onto my customers. Sometimes I could arbitrarily increase—just put a fuel surcharge on, but I cannot do that on fixed cost contracts and long term customers, and I cannot arbitrarily raise hourly rates.

One unique problem that I face in the New Orleans area, the fact that many areas are still recovering, is that the availability of service stations is a factor. No long are there sources of fuel on every other corner. It's imperative that my service technicians be properly routed to ensure that they have adequate gas supply for their day's routes as they make their rounds.

The immediate problem of removing flood waters from my property, working to help family and employees return and recover, reestablishing customer contact and establishing necessary financing when my accounts receivable became accounts inconceivable following the storm all seem to have been a foreteller of today's problem of upwarding spiraling fuel costs. Despite such persistence obstacles in the situation in New Orleans has improved. At least I no longer have to fill five gallon gas cans at a remote location and fuel my trucks by hand. Now my main concern seems to be what will the price be at the pump when my trucks roll out in the morning.

It is one thing to deal with such uncertainty and volatility in the midst of what is arguably the worst natural disaster in the nation's history, it is another to have to deal with the day-to-day basis a year and a half after the event occurred.

New Orleans area, we are working to solve these problems. The rising cost of gas is just a devastating problem that we are fighting, but it is something that we are trying to deal with. The NSBA has several issues that they are supporting and ideas that they are behind. I mentioned in my written testimony: Increasing and diversifying the domestic and energy production; improving the efficiency standards which would help anyone; studying utilization of hybrid vehicles especially those that run on alternative fuels but they need to be something that are capable of carrying service loads on major service trucks and most hybrid vehicles will not accomplish that.

Thank you for your time, sir. And I welcome questions.

[The statement of Mr. Mitternight follows:]

TESTIMONY OF
MICHAEL A. MITTERNIGHT
PRESIDENT
FACTORY SERVICE AGENCY INC.
MEMBER OF THE
NATIONAL SMALL BUSINESS ASSOCIATION
AT A HEARING BEFORE THE
SELECT COMMITTEE ON ENERGY INDEPENDENCE AND GLOBAL WARMING
U.S. HOUSE OF REPRESENTATIVES
ENTITLED
"ECONOMICS OF DEPENDENCE OF FOREIGN OIL—RISING GASOLINE PRICES"

MAY 9, 2007

Chairman Markey, Ranking Member Sensenbrenner, and members of the committee, my name is Mike Mitternight, and I am the owner of the of Factory Service Agency Inc., a family-owned small business, established in 1975, located in the NewOrleans suburb of Metairie, Louisiana. My company specializes in commercial air-conditioning service and installation throughout southeast Louisiana. I also am a member of the National Small Business Association (NSBA), the oldest small-business advocacy organization in the United States.

I would like to thank you for inviting me to testify today about impact of rising gasoline prices on small businesses, particularly mine. I am very grateful that you are cognizant of the negative effect increasing gasoline prices are having on small businesses across the country and are seeking to address it. Whatever the cause, the volatile and increasing price of gasoline is wreaking havoc on America's small businesses.

In the day-to-day operation of my small business, I have as many as six service trucks and three management vehicles on the street at any point in time. In order to carry the load of tools and equipment necessary to provide the service for the equipment upon which we work, most of my service vehicles are three-quarter- ton pick-up trucks. Obviously, these trucks fall into the category of non-fuel efficient vehicles. Unfortunately, there is no affordable alternative to this choice.

Currently, the cost of gasoline in the Metropolitan New Orleans area varies from $2.88 per galloon to $2.93 per gallon—this is from a low of $1.98 per gallon late last year. This sudden and unpredictable 50 percent increase hits directly at the bottom line of my business—and countless others. In my industry, one major problem is that many of my service and maintenance contracts are fixed-cost contracts, with billable rates established in advance—sometimes for a period of a year—with no opportunity to recoup increased expenses. Although, I routinely try to include an estimated escalation percentage in my pricing, the actual cost of gasoline is impossible to project.

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If I project too large an increase, I will lose out on the contract. If I project too small, I will lose money on the contract.

The direct impact on cash flow, the life blood of any business, is seen when you compare a weekly operating cost for fuel—from $325 in December 2006 to my current expense of $510 per week. This represents an increase of 60 percent in only five months! A fellow contractor in my area provided me with cost figures for his company, showing an increase of 113 percent in fuel costs between 2002 and 2006. How in the world is a small-business owner like me supposed to cope with this sort of volatile and devastating price increase? How can I be expected to formulate a viable business model with these sorts of wild price fluctuations? How can I grow my business and hire additional workers with this degree of uncertainty lurking behind every contract?

As the summer months approach, fuel costs continue to rise almost exponentially with the temperature. Unfortunately for my business, this summer price surge occurs during a period of increased fuel consumption as a result of expanded service activity. I dare say that these numbers are typical for all businesses, regardless of their geographic location. In fact, 75 percent of respondents to an NSBA energy survey last year reported that their businesses had either been "significantly" or "moderately" affected by rising energy prices. Only seven percent of the small-business respondents reported not having been affected.

In order to maintain any level of profit in my operation, I have no alternative but to pass the cost of rising gasoline onto my customers whenever possible. On variable rate service calls, we have been forced to include a fuel surcharge on our invoices, in order to regain the increased cost, and be fair to our customers by not arbitrarily increasing hourly service rates. I am not alone in rising prices whenever possible. According to 2006 NSBA small-business, energy survey, of the businesses that reported passing along their increased energy costs to customers, 65 percent increased their prices, 47 percent reduced their amount of business travel, and 18 percent reduced their workforce. The ramifications of rising gas prices reverberate throughout the entire economy.

A unique problem that I face is the fact that in some of the still-recovering portions of the New Orleans area the availability of service stations is a factor. No longer are there sources of fuel on almost every corner. It is imperative that my service technicians be properly routed to ensure that they have access to fuel before they embark on their daily routine. Since rushing to reopen my business, only two weeks after Hurricane Katrina struck, I have had to deal with myriad challenges. The immediate problem of removing flood waters from my property, working to help family and employees return and recover, re-establishing customer contact, and establishing necessary financing when "Accounts Receivable" became "Accounts Inconceivable," all seem to have been a foreteller of today's problem of upward spiraling fuel costs.

Despite such persistent obstacles, the situation in New Orleans has improved—at least I no longer have to fill five gallon gas cans at remote locations and fuel my trucks by hand. Now my main concern seems to be, "What will the price be at the pump when my trucks roll out in the

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National Small Business Association

morning?" It is one thing to deal with such uncertainty and volatility in the midst of what was arguably the worst natural disaster in the nation's history, it is another to have to deal with it day-after-day a year and a half after the event.

Like any other business, my company grapples with a spate of business complications, from rising refrigerant prices, increasing costs for construction materials such as copper, compliance costs to satisfy more stringent building codes, escalating labor rates due to workforce shortages, and other ever-increasing expenses such as health care costs. Most of those problems can be dealt with via a planned management approach, however, because the variables are somewhat predictable. Fuel costs that jump three percent to six percent in a matter of days or weeks are virtually impossible to endure.

In addition to being a small-business owner, I also am a member of the National Small Business Association, which recently adopted a comprehensive energy policy. Acknowledging that global climate change is real, the small-business members of NSBA believe that the time has come to conclusively address America's oil dependence and the shortcomings of its national energy policy.

NSBA supports increasing and diversifying America's domestic energy production, and encouraging the research and development of viable and cost-competitive clean and renewable energy solutions. This effort will no doubt require the initiation of myriad regulatory and administrative actions. NSBA is not in the habit of recommending new governmental programs or increased regulatory and tax burdens—preferring free enterprise, market solutions, and a neutral tax system—but the unique and urgent contours of America's environmental and energy policies and energy industry demand governmental intervention. Although I am confident that such an action can be successful, I cannot stress enough that it must be realistic, flexible, and science-based. It also must focus on technological innovation, the development and use of cleaner energy alternatives, and an increase in energy efficiency and conservation. It should utilize the power of the market and protect American businesses and jobs. It also must avoid placing too onerous a burden on America's small businesses, which are particularly vulnerable to increased regulatory and tax obligations and already shoulder a disproportionate share of the costs of federal regulations and paperwork compliance.

Revolutionize U.S. Transportation and Automotive Industries

Transportation is the crux of America's oil dependence: 97 percent of the oil used in the United States is consumed for transportation. Only about two percent of the energy consumed by the nation's transportation fleet comes from renewables. Automobile emissions also are the second-largest source of carbon dioxide in the country. This must change. It is time to make a concerted effort to revolutionize the country's transportation and automotive industry. If the United States is to reduce domestic demand, regulatory incentives to use more fuel-efficient vehicles are needed.

Hybrid Vehicles

Michael A. Mitternight
National Small Business Association

Hybrid vehicle technology, especially the plug-in hybrid variety, has the potential to help curb America's oil dependence and its global warming pollution, and this potential must be fully explored. As I previously mentioned, my business relies on large, non-fuel efficient vehicles—because no affordable or practical alternative exists. If a more fuel-efficient option existed, I certainly would be willing to explore it. My willingness to explore the potential for energy savings that advanced vehicle technology presents is not unique in the small-business community. Nearly 70 percent of the respondents to the NSBA energy survey reported a willingness to lease an alternative-service vehicle if it could provide, per mile of use, significant overall cost reduction. NSBA supports increased funding and incentives for plug-in hybrid vehicle technology, including advanced battery research. NSBA also supports consumer-tax incentives—without limits on the number of qualifying vehicles—for the purchase of highly-efficient hybrid, clean-diesel, and compressed-air vehicles.

Alternative Fuels
NSBA also supports the continued expansion of ethanol utilization and the removal of the protectionist 54 cents per gallon tariff on imported ethanol. NSBA recommends increased funding and incentives for the use, research and development of biodiesel and other biomass-derived fuel. NSBA also backs increased funding and incentives for biomass research with the goal of making cellulosic ethanol cost competitive with corn-based ethanol by 2012. Finally, NSBA urges federal incentives, especially for small businesses, to increase the use of hydrogen energy, and increased federal investment into the research and development of hydrogen energy. With hydrogen-powered buses operating in Chicago, Toronto, and Reykjavik—and on the horizon in London, Madrid, and Hamburg—as well as the news that FedEx and UPS plan to phase in fuel-cell trucks over the next five years—NSBA is insistent that small businesses should not be left behind in the early utilization of this emerging technology.

Fuel Efficiency/CAFE Standards
Higher gasoline mileage standards have been called the "most-needed reform in the U.S. energy policy," and with good reason. The average fuel economy of a new vehicle sold in 2001 was lower than the average fuel economy of a new vehicle sold two decades earlier. At 25 miles to the gallon (mpg), the original 1903 Model T was more fuel efficient than the average new Ford vehicle, at 22.6 mpg, sold in 2003. This is not progress.

The Corporate Average Fuel Economy (CAFE) standards—first established by the U.S. Congress in 1975, largely in response to the nation's first oil shock—have lagged behind the nation's need for increased fuel efficiency far too long. While NSBA applauds the Bush Administration's increase of CAFE standards for light trucks and sports utility vehicles (SUVs)—the first such increase in a decade—from 20.7 mpg to 22.2 mpg for the 2007 model year vehicles, more must be done to improve the fuel efficiency of the nation's transportation fleet. A 2001 report from the National Academy of Sciences concluded that existing technologies could produce a 25-to-35 percent increase in fuel efficiency for new cars, pickup trucks, and SUVs—without sacrificing safety or comfort. This improved fuel-economy standard would displace as much petroleum as

the United States currently imports from Persian Gulf dictatorships. NSBA supports an incremental but steady increase in the nation's CAFE standards and permanently closing the SUV CAFE standard loophole. In keeping with the recommendations of the National Academy of Sciences, NSBA also supports continued federal funding, in cooperation with the automotive industry, of "precompetitive research aimed at technologies to improve vehicle fuel economy, safety, and emissions." Finally, NSBA supports the efforts of the EPA and automakers to improve the accuracy of the miles per gallon estimates of new vehicles. It is imperative that consumers, especially small businesses, be provided with accurate fuel efficiency information so that they can make informed decisions regarding their transportation needs.

While these recommendations may seem academic, their implementation will have real-world consequences for small businesses like mine and I urge you to consider them. This concludes my testimony. Thank you again for inviting me here today and for recognizing the threat rising and volatile energy prices pose to America's small businesses. As you seek to address America's oil dependence, the shortcomings of its national energy policy, and global climate change, I hope you will continue to keep America's nearly 26 million small businesses in mind. I thank you for your time and welcome any questions.

Chairman MARKEY. Thank you, Mr. Mitternight.

Speaking of alternative fuels, Mr. Donn Teske is a farmer from northeastern Kansas. He is now in his seventh year as the Kansas Farmers Union President. He serves on the Boards of numerous other agricultural associations. He has worked at Kansas State University as a farm analyst.

We welcome you, Mr. Teske. Whenever you feel comfortable, please begin.

STATEMENT OF DONN TESKE, PRESIDENT, KANSAS FARMERS UNION

Mr. TESKE. Thank you, Congressman Markey. Thank you Member Sensenbrenner. Members of the Committee.

I consider this a really unique opportunity for a pretty darn nervous redneck farmer from Kansas to be addressing this group. So if I get to stuttering around, have patience with me.

Energy consumption in agriculture is a very significant issue, and I really welcome the opportunity to have it. And representing and speaking on behalf of Kansas Farmers Union and National Farmers Union, we really want to compliment this Committee on the proactive approach that they are having to address in this very serious issue.

Personally we operate a fifth generation farm in northeast Kansas, as the Congressman said. We are on the eastern edge of the Flint Hills in Pottawatomie County, Kansas.

The operation is about 2,000 acres, about two-thirds of that is native bluestem grass, another 500 acres of it is certified organic. On that we raise commodities that we sell into the organic livestock industry, mostly alfalfa hay, red clover hay, corn, milo, wheat, soy beans; that type of thing.

In the past my wife and I operated a dairy farm there for many years. My wife Kathy was really glad to see the cows go.

Agriculture has really been stagnant for quite a few years now. I have farmed for 30 years and a lot of times it ends up, you know, you are in the red. And if it is in the black, it is usually about the difference in the government subsidy payments that make the difference.

Both my wife and I have had to seek off farm employment to sustain a family. To me there is something wrong when you have a farm operation that size and both spouses are working off the farm to feed the family so they can produce their share of the country's food supply virtually for free.

Now on top of that we get into a situation like this where we have been blindsided by super high energy costs, and it is a double whammy.

The former Congressman from Massachusetts John Kennedy once said that the farmer is the only entity out there that buys everything retail and sells everything wholesale. And there is a lot of truth in that. You know, everything that we put into the farm we buy in the marketplace and we have virtually no control over what we get from it. And the new energy costs expenses that we are getting on, we cannot automatically pass on. So the buck stops here, and it is with us, and it has really been a bad situation. And we are trying to deal with this at a time when oil companies are recording record profits? A little hard to digest.

To put it in a little perspective into the farm situation, I got some information from Kansas State University Farm Management data. In 2000 it took about 115 bucks to put in an acre of non-irrigated crops in Kansas. Out of that 26 percent was energy related. In 2005 it took 140 bucks and about 35 percent is energy related. That is over 20 bucks an acre that I got to figure out how to come up with.

To put it on a personal note, I have some letters that I would like to include as support from a real bank and from a trucker.

I had a trucker that took a load of hay to Texas for me a couple of weeks ago. That load of alfalfa hay was 20 tons. It is going to bring me about a $3500 check when it is all done. The increased expenses on the recent escalation in fuel prices compared to what we did before is going to add 600 bucks of trucking expense to that load. Somewhere between the three entities, the trucker, the dairyman and myself, we got to figure out how to absorb that 600 bucks to keep going the way we have been going. And that does not work very well.

Now on the positive side of things it looks to me like society is finally starting to address the issue of our environment. And I think that is wonderful. Global warming to me is very real, and I think it is the scariest thing that I am leaving for my children. Economies can be fixed. Governments can be fixed. You mess up our world, you kind of got a problem.

I think that we as a nation need to take responsibility, and I have four quick steps that I wanted to put in.

Number one and foremost is energy conservation. We are a gluttony nation and we need to do something about it.

Number two. We need a nationwide renewable portfolio standard, especially addressing community wind would be my passion.

Number three. I think we need to address the food issues in our transportation system and food delivery. We need to go back to more local food production and supply and distribution. We are shipping our food all over the country.

And number four. And the worst case scenario is we may have to look at rationing because we may have to separate the entertainment from the necessities.

And I do want to thank you. And would ask that that be included.

Thank you.

[The statement of Mr. Teske follows:]

STATEMENT OF DONN TESKE

PRESIDENT, KANSAS FARMERS UNION

BEFORE THE U.S. HOUSE

SELECT COMMITTEE ON ENERGY INDEPENDENCE AND GLOBAL WARMING

CONCERNING THE ECONOMIC TOLL OF AMERICA'S OIL DEPENDENCE

MAY 9, 2007

Congressman Markey and members of the committee, thank you for the opportunity to address you on the very serious consequences of the high cost energy inputs on my farming operation, and my family.

We operate a fifth generation farm in Pottawatomie County, Kansas. Pottawatomie County is located in northeast Kansas on the eastern edge of the Flint Hills. Our operation consists of about 2,000 acres, two-thirds of which is native Bluestem pasture. We have a cow-calf operation and also do some custom grazing. About 500 acres of the operation is certified organic and on these acres we produce organic commodities sold into the organic livestock industry, mostly alfalfa hay, red clover hay, milo, corn, soybeans, and wheat. My wife Kathy and I spent many years operating a dairy on the farm as well.

Agriculture in Kansas, much like the rest of rural America, struggles every year to sustain itself as a viable industry. Often, in my 33 years of farming the only thing that might make the end of the year analysis positive is the government subsidy payments we receive. Even though this farm was already established, my wife and I must both seek off-farm income to sustain our family. For an operation this size it isn't right that we have to work off the farm to feed our family, while we produce the nation's food virtually for free!

Now, added to our daily struggles, we have outrageous energy costs. There is a saying in agriculture that the farmer is the only entity who buys retail and sells wholesale. This saying has a lot of truth in it. We, the farmers and ranchers, pay for everything our operation needs through the marketplace. What we receive for our products is beyond our control. Yes, things can be fine-tuned with a variety of marketing tools, but as a whole we have to take what is offered to us.

Over the course of the past few years, input costs have skyrocketed. Most of that increase can be traced back to the rise in energy costs. A good example of this is shown by Kansas State University in which the non-irrigated crop expenses averaged about $115 per acre in 2000; of this, about 26 percent was energy related (fertilizer, fuel). In 2005,

the expense per acre was over $140 and energy accounted for 35 percent of the expenses. That is over $20 per acre more! Irrigated cropland, with its huge need for energy pumping, shows even more dramatic ratios.

Wherever rural Americans gather today, at church, picking up parts or getting repairs at the implement dealers, at the feed store, the local cooperatives and, of course, at the local coffee shop, everyone is talking about fuel and energy costs. They are not only talking about the tremendous increase in costs, they are discussing how they will survive and outrageous profits being reported by the oil industry. The rise of environmental concerns has also been a significant focus of rural America.

We recognize the need for enormous amounts of energy in all forms. We should strive to produce this energy while maintaining standards that protect the environment and prevent damage to health, crops, livestock and wildlife. The National Farmers Union (NFU) supports the Clean Air Act and believes that implementing regulations should also emphasize achieving the greatest amount of pollution control through the most cost-effective measures available. This country must recognize that with the exploding demand for energy, we must not rely solely on fossil fuels, the majority of which are produced overseas. Our energy supply must move away from this reliance and into a new economy, which actively takes steps to be friendly to the environment. Let me share, more specifically, what farmers like myself and my colleagues across the country have been experiencing in terms of increasing energy prices.

First, it is prudent to look at the market, both domestic and international, and view what has become an ever-growing volatility that farmers face. A Congressional Research Service report released in November of 2004, while outdated as far as being current with energy statistics, still provides an interesting view into the impact of international oil markets on agricultural production. "Because the United States depends on international sources for so much of its energy needs, U.S. energy prices reflect international market conditions, particularly crude oil supplies. This heavy import dependence renders the United States vulnerable to unexpected price movements and supply disruptions in international energy markets. Agriculture appears particularly vulnerable to energy price increases through both petroleum and natural gas markets, as well as fertilizer markets."[1] The reliance of the agriculture industry on foreign oil markets creates difficulties for farmers and ranchers throughout the country because fuel and fertilizer prices fluctuate rapidly, thereby disabling their ability to accurately project future energy costs.

As a way to deal with this volatility, it is the position of NFU that the production of renewable fuels is essential, not only to ease the growing cost of fuel, but to also deal with the problem of global climate change. Farmers and ranchers have proven time and time again that they are willing and able to deal with this growing problem and we see this as an opportunity to both benefit the environment and provide a new venue for economic growth and development.

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[1] Schnepf, Randy. "Energy Use in Agriculture: Background Issues." November 19, 2004. Congressional Research Service. CRS-24.

Natural Gas and Related Products

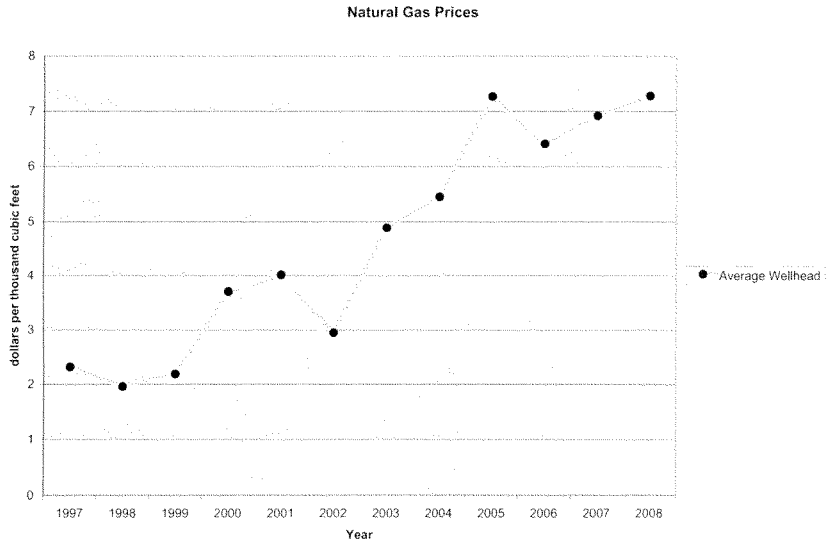
In examining increasing fuel prices, both international oil and international natural gas markets must be considered, especially when we realize that domestic supply comes nowhere close to meeting domestic demand.

Natural gas has a major impact on many aspects of farming, including acting as a power source in many different ways. It is the main ingredient in nitrogen, used as fuel to run irrigation motors and is increasing electricity costs as more electricity is generated at plants using natural gas rather than new clean coal, wind and hydroelectric technologies.

Natural gas is also the main ingredient used to make anhydrous ammonia and liquid nitrogen. These products replenish soil with nitrogen. Later in my testimony, I will address how the costs of anhydrous ammonia and nitrogen have shot up the last few years as a result of the increasing price of both oil and natural gas.

As shown below in Graph 1, the average price of Wellhead natural gas over the last 10 years, and the projection for this year and next, show the sharp increases that farmers and ranchers must deal with. Our reliance on international sources of both oil and natural gas has increased dramatically over the last several years and we see, with projections, that the growth is going to continue.

Graph 1



At this rate, farmers will not be able to afford irrigation and be forced to dry-land farm in an area that has been in a drought for the last several years. Especially in the Midwest

and Great Plains, dry-land farming irrigated ground is not an option. Other options include long-term leasing of irrigation water to a metro area to help meet cash flow needs, resulting in the loss of agriculture production and a significant negative economic impact felt throughout the rural communities.

There are various other expenses that come with increasing natural gas costs. Natural gas, as a primary source of electricity on many farms throughout the country, powers the shops within which we work on machinery, the barns in which we hold and work our livestock and the grain bins in which we must store and dry our crops. The increasing electricity costs that farmers and ranchers face is another side effect of the rising oil and natural gas prices, in addition to rising transportation costs.

Increased Transportation Costs - Diesel Fuel

The main source of fuel that farmers and ranchers use for farm machinery and equipment, the combines, tractors, semi-tractors, pickups, and other equipment, is diesel fuel. If it is on the farm, it probably runs on diesel fuel, although regular unleaded is also very common for other purposes.

In 2003, the national average price for number 2 diesel was $1.50 per gallon,[2] whereas the projected average for this year is $2.75[3] (See Graph 2 and Table 1 below for historical and projected numbers).

In Kansas, we are seeing transportation expenses account for a greater and greater percentage of overall expenses every year. As a supporting document from Falk Trucking states, they delivered a truck load of alfalfa hay to a Texas dairy for me a couple of weeks ago. The check that I will receive for that 20 ton load of hay will be about $3,500. Somehow between the three entities, the trucker, the dairyman, and I, we have to absorb about $600 in increased delivery fuel expense above what it would have cost just a couple of years ago. And we have to struggle with our budgets as the oil companies are reporting record profits year-after-year.

In addition, farmers and ranchers have been facing volatile commodity prices, which have not kept pace with the rapidly increasing input costs. There is no doubt in anyone's mind in rural America that the rural economy has been deteriorating because of historically declining or stagnant commodity prices and skyrocketing input expenses as a result of higher energy costs. It has not been until this year that rural America has seen some positive signs in the commodities market. Even though corn prices shot over $4.00 per bushel, the market has brought the price back down to a level which will still continue to be difficult to handle when combined with ever-increasing fuel and input costs.

Many operators today rent and lease more farm and ranch land than they own. Will these farmers and ranchers be able to continue to rent and lease land considering the production

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[2] Energy Information Administration/Short-Term Energy Outlook – April 2007
[3] Ibid.

costs they are facing in 2007? If they cannot, the likely effect will be lower land rental rates, a drop in farmland values and loss of farm equity.

All over the country, farmers and ranchers are waiting for an indication from Congress and the Administration that says this is a serious issue. We need to see that Congress takes seriously the economic crisis resulting from high energy and fuel costs, and that this problem will be addressed, such as is happening in this very venue. Farmers have no means by which to pass on the higher costs of energy, and it is the opinion of NFU that Congress should consider approving some type of mechanism to help farmers and ranchers offset the higher costs.

National Farmers Union, of which I am a member, and the Kansas Farmers Union, of which I am president, believe that resolution of, or at least relief from, these increasing costs comes from a focus on the production of energy from renewable sources which is cleaner, promotes our domestic rural economy, and provides additional supply to the ever-burgeoning demand for oil. Specific recommendations will be addressed in the renewable fuels section.

Increased Transportation Costs - Unleaded Gasoline

As we all know and have seen in the news, the average price for a gallon of gasoline is over $3.00[4] and many areas of the country are seeing it close to $4.00 a gallon. This price shock is not only felt in populated areas of the country but also in rural America. Our continued and expanded reliance on foreign oil is having a devastating impact on all sectors of the economy, including agriculture. As the price of oil goes up, gasoline prices tend to skyrocket and when prices drop, as little as they do, gasoline usually has a hard time keeping the same pace.

In looking at the price of unleaded gasoline, or at any fuel, it is important to look at the historical trends in order to gauge a valid perspective into the impact of rising costs. As seen below in Graph 2 (and the numbers shown in Table 1), farmers have experienced dramatic increases in the prices of both unleaded and diesel fuel. With the continued reliance on oil, farmers are subjected to an ever-decreasing supply and therefore an ever-increasing input expense. Although released last month, the statistics projected in this report are already outdated as a Lundberg survey released within the last few days shows that the average price for a gallon of regular unleaded gasoline is $3.07.

Graph 2[5]

[4] http://money.cnn.com/2007/05/06/news/economy/gasoline/index.htm?cnn=yes
[5] Energy Information Administration/Short-Term Energy Outlook – April 2007

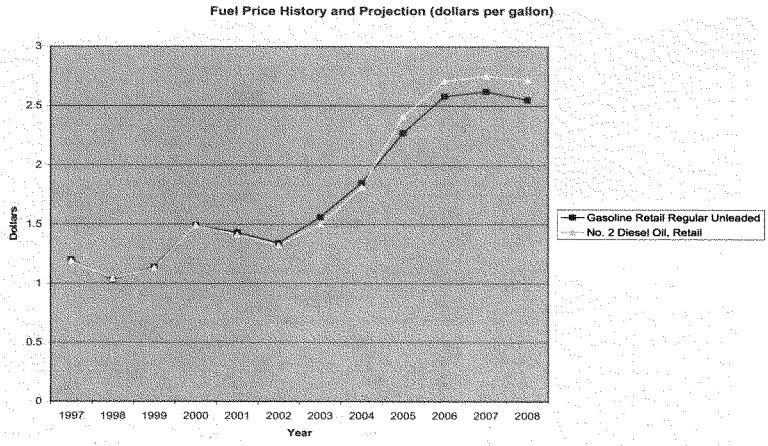


Table 1[6] *(projections in italics)* (dollars per gallon)	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	***2007***	***2008***
Gasoline Retail Regular Unleaded	1.2	1.03	1.14	1.49	1.43	1.34	1.56	1.85	2.27	2.58	*2.62*	*2.55*
No. 2 Diesel Oil, Retail	1.19	1.04	1.13	1.49	1.41	1.32	1.5	1.81	2.41	2.71	*2.75*	*2.72*

Fertilizer

Not many people realize it, but the primary components of most fertilizers are oil and natural gas. There are two important things to consider in this context: the first is, fertilizer is one of the most significant input costs associated with the business of farming; and second, the increasing cost of oil and natural gas not only affects transportation costs, but increases the cost of fertilizer as well.

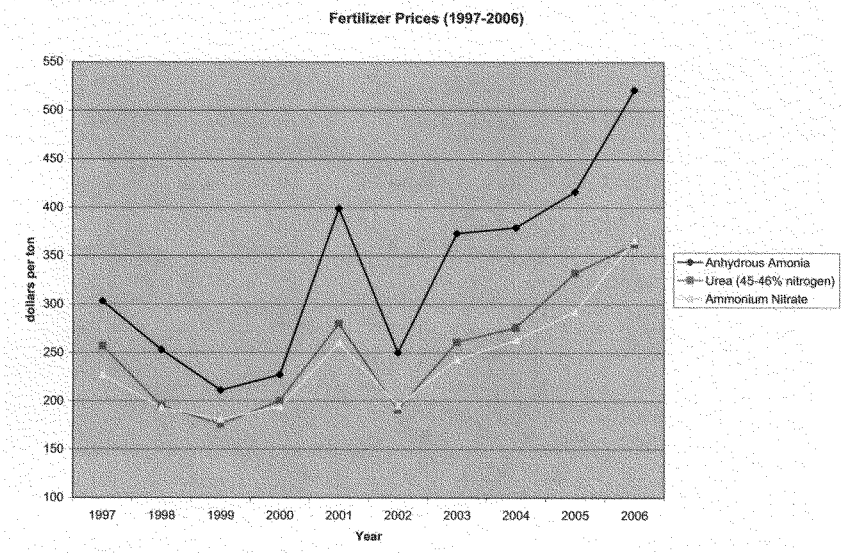
The development of technology includes the development of various types of necessitated fertilizers, which are required to have a successful and high-yielding crop. Therefore, as fertilizer becomes a more significant component of the production process, so too does the percentage cost of this particular input. If we look back to a report by the Congressional Research Service analyzing fertilizer production costs, we find that "in 2002, fertilizer expenditures accounted for about 5 percent of agricultural production expenses. However, they were the single largest outlay among farm energy expenditures, with a 34 percent share of the $28 billion of total energy expenses. That same year, fertilizer also represented the largest single source of farm energy (measured in Btu's),

[6] Ibid.

with a 29 percent share."[7] This was at a time before the sharp price increase in practically all input components of the agricultural sector.

As already discussed, the price of oil and natural gas has risen significantly in the last few years and this increase has translated into recognizably significant increases in the price of fertilizers, as shown below in Graph 3.

Graph 3[8]



The fertilizer component of agricultural production could be relieved if we were to promote the production of renewable fuels because this will also ease the oil demand from the transportation component. When there is greater supply, it is common sense that prices should drop back down, and this could be realized in the fertilizer sector with renewable energy production.

A Big Picture Approach

As a society, we are starting to take responsibility for our energy gluttony. I believe that global climate change is the scariest thing we are throwing at our kids. Economies and governments can change quickly, but if we mess up our environment with our excesses, it is not something that can be fixed overnight.

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[7] Schnepf, Randy. "Energy Use in Agriculture: Background Issues." November 19, 2004. Congressional Research Service. CRS-11.
[8] USDA, NASS

As a nation, we need to look forward responsibly. There needs to be a common sense approach to our energy crisis that addresses the following:

- Energy conservation;
- More competition in the energy industry
- Renewable energy (especially community-owned wind);
- A more responsible food delivery system that utilizes local foods and takes much of the "highway miles" off of the food we eat; and,
- In a worst-case-scenario; a ration system that separates the recreational from the needed energy uses, especially that of producing the nation's food supply.

As stated in the policy of the NFU, renewable energy production is probably the most important step that can be taken to address the growing threat of global warming and diminishing access to energy.

Renewable Fuels

National Farmers Union supports a balanced energy policy that seeks energy independence by 2025 for the United States and, at the same time, protects our nation's environment and recognizes the special energy needs of America's agricultural sector. In order to address the growing prices of energy, NFU believes the appropriate steps are necessary in decreasing our reliance on foreign sources of energy and to reverse the current trend of global warming:

- Any actions taken by the Congress must balance our energy needs with a sustainable environment.
- Congress ought to make the development of renewable sources of energy our number one priority in reducing our dependence on fossil fuels, including economic assistance for family farmers to make agriculture more self-sufficient through increased application of alternative forms of energy such as the expansion of corn-based ethanol, cellulosic ethanol, biodiesel and wind.
- Reverse the trend toward concentration of the ownership or control of sources, production and distribution of energy, targeting incentives to encourage diversified, community-based energy systems that create jobs and new wealth in rural areas of our country. We have already seen rural America take these steps with community-based wind energy projects like those in Minnesota and, as a report NFU recently released shows, the ethanol sector has actually seen a decrease in concentrated ownership and accounts for the single-greatest industry of local ownership at 39percent.[9]
- The ambitious mandates for renewable energy production, specifically the Renewable Fuels Standard (RFS), are a good step but farmers are ready to see it expanded. The RFS should set a mandate for biofuels production to make up one-third of the nation's fuel supply as soon as possible. In addition, it should set up separate mandates of production for each form of biofuel, including cellulosic, ethanol and biodiesel.

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[9] Hendrickson, Mary and William Heffernan. "Concentration of Agricultural Markets." April 2007. University of Missouri in a study commissioned by the National Farmers Union.

- Congress should expand and extend renewable energy incentives, tax credits and other financial programs such as the renewable energy production tax credit, the biodiesel and ethanol blenders' tax credit, and the cellulosic ethanol loan guarantee program.
- Congress must show concern for the survival of independent oil producers, those cooperatives and small well owners which make up a much-needed share of total domestic output, through the elimination of the oil depletion allowance on all but domestic production.
- NFU supports the creation of a renewable energy reserve to reduce price-depressing supplies of farm commodities. The purpose of the program is to provide storage incentives sufficient to encourage renewable fuels processors to purchase and store surplus commodities for use later when commodity prices have stabilized.
- To enable more realistic use of biofuels, NFU urges the dramatic expansion of the biofuel infrastructure, including pipelines and increased and affordable rail transportation. Transmission of other renewable energy sources such as wind and solar is also needed. Congress should establish expanded incentives for the use of blender pumps, as well as E-85 filling stations/pumps. The production and use of flex fuel vehicles should also be expanded so as to increase the use of, and demand for, renewable fuels.
- To promote domestic production of renewable energy, NFU supports a phased-in moratorium on the export of domestically produced energy until such independence is reached. Additionally, no local, state, and/or federal tax dollars, or tax exemptions should apply to imported renewable fuels or derived from imported commodities. No local, state, and/or federal tax dollars or exemptions should apply to foreign-owned companies that produce renewable fuels.
- NFU urges Congress and the Administration to launch an alcohol fuels program to include renewable resources to establish low-interest federal loans to farmer-owned cooperatives, in the same way rural electricity and rural telephones were established. Additionally, NFU supports the extension of the ethanol fuel tax incentive to include the ethanol portion of ethyl tertiary butyl ether (ETBE). NFU supports allowing ETBE refiners the ability to claim the ethanol excise tax exemption at the blend point and we oppose any future efforts to eliminate the tax incentive.
- NFU promotes the increased use of ethanol, biodiesel, animal fats, oilseeds, switchgrass, methane and other agriculturally derived products as alternative sources of fuel energy products to aid rural America in building an energy-independent and cleaner nation.
- Incentives for environmentally-friendly practices should also be expanded by supporting a national mandatory carbon emission cap and trade system to reduce non-farm greenhouse gas emissions. The Chicago Climate Exchange should continue to expand to allow for continuation of financially compensating farmers and ranchers for their environmentally sound practices.

National Farmers Union believes that renewable energy sources like wind and solar for electricity, biodiesel, ethanol and hydrogen can decrease our dependence on imported and fossil fuels; farmers must be integrally involved in the manufacturing side of the process to benefit economically.

Protecting the environment is an issue that farmers take very seriously, which is why National Farmers Union has been at the forefront of promoting environmentally-friendly practices on the farm through our Carbon Credit Program which enables and incentivizes environmentally friendly cropping practices. Additionally, farmers have been at the forefront of developing ethanol plants which produce cleaner burning fuels and enable our fuel supply to be less reliant on foreign oil.

Attached are support letters from a rural bank and my trucker which outline what they see increased energy costs doing to their communities and business. Additionally, there is supporting documentation from Kansas State University's website reporting on the increased energy inputs and the effect it has on Kansas Farm Management operations.

In closing, I appreciate the important venue you provide for hearing testimony from sectors of the economy such as agriculture. On behalf of the Kansas Farmers Union and National Farmers Union, I want to thank you for the opportunity to testify. I would also like to thank the chairman and ranking member for recognizing the importance of rising fuel prices and taking a proactive effort to address the negative impact on all aspects of the agricultural industry.

Thank you very much for your time and the opportunity to be here today. I would be happy to answer any questions of the committee.

Peoples Exchange Bank

May 4, 2007

Mr. Donn Teske
President, Kansas Farmers Union
17925 Golden Belt Road
Wheaton, Kansas 66521

Dear Donn:

As per our telephone conversation this morning, it is my understanding that you will be presenting testimony next week to the House of Representatives Energy Committee about the impact of the current high energy costs for rural America. As a banker dealing with a customer base that is composed of primarily agricultural producers and as a partner in a family farming operation, it is clear to me that there is a significant negative impact.

First, as regards my farming interests, our operation used 14,000 gallons of diesel fuel for crop production and irrigation expense. The average cost of the diesel fuel in 2006 was $2.55 at the farm, but the price ranged from a low of $2.07 to a high of $2.90. In early 2007, we contracted 7,000 gallons of diesel for $2.10. The price has risen steadily since then. However, there is a cost to contracting the fuel and that is the increased credit that we must have and with that comes increased interest costs. Fertilizer prices are also dramatically affected by the energy price. 28% liquid nitrogen was available at $190 per ton early in 2007; the price is now near $300/ton. Again, we were fortunate enough to contract the product at $190/ton, but also with a significant increase in our credit needs and interest costs. For those customers not able or willing to contract in advance, the current prices are devastating and certainly, no one is always able to correctly guess the next market move.

There is a related impact to the suppliers of fuel and fertilizer. Their credit needs have in many cases doubled due to the increased cost. In some cases, the increased credit need can not be met by our bank or local banks. In addition, those suppliers face slowed payment from their customers again due to the increased credit need that those customers have. The loss of any supplier in our area decreases competition, results in fewer jobs and creates an additional exodus of families from our communities.

The impact is very real to many of our bank's consumer customers who live in our smaller communities and drive 30-50 miles one way each day for their employment in a larger community with greater employment opportunity. If you are commuting some 400

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miles per week and using 20 gallons of gasoline to do so, the cost of fuel is $60/week just for the work commute. For many of our families where one of the spouses has employment that is of a "secondary income level", that translates to one day per week just to pay the fuel bill to go to work. With the reduction to these families of disposable income created by the high energy costs, they must cut back somewhere and that is often to the detriment of our local merchants. Clearly, our rural economies suffer since there is no real public transportation alternative.

The unfortunate reality for most residents in North Central Kansas is that they face much greater costs whether it is in their farming operation, in their agricultural input supply business or in their commute to work with no real opportunity to directly price their product or their labor to offset these costs. We find it disturbing that current energy prices are now nearly as high today as they were one year ago when oil was several dollars per barrel higher.

Sincerely,

James M. Koch
President

Falk Trucking
22205 Clear Fork Rd.
Wheaton, KS. 66521
785-799-5209

5-7-07

Donn Teske
President, Ks. Farmers Union
Box 1064
McPherson, Ks. 67460

Mr. Teske,

This letter is in response to your contacting me in regards to your testimony this coming Wednesday before the Select Committee on Energy Independence and Global Warming in Washington DC.

You asked me for a letter from my business outlining what the high petroleum prices have done to my operation here in Kansas and how it reflects back to my customer base.

I am very happy to oblige.

My business, Falk Trucking, operates in a rural area of Kansas and my customer base is primarily agricultural producers. I haul cattle, hogs, grain commodities, and a lot of hay for my customers. Also there is quite a lot of Misc. hauling of all kinds of things. I will travel all over the Great Plains to deliver these commodities for my customers.

Trucking is a pass-through business. My expenses I spend to operate my business has to be passed on to the customer paying for my services; otherwise I'm out of business. Yet there are other independent truckers out there and I have to offer a competitive price. I also fill guilty raising my prices so much, knowing that my customers are already struggling to survive, so I tend to shave my own margin tighter in the process. At some point I won't be able to financially make it work any longer. That point isn't far off! The tightened margin forces me and my fellow truckers to spend more hours on the road trying to make it work and our quality-of-life at home with our families suffer.

Not that long ago I could fill up my truck on $500 to $600. Now it takes a $1,000 to fill my truck and often that tank of fuel won't make a full run for me! Those extra four or five hundred dollars has to be passed on to the customer!

A couple of weeks ago I hauled a load of hay to a Texas dairy for you. This has been an ongoing arrangement for us over the past several years and it has worked well for all of us. Now I have to pass the extra fuel expenses on to the customer and somewhere in the whole budget the extra fuel cost has to be cash-flowed. This on just 20 tons of hay! You have higher input costs to produce the hay, the dairy has higher energy costs to produce the milk, and I need to charge you more to cover the costs of delivery. Yet the final end price, the milk, can't be priced on to the consumer to off-set all of the extra energy input.

This has to change and I'm glad that I have the opportunity to send this letter to D.C. in your testimony.

Sincerely,

Eldon Falk

Eldon Falk
Falk Trucking

Impact of Energy Price Increases on Kansas Non-Irrigated Crop Farms

Michael Langemeier, Samuel Funk, and Gabriel Weeden
Department of Agricultural Economics
Kansas State University
August 3, 2006

Introduction

In December of 2005, Dhuyvetter, Funk, Kastens, and Langemeier analyzed the expected impact on Kansas Farm Management Association (KFMA) farms of energy price increases. Inputs examined on non-irrigated farms included gas, fuel, oil, and fertilizer. The estimated increase in cost per non-irrigated acre from 2004 to 2005 was $6.33.

The summary below updates the information contained in Dhuyvetter, Funk, Kastens, and Langemeier. In addition, the summary below compares the increases in energy related input cost to increases in seed, herbicide and insecticide, machinery cost, and crop production cost.

Data

Data for 746 farms in the Kansas Farm Management Association (KFMA) with continuous data from 2002 to 2005 were used in this study. To be included in this study, a farm had to be typed as a non-irrigated crop farm for each year of the study. The 746 farms represent approximately 49% of the farms with whole-farm analysis data in 2005.

All expenses are reported on an accrual basis. Crop machinery cost includes repairs, gas, fuel, oil, machine hire and lease, economic depreciation, and an opportunity charge on machinery and equipment investment. Crop production cost includes hired labor, machinery cost, seed, fertilizer, herbicide and insecticide, storage and marketing, insurance, supplies, utilities, and dues and fees.

Production cost is impacted by price changes, technology, and crop mix. Adopting technology (e.g., switching to a reduced tillage system) and changes in a farm's crop mix often change the optimal mix of inputs. It was not possible to disentangle the impacts of price changes, technology adoption, and crop mix changes in the analysis summarized below.

Analysis

Tables 1-2 contain summary information on crop related expenses for non-irrigated farms. On a per acre basis, crop production cost increased $8.69 from 2002 to 2003, $8.49 from 2003 to 2004, and $14.97 from 2004 to 2005. These per acre crop production cost increases represented an 8.27% increase from 2002 to 2003, a 7.46% increase from 2003 to 2004, and a 12.24% increase from 2004 to 2005.

The increase in energy related expenses (Table 2) was a major contributor to the increase in crop production cost. Energy related expenses increased 27.76% from 2004 to 2005. In 2005, fertilizer expense increased by 24.44% and gas, fuel, and oil expense increased by 35.05%. On a per acre basis, approximately 56% of the increase in crop production cost in 2005 was attributable to increases in energy related expenses. The remaining increase in crop production cost per acre was due to increases in seed, fertilizer, herbicide and insecticide, hired labor, repairs, machine hire and lease, storage and marketing, supplies, utilities, dues and fees, economic depreciation, and opportunity charges on machinery and equipment investment.

Summary Points

Increases in energy related expenses represented 56% of the increase in crop production cost per acre in 2005. Increases in energy related expenses increased per acre cost by $8.36 in 2005 and $15.46 from 2002 to 2005.

Energy related expenses, on a per acre basis, increased 16.56% from 2002 to 2003, 12.25% from 2003 to 2004, and 27.76% from 2004 to 2005.

Table 1. Major Crop Related Expenses per Acre for Non-Irrigated KFMA Crop Farms from 2002-2005.

Expense Category	2002	2003	2004	2005
Expense per Acre				
Seed	$12.47	$13.38	$14.43	$17.06
Fertilizer and Lime	$16.19	$18.93	$20.70	$25.75
Herbicide and Insecticide	$11.69	$12.65	$12.23	$13.16
Gas, Fuel, and Oil	$6.83	$7.91	$9.43	$12.74
Machinery Cost	$43.22	$45.15	$49.13	$54.27
Crop Production Cost	$105.08	$113.77	$122.26	$137.23
Annual % Change in per Acre Expense				
Seed		7.33%	7.85%	18.19%
Fertilizer and Lime		16.92%	9.30%	24.44%
Herbicide and Insecticide		8.23%	-3.32%	7.55%
Gas, Fuel, and Oil		15.70%	19.31%	35.05%
Crop Machinery Cost		4.47%	8.83%	10.46%
Crop Production Cost		8.27%	7.46%	12.24%

Source: Kansas Farm Management Association 2005 Databank.

Table 2. Energy Intensive Expenses for Non-Irrigated KFMA Crop Farms from 2002-2005.

Expense Category	2002	2003	2004	2005
Fertilizer and Lime				
Crop Expense	$22,537	$26,724	$29,229	$37,066
Expense per Crop Acre	$16.19	$18.93	$20.70	$25.75
Annual % Change in per Acre Expense		16.92%	9.30%	24.44%
Gas, Fuel, and Oil				
Crop Expense	$9,512	$11,161	$13,325	$18,338
Expense per Crop Acre	$6.83	$7.91	$9.43	$12.74
Annual % Change in per Acre Expense		15.70%	19.31%	35.05%
Total Energy Related Expense				
Crop Expense	$32,049	$37,885	$42,554	$55,404
Expense per Crop Acre	$23.03	$26.84	$30.13	$38.49
Annual % Change in per Acre Expense		16.56%	12.25%	27.76%

Source: Kansas Farm Management Association 2005 Databank.

An Assessment of the State of the Agricultural Economy due to Increased Energy Prices

Prepared by Kevin Dhuyvetter, Samuel Funk, Terry Kastens and Michael Langemeier[1]
December 1, 2005

Introductory comments
The general outlook for farm incomes across Kansas must take into account the substantial increase in fuel and fertilizer prices directly used on farms, as well as the higher costs of other inputs and services due to petroleum-based products. Even though some energy component prices have been falling in recent weeks, and some models forecast continued price decreases, they are still at extremely high levels.

Energy Forecasts
The following tables and charts show expenses for three major crop inputs for Kansas farmers – fuel and oil, irrigation energy, and fertilizer. With the possible exception of irrigation energy, these costs are important for most producers in the U.S., especially those located in the High Plains and Corn Belt regions. Costs are reported for the previous five years (2000-2004) as well as forecasts for 2005 and 2006. Forecasts for diesel prices and natural gas are based on an average of KSU models and Energy Information Administration (EIA) models. Fertilizer price forecasts are based on KSU models only. The KSU models are based on New York Mercantile Exchange (NYMEX) closing futures prices for crude oil and natural gas as of November 30, 2005. The reason for using an average forecast from several sources is that research has shown that composite forecasts generally are more accurate than individual forecasts.

Forecasts for whole-farm expenses for 2005 and 2006 are based on changes in input prices implicitly assuming that producers do not change their production practices significantly in response to the higher prices. For individual farms, this assumption may not hold, however, historical evidence suggests that at the aggregate level producers generally do not make major changes in response to price. Furthermore, research examining optimal input use (e.g., fertilizer, irrigation water) shows that input levels are reduced only marginally when prices increase. That is, producers still use similar amounts of the input for optimal economic production, but their economic returns decrease due to the higher input prices.

With the 2005 information that is in, and for all three inputs considered, costs are expected to increase significantly in 2005 relative to the previous 5-year average (2000-2004). Percentage increases in prices range from a low of +30.5% for fertilizer (composite of individual products) to a high of +95.4% for natural gas. Furthermore, prices in 2006 are forecasted to generally remain above the 5-year average (2000-2004). This is especially true for fertilizer prices which are forecasted to increase significantly in the fall of 2005 and spring of 2006.

Using the Kansas Farm Management Association (KFMA) Summary's dryland and irrigated farm types, the expense categories of Gas-Fuel-Oil, Fertilizer, and Irrigation Energy were assigned to an energy expense "complex." Across all farms and on a per acre basis, the impact of higher fuel and oil, irrigation energy, and fertilizer prices will increase costs in 2005 $9.30 per acre for farms in Kansas compared to 2004. An increase of additional $6.37 per acre is expected

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[1] Respectively, Professor, Administrator of the Kansas Farm Management Association Programs, Professor, and Professor all in the Department of Agricultural Economics at Kansas State University.

for 2006 relative to 2005. The cost per irrigated acre in the KFMA Summary due to the increase in the energy expense complex is expected to rise $34.15 in 2005 and another $12.97 in 2006. The cost per dryland acre in the KFMA Summary is expected to increase $6.33 from 2004 to 2005 with an additional $5.58 projected for 2006. Assuming that producers do not make major production changes, land rents would need to decrease by $11.91 per acre for dryland acres and $47.13 for irrigated acres from 2004 to 2006 in order to offset the impact of higher energy costs alone.

Based on an average from 2000 – 2004, the percentage of Total Operating Expense for these farms represented by the energy expense complex is 22.8% for dryland crop farms and 29.9% for irrigated crop farms. Holding other expenses constant while using the projected future expenses for the energy complex suggests those figures would rise to 32% and 41% for dryland and irrigated crop farms, respectively, in 2006.

Holding prices, yields and other factors constant; if the 2004 KFMA Summary dryland producers were to absorb the increase in the energy expense complex alone, they would reduce Net Farm Income by $19,230 from 2004 to 2006. For irrigated producers in the 2004 KFMA Summary the reduction in Net Farm Income would be $49,242 in 2006. These figures would represent a reduction in net farm income respectively of 34.4% and 88.9% from 2004 levels.

Given that Machine Hire, Utilities and other costs directly affected by energy prices are expected to increase significantly during this same timeframe we would expect additional upward pressure on input prices. Additional costs are expected for inputs utilizing petroleum-based products such as agricultural chemicals. Furthermore, the increase in building materials and other necessary items in the operation and upkeep of farms likely will continue to impact the total operating expenses of agricultural enterprises.

Revenues would be expected to decline in 2005 as yields for the primary fall crops in Kansas are expected to decline from the historically high levels of 2004.

Factoring in historically high yields for major crops across Kansas in 2004 and downward pressure on farm-level agricultural commodity prices with higher fuel prices and limited export flows, a sustained level of revenues for Kansas farm families in 2005 is not expected. Reduced revenues and increased expenses result in a more pessimistic outlook for overall net farm incomes.

Table 1. Diesel Prices

	Mar-Oct Diesel Price			Year-to-year percent change		
Year	SW KS	US (EIA)	Average	SW KS	US (EIA)	Average
2000	$1.09	$1.04	$1.07	-----	-----	-----
2001	$1.09	$0.98	$1.04	0.6%	-6.1%	-2.7%
2002	$0.94	$0.88	$0.91	-14.1%	-10.0%	-12.1%
2003	$1.05	$1.05	$1.05	12.1%	18.6%	15.3%
2004	$1.37	$1.34	$1.36	30.0%	28.4%	29.2%
2005	$2.04	$2.02	$2.03	48.5%	49.9%	49.2%
2006 (F)	$1.85	$2.08	$1.96	-9.3%	3.1%	-3.1%
05 - Avg(00-04)	$0.93	$0.96	$0.94	83.5%	90.2%	86.8%
06 - Avg(00-04)	$0.74	$1.02	$0.88	66.4%	96.0%	80.9%

F = forecast

Figure 1. Monthly Diesel Prices, Jan 1994 - Nov 2005
(Dec 2005 - Dec 2006 forecasted)

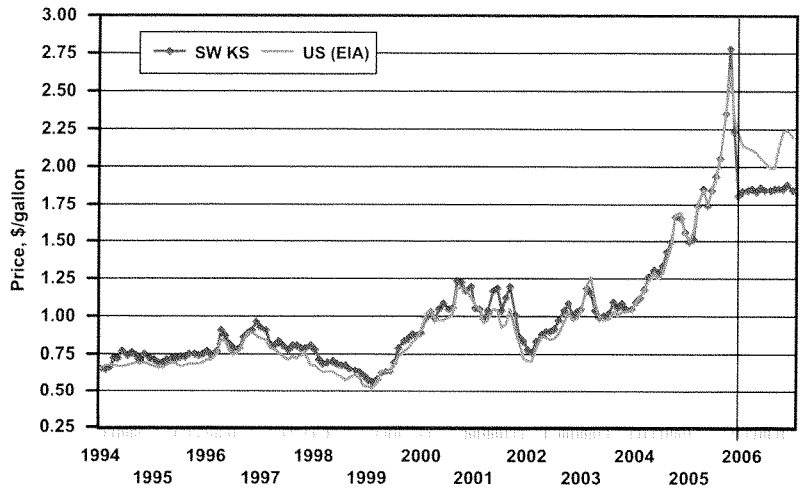


Table 2. Natural Gas Prices

	Mar-Oct Natural Gas Price			Year-to-year percent change		
Year	NYMEX	US (EIA)	Average	NYMEX	US (EIA)	Average
2000	$4.04	$3.85	$3.95	-----	-----	-----
2001	$3.69	$3.49	$3.59	-8.6%	-9.3%	-9.0%
2002	$3.35	$3.12	$3.23	-9.2%	-10.7%	-10.0%
2003	$5.35	$5.24	$5.30	59.5%	68.2%	63.7%
2004	$5.99	$5.63	$5.81	11.9%	7.5%	9.7%
2005	$8.77	$8.33	$8.55	46.5%	47.8%	47.2%
2006 (F)	$10.32	$7.76	$9.04	17.7%	-6.8%	5.8%
05 - Avg(00-04)	$4.28	$4.06	$4.17	95.5%	95.3%	95.4%
06 - Avg(00-04)	$5.84	$3.50	$4.67	130.2%	82.0%	106.7%

F = forecast

Figure 2. Natural Gas Monthly Prices, Jan 1994 - Nov 2005
(Dec 2005 - Dec 2006 forecasted)

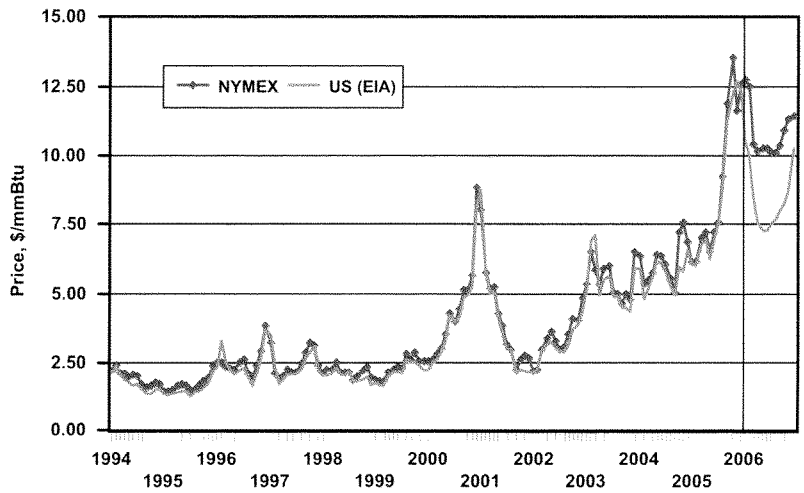


Table 3. Fertilizer Prices (Corn Belt)

Percent of total	40.0%	17.5%	17.5%	20.0%	5.0%	100.0%	
			Oct-May Fertilizer Price*				Year-to-year
Year	NH3 (82%)	UAN (32%)	Urea (46%)	- P -	- K -	Wtd Avg	% change
2000	222.80	130.49	188.59	218.40	177.78	197.53	-----
2001	355.87	194.93	250.31	225.73	177.30	274.27	38.9%
2002	231.93	139.39	171.91	210.48	172.43	197.96	-27.8%
2003	320.33	162.11	208.69	227.49	169.25	246.98	24.8%
2004	357.91	185.50	240.79	243.71	169.45	274.98	11.3%
2005	390.58	228.15	296.30	262.62	208.54	310.96	13.1%
2006 (F)	541.06	304.86	335.43	284.27	227.65	396.71	27.6%
05 - Avg(00-04)	$92.82	$65.66	$84.25	$37.46	$35.30	$72.62	30.5%
06 - Avg(00-04)	$243.30	$142.37	$123.37	$59.11	$54.41	$158.37	66.4%

* Oct-Dec of previous year (P = average of 10-34-0 and 18-46-0, K = muriate of potash)

F = forecast

Figure 3. Fertilizer N Monthly Prices, Jan 1994 - Nov 2005
(Dec 2005 - Dec 2006 forecasted)

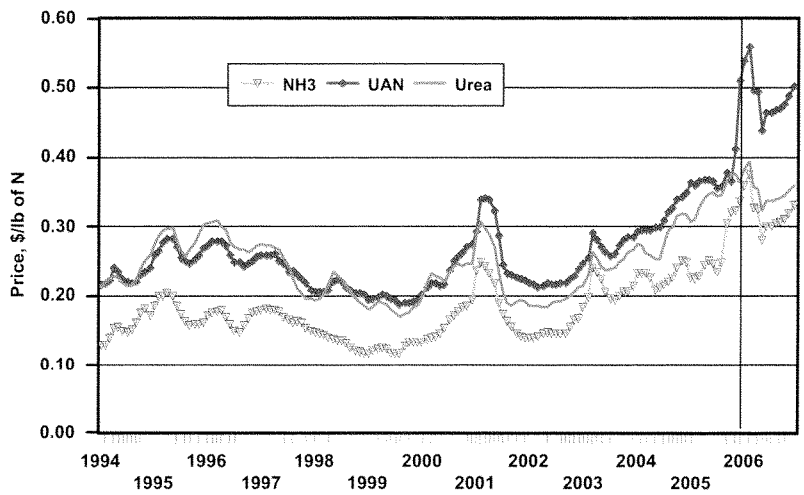


Table 4. Whole-farm Gas, Fuel & Oil Expenses from KFMA Annual ProfitLink Summary

	Non-Irrigated Farms		Irrigated Farms		Weighted
Year	Dollars	Number	Dollars	Number	Average
2000	$10,192	1,367	$19,617	140	$11,068
2001	$10,897	1,308	$17,345	129	$11,476
2002	$9,431	1,270	$15,696	122	$9,980
2003	$10,685	1,210	$16,716	117	$11,217
2004	$12,820	1,179	$19,285	109	$13,367
2005 (F)	$19,129	1,179	$28,776	109	$19,945
2006 (F)	$18,528	1,179	$27,872	109	$19,319

and 2006 relative to the actual diesel price in 2004.

'05 chg from '04	$6,309	49.2%	$9,491	49.2%	$6,578
'06 chg from '05	($601)	-3.1%	($904)	-3.1%	($627)
'06 chg from '04	$5,708	44.5%	$8,587	44.5%	$5,952

Figure 4. Average Whole-farm Gas-Fuel-Oil Costs for KFMA Members

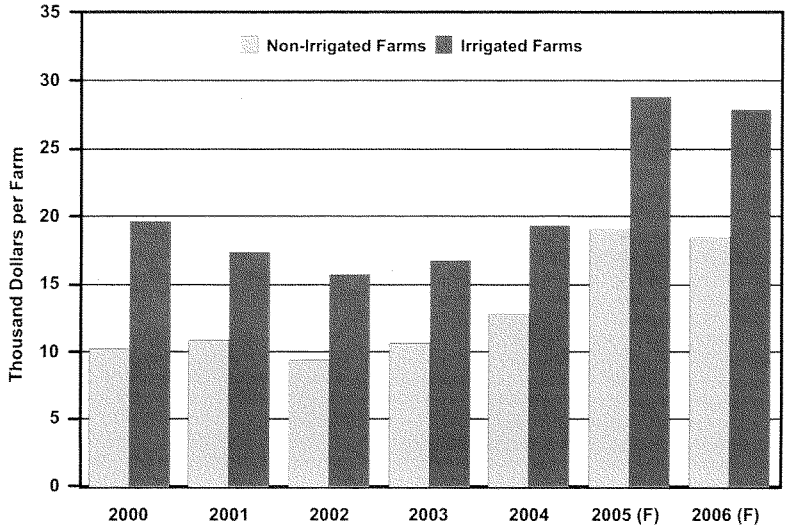


Table 5. Whole-farm Irrigation Energy Expenses from KFMA Annual ProfitLink Summary

	Non-Irrigated Farms		Irrigated Farms		Weighted
Year	Dollars	Number	Dollars	Number	Average
2000	$1,976	1,367	$33,900	140	$4,942
2001	$1,900	1,308	$30,758	129	$4,491
2002	$2,003	1,270	$31,946	122	$4,627
2003	$2,578	1,210	$39,438	117	$5,828
2004	$2,232	1,179	$41,602	109	$5,564
2005 (F)	$3,284	1,179	$61,219	109	$8,187
2006 (F)	$3,475	1,179	$64,766	109	$8,662
2005 and 2006 relative to the actual natural gas price in 2004.					
'05 chg from '04	$1,052	47.2%	$19,617	47.2%	$2,624
'06 chg from '05	$190	5.8%	$3,547	5.8%	$474
'06 chg from '04	$1,243	55.7%	$23,164	55.7%	$3,098

Figure 5. Average Whole-farm Irrigation Energy Costs for KFMA Members

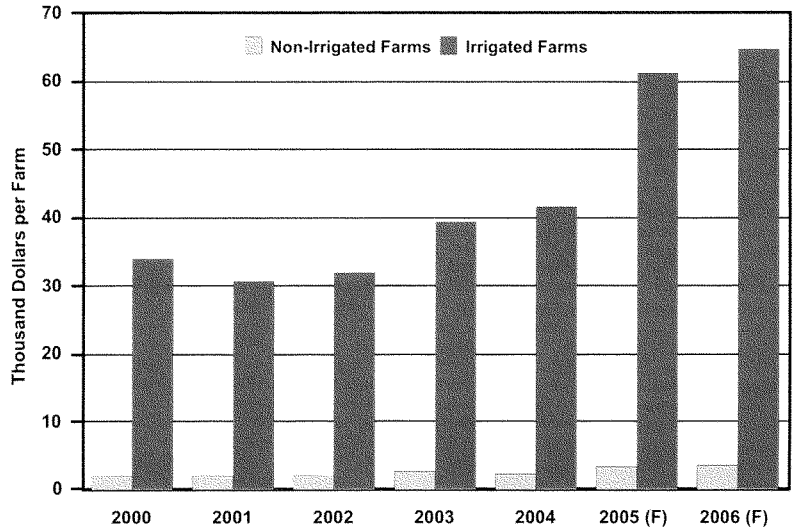


Table 6. Whole-farm Fertilizer & Lime Expenses from KFMA Annual ProfitLink Summary

	Non-Irrigated Farms		Irrigated Farms		Weighted
Year	Dollars	Number	Dollars	Number	Average
2000	$19,999	1,367	$34,515	140	$21,348
2001	$23,806	1,308	$39,076	129	$25,177
2002	$20,705	1,270	$27,506	122	$21,301
2003	$24,638	1,210	$35,434	117	$25,590
2004	$27,737	1,179	$39,511	109	$28,733
2005 (F)	$31,367	1,179	$44,681	109	$32,493
2006 (F)	$40,016	1,179	$57,002	109	$41,454
and 2006 relative to the actual fertilizer prices in 2004.					
'05 chg from '04	$3,630	13.1%	$5,170	13.1%	$3,760
'06 chg from '05	$8,649	27.6%	$12,321	27.6%	$8,960
'06 chg from '04	$12,279	44.3%	$17,491	44.3%	$12,720

Figure 6. Average Whole-farm Fertilizer Costs for KFMA Members

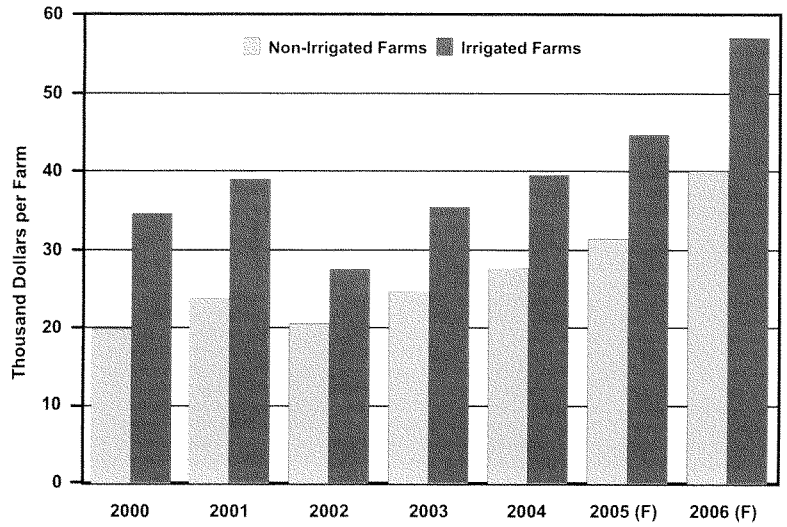


Table 7. Whole-farm Total Operating Expenses/Acre from KFMA Annual ProfitLink Summary

	Non-Irrigated Farms		Irrigated Farms		Weighted
Year	Dollars	Number	Dollars	Number	Average
2000	$112.84	1,367	$177.05	140	$118.80
2001	$120.96	1,308	$189.83	129	$127.15
2002	$112.65	1,270	$178.80	122	$118.45
2003	$118.67	1,210	$195.40	117	$125.43
2004	$127.89	1,179	$209.88	109	$134.83
2005 (F)	$135.95	1,179	$232.69	109	$144.13
2006 (F)	$141.98	1,179	$242.65	109	$150.50
Crop acres in '04	1,365	1,179	1,503	109	1,377
'05 chg from '04	$8.05	---	$22.81	---	$9.30
'06 chg from '05	$6.03	---	$9.96	---	$6.37
'06 chg from '04	$14.09	---	$32.77	---	$15.67

* 2005 and 2006 forecasted expenses are based on changes in prices for 2005 and 2006 relative to the actual prices in 2004.

Table 8. Percent Energy-Related Costs are of Total Operating Costs by Farm Type

	Non-Irrigated Farms			Irrigated Farms		
	2000-04	2005	2006	2000-04	2005	2006
Fuel and oil	6.8%	10.3%	9.6%	6.0%	8.2%	7.6%
Irrigation energy	1.3%	1.8%	1.8%	12.0%	17.5%	17.8%
Fertilizer & lime	14.7%	16.9%	20.6%	11.9%	12.8%	15.6%
Total	22.8%	29.0%	32.0%	29.9%	38.5%	41.0%

Table 9. Amount Land Rent would Need to Decrease to Offset Impact of Higher Energy Costs

Time period	Dryland acres	Irrigated acres	Weighted Average
'05 chg from '04	$6.33	$34.15	$9.30
'06 chg from '05	$5.58	$12.97	$6.37
'06 chg from '04	$11.91	$47.13	$15.67

* Note: this is the rent per acre of non-irrigated and irrigated land ACRES not the rent per acre for non-irrigated and irrigated FARMS (which include some land of both types).

Figure 7a. Operating Costs for Non-irrigated Farms in KFMA

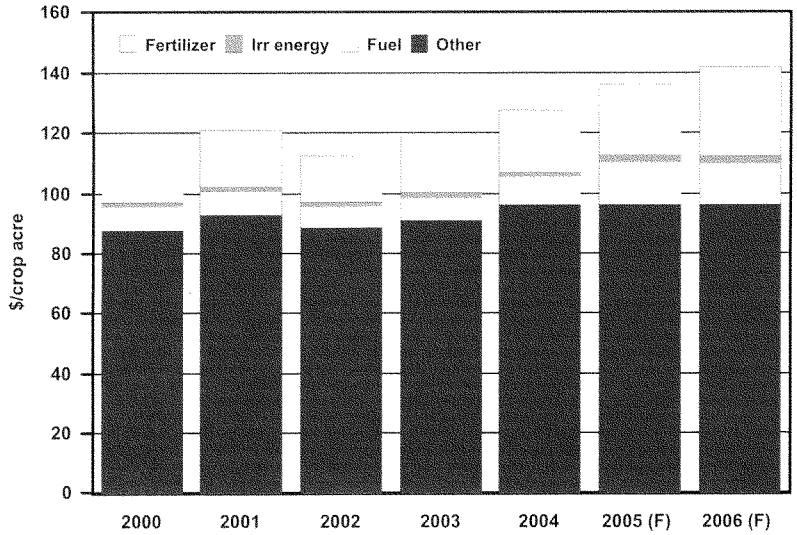
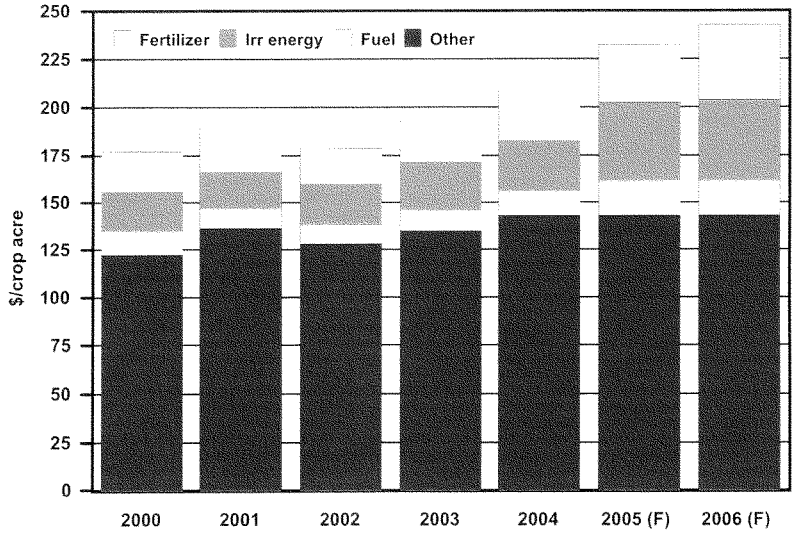


Figure 7b. Operating Costs for Irrigated Farms in KFMA



Energy Prices and Their Impact on Kansas Irrigated Crop Farms

Samuel M. Funk and Michael R. Langemeier
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Kansas Farm Management Association, Department of Agricultural Economics
Kansas State University

In December of 2005, Dhuyvetter, Funk, Kastens, and Langemeier analyzed the expected impact on KFMA Farms of energy price increases for the components of an Energy Expense Complex (EEC). The EEC was comprised of the KFMA expense categories of: Fertilizer, Gas-Fuel-Oil, and Irrigation Energy (where appropriate). At that time, the estimated increase in costs per dryland acre in the KFMA Summary from 2004 to 2005 was $6.33 due to expected prices of EEC components. $34.15 was the expected rise in per irrigated acre costs from 2004 to 2005.

The summary below updates the data for Irrigated Crop Farms in Dhuyvetter, Funk, Kastens, and Langemeier. In addition, the summary below discusses the impact of changes in acres farmed on energy intensive inputs.

Impact of Energy Price Increases on Expenses

Prices for energy and several production agriculture inputs that are dependent on petroleum or other energy-based components soared in 2005. The impacts were especially noticeable in Kansas on irrigated crop farms. Total farm outlays for more energy sensitive expenses for the years 2003, 2004, and 2005 are summarized in Table 1 from summary data collected on farms categorized as Irrigated Crop Farms in the Kansas Farm Management Association (KFMA).

It is important to note that the increases in the whole farm expenditures are not purely the result of the increased energy prices in 2005. As illustrated in Table 2, significant changes occurred in the number of crop acres for Irrigated Crop Farms. The increased acreage in these farms contributed significantly to overall expenses.

While the total crop acres for the farms classified as Irrigated Crop Farms decreased from 2003 to 2004, the total increased significantly in 2005. Considering that the average number of Total Crop Acres decreased by 7.2% from 2003 to 2004, the increase in whole farm EEC expenditures by 9.6% for the Irrigated Crop Farms demonstrates a marked increase in overall energy expenses.

Table 3 contains the cost per crop acre, or irrigated crop acre in the case of irrigation energy, for the energy intensive expense categories for Irrigated Crop Farms in the KFMA Summary from 2003 to 2005.

Summing the per crop acre charges for Fertilizer, Gas-Fuel-Oil, and the per irrigated crop acre expenses for irrigation energy; the Energy Expense Complex per acre for the 2005 Summary of Irrigated Crop Farms was $98.46. This represented a rise of $10.04, an 11.4% increase above the average EEC in 2004 for irrigated crop farms. This came on the heels of a $9.54 increase from 2003 to 2004, an increase of 12.1%.

Summary Points

- While higher energy prices certainly led to higher costs for irrigated farms in 2005, increased crop acres for farms included in the Irrigated Crop Farm typology for the KFMA Summary resulted in a significant portion of the overall farm-level expense increase for the energy-based components.
- The higher energy prices being faced by producers are not a one year phenomena. They have been escalating for several years. The Energy Expense Complex per acre for Irrigated Crop Farms in the KFMA Summary has increased $23.91 from 2002 to 2005, a 44.9% increase.
- Pesticide expenses, while a major cost in the whole-farm operation, did not increase on a per acre basis as much as other energy-based expense components. Changes in pesticide expenses are difficult to assess because the adoption of reduced-till practices typically increases per acre pesticide costs. Information directly related to the adoption of reduced-till practices is not available.
- Energy prices and the resulting impacts on expenses will continue to be major areas to examine opportunities and strategies to maximize farm profitability through cost management.

Table 1. Energy intensive expenses from 2003 to 2005 for Irrigated Crop Farms.

				Percent Increase (Decrease) From Prior Year	
Expense Category	**2003**	**2004**	**2005**	**'03-'04**	**'04-'05**
Fertilizer	$35,434	$39,511	$53,276	11.5%	34.8%
Gas-Fuel-Oil	$16,716	$19,285	$25,412	15.4%	31.8%
Irrigation Energy (Per Irr. Acre)	$39,438	$41,602	$49,341	5.5%	18.6%
Herbicides	$26,957	$28,415	$34,944	5.4%	23.0%

Source: 2003-2005 Kansas Farm Management Association Summary Data

Table 2. Total Crop Acres, Irrigated Crop Acres and Non-Irrigated Crop Acres for Irrigated Crop Farms in the KFMA Summary.

				Percent Increase (Decrease) From Prior Year	
	2003	**2004**	**2005**	**'03-'04**	**'04-'05**
Total Crop Acres	1520	1411	1659	-7.2%	17.6%
Irrigated Crop Acres	885	890	967	0.6%	8.7%
Non-Irrigated Crop Acres	687	668	723	-2.8%	8.2%

Source: 2003-2005 Kansas Farm Management Association Summary Data

Table 3. Per crop acre costs for energy intensive expense categories Irrigated Crop Farms.

				Percent Increase (Decrease) From Prior Year	
Expense Category	**2003**	**2004**	**2005**	**'03-'04**	**'04-'05**
Fertilizer	$23.31	$28.00	$32.11	20.1%	14.7%
Gas-Fuel-Oil	$11.00	$13.67	$15.32	24.3%	12.1%
Irrigation Energy (Per Irr. Acre)	$44.56	$46.74	$51.02	4.9%	9.2%
Herbicides	$17.73	$20.14	$21.06	13.6%	4.6%

Source: 2003-2005 Kansas Farm Management Association Summary Data

Chairman MARKEY. I thank you, Mr. Teske. And without objection it will be included in the record.

We thank you for quoting President Kennedy on farm policy. That is very helpful to me. Actually, we were just the reverse in the Markey family. My father was a milkman, so we actually go back to the retail again, going door-to-door with it, having the company purchase it wholesale.

We will now move on to our next witness. Our next witness is Sylvia Estes. She is a Native American Indian. She owns two businesses in Virginia Beach, Virginia; the Pipeline Industrial Group performs new construction, demolition, design build, emergency response mostly for the Federal Government.

We welcome you, Ms. Estes. Whenever you are ready, please begin.

STATEMENT OF SYLVIA ESTES, PIPELINE INDUSTRIAL GROUP

Ms. ESTES. I am more nervous than he is.

Chairman MARKEY. Well, he did a great job. I am sure you will, too.

Ms. ESTES. He did a fabulous job.

I am a farmer as well. I have a horse farm and a construction company, both of which, anyone here we all know that fuel costs going up have firm fixed price contracts which means we do not get economic adjustments and we eat it off the bottom line. So as your costs keep going up or our costs keep going up, our profit margins keep going down.

I will sit here and try go back to my prepared statement.

Founded in January 2000 Pipeline Industrial Group started with four employees and two trucks. Our primary work was petroleum. The field of petroleum had lapsed, and we went into construction. The Government grew us in construction. As of today, we support 120 people, that includes wives and children. We are a team. We work together as a team. Together we overcome problems every single day. We do whatever the Government ask of us, whether it is new construction or Hurricane cleanup.

I have talked about rising gas prices and how they are effecting the small businesses like mine and the families and the community they support. We cannot build in contingency to our proposals with the Government. Any additional costs at all comes off our bottom line profits.

The rise in fuel costs effect nearly every aspect of my business in one way or another. Many direct costs. It costs me more to run my business. Costs of materials, copper, steel, they have escalated in price. The cost in labor, and my employees expect more money. In order for them to even get to work I have to pay them more money. And in order to keep them, I have to get employees that do not have as much experience so that I can afford them. And then I have to train them and I have to start all over again.

Every time our economy shifts, the small business shifts. We are good people. We work hard. We want to do good for you. We believe that there is technology available to you that we all hope that you would look at. Technology that is a little different than the normal.

I spent four days writing your speech that I cannot even remember. I looked at every single thing on the internet I could possibly

read, and my poor brain got fried. I did find one thing that I found was extremely interesting and it was called SkyTran. Runs off of solar energy. It is not paid for by the government. It is private industry. Whether it will work or not, I cannot answer that. I do not have your answers, but I do know that there is technology here in the United States that does have your answers.

And instead of us relying on someone else to give our country what we need to exist, why can we not rely on ourselves? We do it everyday as a team. Look at Hurricane Katrina. We all pitched in together. That is what America is made of. It is not made of politics. And I will give you small joke that I have recently been told. Politics are the worst kind of ticks to have. And as a country girl, I agree with that.

I am sorry. We are out here earning a living. We want to make the best for our employees. We treat them with respect. We give them the respect that they are out there working for us. And as long as we keep that respect in life, we all keep moving up. When we take that respect away, and when you start raising the cost consider the fact that these people are not eating lunch. You may actually have enough money in your bank account to afford to go out to lunch, but most employees do not. They skip lunch, they skip breakfast and they eat dinner.

I have a nursery in my office so I can keep my employees. A lot of babies being born. It is one way that I can give back instead of giving raises. Every employer should be responsible for their employees. You should not go to sleep at night if you do not think your business is going to make it. You should figure out how to make it.

I would like to ask you guys to look at how to make it. If I can tell you in four days between running a business, two businesses and two teenagers, there is not much left of me. But I do know that there are answers. I know they are here. I know the internet is a great source for them. I have read more articles. One says it is pro, one says it is against. I mean, what is real? Does anyone truly know what is truly real? I agree with him, global warming is real. We are experiencing more storms. In fact, I have been invited by the government to go next week or the week after to a world global emergency summit because we all are facing problems.

We need to pay attention to what it is going to be twenty years from now, forty years from now, not just today. We have children and, hopefully, someday grandchildren.

And I thank you.

[The statement of Ms. Estes follows:]

TESTIMONY OF
SYLVIA ESTES
PRESIDENT
PIPELINE AND INDUSTRIAL GROUP, INC.
AT A HEARING BEFORE THE
SELECT COMMITTEE ON ENERGY INDEPENDENCE AND GLOBAL WARMING
U.S. HOUSE OF REPRESENTATIVES
ENTITLED
"ECONOMICS OF DEPENDENCE OF FOREIGN OIL—RISING GASOLINE PRICES"

MAY 9, 2007

Chairman Markey, Ranking Member Sensenbrenner, and distinguished members of the committee, I am Sylvia Estes. I am a Native American Indian, single parent of teenagers, and small-business owner. I own two businesses in Virginia Beach, Virginia: Pipeline and Industrial Group, Inc. (PIG, Inc.) and Cypress Creek Stables, a horse farm.

Founded in January 2000, Pipeline & Industrial Group started with four employees and two trucks, and our primary work was in the petroleum field. The principals of my business were and are simple: we believe in honesty, integrity and customer satisfaction. Today, my business has expanded into construction, and I am a government, Class "A" General Contractor. My company has grown because of United States Navy contracts; and if you were to ask me what I do, I would tell you that I do whatever the government asks, whether it is new construction, demolition, design build, emergency response, or federal compliance. My company is a team of every-day Americans that pay their taxes and support their families—and, today, my small business supports over 120 people, including spouses and children.

I am here to talk with you about rising gasoline prices and how rising energy prices are affecting small businesses, like mine, and the families and communities they support. Government construction contracting businesses, like mine, are greatly affected by rising gas prices. The contracts awarded are firm, fixed-price construction contracts, which do not contain economic price adjustment clauses. As a government contractor, we cannot build-in contingency costs in our proposals. Therefore, any additional cost that we incur comes directly off our bottom line.

Sylvia Estes

As we bid on most of our contracts the year before we perform the work, you can imagine the devastating uncertainly that surrounds every contract.

The rise in fuel prices affects nearly every aspect of my business in one way or another. Most directly, it costs me more to run necessary equipment. Rising gas prices translate into increased material costs as well. Copper, steal, and concrete are just a few of the construction materials that have seen significant price increases recently. Rising fuel costs also increase labor costs, as my employees expect higher salaries to cover their increased personal expenses, such as escalating utility bills and travel expenses. My company's accounting is set up in direct and in-direct costs. All told, the in-direct cost of fuel has increased 1,600 per month in the last year—from an average of just over $4,100 to nearly $5,800. I recently had a monthly fuel bill that topped $7,000.

My small business cannot afford to absorb much more volatility or increasing fuel costs. My profit margins already have shriveled. Two years ago, my customers would pay ten percent profit margins. Today, they pay seven percent. For a company such as mine, this sort of razor-thin profit margin is a cause of great concern, as it negatively impacts company stability and nearly precludes any advancement or growth.

I have worked extremely hard to create a solid business in a very demanding client atmosphere. It has been very rewarding being a part of a team to support the Department of Defense. However, the rate at which gas is increasing is alarming and will have a major impact on how I manage future business. It certainly has put a question mark on any future growth for my company and the many small companies with whom I partner.

Mr. Chairman, I really appreciate the opportunity to come before you today to tell you, my story of my American dream and the fight I am now engaged in to keep my American dream alive for both, me and my children. The rising cost of all types of fuels are not only having direct impacts to my business and family, but are having second and third order affects on our nation that we are

just now beginning to see. I see the rising costs of fuels just as much a threat to our national security as terrorism. Again, thank you for hearing me today and God bless America.

Pipeline & Industrial Group, Inc.

General Contracting

Pipeline Pigging Demolition Pressure Testing Tank Cleaning

Department of Navy / Army Corp of Engineers

	Government	Commercial
2005	$ 5,391,978.00	$ 1,042,388.00
2006	$ 11,823,355.77	$ 333,899.73

2669 Production Rd, Suite 103 * Virginia Beach, VA 23454
Office (757) 518-2970 * Fax (757) 518-2972

SBA 8(a) Certified * Virginia Class "A" Contractor * Certified Small Disadvantaged Business

FUEL

WRIGHT EXPRESS PAYMENTS 2005/2006/2007

2005	Type	Date	Paid
	Bill Pmt -Check	02/14/2005	$ 3,019.63
	Bill Pmt -Check	02/24/2005	$ 3,002.03
	Bill Pmt -Check	03/06/2005	$ 3,272.43
	Bill Pmt -Check	04/27/2005	$ 4,378.54
	Bill Pmt -Check	05/20/2005	$ 3,800.94
	Bill Pmt -Check	06/21/2005	$ 3,458.13
	Bill Pmt -Check	07/29/2005	$ 3,229.84
	Bill Pmt -Check	08/15/2005	$ 4,685.82
	Bill Pmt -Check	09/29/2005	$ 5,382.94
	Bill Pmt -Check	10/27/2005	$ 5,594.19
	Bill Pmt -Check	11/14/2005	$ 5,141.24
	Bill Pmt -Check	12/14/2005	$ 4,438.53
			$ 49,404.26
		Monthly Average: 2005	**$ 4,117.02**

2006	Type	Date	
Wright Express			
	Bill Pmt -Check	01/18/2006	$ 5,331.73
	Bill Pmt -Check	02/15/2006	$ 6,812.44
	Bill Pmt -Check	03/14/2006	$ 5,494.61
	Bill Pmt -Check	04/17/2006	$ 6,178.50
	Bill Pmt -Check	06/08/2006	$ 7,021.03
	Bill Pmt -Check	06/19/2006	$ 6,646.94
	Bill Pmt -Check	07/26/2006	$ 6,997.35
	Bill Pmt -Check	08/15/2006	$ 6,813.92
	Bill Pmt -Check	09/29/2006	$ 5,696.57
	Bill Pmt -Check	10/20/2006	$ 4,027.00
	Bill Pmt -Check	11/20/2006	$ 3,635.87
	Bill Pmt -Check	12/28/2006	$ 4,735.92
			$ 69,391.88
		Monthly Average: 2006	**$ 5,782.66**

2007	Type	Date	
	Bill Pmt -Check	1/6/2007	$ 4,763.97
	Bill Pmt -Check	2/6/2007	$ 5,649.39
	Bill Pmt -Check	3/6/2007	$ 5,153.70
	Bill Pmt -Check	4/6/2007	$ 5,243.93
			$ 20,810.99
		Monthly Average: 2007	**$ 5,202.75**

VAC's SOLD on 02/28/07

PIG CONSTRUCTION PROJECTS

JOB #	Contract Number-Task Order	Short Title	Government Agency	ACTUAL BID DATE	AWARD DATE	CONTRACT AMOUNT
00-225	N62470-02-D-3017-0002	Pig OWWO Pipeline	Commander Atlantic Division NAVFACENGCOM		9/30/2002	$524,322.00
00-579	N62470-03-D-4473-0019	Pier 12	NAVFAC MID ATLANTIC ROICC SEWELLS POINT	4/21/2005	8/4/2005	$639,226.00
00-564	N62470-02-D-3017-009	T2C&T2D	NAVFAC MID ATLANTIC ROICC NORFOLK NAVAL SHIPYARD	8/10/2005	8/25/2005	$572,758.38
00-621	N40085-05-D-0079-0001	Pool House	NAVFAC MID ATLANTIC ROICC NORFOLK NAVAL SHIPYARD	9/9/2005	9/29/2005	$350,016.00
00-626	N40085-05-D-0737-002	Clean pier pipelines	NAVFAC MID ATLANTIC ROICC SEWELLS POINT	9/12/2005	9/30/2005	$1,159,369.72
00-563	N40085-05-D-0602	L/C Fire Protection FY-06	NAVFAC MID ATLANTIC ROICC VIRGINIA BEACH, LITTLE CREEK		10/1/2005	$152,487.31
00-769	N40085-05-D-0737-06	NELO, Bldg X-137	NAVFAC MID ATLANTIC PWD NORFOLK	5/16/2006	6/28/2006	$691,000.00
00-787	N40085-06-D-0301-0002	SA & NH Upgrade	NAVFAC MID ATLANTIC PWD NORFOLK	4/14/2006	6/28/2006	$1,793,907.00
00-790	N40085-05-D-0079-0002	Bldg 1500 2nd Floor Renovations	NAVFAC MID ATLANTIC ROICC NORFOLK NAVAL SHIPYARD	5/17/2006	7/11/2006	$101,024.00
00-794	N40085-05-D-0737-0005	CD-3 Waste Piping	NAVFAC MID ATLANTIC PWD NORFOLK		7/13/2006	$16,668.00
00-828	N40085-06-R-0413	Riverine Warfare Group	NAVFAC MID ATLANTIC PWD LITTLE CREEK	8/31/2006	9/12/2006	$809,791.87
00-829	N40085-06-D-0341-0002	Secondary Spill Containment, CEP-11	NAVFAC MID ATLANTIC PWD NORFOLK	8/9/2006	9/14/2006	$301,188.00
00-830	N40085-06-D-0301/0001	Elec. Emergencies, Navsta Norf.	NAVFAC MID ATLANTIC ROICC SEWELLS POINT		4/4/2006	$200,000.00
00-830	N40085-06-D-0301/0003	LF-18 Fault Cable-Elec Repairs	NAVFAC MID ATLANTIC ROICC SEWELLS POINT	8/22/2006	9/14/2006	$1,000,000.00
00-835	N40085-06-D-0403/0002	L/C Chapel windows	NAVFAC MID ATLANTIC PWD LITTLE CREEK	3/15/2006	9/14/2006	$235,929.00
00-836	N40085-05-D-0079/0003	Replace 4th Floor Computer A/C Units	NAVFAC MID ATLANTIC ROICC NORFOLK NAVAL SHIPYARD	8/31/2006	9/19/2006	$272,283.00
00-841	N40085-05-D-0737/0009	A-50 Restrooms, Third Floor	NAVFAC MID ATLANTIC PWD NORFOLK	8/10/2006	9/26/2006	$126,037.00
00-842	N40085-06-D-0342-0002	Building A, LRA Renovations	NAVFAC MID ATLANTIC PWD NORFOLK	9/12/2006	9/27/2006	$306,162.00
00-844	N40085-06-R-6024	Desert Cove & West Annex Fuel Farm	NAVFAC MID ATLANTIC PWD LITTLE CREEK	5/3/2006	9/30/2006	$299,335.00
00-845	N40085-06-D-0337/0001	Pier F Repair Construction	NAVFAC MID ATLANTIC PWD NORFOLK	8/30/2006	9/30/2006	$1,996,000.00
00-847	N40085-06-D-0403/0003	New Fence in CB Area	NAVFAC MID ATLANTIC PWD LITTLE CREEK	9/27/2006	9/30/2006	$127,995.00
	N62470-01-D-5983	Annual Hydro Testing of POL lines	Commander Atlantic Division NAVFACENGCOM HAMPTON ROADS/ICELAND IPT		10/11/2006	$428,728.11
00-890	N40085-06-D-0337/0002	Renovations Bldg. Z133	NAVFAC MID ATLANTIC HAMPTON ROADS IPT	1/18/2007	1/30/2007	$711,829.70
00-897	N40085-06-D-0337/003	Removal of Hydroids	NAVFAC MID ATLANTIC PWD NORFOLK	-	3/14/2007	$300,000.00

Chairman MARKEY. Thank you. Thank you Ms. Estes very much.

And I heard what you said at the beginning of your statement and I know you will not take this as a compliment, but you would be an excellent politician. Really, you have the makings of one. You are very good.

And next we have John Felmy. Dr. Felmy is the Chief Economist of the American Petroleum Institute. He is responsible for overseeing economic statistical and policy analysis of the American Petroleum Institute. He has over 25 years experience in energy, economic and environmental analysis. He received bachelor's and master's in economics from Pennsylvania State University, and a Ph.D. in economics from the University of Maryland.

Welcome, Dr. Felmy. Whenever you are ready, please begin.

STATEMENT OF DR. JOHN FELMY, CHIEF ECONOMIST, AMERICAN PETROLEUM INSTITUTE

Mr. FELMY. Chairman Markey, Ranking Member Sensenbrenner, Members of the Committee, I am John Felmy, Chief Economist at API, the national trade association of the U.S. oil and natural gas industry. API represents nearly 400 companies involved in all aspects of oil and natural gas industry, including exploration and production, refining, marketing, transportation as well as service companies that support our industry.

U.S. oil and gas companies understand the frustration that consumers are expressing about gasoline prices. We recognize that these higher prices adversely impact individuals, households, businesses and potentially the economy. Our member companies are doing everything they can to meet the fuel needs of U.S. consumers.

As of today, crude oil inventories have been building and are 8.9 percent above the five year average at this time.

Year to date gasoline production is 8.85 million barrels per day, the highest ever. Thanks to the industry's major investments in state-of-the-art refining technologies, our companies are able to squeeze more gasoline and diesel fuel from a barrel of crude oil compared to past years. Looking ahead, we expect to bring the equivalent of an additional eight new refineries into operation by 2011.

Despite the industry's all out efforts we are still faced with a set of challenges that in combination have driven up gasoline prices. Most importantly, crude oil prices have fluctuated significantly driven by lingering geo-political tensions, OPEC's continuing production controls and worldwide demand growth.

More than half the price of gasoline is attributable to crude oil. Oil companies do not set the price of crude. It is bought and sold in international markets and the price paid for a barrel of crude reflects the market conditions of that day.

A second major factor is that gasoline demand in the U.S. reached a record high in the first quarter of this year. The Department of Energy forecasts that demand will increase further in the summer driving season, which begins this month.

Moreover, nearly half of U.S. gasoline is blended with ethanol so as demand has gone up, ethanol prices and the cost of ethanol blended gasoline has risen as well.

In addition, the annual switchover to summer blend gasoline required by EPA has occurred. And this warm weather gasoline is more expensive to produce. The switchover requires a large supply drawdown to meet regulations. Unless gasoline is available to import because of spring refinery maintenance in Europe, an 18 day French port workers strike in March led some European refiners to reduce production.

U.S. gasoline production this year is at all time record highs despite regularly scheduled refinery maintenance and several unexpected problems that have interrupted some refining operations. The maintenance is a normal procedure, though delayed in some cases by damages suffered from the catastrophic hurricanes in 2005.

While maintenance curtails refining operations temporarily, it helps to ensure the longtime viability of the refinery and protects the health and safety of our workers.

Some are again accusing the industry of illegal activity. Our industry has been repeatedly investigated over the many decades by the Federal Trade Commission and State Attorneys General. Of more than 30 investigations that we are aware of, all have resulted in exoneration.

I would also note the introduction of price gauging legislation in Congress. I would caution that this legislation could have many unintended consequences that would not benefit consumers.

Rising gasoline prices are a burden on U.S. consumers, but they cannot be viewed in isolation from the U.S. energy situation. Solution to the energy challenge that we face is to increase and diversify sources of supply, including alternatives, reduced demand and expand infrastructure. We have plentiful domestic oil and gas resources remaining to be discovered in the U.S. Only government policies stand in the way of increasing access to these resources, facilitating refining capacity and pipeline expansions and increasing energy security.

America can meet its energy challenges just as it has met great challenges in the past. But meaningful changes in energy policy will be required.

API stands ready to work with your Committee and others in the Congress and the Administration to help bring about these changes that are so important for America's energy future.

With that, I will thank the Committee and I will be happy to answer any questions you might have.

[The statement of Dr. Felmy follows:]

Statement of API Chief Economist John Felmy before the House Select Committee on Energy Independence and Global Warming

May 9, 2007

I am John Felmy, Chief Economist of API, the national trade association of the U.S. oil and natural gas industry. API represents nearly 400 companies involved in all aspects of the oil and natural gas industry, including exploration and production, refining, marketing and transportation, as well as the service companies that support our industry.

The oil and natural gas industry understands the frustrations that consumers have expressed about gasoline prices. We recognize that these higher prices are adversely impacting individual households and potentially our economy.

Higher Gasoline Prices: An Overview

For 12 of the last 13 weeks, the average U.S. retail price for regular gasoline increased, according to the Energy Information Administration.

Our member companies are doing everything they can to deal with this situation and meet the fuel needs of U.S. consumers. Crude oil inventories have been building and are 8.8 percent above the five-year average for this time of year. Year-to-date gasoline production is 8.83 million barrels per day, the highest ever (see Figure 1). Thanks to the industry's major investments in state-of-the-art refining technology, our companies are squeezing out more gasoline and diesel fuel from a barrel of crude oil this year compared

to past years (see Figure 2). Looking ahead, we expect to bring the equivalent of an additional eight new refineries into operation in the U.S. by 2011.

Despite the industry's all-out efforts, we are still faced with challenges that, in combination, have driven up gasoline prices. Most importantly, crude oil prices have fluctuated significantly, driven by lingering geopolitical tensions, OPEC's continuing production controls, and worldwide demand growth. More than half the price of gasoline is attributable to the cost of crude oil. Oil companies do not set the price of crude. It is bought and sold in international markets, and the price paid for a barrel of crude reflects the market conditions of that day.

A second major factor is that gasoline demand in the U.S. reached a record high in the first quarter of this year. The Department of Energy forecasts that demand will increase further in the "summer driving season" which begins this month. Moreover, nearly half of U.S. gasoline is blended with ethanol, so as demand has gone up, ethanol prices and the cost of ethanol-blended gasoline have risen as well.

In addition, the annual switchover to "summer blend" gasoline required by EPA has occurred and this warm-weather gasoline is more expensive to produce. The switchover requires a large supply drawdown to meet regulations. And less gasoline is available to import because of spring refinery maintenance in Europe, and a 17-day French port-workers' strike in March led some European refiners to reduce production (see Figure 3).

U.S. gasoline production this year is at all-time record high levels despite regularly scheduled refinery maintenance and several unexpected problems that have interrupted some refining operations. The maintenance is a normal procedure, though delayed, in some cases, by damage suffered from the catastrophic hurricanes in 2005. While maintenance curtails refining operations temporarily, it helps ensure the long-term viability of the refinery and protects the health and safety of our workers.

Factors in the cost of gasoline

In order to understand the higher costs of gasoline and other motor fuels, we need to consider them in the context of the world energy supply and demand situation.

We currently import more than 60 percent of the crude oil and petroleum products we consume. American refiners pay the world price for crude and distributors pay the world price for imported petroleum products. Whether a barrel is produced in Texas or Saudi Arabia or elsewhere, it is sold on the world market, which is comprised of hundreds of thousands of buyers and sellers of crude oil from around the world.

There is a fragile balance between the world's supply and demand for crude oil. Because of this tight market, any disruption of oil supply – or even the threat of a disruption – can push prices upward as buyers and sellers in the worldwide marketplace look to secure supplies for their customers.

It is well recognized that the market for crude oil has tightened. World oil demand reached unprecedented levels in 2005 and continues to grow due to strong economic growth, particularly in China and the United States. World oil spare production capacity – crude that can be brought online quickly during a supply emergency or during surges in demand – is at its lowest level in 30 years and is a critical factor to observe. Current spare capacity is low by historical standards. Accordingly, the world's oil production has lagged, forcing suppliers to struggle to keep up with the strong growth in demand.

The delicate supply/demand balance in the global crude oil market makes this market extremely sensitive to political and economic uncertainty, weather conditions, and other factors. Over the past several years, we have seen how the market has reacted to such diverse developments as dollar depreciation, cold winters, the post-war insurgency in Iraq, hurricanes in the Gulf of Mexico, the Venezuelan oil workers' strike in 2002-2003, uncertainty in the Russian oil patch, ongoing ethnic and civil strife in Nigeria's key oil producing region, and decisions taken by OPEC.

Some are again accusing the industry of illegal activity. Our industry has been repeatedly investigated over many decades by the Federal Trade Commission and state attorneys-general. Of the more than 30 investigations that we are aware of, all have resulted in exoneration.

Some have proposed federal controls on fuel prices to prevent "price gouging." Such measures would prove a disaster for the nation's economy and hamper the oil and natural gas industry's efforts to supply U.S. consumers with the fuel they need.

Pricing is the mechanism any market uses to balance supply and demand. Higher fuel prices are an inevitable and necessary consequence of supply shortages and they allow a market to rebalance itself by rationing scarce fuel supplies among consumers while also attracting new supplies. This was evident in the South after Hurricane Katrina. Higher fuel prices attracted additional fuel supplies, both domestic and imported, that eventually drove prices down – all without government intervention.

In fact, the Federal Trade Commission came to similar conclusions in a recently completed fuel pricing investigation. It found that, in nearly all cases, price increases, given the amount of production and refinery capacity knocked off-line, were approximately what would be predicted by supply and demand principles.

Price gouging legislation, by introducing price controls, interferes with normal market forces that can efficiently address supply/demand imbalances. History has demonstrated that price controls and allocations simply do not work. Price controls on crude oil and petroleum products were in effect from 1971 to 1981. They established price ceilings on domestically produced crude oil and refined products, keeping them artificially low compared to world prices. This resulted in decreased domestic crude production while domestic demand for crude and refined products increased, leading to a worsening of

shortages and increased oil imports. FTC Chair Deborah Majoras has also observed, "Price gouging laws that have the effect of controlling prices likely will do consumers more harm than good."

Further, price gouging laws are vague and, therefore, difficult to comply with and enforce fairly. This legal uncertainty, especially when coupled with the serious risk of criminal penalties, fines, and civil liability, may discourage a supplier from doing business in an affected area and, therefore, delay a return to normal conditions.

Oil and natural gas industry earnings are comparable to those of other industries

There is also considerable misunderstanding about the oil and gas industry's earnings, which are typically in line with other industries and are often lower. For 2006, the industry's annual earnings averaged 9.5 cents on each dollar of sales. The average for all manufacturing industries was 8.2 cents or about a penny lower. From 2002 to 2006, average earnings for the industry stood at approximately 7.4 cents on each dollar of sales – a penny above the five-year average for all U.S. manufacturing industries.

It should not be forgotten that the energy Americans consume today is brought to us by investments made years or even decades ago. Today's oil and natural gas industry earnings are invested in new technology, new production, and environmental and product quality improvements to meet tomorrow's energy needs. Between 1992 and 2005, the industry invested more than $1 trillion – on six continents – in a range of long-term energy initiatives: from new exploration and expanding production and refining capacity

to applying industry leading technology. In fact, over this period, our cumulative capital and exploration expenditures exceeded our cumulative earnings.

Furthermore, the industry's future investments are not focused solely on oil and natural gas projects. For example, one oil company is among the world's largest producers of photovoltaic solar cells; another oil company is the world's largest developer of geothermal energy; and the oil and gas industry is the largest producer and user of hydrogen. Over the last five years in North America alone, we have invested $12 billion in renewable, alternative and advanced non-hydrocarbon technologies. In fact, when you add up all of the various types of emerging energy technologies, our industry, over the five years, has invested almost $100 billion -- that's more than two and half times as much as the federal government and all other U.S. companies combined.

It also requires billions more dollars to maintain the delivery system necessary to ensure a reliable supply of energy and to make sure it gets where it needs to go: to industry customers. Americans' oil and natural gas use is expected to grow by one-third in the next 25 years. The industry is committed to making the reinvestments that are critical to ensuring our nation has a stable and reliable supply of energy today and tomorrow.

It is also important to understand that those benefiting from healthy oil and natural gas industry earnings include numerous private and government pension plans, including 401K plans, as well as many millions of individual American investors. While shares are owned by individual investors; firms, and mutual funds, pension plans own 41

percent of oil and natural gas company stock. To protect the interest of their shareholders and help meet future energy demand, companies are investing heavily in finding and producing new supplies.

Higher gasoline prices cannot be viewed in isolation

Rising gasoline prices are a burden on U.S. consumers – but they cannot be viewed in isolation from the U.S. energy situation. If we are to avoid price volatility and tight supplies and ensure that the fuel needs of U.S. consumers are met, we must focus on three areas: efficiency, technology, and diversity.

- First, America's energy companies must continue to improve our own energy efficiency, and encourage energy efficiency in other industries and by the American people;
- Second, we must increase the use of advanced energy technologies that allow us to develop our resources cleanly and responsibly; and
- Third, we must increase the diversity of our oil and natural gas supplies, both here at home and from around the world.

One of the first steps toward increasing our energy security is making the most of what we already have. We all need to become more energy efficient.

Our efforts go beyond just our operations. Last summer, our refineries began to deliver an impressive, new fuel that significantly reduces emissions and allows the increased use

of energy-efficient diesel engines. It's called Ultra Low Sulfur Diesel and it's the cleanest diesel fuel supplied in the world today – with a 97 percent reduction in sulfur content.

In addition to energy efficiency, our industry has researched and developed breakthrough technologies to help us find, develop and deliver energy. For example, we now have 4-Dimensional Imaging, which helps us better locate oil underground. Imagine a geoscientist watching multiple data screens of 3D visuals revealing exactly what exists below the surface – like stepping into the earth and seeing specific rock strata: sandstone, limestone, and salt domes, along with oil. Time being the fourth dimension, we can take snapshots of those underground reservoirs over time and overlay the pictures to see in which direction the oil is moving. That's how we find oil today. It's non-invasive and more environmentally-compatible than ever.

We also use what's called multi-directional drilling. We can drill down at one site, then turn left or right and drill for more than five miles, and then go further down or back up – whatever is needed to encounter the oil. Advanced techniques like this have dramatically reduced our environmental footprint. Today it's possible to develop nearly 80 square miles of area below the surface from a single two-acre site on the surface. These technological innovations are making a difference.

Just as we need to diversify the kinds of energy we use, we also need to acknowledge that a diversity of sources is the best way to ensure energy security and meet growing demand. Our country should be doing all it can to increase the amount of energy

produced in the United States. We should encourage the development of alternative and renewable sources of energy, which are growing at a rate faster than traditional sources.

However, it's important to place U.S. energy sources in the proper perspective. According to the Energy Information Administration (EIA), renewable energy presently accounts for about 6 percent of our nation's energy use. And, this EIA figure is projected to climb to 7 percent over the next 25 years. Concurrently, the Department of Energy estimates that oil, natural gas, and coal will continue to meet approximately 86 percent of U.S. energy demand for at least the next two decades.

We have abundant volumes of oil and natural gas resources beneath federal lands and coastal waters. However, more than 85 percent of U.S. coastal waters that are up to 200 miles from our shores are off-limits to oil and natural gas exploration. These areas, and 75 percent of the technically available U.S. onshore areas, are "off-limits" or accessible only with significant restrictions -- despite federal government estimates that there is enough oil in these areas to power more than 60 million cars for 60 years and heat more than 25 million homes for 60 years. And there is enough natural gas to heat an additional 60 million homes for another 60 years.

Conclusion

The U.S. oil and natural gas industry is doing everything it can to produce the fuel supply needed to meet consumer energy needs. However, the industry cannot meet U.S. energy challenges alone. Our nation's energy policy needs to focus on increasing supplies;

encouraging energy efficiency in all sectors of the economy, including transportation; and promoting responsible development of alternative and non-conventional sources of energy.

Congress needs to allow the oil and gas industry to invest today's earnings in meeting tomorrow's energy needs. To do otherwise will threaten our energy future. Congress can help by opening up more of the resource-intensive areas in our nation that are off-limits to new production. Because the market remains healthy and competitive, it is imperative that it be permitted to continue functioning as freely of artificial restraints as possible.

Figure 1

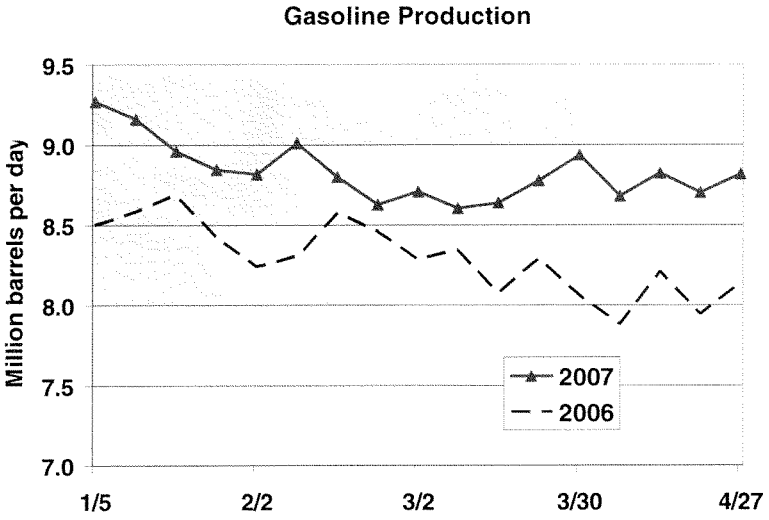

Gasoline Production
Million barrels per day
9.5
9.0
8.5
8.0
7.5
7.0
1/5
2/2
3/2
3/30
4/27
2007
2006

Figure 2

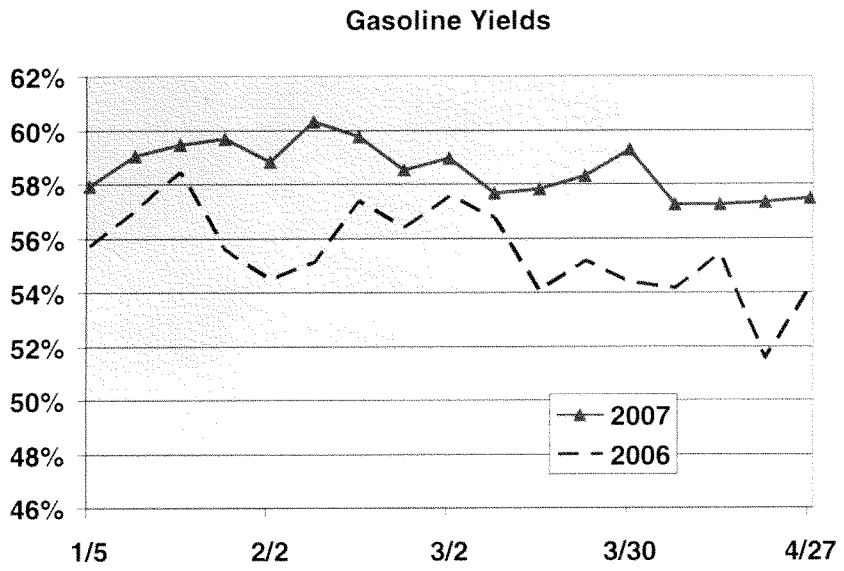
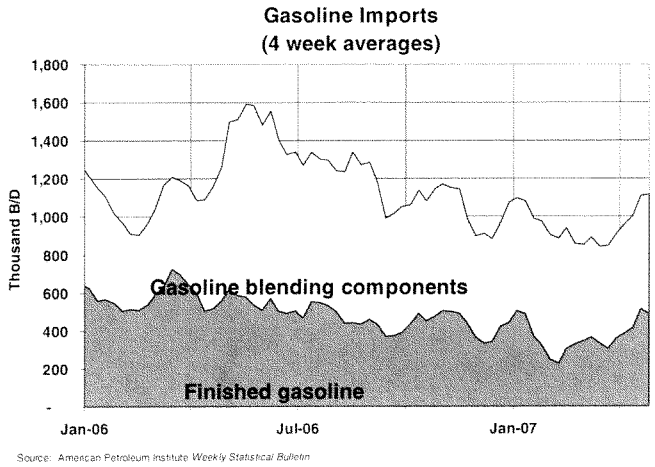

Gasoline Yields
62%
60%
58%
56%
54%
52%
50%
48%
46%
1/5
2/2
3/2
3/30
4/27
2007
2006

Figure 3


Gasoline Imports
(4 week averages)
Thousand B/D
1,800
1,600
1,400
1,200
1,000
800
600
400
200
-
Gasoline blending components
Finished gasoline
Jan-06
Jul-06
Jan-07
Source: American Petroleum Institute Weekly Statistical Bulletin

Chairman MARKEY. Thank you, Dr. Felmy, very much.

That completes the time for opening statements by the witnesses. The Chair will now turn and recognize himself for five minutes.

Dr. Felmy, yesterday in the Senate Commerce Committee legislation dealing with fuel economy of cars and light trucks was passed. Senator Cantwell added an amendment which dealt with the issue of oil price gauging. Can I ask you some questions about that?

Do you agree that President Bush should have the authority to declare a temporary national emergency if there was a threatened or existing disruption of oil and petroleum supplies due to events such as a hurricane or a terrorist attack?

Mr. FELMY. I believe that in the area of price gauging you have a number of possibilities that could be considered. I have not seen the exact legislation to know the exact wording on how that could be declared and what else would go with it. But we do have cases where governors have the ability to be able to declare emergencies for some situation such as that. So it would be something that we would have to look at carefully.

Chairman MARKEY. Well, you were quoted in yesterday's newspaper as saying that "Senator Cantwell's legislation was unfortunate political rhetoric with no basis in facts." So I think that today's answer is somewhat different, in fact radically different from what you said yesterday.

Let me ask another question. Do you agree that in the event that there was a national emergency, national energy emergency that it should be illegal to charge unconscionably excess prices for gasoline?

Mr. FELMY. As an economist, Mr. Chairman, I do not know what "unconscionable" means.

What we have seen in the past in terms of changes have been largely as a result of market forces at all levels of the supply chain. I simply do not know what "unconscionable" means in terms of a definition that can be usefully employed that would not cause potential problems in the marketplace that could, again, have unintended consequences.

Chairman MARKEY. I think the other witnesses know what unconscionable would mean in terms of high energy prices. I see all four heads nodding.

Do you agree, Dr. Felmy, that especially at a time when we might be in a national energy emergency that there should be an explicit statutory ban on manipulative practices in wholesale petroleum markets?

Mr. FELMY. I am not an attorney, Mr. Chairman, so I cannot comment beyond just I believe the understanding of the law is that you already have many provisions in place to deal with manipulation under the regulatory authority of the Commodities Future Trading Commission and the Federal Trade Commission.

Chairman MARKEY. Do you agree that it should be illegal to knowingly submit false information about wholesale petroleum to the Federal Trade Commission?

Mr. FELMY. I—again, Mr. Chairman, I am not an attorney. But my understanding is that you already have those provisions in place. You have had prosecutions to that effect for false submitting of data to various entities.

Chairman MARKEY. Let me ask the other witnesses quickly if each of you could tell us what it would mean to each of you briefly if the price of gasoline moved over $4 a gallon. Very briefly.

Mr. Thomas.

Mr. THOMAS. The number of students riding school buses would dramatically increase, but the problem would be that we would not be able to afford to deliver that bus service because that money would be taken out of the education.

Chairman MARKEY. Mr. Mitternight.

Mr. MITTERNIGHT. It would require me to definitely raise prices to my customers and try to renegotiate contracts. I would have to find some way to pass that cost on in order to make any profitability.

Chairman MARKEY. Mr. Teske.

Mr. TESKE. At this point in agriculture, we do not have that ability to pass it on. So we are talking about disaster within the agriculture industry. And you are talking about additional subsidies or you are talking about some major change within the marketing system.

Chairman MARKEY. Ms. Estes.

Ms. ESTES. I work for the Federal Government, and I know they do not have any money, so I cannot pass it on either. So I would say it be closing my doors down.

Chairman MARKEY. Well, I will say this: It is the goal of the speaker to pass legislation that will deal with this issue of price gouging. And we intend on doing that this year, very very soon.

In the first three months of this year ExxonMobil, Chevron, ConocoPhillips, Shell and BP collectively reported $29.4 billion in profits.

This Congress in January in one week, the first week, passed legislation to reclaim $14 billion in excessive royalties that the oil companies had received and created a fund for renewable energy and for energy conservation. The White House opposes that. That is half of the money that these oil companies made in three months. And we are trying to move the country in a different direction, which this Administration continues to fight us.

The time of the Chair has expired. We will turn and recognize the gentleman from Wisconsin, Mr. Sensenbrenner.

Mr. SENSENBRENNER. I thank the gentleman for giving me this time.

We live in a market economy. And one of the laws that Congress cannot repeal is the law of supply and demand. So if we want the price of anything, including petroleum, to go down we have to either increase the supply or reduce the demand or a combination of the two.

I think probably the most telling immediate statistic that we have is that our refining capacity is about 17 million barrels a day and the demand for gasoline is about 21 million barrels a day. Can I ask all five witnesses if they think that we would get immediate price relief if we went on a crash program to increase our refining capacity so that we are able to have more product on the market, starting with you Dr. Felmy?

Mr. FELMY. Mr. Sensenbrenner, I would agree that increase in capacity would allow more refining of petroleum products for the consumer. And as an economist, whenever you increase supply——

Mr. SENSENBRENNER. Okay. I want some brief answers. I got five minutes.

Mr. FELMY. Yes, sir.

Mr. SENSENBRENNER. Ms. Estes.

Ms. ESTES. Absolutely.

Mr. SENSENBRENNER. Mr. Teske.

Mr. TESKE. I'm not convinced in that itself would do it.

Mr. SENSENBRENNER. Okay. Mr. Mitternight.

Mr. MITTERNIGHT. I think in the long run it would. I do not think it would be immediate because the cost of the fabrication or the construction of the new refineries would be there. But I think in the long run it would definitely bring the cost down.

Mr. SENSENBRENNER. Mr. Thomas.

Mr. THOMAS. I think it would bring the cost down.

Mr. SENSENBRENNER. Okay. Now another way to reduce demand is to raise the price. In my opening statement I talked about the carbon tax that the U.N. is talking about imposing of approximately $100 a ton which translates to about a dollar a gallon of gasoline, according to last Saturday's Washington Post. What do you think would happen to your businesses if we passed this carbon tax, starting with your, Mr. Thomas?

Mr. THOMAS. Well, as long as the school buses remained exempt from the Federal taxes that they are now——

Mr. SENSENBRENNER. Okay. That is a good thought.

How about you, Mr. Mitternight.

Mr. MITTERNIGHT. Any increase in taxation, if there is anyway to reduce taxes and being from Louisiana we have above and beyond our far share of taxes on everything that we do. So we could not——

Mr. SENSENBRENNER. Just come to Wisconsin if you want to see how bad taxes are.

Mr. Teske, how about the dollar a gallon increase because of the carbon tax that has been talked about.

Mr. TESKE. You know, I would not like that for the same reasons we said all along, but at the same time if all the polluters had that same carbon tax on it, I think we could make dramatic differences. Those coal plants do a heck of a lot more than my farm equipment does.

Mr. SENSENBRENNER. Okay. Ms. Estes.

Ms. ESTES. Bottom line, it would hurt my employees more than it would hurt me. Financially at this point I cannot keep giving them raises. They are going to go without food. So——

Mr. SENSENBRENNER. Dr. Felmy.

Mr. FELMY. A carbon tax could have severe negative impacts on the economy. API does not have a specific position on many of these global policies that are being discussed, but we would certainly welcome the opportunity to talk about all of them.

Mr. SENSENBRENNER. Okay. Now some people around here, including my dear friend the Chair seemed to think that the magic wand is increasing CAFE standards. And I saw the chart that he had raised behind him during his opening statement. I ask you be-

cause my time is running out, Dr. Felmy, when the CAFE standards kicked in we had a period of double digit interest rates stagflation and then followed by a recession. How much of the reduced imports do you think were caused by economic factors other than the increase in the CAFE standards?

Mr. FELMY. Mr. Ranking Member, I have not done an analytical study but there is no question there were three broad factors that caused the reduction in demand.

CAFE standards could have had an impact.

We also had high prices. We had $3.22 per gallon in 1981 in today's dollars for gasoline.

And finally economic activity slowed down and recession all had significant impacts.

Mr. SENSENBRENNER. Okay. So it would be your considered judgment that it was not exclusively the raising of the CAFE standards that caused the reduction in our percentage of oil that we imported from overseas?

Mr. FELMY. That would be my judgment, sir.

Mr. SENSENBRENNER. I thank the Chair.

And I yield back the balance of my time.

Chairman MARKEY. The Gentleman's time has expired.

The Chair recognizes the Gentleman from Oregon, Mr. Blumenauer.

Mr. BLUMENAUER. Thank you.

And I, Mr. Chairman, would like to thank you and the staff of assembling I think a very useful panel. I thought the range of experience that was given in real life, putting a face on this, was extraordinarily helpful. And I appreciate what we have heard.

I am particularly want to, just if I could, Mr. Teske, you had given a hint there, you talked about the carbon tax or some sort of carbon system. I mean I think most people agree the world is moving in this direction. We have got ten northeastern states that are doing it, most of the business community understand that there will be some carbon constraint.

You hinted at something. Would it make a difference to you or any of the panel members if there was some sort of carbon constraint in terms of what happened to it? If it was used to be able to help give you the type of energy technology that you want? If it was used to defray the high costs that some particularly lower income people were contending with? If it was used to offset the costs, for example in some cases, of more energy efficient equipment or technology? Does that make a difference to you in terms of how this money is used? Are there ways that it could be used that it would make a difference to how you do business?

Mr. TESKE. That is kind of an interesting concept. As I kind of hinted at there, I do not like new taxes but we have to take environmental responsibility. My belief is that global warming is true, and so where do we take those steps. And so I was having this discussion with a close friend that I have a lot of respect in recently, and we were talking about the current marketing structure and could we address increased fuel costs alone to reduce demand. And both of us did not think that marketplace would allow that flow through to happen so the general economies could flow.

And so about the only we are going to have to do it is with some type of Federal Government interaction. And whether that is a carbon tax or something else, I do not know what the proper structure for that is. But I do not think the "free marketplace" that we have now is going to absorb that and pass that through the system. And so we would have devastated businesses and economies all around the country with trying to do it with just increased gas prices alone.

If the polluters that were building this carbon problem were taxed equally across the board, I would have a hard time arguing with that.

Mr. BLUMENAUER. Let me just say, I do not want to catch any of unawares, but I want to plant the seed and invite you to think about ways that it might make a difference to you.

And I would like to follow up, Mr. Teske, with one thing that you talked about in terms of the farm legislation. Because one of the things that this Committee is looking at, we are not originating legislation per se, but we are looking at big concepts. We do have a farm bill that is coming along that has lots of opportunities to deal with rural redevelopment, to deal with—there will be an energy title in it. To deal with things from wind to solar to biomass where Federal farm policy might be able to reduce the carbon footprint of American agriculture and help farmers do that. And I wondered if you had any thoughts about what the farm bill might do to help in your situation with the energy question?

Oops. I realized I have less than a minute, and that is not fair either. I will follow up with you personally on that.

I just wanted to make one point. We talked about refining capacity, Mr. Chairman. It just seems to me that there is a pretty clear record that there were opportunities for—there has only been one refinery proposal, to my knowledge, in the last 30 years. One in Yuma. Since the early 1990s it has received all of its environmental permits, but could not get financing because nobody wanted to invest in it. And the oil companies had lots of money. It was not that they did not have money to invest. It seems to me that there were bets made that they could make money without increasing refining capacity.

Thank you, Mr. Chairman.

Chairman MARKEY. Okay. The Gentleman's time has expired.

The Chair recognizes the Gentleman from Arizona, Mr. Shadegg for seven minutes.

Mr. SHADEGG. Thank you, Mr. Chairman, and thank you for holding this hearing.

I do not really want to get into the issue in great depth, but I want to begin by asking unanimous consent to put into the record a letter from Arizona Clean Fuels Yuma, which goes into the issue raised by the Gentleman from Oregon just a moment ago. Arizona Clean Fuels Yuma, I believe, is very close to having its financing. The letter includes with it a lengthy analysis of the delays in the construction project. The Gentlemen is correct, I think that is the only effort to get a new refinery on line. They detail at length the regulatory impediments to that. And I would put that in the record, if I might.

Chairman MARKEY. Without objection, it will be included in the record.

Mr. SHADEGG. I want to thank the panel for their testimony. I think it is very interesting. It actually reminds me of a number of conversations with my wife over what happens at this time of year, and I will go into that in just a moment.

I do want to follow up on a line of questioning that Mr. Sensenbrenner had. He asked you about a carbon tax and were a carbon tax to add a dollar to the cost of fuel, what that would do in terms of having an impact on you.

Another idea that is floating out there, and it has been proposed by a lot of thoughtful people, and has been implemented in part in Europe is the idea of a cap and trade program. That is we would set a cap on carbon emissions and then you would buy and sell trading permits. Europe has implemented such a cap and trade system, not by the way for mobile sources but for fixed courses of carbon. And it has caused an increase in the cost of energy of between 16 and 25 percent. Let us assume it is half of that, an increase of eight percent or ten percent.

Each of you expressed concern about a carbon tax in terms of driving up the cost of fuel. I assume your thoughts about an increase in cost would be the same if it were as a result of the imposition of a cap and trade system? Mr. Thomas, would you——

Mr. THOMAS. Yes, the result would be the same.

Mr. MITTERNIGHT. Yes. Any increase in taxation does the same thing.

Mr. SHADEGG. Mr. Teske.

Mr. TESKE. I believe I have addressed that issue.

Mr. SHADEGG. Fair enough.

Ms. Estes.

Ms. ESTES. I am not sure if the increased tax of a $1.00 is going to make a difference.

Mr. SHADEGG. Mr. Felmy.

Mr. FELMY. If implemented in the same technique as using a carbon tax, then you would likely have the same impacts. The issue with cap and trade is allowances and a whole host of much more complicating factors that can distort the system significantly.

Mr. SHADEGG. Yes. One of my concerns is that in Europe it appears to have added cost without having achieved the environmental goal. And that would be one of my concerns.

Let me ask another concern, because I am curious about this. I personally favor if you are going to impose a cost to, for example, reduce carbon emissions, I would rather have it be a visible cost. I have a little bit of concern that if it were in a cap and trade as opposed to a carbon tax, it would be buried and people would not be able to see it. I hope you all understand what I am saying.

If there is going to be a cost to reduce carbon in our atmosphere, would you rather it be clearly set out and visible so we know what that cost is, or does that not matter and if it were buried in a cap and trade system, that would be just as well with you? Mr. Felmy.

Mr. FELMY. API only has a position that we would like all the different options to be discussed. These are very complicated systems to put in place.

Mr. SHADEGG. Fair enough.

Ms. ESTES. It is a question of whether you would see it or not or have it varied?

Ms. ESTES. I would rather see it. And I think the American people, right now one of the big things I saw is we do not have any trust.

Mr. SHADEGG. Right.

Ms. ESTES. So I would rather see it. I believe they need to see it.

Mr. SHADEGG. Fair enough.

Mr. Teske.

Mr. TESKE. I would like to see it.

Mr. SHADEGG. Mr. Mitternight.

Mr. MITTERNIGHT. I agree. I would want to know where it is going.

Mr. SHADEGG. Mr. Thomas, I had the impression that most school buses run on diesel, but maybe I am wrong about that.

Mr. THOMAS. You are correct.

Mr. SHADEGG. Okay. And so your fleet would be diesel fleet. And when we are talking generally gasoline prices, you are talking about diesel prices having gone up the same, is that what you are saying?

Mr. THOMAS. Actually more.

Mr. SHADEGG. Diesel prices have gone up more?

Mr. THOMAS. Yes, they have.

Mr. SHADEGG. Have you taken a look at natural gas as a fuel for your fleet?

Mr. THOMAS. Yes. Actually the industry has. And the net effect is that we believe that clean diesel has the best effect overall on both the supply for the fleet and not only the global impact, the emissions impact, but the availability to school districts.

Mr. SHADEGG. There are developments in clean diesel which dramatic recent development making it even cleaner than natural gas, is that correct?

Mr. THOMAS. It actually almost reduces all the emissions that we consider toxic.

Mr. SHADEGG. So you would——

Mr. THOMAS. Clean diesel.

Mr. SHADEGG. That leads me to kind of a broad question. Would you all agree that we need to keep a broad diversity in our fuels, that is gasoline, diesel, biodiesel, liquid to gas, coal liquid to gas? Is a broad diversity something you think will help hold down costs for down the line?

Mr. THOMAS. Well, I think it would.

Mr. SHADEGG. Mr. Mitternight.

Mr. MITTERNIGHT. I would think it would, again as long as it is adaptable to a small business' fleet of vehicles that you can adapt easily.

Mr. SHADEGG. Mr. Teske.

Mr. TESKE. In the short term yes, in the long term I think we will have something come out a clear winner that is a lot better than petroleum. Hopefully, hydrogen or something like that.

Mr. SHADEGG. Well, yes. I am not limiting this to petroleum, by any means.

Ms. Estes.

Ms. ESTES. Yes, I definitely agree that you need to look at the wider spectrum. There are other alternatives out there. You have mentioned Europe is using a nuclear power system——

Mr. SHADEGG. I appreciate that. We will look into it.

Mr. SHADEGG. Mr. Felmy.

Mr. FELMY. Going forward we will need all sources of energy to increase, we will need energy efficient and we will need more infrastructure.

Mr. SHADEGG. My time is just about expired.

You said, Dr. Felmy, that there is a large supply drawdown required by regulations. My wife says why do the gas prices go up at this time of year every year. And she says why—you said summer fuel is more expensive. Is the Government causing by either regulation or by prescription of a formula gasoline causing prices to go up at this particular time of year?

And with that, I yield.

Mr. FELMY. The regulations require summer blend gasoline starting May 1st, unless you are in California, and then it is March 1st, April 1st, May 1st. So it is a much more complicated system.

You need cleaner burning gasoline that has less vaporative properties, and that is more expensive to produce.

Mr. SHADEGG. I am done. I yield.

Chairman MARKEY. The Gentleman's time has expired.

The Chair recognizes the Gentlelady from California, Ms. Solis.

Ms. SOLIS. Thank you, Mr. Chairman.

I would like to make a comment directed to Mr. Felmy. While I appreciate your testimony on the oil and natural gas industry claiming that they understand the frustrations of our consumers, I tend to question that appreciation of your testimony and what I have read in your statement.

First you go to great length to defend the industry profits and criticize efforts to protect consumer gauging. And you left out several details, some of which I would like to mention.

In April of 2004 Bloomberg New Service reported that ExxonMobil refining profit rose 39 percent. And we heard earlier from our Chairman regarding that. They actually made a profit of $1 billion.

ConocoPhillips in their first quarter 2004 report stated that the U.S. refining margin increased almost 31 percent and that most of their overall corporate earnings came from the refining side of the business.

And another report released in 2005 shortly before Hurricane Katrina hit showed that in August of 2005 refinery margins rose 54 percent and that those profit margins were responsible for 60 percent of the increased cost of fuel at the pump.

Other studies estimated that as much as two-thirds of the increased cost of gas at the pump is a direct result of profit margins of refiners.

And immediately after Hurricane Katrina Murphy Oil, a company with refineries impacted by the Gulf Coast, lamented the fact that it had refineries off line because it is missing out "record margins."

And in your written testimony you also contend that Congress can help by opening up areas which are off limits to new produc-

tion. However, you leave out critical information about the lands which are available for leasing upon which there is no current production. In 2003 the Bureau of Land Management reported that 85 percent of the oil and 88 percent of the proven gas on Federal lands in Colorado, New Mexico, Utah, Montana and Wyoming were available for leasing and development. Of those areas which are currently available offshore, only 35 percent are currently in production.

It is disingenuous in my opinion to argue that your industry needs greater access when it is not currently producing in areas already available.

Do you have a comment?

Mr. FELMY. There are several points you brought you, Congresswoman.

First in terms of access. While you may have access for leasing, there are a whole host of other restrictions postly that can prevent you from actually exploring. But irrespective of that, the ability to produce more oil and gas anywhere will increase supplies for whatever reason and potentially help consumers.

Now in terms of the refinery situation, this is a fundamental focus of markets at work. Refining margins go up, they go down. They were very low at the beginning of the year. They increased subsequently from that. But these are forces of supply and demand that effect the prices of crude oil, the prices of natural gas and ultimately refining margins. And I would also like to point out those are margins and not necessarily profits. Because the margins themselves are gross margins for which you then have to deduct all the costs. And it is very difficult to see what happens.

In the first quarter, for example, if you also put it in context, the oil industry in terms of earnings on the dollar made 9.1 cents on a dollar. Comparing that to all of manufacturing for 2006, which is the only data we have available right now. We do not have the first quarter. You had, taking out the car companies which of course they have had their struggles, the average profit earnings margin for manufacturing industries was 9.5 cents on a dollar.

So what we have is a situation where——

Ms. SOLIS. I would also like to hear from our other witnesses, if possible. Thank you.

Mr. FELMY. Okay. Thank you.

Ms. SOLIS. I think I got the gist of your comment.

If we could start with Mr. Thomas, briefly.

Mr. THOMAS. I am going to pass.

Mr. MITTERNIGHT. I am not a 100 percent sure of the question. Can you briefly——

Ms. SOLIS. More of a comment. I mean what I was saying that actually we are finding that there are lands available to conduct and produce, provide for more production but there really has not been an effort on the part of the oil corporations or companies to do that.

Mr. MITTERNIGHT. Right.

Ms. SOLIS. You heard a little bit of that from one of our colleagues who left, Mr. Blumenauer, who said that the last refinery or proposed permit that was actually issued was almost, what? Several years ago. And the blame or attempted blame was that the

regulations were onerous that kept the production from occurring from that facility coming out in play. That is not necessarily true, and that is what we are trying to get to.

Mr. MITTERNIGHT. Just a brief comment. Again, being from Louisiana where we have our fair share of offshore drilling going on, there is a serious problem. There is still lots of area to further development offshore. But there are a lot of State regulations as well as Federal regulations. And as much as we trying to salvage our coast, there are a lot of problems in developing that area.

Chairman MARKEY. The Gentlelady's time has expired.

The Chair recognizes the Gentleman from Oregon.

Mr. WALDEN. Thank you, Mr. Chairman.

I want to thank our witnesses today. I have enjoyed your comments and your testimony.

For more than 21 years I have also been a small business owner with my wife. We are in the radio business. So our transmitters run electricity, not oil, which is a good thing at least unless there is a power outage, then they run on LP gas.

So I am concerned about the economy, obviously. I understand, Ms. Estes, what you are saying and Mr. Mitternight and others about what it is like to make a payroll and take care of the people that work for you. It is not easy and it is always challenged, and especially when you have uncontrollable costs. And the radio business in small markets, very reflective of the local economy. And we cannot really push our costs up to somebody else either. And so it is a challenge.

With that, let me just ask you Mr. Teske recommended a national energy portfolio standard, right? A requirement, a mandate that says every power company has to have a certain percentage of renewal energy in their portfolio, the percentage of which we might all argue about. There are some who would say that in some regions of the country that will drive up the cost of energy because you will be forced to perhaps buy a renewable energy source that is more expensive than what you are today getting.

So, Ms. Estes, you have raised the question about additional costs in your business. Is that direction from the Government a mandate on what your local supplier has to buy, does that effect you if your price goes up?

Ms. ESTES. Yes, it effects me. It effects me through the——

Mr. WALDEN. Can you move that mike a little closer. That is why it cuts out on you.

Ms. ESTES. Sorry about that. Yes, it effects me. It not only effects me through my employees, it effects me through the supplies, through the materials; pretty much everything.

Do I believe that we need to mandate and add more alternatives? Absolutely. Is it going to cost us? Yes, but in the long run, is it not going to save us?

Mr. WALDEN. Well, it might. And I guess—see, I come at it the other way, which I would rather have an incentive system. And in the Energy Policy Act of 2005, which some of us on this Committee were on the other Committee that wrote that and it is now law, that created the incentives for example that are driving the production of ethanol by putting a $1 a gallon tax credit there, that are giving .51 cent a gallon credit for agrobiodiesel development. And

I assume those who are in agriculture have seen some benefit if you are on the growing end of it.

I will tell you the story about my cattle rancher. It cost him $100,000 a year more to finish off his herd because of the increased cost of corn. So he did not think much of ethanol out in Oregon, because we are not raising a lot of corn out in Oregon, so I mean it has that effect.

But that Energy Policy Act we passed and put into law also has the incentives, I think it is 1.9 cent a kilowatt hour to encourage production of wind energy, geothermal energy, solar energy. Half that credit for woody biomass.

So I kind of come at that I would rather incent the market to go rather than arbitrarily demand and mandate and drive your costs up and your costs. That is my own personal preference, but I do not know. Maybe you wanted the mandated costs from here. We can pick 20 percent of all your power has to be green and let you figure out why. But there are members of this Committee that pose wind generation off their coasts.

Dr. Felmy, we talk about trying to be energy independent. Can you speak to the reserves that are in the United States in the lower 48 and Alaska of what that could do if we could access those reserves in terms of energy independence?

Mr. FELMY. In terms of undiscovered resources that if we could have access to them, they could do a substantial amount toward reducing imports. It is in excess, I believe, of a 100 billion barrels of oil that could be available for developing that would go a long way to helping reduce our import dependence.

Mr. WALDEN. I want to go to the issue of refinery capacity. Because I gassed up in Brothers, Oregon, which none of you should ever know about necessarily because it is a very small little burg on the way between Burns and Bend and there is one pump and a diesel pump. And it was like 3.99 a gallon, if my eyesight was right. And they would sell me $15 worth because it is that kind of limited capacity, but it got me to the next town where I could gas up fully for $3.35.

The point is, though, I talked to a group of cattlemen that were there. And they are concerned about this price because what it takes to run their pickups and haul their horses and cows and all. And they asked me about refinery capacity. And so my colleagues have raised this issue as well, and I am concerned. Because I know your capacity has increased. Even though the number of refineries has been reduced, the refinery capacity itself through new technology has increased, correct?

Mr. FELMY. That is correct.

Mr. WALDEN. How many companies own the refineries, do you know? How consolidated is that market?

Mr. FELMY. Well, if you look at the top eight refiners, I have looked at this in comparing it to Commerce Department Census Bureau data, the share of total refining capacity is about two-thirds. And that compares to other industries that are large consumer products industries which have more concentration of ownership than the refining industry.

So it does not look to me as though it is an overly concentrated. And I firmly believe it is a highly competitive industry.

Mr. WALDEN. If it is highly competitive, the profit margins are fairly significant even though the percentage, I understand, is 9 percent. But many industries, 9 percent is not a bad margin to have. Why is it we are not seeing more investors build refineries? I mean, we are on the bubble, I mean that is my sense after several years on these committees. The big storm in Louisiana that knocks out a couple of refineries or a fire here, or a breakdown there, prices go through the roof all of a sudden, you know. Why are we not seeing more—do I not have another minute to finish up here? Yes.

Why are we not seeing more refineries being constructed?

Mr. FELMY. Well, in terms of new refineries, I think Congressman Shadegg pointed out the difficulties of Arizona Clean Fuels in terms of all the hurdles they have to face. But the industry has expanded the refinery capacity. The equivalent of a new refinery every year for the last ten years within the gates, and their announcements indicate that you could see, as I believe and my testimony said, an additional equivalent of eight more refineries. But it is a cyclical business. The returns have not been good. And ultimately if you want to invest, say, $2 or $3 billion in a new refinery, you have to assure returns to your shareholders.

Mr. WALDEN. And is supply of the feedstock an issue domestically to get it refined or do you have enough of the raw product coming in?

Mr. FELMY. Well, worldwide markets are fairly efficient so you are able to usually attract imported crude oil to be able to refine it into petroleum products. But it is more expensive, as my testimony indicated.

Ms. SOLIS [presiding]. Time is up. Thank you.

Mr. WALDEN. My time has expired. Thank you very much.

Thank you, Madam Chair.

Ms. SOLIS [presiding]. Thank you.

I would like to recognize Congressman Cleaver for seven minutes.

Mr. CLEAVER. Thank you, Madam Chair.

I thank all of you for being here. Thank you, Mr. Thomas, for being here. I am very much interested in school bus issues. And I look—I am from Kansas City, Missouri. I have looked at the fleet of school buses and I know why they are yellow. We used to have red fire trucks and we did a study and it showed that yellow was much better seen.

But we have got to improve, I think, the look of the buses, which is secondary to my real concern, which is what do you think the capacity of school districts would be if by 2017 school buses were required to have a fleet of biodiesel buses or hybrids? It is a ten or 15 year period for the school districts to ramp up and get fuel efficient vehicles?

Mr. THOMAS. The impact, because of the hybrids that we have available now, IC Corporation has a hybrid out there that is being tested in several states and the results are dramatic. There is a dramatic decrease in the emissions, almost 90 percent and there is a dramatic increase in its fuel efficiency, the miles per gallon would get. If the Federal Government would mandate that, certainly the industry would respond. And industry would, just as they have re-

sponded with clean diesel, and this is the first year we have had to outfit the whole fleet with clean diesel engines, we would comply. So the impact, I think, would be dramatic and positive.

Mr. CLEAVER. Thank you.

Mr. Felmy, I am one of the co-sponsors of the Federal Price Gouging Prevention Act that was mentioned earlier. And I agree with you that there may be some difficulty in defining unconscionably excessive. I think I could do it. But you are in that industry. Could you give me just your belief or figure for unconscionably excessive movement of gasoline prices?

Mr. FELMY. Congressman, as an economist I cannot do it. What we have seen over repeated increases in prices, whether it be Hurricane Katrina or Rita or what we have experienced this year, is markets at work. And so I would be very concerned that if you were to put in an artificial definition, however crafted, that it could have the unintended consequence especially when combined with civil, criminal penalties, jail time and so on, of traumatizing the market at a point where you actually need movements of supplies, you need to be able to attract imports, you need to be able to bring—you need a demand restraint and so on. I would just be very concerned that this could set us back to the price controls of the '70s, which were an unfortunate episode we experienced.

Mr. CLEAVER. Well, this Act would not prosecute anyone for the normal natural movement of prices. The market will deal with that. But what this legislation would deal with is situations where it appears based on either natural disasters or other events that may not have had an impact on the industry, and yet the prices would soar.

And as members of Congress, I think you would agree that it is difficult to explain to the constituents, or I would like for you to give me information on how to do it when you go home and people talk to at your neighborhood meetings about a $400 million bonus for an executive for MobilExxon, Lee Raymond. And then they go and look—in Kansas City the average price of gasoline today is like $2.92 and rising. So when you look at Raymond getting $400 million as a retirement benefit, the people at my town hall meetings are not interested in me saying well the market is just kind of taking care of things and do not worry about. I mean you can, or at least I hope, understand that people are angry out here. And someone mentioned it earlier, there was a $14 billion tax cut for the oil industry. And then they recorded the highest profits in the history of the planet.

And so, you know, I am not a bomb thrower, you know. I want to be able to sit down and have an intelligent discussion. The public is not inclined to be that patient right now. They are angry, and so can you help me?

Mr. FELMY. Well, Congressman, we clearly know the frustrations of consumers. I cannot comment on any individual company's compensation policies. But if you look at the size of that in the context of a multi hundred billion dollar corporation, it really is insignificant in the scheme of things.

Mr. CLEAVER. That will not work. I can tell you now, that will not work out on Blue Ridge Boulevard in Kansas City. So give me something else.

I mean, these people are having difficulty earning $13 an hour or, you know, they are working all day and you start saying well that is not much money in the context of things.

Mr. FELMY. And, Congressman, I understand that. But one has to put it in proper context, just as you need to put the overall earnings of the industry in proper context. That they are consistent with the earnings, as I mentioned earlier, with manufacturing industries. And we understand the frustrations of consumers.

Ms. SOLIS [presiding]. Unfortunately time has expired.

Mr. CLEAVER. Thank you, Madam Chair.

Ms. SOLIS [presiding]. I would like to recognize Congressman Sullivan for five minutes.

Mr. SULLIVAN. Thank you, Madam Chairman.

And in my opening statement I wanted to submit these two letters into the record, and I ask unanimous consent to do it. I didn't ask unanimous consent earlier.

Ms. SOLIS [presiding]. Without objection.

Mr. SULLIVAN. Thank you.

You know, you hear a lot about all this stuff. And I agree with you. I think that compensation is big and I do think saying that, you know, it is insignificant is a good answer. It does not work, does it, out there? But companies do what they do and we cannot control that.

But, you know, I was going to ask I guess Mr. Felmy, you know we have gas prices are high, higher than usual, people are going to experience that probably more so this summer. And, you know, well I guess I will ask you if we had more refineries, do you think that would help the prices?

Mr. FELMY. I think that anytime you are able to increase the supply of any product, whether it be gasoline or whether it be any other product, you help the market conditions.

Mr. SULLIVAN. And do you think Katrina, because of the geographical location—we did not have much geographical diversity on our refineries in this country. Really, a lot of them—I guess 40 percent or so are down in that area that was effected by Katrina and Rita. Did that have any impact on price, do you think, as an economist?

Mr. FELMY. Well, as an economist the industry took a beating from refining capacity shutdown, 25/30 percent of capacity, pipelines were shutdown, import facilities were shutdown, production, complete production in the Gulf of Mexico was shutdown. We had a real supply hit of all different dimensions. At the same time you had increased demand leading into the Labor Day holiday.

So there is no question we took a hit from both supply and demand and what you saw, markets respond as a result.

Mr. SULLIVAN. You, sir, or anyone here, does anyone have any evidence, or the FTC or anybody have any evidence of any price gouging that occurred after Hurricane Rita and Katrina? Is there anything that we can point to that is overwhelming evidence that states that there absolutely was price gouging and collusion and price fixing? Does anyone have anything they can say?

Mr. MITTERNIGHT. I can answer it from my personal experience. Prices escalated somewhat immediately thereafter, but the State Attorney General and the State put a price cap so that no prices

could be increased. You know, they froze prices where they were to try to protect people.

It was not necessarily a price problem as much as an availability. You know, there were no places to——

Mr. SULLIVAN. So, Mitternight, you have experienced a great deal of adversity down there during all that. I heard you talking about it and it was terrible and prices were high. But was anybody convicted of price gouging down there?

Mr. MITTERNIGHT. There may have been one or two isolated instances in some of the rural areas around the city. But in general, no.

Mr. SULLIVAN. But probably if that happened, it was like an independent guy?

Mr. MITTERNIGHT. Correct.

Mr. SULLIVAN. Not like ExxonMobil or anybody with a concerted effort to fix prices?

Mr. MITTERNIGHT. No. In fact in most cases some of the larger corporations, the Shell and those kind of places worked diligently to try to get a few isolated stations open to provide a supply. And they were working with the emergency relief people also and providing the fuel for them.

Ms. CLARKE. Okay. Yes, I know you have been through a lot down there.

Dr. Felmy, have you heard of anything, any evidence by the FTC, any evidence by anybody, State, law enforcement agency of conviction or suspicion or anything of any price fixing or gouging that has occurred in the United States of America?

Mr. FELMY. In terms of any type of illegal activity beyond the subjected price gauging, no. I mean, I think there probably were a handful of instances in a few states where individual owners, perhaps, exercised poor judgment in terms of the results. But it certainly was not widespread. And that is my recollection from what the discussion was.

Mr. SULLIVAN. So I guess it is safe to say, though, we can say today in this hearing that there has never been evidence of any widespread price fixing or price gouging that has occurred in the United States of America through any of these companies with an organized effort to do that? Would that be safe to say? Everybody? Mr. Thomas, would you say?

Mr. THOMAS. I think that would be safe to say?

Mr. SULLIVAN. Mr. Mitternight.

Mr. MITTERNIGHT. Not to my knowledge, no.

Mr. SULLIVAN. Mr. Teske.

Mr. TESKE. I am just a cynical old redneck from Kansas. I do not believe a bit of crap that comes out of the petroleum industry.

Mr. SULLIVAN. All right.

Mr. TESKE. But that is just my opinion.

Mr. SULLIVAN. And it is America. You can say that, sir.

Ms. Estes.

Ms. ESTES. I was able to read both sides of it. And you asked if anyone brought literature. Yes, I did. And I brought it about that thick. And to go through that information, it goes both ways. For every article that says that there was, there is an article that says

they are wrong. For every article that says there is, there is an article that says it is something else.

So for me to determine what is right, I cannot tell you. I would need more than four days.

Ms. SOLIS [presiding]. Unfortunately, time has expired.

Thank you.

Mr. SULLIVAN. Thank you.

Ms. SOLIS [presiding]. I would like to recognize Congresswoman Herseth Sandlin for five minutes.

Ms. SANDLIN. Thank you, Madam Chairwoman.

Thank you all for your testimony today.

And before I pose some additional questions on this refining capacity issue, I do want to just clarify a few things.

My friend Mr. Walden from Oregon and I see eye-to-eye on a lot of things, but I do want to sort of clarify what I viewed as important in the Energy Policy Act of 2005. The incentives that Mr. Walden referred to in terms of the dollar per gallon for biodiesel and the 51 cent credit on ethanol, those have been around for over 20 years, these incentives. It was the renewable fuel standard as a mandate that in my opinion caused the mix of incentives, existing incentives, and expanding those, extending them in the Energy Policy Act and the mandate creating the market, imposing the competition that for years was not there and I think attributes perhaps, Mr. Teske, to some of what we know the attitude is farm country because of our difficulty of getting a market for ethanol for a long time until we had that mandate. And since we have had that mandate we have seen start-up companies take off in the investment of new technologies to make the production process even more efficient. Not just for corn ethanol, but increasingly cellulosic ethanol and the potential that has. And that leads me to this refining capacity issue because we are focusing on refining capacity only for fossil fuels and petroleum products.

But, Mr. Felmy, would you agree that along Mr. Sullivan's question, because you did take this body blow, right, in terms of your imports, port of entry, the refining capacity being concentrated in a certain geographic region of the country. That it is not just increasing the supply of the product, it is having a decentralized and geographically diverse distribution system and where the refining capacity would exist?

Mr. FELMY. I am not quite sure. Are you asking that it would be preferable to have a geographical dispersed capacity on that?

Ms. SANDLIN. Yes. Would that not in terms of how the market—would the market function more effectively in terms of insulating us from those types of body blows if geographically our refining capacity either for petroleum products or refining capacity in biorefineries throughout rural American would assist in insulating us from those types of price fluctuations?

Mr. FELMY. Well, it would likely help in terms of specific disasters, such as hurricanes which are, of course, concentrated in the Gulf of Mexico. There is, however, a trade off with costs that when you get to a highly dispersed level of production, it can increase your distribution costs. So there is somewhat of a trade off. But certainly to the extent that you do not have all your capacity lo-

cated in one area that is vulnerable to hurricanes, that of course can help in terms of more supply reliability.

Ms. SANDLIN. But if highly dispersed and used more locally increased with flux-fuel vehicles, that type of infrastructure, that would assist consumers as well, correct?

Mr. FELMY. That would certainly lower the transportation costs versus long distance shipping, which can be quite expensive ethanol because you cannot include it in pipelines.

Ms. SANDLIN. And you had mentioned that over the years the industry has expanded existing refineries equivalent to one new refinery, but in doing so has that not enhanced the degree of concentration geographically of where our refining capacity exists?

Mr. FELMY. Yes. You are expanding the existing within the existing fences. And so if you have a concentration there, then of course it increases more of that capacity in a area. And that is unfortunate, but it is the only place we can locate the refineries right now.

Ms. SANDLIN. But is it not also true that while the industry may have expanded in certain existing refineries, there were a number of mergers throughout the 1990s that led to closures of some existing refineries? Is that true?

Mr. FELMY. I do not think so much the mergers led to closures of refineries. I think what you saw is divestiture of those refineries actually to a whole new class of independent refiners who have gotten much larger.

So, for example, refiners such as Valero, who were much smaller, it picked up assets from these divestitures. And so the concentration impact has gone up since 19—I guess the first date I have is '97 from around 49 percent to about 66⅔ roughly. But that still does not put it out of line with other industries in terms of supplying consumers.

Ms. SANDLIN. No, it does not. But some of us share the same concerns about other sectors and industries like the livestock industry and the concentration there when we do not have the kind of competition when you have that type of concentration develop and the impact that that ultimately has on prices for producers, for consumers and on down the line.

I see my time is up. So I will yield back any remaining time. I do not have it. So thank you, Mr. Chairman.

Chairman MARKEY. Thank you. The Gentlelady's time has expired.

The Gentlelady from Tennessee, Ms. Blackburn, is recognized for five minutes.

Ms. BLACKBURN. Thank you, Mr. Chairman.

Mr. Mitternight, I know a little bit about that area where you are from. I have a dad who, 81 years old, just sold his oil filled equipment business, worked in it every day of his life up until recently down in southern Mississippi. I know Metairie. And I would imagine that you would probably agree with me that regulation is just choking the business down there. And I imagine you also would support one-stop regulation, a one-stop shop for working with all these regulatory State and Federal agencies to get these refineries up and running?

Mr. MITTERNIGHT. I agree, a thousand percent. There have been some negotiations between economic development people in Lou-

isiana and some of the foreign countries to try to establish a new refinery, the first one in 35 years in the country, so——

Ms. BLACKBURN. Right. It would go a long way to solving the problem we have.

Mr. MITTERNIGHT. It would. Right.

Ms. BLACKBURN. And it sounds like Mr. Teske and Ms. Estes would also like to get rid of a little bit of regulation that hampers small business. Most of us small business people would.

Mr. Mitternight, on the energy expenses fuel cost, what percentage of your total business expense do you give toward fuel cost?

Mr. MITTERNIGHT. It is fluctuating. But right now my energy costs are probably 6 to 8 percent of my overall expense.

Ms. BLACKBURN. Six to 8?

Ms. Estes, how about you? What is your percentage?

Ms. ESTES. In the last year—in the last two years, about 1600 a month. And I have actually had one month——

Ms. BLACKBURN. No. I just need a percentage. $1600 a month does not really—I mean, there is nothing to balance that against.

Ms. ESTES. Within 4800 to 7,000.

Ms. BLACKBURN. That would be helpful.

You know, you said your employees would like to have a little bit of a raise to help offset some of those energy and fuel costs. And I think most people in America would like to have that. And I look forward to a day when our small businesses can be more taxation and regulation free so that they can enjoy that.

You said you had a seven percent profit margin?

Ms. ESTES. Yes.

Ms. BLACKBURN. Okay. That is pretty good, is it not?

Ms. ESTES. For Federal contracts——

Ms. BLACKBURN. I think for most small businesses, you know you are running twice the GDP. So that is a pretty good profit margin, I would think. So congratulations on having a 7 percent profit margin at the end of the year. Having been a small business person you enjoy those years when you do come out ahead.

Mr. Felmy, I know I am going to run out of time and we are getting ready to have votes in a few minutes. There are others who want to ask questions.

When I am with my constituents in Tennessee and we talk about the increase in transportation fuels, the increase in electricity and all of these energy costs, people turn around and they look at you and they say "You ought to be able to do something about this." The Federal Government has been piling on regulation for years and years and years. Federal Government increases our taxes. The gas tax goes up, it is not going to the Highway Fund, now they are sending over to research global warming. And they do not like that.

I would love to hear from you as an economist what three or four things you feel like we could do that would actually make a difference in the price at the pump and the price that people are paying for energy. Because I think that is part of the frustration.

You know, we talk about things that need to happen short term, mid term, long term. We talk about conservation efforts. We talk about incentives. And all of those things, the Energy Act of '05, which has been referenced, did a good bit of that. And that is commendable. But people want to know what we could do that would

actually help make that change. And I would love to hear from that. And if I run out of time, if you would submit it to me in writing.

Mr. FELMY. Thank you, Congresswoman.

Put simply we need to increase supply. That means to increase supply of production of oil and gas in our own country, which would both stimulate the economy, lower our trade deficit and help economic activity.

We need to streamline regulations so that we can more expeditiously expand refinery capacity or perhaps build a new refinery.

And we need infrastructure to be put in place, whether it be pipelines or power lines, or ports, or terminals, or everything that goes to actually getting that fuel to consumers. We are going to need more renewable energy, we are going to need more emerging energy technology to be able to help and we are going to need more energy efficiency.

So things that would help consumers in terms of more efficient vehicles, more efficient houses, more efficient operations will reduce the demand. That combined with increased supply can help consumers.

Ms. SANDLIN. Thank you, sir.

I yield back.

Chairman MARKEY. The Gentlelady's time has expired.

The Chair recognizes the Gentleman from New York, Mr. Hall for five minutes.

Mr. HALL. Thank you, Mr. Chairman.

And thank you for your presence here and your discussion with us. I am sorry I missed your opening statements. I was booked in another Committee at the same time. Funny how they do that.

The good news, I wanted to point out, from the latest IPCC report that the Ranking Member mentioned in his opening statement is that there are plenty of currently available and affordable technologies, and policies, that can reduce global warming, pollution and oil imports.

As this Committee is already discovering in hearings we have held, and Mr. Teske made clear, when it comes to global warming the costs of inaction far outweighs the cost of action. Many of the smart actions we could take today like raising CAFE standards would save consumers money.

And I wanted to ask Mr. Thomas, you are probably familiar with this. My home District, one of the five counties I represent, Westchester County, is running hybrid buses on their bus loops around the country. And has there been any discussion that you have heard about combining that with if you are running hybrids you can certainly run biodiesel hybrids.

Mr. THOMAS. Yes.

Mr. HALL. So there you are compounding one new technology with another, and it would seem to increase the efficiency or shall we say, to lower the demand for petroleum products.

Mr. THOMAS. Exactly. We are very excited about it as an industry. The IC Corporation has taken the lead on this and as well as Westchester County, New York and several other states they have introduced the hybrid. And we are excited about the results.

The problem is is that the cost of that vehicle is dramatically more than the cost of today's regular old clean diesel school bus. So we have to do something about coming up with the up front cost to offset the capital expense in order to get the emission and the fuel efficiency benefits.

Mr. HALL. But given the size of the overall yellow school bus fleet in the United States, which was amazing when I read about it in your written comments, would it not be worth it in your mind——

Mr. THOMAS. Certainly.

Mr. HALL [continuing]. If the Government were to incentivize or subsidize the up front costs?

Mr. THOMAS. And the congestion mitigation air quality formula funds that come out of DOT would be a perfect avenue to do that.

Mr. HALL. I am driving an American made hybrid which shuts down the motor when you are a standstill. So if a school bus is caught at a stop light or in a traffic jam, and suddenly stops pumping out fumes from diesel or biodiesel, that would contribute to air quality——

Mr. THOMAS. Definitely.

Mr. HALL [continuing]. As well as reducing global warming.

Mr. THOMAS. And for every bus that is on the road, you have 50 cars that are not.

Mr. HALL. Right. So I just wanted to comment also on a remark that was made from a member on the other end of the bench here about "companies do what they do, we cannot control that," I think was quote/unquote. The fact is that we do control that. That we regulate airlines, we regulate meat packing companies, we recognize all kinds of—you know, when the public interest and health or national security are at stake, we do sometimes decide that it is in our interest to regulate.

And I just wanted to ask starting with Dr. Felmy, I guess, about the sort of rockets and feathers syndrome that when petroleum prices or gas prices at the pump go up, they seem to go up fast. And then they seem to drift down more slowly like a feather. My constituents are seeing that and talking to me about it. It does not seem to follow the price of oil. And, in fact, the gasoline that is already in the ground at a particular gas station, the truck has already come and delivered it, and then you see the guy on his ladder up that night changing the numbers. And I have driven to events and come back later the same night and the price was .10 cents higher. I am just curious why it is also so fast to go up and so slow to come down?

Mr. FELMY. Sometimes it does, sometimes it does not. In some cases in the past if you look, you have had perfectly symmetrical rises and falls. The public does not always recognize that, though. They tend to have a very visile response to the price increases, but as they come down and economic studies have verified this, you tend to have less shopping behavior, less discipline on the market and so you sometimes see prices.

Ultimately it really is a function of why did the prices go up. If crude oil prices went up rapidly and gasoline prices followed and crude oil prices do not come rapidly, then there is no reason to sug-

gest why gasoline prices would. Because the cost of producing gasoline is most importantly tied to crude oil costs.

In terms of the individual gas station owner, 95 percent of the stations roughly are owned by independent businessmen who make their own decisions about what the price is. They do that as a function of the market for the gasoline based on their local conditions and the costs of what they spend it, along with a lot of other things that they take into account. Their decision about the price is not necessarily tied to what they paid for the gas in the pump.

Generally we have heard from, for example, the dealer organizations that it is more of a replacement cost that is a challenge for them. As an independent businessman if he sees the price going up dramatically, has a feeling that the cost of gasoline is going to be much higher, then he is concerned about not having the cash flow to be able to buy that next tank load of gasoline.

Mr. HALL. Thank you, Mr. Felmy.

I am sorry. My time has expired for my other questions.

I yield back.

Chairman MARKEY. Okay. The Gentleman's time has expired.

What we are going to do now is ask the witnesses if they will each give us the one minute they want us to remember about skyrocketing gasoline and oil prices.

And we thank each of you for testifying here today. And your one minute summation of your views on this looming $4 a gallon gasoline threat to our economy is something we very much appreciate.

Mr. THOMAS. One minute.

Mr. THOMAS. Thank you.

The impression that I would like to leave the Committee with is very simple. As gas and diesel prices go up, I hate to say it this dramatically, but children are at risk and in many cases when school bus service is pulled off the road, actually we have an increase of student injuries and fatalities. That is how dramatic it is in my industry. And I would just like to leave you with that impression.

Chairman MARKEY. Mr. Mitternight.

Mr. MITTERNIGHT. I would just like to say, as I indicated in my written testimony, a 60 percent cost increase in the cost of gasoline from December of '06 to the current time is impossible for me to recoup on fix contracts. And it comes right out of the bottom line, which impacts salaries and everything else. So it is a dire situation for small businesses to compete with.

Chairman MARKEY. Mr. Teske.

Mr. TESKE. Thank you.

As I said earlier, I am pretty cynical about what I hear. There has been enormous amounts of—that is going other directions now. And I have never seen anybody that has been short of fuel. Everyplace you go to buy gas, they will sell it to you. So I am puzzled. I mean, I do not quite understand the concept.

So my ideal world would be every farmer having his own wind turbine where he goes and plugs his tractor in at night and he is completely off the grid and off the petroleum. That would be my perfect world.

Thank you.

Chairman MARKEY. Thank you.

Ms. ESTES. I agree. The fact that the firm fixed price, there is not much we can do about it. What my concerns are, and the one thing I will leave with you, is the American public. The effects that it is having on the lower class, they cannot afford any increases. And that is my main concern. You are creating anger and poverty.

Chairman MARKEY. Dr. Felmy.

Mr. FELMY. The current gasoline situation is clearly a function of markets at work. Higher cost to manufacture gasoline, crude oil costs, ethanol costs, summer blend fuel that is coming in, marry that to market conditions with strong demand for gasoline, a supply challenge because of lower imports. The refiners have responded by producing record amounts of gasoline, but we still have a tight market. And it is that movement of the market that allows supplies to be able to be diverted where they are needed and does not foster gas lines that we have experienced in the past.

Chairman MARKEY. Thank you, Mr. Felmy, very much.

All I can tell you is that your testimony was really excellent, and especially the ordinary citizens that came here to Washington. I mean, it is right out of central casting. You really did a great, great job.

We are committed to answering this question. We have to change our behavior here in the United States. We have seen a doubling of the price of gasoline over the last ten years. It is unsustainable if it goes to $4 a gallon. In other words, the price of not doing something is much, much higher than the price of doing something. It has already gone up a buck and a half and it is heading toward two and a half bucks that it will have gone up over the last ten years. So now we have to change direction. We have to innovate. We have to ensure that the automotive sector, that every sector changes and that we take the revenues that we have been sending into the oil and gas industry and we begin to redirect them towards the renewable energies, towards the innovative new technologies that can change the direction in this country. That will be our task including our goal of passing legislation that outlaws price gauging by oil companies in this country, and to do it this year.

We thank each of you for your testimony.

With that, this hearing is adjourned.

[Whereupon, at 4:10 p.m. the Committee was adjourned.]

Responses to Questions
for
Terrence V. Thomas
Community Bus Service

1) Do any of you use ethanol or other alternative fuels in your vehicles? Have any of you bought hybrid vehicles for your business or personal use?

As far as I know, no school buses use ethanol, and very few use propane because of safety concerns. There are some natural gas school buses on the road, but they are a very small minority due primarily to the infrastructure expense. Several school bus fleets are now using B-20 biodiesel, however.

Hybrid school buses are still in the pilot stage. The Plug-in Electric School Bus Project delivered 20 IC school buses to districts and contractors (2 contractors, 13 districts) in 2007 for demonstration projects (see www.hybridschoolbus.org). Additional information on this issue is covered in our answer to Question 5 below.

While I personally do not drive a hybrid vehicle I recognize their contribution to helping to reduce fuel consumption and emissions. Federal and state incentives to encourage their use, through tax credits and access to High Occupancy Vehicle lanes can help to encourage these technologies. Also, although I can't claim credit for it, I know that a number of our colleagues in the industry drive hybrids – some more than one – and also our two lead lobbyists in Washington both drive hybrid vehicles.

2) On the CMAQ program, that seems like a pretty common sense approach to allow use of the program to get more school kids on buses, but do we need to worry about keeping the playing field level for the private sector and the public sector? Your question is quite perceptive, noting the need to worry about a level playing field. Federal grant programs need to be available on an even basis for both public-sector and private-sector school transportation operations. This has been a problem in the EPA Clean School Bus USA grant program, where contractors are unable to access grant funds directly. For a variety of reasons, some school districts that outsource their transportation service have refused to apply for grants that would upgrade their contracted buses. This effectively blocks the bus owners from participating in the program and denies those students the benefits of reduced emissions. We want to avoid that same problem in the CMAQ program by ensuring that the funds are distributed without regard to who owns and operates the buses. After all, the benefits to the community are the same, whether the school bus system is operated by a public or a private entity.

3. Besides schools, do you all contract out for any other transportation services? What accounts for the remarkable savings that a school can experience by contracting out services?

Many school bus contractors do offer other services as well. At the simplest level, contractors may use their school buses for summer camps and other youth programs when they are not being used for school transportation. Sometimes they also use them for community transportation, such as senior trips or municipal charters. Other companies have divisions separate from their school bus service that provide motorcoaches for charter transportation or transit buses for public transportation service.

The savings that schools experience when they outsource transportation is often a result of improved management and increased efficiencies. In one case, my company is saving a school district over 30% in fully allocated costs, and almost all of the cost efficiencies are based on tight routes, tight supervision, and cost controls on all expenses. Community Bus simply does not run as many buses as the public sector did previously to get the job done. One of my customers gives us 11 routes at a time, and within two weeks we run the 11 routes with 10 buses simply by auditing what the bus actually does from stop to stop, and then working with the driver to assure that safety is maintained.

The larger contractors offer cost efficiencies based on volume purchasing of big-ticket items such as buses, fleet insurance, health insurance, fuel, and tires. But smaller contractors who service more than one district in a relatively small geographic area can also produce savings by consolidating facilities and operations. Generally public and private operators pay drivers similar wages within a geographic region, so cost savings must be found in operating efficiencies, volume purchasing, and better utilization of assets.

Also, some school districts find additional non-monetary benefit from outsourcing in that it allows them to concentrate their scarce resources on the job of education rather than focusing manpower and management resources on meeting transportation needs.

4) As you know, a large part of what we must do is to search for reasonable, practical solutions to problems that our communities face. In light of this goal, you continuously highlight the safety factor for high-school students who do not ride the bus. Would you support a school district that chose to impose a parking premium for high-school students who drive and exclusively devote that revenue towards paying for higher fuel expenses for school buses? Would this solution provide a greater incentive for more students to ride the bus (thus, providing increase safety), while also providing a revenue stream?

Frankly, I'd prefer to see a parking ban on all student cars, with hefty fines for violators. Failing that, the parking premium—if it is high enough—will discourage some drivers, though probably not all. I would suggest, however, that the revenue be directed exclusively to defraying the costs of school busing rather than limited to paying for higher fuel costs. That way, schools need not discontinue the fee if fuel costs go down. I would also ask the cooperation of local police in establishing and enforcing no-parking zones on the streets around the high school. Anything we can do to prevent or discourage teenagers from driving to and from school will save lives, reduce traffic, and conserve energy—and if it also provides a revenue stream for schools to help defray fuel costs, so much the better.

5) What advances in hybrid technology, such as plug-in hybrids and flexible fuel hybrids are expected, and when do you anticipate these technologies will be widely available at cost comparable to non-hybrid buses? What further actions could federal and state governments take to encourage the production and purchase of hybrid vehicles?

We contacted the three major manufacturers of school buses, Blue Bird, IC Bus, and Thomas Built Buses to ask them for input on new school bus technologies on the horizon. As you may know, IC Bus introduced a plug-in hybrid diesel-electric engine in the school bus market in July of 2006. According to the manufacturer, the bus reduces emissions by 70 percent and improves fuel efficiency by up to 70 percent. Improving fuel economy also reduces emissions of greenhouse gases. However, the cost of the bus when introduced was significantly higher than the cost of a comparable diesel vehicle. IC Bus recently announced a significant price drop for the vehicle in the $30,000 to $40,000 range but the cost remains about $90,000 to $100,000 higher than the cost of a regular clean diesel school bus.

The major issue with this technology is cost. For this to become a viable technology at volumes which will reduce the cost of the system, Federal and state funding will be needed to help foster market acceptance. This still does not address the issue that it will take 5 to 10 years to get a return on this investment at production volumes based on projected fuel savings. Also, energy savings needs to also consider the cost of any electrical energy added using plug in hybrid technology, and not only the savings in diesel fuel. Additional information about hybrid technology school buses can be found in the Hybrid Electric School Bus Preliminary Business Feasibility Report conducted by Advanced Energy, dated June 3, 2005 which can be found at http://www.advancedenergy.org/corporate/initiatives/heb/pdfs/HESB%20Business%20Feasibility%20Study.pdf.

In addition, this does not address the potential impact on safety from diverting funds away from maintaining school bus fleet size due to higher per unit costs if special funding is not available for hybrid technology. For example even if years from now the unit cost of a hybrid bus could come down to a point where the cost differential between hybrid and clean diesel might be only 25 percent of what it is today, that incremental cost could mean that school districts with a limited amount in their budget for capital purchases would need to buy fewer buses and might need to reduce the number of children transported by bus. This exposes more children to greater safety risks in getting to school.

The manufacturers are continuing to look at new technologies including plug in hybrid and on board electrical generation through the use of fuel cell technology but I believe these technologies may still be years away and are also likely to be prohibitively expensive in the early years of deployment. It is important the Federal government continue to provide grant funding and tax incentives to help defray some of the cost if these new technologies if they are to have any chance of achieving market acceptance.

In regards to other alternative fuels (Bio-diesel, Flex-fuel, CNG, and Propane) depending on the size of the vehicle most are commercially available or will be by 2010. Bio-diesel is available for use on current diesel engines in use in the marketplace. The new type-A Blue Bird bus with a General Motors chassis will be flex-fuel capable for 2010. CNG and Propane are currently available for their Type D and Type C products respectively.

To date fuel cell technology is cost prohibitive for the School Bus market. For this to become a viable option this would need to be first developed for the heavy truck market.

6) Would you please clarify what you meant by reasonable exploration of oil? Should the federal government encourage more exploration and drilling offshore and on public lands?

Although this is an area beyond my expertise as a school bus transportation provider, it is my understanding that the United States possesses large areas that have great potential reserves of crude oil but are currently off limits to explorations and drilling. There has been much controversy surrounding drilling in the Alaska National Wildlife Refuge and in the outer continental shelf in coastal areas. I understand the concerns about adverse impacts on wildlife and natural habitat but believe that with adequate safeguards, some of these resources could be tapped with minimal risk to the environment.

7) You state in your testimony that transportation is only 4% of the total school budget on average, it is one of the first targets when districts must reduce expenditures, particularly in states where there is no mandate. Would you agree that before the federal government steps in with federal dollars that states should take more responsibility for children's safety, such as mandating busing, and thus deterring bus cuts as the first response to increasing transportation cost?

I agree that we need a multi-level approach to increasing student safety through school bus transportation, just as we have a multi-level approach to highway safety and to education. In both those areas, the federal government provides significant funding—but with strings attached. States must meet certain minimum standards in order to qualify for the funds. The Federal government provides billions of dollars each year to support mass transit but almost nothing to support public transportation for school children. I would support a federal assistance program for school transportation whereby 1) the moneys are allocated to the states in proportion to the number of students transported in school buses; 2) in order to be eligible, a state must require that transportation be available for students in grades K-12; 3) states must provide matching funds; and 4) funds must be distributed to school districts without regard to whether the transportation system is publicly or privately operated.

8) On Page 4 of your testimony, you mention how much money the industry will have to absorb to meet new ultra low sulfur fuel and clean diesel engines - you say more than $6000 per vehicle. That sounds like a lot of money. Do you think this is a fair cost for doing your part for global warming?

A) Most of this additional cost does not affect greenhouse gas emissions and will not impact global warming. Rather, these costs have been imposed in order to significantly reduce emissions of VOCs, NOX and PM from diesel engines. Not only is our industry absorbing these costs, but we are also working to adopt retrofit technologies that can significantly reduce pollutant levels from much of the legacy fleet of vehicles which will remain in service for years to come. These technologies are also expensive to install and often come with added maintenance costs. Existing Federal grant programs administered by EPA and DOT can help with some of the costs but are not adequate to cover the number of vehicles that could benefit from such equipment.

We have been notified by the manufacturers that the next stage of emissions control in the 2010 models will increase the price of a school bus by another $6,000, and we will absorb that cost as well. Our industry recognizes the benefits of cleaner air for all of us and no segment of our country is more important than the children we transport.

Mr. Michael Mitternight, owner of Factory Service Agency, Incorporated

Answers to submitted questions

1) Do any of you use ethanol or other alternative fuels in your vehicles? Have any of you bought hybrid vehicles for your business or personal use?

No, I have no service or personal vehicles that are designed or have been modified to run on alternative fuels. I have never purchased a hybrid vehicle.

2) You state in your testimony that the NSBA has adopted a comprehensive energy policy. However, the recommendations of increased expansion of alternative fuels such as cellulosic ethanol, more hybrids, etc. seem to me long term projects. What actions could the federal government take in the short term to reduce fuel prices?

Although expanding the United States' domestic oil production will do little to reduce the long-term strategic vulnerability caused by its oil dependence, it is an important short-term action that may help offset escalating energy costs and assist American consumers and small businesses with their immediate energy needs.[i] Sen. Jeff Bingaman (D-N.M.), Chair of the Senate Energy and Natural Resources Committee, often has said, "Increased domestic energy production, in an environmentally sensitive manner, is one of the four key elements of sound energy policy."[vi] Additionally, enlarging U.S. domestic production is a "valuable, if not essential, element for increasing the credibility of U.S. efforts to persuade other nations to expand their exploration and production activities."[vii] To lower the energy costs of millions of American consumers and to curtail supply disruptions that add volatility to the market and undermine business plans, the U.S. must increase its domestic energy production and expand its refinement capacity.

Currently, outer-continental shelf (OCS) drilling provides more than 25 percent of U.S. natural gas production and more than 30 percent of total domestic oil production. It is estimated there are an additional 76 billion barrels of oil and 406 trillion cubic feet of gas in undiscovered OCS fields. It is time to discover them. It is imperative to small-business owners that the soaring price of energy be addressed. Increasing the amount of domestic energy available will accomplish this vital goal. ***NSBA supports increased outer-continental shelf production in states that support such development.***

It also is vitally important that the United States expand its capacity to refine crude oil. Domestic oil refineries have been put under enormous strain in recent years, having operated at more than 90 percent capacity for some time. This overload renders the U.S. refinery system extremely susceptible to disruption, which leads to high and volatile fuel prices. ***NSBA supports increased investment in U.S. refinery capacity. NSBA also supports an expedited permitting process and a comprehensive review of the numerous regulations discouraging vital capacity improvement investments.***

Although the spiraling price of oil attracts more attention, the increased wholesale price of natural gas has been nearly as precipitous, and arguably more troubling. With the depletion of older gas wells, lower production from new wells, and 60 percent of new power plants gas fired, the supply of natural gas is flat and tight. Demand, however, has increased and continues to grow. This situation is leading to high and volatile natural gas prices, which are wrecking

havoc on America's small businesses. For this reason, NSBA applauds the Bush Administration's efforts to provide new access to domestic natural-gas supplies by streamlining the permitting processes, providing more funding for the processing of permit applications, and offering new lease sales in promising areas.

The North Slope of Alaska, including Prudhoe Bay, represents the largest, recoverable reserve of oil and natural gas in the United States.[v] Although oil was discovered there in the 1960s, commercial production did not begin until 1977, when the Alaska Pipeline was completed. Prudhoe Bay now provides eight percent of U.S. domestic crude oil production. According to a 2005 U.S. Geological Survey, there also are about 37.5 trillion cubic feet of undiscovered, recoverable natural gas in the North Slope.[v] A natural-gas pipeline is required to carry this vast reserve—from the part of Alaska already open to energy development—to the lower 48 states. This endeavor has been called "the second-most-needed improvement to the United States energy policy."[vi] ***NSBA supports the construction of a natural-gas pipeline—along the shorter and more cost-effective Northern Slope route—that would enable more than 35 trillion cubic feet of natural gas to reach the U.S. domestic market.*** *NSBA also supports the continued exploration of the desirability and feasibility of oil production in the Artic National Wildlife Refugee, which could produce as much as one million barrels of oil per day.*

Shale Oil

Global and U.S. shale oil resources are huge. It is estimated that at current demand levels U.S. resources alone could supply more than 100 years of domestic consumption. At present, the two principle methods of shale oil extraction are problematic, however.[vii] The shale oil underground mining method may not prove viable due to adverse environmental affects—including significantly higher emissions of carbon dioxide than conventional crude oil production—and it could take at least 15 years to establish the commercial viability of the in situ recovery method.[viii] With America's largest oil shale resources located on federal land, NSBA recognizes that the U.S. government must play a central role in any development of this potential energy source.[ix] In keeping with the recommendations of the RAND Corporation, ***NSBA supports maintaining a small but on-going shale oil research and development portfolio within the U.S. Department of Energy (DOE).*** *The long-term potential of U.S. shale oil reserves is simply too great to ignore.*

Coal

With more than a quarter of the world's coal reserves, the United States has a 250-year supply of coal at its disposal.[x] The energy content of this coal exceeds the energy content of the world's known recoverable oil reserves. Coal is expected to generate as much as 54 percent of the nation's electricity by 2025 and already supplies more than half of the electricity consumed in the United States.[xi] The vast potential of this vitally-important domestic energy source must be more fully explored. ***NSBA supports increased funding and incentives for clean-coal technologies research and development.*** *NSBA also supports Bush's FutureGen initiative, a public-private partnership aimed at developing "innovative technologies for a nearly emissions-free coal plant of the future that captures and stores the carbon dioxide it produces rather than releasing it into the atmosphere."[xii]* ***NSBA supports more research into the development of coal-based transportation fuels as well.***

Nuclear

Operating in 31 states, the 103 commercial nuclear power plants in the U.S. are the country's second-largest source of electricity, supplying about 20 percent of the electricity Americans use each year. Nuclear energy produces no emissions and its costs are low, predictable, and stable. An increase in research and development investment is unnecessary to make electricity

generated from nuclear energy cost-competitive—it already requires less money per kilowatt-hour than electricity generated from coal, oil, or gas.[xiii] *Nuclear energy is an integral element of the nation's power industry and it promises to be so in the future.* ***NSBA supports an expansion of the nuclear energy industry and encourages efforts to eliminate the risk of proliferation, address the issue of spent nuclear fuel, and create a reasonable licensing framework with acceptable safety risks.***

[1] David B. Sandalow, "President Bush and Oil Addiction," The Brookings Institute, 3 February 2006, <http://www.brookings.edu/views/op-ed/fellows/sandalow_20060203.htm>.
[1] Senator Jeff Bingaman (D-N.M.), "Statement on Energy Bill Conference Report," 1 August 2005, <http://energy.senate.gov/public/index.cfm?FuseAction=Speeches.Detail&Speech_id=6&Month=8&Year=2005&IsChairman=0>.
[1] Council on Foreign Relations Independent Task Force, "National Security Consequences of U.S. Oil Dependency,"October 2006, <http://www.cfr.org/content/publications/attachments/EnergyTFR.pdf>.
[1] Mary Pemberton, "Alaska Nearer Natural Gas Pipeline," *The Boston Globe*, 11 August 2006, <http://www.boston.com/business/articles/2006/08/11/alaska_nearer_natural_gas_pipeline?mode=PF>.
[1] U.S. Geological Survey, "Oil and Gas Assessment of Central North Slope, Alaska, 2005," National Assessment of Oil and Gas Fact Sheet, 2005, <http://pubs.usgs.gov/fs/2005/3043/>.
[1] Gregg Easterbrook, "Vote Yes for the Energy Bill, Then Start Working on the Real Issues," Brookings Institute, 28 June 2005, <http://www.brookings.edu/views/op-ed/easterbrook/20050728.htm>.
[1] Energy Information Administration, "Annual Energy Outlook 2006," February 2006, <http://www.eia.doe.gov/oiaf/aeo/pdf/issues.pdf>, 53-54.
[1] James T. Bartis, Tom LaTourrette, Lloyd Dixon, D.J. Peterson, and Gary Cecchine, "Oil Shale Development in the United States: Prospects and Policy Issues," RAND Infrastructure, Safety and Environment, 2005, <http://www.rand.org/pubs/monographs/2005/RAND_MG414.pdf>.
[1] Anthony Andrews, "Oil Shale: History, Incentives, and Policy," CRS Report for Congress, 13 April 2006, <http://www.fas.org/sgp/crs/misc/RL33359.pdf>.
[1] National Mining Association, "Fueling Our Future: A Strategy For Increasing America's Energy Independence with Coal," <http://www.nma.org/pdf/fueling_our_future.pdf>.
[1] National Mining Association, "Fueling Our Future: A Strategy For Increasing America's Energy Independence with Coal," <http://www.nma.org/pdf/fueling_our_future.pdf>.
[1] President George W. Bush, "Advanced Energy Initiative," 20 February 2006, <http://www.whitehouse.gov/stateoftheunion/2006/energy/index.html>.
[1] NEI, http://www.nei.org/doc.asp?catnum=2&catid=106

3) Do you support opening up more areas, such as deep-water sites off the coast, for oil and gas exploration?

Yes, I strongly support increased drilling activity, both in deep water sites, as well as government owned and managed properties. Areas of Alaska, Colorado, Montana, etc. should all be explored. There should be legitimate controls in place for environmental protection, but in most areas, those guidelines already exist. If new constraints are applied, there should be a minimal time limit included within the regulations to ensure that there are no lengthy delays in proceeding with development.

4) Currently, after a manufacturer produces 60,000 vehicles eligible for the hybrid tax credit, the tax credit for that manufacturer's vehicle begins to phase-out. Would you support eliminating the phase-out provision?

I am not overly familiar with the total provisions of the phase out. If auto manufacturers are making an adequate profit on the hybrid vehicles, they shouldn't need a tax credit. The credits if provided, should be passed on ultimately to the consumers who are willing to try experimental vehicles until they are proven. Once established, there should be no need for credits.

5) What further actions could federal and state governments take to encourage the production and purchase of hybrid vehicles?

Until consumers are comfortable with the dependability and performance of hybrids, the market will struggle. Hybrid vehicles will have to be designed and modified to provide adequate space and performance to lure the typical American consumer to try them. I am personally, a product of the 50's and 60's, a racing and power fanatic from the muscle car era, and although maybe not typical of my era, I think I have a great deal of similar thinking cohorts. At the present time, Hybrids have the stigma of being designed for the Environmentalists and Green fanatics, and their performance is still questionable. In addition, there is no way to utilize them in my type of business, due to power constraints. I feel certain those problems could be resolved and enhance sales.

6) The American Jobs Creation Act provides a tax credit of up to $1.00 per gallon for the sale and use of "agri-biodiesel" -- biodiesel from virgin agricultural products. The credit is $0.50 per gallon for biodiesel from recycled grease. In addition, the law provides an excise tax credit for biodiesel blends (i.e., biodiesel and conventional diesel). Producers are eligible for one credit or the other, but not both. The Energy Policy Act of 2005 extends these credits through 2008. Do you support making these credits permanent? Do you support increasing these credits?

Not necessarily permanent, but a possible extension if they can be proven to be beneficial. I believe that if a product is profitable, it will finance itself, without government subsidies.

7) In your testimony you state that you have both fixed rate contracts and variable rate service calls, so if you negotiate your contracts to allow you to tack on a fuels fee when the price goes above a certain amount, you can recover your costs, correct?

The fuel surcharge that I add to invoices can be included only on those invoices for service wherein my number of hours varies. These are the emergency type service calls that are unscheduled. They are not negotiated amounts, but a Time and Materials type of invoice which allows a fuel surcharge to be to be included as part of the cost.

On fixed rate maintenance contracts, an amount is negotiated for a year at a time with automatic extensions for additional years at the same rate. Some of those contracts are through National accounts where another company is actually establishing the total rates. Those types of contracts are the ones to which I referred as not being able to recoup unexpected increases. On construction projects, where fuel prices are part of overhead in a signed contract, there is no way to anticipate extreme levels of increase.

Overhead and profit margins are based on experience and estimated increases, and when increases exceed those estimated projections, the overhead margin eats into the (already minimal) profit level.

8) The United States economy has shown steady, positive growth in recent years, despite continual dire predictions of economic implosion due to rising energy costs. How can this statement be reconciled with your statement that "ramifications of rising gas prices reverberate throughout the entire economy?"

Several factors come into play. Remember, I am an Air Conditioning contractor, not an economist, however, I would theorize that continued growth is based on small businesses absorbing a great deal of the cost increases, as well as the fact that there are numerous new companies entering the market that have not realized the volatility of the fuel portion of their overhead. I do not think the personal income level of Small Business owners has maintained a comparable growth with the salary levels of major corporation CEO's. (You hardly ever see us in the news). Corporate growth may seem strong and the Dow Index certainly indicates a strong economy, but my main area of concern for implosion are in those segments of the economy that rely more specifically on fuel supplies. (Areas such as transportation, service vehicle related business, etc.)

9) You express frustration at the lack of affordable alternatives to non-fuel efficient vehicles needed to haul your equipment. What situation would be necessary to ultimately lead to more efficient vehicles in the marketplace? Do you think café standards should include a requirement for heavy-duty equipment?

I think increased engineering research and innovation is the key. Once the necessary advancements are made, and service type vehicles are developed that will provide adequate power and performance for companies such as mine, it may be necessary to offer tax incentives or rebates to enable us to purchase such vehicles. Acquisition of a fuel efficient service truck that costs twice as much as the current models would be impossible to justify, if there are no apparent savings.

CAFÉ standards are another government imposed limitation that I personally do not favor. However, evidence indicates that there are existing technologies that could drastically enhance the fuel efficiency for even the larger vehicles. I would thus agree with a gradual inclusion of increasing the performance standards for heavy-duty equipment.

10) Alternative fuels must play a role in an energy agenda. You mention that large cities and some corporations are taking strides forward in use of hydrogen energy. What sort of incentives would you advocate for small businesses to use alternative energy? Is reduced price and a lack of a volatile market not enough of an incentive?

Affordability, dependability and availability are the three key elements necessary for a small business to participate in any activity. As the owner of a small business, I must have the confidence that when my service technician in his truck, leaves my place of

business, he can complete his scheduled routine without disruption. As mentioned earlier, if the vehicle and fuel source is not affordable, I will not participate, thus, if rebates or incentives are necessary to allow me to afford the product that would be a key component. I would have to see the reduced price to believe it and if the alternative fuels are affordable and available, it will help reduce the dependence and thus the volatility.

With regard to Hydrogen, I have seen a video clip referring to an American inventor who is attempting to develop Hydrogen through a device that converts H2O to HHO. The government and private investors are working with him, and I believe that the Committee should investigate and include his ideas before he is eliminated by unfair competition. I am attaching the video clip as a point of interest.

11) Do you support suspending or reducing the number "boutique fuel mixes" that each state mandates in order to reduce gas prices in the near future?

I think all mandates should be eliminated, not only with regard to fuels, but ALL mandates. If elimination of the "boutique fuel mixes" would lower prices, then they should never have been imposed.

12) Do you support legislation to encourage Coal-to-Liquids to decrease our dependence on foreign energy sources?

Yes. Not only do I think that it would help reduce our dependence on foreign energy, it also offers more opportunity for economic development and growth in the private sector of the economy. Once such endeavors are allowed, it will open up the opportunity for ancillary small business growth in related areas and fields of endeavor.

13) I can understand the frustration about finding fuel sources after so much infrastructure was damaged by Hurricane Katrina. Are the state and local governments doing anything to rectify this situation and rebuild infrastructure assets in your community?

Pardon my frustration, but I will give you as direct an answer, with a modicum of restraint, as I can transmit. Unfortunately, the state, local and federal government is doing what appears to be very little to restore any infrastructure in the New Orleans area. Private industry is working diligently to rebound. Without trying to be mis-leading, we are coping and life goes on. We are living with such a unique and unfathomable situation, that every day is a challenge. The Corps of Engineers is working feverishly to rebuild their under prepared structures that protect us from the environment, but we have no guarantees.

As a business owner, I have doubled and tripled my civic and business related involvement in an effort to help rebuild and resurrect the area, but the average citizen sees only bickering and squabbling between the various levels of government. As a

native New Orleanian, one of the reasons that I welcomed the opportunity to testify before the Select Committee was to have the chance to discuss an issue, other than Katrina. I hope that I have offered some valuable input, and the mere idea that you requested additional information from me, has provided me with a welcome diversion from the tedium of daily problems that surface everyday in the Big Easy.

With regard to fuel sources, those elements are returning at a reasonable rate. In the areas of the city where there is little rebuilding, there are, obviously, no fuel sources returning. It is simple economics: if there are no citizens in an area, there is no need or viable opportunity for product sales, thus, no sources. In those areas where there is rebuilding and a viable customer base, there are available fuel sources.

Respectfully submitted,

Michael A. Mitternight
President
Factory Service Agency Inc.
Member / NSBA

1. Do any of you use ethanol or other alternative fuels in your vehicles? Have any of you bought hybrid vehicles for your business or personal use?

No, I do not yet have a hybrid vehicle for my work. I would like to, but am not able to drive new cars and there really aren't any used hybrids out there yet at a price that I can afford to pay. I do use ethanol, but quite frankly I will fill the car up with whichever is cheapest at the pump.

2. The Farmers' Union supported the Energy Policy Act's 7.5 billion gallon Renewable Fuels Standard, did it not?

NFU did support the establishment of the Renewable Fuels Standard in the 2005 Energy Policy Act. Since its enactment, we have called for an expansion and acceleration of the RFS. Our grassroots policy calls for setting a RFS mandate for production of biofuels that make up one-third of the nation's fuel supply as soon as possible. Additionally, we support setting up separate mandates of production for each form of biofuel, including cellulosic ethanol and biodiesel.

3. Are you personally developing biofuels on your farm? What kind? Do you support tax incentives and low interest loans for farmers who wish to participate in developing renewable fuels?

I am not currently developing biofuels on my farm, but do have an interest in on-farm biofuels, specifically biodiesel.

I do support tax incentives and low interest loan for producers who wish to develop renewable fuels. Farmers Union supports making permanent the renewable energy production tax credit, the biodiesel and ethanol blenders' tax credits and the cellulosic production loan guarantees. It is vital that these incentives be targeted at locally owned projects to ensure the economic benefits and success of renewable energy efforts stay within the community it is occurring.

4. On wind power, what incentives do farmers currently have for participating in wind power projects? What else is needed?

Incentives for farmers to participate in wind power projects are available primarily through the U.S. Department of Agriculture's Rural Development agency. The principle problem for a group of farmers wishing to develop community-owned wind is access to the grid. Currently, two groups of farmers in Kansas are ready to go with community-owned wind farms, but control that utilities have over the grid makes is virtually impossible to proceed with the projects. A national Renewable Portfolio Standard (RPS) standard would help a lot, especially in a state like Kansas, which has the third best wind in the nation, but whose state politics makes wind development a difficult uphill battle. The solution to this challenge from my perspective is a standard national policy that would allow a workable procedure for acquiring grid access for the common man willing to invest in renewable electric generation.

More needs to be done to move forward on development and distribution of electric generation from wind. With today's technology, farmers and ranchers have the ability to supply a substantial portion of the nation's electricity from wind and recognize new income potential.

- Educate farmers and ranchers about their wind rights and other related issues;
- Establish federal legislation to require all utilities to allow community-based wind projects access to the electric grid by actively pursuing power purchase agreements;

- Establish a grant program directed to local rural electric cooperatives associations that commit to upgrading their system to monitor the flow of energy both ways within their system to accept net-metered energy produced locally.
- Extending production tax credits to provide financial incentives for wind energy development, including:
    - Provide long-term credits, 20 years at a minimum;
    - Include active, not just passive income tax credits;
    - Set the production tax credit levels for local community and farmer-owned wind systems at higher levels; and
    - Encourage local ownership of wind turbine manufacturing, development and operations.

Farmers Union also supports a national RPS of 25 percent by 2025 that includes a strong local ownership component. The State of Minnesota has done outstanding work with its Community-Based Energy Development (C-BED) state policy of local, community and farmer-owned wind development. That ownership model provides the most economic and social benefit while providing an economic base for further rural economic development. The C-BED ownership model should be adopted by other states and also used by Congress in developing wind energy-related policies.

In order to help expand the use of smaller wind energy systems, Farmers Union supports net metering for systems up to 100kW and billing small wind generators on an annual basis. Net metering allows bidirectional metering of electricity, measured by one meter, where there is no discrimination between electricity produced and electricity consumed by the small electricity consumer-generator.

Land Owner Rights in Wind Energy Development

NFU supports a comprehensive policy that protects landowners from speculation and unfair contracts in the development of natural resources such as wind development. We support the following landowners' rights:

- Prohibition of non-disclosure, secrecy and mandatory arbitration clauses in leases.
- Establishing a registry of current standard wind leases, that is made accessible to the public.
- Limiting length of lease options to prevent companies from tying up large tracts of land for extended periods, thus encouraging the use of lease options for actual development instead of speculation;
- Authorizing collective bargaining of leases for standard lease terms throughout a region or development project to encourage fairness in the application of lease terms among multiple landowners;
- Including bonding and reclamation protections to encourage responsible energy development and transmission at the outset of a lease by providing funds up front for reclamation of land after turbine, tower or project life has expired;
- Prohibiting prior investment as a condition of lease or option of fulfillment;
- Prohibiting farmland ownership by energy development or generation companies to ensure agricultural land remains in the hands of producers and retains the agricultural value of the land used in energy development;
- Prohibiting rights of first refusal by developers;
- Requiring disclosure of actual lease payments in contracts. This requires that actual lease payments, potential premiums and formula used determine said premiums be established and disclosed as a condition of a final lease agreement during negotiation of a contract;
- Including a three day cooling-off period after a lease agreement is signed to allow a landowner a window to reconsider if, for example, his attorney has an objection to the contract language;

- Prohibiting severability of surface rights and wind to ensure land ownership is not severed from natural resources associated with the surface; and
- Establishing a moratorium on industrial wind siting in federal waters until an open public process is developed for siting industrial wind power generation.

5. Just to give me some perspective - What is the split between fuel that you need for farming, and fuel that you need to deliver goods to market? Have you found any ways to be more efficient in farming to cut down on the amount of fuel you use for that?

On my farm operation, all of my products are sold freight-on-board (FOB) off the farm; therefore the fuel used for delivery of goods to market doesn't actually come out of my fuel tank. However, it does reflect back to me through the price I get for my products. The purchaser and trucker of my commodities has to make their cash flow work, as I mentioned in my oral testimony, and as such we all have to absorb the increased cost of fuel.

Many farmers have adopted no-till farming, which does decrease fuel usage. I myself am a certified organic producer, which makes no-till practice on fall crops is difficult because I rely on mechanical weed control. I have been able to reduce my tillage trips, and therefore fuel expense, with an intensive crop rotation plan that allows me to interseed my nitrogen rotation crop (usually Red Clover), directly into my wheat before it comes out of dormancy in early spring. As an organic producer, I do not use commercial fertilizer, which uses significant amount of natural gas in its production.

6. You mentioned the increased cost for natural gas as well as transportation fuels. Are you concerned that if we restrict coal as a fuel that the demand for natural gas will spike and therefore the price will rise even higher?

No. It is my understanding that at current prices, natural gas does not compete with other forms of energy production.

7. On Page 5 of your testimony, you say "Farmers have no means by which to pass on the higher costs of energy, and it is the opinion of the NFU that Congress should consider approving some type of mechanism to help farmers and ranchers offset the higher costs." What type of mechanism would you suggest?

NFU supports revising the current farm income safety net to one that uses counter-cyclical payments indexed to the cost of production to support family farmers during periods of low commodity prices. When it became apparent that the budget baseline for commodity programs would be less in the 2007 Farm Bill, NFU started looking at other alternative safety net proposals that would cost less, but still provide the same level of support as the current commodity programs. We commissioned an economic study that looked at adding a cost of production component, set at 95 percent of the cost of production, to a purely counter-cyclical safety net. This proposal allows for increased input costs to be reflected in a counter-cyclical payment in the event that prices drop below a certain level. It would guard, for example, against sharp increases in energy prices like we witnessed in 2005 and are seeing again this year.

8. On page 7 of your testimony, you talk about the fertilizer component being relieved by production of renewable fuels – could you explain that a little more?

Because fertilizer primarily consists of oil and natural gas, any relief in the price of oil and natural gas would, by default, relieve increased pressure on fertilizer prices. As my testimony states, fertilizer is the single largest outlay among farm energy expenditures, with a 34 percent share of the $28 billion of total energy expenses. If the supplies of renewable fuels are increased, the demand for oil in both the production of fertilizer and use throughout other areas of a farming operation would be eased.

As I mentioned earlier, the production of commercial fertilizer requires significant amounts of natural gas, which results in most fertilizers being produced abroad and imported into the United States. It is my understanding that the University of Minnesota has perfected the ability to produce anhydrous ammonia from wind energy and that a 70 tower wind farm could produce enough anhydrous to fertilize the upper third of the nations corn belt. Wouldn't that be a wonderful development -- fertilizing our crops from free wind!

Responses to Submitted Questions

Witness Estes

1) Do any of you use ethanol or other alternative fuels in your vehicles? No Have any of you bought hybrid vehicles for your business or personal use? No, we have not purchased any new vehicles

2) I can see why government fixed price contracts pose a challenge because of the inability to estimate contingency costs and you mention other materials that can increase costs too. Do you do bids for non- governmental contracts? (if yes then) Yes Do those contracts allow for contingency costs? No, they are firm fixed price contracts. Should cost plus contracts be used for the government? No. Cost plus contracts are not used for construction contracts as they are too labor intensive for the government to administer, as well as being too expensive monetarily.

3) You state that the uncertainty of gas prices in the future causes you great worry. What sort of business models and changes can you anticipate to incorporate into your government contracts? Negotiate increases in profit because of the greater risk due to costs our company has to absorb. For example, if you note that gas prices have been steadily rising for 3 years, why not include anticipated gas prices in contracts? I have rules and regulations that I have to follow. Example please refer to the FAR. If I was to include excavated pricing in my contracts, I would lose my ability to continue working with the Government. As per their regulations we are not allowed to. Further, have you ever planned for higher gas prices and then had excess profit when the price was reduced? No. For example, in November 2005 you paid $5,141 for fuel, and in November 2006 you paid, $3,635. The reason my fuel prices dropped was because I sold two large pieces of equipment, that I was losing money on. Fuel and insurance prices were too cost intensive for there to be a profit.

EDWARD J. MARKEY, MASSACHUSETTS
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RANKING MEMBER
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GREG WALDEN, OREGON
CANDICE S. MILLER, MICHIGAN
JOHN SULLIVAN, OKLAHOMA
MARSHA BLACKBURN, TENNESSEE

Select Committee on
Energy Independence and Global Warming
U.S. House of Representatives

Dear Dr. Felmy,
Following your appearance in front of the Select Committee on Energy Independence and Global Warming, members of the committee submitted additional questions for your attention. I have attached the document with those questions to this email. Please respond at your earliest convenience, or within 2 weeks. Responses may be submitted in electronic form, at aliya.brodsky@mail.house.gov. Please call with any questions or concerns.

Thank you,
Ali Brodsky

Ali Brodsky
Chief Clerk
Select Committee on Energy Independence and Global Warming
(202)225-4012
Aliya.Brodsky@mail.house.gov

1) **One Page 2 of your testimony, you say that the "we expect to bring equivalent of an additional eight new refineries into operation in the US by 2011. Could you clarify what that means? Do you think this capacity is enough? What are the challenges to accomplishing this?**

At the time of the hearing, public announcements of companies' expansion plans totaled more than 1.6 mmbd. At 200,000 barrel per day capacity, this translates into about 8 refineries (The average sized US refinery is approximately 125,000 barrels per day). Since the hearing, the Energy Information Administration (EIA) has indicated that the expansion plans have been reduced to 1.0 mmbd, which is consistent with historical expansion rates but may not be as high as many were predicting last year. In either case, this new capacity total with the announced plans is less than projected demand by the EIA and will mean continued imports of refined products.

The challenges of building a new refinery capacity are many, as the experience of the Arizona Clean Fuels Yuma project attests. They include cost, local opposition, ability/proximity to the infrastructure needed to bring crude in and ship product out from a refinery, changing market conditions and policies that affect the economics of the project. Increasingly, refinery expansion projects, despite adherence to strict environmental requirements, are running into opposition as well, such as BP's proposal to increase capacity at its Whiting, Indiana, refinery In addition, crude oils are getting heavier, so refiners have to shift their operations to process heavier crude slates, including more Canadian crude and less Gulf of Mexico and overseas light crudes.

Government should avoid policies that would discourage investment in domestic projects or change the economics of projects currently under consideration. The Senate-passed energy bill, H.R. 6, for example, includes an "oil savings" provision that runs counter to calls for increased refinery capacity. Additionally, changes in tax policy could very well alter the economics of significant, long-term industry projects such as refinery expansion, prompting a reconsideration of plans or encouraging investment to take place elsewhere.

2) **Am I correct that API supports drilling on the outer continental shelf and the coastal plain of the Arctic National Wildlife Refuge? Respectively, what is the estimated production capacity of those areas?**

API supports production of oil and gas in an environmentally sound manner wherever it is economically justified. The USGS estimates that the mean amount of oil potentially available in ANWR is 10 Billion barrels. The OCS is estimated to hold almost 75% of U.S. crude oil reserves, almost 86 billion barrels, and just under half of domestic natural gas reserves, with about 420 trillion cubic feet of natural gas.

3) **What do you think of the development of the Canadian tar sands? Does the production potential in Canada provide a resource for us to shift away from being dependent on Middle Eastern oil?**

Production from Canadian oil sands has expanded significantly, and announcements have indicated that will continue. Whether or not we import oil from the Middle East of elsewhere depends on our total demand for oil, access to abundant domestic resources and the cost of relative oil supplies from around the globe. We have in recent years seen increased investment in the infrastructure necessary to process heavier crudes such as Canadian oil sands.

4) **On page 4 of your written statement, you mention that the world spare oil production capacity being at a low level. Can you expand on that? Is there something we should be doing to deal with that issue?**

According to EIA, worldwide spare oil production capacity is about 3 mmbd above total demand of about 86 mmbd. We can encourage increases in productive capacity in the U.S. and abroad and reduced consumption at home. API supports increased conservation across all industry sectors, and industry continues to work on improving energy efficiency in refinery operations. I would urge Congress to reconsider policies that take additional resource-rich areas of our nation "off the table" or otherwise unnecessarily restrict or slow domestic resource development and production. Title VII of the House-passed energy bill, H.R. 3221, includes a number of such provisions.

5) **To what degree has ethanol used as an the primary oxygenate contributed to increase gas prices?**

Earlier in the year, ethanol prices had increased. This raised the cost of producing gasoline. More recently, ethanol prices have decreased such that the current BTU-equivalent price, including the federal subsidy, was less than the futures price of gasoline on the NYMEX.

6) **What kind of work are your member companies doing to prepare for the inclusion of various bio-fuels into the marketplace? Are they just ignoring them as options or are they actively participating in some of the new development in that area?**

API member companies continue to use ethanol as economically justified. In fact, last year our industry used 25 percent more biofuel than the government mandated (almost all of which was ethanol). Far from ignoring ethanol and other alternatives, industry is a key player in research and development of alternatives and advanced end-use technologies, from cellulosic ethanol to renewable diesel to hydrogen fuel cells, while also investing in R&D of frontier hydrocarbons such as oil shale.

7) **Do any of you use ethanol or other alternative fuels in your vehicles? Have any of you bought hybrid vehicles for your business or personal use?**

Just about anyone buying gasoline in the Washington, D.C. metropolitan area gets 10% ethanol with every purchase. I personally looked at a hybrid vehicle last year and determined it was not economically justified given the high price charged for the vehicle. Because of privacy concerns, API does not collect records on employees' personal choice of vehicles.

Arizona Clean Fuels Yuma

May 8, 2007

The Honorable John Shadegg
U.S. House of Representatives
306 Cannon House Office Building
Washington, D.C. 20515

Dear Congressman Shadegg:

I would like to thank you for your ongoing interest in and support for our Arizona refinery project.

We continue to make progress on the development of our project with technical work, market and business development, and financing being our current focus. As you can appreciate, there are many issues to address for this type of project and the attached summarizes some of the more complex parts of a project such as this. Having support from yourself and other key political figures is crucial to our efforts.

As you know, Arizona Clean Fuels Yuma purchased the property for its refinery site from the Wellton-Mohawk Irrigation and Drainage District in late March 2007 following the transfer of this and other land from the Bureau or Reclamation. Shortly thereafter, the Quechan Indians filed suit in federal court to stop all work on our and other property and to stop any further transfers to the District. Their claim is that the EIS/NEPA process that was followed by BOR was deficient.

We believe that evidence is clearly contradictory to this claim – seven years of studies, consultation and developing detailed surveys and analysis resulted in a very complete and comprehensive EIS. However, we, along with BOR and the District, volunteered to a standstill on the property until the court has heard the merits of the case.

Arizona Clean Fuels Yuma is continuing to develop its project for design and construction on this site.

Again thank you for your support for our project.

Yours truly

R. G, McGinnis
Chief Executive Officer

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Arizona Clean Fuels Yuma

Situation Analysis
New United States Oil Refinery
Project Development Considerations and Issues

The objective of this paper is to briefly highlight the key considerations and issues involved in the corporate, government and public decisions that must be made prior to the implementation of a new oil refinery project in the U.S.

The refining industry has successfully gone through a major effort over the past decade to respond to changes in product fuel quality mandated by Clean Fuels requirements. During this time, the industry has met the growing domestic demand for petroleum products by limited capacity expansions of existing refineries, and by imports. No new refineries have been built in the U.S. in over twenty years and product imports have reached over 3.5 million barrels per day. Economic growth in other countries has reduced the availability of products to U.S. consumers and increased competition for imports. Recent petroleum product prices have reached and sustained record highs, driven by a growing shortfall in supply. There are a number of reasons that this shortfall is a major concern for the U.S., most of which have been documented in abundance recently in the press. It is perhaps sufficient to state that shortfalls create economic hardship and slow the economy. It is also a strategic issue for the U.S. to grow imports and increase the threat of shortages and embargos.

One of the major solutions to this growing shortfall is to provide additional domestic refining capacity.

The problems and impediments preventing the growth and investment for new refining capacity in the U.S. are significant. Despite this, a new refinery project, the Arizona Clean Fuels Yuma (ACF) project, has been proposed and will be completing engineering design consistent with the final Air Permit which was re-issued by the Arizona Department of Environmental Quality last fall. This project will be used below to highlight specific costs and permitting requirements.

New Refinery Construction Considerations

There are four general areas of consideration that drive the feasibility and timing of new refining projects:

1. Overall Project economics driven by product values, feedstock costs, and operating costs,
2. Technology choices driven by crude slate, target product mix, legislated and target product quality requirements (and projected changes) – a lengthy process of project development, engineering and construction,
3. Public Acceptance – significant reluctance in most areas of the U.S. to allow a new refinery "in my back yard". Public communication and hearings processes are lengthy and often confrontational,
4. Permitting processes for environmental permits, access permits, construction permits and zoning, etc. – driven by federal, state, and local legislation and zoning.

Refining Economics

Prior to the previous two years, historical refining margins in the U.S. have, on average and in general, not been adequate to support new refinery construction. Returns on Capital Employed have been in the 5% to 7% range. Capacity expansions and modifications have been economic due to leverage on base infrastructure and facility investments.

Refinery sales transactions over the past ten years have, on average, been at about 25% of the cost of new-build facilities. Condition of the plants, local markets, and a company's perspective on future cash flows drive the valuation process. These facilities often require significant additional investment to ensure reliable operation and compliance with regulatory requirements.

Refineries are by their nature very costly facilities. The proposed ACF refinery which will produce about 150,000 barrels per day of gasoline, diesel, and jet fuel products, will cost over $3 billion with an additional $700 million required for crude oil and product pipelines. Rapidly growing demand for petroleum products in the southwestern U.S. makes this project economic.

Technology Choices

The refining industry is not traditionally viewed as "high tech". However, the need for high quality products and significant flexibility to process wide ranges of crude oils, and the need to implement state-of-the-art environmental controls, has led to the development of very sophisticated processes. There are several process licensors and choices for each type of facility that a refiner needs. Also, due to the high cost of each process facility, extensive studies and comparisons are required to match a refiner's products and processing objectives.

One area where the industry has led in major technology developments is in the "Best Available Control Technology" for emissions as defined in and required by the Clean Air Act. Every refinery modification and new process unit has required the development and application of specific control technology.

The development of the Arizona Clean Fuels project included an extensive analysis of emission sources and inclusion of the Best Available Control Technology. This will be the first refinery where all sources will be addressed at the same time in this manner.

Public Acceptance

A major hurdle to the construction of a new oil refinery is to overcome the historic public perceptions of oil refineries and to obtain public acceptance. Generally, the public has a "not in my back yard" attitude to oil refineries. Certainly, refineries of the past have, to some extent, earned this reaction from the public. Modern facilities have overcome the shortcomings of these previous refineries. The refining industry has developed and implemented emissions controls, operating practices, and outreach programs to address the concerns of both government agencies and the public. Certainly these programs and projects have increased costs, but have been viewed by the industry as necessary.

Refineries have significant benefit to the public by generation of both direct and indirect jobs and economic activity. Local communities can benefit significantly from the operation of a refinery.

A new refinery, such as the Arizona Clean Fuels Yuma project, with the control and monitoring required by current regulations will have minimal impact on the surrounding environment. The proposed location in Yuma County, Arizona, is remote from population concentrations. The project has gained support from local politicians and business leaders.

Permitting Processes

Certainly the most-often noted issue in new refinery construction is that of the extensive permitting that is required. Generally, permits are required from multiple agencies at the federal, state and local levels. Also permits are required not only for the refinery but also for pipeline and utility services to and from the site. The permitting processes are lengthy and costly. Project developers are also not in control of the pace and timing of permit review and issue and this uncertainty can lead to project delays and cost escalation.

The most extensive and important permit is often the "Air Permit" that is usually issued by the relevant state agency and outlines all requirements for compliance to the Clean Air Act and New Source Performance Standards with emission levels, reporting and Best Available Control Technology requirements. The extensive scope of this permit requires detailed air modeling, technical review of all facilities, and agreement on the Best Available Control Technology. For example, the initial Arizona Clean Fuels Yuma permit application was submitted to the Arizona Department of Environmental Quality on December 22, 1999, and a Draft Permit issued on October 10, 2003 – a time period of almost four years. In response to the declaration of large portions of Maricopa County as a "Non-Attainment Zone" for federal Ozone standards in the summer of 2003, the proposed refinery was moved to a site in Yuma County. This required modifications to the permit and the final permit was issued in april 2005.

Fortunately, some other federal and state agencies review and comment on the permit and project coincident with the preparation of the Air Permit. For example the EPA, the U.S. Forest Service and the National Park Service were consulted by ADEQ. However, all of these agencies have seen increased demands on their time and reviews don't always meet the expected timeframes thereby extending the permitting schedule. In the western United States, for example, EPA Region IX encompasses the most dramatic growth seen anywhere in the country. However, large projects that would support and provide jobs for that growing population can be held up for years by the air permitting process alone. This Regional EPA office has a limited number of technical staff members who must review and approve the air permits for every project in California, Nevada, Arizona, Hawaii, and Guam. Similarly, the National Park Service, Bureau of Land Management, and U.S. Forest Service must compete for the services of only a few federal staff members who have the technical expertise and responsibility to review all proposed major source air permits for projects across the entire western half of the country. This coupled with the lack of regulated or recommended timing requirements for permit issue leads to significant delays.

Although the Air Permit is one of the most important permits for any project, there are many other rigorous permits that must be obtained for both refinery and pipeline projects from a multitude of agencies. For example:

- NEPA Compliance from a controlling agency such as the Bureau of Land Management
- Land Use Permits from controlling agencies and jurisdictions
- National Historic Preservation Act Compliance
- Access permits from Bureau of Land Management, U.S. Army Corps of Engineers, and State Land Commissions as well as private land owners.
- Military Agency approvals if military facilities involved.

A listing of permits required by the Arizona Clean Fuels Yuma refinery and pipeline projects shows about thirty permits required excluding local zoning, access and construction permits. The majority of these permits are not initiated until the Air Permit is issued, since it finalizes the basis for the project. The timing of these can be extensive and is estimated to be about eighteen to twenty-four months. Although design engineering can be done in parallel to these permitting activities, no significant construction can begin until they are in place. Construction of a large refinery such as ACF proposes takes about three years. This sequential process results in long lead times for project development and completion.

Conclusions

The refining industry in the U.S. has not constructed a new grass roots refinery for over twenty years. Refining economics have generally not supported new refinery costs and the industry has focused on expansions of existing refineries. Major investments in Clean Fuels production and regulatory programs have also absorbed

much of the industry capital. The total capital cost of an economically-sized facility of about 150,000 barrels per day is now over $3 billion.

The complexity of the refining processes and technology choices results in lengthy project development time: which can be one to two years. Following this project definition, corporate strategic decisions, public reviews local government discussions, and multi-level permitting process typically take four to five years before a fin: "go-decision" can be made. Engineering and construction on a significant project is a major undertaking and takes three to four years. Total project time from inception to startup is in the order of ten years.

The massive investments required for development of a new refinery project coupled with uncertainty on timi and final approval of permits, issues of public acceptance and market uncertainty in the future, have deterred refining industry from new projects.

Some efficiencies may be possible in the overall development timing. Internal corporate engineering and construction efficiencies may reduce overall project timing. Reducing the number of agencies involved in ma project permitting through the "lead agency" approach and ensuring internal accountability for permit issue timing could reduce time and workload on all agencies involved.

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National School Transportation Association
113 South West Street, 4th Floor
Alexandria, VA 22314
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May 3, 2006

The Honorable Dennis Hastert
Speaker
House of Representatives
Washington, DC 20510

The Honorable Nancy Pelosi
Minority Leader
House of Representatives
Washington, DC 20510

Dear Mr. Speaker and Minority Leader Pelosi:

On behalf of school transportation interests around the country (both public and private), I am writing to urge quick action on H.R. 5254, to increase the availability of reasonably priced fuel by streamlining the permitting process for new or expanded refineries and H.R. 5253, to ensure that the Federal government has the authority necessary to investigate price gouging by fuel suppliers. Our industry is struggling with staggeringly high fuel costs that are threatening our ability to provide low-cost, safe transportation for 25 million school children each day. Enactment of these two measures can help drive down the cost of fuel in the long-run and we support their approval by the House.

The nation's school bus fleet is the largest mass transportation fleet in the country, 2.5 times the size of all other forms of mass transportation including transit, intercity buses, commercial airlines and rail, combined. This system is also the safest way to transport children to and from school every day. The National Academy of Sciences has reported that there are approximately 800 fatalities per year among children who do not ride school buses, while the school bus related annual fatality rate is less than 20. Keeping our school buses running is vital to the safety of our children.

In the wake of instability in crude oil supplies, Hurricane Katrina and other factors, rising fuel costs have devastated the industry and now threaten to force the involuntary reduction of school bus transportation nationwide. In addition, today's diesel fuel prices are significantly higher than they were one year ago and are more than twice what they were four years ago. This is proving to be a burden to public and private operators alike.

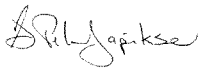
Public school systems and their school transportation providers are not able to pass on the costs to the students they drive to and from school every day. Instead, many school districts have responded to this crisis by eliminating field trips and worse, reducing transportation to and from school, forcing students to find less safe and reliable ways to access their education or even temporarily closing schools. For example, in Ohio school districts have eliminated school bus

service to 80,000 school children a day and, just last week a local school system in Tennessee closed for two days due to the inability to provide school transportation due to the high cost of fuel for their buses.

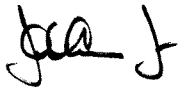
We understand that there are no easy solutions to this problem, but are writing to ask for your help nonetheless. We ask that Congress act quickly to help increase supplies of fuel by ensuring that adequate refining capacity is available as quickly as possible and that any allegations of price gouging are fully investigated. We understand that the House is preparing to act on H.R. 5254 and H.R. 5253 later today. We welcome and support these initiatives and ask for broad, bipartisan action to enact these important measures as a way to help bring down prices for fuel as quickly as possible so that school children will continue to be able to have access to the safest possible mode of transportation. We also pledge to work with you to find and advance other solutions that might provide more immediate relief, such as H.R. 4158, legislation introduced earlier this year to provide grants to cover the cost of energy for financially strapped school districts.

Sincerely,

Leonard Bernstein, President
NAPT



Pete Japikse, President
NASDPTS



John D. Corr, Jr., President
NSTA