

Testimony
of the
Clean Fuels Development Coalition


Before the

Committee on Small Business
Subcommittee on Government Programs and
Oversight of the
U.S. House of Representatives

April 23, 1999

CLEAN FUELS DEVELOPMENT COALITION

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Good morning Mr. Chairman and members of the Committee. My name is Douglas Durante and I am the Executive Director of the Clean Fuels Development Coalition (CFDC) based here in Washington. I appreciate the opportunity to comment on your examination of the need to conserve natural resources and the role of alternative fuels and technologies.

We have a unique and broad membership that includes ethanol and ether producers, agricultural interests, automobile manufacturers, state government agencies, and engineering and new technology companies. We have been directly involved in the formation of national energy and environmental policy for the past 10 years at both the state and federal level.

Dependence on Imported Oil. One of the areas you suggested for discussion, Mr. Chairman, was the consequences of our dependence on foreign sources of oil. That dependence is clear and irrefutable and I am sure we have all heard statistic after statistic that should serve to scare us into action, but unfortunately they do not. In fact, we are just not very good as a country at reducing imports.

While the consequences of our dependence on imported oil may be subject to debate, the fact we are hooked on these foreign sources cannot. With 5 percent of the world's population and only 2 percent of the known oil reserves, the U.S. consumes more than 25 percent of all the oil used in the world. Numbers that would have seemed absolutely unacceptable a decade ago in terms of our percentage of imports, we now shrug at. While the prospect of approaching a 50 percent dependence level horrified many energy analysts not long ago, we have hit that mark and flown right by it. The Energy Information Administration (EIA) recently revised their projections of U.S. imports, as a percentage of oil used up to 63 percent, by the year 2005. This was announced at a hearing late last year in the Senate Energy Committee on the status of the domestic oil industry. That hearing demonstrated that the industry is in serious decline and the steady and undeniable rate of increase in imported oil is at the expense of domestic production and brings with it staggering hidden costs with a direct relationship to the U.S. trade deficit.

These hidden costs, which are estimated to be as much as an additional \$100 per barrel over market costs, include environmental and economic outlays to ensure the flow of this oil. This is a fact acknowledged by the General Accounting Office in various studies they have conducted (1992, 1996). The problem with the most recent of those studies, however, is that they concluded that the benefits resulting from cheap and abundant oil versus the risks of being that dependant were worth it. In my view, under no circumstance should dependence of the level we are now experiencing in this country be an acceptable situation. Making the argument that low energy costs are a key to controlling inflation is really only a small part of the story. The more important part is the dependency and how that puts us in an untenable position. I believe that particular study failed to recognize the global demand for petroleum that clearly is taking place in developing countries like India, China, and Korea which alone are estimated to double the demand -- and along with it perhaps the price -- over the next two decades).

I think we worry a bit too much about gasoline prices and as a nation we seem to have fallen in

this trap where the public regards low gasoline prices as a fundamental right. Consequently, we have been reluctant to take any bold measures to turn this situation around. According to the EIA, after adjusting for inflation, gasoline prices are the lowest since 1942 so we certainly ought to be able to withstand an increase. Deploying a single ship to the Persian Gulf costs millions of dollars in taxpayer money and the public accepts that. But raise their gasoline prices five cents and there is a public outcry. And speaking of ships in the Persian Gulf, a final

consequence of the path we are on that absolutely must be recognized by all is the fact that military intervention is necessary from time-to-time to ensure this flow of cheap imported oil and our sons and daughters fight to stabilize regions we would otherwise have very little interest in.

Conservation and Alternatives. Reducing energy consumption should always be a national goal but conservation does not have to mean doing without. While we ought to do everything possible to get more out of the energy we use, both in transportation and stationary sources, we also ought to be developing alternatives.

A successful response to our import situation has to operate off of several basic principles. The first is that any discussion of energy policy and strategies should attempt to marry as many other objectives as possible such as economic development, environmental protection, and public health. The use of clean alternative fuels in the Oxygenated Fuels and Reformulated gasoline program is an example of how we are able to extend energy supplies and provide a public health benefit at the same time. This should clearly be a consideration in any greenhouse gas mitigation programs we undertake.

Another cornerstone of any successful energy strategy plan must be commitment and continuity. In the case of alternative fuels, we have not provided the kind of commitment and continuity over the last several decades that was necessary for this new industry to truly establish itself. We have not stuck by our goals and objectives and often succumbed to the low world oil prices that made it easy to abandon or at best, half-heartedly pursue some of these alternatives.

As an example of failing to meet our goals, lets look at domestically produced fuel-grade ethanol, which is one of the few legitimate alternatives we have to displace petroleum. The Energy Security Act of 1980 had a stated goal of producing what would have been the equivalent of 10 billion gallons of ethanol within a decade, yet 18 years later we produce less than 2 billion gallons.

We are seeing similar shortcomings in the alternative fuels program created by the Energy Policy Act of 1992. There were a number of aggressive goals for petroleum displacement by requiring alternative fueled vehicles in fleets, yet we have not even begun to approach those levels and we are already years behind schedule.

Why? It is simply more expensive to use these other fuels so we resist it. No one wants mandatory programs so we make them voluntary and we don't get enough volunteers.≡ As far as the role of government in these affairs, which is also something you asked to be addressed, our leadership has to admit and acknowledge we simply cannot produce petroleum products or get oil out of the ground as cheap as others.

The Role of Government and Lessons from Small Businesses. The question is what are we prepared to do about it? If the table is tilted against domestic producers, and we want to tilt it back towards our own producers, then we have to take some action. Whether that be increased tax incentives for domestic production and/or taxes on imports there is clearly going to be government action required. Any concerns about interfering in the free market are misplaced -- our current oil prices are not the result of a truly free market.

There is certainly precedent for that kind of approach and frankly Mr. Chairman I do not understand why we don't employ some of the techniques we use for small businesses in solving our energy situation. Small, disadvantaged, and minority businesses get preferential treatment in a number of ways because we recognize they would otherwise have a difficult time competing. Is it fair to larger companies that are penalized simply because they are big? Perhaps not but we do it anyway. Would it be fair to tax imported oil simply because it is cheaper than domestic oil? Given all the aforementioned hidden costs and consequences, I think the answer is yes. More

importantly, you in Congress need to adopt the belief that without intervention such as a tax or other incentives, it simply is not going to happen on its own.

Another thing Congress needs to recognize is that although we certainly have tried to deal with this issue in the past, the numerous energy strategies we have developed over the years, including one as recently as last year from the Department of Energy, all have had a serious and glaring flaw. That flaw has been that we have failed to target those alternatives to ensure that any domestic transportation fuels we produce actually displace imported oil. Constructing an ethanol plant in Nebraska that closes down a refinery in Louisiana does not do us any good. So while we may wind up producing a fuel, since the imported barrel of oil is always going to have the advantage in price (which is evident by the steady decline in U.S. refining), we have not really accomplished anything.

There are a number of alternative fuels available that all can reduce petroleum use and improve air quality such as natural and liquified gas, ethanol, methanol, and various hybrids -- including electricity. One fuel I would like to key on today is ethanol which could be a specific tool to address some of these concerns. Ethanol production is dependent on the continuance of tax incentives that Congress established for the very purpose of creating a new source of energy. Yet Congress throughout the last two decades has constantly threatened this industry by attempting to revoke this reduced tax rate under pressure from the petroleum industry. The various administrations that have been in place during that period have been everything from indifferent to supportive but usually inconsistent. A President might issue statements of support for ethanol while his own Treasury Secretary condemns it.

On one level I am disappointed over the amount of ethanol that has been produced over the last 20 years. On another level, however, I would argue that the ethanol tax incentive is the most successful renewable tax credit in our history. It is important to understand it is an end-use incentive in that it only is realized once plants have been constructed, money has been invested, employment has been rendered, and the final product has been produced and put in to the market. Even then the incentive is in the form of a reduced tax rate. Imagine how successful the program would be if it was not constantly being threatened with repeal.

Our Reformulated Gasoline Program requires oxygenates in the formula in part to make sure we are reducing petroleum use while we clean the air. Yet there are several bills currently in Congress to remove that oxygenate requirement after industry has established capacity to meet this requirement. So in this case, Congress agreed 10 years ago to this particular path of fighting imports, but now may change its mind. Is there any wonder why we haven't made more progress in this battle to curb imports?

This kind of uncertainty also stifles technological innovation, much of which emanates from small businesses. Ways to produce and use fuels are always subject to innovation but it certainly helps to know the market you hope to serve will be there if you succeed. Our colleagues in the auto industry, in addition to their work in electric vehicles and fuel cells, should be applauded for making ethanol vehicles widely available, somewhat based on the assumption that ethanol would be there.

And ethanol is something we should continue to develop. Ethanol can be efficiently produced from any number of sources, including corn which is the most commonly used feedstock. Tremendous increases in efficiency have resulted in a net-positive impact on energy balance and the emission of greenhouse gases. Ethanol production from corn in no way affects food supply because the feed value of the grain remains intact after the ethanol has been derived from the starch and sugar content. The existing ethanol industry has blazed a difficult trail to gain acceptance of ethanol as a fuel and provide many economic and environmental benefits. This pioneering trail has made it possible for other feedstocks and technologies to have a chance to

succeed.

Ethanol can also be made from a variety of non-grain feedstocks which is where the Department of Energy's Biofuels Program comes in. Agricultural, wood, and urban wastes can be converted to ethanol as well as speciality crops grown solely for that purpose. We are close on these technologies but not quite there yet and the role of government should be to develop and support these efforts by continuing to provide budgetary resources to carry out this mission.

Conclusion. In summary, if we want renewable or alternative technologies and fuels to take the place of hydrocarbon fuels, whether that be in pursuit of environmental, climate, or energy security goals, our government must create a situation where it is more advantageous to use them. Taxing them at a lower rate is an efficient and justifiable way to do so.

Tax incentives need to be structured to be as flexible and useful as possible. For example, establishing tax credits but then subjecting the person with those credits to Alternative Minimum Tax is counterproductive, and the AMT should be removed in some cases. And to the extent we provide tax incentives, they could be even more effective if they were not fixated on sunset dates. Again, using ethanol as an example, how much sense does it make to have a seven year tax incentive that by its very nature diminishes in value every year?

You must then remain consistent in order to provide the investment climate and certainty necessary for the private sector to take the hand-off from the federal government when the fruits of the research and development programs are available.

Frankly, all of this holds true for domestic oil as well if we want to balance the scales against imports. Our national priorities for energy should be that it is clean, domestic, and renewable and fuels with those characteristics should get special treatment.

I appreciate the opportunity to share these views with you and commend the Subcommittee for your efforts to try and help solve this very important issue. I would be pleased to answer any questions.