

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

Memorandum

TO: Members, House Small Business Subcommittee on Agriculture, Energy & Trade

FROM: Chairman Scott Tipton

DATE: April 12, 2011

RE: Hearing: "Drilling for a Solution: Finding Ways to Curtail the Crushing Effect of High Gas Prices on Small Business."

At 10:00 AM on April 14, 2011, in room 2360 of the Rayburn Building, the House Small Business Subcommittee on Agriculture, Energy & Trade will hold a hearing titled: "Drilling for a Solution: Finding Ways to Curtail the Crushing Effect of High Gas Prices on Small Business." The purpose of this hearing is to bring to light the negative impacts of rising fuel costs on small business, focusing on different industries, including aviation, agriculture, and food production.

Witnesses:

Jim Ehrlich – Executive Director, Colorado Potato Administrative Committee

Richard Richter – Owner, Richter Aviation & President Agricultural Aviation Association

Dick Pingel – Owner, Finally Trucking, Inc., Representing the Owner-Operator Independent Drivers Association, Inc.

Robert Weiner – Professor of International Business, Public Policy and Public Administration, and International Affairs, George Washington University.

BACKGROUND

Every American is affected in some form by the rising prices of fuel in the United States. In particular, small businesses who rely on oil and gasoline to operate their establishments have felt the impact. Substantial price increases for fuel are more easily absorbed by large corporations when energy costs are a small portion of total production. However, small businesses across various industry sectors face unique challenges that directly affect their ability to absorb increases in energy prices. In fact, the median commercial sector industry has a small entity energy cost per sales ratio that is 2.7 times greater than that of larger industries.¹

There are several initiatives being proposed or suggested to alleviate the burdens of high fuel prices. Congress should consider fully developing domestic resources to make the United States less vulnerable to foreign disruption in fuel supply in the short term, and would help keep fuel prices low while newer renewable sources are developed for long-term fuel sustainability. Additionally, Congress should not seek to impose additional taxes on the energy industry, steps that have the potential to further repress production of domestic energy resources, which could increase fuel prices for small business consumers.

CRUDE OIL & FUEL PRICES

Several factors influence increases in gasoline and fuel prices. Due to the fact that crude oil is a world-distributed commodity, the price per barrel is not simply dependent on global supply and demand, but also on other extraneous factors, including political unrest, economic booms/downturns, and natural disasters in oil-producing nations.

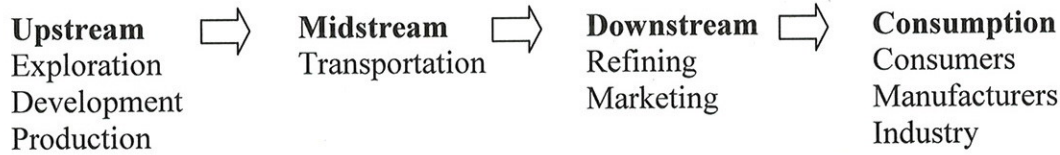
Much of the surging energy prices are a result of the increase in the price of crude oil. Crude oil is the base product used to create gasoline, jet fuel, diesel fuel, heavy fuel oil, and enumerable other products that impact small business energy costs. Additionally, oil is used in widely utilized products such as fertilizer, manufacturing components for solar panels and wind turbines, as well as petroleum-based composites that allow aircraft and other vehicles to travel further on less fuel.

Average crude oil prices grew to over \$104.79 per barrel on March 29, 2011 (resulting in \$3.60 per gallon at the pump – an increase of \$.80 per gallon of gasoline over the same time last year). This figure far exceeds the costs of imported oil in 2009, which averaged roughly \$58.40 per barrel, and even the 2010 average of \$74.60.²

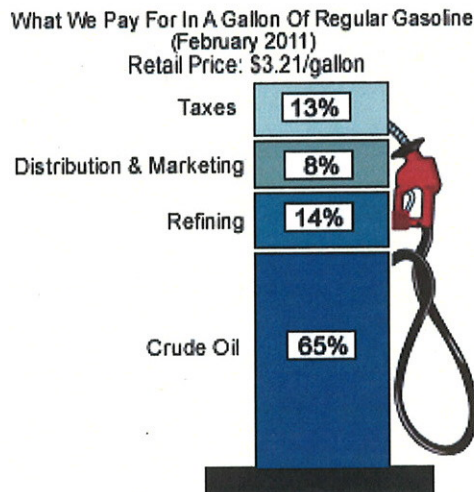
¹ Small Business Administration Office of Advocacy, “Characterization and Analysis of Small Business Energy Costs,” April 2008.

² Figures derived from Energy Information Administration F.O.B Costs of Crude Oil Imports, available at http://www.eia.doe.gov/totalenergy/data/monthly/pdf/sec9_4.pdf.

The Physical Flow of Oil



Fuel prices increase with every step along the supply chain. In addition to base crude oil prices, additional costs are passed down to consumers to compensate for refining, distribution and marketing, in addition to federal and state taxes. Next to crude oil prices, taxes comprise the largest component of retail gasoline costs. Currently, Federal excise taxes are 18.4 cents per gallon and state excise and other taxes average roughly 29.7 cents per gallon.³ Refining costs reflect the cost of the processes as well as market conditions in the refining industry – shortages of certain types of refining capacity can also contribute to higher product costs. Distribution and marketing costs include the cost of transporting goods, selling them to consumers, and operations of retail stations. Ethanol, primarily produced by microbial fermentation of sugar (typically from corn or sugar cane), is blended with gasoline in most U.S. markets, which can defray some of the demand for oil.



Source: Energy Information Agency

³ American Petroleum Institute, Gasoline Taxes, January 2011. Available at http://www.api.org/statistics/fueltaxes/upload/Gasoline_Diesel_Summary.pdf.

THE GLOBAL OIL MARKET

The market for crude oil and oil products is large and globally integrated. The world consumes roughly 85 million barrels a day, with the United States taking a role as the world's largest oil consumer constituting 22% of global consumption at roughly 18.7 million barrels a day, yet the U.S. is the world's third highest oil producer (at 9% of oil consumed), requiring the U.S. to import a significant amount of oil to meet consumer needs.

Although there is no single country that controls the oil market, some countries or groups can have influence on the market. One such example is the Organization of the Petroleum Exporting Countries (OPEC), a group of oil producing countries that affect the price of oil through increasing or decreasing production. Due to the fact that oil is produced, consumed and traded around the world, what happens in one part of the market can affect the broader market.

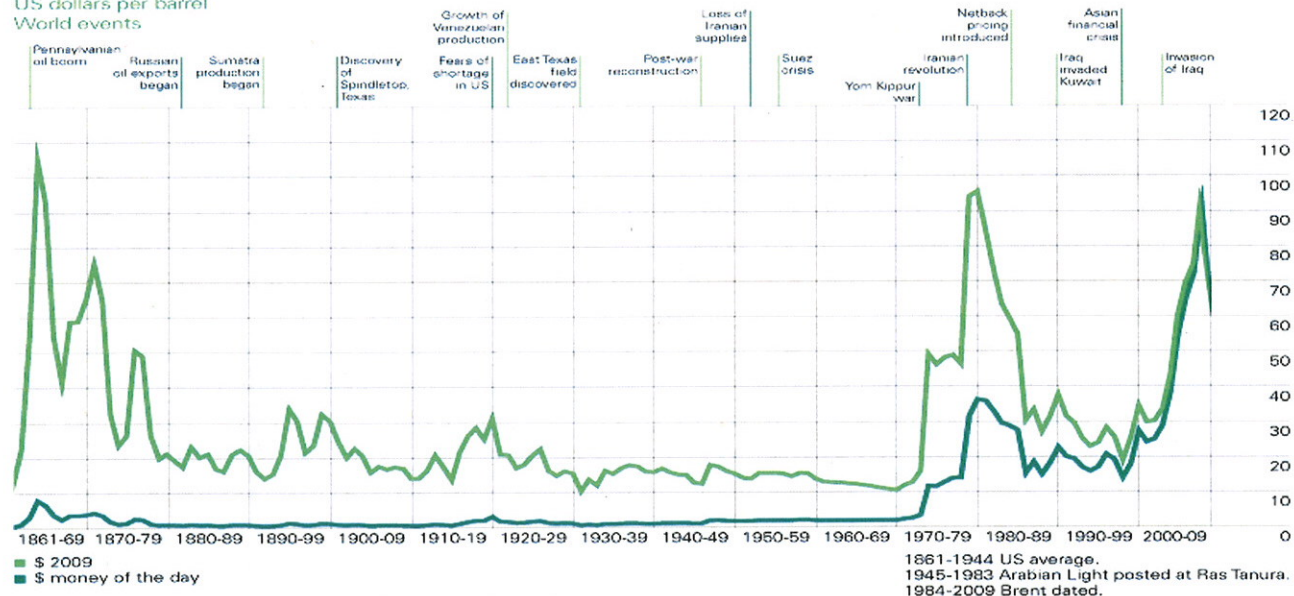
Among the sources of imports to the United States, roughly one quarter come from Canada, while half come from OPEC nations, specifically from the Persian Gulf. As political unrest escalates throughout the Middle East, speculation is that oil prices will increase due to potential disruption or diversion of exports through sea trade routes.

International Events Impacting Crude Oil Prices

Crude oil prices 1861-2009

US dollars per barrel

World events



Source: BP Statistical Review of World Energy 2010

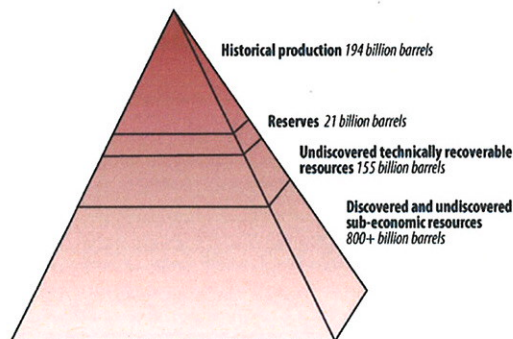
INCREASED DOMESTIC PRODUCTION

It is believed that increased domestic production of fuel will alleviate some financial impact on small businesses, while also allowing for increased job creation. This includes allowing increased access to federal lands believed to have petroleum and oil shale reserves. Not only would increasing domestic resources ultimately promote a reduction in fuel costs, but it would also create jobs across various business sectors, especially in the energy industry – through exploration, transportation, and other avenues.

Through the passage and enactment of the Continuing Appropriations Resolution of 2009 (P.L. 110-329), and the Omnibus Appropriations Act of 2009 (P.L. 111-8), Congress allowed the annual congressional moratoria on offshore oil and gas leasing and drilling by not extending these authorities beyond September 30, 2008. Additionally, then-President George Bush lifted the executive moratoria on offshore leasing⁴ to allow for increased domestic production of energy.

According to a study released by Wood Mackenzie, developing oil and natural gas resources where access is currently blocked on the Outer Continental Shelf, at the Arctic National Wildlife Refuge and in the Rocky Mountain states would create 530,000 new jobs in the United States by the year 2025.⁵

Resource Pyramid for U.S. Oil



Source: Historical production and proved reserves figures are from Energy Information Administration, undiscovered technically recoverable resource value is from U.S. Geological Survey, and discovered and undiscovered sub-economic resources uses the lower estimate for oil shale resources from RAND as a minimum.

⁴ “Memorandum on Modification of the Withdrawal of Certain Areas of the United States Outer Continental Shelf from Leasing Disposition,” Weekly Compilation of Presidential Documents, vol. 44 (July 14, 2008).

⁵ Wood Mackenzie, “Assessing the Impacts of Increased Access Versus Higher Taxes in US Oil and Natural Gas Production,” January 4, 2011.

Alaskan Resources

The United States Geological Survey assessed that the National Petroleum Reserve in Alaska (NPRRA) has within its borders 896 million barrels of oil and roughly 53 trillion cubic feet of non-associated natural gas in conventional undiscovered accumulations.⁶ Additionally, declining production on the Alaskan North Slope due to a lack of federal permits poses a threat to the efficiency and cost-effectiveness of the Trans-Alaska Pipeline, which is a vital source of domestic oil. Access to these resources would help to alleviate some of the dependence of the United States on foreign energy sources.

Oil Shale

The Bureau of Land Management (BLM) at the Department of the Interior manages public lands that have the potential to make contributions to the nation's energy portfolio, which includes 245 million surface acres as well as 700 million sub-surface acres of mineral estate.⁷ According to BLM, oil and gas leasing in the Rocky Mountain West (CO, NM, UT, WY, MT and ND) has fallen by 67% since 2005. This is significant because it is believed that the Western United States holds roughly 1.5 trillion gallons of shale oil⁸ – which comprises roughly half of the estimated shale oil globally and six times Saudi Arabia's proven resources.

Although surface mining in the past yielded poorer product quality than crude oil, newer technologies such as hydro-processing and situ conversion provide higher quality product. The estimated shale in the West has the potential to power the United States for a sufficient time as we further develop and transition to cleaner, more renewable energy sources that would drive the cost of oil down. Production growth in shale has been exponential in recent times, and can potentially increase available U.S. supply by 30 percent⁹ over the next 15 years.

Natural Gas

Creating substitutes for oil has the potential to lessen demand and reduce fuel prices for consumers. A cleaner byproduct of shale is shale gas, more commonly known as natural gas – a methane based fuel source. According to the Energy Information Agency, there are more than 210 natural gas pipeline systems with over 305,000 miles of interstate and intrastate transmission

⁶ United States Geological Survey at the U.S. Department of Interior, "2010 Updated Assessment of Undiscovered Oil and Gas Resources of the National Petroleum Reserve in Alaska (NPRRA)," October 2010.

⁷ U.S. Department of the Interior, Bureau of Land Management website. Available at <http://www.blm.gov/wo/st/en/prog/energy.html>.

⁸ "Topic Paper # 27: Oil Shales," National Petroleum Council, July 18, 2007.

⁹ Alternative Fuels & Advanced Vehicles Data Center at the U.S. Department of Energy, "North American Natural Gas Supply Assessment." Available at http://www.afdc.energy.gov/afdc/pdfs/ng_supply_assessment_2.pdf.

pipelines¹⁰ that allow for the transport of this natural resource quickly and efficiently throughout the mainland United States. By increased shale drilling and promoting the use of natural gas as a fuel, the United States could decrease transportation emissions and reduce dependence on foreign natural gas.

Potential New Taxes and Regulations on American Energy

The President's FY 2012 budget proposal includes roughly \$90 billion in tax and fee increases on American energy production – including a repeal of Section 199 tax deductions for oil and natural gas companies (created as a result of Public Law 108-357, the American Jobs Creation Act of 2004) estimated at \$18.2 billion¹¹, the repeal of LIFO at roughly \$22.5 billion (LIFO, or 'Last In, First Out' accounting techniques allow companies that anticipate inflation or rising prices to determine book and taxable income), a \$12.4 billion repeal of expensing Intangible Drilling Costs, \$10.5 billion to reinstate Superfund taxes on crude oil and petroleum products, and others.¹² These steps could further stifle domestic production of energy resources and continue to drive fuel prices higher for consumers, further hindering small business at a time of economic uncertainty.

Drilling Permits in Shallow and Deepwater

Since roughly this time last year, the Department of Interior has issued few shallow water permits and one deepwater permit since the Deepwater Horizon incident and subsequent moratorium on underwater drilling. According to the Administration's estimates, the moratorium could result in upwards of 23,000 job losses,¹³ and rigs are actively leaving the Gulf for foreign countries. In addition to a moratorium on Gulf drilling, the Administration has placed other waters bordering the United States off-limits for drilling, including much of the Outer Continental Shelf in Alaska. Estimates indicate that increased production in the Outer Continental Shelf of Alaska alone could generate 1.2 million new jobs and an \$8 trillion growth in economic output, or GDP.¹⁴

¹⁰ U.S. Energy Information Administration, "About U.S. Natural Gas Pipelines." Available at http://www.eia.doe.gov/pub/oil_gas/natural_gas/analysis_publications/ngpipeline/index.html.

¹¹ Referring to Internal Revenue Code Section 199, on Income Attributable to Domestic Production Activities, passed into law as part of Public Law 108-357, the American Jobs Creation Act of 2004.

¹² "Significant Industry Tax Issues Contained in President Obama's FY 2012 Budget," American Petroleum Institute. Available at http://www.api.org/policy/tax/upload/FY2012_Budget-Short_Tax_Issues_Paper.pdf.

¹³ Stephen Power and Leslie Eaton, "U.S. Say Drill Ban Killing Many Jobs." Wall Street Journal. Available at <http://online.wsj.com/article/SB10001424052748704488404575441760384563880.html>.

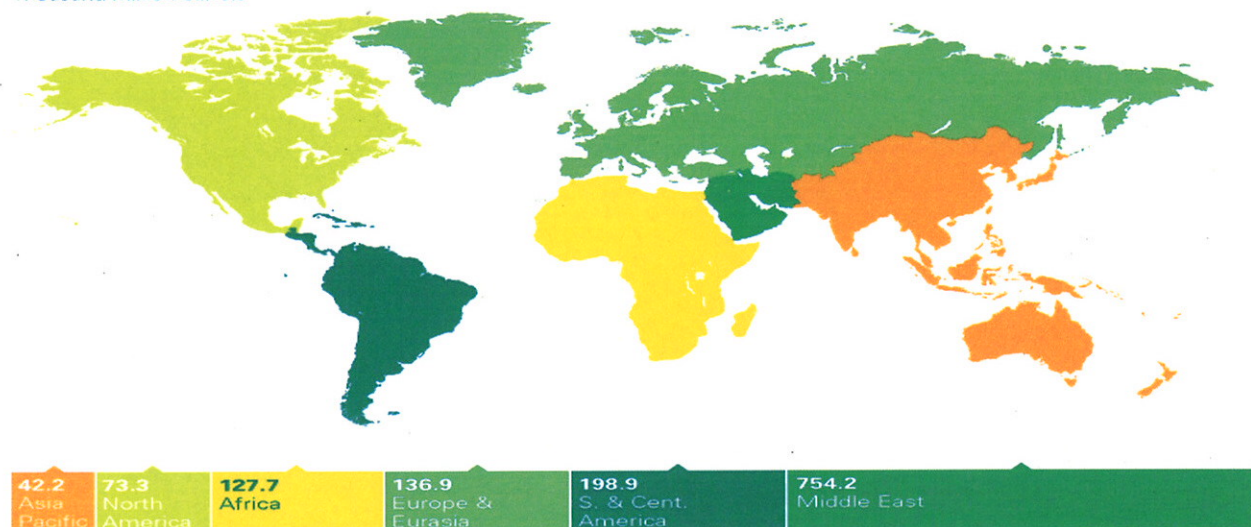
¹⁴ American Energy Alliance, "The Economic Contribution of Increased Offshore Oil Exploration and Production to Regional and National Economies." Available at http://www.americanenergyalliance.org/images/aea_offshore_updated_final.pdf?phpMyAdmin=fa972a975ccbf0bd709c38b1080539f5.

Biofuels

In an effort to alleviate some of the dependence of the United States on foreign oil, programs to encourage alternative sources of energy, including biofuels, have been enacted to help guide the country closer to energy independence. Many U.S. policies have been put into place at the state and federal levels to encourage the production of biofuels. These policies include blending and production tax credits, research grants to stimulate the development of new ideas, loan and loan guarantees to help assist biofuels production, as well as minimum usage requirements to guarantee a market for biofuels.

Proved reserves at end 2009

Thousand million barrels



Source: BP Statistical Review of World Energy 2010

Note: Proved reserves are based on analysis of geologic and engineering data that demonstrates that resources are recoverable under existing economic and operating conditions; as indicated before, the United States Geological Survey and the Department of Interior estimate significant oil resources in the United States that are not yet proven. Once proven, the comparable proved reserves for the United States could feasibly be greatly increased.

CONCLUSION

In light of the political unrest in several Middle Eastern countries, increased demand, and other factors, oil prices (and thus gasoline) have been amplified 27 percent in the one-year period from April 2010 to April 2011, contributing to the highest costs per barrel since the energy crisis in 2008. High prices at the pump disable consumers, especially small businesses that rely on gasoline and other oil and petroleum-based products to conduct business.

In order to mitigate the fuel pressures on small business, the United States government should consider an 'all of the above' plan that includes short- and long-term solutions such as increased domestic oil production and exploration and the approval of permits to drill on U.S. soil and bordering waters in addition to continued support for renewable energy sources including biofuels.

If actions to alleviate the current oil and gasoline prices are not taken in the near future, small businesses may not be able to be as competitive in the global market, which could result in job losses and business closures.