CRUDE OIL TAX

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SIXTH CONGRESS

FIRST SESSION

ON

H.R. 3919

JULY 10, 11, 12, 18, AND 19, 1979

PART 1 OF 2 PARTS

(JULY 10, 11, 1979)

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE
48-372 O WASHINGTON : 1979 HG 96-19

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CRUDE OIL TAX

TUESDAY, JULY 10, 1979

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met at 2:30 p.m., pursuant to call, in room 2221 Dirksen Senate Office Building, Hon. Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Ribicoff, Byrd, Gravel, Bentsen, Moynihan, Baucus, Boren, Bradley, Dole, Roth, Danforth, Chafee, Heinz, Wallop, and Durenberger.

[The press release announcing these hearings and the bill H.R. 3919 follow:]

FINANCE COMMITTEE ANNOUNCES HEARINGS ON H.R. 3919, THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1979; PROPOSED CHANGES IN THE FOREIGN TAX CREDIT; AND PROPOSED USES OF WINDFALL PROFIT TAX REVENUES

The Honorable Russell B. Long (D., La.), Chairman of the Senate Committee on Finance, today announced the Committee will hold hearings on the Crude Oil Windfall Profit Tax Act of 1979, on proposed changes in the foreign tax credit for certain oil related income, and on proposed uses of windfall profit tax revenues beginning Tuesday, July 10. Treasury Secretary W. Michael Blumenthal will testify before the Committee on that date. Energy Secretary James Schlesinger will testify on Wednesday, July 11.

The hearings will begin at 10:00 a.m. in Room 2221 Dirksen Senate Office Building each day.

Requests to testify.—Chairman Long stated that witnesses desiring to testify during these hearings should make their requests in writing to Michael Stern, Staff Director, Committee on Finance, 2227 Dirksen Senate Office Building, Washington, D.C. 20510, not later than Friday, July 6, 1979. Witnesses will be notified as soon as possible after this cut-off date as to when they will be scheduled to appear. If a witness is unable to appear at the time scheduled, he may file a written statement for the record in lieu of his personal appearance.

Consolidated testimony.—Chairman Long also stated that the Committee urges all witnesses who have a common position or with the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Committee. This procedure will enable the Committee to receive a wider expression of views than it might otherwise obtain. The Chairman urged that all witnesses exert a maximum effort, taking into account the limited advance notice, to consolidate and coordinate their statements.

Legislative Reorganization Act.—Senator Long stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify must comply with the following rules:

(1) A copy of the statement must be filed by the close of business two days before the day the witness is scheduled to testify.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 100 copies must be submitted by the close of business the day before the witness is scheduled to testify.

(4) Witnesses are not to read their written statements to the Committee, but are to confine their oral presentations to a summary of the points included in the statement, and may not exceed 10 minutes.

Written testimony—Senator Long stated that the Committee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 20 double-spaced pages in length and mailed with five (5) copies by July 20, 1979, to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510.

96TH CONGRESS
1ST SESSION

H. R. 3919

IN THE SENATE OF THE UNITED STATES

JULY 10 (legislative day, JUNE 21), 1979
Read twice and referred to the Committee on Finance

AN ACT

To impose a windfall profit tax on domestic crude oil.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; AMENDMENT OF 1954 CODE.

(a) SHORT TITLE.—This Act may be cited as the "Crude Oil Windfall Profit Tax Act of 1979".

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

SEC. 2. WINDFALL PROFIT TAX.

(a) IN GENERAL.—

(1) AMENDMENT OF SUBTITLE D.—Subtitle D (relating to miscellaneous excise taxes) is amended by adding at the end thereof the following new chapter:

"CHAPTER 45—WINDFALL PROFIT TAX ON DOMESTIC CRUDE OIL

"SEC. 4986. IMPOSITION OF TAX.

"(a) IMPOSITION OF TAX.—An excise tax is hereby imposed on the windfall profit from taxable crude oil removed from the premises during each taxable period.

"(b) TAX PAID BY PRODUCER.—The tax imposed by this section shall be paid by the producer of the crude oil.

"SEC. 4987. AMOUNT OF TAX.

"(a) IN GENERAL.—Except as provided in the provisions referred to in subsection (b), the amount of the tax imposed by section 4986 with respect to any barrel of taxable crude oil shall be 60 percent of the windfall profit on such barrel.

"(b) PROVISIONS PROVIDING FOR 50 PERCENT RATE.—For provisions providing tax rate of 50 percent in the case of—

"(1) a certain portion of the windfall profit from newly discovered oil, see section 4991(a)(2), and

"(2) Sadlerochit oil, see section 4991(b)(1)(A).

"(c) FRACTIONAL PART OF BARREL.—In the case of a fraction of a barrel, the tax imposed by section 4986 shall be the same fraction of the amount of such tax imposed on a whole barrel.

"SEC. 4988. TAXABLE CRUDE OIL; THE 3 TIERS FOR TAX PURPOSES.

"(a) TAXABLE CRUDE OIL.—For purposes of this chapter, the term 'taxable crude oil' means all domestic crude oil other than—

"(1) qualified Alaskan oil (within the meaning of section 4992(b)(6)), and

"(2) newly discovered oil and incremental tertiary oil removed (or deemed removed) from the premises after December 31, 1990.

"(b) TIER 1 OIL.—For purposes of this chapter, the term 'tier 1 oil' means domestic crude oil which—

"(1) is lower tier oil, or

"(2) would be lower tier oil if the base production control level for such oil were reduced for January

1980 and each month thereafter by 1½ percent (instead of 3 percent).

For purposes of paragraph (2), the base production control level shall be determined under the June 1979 energy regulations as if the producer had elected the 1½ percent monthly reduction for 1979 and the 3 percent monthly reduction thereafter.

"(c) TIER 2 OIL.—For purposes of this chapter, the term 'tier 2 oil' means upper tier oil other than—

"(1) oil described in subsection (b)(2),

"(2) oil removed (or deemed removed) from the premises after December 31, 1990, and

"(3) Sadlerochit oil (within the meaning of section 4991(b)(3)).

"(d) TIER 3 OIL.—For purposes of this chapter, the term 'tier 3 oil' means taxable crude oil other than tier 1 oil and tier 2 oil.

"(e) LOWER AND UPPER TIERS.—For purposes of this chapter—

"(1) LOWER TIER OIL.—The term 'lower tier oil' means domestic crude oil which is or would be subject to the lower tier ceiling price rule of the June 1979 energy regulations.

"(2) UPPER TIER OIL.—The term 'upper tier oil' means domestic crude oil which is or would be subject to the upper tier ceiling price rule of the June 1979 energy regulations.

"SEC. 4989. WINDFALL PROFIT; REMOVAL PRICE.

"(a) GENERAL RULE.—For purposes of this chapter, the term 'windfall profit' means the excess of the removal price of the barrel of crude oil over the sum of—

"(1) the adjusted base price of such barrel, and

"(2) the amount of the severance tax adjustment with respect to such barrel provided by section 4992(d).

"(b) NET INCOME LIMITATION ON WINDFALL PROFIT.—

"(1) IN GENERAL.—The windfall profit on any barrel of crude oil shall not exceed the net income attributable to such barrel.

"(2) DETERMINATION OF NET INCOME.—For purposes of paragraph (1), the net income attributable to a barrel shall be determined by dividing—

"(A) the taxable income from the property for the taxable year attributable to taxable crude oil, by

"(B) the number of barrels of taxable crude oil produced from such property during such taxable year.

"(3) TAXABLE INCOME FROM THE PROPERTY.—For purposes of paragraph (2)—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, the taxable income from the property shall be determined under section 613(a).

"(B) CERTAIN DEDUCTIONS NOT ALLOWED.—No deduction shall be allowed for—

"(i) depletion,

"(ii) section 263(c) costs, and

"(iii) the tax imposed by section 4986.

"(C) TAXABLE INCOME REDUCED BY COST DEPLETION.—Taxable income shall be reduced by the cost depletion which would have been allowable for the taxable year with respect to the property if—

"(i) all section 263(c) costs had been capitalized and taken into account in computing cost depletion, and

"(ii) cost depletion had been used with respect to such property for all periods.

"(D) SECTION 263(c) COSTS.—For purposes of this paragraph, the term 'section 263(c) costs' means intangible drilling and development costs which (by reason of an election under section

263(c)) may be deducted as expenses for purposes of this chapter (other than this paragraph). Such term shall not include costs incurred in drilling a nonproductive well.

"(4) SPECIAL RULES FOR TRANSFERS OF PROVEN OIL OR GAS PROPERTIES.—

"(A) IN GENERAL.—In the case of any proven oil or gas property transfer which, but for this subparagraph, would result in an increase in the amount determined under paragraph (3)(C) with respect to the transferee, paragraph (3)(C) shall be applied with respect to the transferee by taking into account only costs incurred during periods after such transfer.

"(B) PROVEN OIL OR GAS PROPERTY TRANSFER.—For purposes of subparagraph (A), the term 'proven oil or gas property transfer' means any transfer (including the subleasing of a lease) after 1978 of an interest (including an interest in a partnership or trust) in any proven oil or gas property (within the meaning of section 613A(c)(9)(A)).

"(5) SPECIAL RULE WHERE THERE IS PRODUCTION PAYMENT.—For purposes of paragraph (2), if any portion of the taxable crude oil removed from the property is applied in discharge of a production payment, the gross income from such portion shall be included in the gross income from the property in computing the taxable income of the producer.

"(c) REMOVAL PRICE.—For purposes of this chapter—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the term 'removal price' means the amount for which the barrel is sold.

"(2) SALES BETWEEN RELATED PERSONS.—In the case of a sale between related persons (within the meaning of section 103(b)(6)(C)), the removal price shall not be less than the constructive sales price for purposes of determining gross income from the property under section 613.

"(3) OIL REMOVED FROM PREMISES BEFORE SALE.—If crude oil is removed from the premises before it is sold, the removal price shall be the constructive sales price for purposes of determining gross income from the property under section 613.

"(4) REFINING BEGUN ON PREMISES.—If the manufacture or conversion of crude oil into refined products begins before such oil is removed from the premises—

"(A) such oil shall be treated as removed on the day such manufacture or conversion begins, and

"(B) the removal price shall be the constructive sales price for purposes of determining gross income from the property under section 613.

"(5) MEANING OF TERMS.—As used in this subsection, the terms 'premises' and 'refined product' have the same meaning as when used for purposes of determining gross income from the property under section 613.

"SEC. 4990. ADJUSTED BASE PRICE.

"(a) ADJUSTED BASE PRICE DEFINED.—For purposes of this chapter, the term 'adjusted base price' means the base price for the barrel of crude oil plus an amount equal to—

"(1) such base price, multiplied by

"(2) the inflation adjustment for the calendar quarter in which the crude oil is removed (or deemed removed) from the premises.

The amount determined under the preceding sentence shall be rounded to the nearest cent.

"(b) INFLATION ADJUSTMENT.—

"(1) IN GENERAL.—For purposes of subsection (a) the inflation adjustment for any calendar quarter is the percentage by which—

"(A) the implicit price deflator for the gross national product for the second preceding calendar quarter, exceeds

"(B) such deflator for the calendar quarter ending December 31, 1978 (June 30, 1979, in the case of tier 3 oil).

"(2) FIRST REVISION OF PRICE DEFLATOR USED.—For purposes of paragraph (1), the price deflator used shall be the first revision thereof.

"(c) BASE PRICE FOR TIER 1 OIL.—For purposes of this chapter, the base price for tier 1 oil is the lower tier ceiling price (as of May 1979) for such oil under March 1979 energy regulations.

"(d) BASE PRICE FOR TIER 2 OIL.—For purposes of this chapter—

"(1) IN GENERAL.—Except as provided in paragraph (2), the base price for tier 2 oil is the upper tier ceiling price (as of May 1979) for such oil under March 1979 energy regulations.

"(2) MONTHLY INCREMENTS STARTING NOVEMBER 1, 1986.—Beginning with November 1986, the base price for tier 2 oil of any grade and location shall include such monthly increments as may be provided pursuant to regulations prescribed by the Secretary (and modified by him from time to time) for the purpose of eliminating (as ratably as may be practicable) over the 50 month period ending December 31, 1990, the gap between the tier 2 base price for such oil and the tier 3 base price for such oil.

"(e) BASE PRICE FOR TIER 3 OIL.—For purposes of this chapter, the base price for tier 3 oil is the price provided pursuant to regulations prescribed by the Secretary for the purpose of estimating (as nearly as may be practicable) the price at which uncontrolled crude oil of the same grade and location would have sold in December 1979 if the average landed price during such month for imported crude oil were $16 a barrel.

"SEC. 4991. NEWLY DISCOVERED OIL; TERTIARY RECOVERY PROJECTS; CERTAIN ALASKAN OIL.

"(a) NEWLY DISCOVERED OIL AND TERTIARY RECOVERY.—

"(1) BASE PRICE TO BE $17.—The base price for any newly discovered oil and incremental tertiary oil shall be determined by substituting '$17' for '$16' in section 4990(e).

"(2) RATE OF TAX ON FIRST $9 OF WINDFALL PROFIT SHALL BE 50 PERCENT INSTEAD OF 60 PERCENT.—For so much of the windfall profit on any barrel of newly discovered oil and incremental tertiary oil as does not exceed $9, the tax rate applicable under section 4987(a) shall be 50 percent instead of 60 percent.

"(3) ADDITIONAL ½ OF 1 PERCENT QUARTERLY ADJUSTMENT.—

"(A) IN GENERAL.—The adjusted base price for any barrel of newly discovered oil and incremental tertiary oil shall be determined by substituting for the implicit price deflator referred to in section 4990(b)(1)(A) an amount equal to such deflator multiplied by 1.005 to the nth power where 'n' equals the number of calendar quarters beginning after September 1979 and before the calendar quarter in which the oil is removed (or deemed removed) from the premises.

"(B) INFLATION ADJUSTMENT AND ADDITIONAL ½ OF 1 PERCENT QUARTERLY ADJUSTMENT ALSO APPLY TO AMOUNT OF WINDFALL PROFIT SUBJECT TO THE 50 PERCENT TAX.—The $9 figure contained in paragraph (2) shall be adjusted in a manner similar to that provided under subsections (a) and (b) of section 4990 (as modified by subparagraph (A) of this paragraph).

"(4) SEVERANCE TAX ADJUSTMENT NOT TO APPLY TO PORTION SUBJECT TO 50-PERCENT RATE.—For purposes of determining the windfall profit on any barrel of newly discovered oil and incremental tertiary oil, section 4992(d)(1)(B) shall be applied by substituting for 'its adjusted base price' the following: 'its adjusted base price plus $9, adjusted as provided in section 4991(a)(3)(B)'.

"(5) NEWLY DISCOVERED OIL DEFINED.—For purposes of this chapter (including the application of the June 1979 energy regulations for purposes of this chapter)—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term 'newly discovered oil' has the meaning given to such term by the June 1979 energy regulations.

"(B) REOPENINGS.—The term 'newly discovered oil' does not include crude oil produced from a property from which there has been any production of crude oil after 1969 and before 1979. For purposes of this subparagraph, the term 'property' has the meaning given to such term by the June 1979 energy regulations.

"(C) BEHIND-THE-PIPE OIL.—The term 'newly discovered oil' does not include crude oil produced from a reservoir on a tract or parcel if—

"(i) the reservoir was penetrated after 1969 and before 1979 by a well (on such tract or parcel) from which crude oil was produced (whether or not such production was from such reservoir), and

"(ii) crude oil could have been produced from such reservoir through such well before 1979.

"(D) PRODUCTION MUST HAVE BEEN IN COMMERCIAL QUANTITIES.—For purposes of subparagraphs (B) and (C), only production in commercial quantities shall be taken into account.

"(b) ALASKAN OIL FROM SADLEROCHIT RESERVOIR.—For purposes of this chapter—

"(1) IN GENERAL.—In the case of Sadlerochit oil—

"(A) RATE OF TAX.—The rate of tax provided in section 4987(a) shall be 50 percent instead of 60 percent.

"(B) BASE PRICE.—The base price shall be $7.50.

"(C) ADJUSTED BASE PRICE INCREASED BY TAPS ADJUSTMENT.—The adjusted base price for any calendar quarter (determined without regard to this subsection) shall be increased by the

TAPS adjustment (if any) for such quarter provided by paragraph (2).

"(D) REMOVAL PRICE DETERMINED ON MONTHLY BASIS.—The removal price of such oil removed during any calendar month shall be the average of the producer's removal prices for such month.

"(E) SEVERANCE TAX ADJUSTMENT NOT TO APPLY.—The amount of the windfall profit shall be determined without regard to section 4989(a)(2).

"(2) TAPS ADJUSTMENT.—

"(A) IN GENERAL.—The TAPS adjustment for any calendar quarter is the excess (if any) of—

"(i) $6.26 plus the product of $6.26 and the inflation adjustment, over

"(ii) the TAPS tariff for the preceding calendar quarter.

"(B) INFLATION ADJUSTMENT.—For purposes of subparagraph (A), the inflation adjustment shall be determined under section 4990(b) as if paragraph (1)(B) thereof referred to the calendar quarter ending June 30, 1978.

"(C) TAPS TARIFF.—For purposes of subparagraph (A), the TAPS tariff for the preceding calendar quarter is the average per barrel amount paid for all transportation (ending in such quarter) of crude oil through the TAPS.

"(D) TAPS DEFINED.—For purposes of this paragraph, the term 'TAPS' means the Trans-Alaskan Pipeline System.

"(3) SADLEROCHIT OIL DEFINED.—The term 'Sadlerochit oil' means crude oil produced from the Sadlerochit reservoir in the Prudhoe Bay oil field.

"(c) INCREMENTAL TERTIARY OIL TREATED AS TIER 3 OIL.—For purposes of this chapter—

"(1) TREATMENT AS TIER 3 OIL.—Incremental tertiary oil which is taxable crude oil shall be treated as tier 3 oil and not as tier 1 oil or tier 2 oil.

"(2) INCREMENTAL TERTIARY OIL DEFINED.—

"(A) IN GENERAL.—The term 'incremental tertiary oil' means the excess of—

"(i) the amount of crude oil which is removed during any month and which is produced on or after the project beginning date and during the period for which a qualified tertiary recovery project is in effect on the property, over

"(ii) the base level for such property for such month.

"(B) BASE LEVEL.—The base level for any property for any month is the average monthly amount (determined under rules similar to rules used in determining the base production control level under the June 1979 energy regulations) of crude oil removed from such property during the 6-month period ending March 31, 1979, reduced by the sum of—

"(i) 1 percent of such amount for each month which begins after 1978 and before the project beginning date, and

"(ii) 2½ percent for each month (after the last month described in clause (i) or, if no such month, after 1978) which is before the month for which the base level is being determined.

"(C) MINIMUM AMOUNT IN CASE OF PROJECTS CERTIFIED BY DOE.—In the case of a project described in paragraph (4)(A), the amount of the incremental tertiary oil shall not be less than the incremental production determined under the June 1979 energy regulations.

"(3) ALLOCATION RULES.—The determination of which barrels of crude oil removed during any month are incremental tertiary oil shall be made—

"(A) first by allocating the amount of incremental tertiary oil between oil which (but for this subsection) would be tier 1 oil and oil which (but for this subsection) would be tier 2 oil in proportion to the respective amounts of such oil removed from the property during such month, and

"(B) then by taking into account barrels of crude oil so removed in the order of their respective removal prices beginning with the highest of such prices.

"(4) QUALIFIED TERTIARY RECOVERY PROJECT.—The term 'qualified tertiary recovery project' means—

"(A) a qualified tertiary enhanced recovery project with respect to which a certification as such is in effect under the June 1979 energy regulations, or

"(B) any project for the tertiary recovery of crude oil which meets the requirements of paragraph (5).

"(5) REQUIREMENTS.—A project meets the requirements of this paragraph if—

"(A) the project involves the application (in accordance with sound engineering principles) of one or more tertiary recovery methods which can reasonably be expected to result in a significant increase in the amount of crude oil which will ultimately be recovered from the property,

"(B) the project would be uneconomic without the benefits of this subsection,

"(C) the project beginning date is after May 1979, and

"(D) the operator submits (at such times and in such manner as the Secretary may by regulations prescribe) to the Secretary—

"(i) a certification from a petroleum engineer that the project meets the requirements of subparagraphs (A), (B), and (C) (and continues to meet the requirements of subparagraph (A)), and

"(ii) such other information as the Secretary may by regulations require.

"(6) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

"(A) TERTIARY RECOVERY METHOD.—The term 'tertiary recovery method' means—

"(i) any method which is described in subparagraphs (1) through (9) of section 212.78(c) of the June 1979 energy regulations, or "(ii) any other method to provide tertiary enhanced recovery which is approved by the Secretary.

"(B) PROJECT BEGINNING DATE.—The term 'project beginning date' means the date on which the application of the method or methods referred to in paragraph (5)(A) begin.

"(C) PROJECT ONLY AFFECTS PORTION OF PROPERTY.—If a qualified tertiary recovery project affects only a portion of a property, such portion shall be treated as a separate property.

"(D) SIGNIFICANT EXPANSION TREATED AS SEPARATE PROJECT.—A significant expansion of any project shall be treated as a separate project.

"(d) FRONT-END FINANCING FOR TERTIARY RECOVERY PROJECTS.—If under any energy regulations crude oil receives special price treatment for purposes of providing front-end financing for tertiary recovery projects, for purposes of this chapter, such crude oil shall be treated as tier 2 oil.

"SEC. 4992. OTHER DEFINITIONS AND SPECIAL RULES.

"(a) PRODUCER.—

"(1) IN GENERAL.—For purposes of this chapter, the term 'producer' means the holder of the economic interest with respect to the crude oil.

"(2) EXCEPTION IN CASE OF CERTAIN SPECIFIED AMOUNT PRODUCTION PAYMENTS.—If a portion of the crude oil removed from a property is applied during the taxable year in partial or complete discharge of a production payment which—

"(A) is not limited by time or to a specified number of units, but

"(B) will be fully discharged only when a specified dollar amount (plus interest or other charges, if any) has been received by the holder of the production payment,

then the holder of the economic interest from which the production payment was created (rather than the holder of the production payment) shall be treated as the producer of such portion.

"(b) OTHER DEFINITIONS.—For purposes of this chapter—

"(1) CRUDE OIL.—The term 'crude oil' has the meaning given to such term by the June 1979 energy regulations.

"(2) BARREL.—The term 'barrel' means 42 United States gallons.

"(3) DOMESTIC.—The term 'domestic', when used with respect to crude oil, means crude oil produced from an oil well located in the United States or in a possession of the United States.

"(4) UNITED STATES.—The term 'United States' has the meaning given to such term by paragraph (1) of section 638 (relating to Continental Shelf areas).

"(5) POSSESSION OF THE UNITED STATES.—The term 'possession of the United States' has the meaning given to such term by paragraph (2) of section 638.

"(6) QUALIFIED ALASKAN OIL.—The term 'qualified Alaskan oil' means any crude oil produced from a well north of the Arctic Circle other than Sadlerochit oil.

"(7) TAXABLE PERIOD.—The term 'taxable period' means each calendar quarter beginning after December 31, 1979.

"(8) ENERGY REGULATIONS.—

"(A) IN GENERAL.—The term 'energy regulations' means regulations prescribed under section 4(a) of the Emergency Petroleum Allocation Act of 1973, as amended.

"(B) MARCH 1979 ENERGY REGULATIONS.—The March 1979 energy regulations shall be the terms of energy regulations as such terms existed on March 1, 1979.

"(C) JUNE 1979 ENERGY REGULATIONS.—The June 1979 energy regulations—

"(i) shall be the terms of energy regulations as such terms existed on June 1, 1979, and

"(ii) shall be treated as including final action taken pursuant thereto before June 1, 1979, and as including action taken before, on, or after such date with respect to incremental production from qualified tertiary enhanced recovery projects.

"(D) CONTINUED APPLICATION OF REGULATIONS AFTER DECONTROL.—Energy regulations shall be treated as continuing in effect without regard to decontrol of oil prices or any other termination of the application of such regulations.

"(c) PURCHASER COLLECTS TAX.—If the removal of any taxable crude oil is determined under section 4989(c)(1)—

"(1) the tax imposed by section 4986 with respect to such crude oil shall be collected by the purchaser of such crude oil by deducting the amount of such tax from amounts payable for such oil, "(2) the producer shall not be required to file a return of the tax imposed by section 4986 with respect to such oil, and

"(3) the producer shall be treated as having paid the amount of tax collected by the purchaser on the due date prescribed by section 6076 for filing the return for the taxable period in which such oil was removed from the premises.

In determining the amount to be collected under paragraph (1), section 4989(b) shall not apply.

"(d) SEVERANCE TAX ADJUSTMENT.—For purposes of this chapter—

"(1) IN GENERAL.—The severance tax adjustment with respect to any barrel of crude oil shall be the amount by which—

"(A) any severance tax imposed with respect to such barrel, exceeds

"(B) the severance tax which would have been imposed if the barrel had been extracted and sold at its adjusted base price.

"(2) LIMITATION ON AMOUNT OF SEVERANCE TAX.—The amount of severance tax taken into account under paragraph (1) shall not exceed the amount which would have been imposed under the State law in effect on March 31, 1979.

"(e) SPECIAL RULES FOR POST-1978 TRANSFERS OF PROPERTY.—In the case of a transfer after 1978 of any portion of a property, for purposes of this chapter (including the application of the June 1979 energy regulations for purposes of this chapter), after such transfer—

"(1) crude oil produced from any portion of such property shall not constitute stripper oil or newly discovered oil if such oil would not be so classified if the property had not been divided, and

"(2) the allocation of the base production control level among portions of the property shall be made under regulations prescribed by the Secretary.

"(f) EXEMPTION FOR CERTAIN INTERESTS HELD BY STATE OR LOCAL GOVERNMENTS.—

"(1) IN GENERAL.—If—

"(A) an economic interest in crude oil is held by a State or political subdivision thereof, or by an educational institution which is an agency or instrumentality of any of the foregoing, and

"(B) under the applicable State or local law, all of the net income received pursuant to such interest is dedicated to public education,

then no tax shall be imposed by section 4986 with respect to crude oil properly allocable to such interest. For purposes of this paragraph, the term 'net income' means gross income reduced by production costs, and severance taxes of general application, allocable to such interest.

"(2) AMOUNTS PLACED IN CERTAIN PERMANENT FUNDS TREATED AS DEDICATED TO PUBLIC EDUCATION.—The requirements of paragraph (1)(B) shall be treated as met with respect to any net income which, under the applicable State or local law, is placed in a permanent fund the earnings on which are dedicated to public education.

"SEC. 4993. RECORDS AND INFORMATION; REGULATIONS.

"(a) RECORDS AND INFORMATION.—Each taxpayer liable for tax under section 4986, each partnership, trust, or estate producing domestic crude oil, each purchaser of domestic crude oil, and each operator of a well from which domestic crude oil was produced, shall keep such records, make such returns, and furnish such information with respect to such oil as the Secretary may by regulations prescribe.

"(b) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purpose of this chapter, including such changes in the application of the energy regulations for purposes of this chapter as may be necessary or appropriate to carry out such purposes."

(2) CLERICAL AMENDMENT.—The table of chapters for subtitle D is amended by adding at the end thereof the following new item:

"CHAPTER 45. Windfall profit tax on domestic crude oil."

(b) TECHNICAL AMENDMENTS.—

(1) The first sentence of section 164(a) (relating to deduction for taxes) is amended by inserting after paragraph (4) the following new paragraph:

"(5) The windfall profit tax imposed by section 4986."

(2) Subsection (a) of section 613 (relating to percentage depletion) is amended by inserting before the last sentence the following new sentence: "For purposes of this subsection and section 613A(d)(1), in the case of taxable crude oil (within the meaning of section 4988(a)), gross income from the property shall be reduced by the amount of the windfall profit (within the meaning of section 4989(a) determined without regard to the severance tax adjustment) and taxable income shall be determined without regard to the tax imposed by section 4986."

(c) TIME FOR FILING RETURN OF WINDFALL PROFIT TAX; DEPOSITARY REQUIREMENTS.—

(1) TIME FOR FILING RETURN OF WINDFALL PROFIT TAX.—

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(A) Part V of subchapter A of chapter 61 (relating to time for filing returns and other documents) is amended by adding at the end thereof the following new section:

"SEC. 6076. TIME FOR FILING RETURN OF WINDFALL PROFIT TAX.

"(a) GENERAL RULE.—Each return of the tax imposed by section 4986 (relating to windfall profit tax) for any taxable period (within the meaning of section 4992(b)(7)) shall be filed not later than the last day of the second month following the close of the taxable period.

"(b) CROSS REFERENCE.—

"For depositary requirements applicable to the tax imposed by section 4986, see section 6302(d)."

(B) The table of sections for such part V is amended by adding at the end thereof the following new item:

"Sec. 6076. Time for filing return of windfall profit tax."

(2) DEPOSITARY REQUIREMENTS.—Section 6302 (relating to mode or time of collection) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) WINDFALL PROFIT TAX.—The mode and time for collecting the tax imposed by section 4986 (relating to windfall profit tax) shall be established by the Secretary by regulations."

(3) TECHNICAL AMENDMENT.—Section 7512 (relating to separate accounting for certain collected taxes, etc.) is amended—

(A) by striking out "or by chapter 33" in subsections (a) and (b) and inserting in lieu thereof ", by chapter 33, or by section 4986", and

(B) by striking out "or chapter 33" in subsections (b) and (c) and inserting in lieu thereof ", chapter 33, or section 4986".

(d) CERTAIN INFORMATION REQUIRED TO BE FURNISHED.—

(1) GENERAL RULE.—Subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) is amended by adding at the end thereof the following new section:

"SEC. 6050C. INFORMATION FURNISHED BY PURCHASER AND OPERATOR REGARDING WINDFALL PROFIT TAX ON DOMESTIC CRUDE OIL.

"(a) CERTAIN INFORMATION FURNISHED BY PURCHASER.—Under regulations prescribed by the Secretary, the purchaser of taxable crude oil (within the meaning of section 4988) shall furnish to the taxpayer liable for tax under section 4986 with respect to such oil a monthly statement showing the following:

"(1) the amount of taxable crude oil purchased from such taxpayer during such month,

"(2) the removal price of such oil,

"(3) the base price and the adjusted base price with respect to such oil,

"(4) the amount of such taxpayer's liability for tax under section 4986 with respect to such oil, and

"(5) such other information as may be required by regulations prescribed by the Secretary.

"(b) INFORMATION FURNISHED BY OPERATOR.—Under regulations prescribed by the Secretary, if the purchaser of taxable crude oil and the operator of the well from which such crude oil was produced make a joint election under this subsection, the monthly statement required to be furnished by the purchaser under subsection (a) shall be furnished by such operator.

"(c) TIME FOR FILING MONTHLY STATEMENT.—Each monthly statement required to be furnished under subsection (a) or (b) for any month shall be furnished before the first day of the second month which begins after the close of such month.

"(d) CERTIFICATION FURNISHED BY OPERATOR.—Under regulations prescribed by the Secretary, the operator of the well from which crude oil subject to the tax imposed under section 4986 was produced shall certify (at such time and in such manner as the Secretary shall by regulations prescribe) to the purchaser the base price (within the meaning of section 4990) with respect to such crude oil. For purposes of section 6652(b) (relating to additions to tax for failure to file other returns) such certification shall be treated as a statement of a payment to another person.

"(e) CROSS REFERENCES.—

"(1) For additions to tax for failure to furnish information required under this section, see section 6652(b).

"(2) For penalty for willful failure to supply information required under this section, see section 7241."

(2) TECHNICAL AND CONFORMING AMENDMENTS.—

(A) Section 6652(b) is amended by striking out "or section 6051(d)" and inserting in lieu thereof the following: "section 6050C (relating to information regarding windfall profit tax on domestic crude oil), or section 6051(d)".

(B) The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by adding at the end thereof the following new item:

"Sec. 6050C. Information furnished by purchaser and operator regarding windfall profit tax on domestic crude oil."

(e) CRIMINAL PENALTY FOR FAILURE TO FURNISH CERTAIN INFORMATION.—

(1) IN GENERAL.—Part II of subchapter A of chapter 75 (relating to penalties applicable to certain taxes) is amended by adding at the end thereof the following new section:

"SEC. 7241. WILLFUL FAILURE TO FURNISH CERTAIN INFORMATION REGARDING WINDFALL PROFIT TAX ON DOMESTIC CRUDE OIL.

"Any person who is required under section 6050C (or regulations thereunder) to furnish any statement, information, or certification to any other person and who willfully fails to furnish such statement, information, or certification at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 1 year, or both, together with the costs of prosecution."

(2) CLERICAL AMENDMENT.—The table of sections for such part II is amended by adding at the end thereof the following new item:

"Sec. 7241. Willful failure to furnish certain information regarding windfall profit tax on domestic crude oil."

(f) INFORMATION FURNISHED BY PARTNERSHIPS, TRUSTS, AND ESTATES.—

(1) INFORMATION TO BE FURNISHED TO PARTNERS AND TO BENEFICIARIES OF ESTATES AND TRUSTS.—Subpart B of part III of subchapter A of

chapter 61 is amended by adding at the end thereof the following new section:

"SEC. 6050D. WINDFALL PROFIT INFORMATION TO BE FURNISHED TO PARTNERS AND TO BENEFICIARIES OF ESTATES AND TRUSTS.

"(a) REQUIREMENT.—Under regulations prescribed by the Secretary, each partnership, estate, and trust producing domestic crude oil for any taxable period shall furnish to each partner or beneficiary, as the case may be, a written statement showing the following:

"(1) the name of such partner or beneficiary,

"(2) information received by the partnership, trust, or estate pursuant to section 6050C,

"(3) such partner's or beneficiary's distributive share of the items referred to in paragraph (2), and

"(4) such other information as may be required by regulations prescribed by the Secretary.

"(b) TIME FOR FURNISHING WRITTEN STATEMENT.—Each written statement required to be furnished under this section with respect to any taxable period shall be furnished before the first day of the third month following the close of such period."

(2) CLERICAL AMENDMENT.—The table of sections for such subpart B is amended by adding at the end thereof the following new item:

"Sec. 6050D. Windfall profit information to be furnished to partners and to beneficiaries of estates and trusts."

(g) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1980.

SEC. 3. ESTABLISHMENT OF ENERGY TRUST FUND.

(a) CREATION OF TRUST FUND.—There is established in the Treasury of the United States a trust fund to be known as the "Energy Trust Fund" (hereinafter in this section referred to as the "Trust Fund"), consisting of such amounts as may be appropriated or credited to the Trust Fund as provided in this section.

(b) TRANSFER TO TRUST FUND OF AMOUNTS EQUIVALENT TO CERTAIN TAXES.—

(1) IN GENERAL.—There are hereby appropriated to the Trust Fund amounts determined by the Secretary of the Treasury (hereinafter in this section referred to as the "Secretary") to be equivalent to the amounts received in the Treasury under section 4986 of the Internal Revenue Code of 1954.

(2) METHOD OF TRANSFER.—The amounts appropriated by paragraph (1) shall be transferred at least monthly from the general fund of the Treasury to the Trust Fund on the basis of estimates made by the Secretary of the amounts referred to in paragraph (1) received in the Treasury. Proper adjustments shall be made in the amount subsequently transferred to the

extent prior estimates were in excess of or less than the amounts required to be transferred.

(c) MANAGEMENT OF TRUST FUND.—

(1) REPORT.—It shall be the duty of the Secretary to hold the Trust Fund, and to report to the Congress each year ending on or after September 30, 1980, on the financial conditions and the results of the operations of the Trust Fund during the preceding fiscal year and on its expected condition and operations during the next 5 fiscal years. Such report shall be printed as a House document of the session of the Congress to which the report is made.

(2) INVESTMENT.—

(A) IN GENERAL.—It shall be the duty of the Secretary to invest such portion of the Trust Fund as is not, in his judgment, required to meet current withdrawals. Such investments may be made only in interest-bearing obligations of the United States. For such purpose, such obligations may be acquired (i) on original issue at the issue price, or (ii) by purchase of outstanding obligations at the market price.

(B) SALE OF OBLIGATIONS.—Any obligation acquired by the Trust Fund may be sold by the Secretary at the market price.

(C) INTEREST ON CERTAIN PROCEEDS.—The interest on, and the proceeds from the sale or redemption of, any obligations held in the Trust Fund shall be credited to and form a part of the Trust Fund.

(d) EXPENDITURES FROM TRUST FUND.—Amounts in the Trust Fund shall be available, as provided by appropriation Acts, for making expenditures for such purposes as may hereafter be specified by law.

SEC. 4. STUDY OF EFFECTS OF DECONTROL OF OIL PRICES AND OF WINDFALL PROFIT TAX.

(a) GENERAL RULE.—The President shall, not later than January 1, 1983, submit to the Congress a report on the effect of decontrol of oil prices and the windfall profit tax on—

(1) domestic oil production,

(2) foreign oil imports,

(3) profits of the oil industry,

(4) inflation,

(5) employment,

(6) economic growth,

(7) Federal revenues, and

(8) national security.

(b) REPORT TO INCLUDE RECOMMENDATIONS.—The report required under subsection (a) shall include such legislative recommendations as the President determines to be advisable.

Passed the House of Representatives June 28, 1979.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

The CHAIRMAN. This hearing will come to order.

We are pleased to have with us today the Secretary of the Treasury, the Honorable W. Michael Blumenthal, to testify on H.R. 3919, the Crude Oil Windfall Profit Tax of 1979, proposed changes of foreign tax credits, and proposed uses of windfall profits tax revenue.

The CHAIRMAN. Mr. Secretary, we are privileged to have you here. Senator Dole, would you care to make an opening statement?

Senator DOLE. No; please proceed.

The CHAIRMAN. Senator Roth.

Senator ROTH. Mr. Chairman, as the Finance Committee begins its consideration of the windfall profits tax, I want to urge the committee and the administration to recognize the energy program should not be viewed in a vacuum. While the windfall profits tax is important, I believe it is even more important for this committee to develop a comprehensive program to attack energy shortages, inflation, and the approaching recession.

The American people are facing higher prices, higher unemployment, and virtually no economic growth. Taxes are increasing at a staggering rate and the average worker's take-home pay has dropped to its lowest level in 4 years. Because of inflation and increased social security taxes, the American people are facing tax increases of $20 to $25 billion in the upcoming year. The massive tax increases are imposing a tremendous drag on the economy, driving up prices and pushing the economy into a recession.

Therefore, I urge the committee to look beyond the single issue of windfall profits tax.

I support a windfall profits tax and I believe we can fashion a windfall profits tax which promotes energy conservation and encourages energy production. But I also believe we must combine the oil tax with measures to reduce the enormous tax burden on working Americans.

First, I believe we must act immediately to adopt across the board tax cuts for all Americans. And second, I believe the committee should use a substantial portion of the windfall profits tax revenues to roll back the massive Social Security taxes facing the American people.

According to the analysis of this proposal prepared by CBO, a rollback of the scheduled social security tax increase would increase real GNP by $15 billion, increase employment by 500,000 jobs, and reduce price levels by 0.3 to 0.4 percent.

Unless this action is taken, the higher oil prices and increased taxes will deliver a one-two punch situation to the economy. Higher taxes and energy prices will further increase inflation and impose a tremendous drag on the economy.

Now, Mr. Chairman, the windfall profits tax passed by the House will raise an estimated $40 billion between 1980 and 1984. Increased income taxes resulting solely from decontrol could raise an additional $50 to $60 billion.

Over this same period of 1980–84, total Federal taxes will nearly double, increasing from approximately $500 billion to $840 billion by 1984. As a result, the American people face tax increases of nearly a half a trillion dollars over the next 5 years.

I do not believe we should delay action until we are mired in a deep recession. I believe we must act now to head off the approaching recession by returning a substantial portion of the oil tax revenues to the American people.

Thank you.

The CHAIRMAN. Senator Dole, do you care to make an opening statement?

Senator DOLE. I ask my statement be made a part of the record. Mr. Secretary, as one just down from the mountain, can you give us some idea of what is going on at Camp David? We are all very curious, particularly those of us on this side of the aisle.

We have had considerable debate on energy and the windfall profits tax, but so far it has not yielded much in a constructive nature. We have lost sight of the problem. We have had rhetoric from all over the Capitol and the executive departments.

We are starting today consideration of H.R. 3919. The last Congress and this committee is again presented with a tax bill, not an energy bill. We are still considering more taxes and not more energy.

This bill is only the first part of the energy tax legislation that we are likely to consider. The second part, the foreign tax credit, is still in the Ways and Means Committee. The third part, the conglomeration of tax credits, has not even been proposed in Congress.

The committee and the Senate may have a better perspective if all the legislation were considered together and not in a helter-skelter piecemeal fashion. The issue is too important and too vital to start some piecemeal operation.

Mr. Chairman, I support the decision to decontrol the price of domestic oil. Artificial prices more than any other factor have increased our reliance on imported petroleum. However, the purpose of decontrol is to increase supplies of oil. Thus the administration's proposal amounts to only a half step in the right direction.

The administration refers to their plan as a windfall profits tax. As I have stated before, the administration's plan is not a windfall profits tax. It is not a tax on profits. Nowhere is either the term or even the concept of profits mentioned. The tax is simply an extremely complicated excise tax on crude oil imposed at the wellhead. In that sense it is similar to the crude oil equalization tax. The oil tax will not increase the supply of energy. It will, however, raise billions of dollars in new taxes. The excise tax is a revenue machine that will fill the Treasury—not shorten the American gas lines and fuel American commerce.

Mr. Chairman, the tax passed by the Ways and Means Committee was punitive. It was tempered only slightly by the House. I believe the Senate will act rationally and report a bill that is fair to industry and meets the expectations of the American consumer.

There is enormous latitude for improvement. Specifically, I believe the committee should address the notion of the small producer's exemption. Independent oil producers should not be penalized by the tax.

The committee should also provide the maximum incentive for newly discovered oil. I might point out that the House bill is expected to deny this country over 700,000 barrels of oil a day in 1985 as compared to no tax.

And finally, the committee should consider a production credit against the tax, a reward for those who increase exploration and development.

I might add, Mr. Chairman, and Mr. Secretary, certainly we have every hope that we can cooperate with the administration but it does seem to me that when we start talking about a windfall profits tax, we must have some measure before us that is in fact a windfall profits tax. This Senator and probably others will be addressing that point throughout the hearings, and I hope to offer a proposal which encourages production.

[The prepared statement of Senator Dole follows:]

OPENING STATEMENT OF SENATOR BOB DOLE

Mr. Chairman, the Federal Government is in a state of energy panic. Everyday Government officials try to assess the blame for our energy shortage. The administration demagogues about the oil lobbyists on Capitol Hill and accuses the Congress of inaction. Congress complains about the Department of Energy and the OPEC cartel. The result is a state of confusion.

This "debate" has yielded virtually nothing. We have lost sight of the problem. Rhetoric and policies designed to punish the energy industry and the American consumer may make great re-election speeches but do little to address the issue. Promising quick-fix solutions and energy gimmicks just further deceives the American public.

Mr. Chairman, the committee today is beginning its consideration of H.R. 3919—the Windfall Profits Tax Act. As in the last Congress, the committee is presented with a tax bill—not an energy bill.

ENERGY PACKAGE

However, this bill is only the first part of the "Energy Tax" legislation the committee is likely to consider. The second part—the foreign tax credit is still in the Ways and Means Committee. The third part—the conglomeration of tax credits—has not even beeu proposed in Congress. The committee and the Senate may have a better perspective if all the legislation was considered together—not in a helter skelter, piece-meal fashion. The issue is too important—too vital to the future of our country to make hasty decisions. In addition, the President has been secluded and isolated for a week. We must all wait in anticipation for the momentous decisions that are surely to be announced. I'm sure it will take some time to digest the change of events.

DECONTROL

I support the decision to decontrol the price of domestic oil. Artificial prices, more than any other factor, have increased our reliance on imported petroleum. However, the purpose of decontrol is to increase supplies of oil. Thus, the administration's program amounts to only a half-step in the right direction.

EXCISE TAX

Administration refers to their plan as a "Windfall" profits tax. As I have stated before, the administration's plan is not a tax on profits. Nowhere is the term or even the concept of "profits" mentioned. The tax is simply an extremely complicated excise tax on crude oil imposed at the well head. In that sense, it is similar to the crude oil equalization tax. The oil tax will not increase supplies of energy. It will, however, raise billions of dollars in new taxes. The excise tax is a revenue machine that will fill the Treasury, not shorten gas lines and fuel American commerce.

Mr. Chairman, the tax passed by the Ways and Means Committee was punative. It was tempered only slightly by the House. I believe the Senate Finance Committee will act rationally and report a bill that is fair to industry and meets the expectations of the American consumer.

CONSTRUCTIVE APPROACH

There is enormous latitude for improvement. Specifically, I believe the committee should address the notion of a small producers exemption. Independent oil producers should not be penalized by the tax.

The committee should also provide the maximum incentive for newly discovered oil. I might point out the House bill is expected to deny this country over 700,000 barrels of oil a day in 1985 as compared to no tax. Finally, the committee should consider a production credit against the tax—A reward for those who increase exploration and development.

Mr. Chairman, the energy situation is a national crisis. It will take firm leadership to move the country on the path towards energy independence. It is my hope, we can devise a constructive approach.

The Chairman. Are there any further statements?

Senator Durenberger. If I may? I have a brief statement and a longer statement I would like to introduce into the record.

I am sure my colleagues would share my sentiments when I say we are not here to pass a new and burdensome excise tax on the American consumer. We can all agree that the windfall profits tax is not a major new piece of energy legislation. The tax will not produce one additional gallon of gas or Btu of energy nor will it cause an American to save a gallon of gas or a kilowatt-hour of power.

Even though this tax will do nothing to improve our current energy situation, it may deserve support.

When the price regulations are removed in 1981, the domestic oil will sell at the world price, the price set by the cartel decisions of OPEC. A carefully constructed windfall profits tax will not increase the price of petroleum products to consumers but it will reduce the revenues available for expanded exploration by the producers.

An important matter to be determined by these hearings is the impact of decontrol on the incentives for expanded exploration and drilling. I suspect that the major oil companies may currently have sufficient cash flow to support increased production. But that additional cash flow may be an important incentive for the independent drillers.

If the decontrol of old oil does in fact produce windfall profits for the major oil companies and if this windfall is not necessary and will not increase production, it ought to be returned to the consumer. This can best be achieved through new conservation incentives, lower taxes, and income assistance.

I am confident through the process today we will find a tax that is fair to the industry and to the public.

I will look for legislation that in its detail reflects the economic reality of the oil industry.

Thank you, Mr. Chairman.

[The prepared statement of Senator Durenberger follows:]

Statement of Senator Dave Durenberger

During the energy crisis of 1973 and 1974, and as a companion to an oil embargo, the OPEC nations quadrupled the world price of crude oil. The United States Congress acted to protect our economy from the full effects of those events by controlling the price that domestic refiners paid to domestic producers for petroleum resources. Since that time the price regulations have been modified and extended in several respects, so that today we have a very complicated, almost unworkable, regulatory system that is the target for criticism from all sides.

The legislative authority for this regulatory mechanism expires in September, 1981, and the President has announced his intention to install an even more complicated decontrol program that will move domestic prices to world levels by that date. In the swirl of arguments that have been used to attack and to defend the President's program, it seems that many have lost sight of the basic realities of our petroleum economy. Mr. Chairman, I would like to recite, as best I know it, the logic of our energy condition as the foundation for my participation in these hearings.

The Economics of the Oil Industry

The first and most fundamental fact is that the world price of crude oil bears no economic relationship to the cost of production or the incentives necessary to attract new capital for further development. The price is set by a cartel of thirteen actions, not by a market. Gasoline made from Middle Eastern oil is selling for 99 cents a gallon in Minneapolis, while gasoline made from that same oil is priced at 15 cents in Riyadh.

The cartel price dominates the market of all importing nations, even those like the United States, where a significant amount of domestic demand is satisfied by domestic production. The purpose of the price regulations contained in the Emergency Petroleum Allocation Act of 1973 and the Energy Policy and Conservation Act of 1975 was to insulate the domestic price from the marker level set by Arabian light crude. Decontrol strips us of that protection.

The third point to keep in mind is that crude oil is a nonrenewable resource and as such, the cost of recovery will increase as the known and producible reserves decline and new reserves become more difficult to find. Although the current OPEC price does not reflect the economic reality of the oil industry, we can expect that $20 per barrel incentive to new production may be a realistic level within the next decade.

DECONTROL

The purpose of decontrol as described by President Carter on April 5 was to recognize this inevitably higher price now rather than later, so that we begin the job of converting our capital structure to more efficient energy consumption and to alternative sources of energy production. We must take these actions in any event. I believe there is considerable wisdom in beginning this process now, rather than at some later date. If we wait, we will only become more susceptible to economic ruination at the hands of the OPEC cartel.

Perhaps I praise the President overmuch, for I have found his statements on this issue since April 5 somewhat confusing, and not at all helpful. I suspect that he may be among those who have lost sight of the reasons for decontrol. It is, after all, the OPEC nations and not domestic oil producers who set the world price and are thus responsible for the windfall profits. It is no doubt true that the major oil companies have not done enough to resist the steep price increases of the OPEC nations, but the same charge can be leveled at those who have responsibility for national energy policy over the last few years.

The proposal made by Mobil Oil Corp., and several United States Senators of the President's political party to extend mandatory controls was not irresponsible as the President charged. Need we remind him that crude oil price controls have been the centerpiece of national petroleum policy since 1973. The President would be better advised to stick to the correct arguments for decontrol that he stated on April 5, and to forego the rhetoric which only confuses an already complex issue.

The critics of decontrol point out that only a small reduction in imports will be realized between now and 1985 as a result of the supply and conservation effects that flow from decontrol. They do not believe that these small savings can justify the very large increases in energy costs associated with the President's policy. This citicism reflects a fundamental misunderstanding of the purpose of decontrol. This action is designed neither to provide incentives to producers nor to force short-term conservation with higher prices. Decontrol is designed to provide a gradual adjustment within our economy to higher energy prices—prices which are inevitable in the midterm period due to the nonrenewable nature of this resource.

It is apparent from these facts that decontrol cannot be described as a major action to end our immediate energy woes. And it follows by extension that the windfall profits tax is even further removed from the important legislative measures that are necessary to increase our supply and reduce our demand for energy over the next few years. As much as any other Senator, I want the chance in this session to vote for effective legislation that will meet our needs for a truly national energy policy. But I do not fool myself into thinking that the windfall profits tax will be a major piece in that legislative package. The windfall profits tax will not produce one additional btu of energy, nor will it cause any American to save a gallon of gas or a Kilowatthour of power for more productive use.

THE ENERGY SECURITY FUND

So my constituents ask, "why is the Congress about to place a new burden on the American taxpayer? Why not leave the profits with the oil companies who are better able than government to put the money into projects which will increase our energy supplies?"

President Carter has answered these questions by attributing an almost sinful character to the new oil profits and by promising an Energy Security Fund to assist those of low income to subsidize additional mass transit, and to develop alternative energy resources.

For myself, the pig-in-a-poke trust fund of H.R. 3919 seems to encourage less, not more confidence in the future energy security of the United States. If there are energy projects which will increase our supplies at a reasonable cost or conserve our resources without unreasonable regulation, we don't need the largest of the windfall profits tax to justify spending the money to put them in place. We ought to be legislating such programs now. That we are even considering a blind fund dedicated to support projects which are not included in a massive federal budget, should raise some serious question as to the wisdom of the entire trust fund concept.

THE WINDFALL PROFITS TAX

Apart from the promise of an Energy Security Trust Fund, there are good reasons to support the President's Windfall profits tax proposal. As with the justification for decontrol, those reasons lie within the economic structure of the oil industry.

In the short-term the world price for crude oil does not reflect the economic cost of domestic oil production. Thus, windfall profits will result when the OPEC price becomes available to domestic producers through decontrol. The new profits will be truly excessive for producers who lift crude from wells that are already in production. The President proposes to capture these windfall profits through an excise tax on crude oil revenues.

The oil industry has opposed the President's tax with the argument that the increased gas flow which results from decontrol is necessary to sustain high levels of exploration and drilling. Although there are distinctions to be drawn between the application of this argument to the position of the majors as opposed to the position of the independents, the best evidence indicates that additional cash flow is not necessary to increase exploration. In 1978 U.S. drilling activity was at an all-time high. The major oil companies were using their cash to invest in other energy fields or into totally new business ventures. When Exxon offered to purchase Reliance Electric, it reportedly had $5 billion in the cash that was not being plowed back into the ground. Between 1973 and 1978 the price level for oil from lower tier wells was increased by 177 percent under eixsting price regulations, this increase has been more than sufficient to sustain the cash position of the integrated oil companies.

It is apparent that the condition which will lead to more petroleum development by major oil companies is higher prices, and thus improved return for new investments, rather than more cash flow from existing wells. The windfall profits on old oil produced by the major oil companies should be returned to the American consumer through income assistance, new energy resources or lower taxes. If left with the oil companies, it will not provide significant new incentives to expand exploration or increase production.

The situation of the smaller, independent oil producers is somewhat different, and the economics of their activities should receive special attention in the work of this committee. Because many of these independents operate within the framework of Internal Revenue Code for personal income, they do see significant incentives to plow increased cash flow into new exploration. In addition, the tier three tax on new oil properties should be designed with recognition that this tax impacts more significantly on the independent operators who drill the large majority of exploratory wells, then it does on the business of the major integrated oil companies.

A PERMANENT EXCISE TAX

The President proposes to capture these unnecessarily high revenues through an excise tax rather than an excess profits tax. And because of the excise character of the tax that will be imposed, this committee must be especially diligent in its efforts to rationalize the details of this tax package.

In reviewing the House floor debate on H.R. 3919, I found that many opponents of this new tax rested their case on the difference between production levels with and without the tax in 1985. With a new Federal excise tax on crude oil production, all analysts agree that production levels will be somewhat lower in 1985 than they would be without the tax. However, I found that some of the House opponents spoke as if these lower production levels represented a permanent loss of crude oil supply to the nation. I feel obliged to point out that no crude oil is lost because of the excise tax; it simply comes into production at a later date.

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To the crude oil producers there is no difference between $20 controlled price and $25 market price with a $5 excise tax. However, if $20 is the necessary price incentive to bring a well into production, the excise tax will delay the date of production until the world price is sufficient to pay the tax and produce $20 in revenue.

This I believe is an important point, because in the long run a permanent excise tax will become the cause of and not the protection against windfall profits. If we focus only on the tier three tax of H.R. 3919 and assume that at some point we can bring the world price into line with the correct economic incentives for production, the tax loses its character as protection against windfall profits and becomes simply an excise tax.

The transition from windfall profits tax to excise tax does not occur at one time or at one price for all producers. The character of the tax depends upon the detail of individual cases, the costs of producing the oil and the incentives necessary to attract the risk capital to find it. Designing legislation that recognizes these differences is the important work that lies before us.

I am sure my colleagues will share my sentiments when I say that we are not here to pass a new burdensome excise tax onto the American consumer. In debating and deciding the detail of tax rates, decline curves, exemptions and deductions, we must be careful to define as best we can the fine line that falls between this tax as protection against profits and this tax as a new burden on the American public.

COMPETITION: AN ALTERNATIVE TO A NEW TAX

Mr. Chairman, I would like to make one further point about the economics of the oil industry before closing this statement. The necessity for the price regulations of EPAA and EPCA, the difficulty of President Carter's decontrol decision and the purpose of the windfall profits tax are all related to the one fundamental principle which dominates all petroleum economics. The plain fact is that without governmental intervention the price of crude oil produced and sold in the United States will be determined by the decisions of the OPEC cartel.

We have attempted a program of price controls to avoid this result, but those policies produced an even greater dependence on foreign oil. With other Senators I am searching for some alternative policy that will insulate the domestic market from the foreign market price. If we could restore competition to domestic petroleum transactions, we could avoid the difficulty of the windfall profits tax altogether. Mr. Chairman, I will continue my efforts to discover a policy which achieves this purpose and with your indulgence hope to explore this issue to some extent in these hearings.

In conclusion I would like to say that I am confident that through the process we begin today, we will find a tax that is fair to the industry and that captures the windfall without putting a new excise burden on the American public. I do not seek a tax to pad a pork barrel of new energy initiatives. Rather I will work for legislation that in its detail reflects the economic reality of the oil industry.

Thank You Mr. Chairman.

Senator WALLOP. Mr. Chairman, I have a statement I would like to insert in the record. I would like to make a couple of quick points.

I think it important for everybody in this room to recognize not 1 penny of tax will be levied on foreign oil. That tax is all going to be levied on American oil. I think it important to realize that the net effect is going to be increased rather than decreased concentration within the oil industry, And for those who have been crying for divestiture, I can't see a course that we could undertake that would do more to concentrate and more tightly cohese the industry than this tax.

Third, I think that the major oil companies, the major energy companies are going to ride to the synfuel technology on the backs of the independent producers of America because no independent producer is going to have capital enough to bid on a major synfuel project.

That is going to be way beyond them. The tax will take the capital away from the independents. They are going to have to merge with major companies in order to get capital enough to go on with drilling programs now underway. We are going to just pay to the major oil companies a risk-free investment in synthetic fuels if we go the way we are going.

Lastly, I would just like to point out there are some tremendous invasions of traditional States rights in the bills passed by the House.

By what right does the Federal Government tell the States that the only thing it can spend its money on is education when we have certain other programs in our State that are now funded by oil trust funds?

By what right does the Federal Government co-op traditional option of the States' own property by telling them that any new severance taxes or industry taxes that they may levy will be in addition to the so-called windfall profits tax?

It is an excise tax. It has nothing to do with profits. And it is going to severely deplete the talented reservoir of venture capital of brave people who are now processing the oil exploration events in this country.

I would like to put the remainder of my statement in the record.

The CHAIRMAN. Without objection, it will be printed in full in the record.

[The prepared statement of Senator Wallop follows:]

OPENING STATEMENT OF SENATOR MALCOLM WALLOP

In the weeks ahead the committee will be dealing with a complex set of energy tax proposals that have already been clouded by rhetoric and false accusations regarding excess profits in the oil industry. I hope that at the outset of these hearings we can add some clarity to the energy tax debate by referring to the proposal before the committee as the Domestic Crude Oil Production Tax of 1979.

By referring to the legislation as a windfall profits tax, we imply that this tax is in some way linked to profit levels in the oil industry. As an excise tax, the administration's proposal and the bill that passed the House has no relationship to profits.

The tax is imposed on the production of domestic oil—American oil—that is an important distinction we should make clear to the American public. We are proposing to tax oil production, not profit levels in the oil industry as the administration's title would lead people to believe.

The American people understand basic economics, and they know that when you tax something, you get less of it. In this instance we are taxing domestic oil production and the people can expect to get less domestically produced oil. Looking toward 1985, decontrol of oil with no new production tax would result in at least 1.5 million barrels a day of additional production. The House-passed production tax would cut those additional production levels in half.

It's crucial to recognize that by taxing domestic production, we strike the hardest blow on the small independent producers who depend upon the production of domestic oil for their income. The independents have no refineries, no downstream transport or distribution activities, no sources of foreign oil. They drill over 90 percent of the exploratory wells, and if they are skillful and lucky, the income from successful wells allows them to explore for more oil. A production tax hits the independent the hardest, since they have no other oil related operations that can generate the capital for exploration. It only hampers their ability to finance exploration projects that have become increasingly expensive.

This is a point that I hope is fully understood by the Senators who are concerned about excess concentration in the oil industry. As we tax and limit the ability of independent companies to capitalize drill deeper wells, or search for oil in more complex geologic formations, we must not only expect less oil production but fewer independent companies. Independent oil companies have the talent, the experience, and essential manpower to find more oil. What is in short supply for the independent producer is internally generated funds for exploration. By taking the source of the independent producer's income we set the stage for more mergers and further concentration in the oil industry.

Finally, the media and the American people should recognize at the outset that the President and the House have failed to deal with the basic cause of our dependence on foreign oil. The domestic oil production tax does nothing to deter the consumption of foreign oil. The tax perpetuates the system that allows a higher return on foreign produced oil than domestically produced oil.

Under the House bill, we must wait until 1990 before domestic oil companies can expect to receive the same price on new oil as the OPEC countries. We are looking at a tax proposal that creates higher cost energy for the consumer, cuts our increased oil production levels in half, and continues to subsidize the OPEC cartel.

By taxing the domestic production of energy, and failing to deter the consumption of imported oil, we cannot weaken the stranglehold that the OPEC monopoly maintains on this country and the West.

We only increase our shameful dependence on foreign supplies.

I trust and hope—perhaps vainly, but still fervently—that the Senate will reject this approach, and develop legislation that will enhance our ability to produce American oil and wean us from our dangerous dependence on foreign oil.

The CHAIRMAN. Mr. Secretary, please proceed.

STATEMENT OF HON. W. MICHAEL BLUMENTHAL, SECRETARY OF THE TREASURY

Secretary BLUMENTHAL. Thank you very much, Mr. Chairman, and distinguished members of this committee.

I have a formal statement which I would like, with your permission, to submit for the record and then make some general comments.

Let me say that I was most interested to hear the preliminary comments by several of the members of the committee. I agree with all of them. The problem that we are addressing here this afternoon, namely, the windfall profits tax, is a part of the President's decision to decontrol crude oil prices as one response to the energy crises that we are facing in this country. These issues are intimately interrelated with questions of the economy and with questions of inflation. Of course they are.

Moreover, since the President's proposal of early April to decontrol oil prices in conjunction with a windfall profits tax there have been further most serious developments by virtue of the substantial increase in the price of OPEC oil, which now has led to a 60-percent increase in the price of OPEC oil from December of last year until now. That has a very, very significant impact on the U.S. economy. And, of course, that whole problem needs to be considered in its entirety.

In answer to questions posed by Senator Dole, what the President is doing is to consult with a wide range of people, including a good many Members of Congress, the distinguished chairman of this committee as well as Senator Bentsen, participated in a meeting last night to discuss this whole range of issues: Of energy, of the economy, and of how to respond to the very, very serious problems this country is facing in energy and the related economic problems of inflation.

The particular proposal to which I would like to address myself this afternoon which this committee is considering is only a part of the problem. It is the windfall profits tax that the President is proposing in conjunction with his decision to decontrol crude oil prices. This whole program is designed to lessen our dependence on foreign oil, to impact the trade balance favorably and to protect the value of the dollar, and to reduce the lack of control over our economy which we are having as the result of this very, very substantial dependence at the present time on uncertain foreign sources of oil as a major source of energy for this country.

What has happened since that date is worth mentioning. With the increase of the price by OPEC to something like $20 or more a barrel from the $12.97 which prevailed in December of last year, we have had a 60-percent increase. That means that our growth in GNP this year will be cut 1 percent from our growth rate in 1979. By the end of 1980 the level of GNP will be 2 percent below what would otherwise have occurred.

The rate of inflation will rise by 1 percent in 1979 and another 1 percent in 1980 above what it would have been.

The domestic unemployment will be higher by, we estimate, some 250,000 people this year than it would have been. And by another 550,000 next year; altogether by some 800,000 people.

And it does mean that that action in and of itself will increase the price of gasoline at the pump at least 12 cents.

I think these numbers indicate that we are faced with a very serious problem. This particular proposal does not consititute the sum total of the President's program. It is worth recalling, though, that the President was one of the first to point to the seriousness of the energy problem that this country faces; that his proposals of April of 1977 were one of the very first legislative intitiatives that he presented to the Congress; that after 1½ years of debate and the passage of a bill he went back in April of this year with this proposal.

And I have every confidence that he will respond forcefully to the challenge presented by the latest developments to our country.

This particular program involves and is related to the President's commitment of March of this year to share the burden of reducing consumption of oil in the world with other consuming countries. In fact, the United States committed itself to a reduction of 1 million barrels by the fourth quarter of 1979, and similarly related to the Tokyo commitment at the Tokyo summit, he committed that imports of oil into the United States in 1979 would be no higher than they were in 1977; namely, 8.5 million barrels a day on the average, and that, indeed, our target for 1985 would be a similar cap on imports.

In other words, in 1985 no more than 8.5 million barrels a day.

He decided that decontrol on a phased basis over a 28-month period of crude oil prices was absolutely essential so as to allow by October 1981, the price of crude oil in the United States to reflect the actual price prevailing in the world; to end thereby the bureaucratic nightmare that is inherent in the present control system, and to end the situation in which in fact we had been disguising for ourselves and for our consumers the real impact of the OPEC-induced, cartel-induced, ratcheting up of prices by, in effect, mixing in the controlled domestic price with the steadily increasing higher price; and therefore retarding investment, retarding the serach for alternatives, retarding the absolutely essential and most urgent requirement to get on with the job of moving to substitute fuels.

That means that he is ending the present system under which lower tier oil, that is, oil produced, developed before 1973, is capped at $6 a barrel; that upper tier oil, that is, oil produced since 1973, is capped at $13 a barrel, and that the payments have to be made between different types of refiners in order to equalize the cost of crude ot all the different refiners.

That system in April of this year led to a price that was several dollars below that which OPEC was charging. OPEC was charging in April of this year—we were paying—$17.55 and the refiners were paying $14.52 for domestic oil because of this complicated system.

In other words, there was a Federal subsidy actually for crude oil of over $3 in April of this year. Clearly that lessens the incentive to find other fuels, and it distorts the whole system.

The proposed change that is inherent in this program is that the lower tiered oil, that is, the old oil, that the amount which must be sold at the $6 price will be reduced by 1.5 percentage points a month in 1980—no, 1979; and between 1980 and 1981, September 1981, by 3 percent a month. So that, in other words, if you started off with 100 barrels of oil, 82 barrels by the end of 1979, 46 barrels by the end of 1980, and the rest can be sold as upper tiered oil by October of 1981.

Second, that new oil, the upper tiered oil will be phased up to the world price between January of 1980 and October of 1981.

Third, that newly discovered and tertiary will be decontrolled as of June of this year.

Fourth, that marginal wells, in other words, wells producing less than a certain small amount per day will sell as upper tier oil, most as of June 1, and all of them as of January of next year. And that by this means, by October of 1981 all of the oil produced in this country will get into the market at the world price, at the price that we have to buy our oil for in world markets.

The windfall profits tax, that is, a part of it, is designed to capture some of the windfall profits which will accrue to the oil companies. In other words, to capture that excess which is over the price necessary to induce maximum production by the oil industry. This will happen because we are increasing prices so rapidly over a period of 28 months that clearly there is some element of price that will accrue to the producers which is over and beyond what can be used for maximum production. It is that element that will be recaptured, but it is frankly designed to be done in such a way that enough revenue is left to the producers to provide maximum incentives for them to go out and to produce as much as possible.

Since the tax is only 50 percent, it is clear that only some of the windfall is being captured.

And as I will point out in a minute, there is another very important reason for this which relates to all of the other things that some of the distinguished members of the committee have mentioned in their opening statements, namely, that we needed to do a great deal more in order to move to substitute fuels, whether it is synthetics or whatever, in order to get away from the dependence of imported oil. That will cost a great deal of money.

The strains on the budget are clear to all. Inflation is a point that has been mentioned and it is clear to everyone. The inflation problem is a devilishly serious one in this country. These revenues which are collected here in the windfall profits tax can be dedicated in very large measure to finance the very serious crash programs that are required to lessen the dependence on imported oil. And the windfall profits tax has to be seen, and I hope will be seen by you, Mr. Chairman and members of the committee in that light.

The administration proposal in short is for a 50-percent tax on three bases: That is, to tax 50 percent of the windfall profits derived from moving from the lower to the upper tier, 50 percent of the windfall profits derived from moving from the upper tier to the world price, and third, 50 percent of the windfall profits derived from any future real increases in world prices. And I am going to define those terms in a moment.

As to lower tier oil, it means that that is 50 percent of the difference between the actual sales price that the producer gets and the control price; that is, the $6 plus inflation after January 1, 1980.

That applies to an amount freed to the upper tier that exceeds 2 percent of the decline rate, a 2-percent decline rate.

For the upper, specifically it means 50 percent of the difference again between the sales price and the inflation adjusted upper-tier price. And that tax we are providing for will phase out between November 1986 and January 1991.

In other words, as to the uncontrolled third tier, the windfall profits tax again will apply to 50 percent of the difference between a price which we have defined as being $16 adjusted for inflation and the world price as of January 1, 1980.

That tax, and only that tax, would be permanent. And included in our proposal would be stripper, newly discovered, and tertiary.

The House bill is substantially the same as the bill proposed by the administration. It differs in two or three respects, and I would briefly like to dwell on these.

First, with regard to the uncontrolled tier, the House bill breaks that tier down into two parts: On the one hand, for newly discovered and increases in tertiary it provides for a tax of 50 percent on the difference not between 16, but between $17, uplifted by 2 percent in real terms over and above inflation and $26, and 60 percent above $26. And second, it terminates the tax in 1990, whereas, in the administration's proposal that tax on the uncontrolled oil would be permanent.

For the rest of the uncontrolled, such as stripper, like the administration's it would be a permanent tax under the House proposal, but it would be at a 60-percent rather than a 50-percent rate.

In our view, we continue to believe that the tax for the uncontrolled tier should be a permanent tax; that it should not end after 1990. The reason for that is simply that we are dealing for some time to come with a cartel price; that that price by its very nature is very uncertain; that it presents these kinds of sudden windfalls; that there is no economic reason for these sharp upward movements that the cartel can engage in, and if we still have that in 1990, since these programs are certainly going to be long-term programs, the continued need for revenue will enable us to put these resources to good use.

Second, we do not believe that the fact that we have a tax will divert any money from exploration, domestic exploration, or will go to foreign exploration. The main reason being that all countries in fact tend to tax away some very substantial portion between the price charged by OPEC or the price that they can get and the price that they allow the producer to have. No country allows the full price to accrue to the producer.

Sudden surges in price would, if we did not have some kind of control, would certainly run the political risk that controls across the board would be reinstituted. The very controls that the President is now taking off would be back with us again. And the fact that we have this factor available is considered to be a safety factor in that regard.

Second, we believe that rather than going to $17 plus 2 percent real increase over and above inflation, our original proposal of $16 adjusted for inflation only, is the right base from which to assess the windfall profits tax.

Now, how do we get to the $16? The $16 represents the price back to the United States which would have prevailed in the first quarter of 1980 based on OPEC's price decisions as of December of last year. Anything that has happened since December of last year when they made the decision and raised prices fairly substantially, whether it was in the form of surcharges for several months or now in the form of this new price agreement that was just agreed on a couple of weeks ago, is exactly the kind of unanticipated windfall that we are trying to capture in conjunction with decontrol in order to put back into the economy, primarily for the development of alternative sources of energy.

We don't think that there is any particular reason to go from $16 to $17; $16 is the right benchmark. We think adjusting it for inflation is fair. We think that there is no reason to go beyond it.

We are allowing for full recapture of inflation type costs and that ought to be sufficient.

Further differences between ourselves, our own proposal and that of the House bill are we are opposed to the House education exemption. We think that is just a subsidy for a certain kind of activity. We feel about that the way we feel about any tax expenditure. If it is justified we feel ~~then~~ it ought to be voted as a subsidy and directly appropriated but not inserted into this program in this way.

Now as to Alaskan oil, the administration bill—I am glad that Senator Gravel is returning—the administration bill exempted entirely Alaskan oil from the windfall profits tax even though it is upper tier oil. The reason at that time was because there was the large differential and there was one at that time between the then excessive wellhead price in Alaska and elsewhere. And we thought, we had reason to think that Alaskan oil would not soon approach the threshold price of $13. Now with this big surge in prices what has occurred is that on the existing, not on new oil but on the existing Sadlerochit Reservoir the threshold level is being reached. And therefore we are suggesting that when that oil at the wellhead gets to $13, that then we tax it as upper tier oil like any other because at that point the same windfall accrues to Alaskan oil as it does to oil in the Lower 48.

In other words, we tax it at 50 percent of the difference between 13, corrected for inflation, and the sales price, which is the proposal in the House bill. In other words, we do not want to go as far in taxing Alaskan oil as the House bill did, but we do feel now when it reaches the wellhead price of $13, then on the already existing oil, Sadlerochit oil, it should be taxed beginning at that particular point and in the same way as upper tiered oil from the Lower 48.

There are a number of other factors that are contained in my written testimony, which I will not go into here. I might say a word about the energy security trust fund, Mr. Chairman.

We recommend and propose that such a fund be set up, that it receive all of the proceeds from the windfall profits tax—and from the chart appended to my formal testimony you will see that these amount are very substantial—and the increases in Federal income taxes for a period of time at least directly related to the decontrol of oil price. A certain portion of those very substantial resources would be allocated to fund the additional amounts that would be needed to help poor people cope with the substantially higher price of oil and a certain further limited amount to help us in the mass transit field in order to develop needed mass transit.

Most of the very substantial amounts would be dedicated to fund all of the new program, properly authorized and appropriated, by the Congress—all of the new program designed to reduce the dependence of the United States on these sources of imported oil and to get us away from that dependence quickly by developing the many alternatives, all the way from coal to shale and to tar sands, anything that we do in this area.

The House has in its version of the energy trust fund dropped the general revenue financing and deleted the new tax expenditures as being charged to this fund. We disagree. We believe that any tax expenditures that are voted on by the Congress should be properly charged against this fund and that only if the resources are available should it be spent.

On the foreign tax credit, Mr. Chairman, we believe that it is important that we retain the principle that all U.S. taxpayers be taxed on all sources of their income, foreign and domestic on the one hand, but that they be taxed only once and that we avoid double taxation in this way. We have recently issued, the IRS has, some regulations to define what an income tax actually is, which is a complicated matter in this particular field. This proposed legislation is a companion piece and is designed to insure that the credit for income taxes paid on oil, on foreign oil extraction is credited only against U.S. tax and only on that same income.

That would cure some defects that are in the present regulations and is essentially a technical change. Defects which presently reduce the U.S. tax liability over and beyond what we think is justified, and particularly reduce the U.S. tax liability in other than extraction income.

In conclusion, may I just say a word about the economic effect of this particular decontrol proposal. They are relatively minor when compared to the economic effect of the OPEC price decisions that have been made over the last several months. That decontrol decision in and of itself would in fact raise the price level we believe by about 0.1 of 1 percent this year and by 0.2 of a percent for each of the next 3 years if prices would only go up by the rate of inflation. If prices go up by 3 percent in real terms, the sum total would not be about 0.7, it would be 0.9. To the extent to which prices go up more, it would have been somewhat in excess of 1 percent in real terms.

We believe, however, that the effect of decontrol on more exploration, on a more urgent search for new sources of energy as well as on lower consumption and on making the resources available to go to other forms of energy are so important that if we have to get on with this, that we have to end the insane system that we still have of subsidizing in effect the price of imported energy and of hiding from the American consumer the real costs which this increasingly scarce and uncertain resource is burdening the American economy, to end all of this.

Mr. Chairman, may I emphasize what I said at the beginning: Obviously this is not the total answer to our very serious energy problem which has become substantially more serious since this proposal was presented to the Congress and, indeed, since the House considered it. We do believe that decontrol of crude, whatever else is done, is absolutely essential. We do believe that decontrol of crude should be accompanied by some such device which captures some portion of that amount of the additional revenue which will be accumulated by the producers which is not available—which can not be used—for increasing production, but which can be used, properly appropriated and authorized by the Congress, Mr. Chairman, to speed the day when our reliance on foreign oil will be substantially less than it is today. It is for this reason I hope you will give favorable consideration to this particular tax.

Thank you very much.

The CHAIRMAN. Thank you very much.

I would suggest that we go by a 5-minute rule for the first round of questions. I will use the usual system of calling on Senators in the order in which they arrived in the room.

Senator Roth.

Senator ROTH. Mr. Secretary, between the windfall profits tax and the increase in income taxes, something like $80 to $100 billion will be raised in the years between 1980 and 1984. I proposed in my opening statement that some of these funds could be used to offset the social security tax increases facing the American people.

I wonder what your reaction to this proposal would be.

Secretary BLUMENTHAL. I think the question of tax reductions in whatever form have to be addressed on their merits. They have to be addressed as any tax proposals are traditionally addressed by the Congress in the light of all of the factors relating to the present and prospective economic situation.

I do not believe that we should intermingle the energy problem with the problem of social security taxes. I believe each of these is serious and is important, but I would think that the Congress could consider these matters quite separately at the proper time, and at the time it makes that examination it would also determine from what source a reduction, if any, should be financed.

Senator ROTH. Mr. Secretary, I have just spent a week back in my home State. People are concerned about recession, about gas shortages, about home heating oil, about their jobs. Putting aside technical economic answers, I wonder what my constituents can look forward to in the next 6 to 12 months. One of my concerns is that we are always reacting to events after they occur. In your opening statement you discussed the OPEC increase and what our reactions should be to that. But I agree very strongly with what Senator Dole said earlier, that we need a comprehensive picture, we need some certainty. And I just wonder what you see the economic picture to be during the next several months and what the administration's answer to it will be.

Secretary BLUMENTHAL. Well, Senator, I believe it is on Friday morning or Thursday after the close of business of this week that the administration will be presenting its official updated forecast on the economy for the rest of this year. I would not want to scoop the rest of the administration by giving you what I know the likely figures to be.

Let me say, however, which will be the most open secret ever revealed, that the figures will be somber; they will not be good. They will show precisely the effects that I referred to of this OPEC action on prices. Higher, more inflation. And they will show less growth than we had anticipated. It will not be all bad. There are some favorable factors. Clearly the numbers do not indicate that we are heading into a serious recession but at the same time the figures will not be good.

I think what I can look forward to—and what the American people can look forward to—is clear and specific proposals by the President to deal with this new situation—and it is a new situation—a new situation as regards energy and a new situation as regards the economy. And the considerations and consultations which he is now undertaking are designed to provide him with the best possible perspective to do that. When he makes these proposals and when the Congress considers them I would hope that it would be in the light of recollection that there are no easy answers; that over the next 6 to 12 months, because we have a problem imposed on us from the outside, unless we work together and tighten our belts we are not going to like it. But if we do, we can lick it in time.

Senator ROTH. Well, Mr. Secretary, I feel that much of what has happened recently could have been anticipated. I don't think there was any question that OPEC was going to raise their price again.There is nothing new about the energy crisis. But what is concerning me is that the economy is approaching or is already in a recession. The take-home pay of the average worker has dropped. Taxes are increasing at a staggering rate. The question I would like to have you elaborate on is: Is the administration prepared to drop its opposition to a general tax reduction? There have been rumors in the papers that the administration may be considering a $20 billion tax cut. Do you see this as part of your proposal in the near future?

Secretary BLUMENTHAL. There have been no decisions made that would allow me to indicate any change in the administration's position with regard to the fact that we have a serious energy problem and that we have a most serious inflation problem; 13 percent in the first few months of this year. And that above all what the American people would like to see is to have us deal with the energy and with the inflation problem.

When and how taxes can be reduced in the context of that situation is something that the President has to consider and make a judgment on and then propose to the Congress to make its decision. He has not yet done so. I therefore cannot tell you of any change in that position except that I know that he is officially concerned with the tax burden but he is equally concerned, he is very concerned, with the tremendous inflationary and energy problems that this Nation faces.

And he knows that he must ask for the help of the Congress and the American people to lick that problem.

Senator ROTH. Well, Mr. Chairman, my time is up. I would just like to comment that I don't think you can separate the energy picture from the economy, from the tax picture. I think the tax drag on the economy is a basic cause of our whole problem, and I would hope that whenever the President comes down from the mountain that he would lay out a very comprehensive picture.

This administration is trying to balance the budget by higher taxes on the American people. I think it is absolutely important that we get your tax proposal, a comprehensive tax cut proposal.

I would point out that many members of this committee have recently come out in favor of a general tax reduction and I think the sooner we get it the better off this country's economy will be.

The CHAIRMAN. Senator Ribicoff?

Senator RIBICOFF. Thank you, Mr. Chairman.

Mr. Secretary, I assume that our main purpose is to produce more energy and not to increase revenues. It is very obvious that we are now dealing with two selfish groups in the world society, the one abroad, run by OPEC, over which we have no control and the other one, the major oil companies of this country, over which we have control.

So our objective is to increase more production, to stop the export of dollars, to use the capital in the United States instead of it being used abroad, and to get normal taxes.

I can understand the windfall profits tax on tier 1 and on tier 2 oil, but if we want more production—and that is our key—why not exempt newly discovered oil as of now, instead of 1990? Will the increased revenues that you would receive from tier 3 taxes justify a depressing effect on new production?

It would seem to me that producers will hold back until the tax is phased out in 1990, so you will get neither increased production nor normal corporate taxes.

We are dealing in a world where petrol politics has taken the place of geopolitics and affairs of nations. The OPEC countries have us and the entire West against the wall. The time has come to do away with "liberal," "conservative," and all the cliches of terms, and to unite in the conclusion that will produce more energy, period.

And it would seem to me that neither your proposal nor the House action on tier 3 oil will produce more energy.

Secretary BLUMENTHAL. Senator, the best judgment that is reflected in this proposal is that the substantially increased price for tier 3, which is available to American producers, is sufficient to bring about all the additional exploration and all the additional production of domestic oil that is possible, that anything beyond that amount, in fact, would be a windfall, and that the use of those resources to fund other kinds of energy development which would reduce our dependence on that uncertain source of supply across the ocean is the best use of those funds.

Senator RIBICOFF. You mean those are the funds that are going to the Energy Trust Fund?

Secretary BLUMENTHAL. Yes, the difference between what the producer for newly discovered oil gets and what the world price is, which is uplifted by inflation.

Senator RIBICOFF. Let me ask you this: Before you became Secretary of the Treasury you were a very successful businessman. If you remove the restraints on new production you will also provide additional incentives for other types of energy—synthetic or otherwise—and would not the private sector then generate the extra capital to go into all sorts of energy? Is not the capital generated from new discoveries better placed in those discoverers hands than in the trust fund?

Secretary BLUMENTHAL. The restraint has never been the availability of capital, in my judgment. I believe that there is adequate capital available in all business, including in the energy business, Senator, if the price is right. If you can make a fair return on that capital, you can get capital; you can borrow it. There are plenty of willing lenders. As a matter of fact, some of the bankers are complaining there are not enough people who want to borrow.

The real question is whether or not people think that in terms of risk and price they are going to get enough for their product and then they will find the money to invest.

We believe that those prices, after the windfall profits tax is imposed on the newly discovered oil, which is so much higher than what people would dream of getting only a few years ago, are adequate to induce peope to raise the capital to do that.

Senator RIBICOFF. But it is not going to work that way. Oil keeps going up from $6 to $8 to $12 to $14 to $18 to $23, and it is going to go up to $30 and $40 a barrel in a couple of years. The people who get the energy are going to hold on to it until it goes up; they are making so much money now they can hold up for the last dollar.

As I said, we are dealing with two selfish groups: domestic and foreign. We can't do anything about the foreign, so let's be as sophisticated as we can for the sake of this country. Let's see what we can do on the domestic side. I don't think we are going to get it unless we are determined that the production of energy becomes a priority for this country.

The CHAIRMAN. Senator Byrd?

Senator BYRD. Thank you, Mr. Chairman.

For clarification, Mr. Secretary, you are testifying, I assume, in behalf of a 50-percent windfall profits tax and not the 60 percent as passed by the House—is that correct?

Secretary BLUMENTHAL. We will accept the 60 percent if the Congress so desires.

Senator BYRD. What are you advocating?

Secretary BLUMENTHAL. We advocated 50. The House decided on 60. We are willing to accept 60.

Senator BYRD. On page 3 of your statement you mentioned the Tokyo Conference and that the President was able to get through an agreement to severely limit imports. Then you say "This is an ambitious goal" and "it will require much sacrifice."

What do you have in mind in the way of sacrifices?

Secretary BLUMENTHAL. Well, in the first place, in order for us to not increase by 1985 the amount of foreign oil imported—indeed I would hope to try to reduce and get below the level of 8.5 million barrels a day which we are importing at the present time—we have to make a very major effort to conserve energy, to conserve oil.

We are going to have to live with higher prices; that is the second kind of sacrifice.

We are going to have to take into account and live with certain increases, such as the thermostat legislation that was passed.

Senator BYRD. Gas lines?

Secretary BLUMENTHAL. I would certainly think that to the extent to which we can reduce our consumption by these savings measures, and other countries do the same, and, therefore, here is some lid on supply, the demand/supply situation will be better and we will have less or no lines.

I did not have in mind the artificial creation of gas lines; of course, not. What I did have in mind are these other kinds of sacrifices and, really, the higher prices due to decontrol which will be painful, which are costing us, just as the OPEC induced increases are costing us even more; and the use of those revenues, not to spend possibly on some of the many good purposes we could spend on in this country, but the use of these resources to expand the supply base, so as not to increase the budget deficit.

I would hope to expand the supply base of this economy and the supply base in the energy field so that we have adequate resources and sources of supply in oil and in other fields. That is the kind of sacrifice I had in mind. Because it would be nice otherwise to take that money and to spend it for other purposes. We can't afford to do that.

Senator BYRD. You mentioned OPEC. Should steps be taken against the OPEC cartel, and if so, what?

Secretary BLUMENTHAL. I think that the joint action that the leaders of the seven major countries discussed in Tokyo to work together to reduce their demand for OPEC oil, to collaborate and to exchange information and R. & D., to accelerate as much as possible on a crash basis the development of substitute fuels—of which we have plenty in this country.

All we need to do is apply our technical ingenuity to develop them, and that doing those things is the most effective answer to a cartel, which otherwise will be constantly operating in the kind of tight market in which they can move up the price at will; we reduce our demand on their product, their power will decrease.

Senator BYRD. Bearing in mind the phasing out of price controls on domestic crude oil is not involved in this legislation—it has already been done by executive action and is not involved in this legislation—what in the legislation before the Senate Finance Committee today, what is there in that legislation which would encourage the independent exploration for new energy sources.

Secretary BLUMENTHAL. Clearly, if there were decontrol—which is what the President is already putting into effect, as you correctly pointed out, Senator—and there were no tax whatsoever and therefore there were greater resources in the hands of the producers, there would be some possible, very slight, very marginal increases in production.

On the other hand, at the same time, the use of some of these resources, which, as the result of this windfall profits tax, would not be available, namely, the resources that we call windfall profits, the use of those to reinvest in the American economy for the development of synthetic fuels or any of the other substitutes—development of our coal and other natural resources—will also be an important factor in making us less dependent on OPEC and on reducing the cost ultimately in this country.

So the windfall profits tax has that indirect effect on the demand/supply situation down the road, an investment now, to pay dividends tomorrow, which is very important.

Senator BYRD. My time has expired, but do I understand you to say that the windfall profits tax will help encourage greater supply?

Secretary BLUMENTHAL. I think the windfall profits tax will not reduce the supply, except very, very marginally; but at the same time it will help provide resources which will allow us to expand the supply of alternative forms of energy, and those are just as important as our oil resources on which a lot of people feel there is some absolute limitation anyway. That is an exhaustible resource and the possibilities for increasing that are certainly not unlimited by any means.

Senator BYRD. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Dole?

Senator DOLE. Well, just following up on Senator Byrd, it is my understanding that a no-tax scenario would produce about 1.5 million barrels a day by 1985. If we took the Ways and Means proposal, increased production would be only 300,000 barrels a day by 1985. The version passed by the House is going to be 8 million barrels a day by 1985.

In effect, we are going to raise about $45 billion in gross tax in the next 5 years, but we are going to deny this country about 700,000 barrels of oil per day.

You are not suggesting the proposal is a windfall profits tax, are you?

Secretary BLUMENTHAL. Sir, I have some numbers.

Senator DOLE. But, I want to make certain. This is an excise tax or a severance tax, not really an excess profits tax.

Secretary BLUMENTHAL. No, no; it is not an excess profits tax——

Senator DOLE. I mean an excise tax, not a windfall profits tax.

Secretary BLUMENTHAL. Well, we called it a windfall profits tax.

Senator DOLE. Others in the Treasury call it an excise tax.

Secretary BLUMENTHAL. It is an excise tax in that sense, yes; however, I would like to indicate to you our numbers, which have been worked up by the Department of Energy, as to the effect if there were no tax by 1985, calendar year 1985, and assuming an uncontrolled oil price of $22 a barrel, and no real price increases, then there would be an increase of 1,240,000 barrels a day by 1985.

The administration's modified proposal—well, let's take the House bill first.

The House bill would lead in 1985 to 1,090,000 barrels additional; our proposal, modifying the House bill, to 940,000, almost 1 million barrels by 1985. Those are the numbers and I would be glad to——

Senator DOLE. I would be glad to give you mine, if you give me yours.

Secretary BLUMENTHAL. Yes, sir.

Senator DOLE. But I think, beyond that, I think we all—as Senator Ribicoff has stated, this country needs to produce energy.

Are you prepared to tell us what may be going on at Camp David?

Secretary BLUMENTHAL. Well, Senator, the President is consulting with a wide-range of people, including a good many Members of Congress. Some of the distinguished members of this committee were up there yesterday, more than once, as a matter of fact. Essentially, they were reviewing the energy and economic and total situation of this country in the light of what is truly a very serious situation that we face, brought on, crystallized by this most recent OPEC action.

Senator DOLE. What will be the administration's position?

Secretary BLUMENTHAL. I wouldn't characterize anything as a party line.

I choose my words carefully. Crystallized by the most recent OPEC action. Of course, there are a great many factors that have brought us to where we are today; and one of them is that we have not done anything as a country about energy in the last 10 years or last 20 years, or since the Suez blockade. That is one of them. I can list 10 more.

Senator DOLE. Right.

Secretary BLUMENTHAL. But we are at a certain point now, and the President is assessing, with the advice of a lot of capable people from business and outside government, what that means and what we have to do as a country and what he must propose as the leader of this country.

Senator DOLE. No, I don't quarrel with that. In fact, I hope and I wish the President succeeds. However, if we are going to have a program it shouldn't be piecemeal. We should wait until we get this package and then figure out where the windfall profits tax fits in, where the syn fuel fit in. Shouldn't it be one omnibus bill that would sweep the Congress?

Secretary BLUMENTHAL. Senator, I think in the natural course of events you will have an opportunity to know a great deal about other Presidential proposals sometime before you have to make your final decision on this particular piece of legislation.

I would suspect that regardless of what the sum total of proposals is, decontrol, which is already begun, would be carried forward and concluded in 1981, and the windfall profits tax and the resources derived therefrom will be very much needed for whatever the President suggests we can do to speed up reducing our dependence on OPEC oil, and that in any case you are going to have to break it up into pieces as you consider this, since you can't be too big to do it all in one piece.

The CHAIRMAN. Senator Durenberger?

Senator DURENBERGER. Thank you, Mr. Chairman.

Thank you, Mr. Secretary. I am not sure I care what is going on on top of the mountain. I do know Bob Dole would love to be there, if you can wrangle him an invitation. But I worry about what is going on.

Senator Ribicoff talked earlier about two selfish groups, and he identified one that the President has been on since April, and another the Vice President got on last week. He left out the third and most important, and that is, you and me, and everybody else in this room, and everybody else in this country. And I have a deep concern that the President of the United States and his advisers are somehow or other not cognizant of the fact that the American people somehow or other in the last few months have recognized that themselves, and I think that you have recognized, from your comments, that we are going to have to sacrifice, and we are going to have to do with less, and all of that sort of thing.

I just wish to God you or somebody would say that to the American people, say, "Here is how we are going to make it fair."

I found in my last trip home to Minnesota that people are willing to support rationing. And I don't think rationing is fair, and I voted against it, and will continue to. But I asked them why, and they said, "Well, you know, at least it seems like the guy next door is getting the same amount of gas as I am."

And that is a lousy reason to be going after rationing, and it is a lousy way to approach conservation.

Let me ask you, first, about the recession.

What is the energy impact? You talked about the OPEC prices, but isn't there also an even more substantial impact on the, you know, just consumer choice, failure to buy, making decisions to put things off, and all of that sort of thing? And I am obviously getting at the uncertainty that sitting around on top of a mountain creates, and the impact that has on recession.

Secretary BLUMENTHAL. Well, I think that uncertainty, as the result of what I think are different causes; uncertainty as the result of what has happened recently in energy, as the result of the gas lines that we have had in parts of the country, as the result of the rapid rise of inflation that we have had in the early months of this year, and I think the recognition that you referred to, which you noted in Minnesota and which I guess we all noted across the country, that something has to be done about this and what will it be—I think that clearly is a factor.

The economists that I have talked to and that I have listened to over the last several days, from wherever they come, are for once unanimous on something, and that is, that this economy at this point is very, very difficult to read, because you have so many crosscurrents. Clearly, people who sit in line, in gas lines, don't go into stores to buy the normal products, not only automobiles I speak of but they don't buy lots of other things that they would otherwise buy.

Clearly, people who see the prospect—and maybe they would accept it—of the price of gasoline going up, wonder whether they should spend the money on something else. Clearly, that is a factor, hopefully only a temporary factor. Clearly, the fact that we have had this very rapid rise in inflation for a variety of reasons is causing people to hold back. Clearly, the truck strike had an impact, or the teamsters' strike had an impact. There are many such factors that enter into this, all of them together, but very importantly the recent actions of OPEC are adding up to an economic situation that makes for less growth and for more inflation for this year at least than any economists inside or outside the Government anticipated.

Now, please don't ask me again whether we were wrong or not, or I will get into trouble.

Senator DURENBERGER. Well, I just want to ask you one more question before I get the red light. I have a long list of questions I would like to give you.[1]

Would you consider—and let me say first, the sooner the Energy Security Fund and the things you talked about—income assistance, mass transit, that sort of thing—get here, the easier it is going to be on me—but would you consider—I heard you speak to Senator Roth about the social security—but would you consider tax credit incentives to conservation and so forth as part of that fund, other things other than the grant programs that we could expect to come down on, alternative fuels and so forth?

Secretary BLUMENTHAL. Senator, I will have to give you an answer as the Secretary of the Treasury, and an answer as a realist, and those two things are not always inconsistent, but sometimes I find they are.

As the Secretary of the Treasury, I would say to you that I hope no tax credit, because Secretaries of the Treasury don't like tax credits. Secretaries of the Treasury take the position—and I do too—that if

[1] See part 2 of these hearings.

we are going to spend it, then let's spend it, but let's spend it out there in the open where everyone can see it and where we appropriate it.

If it is worthwhile to do, then let's do it and do it properly.

As a realist, I would have to say to you, yes, there probably will be some tax credits—and you can make a better case for some than for others—and my only hope is that those tax credits that—some already have been proposed or others that might be proposed—will be those that really will get us somewhere.

There are so many ideas about tax credits that are foolish, that I hope at least we can prevent the foolish ones from being enacted.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. Let me see if I can restate what I think is the administration's position and ask you to elaborate on it or correct me where I am wrong. America has a serious energy problem right now and the solution to the problem is going to entail the investment of a significant additional amount of American resources into a resolution of this problem.

Part of this investment should be made in the exploration and production of oil. And part of this investment should be made in "farther-down-the-line" forms of energy: Research, development, and new technology.

The decision that is before us, as I understand it, is now to allocate the additional resources that are going to be generated through the decontrol of crude oil prices between oil exploration and production and other forms of energy. Decontrol of oil is going to lead to an enormous transfer of wealth from the American people to somebody or to something. And the question is, as I understand it, to what extent will that transfer of wealth go to the oil producers for the sake of exploring for and producing oil and to what extent should it go for other purposes? Your intention in the windfall profits tax is not to impose a tax just for the pleasure of it but is instead to impose tax for the sake of establishing an energy trust fund.

A fraction of the money in the trust fund would go for mass transit, a fraction of it would go to alleviate the problems of the poor, but the lion's share, the great majority of it, would go for research and for development and for new technology. Am I right so far?

Secretary BLUMENTHAL. I think that is a very excellent statement. I have a few little comments but they do not detract from the basic thrust. You are quite right in your basic thrust.

Senator DANFORTH. Now, in determining how much should be spent for the production of oil and how much should be spent for development of new technologies, what was your approach? Did you flip coins or draw numbers out of hats or was there some process of decisionmaking, as to what form and amount of windfall tax would produce the optimum amount of the funds for oil exploration and development on the one hand and for R. & D. technology on the other hand?

Secretary BLUMENTHAL. The notion of the fund—rather, the notion of the tax was based on the belief that there would be a large amount of additional money coming in very rapidly which could not be used for additional oil exploration and production and, if used, would not lead to any production over and beyond what would be produced. It is just technically not possible.

And the effort was to find a level at which to cut the revenues off which on the one hand, would leave all of the incentives and revenues to produce what can be produced and to take the risk for the other purpose.

Senator DANFORTH. And how is that——

Secretary BLUMENTHAL. Now, that amount of $16 that we selected obviously is not a scientifically arrived at number. It is an arbitrary number, just like the House's number of $17 plus 2 percent real increase is an arbitrary number. And you can take $14 or $18 and they are all arbitrary numbers.

We picked what was at that time a price that OPEC had decided to charge by the first quarter of 1980 as determined in December 1978 and we said: "That is a major increase, a further major increase." That represented I believe at the time a 14-percent increase over the previous level. That is it.

Senator DANFORTH. But it was the best information, the opinion of the best experts you could find in Treasury and the Department of Energy, that this was the optimum way to divide the increased revenues from decontrol between oil production and exploration on the one hand, and other uses for other sources of energy on the other; is that correct?

Secretary BLUMENTHAL. Correct.

The CHAIRMAN. Senator Wallop.

Senator WALLOP. Thank you, Mr. Chairman. Mr. Secretary, I assume that you still stand by the fact that you call it a windfall profits tax?

Secretary BLUMENTHAL. Yes.

Senator WALLOP. What then happens to windfall losses?

Secretary BLUMENTHAL. Windfall losses? There are no such things as windfall losses. If OPEC should reduce the price and if the market should begin to work because supply exceeds demand, then the market is working and we are in good shape.

Senator WALLOP. What happens if you drill a $25 million exploratory well, which has happened in my State, and it proves to be dry?

Secretary BLUMENTHAL. Then you write it off.

Senator WALLOP. Against what? Not the windfall profits tax?

Secretary BLUMENTHAL. Well, you presumably have lots of other profits. We are only dealing with that portion of the additional profits that can be ascribed to the arbitrary actions on the part of OPEC.

Senator WALLOP. Additional moneys then, not really profits, because it has nothing to do with whatever you make a profit on, isn't that correct?

Secretary BLUMENTHAL. Additional funds derived from increases in the price over and beyond.

Senator WALLOP. But if your increasing the price does not match your increase in the cost of production, then you will quit producing, will you not?

Secretary BLUMENTHAL. Well, that is a decision. That is as it should be. There are always people who quit and other people who come in, some who are smarter than others.

Senator WALLOP. But it really has nothing to do with profits; it has to do with the differential in prices, is that correct?

Secretary BLUMENTHAL. I think it has a lot to do with prices because prices beyond a certain point, if they are imposed on us by

OPEC, are not market related; they are cartel determined and they do represent some windfalls in that sense.

Senator WALLOP. Well, I ask you this: Does the President plan to limit imports of foreign oil by Executive order or some other way?

Secretary BLUMENTHAL. He has no such intention at the present time.

Senator WALLOP. Well then, how will this proposal end up decreasing our dependence on foreign oil when many investment houses are now suggesting to their investors that they not invest in domestic American production or companies with basically American production but those with foreign reserves?

Those foreign reserves are never going to be taxed in this way when they are brokered by people who have them, correct?

Secretary BLUMENTHAL. I have no knowledge of what different investment houses are suggesting to their customers. I do know that this program, the decontrol with the tax, Senator, will by any measure, even by the numbers that Senator Dole cited, will increase production in this country.

The disagreement is over the degree to which it increases. It will provide additional incentives. And it already provides higher prices. It is not a 100-percent tax. It is a 50-percent tax on the difference, starting at a very high base, much higher than anybody ever dreamed of even a few months ago.

So, clearly, that is a pretty profitable business to be in.

Senator WALLOP. Well, I have no quarrel with the idea that the country needs to recapture some of these but I have a quarrel with the assumption that the only way to accomplish synfuel or the move to synfuel is by the public expenditure of billions of dollars.

I am concerned that the Federal subsidy may be done but the attractiveness remains for those who broker foreign oil because they simply match purchasers and producers. They do not own it or produce it.

And how, could you explain to this Senator, are we going to end the bureaucratic nightmares you suggested in this when one barrel of oil can have three tiers of taxes on that same barrel of oil levied biweekly—try to figure that out—and remain with any capital at all in the independent sector.

There are two different sectors: We are talking about major companies and we are talking about those who produce and refine most of the oil.

Senator BLUMENTHAL. We would no longer have to have the kind of system of equalization that we have had up to the present time. Once the old oil has been moved up by 1981, Senator, that will be gone and it will be progressively a much simpler system than we have had under the present one where we have had a very complicated system of entitlements in order to equalize between different groups.

Clearly, the new system would be infinitely a simpler one down the road. Let me give you the specific points. The small refiners, under the present system, under the entitlements system, the small refiners are granted additional entitlements under the program.

The entitlements program reduced wellhead value of old California crude by some amount, by $3 a barrel. So, DOE had to make a special adjustment to the entitlements program to bring that value back by the $3.

You had a problem with Caribbean producers of residual fuel oil. That started getting diverted in various ways. So that had to be allowed for. And the one thing we have found is that decisions made by bureaucrats, however good they are and wherever they are located, cannot take the place of the market.

Here in this instance you will have in fact everyone paying the market price in this country and a phaseout of the old oil and the new oil and eventually one price, which is the world price.

Senator BYRD. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Secretary, I am grately concerned about the homeowner's fuel oil problems. Two years ago when you testified on behalf of the President's crude oil equalization tax, you discussed a proposal for oil customers to receive relief from dramatically increasing oil prices through a system of rebates to the heating oil dealers, which would then be passed on a dollar-to-dollar basis in costs to their customers.

Do you have any such similar proposals under this measure that you have brought before us today?

Secretary BLUMENTHAL. There is nothing in this proposal that deals specifically with heating oils.

Senator CHAFEE. With home heating oil?

Secretary BLUMENTHAL. With home heating oil.

Senator CHAFEE. Now, is that left for the energy security trust fund, for that grab bag, as to how it is going to be determined?

Secretary BLUMENTHAL. The first requirement for dealing with this problem is to insure that there is an adequate supply available. The President has indicated that the Department of Energy will insure that that is the case.

Second, for those who are dependent on home heating oil and who are particularly hard hit by these price increases and who cannot afford these higher prices, the energy security trust fund will be available for that purpose. And by this means and by making sure that adequate supplies are available, we expect to be able to handle that problem.

Senator CHAFEE. Now, Mr. Secretary, I feel very strongly about these separate trust funds. It seems to me from my experience that either they do not produce enough or they produce too much. And thus the money is not being spent in the most effective manner.

And I suspect, as the Secretary of Treasury, you probably feel the same way. And indeed in answer to Senator Durenberger's question, if I can quote you correctly, you said if it is worthwhile to do it, do it. It seems to me if it is worthwhile to make a payment from the Federal Treasury for such and such purpose, it should be done and should not be dependent on whether or not there is enough money in a separate fund.

Could you discuss why the administration is proposing a separate trust fund?

Secretary BLUMENTHAL. Yes, I will certainly do that, Senator, but let me just make sure that I was properly understood. In replying to Senator Durenberger's question, I meant to say, I tried to say that if a particular project is worthwhile, then it ought to be properly appropriated but not paid out in the way of a tax credit. That is all.

Senator CHAFEE. But it seems to me the problem is similar. You may have a fund that may be too big or may be too little. If the project is worthwhile doing, whether it is some kind of a home heating oil rebate or credit, it should not be dependent on whether the fund is big enough or too small, should it?

Secretary BLUMENTHAL. Well, there is nothing to stop the Congress from voting on any measure to help certain groups of people if Congress feels that that is necessary. But the reason why the administration is proposing a trust fund is because this is an unusual situation, an unusual tax to deal with what amounts to really a national emergency.

And we felt that it was important to separate out and to segregate the amounts that would be collected purely as the result of OPEC raising these prices in the way in which we have and our taking some of that money. So that we knew how much money we had available from that step.

And that as we put it back, whether it is in the form of a tax credit here or there or of a direct subsidy if it is for heating oil or in a major way to fund the development of other forms of energy, Senator, that all of those expenses would be totaled up against that trust fund.

If the Congress at any point wishes to spend additional amounts of money, that is of course always open to the Congress to do. That gets you into the general question of what is available in the budget.

Senator CHAFEE. I think that setting up a separate trust fund is a bad idea. Thank you very much.

Senator BYRD. The Senator from Montana, Mr. Baucus.

Senator BAUCUS. Thank you very much.

Mr. Chairman, Mr. Secretary, I think all of us agree that one of the basic problems here, at least for the time being, is OPEC who got us in the bind. I wonder though at the degree to which the Department of the Treasury and the administration either in the past or presently during these few days at Camp David is trying to figure out some way to address the problem of OPEC more directly; that is, much of the discussion this afternoon has assumed there is not a lot we can do about OPEC, that it is a given, that we have decontrol of price of crude oil and we can enact some kind of windfall profits tax to redirect the shift of income in the country.

But it seems to me that we should not give up yet our efforts to try to deal more directly with OPEC because that is part of the problem. But I am wondering if you could outline for us this afternoon what much more direct and more significant proposals you have discussed, at least in trying to knock some sense into OPEC with respect to the world terms and some of the problems they are causing and why you have disregarded that. If you have, could you tell us the kinds of proposals that are being discussed out at Camp David that would put more pressure on OPEC more directly.

Secretary BLUMENTHAL. I have not discussed any other program in this connection other than the acceleration of the development of our own resorces of both oil and substitutes to reduce our dependenced on OPEC. And I am not aware of whether the President has discussed anything else with anybody else. I just do not know.

I would think though that it is important, at least I would like to make this point, to recognize that OPEC is an aggregation of 13 nations, 13 or 16 nations, more than 12, and that there are great variations among them. And we all live in the same world; we all have to live together. And as we try to be masters, as we are masters of our own fate and regain full control over our economy, that is by far the best way to insure that no one country or one group of countries can dictate to us that I know of.

If the other people are smarter and know of other ways, I do not.

Senator BAUCUS. I think that is right. We are American. We have a democratic form of Government. We do not directly control other countries. In fact, there is question to the degree to which we should.

Nevertheless, as you said, there are variances and differences among each of the member countries of OPEC. And it just seems to me that we cannot take this sitting down or lying down, that we have to be much more protective of our interests within the borders of the confines of our country but in addition in fact what OPEC is doing to us and other countries in the world.

So, I just encourage you and the administration to address that problem more directly.

The second question I have is related to Senator Chafee's and also Senator Danforth's comments and that is, I take it that the main reason and rationale for decontrol and windfall profits is to redirect our efforts to produce more energy in the country.

And I am wondering why you seem to have disregarded more reliance upon the market. You in your own words just a short while ago said that decisions by a bureaucrat is no substitute for the marketplace.

Why in the world don't you fashion a proposal through tax credits, plowbacks, all the myriad tools that are available in the Tax Code and also in some degree the appropriations process, and fashion a proposal that relies more upon private enterprise rather than funneling the large portion of the revenues derived from decontrol into a trust fund and redirecting it through the bureaucratic process?

Secretary BLUMENTHAL. The main purpose of this program is not to get a lot of money for other purposes, although we can use it for development of other forms of energy. The main purpose of this program is, first of all, to rely on the market—that is why we are decontrolling; the whole decontrol aspect of it is to rely on the market and for the people to have to pay the market price—and to insure that the American people get the benefit of whatever windfall there is by making this step very quickly rather than letting it accrue to a few. That is the main purpose of the program.

Now, how the proceeds will actually be used really depends on future decisions taken by the President and Congress. And I would not at this point presume that whatever those decisions involve will necessarily involve a lot of Government employees or a lack of reliance on the private system.

It may well be that those resources can be used by relying on the private enterprise system. I personally would hope so. And I certainly urge that this be done.

So, we must not assume that just because it goes into the trust fund its use will be only for some Government program.

Senator BAUCUS. We could explore this if we had more time but thank you very much.

Senator BYRD. Senator Boren.

Senator BOREN. Mr. Secretary, first I do want to say while I have some criticisms of this tax proposal and some questions about it that I think the President and the administration are to be commended for moving with decontrol and toward really the first positive action that has been taken to encourage more energy production in this country or a long time.

And I hope my questions will be viewed in the context of that commendation because we have been a long time coming to this step. Decontrol should bring us additional capital needed to produce more energy. We all know if we are going to produce more, it costs money to do that.

The price should reflect the real costs of energy. Instead of discouraging the development of alternate sources, by reflecting the real costs of oil, we begin to make the alternate sources look more attractive in terms of being an alternative.

Much benefit is going to flow from the proposal which the administration has made. And I am very pleased to see the move at least at the beginning in the right direction.

But I am concerned, going back to the same question that has been raised again and again, we are concerned, and I have heard you express the concern, that a few people should not profit unduly from the higher prices that the American people must pay. We want to make sure that the American people get the benefit, just as you have brought it here today in response to Senator Baucus.

I am concerned that in focusing all of our attention to the oil companies and making sure, as some commentators have done, that we do not rip off the consumer by letting the companies make unduly high profits, that we are setting the consumer up for the ultimate rip-off; that is, most of the money in the higher prices will go to the Government in the form of higher taxes.

And if there is anybody inefficient in using the people's money, particularly in making investment decisions, it is the Government, which has the most notorious record of all in making investment decisions.

So, I want to ask the question again, if, as you have said, the private sector is more efficient than the public sector in making investment decisions, why do we come along with a tax proposal to take roughly half the proceeds, half the capital being raised through decontrol, and instead of letting the private sector make that investment decision, instead of encouraging them to channel the capital through tax credits and plowbacks and other mechanisms, why do we take it and put it in the hands of the Government in the first place, to be handed back perhaps to the private sector—but why have it in the first place?

Why not fashion the incentives, once the capital is going to the private sector, to let them keep it and use it instead of putting it in the hands of the Government?

Secretary BLUMENTHAL. Senator, the original calculations I saw—I think they are probably a little different now—would have reduced the amount of money left to the oil companies for each additional dollar of revenue higher price from 43 cents down to 29 cents, roughly a 30-percent reduction.

That is, I think probably somewhat larger now. I do not know what the exact amount is. But it certainly leaves in the hands of the private sector a large portion of the revenues. Also bear in mind that the windfall profits tax is a 50-percent tax which does not trigger in until a very high price is reached.

And bear in mind that that tax only is supposed to reflect the arbitrary, unexpected and sometimes quite unmarket related actions of the OPEC countries. It seems that that represents a reasonable compromise. And that is really all it is.

Senator BOREN. I understand it is a compromise but again according to your chart I see the billions of dollars that would go into the hands of the Government. Do you really think that the Government—could use those billions of dollars and make cost effective decisions on them as well as could the private sector with the proper incentives?

Secretary BLUMENTHAL. Well, it depends on how that money is used. There have been proposals, indeed there is a bill in the House—maybe there are some in the Senate—it has already been acted on partly in the House, for a major synthetic fuel's program. That clearly has to be developed in large part by private industry, if not totally by private industry.

I think the resources that are collected in the fund could be used to encourage private industry to do that. A lot of these involve technologies that are not yet proven and which a prudent investor would not want to take a chance without some guarantee as to price or even a price of one kind or another.

It seems to me that it all depends on how you use the resources.

Senator BOREN. In the private sector would the oil and gas companies and existing energy companies also be encouraged to go into the production of synthetic fuels?

Secretary BLUMENTHAL. Certainly. I would think anybody should be encouraged to do that. It is just an assumption that some help from the Government, basing itself on the private sector, will be needed. And, therefore, that having made this compromise decision that those resources are not going to stay in the pocket of the Treasury. They are going to go out into the private economy for the very purposes you and I have in mind.

Senator BYRD. Senator Bentsen.

Senator BENTSEN. Thank you very much.

Mr. Secretary, as a Senator from an oil producing State, I am very supportive of developing synthetic fuels. But I also want to really encourage the exploration of oil and gas and finding those new energy reserves.

Now, if you have a company who goes out here and builds a synthetic plant and it is liquefaction of coal or they take some other source and convert it to a barrel of oil, synthetic oil, $20 a barrel they get for it, are you going to tax them 50 percent between $16 and $20? Are you going to put a windfall profits tax on them for that differential?

Secretary BLUMENTHAL. For synthetic oil?

Senator BENTSEN. Yes.

Secretary BLUMENTHAL. No.

Senator BENTSEN. No, of course. Well, why the difference? Where is the equity? How do we know it costs any more to develop that synthetic fuel than to drill? You talked about incredible prices for oil we never dreamed of, and that is true.

But also there are incredible costs for drilling on that oil. I looked at a cost of $2.6 million for a 12,000 foot hole in the Rockies the other day. No one ever dreamed of those costs before.

So, I listened to Senator Ribicoff talking about if we really want to encourage the finding of new oil, why the windfall profits tax on new oil we go out and find? And I sympathize with that.

Then I looked at the independent producer in this country who drives 90 percent of the wildcat wells, finds about 75 percent of the new oil and gas significant reserves. And I know we think, at least most of the big reservoirs and reserves have been found, at a great increase in cost. And he is the speculator, you know, he is the wildcatter.

And I really get concerned about putting this kind of a tax on him. Would you care to comment on that? I do not want to slow him down.

Secretary BLUMENTHAL. No, no, no, my answer must be obvious. My answer is that that independent who is essentially operating not with old oil but with new oil is getting a price that is several times higher than anything he could have dreamed of a few years ago.

Senator BENTSEN. And a cost to drill several times higher than he ever dreamed of?

Secretary BLUMENTHAL. Right. Are we really saying that the cost of drilling has increased as fast as OPEC has increased its price?

Senator BENTSEN. I think it depends on where you are drilling.

Secretary BLUMENTHAL. I certainly defer to you, Senator, for a much deeper and more thorough knowledge of the economics of that industry.

Senator BENTSEN. If we take the general average, I do not think it is.

Secretary BLUMENTHAL. I do not have it but it was my general impression that OPEC has been ahead of the cost of the——

Senator BENTSEN. In general that is certainly true but if you do it hydraulically today you are talking about $800,000 of expenditures. If we want to relate that to the OPEC price, I am sure it would.

I am concerned about really deterring that speculator, that wildcatter from drilling that well.

Secretary BLUMENTHAL. I think there are probably people at the margin—there must be people—I mean it stands to reason that there are people at the margin who if you had no tax at all, maybe even no income tax, if you had no tax at all, you keep everything you make, would be out there drilling and maybe finding something who otherwise will not do so.

I think though that those people at the margin are probably a relatively small number, and that the amount of production that we lose by virtue of having those taxes is relatively small and that we should not develop a whole national program in order to encourage that last fellow at the margin to drill if he can get all of $25 or $23 and keep every dollar.

You have to cut it off somewhere. And again it is an arbitrary judgment but I think not an unreasonable one.

Senator BENTSEN. Let's get back to the question of discriminating against oil as opposed to synthetic fuels. Why should we put a windfall profits tax on the oil above $16 and not put it on the synthetic fuel above $16?

Secretary BLUMENTHAL. As I understand it, Senator, the reason is that the cost and technology for synthetic fuels is much less certain, is much higher than the cost of producing oil.

Senator BENTSEN. We want to talk about just to drill a dry hole when you make that and——

Secretary BLUMENTHAL. The numbers that I have seen are that the prices, the estimated prices for some of those synthetics, depending on whether they are for shale or coal or whatever, range up to $35 equivalent or maybe even more, so clearly from about $20 up.

So, we are talking about something that is much more expensive. Normally the cost for regular oil has been substantially lower. Now if it really turns out that on the average it costs that much to drill more for regular oil, then obviously I think you would have a very good point. I do not think we have reached that point yet.

Mr. BYRD. Senator Heinz.

Senator HEINZ. Thank you very much, Mr. Chairman.

Mr. Secretary, about how much oil do you estimate we will import in 1980? About 3.5?

Secretary BLUMENTHAL. 1980?

Senator HEINZ. About 3.5?

Secretary BLUMENTHAL. No more than 8.5 million barrels a day.

Senator HEINZ. Which is about 3.5 billion barrels for the year?

Secretary BLUMENTHAL. I do not——

Senator HEINZ. It is. Trust me.

Secretary BLUMENTHAL. I will take your arithmetic.

Senator HEINZ. And what is the average price of that going to be: between $20 and $22 and $23?

Secretary BLUMENTHAL. Only the good Lord and OPEC know.

Senator HEINZ. It could be $25, couldn't it?

Secretary BLUMENTHAL. I would certainly hope not.

Senator HEINZ. We would all hope not. It is now $23.50 for surcharged countries.

Secretary BLUMENTHAL. The average price is about $20.

Senator HEINZ. Let's say it is $20 and that is today's prices. Of course, there is inflation, and too much of it as you well know. But we are talking about $70 or $80 billion, therefore, in the cost of oil for next year.

Now, how much would it be worth to this country to have that $70 or $80 billion—and this is every year in current dollars, in constant dollars—how much would it be worth to this country on an annual basis, over and above that $70 to $80 billion, to have that $70 to $80 billion be spent here rather than overseas? What is the opportunity cost per barrel of relying? Is it $1 a barrel, is it $10 a barrel? What is it worth to us?

Secretary BLUMENTHAL. I do not know. The quick answer is a great deal but I cannot give you a number.

Senator HEINZ. Has anybody given this any thought? We are floundering around for an energy policy. We are making decisions in the dark. People are wondering how much we should pay for substitutes for oil, whether they be synthetic oil but things that reduce imports, and not anybody that I have talked to, not you or anybody else has given this question a moment's thought: How much is it worth to not import a barrel of oil and pay extra for something produced here?

Now, you and I both have some things in common. We have been schooled in business, we have been trained to look at opportunity costs. And somehow neither you nor anybody I have met yet has done that.

Secretary BLUMENTHAL. Well, Senator, we are trying to move in the direction of finding out, by virtue of the President's program, that involved in the first instance decontrolling and therefore no longer subsidizing the price of domestic oil or the price at which domestic oil is acquired in this country, Senator. That is a pretty good beginning.

Senator HEINZ. Well, the question unfortunately, although it has academic overtones, is not academic. Here we are debating a windfall profits tax. In various guises the revenues from that tax over the next 5 years could approach as high as $40 or $50 billion.

Everybody who wants to get reelected this year and a lot of others besides are floating synthetic fuel proposals. The question is: Are we going to try and take any of the revenues or all of the revenues from a windfall tax, which at this point looks like it is in pretty good shape both in this committee and on the floor, and what are we going to do with that money?

And yet we do not seem to have answers to the most basic question, which is: What is it worth to us? Without that answer we will flounder around and make some kind of a shot from the political decision. We have been through that for 6 years since the Arabs first cut off our oil in 1973.

And I do not point a finger of blame at you or at the President or at the Congress. There is more than enough blame to go around. But I would suggest that it is time for us to try, and for the Treasury Department in particular which has sharp pencils, to look at this question.

I will try and also do one other thing and give you a reason why——

Senator DOLE. Would the Senator yield there? Would this be something like a price support program?

Senator HEINZ. I know the Senator has agricultural experience on the Agriculture Committee. Obviously, if you knew that it was worth $5 a barrel extra to displace one barrel of imported oil, one logical conclusion that you could come to is that it will be worth a producer payment of some kind, of $5 or $4.99—so you make a one-cent profit—to displace that oil.

It could apply to wheat; it could apply to sugar.

Senator HEINZ. We could sweeten this up in all kinds of ways.

Senator DOLE. It could be a refundable tax credit.

Senator HEINZ. It could be a refundable tax credit. And I know that the Senator and I have a geat deal of interest in trying to explore this question. And I do not want to belabor the point, Mr. Secretary, but it does strike me that before we can have a rational energy policy that is a question where we really do—and I mean this century—we need your help. We really do.

Secretary BLUMENTHAL. Senator, if you will allow me to suggest that sometimes it is easier to phrase questions than not only to find answers, but that the questions may seem to have meaning but that you cannot find meaningful answers. And I would suggest with all respect that the answer or I would say answers to this question are simply not available.

What is it worth in economic terms, what is it worth in political terms, what assumptions must you make about what happens to OPEC price, what assumptions should you make about what happens to price levels in different countries? I can give you any set of the numbers you want.

I am not totally sure you or I would be a great deal wiser after we have gone through this kind of theoretical mathematical calculation. We know we must be independent. We know it is worth something to us. We know the price will be more than $20. We know we must get on to substitute fuels to pay for it.

Senator HEINZ. But we haven't a clue as to how much it will be worth for us to do it?

Secretary BLUMENTHAL. I submit nobody can tell you that.

Senator HEINZ. Let me just ask one more question. Has anybody tried?

Secretary BLUMENTHAL. I am sure people have tried.

Senator HEINZ. Has anybody in the Treasury Department tried?

Secretary BLUMENTHAL. They have not come to me with it. I do not know. [To Mr. Sunley]. Have you tried?

Senator HEINZ. Well, let me suggest to you, Mr. Secretary, that your earlier answer is unworthy of you. If you have not tried, do not tell me it cannot be done.

Thank you very much.

Senator BYRD. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

Let me just say in reaction to Senator Heinz' comment about opportunity cost is that one tangential issue it can be directly applied to is in the area of energy efficiency.

And we now know through a number of studies, through a number of conservation methods that it costs $15 to save a barrel of oil and the equivalent barrel of oil in the world market is $22 and by the time it is delivered it is close to $30 with refining and transportation costs.

So, I think it is an effective way to begin to look with respect to new values applied to things we previously might not have applied to them.

Now, one of the things that I wanted to ask you, Mr. Secretary, is that one of the most pernicious aspects of the problem that I see is not simply that we are experiencing inflation and shortage simultaneously but that the decisions on both of those are in the hands of a foreign cartel.

Now, since December the price has raised about 63 percent. Assume that we get to 1982 and we have not been quite so successful in meeting our import reduction levels and assume that OPEC meets and decides not to raise the price 63 percent but let's say the raise it half, 32 percent.

Now, how much more money will flow into the energy security trust fund?

Secretary BLUMENTHAL. Well, I would have to make that calculation for you, Senator. We easily can. We will supply it for the record. You want to assume that by 1982 OPEC will raise its prices by another 32 percent. And what would be the amount in the social security trust fund.

Let me see if we can give it quickly. We will have to submit it later.

Senator BRADLEY. I did some quick calculations and the figures get into the high billions. We are not talking about peanuts here. We are talking about a lot of money. And so when you think of a windfall profits tax that is somewhat open ended or at least extends in some categories to 1990, you are talking about the potential of creating a very sizable quantity of dollars.

And I think that raises the real issue: What do you want to do with those dollars? And in your testimony you have said tax expenditures should be charged against the fund.

Now, have you reached a point where you have decided how much you want the fund to be tax expenditure, how much you want it to be direct subsidies of various kinds and whether you have firmed up in your opinion, since the objective is to create reduced foreign dependence and increased domestic sources, whether you think that is best done by oil and gas, mass transit, conservation, other alternate sources?

Secretary BLUMENTHAL. We have not yet developed detailed proposals for the use of the fund. And, therefore, I cannot give you details of what that would be used for in all of its elements. I think I may be able to give you some points.

In the original proposal that we made we recommended that the revenues in the trust fund be used for the following three basic purposes: First, not to exceed $800 million for assistance to low income, and then $350 million for mass transit and the rest for other purposes.

Now, in the light of future further developments that have occurred since then, I would suspect that those numbers may well change.

Senator BRADLEY. In effect, you really have not firmed it up on any real ways to how it should be divided. You are leaving that to the Congress in its wisdom?

Secretary BLUMENTHAL. Well, we will be testifying on that before the House I believe in the near future.

Senator BRADLEY. I would just like to ask one more question and that is: Why did the administration exempt Alaska oil and the House decided to tax Alaska oil over $7.50 at 50 percent and whether you can live with that?

Secretary BLUMENTHAL. We exempted Alaskan oil originally because there is a very major transportation differential that Alaskan oil has to bear, so that a price at the wellhead in Alaska was well below the $13 that is the trigger for the new oil—for that tier oil. So we felt that there was no point in having a tax, since what they were getting at the wellhead, backing out, the very substantial—about $8 a barrel—transportation cost, putting them way below the $13.

What has happened is that with the dramatic explosion of oil prices, however, that we have now for the already producing reservior, Sadlerochit Reservoir, we have now reached a situation where we are about at the point, or could be at the point, where even with that substantial transportation differential the price at the wellhead in Alaska will be at the $13 level; and that we are saying at that point, anything more than is received by Alaskan producers is no different than that of any other producer and, therefore, should be taxed in the same way.

Senator BRADLEY. In testimony before the Ways and Means Committee, the oil companies stated they made money at $5.25 as the base price, so——

Secretary BLUMENTHAL. I think——

Senator BRADLEY. So are you saying you don't want to go with $7.50, but want to go with $13?

Secretary BLUMENTHAL. That is right. At $13 they are treated in the same way as anyone in the Lower 48. They made those investments on the basis that they would not have any taxes.

The windfall profits situation has come along since then, because the OPEC action has come along since then. There will be no tax of any kind on any new development. It is only on the existing reservoir. We feel we are living up to what they expected, namely, no tax until they reached the windfall level. We didn't think at the time we testified before the House that they would get there for a long time. Unfortunately, in a sense, because of OPEC action, they may well be there rather soon.

Senator BRADLEY. Thank you.

Senator BYRD. Before calling on Senator Moynihan, Senator Heinz has an opening statement he would like to have inserted in the record. Without objection, it will be inserted.

[The opening statement of Senator Heinz follows:]

STATEMENT OF SENATOR JOHN HEINZ

The hearings on the proposed windfall profits tax which the Finance Committee is holding this week are of particular significance as a result of the severe energy crisis confronting the nation. Undeniably, the failure of the federal government to exhibit strong leadership by establishing a national energy policy with well-defined goals has contributed significantly to the development of current problems. Moreover, every day that Congress delays addressing the difficult question of how our energy needs will be met, the supply shortages, the gasoline lines, the economic disruption and the public's frustration are exacerbated. If price and supply stability are to return to the energy market, we must achieve the goal of facilitating the development of domestic energy supplies and thereby eliminate unnecessary dependence on unstable foreign supplies.

The decontrol program announced by President Carter will eliminate one of the major disincentives to fully developing the nation's oil reserves. However, the program will also result in dramatically higher revenues from the sale of oil which is already being produced. How these revenues are used will have a dramatic effect on the success of efforts to achieve energy self-sufficiency.

Administration estimates indicate the decontrol will increase oil revenues by $30.7 billion through 1982. It is incumbent on the Congress to insure that the extra revenues derived from higher prices paid by consumers are spent in a manner which improves the stability of both price and supply.

A tax on the increased revenues resulting from decontrol will enable the federal government to encourage the development of alternate domestic energy sources and to help those with insufficient incomes meet the burden of rapidly rising energy prices. However, it is imperative that the structure of this tax be carefully considered so that the production incentives resulting from decontrol are not eliminated by the tax.

For example, it is important to consider the impact of the tax on small producers who account for 90 percent of the exploratory drilling done in this country. Any measure which through an undue regulatory burden or the elimination of sufficient return on investment would remove the incentive for these individuals to continue exploratory drilling would run counter to the goal of developing domestic oil reserves.

Attention has been focused on the amount of revenues the various windfall profits tax proposals will raise. The purpose of these hearings goes beyond totalling columns of numbers to understanding how the revenues will be raised and what the effect of the tax will be on the ability of the nation to meet its energy needs.

Senator BYRD. Senator Moynihan?

Senator MOYNIHAN. Thank you, Mr. Chairman.

Mr. Secretary, can I address this fourth aspect of the tax in the Alaskan context, that is, the windfall profits that arise from recent and future real increases in the world price? You weren't there, but perhaps you know that when the administration first briefed the Senate, this was described as the OPEC ripoff tax. It had its purpose, the withholding in some measure of the profits that would redound to domestic producers as a consequence of OPEC price increases above the general price level. I see that you are nodding in agreement. That that was the effect.

And you assert that this last OPEC increase hadn't been anticipated in the degree that took place. Without the least touch of reproach, I want to ask, have we just agreed to this latest form of international piracy? Are we institutionalizing it? Are we writing OPEC into the Internal Revenue Code? And how long are we to accept the notion of this cartel? I need not tell so distinguished a public servant as yourself that for half a century since Cordell Hull began the reciprocal trade agreement program, it has been essential to American international policy to free up trade, to break down barriers and particularly to oppose the conclusions and restraints of trade which are typically associated with controls that develop political agendas as well as economic ones.

We began this policy in opposition to the Nazi cartels. Have we become supine? I mean, one of the things about the windfall profits tax in this last respect, Mr. Chairman, is that through no fault of their own whatever, it creates an interest on the part of a great many American firms and individuals in the perpetuation of OPEC. They have to cough back half what is extorted but they keep the other half. And are we not going to hear from the administration that it is outraged by OPEC? OPEC has just wiped out every bit of economic growth we will have next year. It has added 2 or 2–½ points to our inflation. It means almost all Americans will live less well next year and will have less to spend.

And I don't mean to prejudge you, Mr. Secretary, but how can we come to accept OPEC to the degree that we write the expectation that its extortions will continue into the Internal Revenue Code?

Secretary BLUMENTHAL. Well, Senator, I don't think anyone has accepted that as being either natural or proper, the actions of OPEC. The President was one of seven world leaders who made a statement on the recent OPEC price increase on the occasion of the Tokyo Summit that indicates considerable concern in the proper diplomatic language; second, the——

Senator MOYNIHAN. A little too proper.

Secretary BLUMENTHAL. Second, the very urgent response that we will have to make to free us from dependence on OPEC and, therefore, on their ability to do what some people call a ripoff and others call an extortion, is, I think, a very legitimate one.

Until we have achieved that freeing, it is not that we have legitimatized OPEC by enacting a tax; it is rather that we make sure that we accelerate by means of that tax, Senator, our ability to no longer validate, have to validate, what they have done.

I am not aware, and I have not been a party to, any other scheme that would wipe OPEC away. If there are viable notions around, I am sure that the proper people in the administration would like to know about it.

I would think, finally, that we must be a bit careful about this business of producer countries getting together to fix the price for their product in the sense that that is a notion that has been around also for 30 years. Indeed, we are participants in some such groups. They are called commodity agreements.

Senator MOYNIHAN. Indeed, you have negotiated some.

Secretary BLUMENTHAL. I have negotiated some and so have you, if I remember correctly; and so we have just never faced a situation where we have an exhaustible resource becoming increasingly scarce, on which the world is so dependent, and where there is so much unilateral power that we have to deal with.

It is a very serious problem. I mean, I don't in any way want to downgrade your outrage at that. I think it very proper, the outrage. How we respond to it, I think, is along the lines I have indicated; and the sooner we do so, the sooner that power will no longer be effective.

Senator MOYNIHAN. I want to thank you. Mr. Secretary, and say you know of my high regard for you, and we known where your view on this is, and we hope that you prevail.

Senator BYRD. The distinguished Chairman has not had the opportunity to ask questions.

The CHAIRMAN. First let me submit some questions Senator Nelson asked. He would appreciate your responding in writing as soon as you can.[1]

Mr. Secretary, it is my impression that it is generally known that Chancellor Helmut Schmidt of Germany, when he was over here, was predicting that the world price of oil is going to double, and then double again, and quadruple. He said it is really simple: We have nothing to hold it down with; and apparently military action, from his point of view, is unthinkable; and that being the case, we just have no choice.

The way I feel about it, it is simple for America to become energy independent and have the potential to export energy the way we did when I first came here. We could export a lot back at that time. We have enough fossil fuel alone to last us for at least 400 years, if you count shale as well as oil, and the things we know we can use to make energy with and that can be used effectively.

President Nixon, at the time of the boycott, asked the industry to tell him how long it would take to give us energy independence, how soon they could do it. They said, 7 years. He said, OK, let us try to be energy independent in 7 years.

Now, as I recall at that time the majority of the Democrats in the Congress—I was not one who felt that way—but the majority of the Democrats in the Congress, especially the liberals, said, Oh, no, the American people would not be willing to make any sacrifices or pay any such price for energy independence, and they came up with an idea of importing energy on and on into the future. But I was wondering if they would feel that way if they were thinking in terms not only of what we are paying now, but also in terms of the price doubling and then doubling again, and the whole free would being unable to defend itself because the United States insists on hogging up the energy of the world.

What percentage of the world's energy are we using right here in the United States? Can you tell me that?

Secretary BLUMENTHAL. Of the available energy or graded?

The CHAIRMAN. Of the total energy that is being consumed in the world.

Secretary BLUMENTHAL. I think it is around the neighborhood of 30 percent. It is way out of proportion.

The CHAIRMAN. Thirty to 40 percent of the world's energy is being consumed right here.

Now, we have the potential to produce that much energy and more. Has this administration ever considered trying to make America energy independent, as President Nixon was suggesting?

Secretary BLUMENTHAL. It is my impression that the programs that are now being considered for substitute sources of energy will have to set very important targets, such as Tokyo set some very beginning targets, but targets going way beyond that, that would lead us along that road.

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[1] See part 2 of these hearings.

Now, to go all the way to independence, I think, will take quite some time, and I don't know whether the industry was entirely justified in suggesting that that could be done in 7 years.

Obviously, we didn't get very far in that. Instead, we are more dependent than we were then.

The CHAIRMAN. Well, the Congress did the opposite; they proceeded to raise the tax on the producers, to roll back the price, and tie the industry up in so much redtape it couldn't move. But I have talked to some of the spokesmen in other industries today, some who are highly regarded, and the limited number I have talked to said, yes, if the President and the Congress wanted to give it the kind of priority President Nixon was talking about, it could have been done. We could have been completely independent in producing all our requirements of energy next year, in 1980, and we would almost be there now.

As you know, we are importing more oil now than we were then.

Secretary BLUMENTHAL. Right.

The CHAIRMAN. It would seem to me that we ought to at least consider it, because it is not just important to the United States, but it is also important to the whole world.

We can't do anything to help all these people around the world who are getting the worst of it, a lot worse than we are, and are powerless to defend themselves.

Nowadays, with atomic warfare, we wouldn't want to risk atomic extermination over energy, but we have the capability of improving situation by producing more energy and exporting great amounts of it.

Don't we really have the potential to break that cartel right here in America?

Secretary BLUMENTHAL. I think, put in those terms, we do, Senator. If we get on with the job of developing our own energy resources, which are greater than the energy resources of OPEC—if we add up all the gas and the coal and shale, we have more resources than they have by a considerable margin, based on the numbers I have heard—if we get on with that job and if we do it as quickly as possible, then clearly their power over us will be eliminated; and that is what we need to do, and we really need to do it, however, not just by setting goals but by also passing the laws that enable us to achieve those goals.

That means we will have to look at all the impediments that have served in the past to be the roadblocks towards producing and lead to greater dependence than 7 years ago, as you correctly pointed out.

The CHAIRMAN. Senator Gravel?

Senator GRAVEL. Thank you, Mr. Chairman.

We had very important matter affecting Alaska in another committee, which I lost, unfortunately. I apologize for being late.

I might say, I hope I can do better here.

What is the range of reasonable profits in the United States of America and a free enterprise system?

Secretary BLUMENTHAL. Well, reasonable profits, I guess, are like reasonable salaries: 20 percent more than you are currently making.

Senator GRAVEL. Then am I to understand that anywhere between 10 and 20 percent is a reasonable profit margin for American industry?

Secretary BLUMENTHAL. On what?

Senator GRAVEL. On return on equity.

Secretary BLUMENTHAL. Oh, that depends on how you are capitalized. I think the average return on manufacturing—I am going to put on my extra hat—the average return on manufacturing net after taxes and return on equity or net worth is somewhere in the area of about 8 or 9 percent.

Senator GRAVEL. Well, Mr. Secretary, I would beg to disagree with you. I have in front of me the Forbes Annual 1,000 Corporations of America which rates them going on down the line. It is interesting to note that this year Lockheed rated first for the 12 months of activity in 1978, with 25.8 percent profits.

Secretary BLUMENTHAL. On return on equity?

Senator GRAVEL. Yes, that is what it says. It says, "Return on equity, latest 12 months." Forbes reports that Lockheed's 5-year average rate of return, at 56.5 percent, ranks No. 1 while Lockheed's rate of return for the latest 12 months was 25.8.

The next is Columbia Pictures with a 57 percent rate of return. Their 5-year average was slightly less, totaling only 50.5 percent.

Then you come down to American Home Products, 32.4 percent; that is 13th on the list.

Levi Strauss, these jeans we love to wear, reported a 29.5 percent profit. You keep on going down the list and you get not to 100 but you get down to the 246th corporation and you come to Phillips Petroleum, the first major oil company on that list. Phillips had 18.1 percent return on equity last year, but a 5-year average of only 17.8.

And then continuing, Standard Oil of Indiana is 276 and Exxon is 352d, with 12.8 percent return on equity.

As you continue on down the list it is interesting to note the low ranking of many other oil companies. I read in the Washingtonian recently about what they thought was quite an outrage; when they made the same comparison between major oil companies and another industry and that was they were outraged that the Washington Post would have a 28 percent return on equity for their performance of last year, when Gulf Oil had only 10.2, Exxon had 13.7, and the average for all oil, for the big ones, was 11.8.

So, just looking at the evidence which I have seen, and as a student of the free enterprise system, I have looked very closely at all of this, I think it fair to say if a company is doing well over time, a rate of return between 10 and 20 percent is what you expect.

If you get above 20 percent, you are really hitting it hard, but a lot of good companies really do that. Is that a fair statement?

Secretary BLUMENTHAL. Well, Senator, I think the real problem is—I take your point well and I think it worthwhile discussing what is the relative profitability of the oil industry or a particular part of the oil industry, compared to the rest of American industry.

I don't think that return on equity is a very good measure at all, because return on equity relates to how a particular company is capitalized. Return on assets, for example, total assets employed, is a much better measure. If you have a debt/equity ratio that is 20 percent, you will have a different number than if you have one that is 70 percent, for example.

Senator GRAVEL. I happen to have that figure. For Lockheed it is 10.7; for Columbia Pictures it was 34.7; for Computer Sciences it was 17.2. Let's see—for American Home Products it was 31.6.

So I have looked at that facet of it and I find that there is a reasonable correlation, give or take a point or two.

But, Mr. Secretary—and my time has run out, so I would just like to make my point because I am not here to embarrass you; I have a great deal of personal respect for you; I think you are fighting one heck of a good battle, and I hope you win at Camp David. I think you are on the right side of the issues and the others are on the wrong side of it—but let me just make my point, since I didn't have an opening comment.

Senator DOLE. Who are the others?

Senator GRAVEL. That is right. And it is very tragic, because when you talk in terms of profits, you have to assume that here is going to be excess profits or windfall.

Well, I think reasonable persons could recognize that you could have an oil company that could lose money at the end of the year and still pay your windfall profits because it is an excise tax and not an excess profits or windfall profits tax.

What you do when taxing profits is to judge the company at the end of the year's performance. You don't judge it if you only hit a gusher; you have to judge and take into consideration the cost of drilling the holes, the exploration, the lease payments and all of that. So I think the best figure to look at in the last 5 years is what happened to the oil companies in this country when the price of oil was quadrupled in 1974. The figure you come up with is that on the average the international oil companies earned 19.9 percent, and the domestics earned 18.3.

Now, that is not even close to what Lockheed is making as a Government contractor; but be that as it may, it is within what is a reasonable range.

Now, that was conceivably the best possible year on Earth that they could get. Prices went up four times and that is all they got.

Now, what is going to happen with the deregulation? Right now their average is about 13 at best this year. What little oil that is going to be deregulated is minuscle compared to the amount that quadrupled. So, in point of fact, there are going to be no excess profits next year or this year with deregulation; and that is a judgment that any reasonable person looking at American industry could make.

What has happened is that political leadership in this country, regardless of the partisanship of it, has made a decision: they can't tell the people the bad news. So you always have to find a scapegoat; you have to blame somebody; so what we are doing is setting up a cosmetic tax; that is all it is. We know we have got to get more money into energy but we are going to pull back a bit under the guise of excess profits. That is tragic, because there are no excess profits. All we are going to do is pull back a little money that should be going hog wild into energy. But it is not, in order that we can keep this cosmetic approach.

Now, I don't know what motivated the House to go ahead and put on a tax on Alaskan oil.

Let me give you the figures, Mr. Secretary. I don't think anybody knew that in the next 20 years for one company alone, Exxon, to move the oil from under the ground at Prudhoe Bay to the head of the Alaskan pipeline would cost $12 billion dollars. This $12 billion dollars is the cost just to pump it out of the ground and move it to the head of the pipeline. Construction of the Alaskan pipeline cost $8 billion and was the most expensive project in the history of mankind.

It will be a little like what happened in Cook Inlet. There the oil companies had to come to me when the DOE would not raise the price of oil. The companies were going to shut down the platforms because they couldn't even cover the cost of employment.

The point I want to make is, it is most unfortunate that this administration has chosen to be cosmetic and tell the American people there are excess profits when, in point of fact, the oil industry is performing no differently than any other part of American industry. It is a tragedy that we demean a major sector of American industry and perpetuate a lie that exists and misperception that exists in the minds of the American people that there are ripoff profits when there are not.

And that, Mr. Secretary, is a great disservice to this country which cries out for solutions, which cries out for energy. As was stated earlier by my colleagues, the only way to break OPEC is to produce more of what we have. Let me just say that there are knowledgeable geologists in this country who indicate that we have not scratched the surface of our petroleum potential, that we have 98 percent yet to discover.

And I would add one other figure of my distress over the administration. This President, who is advocating rationing and a windfall profits tax, with a stroke of a pen took out 40 million acres of sedimentary basin from possible search for oil and gas when he laid the Antiquities Act on Alaska.

So you can understand, Prudhoe Bay has one-third of all the oil and gas reserves in the United States and it lies on a piece of ground that is only 190,000 acres.

Thank you, Mr. Secretary.

Secretary BLUMENTHAL. Senator, can I agree with one thing, so you win something today? Let me agree with the basic point that you make, that the rates of return on total assets employed in the oil and gas extraction industry, or in integrated petroleum and refining, are not greater than they are on the average in other manufacturing; they are about the same.

There are no excess profits historically in that industry except in the year 1974, when there was that first sudden upsurge of prices.

Senator GRAVEL. Did you consider those excess profits?

Secretary BLUMENTHAL. Only in that year.

Now, the windfall profits tax, however, is designed to deal with a future situation that I think would make those figures look somewhat different.

Senator BYRD. For the second round, Senator Roth.

Senator ROTH. Mr. Secretary, in the evening paper it says that: "The Carter energy task force has been working on a proposal for a 25 cents a gallon tax on refinery, and that proceeds from the tax would be put into the Social Security Fund." The latter part is not significantly different from the proposal I made earlier: but my question to you is: Is this going to be part of the package? I am concerned that we are working in a vacuum. You are asking us to approve a windfall tax which basically, as I said, I support, but what further proposals are you going to have in this area?

Secretary BLUMENTHAL. Senator, there are a group of people working on a whole range of proposals and that changes from time to time—I was about to say nightly—and I have not seen the latest version. That does not ring a bell with me. I don't believe the President has seen it.

So I can't tell you whether I would recommend it, let alone whether the President would want to do it, or whether it has been proposed. I don't know.

Senator ROTH. My recommendation is we ought to have all your proposals in the immediate future. We are going to go out August 1. It makes no sense for us to act in a vacuum. This new energy tax is a significant proposal; it would mean another $20 billion to $25 billion tax increase if that is what is proposed.

As a matter of fact, if you look at the record, it looks like all the administration is doing is proposing more taxes and more spending, which I think is directly opposite to what the economy needs right now.

Mr. Secretary, in that same line, and not being critical of you personally, but a while back in answer to another question, you said the administration had not made up its mind on a number of details. You have asked us to create an energy trust fund but for what purpose is that to be used? It seems to me that the administration should come up with some specifics, not just vague language.

Another question I would like to ask you: I have heard Secretary Brock Adams use the expression, "Reinvent the car." Now, we use roughly 40 percent of our oil for cars. There has been a lot of, I think, idle dreaming in Washington that the American love affair with the car is over. I think nothing could be further from the truth. Has the administration given any thought to earmarking some of these funds for research into reinventing the car and making it a lot more efficient? If you doubled the mileage—and there are scientists who claim this can be done—we would save up to as much as 20 percent or more of our daily use of oil and gas.

What studies are being made in this area?

Secretary BLUMENTHAL. Senator, the purposes are, and have been, determined to which the fund is to be put: first, to help those who cannot help themselves as the result of the substantial increase in energy prices; second, to support some mass transit initiatives; and, third, for a variety of schemes to develop substitute fuels, R. & D., and to savings and conservation.

Now, in that category, there might well be some projects which would have to be separately authorized and appropriated, that could be funded, which would go in the direction of R. & D. and that perhaps the industry would not do in a more efficient or—well, more fuel efficient automobile.

My own personal view, having had something to do with that industry over quite a few years, is that there are severe limitations about what the Government can do in R. & D. in that area if General Motors and Ford and others with their vast resources are not doing it. There may be, but I think it would be few and far between.

Senator ROTH. That is all I have.

Senator BYRD. Mr. Secretary, I think most people will agree that we are underproducing in this country so far as our petroleum needs are concerned. What is in the bill before the Senate Finance Committee to encourage greater supply of petroleum?

Secretary BLUMENTHAL. A greater supply of petroleum——

Senator BYRD. Yes.

Secretary BLUMENTHAL (continuing). Will be brought about by virtue of the decontrol——

Senator BYRD. Excuse me. That is not in the bill.

Secretary BLUMENTHAL. It is a part——

Senator BYRD. It is not in the bill at all.

Secretary BLUMENTHAL. The program that the President is proposing to the Congress is decontrol, coupled with this tax that is before you; and that program will bring about higher prices, greater revenues, and therefore somewhat greater production, not in the short-run but over the longer run.

The bill itself will not in itself—the tax will not bring forth more oil production; it is not intended for that purpose; it is intended for different purposes.

There is nothing in the tax itself which will bring about greater oil production.

Senator BYRD. Yes. I am not speaking critically of the bill; I may support it. I have not made a decision about the bill; but I think it is important that we understand what the bill does do and what the bill does not do.

Secretary BLUMENTHAL. The windfall profits tax, if enacted, by the Congress, will not bring forth more oil production by itself. That tax will not bring forth more oil production; it is not intended for that purpose.

Senator BYRD. I gather from what you said earlier that the administration is beginning to show greater interest in coal—is that correct?

Secretary BLUMENTHAL. The administration is keenly interested in coal, since we have an abundant supply of coal and since it is a logical source for substitute energy that could substitute for oil.

Senator BYRD. Yes, you are quite right. But Government regulations and policies are putting coal operators out of business. This is true in the State of Virginia where we have a very large amount of coal production.

I would think the time has come—as a matter of fact it is well past the time—if we are going to meet our energy needs the administration had better come to grips with the problem of coal and make it possible to produce more coal.

Senator MOYNIHAN. Would the Chair yield?

Senator BYRD. Yes.

Senator MOYNIHAN. Mr. Chairman, let me say the time is at hand to save the Constitution, Mr. Chairman. We have to break off and vote.

Senator BYRD. One other question and then I will yield to Senator Dole.

You say the details of the Energy Trust Fund have not yet been worked out. Now, I assume that the details would be available before we are called upon to vote on a tax. We whould not vote a tax without knowing what is going to be done with the tax?

Secretary BLUMENTHAL. Yes, sir.

Senator BYRD. Thank you.

Senator Dole?

Senator DOLE. The Saudis have announced they are going to increase their production by about 1 million barrels a day. How much of that increase will we receive? Do you have any idea?

Secretary BLUMENTHAL. That is very hard to say. It adds to the total world supply. There has been a shortage prior to some of these measures that the countries agreed to take in the IEE and elsewhere of close to 2 million barrels a day.

So it closes the gap of some of the world shortfall.

Now, I don't know exactly—it depends on what qualities they produce, what grades—how much of that exactly would come here; but it releases the pressure elsewhere, so in an indirect way we benefit.

Senator DOLE. Will that dampen the prices, and if so, when can we expect to receive the oil? Are we looking at 2 or 3 months from now?

Secretary BLUMENTHAL. Yes, the impact on the world supply and, therefore, on prices, is some months in the future. It takes certainly, I would say, 90 days or so.

Senator DOLE. Senator Bentsen asked earlier whether the price of crude oil has kept pace with the increased cost of production. Do you have any analysis that in fact the prices of crude, in most cases, exceeded the cost of development, production and exploration for new oil?

Secretary BLUMENTHAL. Well, I just made a very rough calculation: If I recall correctly, prior to the first energy crisis, that is, 1973, I believe, the price of a barrel of oil was a couple of dollars or something like that. Somebody may have to refresh my memory. We are now at $20. You know, that is 10 times, even allowing for inflation. I doubt whether in 6 years the cost of production has gone up by 10 times—has gone up tenfold.

Senator WALLOP. Would you yield? One of the things you miss on that point is that those days the average depth of an oil well in this country was around 3,000 feet, and now it is approaching 9,000 feet, which is a considerable difference. There are no economies of scale in there; it gets worse.

Secretary BLUMENTHAL. Yes, I think it gets progressively more expensive as we have wells that are getting older and older. I think that is clear.

Senator WALLOP. Well, and deeper and deeper. The farther you go the worse it gets. That is the significant thing.

Senator DOLE. If there is any analysis of that, I would like it. According to a U.S. Department of Energy and Chase Manhattan Bank analysis the drilling expenditures of producing wells in dry holes has gone up rather radically since 1973 as compared to the increase in the dollars per barrel of oil.

Secretary BLUMENTHAL. Well, we will look to that.[1]

Senator DOLE. If that information is available, I think it would be helpful.

I don't have any additional questions. I think there may well be some as we learn just what the administration's package is, but I think everybody wants the President to be successful in any effort.

Senator Long, I understand, is on the way back. Do you want to ask questions now?

Senator WALLOP. Yes, Mr. Chairman, I would like to just ask two.

Senator DOLE. Now that we have the votes, do you want to move for a vote? [Laughter.]

Senator WALLOP. Mr. Secretary, could I ask you to comment on one thing? It seems to me that if the country has made up its mind that it is at the dead end of its petroleum energy road, then you could tax—with your windfall profits or wherever you wanted—the energy that is yet to be produced up to 100 years if you want, and just take it over and produce what is left. If, on the othe hand, you feel, as many people responsible in the industry do, that there is a considerable

[1] See part 2 of these hearings.

amount of hydrocarbon fuel, not coal, yet to be discovered, both oil and gas, then it seems to me only logical that you would be basing the tax not on the cost of production, but on the cost of replacement, and that you cannot do with an excise tax. Can you comment on that?

Secretary BLUMENTHAL. I think that the general judgment underlying this kind of a proposal, Senator, is that there clearly is more oil to be discovered and to be produced.

Both from older wells and from wells and sources yet to be discovered in this country. But that under the best of circumstances our future energy needs will have to importantly be met by, importantly, to a much greater extent be met by other kinds of energy. And that, therefore, we have to do some of both.

Senator WALLOP. I don't quarrel with that. But the plain fact is even in my State they have discovered in the last 3 years an area that is now deemed by many, many responsible petroleum engineers and geologists to be in excess of Prudhoe Bay and it is only 10 percent explored. It has 90 percent yet to go. Nobody even knew that was there. Nobody even had the vaguest idea that was there 3 or 4 years ago.

It seems to me that one of the things that we are ignoring is the fact that about 60 percent of the country has yet to be explored that could possibly hold reserves. And they are expensive. Some of the wells going down in there go to 15,000, 16,000, 18,000 and I mentioned the 25,000-foot dry hole.

That is what I meant by windfall losses, because they are operating on the presumption that everybody in the oil and gas business every time they punch a hole makes a winner. And they don't. And there is nothing to write that off in the proposal.

Now let me ask quickly. You say that the oil companies cannot effectively absorb the money from decontrol. However, since the beginning of this administration the composite price has been kept below the prices it could have risen and has been denied oil producers to the tune of about $5 billion. Now has it been the position of the administration all along that oil companies cannot reinvest and properly use oil income?

Secretary BLUMENTHAL. Well, the judgment has been that the resources available to the oil companies were adequate. They have been increased and are going to be increased substantially by virtue of the greater prices that are now available. And it is the position of the administration that that will be a sufficient amount.

Senator WALLOP. Mr. Secretary, I have to leave. We will recess the hearing until we return.

[A brief recess was taken.]

Senator DANFORTH. Mr. Secretary, returning to the use to which the trust fund could be put, some have asked why does the Government have to get involved in this kind of thing, why not just leave the normal market processes to make decisions as to the allocation of resources with respect to improving our energy supply? I am told that some of the more promising down the road answers to our energy problem would require a very substantial investment just to produce the trial technologies to use, that the payouts are somewhat problematical; and if the payouts do occur, they would occur far into the future.

The prudent business person would not ordinarily make a decision to invest assets of his company in such a problematical venture with such a long-term payout. Therefore, the notion is not to have a bunch of crazed scientists in Washington spending money on a willy-nilly basis but the notion is to find those projects which are most promising, which would require a tremendous investment even in a pilot project to create new technology and to provide subsidies to the private sector to develop those technologies.

For example, there is a company in St. Louis called McDonnell-Douglas. It is a very well known and reputable company. I am told that it has a Government contract to work on fusion research. And it is the kind of thing that the company probably would not have gotten involved in but for the fact that somebody is helping them to get involved in it.

Is that the purpose, as you understand it, or one of the purposes for the trust fund?

Secretary BLUMENTHAL. That, as I understand it, might well be one of the purposes of it. It is not the only purpose. The moneys would be used for any one of a variety of purposes, including the one for helping to fund in one of a variety of ways. And there are many ways in which that could be funded either with some sharing in the risks or with guarantees of loan capital or actually putting some equity capital in, or with a guaranteed price contract so that a producer knows he gets x at the end of the road; any one of these purposes in order to take the excess risk, if you will, to use the windfall profits tax to take the excess risk out of some of those experimental projects.

Senator DANFORTH. Right, and I am told that the technology which is needed is very expensive to produce, and that a prudent businessman without some sort of subsidy, some sort of incentive, or some sort of contractual relationship, would not be likely to enter into that project.

Secretary BLUMENTHAL. And some ventures might fail. In order to get to the right ones and the most cost effective ones you are going to have to take risks and try some that don't work out. So maybe there are some that no one wants and that is where the Government really ought to underwrite them.

Senator DANFORTH. Now then with respect to the so-called plowback, some have suggested in connection with a windfall profits tax that there be a plowback.

The approach here is that if the proceeds of oil decontrol are put back in the ground, then there should be some sort of credit against the tax that would be otherwise payable.

Detractors of the plowback say two things about it. First of all, the whold concept of a plowback means that we are going to put our eggs in the oil companies basket, that is, we are going to allow the additional revenues that are going to be realized by decontrol to be spent by the oil companies probably for the things that oil companies do best. Namely, producing oil. Therefore, to the extent that the money is plowed back to the oil companies, it would not be available for the kinds of subsidies, guarantees, other kinds of programs, contractual arrangements the Government could enter into for the development of new technologies.

Second, it is said that the plowback is something of a loophole; that it cannot in fact be administered; that it is very difficult to determine what is new exploration and what is already planned exploration and how you divide up the dollars between each. Would you comment on the plowback and on those two criticisms of it?

Secretary BLUMENTHAL. You stated them very well. I agree with them fully. We do not support any plowback. Plowback really means a dollar for dollar reduction of the taxable obligation of an existing company, of an existing producer. If the Congress wishes to reduce the tax, then let the Congress make that determination, but not by this means. This in fact does discriminate against new entrants. It is an anticompetitive device to that extent since it accrues only to those already in the business.

In large measure it would go to the owners of the properties, that is those receiving royalties; those receiving royalties are not the ones who produce and make the production decisions. That is the second point.

The third point is really the one you referred to, which relates to the whole question of how you determine what is an incremental investment; what base you use, how you measure it, and how you administer it. And we have the most severe difficulties, and indeed we don't think it could be administered.

Senator DANFORTH. Other than what might be called technical problems, the whole concept of a plowback, as I understand it, is to say that the future of American energy is in fact in oil?

Secretary BLUMENTHAL. With the companies now in the oil business.

Senator DANFORTH. That is right. And that we should not divert money from the oil companies into say fusion, or into coal gasification, or whatever sorts of technologies could be developed with governmental subsidies?

Secretary BLUMENTHAL. Well, I suppose some people could try to answer that argument with the counterargument that you could define the purposes for which a plowback is applicable very broadly. You could say, well as long as a company puts it into some energy purpose, you know, it can have that credit. But then again you have to draw the distinction what is an energy purpose and what is not.

Why do you only give that to people who are now in the oil business and not to others? The same objections occur. You could deal with the problem of breadth of purpose but you could not deal with all the others.

Senator DANFORTH. You have certainly limited those potential contractors who would be working with the Government, haven't you?

Secretary BLUMENTHAL. That is right. It is very anticompetitive.

Senator DANFORTH. Yes. Now let me ask you one other question. One of the criticisms that has been directed at the oil companies has related to the fact that they have not always invested the resources that they have had available in exploration and in production of oil.

In short, they have done other things with it, that they have bought Montgomery Wards for example. I understand Exxon is anticipating buying a company called Reliance Electric. Exxon says this acquisition is related to energy because they have a more efficient electric motor and their acquisition of Reliance Electric will allow this motor to be marketed in an expeditious manner. This is at least debatable. It would seem to me that if there is going to be a substantial increase in the wealth of oil companies, there should at least be some requirement from the standpoint of public policy that that increased wealth be invested for something that is of national purpose, namely, the development of energy.

Now, those who advocate the plowback say, well, plowback is the way to accomplish this goal. Those who oppose the plowback say, well, the plowback is so full of loopholes it would not accomplish that. And, therefore, I have been casting around for some alternative method of trying to encourage the direction of oil company profits into the production of energy.

And one thought that I have had, and it is not something that has been handed down on tablets, is why not impose an excise tax on energy producing companies for either investments in new acquisitions or additional capital contributions to unrelated energy activities?

Secretary BLUMENTHAL. Well, I think you start off with the proposition that if you make investments in the energy business, in the oil business or other forms of energy, sufficiently attractive and if you provide certainty—one of the real problems is that the oil companies have faced an environment of uncertainty, lots of Government interference, control of crude and all of those sorts of things—if you removed that uncertainty and if you provided a profitable environment, it is exceedingly unlikely oil companies would continue to move out and buy circuses or department stores or what have you.

And that is why energy policy really should be directed to providing long term certainty and to provide the kind of profits that are now going to be available with decontrol, even with the windfall profits tax. Beyond that perhaps there ought to be, and the President has indicated that he is willing to consider some restrictions on merger activities by oil companies as one way of stopping it but when you get into taxes—and I have a kind of philosophical aversion, quite frankly, to these kinds of rules and regulations which restrict the right of shareholders to do with their money what they please. In other words, if I decide this is my money and I want to retain that and I want to invest it in something else, in a way within our system I ought to have the right to do that.

Senator DANFORTH. Well, Mr. Secretary, we are permitting decontrol—and I am for decontrol—but it is not a free market situation. We are permitting oil companies to participate in an international cartel, in a very artificial situation. And would it not be reasonable as quid pro quo to put some sort of requirement on them that this additional advantage be placed in energy?

Now, if the plowback system doesn't work, there are several other possibilities. I suppose you could use some absolute prohibition, and antitrust type of prohibition. But I am not on the Judiciary Committee and I don't think in those terms. In the alternative you could use an excise tax which would say, all right, if you want to, Exxon or Gulf or whoever, sure, you can invest in an electric company, or sure you can invest in a department store, a circus or anthing else, but we are going to increase the cost of doing that by imposing say an excise tax equal say to 20 percent of the cost of the acquisition or the additional capital contribution. What is wrong with that?

Secretary BLUMENTHAL. Well, it is a thought that has not occurred to me before. I would want to think about it a little bit. I agree with you that they should be discouraged from doing so. I agree with you it is an extraordinary situation and not a free market situation.

As the President has indicated, he was thinking in terms of some sort of judicial situation. Maybe a tax is better, I would have to look at it.

Senator DANFORTH. I would appreciate it. It is something I have given some thought to, and it seems to me that from the standpoint of public perception there is only one group that I know of less popular than politicians. That is oil companies. We have to, I think, mobilize public support for solving this energy problem that we have gotten ourselves into.

So if we could provide some sort of assurance to the people of our country that it is not imposing a windfall tax just for the sake of it, but that the tax policy is related to a total national mobilization to produce more energy, it would seem to be that it would have a tremendous public appeal to the people.

Mr. Secretary, thank you very much.

[The prepared statement of Secretary Blumenthal follows:]

STATEMENT OF HON. W. MICHAEL BLUMENTHAL, SECRETARY OF THE TREASURY

Mr. Chairman and members of this distinguished committee, I appear before you today to discuss our nation's energy crisis, particularly as it relates to crude oil.

I will first review the severe energy problems we face. Then, I will turn to the President's program: his decision to decontrol crude oil prices, the imposition of a windfall profits tax on domestic crude oil production, the creation of an Energy Security Trust Fund, and revisions of the foreign tax credit.

NATURE OF OUR ENERGY PROBLEM

At the core of our energy problem is the country's dependence on crude oil imports to supply our energy demands. We supply less than 60 percent of our needs from domestic production despite gains from Alaska. As a result:

Our economy remains vulnerable to interruption of our crude oil supplies for a variety of reasons, including political instability in foreign countries;

Our economy remains vulnerable to sharp and inflated increases in the price of oil which enlarge our trade deficit, threaten the value of the dollar, and erode real incomes;

Our economic planning remains vulnerable to the unscheduled and unpredictable pricing decisions of a foreign cartel.

These problems are not unique to the United States. They are shared by all the oil importing countries of the world. The harsh reality of our situation was evident even before OPEC's decision in June to raise once again the posted price of crude oil. The cutoff of production from Iran had diminished world petroleum stocks and sent the price of crude oil soaring. As of the beginning of June 1979, world oil prices (outside of the spot market) had reached an average of over $17 per barrel, an increase of more than 38 percent from December 1978. The effects of the cutoff in Iranian production, gasoline shortages and rising prices for refined products, were already rippling through the economy.

Our domestic energy problems were strained further by the June OPEC price increase, despite the moderation shown by some countries and despite Saudi Arabia's decision to increase temporarily its level of production. OPEC's price of $18.00 for Saudi marker crude was coupled with allowances for surcharges and quality and location differentials of up to $5.50. We now calculate that this will translate into an average OPEC oil price of between $20 and $21, an increase of about 60 percent since December, 1978.

The oil price increases this year, when compared to the schedule announced by OPEC last December, increase the likelihood of a recession. The direct, first round effect of increases made since December, 1978 will be to cut 1 percent from our growth rate in 1979. By the end of 1980 the level of GNP will be 2 percent below what would otherwise have occurred. The rate of inflation will rise by 1 percent in 1979 and another 1 percent in 1980 above what it would have been. Unemployment will increase by 250,000 by the end of 1979 and another 550,000 by 1980, for a total of 800,000. Total OPEC pricing actions this year will add about 12 cents a gallon to the price of gasoline and heating oil, assuming a straight dollar and cents pass through.

THE PRESIDENT'S PROGRAM

President Carter took the lead in curbing our dependence on oil imports long before the latest round of OPEC increases, and he responded with decisive leadership at the Tokyo Summit after the most recent OPEC price increase was announced.

In March, 1979 we agreed with our allies in the International Energy Agency to reduce U.S. imports (by the fourth quarter of 1979) by up to 1 million barrels a day below levels expected prior to the 1979 OPEC price increases. At the Tokyo Summit the President pressed for and won a more extensive commitment. In addition to limits on oil imports in 1979 and 1980, specific goals for each country were set for 1985. The U.S. goal for 1985 is the same as the gaol for 1979 and 1980—8.5 million barrels a day.

This is an ambitious goal, and it will require much sacrifice. We must move forward along the lines the President is already implementing and along the lines the Administration will propose soon. Close coordination between the Administration and Congress is essential if we are to achieve these goals.

The two key elements of the program already set in motion by the President are:

Phasing out price controls on domestic crude oil, and

Proposing a windfall profits tax.

THE DECONTROL PROGRAM

The first element in the President's program is the phasing out of the perverse system of price controls and entitlement imposed on domestic oil production.

The system originated with the comprehensive wage and price controls instituted by the Nixon Administration in 1971 and has operated in its present form since 1973. The system has grown steadily more complicated. At present, no single expert can pretend to understand how all the regulations work or whom they benefit. If ever a federal program deserved to be called a "bureaucratic nightmare", the regulation of U.S. oil prices has earned that distinction.

What is clear about the system is that it has intensified our energy problems. It does so by disguising from the American people—consumers, investors, and industry alike—what we are all really paying for oil. Because of the system, we use and import more oil than we should; we produce less domestic oil than we should; and we neglect to make economically sensible and necessary investments in alternative energy sources and technologies.

The oil pricing system has two components. First, it sets various celing prices for the domestic production of oil. Lower-tier oil—production from fields in operation in 1973—is generally capped at about $6 per barrel. Upper-tier oil—production from fields placed in operation since 1973—is capped at approximately $13 per barrel. Second, the system requires refiners to make payments—known as "entitlements"—to each other so that each refiner pays the same average price for a barrel of oil, regardless of the source of supply.

The results of these controls and regulations are rather obvious:

The average price of oil to refiners, and thus to individual and industrial consumers of oil, is substantially less than the world price. For example, on April 1 of this year, the country was facing a price of $17.55 a barrel for imported oil on the world market. But the controls-and-entitlements system established an average refiner price of $14.52 per barrel, regardless of source. As a consequence there was an effective, federally-mandated incentive of $3.03 per barrel to import oil, rather than use domestic oil, and a like incentive to consume oil, rather than to conserve it or use some alternative form of energy, such as coal, natural gas, or solar energy.

The incentive to produce oil domestically is artificially depressed. About 40 percent of domestic oil has been subject to the lower-tier cap of about $6, and another 30 percent to the upper-tier cap of about $13. Compared to the price for imported oil of $17.55 in April, these controls constituted a straightforward signal to oil owners to invest in more profitable ventures, either here or abroad.

The President's decontrol program will end the subsidy to consumers of oil, encourage conservation and substitution of other energy sources, and provide the appropriate incentives to expand domestic oil production. The route chosen will delay as much of the inflationary impact of decontrol until 1981 or 1982 as practical while maximizing the incentive to increase production in 1979 and 1980.

The major features of the President's decontrol program are:

Producers of lower-tier oil (also called "old" oil) will be allowed to reduce the volume of output they are required to sell as old oil by 1½ percent each month in 1979 and 3 percent each month from January 1980 through September 1981, determined from new control levels established as of January 1979. This means that a property whose old oil control level is 100 barrels a day in January 1979 will be required to sell as old oil only 82 barrels a day in December 1979, and 46 barrels a day in December 1980. Production above these levels may be sold as upper-tier oil.

The price of upper-tier oil will be phased up to the world price beginning on January 1, 1980 and ending on October 1, 1981.

As of June 1, 1979, newly discovered oil was decontrolled, as was that volume of production from any oil field that results from introducing tertiary recovery programs.

Eighty percent of production from marginal wells—that is, wells producing less than specified amounts of oil in 1978—was allowed to sell at the upper-tier price beginning June 1, 1979. The balance is to be released to the upper tier on January 1, 1980.

A key aspect of this program is the decontrol of old oil. From 1976 to 1978, oil price regulations gave the lowest return to those producers who made the greatest effort to increase production after the 1973 embargo, while giving the highest return to those producers who did the least to meet the national need after 1973. The decline rate change for lower-tier oil announced by the President eliminates the disincentive to produce from old oil fields, since the profit earned from increased production in old oil properties will be the same as from investments in new oil properties. From the standpoint of production incentives, a rapid decline rate is the most efficient method of decontrolling lower-tier oil.

Another key aspect of the President's program is the decontrol of newly discovered oil and incremental production which results from the completion of tertiary recovery projects. No longer will exploration for new reserves in untapped areas be discouraged by a stifling system of price controls. Further, the incentive to invest in tertiary projects which involve risky efforts to apply expensive, experimental procedures to the recovery of additional oil from depleted reserves will be as great as the incentive to explore for newly discovered oil. This is as it should be in a competitive economy.

WINDFALL PROFITS TAX

Decontrol is an essential step toward a sensible national energy policy. However, decontrol will create some windfall profits since, in many instances, the world price exceeds that necessary to induce rapid discovery and production. To recapture some of these windfall profits, while at the same time preserving production incentives, we have proposed to tax a portion of the windfall profits generated by decontrol and by recent and future OPEC price increases. An additional portion of the windfalls will automatically be recovered through existing federal income tax laws.

1. *The Administration Proposal*

The President proposed a 50-percent tax on three bases:

The windfall profits from moving lower-tier oil to the upper-tier;

The windfall profits from moving upper-tier oil to the world price; and

The windfall profits from recent and future real increases in the world price.

A. *Lower-tier*

The tax on old oil would be equal to 50 percent of the difference between the price at which the oil is sold and the control price of the old oil. The control price is currently about $6 per barrel and is to be increased by inflation. The tax would apply beginning January 1, 1980 to that volume of lower-tier oil freed to the upper tier under decontrol which exceeds the volume of oil which would be freed under a 2 percent decline rate.

B. *Upper-tier*

The tax on upper-tier oil would be equal to 50 percent of the difference between the price the oil sells for and the inflation adjusted price of upper-tier oil. The upper-tier tax is structured differently from the lower-tier tax because upper-tier oil is to be decontrolled by ramping the control price to the world price level by October 1981, rather than by using a decline rate mechanism. The tax would begin phasing out in November 1986, and would disappear by January 1991.

C. Uncontrolled tier

The third base of the windfall profits tax applies to most uncontrolled oil to the extent not subject to the lower-tier or upper-tier tax. The 50-percent tax would be imposed on the difference between what the producer receives, and a base price of $16 per barrel as of January 1, 1980. The base would be adjusted for domestic inflation occurring after 1979. Eventually, the decontrolled tier tax would apply to all other domestic oil, as it is decontrolled.

2. The House Bill

The House approved the basic structure of the windfall profits tax, but did make a few significant changes. In view of the overall supply and revenue impacts of the House bill, we believe that the House has adopted a basically sound approach to the problem of windfall profits. We greatly appreciate the prompt and reasoned action of the House and the cooperation and encouragement provided by the House leadership.

The House bill, like the Administration bill, imposes an excise tax on the difference between the amount received for domestically-produced crude oil, and a base price. The tax is imposed on three different bases, derived approximately from the existing price control structure. The bases corresponding to existing production would gradually be phased out. Incentives are provided in order to stimulate production for oil (such as incremental tertiary) which is especially difficult to produce. The revenues derived from the tax are to be set aside in a special trust fund.

The Administration endorses the overall approach taken by the House. I will therefore, not take time here to review each of the elements of the House bill. Rather, I would like to discuss with you those differences between the House bill and the Administration bill which are of particular concern to us, and the reasons why in certain instances we would prefer that you modify the House bill. In addition, there are certain issues not specifically covered by the legislation which merit your attention.

3. Windfall Profits From Uncontrolled Tier

The Administration proposed a permanent tax on production that is now decontrolled or effectively decontrolled, and therefore is able to earn the world market price. This includes oil from stripper wells (wells that produce less than 10 barrels a day for a 12-month period), newly discovered oil and incremental production resulting from the introduction of tertiary recovery procedures in old oil fields. This base also includes oil from producing reservoirs as this oil is decontrolled and the windfall profits tax on lower and upper tier oil gradually phased out.

The House bill divides the tax on the uncontrolled tier into two parts, only one of which is made permanent. Newly discovered oil and incremental tertiary oil are taxed at a 50-percent rate on receipts between $17 and $26 per barrel, and a 60-percent rate on receipts in excess of $26. The $17–26 base is adjusted for inflation plus 2 percent. The tax on these two categories of oil terminates abruptly on December 31, 1990. The balance of oil in the uncontrolled tier is taxed in a manner similar to the Administration's proposal, except that a 60-percent rate applies. This part of the tax is permanent.

A. Permanency

The Administration believes that both parts of the uncontrolled tier should be permanent.

It has been argued that a permanent tax on the uncontrolled tier would permanently condemn producers to a lower price at home than they might realize abroad, and that the United States will produce less oil than would be produced in the absence of a permanent tax.

The world price of oil is not determined by the workings lf a free market where supply and demand equate price to the marginal cost of production. Since 1973, it has been set by a cartel well above the cost of production. Given these circumstances, there is no economic reason for allowing producers of domestic oil to receive the world price of oil on their production.

It has been argued that the imposition of a windfall profits tax on increases in world price in excess of inflation will drive producers toward foreign exploration. This is simply not true. The United States is not unique in seeking to capture a portion of higher oil prices. In every other producing country, increases in the price of oil have immediately been accompanied by increases in taxes on producers or by nationalization. Either action deprives the producer of the increased revenues. In the United Kingdom, the tax on North Sea producers in designed to make the government the principal beneficiary of higher world oil prices. This same effect has been realized in Venezuela through nationalization. Similar examples can be found in most other countries.

Finally, those who argue that we will lose a small amount of domestic production due to the uncontrolled tier tax fail to recognize the risk of imposing no tax at all. Political forces will not allow complete and permanent decontrol of oil so long as we face an unqualified threat of embargoes and sudden price increases. In the absence of a permanent tax, a future surge in oil prices could compel a return to regulation. It is preferable to risk sacrificing the very small potential supply response in order to avoid such a situation.

B. Threshold price and inflation adjustment

The Administration recommends that the entire uncontrolled tier tax base begin at $16 per barrel and be adjusted no more rapidly than the domestic inflation rate. The House bill treats newly discovered and incremental tertiary oil specially, starting the tax at $17 per barrel and adjusting for domestic inflation plus 2 percent.

The Administration's $16 figure is based on the estimated world price which would be in effect as of the first quarter of 1980 as a result of the December, 1978 OPEC price announcement. The base price was calculated to allow for uncertainties about the difference between the posted price of Saudi Arabian marker crude, and transportation costs, quality differentials and other relevant factors. By choosing $16, most domestically produced uncontrolled crude oil would pay no tax unless OPEC were to raise its prices in excess of inflation.

It has been suggested that the $16 base be increased because recent OPEC surcharges and the increase in the price of Saudi marker crude have already increased the price of oil. However, the President's windfall profits tax proposal is designed to prevent domestic producers from benefiting from just these kinds of sudden price increases. There is no rational reason for exempting from the windfall profits tax the profit domestic producers are realizing from these recent increases.

Allowing the tax base to be adjusted upwards by 2 percent more than inflation seems excessive. The price received by oil producers should increase no more rapidly than the general price level. The argument that drilling costs have risen more rapidly than inflation is simply not a sufficient justification for providing the very generous 2 percent additional adjustment.

C. Tax Rate

We agree with the reduced tax rate provided in the House bill for newly discovered and incremental tertiary oil when receipts are not more than $26 per barrel.

4. State-owned Lands

Under the House bill, income from interests in oil production owned by State or local governments, or their instrumentalities, is exempt from tax if it is dedicated to public education. The Administration's bill did not have this exemption.

The Administration opposes the House "education" exemption and recommends that it be deleted from the bill. The exemption bears no relationship to oil production or to windfall profits. It is, in effect, a form of "revenue sharing" to subsidize certain educational activities in states fortunate enough to have oil-bearing lands. If these activities are in need of a subsidy, there are surely more direct, simpler, and fairer means than providing a special exemption from the windfall profits tax. After all, under decontrol, even with a windfall tax, revenues for these educational purposes will increase substantially. Moreover, these additional revenues are not subject to income tax.

5. Alaskan Oil

The House bill taxes certain Alaskan oil production to a limited extent. The Administration bill would have exempted Alaskan oil entirely from the tax, even though Alaskan oil currently being produced is upper-tier oil under the oil price control program.

The exemption in the Administration bill was based on the large differential between the wellhead price for Alaskan oil (only $5.40 a barrel when the proposal was made) and the $13 control price which is also the threshhold level for the upper-tier windfall tax base. It was believed that since the wellhead price of Alaskan oil would not soon approach the threshhold tax level, an outright exemption was preferable to the administrative inconvenience of requiring producers to demonstrate that their oil was not taxable.

World oil prices have surged dramatically since the Administration proposed its windfall profits tax. The assumption underlying the Alaskan oil exemption is no

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longer valid. Consequently, the Administration has no objection to taxing oil from existing Alaskan production. This is entirely consistent with the overall policy behind the windfall profits tax.

We believe, however, that the threshhold tax level in the House bill is too low. Since Alaskan oil does not benefit from decontrol until the wellhead price reaches $13 per barrel, we would prefer that Alaskan oil from the Sadlerochit reservoir be taxed as upper-tier oil. Newly discovered Alaskan oil should be exempt from the windfall profits tax.

6. Windfall Profits Tax and Production Capital

Some have argued that the windfall profits tax denies capital required for further exploration. Such arguments are without economic foundation. The economic incentive is provided by the price of newly discovered oil, not by the cash flow from existing production. The cash flow argument is premised on the untenable proposition that those now engaged in the exploration for oil and gas deserve a cheap source of capital while new entrants should pay the market price for capital. This is inconsistent with commonsense rules of fair play in a competitive economy, because it would further impede entry by non-oil firms into oil production and thus reduce competition.

A variation on the "cash flow" argument is plowback. Plowback is an offset against the windfall profits tax for certain oil-related investments. Plowback should be recognized for what it is: a subterfuge for windfall profits tax relief for oil producers. This tax is being sought in part because some of the increased profits from decontrol are windfalls that do not lead to appreciably increased domestic oil production. Likewise, plowback—which is merely an arbitrary forgiveness of the tax—will not necessarily add to domestic oil production.

Proponents of plowback argue that it provides assurance that this additional income would be reinvested only in domestic oil production. However, as a targeted subsidy, a plowback is deficient. Since plowback would be limited only to present owners of oil, it would provide no incentive to new entrants into production. This would discourage competition in the industry and encourage concentration. Moreover, plowback subsidies would be distributed only to the owners of interests in the oil, such as royalty holders. Not all owners look for, find, and produce oil, and it is discovery leading to production by anyone, not merely those who presently own oil, which should be encouraged. In addition, plowback would require complex and arbitrary definitions of threshhold, or base period, investment levels and of qualifying investments, leading to interminable administrative disputes and litigation.

ENERGY SECURITY TRUST FUND

The President has proposed to convert windfall profits derived from OPEC pricing into the direct advancement of energy technology, the development of energy efficient mass transit, and for assistance to those least able to afford energy price increases attributable to decontrol. This will be done through the Energy Security Trust Fund.

Under the President's proposal, the Fund would consist of the proceeds of the windfall profits tax, and increased federal income taxes attributable to decontrol during the deregulation period. The Fund is an addition to, and not a replacement of, existing Department of Energy funding. The cost of all Fund programs will be limited to Fund resources. The new programs will be undertaken only if the windfall profits tax is enacted. The cost of any new energy tax expenditures will be charged against Fund receipts in order to control these subsidies more effectively. All spending programs financed from the Fund will be subject to annual authorization and appropriation. Given available funds, additional initiatives may be undertaken to reduce U.S. oil import dependence.

Although the House adopted the general concept of a trust fund, it made several important changes to the President's proposal. The program specifications were left out; general revenue financing was dropped; and the charge against the Fund for new tax expenditures deleted.

We believe that the Trust Fund should be augmented by the increase in federal income taxes from decontrol collected through fiscal year 1982. It is important that this revenue be available to finance Trust Fund programs. In addition, for reasons of sound fiscal as well as energy policy, it is essential that any new energy tax expenditures be charged against the Fund. This would provide at least some measure of accountability for subsidies that are functionally equivalent to direct spending programs.

FOREIGN TAX CREDIT

The President is also proposing certain changes in the way the foreign tax credit applies to oil and gas income.

The foreign tax credit is fundamental to the United States system of income taxation. It is intended to prevent the double taxation of income earned abroad. To ensure that the credit operates as intended, the Treasury Department has recently proposed new regulations to clarify existing law on the standards to be applied in determining when a payment to a foreign government qualifies for the credit.

Our legislative proposal is designed to improve the credit in one important area. In essence, the proposal seeks to ensure that income taxes paid to a foreign country on income from oil extraction in that country may be credited against the U.S. tax on that same income, and only on that same income.

There are already special rules in the law, introduced in 1975 and modified in 1976, which limit the credit available for foreign taxes paid on income from oil extraction. The amount of foreign taxes paid on such income which may be claimed as a foreign tax credit is limited to the U.S. corporate tax rate times foreign oil extraction income. That credit may only be used against the U.S. tax on income from foreign oil extraction or from other foreign oil-related activities. Thus, the President's proposal builds upon concepts inherent in existing law.

There are, however, some defects in present law which prevent it from operating as intended: to limit the credit for extraction taxes to the U.S. liability on the very same income that was burdened by those taxes. As a result of those defects, high taxes paid on foreign oil production and losses generated by foreign drilling expenses in a particular country may still reduce U.S. tax on other income. Although these defects are highly technical, they are also highly important.

Our proposal would cure these defects by making three changes. First, the foreign tax credit with respect to oil extraction income would be strictly limited to the U.S. tax on extraction income. We would accomplish this by requiring that the credit for taxes on foreign oil extraction income be computed separately from the credit on all other foreign income. Thus, extraction taxes or losses will no longer be able to shelter other income, such as foreign shipping or refining income, from U.S. tax. Second, the credit for foreign oil extraction taxes would be limited to the lesser of the amounts computed on a country-by-country or overall basis. Where there are substantial losses, the overall limitation will be retained to prevent the losses from reducing U.S. tax on U.S. source income. But where there are not such losses, the country-by-country limitation will prevent the averaging of high taxes and low taxes to the detriment of the U.S. Treasury. Third, the proposal provides for the recapture of the U.S. tax benefit attributable to extraction losses incurred in any given foreign country. Recapture will apply in a situation where a loss reduces U.S. tax, and a later gain in the same country generates taxes. Without recapture, the allowance of both the loss and the foreign tax credit would represent a double benefit.

The proposal is estimated to increase U.S. tax liability by about half a billion dollars at current (1979) income levels. Considered in the context of the Administration's overall energy package, the proposal should not curtail the incentive to look for new sources of oil.

ECONOMIC IMPACTS

Our initial estimate, based on an assumption of no real increases in OPEC prices, was that the additional inflation resulting from phased decontrol compared to retaining controls indefinitely would have been 0.1 percent in 1979 and 0.2 percent on average over the next three years. By 1982, the level of the consumer price index would have been approximately 0.75 percent higher. We also estimated a case in which world oil prices rose 3 percent a year faster than world inflation. Under this case, the level of the consumer price index in 1982 would have been 0.9 percent higher than otherwise.

Of course, OPEC has raised its prices at a far higher rate than we forecast. However, the basic conclusion we reached earlier—that the inflation rate is not substantially affected by phased decontrol—is unchanged. This is because price controls govern only about a third of the oil consumed by the United States. The remaining two-thirds (imports, stripper production, and Alaskan oil) are already free to receive the world price.

Let me illustrate. By the fourth quarter of 1980, we estimate that the inflation rate will be approximately 0.3 percent higher under a revised decontrol path which takes into account the most recent OPEC increases. This represents an increase of 0.1 percent in our earlier forecasts. To put this into perspective, we estimate that, by the fourth quarter of 1980, OPEC price increases above the December, 1978 schedule will be adding a full 2 percent to the inflation rate, even if OPEC imposes no additional real price increases in the interim.

These inflation estimates are based only on quantifiable decontrol effects, such as the higher prices of gasoline, heating oil, and goods manufactured from petroleum, and the induced impact on prices resulting from wage increases caused by cost of living adjustments made in response to the additional inflation. The estimates do not include any effects from reduced prices of nonenergy imports due to the strengthening of the dollar, and from the lower oil prices which would result from future world oil price moderation due to reduced U.S. demand. The excluded effects are simply not quantifiable. Since the nonquantifiable elements suggest lower inflation impacts, it is probable that our numbers overstate the effect of decontrol on inflation.

Decontrol will restrain aggregate demand and economic growth slightly over the next two years—by perhaps 0.1 percent a year. In later periods, fiscal and monetary policy can be adjusted to the needs of the economy as they develop, taking into account the specific economic impacts of decontrol and expenditures from the Energy Security Trust Fund.

The Department of Energy estimates that, relative to continued price controls, the President's program will reduce oil imports by about half a million barrels per day in 1981 and 1.3 million barrels per day by 1985, assuming OPEC prices increase only with inflation. Should OPEC raise prices at a rate in excess of inflation, the oil import savings would be greater.

CONCLUSION

In the past we have refused to address the problem of oil prices because of the windfall profits involved. We can no longer afford to avoid the issue. By artificially suppressing the price of oil, too much oil is consumed and too little produced; other efforts to solve our energy problem are frustrated; and less incentive to switch to other fuels or to conserve energy is provided.

The President has proposed a way to resolve this dilemma. He has acted to decontrol crude oil prices permanently by the end of 1981. He has also addressed in an effective manner the issue of windfall profits created by decontrol. He now needs your assistance to complete the program.

I look forward to working with this Committee in taking these next steps in resolving our energy problem.

REVENUE EFFECTS OF DECONTROL AND THE WINDFALL PROFITS TAX AS PASSED BY THE HOUSE OF REPRESENTATIVES AND AS ENDORSED BY THE ADMINISTRATION (ASSUMING A $22 UNCONTROLLED OIL PRICE, 1979-III, AND NO REAL PRICE INCREASE)

[Calendar year liabilities, 1980-84; in millions of dollars]

	1980	1981	1982	1983	1984
H.R. 3919 as passed by the House:					
Change in tax receipts before the windfall profits tax	2,983	7,665	10,339	10,925	11,542
Net windfall profits tax[1]	3,539	7,312	8,990	8,603	8,125
Total, decontrol and windfall profits tax	6,522	14,977	19,329	19,528	19,667
Revenue effect of changes proposed by the administration:					
Tax newly discovered and incremental tertiary oil on the difference between the sales price and $16 adjusted for inflation	84	170	315	546	898
Eliminate the exemption for State and local royalties allocated to public education	245	380	446	441	434
Tax Alaskan oil other than newly-discovered oil as upper-tier oil	−705	−726	−713	−699	−685
Net revenue effect of proposed changes	−376	−176	48	288	647
Decontrol and the windfall profits tax as endorsed by the administration:					
Change in tax receipts before the windfall profits tax	2,990	7,659	10,311	10,864	11,437
Net windfall profits tax[1]	3,156	7,142	9,066	8,952	8,877
Total, decontrol and windfall profits tax	6,146	14,801	19,377	19,816	20,314

[1] Windfall profits tax net of the income tax offset due to the deductibility of the windfall profits tax.

Note: The revenue effect details of the proposed changes are dependent upon the order in which they are listed; that is, on the assumption that preceding modifications are effective.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

ENERGY SECURITY TRUST FUND RECEIPTS UNDER THE WINDFALL PROFITS TAX ENDORSED BY THE ADMINISTRATION ASSUMING A $22 UNCONTROLLED OIL PRICE, 1979-III, AND NO REAL PRICE INCREASE

[Fiscal years 1980-84; in millions of dollars]

	1980	1981	1982	1983	1984
Energy security trust fund receipts:					
Income tax receipts before the windfall profits tax	1,385	5,056	8,833		
Windfall profits tax:					
Gross windfall profits tax	2,907	9,311	14,694	14,747	14,517
Income tax offset	-863	-3,067	-5,039		
Windfall profits tax allocated to the trust fund	2,045	6,244	9,655	14,747	14,517
Total, trust fund receipts	3,430	11,300	18,488	14,747	14,517

Note: Details may not add to totals due to rounding.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

Senator DANFORTH. I appear to be the only one here. And I have been told that the committee will be in recess until 10 o'clock tomorrow morning and at that time Secretary Schlesinger will appear before us.

[Whereupon, at 5:30 p.m., the committee meeting adjourned, to reconvene at 10 a.m. Wednesday, July 11, 1979.]

APPENDIX

DESCRIPTION OF H.R. 3919: THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1979 AS PASSED BY THE HOUSE

CONTENTS

INTRODUCTION

This pamphlet provides a description of H.R. 3919 (the "Crude Oil Windfall Profit Tax Act of 1979"), as passed by the House of Representatives on June 28, 1979.

The first part summarizes the provisions in the House bill. The second part explains the bill in detail. The third part shows the revenue effects of the bill.

I. SUMMARY OF THE HOUSE BILL

Overview

H.R. 3919, the "Crude Oil Windfall Profit Tax Act of 1979," (as passed by the House on June 28, 1979) imposes a 60-percent windfall profit tax on increases in domestic crude oil prices resulting from the deregulation of crude oil prices or from excessive increases in world oil prices. This tax would reduce the profits of oil producers and royalty owners; it would not be passed on as higher prices to consumers. Revenues from the tax would be placed in an energy trust fund to finance programs for dealing with the energy problem. Amounts in the trust fund would be available for purposes to be specified by law at a later date, subject to the usual authorization and appropriations process.

The tax would raise $3.7 billion in calendar year 1980, $7.7 billion in 1981 and $9.7 billion in 1982. In fiscal year 1980, the revenue raised would be $2.6 billion.

Windfall Profit Tax

The windfall profit tax is an excise, or severance, tax applying to all crude oil produced in the United States according to its classification in one of three tiers. Essentially, the tax structure is the same for the three tiers except that each tier has a different base price above which price increases are subject to tax.

Tier one tax

For oil in tier one, the tax is 60 percent of the difference between the actual selling price of the oil and the May 1979 lower tier, or old oil, ceiling price (which averaged just under $6 per barrel), adjusted for inflation.

The tier one tax applies to oil which would have been controlled as lower tier oil if the pre-June 1979 price controls had been continued but which receives a higher price as a result of decontrol. This tier does not include oil from "marginal" properties, which were given special treatment under the President's decontrol program.

The quantity of oil subject to the tier one tax on a property is the amount of production from the property below an amount represented by a statutory decline curve. This decline curve initially equals the average daily production of lower tier oil from the property in the period October 1978–March 1979. This base is reduced by 1½ percent per month beginning January 1979. This decline rate causes the tier one tax to phase out after June 1984. By July 1984, all of this oil will be taxed in tier two; that is, on price increases above the inflation-adjusted upper tier ceiling price, rather than the lower-tier ceiling price, which is the base for the tier one tax.

Tier two tax

The tier two tax is 60 percent of the difference between the actual selling price and the May 1979 upper tier, or new oil, ceiling price (which averaged just over $13 a barrel), adjusted for inflation. The tier two tax is to be phased out between November 1986 and the end of 1990 by increasing the tier two base price up to the tier three base price. After 1990, this oil will continue to be taxed in tier three.

The tier two tax applies to oil produced on a property in excess of the amount indicated by the tier one decline curve. Thus, the tier two tax base will include most oil which had been controlled as upper tier oil prior to the decontrol program (generally, oil discovered between 1972 and 1979) as well as oil released to tier two through the 1½-percent monthly decline curve. Because of the decline curve, increases in production on old properties resulting from additional drilling, secondary recovery or other methods generally would be taxed under the more lenient tier two tax. This tier also includes oil released from the lower tier to the upper tier of price controls to provide "front end financing" for tertiary recovery projects, and all production from "marginal properties." A property would qualify as being marginal if, for calendar year 1978, the average completion depth of all the property's producing wells and the average daily per well production from the property meet the following limits:

Average depth (in feet)	*Average daily production (in barrels)*
2,000 but less than 4,000	20 or less
4,000 but less than 6,000	25 or less
6,000 but less than 8,000	30 or less
8,000 or more	35 or less

Tier three tax

The tier three tax applies to newly discovered oil, stripper oil, taxable Alaskan North Slope oil, oil produced on the Naval Petroleum Reserve (NPR) and incremental oil produced with qualified tertiary recovery methods. After 1990, all oil which was in tiers one and two also will be taxed in tier three.

The basic tier three rules apply to stripper oil, oil produced on the NPR and, after 1990, oil which was tiers one and two. This basic tier three tax is 60 percent of the difference between the actual selling price of the oil and $16 per barrel, adjusted for inflation and for differences in quality and location. Special rules apply to newly discovered oil. Alaskan North Slope oil, and incremental tertiary oil.

Newly discovered oil and incremental tertiary oil are taxed in tier three, but only to the extent the selling price exceeds a $17 base price (instead of $16). In addition, the first $9 of windfall profit on newly discovered or incremental tertiary oil is taxed at a 50-percent rate (instead of 60 percent), and the inflation adjustment to its base price and to the $9 of windfall profit eligible for the 50-percent rate is set 2 percentage points above the generally applicable inflation rate. The bill contains a more restrictive definition of newly discovered oil and a more liberal definition of incremental tertiary oil than the ones used for price controls. After 1990, newly discovered oil and incremental tertiary oil are exempt entirely.

Oil from the Sadlerochit reservoir in Alaska, which is the only North Slope reservoir now in production, is taxed in the third tier, but at a 50-percent rate (instead of 60 percent). The base price for

Sadlerochit oil is $7.50 per barrel (compared to an average wellhead price of $5.22 in 1978), adjusted upward for inflation and upward to the extent of any reductions in the real value of the Trans-Alaskan Pipeline System tariff. Oil from other Alaskan reservoirs located North of the Arctic Circle, including those already discovered but not yet developed, is exempt from the windfall profit tax.

Rules applicable to all three tiers

For oil subject to the 60-percent rate, the windfall profit subject to tax is reduced by the State severance taxes on the windfall profit.

To prevent the tax from burdening high-cost properties, the bill also limits the windfall profit subject to tax to 100 percent of the net income from a property.

Income from interests in oil production owned by State or local governments, or by public educational institutions, is exempt if the income is dedicated to public education.

The windfall profit tax is a deductible business expense under the income tax. In addition, gross income for purposes of determining percentage depletion is reduced by the amount of windfall profit.

The windfall profit tax also contains a number of provisions designed to aid taxpayers and the Internal Revenue Service in the administration and enforcement of the tax.

While the windfall profit tax is structured to be consistent with the proposed deregulation of crude oil prices, it is not contingent on decontrol and will apply even if some form of price controls were continued or reimposed.

Trust Fund

The revenues from the windfall profit tax are to be deposited in an Energy Trust Fund created by the bill. The purposes for which money may be spent from the trust fund will be specified in future legislation.

Effective Date and Study

The windfall profit tax is effective January 1, 1980. By January 1, 1983, the President is required to submit to Congress a study of the effects of both oil price decontrol and the windfall profit tax.

II. DESCRIPTION OF H.R. 3919 AS PASSED BY THE HOUSE

A. Windfall Profit Tax

1. Overview of Price Controls

Old pricing regulations

Under the old crude oil price control regulations, which were superseded on June 1, 1979, by the President's phased decontrol program, there were essentially six categories of crude oil: lower tier oil, upper tier oil, stripper oil, Alaskan oil, oil produced on the Naval Petroleum Reserve, and incremental tertiary oil. Lower tier oil was controlled at an average ceiling price of about $6 per barrel. Upper tier oil was controlled at an average ceiling price of about $13 per barrel. Stripper oil was, and continues to be, statutorily exempt from all price controls. North Slope Alaskan oil, while technically in the upper tier, generally has sold below its ceiling price, so that it has been effectively uncontrolled. In addition, incremental tertiary oil and oil produced on the Naval Petroleum Reserve were exempt from controls.

Under both old and new price control regulations, the status of a particular barrel of oil depends on the property from which it is produced. A property, as defined under price control regulations, is either the right, arising generally from a lease or some other legal interest, to produce oil from a particular geographical area or any separate and distinct producing reservoir which the producer elects to treat as a separate property.

To determine the quantities of upper and lower tier oil on a property under the old regulations, a producer first determined the property's base production control level (BPCL). This BPCL equaled the lower of (1) 1972 average daily production of all oil on the property or (2) 1975 average daily production of old oil. If production declined between 1972 and 1975 and dropped below the BPCL after 1975, a producer subsequently could adjust his BPCL downward by applying the 1972–1975 decline rate. Also, if production was first above the BPCL and subsequently dropped below it, any shortfalls led to a "cumulative deficiency." On any property not exempt from controls, all production up to the level of the adjusted BPCL, plus any cumulative deficiency, was defined as lower tier oil; all remaining production was upper tier oil.

Stripper oil is any production from a property whose average production was less than 10 barrels per well per day for any consecutive 12-month period since 1972. Incremental tertiary oil is any production obtained from a property using qualifying tertiary recovery techniques that is in excess of an estimate of what the property could have produced using the best available nontertiary method.

New pricing regulations

The new Department of Energy (DOE) price regulations phase out these controls by September 30, 1981, when the legal authority to control oil prices expires; but for the interim period, several new categories of oil are established. Upper and lower tier oil are redefined, and there are special provisions for newly discovered oil, marginal properties, and "front end money" for qualifying tertiary recovery projects.

Under the new regulations, the lower tier ceiling price stays approximately where it was in May 1979, adjusted only for inflation. The upper tier ceiling price, starting January 1, 1980, will be raised on a path designed to take it to the world price by September 30, 1981, although the details of this path have not yet been set by final regulations.

Newly discovered oil was deregulated on June 1, 1979. This oil is defined as all production from an onshore property from which no oil was produced in 1978 or from an offshore lease entered into after December 31, 1978.

Under the new pricing regulations for properties which are not stripper, newly discovered, or marginal, producers will recompute their BPCLs for each property and adjust them in a manner designed to phase out the lower tier by October 1, 1981. The new BPCLs will equal the average production of lower tier oil in the six months ending March 31, 1979. Producers will adjust each BPCL downward by 1½ percent per month in 1979 and 3 percent per month in 1980 and the first 9 months of 1981. Starting on June 1, 1979, lower tier oil is defined as production below this new adjusted BPCL. The new regulations eliminate pre-June 1979 cumulative deficiencies, but a property's volume of upper tier oil is to be reduced by any cumulative deficiencies built up in the future.

The new pricing regulations will release marginal properties, defined according to average well depth and average production per well in 1978, to the upper tier more quickly. On June 1, 1979, the BPCL of a marginal property became 20 percent of its average production in the last six months of 1978; and on January 1, 1980, all oil from marginal properties goes to the upper tier. Also, on properties where approved tertiary recovery projects will be undertaken, additional quantities of lower tier oil may be released to the upper tier to provide "front end money."

All price controls are scheduled to expire after September 30, 1981.

2. Tier One

a. *Treatment under price controls*

Old pricing regulations.—Under DOE price control regulations as they stood prior to the President's decontrol program, lower tier oil generally was most oil produced on a property which first began production prior to 1973. Lower tier oil was, and continues to be, subject to a ceiling price equal to the sum of (1) the highest posted field price for that oil on May 15, 1973, (2) $1.35 per barrel, and (3) certain post-1975 increases intended to provide adjustments for inflation and to provide production incentives.

The volume of lower tier oil on a property was determined by computing a property's "base production control level" (BPCL). Oil production above this level was classified as upper tier oil and production at or below this level was classified as lower tier oil. Prior to recent regulatory changes, a property's BPCL was the lesser of (1) the average daily amount of all oil produced from the property in 1972, or (2) the average daily amount of lower tier oil produced from the property in 1975.

In the case of certain properties, the BPCL could be adjusted downward to project the 1972–1975 rate of production decline on the property. Under the DOE regulations in effect before June 1, 1979, downward adjustments to the BPCL worked as follows: if production from the property during the five-month period between February and July 1976 was less than the BPCL during that period, the property quualified for a downward BPCL adjustment beginning July 1, 1976. If upper tier oil was produced between February and July 1976, the property could not qualify for a downward adjustment to its BPCL until the first six-month period following the six-month period in which the property's total production fell below the BPCL. If the property qualified for a BPCL adjustment, the producer could reduce the BPCL every six months at a rate equal to the property's historic 1972–1975 decline rate. Otherwise, its BPCL remained constant. Oil actually produced in excess of the adjusted BPCL was classified as upper tier oil, and was entitled to receive the upper tier price.[1]

Decontrol Regulations.—Pursuant to regulations published by DOE on April 12, 1979, a producer may elect to have the BPCL for any prop-

[1] Once a property had produced an amount of oil above its adjusted BPCL, if it subsequently produced an amount of oil below the level of its adjusted BPCL, the difference between the actual production and the adjusted BPCL resulted in a "cumulative deficiency." Before a property's production in excess of its adjusted BPCL could be classified as upper tier oil, any amount of oil by which the property fell below its BPCL for all prior months, *i.e.*, its cumulative deficiency, had to be eliminated or "paid back." A cumulative deficiency, however, can be eliminated through the DOE Exceptions Relief process by a showing that it was caused by force majeure.

erty be the average daily production of lower tier oil from the property for the six-month period ending March 31, 1979. For properties for which the producer elects to use this BPCL, the BPCL is reduced by 1.5 percent per month for 1979. The first such adjustment was effective as of June 1, 1979, and was calculated as if the adjustment had become effective January 1, 1979. Therefore, if an election was made for a property, its BPCL was reduced by 9 percent, effective June 1, 1979 (six months×1.5 percent).

Effective June 1, 1979, the regulations eleminated all existing cumulative deficiencies. However, cumulative deficiencies may be built up in the future and will reduce the amount of oil eligible for the upper tier price.

On January 1, 1980, the BPCL decline rate will be increased from 1.5 percent to 3 percent per month. The 3-percent decline factor applicable to 1980 and 1981 will be available to all properties, including those electing not to use the updated BPCL and the 1½-percent decline rate in 1979.

The effect of the DOE pricing decline curve is to phase down the lower tier of price controls so that relatively little lower tier oil (19 percent of the original updated BPCL) will remain just before price control authority expires after September 30, 1981.

Marginal properties.—Under the DOE regulations published on April 12, 1979, oil produced from "marginal properties" would be established as a new classification of oil generally eligible to receive upper tier prices. Pursuant to these regulations, specific properties could qualify as "marginal." depending upon the average production level at different average well depths. A property would qualify as marginal if, for calendar year 1978, the average completion depth of all the property's producing wells and the average daily per production from the property met the following limits:

Average depth (in feet)	*Average daily production (in barrels)*
2,000 but less than 4,000	20 or less
4,000 but less than 6,000	35 or less
6,000 but less than 8,000	30 or less
8,000 or more	35 or less

For pricing purposes, on June 1, 1979, the BPCL for a marginal property was reduced to 20 percent of the average daily production of lower tier oil from that property for the last six months of 1978, and the BPCL for marginal properties will be reduced to zero on January 1, 1980. Hence, after June 1, 1979, all production on a marginal property in excess of 20 percent of 1978 old oil production from the property can be sold at upper tier prices. On January 1, 1980, all oil from marginal properties will be eligible for the upper tier price.

b. *Oil in tier one of tax*

Virtually all oil taxed in tier one is oil which would have been lower tier oil for pricing purposes had the old pricing regulations been continued. However, some of the oil which would have been lower tier oil under the pre-June pricing regulations is taxed in a higher tier.

All production from certain kinds of properties is specifically exempt from tier one of the tax. These are stripper properties, proper-

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ties producing newly discovered oil, marginal properties and properties located north of the Arctic Circle. Also, on certain properties which may have some oil taxed in tier one, some production on these properties may be automatically taxed in a higher tier. For example, oil released from the lower tier to the upper tier for pricing purposes to provide "front end financing" for tertiary recovery projects is taxed in tier two, and a certain volume of oil produced on properties on which the producer used qualifying tertiary recovery techniques is taxed in tier three.

Apart from these exceptions, the amount of oil on a property taxed in tier one will be all production up to an amount represented by a linear decline curve plus any cumulative deficiencies built up for tax purposes. The tier one decline curve will be the same as the decline curve used for phasing out the lower tier of price controls under the DOE regulations issued April 12, 1979, except that the monthly decline rate will be 1½ percent throughout the life of the tier one tax (i.e., until the 1½ percent curve reaches zero after June 1984), instead of accelerating to 3 percent after 1979. For tax purposes, producers will use the 1½-percent monthly decline rate even if they elect not to use the 1½-percent decline rate in 1979 for pricing purposes. (Under the new pricing regulations, if the producer elects the updated BPCL, he cannot use the 1½ percent decline rate in 1979.)

If total production on the property is less than the amount represented by the 1½-percent monthly decline curve plus any cumulative deficiency built up for tax purposes, all production on the property will be taxed in tier one. If production exceeds the sum of the decline curve and the cumulative deficiency, then an amount of production equal to the amount represented by the 1½-percent decline curve and the cumulative deficiency would be taxed in tier one, and remaining production would be taxed in tier two.

The cumulative deficiency used for tax purposes is the same as that used for pricing purposes except that it involves shortfalls in production below the 1½-percent tax decline curve, not the 3-percent pricing decline curve.

In the case of oil still controlled in the lower tier, it is expected that DOE will adjust lower tier ceiling prices so that they will always be equal to or less than the tier one adjusted base price, in which case there would be be no tier one tax on oil still controlled in the lower tier. (Decontrol of lower tier oil is being accomplished through the use of a special decline curve rather than through increases in the lower tier ceiling price, as discussed above.) However, should the DOE fail to do this, and should the lower tier ceiling price exceed the tier one adjusted base price on a particular property, some oil controlled in the lower tier for pricing purposes could be subject to the windfall profit tax on the (presumably small) gap between the lower tier ceiling price and the tier one adjusted base price.

c. *Base price and adjustments*

Oil subject to the tier one tax will have an initial base price, determined separately for each property, equal to the May 1979 ceiling price of lower tier oil from the property. May 1979 ceiling prices averaged about $5.86 per barrel. This base price would be adjusted quarterly for increases in the GNP deflator, but the inflation adjustment would be lagged by two quarters. Thus, the first inflation adjustment to the tier one base price would occur for the third quarter of 1979 (July–September) and would be based on the inflation which occurred between the last quarter of 1978 and the first quarter of 1979.[2]

d. *Tax rate and computation*

The windfall profit on a barrel of taxable crude oil included in the tier one base equals the difference between the actual selling price of the oil and the applicable inflation-adjusted base price. However, in computing the windfall profit on oil included in the tier one tax base, the windfall profit subject to tax may be reduced by the amount of any increase in the applicable State severance tax that results from the increased price of the oil over the adjusted base price; however, severance tax rate increases after March 1979 may not be taken into account. (For more detail on the severance tax adjustment, see section 8(d) below.) The windfall profit tax on oil in tier one is 60 percent of the difference between the selling price and the sum of the adjusted base price and the severance tax adjustment.

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[2] More precisely, if B_o=the May 1979 lower tier ceiling price on a property and P_i=the GNP deflator in the ith quarter, the adjusted base price in the ith quarter is

$$B_i = B_o\left(\frac{P_{i-2}}{P_{1978.4}}\right)$$

3. Tier Two

a. *Treatment under price controls*

Under DOE regulations, upper tier oil is the amount of oil produced from a property in excess of its adjusted BPCL, less the amount of any cumulative deficiency. This includes all production from properties which first began production after 1972. However, it does not include oil produced from a stripper well property, oil classified as newly discovered, or incremental production from a qualified tertiary enhanced recovery project.

The DOE regulations published on April 12, 1979, established oil produced from "marginal properties" as a new classification of oil generally eligible to receive upper tier prices (see description of marginal properties in section 2(a) above). In addition, the Administration has announced its intention to release an unspecified amount of lower tier oil to the upper tier price to provide front end money for the financing of tertiary recovery projects.

Generally, the ceiling price for upper tier oil from a property is the highest posted field price for uncontrolled oil on September 30, 1975, less $1.32 per barrel, plus certain post-1975 increases intended to offset inflation. (EPCA required a rollback of the upper tier ceiling price.) The estimated average May 1979 ceiling price per barrel of upper tier crude oil was $13.06.

The Administration has announced its intention to allow upper tier prices to increase, in equal monthly increments, to the world price between January 1, 1980, and October 1, 1981.

b. *Oil in tier two of tax*

The oil included in tier two of the tax generally will be (1) oil production on a property in excess of the amount represented by the 1½-percent monthly decline curve (minus any cumulative deficiency built up for tax purposes) (2) oil produced from marginal properties, and (3) oil released from the lower tier to the upper tier for pricing purposes to provide "front end financing" for tertiary recovery projects. This tier includes oil discovered after 1972, because that oil will have a BPCL of zero. All oil on stripper properties, newly discovered oil, and oil produced north of the Arctic Circle is specifically exempt from tier two. Also, on properties using tertiary recovery techniques, a certain volume of oil will be released from tiers one and two to tier three (discussed below in section 6). Tier two merges into tier three after December 31, 1990.

c. *Base price and adjustments*

The base price for oil included in tier two is the May 1979 ceiling price of upper tier oil for each property. May 1979 ceiling prices averaged about $13.06 per barrel. This base price, with respect to which any windfall profit is measured, is adjusted quarterly for increases in the GNP deflator in exactly the same manner as the tier one base price.

The tier two tax is to be phased out between November 1986 and the end of 1990 by increasing the tier two base price up to the tier three base price. The precise adjustments are to be determined under Treasury regulations.

d. *Tax rate and computation*

The windfall profit subject to the tier two tax is any amount by which the price of a barrel of oil exceeds its adjusted base price. In computing the tax base, producers may reduce the windfall profit by the amount of any State severance tax attributable to the increase in price of the barrel of oil over the adjusted base price; however, severance tax rate increases after March 1979 cannot be taken into account for this adjustment. (For more detail on the severance tax adjustment, see section 8(d) below.) The windfall profit tax on oil in tier two is 60 percent of the difference between the selling price and the sum of the adjusted base price and the severance tax adjustment.

4. Tier Three—Stripper Oil and General Rules Applicable After 1990

Tier three consists of several categories of oil which are not now subject to effective price controls. These categories include: (1) oil produced from stripper well properties, *i.e.*, those properties where the average daily production per well has been 10 barrels or less per day during any consecutive 12-month period after 1972, (2) certain production from properties where the producer used qualifying tertiary recovery methods, (3) "newly discovered oil" which is sold on or after June 1, 1979, (4) oil produced from the Sadlerochit reservoir in Alaska and (5) oil produced on the Naval Petroleum Reserve.[3] In addition to the five categories of oil initially in tier three, all tier one and tier two oil will be taxed in tier three after December 31, 1990, when tier two is merged into tier three. This section deals with stripper oil and with the general tier three rules applicable to all taxable oil produced after 1990. Newly discovered oil is discussed in section 5, incremental tertiary oil in section 6, and Sadlerochit oil in section 7.

a. *Treatment under price controls*

The Trans-Alaska Pipeline Authorization Act initially provided a statutory exemption from price controls for the first sale of crude oil produced from stripper well leases. This provision was modified several times before the Energy Conservation and Production Act provided the present exemption from price controls for stripper oil. To qualify for this exemption, a property's average daily per well production of crude oil (excluding a condensate recovered in non-associated production) must have been 10 barrels or less per day during any consecutive 12-month period beginning after December 31, 1972.

To qualify under the stripper exemption a property must be operated at the maximum feasible rate of production and in accordance with recognized conservation practices. However, once a property has qualified as being within the exemption, it retains that status regardless of any future increase in the level of its production.

b. *Oil in tier three of tax*

The tier three tax base generally includes all newly discovered oil, stripper oil, oil produced from the Sadlerochit reservoir in Alaska, and certain oil produced on properties on which the producer uses qualifying tertiary recovery techniques. Also, after 1990 tier three in-

[3] Production from the Naval Petroleum Reserve is owned by the United States, as is oil production from various other Federal enclaves. Production from the Naval Petroleum Reserve is not subject to price controls and, therefore, is subject to the tier three tax. Any windfall profit tax imposed on this oil would be deposited into the energy trust fund. These tax revenues would not change the Federal unified budget deficit because the government would, in effect, be paying a tax to itself. The revenue estimates in part III of the pamphlet ignore any tax revenue from the NPR or from Federal royalties.

cludes all oil which would otherwise have been in tier two but for the phaseout of tier two. Special rules, discussed below in sections 5, 6 and 7, apply to newly discovered oil, incremental tertiary oil and Sadlerochit oil. The basic rules of tier three, therefore, apply only to oil produced from stripper properties and, after 1990, to the oil which would have been in tier two.

Stripper oil.—Stripper oil is oil produced on properties on which the average daily production per well has been 10 barrels or less for any consecutive 12-month period after 1972. All oil which qualifies for stripper treatment under the standards of the price control regulations in effect on June 1, 1979, is included in tier three. However, there is one exception relating to cases in which a nonstripper property is divided into several properties and one or more of the new properties qualifies as a stripper property for pricing purposes. If the entire property would not have qualified for stripper treatment prior to the transfer, then none of the subdivisions are eligible for the tier three tax, and they must instead follow the general tier one and tier two rules. (See section 8(b) for a discussion of the transfer rule.)

c. *Base price and adjustments*

The base price for oil included in tier three generally is the estimated price, to be prescribed by Treasury regulations, at which uncontrolled crude oil of the same grade, quality, and location would have sold in December 1979 if the average landed price for imported crude oil were $16.00 a barrel. This base price is adjusted for inflation, with the first adjustment occurring in the first quarter of 1980 based on inflation between the second and third quarters of 1979.[4] The windfall profit is the difference between the selling price and the sum of the adjusted base price and the severance tax adjustment. Use of this variable $16.00 formula is intended to take quality and location differentials into account in measuring the windfall profit. The Secretary of the Treasury will publish a schedule of tier three base prices for various classifications of oil based on quality, grade and location differentials.

d. *Tax rate and computation*

Except as provided in the case of newly discovered oil, incremental tertiary oil, and Sadlerochit oil, which are accorded preferential windfall tax treatment, the windfall profit on a barrel of crude oil included in the tier three tax base is subject to a 60-percent tax. The amount of the windfall profit may be reduced by the amount of any State severance tax attributable to an increase in the price of the barrel of oil sold over the adjusted base price; however, increases in tax rates after March 31, 1979, are not taken into account.

[4] More precisely if B_0=the base price on a property and P_i=the GNP deflator in the ith quarter, the adjusted tier three base price is

$$B_i = B_0\left(\frac{P_{i-2}}{P_{1979\cdot 2}}\right)$$

5. Tier Three—Newly Discovered Oil

a. *Treatment under price controls*

Under regulations published on May 2, 1979, "newly discovered oil" is defined as crude oil which is sold after May 31, 1979, and which is produced from (1) an outer continental shelf area for which the lease was entered into on or after January 1, 1979, and from which there was no production in calendar year 1978, or (2) an onshore property from which no crude oil was produced in calendar year 1978. Oil produced from a property, as defined by DOE regulations, which previously had been developed but from which there was no production in calendar year 1978 is treated as newly discovered oil under this definition. The determination of whether crude oil production from a particular property may be sold as newly discovered crude oil on or after June 1, 1979, is to be made by the producer, subject to DOE's possible review.

Newly discovered oil sold after June 1, 1979, is exempt from price controls.

b. *Definition*

For windfall profit tax purposes, the term "newly discovered oil" generally has the same meaning given to that term by DOE's May 2, 1979, regulations. However, not all oil which could qualify as being newly discovered under the DOE regulations can qualify as being newly discovered for windfall profit tax purposes. Oil produced from a property, as defined by DOE regulations, which produced any oil in commercial quantities after 1969 and prior to 1979 does not qualify as being newly discovered for windfall profit tax purposes. (The pricing definition requires only that there was no production in 1978.)

In addition, the term "newly discovered oil" does not include oil produced from a reservoir on any tract or parcel of land if the reservoir was penetrated after 1969 and prior to 1979 by a well on that tract or parcel from which oil was produced in commercial quantities if oil could have been produced from the penetrated reservoir through that well prior to 1979. This rule is called the "behind-the-pipe" exclusion. It applies if oil could have been produced from the penetrated reservoir through the penetrating well prior to 1979 by taking whatever appropriate completion measures, *e.g.*, perforating the pipe, would have been necessary to obtain production from that reservoir. The behind-the-pipe exclusion applies only to production from the tract or parcel on which the original producing well which penetrated (and bypassed) the reservoir was located; it does not apply to wells located on new tracts or parcels which did not produce between 1969 and 1979. For example, the behind-the-pipe exclusion from the definition of newly discovered oil would not apply if a producer obtained production from a reservoir which has been penetrated by another producer from the latter's property.

Also, when a property which does not qualify for treatment as newly discovered oil is divided into several new properties, production from any of the new subdivisions does not qualify as newly discovered oil.

c. *Base price and adjustments*

The base price for newly discovered oil is to be determined in the same manner as that applicable to tier three oil generally except that it is to be $1 higher. Thus, the base price is to be that price at which uncontrolled crude oil of the same grade, quality, and location would have sold in December 1979 if the average landed price for imported crude oil had been $17 a barrel.

The adjusted base price for newly discovered oil is to be determined by adjusting the base price quarterly for net increases in the GNP deflator multiplied by 1.005^n where n equals the number of calendar quarters beginning after September 1979 and before the calendar quarter in which the oil is removed, or deemed removed, from the premises. (Thus, "n" will be 1 in the first quarter of 1980, 2 in the second quarter, etc.) This has essentially the same effect as adjusting the base price for newly discovered oil by the rate of inflation plus 2 percent annually, with the 2-percent compounded quarterly.[5] This special inflation adjustment also applies to the $9.00 amount which measures the windfall profit on any barrel of newly discovered oil subject to the 50-percent rate.

d. *Tax rate and computation*

The windfall profit on a barrel of newly discovered oil is the amount by which the price of the barrel of oil exceeds its adjusted base price. The first $9.00 of windfall profit, as adjusted by the special inflation adjustment, including the 2-percent add-on, is subject to a 50-percent windfall profit tax rate; increases above that adjusted amount are subject to the generally applicable 60-percent windfall profit tax rate.

The windfall profit on a barrel of newly discovered oil may be reduced by the amount of any additional severance tax imposed with respect to the barrel as a result of price increases above the base price plus $9, as adjusted for inflation and the 2-percent kicker. Severance tax rate increases after March 1979 are not taken into account. Thus, no deduction for severance taxes is allowed with respect to the windfall profit which is subject to a 50 percent tax rate, but the adjustment is allowed for that part of the windfall profit taxed at 60 percent.

Newly discovered oil is exempt if produced after December 31, 1990.

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[5] More precisely, if B_o is the base price for oil from a property and P_i is the GNP deflator in the ith quarter, the adjusted base price in the ith quarter (B_i) is given by

$$B_i = B_o \left(\frac{P_{i-1}}{P_{1979\ 3}} \right) 1.005^i$$

6. Tier Three—Incremental Tertiary Oil

a. *Treatment under price controls*

Under DOE regulations, first sales of incremental crude oil resulting from the implementation or expansion of a "qualified tertiary enhanced recovery project" are exempted from the otherwise applicable ceiling price limitations. A qualified tertiary enhanced recovery project is one certified by DOE as being uneconomic at the otherwise applicable ceiling prices, and which involves one or more of several specified chemical, fluid or gaseous recovery techniques.

Generally, incremental tertiary production is the amount of production on a property, on which a qualifying project is being undertaken, in excess of an estimate of what production would have been without the tertiary project. The estimate of what production would have been without the project must be done as a case-by-case basis.

b. *Definition*

For tax purposes, incremental tertiary oil is the amount of production from a property on which the producer uses a qualified tertiary recovery method in excess of a base level amount for the property. Unlike the case-by-case determination of the base level required under price controls, the tax uses a statutory decline curve to measure the base level production.

Specifically, the base level is the average daily amount of oil removed from the property during the six-month period ending March 31, 1979, reduced by the sum of (1) 1 percent of that average for each month beginning after 1978 and before the beginning date of the project, and (2) 2½ percent for each month thereafter. However, if DOE, in connection with its case-by-case deregulation of incremental tertiary production, determines that the incremental production resulting from the tertiary project exceeds the amount in excess of this statutory decline curve, then the larger amount deregulated by DOE qualifies for tier three. If a certification is obtained from DOE prior to the effective date of the tax, the 2½-percent decline rate may be used for all months subsequent to the commencement or expansion of the project (or, if the project began before 1979, all months subsequent to December 1978) if that decline curve is more favorable than the one determined by DOE.

If a qualified tertiary recovery project affects only a portion of a property, that portion is to be treated as a separate property. Similarly, if a preexisting tertiary recovery project is expanded significantly, the expansion is to be treated as a separate project. If a project affects more than one property, the base level is to be computed with respect to all of the affected properties under the rules generally applying to unitized properties. In determining the base level with respect to which the incremental production from a tertiary recovery project is measured, therefore, it may be necessary to allocate the base level of a single property or to combine the base levels of more than one property.

If the tertiary project is discontinued, oil production from the property is no longer eligible for tier three treatment under this provision.

The project's beginning date after which the 2½-percent decline rate starts is that point at which the tertiary method significantly affects the reservoir. Thus, the project is considered to have commenced when significant use of the relevant tertiary process or injection begins; mere preparation or planning for the tertiary process, such a drilling an injection well, or use of the tertiary method on a pilot basis, is not sufficient to establish the project's beginning date. This beginning date may be a few months before the tertiary process actually begins to increase production.

Before the tier one decline curve has phased out in July 1984, producers using qualifying tertiary methods will have to calculate two decline curves: the generally applicable 1½-percent tier one decline curve based on the production of lower tier oil in the six-month period ending March 31, 1979, and the 1-percent/2½-percent tertiary decline curve based on production of all oil on the property in that period. Producers will first calculate how total production would have been divided between tiers one and two in the absence of any special rules for tertiary projects, using the 1½-percent decline curve. Then they will use the special tertiary decline curve to measure how much oil will be released to tier three. The oil released to tier three comes pro rata from oil which would have been in tiers one and two. To determine exactly which barrels from tier one and tier two are released to tier three, the producer first releases oil from each tier in order of its removal price, starting with the barrel with the highest selling price.

Qualified tertiary projects.—For purposes of the windfall profit tax, a qualified tertiary recovery project is either (1) a project with respect to which a DOE certification is in effect for pricing purposes, or (2) a project for the tertiary recovery of oil which meets specified requirements. In either event, the preferential windfall profit tax treatment for the incremental tertiary production continues only so long as the DOE certification is effective or the project continues to meet the tax's requirements. (After price control authority expires on September 30, 1981, a DOE certified project will have to continue in operation to retain the preferential windfall profit tax treatment.) If a DOE certification is not in effect, a project may qualify if it meets the following specifications: (1) it involves the application of one or more tertiary recovery methods, (2) the methods are applied in accordance with sound engineering principles, (3) the application of the tertiary recovery methods can reasonably be expected to result in a significant increase in the amount of oil which ultimately will be recovered from the property, or the project area, above the amount which reasonably could be expected to be recovered in the absence of the project, (4) the project could not be expected to be economic without the preferential tax treatment; (5) the project's beginning date is after May 1979, and (6) the operator submits to the Secretary such information, forms, and certifications as may be required by regulations.

This procedure of allowing producers to certify their own qualified tertiary recovery projects, subject to IRS audit, was intended to reduce the red tape associated with the certification procedure used under price controls, in which advance approval from DOE is needed.

Production from a tertiary recovery project will not be accorded preferential windfall profit tax treatment if the producer uses the project merely as a method of accelerating (as opposed to increasing) the total amount of oil expected to be recovered from the property or project area. An increase in the amount of oil expected ultimately to be produced would not be considered significant if the revenue from the increased production were not sufficient to cover the costs of the project at expected world oil prices. The requirement that the tertiary project be expected to increase production from the property could be satisfied by showing that the project would reduce the decline in production significantly below what it would otherwise be; that is, an actual increase in production over earlier levels is not necessary. In addition, the House Committee Report states that the requirement that the project would be uneconomic without the preferential tax treatment is to be construed liberally in favor of qualifying tertiary projects. For example, the calculation of whether a project is economic should take into account the high rate of return which must be expected to justify an investment in a new or risky technology.

To qualify the incremental production from a teritary recovery process for inclusion in the tier three tax base, the operator must submit to the Secretary a certification from a petroleum engineer that the project meets, and continues to meet, all the necessary requirements, and continues to involve use of an approved method in a sound manner, as well as any other information which the Secretary may require by regulations. The certification submitted by the operator must include the specifications of the project, including the tertiary methods to be applied, an identification of the area to be affected, supporting geological and engineering data, and other information sufficient to establish that all requirements for a qualified tertiary enhanced recovery project are satisfied.

For windfall profit tax purposes, a tertiary recovery method is any of the following: (1) miscible fluid displacement, i.e., the pressurized injection of alcohol or gas so that the reservoir oil is diplaced by the resulting mixture, (2) steam drive injection, (3) microemulsion, i.e., an augmented water flooding technique, (4) in situ combustion, (5) polymer augmented waterflooding, (6) cyclic steam injection, (7) alkaline flooding, (8) carbonated waterflooding, and (9) immiscible carbon dioxide displacement.

In addition, the Secretary is authorized to approve other tertiary enhanced recovery methods.

c. *Base price and adjustments*

The base price for incremental tertiary oil is to be determined in the same manner as that applicable to tier three oil generally except that it is to be $1 higher. Thus, the base price is to be that price at which uncontrolled crude oil of the same grade, quality, and location would have sold in December 1979 if the average landed price for imported crude oil had been $17 a barrel.

The adjusted base price for incremental tertiary oil is to be determined by adjusting the base price quarterly for net increases in the

GNP deflator multiplied by 1.005^n where n equals the number of calendar quarter beginning after September 1979 and before the calendar quarter in which the oil is removed, or deemed removed, from the premises. (Thus, "n" will be 1 in the first quarter of 1980, 2 in the second quarter, etc.) This has essentially the same effect as adjusting the base price for incremental tertiary oil by the rate of inflation plus 2 percent annually, with the 2-percent compounded quarterly.[6] This special inflation adjustment also applies to the $9.00 amount which measures the windfall profit on any barrel of incremental tertiary oil subject to the 50-percent rate.

d. *Tax rate and computation*

The windfall profit on a barrel of incremental tertiary oil is the amount by which the price of the barrel of oil exceeds its adjusted base price. The first $9.00 of windfall profit, as adjusted by the special inflation adjustment, including the 2-percent add-on, is subject to a 50 percent windfall profit tax rate; increases above that adjusted amount are subject to the generally applicable 60-percent windfall profit tax rate.

The windfall profit on a barrel of incremental tertiary oil may be reduced by the amount of any additional severance tax imposed with respect to the barrel as a result of price increases above the base price plus $9, as adjusted for inflation plus the 2-percent kicker. Severance tax rate increases after March 1979 are not taken into account. Thus, no deduction for severance taxes is allowed with respect to the windfall profit which is subject to a 50 percent tax rate, but the adjustment is allowed for that part of the windfall taxed at 60 percent.

Incremental tertiary oil is exempt if produced after 1990.

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[6] More precisely, if B_0 is the base price for oil from a property and P_i is the GNP deflator in the ith quarter, the adjusted base price in the ith quarter (B_i) is given by

$$B_i = B^o\left(\frac{P_{i-1}}{P_{1979.3}}\right)1.005^i$$

7. Tier Three—Alaskan Oil

a. *Treatment under price controls*

Oil produced from wells located north of the Arctic Circle, like most other domestic production from a property which commenced production after 1972, is permitted to be priced at the upper tier ceiling price under existing DOE price regulations applicable to the first sale of domestic crude oil. Although technically it is controlled as upper tier oil, oil produced from wells located north of the Arctic Circle sells at a market price below its ceiling price. In 1978, when the price of uncontrolled stripper oil was $14 per barrel and Alaska's upper tier ceiling price was about $12 per barrel, Alaskan oil sold for $5.22 per barrel at the wellhead. Basically, Alaskan oil sells at a wellhead price below its ceiling price because of the large costs involved in transporting the oil to the market and because purchasers will pay no more for oil which is subject to high delivery costs than they will for oil which is not subject to such charges. Thus, for example, if a producer can purchase a locally produced barrel of oil for $18, including delivery fees, he generally would not pay the same amount, plus about $8 in transportation charges, for Alaskan oil. As a result, the amount paid at the refinery gate for Alaskan oil must be reduced by the transportation charges to arrive at the producer's wellhead price, which in this example would be $10.

b. *Definition*

The windfall profit on a barrel of oil from the North Slope reservoir from which oil production occurred in 1979, *i.e.*, the Sadlerochit reservoir, is subject to tax under special rules. Production from other reservoirs located north of the Arctic Circle is not subject to tax.

c. *Base price and adjustments*

The base price for Sadlerochit oil initially is $7.50 and is to be adjusted by the inflation factor generally applicable for adjustments to oil included in tier three (other than newly discovered and incremental tertiary oil).

The adjusted base price for Sadlerochit oil is to be adjusted further for changes in the real value of the Trans-Alaskan Pipeline System tariff from its 1978 level of $6.26 per barrel (*i.e.*, the extent to which the TAPS tariff in a particular quarter, adjusted for inflation, is less than its value in 1978). The TAPS adjustment, which may not be negative, for any calendar quarter is the excess, if any, of $6.26, adjusted for inflation, over the TAPS tariff for the preceding quarter. The TAPS tariff for the preceding quarter is the weighted average per barrel amount paid by all the producers for transportation of crude oil through the TAPS ending in that quarter (including pipeline liability charges). The inflation adjustment by which the $6.26

figure is increased is identical to that which is generally applicable to oil included in tier three except that it uses the price level in the second quarter of 1978 for its base.[7]

The windfall profit subject to tax on the sale of Sadlerochit oil by any producer is the amount by which the average removal price of a barrel of that producer's oil during the month exceeds the adjusted base price of oil from the property. The average wellhead price for each producer is used in lieu of the actual sale price of each particular barrel of oil to make sure that wellhead price differentials attributable only to the final destination of a particular barrel of Alaskan oil do not affect windfall profit tax liabilities. (Unlike other oil, North Slope oil produced from the same reservoir at the same time can have different wellhead prices depending on the final destination of the oil because each integrated producer determines the wellhead price for each individual barrel by subtracting transportation costs for that barrel from the price of the oil at the refinery gate.)

d. *Tax rate and computation*

The windfall profit on a barrel of Sadlerochit oil is the amount by which the average wellhead price exceeds its adjusted base price. No reduction in the windfall profit is allowed for State severance tax because the oil is subject to a special 50-percent tax rate. For purposes of computing the windfall profit, a producer's selling price is his average weighted selling price for Sadlerochit oil in a particular month, rather than the actual per barrel selling price. The difference between this figure and the adjusted base price is subject to a 50 percent tax.

[7] More precisely, the adjusted base price for Sadlerochit oil is determined as follows: If Pi is the GNP deflator in the ith quarter and Ti is the average TAPS tariff in the ith quarter, the adjusted base price for Sadlerochit oil is

$$B_i = 7.50\left(\frac{P_{i-1}}{P_{1979.1}}\right) - T_i + 6.26\left(\frac{P_{i-1}}{P_{1978.2}}\right)$$

8. Special Rules and Definitions Applicable to All Tiers

a. *Definition of "property"*

For windfall profit tax purposes, the word "property" has two different meanings. Generally it has the same meaning as that term is given by the price control regulations. "Property," therefore, generally means either (1) a right to produce domestic crude oil which arises from a lease or fee interest, or (2) at the election of the producer, separate and distinct producing reservoirs which are subject to the same right to produce and which are recognized as separate and distinct reservoirs by the appropriate government regulatory authority.

However, in some cases the word "property" has the meaning given to it in section 614 of the Code, which generally does not allow a producer to elect to treat separate reservoirs on a single tract or parcel of land as separate properties. In the bill, this tax definition of the term property is used in reference to percentage depletion and to the 100-percent-of-net income limit on the taxable windfall profit.

b. *Property transfers*

To prevent avoidance of the windfall profits tax by a transfer of a portion of a property, the bill provides that oil produced from a portion of a property which was transferred after 1978 is not to constitute either stripper or newly discovered oil if the oil would not have qualified as stripper or newly discovered oil had the property not been subdivided. This provision is intended to prevent abuses resulting from transfers of portions of properties designed to create new properties qualifying for special treatment. In addition, in the case of post-1978 transfers of any portion of a property, the bill requires allocation of the BPCL among the portions of the divided property.

c. *Determination of selling or removal price*

The term 'removal price' generally means the amount for which the barrel of oil is sold. The bill provides special rules for determining a constructive sale price when oil is removed from the premises prior to sale, when the sale is between related parties, or when refining is begun prior to the oil's removal.

d. *Treatment of State severance taxes*

Various States impose severance or production taxes on the extraction of oil. These taxes are imposed either on each unit of production as a fixed fee per barrel or as a percentage of the value of each barrel.

Severance taxes generally are imposed on the owners of the various interests in a property (i.e., the operator, other investors, royalty owners, etc.). However, the taxes normally are paid by the first purchaser of the oil, who withholds the tax from the amount paid to the producer and royalty owners. For Federal income tax purposes, the amount of severance taxes is included in the producer's or royalty owner's gross income from the property, and an offsetting deduction for the severance tax is permitted.

The bill permits a deduction in computing taxable windfall profits for the State severance taxes imposed on the windfall profit element of the price of a barrel of oil—the difference between the selling price and the adjusted base price. The severance tax adjustment is necessary to avoid placing an undue burden on the producer of oil when the combined effect of the 60 percent windfall profit tax rate, the severance tax, and State and Federal income taxes is taken into account. However, at a lower tax rate, such as the 50 percent rate imposed on the first $9 of windfall profit on the sale of a barrel of newly discovered oil or incremental tertiary oil and on Sadlerochit oil in Alaska, the reduction for severance taxes is not provided. To discourage States from raising severance taxes at the expense of the federal Treasury, the amount of the severance tax adjustment may not exceed the severance tax that would have been imposed on the windfall element at the rate of severance tax in effect on March 31, 1979.

e. *Regulatory authority*

The bill authorizes the Secretary of the Treasury to prescribe such regulations as may be necessary to effectuate the purpose of the tax. The windfall profit tax is based on several concepts used in previous price control regulations. To apply these concepts within the context of an excise tax structure, the Secretary may have to prescribe regulations which interpret how the price control regulations are to be applied for the windfall profit tax. The regulatory authority is essentially the same as the authority which the Secretary ordinarily has with respect to tax legislation. Although it is not anticipated that major changes in price control regulations will be needed to apply them for tax purposes, references to price control regulations in the bill are not to be interpreted as denying the Secretary the usual regulatory authority.

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9. Taxable Income Limit

The windfall profit on a barrel of oil may not exceed the net income attributable to the barrel. In applying this limitation, the net income attributable to a barrel is determined for the taxable year by dividing the taxable income from the property which is attributable to taxable crude oil by the number of barrels of that oil produced from the property during the taxable year. In computing net income for this purpose, taxable income from the property is determined under section 613(a) of the Internal Revenue Code (relating to percentage depletion) but without any deductions for depletion, intangible drilling and development costs under section 263(c) (except the costs of drilling a dry hole), and the windfall profit tax. For this provision, "property" has the meaning given to it in code section 614, not in the price control regulations.

The bill further provides that, in determining the 100-percent limit, the producer's taxable income from the property is to be reduced by the deduction for cost depletion which would have been allowable if all intangible drilling costs (other than those incurred in drilling a nonproductive well) had been capitalized and taken into account in computing cost depletion, and if the producer had used cost depletion for the property for all periods (even if he had actually used percentage depletion on his income tax return). However, if a producer actually capitalizes intangible drilling costs for income tax purposes, he may reduce his taxable income from the property by whatever amounts he deducts under section 611 of the Code in connection with those costs (either as cost depletion or depreciation) instead of assuming that all of those costs were deducted as cost depletion.

The bill provides a special rule for determining the taxable income limit in the case of certain transfers of proven oil or gas properties after 1978. If a transfer of a proven property would result in an increase in the amount by which a transferee producer's taxable income could be decreased by virtue of a larger imputed depletion deduction, the bill provides that the transferee producer may compute his imputed cost depletion deduction on only those costs incurred during periods after the transfer of the property. For purposes of this rule, a proven property is given the same meaning as that applicable to the Code's limitation on the allowance for percentage depletion in the case of oil. This rule applies to any post-1978 transfer, including leases and subleases of an interest (including an interest in a partnership or a trust) in any proven oil or gas property.

In the absence of this rule, the owner of a producing property with a low cost basis could transfer the property to another who could hold the property at an increased basis. The increased basis would increase the cost depletion deduction and, therefore, lower the taxable income limitation. The net effect could be the avoidance of a significant portion of the windfall profit tax liability. For example, if an operator owned a producing property with a cost basis of $2 per barrel, lifting costs of $2 a barrel, an adjusted base price of $8 a barrel and a selling price of $18 a barrel, that operator would pay a windfall profit tax on $10 for each barrel produced ($18 minus $8). If the owner were to sell the oil in place at a cost of $10 per barrel for each barrel of estimated reserve, the transferee would have a cost depletion deduction of $10 a barrel and other costs of $2 a barrel; his taxable income limitation would be $6 ($18 minus $12). Thus, the windfall profit subject to tax would be reduced from $10 to $6 by the transfer. The transfer rule in the bill would provide a net income limit of $16, so that the taxable windfall profit would continue to be $10.

If any portion of the taxable crude oil removed from the property is applied in discharge of a production payment, the gross income from such portion must be included in the gross income from the property in computing the taxable income of the producer.

10. Taxable Person

a. *General rule*

The bill imposes the windfall profit tax on the first sale of taxable crude oil and requires payment of the tax by the producer of the oil. Generally, the tax is to be withheld by the first purchaser of the oil and deposited with the Treasury by him. The bill defines the producer as the owner of the economic interest in the oil, generally the person who will receive the increased income resulting from decontrol and OPEC price increases. Thus, each investor and royalty owner who owns an economic interest in the oil (including government units and organizations described in code section 501(c)(3)) is liable for tax on its share of the gross revenues.

b. *Public education exemption*

The bill provides that if an economic interest in crude oil is held by a State or political subdivision thereof, or by an educational institution which is an agency or instrumentality of any of the foregoing, and under the applicable State or local law all of the net income received pursuant to such interest is dedicated to public education or to a permanent fund the income from which is dedicated to public education, then the windfall profit tax would not be imposed with respect to crude oil properly allocable to such interest. For this purpose, the term 'net income' means gross income reduced by production costs and severance taxes of general application. A severance tax of general application is one imposed at a uniform rate on all owners of rights in oil production, both public and private. The exemption would not apply to the extent another party had an economic interest in the production.

c. *Production payments*

The only case in which the bill imposes the tax on a person other than the holder of the economic interest in the oil is that of a production payment which involves payment of oil to someone until such time as the total cumulative payment has added up to a fixed number of dollars (as opposed to a fixed number of barrels). In these cases, the windfall from higher prices really is received by the owner of the residual interest in the oil, not the holder of the production payment, because the payment can be worked off with fewer barrels of oil owing to the higher price. The bill shifts the tax burden to the holder of the residual interest in this case. If the owner of the residual interest fails to capture the windfall profit immediately because of the nature of the contracted agreement with the production payment owner, the Secretary could, under Code section 6161, grant an extension of the time for payment of the tax.

11. Administrative Provisions

In administering the tax, existing business and administrative practices are relied on as much as possible to minimize the reporting and processing burdens. However, some additional recordkeeping and reporting will be necessary. The bill authorizes the Secretary to prescribe such recordkeeping, return filing, and information exchange requirements as may be necessary to carry out the purposes of the tax. The bill also contains specific provisions requiring operators and purchasers to furnish other persons the information necessary to calculate their liabilities under the tax.

a. *Deposit and return requirements*

The bill requires that only a few hundred persons file returns and make deposits of tax. The purchaser of any taxable crude (usually a refiner) must deposit the tax bimonthly under regulations to be promulgated by the Secretary, must provide producers with monthly information statements with respect to their oil production, and must file quarterly returns with respect to the tax. The purchaser would deduct the tax from the amount he would otherwise pay to the producer. The purchaser's obligation to make the tax deposits are not affected by the fact that a producer may be entitled to tax relief under the net income limit. Except for the operator of the property, other parties (such as the operator's partners or royalty owners) normally would not be subject to any return filing, reporting or depository requirements.

Producers and purchasers occasionally enter into arrangements which allow the purchasers to pay for the oil sometime, e.g., 30, 60, or 90 days, after its delivery. Where such delayed payment contracts exist, the committee report on the House-passed bill states that the arrangement may constitute reasonable cause for the Internal Revenue Service to grant an extension of time, under Code section 6161, to pay the tax. Such an extension would not be granted to integrated companies and, as generally is the case under section 6161, interest (but not penalties) would accrue on the unpaid tax for the duration of the extension period.

The bill would require that the quarterly returns of the windfall profit tax be filed not later than the last day of the second month following the close of the quarter. This is the same as the requirement presently imposed with respect to other quarterly excise tax returns.

b. *Refunds of tax*

If the net income limitation provided in the bill reduces a producer's windfall profit tax liability, the producer or royaltyholder may claim a refund of the excess windfall profit tax paid at the time he files his annual income tax return.

12. Windfall Profit Tax Enforcement

a. *Imposition of tax at first sale*

DOE price controls must be applied at several stages of production and distribution, each of which presents an opportunity for noncompliance. In contrast, only one event determines the windfall profit tax liability—the first sale. Because the tax is imposed on the producer and collected at the first sale by the purchaser, there is only one opportunity for a party to falsify "well data," such as meter readings or oil classifications. The items of information required to calculate the tax liability have to be reported or certified under the provisions of the bill. Each of these items is an operative element in the determination of any party's tax liability, so that the misrepresentation of any item gives rise to the imposition of the appropriate tax sanction. Each item of information also must be categorized as a "material fact" necessary for the filing of a valid return or the furnishing of accurate information statements. As a result, supporting records must be maintained, and misrepresentation of any of these items will render a party subject to any applicable civil or criminal sanction.

b. *Information requirements and penalties*

The bill requires the purchaser to furnish monthly statements to the producer. These statements must show the following items: (1) the amount of oil purchased, (2) the purchase price, (3) the base price and adjusted base prices, (4) the amount of tax withheld, and (5) any other information that is required by regulations. In addition, the operator of the well would be required to furnish the purchaser with such certified information as may be specified by regulation. Such information must include the type and classification of the oil purchased.

Noncompliance with the obligations imposed by the windfall profit tax subjects the producer both to the generally applicable civil and criminal penalties and those set forth in the bill. Specifically, the bill makes it a misdemeanor punishable by a fine of up to $10,000 and up to 1 year of imprisonment to fail willfully to comply with these obligations. Further, additions to tax for failure to comply are required. In addition, the obligations imposed upon the various parties by the windfall profit tax also are subject to generally applicable tax penalties for civil or criminal fraud, as well as those for negligence.

c. *Burden of proof*

The inclusion of DOE regulation concepts in the windfall profit tax does not affect the general rule that the burden of establishing the entitlement to preferential tax treatment is upon the taxpayer asserting that right. Each producer must be prepared to establish the various items upon which windfall profit tax liability is predicated, including the classification and base price of oil sold and the category to which the producing property belongs.

d. *Responsibilities of DOE*

Responsibility for administration and enforcement of the windfall profit tax will fall primarily upon the Treasury and the Internal Revenue Service. However, under OMB guidelines on the Privacy Act, DOE is not prevented from assisting the Treasury and the Internal Revenue Service by granting access to records held by DOE. It is also anticipated that DOE will assist the Secretary in formulation of regulations under the tax. In addition, DOE certifications of qualified tertiary enhanced recovery projects and release of front-end money for such projects are recognized specifically for windfall profit tax purposes.

13. Interaction with Income Tax

a. *Deductibility*

Under the bill, a deduction from Federal income taxes for windfall profit taxes paid is permitted. Such a deduction is consistent with the usual treatment of excise taxes and prevents the imposition of combined income and excise taxes in excess of the taxpayer's gross windfall profit.

b. *Depletion*

Generally, percentage depletion is not available in the case of oil and gas production. However, independent producers and royalty owners, those not involved in the "downstream" activities of the oil business, are entitled to percentage depletion to the extent that their average daily production does not exceed a specified exemption. For 1979, the exemption is 1,200 barrels per day or the equivalent amount of natural gas. The exemption will be established permanently at 1,000 barrels per day in 1980. Oil production eligible for percentage depletion represents approximately 23 percent of domestic production, which is split about evenly between royalty owners and independent producers. The rate of percentage depletion is 22 percent of gross income from the property, but this is scheduled to phase down to 15 percent between 1980 and 1984 except for oil produced from secondary and tertiary recovery, which remains at 22 percent depletion until 1984 when it too drops to 15 percent. The percentage depletion deduction may not exceed 65 percent of the taxpayer's overall net taxable income, computed without regard to the depletion deduction, net operating loss carrybacks, or capital loss carrybacks. In addition, the percentage depletion deduction from any single property may not exceed 50 percent of the taxpayer's taxable income from the property, computed without regard to the depletion deduction.

The percentage depletion allowance is calculated by multiplying the taxpayer's gross income from the property by the applicable percentage specified in the Code. Thus, the amount of the taxpayer's gross income from the property directly affects the amount of the percentage depletion deduction. Absent the provision in the bill to the contrary, the increase in the sales price of oil occasioned by decontrol would result in a proportionate increase in the percentage depletion allowance.

The bill provides that, in determining the percentage depletion allowance under sections 613 and 613A of the Code, gross income is to be reduced by the difference between the selling price and the adjusted base price of taxable oil (i.e., the windfall profit without regard to the severance tax adjustment). Also, for determining the 50-percent and 65-percent-of-taxable-income limits on percentage depletion, the windfall profit tax itself is not to be deducted in determining taxable income.

14. Effective Date

The windfall profit tax applies to oil removed on or after January 1, 1980. While the tax is intended to be consistent with President Carter's oil price decontrol program, the tax will apply regardless of whether that program is in fact carried out or whether controls are reimposed at some time in the future.

B. Trust Fund

The bill creates a special trust fund, called the Energy Trust Fund, in the U.S. Treasury for the receipts of the windfall profit tax. The Energy Trust Fund is structured in a manner similar to existing trust funds administered by the Secretary of the Treasury.

The Secretary must determine the amounts to be transferred to the fund on a monthly basis. Such amounts are to be based on estimates of the revenue produced from the windfall profit tax. If estimates prove to be either excessive or insufficient, adjustments are to be made in subsequent transfers to the extent necessary to rectify any earlier error. The Secretary must manage the trust fund as the trustee, and must report to Congress on its financial condition at the close of each fiscal year ending on or after September 30, 1980. This report must include the results of the fund's fiscal year operations and a projection of its condition for the following 5 fiscal years. This report will be printed as a House Document. Any amounts not required for current withdrawals must be invested in interest-bearing obligations of the United States. The Trust Fund may purchase these obligations either at the issue price, if an original issue, or at the market price, if an outstanding obligation. Such obligations may be sold by the Fund at the market price. Any income from the fund's investments will be credited to it.

Amounts in the trust fund are to be available, as provided by future authorization and appropriation Acts, for expenditures for purposes to be specified by law. The amount and purpose of these expenditures will be determined by the Congress in subsequent legislation, which will be developed and reported by the appropriate legislative committees of both Houses.

C. Study of Decontrol and Tax

The bill requires the President to submit a report to the Congress no later than January 1, 1983, on the effect of decontrol and the windfall profit tax on (1) domestic oil production; (2) oil imports; (3) oil company profits; (4) inflation; (5) employment; (6) economic growth; (7) Federal revenues; and (8) national security. The report is to be accompanied by such further energy-related legislative recommendations as the President may care to make.

III. REVENUE EFFECTS

Table 1 shows the revenue effects of the windfall profit tax in calendar years 1980 to 1984. Table 2 shows revenue effects in fiscal years 1980 to 1984. The revenue raised is estimated to be $3.7 billion in calendar year 1980, $7.7 billion in 1981 and $9.7 billion in 1982. In fiscal year 1980 the revenue raised is estimated to be $2.6 billion.

The windfall profit tax by itself will raise a certain amount of revenue, shown in the table as the "gross windfall profit tax." However, imposition of the windfall profit tax will cause several changes in individual and corporate income tax receipts. The "net windfall profit tax" in tables 1 and 2 is the gross windfall profit tax minus the reduction in income tax receipts resulting from the windfall profit tax.

There are essentially four reasons why imposition of a windfall profit tax can be expected to change individual income tax receipts. First, the bill denies percentage depletion on the amount of gross income defined to be a windfall profit. This change increases income tax paid by independent oil producers and royalty owners and is shown separately in tables 1 and 2. Second, the windfall profit would itself be a deductible expense under the income tax. Third, the windfall profit tax generally would be deductible under State income taxes, thereby reducing taxpayers' Federal income tax deductions for State income taxes. Finally, the imposition of the windfall profit tax can be expected to cause a reduction in oil drilling and production, which would affect the income tax paid by oil producers. The revenue estimates in tables 1 and 2 attempt to measure the effect of all of these factors on income tax receipts in deriving the net revenue raised by the windfall profit tax.

Under the bill, the gross windfall profit tax is put into an energy trust fund. Thus, trust fund receipts, excluding interest, are expected to be $6.1 billion in calendar year 1980, $12.9 billion in 1981 and $16.5 billion in 1982. The trust fund receipts are expected to be $3.6 billion in fiscal year 1980.

The revenue estimates are highly sensitive to the assumed world oil price. The assumption used is an $22 price for unregulated domestic oil in the third quarter of 1979, growing at the rate of inflation plus one percent per year. The $22 price is approximately the wellhead price for uncontrolled domestic crude oil which will result from the recent price increases announced by OPEC.

Table 1.—Calendar year revenue effect of House-passed windfall profit tax

[In millions of dollars]

	1980	1981	1982	1983	1984
Gross windfall profit tax	6, 118	12, 901	16, 459	16, 672	16, 884
Reduction in income taxes	−2, 592	−5, 578	−7, 211	−7, 489	−7, 669
Tax increase from disallowing depletion on windfall profit	180	380	445	400	379
Net windfall profit tax	**3, 707**	**7, 703**	**9, 694**	**9, 643**	**9, 594**

Table 2.—Fiscal year revenue effect of House-passed windfall profit tax

[In millions of dollars]

	1980	1981	1982	1983	1984
Gross windfall profit tax	3, 580	10, 497	16, 233	16, 615	16, 691
Reduction in income taxes	−1, 100	−3, 913	−6, 301	−7, 308	−7, 535
Tax increase from disallowing depletion on windfall profit	80	269	409	425	390
Net windfall profit tax	**2, 560**	**6, 852**	**10, 341**	**9, 733**	**9, 546**

CRUDE OIL TAX

WEDNESDAY, JULY 11, 1979

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (chairman of the committee), presiding.

Present: Senators Long, Talmadge, Ribicoff, Byrd, Gravel, Bentsen, Moynihan, Baucus, Boren, Bradley, Dole, Packwood, Roth, Danforth, Chafee, Heinz, and Durenberger.

The CHAIRMAN. This hearing will come to order.

We are very pleased to have with us today the Secretary of Energy, the Honorable James R. Schlesinger, who has done a dedicated job in seeking energy for this Nation against very difficult odds.

We are very pleased to have you, Mr. Secretary, and will be happy to hear your statement, and then we will ask a few questions.

Please proceed.

Secretary SCHLESINGER. Thank you, Mr. Chairman.

Mr. Chairman, I have a very brief statement, in order to allow maximum opportunity for questioning.

STATEMENT OF HON. JAMES R. SCHLESINGER, SECRETARY OF ENERGY

Secretary SCHLESINGER. Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you today to discuss the President's crude oil pricing program and the proposed windfall profits tax.

Two years ago, I discussed with this committee the future prospects for world oil production. At that time, I expressed doubt that world oil production by conventional means would increase by more than 20 percent from then prevailing levels or would ever reach more than 70 to 75 million barrels a day.

Developments since that time have been even less promising and we now have little assurance that world oil production will ever exceed 65 million barrels per day—little more than present levels.

Thus, the long term oil supply outlook is indeed grim. Moreover, the shock of events in Iran has resulted both in a further lowering of supply projections and simultaneously in telescoping the time in which longer term energy stringencies affected current supply/demand balances.

It is in this context that the issues of decontrol and the windfall profits tax should be discussed.

In proposing the decontrol program and the windfall profits tax, the President was required to balance two critical, and sometimes conflicting, considerations—equity for the Nation's consumers and adequate incentives for increased production of domestic crude oil. It is important that the windfall profits tax as it is finally enacted strike a similar balance.

If the incentives for domestic oil production and the prospects for capital formation are reduced excessively, the Nation will suffer from even a greater dependence upon imported energy and greater deficits in its balance of trade. If the tax leaves an excessive amount of windfalls with the producers, there would be inadequate resources available to develop new alternative energy sources for the future and assist those who can least afford rising energy prices now.

While there is a growing recognition that synthetic fuels must be expeditiously delayed, it will be 7 to 10 years before such initiatives can make a substantial contribution to providing our energy supply.

The leadtimes for development of conventional domestic resources are far less. Conventional domestic oil production—based on proved reserves and potential resources of 140 billion barrels or more—must therefore provide an essential energy supply bridge during the intervening years of our transition to new energy technologies.

These conventional resources will be developed at a more accelerated pace over the next several years only if producers have adequate incentives and capital.

The President initially proposed a significant windfall profits tax that would reduce incremental producer revenues by approximately one-third. He has also indicated a willingness to see the tax strengthened in responsible ways.

In view of the critical bridge role which conventional production must play over the next decade, care must be taken to ensure that any strengthening of the tax does not unduly threaten the need for production incentives and sufficient capital formation.

Increases in producer receipts and profitability simultaneously increase production and windfall profits. While every effort must be made to avoid unnecessary windfalls, the effects of some strengthening amendments on production must not be overlooked. The requirements of equity and energy production sometime conflict. The Congress must now grapple with the judicious resolution of such competing values.

Secretary of Treasury W. Michael Blumenthal yesterday outlined the several areas in which the administration proposes that H.R. 3919 should be amended. I need not repeat them in detail today.

There is one point, however, that I wish to stress. From the development of the first national energy plan, new frontier areas have been recognized by the administration as a major source of future energy supplies. The House bill would impose a tax on crude oil produced from the Sadlerochit Reservoir on the Alaska North Slope from a base price of $7.50 a barrel plus future adjustments for declines in the trans-Alaska pipeline tariff.

If there had been no decontrol, that oil would be classified as upper-tier oil and be entitled to receive a wellhead price of over $13 per barrel. in 1979 dollars.

There is no justification for treating that oil differently from similarly classified oil in the lower 48 States simply because of an accident of geography. Establishing a higher tax on Alaskan oil would subject the Alaska North Slope producers to a penalty solely because Alaskan oil incurs a sizable transportation cost.

Such action could weaken the national intent to encourage rapid development of frontier areas. Crude oil from the Sadlerochit Reservoir should be treated as upper-tier oil. The administration, of course, continues to support exemption of other Alaska North Slope oil because of the high uncertainty regarding future costs in that area and the high transportation charges that must be incurred to move the oil to market.

In conclusion, Mr. Chairman, I must note that even now the implications of this Nation's long-run energy problem have not been fully recognized by the American people. In the last 2 years, we have been stressing the seriousness of this problem. Yet, today, the energy crisis has reached a stage even more critical than 2 years ago.

Thank you, Mr. Chairman. I shall be pleased to answer any questions the committee may have.

The CHAIRMAN. I would suggest to the committee that if there is no objection, we will use a 7-minute rule this morning in the usual fashion. We will first call on the first Senator who was here, Senator Dole.

Senator DOLE. Thank you, Mr. Chairman, and Mr. Secretary.

Let me say, first of all, that I appreciate your efforts in rather difficult times. There is always someone looking for a scapegoat, as I found out. It says a lot about the measure of a man to stand up and take the criticism and not whimper about it. I appreciate your efforts to solve the energy problem, you have done an outstanding job and we appreciate for efforts.

Secretary SCHLESINGER. Thank you, Senator.

Senator DOLE. Does the administration plan to scrap the gasoline allocation program and decontrol gasoline?

Secretary SCHLESINGER. Sir, that has been an objective of the administration since the spring of 1977. As you know, in yesterday's announcement of Camp David, it was indicated that that continued to be an objective, but the President has decided that at this time he does not want to scrap the price controls and, quite naturally, the allocation system follows in the wake of price controls.

Senator DOLE. If we pass the administration's proposal—I call it an excise tax although some may call it a windfall profits tax—would that increase the domestic production? Would that produce any more gas or heating oil?

Secretary SCHLESINGER. I am sorry, if we scrap it?

The windfall profits tax, in itself, of course, does not contribute to additional production. What contributes to production is the decontrol program and the increase in incentives and revenues associated with it. The windfall profits tax limits the impact.

Senator DOLE. On page 2 of your statement you indicate, that synfuels would make a substantial contribution to our energy supplies in 7 to 10 years. It would be helpful to know what you consider to be a substantial contribution? What oil equivalent? At what cost to the Government? What types of alternatives do you envision in that 7 to 10-year period?

Secretary SCHLESINGER. No decisions have been made by the President with regard to the composition of the synfuels program. As you know, the House has passed a bill that includes 2 million barrels a day by 1990 of synfuels narrowly defined and, in addition, there may be measures of augmenting conventional supplies, as well as additional conservation efforts, which leads to import reduction goals of about 3 to 5 million barrels. No decision has been made as yet with regard to costs.

The cost of producing synthetic oil by the Fischer-Tropsch method depends upon the price that we assign to production of methane. As you know, this method was used by Germany in World War II. It has been improved. In recent times, it has been used for some production by South Africa.

This method would bring in oil at about $35 a barrel, if we priced the methane at the equivalent of residual fuel oil. Other methods, the direct methods that we have not proved up as yet, look to be in the range of $40 to $45 a barrel for syn crude, narrowly defined.

Our estimates of oil produced from oil shale run in the range of $22 to $25 a barrel.

Senator DOLE. Those would be the alternative areas that you are looking at?

Secretary SCHLESINGER. Alternative to increased domestic production from conventional sources, yes, sir.

I do not think that we have to make a hard choice between the two. We need both.

Senator DOLE. I believe Congress will pass an oil tax. Certainly your assessment is accurate. The approach should be balanced.

There are some who indicate the oil industry cannot handle all the resources if there was not some tax.

In addition, for the sake of discussion and debate, I have one suggestion—I will not ask you to comment on it now I would like for you to study it. We have been working for several weeks for a proposal that would provide an 80 percent tax rate, while at the same time provide incentives for increasing production from existing oil wells.

The proposal would have a small producers exemption of 1,000 barrels a day. This is the same threshold for the depletion allowance. The proposal would have a production incentive credit for increased exploration and development.

The proposal would increase the cash flow to industry and reduce paperwork and regulation.

We also provide a definite termination date of 5 years. That is something that we have to address. I do not think we can have a tax to continue forever.

In spite of the image of the industry, in the final analysis, this county is going to have to rely on the oil industry. We can kick them around it may be good politics. Nobody gets hurt. But in the final analysis, we have to go back to the industry and ask them to help us out.

I would hope that you would have a chance to, at least, look at our tax and see if it has any merit.

Secretary SCHLESINGER. Yes, sir. I would be happy to do so.

If I may say so, Mr. Chairman, we do not know—right now, we know reasonably well what the cost of production would be for the next 4 or 5 years but we do not know what the cost of production will be when we go into, as I trust we will, the Chukchi Sea off the coast of Alaska. The cost of production may be very high.

For that reason, Senator Dole's point that there must be some flexibility longterm is a well-taken point.

Senator DOLE. Thank you.

The CHAIRMAN. Senator Durenberger?

Senator DURENBERGER. Mr. Secretary, let me say that the reason I am still in your corner is because, as pointed out on the first page, of your testimony, you have been one of the few people in this country who, in advance of the American people, came to the conclusion that we are going to run short of nonrenewable energy sources. You have been pointing out this shortage to us in terms of the critical bridge role of conventional domestic production that was alluded to earlier. I assume the bridge will also include a combination of alternative energy sources, conservation and a variety of other solutions that we ought to be doing.

What is the role of a crude oil import curb in either forcing or helping design all of the other policies we should be dealing with, particularly in terms of alternative energy sources?

Secretary SCHLESINGER. The crude oil import limitation, I think, is a necessity. It reflects the reality of the amount of oil that will be delivered by the OPEC nations in the 1980's.

Each time that we have made a judgment on that, the prospects appear somewhat more grim.

So all of the consumer nations must get together to restrict their appetite for oil. Otherwise we will have a combination of prices going unbelievably high and the unavailable of crude.

In order to achieve these targets—say 8.5 million barrels a day—given the levels of demand in the United States, we must shift early on to other technologies. We must, in the short term, make ready use of coal and nuclear power that are available today and in the longer term, we will have to bring in these more exotic technologies.

Unless we shift to these alternative sources of supply, we will face the American economy with the cruel dilemma of choosing between increased unemployment, slower growth rates—or no growth rates—higher rates of inflation on the one hand, or the greater use of coal and alternatives.

If we simply restrict the supplies of energy, the effect will be to suppress the gross national product in the years ahead, with all the economic and political ramifications.

Senator DURENBERGER. Have you given that idea much thought, particularly the emphasis on exisiing fuel sources such as coal, especially as we try to determine what approach we most take to developing incentives for additional domestic crude oil production? Have you designed a system in which we can balance what we have to do for coal against what we must do for crude oil in order to build this bridge?

Secretary SCHLESINGER. The economic incentive to burn crude, to burn coal, and produce coal, is there. The problems that we face are two.

First, burning coal will require, I believe, review of certain aspects of the Clean Air Act, not necessarily—indeed, not appropriately, reductions of the ambient air quality standards, but a review of the mechanics of the Clean Air Act which, at this juncture, tend to bias decisions against the burning of coal.

Second, we will have to do much more than we have done with regard to coal transportation and the like.

Senator DURENBERGER: On page 2 of your statement you said, "If the tax leaves an excessive amount of windfalls with the producers there would be inadequate resources available to develop new alternative, energy sources for the future, et cetera.

This would indicate, to me, that you believe the role of developing sources of alternative energy should be performed by someone other than the oil companies. Is that yoür position?

Secretary SCHLESINGER: No, sir.

I think what that implies is that, in order to encourage this infant industry of syncrudes more rapidly than the market would bring it on, the market would ultimately bring it on—we have to have some form of subsidy. The subsidy will go to those companies that can effectively perform in this area.

On the question of refined coal, too, we have entered into a contract with Gulf Oil as the major participant on the industrial side. We are supported by three governments: The Japanese, German, and American governments are providing the subsidy to bring on this technology.

It does not imply, either, that other alternative energy sources need a subsidy or that the industry would be excluded. Quite the contrary.

The Federal Government does not have the technical resources in-house to conduct these programs. The great depth of technical understanding lies within the industry and in this crisis, we will have to make use of those resources.

Senator DURENBERGER. At what point does the industry make the decision that it cannot use internally generated capital resources to engage in high-risk technology ventures?

Secretary SCHLESINGER. In these high-risk technologies that industry would be reluctant to pay the full cost on its own. Indeed, that has been all of our experience.

The role for the Federal Government, it seems to me, is to provide assistance in those high-risk areas which the responsibility of the corporate leadership to the stockholders would preclude making major high-risk investments.

I think that there are two aspects to the problem. First, to the extent that revenues are restricted, the companies may not make sufficient investment in conventional technologies, ordinary oil, and gas production, but in these newer, high-risk, more exotic technologies, there would be a requirement for outside financing because it is not an appropriate role for the private sector.

Senator DURENBERGER. Thank you.

The CHAIRMAN. Mr. Secretary, on the wall over there we have put a chart which was obtained by my office outlining the steps that someone has to go through in order to drill a well beyond the 3-mile limit off Louisiana. This is one of the most promising and productive areas in the entire United States—I would say that in the lower 48 States, it is the most productive area there is.

That chart sets out approximately 80 steps that one has to go through in order to drill for oil or gas out there.

You have to go through about the first 67 steps before you get the permit to start drilling. That takes about 7 years; 7 years is about par for the course. And then after that, if you are lucky, it takes about another year.

Of course, all of that is assuming you are lucky, because what is indicated by the horizontal lines on the chart are those periods during which any private individual, if he can convince a judge to give him an order, can hold you up indefinitely.

It is this kind of thing that caused Senator Gravel to put an amendment on the Alaskan pipeline bill to say that the Congress gave its approval to the environmental study that stacked 2 feet high at that point so that the environmentalists could not hold up for another 15 or 20 years the building of the Alaskan pipeline.

I think the principal achievement since the energy crunch started is that the Alaskan pipeline was constructed. It cost eight times what it was supposed to cost—about $8 billion when $1 billion would have done it.

It turns out that the caribou loved the pipeline, contrary to what people thought. They snuggle up to the pipeline. They get warmth in the winter. They love the pipeline. It has not destroyed the caribou at all.

This last year, about 12 more steps were added to the chart. Most of those steps are not in your department; they are in the Department of the Interior. I assume those are great victories for the Interior Department over the Energy Department. Everything in the heavy black squares are the new steps that have been added in recent years.

Do you think you could support some program to cut that 8-year leadtime down to 4 years?

Secretary SCHLESINGER. Down to less than 4 years if we can possibly do so, Mr. Chairman. I think that because of the smallness of this room you have not been able to lay out the full story. That only carries it up to the point of production. Beyond that there are monitoring arrangements against waste, and things of that sort, that have to be reviewed and could lead to a shutting in of production.

That is only part of the story. It reflects, I think, the institutional morass that for a variety of laudable objectives we have entered into in this country with conflicting objectives, time-consuming processes. All of this it seems to me must be cut through if we are effectively to grapple with this problem.

The CHAIRMAN. Mr. Secretary, if anybody asked me to take the kind of job you have, especially in the kind of situation this Nation finds itself in, I would only consider it on one basis: That I would have the complete authority to do what I thought had to be done and none of these decisions that I made could be vetoed in that Oval Office. It would have to be 100 percent my decision about what ought to be done about the matter, and the boss man could not second-guess me—he could ask for my resignation, but he could not second-guess me.

I think to ask someone to overcome all of this redtape really is asking too much of any mortal human being.

I have asked the committee to go take a look at the highest platform ever built in the ocean. It is twice as high as the Washington Monument, the platform out there off Louisiana, and we will have some good wells out there—by Western Hemisphere standards, very good wells.

It will represent about an $800 million investment by one company. There are some associates, but mainly one company will go out there and drill 64 wells from that platform. They were working on that platform at the time that the President went out to look at the drilling rig out there, and they may have pointed it out to him at that time. Erecting that platform was a 3-year job, to build a platform higher than the Empire State Building that will stand a hurricane out there in the middle of the Gulf of Mexico in a thousand feet of water.

To do those kinds of things someone needs to be able to expedite matters to get on with the business.

Prior to the time that the Federal Government moved the State out of it, they would have their permits within the year under competitive bidding, and as far as all of these legal impediments are concerned, they would have been in the clear to go on and drill, to lay pipe and get the oil or the gas, as the case may be.

It seems to me that if we really want to get on with this job, the starting point ought to be to cut those lease times in half.

I am told that if you open a coal mine, the company thinks it should only take 18 months, but they have coal mines they have been trying to open for 8 years. What do you think about shortening the time on opening these coal mines?

Secretary SCHLESINGER. Unquestionably, we have to cut through this regulatory morass. Congress has its role to play in that, simply because the legislation, which is executed by agencies in the executive branch, results inevitably in conflicts to the extent that one tries to work these out at the bureaucratic level. That leads to delays in and of itself.

One must also bring in the States because the States, as the SOHIO pipeline case has indicated, have enormous powers of delay for critical energy product.

It will require radical surgery in order to simplify the process and shorten these leadtimes.

The CHAIRMAN. Mr. Secretary, it just seems to me that we have a right to ask for a little consideration for a State like Louisiana. If we had our way we would be drilling a lot faster than we are doing.

The Federal Government by muscling us out of the tidelands area and taking over has not done anything but slow down production. If we had our way, we would be going ahead a lot faster—if somebody wants to build a refinery, just come on down there. We will be glad to welcome them.

As far as we are concerned, it means jobs. We will put up with the pollution; whatever it might take, we can handle it. We are glad to have the jobs.

I would think that it is unfair to ask us to share our energy with California when California will not even let them bring Alaskan oil ashore.

Do you reckon you could recommend something, or support something, that would say that the States that are cooperating get a little bonus with regard to the gas being passed around?

Secretary SCHLESINGER. We will review that very carefully, Mr. Chairman.

The CHAIRMAN. Thank you very much, sir.

Secretary SCHLESINGER. Mr. Chairman, I must say that the last results are not in with regard to the long-term story of the caribou—the genetic effects of snuggling up to that pipeline in future generations of caribou are still a cause of deep concern in some quarters.

The CHAIRMAN. I am very distressed to hear about that.

Senator Roth?

Senator ROTH. Mr. Secretary, as Senator Dole pointed out, I do not envy you your job, but I respect you for what you are trying to do. When the Government Operations Committee reported out the Department of Energy, one of the grave concerns at that time was that the American people did not believe that there was an energy crunch.

There is no source of reliable figures. I must say in all candor, 2½ years later, I do not think that situation has changed one iota. The American people do not trust the oil companies. They do not trust the figures being reported out by the Department of Energy, and I wonder why this situation has arisen?

As I go around my little State of Delaware, for example, people do not believe—many of them—that there is an energy crisis. They are really concerned about when are the gas lines going to go away; will there be enough gas for them to take their vacation?

I think one of the critical needs is to get some certainty in this picture. For example, can you tell the American people today what they can expect in the next several months as to energy supply and price?

Secretary SCHLESINGER. Yes, sir, I think you can, with certain caveats. We recognize that the world oil supply is precarious, the post-Iran system of delivering oil is stretched taut.

We have had threats, or implicit threats, from such producing states as Nigeria and Libya. There is continued anarchy in Iran. Any of these countries, for one reason or another, can reduce production.

I think that the stability of the Middle East is a longer term problem that we must be concerned about. But, assuming the situation should vary more that that production continues and imports flow. We have increased our arrivals of crude oil from the low points of April–May when it reached 5.8 million barrels a day to 6.2 to 6.5 million barrels a day.

As a result, refinery utilization rates are up toward 90 percent.

I believe that, under these circumstances, the very severe shortfalls in gasoline supply will be alleviated over the course of the summer. Indeed, we have already seen that alleviation, and that was predictable—indeed, it was predicted—as we saw that upturn in crude oil arrivals.

Senator ROTH. Can you make any predictions as to what is going to happen to the price of gasoline for the remainder of this year?

Secretary SCHLESINGER. The continuation of price controls will, in the foreseeable future, mean that one feeds through the cost of additional crude oil imports which resulted from the decision at Geneva by the OPEC nations. The increased cost has been reflected in the prices charged by non-OPEC producers, such as Britain, Norway, Mexico, and Canada. It also provides some prospective relief for retail operators of gasoline stations who have seen their volume diminished in recent months.

I would think there would be some continued updrift in gasoline pricings. I would hesitate to make predictions for any specific area.

Senator ROTH. Mr. Secretary, as the President's chief energy adviser, what do you believe we really have to do to become energy independent? In your opening remarks, in answer to a question, you talked about the needs for the next 10 years.

We have agreed—or the President has agreed—to limit imports to 8.5 million a year. We must have some predictions, I would assume, in your Department as to how much domestic oil will be produced.

What are the specific goals for the alternate sources of energy that we need to develop in the next 10 years and when do they have to come onstream?

If I may say so, one of my concerns is that we are asked here to deal with a windfall profits tax on a piecemeal basis. In all candor, we really do not know what the President is going to recommend.

The hour is late. I think we are entitled to know exactly what our goals are year by year, how we are going to reach them, what we have to do to meet it.

It is not enough to say we want to create an energy trust and pour a lot of money in there. How much are we spending now for R. & D. in these areas? How much more do we need?

Secretary SCHLESINGER. Right now, we are spending about $3 billion a year on energy research and development, Senator.

With regard to the goals for future years, as I indicated earlier, the President has not come down on any specific import reduction.

Senator ROTH. Could I ask you what your recommendations are, sir?

Secretary SCHLESINGER. My personal inclination would be in the synthetic fuels area to go along with the objectives stated in the House bill of 2 million barrels a day.

Senator ROTH. By 1990?

Secretary SCHLESINGER. By 1990.

May I add one point, Senator?

These synthetics are not going to solve our problem in the next 7 years—indeed, not for the next decade. We are going to have to do a better job with regard to coal and nuclear power, the technologies that are on hand now.

Senator ROTH. How much energy, may I ask you, should be supplied by nuclear and coal?

Secretary SCHLESINGER. If we are to have continued economic growth of something on the order of 3 percent averaged over several years and if the coefficient of energy use is 0.5—which means 1.5 percent growth each year in energy consumption—the burden of that will have to be taken up by coal and nuclear power. We are running something on the order of 40 million barrels a day equivalent at the present time.

Senator ROTH. What would that take, sir, in capital formation or Federal funds. Do you have any studies?

Secretary SCHLESINGER. In Federal funds, sir?

Senator ROTH. Yes.

Secretary SCHLESINGER. The Federal funds, I think, will largely be in the synthetics area, in the area to which you refer. I think that we should consider some assistance from the utilities which are very hardpressed at this juncture. They are burning more than 1 million barrels of oil a day in powerplants. A lot of that could, indeed, be replaced.

There may be some need for Federal assistance in that area, but generally speaking our private capital can handle it.

The cost for a barrel of oil or a barrel of oil equivalent are on the order of $25,000 or $30,000 per barrel per day.

Senator ROTH. My time is up, but I would like to return to some of these questions later, Mr. Secretary.

Secretary SCHLESINGER. Yes, sir.

The CHAIRMAN. Senator Ribicoff?

Senator RIBICOFF. Thank you, Mr. Chairman.

Secretary Schlesinger, some of my Republican colleagues have given you an endorsement. I want to be a Democrat that gives you my endorsement, too.

You have been more right in your predictions and policies on energy than your critics. Your critics, who are calling for your head, have been consistently wrong.

The Members of Congress who have been trying to put the blame on your shoulders are the ones who should take the blame and take the heat from their constituents. They have consistently failed to pass the necessary legislation and it is a national disgrace the way Congress has addressed the energy problem.

You have been consistently right and I hope the President has the fortitude to keep you, in spite of the critics who want to see you go.

Secretary SCHLESINGER. Thank you, Senator.

Senator RIBICOFF. In looking at your testimony, you weave a very careful way that seems to be inconsistent with the administration when it comes to the problems of taxes.

On page 2, you say, "if incentives for domestic oil and the prospects for capital formation are reduced excessively, the Nation will suffer from an even greater dependence upon imported energy and greater deficits in its balance of trade."

On page 3, "care must be taken to insure that any strengthening of the tax does not unduly threaten the need for production incentives and sufficient capital formation. Increases in the producer receipts and profitability simultaneously increase production."

Now, you also state that the cost of synthetic fuels will be somewhere in the nature of $35 to $40. It will take some 7 to 10 years to produce them, and you could produce conventional sources of energy at an earlier time and at a lower price.

If this is the case, how do you justify a windfall profits tax on third-tier oil? I could understand a windfall profits tax on first- and second-tier oil which is being produced now and for which capital is already receiving a return. Would not a windfall profits tax on third-tier oil act as a deterrent on the production of energy?

Secretary SCHLESINGER. The concern that I have expressed, Senator, is that I think that there were some proposals on the House side which were very severe—an 80-percent windfall profits tax and the like, not in the form that Senator Dole mentioned, but in straight receipts of the Treasury.

I think that we must strike a balance in this area and admittedly I was concerned when I saw some of the proposals on the House side that, in the attempt to capture windfall profits, would throttle the very incentives that we are attempting to unleash.

The specific question that you asked is with regard to the third-tier tax and, at the time that the tax was put together, the price of oil internationally was $16 a barrel. It is now $22 a barrel.

In other words, even with the 50-percent levy, the effect is an incentive price of about $19 a barrel which was higher than we anticipated say 9 months ago or 6 months ago when these subjects were being booted about. It is a substantial percentage, even with that 50-percent levy.

The judgment of a computer model—and I distrust computer models—on the absence of that tax would lead to 150,000 barrels a day additional production in 1985.

But as I say, that is a computer model. It is based upon all sorts of assumptions. Take it as an indicator, but not as anything conclusive.

Senator RIBICOFF. But there is another problem, and that is that if we invest in synthetic fuels, that is going to take a substantial amount of capital.

Secretary SCHLESINGER. Yes, sir.

Senator RIBICOFF. That capital, then, is going to be Government supplied.

If we can work out a program to encourage the private sector to take their profits from their oil, conventional oil, and put it into synthetics so you avoid Government revenues and Government bureaucracy and Government management and Government trying to run energy production, are we not better off?

Secretary SCHLESINGER. I think that is an area that is worth examining, Senator Ribicoff. As I indicated to Senator Durenberger some moments ago, these are very high-risk areas. They are areas which the private sector has traditionally left to the Government. I fully agreed with your point that what we will need is the lease management though the Federal bureaucracy of these programs as is possible and the maximum freedom that we can supply so that the private sector can get on with the technical job. They will require outside financial assistance.

Senator RIBICOFF. Today's press has a report in it that the CEQ states that the synthetic fuels program would contribute to raising the CO_2 level in the atmosphere, a development which may have very deleterious effects upon climate growing seasons and the world generally. My understanding is that the DOE has done a study on the impact of synthetic fuels on the development of the CO_2 and the atmosphere and that that report has not been released.

Do you have any comments on the press reports today on the CO_2 levels?

Secretary SCHLESINGER. Yes, sir. We have a major effort in the Department in the area of basic sciences to determine what the consequences of prospectively rising CO_2 levels in the atmosphere. We do not know very much about that subject because, for some generations, the CO_2 has been absorbed in the oceans.

These are alarming statements that have been made and there certainly are alarming prospects. The burning of all fossil fuels results in the production of carbon dioxide. The burning of synthetic fuels, of course, results in a much larger production of carbon dioxide than say natural gas. The production of carbon dioxide in synthetic fuel burning is less dramatically greater in the case of oil and even less dramatically greater in the case of coal.

If we are going to burn conventional fuels, we have, I believe, a 10- or 20-year period, at a minimum in order to study these effects. The impact of carbon dioxide burning, of course, has been one of the reasons cited by proponents of nuclear power that we should turn to nuclear power rather than burn conventional fuels. I think that it is fair to say that Chancellor Schmidt, who is a strong proponent of nuclear power has emphasized the carbon dioxide problem as a way of encouraging support for nuclear power developments. This was reflected at the Tokyo summit.

Senator RIBICOFF. We are being asked in the Congress to go forward with a synthetic fuel program. Should we go ahead with the snythetic fuel program without knowing the impact on the overall health of the people of this country?

Secretary SCHLESINGER. It would not impact health. What we are talking now is building toward 500,000 barrels a day, 2 million barrels a day perhpas by 1990. That would not, in itself, be a very large amount.

I think the concern about synthetic fuels results if one contemplates the burning of 60 or 70 million barrels a day worldwide. If these carbon dioxide problems do turn out to be as severe as some of the scientific community suggests, and we must take advantage of the sequential decisionmaking in this country. I think that we have no alternative but to start on the route of making synthetic projects and then carefully, in the next decade, review possible health effects as well as longer-term implications for carbon dioxide.

The volume of production in the early years would not make a major contribution to the production of carbon dioxide worldwide.

Senator RIBICOFF. Thank you, Mr. Chairman.

Senator BYRD. Thank you, Mr. Chairman.

Mr. Secretary, the administration recommended a 50-percent windfall profits tax. The House of Representatives passed a 60-percent windfall tax.

Are you talking today on behalf of the 50 percent or the 60 percent?

Secretary SCHLESINGER. I support the position that the administration took yesterday in Secretary Blumenthal's testimony, to support that particular variance in the House bill.

Let me say that that works out to about a 57 percent tax rather than a 60 percent tax because State severance taxes are taken out before the taxes are applied.

Senator BYRD. You are not testifying then on behalf of the 50 percent proposal?

Secretary SCHLESINGER. No sir.

Senator BYRD. The one that was first recommended by the administration?

Secretary SCHLESINGER. No, sir. I am not.

Senator BYRD. President Carter, in Tokyo, severely condemned OPEC for the recent price increase. Do you favor a specific policy or policies designed to break the stranglehold that the OPEC nations now have on our oil prices and supplies?

Secretary SCHLESINGER. Yes, sir. I support the policy of reducing our dependence on foreign sources of supply and notably on a cartel. That can come only through additional domestic production of all sort of fuels and through restraints on our appetites for imported oil.

Otherwise, we get into the position in which we rail against, or flail about, the cartel but we are not doing very much about it.

I think the reactions in Tokyo reflecting what were some very peculiar judgments, to say the least, in the OPEC communique in which they placed the blame on the industrial nations for the deteriorating position of the nonoil LDC when it was quite obviously the increase in the oil price that was the source of that problem.

It was a flat denial, dismissal, by the OPEC nations for that kind of dialog. It was those kinds of considerations that led to the sharp repudiation of OPEC by the assembled leaders.

Senator BYRD. You had no plan to moderate the cartel pricing system except a long-range one of conservation?

Secretary SCHLESINGER. No, sir. Augmenting alternative supplies.

Senator BYRD. That is a long-range program, is it not?

Secretary SCHLESINGER. I think the movement of natural gas that we have noted during the course of this year is a result of the Natural Gas Policy Act. It has permitted us to back out of 300–400,000 barrels a day that would otherwise come into the United States.

That is the major short-term alternative. I think we can ship some of our existing coal-burning facilities back to coal. It is only if we provide additional energy supplies or limit our appetites that we can affect economically the decisions of OPEC.

As you know, on the diplomatic front, the Government of the United States has been quite vigorous in its representations to the more moderate members of the OPEC group in more recent years, and they have been responsive to those diplomatic representations.

Senator BYRD. You mentioned national gas. Has any progress been made with the Mexican Government about the purchase of their natural gas at an agreed price?

Secretary SCHLESINGER. There are negotiations going on as of this evening in Mexico City. The question continues to be the establishment of a price for those gas exports so that those exports could effectively compete at the burner tip in the United States with residual fuel oil.

In the absence of that, American firms are not going to shift to natural gas. They will continue to burn resid. In order to back out additional resid and oil imports, the price of imported natural gas will have to be competitive at the burner tip. That is the continued basis of the discussion.

Senator BYRD. What is the United States importing from Mexico now on a daily basis in regard to oil?

Secretary SCHLESINGER. We are taking 80 percent, approximately, of Mexico's oil exports.

Senator BYRD. 80 percent?

Secretary SCHLESINGER. 80 percent of their exports.

Senator BYRD. What does that mean in the way of barrels?

Secretary SCHLESINGER. In the range of a half a million barrels a day. I do not have the exact number. Perhaps 500,000 barrels a day.

Senator BYRD. In your reply to one of my previous questions, you mentioned the need to revert to coal. In the colloquy with Senator Long, it was pointed out that the vast amount of time involved in getting the required permits, in going through Government red tape and so forth, you mentioned at that point that it will—and you used the future tense—it will require major surgery to cut through that red tape.

What major surgery has been proposed in that regard?

Secretary SCHLESINGER. Senator Byrd, the President is reviewing some options in that area. I think the Jackson bill of which some of the members are familiar, proposes a variety of techniques. An Energy Mobilization Board has been recommended to cut through that red tape.

Those are the kinds of options that are under consideration.

Senator BYRD. Why are we delayed so long to begin to cut through that red tape?

On page 4 of your statement, in conclusion, Mr. Chairman, I must note that even now the implications of this Nation's longrun energy problem have not been fully rcognized by the American people. In the last 2 years, we have been stressing the seriousness of this problem.

Now you are saying we are just now beginning, We have not yet begun to cut through the red tape in regard to coal.

Secretary SCHLESINGER. Well, contemplating cutting through the red tape, that is a very substantial chore, given the nature of the legislation on the books.

It was only last year that the Congress passed amendments to the Clean Air Act that are quite restrictive, that the Congress passed the Surface Coal Mining Act which requires procedures by the Department of the Interior similar to the procedures laid out.

We have the Administrative Procedures Act that requires public commentary, publication in the Federal Register, for 60 days before something is considered and the National Environmental Policy Act requires a review process for an Environmental Impact Statement that is no less than 90 to 120 days. It may go on through extended court reviews for some years.

It is these legislative goals that I mentioned to the chairman, adopted for laudible reasons, that tend to conflict with each other and which tend to induce delays and Congress has its share of the responsibility, let me mention again.

Senator BYRD. Which laws do you feel should be changed? The laws you have indicated, the laws that you mentioned there you feel need to be changed?

Secretary SCHLESINGER. No, sir. Some of those laws will have to be changed, in my judgment, but many of these things can be done more expeditiously through different procedures.

We have established an Energy Coordinating Committee under Executive order. That committee does not cut through redtape; it merely provides better scheduling for different agencies so you do not have sequential review by different agencies, so that you have some kind of simultaneity in the review by different agencies.

We are going to have to do far better in establishing termination dates by review by agencies and in addition, in my judgment, Senator Byrd, we will have to do something to foreshorten the review processes in the Federal courts.

The chairman mentioned Senator Gravel's amendments on the Alaska pipeline bill. He permitted, and required in effect, one court review. But as long as an issue can be repeatedly challenged on different grounds, in different Federal courts, irrespective of what the Congress may do; irrespective of what the Congress may desire and what the executive branch may do, the opportunities for delay are there. This has become a nation given over to litigation.

Senator BYRD. I agree. I hope the administration will recommend to the Congress proposals to change all of that. I doubt that it will be done.

Thank you.

The CHAIRMAN. Senator Danforth.

Senator DANFORTH. Mr. Secretary, yesterday Secretary Blumenthal testified that between 1980 and 1984 about $62.5 billion would go into the energy security trust fund. What portion of that $62.5 billion would come from the windfall tax?

Secretary SCHLESINGER. All of it.

Senator DANFORTH. All of it?

Secretary SCHLESINGER. That is right.

Senator DANFORTH. It is my understanding that a portion of it would come from the windfall tax and a portion of it would come from increased income tax revenues resulting from decontrol.

Secretary SCHLESINGER. It is, as you indicate, the results of decontrol whether it comes through the income tax or the windfall profits tax, which are coordinated devices.

Senator DANFORTH. How much comes from the windfall tax?

Secretary SCHLESINGER. Two-thirds, approximately.

Senator DANFORTH. Two-thirds from the windfall tax and one-third from income taxes?

Secretary SCHLESINGER. Yes, sir. And I think that one would have to adjust these figures depending upon trends in world oil prices.

Senator DANFORTH. I understand. But that is the approximate estimate right now. Now of this $62.5 billion, it is my understanding that a portion of it would be used for mass transit, a portion of it would be used for alleviating the problems of poor people who have their energy costs going up and a portion of it would be used for investment in new technologies and research. Is that right?

Secretary SCHLESINGER. That is correct, sir.

Senator DANFORTH. Approximately what portion of the $62.5 billion would be used for research and technology for that part of the three-part program?

Secretary SCHLESINGER. There have been no final figures on that but the great bulk of the funds as indicated in the message from the President on the 5th of April would be used for energy research, the great bulk.

Senator DANFORTH. That is my understanding, too. Would it be fair to say that of the $62.5 billion, perhaps $50 billion would be used for research and technology?

Secretary SCHLESINGER. That is a good ball park estimate, yes, sir.

Senator DANFORTH. Now then, if it were $50 billion a year for new technology and for research, I think you said that presently we are spending about $3 billion a year for energy R. & D.?

Secretary SCHLESINGER. That $50 billion would be cumulative over a period of 5 years.

Senator DANFORTH. Of 5 years, so that would be about $10 billion a year, roughly?

Secretary SCHLESINGER. Yes, sir.

Senator DANFORTH. Today we are spending approximately $3 billion a year?

Secretary SCHLESINGER. Yes, sir.

Senator DANFORTH. So you are talking about approximately a 300 percent increase in expenditures for research and development, is that right?

Secretary SCHLESINGER. Some of this would not nceessarily be direct expenditures, Senator Danforth,—it also includes those tax credits, for example, the oil shale tax credit that this committee looked at last year.

Senator DANFORTH. I understand.

Secretary SCHLESINGER. That could be a substantial drain on those funds.

Senator DANFORTH. That is right. But essentially whether it is by a so-called tax expenditure or direct expenditure by the Treasury, you are talking about more Federal dollars that are going to be used for what might be called exotic forms of energy.

Secretary SCHLESINGER. More Federal support, I do not regard tax relief as direct Federal support.

Senator DANFORTH. All right, I would just as soon not argue about that. But I just wanted to find out approximately what you were thinking about. So that would be about a 300-percent increase, correct?

Secretary SCHLESINGER. Yes, sir.

Senator DANFORTH. Now what I would like to ask you about is how do you arrive at the optimum figure which should be spent for research and development and new technology?

Secretary SCHLESINGER. I think that it is both a proving question, Senator, and it answers itself. In this case the size of the energy security fund is determined by the movement of world oil prices, and the optimization process that you are seeking in this case does not exist.

Senator DANFORTH. I am sorry, I do not want to be argumentative but I cannot accept that. It seems to me that if we are trying to make the decision as to how much we should invest in research and development and technology per year over a 5-year period of time, there has got to be some basis of making a decision other than there is the money that is available.

Secretary SCHLESINGER. I agree entirely, Senator, and we will be happy to work with you on that problem. Let me say that the energy security fund was initially established under different prospects with regard to world oil prices and at that time the flow of funds was a much lesser number than you mentioned and that the optimization process that you seek has not occurred to date.

Senator DANFORTH. I think that it is important before we decide what sorts of tax revenues we are going to try to raise, to try to figure what we are spending the tax revenues, don't you?

Secretary SCHLESINGER. I fully agree, Senator. All I have indicated is to date that has not been done, we do not have decisions or recommendations.

Senator DANFORTH. Mr. Secretary, I am really prepared to support the administration, and I want to. But I am not going to buy a pig in a poke. And if you can persuade me that money is going to be well spent on research and development and new technology and providing the sort of subsidies for the private sector to engage the new technologies, I am with you.

But if we are just drawing figures out of the air and saying "Here is how much we can raise, maybe we can spend it," then I have fallen off of the bandwagon, so to speak.

Secretary SCHLESINGER. I fully understand the point. All that I am saying, Senator, is that we have not had decisions with regard to the composition of this program as yet from the President.

Senator DANFORTH. Would you do it before I have to vote, for my sake?

Secretary SCHLESINGER. Yes, sir, we will be happy to do that. I have indicated that I do not have the information today but the information that you seek is of course relevant to any decisions made by this committee.

Senator DANFORTH. OK. Now let me ask you one other question. Who is going to make the decisions on a day-by-day, year-by-year basis as to how this money is to be spent?

Some people have said that, for example, in solar energy some of that money has been pork barreled away. Some people have said that with respect to this particular trust fund, every Congressman whose vote is needed will have a windmill in his district.

Normally, the way we go about spending things in Government is a little bit here, a little bit there, let us get the gravy spread around. Now who is going to give us the word as to what sorts of projects make sense for the energy development of this country as opposed to the political futures of Members of Congress?

Is it going to be the Department of Energy? Is there going to be some sort of task force made up of the best scientists of our country drawn, for example, from the National Academy of Sciences? How are we going to do that?

Secretary SCHLESINGER. The particular organizational structure is one of those issues with which the President will be wrestling between now and the time that he addresses the Nation. I cannot give you an answer, I can give you a response in general terms, to wit, I agree with it. What I think is the inference to be drawn from your question that the maximum that we can do to separate this from the ordinary bureaucratic process the more effectively is that money likely to be spent.

Therefore one should look at some board or corporation insulated from the ordinary political process. That will require the cooperation of the Congress, and there has not always been uniformity in the judgment that pork barreling should be minimized.

Senator DANFORTH. Mr. Secretary, it is my understanding that you or other representatives of the administration appeared before a group of university presidents and told them that this is going to be a big fund to be used for science departments and universities.

One university president I know fairly well who was there told me that in his opinion the science programs of the universities would be swamped by this kind of influx of funds.

So it seems to me that before you ask Congress to fund a tremendous trust fund for the use substantially of research and development, you better give us some idea of; one, how money can appropriately be used; two, your basis for that kind of a decision and; three, who is going to be in charge of making these decisions as we go down the road.

Secretary SCHLESINGER. I fully agree, Senator. Let me say that the views in the two Houses have been somewhat different. The House of Representatives felt that if we ever began to discuss how the money was used, that for a variety of reasons, that there would be endless debate, endless higgling and piggling of the political market or whatever.

And that therefore, the thing that had to be done was to deliver the establishment of the energy security fund and the nature of the windfall profits tax without any discussion of how that money might be utilized or otherwise it would be dragged through the House only with infinite delays.

The attitude of the Senate is different. Therefore we will attempt to accommodate this body sequentially.

Senator DANFORTH. I do not want to know how it is going to be used, I want to know the decisions are going to be made as to how it is going to be used.

Secretary SCHLESINGER. Yes, sir.

The CHAIRMAN. Senator Heinz.

Senator HEINZ. Mr. Secretary, first let me ask you about a problem we are currently facing in my State of Pennsylvania. It is one that I had not really intended to bring up when I learned that you were going to appear here last week, but unfortunately is one I must. It relates to the threatened Pennsylvania-Delaware service station dealer's strike.

Now you and I, back on Thursday, June 21, before you left for Tokyo, discussed this matter. And my recollection of our conversation at the time was that you would try and get a decision for relief of the legitimate grievances of the service station dealers. Obviously up to or until now there has been no decision and no relief whatsoever put forward either by the Department of Energy or by the White House.

The present gasoline allocation system based on 1978 which went into effect March 1 without any public hearings before it went into effect, is still in effect. The allowable profit margins of the service station dealers which were frozen in 1974, I think, are still frozen at those margins.

Pennsylvania has received for the latest month an 83 percent allocation of gasoline, at least according to articles appearing in the Washington Post in the last couple of days, as opposed to what appears to be an 87 to 89 percent average nationwide. And as of tomorrow a lot of stations, we do not know exactly how many, would appear to be on the verge of shutting down. This is not very good for recreation or tourism or for people who want to get to work.

Now my purpose is, what can be done?

Secretary SCHLESINGER. Senator, as we proposed relief in this area, and that relief at the time we discussed, was pending at the White House. We had White House approval, I believe, the next day or within 48 hours of our conversation to go ahead with a pattern of relief.

Unfortunately, our lawyers tell us that in accordance with the Administrative Procedures Act, that we would be challenged in the courts for some of the very precepts that the chairman has discussed as he laid out this long chart. We would be challenged in the courts.

We have indicated that on the 15th of July, we have indicated to all of the retail associations that that announcement with regard to the pattern of relief will be made public and final as a rulemaking. In the interim we have published in the Federal Register the characteristics of that relief. So that it is now a question of 5 days from now that the final rulemaking would take place.

The characteristics of the relief have been outlined in the notice of proposed rulemaking in the Federal Register. We have compressed the time under the Administrative Procedures Act to the maximum extent that we can possibly do with regard to the initial question that you raised, the change in the base period from 1972 to 1978.

That was necessitated by the events in Iran, in which there was a close-down in Iran at the end of December. Within 6 weeks we had to change the base period because it had become irrelevant.

This is one area, Senator, that we cannot accommodate the desire of some retail operators because many filling stations have closed since 1972, many have had a much reduced volume since 1972. Quite naturally those who have closed or those who have reduced volume would like to get back their volumes of 1972 through allocations. And the effect of that would be to give them phantom allocations which would not be based upon their commercial performance in the recent past.

That rulemaking with regard to the permanency but in the area of relief on the margins, we have not been able to compress it to less than the 15th of July. That is the date that Mr. Watson at the White House indicated to these retailers that we would be able to complete the rulemaking.

I would trust the retailers will wait at least until the 15th of July, which is 5 days from now, to see the relief that is provided in that rulemaking and not shut down.

Senator HEINZ. So you are urging today that the service station dealers wait for 4 additional days?

Secretary SCHLESINGER. Yes, sir.

Senator HEINZ. And that is what you might call an official administration plea or request?

Secretary SCHLESINGER. Yes, sir. I think it is in their interests as well as the interest of the public in Pennsylvania for them so to do.

Senator HEINZ. Could you pull your microphone forward just a little bit, Mr. Secretary? I do not think anyone heard that.

Secretary SCHLESINGER. I am sorry. I say it is in their interests as well as the people of western Pennsylvania for them to do so.

Senator HEINZ. Mr. Secretary, thank you. I hope that what does come out on the 15th is real and deals with what I conceive to be a number of very legitimate and understandably legitimate grievances.

In the 30 seconds or so remaining to me, I will ask you one question that relates directly to this. Well, I guess I have to wait until my next turn. Thank you.

The CHAIRMAN. Go ahead.

Senator HEINZ. Well, all right. The question is this: Under the President's plan we have this decontrol proposal and windfall profits tax. It is going to produce over the next 5 years x amount of oil. I have not seen any very good number on exactly what x is but it is a derivable if inaccurate number.

Secretary SCHLESINGER. I am sorry.

Senator HEINZ. I say it is a derivable if inaccurate number. There is an alternative to the President's plan that is worth considering, and that is leaving the price controls on the old oil and giving a market price for the production of truly new oil.

Not unlike in some respects the Senate position on natural gas, the benefits of that plan are that there is not a high price rise on the old oil and that we do not get into the very good and thoughtful arguments of Jack Danforth, and what do we do with this energy trust fund bonanza, which may be windmills and may be something else.

My question is: How much, in your judgment, would such a plan which gave whatever the market price was for truly new oil and did not give any windfall on the old oil, produce more or less oil domestically over the next 5 years than the plan which we know produces x amount of oil over the next 5 years? Is y the oil yielded, going to be greater or less than x under the alternative plan?

Secretary SCHLESINGER. Senator, that is a complex question. Let me start by observing with regard to your observation of Senator Danforth. Yesterday, I heard the proposal that we build a syncrude office building in every congressional district in the United States just for starters. So there is the danger that you referred to.

As you know what you have proposed, just suggested, I should say, or examined, is what was included in the original national energy plan which has been endorsed, oddly enough, of late by Mobil Oil and by others. That was to free new oil to world prices.

Senator HEINZ. Well the Mobil plan would have—I am not proposing exactly the Mobil plan because they would have total decontrol of old oil in the middle of 1981. I am looking at over a 5-year horizon.

Secretary SCHLESINGER. We have been concerned for 2 years now about marginal wells, and I do not know whether your proposal includes the relief for marginal wells that we have already gone ahead with. I think that last year at this time there was certainly a consensus that we required marginal well relief.

Senator HEINZ. Let us assume that it does.

Secretary SCHLESINGER. In my judgment, unless we give relief now for these older fields, as we have suggested in these recommendations.

With regard to world price for new oil without a windfall tax, indeed as you suggest, that would produce somewhat greater production by 1985. It is estimated in the computer models of 150,000 barrels a day.

These estimates are of course subject to some serious challenge between the time of the national energy plan, and today world oil prices have gone up very significantly so that we are looking at the incentive effects in effect of $19 a barrel oil, even with the windfall profits tax. And that has been felt to be adequate.

You would probably get more oil short-term by doing what you propose. You would damage to some extent the long-term recovery from older fields.

Senator HEINZ. Mr. Secretary, in order to try and keep this discussion short, let me just ask you if you could provide to us two pieces of information. That is an analysis of what I have described would produce out over as far as you can go, 10 years, that would be very helpful, more than what the present energy plan would produce.

We recognize their inaccuracies on specific numbers, yet, if you use the same methodology for both, you should have some kind of a relative measure that is meaningful.

The second thing I would appreciate is the same kind of anaylsis of the consumer price effect which will be under the administration's current plan substantial and under the plan that I have suggested, not proposed, but suggested that we should analyze would be certainly less, exactly how much, I do not know myself. If you could do that, it would be most helpful.

Secretary SCHLESINGER. I will be happy to do that.[1] I add one point, if I may, Senator, that we will also include in there the profile of the impact on the rate of inflation. Because if controls do come off in September, 1981, then there would be a sudden jolt to the economy unless we phase in decontrol.

One of the reasons for proceeding as we have is in order to allow the impact on the economy to be gradual rather than sudden.

[1] See part 2 of these hearings.

Senator HEINZ. Under the suggestion I am asking you to analyze controls would not come off in 1981. We would retain present controls. Thank you, Mr. Chairman.

Secretary SCHLESINGER. We will analyze that. I believe that decontrol is desirable. But if I believe the contrary, I do not believe that there are the votes on Capitol Hill to extend controls beyond September 30, 1981, and I am not sure whether or not those votes would be gathered if you were to be convinced of the superiority of this.

Senator HEINZ. Mr. Secretary, I think that the Congress is not beyond hope here. But if we can find an alternative that will result in more production at a lower cost, we are still rational enough to vote for it.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Mr. Secretary, I would like to return just a bit to the chart over there, and to your remark that what we are involved in is an institutional morass. And in thermodynamic there is the term "entrophy" which describes the diminishing capacity of a system to do work. And entrophy is part of the problem, part of the condition we see.

But you know there are explanations for this. One of the characteristics of such an affected system is that you cannot get anything done because it wants to do two things. Without asking you to comment on the first part, let me just say that as you know, your principal deputy has just resigned. A man much admired, you know.

He remarked that the reason he could not get more energy production decisions out of the administration is that the White House was filled with people who were against those decisions. They were against more energy, against more growth. I see you nodding there.

Secretary SCHLESINGER. No comment.

Senator MOYNIHAN. No comment?

The CHAIRMAN. What he meant was that he heard what you were saying.

Secretary SCHLESINGER. I may have involuntarily moved my head, Senator.

Senator MOYNIHAN. The President cannot have an administration equally divided between those that want more energy and those that want less, and expect to have a positive, or for that matter a negative outcome. They should expect to have this morass.

I think I have the same concern about OPEC. Over the weekend in the a memorandum we learned that Congress was hopeless. This was a memorandum for the President by his chief staff advisor written by members of the advisor's staff.

The President has people who read the memos prepared by people who write them. It said to make OPEC a target. And yet as we learned yesterday, the White House expressed its great appreciation for the Saudi Arabians producing another million barrels of oil a day, and said it subscribed to our long friendship.

As the Washington Post this morning said, "it makes your head spin." They raise the price 61 percent, we buy more and we say it is a friendly act.

This gets us to the whole question of the energy conservation trust fund. You remarked that the amount of money in the trust fund would depend on the movement of world oil prices, which is as much as saying that, the more OPEC raises its prices, the more we are going to have in the energy conservation trust fund, although we will have less money in the United States.

I want to ask you, is this administration really of one view on this. Because when we first were presented this program, the administration described this tax as the OPEC rip-off tax.

Now I wonder are we institutionalizing on interest of our own in OPEC continuing to increase prices? Certainly we do not protest it. We actually describe it as an act of friednship when they increase prices 61 percent and then agree to sell us more. Are we in a situation where we are writing OPEC in the Internal Revenue code? Should we not be out to put an end to that cartel?

Secretary SCHLESINGER. This cuts a number of ways, Senator, as you indicate, and there would be some institutional beneficiaries under this arrangement of increases in world oil prices.

Senator MOYNIHAN. You mean there are people who are going to get rich in this country if OPEC gets richer? That is right, is it not? I do not think you can do anything about it, but that is right.

Secretary SCHLESINGER. I think that any transformation of prices will have that effect. It will relate to shifts in the distribution of income. In this case it would augment the receipt of those who were working on these new technologies amongst others.

But I think it is fair to say that the Saudis, that OPEC is made up of different groups. It is made up of moderates and it is made up of those who are radical with regard to price issues, that in all cases the Saudis have been on the moderate side, that they have attempted to moderate price increases.

The position of the U.S. Government very clearly has been that the lower the price increase, the better it has been. The U.S. Government certainly did not welcome these price increases, quite the contrary, but the Saudis have been helpful. They have attempted to be helpful in the past on price issues, and certainly an augmentation of production given the chaotic state of the international oil market is beneficial to the United States. It should be welcome.

Senator MOYNIHAN. Mr. Secretary, you have to be on friendly terms with those countries, and I understand what you say. But it is the fact that OPEC by that action, as the President said in Tokyo, wiped out every bit of growth we are going to have next year in this country. It added 2½ points to inflation. And every American, with few exceptions, will be worse off next year because of the OPEC decision.

It was not a friendly act. And I hope this administration really is not just accommodating itself to OPEC but really hopes in the end to make it an ineffective cartel to break the current cartel. Would you tell us that that really is your purpose? It makes a difference on how I am going to decide here.

Secretary SCHLESINGER. The purpose is to gradually lessen the influence of the cartel, to reduce its role, that can only be done by limiting demand on the product sold by the cartel either through greater efficiency or the substitituion of other alternative sources including for the most part increased domestic production. That is the only way aside from diplomatic means to deal with it.

The goal of lessening the cartel's role has been a permanent element of American policy.

Senator MOYNIHAN. I would only say, Mr. Secretary, and I will not keep the chairman another moment. It is like the domestic group. One is for production and the other one is against. There is the same ambivalence.

Secretary SCHLESINGER. I understand the point that your are making, Senator, and there are diverse views with regard to this problem. But for those to whom you are referring, I think that they have the belief that far more can be accomplished in terms of conservation or curtailments of energy consumption in the United States and through solar energy and some of the rest of this field is practicable. But both go in the direction of reducing the demand for OPEC products.

Senator MOYNIHAN. I would like to be one more of those who adds his professional gratitude. Hang in there, Mr. Secretary.

Secretary SCHLESINGER. Thank you.

The CHAIRMAN. Mr. Chafee.

Senator CHAFEE. Thank you, Mr. Chairman. I would like to join in the tributes to you, Mr. Secretary. You have had grace under pressure, as Hemmingway says, through a long ordeal. And I think that the country is the beneficiary for your services.

You were discussing limiting demand on OPEC. In the final analysis, what is going to make conservation work or what is going to curtail demand? Is it not really going to come through price?

Secretary SCHLESINGER. In my judgment that is an essential ingredient. It is not the only element, it can be helped along by ancillary measures of public policy. But if you are attempting to fight the price mechanism, you are not going to get the results that you want. You have to have the price mechanism working for you rather than against you.

Senator CHAFEE. Right. And so its price is going to make the substitutes that you outline come onstream, it is going to unleash the inventive and ingenious powers of the American people to go find them.

I see the Vice President gave a stirring speech to the national Governors the other day. He was not quite as pessimistic as you, that this would take 8 years to find substitutes. He had them in, I think, substitutes for rubber, I think he said in a year. And he indicated that we might find substitutes for gas in a short time.

If such is so then, why is the administration refusing to go to the freeing of prices on gasoline and lifting the allocations? And I would like to know your personal recommendations on that.

Secretary SCHLESINGER. Senator, in the national energy plan in 1977, it was established as an immediate goal that we deregulate gasoline prices.

Senator CHAFEE. That was how many years ago?

Secretary SCHLESINGER. That was in 1977, in the national energy plan. That has continued to be the objective of the administration. It was renewed yesterday as an objective. I will return to that in a moment.

We were held up on gasoline decontrol by the Congress, which would not entertain an energy action until such time that the "dealer day in court" legislation was passed.

By the time that was passed, we were held up in part because of the feeling of some Members that there would be a confusion between gasoline decontrol and deregulation.

That was referring to natural gas, and therefore that it should not move forward at that time. We were also held up by a challenge in the courts, a challenge to NEPA in regard to the increased differential between the prices on leaded gasoline and unleaded gasoline, and that had to be resolved.

We were then required at that juncture to prepare an EIS, which was started in the summer of 1978. We were then faced with a court challenge. That EIS was finished in the fall of 1978, and put out for public commentary.

We were prepared to go for gasoline decontrol last winter when the Iraninan situation came on, and it was felt that the jump in prices would be too severe.

That brings me back to the initial point that I think that the judgment that has been made in regard to gasoline decontrol has been based upon the fear of the consequences for the consumer of a sudden jump in prices of 35 cents per gallon or what have you.

Senator CHAFEE. Well, we are getting regular increases in prices anyway.

One other question, Mr. Secretary, getting to the chairman's chart up there, everybody is saying, that is just for oil, what if it were for coal?

As you point out, Congress has had a hand in all of this. The Congress has had a hand, but in all fairness, there is somebody at the top overlooking everything. It is both you and the President. The Congress works in limited spheres. This committee works in this area, another committee works in another area.

Yet, when each of these legislative measures were passed, dealing with clean air, whatever that might be, there is a magnificent Rose Garden signing ceremony, in which everybody joins, pictures are taken, cheers are emitted, and it is a grand occasion.

Yet, now you tell us that each of those measures which were so widely applauded at the time have contributed here. Do you not think that it is somebody's responsibility to say, stop, this is a detriment to the national interest? Nobody has done that.

Are you coming forward with plans or some proposal to limit this? The chairman said that it would be 8 years, and that he would be happy with 4. I would be bolder and suggest 2, or maybe compromise at 3 years or less.

What do you propose?

Secretary SCHLESINGER. Well, I cannot give you the specifics on that, but something indeed will be proposed. I suggested a variety of options earlier, that I would be prepared to review again.

Again, the reason that these things are applauded in Rose Garden ceremonies is that they are laudable objectives. The problem is that legislation is passed piecemeal. I have often thought, Senator, that we are often in the same position with these legislative objectives as we were in regard to Budget and Accounting Act of 1922, that required conscious tradeoffs among spending programs.

We do not have that in regard to these legislative objectives, so that each one is piecemeal, and maybe the goal should be to establish a Bureau of the Budget equivalent in order to examine these tradeoffs before, for laudable reasons, we restrict one program for laudable goals in another area.

We will come forward with some proposals, I believe, in that area, but the President has not yet decided on it.

Let me say, that I do not think that DOE is a part of that chart. We are a part of other charts, but not this particular chart.

Senator CHAFEE. I certainly would encourage you to come forward with those proposals.

Thank you.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. Mr. Secretary, every now and then, I sit long enough on this committee and muse back on other witnesses, things seem to come into focus as an accommodation of some of our experiences.

During this recess, one of my bright young legislative assistants hit upon a capital idea from a public relations standpoint, or my traveling around the State in parades in automobiles that were powered by other than gasoline. It was a capital idea from a public relations standpoint. It taught me a lot. I was struck by the fact that they were both practical and usable.

Your statement today, that you make this in terms of reserves of oil, based on proven reserves and potential resources of 140 billion barrels or more, and I assume that your source for that figure is USGS.

That is the same survey, the same figure that they had, and that is for identified resources. That is what the USGS calls them.

Secretary SCHLESINGER. Let me check on that.

Senator PACKWOOD. All right. You can check on that because the undiscovered I have on USGS is economic 50 to 127 and sub economic 44 to 111.

Secretary SCHLESINGER. I think that is right. It includes only those resources prospective undiscovered resources that are prospectively regarded as economic as opposed to those——

Senator PACKWOOD. Right, with about a 90-percent surety factor in their charts although the only thing that makes me have some misgivings is they refer to it as derived by the Monte Carlo aggregating technique. The name does not give me any great security as a method of statistics. Then, we go back a couple of years to Barry Commoner's testimony before this committee, yes I know he is a friend of yours, Jack, Barry Commoner's testimony, who of course wants to skip the nuclear age and go immediately to solar.

But he uses roughly the same figures you are using of oil if you count the undiscovered but probable, roughly 276 to 440 billion barrels and at 6½ billion barrels a day enough to last us for 40 to 60 years which is, in Barry's estimation, enough to get us to the solar age. Now that is just all past history. Every now and then——

Secretary SCHLESINGER. Could I comment on that last point Senator?

Senator PACKWOOD. Yes.

Secretary SCHLESINGER. In recent years the United States has been producing 3 billion barrels of oil a year and discovering 1½ billion barrels of oil a year. As a result our reserves have gradually diminished. It is going to require one substantial increase in drilling activity, a great deal of luck and effort, simply to bring our present discovery up to the rate of our present production.

We are not going to be able to produce 6½ billion barrels of oil that Mr. Commoner referred to and we are going to have to discover it at a hell of a pace in order to have that 40 years of supply. Right now the present tendency is down.

Senator PACKWOOD. I remember when the USGS testified and we had the debate over the firing of Dr. McKelvy and it very clearly indicated that. It doesn't matter how much money you put in, we are not going to from 3 billion to 6 billion barrels a year in production, but that we with sufficient money, based upon their expirations and a sufficient price, could get there over a period of time.

Now the thing that pulled all this together for me and I don't read many of these books that are sent to us, but we have all received this book "Energy Future" which I had a chance to read during the recess put out by the Harvard Business School, edited by Robert Straubaugh, who has testified before this committee a number of times. Normally on the multinational business of conservative guide, for lack of a better word. This book concludes that pretty much based upon what the USGS says and the fact that we can make our oil last, that economically and this is where they were coming down on a marketplace conclusion, that our best future lies in conservation and solar energy and they meant it for the remainder of this decade and that by the end of this decade solar energy can be producing between a fourth and a fifth of our energy needs, assuming you are willing to let the price of oil rise and assuming you are willing to use up the resources that we think we have and I am curious if in your estimation this is a valid conclusion.

Secretary SCHLESINGER. Our projections given present incentives, including those passed in the National Energy Act, shows that solar energy, including hydropower and the burning of wood, which is fairly old-fashioned, will produce about 13 percent of our energy budget by the year 2000.

The President has called for an objective to raise that, if possible to 20 percent. So I think that by the end of the decade of the eighties it is just not conceivable that we are going to extract as much from solar energy by the end of the eighties.

You mentioned 1990, did you not, or did you mention the year 2000?

Senator PACKWOOD. No; he was talking about two decades hence. He is talking about the year 2000.

Secretary SCHLESINGER. The President has called for what is a fairly ambitious, indeed a very ambitious goal of 20 percent by the year 2000. But I think that, and we should, all of us, strive to make as much as we can of solar energy. It will not come in immediately. I think that we have got the short-term problem as well as the long-term problem. We are not going to have increases in oil supply in this country in the course of the next 5 or 6 years.

We will be lucky to maintain domestic production even with the additional incentives. We will be freezing availabilities from overseas at about 8½ million barrels. If this country is to continue to grow we are going to have to turn to coal and I think, nuclear power.

That is irrespective of what Mr. Commoner said.

Otherwise we face the alternative of low economic growth and lower levels of employment, rising levels of unemployment. Indeed the summit, the seven leaders of the industrial nations, concluded that without a substantial expansion of nuclear generating capacity all of us face higher levels of unemployment and slow economic growth and I think that that reflects a recognition that our near-term alternatives are not sufficiently grandiose that we have the luxury of choice.

Senator PACKWOOD. Let me ask you one concluding question on the oil in USGS surveys. You said for 5 or 6 years we cannot count on any increase. Is it an accurate statement that we can count on an increase over two decades assuming we were willing to start with the premise that we were going to use up our oil supplies and would not let price be a deterrent—I mean in the sense of controls or limits on price?

Secretary SCHLESINGER. I cannot say yes to that. I cannot however suggest that that is wholly impossible. The problem that we have had is that those vast fields, the supergiant fields, the billion barrels, 500 million barrels, are probably for the most part discovered in the United States.

That this is the most drilled-over area of the area. When we drill now we find a reservoir of 2 million, 3 million barrels, instead of that ½ billion barrels. Half of our production today comes from those giant fields that were discovered in the forties and fifties. It will require immense effort to increase the discovery of new reserves.

If we were to put 10,000 rigs to work we could increase the rate of discovery of reserves over recent levels of production. I would hope that what you say is correct, what you suggest is correct, but I have got to see the evidence of that. In the near future, in the near future indeed the prospects are grim.

The CHAIRMAN. Mr. Secretary, could I interrupt you for just one second?

Secretary SCHLESINGER. Yes.

The CHAIRMAN. Mr. Secretary, the Mineral Board of Louisiana had a study done on potential, recoverable reserves of oil and gas. You may be familiar with it. What they say is that in Louisiana, which is the most thoroughly drilled area in the world, that only 15 percent of the structures have been drilled down to 30,000 feet. In other words, only 15 percent have been drilled, much less developed, so that 85 percent is yet to be drilled.

Now Louisiana is the most thoroughly drilled area in the world, and it would seem that we have only drilled 15 percent. If your people are estimating that we can't provide enough oil and gas for the next 25 or 30 years, I would think that this must go back to some kind of estimate they gave us a couple of years ago, that we would be using all our drilling rigs at a certain figure and therefore we couldn't get any more energy than we would get otherwise—completely overlooking the fact that you ought to have about four times as many rigs working. I would like to check with you on that estimate that we can't find the oil and gas to see us through for the next 25 years.

Secretary SCHLESINGER. The conventional estimates, Senator, and they are conventional, Mr. Chairman, are that we have produced about 140 billion barrels of oil in this country through our history and that we may produce that amount again through conventional techniques, putting aside the very substantial increases in the recovery fact. I hope that you are right, but when one talks about 15 percent of the structures, one must recognize that the very big structures, with the exception of the Alaskan north slope, have been the ones that have already been drilled and it takes a great deal, a great many structures of 2 or 3 million barrels to equal, in effect, in production effect, one of a billion barrels.

The CHAIRMAN. Someone just told me a couple of days ago they have discovered this Tuscaloosa sand that you have heard about, I'm sure, in Louisiana. They said the gas is about 20,000 feet deep sand, but they said that they expect that to produce more gas than Louisiana has produced in history.

Secretary SCHLESINGER. We certainly agree with the aspirations and the hopes with regard to deep formations. It was the reason that gas below 15,000 feet was deregulated immediately under the legislation of last year 1 year after the passage of that legislation. Below 15,000 feet one does not get much oil, but there is every reason to believe there is very substantial opportunity to get gas down there 20,000 feet, maybe even deeper than that and there are no geological reasons to suggest that in these areas that have not been drilled there are not substantial reserves of gas. We don't find oil down there, however.

The CHAIRMAN. Pardon me, Senator, I just thought we would——

Senator PACKWOOD. I think I ran through my time already.

The CHAIRMAN. Do you want to ask another question?

Senator PACKWOOD. I have asked all I wanted to. Thank you.

The CHAIRMAN. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, I think all of us agree that we are in a very difficult position and while we may not agree with every detail, I think you have done a very creditable job. I have four questions to ask in 7 minutes so I will just briefly run through them.

The first concerns the likelihood that the administration might institute immediate decontrol on the price of crude oil. What is the likelihood of that?

Secretary SCHLESINGER. I do not think that that is likely, Senator. I think that we all recognize that on the House side that support for phased decontrol was tenuous at best and that many of those who supported it with some reluctance or some ambivalence, I should say, would jump off if there were immediate decontrol.

Second, that phased decontrol does serve the purpose of moderating the impact on the domestic economy, so I think that the probabilities of that are very low.

Senator BAUCUS. Reading between the lines it looks like the administration is with whatever revenue it can find, that is, it supports the House figure of 60 percent rather than what it did earlier——

Secretary SCHLESINGER. The administration is supporting that 60 percent.

Senator BAUCUS. I am sure that the administration is worried about balanced budgets for next year too. Also I am sure there is a tremendous incentive for the administration to try to take measures which will ease the burden on the budget as much as possible, such as looking toward development of other sources of energy.

Secretary SCHLESINGER. I cannot confirm that. I do not have any reason to dispute it however.

Senator BAUCUS. I am also in agreement with the general approach of weaning ourselves away from OPEC, producing more, and establishing price incentives in order to make other sources of energy more price competitive.

Personally I am a little concerned that the administration still is not taking a harder line with respect to OPEC and some of the cartel countries. I have read that Saudi Arabia has been a moderating influence, but nevertheless, they have gone along with the increases and have contributed significantly to our problems.

I agree that perhaps we have more of what they have and we have what they want, but I would encourage you and the administration to be more specific in coming up with more direct proposals and more directly discourage some of the actions some of the cartel countries have taken. My sense is that we have been too lenient, too lax, and that we are paying too high a price for ultimate production through means that you are talking about.

Secretary SCHLESINGER. I think that that country has suffered from illusions. We have suffered from illusions as to the ease with which oil could be produced, volumes of oil that might be produced elsewhere. We comfort ourselves as a country for 2 years with the notion of an oil glut worldwide. In prior years there was a belief that the cartel would fall of its own weight and that the price would become $5 a barrel.

I think that all of those comforting tales were told and that therefore we have been slow in facing up to the long-term problem.

Senator BAUCUS. There are wide differences it would seem to me between the cartel countries.

Secretary SCHLESINGER. I beg your pardon?

Senator BAUCUS. There are wide differences between the countries. You have the militants and the moderates and even liberals in the cartel.

Secretary SCHLESINGER. And for the period 1977–78, there was no price increase because the moderates had the inclination and the bargaining power to prevent such price increase. We worked through diplomatic means to achieve that.

Senator BAUCUS. I understand what you are saying, but I personally think we could be much stronger and tougher than we have been so far.

The third basic question is the degree to which, in your judgment, the drop in domestic production in the United States is attributable to anticipated price decontrol. That is, if you look at the figures, production in the United States during the first few months of this year was slightly higher than it was for each of those months last year, beginning about the third week in March, in yearly figures. I got my information from CRS and DOE, and it shows that there is suddenly a tremendous drop in domestic production, and it is lower than it was in each of the corresponding months of last year—in the neighborhood of about 200,000 to 300,000 barrels a day.

I don't know that it is necessarily attributable to an anticipated increase in crude oil price, but I am asking your judgment on the drop of the domestic production.

Secretary SCHLESINGER. Let me say that the sudden drop that was reported in the press and so forth that that reflects not so much what is happening in the real world than the difference between two time series. One was the BOM, Bureau of Mines series and the other is the DOE first-purchaser series. There is a difference of about 150,000 or 200,000 barrels a day immediately between those two series because one of them is less complete than the other and ultimately there is a correction. I think there may be some misapprehension of a sudden drop that has mysteriously occurred around the beginning of this year that probably has not occurred on the basis of the differences between these two series.

Senator BAUCUS. Go ahead.

Secretary SCHLESINGER. There has been a steady drop over the last 4 years of about 380,000 barrels a day in production in the lower 48 States.

Senator BAUCUS. In the interest of time has any of it dropped, in your judgment, or are the companies holding back?

Secretary SCHLESINGER. No, sir, not in my judgment. There may be exceptional cases somewhere, but there is no large element uncertainties on the part of the companies about the future may have affected what they have done, but I think you have seen a steady decline of production in the lower 48 States. We peaked out in 1970–71. It is a perfectly natural phenomenon and it has probably been reinforced somewhat by the control system on oil since 1973–74, but I don't think withholding is a problem or a significant aspect of the problem.

Senator BAUCUS. I had one more question, but my time is up.

Secretary SCHLESINGER. All right. I am sorry.

Senator BAUCUS. Thank you.

The CHAIRMAN. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

Mr. Secretary, earlier you tied growth of the GNP to growth of energy and you said we have to have 1½ percent increase in energy in order to feel a 3-percent increase in GNP.

Secretary SCHLESINGER. If we achieve a point——

Senator BRADLEY. Now what level of savings due to improved energy efficiencies embodied in that 1½ percent increase in energy?

Secretary SCHLESINGER. Until recent years the United States had an energy coefficient of 1.45. We have in recent years reduced that coefficient to 0.54, which is better I might say in passing, than our European associates have done. That is an accomplishment. We may have done even better in the past, but using that as a benchmark, that reflects very substantial improvement in the use of energy by industrial users in particular and some improvement in the home and some improvement in the efficiency of automobiles.

Senator BRADLEY. Well I would like to suggest that what Senator Packwood said didn't relate solely to solar, but also to improved energy efficiency and that the particular study he referred to said that by the year 1990 we could achieve 8 million barrel equivalent in improved efficiency.

Now I think that yesterday the chairman alluded to the fact that we consume 30 percent of the world's energy and we certainly know that we have abundant resources in coal, oil shale, oil, compared to most of the Western World, but we also have an abundant resource in the constant use of energy and I think the problem is that we have sold conservation, as good puritans always sell it, through increased sacrifice and tightening the belt when in fact there is a great opportunity out there to make money, reduce our imports, improve our environment, create jobs for people in the country that don't have jobs. I would like to know, in your opinion, why haven't you moved more aggressively and why haven't the major obstacles that would prevent this country from becoming more energy efficient and meeting the goals that the Harvard Business School study said were economically feasible and reasonable of 8 million barrels a day by 1990?

Secretary SCHLESINGER. Well, Senator, I just do not wish to contend with the observations that you have made because we are in full agreement about that. Our conservation, at least as far as we have gone, has been one of the really substantial successes we have had in recent years. It was a major element in the national energy plan of 1977 and I think there was scepticism at the time.

I think it has been demonstrated that the perception of a lock-step relationship between GNP and increased use of energy was erroneous and to this point we have pulled down the coefficient to the point that we are better than the Europeans and that we are approaching Japanese standards. Let us strive for more, but do not let us understate what we have accomplished to this date.

The national energy plan has many incentives in it, including tax incentives. Industry is pushing ahead. There are EPA standards to increase the efficiency of automobiles. We have incentives for the improved efficiency in homes and that will be driven further by price increases. I think this is a glorious future.

Senator BRADLEY. Well I applaud our energy conservation coefficient as well, but as you have testified, it has come primarily in the industrial sector and not in residential or in transportation. In the industrial sector you also pointed out that in Germany there was a big push for nuclear because that was the only way that we could meet our increased energy consumption. Yet in Germany in the industrial sector, 27 percent of their electricity is provided by cogeneration and in this country 5 percent.

Now if you are looking for where you can put your dollar from an antisecurity trust fund to generate the maximum return in the way of increased energy and less independence on foreign sources oil, where would you put that dollar?

Secretary SCHLESINGER. Oh, I couldn't agree more. It has been our point that the cheapest barrel of oil that we can buy is the barrel of oil achieved through increased energy efficiency. That does not mean curtailments or sacrifice. It means increased energy efficiency. We put through legislation, as you gentlemen all know last year to encourage cogeneration.

We have been laggard in this country. That gives us a greater opportunity to catch up. The President will be proposing additional conservation measures which will affect the homes of America, hopefully in a similar extent to the accomplishments of the American industry.

So I would like to endorse your comments. We have no inhibitions about conservation. I think that the argument about whether it be production or conservation is wrong. We need both.

Senator BRADLEY. Well I understood from your earlier comment that you preferred production which is fair enough.

Secretary SCHLESINGER. Well at the time of the national energy plan it required great persuasiveness I think to carry across the view that indeed that lock-step relationship could be broken. We have had success in this area. We shall continue to strive for success. Perhaps we should rhetorically emphasize that.

We are assuming that we will make every effort on conservation that is reasonably cost-effective and perhaps some that are not reasonably cost-effective.

Senator BRADLEY. Are you willing to ascribe a new value to save energy? If you talk about the comparative pricing to produce the equivalent of synfuel of $35 to $40 by the time it gets in use to, to produce the equivalent of a savings of oil, are you willing to put that into utilities price and the way utilities move toward conservation?

Secretary SCHLESINGER. My inclination, I cannot give you a flat answer to that, but my inclination is to say yes. When we talk about import reduction we are not only talking about 2 million barrels of synfuel in the House bill or whatever the President's ultimate decision may be. It also includes these conservation measures that may carry 3 or 4 million barrels.

Senator BRADLEY. Just one more comment and that is, everything I have read about the meetings in Camp David, have emphasized the production in the energy problem and if you read that our critical problems in the next 5 years, even if we reduced this from 8 years to say, 6 years, if we talked about synfuels at 6 to 7 years, the only way we are going to obtain immediate savings and release from the pressure of OPEC is through energy-efficiency and yet there is not one report and you say we could do more, and yet there is not one report emanating from Camp David that gives us any inclination that there is going to be this effort made.

Secretary SCHLESINGER. Senator, I think in the final conclusion you will not be disappointed in that regard. I cannot answer to what one may call relative leakages to the press.

There is, right now there is a glamour about synfuels and there is a great attention to it. Two years ago perhaps conservation was more glamorous.

Senator BRADLEY. I don't think conservation the way it has been presented has ever been glamorous. I think it has been deferred gratification. That is the way it has been presented.

Secretary SCHLESINGER. I think there has been a great deal of that but when we talk about improving energy efficiency that is the heart of conservation, improved energy efficiency, not curtailments. And to the extent that arguments for conservation have been presented by people with puritanical inclinations who want to change lifestyles, that that has not served the purposes of conservation for the very reason that you mention.

A conservation need not mean belt-tightening or curtailments. That it can be the most efficient way to supply our energy needs through cost-effective measures.

Senator BRADLEY. Thank you.

The CHAIRMAN. Senator Boren.

Senator BOREN. Mr. Secretary, in response to another question you talked about the necessity of maintaining production from the older formations and maximizing it, marginal oil and stripper oil, I wonder about the treatment of stripper oil under the proposal of where stripper oil has now under the status quo of world-price, $20 or more and under the tax you would go back to a base of $16 and it would be taxed on the differential. So in terms of producer revenues we would actually in essence have a rollback in terms of stripper production and I believe stripper production is somewhere between 10 and 15 percent of the national production.

Would that not be a disincentive in terms of production and might the committee be advised to look carefully at the treatment of stripper oil under this proposal?

Secretary SCHLESINGER. Your point is well taken, Senator. The real question is the base point for such analyses and uses as a base point last December quite obviously, incentives have very much improved. If one uses as a base point the recent OPEC prices increases and then imposes a windfall tax that would relate to some shrinkage of incentives.

I have indicated what the administration's position is. I would not presume what to advise the Senate what to review or not to review.

Senator BOREN. The questions have been asked and I certainly associate myself with the comments that have been made by Senator Danforth and by Senator Ribicoff, I think indicate some distress by at least some members of the committee of turning over vast sums of capital to the Government to make investment decisions with. I think the history of investment decisions by units of government worldwide is pretty notoriously bad.

You have talked about in your statement the need to make sure that we have adequate capital formation of the private sector and I wonder, Secretary Blumenthal's testimony yesterday, I was endeavoring to find out if the administration was sympathetic to allowing existing energy companies or encouraging them to go into new forms of energy production, synthetic fuels and so on, that the administration was positive on that.

Now if we can find a way instead of taking and of course every time OPEC freezes its price, more and more of the money generated by decontrol will in fact end up in the Government treasury. We have talked a good deal about are the oil companies really happy in the league with OPEC every time they raise their prices. It looks to me like we are setting the stage for a Government treasury to be the main beneficiary of the increased prices by OPEC.

Will it not be advisable for this committee to try to determine how we avoid the money having to go through the hands of the Government, if for example, we have company A that is an existing energy company and the cash flow is coming to them prior to any tax, instead of taking that money that you might want them to invest and encourage them to invest in synthetic fuel, sending it to some bureaucracy in Washington and have 40 percent of it fall through the cracks as committee after committee does cost benefit studies of whether this project or that project might be worthwhile.

Wouldn't it be better for us to devise ways through tax credits and other mechanisms of giving an incentive of company aid to keep the gas, not send it to Washington where we will have this great overhead cost and surcharge against us and have it go directly into the kinds of production facilities that we would like to see built through the private sector approach?

Secretary SCHLESINGER. It has been our objective to minimize Government involvement and engage the private sector that has the technical resources. As I indicated to Senator Danforth, I think, we should pursue these high-risk areas where the companies understandably have been very reluctant to go. A mechanism that provides a Government subsidy could be used to engage them. I fully agree and I think that further investigations of such mechanisms is well warranted.

If we might come up with a list of categories, the types of projects we want to encourage perhaps the Government could always be a standby purchaser to guarantee price which probably they would never have to step in and it gives a tax credit so that the company could take the cash it has rather than send the cash to Washington and have it sent back.

Senator, what we have been suggesting is not necessarily in conflict with what you are suggesting. For example, the oil shale tax credit that Senator Talmadge in particular pushed very hard for last year which we endorsed and we were disappointed not to see go through, is designed simply to avoid that bureaucratic process and the tax credit roof may be an effective way of bringing on these infant industries. So there is not necessarily a conflict between what you said and the energy trust fund. The tax credit is a valid way of using that energy trust fund.

Senator BOREN. Senator, while you and I have had some differences over parts of energy policy, one of the things we have agreed about is the need to have some mechanism for resolving the environmental versus the production balances mentioned by Senator Moynihan and others, some place that we can actually strike this balance and get on with the job at hand instead of having this indeterminable delay.

I read an article in this morning's paper that said they thought it was really the crux of the challenge that the President faces and it may well be the test of his Presidency, whether or not he comes to grips with this problem.

We have never yet created in the Federal Government one single focal point, one place where these differences can be resolved for the decisions to be laid out for everybody to see. Everybody wants more production for cleaner air and cleaner water. Are you really and truly optimistic that out of the current deliberations will come a resolution in the way of creating a forum for the making of those kinds of decisions and focusing accountability frankly, for those kinds of decisions.

Secretary SCHLESINGER. I am reasonably optimistic. I think there is broader recognition of the problem and the direction in which we will be going I think is foreordained.

The speed with which we pass along that path I think remains to be determined.

The CHAIRMAN. Senator Bentsen.

Senator BENTSEN. Thank you very much, Mr. Chairman.

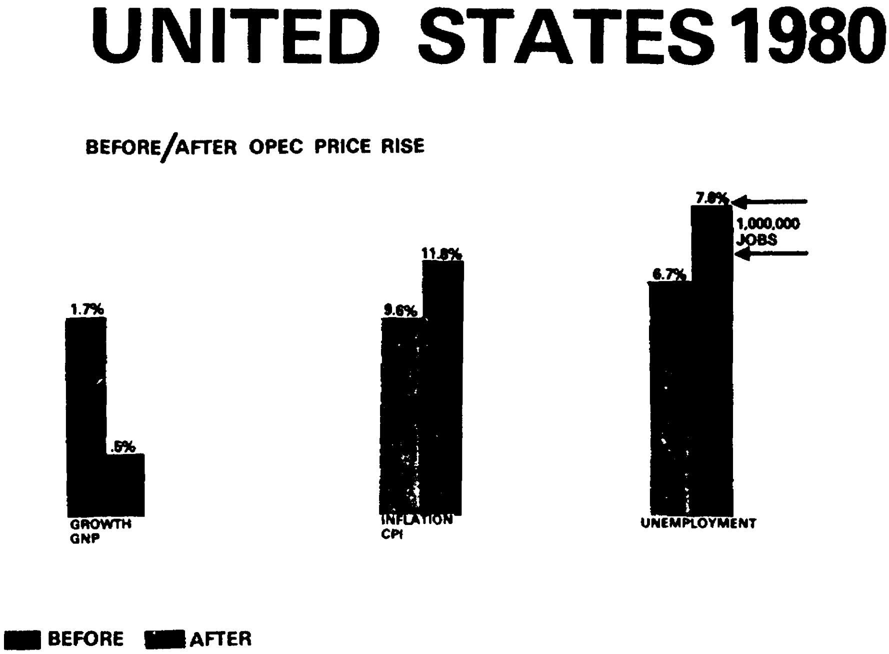
Mr. Secretary, I have been sitting here listening to you and the tough questions that you are being asked, never looking down for notes and I was thinking how you came to this job without any great long line of experience in the energy field.

The fact that you have been able to master the complexities of this problem to the extent that you have and the direction that you are giving this program now, I would certainly feel that the American public is the beneficiary of your service. I for one am appreciative of it.

Secretary SCHLESINGER. Thank you, Senator.

Senator BENTSEN. Mr. Secretary, I am concerned once more about the independent's production. They do about 90 percent of the drilling, exploratory drilling, wildcatting for this country. They find 70 to 75 percent of the new fields. They are real speculators. I am concerned about windfall profit tax being put on top of that, on top of their present 70 percent tax and frankly, I am going to propose to exempt for the independents and I am working on that at the present time. So we can keep them out there doing the job that has to be done and the kind of wildcatting to find these fields. But I was just over to the Joint Economic Committee and we have a chart here that was developed for us by Wharton. And it shows what is going to happen to us because of the OPEC countries in this last price increase. It shows that the GNP that was estimated for this forthcoming year of 1980 to be 1.7 percent, but after the increase in price, 5/10 of 1 percent and that inflation and the CPR was going to be 9.6 percent.

[The chart referred to follows:]



Senator BENTSEN. And instead it is going to be 11.8 percent unemployment instead of 6.7 percent going up to at least 7.6 and most think that million jobs lost is a conservative estimate. Now I know the economists will differ as to the exactitude of this, but I haven't any of them that don't say that it is a very serious impact on the economy and the future of this country.

Now the OPEC people the other day debated seriously in a very almost reluctant way not to have their meeting in September and now they are going to have it in December in Caracas. We don't have any assurance at all that they aren't going to ask for another substantial increase. We are facing the toughest, most extensive price-fixing cartel this Nation has ever seen which can have a really serious impact on Western civilization. What is this administration planning to try to break that kind of price fixing?

Secretary SCHLESINGER. As I have indicated, Senator, that the economic tools that we have are limited. We can constrain demand for oil since oil is our marginal fuel. We can bring off additional supplies, either domestically or in non-OPEC areas of the world, the latter is of limited utility simply because some of the OPEC countries price more sharply as it were than the OPEC cartel itself.

It is not necessarily harmful to be a large outsider, outside of a cartel. You have the umbrella of the cartel. But we will certainly pursue increasing production elsewhere, increasing domestic production and attempting to constrain demand, otherwise we face as your comments indicate, the possibilities that the way we bring the market into balance is by shrinkage of real output in the United States.

Senator BENTSEN. Mr. Secretary, there is a big push for synthetic fuels and here I am from a producing State on oil and gas, but I strongly support that.

If we had a price on synthetic fuels, on a barrel of oil, $20, would we put a 50 percent tax on the differential between $16, $20?

Secretary SCHLESINGER. No, sir.

Senator BENTSEN. But we sure would on oil. Now I don't understand equity in that. What we are trying to do is resolve the energy problems of this country whether it comes from bad old oil or not. But new oil is what I am more concerned about in trying to find, something to solve the energy problems. Or whether it comes from synthetic fuel, and prices in oil have escalated to prices that were never dreamed of before, but the problem is that the cost of drilling has also escalated to levels never dreamed of before.

I saw some figures on one 12,000 feet in the Rocky Mountains, $2.4 million. Hydrofacting now, $600,000, a high-risk business when you are doing wildcatting. I am deeply concerned about our trying to dampen that, particularly on new oil or particularly to the wildcatter or the independent.

Do you have a comment on that?

Secretary SCHLESINGER. I think that my testimony, Senator, reflected the need for balance in this area and not to go too far as some on the outside had proposed doing in this regard. We had a very substantial surge of prices internationally so that the incentives for production now are greater than we would have anticipated 6 months ago.

At $22 a barrel landed cost of oil in the United States, that means that effective price of oil with this windfall profits tax is $19 a barrel. Six months ago, one would not have anticipated the incentives associated with $19 a barrel.

Undoubtedly any windfall profits tax will to some extent dampen incentives. I think that your questions about the independents are well taken. They do drill the 90 percent of the wells and that one of the characteristics of this act is that it does bear more heavily on unincorporated independents than it does on either incorporated independents if that be the case or on a major oil company and that they are subject to the 70 percent tax rate as opposed to the 46 percent corporate tax rate. As a consequence of which for such an unincorporated independent, instead of getting an additional 20 cents at the margin, he may be getting something on the order of 7 or 8 cents which is indeed, dampened incentives because of the different structure.

Senator BENTSEN. Thank you very much, Mr. Secretary.

The CHAIRMAN. Senator Talmadge.

Senator TALMADGE. Thank you very much, Mr. Chairman.

Doctor Schlesinger, I am sorry I couldn't get here to hear your entire testimony. I was detained in another committee.

As you know, the OPEC nations have declared war on the remainder of the world, at least the industrialized world. I don't see anything different in what they have done in recent years what the Barbary pirate did in the early history of this country. We took action at that time and I think under normal conditions perhaps the industrial powers of the world would have taken action earlier than this. Sometimes I think that the industrial powers of the world cease to care about whether or not they continue to exist. So it looks like now we are at the mercy of OPEC and the American people can't get at OPEC, but they can get at the oil companies, they can get at the President, they can get at the Congress, they can get at you. It looks like the American people have gotten mad with the oil companies, mad with the President, mad with the Congress, mad with you. A lot of people, it looks like, want to make you the fall guy in this whole problem simply because you are presiding over the energy and it is in short supply. There is no way you can be popular. Santa Claus can be popular because he brings gifts. You can't be popular because you are taking gasoline and diesel oil away. I have great sympathy with you and the problems that you are confronted with and hope you aren't made the fall guy because the American people can't get at OPEC.

Now last year this committee took leave, I think we were a little foresighted, in trying to develop incentives for alternative sources of energy. This committee did that and we put through the Senate and we provided a tax subsidy for every alternative source of energy we thought was reasonable or feasible and could bear results.

Unfortunately, when we got to the House, as you know, we met an absolute stone wall of resistance. They didn't mind OPEC gouging us, but they didn't want to set up alternative sources of energy in this country. Now the very people that resisted in taking the lead in what we advocated in the past Congress and the only difference is we were going to subsidize them after the fact. We would say, "Mr. Energy, you produce fuel, we will subsidize you," they want to subsidize them before the fact and hope that they can produce the energy.

Which is the most feasible route to go? To subsidize them after the fact when they produce the energy or to subsidize them before the fact, before they produce the energy?

Secretary SCHLESINGER. It is more desirable to subsidize them after the fact if it is feasible. It is feasible as we have discussed in the oil shale area. That is why the tax credit makes a great deal of sense. For some of the very complex, high-risk ventures, perhaps not.

Senator TALMADGE. What are the alternatives in the Government spending the money and hoping you will get the energy, we wouldn't reward them unless they produced the energy.

So you would advise this committee to go the tax credit route and try to develop alternative sources of energy, would you?

Secretary SCHLESINGER. I should do that with some prudence, but I think it is the preferable route where the circumstances warrants as in oil shale and some of these other areas.

Senator TALMADGE. It seems to be the preferable route.

Thank you, Mr. Chairman.

Secretary SCHLESINGER. May I make just one observation? What Senator Talmadge has indicated is need for additional economic incentives. The barriers for the development of oil shale are the uncertainty with regard to the environmental regulation on which you have placed considerable stress with your chart. Even with a $3 tax credit unless we eliminate some of those uncertainties while we get Union Oil to come in and others that have committed themselves, their degree of enthusiasm will reflect the degree of certainties they see with regard to environmental regulations.

Senator TALMADGE. If the chairman of the committee will permit one further question.

I think you are exactly right. It seems to me that we must if we are going to have an energy policy worthy of the name is to commit someone like we did for the Mobilization Board in World War II to make a decision. We have got to act. We are in war. And would you recommend that Congress give to the President, or give to the Secretary of Energy, or someone, the authority not only to act, but to make these decisions about productions of energy and the environment so long as they do it tomorrow, or today, not be tied up in court ad infinitum.

Secretary SCHLESINGER. I would prefer to withhold the recommendation until the President comes down on the options that I mentioned earlier. I have been sympathetic to this kind of notion, however.

Senator TALMADGE. Thank you very much.

The CHAIRMAN. Senator Dole.

Senator DOLE. Are there options under consideration with reference to the OPEC countries, for no fuel, no food? All these ideas sound attractive. I notice the Washington Post had an article recently.

Secretary SCHLESINGER. I think it is fair to say that that was a subject that was raised during recent days at Camp David. I won't go further.

Senator DOLE. I know it was raised in White House memorandum last week——

Secretary SCHLESINGER. I was not referring to that.

Senator DOLE. There was a discussion? It was actually discussed? And I don't suggest that in a hostile way to the OPEC countries but in a way of self-preservation. I think it was much like what Senator Moynihan was indicating: It is hardly a friendly act to increase the price 61 percent. I assume we will get some of the Saudi oil increase, is that correct?

Secretary SCHLESINGER. Yes, sir.

Senator DOLE. The increased imports will not put us over the 8½ million barrels that was agreed to recently?

Secretary SCHLESINGER. During the first half of this year it looks like our oil imports were about 8.1 or 8.2. So there is no limit on our imports in terms of that ceiling; that is, no practicable limit.

Senator DOLE. Right. There won't be any problem with the pledge made at the summit in Tokyo?

Secretary SCHLESINGER. There would be no problem that is created by that in regard to the summit.

Senator DOLE. Has there been an attempt to look at a price support program where you would measure the support level in Btu's say $5 per million Btu, which is equivalent to about $30 barrel of oil. Hopefully through the private sector some arrangement could be made to produce synthetic fuels, and then only pay the difference. For example, say the synthetic fuel sold for $23, then there would be a price support payment for $7, which would have to be repaid out of profits in a 5-year period.

The concept is similar to the idea that Vice President Rockefeller supported before this committee in September of 1977. His program was more of a loan guarantee. This would be more of a price support program much like we have a farm commodities?

Secretary SCHLESINGER. I think there has been a scan of these kinds of measures. That they have a great deal of attractiveness, that nobody has come down on any specific measures as yet. I think that the notion would be that whatever institution is established—aboard or whatever—would have available to it these kinds of measures, which might have exactly the kinds of effects that you mentioned, Senator, of bringing on additional production.

Senator DOLE. It is somewhat in line with Senator Talmadge's idea that you subsidize success, not failure.

Secretary SCHLESINGER. That is right.

The notion here amongst other things, there is a notion of a purchasing agreement, a purchase price so that if you are prepared to bid to produce say methanol at $27 a barrel and you bid in such a way that you take the share of $21 a barrel or $21.50, the Government, therefore, is implicitly responsible for the rest. And if you manage to hold down your costs to $19.50 a barrel, that that will enhance your position.

The Government having taken up that $6.50 or what have you. That there are a variety of these techniques. And we share what I think is this committee's objective to provide as much incentive for the producers to go in this direction rather than some kind of cost plus or cost plus fixed fee phenomenon that might lead incentives in the opposite direction.

Senator DOLE. That is another idea some of us have been looking at the alternative energy development authority, which would also eliminate some of the functions of the DOE.

Secretary SCHLESINGER. Yes, sir, I think that is correct. I think that many of the functions of the DOE are transitory functions and should be eliminated or reduced. I think we have drawn up the budgets for 1979 and 1980 on the assumption that gasoline price controls would be eliminated.

As the result we are attempting to enforce a program without the personnel.

Senator DOLE. Do you need the 200 auditors that were tacked onto a bill last week in the Senate? Senator Javits authorized enough money so you could hire 200 more auditors. [Laughter.]

Do you need 200 more?

Secretary SCHLESINGER. I will have to look at that, Senator. As you know, we have about 200 auditors out there in the field in the major refineries right now. And I think that——

Senator DOLE. This is going to be the buddy system then because you are going to have maybe 200 more.

Secretary SCHLESINGER. I hesitate to hear you mention buddy system. I think the important thing about that is the fact that there are these auditors out there in the major refineries is something the public does not know and I believe will ultimately dispell these conspiracy theories, which I think——

Senator DOLE. That is what Senator Javits had in mind. It was a positive attempt to try to dispell or close the credibility gap.

Secretary SCHLESINGER. I would have to look at the numbers.

The CHAIRMAN. Mr. Secretary, you have touched on this matter. Here is a poll. Maybe it is a little behind the times, but I think it is not too far off even now. It was taken in June of this year by CBS and the New York Times.

They asked this question: Do you think the oil shortage we hear about is real, or are we just being told there is a shortage? The answers were: real, 30 percent; just being told there is a shortage, 62 percent; and no opinion, 8 percent.

This is a democracy. In this country we elected officials are supposed to be doing what the people want us to do. Let me tell you, you take your political life in your hands when you do what the people don't agree with. So as long as the people think that the energy crisis is a conspiracy, that is a problem. They think that oil is hidden somewhere, somebody is holding out. I ran into a fellow in my own home town, where they have one of the biggest refineries in the world, and he said, "Russell, there is plenty of stuff around. There is a tank right down at the Exxon refinery that is damn near overflowing."

Just like some fellow said the other day: Here is this transshipment point, and there was some oil they thought they would use in D.C., but instead it is being shipped to New Jersey because the tank is filled in the District.

Well, at some point somebody has to find out that the matter is not a conspiracy. They don't have 10 fleets out there in the Gulf, in the Atlantic waiting for the price to go up. They don't have all of these millions of barrels of oil hidden out there, these millions of gallons of gas hidden somewhere waiting for the price to go up. But I guess there are many people who might believe it. And if anybody believes it in the Congress, it ought to be the Judiciary Committee that acts.

And I am here to issue them a standing invitation, if there is a conspiracy, go find it. I will vote to give another 200 or 300 or 500 auditors to go around and see if they can find a conspiracy. Give them a whole army. We might be able to spare a couple of army divisions to send them around to look. [Laughter.]

Have you been able to find any evidence that all of this energy is being hidden out somewhere?

Secretary SCHLESINGER. No, sir. There is no evidence of a conspiracy. We have been instructed to review and we have searched for conspirators everywhere; among the dead even. We are anxious, if there are conspirators, to find them. But we have found no conspirators as yet.

We have the Coast Guard out there watching for these tankers. [Laughter]

The Coast Guard reports that there are no such tankers. Perhaps the Coast Guard is part of the conspiracy. [Laughter.]

I think it was Senator Moynihan the other day who said the first report of these strange vessels off shore occured in Rome during the days when the price of bread was going up; that there were reported to be grain ships off Austea waiting to come in once the price of bread rose.

I think we are dealing with a difficult problem but that if people of common sense continue to look for a conspiracy and don't find it, after a while that notion will be dispelled.

The CHAIRMAN. Let me get to question number 2. This is a question asked at the same time, June of 1979. That is only, you know, a month ago. "Do you think the United States has to import oil to meet our needs or do we produce as much as we need?"

Now imagine this. 51 percent really do believe that we must import oil.

Secretary SCHLESINGER. That is incredible.

The CHAIRMAN. Thirty-six percent don't know and thirteen percent have no opinion. That means that 49 percent of the people of this country as of June didn't know that we must import oil. In other words almost half the people in the country as of June didn't know that we are importing oil and have been for a long long time.

How long have we been importing oil now?

Secretary SCHLESINGER. Well, essentially since the 1950's.

The CHAIRMAN. All right, so that then has been about 25 years anyway. And how much of our oil are we importing, what percentage of it?

Secretary SCHLESINGER. About 44 percent now.

The CHAIRMAN. Almost half of it. All right, so that somehow we are going to have to educate the people to the problem because otherwise I don't see how we can expect them to support us in trying to provide the answer if they don't think the problem exists at all. And I would hope that maybe when the President speaks he won't just say the energy crisis is real, as he did last time—just make that reference and go on—but would explain a little how we got in this trap.

Now I was one who was accused of trying to be parochial; saying we ought to maintain our capacity, because we do produce a lot of it down in Louisiana. But the people just don't know.

Mr. Secretary, do you agree that is part of the problem; the people just don't know what the problem is?

Secretary SCHLESINGER. That is the critical part of the problem. And in this respect the United States is unique. Elsewhere in Europe or in Japan, everybody understands that there is a real energy problem. The EEA says that there is a real energy problem, the OECD says there is a real energy problem, OPEC says so.

The leaders of the seven industrial nations, everybody agrees on this but there is still a reluctance to accept that here in the United States.

The CHAIRMAN. My understanding is that at the rate that we are importing oil, it is costing us $1 billion a week to pay for that oil. That would be about $52 billion a year.

Secretary SCHLESINGER. At the present rate it would be in excess of that. It is now in excess of that. Our oil bill next year will be at the current rates about $70 billion.

The CHAIRMAN. Now I ran into quite a few people down my way who say they don't have the slightest doubt that when the price goes up to a certain point, there is going to be plenty of gas. And I think they are probably right but not for the reason they think; not that there will be plenty of gas because the people that have it hidden out will bring it in but rather I think there will be plenty of gas because at that price they won't buy so much and therefore there will be plenty to go arond.

But I must say that is a problem.

I just wanted to mention, insofar as we can, won't we be better off to use loan guarantees rather than to have to pay all of this money out of the Treasury for synthetics and things of that sort?

Secretary SCHLESINGER. Yes, sir, loan guarantees is also a very attractive way of proceeding. And, for example, in the gasification programs on which the technology is well known, the companies that have put together the ANG proposal in North Carolina have asked for a loan guarantee. Some of those who favor the Alaskan natural gas pipeline, but not under the present arrangements, have called for a loan guarantee.

It is a very useful and flexible tool and it may be the best in many circumstances.

Senator DOLE. Thank you.

The CHAIRMAN. Senator Byrd.

Senator BYRD. Mr. Secretary, several times today you have stated, and I think accurately, that there is very little the Government can do in the short run about the OPEC pricing. Now, I think that is correct. Now most persons with whom I talk outside of Washington feel that one of the great problems in regard to developing energy sources, one of the great problems is the multitude of regulations and redtape imposed by the Government.

Do you agree with that?

Secretary SCHLESINGER. Unquestionably.

Senator BYRD. Now, the President 15 or 16 months ago said that the energy crisis facing this country is the moral equivalent of war. You have stated today that in order to cut through the redtape and regulations would require major surgery.

Now my question is being in what the President regards as the moral equivalent of war, why have not steps been taken to cut through the regulations and redtape which you say and which most people think is a sure deterrent to obtaining new energy?

Secretary SCHLESINGER. There are a variety of reasons to that, Senator Byrd. I think that during the period that is under discussion we have had new legislation from the Congress which in effect implies additional new redtape——

Senator BYRD. Excuse me, let us analyze that.

And the administration has recommended and urged the Congress to adopt such regulation, has it not?

Secretary SCHLESINGER. I think that is correct, sir. I don't think there was a sense of urgency in April of 1977——

Senator BYRD. Well, the President said there was. He said it was a moral equivalent of war.

Secretary SCHLESINGER. I think a sufficient national sense of urgency, to the extent that we have acquired that lately, I think that the events of the Iranian crisis, of these recent OPEC price increases have swept away many national illusions and therefore we may be prepared now to do these we should have been prepared to do earlier.

Senator BYRD. By "we" are you speaking of the American people or you speaking of the administration?

Secretary SCHLESINGER. I am speaking of both but that is conjecture on my part. The President indeed is reviewing some of these areas, as I have indicated.

And there is, as Dr. Johnson once said, nothing that collects a man's mind so much as the knowledge he is about to be hanged. And given that fact, we may be prepared to address some of these problems which are reflected in the chart, sir, because of a sense of urgency that rightly or wrongly did not exist 1½ years ago.

Senator BYRD. But the point I am suggesting, Mr. Secretary, is that the President did recognize it, at least he said he recognized it because he told the American people on television that this country faces the equivalent of war.

Secretary SCHLESINGER. No; he called for a sense of common purpose that was the moral equivalent of war.

Senator BYRD. Correct.

Secretary SCHLESINGER. But he was not talking then about wartime measures.

Senator BYRD. Correct. And——

Secretary SCHLESINGER. What we are talking about now may imply the equivalent of wartime measures.

Senator BYRD. What I am suggesting is the executive branch in most cases acting alone and certainly the executive branch acting in cooperation with Congress, Mr. Secretary, can take steps to dramatically increase energy sources without any cost to the taxpayers and with indeed a savings to the consumers if the Government itself will cut through the redtape and regulations that are strangling certain areas of our country, certain fields in our energy areas, particularly coal and many other areas for that matter.

You don't disagree with that, do you?

Secretary SCHLESINGER. I agree with the objective. I think we are going to need the help of the Congress.

Senator BYRD. Well, have you asked for the help of the Congress?

Secretary SCHLESINGER. I think to this date there have been only limited proposals but I think that these are questions that are under review by the President at this time.

Just what kind of recommendations he should make to the Congress.

Senator BYRD. Well, it is a long time in coming. Now let me ask you this.

What technologies for synthetic and/or alternate fuels do you see as becoming economically viable in the near future; namely 1980, 1981, and 1982?

Secretary SCHLESINGER. The synthetic fuels will not be economically viable without Government subsidy for the most part.

Possibly oil shale might make it on the premise that you deal with that problem of environmental regulation and establish some certainty. The premise right now is $22 a barrel for oil shale, which is just on the verge of economically cost effective.

Devonian shale looks to be marginally competitive; tight sands in the West, conventional, quasi-conventional production. Those are the kinds of things, but they don't normally, with the exception of oil shale, fall under the heading of synthetics.

Senator BYRD. And that can be done within 2 or 3 years, a 2- or 3-year time frame?

Secretary SCHLESINGER. In my judgment, yes, sir. These are things that are marginally attractive and are competitive—tight sands are coming. The question is to what degree the production should be stimulated beyond that that would be provided by the ordinary market forces.

Senator BYRD. My time has expired. But I just want to say again that if the Government itself, if the Government itself is not willing to cut through the redtape and the regulations, I don't see how the Government, including the President and Congress, can expect the

American people to take the steps that the President previously has called upon the American people to take. It is up to the Government to clean up its own house and to cut through the redtape and regulations so that we can get on with the problem that so severely faces this country and which you are coping with to the very best of your ability.

Thank you.

The CHAIRMAN. Mr. Secretary, I believe at this moment we could use every big drilling rig we have—and I say big ones, because you are familiar with the fact that to drill down to 20,000 feet the ordinary rig just won't hold it; you've got to get a big rig, and you have to use heavier pipe.

It seems to me that for the time being we could use every big rig that can be found in Louisiana, and I think if you are going to put a crash program in, you may have to do some things to make priority use of what you have. In other words, there may be a fellow who would go out and drill a wildcat well, where he might find something, but perhaps there is at the same time a big company sitting on the lease and they are planning to take their happy time getting around to drilling it.

Now, we in Congress have been at fault on that. We passed a tax law a while back making it less attractive to farm a lease out. But we ought to make whatever changes need to be made, and I think this committee will cooperate in making any changes in the tax law that are needed to get on with production. But in due course, the question will come about using those same kinds of rigs to drill that geopressurized brine that is down below 20,000 feet.

I am told that stuff is down there at about 2,000 pounds per square inch of pressure, and it is at about 650 degrees, and that a tremendous amount of methane gas is in there. Methane gas is just like any other gas; you can't see or smell it. It would do what any other gas can do. If you can liberate just 45 percent of it, it would heat the country for the next 100 years.

It would seem to me that we ought to get on with developing that energy resource, and see if it will work.

What is your reaction to that?

Secretary SCHLESINGER. I am in total agreement with you, Senator. There are some difficult technical problems. The brine is highly corrosive. There are, therefore, some environmental problems. Nobody knows at this juncture what to do with the brine, whether to put it in a long pipe and put it out in the Gulf of Mexico or whether to reinject it. Most metals—all metals will not stand up to the corrosive effects of that brine.

The CHAIRMAN. But. Mr. Secretary, since the beginning of time that kind of salt has been seeping up into the ocean; that is why the ocean is so salty.

Secretary SCHLESINGER. I am on your side, Senator. I think we ought to get on with developing the technologies. We estimate right now that that looks to be the equivalent of when we have a technology of about $4.50 per thousand cubic feet gas. We are now getting up there in terms of world prices and are not too far away, $3 per thousand cubic feet is being encountered frequently as the result of the marching up of these prices with the Btu equivalent of crude oil after the OPEC price increase.

And all of that makes the development of this resource more attractive.

The CHAIRMAN. Well, I like clean air and I like clean water, but I also don't believe in being ridiculous about it. It seems to me one of the things we are going to have to do if we are really serious about this problem, we are going to have to take Mr. Environment away from the driver's seat and put Mr. Energy in the driver's seat.

Now Mr. Environment can ride along, but he ought to be back in the rumble seat. We had rumble seats when I was a young man and it is really nice back there, as long as it is not raining and not too cold. But if you have the fellow back in the rumble seat and you don't want to listen to him, you don't really have to listen to him; you can't even have backseat driving, because he is far enough back there to where he can't break your eardrum shouting at you if he doesn't like the way you are driving.

Now, those kinds of things will have to be done; otherwise we are just kidding ourselves. Governor Edwards attended a Governors conference about 2 years ago, talking about this, and he said, "Well, gentlemen, at the rate this thing is going," he said, "the people in this country are going to freeze to death in pristine pure air." And we have to face up to that.

Now, isn't this true, that if you are willing to put enough money into it, we can be energy sufficient, that with enough money and high priority, given some time, we are going to be energy sufficient? It is all a matter of degree and a matter of priority is it not?

Secretary SCHLESINGER. That is correct, sir.

The CHAIRMAN. Well, I just hope we will think about it in those terms. I was around here when Richard Nixon saw the boycott and he said to the oil companies and everybody else in the energy business, "Now come in and tell me how long will it take to give us energy independence."

They said, "7 years." He said, "OK, 7 years. Tell the Arabs over there that 7 years from now they can make their plans to bathe in that oil; they can use it how they want to, because we won't be needing it."

Now, 7 years from then would be 1980, next year—but instead we are importing more energy than ever. The reason it is that way is back at that time the Congress, including many Democrats, would not go along; they said the people are not willing to pay that kind of price or make that kind of sacrifice.

But in any event, we don't need to look as far as the White House for scapegoats; we have plenty here on Capitol Hill.

Then Gerald Ford proposed his ideas, but the opponents said, "Oh, no, no, the President has the wrong idea. We won't go along." They sent him down something for him to sign, which created a whole lot of those things we are talking about on that chart.

President Carter has had some ideas that haven't been enacted here; and I just hope that under the pressure of what is happening right now with a Democratic President and a Democratic majority in the Congress—and I think they have a lot of patriotic people on the other side of the aisle who will be equally cooperative—we ought to pull this Nation together and set a timetable on what we are going to do; and I would hope that if the President doesn't want to take Mr. Nixon's idea about energy independence, that he will go Mr. Nixon one better, and that we will be an energy exporter, because we can do these things.

How old are you, Mr. Secretary?

Secretary SCHLESINGER. Fifty.

The CHAIRMAN. I was old enough to be in World War II; you were old enough to see what went on back at that time, aren't you?

Secretary SCHLESINGER. Yes, sir.

The CHAIRMAN. This Nation showed what it could do then. If we can do the kind of thing Senator Talmadge referred to, is there any real reason why we could not have energy independence if we put enough priority on it?

Secretary SCHLESINGER. No, sir, if you are willing to commit the resources, take the time, and do those things organizationally necessary, you can get the job done.

The CHAIRMAN. Well, I think that is 100 percent right, Mr. Secretary.

Let me thank you for the very fine presentation you made before the committee.

Senator BYRD. Russell?

The CHAIRMAN. Yes; Senator Byrd?

Senator BYRD. I have just a couple of questions, Mr. Secretary. In getting out amongst people during the last recess, I find that there is perhaps even more concern in regard to what will happen to home heating oil this winter than there is about the current gasoline crisis. The current gasoline crisis has been very inconvenient and it has been an economic hardship on many people, but I find that there is great concern now as to what will happen this winter in regard to home heating oil.

The CHAIRMAN. Might I ask that you put the chart over here where everybody can see it?

Secretary SCHLESINGER. We have been in very poor shape with regard to the distillate available for some time.

In the last 2 weeks we have had a significant turnaround with regard to the production of distillates. Distillate production, inventories have increased by 14 million barrels. We are building toward that 220 million, 240 million barrel objective for October. Now that we have higher rates of crude oil import input into refineries, reflecting higher rates of crude oil available and increased imports, I believe that we will be able to put aside by October, by the end of October, the necessary inventories of crude oil.

Senator BYRD. How does the inventory now compare with 1 year ago?

Secretary SCHLESINGER. Right now—I am happy that you asked that question this week rather than 2 weeks ago—but right now we are 15 million barrels below the inventory at a comparable date last year. In other words, the growth of these inventories in recent weeks is beginning to resolve, I think, what was a very severe shortfall reflected in the fact that since January we have been below what we regard as the minimally acceptable level by and large.

We are beginning to pull out of that.

Senator BYRD. But you feel that by October your inventory will be up to the point that you consider to be adequate?

Secretary SCHLESINGER. During October.

Senator BYRD. October?

Secretary SCHLESINGER. Yes, sir; that is our objective.

Senator BYRD. Good.

Secretary SCHLESINGER. We are going to have ample heating oil for this winter.

Senator BYRD. One of the charts that was in this batch of charts gives Persian Gulf crude oil production and exports, 1978. I want to see whether I am reading it correctly. Does this mean that through the Gulf of Hormuz flows 19 million barrels of oil a day?

Secretary SCHLESINGER. Yes, sir. It has been around 20 million barrels a day; and that is 65 percent of all the oil flowing in international commerce; and as you know, Senator, the Straits of Hormuz are about 2 miles across in the channel; so it is a leverage point and it is a strategic point of considerable significance.

Senator BYRD. Yes; I flew over that strait during Easter recess and I was told I was the only member of the United States ever to have flown over it.

But you say now that 65 percent of what flows there?

Secretary SCHLESINGER. Of all the oil flowing in international commerce, in the free world. It is about 40 percent of all consumption and production in the free world that goes through those straits. That is why it is so vulnerable.

Senator BYRD. Well, would it be accurate to say then it is 45 percent of all the free world oil flows through there?

Secretary SCHLESINGER. Of that oil that flows in international commerce. I am leaving out domestic production that is used in the United States, domestic production in Canada and so on; but of the 35 million barrels, approximately that are flowing in international commerce, that represents about 60 percent.

Senator BYRD. That is an astonishing——

Secretary SCHLESINGER. That is depressing.

Senator BYRD. Do you have the feeling that it is a rather vulnerable area?

Secretary SCHLESINGER. Geostrategically, it is an area of enormous importance and of enormous vulnerability; and the U.S. position in that area, the Western position has been deteriorating in recent years. I think that that will have to be arrested if we and the rest of the free world are to survive in any way in the kind of manner in which we have traditionally done.

Senator BYRD. My understanding is that Iran assumed the responsibility under the Shah for the protection of the straits, and now there is virtually no protection there?

Secretary SCHLESINGER. That is correct. For many years we relied on the British. In 1968 the British decided to withdraw east of the Suez and had done so by 1971, at which point the Shah took over the duties or at least arrogated to himself the duties of guardian of the gulf. But since the British withdrawal, the Western presence has been shrinking, Western influence has been shrinking; and the events in Iran and elsewhere have been vastly disturbing in that area.

I need not list them oft, Senator. The events in the Horn of Africa, Afghanistan, Iran itself, Pakistan, Turkey, the two Yemens, are very indicative.

Senator BYRD. To get back to the 19 to 20 million barrels that flow through that strait, you mentioned a figure of 45 percent. What is that 45 percent?

Secretary SCHLESINGER. I didn't—I think I mentioned 40 percent of all the oil that is consumed or produced in the Western World.

Senator BYRD. Forty percent of all the oil consumed or produced in the Western World?

Secretary SCHLESINGER. A higher percentage of international commerce.

Senator BYRD. Yes; now just two other factual questions:

What was the consumption of petroleum in the United States from January through June of 1979, and what was it through June of 1978?

Secretary SCHLESINGER. The consumption was slightly less this year than it was last year, but approximately equal—approximately equal. In the first quarter of this year we used more than in 1978. In the second quarter of the year, partly because of constraints, we used slightly less. To be precise, in 1979, the first 179 days we used 19,210,000 barrels. In the first 180 days of 1978 we used 19,349,000 barrels, a decline of seven-tenths of 1 percent.

Senator BYRD. A decline of seven-tenths of 1 percent?

Secretary SCHLESINGER. Yes, sir.

Senator BYRD. Now, what were the imports during the months of 1979, versus 1978?

Secretary SCHLESINGER. These import figures are somewhat misleading, Senator, because imports have got to be taken in connection with stock drawdowns, which in 1978 were the most rapid in our history, a very substantial drawdown of stocks.

Imports themselves increased from approximately 5.8 million barrels a day in 1978, the first 180 days, to 6.2 million barrels a day in 1979, the first 179 days, a slight increase in imports; but, as I say, that is misleading because we had the most rapid drawdown of our inventories in the Nation's history during the first 6 months of 1978, and consumption was naturally higher.

Senator BYRD. Well, haven't the imports been running—where did I get the figure of 8.5 million for imports?

Secretary SCHLESINGER. I am sorry. The figure I gave you was for crude oil. The total imports for 1978 were 7.9 million barrels a day for the first 180 days, and the total imports, including product for 1979, were approximately 8.1 million barrels a day.

Senator BYRD. But that 8.1 included a much heavier drawdown of inventory?

Secretary SCHLESINGER. Was associated——

Senator BYRD. Was associated with that?

Secretary SCHLESINGER. It was the 7.9 that was associated with the heavier drawdown of inventories.

Last year we were consuming more than we produced or imported because of that drawdown of inventories, Senator, an opportunity we didn't have this year.

Senator BYRD. Thank you very much, Mr. Secretary.

Secretary SCHLESINGER. Thank you, Senator.

Senator BYRD. The committee will next meet at 9 a.m., tomorrow morning, in executive session.

The windfall profits tax hearings will continue after that session at about 10:30 tomorrow morning.

[Whereupon, at 1:20 p.m., the hearing was adjourned, the committee to reconvene at 9 a.m. Thursday, July 12, 1979.]

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