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THE IMPACT OF RISING GAS PRICES ON AMERICA'S SMALL BUSINESSES

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

JUNE 14, 2007

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ONE HUNDRED TENTH CONGRESS

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THE IMPACT OF RISING GAS PRICES ON SMALL BUSINESS

THURSDAY, JUNE 14, 2007

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP,
Washington, DC.

The Committee met, pursuant to notice, at 9:41 a.m., in room SR–428A, Russell Senate Office Building, the Honorable John F. Kerry (Chairman of the Committee) presiding.

Present. Senators Kerry, Cantwell, Cardin, Tester, Snowe, Coleman, Thune, and Corker.

OPENING STATEMENT OF THE HONORABLE JOHN F. KERRY, CHAIRMAN, COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP, AND A UNITED STATES SENATOR FROM MASSACHUSETTS

Chairman KERRY. Good morning. This hearing will come to order, and I apologize to all our witnesses and my colleagues for being a little late, but traffic today was more incomprehensible than it normally is. I see some heads nodding. So we were a bit delayed and I do apologize to everybody.

Thank you very, very much to this panel particularly for taking time to come in here and discuss the important impact of rising gas prices on America's small businesses. Obviously, this is an important topic not just for our businesses, but with respect to American security and energy policy as a whole.

I am grateful to all the members of this panel for coming in. I particularly want to thank Fred Smith and I look forward to his testimony. Federal Express got its start as a small business back in 1971 and its success was built in large part by servicing America's small businesses and facilitating the ability of a small business to be able to grow and do what it does. Because he has contact with so many small businesses in so many parts of the country and the world, I think he is particularly qualified to share with us his view on how fuel prices are impacting those businesses and his company.

In addition, he represents an important shift that is taking place in the country with respect to energy policy, and that is the recognition among key business leaders, big business leaders, that our Nation's energy policy is directly linked to our overall economy, to our security, as well as to a host of environmental issues. And without a strong energy policy that invests in efficiency and renew-

able energy sources, America is digging itself deeper and deeper into a hole.

Last month, Americans emptied their wallets at the pump, paying record prices that reached, according to the Department of Energy Information Administration, $3.22 a gallon. This price represented a 28 percent increase over a period of just 2 months and a 52 percent increase since the end of January. That is a big increase for small business folks who use vehicles in their business on an everyday basis to swallow, and those rising prices underscore the increased attention that small business owners are now paying to this issue.

According to a survey conducted by the National Small Business Administration, 62 percent of small businesses in our country use vehicles for delivery or customer transportation, and a majority of those who use vehicles travel more than 50 miles a day.

So we will hear from Administrator Caruso today that we are not simply dealing with a temporary spike in prices. The Energy Information Administration projects that gas prices will remain above $3 at least through the summer months. Meanwhile, small businesses like the ones we will hear from today, businesses that operate close to the margin and that rely on vehicles every day to maintain their competitiveness are struggling to keep up.

These are the same businesses that are coping with double-digit increases in the cost of providing their employees health care, the same burgeoning entrepreneurs that we count on to create nearly three-quarters of the jobs of our country. These businesses can no longer be expected to shoulder the burden that is created by this rapid increase in oil prices coupled with serious questions about refinery rates and about input rates to those refineries, as well as output rates.

The good news is that right now, even as we sit here, the Senate is debating legislation that can put this country on a clear path toward energy independence. In a single month, we could rewrite the story of procrastination, manipulation and to some degree failed leadership, that has defined energy policy for 30 years. On a bipartisan basis in the Senate, Senators are working to develop a comprehensive energy policy that will make the country safer and stabilize and lower fuel costs for small businesses and all Americans.

I think it is clear that to do that effectively, the final legislation has to particularly embrace three components. One, a major increase in the efficiency of all sources and uses of energy, from pickup trucks to fluorescent light bulbs.

Two, dramatic incentives for all renewable energy sources, including a requirement that at least 20 percent of our energy come from renewable sources like wind and solar by 2020. That sounds like a lot, but let me tell you, 24 States have already adopted a standard. Minnesota recently set a 25 percent standard and California is already near reaching that level. If the sixth-largest economy in the world can do that on its own, surely we have the ability to set a standard nationally that we can meet across the board.

And finally, we need a comprehensive plan to get clean coal technologies and carbon sequestration off the drawing board and under construction. Improving fuel economy is also a cornerstone of this strategy.

I will just end quickly by saying I will put the rest of my comments in the record.

But after America's second oil crisis in 1980, and many of us remember President Carter's response to that and the initial unbelievable gains we made when we made a commitment to renewables and alternatives, opened the laboratory in Colorado and committed incentives to that sector, we became the world's leader in alternatives and renewables. But when ideology trumped common sense and we pulled the guts out of those incentives, Germany and Japan took over as the world's leaders. When the Eastern Bloc countries came into the marketplace in the 1990s and they realized they needed to clean up the devastation that communism had left them with, they turned to Germany and Japan for those technologies. It is estimated that we have lost upwards of 200,000 jobs or more because of our myopia with respect to those incentives.

The same is true today with oil imports that have increased from 37 percent back then to 56 percent today, and our passenger fleet averages only 25 miles per gallon, which is exactly the same that it did in 1981. That is happening, despite the fact that small businesses are contributing to the technology that could change this.

There is a Massachusetts company in Watertown called A123 which will retrofit a current hybrid with a lithium battery that gets 40 miles to its one-time use. The average commute of Americans is less than 40 miles a day. So if more cars were retrofitted with this, most Americans could actually drive to and from work without ever touching a drop of gasoline. The dramatic impact would be that, per vehicle, you could go to 150 miles per gallon in a matter of months.

All of this is achievable, but it is going to take some leadership and that is what we are here today to talk about. So I welcome the panel. We look forward to your testimony.

[The prepared statement of Chairman Kerry follows:]

PREPARED STATEMENT OF HON. JOHN F. KERRY, CHAIRMAN

Good morning. I want to thank our esteemed panel of witnesses for coming together today to discuss the impact of rising gas prices on America's small businesses, a crucial topic not only for America's small businesses, but for this nation's continued security and economic sustainability.

I am glad that Mr. Smith is able to join us today, and I'm looking forward to his testimony. Mr. Smith's company Federal Express got its start as a small business back in 1971, and its success was built in large part by servicing America's small businesses, so he is in a unique position to speak on how fuel prices are impacting both his company and his small business customers.

Mr. Smith also represents an important shift that is occurring in this country—the recognition among key business leaders that that our nation's energy policy is linked directly to our economy, our security and our environment. Without a strong energy policy that invests in efficiency and renewable energy sources, America is digging itself deeper into a hole.

Last month, Americans emptied their wallets at the pump, paying record prices that reached $3.22 a gallon according to the Department of Energy's Energy Information Administration. This price represented a 28 percent increase over a period of just 2 months, and a 52 percent increase since the end of January.

Rising prices underscore the increased attention that small business owners are paying to this issue. According to a survey conducted by the National Small Business Association (NSBA), 62 percent of small businesses use vehicles for delivery or customer transportation, and a majority of those who use vehicles travel more than 50 miles a day.

We'll hear from Administrator Caruso today that we're not simply dealing with a temporary spike in prices. The Energy Information Administration projects that

gas prices will remain above $3.00 at least through the summer months. Meanwhile, small businesses like the ones we'll hear from today—businesses that operate close to the margin and that rely on vehicles every day to remain competitive—are struggling to keep up.

These are the same businesses coping with double digit increases in the cost of providing their employees health care—the same burgeoning entrepreneurs that we count on to create nearly ¾ of the jobs in this country. These businesses can no longer be expected to shoulder a burden created by price gouging oil companies and a government that has been reluctant to shift its priorities from serving the same old special interests.

The good news is that right now, the Senate is debating legislation that would put the country on a clear path toward energy independence. In a single month, we could rewrite the shameful story of procrastination, manipulation and—most of all—failed leadership that has defined our energy policy for thirty years.

On a bipartison basis in the Senate, Senators are working to develop a comprehensive energy policy that will make America safer and will stabilize and lower fuel costs for small businesses and all Americans. But in order to effectively address energy security, the final legislation must include three components: (1) a major increase in the efficiency of all sources and uses of energy, from pickup trucks to fluorescent light bulbs; (2) dramatic incentives for all renewable energy sources, including the requirement that at least 20 percent of our energy come from renewable sources like wind and solar by 2020; and (3) a comprehensive plan to get clean coal technologies and carbon sequestration off the drawing board and under construction.

Improving fuel economy is the cornerstone of the strategy to reduce our reliance on imported oil and to stabilize the volatile market for gasoline. Since America's second oil crisis in 1980, our oil imports have increased from 37 percent to 56 percent, but our passenger fleet averages 25 miles per gallon (mpg), the same as in 1981.

Thankfully, small businesses are helping to contribute to a solution. Today there's a company in Massachusetts that has developed the technology for a plug-in hybrid car that gets 150 miles per gallon. The average American's commute is 40 miles—and this car can travel that far on batteries alone. Just think of the fuel savings if the average commute didn't require any fuel.

Senator McCain and I first proposed a 35 mpg increase to fuel standards in 2002, and I've supported efforts to move in this direction for my entire Senate career. The Commerce Committee has reported a bill that would achieve 35 mpg by 2020. We must work to guarantee those improvements and fend off any efforts to weaken the Commerce bill on the floor.

Second, we need to establish a mandate for renewable energy production. Over the last 5 years, 24 states and the District of Columbia have implemented local requirements that a certain percent of their energy comes from renewable sources by the year 2020. And yet Republicans continue to stand in the way of a Federal Renewable Portfolio Standard. States are screaming for leadership on this issue, and I will once again fight for an aggressive renewable portfolio standard in this bill.

Finally, this energy bill doesn't adequately address our number one source of energy: coal. Coal is available, abundant and cheap, that's true—but it's also a huge source of US greenhouse gas emissions—1.5 billion tons of carbon dioxide each year. Any energy bill worth the paper it's printed on should make dramatic investments in developing technologies for clean coal.

These are the first steps Congress must take to address the long term security and stability of this country's fuel supply. But there are other steps we can take in the short term to make sure our small businesses are protected against dramatic interruptions in fuel.

Today, I'm introducing legislation that creates an emergency fuel assistance program for small businesses in the event of a severe fuel interruption. Under this program, small businesses and farms that rely on fuel as a key operating cost would be eligible to receive grants to help them stay afloat during periods of extraordinarily high gas prices. This program could go a long way toward helping businesses operating close to the margin deal with costs that are beyond their control.

I'm also reintroducing legislation to provide low interest SBA loans to small business owners dependent on fuel. This legislation has passed the Senate in two previous Congresses and would provide the capital that small business owners need to cope with extraordinarily high increases in fuel prices.

For too long, we've asked Americans to put up with an energy supply that is unstable and flat out dangerous. The path to energy security—a path that's being cut in the Senate as we speak—will lead to stability and lower prices at the pump. I look forward to hearing your testimonies today, and to working together to secure this nation's energy future.

Chairman KERRY. Let me turn to my colleagues first. Senator Corker.

OPENING STATEMENT OF THE HONORABLE BOB CORKER, A UNITED STATES SENATOR FROM TENNESSEE

Senator CORKER. Mr. Chairman, thank you for convening the meeting. I might have a few editorial comments regarding your opening statement, but I will reserve that for the floor. I would rather——

Chairman KERRY. You mean you don't agree with me 100 percent?

[Laughter.]

Senator CORKER. But I do want to welcome this distinguished panel and thank you all for coming. We all apologize for starting late. You all are very distinguished and we want to hear from you.

I do want to make some comments about Fred Smith. He is an icon in the State of Tennessee, wrote a paper in graduate school that received an "F" and proceeded to build a global enterprise off that failed paper. He is a civic leader. He is a great American, was a veteran between 1966 and 1970. He is someone that the State of Tennessee looks to for tremendous leadership, and Mr. Chairman, I am glad you have called upon him to help lead us here at the Nation's capital.

So I welcome him and all of the other panelists, some of which I know personally, and thank you for your testimony.

Chairman KERRY. Thank you very much, Senator. I think, if I can correct one piece of mythology here, because Mr. Smith was my classmate and collegemate and I am not too sure that I didn't see that paper back then when he wrote it, but I know he didn't fail on it.

[Laughter.]

Chairman KERRY. Am I correct?

Mr. SMITH. Senator, the record would show, I think, that it was a "C" grade, which, as you know, I was very gratified to receive.

[Laughter.]

Chairman KERRY. Well, we have seen what people with "C" grades accomplish.

Senator Tester.

OPENING STATEMENT OF THE HONORABLE JON TESTER, A UNITED STATES SENATOR FROM MONTANA

Senator TESTER. Well, thank you, Mr. Chairman. I, too, want to commend you on holding this hearing. I also want to commend you on your energy vision for this country. I think it is on the right track.

As many of you know and some of you may not, I happen to be a farmer in production agriculture. We use a lot of energy. It is part of the business. So when fuel prices go up approaching $3 a gallon for untaxed fuel for my tractor, it cuts a pretty big hole in my profit margin.

I look forward to hearing from Guy Caruso on the energy outlook. I certainly sympathize with Mr. Lynch's situation that he is in in the trucking business. I can't imagine what the increase in gas prices has done to your bottom line, as well as Janet Myhre

in the office supply business. Mr. Smith, you have already been talked about. With Federal Express, it speaks for itself. And to a guy who knows the way to get to my heart, and that is through my mouth in the pizza business, the food delivery business, I can imagine your challenges, each and every one of you. Making sure your business remains profitable in this time when energy prices have gone up like they have is truly a challenge, as it is for me.

I can also tell you that if we continue to do business from an energy standpoint, as we have done over the past 20 years, my future doesn't look very bright. So we need to make some changes. We need to make some administrative changes at the Federal level if we are going to empower small business to be all they can be and to grow and flourish.

I certainly look forward to each and every one of you folks' perspective as to how you deal with the current energy situation and, by the way, I look forward to any ideas, any silver bullets you may be able to pull out of your holster that could help us make our energy future bright.

Thank you, Mr. Chairman.

Chairman KERRY. Senator Tester, thank you. Thanks for your comments. I think everybody on the Committee is thrilled with your participation on this Committee because you bring very practical and real-time experience to the Committee. It is enormously helpful to all of us.

Guy Caruso is the Administrator of the Energy Information Administration, nominated in February of 2002. He runs the statistical agency within the U.S. Department of Energy which provides policy independent data, forecasts, and analyses regarding energy. We welcome his testimony.

Fred Smith, I have already mentioned, the CEO of FedEx, a $32 billion global transportation and logistics company that, I think, if memory serves me correctly, had the benefit in its early days of a Federal guaranteed loan through SBA. Am I——

Mr. SMITH. SBA guaranteed small business investment companies' investment——

Chairman KERRY. Right, SBIC.

Mr. SMITH. Very important.

Chairman KERRY. He has obviously served on the boards of a number of large public companies. He is Chair of the Business Roundtable's Security Task Force and a member of the Business Council and the CATO Institute.

Sal Lupoli, from my State, president and co-founder of Sal's Pizza from Lawrence, Massachusetts. I have been to his place. He has hosted a small business consortium that we put together there. At the age of 22, after graduating from Northeastern with a degree in business management, he founded Sal's Pizza with his brother, Nick. Their first year annual sales were $200,000. Today, his pizza company produces over 12,000 pizzas a week for schools throughout New England and provides product to several supermarket chains, convenience store distributors and various concession groups.

Tim Lynch, senior vice president of the American Trucking Associations. He is charged with developing and executing strategic plans to ensure that ATA and its member motor carriers achieve

the necessary public policy goals to keep the U.S. trucking industry safe, efficient and profitable.

And Janet Myhre, director, Government Services Group, Chuckals Office Products. She joined Chuckals Office Products in 1999 as the administration operations director and holds a B.S. in business administration from Park University.

So we are really delighted with the expertise the panel brings. Mr. Caruso, why don't you lead off.

STATEMENT OF GUY F. CARUSO, ADMINISTRATOR, ENERGY INFORMATION ADMINISTRATION, U.S. DEPARTMENT OF ENERGY, WASHINGTON, DC

Mr. CARUSO. Chairman Kerry and Members of the Committee, thank you very much for this opportunity. The Energy Information Administration, as the Chairman mentioned, is an independent statistical and analytical agency and because we have an element of statutory independence, with respect to our activities, our views are strictly those of EIA and should not be construed as representing those of the Department of Energy or the Administration. Today, I will focus on our latest short-term outlook, which we released on Tuesday, looking at crude oil and gasoline markets and discuss, some of the factors that have led to these high prices and particularly, as the Chairman noted, the continued uncertainty that we face in both the short and the longer term.

Global oil markets have tightened for crude oil and light petroleum products, especially gasoline. Commercial oil inventories have dropped sharply since the end of September, reflecting strong oil demand, production cuts by the Organization of Petroleum Exporting Countries (OPEC), and only modest increases in non-OPEC production. Plus, increasing global demand for light products has put pressure on refinery capacity worldwide. We project crude oil prices will average in the mid-$60 per barrel this summer.

Against this background of already tight world markets, global geopolitical uncertainties continue to threaten global oil supplies and transport. Geopolitical uncertainty in a number of countries in the Middle East and Africa will continue to keep markets on edge. For example, Nigeria's problems have aggravated the gasoline situation both internally and globally because that country produces light and sweet crude which is used by the world's refineries to maximize production of gasoline.

Turning to gasoline markets, we expect gasoline markets will remain fairly tight, although we anticipate some improvement over the next several months. U.S. regular grade gasoline prices are projected to average $3.05 per gallon over the summer, and gasoline inventories, which typically build slightly in April, sharply declined instead because of refinery outages, both planned and unplanned, and low imports.

Gasoline supply has been affected more than usual by refinery outages this spring. U.S. refineries typically have higher outages during the first quarter, which reduces production of gasoline and other products. But this year, outages extended into May and even into June, which along with lower imports and seasonally rising gasoline demand, all contributed to the steep inventory decline and the upward price pressure that the Chairman mentioned in his

opening remarks. Refinery throughputs remain lower than typical for this time of the year, although we expect them to increase over the next several months. We do think that markets should be adequately supplied, assuming that there are no disruptions either naturally-caused or manmade.

Gasoline imports are critical to meeting U.S. summer consumption needs, particularly in the Northeastern part of the United States, and they have been lagging last year's level through this spring. Lower gasoline inventories in Europe resulted in limited volumes available for export to the United States early this year. Recently, total U.S. gasoline imports have returned to more normal levels and we do think that these normal levels, or even above normal, will be needed to avoid persistent upward pressure on gasoline prices.

In conclusion, Mr. Chairman, the combination of tight crude oil and refined product markets, along with ongoing geopolitical concerns, leaves crude oil and gasoline markets poised for continued volatility this summer. If gasoline production increases during the rest of June and import volumes increase, gasoline markets should ease somewhat, causing prices to recede from their current levels. With the hurricane season already beginning, continued tight refinery conditions, low gasoline inventories, and increased demand for summer travel, upward pressure on gasoline prices does remain a concern.

In sum, Mr. Chairman, Members of the Committee, most of the risks in the near term point to upward pressure on prices. And for the medium to longer term, the fundamental problem, as noted in the opening remarks, is the lack of infrastructure investment that we have faced in this country for the last 20 years. We need to increase investment in the infrastructure not only of refineries, but of the distribution system, as well as on the demand side, improving efficiency as noted by the Chairman.

Mr. Chairman, that concludes my remarks. I will be happy to answer questions at the appropriate time.

[The prepared statement of Mr. Caruso follows:]

STATEMENT OF GUY CARUSO
ADMINISTRATOR
ENERGY INFORMATION ADMINISTRATION
BEFORE THE
COMMITTEE ON SMALL BUSINESS AND ENTREPENEURSHIP
UNITED STATES SENATE
JUNE 14, 2007

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to appear before you today. The Energy Information Administration (EIA) is the independent statistical and analytical agency within the Department of Energy. We are charged with providing objective, timely, and relevant data, analyses, and projections for the Congress, the Administration, and the public. While we do not take positions on policy issues, our work can assist energy policymakers in their deliberations. Because we have an element of statutory independence with respect to our activities, our views are strictly those of EIA and should not be construed as representing those of the Department of Energy or the Administration. Today, I will focus on EIA's recent short-term projections for petroleum and gasoline prices and discuss the factors contributing to high prices and continued uncertainty in these markets.

Global oil markets have tightened sharply since the beginning of the year, both for crude oil and light petroleum products, especially gasoline. Commercial oil inventories have dropped considerably since the end of September 2006, reflecting strong oil demand, production cuts by Organization of Petroleum Exporting Countries (OPEC) members, and only modest increases in non-OPEC production. Increasing global demand for light products has put significant pressure on refining capacity in the United States and elsewhere. Given these conditions of increasing demand without commensurate increases in supply, prices have been increasing and will remain highly sensitive to actual or anticipated risks, such as geopolitical events, whose probabilities are often very difficult to quantify.

EIA released its latest *Short-Term Energy Outlook* on June 12 and we project average West Texas Intermediate (WTI) crude oil prices of about $66 per barrel this summer compared with over $70 per barrel last summer. We are also projecting that WTI prices will average about $64 per barrel in 2007 and almost $65 per barrel in 2008. In recent months, however, movements in benchmark WTI prices have not provided an accurate gauge of overall oil market developments. An alternative price—Brent crude oil—increased from $50 per barrel in mid-January to over $70 per barrel early this month.

Retail, regular grade, gasoline prices have increased from $2.17 per gallon at the end of January to a peak of $3.22 per gallon on May 21, before falling to $3.08 per gallon as of June 11. Retail regular grade gasoline prices are expected to average $3.05 per gallon this summer, a 21 cent-per gallon increase over last summer's average price, with peak monthly average prices of $3.15 in May and $3.11 projected for August. However, prices vary significantly by region: for example, EIA's data for June 11 show an average price of $2.96

per gallon in the Gulf Coast region and $3.27 in the West Coast region. California, in particular, has customarily experienced the highest prices in the United States due to several factors, including stricter environmental standards--which result in a more expensive form of gasoline--and the relative isolation of West Coast markets from other supply sources. On the other hand, States in the Gulf Coast region are reporting among the lowest prices in the country due to their proximity to oil fields and refineries.

Recent gasoline price developments reflect both changes in oil markets and factors specific to gasoline markets, as outlined in the following two sections of my testimony.

Oil Markets

World oil markets are projected to remain tight, sustaining high crude prices this summer as well as for the next several years due to continued growth in oil demand, little growth in non-OPEC supply, and continued production restraint by OPEC members. OPEC's production cuts, in combination with a growing demand for oil that is exceeding the growth in non-OPEC supplies, have reduced Organization for Economic Cooperation and Development (OECD) commercial oil inventories from their historically high levels to levels in the middle of the normal range. EIA estimates that OECD inventories declined by 0.8 million barrels per day in the first quarter of 2007 (compared with an average inventory draw over the past 5 years of 0.3 million barrels per day for that quarter). Days of supply (the number of days that inventory can cover projected consumption) is expected to decrease to the low end of the normal range by the end of 2007 **(Figure 1).**

Despite the recent increases in world oil prices, global oil consumption is projected to grow by 1.4 million barrels per day in 2007 and by 1.6 million barrels per day in 2008. About one-half of the projected growth is in China and the United States. Preliminary first-quarter 2007 data indicate that U.S. consumption rose by 400,000 barrels per day, of which 130,000 barrels per day was gasoline, and Chinese consumption also rose by about 400,000 barrels per day, relative to first-quarter 2006 levels. Colder weather relative to last year and robust personal disposable income growth were both major contributors to higher U.S. demand. Double-digit economic growth continues to drive Chinese oil demand growth.
Non-OPEC production increases are projected at roughly half of the global consumption growth, with production (excluding Angola) rising by roughly 0.6 million barrels per day in 2007 and 0.9 million barrels per day in 2008. Output growth from non-OPEC countries reflects strong gains from new projects in the Caspian Sea, Sakhalin Island in far-eastern Russia, Africa, Brazil, and the United States (**Figure 2**). However, declining production from mature basins in the North Sea, the Middle East, Mexico, and Russia will offset the growth potential from these new projects. If these projections for demand and non-OPEC production materialize, demand for OPEC oil will rise accordingly.

From the third quarter of 2006 to the first quarter of 2007, OPEC members cut crude oil production by 1.1 million barrels per day to reduce the buildup in global oil stocks. In the coming months, OPEC members will need to consider accommodating rising demand for their oil, especially the demand for seasonal stock building, to maintain inventories in the middle of the 5-year average range. Our estimates for OPEC crude oil production (including Angola) suggest an increase of 1.5 million barrels per day by the fourth quarter of 2007 (compared with first-quarter 2007 levels) would be required to hold inventories to such levels. The largest increase could occur in Saudi Arabia, which is expected to increase total

production by almost 250,000 barrels per day. If the majority of the current shut-in capacity in Nigeria of up to 800,000 barrels per day is brought back online, Nigeria could be producing as much as 2.7 million barrels per day by December 2007. However, ongoing unrest in the Niger delta will continue to hinder the return of that production capacity.

Even though new crude oil production capacity increases are projected during the next two years in OPEC countries (particularly in the Persian Gulf), continued strong global demand growth and the need for a seasonal inventory build will limit OPEC's spare capacity growth. On balance, EIA expects OPEC spare capacity to average 2.6 million barrels per day in 2007 and 2.8 million barrels per day in 2008, compared with an average spare capacity of 1.3 million barrels per day in 2006. However, recent increases in spare capacity levels due to reduced production have come at the expense of reduced forward supply cover.

Against the background of already tight world markets, global geopolitical uncertainties can create real or perceived threats to global oil supplies and transport. Events can also create spillover effects on neighboring countries. Geopolitical uncertainty in a number of different countries in the Middle East and Western Africa has kept and will continue to keep the market on edge. For example, Nigeria's problems have aggravated the gasoline price situation because the country produces largely light and sweet crude oil, which is used by the world's refineries to produce products such as gasoline.

The lack of timely demand data, especially in emerging markets in the Middle East, Africa, and Asia, may also lead OPEC and other major oil producers to misread prevalent market conditions. OPEC members have not yet raised production levels to meet higher demand for their crude oil this summer, including normal stock building. These factors create imbalances in the market, increase market volatility, and cause upward pressure on energy prices.

U.S. Gasoline Markets

The recent rise in crude oil prices, coupled with tight gasoline markets as evidenced by inventories rapidly falling to very low levels (**Figure 3**), pushed average U.S. regular grade motor gasoline prices from an average of $2.24 per gallon in January to an average of $3.15 per gallon in May. EIA expects gasoline prices to ease somewhat in June and July before rising towards their May level by the end of the summer. With refinery production improving and imports arriving at high volumes over the last few weeks, gasoline markets have eased somewhat in recent weeks. However, with the hurricane season approaching, continued tight refinery conditions—both in the United States and elsewhere—low gasoline inventories, and increased demand for summer travel, upward pressure on gasoline prices will remain in force. As a result, the average price of gasoline for the summer driving season (April through September) is projected to be $3.05 per gallon, up 21 cents per gallon from last summer's average.

According to preliminary data, gasoline inventories, which typically build slightly in April, sharply declined that month, in part due to the high incidence of refinery outages and low imports. During May, an improvement in refinery production and high import volumes resulted in inventory building at a somewhat greater-than-normal pace. Nevertheless, stocks remain well below the average range at the end of May at 201.5 million barrels, nearly 13 million barrels less than last May and 7 million barrels less than the lower end of the typical

range for this time of year. Gasoline inventories are expected to remain tight throughout the summer, which will keep pressure on gasoline prices and likely result in higher margins and retail prices than those seen last summer.

Gasoline supply has been affected more than usual by refinery outages this spring. U.S. refineries typically have high outages during the first quarter, reducing production of gasoline and other products. This year, outages have extended into June and, along with low imports and seasonally rising gasoline demand, contributed to the sharp inventory decline and price pressure in April. While accurate statistics on refinery outages are scarce, preliminary refinery inputs in April were about 300 thousand barrels per day lower, and in May over 400 thousand barrels per day lower, than the average level for the period 2003 through 2005. (Data for 2006 reflect unusually large outages resulting from the 2005 hurricanes.) During April and May, EIA estimates that domestic refinery outages may have reduced gasoline production by 150 to 200 thousand barrels per day over average outages for that period. Refinery throughputs have just begun to show the seasonal increase typical at this time and are expected to increase over the next several months, which should ease pressure on gasoline prices. Should large refinery shutdowns or curtailments occur this summer, however, gasoline prices could increase beyond our current forecast, especially given that U.S. inventories (the immediate source of incremental supplies) are already low.

Gasoline imports, critical to meeting U.S. consumption needs, were significantly below last year's level over the first four months of this year. Gasoline imports are an important source of supply to the United States in the months leading up to the peak summer season, when they contribute to a seasonal build in inventories before demand peaks, as well as during the summer months. However, in the 10-week period ending April 6, total gasoline imports averaged 920,000 barrels per day, down 220,000 barrels per day compared to the same period last year. Even over the 8-week period since April 6, imports averaged 53,000 barrels per day less than year-ago levels.

Extensive refinery maintenance and low gasoline inventories in Europe have resulted in limited volumes available for export to the United States. At the same time, refinery problems in Venezuela have reduced its gasoline exports to the United States by 40 percent, from an average of 75 thousand barrels per day in January through September 2006 to 44 thousand barrels per day in October 2006 through March 2007. In addition, disruptions to refinery activity in Nigeria have caused that country to seek additional gasoline supplies in the world market, thus adding to the global competition for scarce gasoline supplies. However, total U.S. gasoline imports recently began to increase significantly, reaching more than 1.6 million barrels per day for the week ending May 25 and over 1.5 million barrels per day for the week ending June 1. Imports at or above roughly 1.2 million barrels per day are likely to be needed to avoid persistent pressure on gasoline prices.

Prices not only respond to uncertainties in crude supplies, refining, and import availability, but also to weather, particularly the threat of hurricanes, which presents a major uncertainty in petroleum (and natural gas) market forecasts. Shut-in production from hurricane activity is difficult to predict because the severity of tropical weather and the associated impacts on production have fluctuated widely from year to year. For example, no production was shut-in during 2006 as a result of tropical weather disturbances, in contrast to the devastation caused by Hurricanes Katrina and Rita in 2005. For the 30 years prior to 2005, hurricanes caused a seasonal average of about 4.5 million barrels of cumulative shut-in crude oil

production, which is well below the estimated 165 million barrels that was shut in after Hurricanes Katrina and Rita. The National Oceanic and Atmospheric Administration (NOAA) has forecast an active hurricane season this year, with 13 to 17 named storms forming in the Atlantic Basin, including 7 to 10 hurricanes. Based on the NOAA forecast, our projections include hurricane-induced production outages of 13 million barrels of crude oil, primarily occurring in August and September. However, should hurricane damage to petroleum infrastructure (upstream and/or downstream) exceed our base case assumption, crude oil and gasoline prices would be expected to increase substantially.

Conclusion

The combination of tight crude oil and refining markets, along with ongoing geopolitical concerns, leave crude oil and gasoline markets poised for continued volatility this summer. However, with refinery production expected to improve over the balance of the summer period and import volumes remaining at the high levels seen over the last few weeks, gasoline markets may continue to ease somewhat, resulting in further retail price declines. Nevertheless, with the hurricane season just beginning, continued tight refinery conditions—both in the United States and elsewhere—relatively low gasoline inventories, and increased demand for summer travel, upward pressure on gasoline prices will remain in force.

This concludes my testimony, Mr. Chairman. I would be pleased to answer any questions you and other Members may have.

Figure 1

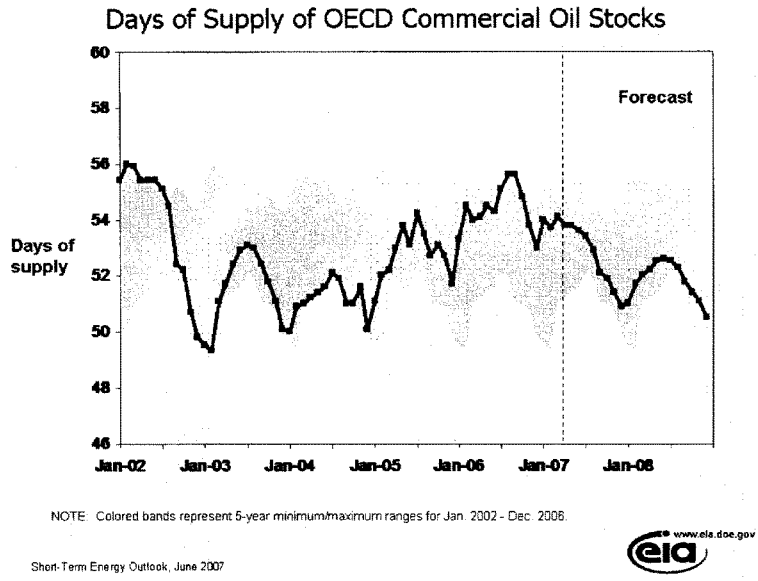


Figure 2

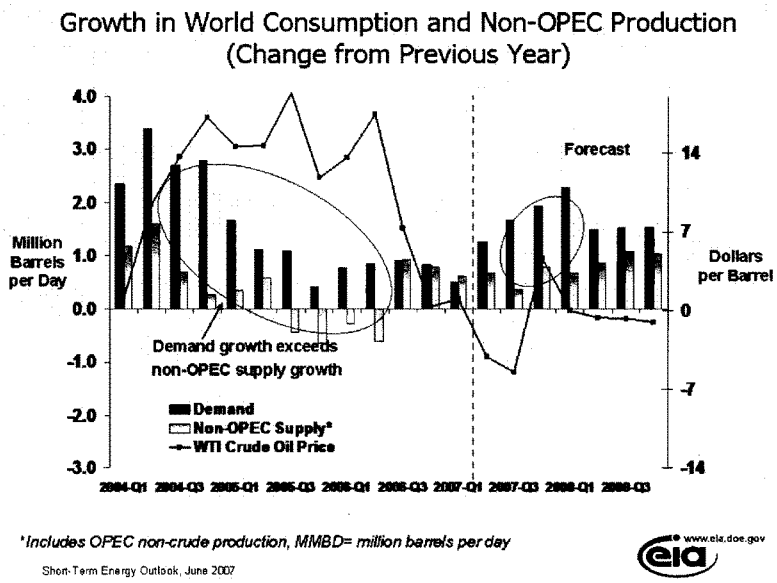
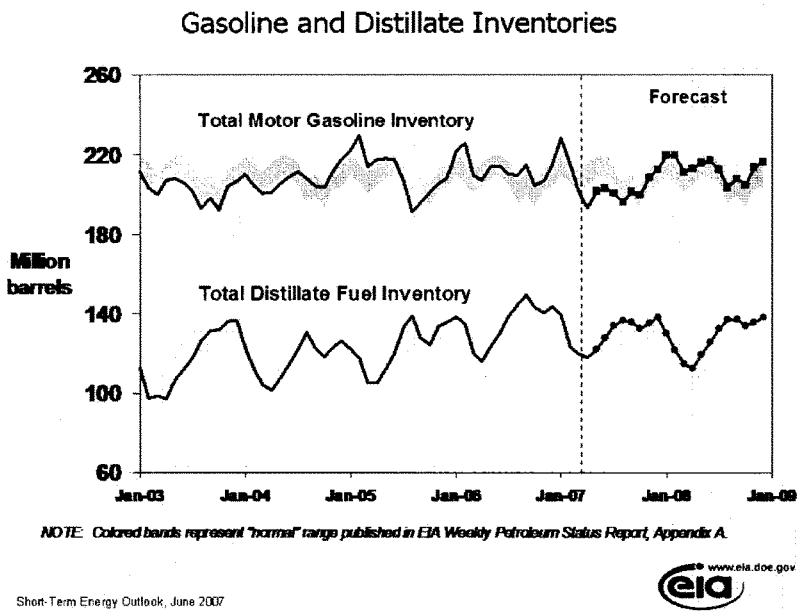


Figure 3


Gasoline and Distillate Inventories
Forecast
Total Motor Gasoline Inventory
Total Distillate Fuel Inventory
Million barrels
260
220
180
140
100
60
Jan-03
Jan-04
Jan-05
Jan-06
Jan-07
Jan-08
Jan-09
NOTE: Colored bands represent "normal" range published in EIA Weekly Petroleum Status Report, Appendix A.
www.eia.doe.gov
eia
Short-Term Energy Outlook, June 2007

Chairman KERRY. Well, we look forward to the opportunity to ask them. Thank you very much.

Mr. Smith.

STATEMENT OF FREDERICK W. SMITH, CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, FEDEX CORPORATION, MEMPHIS, TENNESSEE

Mr. SMITH. Senator Kerry, it is always good to see you, and thank you for clarifying that thing about my school grade. As you noted and Senator Corker, who represents our hometown State, FedEx is indeed a very big company, employing about 275,000 folks around the world, 38,000 of them in Tennessee, Senator. But we did start as a small company and we understand the issues of small business very well, because our four operating companies uniquely provide transportation services that allow small businesses everywhere to connect to an increasingly large global marketplace.

But I am not here today representing FedEx. I speak to you today as the co-chairman of a group, the Energy Security Leadership Council, which is composed of 18 CEOs and retired four-star admirals and generals who came together because we collectively believe that the Nation's increasing dependence on imported petroleum after nuclear proliferation and bioterrorism represents the greatest economic and security threat to this Nation.

We base much of what we have recommended on a very in-depth study conducted by an organization called SAFE, Securing America's Future Energy, which conducted a simulation at Davos a year ago in January which showed that very small perturbations in supply can result in very substantial increases in prices. A 3 to 4 percent reduction in supply could easily run the price of a barrel of oil up to $120, $125 a barrel, which would have very significant deleterious effects on the U.S. economy.

Much more importantly, I think, is the fact as you noted in your opening comments, Senator, that we are now importing almost 60 percent of our petroleum. Transportation is 97 percent fuel petroleum. Ninety percent of the world's oil reserves are now owned by national oil companies, many of whom are controlled by countries who, quite frankly, do not have the best interests of the United States at heart.

If you look historically at the problem, one finds that the reason that our economy has been able to absorb the tremendous run-up in fuel prices over the last few years is that between 1975, after the first Arab oil embargo, to the middle part of the 1990s, the U.S. energy efficiency improved by 100 percent. And a large part of that improvement was based on a system of fuel efficiency standards which were enacted by the Congress in 1975 under a Republican administration, which, I might add, were opposed by the auto manufacturers at the time. And those fuel efficiency standards, so-called CAFE standards, were very, very important in the improvements that our economy has seen and given us the basis to absorb the shock that we have already seen.

So with that background, we prepared a report to the Nation which we published in December which recommended that the Congress consider a balanced piece of legislation which had three

fundamental prongs on which it rested. The first was increased domestic production. The facts of the matter are that, worldwide, oil markets are global in nature and a barrel of oil produced off the coast of South Carolina does have an effect on the price of oil everywhere.

The second part of our recommendation was that the United States should promote the production of alternative fuels to the maximum extent possible. That obviously is something that has been the source of much debate, but it is very important that these goals be realistic and not pie-in-the-sky or the Congress will be sitting here 20 years hence dealing with an even bigger problem.

And third, and very importantly, is the recommendation that the Congress enact a new system of fuel efficiency standards which are quite different from the fleet averages that were used in the 1975 legislation. Instead, we recommended that NHTSA be empowered to regulate a fuel efficiency improvement program by each category of vehicle and by attribute, so that a Suburban car for a soccer mom would not be in the same category as a pick-up truck used for agriculture, and within each category, NHTSA would oversee a program of 4 percent per annum fuel efficiency improvement, provided that there were appropriate off-ramps for safety or technological limitations.

With a balanced program like that, the math that we did in the report to the Nation, which obviously has been made available to all of you, the United States would see in the coming years a significant reduction in our dependence on this foreign imported petroleum.

And I would point out in conclusion, Senator, and I put all of this in a written statement which I have given you for the record, many of us on the Energy Security Leadership Council did not come to this position lightly. I rarely come to Washington over these many years I have been in business to argue for Government regulation. Quite the contrary. But in this particular case, you are talking about very serious economic and national security risk. You are not talking about a free market. You are talking about a market which is set by a cartel whose actions, were they conducted in the United States, would simply be illegal.

And we think what we proposed to the Nation, and bear in mind a company like FedEx, who spends over $3 billion a year in fuel, the CEO of UPS, the CEO of Carnival Cruise Lines, the CEO of Dow Chemical, the CEO of Southwest Airlines, the CEO of Auto Nation, the largest seller of automobiles in the country, and distinguished four-star military officers, including our co-Chair, General P.X. Kelley, the former Commandant of the Marine Corps, and many of the admirals and generals who were responsible in their careers for protecting these oil lanes, have come to the Congress saying this is a problem that has to be addressed, and if the Nation doesn't address it, we do so at our peril.

Thank you very much for your kind attention, Senator.

[The prepared statement of Mr. Smith follows:]

Testimony of Mr. Frederick W. Smith,
Chairman, President and CEO, FedEx Corporation
before the U.S. Senate Committee on Small Business and Entrepreneurship
Hearing on "The Impact of Rising Gas Prices on America's Small Businesses"
14 June, 2007

I thank Chairman Kerry and the entire Committee for this opportunity to testify about the impact of rising gas prices on America's small businesses. Some in the audience may be asking why the leader of one of the seventy largest companies in America is speaking before a body that is charged with advancing the interests of small businesses and entrepreneurs. Well, in my opinion, the reasons are numerous and compelling, and I welcome the chance to explain them.

First, and by no means least important, is the fact that FedEx started as a small business within the lifetimes of most of the people in this room. Since its founding in 1971, FedEx has expanded tremendously, but our corporate culture remains centered on the same commitment to customer satisfaction that enabled our rapid growth. I believe this attention to the needs of the customer is shared by most small business owners and entrepreneurs.

Second, FedEx's value proposition is to build networks that connect businesses of all sizes in all parts of the world. For FedEx, small-business customers are not an after-thought; on the contrary, without an economy that thrives on decentralized initiative, FedEx could not have achieved its current success.

Third and finally, I am here because I recognize that small businesses are severely threatened by the severity of our nation's oil dependence, above all because of our transportation system's overwhelming reliance on gasoline and other oil-based fuels.

I speak to you today on behalf of the Energy Security Leadership Council (ESLC), a non-partisan organization that is working to reduce U.S. oil dependence. I co-Chair the Council along with General P.X. Kelley (Ret.), the 28th Commandant of the United States Marine Corps. We are joined in this effort by a group of distinguished business leaders and retired senior military officers that includes: Admiral Dennis Blair, USN (Ret.), Former Commander-in-Chief, U.S. Pacific Command; Admiral Vern Clark, USN (Ret.), Former Chief of Naval Operations; Michael L. Eskew, Chairman and CEO, UPS, Inc.; Adam M. Goldstein, President, Royal Caribbean International; General John A. Gordon, USAF (Ret.), Former Homeland Security Advisor to the President; Maurice R. Greenberg, Chairman and CEO, C.V. Starr & Company, Inc.; Michael Jackson, Chairman and CEO, AutoNation, Inc.; Admiral Gregory G. Johnson, USN (Ret.), Former Commander, U.S. Naval Forces, Europe; Robert D. Hormats, Vice Chairman, Goldman Sachs (International); Herbert D. Kelleher, Executive Chairman, Southwest Airlines Co.; John F. Lehman, Former U.S. Secretary of the Navy (1981 – 1987); Andrew N. Liveris, Chairman and CEO, The Dow Chemical Company; General Michael E. Ryan, USAF (Ret.), 16th Chief of Staff, U.S. Air Force; Jeffrey C. Sprecher, Chairman & CEO, IntercontinentalExchange | ICE; David P. Steiner, CEO, Waste Management, Inc.; and General Charles F. Wald, USAF (Ret.), Former Deputy Commander, U.S. European Command. Together, we are convinced that government must confront the economic and

national security risks that flow from our excessive reliance on oil, much of which is located in unstable and unfriendly parts of the world.

Oil is the life-blood of our economy. In the U.S., we consume more than 20 million barrels of oil per day (mbd), a quarter of the world total. More than 60 percent of the oil we do use is imported. And nearly 70 percent of our oil consumption goes toward transportation, which relies on oil for 97 percent of delivered energy with almost no substitutes available. According to *Oil Shockwave*, an oil crisis simulation conducted in 2005, a mere 4 percent shortfall in global daily oil supplies could push the price of oil to more than $120 per barrel. That equates to gasoline prices of around $4.70 per gallon.[1] In the event of such a crisis, transportation would be sharply impacted, and this would in turn damage all economic sectors.

The global oil system is incredibly fragile. It is susceptible to politics, war, and terrorism. To grasp the danger, just look at the threats to shipping. Most oil shipments have to pass through a handful of maritime chokepoints. Roughly 80% of Middle East oil exports pass through the Strait of Hormuz (17 mbd), Bab el Mandeb (3 mbd), or the Suez Canal/Sumed Pipeline (3.8 mbd). Another 11.7 mbd pass through the Straight of Malacca and 3.1 mbd through the Turkish Straits. All of these passageways are vulnerable, and threats are proven; indeed, in October 2002, the French supertanker *Limburg* was rammed off the coast of Yemen by a small boat packed with explosives in an Al-Qaeda linked attack. Since alternative routes are lacking, the effect of a major blockage at one of these points could be devastating. Even unsuccessful attacks on tankers are likely to raise insurance rates and thus oil prices.

Small businesses would bear a particular heavy burden during an oil supply crisis. According to the National Small Business Poll on Energy Consumption conducted in 2006 by the National Federation of Independent Business (NFIB), 10 percent of small businesses claim that energy is their biggest cost, and another 25 percent claim that energy is one of their two or three largest business expenses.[2] Thirty-eight percent report that their primary energy costs are attributable to vehicles.

Clearly, many of America's small businesses are engaged in one way or another in the transportation business. This alone would make them highly vulnerable to increases in the price of gasoline and diesel fuel. But the situation is even more precarious because small businesses generally have less pricing power and, thus, a harder time passing along energy costs to consumers; as such, their margins are bound to come under pressure when fuel prices rise. And small businesses are boxed in even more tightly by capital constraints that would make it difficult for them to rapidly replace standing vehicle fleets with more fuel-efficient versions.

Small businesses and entrepreneurs are the backbone of the free-market economy that holds great promise for hardworking men and women from all walks of life. But the

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[1] *Oil Shockwave* (2005), an oil crisis executive simulation conducted by the National Commission on Energy Policy (NCEP) and Securing America's Future Energy (SAFE).
[2] NFIB, *National Small Business Poll*, 6, no. 3 (2006).

American people must recognize that the twenty-first century global oil market is well removed from the free-market ideal. By some estimates as much as 90 percent of all oil and natural gas reserves are held by national oil companies (NOCs) that are either partially or fully controlled by governments. Oil markets are not only politicized, they are also distorted by the presence of large economic externalities, such as military expenditures, that are not factored into the retail price of consumer fuels.

Given these realities, we must accept that market forces alone will not solve our oil problems. Instead, government must step in to spur and, in some cases, require private-sector responses. This is not a decision I came to easily. As an entrepreneur myself, I am not one to encourage regulation where other effective solutions are available. But the fact is the global supply of oil is determined by a group of men who gather together and collude in ways that would be considered illegal in the U.S. To combat such anti-competitive practices, government intervention is not merely desirable—it is essential.

In December of last year, the Energy Security Leadership Council unveiled a set of *Recommendations to the Nation on Reducing U.S. Oil Dependence.* This report calls on government to provide a comprehensive plan for energy security for our country; the Council is convinced that this policy must include strengthened vehicle fuel-economy standards for all cars and trucks, increased domestic oil production in conjunction with expanded environmental protections, greater availability of renewable fuels, and improved international arrangements to secure the global oil supply.

To minimize oil dependence and its associated national security risks, both political parties must discard the dogmatic approaches that have hampered the pursuit of energy security for decades. Democrats must recognize that the failure to press forward with the environmentally responsible development of domestic energy resources exacerbates the dangers of oil dependence. Refusing to develop secure sources of domestic production leads to an unnecessary over-reliance on imported oil. Aside from amplifying the potential risk of a supply interruption, the preference for imported oil unnecessarily transfers hundreds of billions of dollars of the nation's wealth to foreign lands.

For their part, Republicans must accept that the free market has not—and will not—adequately motivate the investments necessary to protect the nation in the event of an oil crisis. As such, mandating improvements in the fuel economy of our cars and trucks is one critical and unavoidable step that Americans must take if we are to halt our national descent into unmitigated oil dependence.

During the last few months, the Council has collaborated with numerous Senators from both parties to develop legislation in keeping with our *Recommendations*. In recent weeks, the Senate has made great strides in this regard, in particular though bipartisan support for dramatically improved vehicle fuel-economy standards. As reported by the Committee on Commerce, Science and Transportation, the "Ten-in-Ten Fuel Economy Act" sets workable standards for the fuel economy of new cars and light trucks with a requirement for fleet fuel economy to reach 35 mpg by model year 2020. Beginning in 2021, the fleet-wide average fuel economy of cars and light trucks would be required to increase 4 percent year over year. The National Highway Traffic Safety Administration

(NHTSA) would have the discretion to require different percentage increases for the different classes of vehicles in pursuit of the prescribed fuel-economy improvement for the entire new vehicle fleet.

Furthermore, "Ten-in-Ten" will set fuel-economy standards for medium and heavy trucks, classes of vehicles that have not previously been subject to mileage requirements, even though they account for as much as 10 percent of U.S oil demand.

This new approach to fuel economy is very different from the Corporate Average Fuel Economy (CAFE) system now in place. Whereas all automakers currently have to meet the same corporate average fuel-economy number, the new system will present each manufacturer with a unique standard tailored to its unique production palette. This will be possible because fuel-economy standards will be formulated for specific vehicles grouped into classes by attributes. This focus on attributes will also ensure that Americans will still be able to purchase different types of vehicles that cater to different transportation needs. Critically, this new system will remove the safety-compromising incentive to down-size and down-weight vehicles, since the mileage attainments of highly efficient smaller vehicles will no longer be averaged with those of less-efficient large ones. Flexibility will be further ensured by "off-ramps" that will allow standards to be relaxed in a given year if they are not cost-effective. The bill will ensure that the standard in any year is the maximum that is safe, technologically feasible, and economically beneficial to our country.

This is truly path-breaking legislation that merits broad support. If paired with complementary measures to diversify our transportation fuel supply and to safely increase domestic oil and natural gas production, it will constitute a viable strategic plan for heightened energy security.

Without an expanded supply of alternatives, conventional petroleum will continue to power nearly all of our motor transport. Such reliance on a single non-substitutable input creates profound economic dangers. For instance, OPEC could slash investment in oil exploration and production to keep oil prices high over the long term, and we would have little option but to pay those prices. Even as we cut our demand, OPEC might continue to perversely cut production in order to maintain exorbitant prices. Only viable substitutes could free us this nightmare scenario.

Corn-based ethanol is by far the most viable domestic alternative transportation fuel. At a maximum, however, corn-based ethanol may be able to displace 10% of our gasoline use before corn demand outstrips supply. Corn ethanol will undoubtedly remain an important alternative fuel, but we must also develop newer technologies that have the potential to loosen the constraint posed by limited corn supplies.

Cellulosic ethanol is one of the most promising emerging biofuels, and the Council has put forth policies for fostering the growth of this industry. In addition, we have proposed plans for growing the demand-side of the biofuels market, in particular through incentives that will aid in the development of critical delivery infrastructure. Finally, we

propose a system of variable subsidies that will safeguard taxpayer dollars by reducing government payments to the ethanol industry when oil prices are high and ethanol production is correspondingly profitable. If oil prices do fall, perhaps through cartel actions, the subsidies would rise again to protect the biofuels industry as a strategic bastion of supply diversification. Our plan will also offer additional protections to biofuels production facilities that have not paid off their capital costs, especially if they employ emerging technologies.

Biofuels are part of the solution, but we should not fool ourselves into thinking that America can "grow" its way out of this problem. America's fuel needs cannot be met with biofuels alone. Even Brazil, which has roughly the same land mass as the continental U.S. but whose fuel requirements are only a small fraction of ours, still relies on oil for most of its transportation energy. The U.S. will continue to require oil for the foreseeable future.

The U.S. plays a critical role in global petroleum production. Currently the third largest oil producer in the world after Saudi Arabia and Russia, America has produced more total oil than any other nation. Nevertheless, the U.S. is the world's largest consumer by far, accounting for 25% of the world's daily oil consumption while providing only around 10% of supply. Much of America's untapped resources are legally off limits to production. These production "moratoria" are often justified on environmental grounds, even though the oil production industry has amassed an excellent environmental record. From 1985 to 2001, U.S. offshore operators produced 7 billion barrels of oil with a spill rate of only .001%. More recently, 3,050 of the Gulf's 4,000 platforms and 22,000 miles of Gulf pipelines were in the direct path of either Hurricane Katrina or Hurricane Rita. Despite the destruction of 115 platforms, damage to 52 other platforms and 535 pipeline segments, and the near total shut-down of the Gulf's offshore oil and gas production, there were no major oil spills attributed to either storm.

The Council believes it is sensible to increase access to exploration and production on the Outer Continental Shelf (OCS) as long as government and the oil and gas industry are willing to reasonably strengthen the legal and financial penalties that can be imposed in the event of any damage to the environment. To be sure, increased U.S. production on the OCS will not fundamentally shift the global distribution of oil resources, the majority of which will remain in the Middle East and under OPEC control. But by boosting production domestically, the U.S. can improve the flexibility and resiliency of the global oil market, especially in an increasingly tight market where spare production capacity is concentrated in a handful of countries.

Rising worldwide demand, increasing levels of international conflict, and limited excess oil production capacity are all combining to increase the probability that we will face a severe oil crisis. I would argue that oil dependence is the most important security issue facing the nation today with the possible exception of weapons of mass destruction. But there is no mystery regarding the steps that can be taken to protect the American people. By strengthening fuel-economy standards, facilitating the development of diversified fuel sources, and expanding stable domestic production, America's leaders can dramatically

boost our economic and national security, but they do not have the luxury of delaying these decisions far into the future. The choices must be made now, and in fact these decisions are confronting the Senate this week. I trust that the Senate will send a clear signal in favor of improved energy security. This would be the best news our small businesses and entrepreneurs could receive.

Chairman KERRY. Well, Mr. Smith, thank you very much. I think your testimony is enormously important for a number of reasons, not the least of which is that I think you bring a special kind of validation to the table which is very important for everybody to hear, not just our colleagues here, but for people in the country. So we will, I know, follow up with some questions, but I think it is important testimony and we really do appreciate your taking time to be here.

Mr. Lupoli.

STATEMENT OF SAL LUPOLI, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SAL'S PIZZA, LAWRENCE, MASSACHUSETTS

Mr. LUPOLI. Thank you, Chairman Kerry, Ranking Member Snowe, and Members of the Committee. My name is Sal Lupoli and I am the owner of Sal's Pizza, a family owned business established in 1990 located in Lawrence, Massachusetts. My company has over 30 retail stores, two upscale restaurants, and a central commissary which sells to supermarket chains and school districts throughout the New England area. I am also on the board of the Merrimack Valley Chamber of Commerce, Workforce Investment Board, and many community organizations throughout the Merrimack Valley in Massachusetts.

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

In the day-to-day operation of my small business, I have as many as 30 delivery trucks and 5 management vehicles on the road at any one point. Every day, my company makes deliveries of fresh ingredients, of product to various supermarkets throughout New England, 30 franchise stores, retail stores, and school districts. Obviously, these trucks fall into the category of non-fuel-efficient vehicles. Unfortunately, there is no affordable alternative to me at this choice.

Currently, the cost of gasoline in the Merrimack Valley varies from $2.80 a gallon to as high as $3.09. This is from a low last year of $1.98. This sudden and unpredictable 50 percent increase hits directly to the bottom line of my business and countless others. Rising fuel costs have a direct impact on my means of delivery for my product, but also other aspects of my business.

For instance, it has a direct impact on my employees. It has a tremendous effect on them. Many of my employees have low to modest means. Many of my employees live in low-income areas, such as Lawrence, Massachusetts, and towns throughout the Merrimack Valley. Many employees drive their cars to work. Often I am faced with employees that are unable to afford the gasoline for their cars. They face days out of work, which often results in myself or my staff having to pick them up. This further disrupts daily business operations. We encourage carpooling. We encourage public transportation. But these options are always not available in the towns of their residences.

Another area in rising fuel costs have impacted my business is to my customers and their expendable income. I have seen a decline in sales when gas prices increase, only to see business pick up when prices go down. A family that I would generally see on a weekly basis on a Friday night is now a twice-a-month customer. Customers in my restaurant that I see two and three times a week may only come to my restaurant once a week as a result of gas price spikes. My business, as any retail, competes for the expendable dollar. I compete for the customer dollar when families make a choice between fixing a leaking faucet or taking the family out to a nice meal at my restaurant. When gas prices are high, the American small business loses.

In addition to the direct impact that rising gas prices has on my business, it is immeasurable. Although my company has moved its corporate offices to Lawrence, Massachusetts and has renovated a mill building along with other businesses, which are my tenants—the mill building consists of 240,000 square feet—I have found it extremely expensive to heat my building during the winter months and pay for increasing electricity for cooling in the summer months. I was forced to consider and chose to install solar panels on the roof of my mill as an alternative to the traditional fossil fuel energy. Solar energy helps defray some costs, but has yet to make a significant impact on the overall operation.

In order to maintain a level of profit in my operation, I have no alternative but to pass the costs of rising fuel on to my customers, whenever possible trying to absorb the cost myself. On most deliveries, we have been forced to include a fuel surcharge on our delivery invoices. I am not alone in the rising prices whenever possible.

According to the 2006 NSBA Small Business Energy Survey of the businesses that reported passing along their increased energy cost to their customer, 65 percent have increased their prices. Of that, 47 percent reduced the amount of business travel and 18 percent have reduced their workforce. The ramifications of rising gas prices reverberate throughout the entire economy.

This concludes my testimony. Thank you again for inviting me here today and recognizing the threat rising and volatile energy prices pose to America's small business. As you seek to address America's oil dependence, the shortcomings of the national energy policy, and the 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.

[The prepared statement of Mr. Lupoli follows:]

TESTIMONY OF
SALVATORE LUPOLI
PRESIDENT
SAL'S PIZZA INC.
AT A HEARING BEFORE THE
COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP
U.S. SENATE
ENTITLED
"IMPACT OF RISING GAS PRICES ON AMERICA'S SMALL BUSINESSES"

JUNE 14, 2007

Thank you Chairman Kerry, Ranking Member Snowe, and members of the committee, my name is Sal Lupoli, and I am the owner of Sal's Pizza Inc., a family-owned business, established in 1990, located in Lawrence, Massachusetts. My company has 30 retail pizza franchises, 2 upscale restaurants and a central commissary which sells pizza to supermarket chains and school districts throughout New England. I also am a board member of the Merrimack Valley Chamber of Commerce, Workforce Investment Board and many community organizations throughout the Merrimack Valley area in Massachusetts.

I would like to thank you for inviting me to testify today regarding the impact of rising gasoline prices on small businesses, particularly mine. I am very grateful that you are cognizant of the negative effect that increasing gasoline prices are having on small businesses across the country and that you 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 30 delivery trucks and five management vehicles on the road at any point in time. Every day my company makes deliveries of fresh ingredients or product to various supermarkets throughout New England, 30 franchises retail stores and school districts. 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 Merrimack Valley area varies from $2.80 per gallon to $3.09 for regular gasoline 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.

Rising fuel costs have a direct impact on my means of delivery for my product, but also impact other aspects of my business. For instance, the impact on my employees is tremendous. Many of my employees have low to modest means; live in low income areas such as Lawrence, Massachusetts and towns and cities throughout the Merrimack Valley. Many employees drive their cars to work. Often I am faced with employees that are unable to afford gasoline for their cars and face a day or days out of work as a result. Often one of my staff or I has to pick them up,

which can further disrupt daily business operations. We encourage car pooling and public transportation, but these options are not always enough or available in the town of their residence.

Another area in which rising fuel costs have an impact is my customers and their expendable income. I have seen a decline in sales when gas prices increase, only to see business pick up when gas prices go down. A family that I would generally see on a weekly basis for a Friday night Pizza is now in my store twice a month. Customers in my restaurants that I see three times a week may only come to my restaurant once a week when gas prices spike. My business as any retail business competes for expendable income dollars. I compete for the consumer dollar when families make a choice between fixing the leaking faucet and taking the family out to a nice meal at my restaurant. When gas prices are high the American small business looses.

In addition the direct impact rising gas prices has on my business is immeasurable. Although my company has moved its corporate offices to Lawrence, Massachusetts and into a renovated mill building along with other businesses, which are my tenants, with over 240,000 square feet of office space I found it extremely expensive to heat my building during the winter months and pay for increasing electricity bills for cooling in the summer months. I was forced to consider and chose to install solar panels on the roof of my mill as an alternative to traditional fossil fuel energy. Solar energy helps defray some, but not all costs and has yet to make a significant impact to my over all operation.

In order to maintain a level of profit in my operation, I have no alternative but to pass the cost of rising gasoline onto my customers whenever possible and often try to absorb the costs when I can. On most deliveries, we have been forced to include a fuel surcharge on our delivery invoices. I am not alone in rising prices whenever possible. According to a 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.

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 KERRY. Thank you, Mr. Lupoli, for very graphic, important and powerful testimony. I don't think a lot of us necessarily thought that people weren't able to get to work or that the CEO is going to have to go out and actually pick them up to get them there, and that is a pretty downstream real impact, so we appreciate your sharing it with us here.

Mr. LUPOLI. Thank you, sir.

Chairman KERRY. Ms. Myhre.

STATEMENT OF JANET MYHRE, DIRECTOR, GOVERNMENT SERVICES GROUP, CHUCKALS, INC., TACOMA, WASHINGTON

Ms. MYHRE. Thank you, Chairman Kerry, Ranking Member Snowe, and distinguished Members of the Committee for the opportunity to testify today. My name is Janet Myhre and I am the director of Government Services Group of Chuckals Office Products, which is headquartered in Tacoma, Washington. I am here on behalf of the co-owners, Chuck Hellar and Al Lynden, and our great team of employees who support the success of our small business. I know that Chuck and Al would have liked to attend today's hearing, but as you know, air fare from the West Coast on short notice is quite high.

Fundamental to Chuckals' growth over the last 13 years has been a combination of innovative use of technology and powerful strategic alliances that have enabled the company to offer big business prices while still preserving small business value and service. Use of a stockless, just-in-time distribution model, partnering with key suppliers like Federal Express, and a commitment to find new and innovative ways to consistently streamline internal operations has furnished a solid platform for sustained growth and enabled us to provide a broad product offering and consistently high service.

Fuel costs impact each and every transaction that our organization manages and it is the third-largest expense item on our financial statement after cost of goods and employee wages. To keep it simple, we have three categories of delivery expense. The first two categories represent the costs and/or expense of getting our product to our customers. Category one is the local and regional deliveries that are handled through our company-owned vehicles and span a large portion of middle and south Puget Sound region in Washington State. Currently, this sector makes up 7 percent of our delivery expense.

Category two is the servicing and delivery to both commercial and Federal accounts under Federal contracts nationwide through the use of third-party carriers such as Federal Express, UPS, and LTL Truckload Relationship. This category represents 91 percent of our delivery expense.

A final category is the cost of shipment from wholesalers and manufacturers to our organizations and other internal fuel expense, such as employee auto reimbursement.

During the past 24 months, we have experienced a total increase in delivery cost of over 35 percent in the combined categories. The highest percentage was experienced in the category of national delivery, which has increased 36.4 percent. Just a quick look at the increases. The local delivery has increased around 18; the national

delivery, 36.4. The third category for internal kind of uses within the business is 30 percent.

To break down the impact on a per delivery basis, in January 2005, the average delivery cost to deliver to a local customer was 56 cents per delivery. Today, our costs have almost doubled and have peaked at $1.02 per delivery.

When we use other carriers such as UPS, FedEx, and DHL, our per delivery costs are experiencing the same type of increase. For example, the cost to ship an order to an Army customer in January 2006 was averaging $12.40 per order. As of April 2007, that cost has risen by 34.2 percent to $18.86 per order.

From the early days of Chuckals' organization, we have applied a business model of continually improving our business practices to embrace technology and efficiency. One of the first applications was to be an early leader in transitioning an industry which heavily depended on a traveling outside sales team to a technology-driven inside team. Even with this transition, a limited outside sales team, we incur another associated cost with fuel for employee auto reimbursement, indexing our expense reimbursement to the IRS guidelines, which we have watched jump by 38 percent.

Today, I presented a brief synopsis of the hard costs and direct impact of double-digit delivery expense that we are incurring in the delivery segment of our business. It is important to also discuss the impact this fuel increase has had on the production and cost of goods. It is quite amazing to discover how many products are petroleum-based, such as vinyl and polypropylene resins, which go into binders and hard plastic office supplies.

We have seen the same percentage increase in our cost of goods. Many times our suppliers do not charge for hard transportation costs, but they increase the unit cost of the product. As an example, we have seen our cost of goods price increase on a carton of paper by 15 percent during the same 24-month period. This increase has a direct relationship with the cost of fuel, both in manufacturing and transportation.

We continue to look for alternative ways to save fuel and cut costs through efficiencies of technology and management, such as mapping of local delivery routes, consolidating customer deliveries, routine maintenance of our fleet, and the continuous measurement and feedback of productivities of our drivers. However, we have no options when it comes to the raw cost of fuel. It is still X miles from point A to point B and that will consume a defined amount of fuel.

As we have discussed with Senator Cantwell and her staff, while there are many new options for the consumer both in alternative fuel and vehicles to combat this fuel emergency, there currently are very few options for the small business owner who has commercial fleets which run on gasoline. Couple the 40 percent increase in fuel cost with the compounding increase in health care that we have also incurred in the past 3 years, the small business professional is finding it harder and harder to compete and stay in business.

As we continue to watch our operational margins shrink, Chuckals will be faced with critical management decisions. What programs and investment in capital and innovation must be foregone to absorb the increased cost of fuel and delivery? What appli-

cation and impact will this have on our competitive position in the marketplace and our viability to win future awards? And finally, what impact does this have on our finest assets, our employees? We will have to change employee benefit plans, head count, and other organization structures to react to the rising costs. Thank you.

[The prepared statement of Ms. Myhre follows:]

Statement of

Janet Myhre
Director of Government Services Group

Chuckals Office Products

Before the

United States Senate
Small Business Committee

Impacts of Rising Gas Prices on America's Small Businesses

Thursday, June 14, 2007

Thank you Chairman Kerry, Ranking Member Snowe and distinguished members of the Committee for the opportunity to testify today.

My name is Janet Myhre, Director of Government Services Group, of Chuckals Office Products. I am here on behalf of the co-owners Al Lynden and Chuck Hellar and our great team of employees who support the success of our small business. I know that Chuck and Al would have liked to attend today's hearing, but as you know, airfare from the West Coast on a limited time frame is quite high.

Fundamental to Chuckals growth over the past thirteen years has been a combination of innovative use of technology and powerful strategic alliances that have enabled the company to offer big business pricing while still preserving small business values and service.

Use of a stockless, "just-in-time" distribution model, partnering with key suppliers and a commitment to find new and innovative ways to consistently streamline internal operations, have furnished a solid platform for sustained growth and enabled us to provide a broad product offering and consistent high service levels to our customers.

Fuel cost impact each and every transaction that our organization manages and is the third largest expense item on our financial statement after cost of goods and employee wages. To keep it simple we have three categories of fuel expense.

The first two categories represent the cost and / or expense of getting our product to our customers. Category one is local and regional deliveries that are handled through company owned vehicles and span a large portion of (middle and south) Puget Sound region in Washington State.

Currently this sector makes up 7% of our fuel cost. Category two is the servicing and delivery to both commercial and federal accounts under Federal Contracts nationwide through the use of third party carriers such as UPS, Federal Express and LTL truckload relationships.

This category represents 91% of our freight expense. A final category is the cost of shipments from wholesaler and manufactures to our organization and other internal fuel expense such as employee auto reimbursement; this represents 2% of our total fuel expense.

During the past 24 months we have experienced a total fuel increase of over 35% in the combined categories. The highest percentage was experienced in the category of national delivery, which has increased 36.4%.

Percent Increase:

Category One - Local Delivery	**17.7%**
Category Two – National Delivery	**36.4%**

(Category based on variables such as weight, order size, freight minimum and delivery method i.e. next day or 3 day delivery)

Category Three - Other	**29.9%**
Total Fuel Increase	**35.1%**

To breakdown the impact on a per delivery bases, in January 2005, the average fuel cost to deliver to a local customer was **$0.56** per every delivery. Today our costs have almost doubled and have peaked at **$1.02** per delivery.

That equates to an **82%** increase to deliver a single order to our customers. When we use other carriers such as UPS, FedEx and DSL, per delivery costs are experiencing the same type of increase. For example, the cost to ship an order to an Army customer in January 2006 was averaging **$12.40** per order, as of April 2007 that cost has risen by **34.2%** to **$18.86** per order.

From the early days of Chuckals organization we have applied a business model of continually improving our business process to embrace technology and efficient practices. One of the first applications was to be an early leader in transitioning an industry which heavily depended on a traveling outside sales team to a technology driven inside team.

Even with this transition, and a limited outside sales team, we incur another associated cost with fuel for employee auto reimbursement. Indexing our expense reimbursement to the IRS guidelines we have watched the auto expense reimbursement jump by 38% over the same period.

Today I have presented a brief synopsis of the hard cost and the direct impact of double-digit fuel expense that we are incurring in the delivery segment of our business. It is important to also discuss the impact this fuel increase has on the production and cost of goods.

It is quite amazing to discover how many products are petroleum based, such as vinyl and polypropylene resins which go into binders and hard plastic office products. We have seen the same percentage increase in our cost of goods. Many times our suppliers do not charge for hard transportation cost but increase the unit cost of goods price.

As an example we have seen our cost of goods price increase on a carton of paper by 15% during the same 24 month period. This increase has a direct relationship with the cost of fuel both in manufacturing and transportation.

We continue to look for alternative ways to save and to cut fuel costs, through efficiencies of technology and management, such as mapping of local delivery routes, consolidating customer deliveries, routine maintenance of our fleet, and the continuous measurement and feedback of productivity of our drivers.

However, we have no options when it comes to the raw cost of fuel, it is still X miles from point A to point B and that will consume a defined amount of fuel. As we have discussed with Senator Cantwell and her staff; while there are new options for the consumer both in alternative fuel and vehicles to combat this fuel emergency, there currently are very few options for the small business owner who has commercial fleets, which run on gasoline.

Couple the 40% increase in fuel cost with the compounding increase in health care that we have also incurred in the past three years, the small business professional is finding it harder and harder to compete and stay in business.

On behalf of Chuckals, I thank Chairman Kerry, our Washington State Senator Maria Cantwell and the distinguished members of the Senate Small Business Committee for the opportunity to address this critical issue for today's small business sector.

Chairman KERRY. Very helpful. Thank you very, very much. That is very helpful testimony.

Mr. Lynch. Let me just say for the record, everybody's testimony will be placed in the record in full as if read in full. Thank you.

STATEMENT OF TIMOTHY P. LYNCH, SENIOR VICE PRESIDENT, AMERICAN TRUCKING ASSOCIATIONS, WASHINGTON, DC

Mr. LYNCH. My name is Tim Lynch. I am a senior vice president with the American Trucking Associations, and on behalf of our membership, we want to thank Chairman Kerry, Ranking Member Snowe, and all the Members of the Committee for giving us an opportunity to testify on this very, very important subject.

The trucking industry is a vital component of our national economy. In 2005, trucks transported nearly 11 billion tons of freight domestically, representing almost 70 percent of all freight transportation tonnage. The trucking industry accounts for 84 percent of the nation's freight bill and exclusively serves the freight needs of over 80 percent of communities in the United States.

While the industry is very large, it includes hundreds of thousands of small businesses. As of November 2006, there were over 700,000 interstate motor carriers in the United States classified as small businesses, 97 percent of which operated 20 or fewer trucks.

For most motor carriers, fuel is the second-largest operating expense after labor. Small carriers are particularly vulnerable to large and swift increases in fuel prices. Typically, the smaller the carrier, the larger percentage fuel represents of total operating expenses.

Over the past 4 years, the price of diesel fuel has steadily increased. According to the Energy Information Administration, the national average price of diesel rose from $1.81 per gallon in 2004 to $2.41 in 2005, and then rose again to $2.71 in 2006. Unfortunately, there doesn't seem to be any relief in sight. EIA analysts now estimate that diesel will average $2.75 per gallon in 2007 and $2.76 in 2008.

This year, in order to haul the Nation's freight, the industry will consume 51 billion gallons of fuel, including more than 38 billion gallons of diesel fuel, at a record cost of $106 billion, $3 billion more than in 2006 and more than double the industry's fuel bill in 2003.

The sharp increase in the cost of diesel fuel is a hardship for small trucking companies, but the full impact must be viewed in the context of what also is occurring with fuel economy and environmental controls. This challenge is fully captured in the comments that were made by Barry Pottle of Pottle Transportation of Bangor, Maine.

> "Twenty-five years ago, my trucks were getting a little over 4 miles to the gallon. In the mid-1990s, my trucks were getting close to 7 miles to the gallon. With the new engines and new requirements for the use of ultra low-sulfur diesel, my trucks are now getting about 5 miles to the gallon."

And let me just say, in making that comment, we were not opposed and do not oppose the new engine requirements and the use of ultra low-sulfur diesel, but we do want to make the point that those don't come without some cost. And to put a fine point on that, for a company like Mr. Pottle's, whose individual trucks might

travel 125,000 miles annually, at a 4-mile-per-gallon average, he would use 31,250 gallons to travel those 125,000 miles. At 5 miles per gallon, that would be 25,000 gallons, and at 7 miles per gallon, that would be 17,857 gallons.

If we were to apply today's rate of $2.79 per gallon cost for diesel, Mr. Pottle's cost per truck would be as follows. Again, at the 4, $87,000. At the 5, $69,000. And at the 7, $49,000. The approximately $20,000 difference between a 5 and a 7-mile-per gallon fuel efficiency rate multiplied by the number of trucks operated by a small business like Mr. Pottle can literally make the difference between business success and business failure.

I have a number of recommendations in our testimony, but I would like to focus on one because given the current debate in both the Senate and the House, is the APU weight exemption. The Energy Policy Act of 2005 included a 400-pound weight exemption for alternative powering units that allow truck drivers to run fuel-efficient devices, such as generators, to operate heating and air conditioning units instead of using the main engine. The Federal Highway Administration has interpreted this language, incorrectly in our opinion, as giving States the option of allowing this exemption rather than establishing a nationwide standard as Congress intended. We need language clarifying Congress' intent to ensure that small trucking businesses don't have to choose between advanced idle reduction strategies and lost productivity due to a weight penalty.

Furthermore, we support legislation currently in the Senate, S. 894, that would provide a tax incentive to help offset the cost of these devices, since many small businesses simply cannot afford to buy them.

I have other suggestions here, including speed limits. Even within our own industry, the speed issue is somewhat controversial. I notice that Senator Tester is smiling. I had the pleasure of presenting ATA's position to the Montana Trucking Association to have a national speed governed at 68 miles per hour, and Senator Tester, I barely got out of the State. But we believe it is the right thing to do and we would certainly urge whatever assistance we might get from the Congress on that, as well.

I would be happy to answer any questions.

[The prepared statement of Mr. Lynch follows:]

Before the

SENATE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

Statement of

THE AMERICAN TRUCKING ASSOCIATIONS, INC.

On

"THE IMPACT OF RISING GAS PRICES ON AMERICA'S SMALL BUSINESSES"

Timothy P. Lynch, Senior Vice President
American Trucking Associations

June 14, 2007

The American Trucking Associations, Inc.
430 First Street SE
Washington, DC 20003

Introduction

On behalf of the membership of the American Trucking Associations, I want to thank Chairman John Kerry and Ranking Member Olympia Snowe for giving us the opportunity to testify on the impact of high fuel prices on small trucking companies. The American Trucking Associations is the largest national trade association for the trucking industry. Through a federation of other trucking groups, the industry-related conferences and its 50 affiliated state trucking associations, ATA represents more than 37,000 members covering every type of motor carrier in the United States. The trucking industry is a vital component of our national economy. In 2005, trucks transported nearly eleven billion tons of freight domestically, representing 69.0% of all freight transportation tonnage. The trucking industry accounts for 84% of all freight revenues and exclusively serves the freight needs of over 80% of all communities in the United States.

While the industry is very large, it includes hundreds of thousands of small businesses. As of November 2006, there were over 700,000 interstate motor carriers in the U.S. classified as small businesses - 97% operating twenty or fewer trucks.

For most motor carriers, fuel is the second-largest operating expense after labor. Small carriers are particularly vulnerable to large and swift increases in fuel prices. Typically, the smaller the carrier, the larger percentage fuel represents of total operating expenses.

Over the past four years the price of diesel fuel has steadily increased. According to the Energy Information Administration (EIA), the national average price of diesel rose from $1.81 per gallon in 2004 to $2.41 in 2005 and then rose again to $2.71 in 2006. Unfortunately, there doesn't seem to be any relief in sight. EIA analysts now estimate that diesel will average $2.75 per gallon in 2007 and $2.76 per gallon in 2008.

This year, in order to haul the nation's freight, the industry will consume 51 billion gallons of fuel, including more than 38 billion gallons of diesel fuel at a record cost of $106 billion -- $3 billion more than in 2006 and more than double the industry's fuel bill in 2003.

The sharp increase in the cost of diesel fuel is a hardship for small trucking companies but the full impact must be viewed in the context of what is occurring with fuel economy and environmental controls. This challenge is fully captured in the comments of the President of Pottle Transportation of Bangor, Maine. Barry Pottle who stated, "25 years ago, my trucks were a little over 4 miles to the gallon. In the mid-90s, my trucks were getting close to 7 miles to the gallon. With the new engines and new requirements for the use of ultra low-sulfur diesel, my trucks are now getting about 5 miles per gallon."

In order for one of Mr. Pottle's trucks to travel 125,000 miles annually – somewhat typical for his type of operation – he would consume fuel at the following rates:

4 mpg	31,250 gallons
5 mpg	25,000 gallons
7 mpg	17,857 gallons

If we apply today's rate of $2.79 per gallon cost for diesel, Mr. Pottle's costs per truck are as follows:

4 mpg	$87,188
5 mpg	$69,750
7 mpg	$49,821

The approximately $20,000 differential between a 5 and 7 mpg fuel efficiency rate multiplied by the number of trucks operated by a small business can make the difference between business success and business failure.

The remainder of my testimony focuses upon several alternative programs that would help reduce the cost of diesel fuel.

Size and Weight

By increasing the amount of freight each truck can carry, our industry can deliver goods using less fuel. For example, trucks loaded to 97,000 pounds will use 15% less fuel to deliver the same amount of freight as trucks that are limited to 80,000 pounds. Federal law, however, prevents states from adopting common-sense changes. For example, trucks operating in the State of Maine enjoy significant fuel savings, among other benefits, because the state allows heavier trucks on its highways. Unfortunately, federal restrictions prevent Maine from fully utilizing this strategy. We urge Congress to give states greater authority to change size and weight regulations on highways under their jurisdiction.

APU Weight Exemption and Tax Credits

The Energy Policy Act of 2005 included a 400 pound weight exemption for alternative power units that allow truck drivers to run fuel efficient devices such as generators to operate heating and air conditioning units instead of using the main engine. The Federal Highway Administration has interpreted this language – incorrectly in our opinion - as giving states the option of allowing this exemption, rather than establishing a nationwide standard as Congress intended. We need language clarifying Congress' intent to ensure that small trucking businesses don't have to choose between advanced idle reduction strategies and lost productivity due to a weight penalty. Furthermore, we support S. 894 that would provide a tax incentive to help offset the costs of these devices, since many small businesses simply cannot afford to buy them.

Speed

Trucks burn less fuel when they drive at a slower rate of speed. ATA has submitted a petition to the USDOT asking the agency to mandate the use of speed limiters on newly manufactured trucks at a setting no higher than 68 mph. We urge the Congress to support this petition.

Environmental Regulations Impact Upon Fuel Economy

The trucking industry is proud of its environmental record. Today's trucks emit only a small fraction of the pollutants emitted by older trucks. In fact, it would take 60 diesel trucks produced today to equal the emissions of a single diesel truck produced in 1988. I have included a chart with my testimony showing the fuel economy trends as calculated by both the industry and government.

However, clean air is not without cost. These environmental benefits have produced dramatic increases in the cost of new trucks and the ultra low sulfur diesel needed to power them. These regulations also have had a negative impact upon fuel economy. In fact, today's trucks are no more fuel efficient than trucks produced two decades ago and the new fuel they require has less energy then the higher sulfur fuel it replaced.

It is important to recognize the historical tradeoff between reduced emissions and fuel economy. Congress should require EPA to properly consider this phenomenon as it evaluates heavy duty diesel engine emission standards.

Conclusion

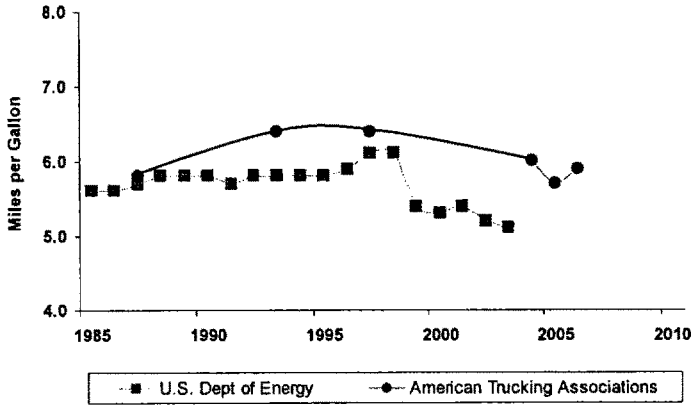
The impact of high fuel costs upon small trucking companies is profound. In seeking to ameliorate this impact, we all must recognize that fuel has become a global commodity subject to the laws of supply and demand. Measures to increase the supply of fuel or reduce demand will lead to lower fuel prices.

On the supply side, Congress should consider the role of renewable and alternative fuels in increasing and diversifying fuel supplies. We also must explore new sources of petroleum, and ways to increase domestic refining capacity.

In examining ways to reduce the demand for fuel, Congress should consider allowing more productive trucks on the nation's roadways, supporting mandatory speed limiters in new trucks, and providing incentives for the use of auxiliary power units to reduce truck idling.

I want to thank the Committee for the opportunity to discuss the impact of high fuel prices upon small trucking companies and the opportunity to introduce strategies to help lower fuel costs.

FUEL ECONOMY TRENDS



Chairman KERRY. Thank you very much, Mr. Lynch. I learned first-hand out there how tough that issue can be for a lot of folks on those wide-open roads for long distances. It is a pretty important issue.

Thank you, all of you, very, very much for the testimony here today. We are going to do about 5-minute rounds, try to give everybody a chance to get in here. We can go for a second round afterwards if all of you can put up with that. I know there will be a lot of questions and a lot of areas we want to try to cover.

Mr. Caruso, if I could just begin, you mentioned quickly that the throughput is lower—the refinery throughput is lower. A lot of Americans don't understand that. They are having trouble seeing the crude prices are low, but we still have this problem of supply. Can you just help explain to people? A lot of small business people keep saying, am I getting manipulated? Am I being jerked around here? The oil companies walked away with, since 2005, $225 billion of profit, record levels of profit, and a lot of people sit there and say, well, what if they had only had $220 billion or $200 billion or $180 billion? Is that really the difference in their success versus the success of these folks over here? So can you help people understand why the throughput is so low given the crude situation and where we are on the manipulation issue?

Mr. CARUSO. Sure. Why the throughput is low is that there have been a number of refineries out for either planned or unplanned maintenance this year. This is not particularly unusual for January and February, because normally refiners take down units that need to be maintained for safety and efficiency reasons in order to be ready for the peak driving season. So——

Chairman KERRY. Question—should that be, therefore, left up—since it is having such a dislocative effect on the marketplace, and as Mr. Smith and others have said, this is not a free market sort of structure, should there be some better planning as to what the rate of that offline maintenance, et cetera, is for the at least planned downtime, because it is having a serious impact on small business, as you can hear.

Mr. CARUSO. Yes.

Chairman KERRY. And a lot of people question whether that planned maintenance truly couldn't be done in a more effectively planned manner.

Mr. CARUSO. Well, the companies, of course, try to plan it to maximize their own individual sales opportunities. So no individual company would take down a refinery because it would be to their own detriment. They would lose sales. So the individual refiner's objective is to do this in the most efficient and planned way so as to maximize their sales.

Now, what has gone wrong is there have been a number of unplanned outages. You know, of course, we are not an investigative agency in any way, but we certainly have not seen any reason to think that there was any attempt to manipulate the market——but that is not our role. That would be the Federal Trade Commission, of course.

Chairman KERRY. Can you comment on the likelihood of the scenario that Mr. Smith described, where you have oil prices at $120 a barrel?

Mr. CARUSO. Well, that is certainly possible, but it would take a huge disruption in either crude oil or refined products to get to that kind of number. One could pose—and I know the group that Mr. Smith is part of did that in the scenario planning that he mentioned—a severe disruption because we are so dependent on imports. It could certainly—in the short run, there is no real pressure relief valve except price because there is very little cushion, as I have mentioned, with such tightness in capacity. And, of course, the Strategic Petroleum Reserve might get you through a short-term situation, but in a long-term disruption, you could get very high prices.

Chairman KERRY. Mr. Smith, to what degree has this increased price changed or affected the way you do business with small businesses? I mean, has it had an impact? Have you changed actual practices?

Mr. SMITH. Well, I think the testimony that you heard indicates where it has had the most effect on small business. We decided a long time ago that we should not be in the oil futures market, so we have in our rates a baseline crude oil price, which we put on the Internet. And then as the price of crude goes beyond that, we have a surcharge. So many of the price increases that were mentioned are the run-up in fuel prices reflected in the surcharges.

For the air express business at FedEx Express, those surcharges have gotten up at times during this run-up in fuel prices to almost 20 percent. For our ground parcel service, it has been somewhat less, but still very significant. And in the aggregate, when you are shipping many small shipments the way many of our small business customers do, this gets to be a very considerable expense to either them or their customers.

Chairman KERRY. So yours is essentially a straight pass-through based on a very transparent—it is very transparent——

Mr. SMITH. Yes, and we have over the last 3 years steadily increased the base barrel of crude price. We use the DOE numbers to establish that.

Chairman KERRY. Also, share with us, if you would, speaking from your experience as a business person, having come to the judgments you have come to, why we still have resistance in some quarters about the change in the CAFE standards and in trying to get better fuel efficiency on cars. I think one of the major auto makers stood up the other day and suggested that this was going to hurt their industry, et cetera. You are obviously of a different opinion, both from a security point of view, as well as a business point of view. Can you share with us quickly why you think it is so compelling and important that we respond with that as one of the components of our overall approach?

Mr. SMITH. Well, as I mentioned during the testimony, and in the simulation that as done in Davos, it assumed a 4-percent reduction in worldwide supply. That is, as you well know with your knowledge of geography and naval matters, very easy to accomplish. By simply shutting down the Straits of Hormuz, you would have far more than 4 percent of worldwide supply taken off the market. Many individual producers, which are subject to very volatile political situations, could take that amount off the market. So

that is not far-fetched and it is about 3 million barrels of oil a day, 4 percent of 80 million barrels of need worldwide per day.

We were very mindful about the issue of the auto manufacturers in coming up with our recommendation. Certainly, the last thing in the world we would want to do is to harm our automotive manufacturers. They are wonderful customers and great business partners, and I think the facts of the matter are that our balanced approach, which provides funds from the government, largely through royalties and all from increased production, and allows them to retool, would get them into a better market position, because I think the record is pretty clear. The U.S. auto manufacturers with the old fleet average CAFE standards built a lot of small and profitable cars and a lot of large profitable trucks, and it would have been a lot better had they, like the foreign manufacturers, been producing a lot more fuel-efficient vehicles.

So we certainly believe that nothing we have suggested at the end of the day is harmful. Now, the auto manufacturers, I certainly can't speak for them, but I do think that they have come around to the point of view that fuel efficiency standards are probably in the cards and now they are really just talking about what those percentages should be.

I would point out one final thing to you, Senator. In 1975, when the Ford administration and the Congress passed the original fuel efficiency standards, as I said in my remarks, they were opposed by the auto manufacturers. Subsequent to the fact, Henry Ford II, who was the CEO of Ford Motor Company, to his credit, said, "I was wrong," that this country would not have achieved the improvements in energy efficiency that it has achieved absent those fuel efficiency standards.

And I think we are simply in the same place we were before, except in a much more serious state of vulnerability because, as you noted in your remarks, imports have gone up from 37 percent to almost 60 percent. So we have an extreme exposure to a disruption in supply in terms of our economy security and we are already in the Middle East and involved in combat operations over there and I don't think these four-star admirals and generals came to this conclusion lightly, either. They see a real prescription for a severe national security challenge unless we do something.

Chairman KERRY. I appreciate that very much.

Senator Snowe.

Senator SNOWE. Thank you, Mr. Chairman for initiating this hearing that rightfully focuses on the impact of rising gasoline prices on small businesses. I also want to thank all our witnesses here today for their very graphic and compelling testimony that speaks to this issue, which affects small businesses and Americans and particularly low-income Americans disproportionately. I know I have seen that in my State.

We in America depend on jobs being created from the small business sector. Approximately two-thirds of all new jobs each year are created from small businesses. So if they are affected disproportionately and they can't survive, we can't thrive in America. So this is clearly an issue of major national priority.

We have abrogated our responsibilities over the years, frankly, in developing a very bold and comprehensive National Energy Policy.

We failed to execute the leadership, and as you mentioned, Mr. Smith, in 1975, it was a generation ago that we enacted CAFE standards for this country that yielded a 40-percent increase. I am just relieved that we are finally considering in the base energy bill that is pending before the Senate, a CAFE standard increase of another 40 percent that Senator Feinstein and I have been working on for the last 6 years. There will be efforts to undermine that and I hope we can resist them. This is the minimum and the least that we can be doing today in order to improve fuel economy standards.

Ater all, the transportation sector represents 40 percent of the fossil fuel that is consumed in America. And we have seen significant job losses in the automobile industry, which needs to be on the vanguard and the cutting edge to be able to offer choices to the consumers. They have lost jobs and yet we haven't increased fuel efficiency standards. And we are losing jobs today, because every 10-percent increase in oil prices results in 150,000 jobs being lost in America.

And so I think that we have much more to do. Hopefully, we can create an ambitious National Energy Policy. We are surrounded by the consequences of a lack of a National Energy Policy and it has repeatedly manifested itself, whether it is in our environment, our economy, or as you say, Mr. Smith,and our national security. We cannot be shifting billions of dollars from America to the most volatile, radical regions and leaders in the world, and that is essentially what we are doing. So it is in our national security interest to reduce our reliance on imported oil.

We need to help small businesses, as well, in this process. People say that we don't have the ability to develop the technology to increase CAFE standards by 10 miles per gallon over 10 years. I mean, this country has been founded on innovation. But when you think about it, 1985, was the last year in which passenger vehicles went up as a result of the 1975 increase. Think of where we are today. We have got hand-held computers from mainframes. We have gone from landlines to cell phones, encyclopedias to the Internet. And we are saying in America we can't do better?

Absolutely, we can, and that is what the bill on the floor hopefully can accomplish in challenging that innovation and the wherewithal, and also spearheading efforts here. And I know Senator Kerry and I are going to be working on an initiative to see if we can help small businesses play a leading role in promoting energy efficiency and combating climate change. But in the meantime, hopefully, we can do everything we can in the bill that is pending.

Mr. Smith, I just wanted to ask you, is there anything more we should be doing in this bill? I thank you for co-Chairing the Energy Security Leadership Council. Is there anything more we ought to be doing in this bill that is before the Senate?

Mr. SMITH. Well, Senator, the council's recommendation, I want to urge people to look at again, is a comprehensive bill. It sits on three fundamental pillars. It is the different, new, by category, by attribute, fuel efficiency standards with the off-ramps, incentives and help for the auto manufacturers to retool, alternative fuel production that is truly feasible. We all would love to think that we could raise switchgrass in Montana and the Plains and fuel our vehicles, but we are a few years away from that and we don't want

to destroy the food markets by overshooting there. And the third part about it, and I know this is controversial in certain areas, is increased domestic production.

So it is all three of those which is the best way to deal with the problem, and quite frankly, from our perspective—and here I am preaching to the choir, you folks know a lot more about this than I do—but it seems to be that you cover the political spectrum in a grand compromise with legislation such as we recommended and I think is reflected in the bill put forward by Senators Dorgan and Craig.

So that is what we would recommend, a balanced approach with all three of those things. And I think the military officers in our council would also say there is a fourth element, and we have to get folks around the world who benefit from the security that the United States military and particularly our Navy provides to the movement of this oil around the world, that they have to get in the game and help pay for this.

Senator SNOWE. Good point. Mr. Lynch, you mentioned Pottle Transportation, and I am very familiar with that company. In talking to them, it is amazing. Last year they made a significant profit. That has now dropped even though they had an increase in business of more than a million dollars. Their lost profit is attributed primarily to the rising price in gasoline.

One of the issues that has surfaced in Maine over the last few years, and one we are trying to change here, is the whole issue of truck weight limits, and you referred to that in your testimony. In fact, I met with a group from Maine yesterday that suggested that we could have a national standard in America on weight limits. There are 29 States that have waivers from the weight limits on the Interstate of 80,000 pounds. Data indicates that if we had a national standard of 97,000 pounds uniform across the country, that we could promote highway safety. This is it a safety question for us in Maine, because having these big trucks rumbling through small towns can lead to accidents. In fact, we have had two serious tragic accidents recently in Maine as a result of that.

But second, it would achieve an enormous savings in fuel cost, not only to the truckers in Maine, the independent truckers, but also to this country, not to mention the impact on the environment. Can you speak to that question?

Mr. LYNCH. Certainly, and I would really give two comments on that. First, that recommendation on the 97,000 pounds was also part of the Energy Security Leadership Council's overall recommendations. When we saw that, there are certainly portions of the recommendations that are going to be a little harder to deal with than others and to accept, but we saw that as a very, very positive step.

It is important to keep in mind the whole issue of truck size and weight, the debate previously has generally been along the lines that we are going to run these bigger, heavier, longer trucks on every road, every time, everywhere. The fact of the matter is that right now today, there is something called the National Highway System, the NHS system. That system represents about 7 percent of the entire road network in the country. That system handles 75

percent, though, of the freight traffic, the truck traffic that runs in the country.

So what we would like to see is concentrate on those roads where the freight is moving. Do what needs to be done. We understand that there are bridge issues that have to be dealt with, off-ramp, on-ramp issues, et cetera. But we think that these are, as you said, these are not insurmountable problems. I mean, we can look at these things, identify where the work needs to be done and what has to happen to make this equipment the standard on the highway, because we can, in fact, reduce the number of trucks that operate on the system if we can look at this from a little more rational way.

Senator SNOWE. Thank you.

Chairman KERRY. Thank you, Senator Snowe.

Senator Corker.

Senator CORKER. Well, thank you, Mr. Chairman. I think this testimony has been very enlightening and timely because of what is on the floor right now and I want to thank the testimony that has been received regarding businesses. I was on the board of one of the companies that Mr. Lynch represents and find it hard for them to figure out how to have a steady stream of profits based on the various volatilities they face, and certainly have dealt with some of the issues that you have focused on in your testimony and want to thank you for that.

I think the reason, though, we are focused over here a little bit today is we are dealing with some global issues, and I think the testimony, Mr. Smith, that you gave could not be more dead on. I was just in Brussels a few weeks ago meeting with European officials, talking about some of the energy policies that have been put in place, and I think that sometimes we here in our country pick winners and losers, or try to pick winners and losers instead of having a balanced approach where we have an overall goal that absolutely focuses on energy security, and I think that is one of the biggest mid- to long-term issues that we face in our country. I could not agree more.

But combine that with raising the standard of living for future generations, growing our GDP, but combines that with certainly lessening the impact that we have on our world, the climate, environmental considerations. And I think if we can hit that sweet spot with our energy policy, then we have done something that will be great for generations to come.

I would like to just reiterate for my colleagues that I think what Mr. Smith has said is that he embraces the CAFÉ standards that are in the base bill put forth by Commerce, and I find that fascinating and I appreciate that. We have had a number of Tennessee companies that do the same.

But I would like for you and Mr. Caruso to focus on an issue. I am proud to be on the Energy Committee and we have a really aggressive alternative fuels bill. I am setting out an amendment that I hope will pass that just sets a standard and doesn't pick alternative fuels specifically, but sets a standard for us to meet, because other technologies will come into play.

But one of the issues that you both have focused on is the refinery issue and domestic production, and that is something that we

seem not to want to embrace here in our country today, and there is a lot of focus on price gouging. There is a lot of focus on refineries being down. I wonder if you all could talk a little bit about what appropriate policies should be in place nationally to affect our refining capacity and our own domestic growth.

Mr. CARUSO. Well, as you know, Senator Corker, EIA is not in the policy business, but I can give you some of the fundamentals that would lead to the investment needed in the downstream refinery sector. There hasn't been a new grassroots refinery constructed in this country since the late 1970s and that is part of the problem. And one of the reasons that exists is that for most of that 25 to 27-year period the return on investment in that sector has been poor. So therefore, the only additions to capacity have been made at existing plants. That is partly a problem of getting permitting and other issues, but it is mainly that the fundamental return on investments was poor.

Now, as one looks forward, how do we change that? The way to change it, of course, is to make it more attractive to invest and for a typical refinery now in the size of, let us say, 300,000 to 400,000 barrels a day, companies are looking at $6 to $8 billion in investments that would require about a 20-year time of operation in which they can get a return on that investment. Frankly, there is a lot of uncertainty about what the investment climate will be for refined products over the next 15 to 20 years.

I think some of the things that are being discussed in the current energy bill and that were passed in the Energy Policy Act of 2005 are helping to clarify that outlook, but clearly companies in the petroleum downstream sector are looking at greater regulatory certainty and issues that you talk about in some of the other industries represented here today. But that is the fundamental issue—getting the investment needed to meet the demand that we are projecting.

Mr. SMITH. Well, Senator, one of the things I would just point out to the Committee that always makes me stop and wonder, we are heavily involved in China, as you know. We have been there 23 years. We have a very large business in China. The paper today talks about four Senators who want to put sanctions on China because of their level of exports to the United States or the balance of payments. But hardly anybody is talking about the balance of payments issue in the petroleum sector.

Five or 6 years ago, Saudi Arabia produced about $30 billion from producing oil. I think the last year we have figures, it went up to $200 billion. Forty percent of our balance of payments problem is from oil exporting countries that buy very little from us. The exports to China are going up at a very rapid rate, not as fast as their exports to us.

So as I said in my remarks, you have to recognize it is a worldwide market for oil, and a barrel of oil produced in the United States, whether it is Alaska or off the Outer Continental Shelf, has an effect on total worldwide prices and total supply.

And in the case of the refineries, when a business is looking at whether it can get a return on that invested capital, there is always a band in there. On the one hand, when prices are too low, they won't invest. But on the other side of the coin, when supply

is constrained, they have a disincentive to invest because they can maximize price on the existing investment. So the way to get refinery capacity, in my opinion, is to have a greater source of supply and let the market work to a greater extent than was the case before.

But it has to be, in our opinion on the Energy Security Leadership Council, a comprehensive approach. We are exporting billions of dollars, as Senator Snowe mentioned, to people who wish us ill. In the debate about U.S. production, there is always this oil spill off of Santa Barbara that is brought up that took place 30 years ago. Well, all kinds of technology, again, as Senator Snowe mentioned, has taken place in 30 years and I would point out to the Committee that during the disasters of Hurricane Katrina and the other one, whose name escapes me—Hurricane Rita and Katrina, there were 1,000 offshore rigs in the Gulf of Mexico. There wasn't one drop of oil spilled.

So not to be producing oil on our Outer Continental Shelf when the Cubans are getting ready to do it and so forth, or Alaska, it seems to me, is not in our strategic interest. So we would say that fuel efficiency standards, alternative fuels, and production are the answer.

Chairman KERRY. Thank you, Senator Corker.

Senator CORKER. Thank you.

Chairman KERRY. I appreciate it. I might just comment quickly, because this is an issue I have been involved with a lot around here for a long time. As we debate Alaska, 95 percent of the Alaska oil shelf is open for leasing and the largest lease in history was letted at the end of the Clinton administration and is still not fully exploited, I might add. In addition to that, the largest explored but unexploited oil field in the world is the offshore Gulf of Mexico, which we have permitted, which is allowed. A lot of the oil companies have not done that, I am told, because they are waiting for the price to be right on it.

So we have permitted significant additional production. I am all for it. I think we ought to have additional domestic production. But those are two places where you don't run into a whole bunch of political and environmental clash. They are there. They are available. They are subject to exploitation now and the oil companies are not doing it.

Senator Tester.

Senator TESTER. Thank you, Mr. Chairman, and I, too, want to express my appreciation to the members of the panel for their testimony today. I am not going to focus on Mr. Caruso or Mr. Smith as much as the other three, but I do want, particularly you, Mr. Smith, I want to thank you for your leadership in the area of production. I think the points you bring up are well founded and I certainly appreciate that perspective.

This can be for Janet or Sal, or both. You both run or are part of successful small businesses, at least to this point they have been successful for a number of reasons, and I am sure that when you do your short-term and long-term planning for the future, energy costs have to be something that you are very concerned about or you wouldn't be here today, as a matter of fact. What are you looking at as potential ways that you can save energy costs down the

line that you think are realistic, or are you just hoping the market gets better as far as price at the pump? Either one or both.

Ms. MYHRE. Just real quickly, with the local delivery, what we are finding is that we just don't have any options associated with the fleet or anything like that. We still only have gas-driven kind of vehicles. So the only thing we have is to sell more to absorb, you know, hopefully we get to that level where as our volume of sale increases, obviously the operational cost for delivery goes down. So that is what we focus on. We focus our energy into increase our volume to be able to absorb some of these without having to go to a downsizing, if you will. We do plan for that, but not in the initial. We plan for growth.

Senator TESTER. OK. Sal.

Mr. LUPOLI. Thank you, sir. Much like this answer that was just given, we found ourselves consolidating a lot of routes. You know, instead of making deliveries two to three times a week, we are trying to make that same delivery one or two times a week. We are trying to carpool with our employees. We really feel—I feel as the owner of the company that our biggest asset is our employees. That is what we have to look at first.

So, as far as looking at that bottom line, it is important. We want to continue to be profitable. But we will not be profitable if we don't take care of the kids that work in our company, and almost in excess of 300 kids that work in our company, or 300 adults, I should say, that work in the company, I find myself speaking to them and speaking to the managers how to help these guys consolidate the driving, public transportation and some of the things that were mentioned at this table. But it certainly results back to focusing on that individual worker that needs the most help in my organization right now.

Senator TESTER. Thank you. Mr. Lynch, just as a sidebar, the reason I was kind of chuckling is because once upon a time in Montana, we didn't have a speed limit, and I happen to have been in the legislature when we put one in and I remember the Trucking Association coming in and saying they wanted, I believe it is 65, and then I remember going back to my offices and getting calls from the independent truckers that were not happy, to say the least. So that is what brought a smile.

But at any rate, what I want to talk to you about real quickly is the low-sulfur fuel and if, and I think it is going to happen, we get standards for biodiesel so biodiesel becomes something that the quality is dependable on, what kind of impact do you see that having on the low-sulfur fuel issue and the fuel economy issue?

Mr. LYNCH. On the ultra low-sulfur diesel, we are in the transitional stage now. I think we are probably almost up—well, frankly, we might even be up close to 100 percent now. That transition began in October. I will be very honest. Many of the problems that had been anticipated did not materialize. There still are some questions about clogging of the filters, some other issues, particularly in the colder weather States, there have been some issues there. But again, we didn't see nearly the number of problems that we had anticipated, but they could be longer-term.

Senator TESTER. Right.

Mr. LYNCH. Now, with respect to the biodiesel, we could not agree with you more on the need for a standard. We think—we are very supportive of biodiesel, very supportive of its use. We certainly want to see, though, standards so that when every farmer decides that they are going to start producing this stuff, that when it gets into the stream, that it is of high quality, because frankly, we have an issue also then with the engines and the warranties on the engines. We have had this sort of back and forth with the manufacturers.

But again, I think if we stick to a standard, a Federal standard, and we would hope that the current pending energy bill would include something along those lines, labeling, and we are a little ambitious. We would like to see a little preemption so that we don't get a plethora of boutique fuels around the country, but we also recognize the challenges with that. But that is certainly what we would like to see.

Senator TESTER. Do you think that will help with the sulfur issue?

Mr. LYNCH. My understanding is that it will not only help with the sulfur issue, but with the emissions issue, as well.

Senator TESTER. OK. Just one other question. It deals with your testimony that talked about the Federal Highway Administration interpreting language on basically a generator that is allowed in the truck for 400 pounds and they are not allowing for that weight exemption. How long has this been going on, because to me, it makes perfect sense from an energy standpoint and from a common sense standpoint to have a generator instead of a big old hunk of cast iron sitting there pumping heat or cooling to your cab. How long has this been going on? When was the exemption given and when did they take it away?

Mr. LYNCH. Language was included in the Energy Act of 2005. Like most things in this town, the intent and then the interpretation when it gets to the agency, sometimes it drops a bit. In this case, the Federal Highway Administration, and we are not critical of them, but Federal Highway said the way the language was written, it is not mandatory. It is basically State by State. Well, for trucks running interstate, they can't purchase the equipment and be able to run it in one State, but not run it in the other, so consequently, it is of little value. So we are still exploring with the Department as well as in Congress ways to get that done.

Senator TESTER. OK. I will rely on people who have more experience than I to figure out ways to influence the bureaucracy. Mr. Chairman.

Chairman KERRY. Thank you, Senator Tester.

Senator Cantwell.

Senator CANTWELL. Thank you, Mr. Chairman, and thank you for holding this important hearing. I think when we talk about all the issues in regards to our energy supplies and the high cost, I think many people often forget the impact on small businesses and those that are particularly impacted because they are in the transportation sector, so thank you for having this hearing.

Mr. Smith, thank you for your leadership on trying to get a larger focus on this issue from an industry perspective and from a national security perspective. I noticed in your Q&A answer back and

forth that you said you no longer were participating in energy futures as part of your business. Why is that?

Mr. SMITH. Senator, it is probably because we are not smart enough. But we simply decided that the markets were so volatile that as a large publicly held company, we shouldn't be speculating on oil prices. We make it very transparent to our customers whether using express, ground, freight, or what have you, that this is the baseline, the barrel price of fuel that is baked into the rate, and then each month, we have a surcharge if the prices go beyond that. And we just think it is a better way to do it. We lose as prices run up because we are about a month behind on the posting, and then we pick up it, hopefully, if it ever goes down, on the other side. It is just a business decision that is fairly standard in our industry as opposed to the passenger airline industry where there is a lot of fuel hedging that goes on.

Senator CANTWELL. Well, it is a very interesting comment. I hope that somebody doesn't write a sequel to "The Smartest Guys in the Room" that now is about how the lack of transparency in energy futures market, which again, you can't figure out. It is too volatile. So a basic function that allowed businesses to do something to protect against future prices no longer works, and it doesn't because it is too volatile and I personally believe we don't have enough transparency there.

I hope you will consider the 787 coming out from Boeing that is 20 percent more fuel efficient. I think that they listened to customers. Given your CAFE comments, I think the aerospace industry listened to customers and said, we need a more fuel-efficient plane. Achieving 20 percent more fuel efficiency is going to be quite a landmark, so we are excited for that.

Mr. SMITH. I might mention, Senator, that we have on order 15 of the new Boeing 777 freighters, which we start taking delivery of in 2009, and that airplane in subsequent editions, based on what the chairman of Boeing, Mr. McNerney, has told me, will incorporate many of these wonderful technology improvements embodied in the 787. So we are looking forward to getting those airplanes. They are about 25 percent more fuel efficient than the MD–11s which we currently operate.

Senator CANTWELL. Thank you. Thank you for that.

Ms. Myhre, when a small business is caught between these high expenses and delivering service, we just heard Mr. Smith say how he had adjusted to large carriers and basically changing and creating a surcharge, what do you do when margins are obviously a lot tighter at the retail end? I mean, what is the end result if prices are going to keep going up? Are you just going to—I mean, is it going to be a job impact? You are going to lose customers? How——

Ms. MYHRE. It can. Originally, we try not to increase our costs to the end consumer. We are trying to absorb——

Senator CANTWELL. Why?

Ms. MYHRE. We are trying to watch the market. As you know, prices went back down very close to the election last year, back down to a manageable thing, and now again they have crept back up, and we understand there is a seasonal fluctuation. So we have tried to put that into our end prices to the customers for our delivery.

Right now, however, the trend has been continually to rise and rise and rise with no slide-back. So what we are going to have to do is start passing on the increase in our expense to the end product, to the end consumer. And we have quite large Federal contracts that that is a good portion of our business. It is destination. So every time I charge for a pencil, my freight cost has to be included in that unit cost.

So you are going to watch—I cannot surcharge the government for delivery. I have to deliver—you know, it is included in the cost of the goods. So we are watching our industry starting to charge more for a pencil and a pen, whereas before—it is starting to be competitive. There are larger plays that can absorb a little bit faster than we can, so——

Senator CANTWELL. Thank you very much. Mr. Lupoli, did you want to answer that, too?

Mr. LUPOLI. I think what is interesting in my business, we have had growth every single year since the inception and our philosophy in our business is we take a portion of the profits every year and reinvest them into the company for expansion. And I think what is happening in the fuel, for example, last year, we spent about $130,000 in fuel expense. This year, we are on budget to probably spend over $200,000. Now, that is going to come directly out of the bottom line. That is going to come directly out of profit. We don't have any intention or desire to cut back quality, cut back certainly employees.

So what is going to happen to us? That means we are going to have to cut back expanding our stores, and by cutting back expanding of the stores, we are not offering additional jobs out there. Although being a small business, every one of our stores typically employ anywhere between 10 and 15 people, and as we have a growth plan of 3 to 4 stores a year, well, that is a big impact if we are not able to expand our stores. That trickles all the way down to somebody that needs a job, a local person, a local mom, dad, individual that is looking for that job that doesn't have the ability or possibly the education for a high-paying job to come over to our organization. It is not going to be there because of these rising fuel costs. So in a——

Senator CANTWELL. Thank you, Mr. Lupoli, and thank you, Mr. Chairman. I appreciate that very much.

Chairman KERRY. Thank you very much, Senator Cantwell. We appreciate it. Thank you very much, and thank you for helping us connect with Ms. Myhre. We appreciate that very much.

Senator Coleman.

Senator COLEMAN. Thanks, Mr. Chairman. This is a very important hearing, Mr. Chairman. I really appreciate it.

Mr. Caruso, has EIA, have they done a study? I mean, we have some great testimony, but have you done a study on the impact of energy prices on small business?

Mr. CARUSO. We have not, Senator. We don't disaggregate our data collection to that level of detail.

Senator COLEMAN. It would be worth having more extensive information, and this has been—I am sitting here listening about 35 percent increases. I am wondering, Ms. Myhre and Mr. Lupoli, is there a point where we simply say—is there a tipping point that

says, we can't handle this any more? Is there a price of gas or something? I am amazed at this figure, 36 percent in a short period of time. I mean, your margins can't be that great. Is there some point where you say, we can't afford it. You are going to drive us out of business, or the price of gas will drive us out of business?

Mr. LUPOLI. That is a very real statement, sir, and the answer is yes. We are getting—my business, our business, we are getting dangerously close to those levels. What we would like to do is continue to increase sales, increase expansion, but we are really finding it difficult to maintain the foundation we built of giving all our employees insurance, offering them 401(k) plans, doing all those incentives to keep the people and create a lifestyle. We are finding it very difficult, very close to the point right now where those options don't exist anymore, or they have to be stopped and we are waiting for this market or this release to take place. Something has to happen in order to give us some kind of opportunity to expand, and the rising gas prices are preventing us from doing that.

Senator COLEMAN. I appreciate that. Ms. Myhre.

Ms. MYHRE. We are in the same option right now, I mean, the same level that you have to make that critical decision whether or not you have to scale back your operations in order to absorb, and what employees and what route. You know, a driver that drives a route, maybe we will go down to two routes. Maybe we will get rid of our local employees all the way around and they will be back home. But maybe we will go to an outside deliver service and pass it on that way. So yes, every day, there is a decision that has to be made to absorb 35 percent—any line item of your financial statement.

Senator COLEMAN. Is there anything, and Mr. Smith, you have looked at the big picture, and maybe Mr. Caruso, is there anything the Government can do in the short term? Is there anything that we are not doing right now that we could be doing to lower the cost of a gallon of gas?

Mr. SMITH. Well, I think, Senator, the situation we are in built up over many, many years. We see this very clearly in our business and I think you would find that the Federal Reserve looks at our traffic and UPS's traffic as an excellent surrogate as to what is going on in the economy as a whole, and since the majority of all business activity is small business, one of the things that we have seen over the last year is the echo effect of this run-up, and there is just no question that the current economic slowdown is directly attributable to the run-up in fuel prices which has acted as a tax, particularly on small businesses and lower-income people, where those dollars have been shipped offshore and they are not recycling in our economy.

I think Sal's testimony was perfect about the people that used to come into his restaurant several times a week have to scale down. So that is what you are seeing. If the situation were to become worse by the withholding of some supply, either because of a political act or the cartel determined to increase it more, I think you would see significant economic travail in this country, particularly in small business.

Senator COLEMAN. And yet we clearly have to take a long-term view, and I——

Mr. SMITH. Well, that is the problem. You know, I don't know any short-term palliative. Obviously, you do something like have the Government short the market or put petroleum out of the Strategic Oil Reserve, but it would just be a short-term effect. I mean, these are long-term issues and they need to be dealt with in a comprehensive long-term fashion, in our opinion.

Senator COLEMAN. Just one question about CAFÉ. Clearly, we have to be more aggressive. With the underlying bill there is going to be an alternative that is out there. The industry is, I think, finally getting it. They are a little slow to the dance, but they are getting it. Do you have a position on a particular—I thought my colleague from Tennessee asked a question about your position on the underlying bill. Do you have a position on a particular proposal or is it just the general concept that the industry has to be at the table and they aren't now?

Mr. SMITH. Our proposal was reflected in the bill that was put in by Senators Dorgan and Craig, which call for a 4-percent by category, per year, administered by NHTSA, but very importantly, with off-ramps if it were technologically infeasible or there were safety considerations, you know, traffic fatalities went up or whatever the case may be. So you have that and then you have, I think in the Commerce bill, Senator Feinstein's bill, I believe it is 3½ percent.

But the council believes that the underlying technology would support what is in the Dorgan-Craig bill. Obviously, politics enters into the equation. Maybe there is a compromise at some other level or lower level, I don't know. But we support the Dorgan-Craig bill and certainly the Feinstein bill is in that direction, as opposed to lower levels.

Senator COLEMAN. I appreciate your leadership in this area. Thank you.

Chairman KERRY. I think, I may be wrong, but I think the Feinstein bill may ramp up after a number of years. It ramps up to the 4 percent. So we actually get much closer than people would think, and there are some restraints on the off-ramps. I think people have been nervous that the off-ramps could be deemed by some people to be a non-compliance invitation. That is a balance that people are trying to get at. But we hope we can hold it together on the floor.

Senator Cardin, welcome, sir. I think we are going to have a vote around 11:30, so go right ahead.

Senator CARDIN. Mr. Chairman, I am going to be very brief. I really apologize for not being here earlier to listen to the testimony and hear my colleagues with the questions and your answers. The Judiciary Committee, as you know, various committees including the Judiciary Committee had markup today and they needed to make a quorum, so I was over in the Judiciary Committee for this morning.

But I really wanted just to come by to thank the Chairman and the Ranking Member for holding this hearing. I think this is a critically important issue to get your input. The energy policy in this country is so important to this Nation for national security, becoming energy independent and less vulnerable to other countries' whims. It is important for our environment. Global climate change

is a real issue that we need to deal with as a Nation and show international leadership.

But it is also important for economic reasons. I can tell you, businesses in my community are hurting from the 40 percent increase in gasoline prices over the last 5 months and energy costs generally. So I look to this Committee and I look to the leadership within our business community to come forward with workable ways that we can find the technology to advance energy independence and can deal with the economic realities of the energy pricing as to economic growth in our community.

Mr. Chairman, I am not going to venture to ask a question that may have already been asked, but I wanted to come by and tell you that I think this hearing was extremely important. I will look forward to reviewing the testimony of the witnesses.

Chairman KERRY. Thanks a lot, Senator Cardin. We appreciate it.

Senator Thune, I apologize. I didn't realize you had come back in. It was my fault. I am sorry about that.

Senator THUNE. Mr. Chairman, I, too, want to express my appreciation to you and Senator Snowe for holding what I think is a very important hearing. The impact of fuel prices and energy prices on small businesses is certainly something that is being felt all across the country. And in my State of South Dakota, we travel long distances and we are very dependent upon the agricultural farm-to-market economy. Obviously that is an input cost that our economy is having to bear out and it is having a profound impact.

I guess I would just like to ask a question of some of the small businesses on the panel about whether any of you have considered switching to alternative fuel-type vehicles, hybrids or flex-fuel vehicles, and if not, why, and what are the barriers to greater use of those types of automobiles.

Ms. MYHRE. The co-owners did do some research with our local fleet management companies, a Ford dealership. We went out and we did research to see if there was anything currently on the market to fit our delivery needs. We are a lot of stops, short route kind of delivery, much like a pizza delivery, I guess. But there currently is no alternative option for the type of vehicle we would use.

We only have one diesel truck, so obviously we could use the biodiesel, and Washington State is starting to have a better distribution system, I guess better than any other State, where you can get access to the biodiesel. But for a gasoline small delivery, we just don't have any commercial options right now.

Senator THUNE. Mr. Smith.

Mr. SMITH. Senator, FedEx, along with the Environmental Defense Fund and Eton Corporation, pioneered the development of a robust pick-up and delivery vehicle, 700-cubic foot delivery vehicle like you see our express and ground units using. It gets about 100 percent more fuel efficiency than the conventional diesel-powered. It emits about 10 percent of the emissions of a standard diesel-powered unit. The problem is, and these are rough order of magnitude numbers, a conventionally powered vehicle will cost about $55,000 and the hybrid will cost about $90,000. So it is impossible with that kind of disparity in capital cost, and if it were reflected in a small-

er vehicle used by office supply or pizza delivery, you would have the same relative, perhaps percentagewise even higher.

So as part of this fuel efficiency quest to reach this 4-percent goal, clearly, the way to do it in the pick-up and delivery area, and we did include in our recommendations that light trucks and heavy trucks be included for the first time in fuel efficiency standards, a big part of that would be to develop at scale hybrid pick-up and delivery vehicles, because it is a logical place to introduce those. But you would have to have incentives to be able to afford them as a small business unit or a company like FedEx, which employs 77,000 vehicles in our operation.

But clearly, as Senator Kerry mentioned, the technology is there. It is just the will and the incentives and the retooling and the production to put these vehicles—battery-powered vehicles for the smaller vehicles are certainly on the horizon. New battery technology can get us where we need to do. And all of those will be driven by a program like we recommended, which come from the fuel efficiency standards, because you have to use technologies like that to get to where you need to get to.

Senator THUNE. Mr. Lynch.

Mr. LYNCH. Senator, the Class 8 engine tractor is truly a marvel. This is an engine that typically for over-the-road truck operations can run anywhere from 150,000 to 200,000 miles annually. In some truck operations, the vehicle barely stops. There is a driver in it. It stops. The next driver comes in after the 10 hours, 11 hours. It is a workhorse vehicle. It is that efficiency and that dependability, I think, that ultimately, not in the P&D operation, but in the over-the-road long-haul operation, that is where the biggest challenge is.

As we look at it, when you are operating at a 4- or 5-mile per gallon standard now, you have a lot of room to grow and improve, and we certainly would like to see that. But part of the challenge there is that same tractor can pull 80,000 pounds or the same tractor can pull 30,000 pounds and that can make one whale of a difference as to how much of a CAFE standard that particular equipment is going to be able to achieve.

But it is certainly something that—I think one of the Senators said, what can we do? I think it is start now.

Senator THUNE. And it sounds like what I am hearing is that it is going to take that kind of a requirement. It is not going to happen, the economics are not there currently for you to start using those types of vehicles until they start producing them and have some sort of a requirement that they achieve a certain level of fuel efficiency and, therefore, get the technology into the assembly lines and what not to be able to move in a direction that would make those types of vehicles more cost effective. I mean, in your operation, that is significant, 55,000 versus 90,000, and I understand you need a workhorse engine.

How much of it, too—it seems to me that is a bigger issue than the question I am going to ask now, but how much of it, too, is having access to alternative fuels at the retail level? We have about 180,000 gas stations in America and of those, only about 1 percent make, for example, the 85 available, and most of that you are probably going to find in the Midwestern region. So it seems like we have also an infrastructure problem we have to solve, and these

things may have to all be solved kind of at the same time. But that is something I have been working on.

I think as we go toward hopefully cellulosic ethanol, we will see more and more, and the research phase is, of course, underway. Hopefully, commercialization is not very far away. But we have got a limit, I think as you noted in your testimony, Mr. Smith, to what we can do in terms of corn-based or kernel ethanol. We now have to look at other biomass to be able to produce it.

I thought your testimony was especially good with regard to what I think is a very precarious situation that we face in the world relative to where we get our energy. I think that it would not take much to disrupt or cause a significant increase in cost to the American consumer, the American business, if there is just the slightest hiccup in the Middle East or Venezuela or someplace like that. I describe that as a terrorism tax. I think we are paying enormous amounts of money to countries around the world who have hostile intentions toward the United States and that we need to diversify away from that.

The energy bills that we are debating this week and hopefully will continue to move legislation through here that addresses this issue, because I think that—I am a big advocate, as you might expect from my part of the country, for renewable energy. But we have got to add supply. We have got to add supply. We have got to figure out ways to get home-grown American energy so that we do not get 60 percent of it from outside the United States. I think that is a very perilous situation for our country.

So I am supportive of whatever steps we can take to move in that direction, but I am appreciative of your testimony and comments in response to questions about the best way to go about that and what makes the most sense in terms of your day-to-day operations. So thank you for being here and thank you for your testimony.

I have got a statement, Mr. Chairman, I would like to get included in the record.

[The prepared statement of Senator Thune follows:]

Statement of Senator Thune
Senate Small Business Committee
Hearing on Rising Gas Prices:

Chairman Kerry and Ranking Member Snowe, thank you for holding this hearing today. I appreciate the testimony from today's witnesses, and I thank the panel for joining us today. The current high fuel costs are having a direct impact on all Americans, including small business owners. Hearings like this one today is an effective forum for Members of Congress to better understand the implications of high gas prices and discuss common sense solutions to our energy challenges.

It is critical that Congress continue to enact meaningful legislation that reduces our dependence on foreign sources of oil and

strengthens our energy security. In particular, I believe America remains too dependent on oil from unstable and often unfriendly regions of the world. As gas prices continue to climb, our nation needs to shift its focus to alternative sources of energy to meet our energy needs.

My home state of South Dakota is well suited for this task. Over half of South Dakota's corn producers have invested in some form of ethanol production and we currently have 13 ethanol plants running and three more under construction.

Unfortunately, as a nation we have a long way to go. While our automakers have placed millions of flex-fuel vehicles on the road and continue to make more; less than 1% of the

180,000 gas station nationwide offer alternative fuels such as E-85.

I have introduced legislation that would greatly expand access to E-85, which is a blend of 85 percent homegrown ethanol and 15 percent regular gasoline. This bill would give small independent gas station owners grants to install E-85 and alternative fuel pumps. This legislation has been included in the comprehensive energy bill currently on the floor of the United States Senate.

Congress needs to act to ensure that American consumers, especially small business owners, have access to cleaner, more cost-effect fuels that are also better for the environment and made here in America. Again, thank you Chairman Kerry and Ranking Member Snowe for

holding this hearing on such an important topic. I also again thank the witnesses' that testified for their testimony. I look forward to working with my colleagues on this important issue.

Chairman KERRY. Without objection, it will be put in the record. I really appreciate the Committee's strong participation in this, obviously.

Just a couple of quick wrap-up questions and thoughts. First of all, I am going to be introducing legislation, the Small Business Emergency Fuel Assistance Act of 2007, which is based on a Presidential declaration of a fuel emergency. As we saw after Katrina and other instances, there are moments where you may really come into the kind of shortfall that Fred Smith has talked about. And under those circumstances, we want to create a grant program to help small businesses through a legitimate fuel emergency. This is not for standard business operation, but rather a legitimate Presidentially declared emergency. Eligibility for these grants would be restricted to businesses with fewer than 50 employees and less than $5 million in gross receipts, eligibility being determined on those businesses having a plan to, in fact, become more energy efficient. So hopefully we have a linkage there.

I might also comment that in the 23 years I have been here now, on the Commerce Committee, when Senator McCain and I tried to get CAFE standards raised to 35 miles per gallon about 5 or 6 years ago, and the mood of the Senate just was not there. In fact, one Senator actually brought a poster of a Volkswagen dragging a plow through a field—a purple Volkswagen, I might add—and that was the image and the sort of sloganeering used to try to deter people from moving in this direction, which has been obvious for a long time.

I think when Harvard and Stanford and Tuck and Wharton and places do their case studies in the future, one of the dramatic case studies is going to be the big three out in Detroit, tragically, who have again and again, from the 1960s on, missed market trends and missed what consumer desire is or could be, or what it might be marketed to. They have taken the simplest marketing route rather than sometimes the most visionary or the best or the most creative.

I know that in 1990, when we negotiated the Clean Air Act, I remember sitting there and listening to industry come into that room where we sat with Senator Mitchell off of the Majority Leader's office, with John Sununu and Bill Reilly and George Herbert Walker Bush involved it, and the industry said, don't do this to us. It is going to cost $8 billion. It is going to take 10 years. You are going to bankrupt us. We just can't do it.

The environmental community and others came in and said, no, it is not. It is going to cost about $4 billion. It can be done in about half that time and it won't bankrupt folks.

In the end, folks, it took half of that. It cost about $2 billion and it was done in about 2½ years. Why? Because no one was able to predict what happens when American ingenuity is unleashed around a national goal or standard.

We already have the National Academy of Sciences telling us we have the technology to dramatically change fuel efficiency. So we run into this simplistic resistance based on old visions of an old market, when there is really an enormous opportunity here to grab this and take the ball and run with it. We want cars made in Detroit. We want American workers making those cars. We want to

beat Toyota and BMW and all the rest of these folks. But you have sure got to market something, which is a product that makes sense.

I wanted to buy an E–85 vehicle to drive around Massachusetts. One gas station, in Chelsea, has the availability. For the price of 1 week of the war in Iraq, we could actually pay to put an alternative fuel pump in every single gas station in America. I mean, these are the real choices that we face.

And I concur with what Fred Smith said. We have to be careful not to go rushing off into the grain-based ethanol because of what it will do to the food markets, as well as what it does to soil, water, and a lot of other usages where you have these cellulosic opportunities.

And if you talk to the venture capitalists in California and Massachusetts and New York and elsewhere, they are already putting billions of dollars into these other sectors, some of them promising. They believe there will be an alternative to fossil fuel maybe 5 or 10 years from now.

So if we set this goal and we start to move our technology and creativity in that direction, I am absolutely convinced, based on past experience and current technology, that this is going to prove so much easier than people think. And Mr. Lynch, you commented on how many of the problems that had been predicted didn't show up in terms of the low-sulfur. I think the same thing will be true here and we ought to have confidence in America's ability to do these things.

I might ask you just one more question, Sal, in terms of your business. I wanted to provide a billion dollars of retooling to the auto industry and I wanted to provide a $4,000 per vehicle credit for hybrids, which I think would change a lot of attitudes. If you had a better tax incentive available to you on solar or on other fuel efficiencies, or you, Ms. Myhre, would that make a difference to sort of the business plan you lay out, what you might be willing to capitalize on, and ultimately, to your bottom line?

Mr. LUPOLI. Absolutely, yes, sir. What we would do is we would look at the long-range vision, not trying to put a band-aid on today but really look at this in 5 to 10 years from now. You know, oftentimes, people tell you, you know, buying electricity, trying to contract it right now, or trying to contract a fuel price right now. I want to extend that. They are trying to hold you to a 16-month or a 2-year program. I want to extend it to a 5- or 10-year program.

And if there were more exemptions and we took advantage of one of them in our State of Massachusetts by putting the second-largest solar panel system on a private business, we would do those things, because in the long run, we will be better off. As opposed to just looking at the short-term gain, I want to look at the long-term gain, because as prices continue to increase, when people try to talk about the amortization of that cost, we really look at it as the gap is going to close even much faster because it is not going to be a 10-year program. If prices continue to rise, it is really a 5-year program we are talking about. So before you know, you will open your eyes and that incentive and that opportunity will be there to take advantage.

Chairman KERRY. Obviously, your product is price-sensitive to your consumer, so there is a limit to how much you can absorb here?

Mr. LUPOLI. That is correct.

Chairman Kerry. Without starting to lose business, just based on your own pricing, and the same for Ms. Myhre. Have you, however, raised prices? Have you sort of reached that limit at all?

Mr. LUPOLI. We really have, Senator. You know, we really feel the product to be competitive, and I think that is the most important thing we are talking about in my industry, there is only so far you can go, sir, to be competitive. And unless you are willing to sacrifice the quality or employees, which we are not, which will never be an option, it really just comes right out of your pocket. And we are at that point where we can't really raise any prices anymore. We can't pass that price over to our customers on the wholesale end of it. So it is just really becoming a financial burden and it is becoming a great problem to the employee.

Chairman KERRY. Well, we really appreciate your business ethics, your values that guide your business, and are very sympathetic.

We are working on this right now, literally today, and the mark should be out on the tax bill that we are doing to accompany what is happening on the energy bill. We are going to put some serious incentives in there for alternative renewable, hybrid electric, and plug-in, and really try to stimulate this. As I said, I fought for a billion dollars in 2004. I think I am going to be able to get about a half-a-billion dollar tax benefit to businesses and to the auto industry here to be able to retool. Hopefully that can help to cushion some of what we need to do to get these vehicles that Fred Smith talked about.

It is crazy that you all don't have better alternatives. It is crazy that a whole bunch of folks can't go out there and find a car or big truck or big SUV, even, that a soccer mom can't be confident that she can get everybody in the team to the game with a fuel-efficient vehicle. There is no reason not to in our country. So——

Senator CARDIN. Would the Senator yield just for one moment?

Chairman KERRY. Sure.

Senator CARDIN. I just want to concur in your comments and just point out what I think is absolutely accurate. You have to make it a little bit easier for individuals and businesses to make that initial investment and I look forward to seeing the tax provisions from the Finance Committee on the energy bill.

Mr. Lynch, we have the technology today to make engines with alternative fuels as reliable and as efficient so that the business concern of having the reliability of an engine that can go 100,000 or 150,000 miles a year, we have that. We just need to make sure it is available.

I just really want to underscore one point you made, Mr. Chairman, and that is in my own State of Maryland, we have governmental fleets and business fleets that want to use biodiesel. The problem is they can't get biodiesel. Most of the diesel stations don't offer it. So we also need to make sure that there is the infrastructure network out there to supply those that are moving forward with alternative fuels, so that they can get it conveniently, and

that may require some action on our part to make sure that network is available.

I thank you for yielding, because I agree completely with your assessment. We have the technology. We have the ability to get this done. We now need—I think we also have the national will, by the way. So let us now enact the policy so that we can get it done.

Chairman KERRY. Well, I really want to thank everybody on the panel. I know you have traveled some distance. You have all sat here giving precious time to the Committee. I think it has been very, very helpful, very important testimony, particularly at this moment with a bill on the floor. I think some of the Senators here will take some of this testimony to this debate, so I think it has been really helpful in that regard.

I will leave the record open in case somebody does have a question they want to submit in writing to you, but we are very, very appreciative and with that, we will stand adjourned. Thank you very much.

[Whereupon, at 11:40 a.m., the Committee was adjourned.

COMMENTS FOR THE RECORD

National Farmers Union

Testimony of Tom Buis
President

Before the
U.S. Senate
Committee on Small Business and Entrepreneurship

Concerning the Impact of Rising Gas Prices on America's Small Businesses

June 14th, 2007
Washington, D.C.

STATEMENT OF TOM BUIS

PRESIDENT, NATIONAL FARMERS UNION

BEFORE THE U.S. SENATE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

CONCERNING THE IMPACT OF RISING GAS PRICES ON AMERICA'S SMALL BUSINESSES

JUNE 14, 2007

Chairman Kerry and members of the committee, thank you for the opportunity to submit testimony regarding the very serious consequences high energy input costs have on farm and ranch families all across the United States. I commend you for holding the hearing on June 14th and look forward to working with you to build support for efficient and effective energy policy.

NFU's policy is revised and updated each year at the local, state and national levels, and formally adopted at our annual convention in early March. Throughout my testimony, you will find our policy positions on energy issues and hopefully gain a better understanding of how dramatic the cost of oil has been on small family farmers. In turn, I also hope to provide you insight into how those same farmers can be part of the solution of reducing our dependence on foreign sources of oil.

Agriculture in rural America struggles every year to sustain itself as a viable industry. Often, the only thing that might make the end of the year analysis positive is the government subsidy payments farmers receive. Now added to the daily struggles, farmers have outrageous energy costs. As President Kennedy once said, "there is a saying in agriculture that the farmer is the only entity who buys retail and sells wholesale." Today I would add to that quote, farmers pay fuel surcharges both ways. The farmers and ranchers pay for everything their operation needs through the marketplace. What they receive for their products is beyond their control because they are price takers.

Over the course of the past few years, input costs have skyrocketed. Most of that increase can be traced back to the increase in energy costs. A good example of this is shown by a Kansas State University study 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 more than $140 and energy accounted for 35 percent of the expenses. That is an increase of $20 per acre! Irrigated cropland, with its significant need for energy pumping, shows even more dramatic changes.

Wherever rural Americans gather, at church, picking up tractor parts or getting repairs at the implement dealer, at the feed store, the local cooperatives and, of course, the local coffee shop, everyone is talking about high fuel and energy costs and how they will survive when faced with tightening economic margins. The focus on the environment has also become of significance in rural America.

We recognize the need for vast 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. NFU supports the Clean Air Act and believes that regulations should 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 environmentally friendly steps forward.

We Rely on the Volatile Markets, Too

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 2004, while outdated in terms of energy numbers, 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 agriculture industry's reliance 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 confront the problem of global climate change. Farmers and ranchers have proven time and time again that they are willing 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.

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 production comes nowhere close to meeting domestic demand.

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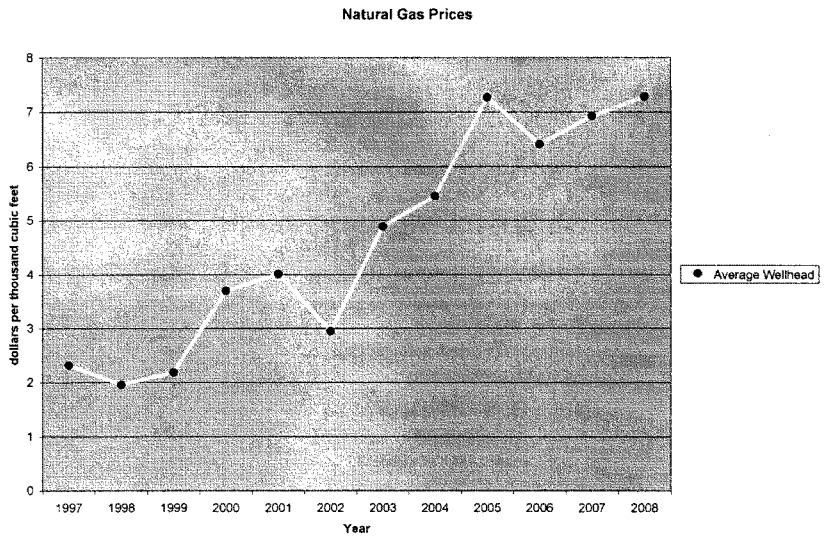
[1] Schnepf, Randy. "Energy Use in Agriculture: Background Issues." November 19, 2004. Congressional Research Service. CRS-24.

Natural gas has a major impact on many aspects of farming. It is the main ingredient in nitrogen, used as fuel to run irrigation motors and increases electricity costs as more electricity is generated at plants using natural gas rather than 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 will be forced to dry-land farm in areas that have been in a drought for 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 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 they work on machinery, the barns in which they hold and work livestock and the grain bins in which they must store and dry 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.

This year, as we all know, fuel prices, including diesel, have been higher than ever. In 2003, the national average price for number two 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). To provide you a real world example, Kansas Farmers Union president and farmer, Donn Teske, experienced first hand earlier this year the significant impact that skyrocketing diesel prices can have on a small farming operation. He hired a trucking company to deliver a load of alfalfa hay to a Texas dairy. The check he received for that 20 ton load of hay was about $3,500 and between the three entities, the trucker, the dairyman, and the Teske farm, $600 in added delivery fuel expense above what it would have cost just a couple of years ago had to be absorbed. Throughout the country, as in Kansas, farmers are seeing transportation expenses account for a greater and greater percentage of overall expenses every year.

Additionally, 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 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 across 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

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

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 input costs.

National Farmers Union believes that resolution of, or at least relief from, these increasing costs comes from a focus on the production of energy from renewable sources which are cleaner, promote our domestic rural economy and provide additional supply for the ever-burgeoning demand for oil. Specific recommendations will be addressed in the renewable fuels section.

Increased Transportation Costs - Unleaded Gasoline

As we all have experienced and seen in the news, the average price for a gallon of gasoline has been over $3.00[4] and many areas of the country have seen 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 prices tend to be very slow in falling back down.

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 accurately 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 continued reliance on oil, farmers are subjected to an ever-decreasing supply and therefore an ever-increasing expense. The statistics projected in this report are already outdated as a Lundberg survey released within the last couple of months shows that the average price for a gallon of regular unleaded gasoline reached $3.07, and has gone higher even since then.

[4] http://money.cnn.com/2007/05/06/news/economy/gasoline/index.htm?cnn=yes

Graph 2[5]

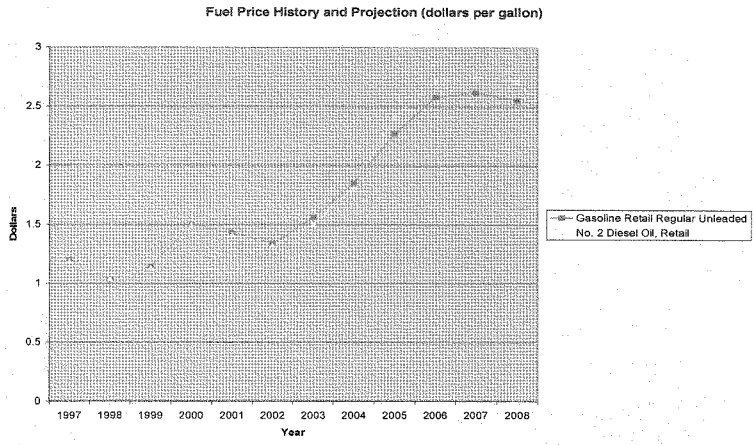


Table 1[6] *(projections in italics)* (dollars per gallon)	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	***2007***	***2008***
Gasoline Retail Regular Unleaded	1.2	1.03	1.14	1.49	1.43	1.34	1.56	1.85	2.27	2.58	*2.62*	*2.55*
No. 2 Diesel Oil, Retail	1.19	1.04	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: first, fertilizer is one of the most economically significant inputs associated with the business of farming; and second, the increasing cost of oil and natural gas not only affects transportation expenses but the cost of fertilizer as well.

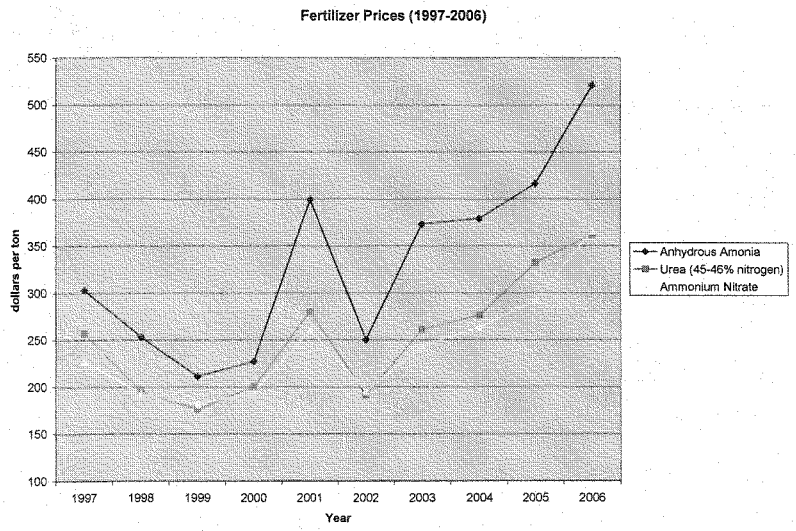
Advancement in technology facilitates the development of various types of required fertilizers, which are needed for a successful and high-yielding crop. Therefore, as fertilizer becomes a more significant component of the production process, so too does the percentage cost of this particular input. 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

[5] Energy Information Administration/Short-Term Energy Outlook – April 2007
[6] Ibid.

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), 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, in turn, ease the oil demand from the transportation sector. 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. The political will of this country has shifted significantly to one that recognizes the environmental and economic consequences of our continued reliance on oil and increasingly, foreign oil. As

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

a nation, we need to look responsibly to the future. 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- and locally- owned); and
- A more responsible food delivery system that utilizes local foods and takes much of the "highway miles" off of the food we eat.

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

Renewable Fuels – Fuels from the Farm

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. This movement is not new. Farmers have wanted to be part of our energy solution for more than 30 years. Through decades of toil, they have finally become full partners in this important effort. They are helping to alleviate our reliance on some of the most troubled regions of the world and produce fuels from the farm that will continue to assist us in the future.

As previously stated, this did not happen overnight. It took decades to combine public policy with farmers' initiative and risk-taking. In earlier days, for example, ethanol was neither energy-efficient nor economically viable. However, the current climate is different, due in great part to the tireless work and investment of family farmers. In my opinion, we have the greatest economic opportunity for farmers and rural communities in my lifetime. Not only is the demand for biofuels driving higher prices for corn, but it is also resulting in better prices for soybeans, wheat, milo, oats and rye.

We shouldn't let anything get in the way of using fuels from the farm and becoming a more energy independent nation. As we move forward, I respectfully urge you to ensure that ownership remains in the hands of local farmers and rural residents. When money stays in rural communities, it makes a real difference in the lives of rural citizens. All too often we see large conglomerates invest in rural areas, but all of the profits leave without being re-invested in the local economy. Small farmers are also then precluded from contributing to local economic development. I encourage the committee to work with their colleagues in the agriculture sector to ensure that USDA rural development and other departmental programs that are used for renewable fuels give a competitive advantage to farmer-owner and locally-owned efforts. This is one significant, but important, provision that ought to be considered by your committee.

In order to address growing energy prices, NFU believes several important steps are necessary to decrease our reliance on foreign sources of energy and to reverse the current trend of global warming:

- Any actions taken by 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 renewable 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 recently released NFU report shows, the ethanol sector has seen a decrease in concentrated ownership and accounts for the single-greatest industry controlled by local ownership at 39 percent.[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.
- 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 Strategic Renewable Energy Reserve to reduce price-depressing supplies of farm commodities. The purpose of the program is to provide sufficient storage incentives 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 fuels derived from imported

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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.

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 production plants which produce cleaner burning fuels and enable our fuel supply to be less reliant on foreign oil.

In closing, I appreciate the important venue you provide for hearing testimony from sectors of the economy such as agriculture. It is indeed truly significant and important that the Senate Small Business Committee actively seek out input from family farmers. On behalf of the 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 economy.

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.

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Statement Submitted for the Record

to the

U.S. Senate Select Small Business and Entrepreneurship Committee

Hearing on the Impact of High Gas Prices on Small Businesses

June 14, 2007

The National School Transportation Association is the membership organization for school bus companies that provide pupil transportation. Our members are private businesses engaged primarily in transporting public school students to and from school and school-related activities for the tens of thousands of school districts across the country that choose not to operate their own school buses. In addition, our member companies provide specialized transportation for students with disabilities, community transportation, charter service, emergency transportation in times of need, and other transportation services. NSTA members range from small family businesses serving one district to large corporations operating thousands of buses across many states, all committed to the safe, efficient and economical transportation of America's children.

The National School Transportation Association (NSTA) appreciates the opportunity to present this testimony to the Senate Small Business and Entrepreneurship Committee for its hearings on Gas Prices and Small Businesses. The NSTA membership, which includes a greater percentage of the larger school bus companies, is still composed of approximately 85 percent small business owners. Our membership, and the industry as a whole, has suffered the effects of rising fuel costs for almost three years, and we have run out of ways to compensate.

School Transportation and Small Businesses

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. About 30 percent of these buses are owned and operated by private companies or individual entrepreneurs; the others are publicly-owned.

Ninety percent of the private school bus contractors in the country qualify as small businesses. In fact, one-third of them operate five buses or fewer. Many are third and fourth generation family operations that are trying to hold onto their businesses in the face of rapidly increasing costs and chronically short school budgets. Many of the very small entrepreneurs contract with rural school districts to service one or two routes. These individuals invest $75,000 to buy a school bus, and then pay for training and licensing fees, maintenance and insurance—for a contract that in some areas of the country pays them $15,000 a year.

The Role of School Buses in Education

According to statistics from the U.S. Department of Education for school year 2002-2003 (the latest available), 56 percent 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 percent 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 which is also rising significantly to meet new clean engine mandates that take affect this year. As you can see, transportation costs were rising steadily before the fuel crisis hit in 2005; they have spiked since then.

During the school year school buses 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 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 percent 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 percent to 100 percent. 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, many 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 percent 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.

School Bus Contracts

School bus companies contract with public school districts to provide transportation service in a wide variety of ways. The one-bus owner who contracts for single routes is at one extreme; management-only contracts are at another. The most common contract is for full service—that is, the contractor provides the buses, the drivers, the dispatchers, maintenance, and management. The contractor is responsible for all operating costs, and is at the mercy of cost fluctuations during the life of the contract. Contracts can range from one year to five years, the latter being the most common. A few contracts contain escalation clauses, or provide the opportunity to re-open the contract in the event of unforeseen circumstances, but most do not. A survey conducted by NSTA at the end of 2005 showed the average yearly increase in contract prices was 2.7 percent. (These were future-year increases in contracts in place at the time.)

The Effect of Fuel Price Increases

From September 2004 to September 2005, the price of diesel fuel increased an average of 58 percent, 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 increased to more than 20 cents higher in most states than the price of regular gasoline. In addition, our members are 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. Since school districts do not typically charge for school bus transportation, neither school districts nor their transportation contractors are ordinarily able to pass on the increased costs to the students they drive to and from school every day.

Comment [R1]:

As this crisis has been going on now for almost three years, we have already implemented all of the fuel-saving tricks in our bag. Our members 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 have changed the way they buy fuel—installing larger tanks for bulk purchase, for example, or even hedging fuel purchases.

Even with these measures, our members cannot keep up with the increases. One contractor in New York State reports that during the past school year, fuel cost represented 6.3 percent of revenues, up from 0.85 percent ten years ago. An Ohio contractor reports that during the past school year, he spent more than $1 million on fuel to service two school districts.

Clearly, with contract price increases averaging 2.7 percent and fuel prices increasing at an average 58.4 percent, contractors are being squeezed. School boards, for the most part, are not in a position to help, since their budgets are also hit with higher energy costs. Already, some

schools have been forced into drastic cuts in service—which, of course, further hurts the contractor by eliminating revenues.

One of the more common responses to budget gaps caused by energy costs has been to shift students from the dedicated school bus service provided by small business owners to public transit. Not only does that jeopardize small school bus companies, but it puts students at increased risk 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 administration's decision to exchange school buses for public bus passes.

What Can We Do?

We understand that the increase in fuel costs and our energy dependence affects more than school bus companies, but we also know that it hits our small business members particularly hard. Transportation is not an ancillary concern for us; our businesses depend on the availability and affordability of fuel. 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 bus contractors in the immediate future.

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

1) 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.

2) The Congestion Mitigation and Air Quality (CMAQ) Program, administered by the Federal Highway Administration (FHWA), is a grant program to the states funded through the Highway Trust Fund. We have asked FHWA to encourage states to include the purchase of new school buses in their grant programs. Increasing private school bus fleets 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, thereby reducing fuel usage.

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 is currently debating legislation (S. 1419) that would allow vehicle manufacturers to take advantage of Federal grants and loan guarantees to assist in expanding energy-efficiency manufacturing.

4) 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 grant funding to poorer school districts to help pay for school-related energy costs, including for transportation fuels. We understand that Congressman Baca may reintroduce this bill soon and we support its favorable consideration by the Congress. We note, however, that such assistance will help private companies only if the funding is available to schools with contracted transportation, and those districts are willing to apply on behalf of their school bus provider. A better solution for small businesses is to allow them to apply directly for the grants as well.

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, school bus companies have had to bear essentially all of the cost of increasing security needed to meet potential terrorist and other threats.

Conclusion

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 percent 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 school bus 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.

We urge Congress to work with us to ensure that school transportation and the small businesses that play a significant role in providing it remain a viable option for all schools. Our members cannot continue to absorb escalating energy costs, and their school district customers cannot afford to relieve them of the burden. States and local municipalities can no longer fund this on their own; they need your help.

M. JODI RELL
GOVERNOR

STATE OF CONNECTICUT
EXECUTIVE CHAMBERS

TESTIMONY SUBMITTED TO THE U.S. SENATE COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
June 14, 2007

M. Jodi Rell, Governor
State of Connecticut

Hearing Concerning The Impact of Rising Gas Prices on America's Small Businesses

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Dear Chairman Kerry and members of the Senate Committee on Small Business & Entrepreneurship my name is M. Jodi Rell and I am the Governor for the State of Connecticut. I appreciate the opportunity to offer my comments as part of the record concerning the important issue of the Impact of Rising Gas Prices on America's Small Businesses, which like many other states, has impacted Connecticut's small businesses significantly.

Thank you for taking the time to investigate this growing problem. I want to begin by discussing the business climate in Connecticut. As I am sure you have already heard first-hand from Senator Lieberman, who serves on your Committee, one of the major issues our businesses continually face is high energy costs. Of particular concern to me is the price of gas particularly in Connecticut and in the other New England states.

Connecticut has approximately 341,400 small businesses. Rising fuel costs negatively impact all businesses, however, that impact is significantly greater on small businesses. They do not have as many coping strategies available to them as do large businesses. With thinner margins, tighter cash flow, and more rigid pricing structures small changes in fuel prices can cause big problems for small businesses. As such, fluctuating prices are actually worse than steadily increasing prices.

Rising and fluctuating fuel (gasoline and diesel) prices affect small businesses in a variety of ways. Prices affect them differentially depending on the degree to which businesses rely on transportation. For example, a small consulting firm would not likely depend on receiving significant shipments of goods used in providing their service or in the delivery of their product. To the extent they do rely on transport, their production costs would increase as fuel prices increase. One would expect to see increased reimbursement for mileage for company business as well as increased costs of office supplies that wholesalers and retailers of such goods pass along to their customers.
Small companies that rely heavily on transport for delivery or shipment of their product would experience disproportionately increased costs of production. This applies especially to livery services, courier services, and moving van firms. In these cases, fuel costs are significant. A company's response would be to attempt to share the increased cost with their customers. However,

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when customers are sensitive to price changes, companies try to absorb as much of the increase as possible. Savings must come form somewhere else, like reducing high cost routes, consolidating shipments, acquiring more efficient equipment, as well as asking fewer workers to do more.

Small businesses do not have the same capabilities as large companies do to weather these storms. They have neither the resources to spread costs or make investments in new equipment, nor the economies of scale or product diversity to overcome price fluctuations. Reduced profits on already thin profit margins that may ultimately drive some businesses to leave the market and others to merge with rivals or large firms can result. Thus, one expects the number of companies and employment in particular sectors to diminish.

In response, during the past legislative session as part of my budget, I proposed capping the gross receipts tax on petroleum products when the wholesale price of a gallon of gas hits $1.75. The wholesale price has recently been as high as $3.20 per gallon. For more than a year, the gross receipts tax has produced millions of dollars more than originally anticipated because of the spiraling cost of the price of oil. In addition to this measure as part of my comprehensive energy plan I also proposed:

- the elimination for two years of "zone pricing" in Connecticut – a practice under which the state is divided into two zones for pricing purposes, in an effort to compensate for travel and delivery distances and
- an extension of the general sales tax exemption on hybrid vehicles to June 30, 2010, as well as a property tax exemption for hybrid vehicles

Increasing fuel costs have some effect on all businesses and all workers. Over time, businesses will print new price lists and catalogs that incorporate higher fuel prices. Reimbursements for mileage will increase. Wages will follow suit as new contracts are negotiated that incorporate the higher costs we all face for heating, cooling and transport. Increasing fuel prices increase heating and cooling costs for all businesses as oil, natural gas and electricity prices increase. As a result, small companies especially will divert resources from developing their business opportunities to coping with increasing production costs.

Fluctuating fuel prices affect small businesses differentially because they rely on accurate price forecasts for long-term contracts. Large companies may be more able to absorb forecast errors, have access to better forecasting, and can better prepare for price increases.

Thank you for the opportunity to address you on this important issue.

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