

March 19, 2002

The Honorable Thomas Daschle
Majority Leader
United States Senate
Washington, D.C. 20510

**Subject: Sections 504 and 505 of the Energy Tax Savings Act of 2002 (S. 1979)
Expensing of Capital Costs and a Tax Credit for EPA Sulfur Regulations (An
amendment to Section 179 of the Internal Revenue Code)**

Dear Senator Daschle:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) has been actively involved in negotiations between small oil refiners and the U.S. Environmental Protection Agency (EPA) over its sulfur regulations. Those regulations will have a dramatic impact on 20 small refiners. Advocacy supports Sections 504 and 505 of the Energy Tax Incentives Act of 2002,¹ which the Senate will soon consider because it helps retain reliable, competitive, domestic refining capacity while also reducing air pollution. We believe the modest cost of this proposal will be more than recovered by promoting stable affordable prices for fuel as a result of competition.

Advocacy has worked with the Senate on many occasions. Advocacy was given the authority by Congress to participate in rulemakings and other activities when necessary to ensure proper representation of small business interests. One of the primary functions of the Advocacy office is to examine the role of small business in the American economy

¹ See S. 1979, Title V, Sections 504 and 505.

and make recommendations to keep regulations from adversely affecting competition.² Another function is to examine the impact of the tax structure on small business.³

Advocacy participated in EPA's rulemakings to establish limits on sulfur in gasoline and highway diesel fuel. Our office, EPA and industry representatives worked diligently to satisfy two very important goals: 1) to develop a regulation that would protect human health and the environment and 2) to maintain to the extent possible reliable, competitive, domestic refining capacity. Ultimately, EPA could meet only its statutory environmental obligations by allowing additional lead time for the small refiners so they would not have to comply with both sulfur rules at the same time and would have additional time to find the financing and expertise required. While the lead time is helpful, small refiners do not have the production volumes over which to spread the costs of regulation, the buying power of many refineries to keep the costs of regulation down or the ready access to capital their huge, multinational competitors enjoy. Small refiners will face increased costs to cover their investment and reduced profits when required to comply.⁴ Once the door closes and the jobs are lost, competition is lost and costs increase for the consumer.

Sections 504 and 505 of the Energy Tax Incentives Act of 2002 help address the concerns of small business. The provision would allow small refiners to expense 75 percent of their equipment costs and receive a tax credit for the other 25 percent. The Finance Committee wisely chose to invest in maintaining as much domestic refining capacity as possible while moving towards achieving the sulfur targets.

A comparison of the costs to the taxpayer by allowing the 25-percent credit and 75-percent expense deduction versus the costs to the consumer reveals that a minimal investment can produce dramatic results. The Joint Committee on Taxation scored this provision at \$57 million over ten years.⁵ Advocacy believes there is a strong case that not

² See the Small Business Act, 15 U.S.C. § 634(a) *et seq.*

³ 15 U.S.C. § 634(b)(4).

⁴ Even if the cost of regulation declines as expected over time as larger companies learn to produce, install, and operate the sulfur control technology more efficiently, the supplier of the technology might be able to obtain a patent or charge monopoly prices, potentially offsetting any "learning curve" cost savings.

⁵ See Document JCX-08-02 at <http://www.house.gov/jct/x-8-02.pdf>.

enacting this provision could cost consumers nearly 1,000 times that much – roughly \$51 *billion* over ten years (see attachment). The average cost to the consumer of highway diesel fuel could rise 10 percent or more nationally if the entire group of small refiners (roughly 5 percent of the market) exit as a result of the sulfur rules.⁶

For these reasons, we support Sections 504 and 505 and feel that these provisions provide good value to small refiners, the taxpayer and the consumer. If you have any questions, please contact Austin Perez in our office at 202-205-6936.

Sincerely,

/s/

Thomas M. Sullivan
Chief Counsel for Advocacy

Attachment

⁶ With an output decline of 5 percent and an elasticity coefficient of -0.5 , the anticipated price increase would be 10 percent in the long run. In the shorter term or in regions where small refiners are the primary suppliers, the price effect could be even more pronounced. For the source of the coefficient see Carol Dahl, "A Survey of Energy Demand Elasticities in Support of the Development of the NEMS," prepared for the U.S. Department of Energy under contract De-AP01-93EI23499 (October 19, 1993), pp. 122-123.

Attachment

Judgements

Gallons/Barrel	42
Calendar Days/Year ¹	346
Direct Price Elasticity of Demand ²	-0.5
Supply Change	-5%
Ten-Year Average Price (\$/gal.)	1.35

¹ Source: U.S. Department of Energy's Energy Information Administration (DOE/EIA).

² Source: Carol Dahl, "A Survey of Energy Demand Elasticities in Support of the Development of the NEMS," prepared for the U.S. Department of Energy under contract De-AP01-93EI23499 (October 19, 1993), pp. 122-123.

Benefits

Year	Price ¹ (\$/gal.)	Barrels/Day ¹ (mil.)	Gallons/Year ² (mil.)	Price Change ³ (\$/gal.)	Total Benefit (\$mil.)
2002	1.37	3.83	52,874.68	0.14	-
2003	1.28	3.96	54,669.38	0.14	-
2004	1.29	4.06	56,049.92	0.14	-
2005	1.28	4.16	57,430.46	0.14	-
2006	1.31	4.23	58,396.84	0.14	-
2007	1.37	4.30	59,363.22	0.14	8,030.22
2008	1.38	4.39	60,605.71	0.14	8,198.30
2009	1.39	4.49	61,986.25	0.14	8,385.05
2010	1.41	4.58	63,228.73	0.14	8,553.12
2011	1.41	4.69	64,747.33	0.14	8,758.55
2012	1.41	4.78	65,989.81	0.14	8,926.62

¹ Source: DOE/EIA, http://www.eia.doe.gov/oiaf/aeo/pdf/aeo_base.pdf, Tables 11 and 12.

² Gallons/Year = Barrels/Day x Gallons/Barrel x Calendar Days/Year x Fraction of Supply Remaining (after the small refiners exit).

³ Price Change = Average Price x (Supply Change/Price Elasticity).

Net Benefits

Year	Total Cost ¹ (\$mil.)	Total Benefit (\$mil.)
2002	0	0
2003	0	0
2004	0	0
2005	0	0
2006	-5	0
2007	-10	8,030
2008	-17	8,198
2009	-27	8,385
2010	-7	8,553
2011	5	8,759
2012	4	8,927
Undiscounted	-57	50,852
Discounted (@7%)	-38	30,690

¹ Source: Joint Committee on Taxation, Document JCX-08-02, <http://www.house.gov/jct/x-8-02.pdf>.