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, 19, AND 31, 1979

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CRUDE OIL TAX

THURSDAY, JULY 19, 1979

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

The committee met, pursuant to notice, at 10 a.m., in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Talmadge, Byrd, Gravel, Bentsen, Baucus, Boren, Bradley, Dole, Packwood, and Wallop.

The CHAIRMAN. This morning we will first hear from Mr. John Rousselot, a Representative from California. Is Mr. Rousselot here?

If he is not, we will call a panel consisting of Mr. Robert Armstrong, land commissioner, State of Texas; Mr. Henry Keplinger, chairman, Energy Consumers & Producers Association; Mr. Benjamin C. Cubbage, Jr., Liaison Committee of Cooperating Oil & Gas Associations; Mr. Harrold Wright, chairman, National Energy Policy Committee on behalf of the Texas Independent Producers & Royalty Owners Association; Mr. Frank B. Taylor, National Stripper Well Association.

Each of these witnesses will be heard for 5 minutes. After that, we will have 5 minutes for each Senator to have questions in the first round, and we can ask what we want to later on.

Mr. Armstrong?

Mr. ARMSTRONG. Yes, sir, Mr. Chairman.

Senator BENTSEN. Mr. Chairman, I would like to comment before Commissioner Armstrong makes his statement.

Bob Armstrong is land commissioner of Texas, an elected official who has been elected, I guess, without opposition for some time, Bob?

Mr. ARMSTRONG. At least.

Senator BENTSEN. At least as I look at the results.

Mr. ARMSTRONG. Without an opponent, but not without opposition.

Senator BENTSEN. He is a man who has done an outstanding job as land commissioner of our State. He is an authority on the use of State lands and the revenues from those lands and, frankly, the mineral production of those lands.

We are fortunate to have him as a witness this morning.

Mr. ARMSTRONG. Thank you very much. Senator Bentsen and I were elected at the same time. We have been serving since, I suppose, 1970.

Thank you very much for that introduction, sir.

The CHAIRMAN. Please proceed, Mr. Armstrong.

STATEMENT OF BOB ARMSTRONG, LAND COMMISSIONER, STATE OF TEXAS

Mr. ARMSTRONG. My name is Bob Armstrong of Austin, Tex. I am appearing as the land commissioner of the State of Texas and chairman of the board for lease of University of Texas lands. I am elected by the people of Texas to preserve, protect and make fruitful those lands which were reserved by Texas in its treaty of annexation with the United States in 1845.

Historically, States have relied heavily on their public lands as a means of financing public education. Texas set aside its public lands for education purposes and provided for permanent education funds to hold all proceeds from the disposition of such lands, including the sales of mineral production.

Since before 1875, the Texas constitution has provided that the proceeds from the disposition of any State lands, which includes the proceeds of oil and gas production, shall be placed in permanent school funds—including funds for both university and preuniversity functions—the principal of which can only be invested, not spent.

Hence, it is only the income from such permanent school funds that may be used currently. Our State believed it would not be wise or prudent to spend the proceeds from oil production, a depleting asset, and therefore dedicated these proceeds as the corpus of the trust. Our forefathers knew that if the revenue from the land that was corpus was used for current purposes, it would be gone forever and their children, our descendants, our Nation, would be the poorer forever. That corpus could never be replaced. All we ask is for market value for our resource. We believe the corpus must be preserved by reinvestment to treat the present generation and those to come equally and fairly.

Therefore, the application of any crude oil windfall profits tax to royalties paid to States with respect to State school lands not only will reduce directly the amount of funds otherwise available to such States for their educational programs, but take away a part of the corpus that we have struggled to maintain.

Incidentally, this has never been taxed by the Federal Government.

I might add that the State royalty is only eight-tenths of 1 percent of the total Texas production; 99.2 percent will be left subject to the windfall profits tax in Texas, under the House bill.

There may be other testimony that might like to reduce that, but at least under the amendment that we seek to protect, we are only talking about eight-tenths of 1 percent.

The House of Representatives in section 4992(f) recognized that it really made no economic sense, nor comported with justice, to characterize as windfall profit any income received by a State from the sale of production that is so dedicated to education. In reality, it means that States could pay their inflated bills for education out of revenue that also would reflect inflation; and those who put revenue into corpus as Texas does, could increase the corpus to meet inflation.

It is quite true, as Secretary Blumenthal said, "That the exemption bears no relationship to * * * windfall profits;" the State has no windfall profits in any normal sense. It should not have to be

concerned with this bill; it is not in the oil business. The State is only using its property for one of the classic government functions, education.

However, the exemption bears a relationship to oil production because it is only out of the production of the depleting reserves of these educational institutions of the States that they can make provision for their future.

Frankly, I was surprised by the allegation that this is a form of revenue sharing unless one means, contrary to all previous understanding, that the State is having to share revenue from the sale of its assets with the Federal Government instead of the other way around.

As for this being a subsidy, this questionable reasoning can only be founded upon the belief that all of the oil revenue from Texas public lands really belongs to the Federal Government and can only be allocated back to the State government—even when the oil unquestionably belonged to the State.

You gentlemen have heard a great deal about plowback provisions for windfall profits. I would just like to ask you, in closing, to consider the most effective plowback program of all—plowing income from the sale of State property back into the education of our young men and women. Every dollar we get will go for education. We will not come to Washington looking for it. We are just seeking to take care of our education business with the income from the sale of the State lands and the oil thereunder.

Thank you very much.

The CHAIRMAN. Mr. Henry Keplinger.

STATEMENT OF HENRY KEPLINGER, CHAIRMAN, ENERGY CONSUMERS & PRODUCERS ASSOCIATION

Mr. KEPLINGER. Chairman Long, we appreciate this opportunity to speak up for the independents on behalf of the House bill. We represent over 500 independent operators in 17 States and the full text of my testimony and exhibits will be handed in for your study.

I served as chairman for the second time of this independent group and by profession I am a petroleum engineer and a geologist. I have spent my entire life working in the oilfields, starting in Russell, Kans., out in western Kansas.

Senator DOLE. Russell is a good place. It is my hometown.

Mr. KEPLINGER. I have known you since you were a little kid. I was west of town and then I moved from there down to Oklahoma to go to college.

Senator BOREN. An even better place.

Mr. KEPLINGER. And I have worked in Texas, have my principal office in Houston, Tex., and worked in every oil-producing State in the United States and almost every producing country around the world, and have represented governments in their matters of conservation, whether it be in China, India, Saudi Arabia, so that our experience in my company is well based upon experience.

We started this association 3 years ago and the purpose was to inform the public of the facts regarding oil and gas production that we were not putting enough money into the oil business.

The statistics, you can get all types of people to work up statistics, and there is a statistician born every minute. In this particu-

lar case, we have been putting less and less money into the oil business and the oil industry requires a capital formation now of at least twice—we are putting in about $20 billion a year and we need $40 billion in order to take us out of the hands of Saudi Arabia.

Saudi Arabia, I saw in the paper last night right here in Washington, their officials were blaming our troubles on the oil companies and that is as far from the truth as anything ever stated by people who are protagonists in this area.

So we feel what we want to say is that we have lots of oil in Russell, Kans., Russell County, in Oklahoma and Texas, and we prepared a chart which is based upon the U.S. Geological Survey and we have here more potential oil in the United States than the proven reserves of Saudi Arabia.

So I want this testimony and what you will read here to indicate that we in America are strong, if we would be given the opportunity to invest about an additional $20 billion and make it $40 billion a year. We have to double our capital expenditures.

We cannot do that without dropping the windfall profits tax, and I feel that if we are not given this, then the independents should be given an exception, that is that the stripper production would be exempt from the windfall profits tax, the remaining category of what we term tier No. 3 be exempt, as well as marginal oil. The Department of Energy has done considerable study. I testified before the Department of Energy in Austin, Tex., on January 7, where I estimated the marginal well exemption alone would increase our production 450,000 barrels a day alone, steaming the shallow heavy oil in this country if it were exempt could increase the production up to 500,000 barrels per day.

After you add up all of the increased production from new oil and from secondary and infilled drilling and tertiary oil, that we have a chance in the next 10 years to increase our production by 5 million barrels per day.

In addition to our production from these various sources, up to 5 million barrels per day, that would save us billions and billions of dollars of buying Saudi Arabian oil in the next 10 years.

Further, I would like that the small producer would be granted elimination of the third-tier pricing grade by location and by grade and that we should be allowed, in your legislation, to set the one base price for each lower tier and upper tier.

And finally, eliminating the need for separate tier and base prices for the tax purposes by adopting the 3-percent-per-month decline factor for tax purposes only.

In addition, we are not only enthusiastic about the future of oil in America, but we are enthusiastic about the oil production around the world which has shown considerable activity in this last year where we have had countries increasing their production by 25 percent.

Egypt went up 25 percent. Several countries in South America increased their production last year, over 1977, up to 33 percent. Mexico, a friend of ours for many years. Their production increased 33 percent, and they are looking up to a 3-million-barrel-per-day production in 1985. So that the possibility of our buying oil around the world in addition to what we are buying now is very attractive and, in closing, I would like to state that, as far as the committee

that runs our association, we would like to see no windfall profits tax for the benefit of the public but benefit them with increased domestic oil and gasoline, if it does come the tax, we feel with these exceptions do help the great majority of independent operators in America. These exceptions should be written into the legislation.

I thank you very much.

The CHAIRMAN. Thank you, Mr. Keplinger.

Now let us hear from Mr. Benjamin C. Cubbage, Jr., Liaison Committee of Cooperating Oil & Gas Associations.

Mr. CUBBAGE. Thank you, Mr. Chairman.

STATEMENT OF BENJAMIN C. CUBBAGE, JR., CHAIRMAN, LIAISON COMMITTEE OF COOPERATING OIL & GAS ASSOCIATIONS

Mr. CUBBAGE. My name is Benjamin C. Cubbage, Jr. I am an attorney, Mr. Chairman, from Henderson, Ky., but today I am here as chairman of the Liaison Committee of Cooperating Oil & Gas Associations. It is an awkward name, but it is descriptive, since we are 21 domestic regional oil and gas associations across the country who informally get together and try to present a unified and unanimous voice on matters that affect us all in common.

We represent every major oil-producing province in the lower 48 States and consist of approximately 10,000 independent oil producers across the country.

Because of time, I will skip over the first couple of pages of my prepared testimony since we are limited to 5 minutes, and I am confident I cannot get through mine in that space of time.

I do, this morning, want to make a distinction which is unique. It is unique in my experience. In the past, in the times that I have appeared here in Washington for various reasons, and always representing the independent oil producer, we have made an effort to hold hands with industry as a whole and present a unified front. We have never separated ourselves, ever. We have always been proud of the fact that we are independent oil producers. We have never separated or segregated ourselves within the industry.

Today I wish to do so for the first time openly. I think it is important that we keep in mind the difference and make a couple of distinctions which affect the independent oil producer. This is the thrust of my statement. I will attempt to summarize.

First of all, the independent oil producer is confined to one product. He produces oil or natural gas, and he has one point at which to make a profit—that is the wellhead.

He does not market, he does not transport, he does not refine. He is not involved in any of the other profit-oriented activities of the oil and gas industry. He merely produces oil.

Even at that, we are confined to the domestic 48 States—onshore, I might add.

With this fact in mind, we then have to look at what effect a windfall, a severance tax, an excise tax, whatever we choose to call it, what effect it will have upon the independent, and whether you want to look at it as a lid or further control to put on his price, or whether you want to look at it as a tax he will pay at the wellhead, which is the way the independent would look at it.

It appears it is an obvious conclusion, he has no way to pass this tax on. He has to pay this out of his pocket. Since he only has the one profit point, he then must bear the full brunt of any tax that is imposed.

It is submitted that the House-passed version of the bill actually has a provision which will cause, the way it is presently written, a $2 a barrel rollback on stripper and one new category of crude oil. Obviously, this is counterproductive to the major thrust of decontrol which, as I understand it, is to increase and stimulate domestic production through price incentive.

I think the most important point I want to make today, however, involves the acquisition of risk capital by the independent oil producer. Contrary to a lot of people's thought, the independent does not go into his own pocketbook or his own bank account to drill for his oil. He simply does not have the resources, in most instances, to finance his own exploration and thus he must go elsewhere for risk capital. He cannot borrow this type of risk capital from the bank. In fact, all too few banks will even lend money for existing and well-settled production.

So therefore he has to go and compete in the money market, if you will, for his risk capital and he has to put together a package and an attractive enough investment for the shoe merchant, for the doctor, for the industrialist or the insurance agent—or yes, even the lawyer—to invest tax money into a drilling deal, or an exploration deal.

I point out in my statement that in an industry where the risk is still eight dry holes for nine holes dug, the independent has to be a pretty darned good salesman to compete, particularly in today's money market.

Finally, I do want to make a point about plowback. I was here and listened to the testimony yesterday on plowback.

I might say that Liaison has pretty consistently over the years been opposed to plowback. We do not think the plowback idea or concept is applicable or helpful to the independent, simply because, as I pointed out in my statement, over the past 5 years, the independent has put back about 100 percent of the value of his wellhead revenues. I think the figures are in the testimony, presented by other statements previously, that it runs on a year-by-year basis from 94 percent to 110 percent of his wellhead revenues.

Therefore, a plow back will not be an incentive since the independents are already plowing back their funds.

Furthermore, when you consider the plowback theory in the light of the method by which the independent raises his risk capital, you lock in your investor with a plowback provision, to the extent, if he is to take advantage of this incentive, he simply must plow back next year his profits, and with a 9-to-1 ratio, gentlemen, that pretty well tells you that he has to stay at the table until he loses and it does not take the investors very long to realize that this is not much of an inducement.

Finally, I make one point that I hope will be kept in mind. The Jones-Moore amendment does contain a sunset provision and certainly if we adhere to the definition of the word "windfall," which, as I understand from Funk & Wagnalls—I even put that in my statement—is "a piece of unexpected good fortune," then I fail to

see how, coupled with the tax, it can continue on year after year. It is submitted, and Liaison would hopefully urge this committee to continue the sunset provision in any recommendation which you have for this tax.

There is, at long last, full recognition that the domestic, independent oilman has, in the past, drilled 90 percent of the onshore exploratory wells in the lower 48 States and has found 75 percent of the present known domestic reserves.

If, therefore, we can learn anything from past performance, it is only reasonable to conclude that the independent oilman will continue to drill for, and produce, crude oil and natural gas if permitted to do so.

Editorially I would add only one comment, that while I do not say so, that while I do not say so in my statement, it obviously shrieks that we are seeking, in any windfall tax that this committee may recommend to the Senate, we are seeking a small producer exemption.

The CHAIRMAN. Thank you.

Mr. Harrold Wright, chairman, National Energy Policy Committee.

STATEMENT OF HARROLD E. WRIGHT, CHAIRMAN, NATIONAL ENERGY POLICY COMMITTEE, TEXAS INDEPENDENT PRODUCERS & ROYALTY OWNERS ASSOCIATION

Mr. WRIGHT. My name is Harrold E. Wright. I am a petroleum engineer and independent producer from Dallas with oil and gas interests in east Texas. I graduated from Texas Tech in 1944 as an electrical engineer and have been active in oil- and gas-producing activities for 32 years.

I appear here today as chairman of the National Energy Policy Committee of the Texas Independent Producers & Royalty Owners Association, which has approximately 4,000 members with an interest in Texas oil and gas production.

TIPRO supports the testimony presented by IPAA in this hearing and, at the same time, appreciates the opportunity to be heard individually as well. I wish to spend a few minutes emphasizing the role of the independent in the producing industry, his need for expansion in investment to maximize producibility, and the problems the excise tax on crude production passed by the House of Representatives last month poses for him.

As has been made clear during this hearing, the independent specializes in exploration, secondary recovery and marginal well operations. He does not refine, transport or market oil products. No service stations bear his name. He usually relies on outside service contractors for well drilling and rework activities.

The average independent concentrates on finding and producing petroleum. His know-how in exploration leads to some 90 percent of exploratory wells drilled in the United States. His efficient low overhead operation results in production of some 60 percent of the Nation's marginal stripper wells.

He is a direct target for any taxation applied to wellhead operations as an individual. He is unlike his larger corporation counterpart. His income is considered investment income for tax purposes,

falling into a possible 70-percent bracket as opposed to a corporation that may never be taxed at more than 48 percent.

The corporation has not been subject to the same rigorous tax requirements as the individual. I cannot help but believe that in a Nation conceived and constituted to protect the rights of individuals that the individual should not be entitled, in every instance, to equal rights to a corporation.

In recent years, the individual has been required to pay a minimum tax while corporations have enjoyed profitable exemptions.

According to the data of the U.S. Census Bureau, during the past 5 years independents spent from 95 to 128 percent of their wellhead revenues in exploration, development and production, relying heavily on the depletion allowed them as their main source of living income.

If you have a picture of oilmen living it up, let me remind you of these percentages which mean that the independent put his money where his faith is, and a lot of his banker's money as well. He has literally mortgaged his future.

That is even so in my case.

Based on the estimates by Pete, Marwick and Mitchell, H.R. 3919 offers the unincorporated producer less than 12 cents on a dollar as a result of decontrol. This sum is much too little to encourage any increase in domestic drilling rates needed to turn around the national decline rate in productivity; 60 cents out of the $1 would be taken by the excise tax while an additional 20 and 26 cents out of the remaining 40 cents would be consumed by other Federal and State taxes.

This leaves the independent producer, who has, for many years, held on to expensive leases and maintained expensive equipment in the belief that decontrol promised in 1973 would result in additional profits, holding the well-known bag.

I was particularly disturbed that Treasury Secretary Blumenthal implied to this committee that the administration's original plan to take $40 billion in decontrol revenues from producers was inadequate, as was the $60 billion in the bill passed by the House. He later recommended an $85 billion take from the industry for the exotic fuels program, but the President's message on Sunday night and Monday upped that tax to an unbelievable $142 billion.

Yesterday, I had the privilege of attending a White House briefing on the newest administration plan in high hopes that the details would clarify my bewilderment. It did not happen. The details are as bad as the TV rhetoric and they want it made permanent to boot.

Taking $142 billion out of the proceeds of decontrol would virtually stop drilling of new oil wells. New discoveries and the drain of our domestic reserve will drop at a far greater rate than all of the savings gained from conservation and the exotic energy sources.

When domestic energy production falls, where are the revenues to be found to finance a $142 billion commitment? When the success of the President's program depends on greatly increased domestic oil production, then every other facet of the plan fails for lack of financing.

Opponents of decontrol say that the additions to the funds to be earned by the industry through decontrol would be wasted if spent

on exploration efforts to find oil which was not there. I invite the committee to review the geological map attached to my testimony which refutes these claims. This map has been previously submitted to Senator Gravel's subcommittee by Mr. Pitts and points out that only 2 percent of the potential petroleum reserve basins in the United States have been extensively explored. Geology easily supports a program of 80,000 wells drilled annually, while our current economics limits the number to only about 50,000 currently.

Taxation along the lines proposed, where it adversely would affect the independent in at least four basic ways:

One, it will deny him an opportunity to increase cash flow so that he can drill the additional wells needed to increase petroleum supplies for domestic and military use.

Two, it will reduce his current and anticipated cash flow determined by the administration's decontrol measures.

Three, it will discourage growth in outside investments necessary for the exploration process.

Four, it will engulf him in tax complexities as disastrous as those created by the now-famous Natural Gas Policy Act of 1978.

It may be true that no man is an island, but an oil well is just that. It stands alone. It is accountable for its profits; it is not a part of a group of wells with an average result. It is a profit center. If it is profitable, or if it is not; if it is profitable, it is pumped; if it is not, it is plugged, which means it is shut off, its parts salvaged to go into wells which do produce, and its potential is lost forever.

A prohibitive tax will force abandonment of thousands of marginal wells, affecting the economy not only of the producer but of more than 2 million royalty owners over the Nation and will result in the ultimate loss of available energy to this country and its consumers.

One of our severest critics, Senator Jackson, has called our profits obscene, yet we find, in the May 7 issue of Fortune magazine a strangely revealing bunch of figures. For example, in 1978 the return to investors in the broadcasting industry was 33 percent; in the aerospace industry, the return was 28 percent; in the office equipment and publishing industry the return was 20 percent. The refining industry was 12 percent and the petroleum and mining industries combined was 1.67.

I hardly think that these represent a range of obscene profits.

Why has there been a decline in the relative profitability of the oil business? We believe that this situation is caused by U.S. controls on crude oil pricing which held price increases essentially to the Nation's implicit price deflator index.

Unfortunately for the producer, his cost in oil exploration and production had far exceeded that and created for him a cost-price squeeze.

Since 1972, for example, when the "implicit" price deflator was climbing to 52 percent through 1978, oil field machinery costs rose 125 percent; casing climbed 112 percent; wages went up 80 percent and drilling costs 113 percent.

This arbitrary tax on oil is not only an unfair burden for the producer who is placed in the position of subsidizing coal liquefication, oil shale and the unconventional gas programs, but constitutes what we believe to be a dangerous national policy.

In conclusion, Mr. Chairman and members of the committee, we urge you to carefully consider how the various provisions of H.R. 3919 will affect the 10,000 independent producers, the 2 million royalty owners, the military security of the Nation, the consumer populous and the maintenance of the U.S. position as a defender of the Free World.

Thank you for this opportunity to be heard.

The CHAIRMAN. Joe McShane, National Stripper Well Association.

STATEMENT OF JOE B. McSHANE, JR., PRESIDENT, NATIONAL STRIPPER WELL ASSOCIATION

Mr. McSHANE. Thank you, Mr. Chairman.

My name is Joe B. McShane, Jr. I am a petroleum engineer residing in Monahans, Tex. My principal activity is the production of crude oil from stripper wells. Additionally, I am president of National Stripper Well Association.

A stripper well, by accepted definition and as defined in law, is an oil well with an average daily production of 10 barrels or less. Actually, the daily average for this class of well nationwide, is 2.91 barrels. In 3 of the 28 States having stripper oil production—Pennsylvania, New York, and West Virginia—the daily average production is less than one-half barrel for 47,188 wells.

These figures may suggest the stripper well is insignificant in our total energy picture. However, this is far from the case.

Nationally, by the last available data, we are actively operating 368,930 such wells. Total current production from these wells, despite their low unit production, is in excess of 1 million barrels daily, the equivalent of approximately 14 percent of our domestic supply of crude oil.

With the low productivity I have noted, it is mandatory that a producer very closely and month by month watch his operating costs; power required, cleanout, labor, equipment replacement, overhead, and other expenses, all of which are increasing under the inflation we are experiencing. In view of these elements it is quite apparent why the stripper well is recognized by operators as having a most sensitive economy.

Any new cost, such as a tax added to costs already faced by operators would automatically move many stripper wells into the deficit column, the exact number depending on the tax level. At this time, under our present stripper economy, we estimate 8,800 wells are at the nonprofit line and marked for abandonment.

An increase in overall operating costs through even a minimal tax increase would result in an increase in abandonment to an estimated 19,800 wells and a tax as heavy as has been proposed would mean an estimated 26,500 or more abandonments. We believe these figures are conservative.

While stripper wells are responsive to any change in the operating economy, they are understandably quick in reacting to an adverse change. We would expect, therefore, that the rate of abandonments would accelerate promptly. While the operator would continue to produce his better wells, his total daily production would be decreased by the volumes he plugged out.

If the tax were to be applied as proposed, the owners of royalty interests—farmers and others—under producing properties would be economically hurt along with the producer. Royalty payments are customarily based on sales after deduction of taxes.

Recent increases in the price of stripper oil have provided much-needed economic breathing room but the operator must still use whatever cost-cutting methods he can find. He intends to keep his wells producing just as long as economically possible regardless of their gradual decline. It is only when a well becomes an economic liability that it is plugged and abandoned.

Despite all innovative efforts, it is sooner or later necessary to plug a well. Each one must reach the end of the road someday. During calendar year 1977, an even 9,000 wells were plugged. This set a 16-year low.

The decline in abandonments I have noted would not have occurred; in fact, would have been in reverse, without the passage of the "Stripper Well Amendment" in late 1973. As you know, this measure removed stripper production from direct price control.

It is interesting to note that for all of that year there were 13,756 abandonments.

C. H. Keplinger, internationally recognized petroleum authority and chairman of the board, Keplinger & Associates, Inc., made a detailed study of the positive influence of the free market price on stripper activity.

Briefly, his conclusions were that the measure saved some 73,000 wells from abandonment January 1, 1974 to January 1, 1978, extended the life of an average stripper well 10 years, resulted in the production of an additional 182 million barrels of oil, and increased stripper reserves which could ultimately be recovered by 2.3 billion barrels.

The proposed tax would certainly reverse these gains with the first evidence being an increase in the rate of abandonments.

A man of prominence conversant with the production tax now being considered quite recently asked me— "Why not just cap wells if the tax goes through and save them for a better economic day?"

My first thought was that we need the oil now. What the need may be in some indefinite future is an unknown.

However, let us give the suggestion careful attention. Suppose I have a particular 1,500-foot well producing just enough oil to come out a little ahead of operating and maintenance costs. Maybe it has produced for 20 or more years but still puts a little oil in the tank without too much expense or trouble. I may regard it as "Old Reliable." An added operating cost, by tax or otherwise, could move that well below the nonprofit line.

I can't simply walk away from that well hoping for better times. The well has valuable equipment—a pump down the hole, a string of sucker rods, surface pumping unit, lead lines, tanks, et cetera. I would necessarily move this investment in equipment to a location where it could recoup some of the cost.

Suppose, however this is done and the well is capped. That well doesn't simply take a prolonged rest. The casing, if left in the well, is subject to corrosion by formation waters. In some areas this is quite severe. The producing formation could cave into the well

bore, or formation water could take over to form a block against the remaining oil.

There is also a legal aspect to either capping or abandoning a well. The producer is legally required to forfeit a lease to mineral owners if production is established but discontinued for a certain length of time. In any case, it would be the end for "Old Reliable."

Stripper wells should be produced just as long as economically practical. With necessary incentives and provided the characteristics of the reservoir suggest it would respond favorably, properties should be converted to enhanced recovery projects before they are abandoned. This could mean another 20 billion to 50 billion barrels of ultimate recovery with a reasonable assist from our technology.

Stripper wells will always be with us. While some decline naturally to the subprofit level, other higher yield wells will always be dropping into the stripper category. The total number is further maintained by expanding stripper development into adjacent tracts or areas that appear favorable.

Stripper production provides a dependable source of domestic crude oil supply. The stripper division is active. There are many areas that can be attractive to some operator given the necessary incentives.

The windfall profits tax would jeopardize stripper operations in every oil-producing region. Production would decline. The rate of abandonment of these wells, nearing the end of their productive lives in any case, would be hastened. The shortage in our domestic crude oil supply would deepen.

In our judgment, stripper oil production should be exempt from any additional tax.

Thank you, sir.

The CHAIRMAN. There is a vote going on in the Senate at this time. I am sure that the Senators will have questions of these witnesses.

It may be we will have enough time to hear Congressman Rousselot at this time. If you would like to, we will wait until the Senators get back.

What would you like to do?

Mr. ROUSSELOT. I do not want to hold up my good Senators who have to go vote. I know what that problem is.

The CHAIRMAN. You will have more Senators to hear you if you wait until they come back.

Mr. ROUSSELOT. I would prefer to do that.

The CHAIRMAN. I suggest that Senator Wallop and I go over and vote. Senator Bentsen can call this meeting back to order when he comes back.

[A brief recess was taken.]

Senator BENTSEN. If the witnesses will return to the table, we will proceed with questioning.

Commissioner Armstrong, I was pleased to hear you say that Texas dedicates the funds from that land, the oil income, for the educational fund. I think that was particularly prudent of the framers of the Texas constitution.

It is also true, is it not, that these reserves are rapidly depleting and this is probably the last opportunity to bolster the endowment fund for the education of the young people of Texas?

Would that be correct?

Mr. ARMSTRONG. There is no question about that, sir.

We run about a 5- to 7-percent decline and it is accelerating.

Senator BENTSEN. Mr. McShane, I cannot help but remember some of the history of the stripper well business. Also I know how tight an operation a man has to run in order to make anything out of stripper wells. The major companies, with their administrative expenses, just cannot do it.

They either cap those wells, or sell them to independent producers who keep them going. I recall years ago when a lot of them were closing down and you tried to save a number of them and you have done that, and many independents have been able to do it. Those are truly the marginal wells. Under the House bill, a tax would be imposed on stripper wells and the proceeds would be used to finance all of the major companies and their synthetic fuel plants.

Is that not the result?

Mr. McSHANE. Senator, I was reviewing the White House factsheet on the President's import reduction program. It calls for an Energy Security Corporation to be financed in the amount of $88 billion.

Senator, the stripper wells produce 14 percent of the current domestic production and therefore, I think it would be safe to assume, would finance at least 14 percent of that $88 billion.

Senator BENTSEN. Do you think any of the stripper well operators are going to build a $3 billion synthetic fuel plant?

Mr. McSHANE. Senator, you understand quite well—and so do many others—the stripper well independent producer does not have the funds to get into the multimillion-dollar synfuel business.

Senator BENTSEN. I wish you would explain. A lot of people do not understand that. Why can you not just cap a well, a stripper well, and then reuse it later?

Mr. McSHANE. In capping a well, you cease production, but the well remains in place subject to down hole corrosion, down hole collapse, ruining of the formation through water blocking. When the well ceases production which it does when it is capped the legal responsibility of the producer-owner is changed.

He must plug and abandon the well, according to law, and then when he does so, the oil and gas lease that he holds reverts to the original mineral owner.

At that time, the well is no longer available for any other use, and the reserves left in the ground remain in the ground and are lost.

Senator BENTSEN. Mr. McShane, I will be offering a stripper well exemption because I think it is unfair to subject these marginal operations to the tax with the accompanying redtape and regulation. I think a lot of them would pull their tent and go about another business.

Mr. Wright, the independent producer drills some 90 percent of the exploratory wells. He is the fellow who goes out and takes the big risk and he finds approximately 75 percent of the new fields. And yet we find that the independents, where we had 20,000 of them in 1950, we have approximately 10,000 now.

Mr. WRIGHT. Yes, sir.

Senator BENTSEN. They are going out of business.

In turn, he is the last fellow that I want to discourage in the business. He is the one who is taking the high risk and finding the new reserves that we need.

I will be offering an exemption for the independent producer at 3,000 barrels or less which will exempt about 98 to 99 percent of the producers. The large companies will still, of course, be subjected to the tax, but it excludes about 15 percent of the production as we understand it. It does not affect that much of the income from the tax.

Mr. WRIGHT. That is approximately correct, sir.

Senator BENTSEN. Those are the numbers that were presented to me thus far.

One of you was testifying—I believe it was Mr. Cubbage—about what this windfall tax would mean insofar as what the independent—I guess it was you, Mr. Wright—could receive. I asked that same question of Secretary Schlesinger.

He said it could be as low as the 7- to 8-percent incentive that he would have left after the so-called windfall profits tax is put on. So it is hardly any inducement to go out and take a big risk.

Mr. WRIGHT. Yes, sir. I think that is correct. In my testimony I said it could be as little as 7 percent. I certainly believe that under such circumstances, that would not induce many people to drill wells with their income.

Senator BENTSEN. My time has expired.

Senator Talmadge?

Senator TALMADGE. Thank you, Mr. Chairman.

Mr. Armstrong, I believe you testified the House-passed bill would levy a tax on oil produced on lands owned by the State of Texas which was dedicated for education?

Mr. ARMSTRONG. No, sir. I believe the testimony is that the House exempted those lands.

Senator TALMADGE. They did?

You want to retain that exemption?

Mr. ARMSTRONG. Yes, sir.

Senator TALMADGE. I was about to ask you if one government can tax another government, does that not involve a constitutional question?

Mr. ARMSTRONG. There is a hard question there. There are some cases that have said, if the State of New York got into the mineral water business, that business could be taxed, but to my knowledge there has never been a tax levied on the sale of property that belonged to the State and the Constitution seems to speak to the ability, or the inability, of the Federal Government to inhibit the State from performing its proper governmental functions.

I think it would be very questionable from a constitutional point of view.

Senator TALMADGE. Is that why the House exempted you in Texas?

Mr. ARMSTRONG. I think there was a broader amendment additionally offered to the Ways and Means Committee that would have exempted all governmental functions that were performed as a result of the sale of oil and gas from the city of Long Beach, for example. I think Congressman Rousselot will talk about that in a

few minutes. I think the same arguments apply to the broader amendment that we made.

It is just that we think it is clearly dedicated to education. It should be protected.

Where it is used for other govermental services, I think that would be up to the wisdom of this committee and the Senate as to whether it should be a broader exemption.

But it certainly would be consistent to argue that where the proceeds and revenue are used for governmental exemptions, that that exemption should apply.

Senator TALMADGE. Thank you, sir.

I have no further questions.

Senator BENTSEN. Senator Wallop?

Senator WALLOP. Thank you, Mr. Chairman.

I would like, Mr. Armstrong, just to pursue that a little further, because in my State of Wyoming, for example, and in New Mexico, there are trusts funded by State-owned mineral issues such as, penal reform, miners' pensions, and a number of others, that are clearly charitable and legitimate State activities.

Do you see any reason why they should not fall in the same category as education?

Mr. ARMSTRONG. No, sir, I think that would be consistent.

The only thing is that historically most of the States have dedicated them to education. As a practical matter, the State of Texas does produce oil and gas in its parks and wildlife lands and prison lands, which would not be covered under the House amendment.

But I think—I worked with Bert King, although I think he is now retired. I am sure that he would have the same interest in seeing that the exemption of the windfall profits tax would apply to any legitimate governmental function.

Senator WALLOP. I would hope that would be the direction that the committee would take.

Let me just throw one question out to you all, for whoever wants to answer it may.

The Secretary of the Treasury was testifying here, and we were mentioning some of the things you mentioned, Mr. Cubbage, the ability of people to attract capital for drilling ventures was one thing he commented on. He said, good lord, there is a plethora of money around this country that needs to be loaned out. There are all kinds of funds that need to be borrowed sitting in banks right now, and we have too much money that is not active.

I wonder if you would care to comment on the willingness of banks to loan money for wildcat ventures, or for the kind of exploratory prospects that are not even offsets, the real step-ups?

Mr. CUBBAGE. Senator, in my experience, I have never known of a bank to lend money for a wildcat venture and the very nature of the business, I think, would indicate why a bank simply could not do that. I am sure the board of directors would fire any banker who did so.

It is difficult even to get production loans in certain areas—for example, my home area, the tristate, Kentucky-Illinois-Indiana—practically none of the banks actively make any type of oil production loans. Twenty-five years ago, they were—all of the banks made these type of loans. Today they are pretty well withdrawn.

The operators in the area who seek production money, production loans for development purposes or whatever, are therefore forced to go elsewhere to some of the western Texas banks, Oklahoma banks, or Chicago.

Senator WALLOP. Mr. Keplinger?

Mr. KEPLINGER. For the last 5 years, every 6 months, we have conducted a school for bankers and insurance people in the United States. We hold the school in Texas in several spots, usually in Houston, and we have had our school full for these 5 years, and there is no chance—I have communicated with hundreds of bankers, through the schools, through other loans that we make with them, and there is no chance that they are going to put this money out.

As Mr. Blumenthal talked about, the oil business is risky and other businesses are risky. You can go out and buy insurance on a well blowing out or some mechanical defect but to go out and buy insurance that you are going to find oil or gas is absolutely impossible.

So that statement is completely wrong.

Senator WALLOP. Let me ask you this, then, as a followup. Many people, producers, seek money for joint ventures, a drilling interest or any other type of interest. As you pointed out, doctors, lawyers, successful grocers, and other people who have money that they want to risk. If the windfall profits in some way or another captures them forever in that industry—in other words, with the plowback provision, if they are not released from it, or they have to pay windfall profits, do you think they will invest in the first place?

Mr. KEPLINGER. I do not know, first, what individual investors will do. We have to look at the picture. They have come to us, who look at that tax picture with their accountants, and some will go one way and some another.

I could not give you a general statement of exactly what they would do.

Senator WALLOP. Mr. Chairman, if I may finish that question, the thing that worries me is when it is on a permanent tax, and you are an outside investor going into the type of investment you have not done previously and do not intend to keep actively as your business, but simply as an investment, are you likely to put your money in something that really is dead ended?

Once you invest, you are going to have to stay in there until the last barrel is found, and when you do get the money out, you will want to invest it in something else.

You are going to pay more tax, on capital gains or any other tax concept that I have heard of.

Mr. CUBBAGE. In my opinion, Senator, for whatever it is worth, I do think it will keep outside capital out of the independent sector of the oil business. The investor, once he sees that he will be locked in and would not have the individual choice year after year, or that his investment would be subject to additional tax burdens, regulation and otherwise, I think he will choose a certificate of deposit or a motel or some other form of investment.

Senator WALLOP. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Boren?

Senator BOREN. Thank you, Mr. Chairman.

I want to thank all members of the panel for their testimony and again, a special word of welcome to Henry Keplinger from my home State, recognized as one of the most knowledgeable people in the energy field, and also representing the Energy Consumers & Producers Association formed in my hometown. I am very proud of that.

Let me direct this question to you. If you have advocated exemptions for specific, newly discovered oil, and a small producers' exemption, what would you estimate, over the next 5 years would be the response in terms of increased domestic production if these proposals were to be adopted?

Mr. KEPLINGER. If only these proposals—the stripper production would increase our oil—the stripper production affects 14 percent now. The remaining categories, what we have, the marginal—we had a hearing on that in Austin, Tex., before the Department of Energy. We came up that 15 percent would be affected by deep marginal wells. That makes a total of 29 percent, and the small stripper exemption, and 10 percent—it could be a range of 35 percent.

My overall figure that new oil—we have looked at the new oil. If we did not have this withholding, this withholding tax, or windfall profits tax, the overall figure is 5 million barrels a day increase if you would allow the industry to plow the money back, spend the money. Now we are spending about $20 billion a year and if they spent $40 billion for the next 10 years, we would increase our production by 5 million barrels per day.

If you would take 35 percent of 5 million barrels in the next 10 years, you are going to come up somewhere 5 percent, 1,500,000 barrels per day. At the end of 10 years, this is roughly the best figure that we can come up with at this time.

Senator BOREN. Let me ask the whole group this question. The people are paying the price. No one is fooled by that. Whether it is collected in a tax or whatever, they are paying for it as consumers.

We are either going to leave it to the private sector to do the job or take it to some government bureaucracy to do one-fourth of the job.

The people are paying for it.

Where are the taxpayer and the consumer going to get the best bargain? If we look at these kinds of exemptions, providing this kind of additional production, we look at the congressional Office of Technology Assessment saying that there are 298 billion barrels of oil still in the ground. There are wells on the scene that we know about, that can produce another 50 billion barrels in enhanced recovery, at less than $30 a barrel.

In your opinion, what is going to be cheaper for the American people, to go in by not encouraging that kind of production, by not taxing it? By paying some huge subsidy to immediately go into a governmentally directed synthetic fuels program?

Mr. WRIGHT. Senator Boren, if I may take a shot at that, I would say that the very best deal for the U.S. consumer would be to get the Government out of the oil business. I am talking about going back to a basic plan of free enterprise and let the market seek its own levels.

Even just this week, Newsweek magazine through a group of their editors have come up with a plan that just says essentially that. If you have not read that little article, I think it would be worth looking at, because it says some things that we have been saying all the time, that free enterprise can do most of these things most efficiently if it is only given the opportunity.

Senator BOREN. Let me ask you this. While we are spending $1 billion to subsidize these new forms of energy production through the Government, this bill, in essence, throws back the price of stripper production so that with the tax, we lose that kind of stripper production.

Why is that important?

If you could explain to the committee, why is it important that we prolong the stripper production, and how would that be related to the ultimate recovery through enhanced recovery projects?

Mr. WRIGHT. There are a lot of reasons why it is important to keep your stripper wells alive and available. Of course, they do produce some income currently. They do produce oil income, produce oil for the market. They preserve a property for future technology. That is another way to look at this thing.

In Oklahoma—your State, for example—through the years, there have been many old fields that in recent years, have improved production by the technology of water flood. The use of thickened water through a pusher, a miscible, phase-type thing. These have all been improved recovery techniques, and now they are relying on these improved techniques for a recovery process that will recover above the 20 percent of the oil that was recovered on the primary.

Those are some of the reasons.

Senator BOREN. You may get every bit as much, if not more ultimate recovery than in the primary production?

Mr. WRIGHT. We are talking generally. There is a rule of thumb in the oil industry that you expect to get 1-to-1 ratio as much on secondary as you get in primary. That is a rough rule, and a lot of things that relate to it.

Senator BOREN. What was the number you gave that would be plugged under this proposal that you thought would be premature abandonment.

Mr. MCSHANE. We would start at 8,800 wells per year abandonments and go to 19,800 then, to 26,500 per year.

Senator BOREN. What you are saying is that not only do we have to look at the tremendous loss that would come from the production of those 8,800 wells, but we also have to view the tremendous magnitude of the lost potential of keeping those fields alive, and may be getting double recovery from——

Mr. WRIGHT. Additional recovery? Yes, sir.

Senator BOREN. Thank you.

The CHAIRMAN. Senator Dole?

Senator DOLE. We are faced with a political problem rather than an energy problem. Some people are more concerned about polls than production.

It may be good politics to run against the oil industry in 1980. Some politicians on both sides are taking shots at the oil industry.

Most members of this committee are trying to address the problem of production. If there is an oil tax, it should to be workable, not destructive. The private sector should not be destroyed to fund a public corporation.

Some of us feel that is what is happening, particularly by syphoning $142 billion out of the private sector and into the public sector.

Do the independent producers have a role in the synfuels program?

Mr. WRIGHT. I would answer that we do not see it that way, in our failure as the small end of the business, because there is no place for it. Practically all of the majors have had some type of lignite, coal, oil-shale projects at one time or another that they have had in their research departments. They are probably in excellent shape to do something with it if they can get it financed through some type of arrangement.

It really does not fit into our program, Senator. Actually we feel like our 30 percent of the overall domestic production is destined to really underwrite this program that the majors may enjoy or someone else may enjoy. There is certainly no way we will.

Senator DOLE. I assume some of the members of this panel were consulted by the administration about energy policy before the President spoke on Sunday evening. Were all of you consulted or none of you?

Mr. CUBBAGE. If I might say, Senator, I do not know of anybody who has been consulted within industry.

Mr. ARMSTRONG. I would like to add we are always being beset upon with new terms and synfuel is one. I had frankly thought that synfuel up until Sunday night was like scotch or bourbon or maybe gin. Apparently it is now going to connote shale oil production and that sort of thing.

Senator DOLE. The situation is important and it is serious we have the obligation to try to come up with a workable plan. The Republican members of the committee are going to meet tomorrow morning, to discuss the problem.

There is interest in a plowback credit. There was more interest in 1975. Now, however, there is not so much interest in it. If plowback were coupled with a small producers' exemption, would that not negate the problem that Senator Wallop raised about the lockin production theory.

Has that been thought about? What would happen if you went into areas where the lease has proved production up and started drilling as many holes as you could? How much short term impact would that have? You may have to change some of the State conservation rules.

Is that a practical alternative as far as short-term increases in production?

Mr. KEPLINGER. Yes; that would be a short term and would be definitely used by the independents.

Senator DOLE. In other words you would have some short-term gain while waiting for synfuels to develop. It would seem to me that might be an area which should be explored. Do you run counter to State statutes? Could you comment?

Mr. KEPLINGER. No.

Senator DOLE. You do not have any problem with spacing requirements?

Mr. KEPLINGER. You can always change them through a hearing with 20 days' notice in the State of Texas. Kansas is the same way. There would be no problem if it is based upon economics.

Senator DOLE. Is that good conservation?

Mr. KEPLINGER. Yes, sir. You would get more oil out of the ground. I would like to make the statement that the cost of finding conventional oil and doing what that would be doing in the case of infill drilling, that cost today and we have studied it quite intensively, it is about $20 a barrel. We have studied synfuel for the last 5 years.

I went to Africa and visited all the plants at SASOL. We feel that cost is in the neighborhood of $40 or $50 a barrel today. As far as the independents that we represent and would recommend a project to, we would recommend continuing conventional methods as more economical. At least it would cost less than half as much to develop a barrel of liquid fuel as it would to go out and do it yourself as you have done it for the last 50 years.

Senator DOLE. My time has expired. I would like to say one more thing. The President's message did not address the short term. There were a lot of long-term possibilities. There was not any emphasis at all on the short term. There was not much emphasis on projection. There was emphasis on more Government, more regulation and more public corporations.

That is why I raised the question. You know where the oil is in these areas. You are just going to have to start poking holes. I do not know how many barrels per day that would add. It seems to me it would be substantial.

The CHAIRMAN. Senator Packwood would have been next. I see my time will come as he is not here.

Assuming some of us would like to at least go along with the President's original recommendation to the extent that we can, can one of you tell me the difference between what the President started out recommending in this area and what the recommendation is now?

Mr. Cubbage, you represent the Committee of Cooperating Oil & Gas Associations. You should know the answer to that. Can you tell me what the difference is between what the President started out with when he sent his decontrol plan down and what he is recommending now?

Mr. CUBBAGE. No, sir, I really cannot. It seems to me it is much the same, maybe a little bit larger.

We have talked and at some times even joked among ourselves that we do not see much difference in what the administration has proposed today as opposed to what the original Energy Policy Act was in 1977. The only difference we see is they called it a crude oil equalization tax back in 1977 and now we are going to call it a windfall profit tax. It is the same wellhead severance tax any way you slice it no matter what percentage you put on it.

I might say I also attended the White House briefing yesterday. There was no doubt left in my mind nor any of the approximately 200 people there that the existing domestic oil production was to serve as the vehicle to finance the package which has been pro-

posed. If that is the case I think that is the answer to Senator Dole's comment that no comment was to be made on the near term because the near term existing production is the financing vehicle for the long term. This is the impression which was certainly given to me.

The CHAIRMAN. Senator Gravel.

Senator GRAVEL. The point I am most fascinated by and all of your testimony was very good, is syncrude.

Mr. Keplinger, you say you went to South Africa with a group of people and visited their facilities?

Mr. KEPLINGER. Yes, sir, at SASOL.

Senator GRAVEL. Your investigation showed the syncrude they are producing today, and obviously that is the only place in the world where you have the technology in operation on any scale, costs $40 to $50 per barrel.

Mr. KEPLINGER. That is what it would cost us to do it right now, $40 to $50 a barrel compared to finding it in America.

Senator GRAVEL. I appreciate that. I just want to focus on the syncrude.

Mr. Chairman, there are only two examples in history of synthetic fuel production. One is Nazi Germany, during the Second World War, which produced the syncrude. People tend to forget that Germany had an economic base of slave labor in order to get away with this. I suspect there is some correlation with the fact that South Africa does have a very unusual lower base of labor, which is one of the indigenous problems they have, that can sustain this kind of situation.

I wonder if we could get somebody from South Africa, and I do not know if it is permissible under the committee's rules of procedure to come and testify before this committee so we can get some intelligent and specific documentation as to what this whole syncrude undertaking could mean. We need some specific data before we launch into a $100 billion rape of the private economy.

Is this possible, Mr. Chairman, that we could have a hearing one day to call these people in from South Africa and maybe pay their way? I do not suggest that the committee travel to South Africa as I am sure we all travel enough. Could we pay to have some people come in and have 1 day of hearings?

I am sure there have been no hearings on this. Everything is prospective. These people have specific experience.

The CHAIRMAN. We will see if we can get them, Senator.

Senator GRAVEL. I thank you. I wonder if, as a product of your trip, you might be able to furnish the record, the committee and myself personally anything in the way of materials you secured to indicate what South Africa's actual experience is right now? They are producing syncrude on a national scale. If they are paying $40 to $50 for it now, not prospectively, we should demand now that the private sector should have $40 or $50, if that is what the market takes, to go look for oil and gas.

Do you see my argumentation?

Mr. KEPLINGER. Surely.

Senator GRAVEL. If you could offer us anything in the way of substantial data, it would be very valuable for us in markup dialog.

Mr. KEPLINGER. I can say that the actual costs are guarded in South Africa because they are under certain restrictions about dealing with the United States. We have some sanctions against them and we also have South Africa having trouble getting oil from certain countries. The amount of oil they have produced is a much held secret.

We are dealing with a hotbed because we do not have the communications we should have.

I have been there. I have looked at estimates. The Rand Corp. has just recently made a study which I think the committee should have in their files. It is a reference to the costs of producing synthetic crude and synthetic liquids here in the United States.

Senator GRAVEL. Based on South African experience?

Mr. KEPLINGER. That is the only real big one. The other one you are talking about during World War II, those volumes were in the neighborhood of 100,000 barrels a day. They were very important. As I recall they were only a little over 100,000 barrels a day.

We are talking about America where we are burning and using over 18 million barrels a day.

Senator GRAVEL. What is your best estimate as an expert of what you think their production is right now, just from your observation?

Mr. KEPLINGER. South Africa would be somewhere between 35,000 to 50,000 barrels of liquids per day. In addition they produce along with their process gas which has Btu value. The total Btu value I do not have. The efficiency of the project, for every Btu of coal they bring up through an elevator right to the main hoppers, that efficiency is around 50 percent plus. You utilize 1 Btu you get in the form of oil or liquid or gas you get 50 percent of a Btu efficiency.

Senator GRAVEL. Thank you.

The CHAIRMAN. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Gentlemen, I appreciate your testimony. I apologize for some of my absence.

I understand and realize and thank the independents particularly for all the drilling activity you have engaged in in the country in finding new production and particularly onshore production. Certainly we all agree we have to wean ourselves away from OPEC and try to increase domestic production supply more than so far indicated by the administration proposals as of this date.

The question I really have is the degree to which you think we can increase domestic production and particularly onshore production. I have heard the estimate this morning up to 5-million-barrels-a-day projected increase.

Mr. KEPLINGER. Ten years.

Senator BAUCUS. 1990. I wonder if any of you who have particularly looked at projected production figures could break that down for me a little, that is either in terms of geography in the country or between newly discovered wells and secondary and tertiary recovery, marginals and stripper wells which produce more oil.

I am just trying to get a feel for how you arrive at the figure of 5 million per day by the year 1990.

Can anyone take a crack at that, please?

Mr. KEPLINGER. The way I arrived at it was 2 million barrels per day of newly discovered oil, 1,500,000 barrels per day of secondary oil and tertiary oil. The bulletin at the Office of Technological Assessments was put out on page 26 which Senator Boren talked about, the data on tertiary, enhanced recovery data is set out in there which tags in with this 1.5 million barrels per day.

We could go ahead and utilize CO_2, carbon dioxide and the sulfinated soaps,' push and reduce the surface tension of the oil in the ground and then we have this heavy oil in California and other States but particularly in California. Standard Oil of California and Union Oil Co. and several large operators are out there. There is the utilization of heat, pushing the steam into the ground and heating the oil. We have in the neighborhood of half a million barrels a day there.

Senator BAUCUS. As I understand it you expect about 2 million barrels of newly discovered oil through enhanced recovery techniques. Is that correct?

Mr. KEPLINGER. It would be 1½ million with the techniques according to the Office of Technological Assessments and then another half a million from just the heavy oil which has not been considered by the Office of Technological Assessments. That would be 4 million. The remainder would be areas where we have had water floods and high cost production where if we have $25 per barrel, you can produce down to 1 percent or 2 percent oil in your total mix and very small declines in percentage of oil produced will lead over a 20- to 25-year period an enormous amount of oil which we have in a Fitz pool in Oklahoma.

Senator BAUCUS. Thank you. Could you tell me how you arrived at the 2 million barrels figure?

Mr. KEPLINGER. This is an estimate. We have over 175 billion potential in the United States which is equal to the reserves in Saudi Arabia.

Senator BAUCUS. With decontrol do you expect to find big fields with billion barrels reserve or do you expect to find a whole multitude of smaller fields? I am trying to get a sense of what the industry anticipates.

Mr. KEPLINGER. In the past 2 years the experience has been we are finding small fields all over the country. This does not consider that we would find some big field such as east Texas. Those fields come into being if you look at the chart maybe every 10 years or something like that. This is the actual distribution of oil fields that have been found in the past 2 years. They are small fields. We have found over 1,000 each year. Those will continue based upon the experience we have had.

Senator BAUCUS. You have not looked at the geographic areas in the country as to where this is going to be; you have extrapolated it, is that correct? I am trying to get a sense of how you put these figures together.

Mr. KEPLINGER. I cannot tell you or give you an assurance that it is going to be one spot or another. It is well distributed from California to North Dakota right now. Also in Montana and the Rocky Mountain overthrust.

In the last year I have looked at more than 1,000 deals in the United States. The gulf coast and Louisiana is an area where we

have only touched the reserves that will come out of Louisiana. It is well distributed. I do not think it is going to be tied into just one State.

Senator BAUCUS. I am asking the question because I think it is important to pin down as accurately as we possibly can. I grant you it is very conjectural. I think it is important to pin down as much as possible the degree to which we are going to establish our independence through additional domestic production compared with other proposals.

The more you can document more precisely with decontrol, with or without the windfall excise tax, the more likely I think the country and certainly the Congress will be able to establish an energy program that is not dreamy and starry eyed but actually makes sense.

Senator WALLOP. Max, if you would yield just half a second, I think the map on the back of Mr. Wright's testimony would give you some indication of where it lies. I do not think there is any way of predicting where somebody is going to explore. I think they will explore where they can find capital and rigs and opportunity.

Senator BAUCUS. I have seen that map. It is a couple of years old I think.

Mr. KEPLINGER. This is brand new.

Senator BAUCUS. I saw one last year which looked exactly the same. Thank you.

The CHAIRMAN. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

I was interested to hear you say we have a potential of 5 million barrels and you have broken it down. What was the total you think could be derived from stripper and enhanced recovery again?

Mr. KEPLINGER. Stripper and enhanced recovery would be 2 million barrels per day by 1990.

Senator BRADLEY. It is my understanding that some stripper wells and some wells which use enhanced recovery are more difficult to get at than others. Therefore, the price would be different.

I wonder if you have determined what price you were looking for in order to get all of those 2 million barrels.

Mr. KEPLINGER. The price that we are looking for is the world price in order for us to compete and not have our hands tied in any way and let the normal taxation take place in taxing whatever the profits are the oil companies make. It is a world price which we would recommend. That would be the same price as you would have to pay Saudi Arabia for a barrel of oil except when you do it through the independent, let him find this oil for you, you get back to the Federal Government 60 percent of the price.

If the price of oil is $20, you are going to get back $12 in taxes to the Federal Government and States. You are going to buy another 35 percent. You are going to spend it in the form of labor to the people of the United States who are going to be working for the oil companies. The other 5 percent of that dollar is going to be the profit that the operators will take for the enormous risks they take to find a barrel.

Senator BRADLEY. Does any other member of the panel want to comment?

Mr. WRIGHT. Yes, sir. Let me add to that, Senator Bradley. One of the big problems in making these types of estimates is trying to hit a moving target of a price on *x* date. As you well can imagine, when all of these are economic projections depending on certain circumstances at a certain time and 2 years ago we were not even thinking about $20 oil and we are seeing $20 oil. We were not projecting on a moving economy where we have 13 or 15 percent inflation factor.

It really makes these things quite difficult to get to but the type of figures Mr. Keplinger is talking about are within the range of what most of us are in agreement on. The big problem is the economics on a given day.

When you get into the Government's involvement in excise tax or the other type of things we see, you further complicate a lot of the problems because what is the tax situation of the individual outfit doing these things? It all gets back to the basic profitability sections.

We are in basic agreement pretty well through the industry I think on the type of figures we are talking about.

Senator BRADLEY. Could you tell me in relative terms how much more energy efficient is drilling for oil as compared to production of synthetic fuels from coal? How much energy do you have to use to produce a barrel of oil versus how much energy to produce a barrel of synthetic coal oil?

Mr. KEPLINGER. On synthetic oil that you make from coal, the best figures are a little bit better than 50-percent efficiency. This is the only practical one that has been running for many years from SASOL.

From a barrel of oil, the energy required, it varies on your deeper wells and your shallow wells. To come up with an average we have figured out it takes so many tons of steel to drill a 10,000-foot well. You will burn so many barrels of distillate to run your motors. My best guess right now when you take that total energy, it is in the neighborhood of 15 percent. I think it could be in that range.

I would yield to others on the panel who have studied this problem also. Another thing is it depends on the amount of oil that your well produces on an average.

We have been producing something like 60,000 to 70,000 barrels per well in the last few years.

Senator BRADLEY. Ten to fifteen percent of the total energy produced is used in the production of the energy?

Mr. KEPLINGER. Yes, sir.

Senator BRADLEY. With synfuels, it is your estimate that 50 percent of the total energy that is produced would be used in the production of synfuel?

Mr. KEPLINGER. A little less than 50. I think the efficiency is 50-plus so it would be a little less than 50 percent.

Senator BRADLEY. Are other members of the panel in agreement with that?

Mr. WRIGHT. I have never approached it that way, Senator. I would not have any way of knowing.

Senator BRADLEY. If we are dealing with the possibility of $130 billion being spent on creating oil from coal and oil shale and it

takes 30 to 40 percent more energy to produce that, the net production is less than if it were produced from oil.

Mr. WRIGHT. I think that is fairly obvious. I would be surprised if it took 15 percent energywise to produce a barrel of oil but I guess you have to consider your dry holes and all these other factors which go into the production of a barrel of energy.

Mr. KEPLINGER. This 15 percent will vary from 15 percent down to 10 percent but this includes the liquid gasoline which you end up with. This includes the extra energy you use in your refinery. This is the overall picture which the Department of Labor several years ago made a report on. I think it is a little over 10 percent. That is the reason I gave you the range of 10 to 15 percent.

Mr. ARMSTRONG. If I might interject and I do not consider myself to be an expert but is it not the sense of the President's endeavor to spend this money on perhaps technological breakthroughs which might get that energy investment down? I think a lot of this would depend on reserves. We all see the reserve picture absent higher prices on a declining basis. It is certainly declining in our State.

The reserves are going to be controlled by price because it is clear as these gentlemen have testified at a high dollar price or the world market price, we are going to have more reserves either because of secondary and tertiary recovery or something of that type. Eventually it is going to get to the point where we will not have the oil and gas capability so the question then becomes do we go to the synthetics and would there be some merit to spending some money so you would have a technological breakthrough which would allow the synthetics to become replacements.

I think that is the gap that we have to get across. It is obvious we will not have the oil and gas forever.

Senator BRADLEY. My point is, you make calculations as to how much you can get out at what price. I agree. If it goes to world price, you have to make the calculation of how much you can get out at what price even though it is the world price.

The underlying assumption is that the world price is automatically going to go up and we are powerless because we are under the control of OPEC. That is not necessarily true depending upon what we do vis-a-vis vulnerable members of OPEC and non-OPEC members who are basically in debt to this country for a whole sort of items.

It is possible to go into a quasi-barter situation and exert a lot more power than we have at the moment where we are simply dealing on the world market. It would be helpful to be able to determine how much we could get and at what price domestically.

I know it is difficult. I know it is a moving target. I think in the overall formulation of national policy, particularly international policy, and in attempting to break OPEC, it is a helpful series of facts to have.

The CHAIRMAN. Are there further questions?

[No response.]

The CHAIRMAN. Thank you very much, gentlemen.

[The prepared statements of the preceding panel follow:]

PREPARED STATEMENT OF C. H. KEPLINGER, CHAIRMAN, ENERGY CONSUMERS AND PRODUCERS ASSOCIATION

Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you today to testify concerning H.R. 3919, the "Crude Oil Windfall Profit Tax of 1979." I appear on behalf of the Energy Consumers and Producers Association (ECPA), an association of approximately 500 small oil and gas producers located in some 15 producing states. I currently serve as chairman of the board of trustees of ECPA. By profession I am a petroleum engineer, and am chairman of the board of Keplinger and Associates, Inc. of Tulsa, Okla. and Houston, Tex. I have been an adviser to oil and natural gas companies, Federal and State agencies and foreign governments for over 30 years. At present, I am petroleum adviser to the State of Tennessee.

ECPA was founded 3 years ago in Seminole, Okla., a county that at one time produced one-third of the world's oil and which is the home county of Senator Boren. Its organizers were small independent producers who were frustrated and angry over retroactive interpretation and enforcement of an increasingly complex set of petroleum regulations.

I am sure that each member of this committee has a general idea of the oil pricing rules. After Senator Long placed his chart on the wall of the committee room last week, I am also certain that all of you have a better understanding of the complexity of the rules relating to drilling and producing oil and gas. During the past 6 years, when the demand for oil and the market price provided increasing incentives for producers to go all out in exploration, drilling, and production, this country has operated under a complex system of confusing and arbitrary controls.

Sitting in our association office is a 14-volume set of Federal Energy Guidelines, which covers 6 years of petroleum regulations. It includes eight bound volumes and 6 volumes which are updated weekly. Within those 14 volumes are statutes, enacted regulations, regulation changes, interpretations of interpretations, orders, decisions, appeals, and court opinions.

Those 14 volumes represent the output of a vast new profession of energy experts. These experts write rules, interpret or explain rules, enforce rules, research rules, and challenge and defend those rules. They have created that 14-volume set of energy guidelines, but they have not helped explore for or produce one drop of oil. Those 14 volumes have frequently resulted in disincentives to both drilling and maximum production from producing wells.

And what has been learned from the past 6 years?

The majority of independent producers produce both oil and gas. Sitting by those 14 volumes in the ECPA office is one bulging volume which represents the first 6 months of administration of the Natural Gas Policy Act. I can assure you that it will have cloned to at least 14 volumes in a few more years with the help of energy experts who do not help produce one foot of gas.

And now the independent producer is faced with a wellhead tax proposal which not only fails to undo the cumulative impact of overloading the oil industry with regulations, but would add new regulations and complexities to those in place. It will spawn another multivolume set of tax guidelines and increase the ranks of the new energy experts while retaining selective disincentives to maximum exploration, drilling and production.

I am here today to say that producers need price decontrol and oil deregulation. It is our strong conviction that price decontrol without an excise tax is in the best interest of this country. This would mean that in 1981, oil would be completely deregulated and the producer would finally be free from the uncertainties and arbitrary distinctions of the regulations.

However, should the committee and the full Senate decide that some tax should be imposed, we urge the Senate to adopt a tax proposal which focuses on increasing economic incentives and on simplification of rules required to put that tax into effect.

Accordingly, our testimony will emphasize: (1) Decontrol; and (2) H.R. 3919 amendments:

a. Exempt stripper production from the excise tax;

b. Exempt newly discovered and other tier 3 oil and in addition exempt marginal properties;

c. Exempt small producers from the tax; and

d. Avoid further regulatory complexities and confusion by: (1) Retaining the DOE definition of "newly discovered oil" without further restrictions for taxing purposes, (2) eliminating any attempt to set the tier 3 base price according to grade and location of oil, (3) setting one base price each for tier 1 and tier 2 oil, and (4)

eliminating the need for a tier one tax base by adopting the 3-percent BPCL decline factor for tax purposes.

(1) DECONTROL

Since 1973 I have advocated, and since its inception the ECPA has advocated, that the U.S. domestic oil and gas exploration industry be given crude oil price incentives equal to the world free market price. Had this decision been made 6 years ago, I am firmly convinced that we would not be so dependent on foreign oil from OPEC countries today.

We hope with all our hearts that we are motivated entirely and solely by our own national domestic and security needs (and I am convinced we are) when we recommend Presidential decontrol with no excise taxes or legislation extending regulations. In that way, we will be able to build up domestic oil production and replace foreign oil until our U.S. oil use mix approaches 75 percent domestic oil and 25 percent foreign oil. At the same time it is essential that we remove environmental roadblocks and other obstructions to get more coal and nuclear energy used. The utilization of coal is this country's long term ace-in-the-hole.

In analyzing what we can do about lessening our dependence on imported oil, we must first answer this question: How much crude oil and natural gas is underground in the United States waiting to be drilled? We have all heard "expert" predictions on future U.S. reserves ranging from calamitous pessimism to enthusiastic optimism.

Studies and publications of the American Association of Petroleum Geologists support a large oil resource base for future drilling. My estimate of the amount of economic and subeconomic undiscovered crude oil resources approximates 172.5 billion barrels—slightly greater than Saudi Arabia's latest proven oil reserves of 165.7 billion barrels as of January 1, 1978. Although the U.S. undiscovered oil resource base is not known with complete accuracy, as of 1975, the U.S. Geological Survey study, published in circular No. 725, estimated that 50 to 127 billion barrels of oil await discovery at current prices with 95 and 5 percent probability estimates. At higher prices, in known reservoirs the subeconomic category has a range of 12 to 140 billion barrels of oil. These estimates are shown on exhibit A.

The geological facts point to a large oil resource base which could be exploited if the price of oil were decontrolled without additional taxes. We continually are surprised with new finds such as the ones in Oregon and Tennessee.

I can say with absolute confidence that historic statistical trends support a direct relationship between investment and oil and gas discoveries. In 1977, the United States found 24 barrels of equivalent oil per foot of exploratory drilling, based upon studies of the American Association of Petroleum Geologists.

For proof of what the domestic industry can do when operating without controls we need only look to the past record in the intrastate gas market, which as we know is now subject to controls. During the five years prior to passage of the Natural Gas Policy Act, increases in the supplies of gas available in the intrastate market greatly exceeded what was found for the intrastate market. During 1975, the interstate new gas supply was increased by 1.3 trillion cubic feet, or 13 percent of the total gas new supply; whereas the intrastate new gas supply was 8.7 trillion cubic feet, or 87.5 percent of the new gas supply.

Had it not been for this success in the unregulated intrastate area, our purchases of foreign oil would have been much greater. Every trillion cubic feet of gas produced in the unregulated intrastate market replaces 180 million barrels of foreign oil, with a savings in dollars in the balance of payments equal to an estimated $3.1 billion at present prices for foreign oil. As indicated earlier, the so-called decontrol of natural gas in the form of the NGPA has contributed to the slowdown in exploration for new gas reserves.

If oil is decontrolled without imposition of new taxes we believe that we can accomplish what was accomplished in the unregulated intrastate gas market and in the U.S. domestic oil market in the 1950's. And I should add that any responsible energy plan for the future should include the immediate repeal of the NGPA and complete decontrol of the production of natural gas.

To justify the tax and continued controls on the production of oil and gas a myth has been perpetrated—windfall profits. It was reasoned, I assume, that this would sound good to the American public, and that it would be good politics to throw darts at the domestic industry. Even though aimed at the majors, the independent producers take the attack personally. The myth is easily dispelled and Senator Gravel's questions and comments in this regard have been effective.

The rate of return of stockholders' equity for oil companies (oil companies are owned by citizens, consumers, pension funds, etc.) has been close to the average of all manufacturing industries, as indicated by the attached exhibit, exhibit B.

Oil income in constant dollars fell for the 25 largest firms between 1974 and 1978. This data is shown in exhibit C. Net income in constant dollars for the 25 companies increased 2.8 percent between 1977 and 1978, but the total remained well below the 1974 level. Furthermore, the net income increase for the oil industry between 1977 and 1978 is below that of any other industries. The overall picture of profits must be studied and the explanations of the oil industry's first quarter 1978 profits must be considered in light of the overall performance of the industry. The overall profit of all industries has seasonal variations and individual quarter statements cannot be considered representative. The tally of all major industry is shown in the attached exhibit D taken from the U.S. News and World Report, dated May 7, 1979.

The increase in costs in finding and producing oil has been staggering. In 1974 it cost approximately $100,000 to drill and complete a 4,000-foot well in Oklahoma. Today that cost has doubled. As Senator Bentsen has indicated in these hearings, the costs of deep drilling in Colorado and the Panhandles of Oklahoma and Texas have increased at a rate faster than the increase in the price of oil and has run into the millions on a per-well basis in many instances. With inflation the replacement cost of finding oil and gas is approaching $20 per barrel or its gas equivalent, and will continue to rise. The costs of producing a well once oil is discovered—power costs, equipment replacement costs, administrative overhead, etc.—have all escalated at a rate that a minimum parallels the price increases in the price of oil.

The time has arrived to discard myths and discontinue looking for villians, either domestic or foreign. Real solutions are needed. The windfall profit tax (as it is called) will not produce more oil, result in more footage drilled or solve the energy crisis. It is an ill-conceived effort by the Federal treasury to raid the domestic oil industry. However laudable the objectives of H.R. 3919 may be in proposing a method of financing the search for alternative fuels, a critical question exists as to the desirability of taking from the domestic oil industry the very funds that could lessen our dependence on foreign oil. The problem of cycling funds through the Energy Trust Fund and the many bureaucratic processes that would be involved need additional study.

We share the concerns expressed by Senators Boren, Chafee, Danforth and others about the trust fund. Tax credits, as advocated by Senator Talmadge, and other avenues of finance should be explored before we build more bureaucracy into the system.

The administration's program for synthetic fuels has a serious flaw because of the extreme costs involved. It will take 10 to 15 years before we are able to manufacture liquid oil in quantities in excess of 1,000,000 barrels per day. On the other hand, conventional oil exploration programs result in new production in a matter of months after exploration starts. The cost of finding a conventional barrel of oil is approximately $20, compared to a $36-per-barrel cost for oil from shale.

Solar energy is still in the experimental stage and in my opinion will never approach the point of supplying 20 percent of our needs by the year 2000. The best estimate is that it could supply 2 percent by the year 2000.

We believe that this country needs a strong U.S. domestic drilling segment which would be capable of drilling approximately 80,000 wells per year instead of the 44,000 wells drilled in 1977. The oil well manufacturing and drilling segment is capable of drilling 80,000 wells per year within a 5-year period. During 1977, 278 new drilling rigs were built. The current U.S. rig building capacity is estimated at around 350 rigs per year, so that within five years the number of drilling rigs in the United States, with decontrol, could double.

We therefore advocate decontrol without an excise tax. A wellhead excise tax is clearly detrimental to the national interest.

AMENDMENTS TO H.R. 3919

In the event this Committee and the full Senate do adopt an excise tax program, we believe there are certain amendments that are absolutely essential.

a. Exempt stripper

In 1973, Congress recognized the necessity of lifting controls on a producing property whose average production was less than 10 barrels per well per day for a twelve month period. The late Senator Dewey Bartlett of Oklahoma played an instrumental role in freeing stripper production from controls and his efforts saved many stripper wells from being plugged. The independent producers, who own most of the stripper production, appreciate the efforts of Senators Dole and Boren to see that we do not lose sight of the importance of what Congress did in 1973 in exempting stripper production.

The considerations that led Congress to adopt the stripper amendment are even more compelling today. The market price extends the life of thousands of wells that would otherwise be plugged and obviously lessens our dependence on foreign oil.

Stripper wells produce over 1,100,000 barrels of oil each day which represented right at 14 percent of our domestic production in 1977. However, in total well count the stripper category represents 73 percent of the total oil wells in the U.S.

The wisdom of Congress in exempting stripper from price controls has kept approximately 73,000 wells from abandonment or plugging, resulting in the recovery of more than 2.3 billion barrels of oil which otherwise would have remained in the ground. These additional reserves and their production over the past five years are attributable solely to the world product price. They mean an equal reduction in the volume of imported foreign oil.

We are pleased to appear along with the National Stripper Well Association. I am certain that its people can tell the Committee in detail the impact that implementing controls and rolling back the price of stripper—which will happen if H.R. 3919 is enacted in its present form—will have on production from stripper oil wells.

We consider an amendment exempting stripper wells from the tax to be essential.

b. Exempt other tier 3 oil and marginal oil

Tier 3 oil includes stripper properties, newly discovered oil, and oil produced north of the Arctic Circle. For the reasons stated in section (1) of our presentation, we believe the need to exempt this oil from the proposed tax is evident. Marginal properties, which are in tier 2 of the tax, are in reality deep stripper properties and the same economics that extend the life of stripper production will extend the life of marginal properties. Likewise marginal properties should be exempt from the tax.

We support the amendments advocated by Senator Bentsen and Senator Dole in this regard.

c. Exempt small producers

The need for special treatment for the small producer is one that has been recognized for a number of years. For example, the Natural Gas Act provides higher ceilings for the small producer in recognition that his production costs are higher.

The NGPA also reduces filing requirements for the small producer. Small producers are recognized in the NGPA and an exemption to the phase out of percentage depletion was granted to the independent producer.

For a brief period stripper oil was placed under the upper tier ceilings. Stripper was subsequently released from price controls in recognition that exemption from record requirements of controlled oil was especially valuable to the small producer who owns most of the stripper production.

I am certain that the ability of the small producer to cope with the growing administrative burden placed upon him by the Department of Energy, by the NGPA, and by various other federal agencies, is of concern to this Committee. The independent producer has in the past years been doing 90 perecent of the domestic exploration. To take his attention and resources away from this task and place them in paperwork lacks in common sense. We can safely say that government controls have at a minimum quadrupled the administrative overhead of a majority of the small independents in the last six years. H.R. 3919 simply adds to this burden.

The description of H.R. 3919 prepared for your use by the Joint Committee on Taxation states at page 31 that:

"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."

On the face of it this statement is rather harmless. But the small producer knows that the only way to comply with the responsibility to be imposed by H.R. 3919 is to go find him one of the so-called energy experts to fulfill these requirments. We are fast approaching the time that the independent producer will spend as much of his resources trying to determine what kind of oil or gas he has after he has been lucky enough to find it, than he does exploring and producing his oil and gas.

A second consideration that supports a small producer exemption is that he is not involved in the "downstream" activities of the oil business. This is true of our membership and if there is a profit to be made it must be based on what we do at the well-head.

And finally the role of the independent since the early fifties cannot be ignored. He has earned the right to special recognition. As the major oil companies began to concentrate on foreign oil, the responsibility of maintaining our domestic industry was left with the independent producer. Thousands of independents went broke in the 1950's and 1960's attempting to make a living producing and exploring for cheap

crude. Thousands of service personnel, geologists, petroleum engineers and other professionals were diverted to other industries and professions. Some managed to hang on and there is no way to describe the contribution made by the independent producer to the future of this country during those tough times. Needless to say there was no mention of any "windfall profits" and few today recognize the importance of the exploration carried on by the independent during these years.

Having maintained this effort and having clearly established a historical practice of putting his resources back into domestic exploration, the small independent producer should be exempt from any well-head excise tax.

The definition of a small independent producer is not altogether clear. Using the NGPA definition and applying it on a price equivalent to oil, a small producer could be defined as one producing less than 3,000 barrels a day. For purposes of percentage depletion, the figure 1,000 barrels a day will be the permanent level in 1980 with the present level being 1,200 barrels a day. We have advocated a definition in keeping with the percentage depletion definition and support the proposals mentioned by Senator Dole.

If Congressman Ullman was correct in stating on the floor of the House that the independent producers produce only 15 percent of the oil in this country, then I would suggest that any excise tax lost by exempting all independents would be recovered many times over in taxes on the bottom line from new discoveries, additional payrolls and all their other spin-offs that occur from increased domestic exploration.

We consider this exemption and the amendments offered in support thereof as absolutely essential.

d. Reduce unnecessary regulatory complexities of H.R. 3919

Again, we hope the committee sees fit to eliminate the tax altogether. If such is not accomplished, we would hope that the tax would be designed to reduce to the greatest extent the complexity and excessive regulation associated with the existing price control mechanism.

The windfall profits tax bill passed by the House is better than that proposed by the Ways and Means Committee, but it continues to duplicate the regulatory errors of the past six years.

Those errors consist in emphasizing the wrong goal, trying to shave profit incentives to producers to the lowest common denominator possible, and then trying to compensate by a profusion of specialized incentives which have created a regulatory quagmire. An arbitrary, complex, confusing, and uncertain regulatory scheme has become of itself a disincentive to increased production.

There is no better illustration of these errors than the price ceiling on old oil. In 1973, we emphasized the goal of controlling oil prices over that of increasing oil production. This was reflected in the regulations. The maximum ceiling price for old oil could have been set at the highest going price for oil prior to controls. However, rather than one ceiling adjusted for inflation, the rules dictated a ceiling for each old oil property based on the posted price for that particular oil on an arbitrary day in May of 1973. Several hundred pages in those 14 volumes are devoted to explanations and arguments over the meaning of posted price and the correct posted price for each field. This one issue has cost hundreds of thousands of dollars in enforcement controversies over a price differential of usually no more than 10 cents.

Increasingly, many old oil properties were unable to generate any oil that would qualify as upper tier as declining production and mounting cumulative deficiencies absorbed extra production efforts. In addition, production costs began to exceed the inflation adjustment. An obvious solution would have been to increase the lower tier ceiling. Since 1976 the FEA and the DOE have had the authority to increase the weighted average price by a production incentive as well as inflation factor, not to exceed 10 percent a year. This authority has never been used, and now represents in excess of $2 billion dollars which should have gone to producers.

Instead, the regulations have mushroomed with selective incentives which tinker with but do not alter the basic problem. There are exception relief procedures, burdensome, expensive, and good for only 6 months at a time. There have been reservoir property designation rules, new unitization rules, and now marginal property rules. All this extra regulation results in hidden enforcement and accounting costs which provide not one cent for production incentive.

Even should the Senate decide to impose some form of extra oil tax, it should be designed to promote the goal of increased oil production while reducing the regulatory burden.

I would hope the Senate would carefully consider changing the following provisions of House Bill 3919.

1. Utilize the DOE qualifications for newly discovered oil rather than enacting more stringent requirements for tax purposes. The DOE has finally realized that a miserly approach to production incentives is penny wise and pound foolish. The definition of newly discovered oil adopted by the House can only be counterproductive and result in more complicated and costly enforcement.

2. Eliminate all reference to grade and location for the purpose of setting the base price for tier 3 oil which is taxed. The House bill provides that "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." This is an excellent example of the miserly approach to oil incentives which will result only in increasing the regulatory and enforcement burden.

3. Eliminate the posted price as the base price for tier 1 and tier 2 oil. One base price could be set for tier 1 and one for tier 2 at the highest regulated price for oil in each tier. Any oil selling below the base price upon enactment would only be taxed on prices received in excess of the base price. This proposal would eliminate all regulations concerning posted price and promote a simplified regulatory scheme.

4. Eliminate the tier 1 tax completely. DOE regulations call for elimination of the base production control level on old oil properties in October of 1981. At that time all oil from the property can be sold at the upper tier ceiling. This result is reached by a 3-percent BPCL decline factor beginning January 1, 1980. For tax purposes, the House has passed a 1.5 percent BPCL monthly decline rate, delaying the complete release of all oil to the tier 2 taxing level until 1984. The tier 1 tax is the most complicated to compute and administer. There would be no need of a tier 1 tax at all if the oil released to upper tier by the 3 percent BPCL decline were all taxed at the tier 2 base level. This would provide a tremendous regulatory simplification as well as production incentive.

In 1973, we chose to emphasize control of oil prices over increasing oil production. It was the wrong choice and the wrong emphasis.

In 1979, we have the choice of emphasizing raising money for the U.S. Treasury or maximizing oil production. We cannot afford another wrong choice and wrong emphasis.

I submit that the creation of revenue for the energy trust fund is secondary to the present need for an all out production effort which must be taken if we are to lessen our dependence on foreign oil from OPEC countries.

If you agree, I believe you will either eliminate or drastically reduce any taxes to be applied to future oil production.

Thank you for this opportunity to express the views of 500 independent oil and gas producers.

EXHIBIT A

CRUDE OIL RESOURCES OF THE UNITED STATES (BILLION BARRELS)

	IDENTIFIED			UNDISCOVERED
	Demonstrated		Inferred	
	Measured	Indicated		
ECONOMIC (RESERVES)	34.250	4.636	23.1	50-127
SUB-ECONOMIC	120-140			44-111

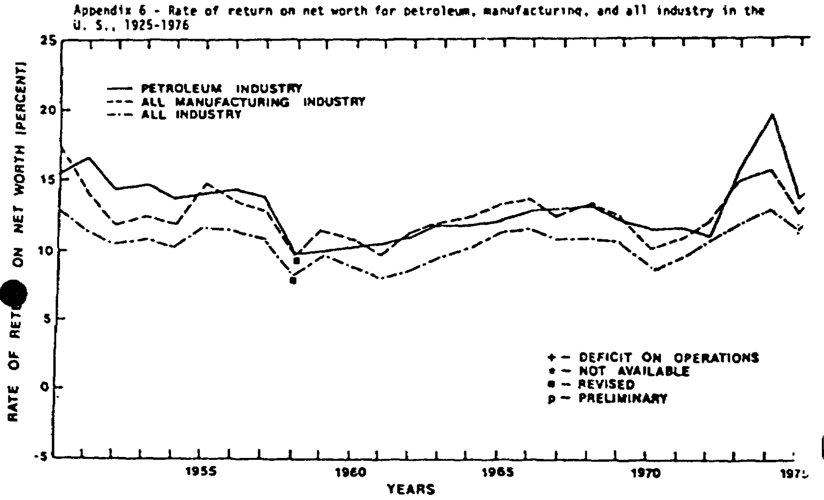
RESOURCES

← Increasing degree of geological assurance

Increasing degree of economic feasibility →

Total U.S. Cumulative Oil Production 106 Billion Barrels - 12/31/74

EXHIBIT B



SOURCE: FIRST NATIONAL CITY BANK OF NEW YORK, MONTHLY ECONOMIC NEWSLETTER, VARIOUS ISSUES

EXHIBIT C

How 25 firms' income, profitability have fared

	1974	1975	1976	1977*	1978*
		Net after-tax return			
Total income (In millions of current dollars)	13,194.0	9,901.2	11,640.9	12,043.6	13,292.0
Change (Percent)		−25.0	+17.6		+ 10.4
Total income (In millions of constant dollars)†	11,333.4	7,787.0	8,702.8	8,504.8	8,739.6
Change (Percent)		−31.3	+11.8		+ 2.8
		Profitability			
Return on stockholders equity‡		Percent			
25 oil companies	18.6	12.8	14.0	13.3	
Total manufacturing	15.2	12.6	15.0	15.0	
Oil firms' return on long-term capital§	15.5	10.8	11.6	11.2	
Oil firms' return on assets‖	10.5	7.0	7.5	7.2	

*Net interim figures based on unaudited data in interim financial statements. Results for 1977 restated to accord with changes in accounting standards in 1978. †Deflated by implicit price deflator for gross national product (index, 1972 = 100). ‡Net income after tax as a percent of total stockholders' equity, based on 1977 annual reports. §Net income after tax plus after-tax interest changes as a percent of total stockholders equity and long-term debt, based on 1977 annual reports. ‖Net income after tax plus after-tax interest charges as a percent of total assets, based on 1977 annual reports.

Source: American Petroleum Institute.

EXHIBIT D

Tally in Major Industries

From earnings reports of representative corporations—

	1st Quarter, 1978	1st Quarter, 1979	Percent Change
Aircraft, missiles	$ 191,303,000	$ 267,584,000	Up 39.9
Airlines	$ 14,454,000	-$ 252,000	—
Banks	$1,114,800,000	$1,541,000,000	Up 38.2
Building materials	$ 427,727,000	$ 631,408,000	Up 47.6
Chemicals	$ 861,654,000	$1,184,105,000	Up 37.4
Coal mining	-$ 22,012,000	$ 46,804,000	—
Computers, office equipment	$ 869,253,000	$1,040,384,000	Up 19.7
Drugs	$ 565,552,000	$ 685,626,000	Up 21.2
Electric utilities	$1,188,672,000	$1,388,031,000	Up 16.8
Electrical equipment	$ 426,421,000	$ 523,620,000	Up 22.8
Food, beverages	$ 295,000,000	$ 324,665,000	Up 10.1
Gas utilities	$ 501,267,000	$ 546,750,000	Up 9.1
Motor vehicles, equipment	$1,409,766,000	$1,972,556,000	Up 39.9
Nonelectrical machinery	$ 224,346,000	$ 270,147,000	Up 20.4
Nonferrous metals	$ 112,388,000	$ 507,695,000	Up 351.7
Oil equipment, services	$ 159,870,000	$ 201,195,000	Up 25.8
Paper	$ 198,702,000	$ 397,528,000	Up 100.1
Personal care	$ 299,347,000	$ 345,436,000	Up 15.4
Petroleum	$2,521,363,000	$3,957,182,000	Up 56.9
Printing, publishing	$ 131,506,000	$ 156,438,000	Up 19.0
Railroads	$ 124,856,000	$ 361,912,000	Up 189.9
Restaurants, lodging	$ 66,188,000	$ 83,793,000	Up 26.6
Retail food stores	$ 82,758,000	$ 90,050,000	Up 8.8
Steel	$ 6,903,000	$ 302,522,000	Up 4,282.5
Telephones	$1,427,217,000	$1,541,097,000	Up 8.0
TV, radio broadcasting	$ 145,059,000	$ 145,669,000	Up 0.4
Textiles, apparel	$ 110,051,000	$ 120,104,000	Up 9.1
Tobacco	$ 235,079,000	$ 319,176,000	Up 35.8
Trucking	$ 33,589,000	$ 44,434,000	Up 32.3

Source: USN&WR Economic Unit

Statement of Benjamin C. Cubbage, Jr., Chairman, Liaison Committee of Cooperating Oil and Gas Associations

Mr. Chairman and members of the committee, my name is Benjamin C. Cubbage, and I am an attorney in private practice in Henderson, Ky. However, I appear before this committee today as a representative of the Domestic Independent Oil Producers of the United States. I have the honor to serve as Chairman of the Liaison Committee of Cooperating Oil and Gas Associations which, though the name is somewhat long and awkward, is exactly what the name implies. We are 21 domestic, regional oil and gas associations cooperating to present a unified and unanimous voice on matters which affect us in common and which may jeopardize our continued efforts to explore for and produce crude oil and natural gas from the lower 48 states. We are 10,000 strong, extend from Pennsylvania to California, and embrace every major domestic oil and gas on-shore producing province. Our membership includes the wildcatter, who is credited with discovering the vast majority of our known on-shore reserves.

Liaison committee endorses fully the testimony presented here today by IPAA as well as the fine statement of TIPRO, one of Liaison's members. It is noteworthy that these two statements bear such a similarity in objective and scope to Liaison's position when it is revealed that the three were prepared separately, without prior consultation, and in three widely separated geographic areas. In this context, it is hoped that such similarity will prove even more meaningful.

Today you have kindly granted to Liaison the privilege of appearing before this committee to discuss some of the problems which confront the independent oil producer as the result of a proposed excise or severance tax, popularly called a "Windfall Profit Tax". Regardless of label, it is a proposed levy having as its genesis the artificial manipulation of the free market through crude oil price controls which, when removed, caused a public backlash of unparalleled intensity aimed at a segment of American industry with apparent punishment as the intended result. The American oil and gas industry has, therefore, been relegated to the role of "scapegoat", is publicly and popularly condemned, and stands accused of creating the very situation which was the subject of our industry warnings as far back as 1966. How quickly and conveniently we forget!!

But Liaison does not wish to dwell on the past now or, for that matter, to point the finger of blame for what we have today. We wish to make a distinction and hopefully one which may be preserved in your deliberations and debate upon this proposed tax.

Never before in my experience, has there been a need to differentiate between various segments of our industry. Previously, the oil and gas industry has stood together, large and small, and attempted to present a unified position. Today, however, the time has come for the domestic independent oilman to stand alone and this is due solely to the unique character of his business as compared to other segments within the industry. Two major points exemplify this necessity:

(a) Simply stated, the domestic independent oilman searches for, drills for and produces on-shore crude oil and natural gas from the lower 48 states. He sells his only product at the well head and must derive his profit, if any, from the price so received. The domestic independent oilman does not market, transport, or refine, and is not involved in other commercial areas of the oil and gas industry. Consequently, any measure which affects the independent's well head price will have a corresponding and direct effect upon his business. A tax upon crude oil will, as a practical consequence, place a lid upon the independents' only product with no corresponding way to recover the cost or pass it along, as would be the case if he were involved in other profit oriented and related activities. One direct result will be that his anticipated cash flow will be reduced and a corresponding reduction in exploration activity would be the logical next step. Thus, the very purpose of deregulation of crude oil prices will, at the very least, be partially frustrated to the extent of the proposed well head tax. It is also submitted that the House passed version of this proposed tax could actually cause a roll-back of present prices up to $2.00 per barrel of certain stripper and new categories of crude oil. It seems almost too obvious to state that such a result is counter-productive to the announced objective of increasing domestic production.

(b) The second point to illustrate our distinction, and perhaps the most important, concerns the ability of the independent oilman to raise risk capital and his sources of such capital. While the major integrated oil companies provide risk or venture capital from overall profits derived from their various products and activities, the independent oilman customarily goes outside of the industry for his risk capital. It is well known that banks will not approve a loan to drill a wildcat well. In fact, only a few banks are willing to lend money on existing and proven production. Conse-

quently, the independent must compete on the money market with other types of investments to raise risk capital with which to drill. His drilling prospect must compete with stocks, bonds, real estate trusts, cattle, and a myriad of other types of investments, including even certificates of deposit. In a business where the success ratio remains 8 dry holes out of 9 holes dug, it not only takes a pretty darn good salesman, but there simply must be some incentive provided to the investor. Therefore, every time the Congress changes the tax treatment for oil and gas, there is necessarily a reaction in the money market for the independent and, too often, an adverse reaction. To the same effect, regulation has adversely affected the independent's ability to raise his risk capital since the average investor simply does not have the patience nor the inclination to endure additional regimentation. The source of the independents' drilling and exploration funds is too frequently overlooked or taken for granted by those both within and without the industry who are not directly associated with independent oilmen.

Much has been said in recent weeks about a "plowback" incentive as a means to ameliorate the effects of the proposed windfall tax. According to some proponents this would exempt from taxation certain funds which were put back into the ground towards additional exploration, the extent and amount of such exemption to be determined by an artificial monetary threshold which would have to be exceeded. We submit that a "plowback" provision is simply not designed to help the independent oilman. There is testimony in the record today that the independents have "plowed back" an average of more than 100 percent of their wellhead revenues over the past five years. How, then, could an additional "plowback" exemption help when no new revenues will be produced. Furthermore, the source of the independents' risk capital must once again be kept in mind when considering the relative merits of a plowback feature.

The outside investor, when confronted with a plowback deduction as opposed to an additional tax, is likely to withdraw from further investment for, to take advantage of the "plowback" would be comparable to standing at the dice table and doubling your bet until you lose it all. Liaison submits that "plowback" is misunderstood by the vast majority of its advocates. It is simply not a benefit to the independent oilman. In fact, it would likely hinder his efforts to raise outside risk capital.

One final but important point. "Windfall" is defined as "a piece of unexpected good fortune." Liaison finds it difficult to understand how a "windfall" arising from the same source can continue year after year as the justification for an excise tax. To their credit, apparently the large majority of the House of Representatives recognized the temporary character of a windfall as they did include a sunset provision in the Jones-Moore Amendment. It is submitted that such a provision should be retained and that any tax approved by this Committee be self-liquidating.

Liaison Committee, therefore, asks this committee to keep in mind the distinction between the domestic independent oilman and other segments of the oil and gas industry, even though we freely admit that we each need the other. Further, Liaison asks that whatever measure you may finally approve contain recognition of the risk capital requirements of the independent oilman and that a sunset provision be mandatory as to all aspects of the proposed levy so as to insure that the word "windfall" not be given a perpetual meaning.

There is, at long last, full recognition that the domestic independent oilman has in the past drilled 90 percent of the on-shore exploratory wells in the lower 48 States and has found 75 percent of the present known domestic reserves. If, therefore, we can learn anything from past performance, it is only reasonable to conclude that the independent oilman will continue to drill for and produce crude oil and natural gas if permitted to do so.

Thank you for the privilege of presenting this statement.

[EPILOGUE: This statement was prepared prior to last Sunday's Presidential address and the various specifics which have since been published. Candidly, Liaison finds no reason to alter its statement in the light of the President's message, and we feel that the points emphasized herein need only be intensified.]

STATEMENT OF HARROLD E. WRIGHT, CHAIRMAN, NATIONAL ENERGY POLICY COMMITTEE OF THE TEXAS INDEPENDENT PRODUCERS & ROYALTY OWNERS ASSOCIATION

Mr. Chairman and members of the committee, my name is Harrold E. Wright, independent petroleum producer from Dallas, Tex. I appear here today as chairman of the National Energy Policy Committee of the Texas Independent Producers and Royalty Owners Association, which has approximately 4,000 members with an interest in Texas oil and gas production.

TIPRO supports the testimony presented by IPAA in this hearing and, at the same time, appreciates the opportunity to be heard individually as well. I wish to spend a few minutes emphasizing the role of the independent in the producing industry, his need for expansion in investment to maximize producibility, and the problems the excise tax on crude production passed by the House of Representatives last month poses for him.

As has been made clear during this hearing, the independent specializes in exploration, secondary recovery and marginal well operations. He does not refine, transport or market oil products. He generally relies on outside services for well drilling and reworking activities. In other words, the average independent concentrates on finding and producing petroleum; thus, he is a direct target on taxation applied to wellhead operations. His expertise in exploration leads to some 90 percent of exploratory wells drilled, and his efficient, low overhead operations result in production of some 60 percent of the nation's economically marginal stripper wells.

Independents rely heavily on outside investment to perform their specialized functions in the industry. Investors must be attracted to augment inside cash flow which is never adequate to do the job alone. Even so, most active independents plow back into field operations more than they earn. During the past 5 years, for example, independents spent from 95 percent to 128 percent of their wellhead revenues in exploration, development and production, according to data of the U.S. Census Bureau.

Recent studies by Chase Manhattan Bank and others warn us that investment in domestic oil exploration and development must double in the years immediately ahead just to maintain current reserve and production potential. This means, in constant 1977 dollars, that such expenditure must move to a level of some $26 billion annually. Such increase far exceeds new net revenue to the industry that would be provided by the Administration's decontrol measures without any tax provision such as that passed by the House and now before this committee.

Actually, as estimated by Peat, Marwick and Mitchell, the bill passed by the House offers the unincorporated producer as little as 12 cents on the dollar resulting from decontrol, far too little to encourage the increase in domestic drilling rates needed to turn around the nation's decline rate in productivity; 60 cents of the $1 would be taken by the excise tax, while an additional 20 to 26 cents of the remaining 40 would be consumed by other Federal and State taxes and royalty ownership.

There has been considerable assertion recently by opponents of oil decontrol who support an unrealistic excise tax that the Nation's petroleum reserve base has been virtually drained. Thus, they contend, additional funds acquired by the industry through decontrol would be wasted on exploration effort that would lead to inconsequential increase in producible reserves. I invite the Committee to review the geographical map attached to my testimony which refutes these claims. The map, produced by the Pitts energy group in Dallas, portrays the fact that only about two percent of the potential petroleum reserve basins in the United States have been extensively explored since the petroleum industry came into being some 110 years ago. Geology could easily support a program of 80,000 wells drilled annually. Economics limits the number drilled to approximately 50,000 currently; to close the gap, the industry needs some $8 to $10 billion annually to join the $16 billion-plus already being spent.

Taxation along the lines proposed will adversely affect the independent in at least four basic ways: (1), it will deny him opportunity to increase cash flow so that he can drill the additional wells needed to increase domestic supply; (2), it will reduce his current and anticipated cash flow determined by the administration's decontrol measures; (3), it will discourage growth in outside investment needed in the exploration process; and (4), it will engulf him in tax administrative complexity as serious as the pricing complexities of the Natural Gas Policy Act.

Producers cannot borrow for exploration, or wildcat operations; production must be evident before banks can be encouraged to finance well operations. Thus, if more wells are to be drilled, producers must improve their cash flow and increase outside investment from the nonfinancial community.

Yet, the proposed taxes not only deny increase in current cash flow in the amount needed, but also roll back prices for crude production in the categories in which independents specialize. Exploratory and stripper crude production, for example, could conceivably be rolled back by as much as $2.00 per barrel in early 1980, should the provisions of the House passed bill become law.

This will adversely affect the outside investor's attitude as quickly as the independent's internal exploration fund. Many investors may soon find that money market CDs and Treasury bonds, commanding interest earnings in the range of 9.5 to 10

percent, are a better and far more safe investment than paying for dry holes in the search for petroleum.

I wish to emphasize at this point that each well operation is an individual profit center, a fact not commonly understood outside the oil producing industry. In other words, each oil well must stand on its own financial merits; producers do not carry uneconomic wells by attributing profit from other more economic wells to their operations. Consequently, an arbitrary excise tax at the wellhead, which bears no relationship to profitability and which, in the case of stripper wells and lower tier marginal wells, results in rollback of attained crude price levels, will inevitably cause the premature shutdown of thousands of individual well operations. Such production will be lost forever at the very time it is needed to reduce import requirements.

This financial phenomenon even applies to new oil discoveries, which frequently involve economically marginal well completions. Should a nonprofit related wellhead excise tax be applied in such circumstances, producers will shut in those wells which no longer are profitable under the new tax burden.

It is true that the House passed version of the excise tax limits taxable windfall profit of a property to the property's net income. Nevertheless, elimination of all net income by such taxation threatens continued production on those marginal operations that would be so affected, particularly wells on properties that are relatively weak in profitability to other wells on the same property.

Industry critics complain when any oil generated funds are redirected to investment in other entities, whether it be CD's or department stores. While the average independent and his investor do not make a career of such diversification, how can they be blamed for doing so if governmental pricing regulation and taxation proposals make other business activity more profitable.

Contrary to public opinion, the domestic petroleum industry is not a financial bonanza constantly creating excess profits to be placed elsewhere in the economy. Profitability is normally assessed by the ratio of profits to investment. Based on that standard, Citibank of New York has determined that over the 1968-77 decade the pretroleum industry averaged 13.9 percent rate of return as compared to 13.3 percent for all U.S. manufacturing. During the last year of that decade, the petroleum industry fell below manufacturing at large with a 14.2 percent return compared to 15 percent return across the board.

This recent decline in relative profitability is due in part to U.S. controls on crude oil pricing which has held price increases essentially to the Nation's implicit price deflator index. Unfortunately, for the producer, his costs in oil exploration and production have far exceeded that index, creating for him a cost-price squeeze similar to the decade of the 1960's when domestic oil prices were deflated by cheap import flow and costs were on a continuous inflation spiral. Since 1972, for example, while the implicit price deflator was climbing 52 percent through 1978, oil field machinery costs rose 105 percent, oil well casing climbed 112 percent, oil field wages rose 80 percent and drilling costs moved upward by 113 percent.

Critics point to incentives in the U.S. income tax code as a means to attract investment in high risk oil exploration activity. Yet, much has been done in recent years to erode such incentives despite the desperate need for this country to double and, perhaps, triple its domestic exploration. Percentage depletion has been slashed, minimum tax requirements have been raised, IRS regulations have become more strenuous, and other moves have already served to dampen tax incentives seriously. The proposed taxation before this Committee would further restrict tax incentives by denying percentage depletion to that portion of crude price subject to the excise tax. This will not serve to encourage the investment needed to expand domestic production and thereby curb expensive, insecure oil imports.

Aside from imposing severe erosion in the financial benefits of decontrol, the House passed excise tax threatens to impose on the independent producer long range complexities related to tax liability. The tax bill creates seven different crude production categories for taxation purposes. Complicated formulas involving tax bases and rates ranging from special base production control levels for marginal wells and lower tier oil to inflation and other selective rates that adjust taxable production amounts will keep CPA's, attorneys and the IRS very busy—at the expense of the producer who is liable for the wellhead tax. Arbitrary elimination of percentage depletion on the taxable portions of wellhead revenue not only discourages investment but also requires independents to adjust to complex cost depletion accounting.

Perhaps the "severance tax adjustment" feature of the House bill illustrates as well as anything the complexity of the bill. How many independents know, or will ever know, what portion of his state production severance tax payments is exempt

from the excise tax and what portion is not exempt? The portion that is exempt is the total tax paid less that amount paid on the amount of his wellhead revenue that constitutes the adjusted base price. The portion that would not be exempt includes any increase in state severance tax production rates occurring after March 31, 1979.

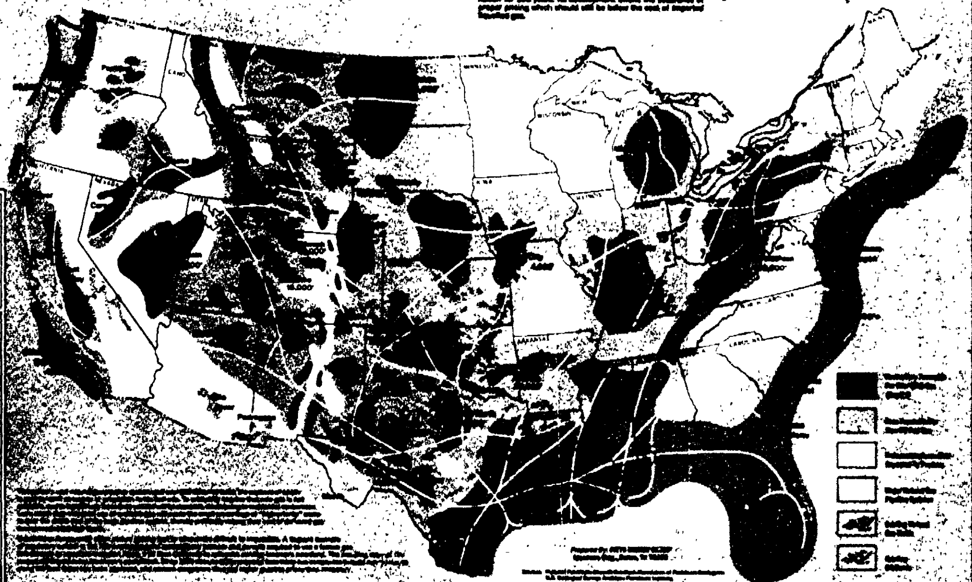
In conclusion, Mr. Chairman, TIPRO urges your committee to consider carefully the adverse effect on the independent producer created by the various provisions of the House passed tax proposal before it. Wellhead taxation can only serve to impede the vital thrust of the independent in his objective to help maximize energy production in this country, which is not only in his best interest but also in the best interest of the Nation's consumers.

Thank you for this opportunity to be heard.

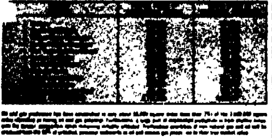
OIL & GAS MAY STILL BE UNTAPPED!

Remain To Be Produced Because Over Twenty Years Of Politically Low Prices Have Left 98% Of The Prospective Sediments Untouched By Drilling.

WILL WE RUN OUT ?



Distribution Of Sediments Prospective For Oil And Gas In The United States



The CHAIRMAN. We will call Congressman John Rousselot of the State of California.

STATEMENT OF HON. JOHN ROUSSELOT, REPRESENTATIVE IN CONGRESS FROM CALIFORNIA

Mr. ROUSSELOT. I thank the committee, Mr. Chairman, for giving me a chance to be here. As you know we are marking up in Ways and Means on which I serve the tax-exempt bonding for housing right now. I just got a call that I have to go back. To your great benefit I will not have an opportunity to read my whole statement. I will summarize it.

The CHAIRMAN. Let me apologize to you, Mr. Rousselot, that we did not get you in sooner. We called for you at the beginning but you could not be here at that moment.

Mr. ROUSSELOT. Ways and Means went in this morning at 9:30 a.m. I apologize. I am sure you will be able to survive without having me read the whole statement.

I would like to say quickly that there is an awful lot of us in the House even though it is not a majority that felt this bill we passed, the so-called windfall profit tax, will do nothing for production. As a matter of fact we know it will not.

Most of the advocates of the windfall profit tax admitted very openly in the Ways and Means Committee and on the floor that it will do nothing for production and yet we are really concerned about production. Those advocates were primarily interested in revenue.

I want to stress with you as a committee that I hope you will take a better look at it than we did and there are not that many of us that are that excited in the House about this so-called windfall profit tax. I want to stress briefly just a couple of points and then I will move on.

We feel that the President's tax proposal as amended and passed by the House without a doubt will result in the flight of American investment capital to foreign shores and the American economy will continue to rely heavily on foreign crude oil production and this bill as we sent over to you does nothing really to slow down that importation of oil from foreign sources and yet that was the big complaint that was discussed.

The targets of the new House tax, the so-called major integrated oil companies, are likely to avoid the penalties by sitting on their domestic oil reserves. They will find it less profitable to develop domestic supplies than to market imported oil since foreign oil will not be covered by the tax and we hope you will at least look at that. The House in summary in its zeal to raise revenues is overlooking a fundamental economic theory and documented history. It is trying to sneak a tax on the American people by burning the oil witch which we spent a lot of time talking about.

Unfortunately the new tax enhances OPEC's ability to raise prices by destroying a market competitor, the U.S. domestic oil production.

Let me encourage you to review some remarks I have included which were basically what I said on the House floor on this subject. It is a lot of fun to kick around the big oil companies in this country. We have an awful lot of Members in both Houses who

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love to kick them around and yet they do nothing to come up with an alternative to better production at the domestic level and as a matter of fact it is a judgment of at least 190 of us in the House that this tax will discourage domestic production and not encourage it.

I hope you will look at alternative sources. If revenue is the game which all the advocates in the House admitted, I would suggest maybe $1 a barrel and maybe also impose that same tax on importation of foreign oil and not just load it up on the domestic side. That is basically a summary of what I have had to say.

The CHAIRMAN. Thank you. Can you stick around for a few questions?

Mr. ROUSSELOT. I would be delighted.

The CHAIRMAN. Senator Dole.

Senator DOLE. John, you mentioned 190 in the House. Was that a record vote?

Mr. ROUSSELOT. Yes; on several votes. I am just saying that is my judgment on the basis of votes we took as to where those that disagree with such a high tax. We did reduce it from what the committee did, from a 70-percent tax to a 60-percent tax. On other votes that we had my guess is we have roughly 180 to 190 judgments of people who really feel this tax is too high, the one we sent you.

Senator DOLE. The House did not decide the fate of the money?

Mr. ROUSSELOT. No. As a matter of fact, Ways and Means scrupulously avoided where the money would go. We were told by our good chairman, Chairman Ullman, that if we got into that it would ruin the whole bill. The giveaway part, where we would distribute it, would have resulted in tremendous disagreements.

Senator DOLE. We all want a little hand in that process.

Mr. ROUSSELOT. We have lots of ways to divide it up in the House. I do not think we lack initiative and ingenuity in how to divide it up. I do not think you should worry about that. Chairman Ullman does. We are going to take that up right after the recess, how to divide it up.

Senator DOLE. I hope California and Kansas do all right.

Mr. ROUSSELOT. I do, too. If it is for production I will be for it. As you know, we have mass transportation. We have all kinds of goodies that we are going to put it into. We have several advocates in the House that say we must find a very equitable way to distribute it to the poor. We have not even fully defined who the poor are.

Senator DOLE. Do you prefer this bill over nationalization? Do you think this is better?

Mr. ROUSSELOT. This bill? I do not want to indicate that I am for the House bill. I voted against it. I did everything I could to reduce it. I think it is going to reduce production. I clearly do not favor nationalization. I think we have had enough nationalization with the creation of the Department of Energy. They have had the power to allocate. They have had the power to direct. As far as I am concerned they messed it up badly and we have had enough nationalization to the degree that the Department of Energy has done it. I now have an awful lot of colleagues and I cannot give you an exact number who are now willing to abolish the Department of

Energy, maybe keep the Regulatory Commission for Nuclear Energy and a couple of those vehicles but other than that get rid of the Department of Energy. That has increased very substantially. Even Toby Moffett is now willing to consider that.

Mr. ROUSSELOT. A big help where?

The CHAIRMAN. Senator Talmadge.

Senator TALMADGE. Congressman, I read your statement in its entirety. I congratulate you, sir. I do not have any questions. I can tell you who the poor are. It is anyone poorer than you are.

Mr. ROUSSELOT. We do not want to tax ourselves 60 percent. Someone wanted to bring that up.

The CHAIRMAN. Senator Wallop.

Senator WALLOP. Thank you, Mr. Chairman. Congressman, I read your statement as well. I would echo what others have said. One of the points you make there is one I also make.

It is interesting that the President has chosen to make the OPEC cartel the focus of American misery and the point at which we launch our war, as he calls it, and yet the country does not know that we are subsidizing foreign oil.

Mr. ROUSSELOT. That is correct.

Senator WALLOP. I agree with you that it would be appropriate that if you are going to tax any barrel of oil, you should tax every barrel of oil, and then at least our own oil would be competitive and it would be more attractive for major oil companies to soak a little money into this country in domestic production.

Have you any idea how we could levy an equal tax on all barrels of oil?

Mr. ROUSSELOT. I think if you were to do it effectively, that is to tax every barrel of crude oil coming into the country from a foreign source, you would also have to figure a way to tax the end products also so that they did not convert all of that crude oil into end products before it got here to avoid a tax.

I think you would also have to figure a way to tax other incoming products and end products. Knowing the ingenuity of the foreign producers, they would figure a way to get the crude oil in here in another way, as end products, without paying the tax.

I would suggest as an alternative and I am not much of a person to advocate taxes, I think a more equitable way to do it if we are going to tax our domestic producers we should tax the incoming crude oil barrel on an equal basis.

Senator WALLOP. I agree. If I had a way to go, a simple tax that would raise the same amount of money that the President and his people are seeking would be a normal tax on everything that had petroleum in it; records, hair brushes, wax for summer canning, gasoline, heating oil, diesel oil, and other things, and the tax would be so small that the country would not notice it, yet you could still raise the money. I hear what you are saying. I am not sure we will get there. I agree with Senator Dole that we would probably have a political problem.

Mr. ROUSSELOT. Yes; I have noticed that. We may have more of a political problem now. I do not know how we are going to finance that $142 billion program.

Senator WALLOP. Let me mention one thing a little bit off track, but a parochial statement that I have been waiting for a chance to make.

If you couple that with other events, which we sometimes fail to do in this Congress, there are a number of related events which concern me. First of all, the Solicitor of the Department of the Interior has issued an opinion about the Federal Reserve water right which affects your State and my State and others with large Federal lands. If they can take sufficient water for any legitimate Federal purpose from Federal land with regard to State water loss, then take that and take the synfuels program, and look at where the coal to gasify is and the oil shale, and the water. It seems we become captive States to the rest of the Nation while they self-indulge in whatever they wish to.

I have real problems about the extenuating related circumstances that exist and I also have another problem. Senator Gravel and I were in a hearing the other day while this committee was meeting on windfall profit tax. I was chairing a subcommittee meeting of the Energy Committee where the Department of the Interior is trying to raise the royalty. We are getting it from both ends. Somehow we have just failed to realize that this country has a product which we are penalizing, at the expense of good people in this country and the subsidy of the people who are supposed to be our enemy in this war as the President has identified it.

Mr. ROUSSELOT. There is no doubt our various Government agencies are not too well coordinated on a lot of things. I think the example you have given is a perfect example. I am sorry I do not have a quick solution.

Senator WALLOP. There may be no solution. But when you have a Federal energy corporation that is designed to spend this $140 billion, and concurs with the Solicitor's opinion to take the water at the same time, it does not look very good for our future.

Mr. ROUSSELOT. If there are any of you who are susceptible to the idea of abolishing the Department of Energy, I would like to get on with that.

Senator WALLOP. There is a list on the Solicitor, too. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Gravel.

Senator GRAVEL. I apologize, Congressman. You know I hold you in high esteem. I had another colleague who was on the phone to me.

I was asking the staff what was the thrust essentially of your proposal and that was to add a dollar tax per barrel on domestic oil and on foreign oil. Is that essentially what you are advocating?

Mr. ROUSSELOT. As a substitute for the bill we sent you.

Senator GRAVEL. I would rather you just burn that bill at the door of the Senate.

Mr. ROUSSELOT. We tried but we just did not make it.

Senator GRAVEL. I would like to ask you why you want a tax of $1. What do you want to do with the money?

Mr. ROUSSELOT. If the big game is revenue which we were told, all the advocates of the bill we sent you and I was not one, all said that the thing we needed was revenue. As I mentioned previously they did not argue that it does anything for production, they said

what we need is revenue. I think a better way to do it would be just a flat dollar tax on a barrel of oil rather than this very complicated procedure that we go through, if we need a tax. I say that is a preferable way to go.

Senator GRAVEL. Let me suggest this to your thinking. Since we consume energy and the final unit of real energy is Btu and that is how you translate it all, rather than skew energy consumption away from one form to another, why not place a tax on Btu consumption? I agree with you. If we need revenue, let's use the income tax or another form of tax; but nobody has persuaded me we need revenue unless we want to pay off some of our shortfalls annually. That would be a reason to raise revenue.

If that is the case, why not have a Btu tax? I have had one drafted for a long time where we would tax all energy equally and thereby give advantage to the most efficient forms of energy and similarly discourage the use of all energy. It is a lot less efficient to use your toaster than your automobile in point of fact. You have to go through the loss of energy through the central power systems. The combustion engine is a lot more efficient for what you are getting than is the utility.

Why not have a Btu tax? Why do we have to discriminate against oil?

Mr. ROUSSELOT. I do not know why we have chosen to do that other than it is a very easy target as I think we all realize by watching television at night to attack the big oil companies. That is an easy target.

We did not undertake to look in our Ways and Means Committee at a tax on Btu. I have not seen any of your proposals. I would be happy to look at them. My only statement as to an alternative tax that I thought would be fair was based on the ultimate product of legislation proposed by the House.

Senator GRAVEL. Congressman, let me give you my 2 cents for what it is worth. You are a person of strong resolve. I would hope you would not be discouraged by the Cassandras of suicide that are abroad in this country asking that we destroy this country. We do not need a tax.

If we went to the market there would be sufficient discipline to take place. I know you feel strongly about the free enterprise system. I think we all need to be reborn again about what is capable under that system and if there is ever a time to say, "No," it is now. It should be, "Hell no."

Mr. ROUSSELOT. I agree with that, if that was our choice.

Senator GRAVEL. We make our choices every day and we can compromise or we can fight or we can give in. We hold our own destiny in our hands. If we want to go ahead and give in, then we deserve what we get.

Mr. ROUSSELOT. I am sure this committee will not give in to what the product of the House is. I certainly hope you do not.

Senator GRAVEL. We need others like you not giving in either.

Mr. ROUSSELOT. We are working on it. My belief is what you send back to the House at a much lower level I hope will probably be taken. I do not think you need to look at that end product of a so-called 60-percent windfall very complicated three-tier program tax and believe that has to be the end product. I think it can be a

much lower tax if we have to have a tax. I am not sure we do. I tend to agree with Secretary Blumenthal but I do not want to get him in trouble when he said before the Joint Economic Committee as you have just indicated, that the more he has been in Government the more he realizes we should return to the marketplace.

Senator GRAVEL. He does not do very much. He talks a good bit.

Mr. ROUSSELOT. Whatever you send back on a lower level of taxation I am sure we would happily receive it over there. I think you could easily get a majority.

Senator GRAVEL. I would not want to embarrass you over there by sending back a Republican proposal of a tax cut when you are advocating a tax increase.

Mr. ROUSSELOT. You can send back a tax cut if you want to. On this bill it would be fine with me.

Senator GRAVEL. Anything is a vehicle for us when it comes from the Ways and Means Committee.

Mr. ROUSSELOT. I am sure it is.

The CHAIRMAN. Thank you, Congressman. You made a very interesting statement and we appreciate it. I am sorry we could not accommodate you sooner. Thank you for sticking around.

Mr. ROUSSELOT. That was my fault for not being here at the proper time. Thank you.

[The prepared statement of Mr. Rousselot follows:]

TESTIMONY OF HON. JOHN H. ROUSSELOT ON CRUDE OIL WINDFALL PROFITS TAX ACT OF 1979

Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you to express my views on H.R. 3919—the Crude Oil Windfall Profits Tax Act of 1979.

It is a misnomer to call the House-passed measure a tax on windfall profits. By definition, a tax on profits is a tax on money left over after all business expenses have been paid. The bill under consideration levies a tax on revenues which are received before business expenses have been calculated. The assumption underlying the tax is that there will be a huge increase in oil company revenues when price controls are lifted. The belief is that revenues will skyrocket and somehow oil producers will reap huge profits.

In actuality, integrated producer-refiners are already receiving roughly 90 percent of the world price for price controlled oil they bring to the market. The catch is that to get world prices for this oil, producer-refiners must produce less domestic oil while importing more foreign oil—an unusual profit maximizing production constraint to be sure.

Like a baker mixing a precise amount of sugar with a precise amount of flour, milk, butter, and eggs to bake a cake, integrated oil companies have been mixing roughly one part price controlled oil with about four parts imported or uncontrolled oil to receive world market prices for their oil despite price controls at the wellhead. When price controls are lifted the prices integrated producer-refiners receive will rise only about $2 per barrel because they have found a way to partially circumvent price controls.

This surprising result is a byproduct of the DOE's entitlement system which subsidizes refiners to import oil. The system works roughly this way: Refiner A, a distiller of low priced domestic oil literally writes out a check to refiner B, a distiller of foreign oil. In exchange refiner B sends to refiner A a ticket stub permitting A to distill domestically produced controlled oil. These tickets are distributed by DOE each month to all refiners based on the volume of price controlled and uncontrolled they distilled the prior month.

The purpose of the entitlements system is to equalize any competitive imbalance that might arise because of unequal access to price controlled oil. The buying and selling of entitlement tickets results in a situation in which all refiners pay the same average price for a barrel of crude oil notwithstanding whether the oil originates from a price control well, or from a domestic uncontrolled source. Naturally, producer-refiners are importing oil to get entitlement tickets which they can sell to

themselves instead of purchasing these tickets from nonaffiliated refiners. The less the producer-refiner pays out to other refiners for the right to refine his own oil, the closer he comes to receiving the world price for that oil. What the producing division loses under controls, the refining division almost makes up through the entitlement system.

Independent producers are not so lucky. Because they are not integrated through the refinery stage of production, any lower tier oil they sell now is priced at roughly $6 per barrel. Independents are not able to recoup more of the market value of their lower tier oil by tinkering with the entitlements system. They are suffering disproportionately more under price controls than are integrated companies. When controls are finally lifted the incremental increase in revenues they will receive per barrel of lower tier oil sold will exceed the incremental revenue increase per barrel going to integrated companies.

After controls are lifted, integrated oil company revenues obtained from lower tier oil are likely to increase by only about $2 per barrel based on DOE's April estimates of the dollar value of the entitlement tickets changing hands in the refinery marketplace. More significantly, the number of barrels of lower tier oil brought to market will increase significantly. Revenues will increase, but any increase in profits that are earned by integrated oil companies will be earned because revenues rose roughly $2 per barrel—not $12-$14 per barrel.

In comparison, independent producers will receive $12-$14 more per barrel of lower tier oil sold, but of course they are not recouping any of the lost value of their oil through the refinery stage of production at the present time. There is a question of equity here. Under current controls independent producers are being taxed disproportionately more on the marginal barrel of lower tier oil they produce in comparison to integrated companies. They are, in effect, subsidizing refiners who are buying this cheap oil and mixing it with enough imported oil to minimize cash payments to nonaffiliated refiners.

It seems reasonable that independents should at least be able to obtain as much value for their oil as integrated companies are obtaining right now. If the independents were integrated through the refinery stage, then decontrol would result in a revenue increase of about $2 per barrel instead of $12-$14 per barrel. Despite all the political rhetoric against bigness and vertical integration, the system is severely biased against the small guy.

Decontrol will not help if the Congress passes an oil industry tax in excess of $2 per barrel. An integrated producer-refiner's production of lower tier oil will decrease—its taxes having been increased. And independent oil company production of lower tier oil will continue to taper off—its incremental revenues under decontrol will be substantially reduced because of royalty payments and various state excises taxes which are tied to the price of the oil.

If raising revenues is the objective then a $1 excise tax on all oil, both foreign and domestic, could raise twice the amount of money now being transferred from one refiner to another through the buying and selling of entitlements tickets. $2.5 billion will be transferred through the mail this year alone. A $1 excise tax on all oil would raise roughly $5.5 billion and would be less harmful to domestic production in comparison to the present system of controls and entitlement payments.

Mr. Chairman, if there is to be a tax, I sincerely hope that it will be an evenhanded one. It should apply to all oil, including oil coming into this country, as well as all imported refined products. The cause of our energy problems, OPEC, should share any tax burden levied by the Congress. A $1 per barrel excise tax at the wellhead or the port entry for foreign product will result in about a 5 cent increase in the cost of a gallon of gasoline. I do not believe that the American people will be willing to pay much more at the gas pump.

Of course, if the Congress was really interested in imposing a windfall profits tax, it would do just that. It would tax profits, and not sales revenues from production. In so doing, it would be surprised to learn after the fact, that increases in production costs have already wiped out almost all of the windfall profits that might have accrued to oil companies. Why?

When the OPEC cartel began raising prices in 1973, the demand for drilling and oil producing equipment quickly escalated as nations around the world began exploring for crude oil to reduce their reliance on OPEC. Naturally, as demand increased, manufacturers of oil field equipment began selling their products at higher prices to take advantage of conditions in the marketplace.

The price of drilling and production equipment has been rising with increases in the price of crude oil in almost lock-step fashion. In other words, crude oil is worth more today because of OPEC's price increases, but it also costs more to produce because of the rise in equipment costs.

In addition, labor costs have also risen dramatically since OPEC first became a world price-setter. American laborers are receiving "battle pay" because of the adverse conditions that they must work under in Alaska. Production costs have also risen because oil production is "energy intensive," and is therefore an energy-expensive business.

In sum, the justification for imposing a windfall profits tax rests heavily on the actual existence of abnormally high profits. Historical data and economic price theory suggests that increases in production costs have already wiped out virtually all of the windfall profits that might have been caused by OPEC inspired price increases. In fact, in comparison to American industry as a whole, oil companies are nearer to the lower rung of the profitability ladder than they are to the top when we measured profits by return on equity, or by return on total capital employed. Integrated oil companies are not abnormally profitable even though they are already capturing almost 90 percent of the world price for their domestically produced oil.

The Congress seems determined to tax the sale of domestically produced oil as if real world dynamics in the marketplace do not exist. Since the House-passed tax will not be applied to the sale of imported oil, domestic oil producers will continue their flight from the lower forty-eight states. They will produce and market more oil from outside of the continental United States.

As OPEC continues to raise its prices, domestic production costs will also continue to rise, but the total sales revenues received by domestic producers will be lessened by the amount of sales tax. As long as the costs of transporting foreign oil to domestic markets is less than the sales tax, then everything else being equal, oil companies will earn more gross revenue and hence profit by producing oil on foreign soil.

In short, the President's tax proposal as amended and passed by the House will, without a doubt, result in the flight of American investment capital to foreign shores and the American economy will continue to rely heavily on foreign crude oil production.

The targets of the new House tax, the major integrated oil companies, are likely to avoid the penalties by sitting on their domestic oil reserves. They will find it less profitable to develop domestic supplies than to market imported oil—since foreign oil will not be covered by the tax. With U.S. production bound to decline, it is only a matter of time before the increased demand for imports equals the President's import quota ceilings. When this happens, prices will rise dramatically since demand will overwhelm total domestic and foreign oil supplies available to American consumers. Perhaps, then, synthetic fuels will become economically profitable to produce. The cost to the American consumer will be very high.

The ultimate victims of the new tax, along with the consumers, will be the 10,000 or so independent oil producers who are not integrated through the refinery stage of production. These producers rely exclusively on domestically produced oil as their sole source of revenue. As costs rise, but sales revenues do not keep pace, they will be put out of business or at best be forced to sell out to some major oil producer who can better afford to wait in hopes that the tax will be repealed.

Such "fire sales" will lead to increased concentration in the oil industry. The major companies will get larger at the expense of the small independent producers. This prospect is not what the gas-starved American consumer has in mind when he writes to his Congressman or Senator and demands a solution to the oil crisis.

The House, in its zeal to raise revenues, is overlooking fundamental economic theory and documented history. It is trying to sneak a tax on the American people by burning the "oil witch." Unfortunately, the new tax enhances OPEC's ability to raise prices by destroying a market competitor—U.S. domestic oil production.

Let me encourage you to review a summary of may remarks before the House on June 28 entitled "Burning the Oil Witch."

BURNING THE OIL WITCH

Since 1973 OPEC's prices for crude oil have skyrocketed in comparison to prices for domestically produced crude oil. Despite these higher prices we find ourselves importing almost twice as much crude today as in 1973, when OPEC first embargoed oil from the western world. Why hasn't consumption of OPEC oil decreased as OPEC's prices have risen? Why has domestic crude oil production declined in the face of higher prices?

One often cited, but incorrect explanation for our increased reliance on OPEC is that the United States is running out of crude oil. Geologists across the country tell us that there are huge amounts of crude oil and other hydrocarbon fuels which have yet to be included as part of "proven" domestic reserves. Much of this fuel is going

to be expensive to produce because it is either located deep beneath the ground, or, because it is located in areas where traditional drilling will not work. At the present time oil is very expensive to buy because the nations of the OPEC cartel control so large a portion of the world's readily producible supplies that they can raise prices by reducing output in the face of rising world demand.

The OPEC finance ministers do not set oil prices capriciously. These men are trying to find a price that will support their authority over the marketplace. To find that price they must carefully estimate the changing capability of the rest of the world to produce oil in response to the lure of higher prices. One of the key variables in their calculations is what the production response of the United States oil industry will be as the price of crude oil rises.

American producers are the unquestioned leaders in oil exploration and drilling technology. If and when they shift into high-production gear, the amount of new oil produced will not be trivial and the OPEC nations know this. Why hasn't U.S. production been increasing to meet the challenge of OPEC? The answer can be summed up in two words: "price controls."

Consider the following: In 1970, domestic crude oil production reached historically high levels of production. Since then it has dropped 10 percent—from 9.6 million barrels per day in 1970 to 8.7 million barrels per day in 1979. Meanwhile, imports of crude oil have skyrocketed from 12.1 percent of consumption in 1970 to 42.7 percent in 1979.

SOURCES OF U.S. CRUDE OIL BEFORE AND AFTER PRICE CONTROLS

[Millions of barrels per day]

	Average daily domestic production	Average daily imports	Imports as a percent of total crude oil needs
Year:			
1965	7.8	1.2	13.7
1966	8.3	1.2	12.9
1967	8.8	1.1	11.4
1968	9.1	1.3	12.4
1969	9.2	1.4	13.2
1970	9.6	1.3	12.1
1971 [1]	9.5	1.7	15.1
1972	9.4	2.2	19.0
1973 [2]	9.2	3.2	26.0
1974	8.8	3.5	28.4
1975	8.4	4.1	32.9
1976	8.1	5.3	39.4
1977 [3]	8.2	6.6	44.4
1978	8.7	6.0	41.1
1979 (preliminary)	8.7	6.5	42.7

[1] Wage and price controls imposed in August 1971

[2] OPEC cartel embargoes crude oil, November 1973.

[3] Alaskan North Slope Oil begins flowing to market, March 1977

Note.—Data from the U.S. Department of Energy.

The reasons behind the acceleration in the growth of oil imports are apparent. Since price controls were imposed in 1971, the Federal Government has discouraged domestic oil production by, in effect, telling oil producers to "milk their assets." Under the price guidelines, and later under specific rules engendered by the Emergency Petroleum allocation act of 1973 (EPAA), the sale of most domestically produced oil has been controlled at prices below the world market.

Unfortunately; the cost of bringing oil to the marketplace has been rising faster than the controlled price of oil. Prices for oil field equipment have been rising almost lock-step with OPEC's price increases because of the world-wide increase in the demand for drilling and producing equipment. In addition the oil business is "energy-intensive" and therefore "energy-expensive."

With prices controlled, but production costs escalating to wipe out any windfall profits that might have accrued to the industry, oil producers were quick to realize that if the trends continued they would be forced out of business. They were faced

with three choices: (1) Stop pumping their reserves and wait until controls were lifted, or (2) pump dry existing wells until profits turned negative (using the funds to get into another business where they could make more money), or (3) do some combination of both while looking for oil in places not governed by price controls—places like Arabia, Equador and Indonesia.

Given the choices, it is not surprising that domestic oil production has fallen off as the spread between the world market price and the DOE below market controlled price has widened. Instead of "milking their assets", much of the oil industry has shifted its drilling and exploration efforts overseas because oil produced there can be sold at world market prices.

DOE entitlements—subsidizing refiners to import oil

Once price controls were in place, the DOE bureaucracy had to find a way to assure that lower prices would be passed on to consumers while maintaining competitive equality in the marketplace. DOE realized that refiners who were able to purchase controlled low price domestic crude were in a position to undersell refiners who relied exclusively on higher priced foreign crude. Therefore, it developed the entitlements program.

The genius behind this program is that refiners of domestically produced oil must pay importing refiners roughly one-half the difference between the price tag on foreign oil and the price tag on domestically produced oil. Payment is made by refiners of domestic oil to refiners of foreign oil for "entitlement" or "right to refine" tickets which are distributed by DOE. In this way, all refiners pay the same average price for crude oil. Where does the money come from? Most refiners of domestically produced oil are also crude oil producers. The money originates from the same pocket. Most of the loss to U.S. producers is shared with refiners of imported oil. The rest goes straight to OPEC. None of it has been going to consumers.

Why decontrol is inevitable

With the crude oil price paid by refiners rapidly approaching the world price, the President has been forced to recommend decontrol. Without decontrol domestic production will continue to decline and imports will continue to rise. As this happens, the entitlements program will fall apart, and all refiners will find themselves paying the world price for crude oil. In the end, price controls will have contributed to increased reliance on OPEC without saving consumers one dime. Consumers have been paying the "world" price for gasoline at service stations for five years. How is this possible when everyone knows that gasoline in Europe costs far more than it does in the United States?

Paying the world price for gasoline despite 5 years of price controls

In actuality, the retail price paid for gasoline in Europe includes steep taxes. The prices we should be looking at in making comparisons across continents are pre-tax, wholesale prices for refined gasoline, and not retail prices.

AVERAGE ANNUAL WHOLESALE PRICES FOR REGULAR GASOLINE ACROSS CONTINENTS

[Cents per gallon]

Year	New York Harbor [1]	Rotterdam, Holland [1]	Average, United States (excluding tax) [2]
1974	33.2	35.4	30.5
1975	33.4	32.6	35.8
1976	35.5	37.1	39.0
1977	38.4	36.4	42.5
1978	42.8	42.6	43.7

[1] Spot price—the price for a cargo of gasoline sold on a daily basis

[2] Dealer tankwagon price—the wholesale price charged to deliver gasoline from the refinery to the service station.

Note.—Data from the Platts Oilgram Price Service

The virtual equality of wholesale spot prices across continents strongly supports the "paying-the-world-price" position advanced by two economists, Charles Phelps at the Rand Corporation, and Rodney Smith at the University of Chicago. Two years ago they said the DOE's complicated formula, which enables refiners to raise prices to cover costs, also enables refiners to sell their products at world prices.

In support of this position, Phelps and Smith cited the existance of the "banks" of unrecouped costs which are reported each month by the Department of Energy. These "banks" represent cost increases which refiners are permitted to pass through in the form of higher prices directly to their service station customers. Even higher prices have not been charged because of competition in the marketplace for the consumer's dollar.

In other words, until recently when the "banks" began to be depleted as refiners and service stations raised prices to meet increased demand, their very existance has meant that refiners have been charging as much as consumers have been willing to pay. All this changed when market conditions, resulting from the reduction in Iranian oil production collided head-on with Federal price controls and allocation rules to create "The Great California Gas Shortage."

California's crisis: Spreading across the Nation

The shortage hit California first because the total demand for gasoline has been rising there much faster there than in the rest of the nation due to California's higher-than-average economic growth during the past year (800,000 more vehicles on the road). In contrast the supply of gasoline available to California has not been keeping pace. In the wake of the Iranian upheaval, the DOE told refiners not to purchase high priced crude oil on the spot market. Inadequate production of domestic crude due to price controls, strict environmental standards, and especially DOE allocation rules which do not allow refiners to shift the flow of gasoline from areas of low demand to areas of high demand, also contributed to the shortage. These allocation rules guarantee localized shortages whenever supplies tighten in the face of rising demand.

The growing imbalance between the forces of supply and demand finally erupted in a series of rapid price increases in California in the months of April and May. These price increases were followed by shortages and long lines at service stations everywhere when prices at gas pumps bumped against maximum Federal price ceilings. DOE's inflexible allocation rules lengthened the lines. With the marketplace no longer signalling to consumers how much to consume, Federal and state governments were forced to step in and adjust gasoline allocations while consumers were forced to wait in line. Unfortunately, consumers will have to get used to the lines because the new oil industry tax virtually guarantees increased reliance on unstable OPEC supplies for years to come.

The windfall profits tax: Burning the oil witch

The new tax will be on sales revenues. It is not actually a tax on windfall profits although it has been heralded as one. To avoid the tax, domestic oil producers will at first try to pass it on to refiners by raising prices. They will not be successful. Refiners will instead purchase less costly foreign oil. The producer's second and more profitable option, is to sit on their unpumped reserves while marketing imported oil since this oil will not be covered by the tax.

Tax revenues are likely to decrease, and not increase, as domestic oil production continues to falter under the heavy yoke of new taxes. Naturally as production decreases, OPEC's stranglehold on the market will tighten. The new tax enhances OPEC's ability to raise prices by destroying a market competitor—U.S. oil production. The Congress may burn the "oil witch" but it is guaranteeing higher consumer prices at the gas pump.

The ultimate victims of the new tax, along with the consumers, will be the 10,000 or so independent oil producers who are not integrated through the refinery stage of production. These producers rely exclusively on domestically produced oil as their sole source of revenues. As costs rise—but sales revenues do not keep pace—they will be put out of business or at best be forced to sell out to some major oil producer who can better afford to wait in hopes that the tax will be repealed.

Such fire sales will lead to increased concentration in the oil industry. The major companies will get larger at the expense of the small independent producers. This prospect is not what the gas-starved American consumer has in mind when he writes to his congressman and demands a solution to the oil crisis.

The CHAIRMAN. We will next hear from Mr. William Breed, New England Fuel Institute.

STATEMENT OF WILLIAM BREED, NEW ENGLAND FUEL INSTITUTE

Mr. BREED. Thank you, Mr. Chairman. I am William J. Breed, president of Johnson & Dix Fuel Corp. in Ascutney, Vt., and I live

in Hanover N.H. I market fuel oil at retail up in the north country of Vermont, New Hampshire and also in a small part of Massachusetts.

I am here because I am representing the marketers. I am past president of the New England Fuel Institute and a present director.

We independent marketers in New England serve 2.4 million retail home heating oil consumers. These millions of consumers both in New England and throughout the Nation are severely and unfairly harmed by the President's action to decontrol the price of domestic crude oil. On their behalf I call upon this committee to include provisions in the windfall profit tax legislation which will soften that blow and eliminate the inequity.

These consumers despite significant efforts and achievements at conserving oil and improving the efficiency of their homes and heating equipment are hard pressed to meet the ever increasing price of heating oil. If any of you have been up in the woods in our country, the piles of wood, the wood splitters that are being made by anybody who knows how to man a welding torch, it is a tremendous change in the space of the last 2 or 3 years.

In addition to the piles of wood there is a great effort on the part of fuel oil dealers like myself to develop energy audit programs. This is a rather simple one that the consumer can subscribe to for $15 which results in a computer printout showing the homeowner how he can save more money, whether it is from a new oil burner or increased insulation or whatever. It is a tremendous increase in conservation effort on the part of thrifty New Englanders.

[The following was subsequently supplied for the record:]

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A significant part of this increase in the price of heating oil is attributed to the President's decontrol action. NEFI does not question the wisdom of the decontrol decision however just as the Congress acted to soften the impact of decontrol on residential natural gas users, Congress should act to minimize the adverse effects of oil decontrol on home heating oil consumers.

Further, it is a grave injustice for residences heated with oil to be required to finance the Nation's energy security program while their neighbors who heat with gas are immune from this energy security tax.

The impact of the President's crude oil decontrol plan combined with the increases in the world price of crude oil this year will substantially hurt home heating oil consumers who comprise about 22 percent of the Nation's homeowners.

As a consequence of decontrol and the OPEC price hikes, heating oil prices are likely to rise 35 to 40 cents per gallon over levels of just 1 year ago. To the average home heating oil consumer, these price increases will mean payment of up to an additional $500 to $600 per year or approximately triple the price increases experienced by home heating oil consumers in the prior 5 years since the Arab oil embargo.

To insure that the home heating oil consumer does not bear a disproportionate share of this burden, the Congress should include within the windfall profit tax legislation protection against some of this enormous inflationary price increase.

NEFI supports the efforts of the President to provide special protection for the poor and elderly who need assistance the most but the administration's proposal does nothing for the bulk of Americans who earn $8,000 to $15,000 or perhaps to $25,000 a year. The impact of decontrol will also seriously strain the budgets of all these middle-income taxpayers who simply cannot afford the increases which will result from the President's program.

Furthermore, the effect will be disastrous for many of the Nation's schools, public housing authorities, hospitals, and churches and they should be helped also.

To soften the economic shock for these millions of homeowners in every region of the country, NEFI urges the committee to include a temporary home heating oil tax credit within the windfall profit tax legislation.

A proposal to accomplish this objective has already been introduced by Senator Ribicoff. NEFI fully endorses the concept of S. 822 and hopes the committee will include it within the legislation. There is a substantial precedent for a home heating oil tax credit.

First, the Senate passed a comparable measure in 1977 as an amendment to the Energy Tax Act. That amendment was introduced by Senators Hathaway and Durkin and received the support of the committee chairman.

It provided for a tax rebate for every residential consumer of heating oil within an adjusted gross income below $30,000. Its purpose was to reimburse home heating oil consumers with an amount approximately comparable to the increased price resulting from enactment of the crude oil equalization tax also called COET. Since COET was not enacted the amendment was deleted in conference.

Second, both the President and the House of Representatives included a provision in the National Energy Act for a dollar for dollar rebate of the price increase caused by COET on home heating oil consumers. The Treasury was to rebate 100 percent of the COET amount.

Once again, because COET was defeated in the conference committee, this provision became unnecessary. The equity for enactment of a home heating oil tax credit is even more necessary following Congress enactment of legislation which protects residential natural gas consumers from the impact of natural gas decontrol. A central provision of the National Gas Policy Act enacted last year requires that residential users not bear the burden of decontrol until all industrial users natural gas prices have risen to the level of home heating oil.

This effectively protects the Nation's millions of residential natural gas users. Does not fairness require comparable protection for the millions of homeowners who use oil heat as well? Why has it become less necessary since 1977 to assist home heating oil consumers to cope with the impact of a Government-mandated price increase?

NEFI believes this help has become even more urgent and is now a matter of basic fairness. The effects of crude oil decontrol combined with the windfall profit tax is no different from the ultimate consumer than was the impact of COET. Either way, the consumer price rises substantially and Federal revenues are increased. Moreover, abrupt changes in Government policy are responsible for the shock to consumers' pocketbooks. It is especially critical that this tax credit be enacted contemporaneously with the windfall profit tax and not await the enactment of an energy security fund. Delay will wreck havoc on these homeowners this winter. Prompt action will ease the difficult but necessary road to decontrol of all energy prices. I thank you, Mr. Chairman. I would be glad to answer any questions.

The CHAIRMAN. Thank you very much, sir. Senator Dole?

Senator DOLE. What is the price of heating oil? How much has it gone up in the past 12 months in New England?

Mr. BREED. Well over 20 cents now.

Senator DOLE. How much is it now?

Mr. BREED. Yesterday in my own case I had increases of 3 cents from one supplier, 2½ cents from another one and 2.4 cents for another one. My price is up 3 cents. I am in the 80's, low 80's right now. It is high 70's in my Massachusetts company and low 80's in New Hampshire and Vermont where we have to truck the oil up to secondary storage. That is a real concern of mine. We really have a problem. We do not have more oil available in primary storage because the mechanics of the situation require that we truck it over a period of time during the summer and early fall. We have to truck it up and put it in our secondary storage, and because the majors are trying to fulfill this 240-million-barrel obligation for primary storage, I am not getting enough oil for my secondary storage and therefore it makes it difficult for me to put oil in tertiary storage, in my customers' tanks.

Senator DOLE. As I understand the Ribicoff bill, the maximum credit is $125.

Mr. BREED. That is my understanding. I have not read the whole proposal.

Senator DOLE. What do you think the average increase in the fuel bill in New Hampshire will be? Do you have any projections on how much they will increase this winter over last winter?

Mr. BREED. It will triple the increase. It will probably be $500 to $600 more the way we are going.

Senator BRADLEY. Not enough, Senator Dole.

They will not increase enough before the primary.

Senator DOLE. I am interested in the testimony. The heating oil is one concern you hear in New Hampshire.

Mr. BREED. There is a lot of vacation travel up there right now.

Senator DOLE. Do you rely on about 80 percent imported oil?

Mr. BREED. Somewhat less than that, although some of my colleagues or fellow dealers' product would be in the 70- to 80-percent range. It depends who they are buying from. You have probably heard about the Sprague Oil being shut off by one of the majors. Some of the dealers are in tough shape. Some dealers have no oil at all until the end of the month, until August.

Yesterday in my office I received calls from two dealers of a particular major. They have no oil at all until the end of the month. It is a sad thing. All of this messing around with the marketplace is wreaking havoc at the final 20 feet of hose.

The CHAIRMAN. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

Mr. Breed, about 2 months ago the President put in a $5 entitlement for heating oil. The purpose was to help us get to the goal he set of 240 million barrels in storage by October 1. Do you think the entitlements program is working?

Mr. BREED. I think it is working and I thought it was working quite well until last week. I understand the figures are just in now from API that in general, and I judge it by saying can we get a million barrels a day into primary storage and we were doing quite well I understand until this week when I think it was only 2.5 million barrels this week instead of 7 million barrels.

I think it is working but not well enough, Senator.

Senator BRADLEY. My fuel oil dealers in New Jersey tell me there is a major problem looming, and that is that we have set this primary goal of 240 million barrels by October 1. What is happening is all of the primary stores are holding their heating oil and cutting off the supply to secondary and to tertiary suppliers—to you and to consumers that at this time of the year would normally have a full tank or 80 percent full tank.

Is there any evidence of that occurring in New England?

Mr. BREED. Yes, definitely. As I started to mention, one of my sources of supply is the pipe from New Haven up to Springfield, Mass., and then my 8,000 gallon trucks go down and pick it up. The oil is only dribbling up that pipe and I cannot seem to find out why.

The supplier in New Haven that I buy from puts it in the pipe up to Springfield. For some reason there is hardly any oil in the tanks in Springfield, Mass. When my trucks come down from Vermont and New Hampshire quite often they are told right in the

middle of the day that is all, that is all you can get today, we have no more oil.

Senator BRADLEY. They are told by whom?

Mr. BREED. By our supplier. I alluded to the mechanics up country that we have to physically get the oil up during the summer or we would not have enough trucks to get it up during the peak of the heating season.

Senator BRADLEY. Is there any way for you to measure how much you have in secondary storage now and how much is in the tanks of your consumers, as opposed to last year, for example?

My people tell me they have 50 percent less in secondary and tertiary storage and they determined this on the basis of a questionnaire they sent to all dealers.

Do you have any further information?

What looms here is the illusion that if we get the 240 million we will be all right in the winter when in fact we have a 50-percent shortfall.

Mr. BREED. The 240 figure, I want to see that met. Everybody seems to be hanging their hat on it. As you say, what about my storage? I have to have the oil in my tanks if I am going to keep up when December and January hit. By February if I do not have enough going into the winter, by February I will be running out. Mechanically, I just cannot get the trucks up the road fast enough.

Senator BRADLEY. How much less do you have in your tanks now than you did this time last year?

Mr. BREED. In general, the dealers up country and that is all of northern New England, I would say are about 15 percent behind. The problem is some have none, whereas others have more than they had last year due to perhaps chance happenings, the choice of suppliers and the fact they had misjudged the final months of the winter and ended up with more oil and inventory in the Spring. You have a few dealers with more oil and some dealers with no oil at all that are being helped in the marketplace.

Senator BRADLEY. Overall, you have 50 percent less in secondary?

Mr. BREED. I would say it was nearer 20 to 30 percent behind.

Senator BRADLEY. How do you know that?

Mr. BREED. You are dealing with conservative Yankees up there and I am not sure the survey is accurate very frankly. What happens is the energy office in the State of Vermont for instance will call and ask what your storage is and how much do you have in stock and then they will compile it.

Senator BRADLEY. Let's get back to the first question, which was the entitlements question—whether that is working or not. The fact that refineries would produce a million barrels a day in this country does not answer the entitlements question.

Do you see entitlements working now? Do you see heating oil coming in from abroad because of the $5 subsidy or does the fact that the spot market has increased $5 nullify any advantage entitlement would give to the New England area?

Mr. BREED. I cannot be sure, Senator, whether it is just the entitlement that is helping. It is beyond my scope at this point in time. I think it is helping.

Senator BRADLEY. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Wallop.

Senator WALLOP. Mr. Chairman, I only have one question and I think it is just a point of clarification.

It is my understanding from listening to you and from reviewing your testimony, that you are not particularly endorsing the windfall profit tax but are seeking relief and certainty of relief for the very real increases in price of home heating oil and fuel in New England. Is that correct?

Mr. BREED. I am not sure I understand the question.

Senator WALLOP. I did not find anywhere in your statement that you actually endorse the windfall profit tax but gathered that you are seeking that something be enacted contemporaneously with the tax so your problems are taken into account.

Mr. BREED. I would have to endorse it at this point since I think it is the reality of the situation but we are not talking so much about separate legislation dealing with how the money is to be used. We are just saying we think the tax probably is a reality but we wonder why the fuel oil consumer should pay this disproportionate share. It is just not fair. That is our view.

Senator WALLOP. I could not agree more. That is one of the problems with the windfall profit tax. It will continue to distort that further. As you pointed out, it will continue to hamper the marketplace.

When the fingers get in there and get dirty and jam gets on every piece of bread on the table, I agree with you. I have no problem with trying to work out circumstances that are necessary to equalize burdens for New England and the rest of the country.

As you may have gathered from listening to some of my questions I do have problems with the windfall profit tax.

Mr. BREED. We all have problems with it.

Senator WALLOP. Thank you.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. No questions, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Breed.

[The prepared statement of Mr. Breed follows:]

PREPARED STATEMENT OF WILLIAM J. BREED, NEW ENGLAND FUEL INSTITUTE

My name is William J. Breed. I am president of Johnson & Dix Fuel Corp. of Ascutney, Vt. I am a past president and chairman of the board of directors of the New England Fuel Institute (NEFI) on whose behalf this statement is made.

NEFI is an association of more than 1,100 independent retail and wholesale home heating oil suppliers throughout the six-state New England region. The region's independent marketers serve over 2.4 million retail home heating oil consumers and market 85 percent of the 4 billion gallons of No. 2 home heating oil sold in our area at the retail level and 45 percent of the gallonage at wholesale; 71 percent of all New England's buildings and 74 percent of its population live in dwellings heated by oil. These millions of consumers, both in New England and throughout the Nation, are severely and unfairly harmed by the President's action to decontrol the price of domestic crude oil. On their behalf, I call upon this committee to include provisions in the windfall profits tax legislation which will soften that blow and eliminate the inequity.

These consumers, despite significant efforts and achievements at conserving oil and improving the efficiency of their homes and heating equipment, are hard pressed to meet the ever increasing price of heating oil. A significant part of this increase is attributable to the President's decontrol action.

NEFI does not question the wisdom of the decontrol decision. However, just as the Congress acted to soften the impact of decontrol on residential natural gas users, Congress should act to minimize the adverse effects of oil decontrol on home heating oil consumers. Further, it is a grave injustice for residences heated with oil to be

required to finance the Nation's energy security program while their neighbors who heat with gas are immune from this "energy security tax."

Impact of decontrol

The impact of the President's crude oil decontrol plan, combined with the increases in the world price of crude oil this year, will substantially hurt home heating oil consumers, who comprise about 22 percent of the Nation's homeowners.

As a consequence of decontrol and the OPEC price hikes, heating oil prices are likely to rise 35 to 40 cents per gallon over levels reached a year ago. To the average home heating oil consumer, these price increases will mean payment of up to an additional $600 per year, or approximately triple the price increases experienced by home heating oil consumers in the prior five years since the Arab oil embargo. To ensure that the home heating oil consumer does not bear a disproportionate share of this burden, the Congress should include within the Windfall Profits Tax legislation protection against some of this enormous inflationary price increase.

NEFI supports the efforts of the President to provide special protection for the poor and elderly, who need assistance the most. But the administration proposal does nothing for the bulk of Americans who earn $8,000 or $15,000 or $25,000 per year. The impact of decontrol will also seriously strain the budgets of all these middle income taxpayers, who simply cannot afford the increases which will result from the President's program. Furthermore, the effect will be disastrous for many of the Nation's schools, public housing authorities, hospitals, and churches, which also should be helped through this decontrol period.

The heating oil tax credit

To soften the economic shock for these millions of homeowners in every region of the country, NEFI urges the Committee to include a temporary home heating oil tax credit within the Windfall Profits Tax legislation. A proposal to accomplish this objective has already been introduced by Senator Ribicoff. NEFI fully endorses the concepts of S. 822 and hopes the Committee will include it within this legislation. There is substantial precedent for a home heating oil tax credit.

First, the Senate passed a comparable measure in 1977 as an amendment to the Energy Tax Act. That amendment was introduced by Senators Hathaway and Durkin, and received the support of the committee chairman. It provided for a tax rebate for every residential consumer of heating oil with an adjusted gross income below $30,000. Its purpose was to reimburse home heating oil consumers with an amount approximately comparable to the increased price resulting from enactment of the Crude Oil Equalization Tax (COET). Since COET was not enacted, the amendment was deleted in conference.

Second, both the President and the House of Representatives included a provision in the National Energy Act for a dollar-for-dollar rebate of the price increase caused by COET on home heating oil consumers. The Treasury was to rebate 100 percent of the COET amount. Once again, because COET was defeated in the Conference Committee, this provision became unnecessary.

The equity for enactment of a home heating oil tax credit is even more necessary following Congress' enactment of legislation which protects residential natural gas consumers from the impact of natural gas decontrol. A central provision of the Natural Gas Policy Act[1] enacted last year requires that residential users not bear the burden of decontrol until all industrial users' natural gas prices have risen to the level of home heating oil. This effectively protects the Nation's millions of residential natural gas users. Does not fairness require comparable protection for the millions of homeowners who use oil heat as well?

Most remarkably, the Committee should be aware that the Natural Gas policy act permits industrial gas prices to rise only to the level of home heating oil prices. The Congress prohibited residential gas prices from rising to the equivalent level of their neighbors who use home heating oil. Only industrial users of natural gas, who can pass these prices on to customers, must bear the burden of natural gas price decontrol that every home heating oil user bears each winter, and will bear most severely in the coming years.

Why has it become less necessary since 1977 to assist home heating oil consumers to cope with the impact of a government mandated price increase? NEFI believes this help has become even more urgent, and is now a matter of basic fairness. The effect of crude oil decontrol, combined with the Windfall Profits Tax, is no different for the ultimate consumer than was the impact of COET. Either way, the consumer price rises substantially, and federal revenues are increased. Moreover, abrupt changes in government policy are responsible for the shock to consumers' pocketbooks.

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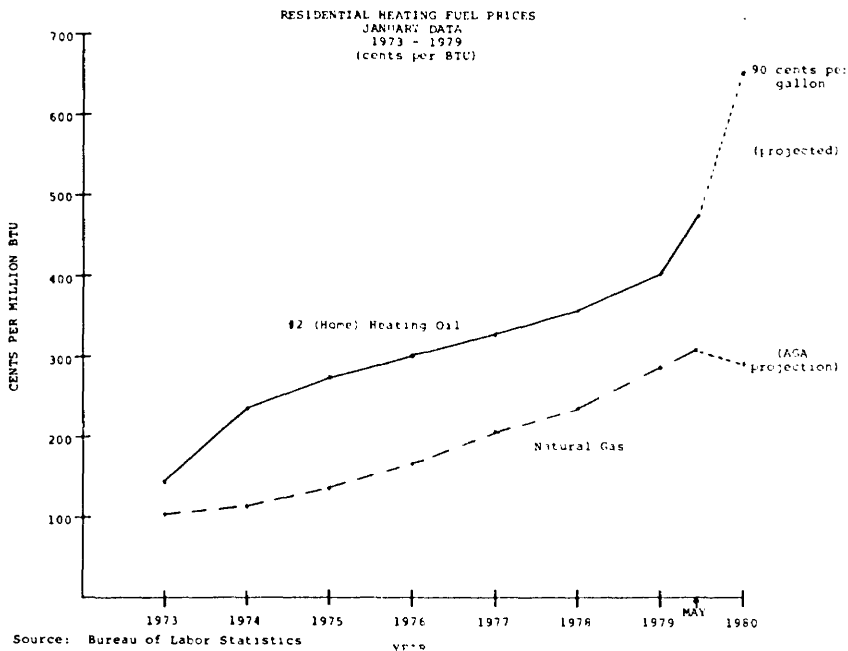
[1] Section 204.

It is especially critical that this tax credit be enacted contemporaneously with the windfall profits tax, and not await the enactment of an energy security fund. As the attached table demonstrates, the gap between residential oil and gas prices is rising substantially this year. In addition, this is a tax credit, operating independently of any federal bureaucratic funding mechanism. Delay will wreak havoc on these homeowners this winter; prompt action will ease the difficult, but necessary, road to decontrol of all energy prices.



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The CHAIRMAN. We will next call on Mr. Fred E. Tracey, vice president of Supply and Distribution, Vickers Petroleum Corp., on behalf of Independent Refiners Association of America.

STATEMENT OF FRED E. TRACEY, VICE PRESIDENT, SUPPLY AND DISTRIBUTION, VICKERS PETROLEUM CORP., ON BEHALF OF INDEPENDENT REFINERS ASSOCIATION OF AMERICA

Mr. TRACEY. Mr. Chairman, members of the committee, my name is Fred Tracey and I am the vice president of supply and distribution for Vickers Petroleum Corp. headquartered in Wichita, Kans. I am appearing before you today on behalf of Vickers and the Independent Refiners Association of America of which Vickers is a member. I am accompanied by Mr. John P. Foley, Jr., assistant general counsel of the association.

In the interest of time I will skip descriptions of Vickers and the Association in order to get to the heart of our presentation.

There are two aspects of the legislation that both Vickers and the Association view require correction. First there is the issue of the potential liability of independent refiners resulting from producers incorrectly certifying their crude oil; and second the issue of timing related to the collection and depository requirements of the tax.

The potential liability issue is of great concern because the independent refiner purchaser is to become a tax collection agent for the IRS. The responsibility for correctly certifying the oil into its proper category rests entirely with the producer under DOE regulations and under the legislation before this committee.

The independent refiner as purchaser has neither the responsibility nor the means to verify the correctness of the producers certification. However, if at some future date the Internal Revenue Service determines the crude oil was miscertified, the IRS will not pursue the producer rather they will seek payment from the refiner as the collection agent.

It is the view of both Vickers and the Association that in as much as certification is the sole responsibility of the producer, independent refiners should be insulated against the possibility of the IRS bringing an action against them for under collection of the tax.

The simplest means of accomplishing this goal would be to include within the legislation a provision that provides that the refiner will not be liable for any under collection of the tax due to improper certification by the producer.

The second aspect of the legislation before this committee which has caused considerable concern to both Vickers and the Association are the mechanics of the depository requirements which are to be placed on an independent refiner purchaser.

As currently drafted, the legislation contemplates the payment of the tax during the month of removal from a particular property. While the current language of the legislation leaves it to the discretion of the Secretary of the Treasury as to how often the refiners will be required to deposit the tax, the administration has already indicated that the tax is to be deposited on a twice monthly basis. This requirement if put into effect will not only be adminis-

tratively burdensome as it is contrary to the accounting procedures utilized by independent refiners but it will also be financially burdensome on the independent refiners.

In order that you may understand the administrative and financial burdens of the twice monthly system I will try to briefly explain current industry lease accounting procedures.

First, field personnel called gagers run the oil out of a lease tank into a pipeline or truck. The gager prepares a record of the oil sold called a run ticket which specifies quality and quantity expressed in terms of the total number of feet and inches of oil run, not barrels, at the existing temperature.

The run ticket is mailed to the headquarters division order accounting department where using computer processing the quantity is converted into barrels at 60° F. for payment purposes.

In addition to determining quantity in barrels for each run ticket, processing involves determining total monthly production from a property comparing total production with base production control levels to ascertain the proper amount of lower tier and upper tier oil applying the per barrel price base on quality, allocating the property's oil to the various interest owners, paying State taxes, summarizing the crude into proper tiers for DOE accounting and finally paying the owners. The existing procedure is complex and with the windfall profit tax, will become more complex with both added maintenance and calculation requirements.

The timing is roughly this. After the end of the month in which the oil is sold, it typically takes approximately 10 to 12 days for all run tickets to be received and another 10 days to process and verify the data. Checks are typically issued to owners by the 25th day of the month following the month of sale.

While the above cited timing schedule for disbursements has been Vickers' experience, there are some refiners who have negotiated with their producer suppliers for even longer delayed payment terms.

Clearly, the twice monthly collection procedure does not comport at all with the existing accounting procedures utilized by independent refiners.

Senator TALMADGE. Mr. Tracey, I hate to call time on you but there are other witnesses waiting and Senate is in session.

You have made some very constructive criticisms of the House-passed bill. I hope you will work with our staff to try to make some technical corrections which I think are most meritorious.

Mr. TRACEY. We will be glad to, sir.

Senator TALMADGE. Any questions, Senator Dole?

Senator DOLE. I am familiar with the two points you are raising. There is some precedent for it.

Mr. FOLEY. Yes, Senator. We did have it.

Senator DOLE. Ninety days?

Mr. FOLEY. Ninety-day extension.

Senator DOLE. Your suggestion makes a great deal of sense. On the under collection, your proposal would take care of fraud. In other words, the government cannot come back on you if a producer falsifies the records.

Mr. FOLEY. Exactly, Senator. The basis for that was as independent refiners with unaffiliated producers, not someone that is controlled by the refiner——

Senator DOLE. You cannot be the policeman for everybody.

Mr. FOLEY. We would like to be insulated against the potential liability.

Senator DOLE. The staff is aware of the problem. It was called to my attention last week when I talked to a couple of independent refiners.

Mr. TRACEY. Exactly. We are a collection agent and we are placed in a position where we could be punished without these changes we are suggesting.

Mr. FOLEY. We will follow up with the joint committee staff and the Congressmen.

Senator DOLE. Thank you.

Senator TALMADGE. Thank you very much, gentlemen. We appreciate your contribution.

[The prepared statement of Mr. Tracey follows:]

PREPARED STATEMENT OF VICKERS PETROLEUM CORP., ON BEHALF OF THE INDEPENDENT REFINERS ASSOCIATION OF AMERICA

Mr. Chairman, members of the committee, my name is Fred E. Tracy and I am the Vice President, Supply and Distribution for Vickers Petroleum Corporation ("Vickers"). I am appearing today before you on the behalf of Vickers and the Independent Refiners Association of America ("IRAA") of which Vickers is a member. I am accompanied by Mr. John P. Foley, Jr., the Assistant General Counsel of IRAA.

Both Vickers and IRAA appreciate having the opportunity to appear before your committee today in order that we may discuss with you some of the effects of the Windfall Profits Tax on independent refiners. However, before discussing the particular problems of independent refiners with the tax, it may be helpful if I briefly describe both Vickers and the IRAA.

Vickers is an independent refiner/marketer whose headquarters is in Wichita, Kansas. Vickers owns and operates a 64,000 barrel per day capacity, complex refinery located in Ardmore, Oklahoma. The principal refined petroleum product produced from Vicker's refinery is motor gasoline which, for the most part, is distributed to end users through Vickers marketing division. The products produced by Vickers are marketed in 20 states, primarily in the mid-continent of the United States. At present, Vickers receives approximately 20 percent of its crude oil supplies from domestic sources on a first purchaser basis.

The Independent Refiners Association of America ("IRAA") of which Vickers is a member, is an association of thirty-three independent refiners of varying sizes and configurations who are located nationwide. The common characteristic shared by all IRAA members is that they do not own nor control any substantial quantities of proprietary crude oil. This means that in order to obtain crude oil supplies to operate their refineries, IRAA members must purchase their crude oil from unaffiliated sources. Given the varying sizes, locations and complexities of the IRAA members, the types and amounts of crude oil and the manner in which individual companies pay for their crude oil supplies vary widely from company to company. However, while individual operations may differ, the fact that Vickers and other IRAA members, by necessity, must purchase their crude oil supplies from these unaffiliated sources means that the windfall profits tax will significantly effect the operations of independent refiners.

There are two aspects of the legislation which is the subject of this hearing that both Vickers and the IRAA view as requiring correction. First, there is the issue of the potential liability of independent refiners resulting from producers incorrectly certifying their crude oil, and secondly, the issue of timing related to the collection and depository requirements of the tax.

The potential liability issue is of great concern because under the provisions of H.R. 3919, the independent refiner purchaser is to become a tax collection agent for the IRS. The responsibility for correctly certifying the oil into its proper category (i.e., lower tier, upper tier, free market, etc.) rests entirely with the producer under

DOE regulations and under the legislation before this committee. The independent refiner as purchaser has neither the responsibility nor the means to verify the correctness of the producers certification. However, if at some future date the Internal Revenue Service determines that the crude oil was miscertified, the IRS will not pursue the producer—rather they will seek payment from the refiner as the collection agent. It is the view of both Vickers and the IRAA that, inasmuch as certification is the sole responsibility of the producer, independent refiners should be insulated against the possibility of the IRS bringing an action against them for under-collection of the tax. The simplest means of accomplishing this goal would be to include within the legislation a provision that provides, where an independent refiner relied in good faith upon the information provided him by an unaffiliated producer, then that refiner will not be liable for any under-collection of the tax. Such a provision will add further incentive to the producer to correctly certify the crude oil sold to refiners, and it would decrease the necessity for refiner/producer litigation in those instances where the producer incorrectly certifies the crude oil subject to the tax.

The second aspect of the legislation before this committee which has caused considerable concern to both Vickers and IRAA are the mechanics of the depository requirements which are to be placed on an independent refiner purchaser. As currently drafted, the legislation contemplates the payment of the tax during the month of removal from a particular property. While the current language of the legislation leaves it to the discretion of the Secretary of the Treasury as to how often the refiners, who are first purchasers, will be required to deposit the tax, the Administration has already indicated that the tax is to be deposited on a twice-monthly basis.[1] This requirement, if put into effect, will not only be administratively burdensome, as it is contrary to the accounting procedures utilized by independent refiners, but it will also be financially burdensome on independent refiners.

In order that you may understand the administrative and financial burdens of the twice-monthly system, I will try to briefly explain current industry lease accounting procedures:

1. Field personnel called gaugers run the oil out of a lease tank into a pipeline or truck. The gauger prepares a record of the oil sold (called a run ticket) which specifies quality and quantity expressed in terms of the total number of feet and inches of oil run (not barrels) at the existing temperature.

2. The run ticket is mailed to the headquarters division order accounting department where, using computer processing, the quantity is converted into barrels at 60° F for payment purposes. Every lease tank has different conversion factors. In addition to determining quantity in barrels for each run ticket, processing involves determining total monthly production from a property, comparing total production with base production control levels to ascertain the proper amount of lower tier and upper tier oil, applying the per barrel price base on quality, allocating the property's oil to the various interest owners (of which there may be hundreds in some cases), paying state taxes, summarizing the crude into proper tiers for DOE accounting and finally paying the owners. The existing procedure is complex and with the windfall profits tax, will become more complex with both added maintenance and calculation requirements.

3. The timing is roughly this. After the end of the month in which the oil is sold, it typically takes approximately 10 to 12 days for all run tickets to be received and another 10 days to process and verify the data from the run tickets. Checks are typically issued to producers by the 25th day of the month following the month of sale. However, while the above cited timing schedule for disbursements has been Vickers' experience, there are some refiners who have negotiated with their producer suppliers for even longer delayed payment terms.

Clearly, the twice-monthly collection procedure does not comport at all with the existing accounting procedures utilized by independent refiners. Nor is the procedure compatible with the provision of the bill that requires the producer to furnish the purchaser with a certification as to the crude oil delivered in one month, on the first day of the second month following the close of the month of delivery. Moreover, the procedure does not take into account that some refiners have negotiated with their producer/supplier for extended payment terms. As this is the current structure of the legislation, it is the recommendation of Vickers and IRAA that this committee incorporate within H.R. 3919 procedures for the collection and deposit of the tax that take into account all of these factors. An appropriate means of doing this would be to include language within the legislation that delays the required date of payment of the tax by the independent refiner by no less than fifteen days

[1] It should be noted that while the language of the House Report speaks in terms of bimonthly payments, what was intended is that payments be made twice monthly.

after the receipt of the certification from the producer. Failure to include such a provision within the legislation would impose the following burdens on independent refiners.

1. In addition to the complex programming changes and maintenance requirements of properly accounting for windfall profits taxes on lower tier, upper tier, and free market crude oil, the independent refiner purchaser would be required to close books three times a month instead of one-two times for the government and once for business purposes. This in intolerable.

2. In reference to price controlled oil, there is no way an independent refiner can correctly calculate the amounts of lower and upper tier oil and the applicable tax on that oil unless he has received a full month's production. This can not be done any quicker than the 25th day of the month following the month of sale.

3. Paying twice monthly would add to the financial burden of inependent refiner purchasers by increasing interest costs to the extent the timing of the windfall profits tax payment is earlier than payment to producers. It also would place an unanticipated cost on those independent refiners who negotiated for larger delayed payment terms.

It is the position of Vickers and the IRAA that any such effects on independent refiners which result from the imposition of the windfall profits tax would be contrary to the intent of the tax.

Thank you very much for the opportunity to present these views. We will be happy to answer any questions you may have.

Senator TALMADGE. Our next witnesses are a panel consisting of Mr. Raphael Sherfy, U.S. Council of the International Chamber of Commerce; Mr. Robert T. Scott, vice president of taxation, Financial Executives Institute; Mr. Robert D. Guy, director of taxes, Tax Council.

Gentlemen, we are honored to have you with us. Please proceed.

STATEMENT OF RAPHAEL SHERFY, U.S. COUNCIL OF THE INTERNATIONAL CHAMBER OF COMMERCE

Mr. SHERFY. My name is Raphael Sherfy.

Senator TALMADGE. You may put your full statement in the record and summarize it if you will, Mr. Sherfy.

Mr. SHERFY. I am testifying on behalf of the U.S. Council of the International Chamber of Commerce on Taxation. Our testimony is directed exclusively toward the computation of the proper foreign income tax credit against income taxes paid with respect to oil activities abroad.

The Secretary of the Treasury made certain proposals with respect to the computation of this tax credit. He seemed to have tackled two basic problems. One of which is the amount of income taxes paid with respect to oil activities in any particular country and then the other is the disallowance to a certain degree of the tax benefit which would be accorded oil and gas extraction losses when compared to the tax benefit that is permitted for all other losses under comparable circumstances.

The U.S. Council agrees that there should be consideration given the royalty issue. The administration's approach as far as losses are concerned, we object to very strongly. The tax-royalty issue of the administration's proposal could be accepted with one minor modification.

Under the administration's legislative proposal, a credit for taxes paid to a foreign country in connection with oil and gas extraction income will be limited to 46 percent. That is the U.S. tax rate. Any taxes paid to the country in excess of 46 percent would not be creditable. Taxpayers would not be permitted to average low rates

of foreign taxes on oil and gas extraction income in some foreign countries with high rates imposed in other countries.

The U.S. Council would modify the administration's proposal to determine creditable taxes on oil and gas extraction income on a per country basis in one respect. If the applicable general tax rate in country X on oil and nonoil companies alike is 55 percent or exceeds the U.S. rate, then we think the 46 percent rate is unfair.

If a U.S. manufacturing company operating in country X can qualify for a foreign tax credit for taxes paid in excess of the 46 percent, the U.S. oil company under these circumstances should be treated no differently. A difference in treatment is a penalty against the oil company simply because it is an oil company.

The U.S. Council believes that if foreign taxes paid to a foreign country with respect to oil and gas extraction income are subject to a limitation as just suggested of the greater of the 46 percent or the tax rate generally applicable in a country, then there is no need to delve into the intricate question of whether the tax does contain or does not contain elements of a royalty.

We oppose the proposal of the Secretary with respect to limiting the applicability of the oil and gas extraction losses against such income in determining the foreign tax credit. In essence, the U.S. Council stands for the position that it is proper to determine the amount of payments made to a particular country which will constitute properly creditable income tax. Once that decision is made and the amount is determined then we believe that the oil industry, the oil activities should be treated exactly the same as other industries. Under the Secretary's proposal, those activities will not be so treated because the losses attributable to extraction activities would be offset against oil income from extraction for credit purposes whereas in all other industries losses abroad are taken into account on an overall basis.

In summary we believe that after the proper amount of creditable income taxes are determined, the oil industry should be treated the same as other industries for foreign tax credit limitation purposes. They should be put on the overall limitation the same as other industries and be treated equally.

Thank you very much.

Senator TALMADGE. Thank you, Mr. Sherfy.

Mr. Scott, you may proceed.

STATEMENT OF ROBERT T. SCOTT, VICE PRESIDENT, TAXATION, FINANCIAL EXECUTIVES INSTITUTE

Mr. SCOTT. Thank you, Mr. Chairman. My name is Robert T. Scott. I am vice president of Johnson & Johnson in New Jersey. I appear today on behalf of the Taxation Committee of the Financial Executives Institute.

Our testimony also is limited to the effects of the administrations proposals on the foreign tax credit. We feel adoption of this proposal would be a move in the wrong direction that may adversely affect the well-being of the country and most importantly establish an unsound precedent that could subsequently be applied to American industry generally.

We are concerned that this hearing arises in an emotionally charged atmosphere and it may not be possible for the Congress to

act with the reasonable degree of care that it has in the past in dealing with fundamental tax principles and that is certainly now warranted.

Moreover, it appears that legislative consideration of the credit at this time may be premature inasmuch as the Treasury has just recently proposed changes in a manner in which it tends to view foreign taxes. The fact that the Treasury has set a September 30 deadline for receiving comments demonstrates a need to carefully consider changes in this area.

Surely if administrative changes in the interpretation of existing law requires extensive consideration, fundamental changes in the law itself are even more deserving of care and as such should not be restricted to such a short timeframe as we are currently facing.

Further legislation if any is required might better follow rather than precede the discussion of the interpretation problems.

The U.S. system of taxation is based on two principles; equal taxation of U.S. taxpayers having the same amount of income regardless of source or origin; and two, tax neutrality as to making decisions whether to invest at home or abroad.

The United States taxes its citizens and corporations on worldwide income but recognizes that the country wherein the income is earned has the primary jurisdiction for tax. Accordingly the United States grants a credit against its tax on foreign source income in order to prevent double taxation.

It is important to note that under the U.S. system and in particular the foreign tax credit limitations which is what we are talking about here, it is impossible to reduce the U.S. tax on U.S. source income.

In other words, when Johnson & Johnson pays a tax on foreign income in the United Kingdom or in Germany or wherever, it is impossible under the present credit system to reduce the U.S. tax on U.S. source income that we may earn from selling Band-Aids or bandages in New Jersey or Washington, D.C.

FEI believes that the foreign tax credit should be maintained in its present form to mitigate the inequities of double taxation and to permit U.S. businesses to compete on an equal footing in foreign markets.

The Treasury has proposed among other things, one, to allow taxes on foreign oil and gas extraction income to be credited only against that income; two, to limit the computation of the credit on a computation which is based on the lesser of and overall of a country basis.

To apply the foreign tax credit limitation separately to specific types of income or to apply it on a per country basis would represent in our view undesirable steps. These two changes would reverse action proposed by the Treasury and taken by Congress in 1976 which required all taxpayers to compute the limitation on an overall basis. This action was in recognition of the fact that overseas businesses including the securing and processing of raw materials and the transporting and marketing of the end product may involve several countries and should be accounted for on a unitary basis for U.S. foreign tax credit purposes.

The use of the overall limitation makes sense from a U.S. tax policy standpoint and cannot be considered to provide a tax loophole.

If several countries impose a tax on income derived from international operations and the combined rate exceeds the 46 percent U.S. statutory rate, we see no loophole in the fact that one of the countries involved taxes its portion of the income at a rate less than 46 percent. So long as the combined rate equals or exceeds 46 percent, which it must, there is nothing that can reasonably be regarded as tax avoidance. The long standing U.S. policy of insuring that foreign income bears tax equivalent to the U.S. rate is not frustrated.

Applying a per country limitation on the foreign tax credit selectively against certain industries or certain types of income does not in our view represent sound tax policy. Applying a lesser of per country or overall limitation appears to be even more unsound and creates a situation where the taxpayer is always penalized.

If applied generally to all American businesses, the effect of the Treasury proposals would be to create double taxation by reducing the effectiveness of the foreign tax credit. This would increase the cost of doing business abroad making U.S. corporations less able to compete against foreign owned companies in world markets. It would adversely affect the U.S. balance of payments and the U.S. economy in general and the U.S. employment connected with that foreign investment.

Accordingly, FEI respectfully urges this committee to reject the Treasury's foreign tax credit proposals.

Thank you very much.

Senator TALMADGE. Thank you, Mr. Scott.

Mr. Guy, it is a pleasure to welcome a fellow Georgian to the committee. You may proceed and insert your full statement into the record, sir.

STATEMENT OF ROBERT D. GUY, DIRECTOR OF TAXES, TAX COUNCIL

Mr. GUY. Thank you, Senator. I am Robert Guy, assistant treasurer and director of taxes of the Coca-Cola Co. of Atlanta, Ga. I appreciate this opportunity to present a brief statement on behalf of the Tax Council.

The Tax Council is a business supported organization concerned with broad aspects of Federal tax policy as it affects the capital formation process and the market system. It is a relatively small organization in total numbers but broad based in terms of industry representation. The Coca-Cola Co. is a member of the Tax Council and I serve on its board of directors.

We think the issues under consideration at this hearing are very important, not just for the petroleum industry but to all business and especially all business with a substantial stake in international markets. Coca-Cola operates in more than 135 countries and thus obviously we have a great interest in any international tax policy matters.

The full Tax Council statement filed with this committee addresses the proposed windfall profit tax and energy security fund but I shall confine my remarks to the foreign tax credit.

Assistant Secretary of the Treasury for Tax Policy, Donald Lubick, stated recently that, "The administration proposals were conceived to apply only to the petroleum industry and they did not represent an assault on the foreign tax credit generally." I am sure the Secretary is sincere in this statement but it does not relieve our grave concern over the implications of the proposals for all business engaged in international operations.

The record indicates that restrictive provisions aimed originally at the petroleum industry have been extended across the board specifically in 1975-76. In important respects the tax proposals are an open invitation for Congress to jump back into controversial areas of foreign source income taxation that we thought were settled at least for some time by the major tax legislation last year.

Furthermore, we do not agree with the justification for the administration's proposals even applied narrowly to the petroleum industry. They appear to be punitive and unrelated to performance in providing the U.S. economy with additional energy.

This is not the occasion for a long discourse on our international investment position or its tax treatment. I believe this committee and Congress have been made fully aware of the benefits to the U.S. domestic economy from our international stake abroad. I would like to emphasize once again the most critical factor of all, the important contribution of foreign earnings to capital supplies for the domestic economy.

The flow of repatriated earnings from direct investment abroad has consistently outpaced the transfer of investment funds overseas. In the last 4 years the surplus of repatriated earnings over outflow of funds cumulated to over $25 billion. This has been a crucial plus factor in our otherwise disappointing balance of payments position and just as important, a crucial source of domestic capital investment. Not so incidentally a number of major petroleum companies would not be able to maintain their U.S. exploration and development programs without the contribution of earnings from overseas production.

In Coca-Cola's case, in the 5 years of 1973-77, we brought a net inflow of capital of almost $675 million in cash into the United States. This represents on the average about 75 percent of our foreign earnings.

While I do not have the final 1978 figures yet, I am sure they will show our continuing policy of substantial repatriation of earnings.

The foreign tax credit mechanism is vital in avoiding confiscatory double taxation of these foreign earnings. Most all tax policy authorities including those at the Treasury, recognize the importance of the foreign tax credit structure. There does seem to be increased awareness now that the foreign tax credit does not in any way reduce U.S. income tax on income earned in the United States. It only serves to avoid double taxation of foreign source income.

Unfortunately that has not stopped attempts to erode the value of the foreign tax credit.

Treasury proposals with respect to the petroleum industry are technical and their interplay is difficult to trace. Their net effect would be substantial additional tax burden estimated at up to $800

million in 1980. They raise important questions of equity and despite the Treasury's disclaimer, carry serious ramifications for all U.S. companies with overseas operations.

As you know in 1975 the option to use the per country limitation in computing the credit on foreign oil income was repealed, putting all multinational oil companies on the overall limitation. In 1976 this treatment was extended to all multinational companies. It was said that the overall limitation was the only fair way to figure it.

Now the administration proposes to apply the lesser of the two in terms of tax savings. Throughout most of the past two decades it was deemed proper to use either of the two methods to achieve the best result to the taxpayer and now a precedent would be set for mandating the worse result.

The proposal for retroactive application of the recapture rule seems most inequitable and another unfortunate precedent.

Stepping back from the specific tax policy questions, we might ask what really would be accomplished by such changes and further splintering of the foreign tax credit at this time. Secretary Blumenthal has advanced the theory that the present system discriminates against domestic investment but the Treasury presents no evidence or analysis as to what the actual economic impact would be with the credit restrictions or considering the billions already invested abroad in expectation of reasonably stable tax treatment, how this investment could be rerouted for domestic purposes.

In our view restriction of the foreign tax credit in the manner proposed is ill conceived. It does not seem likely to have any positive effect on our energy supply situation and it could have serious adverse repercussions for our competitive position and entire investment stake abroad.

We strongly urge the committee not to adopt the proposals.

Thank you, Senator.

Senator TALMADGE. As you know, the foreign tax credit is a fertile field for demigods to play upon and they have from time to time for many years. They say foreign tax credit is a loophole. We know it is taxes imposed by the whole country which they have a perfect right to impose.

As you point out, if that income is taxed a second time by the United States of America, that would be double taxation.

Thank you very much for your contribution.

Any questions, Senator Dole?

Senator DOLE. I am not certain I understand everything that has been said here this morning. I know Wilbur Mills has a better understanding.

We are looking at the issue. It will be another matter we will be discussing among the Republicans tomorrow morning at our meeting. We appreciate the statements.

Senator TALMADGE. I see Mr. Scott held up his hand.

Mr. SCOTT. Senator, I think it might be interesting for you and your colleagues to allow me to elaborate on what Mr. Guy said.

Johnson & Johnson while it is not one of the giant companies, over the period 1960-74 has repatriated over a billion dollars in cash back into the United States from our overseas investment. In 1978, we repatriated 50 percent of the overseas earnings of our

affiliates in the form of dividends and 69 percent of the total earnings of our overseas affiliates in the form of dividends.

I think it is important to say that foreign investment makes a very significant contribution to the economy of this country.

Senator TALMADGE. Balance of payments and the stability of the dollar.

Mr. SCOTT. Employment also. The employment we have in the United States that is directly tied to foreign investment. Ours is significant as it is with Coca-Cola and many other companies.

Senator TALMADGE. Thank you very much, gentlemen.

[The prepared statement of the preceding panel follow:]

STATEMENT OF RAPHAEL SHERFY ON BEHALF OF THE U.S. COUNCIL OF THE INTERNATIONAL CHAMBER OF COMMERCE

Mr. Chairman and Members of the Committee, my name is Raphael Sherfy. I am a partner in the law firm of Miller & Chevalier and a vice chairman of the U.S. Council of the International Chamber of Commerce on Taxation. I appear before you today on behalf of the U.S. Council.

The U.S. Council membership is comprised of most of the major business firms in the United States engaged in foreign trade and foreign operations. It represents American business interests within the International Chamber, which in turn represents the international business community in approximately 60 countries.

The U.S Council has a broad spectrum of member companies. There are oil companies and non-oil companies—energy producers and energy consumers. Thus, the U.S. Council is as concerned as the American people and the Congress in finding the causes and possible remedies for our present oil shortages. We do not believe, and we know that this Committee does not, that a case has been made for using the tax laws, and particularly the foreign tax credit, to penalize the oil companies.

The U.S. Council believes that the foreign tax credit provisions as they pertain to the oil industry should be approached in the same spirit as those provisions would be approached with regard to any other industry—with the spirit of fairness and equity and with the goal of eliminating worldwide double taxation and loopholes allowing less than single taxation.

The foreign tax credit does not merely remove a serious impediment to foreign investment by domestic taxpayers. It permits U.S.-owned businesses to operate in overseas locations with tax costs that are neither discriminatory nor confiscatory. The foreign tax credit, properly applied, can achieve the goals of tax equity and neutrality.

We are pleased that Secretary Blumenthal expressed this view to the Committee when he testified last week. The Administration's proposal, as set forth in Secretary Blumenthal's testimony before this Committee on July 10th appears to be directed primarily toward solving two perceived problems. The first problem is the old issue of how to distinguish a creditable income tax from a royalty or excise tax. The second problem, according to the Administration, is how to prevent taxpayers from using losses in foreign countries to lower United States taxes.

The U.S. Council agrees that the tax-royalty issue is a problem that is worthy of being considered—even in light of the issuance on June 15, 1979, of the proposed Section 901 regulations. The Administration's approach to the second problem—the utilization of losses to lower U.S taxes—is directly contrary to the expressed goal of the President to encourage oil and gas exploration in other parts of the world. The U.S. Council cannot, therefore, support the proposal as it applies to the utilization of losses.

As to the tax-royalty problem, the Administration's legislative proposal, with a modification mentioned later, is a more effective, simpler mechanism for dealing with the problem than are the regulations proposed under section 901. That is, some of the countries in which oil is produced do impose very high rates of tax, sometimes far exceeding the 46 percent U.S. rate. Those countries are also in a position to impose a royalty on the production of oil. The issue whether the tax imposed is in reality a tax or a disguised royalty has been considered at various times for the last 25 years. There is no definitive answer, and the Treasury's proposed regulations give only more specific guidelines for dealing with the problem—they do not provide a solution.

Under the Administration's legislative proposal, a credit for taxes paid to a foreign country in connection with oil and gas extraction income will be limited to

46 percent—the U.S. rate. Any taxes paid to a country in excess of 46 percent would not be creditable. Taxpayers would not be permitted to average low rates of taxes on oil and gas extraction income in some foreign countries with the high rates imposed in other countries.

The U.S. Council would modify the Administration's proposal to determine creditable taxes on oil and gas extraction income on a per-country basis in one respect. If the general tax rate in country X—applicable to oil and non-oil companies alike—is 55 percent, or exceeds the U.S. rate of 46 percent, then 46 percent is not a fair limitation to be applied to oil and gas extraction income. If a U.S. manufacturing company operating in country X can qualify for a foreign tax credit (by means of the overall limitation) for taxes paid in excess of a 46 percent rate, the U.S. oil company under these circumstances should be treated no differently. A difference in treatment is a penalty against the oil company simply because it is an oil company.

The U.S. Council believes that if foreign taxes paid to a country with respect to oil and gas extraction income are subject to a limitation, as just suggested, of the greater of (1) 46 percent, or (2) the tax rate generally applicable in a country, then there is no need to delve into the intricate question of whether the tax does contain or does not contain elements of a royalty. The tax-royalty question can be simply answered by providing in effect that a charge made by a country that contains generally the elements of an income tax (except for the royalty issue) will be considered creditable up to a rate of 46 percent (or the applicable general rate, if greater) and non-creditable to the extent of the excess.

The proposed solution to the second problem perceived by the Administration—the utilization of losses on oil and gas extraction income to reduce United States tax—appears to run directly contrary to the Administration's energy policy of encouraging exploration and will tend to discourage oil and gas exploration in new areas of the world.

The proposal affects the utilization of losses in two ways. First, the Administration has proposed applying the lower of the per-country or overall limitations to determine the credit for taxes paid with respect to oil and gas extraction income. Losses on oil and gas extraction activities are to be taken into account in computing the overall limitation for this purpose. Second, the Administration has proposed to recapture the theoretical tax benefit that can be derived from matching losses from one country against income from another country where the tax rate in the income country is lower than the tax rate in the United States.

It must be pointed out that the proposals with respect to treatment of losses on oil and gas extraction activities are more harsh than are applied under similar circumstances in any other industry. The worldwide operations of an oil company differ from those of a manufacturing company to the extent that the oil company is subject to foreign tax in situations where it would be proper for the foreign country also to impose a royalty. Once that difference is dealt with, however, there should be no differences in the United States tax treatment of oil companies as opposed to companies in any other industry. Once the per-country limitation or "cap" is applied to oil and gas extraction taxes, the oil company should be subject to the same overall foreign tax credit limitation as in every other industry.

There are in fact good reasons at this time why oil companies should not be subject to harsh rules in connection with losses. Oil and gas exploration is enormously expensive and does generally produce heavy losses in the early years of new exploration in a field. With the situation in the OPEC countries and the worldwide shortage of oil and gas reserves, tax policy should not be changed in a direction that tends to discharge the willingness to explore for new oil reserves and diversify our sources of foreign oil.

Additionally, the Administration's proposal to recapture the tax benefit from losses creates a new, highly complex recapture system directed toward what appears to us to be a minor problem hardly subject to tax abuse. We do not believe that the tax benefit arising from losses is anything but an incidental benefit, nor do we believe that taxpayers attempt to manipulate their foreign income and losses so as to derive that benefit. This is an area where oil companies are being subjected to more severe treatment than are companies in other industries.

There can further be no doubt but that the loss recaputre proposal has retroactive effects, and should in no event apply to losses incurred prior to introduction of the proposed legislation.

The other features of the Administration's proposal can be supported, as they tend in the direction of treating oil companies similarly to taxpayers in other industries. The concept of foreign oil related income separate and apart from oil and gas extraction income has had limited usefulness and should be eliminated. The two percentage-point limitation on carrybacks and carryforwards of excess extraction

credits has not been of major significance in light of the high tax rates imposed in most oil producing countries.

In summary, the U.S. Council of the International Chamber of Commerce supports the concept that creditable foreign taxes paid with respect to oil and gas extraction income be viewed on a per-country basis. This support is, however, based on the correlative principle that elimination of the excess taxes on oil and gas extraction income makes it unnecessary to have a complex set of rules to distinguish between taxes and royalties or other charges. Additionally, oil companies should not be separated out for more stringent treatment—if the general income tax of a country is, say 60 percent, the limitation on creditable taxes paid with respect to oil and gas extraction income should be 60 percent. We do oppose the administration's proposals with regard to the utilization of foreign losses to reduce United States taxes.

STATEMENT OF THE FINANCIAL EXECUTIVES INSTITUTE

My name is Robert T. Scott and I am Vice President, Taxation, Johnson & Johnson. I appear today as chairman of the Subcommittee on International Taxation of the Tax Committee of the Financial Executives Institute ("F.E.I."). F.E.I. is the professional association of more than 10,000 senior financial and administrative officials in approximately 6,000 business organizations. These organizations represent a broad cross section of American national and international industry.

We appreciate the opportunity to summarize our views on the foreign tax credit proposal currently before the Committee.

We believe that the changes proposed by the Treasury for further limiting the recognition of foreign income taxes paid on foreign source income represents a move in the wrong direction that may adversely affect the economic well-being of the nation and establish an unsound precedent that could subsequently be applied to American industry generally.

It is unfortunate that this hearing arises in such an emotionally charged atmosphere as exists in the United States today. It may be difficult for the Committee and Congress to act with the same reasonable degree of care that Congress has exercised in the past in dealing with fundamental tax principles and that is certainly now warranted.

Moreover, it appears that legislative consideration of the credit at this time may be premature. The Treasury has just released rather extensive and comprehensive proposed changes in the manner in which it intends to view foreign taxes for tax credit purposes in the future. The fact that the Treasury has set September 30 as the date for receiving comments from the public on the proposed changes demonstrates a need for time to carefully consider changes in this area.

Surely, if administrative changes in the interpretation of existing law require extensive consideration, fundamental changes in the law itself are even more deserving of care and such should not be restricted to such a short time frame as currently scheduled by the Committee. Further legislation, if any is required, might better follow, rather than precede, the discussion of interpretation problems.

Present tax principles regarding foreign source income

The present U.S. system of taxation of multinational businesses has as its basic principles:

Equal taxation of U.S. taxpayers having the same amount of income regardless of its origin.

Tax neutrality as to making decisions whether to invest at home or abroad.

Under present law, the United States taxes the worldwide income of U.S. corporations and allows a credit for foreign income taxes paid against the corporation's U.S. income tax for foreign income taxes paid by it or paid by foreign subsidiaries on income repatriated in the form of dividends. This credit system is based on the principle that the country in which business activity is conducted has the primary right to tax the income from that activity and the home country has a residual right to tax such income, but only so long as double taxation does not result.

An alarming misunderstanding exists today with respect to the application of these longstanding principles. These credit provisions are erroneously described, not as a means for achieving tax neutrality but, as tax incentives or loopholes. Reacting to this misunderstanding would have severe adverse consequences for the United States economy.

Maintain the foreign tax credit

F.E.I. believes that the foreign tax credit should be maintained in its present form to mitigate the inequities of double taxation and to permit U.S. business to compete on an equal footing in foreign markets. Most other industrial nations, including the United Kingdom, Germany, Canada and Japan, also use the credit system to avoid double taxation of income. Other countries, such as France and The Netherlands, avoid double taxation by exempting from home country tax all income from foreign operations. Both systems follow the general principle of tax neutrality. No major industrial country tax system provides for double taxation.

The United States eliminates double taxation by providing for a credit of foreign tax against the U.S. tax on foreign source income. However, contrary to the misconception of some, foreign taxes cannot be credited against U.S. tax on income earned in the United States. Under the United States system, the overall tax burden on income received from foreign sources is the higher of the combined foreign income and foreign withholding tax rates or the U.S. rate applied to such income.

Treasury proposal

The treasury has proposed among other things to allow taxes on foreign oil and gas extraction income to be credited only against such income and to limit the computation of the foreign tax credit on foreign oil and gas extraction income to the lesser of:

The credit computed with respect to overall foreign oil and gas extraction income (net of losses) or,

The credit computed with respect to such income calculated on a country by country basis.

To apply the foreign tax credit limitation separately to specific types of income or to apply it on a per country basis would represent undesirable, regressive steps from the tax neutrality created under the overall limitation. These two changes would reverse action proposed by Treasury and taken by Congress in 1976 requiring all taxpayers to compute the foreign tax credit limitation on an overall basis. That action was in recognition of the fact that overseas business, including the securing and processing of raw materials and the transporting and marketing of the end product may involve several countries and should be accounted for on a unitary basis for United States foreign tax credit purposes.

Overall limitation

The use of the overall limitation, as presently constituted, makes sense from a United States tax policy standpoint and cannot be considered to provide a tax "loophole".

If several countries impose tax on income derived from international operations and the combined rate exceeds the 46% U.S. statutory rate, we see no loophole in the fact that one of the countries involved taxes its portion of such income at a rate less than 46%. So long as the combined rate equals or exceeds 46%, which it must, there is nothing that can reasonably be regarded as tax avoidance. The long standing U.S. tax policy of insuring that foreign income bears tax equivalent to the U.S. rate is not frustrated.

Conclusion

Applying a "per country" limitation on the foreign tax credit selectively against certain industries or certain types of income does not, in our view, represent sound tax policy. Applying a "lesser of per country or overall" limitation appears to be even more unsound, creating a situation where the taxpayer is always penalized. If applied generally to all American business, the effect of the Treasury proposals would be to create double taxation by reducing the effectiveness of the foreign tax credit. This would increase the cost of doing business abroad thereby making United States corporations less able to compete against foreign owned companies in world markets. This would adversely affect the United States balance of payments inflows from foreign investment and therefore the United States economy in general and the United States employment connected with foreign investment in particular.

Accordingly, F.E.I. respectfully urges this Committee to reject the Treasury's foreign tax credit proposals.

STATEMENT OF ROBERT D. GUY, ON BEHALF OF THE TAX COUNCIL

I am Robert Guy, assistant treasurer and director of taxes of the Coca-Cola Co. of Atlanta, Ga. I appreciate this opportunity to present a brief statement on behalf of The Tax Council.

The Tax Council is a business supported organization concerned with broad aspects of federal tax policy as it affects the capital formation process and the market system. It is a relatively small organization in total numbers but broad based in terms of industry representation. The Coca-Cola Company is a member of The Tax Council and I serve on its Board of Directors.

We think the issues under consideration at these hearings are very important, not just for the petroleum industry, but to all business and especially all business with a substantial stake in international markets. Coca-Cola operates in 135 countries and thus, obviously, we have a great interest in any international tax policy matters.

The objectives of The Tax Council in this respect are two-fold: (1) an energy policy that encourages a more dependable supply for the domestic economy; and (2) a tax policy that does not encumber the private sector's ability to provide energy or discriminate against international operations.

We have serious reservations that the "windfall" profits tax bill passed by the House (HR 3919) serves either of these objectives. But we are certain that changes proposed in the foreign tax credit do not serve these objectives and should be discarded.

Windfall profits tax

In April the Carter Administration announced a program of phased decontrol of crude oil prices as the primary means of dealing with recurrent crude oil shortages. The case for decontrol is very compelling. Most now agree that the entangled price control mechanism, in place for the bulk of domestic production since 1971, has been completely counterproductive—overstimulating oil consumption while discouraging domestic production. Nobody knows how much additional production would result from the restoration of full market pricing, but even a relatively small addition to marginal supplies from the U.S. or non-OPEC foreign sources could make a significant positive contribution to the overall energy supply situation. Equally important, market pricing will encourage sound conservation measures and increase the attractiveness of investment in alternative energy resources. In combination, these developments will do much to blunt the effectiveness of the OPEC cartel.

So we certainly would hope that the decontrol process will go forward and that, despite continuing doubts of some, Congress will not place any obstacles in its path.

The political price of decontrol is a "windfall" profits tax on part of the additional revenues generated. There is, of course, an element of "windfall" in the form of high inventory profits on older oil resources even with phased decontrol. Windfalls attend many changes in public policy from the lowliest local zoning revision to massive increases in property values derived from interstate highway and other large scale construction projects. But generally such windfalls have not resulted in the imposition of new taxes, none at the federal level anyway, and we find the basic rationale for a windfall profits tax on oil awkward at best—particularly since the real source of any windfall was the government-mandated artificial ceiling on prices in the first place.

Since Congress appears determined to enact some form of windfall profits tax, there seems little point in extended discussion of its propriety. Still, in the interest of helping secure more adequate supplies for industry and the economy and without getting into technical detail, we offer the following specific observations on the measure as it was adopted by the House:

1. The House bill imposes a 60 percent tax on marginal revenues from oil production with the impact varying according to source and existing price control level for different classifications of oil. The revenue potential for such a tax is enormous. Even if the OPEC cartel adopts a more conservative pricing policy in the future, it could reach $50 billion or more over the next five years. There is disagreement as to what specific proportion of additional revenues the petroleum companies will be allowed to retain under decontrol and after imposition of the tax, but it is quite obvious that such stiff marginal excise tax significantly reduces the industry's cash flow available for additional domestic and international investment.

You are familiar with several studies indicating the huge capital requirements of the petroleum industry merely to maintain present reserves let alone expand new supplies. While many industrial sectors have made important strides in fuel conservation, we simply cannot run the economy for now and the foreseeable future without adequate petroleum supplies. Over the years the U.S. petroleum companies have done a good job in providing these supplies. It just doesn't make sense to impose a very restrictive tax burden hurting the industry's ability to invest and produce because it has a bad press.

2. A windfall profits tax situation is by definition short term. As price-jumped inventories are worked down during the decontrol period and as the costs for new

exploration and development undoubtedly will keep rising quickly both here and abroad, any windfall profits will diminish and eventually wash out. This is recognized to some extent in the House bill which phases out the tax on the "tier" classifications of domestic production. But the so-called "OPEC" tax—the excise on marginal revenues above an arbitrary $16 per barrel—goes on indefinitely. Except in the unlikely event that the OPEC countries actually reduce their prices relative to general inflation, the U.S. producers would be denied the results of full market pricing on a permanent basis.

3. The House bill does not make any provision for the disposition of the huge revenues to be generated. The Administration has proposed an Energy Security Fund to finance research and development of energy resource alternatives, mass transit subsidies, and a limited income maintenance program for the poor. If there is to be a windfall profits tax on production, we would agree that a significant part of the proceeds would go into research and development and demonstration projects for alternative energy sources. These could be critical for long term energy supplies free of the OPEC shadow. But we are skeptical about creating another trust fund with dedicated revenues. Such a device almost certainly guarantees the permanence of the tax levy and at the same time weakens the incentive for imposing rigorous cost-benefit analysis on the disposition of public subsidies. Admittedly, the regular budget process may not have done much better in the past. But we are very leery of the spectre of billions of dollars piling up in another trust fund with attendant pressures to dispose of the funds in politically attractive but not necessarily economically sound ventures. At the very least, we urge the Senate to look at the implications very carefully before committing itself to a trust fund concept.

The foreign tax credit

I will devote the remainder of this statement to proposals to change the foreign tax credit as applied to the petroleum industry.

Assistant Secretary of the Treasury for Tax Policy, Donald Lubick, stated recently that the Administration proposals were conceived to apply only to the petroleum industry and they did not represent "an assault on the foreign tax credit generally." I am sure the Secretary is sincere in this statement but it does not relieve our grave concern over the implications of the proposals for all business engaged in international operations.

The record indicates that restrictive provisions aimed originally at the petroleum industry have been extended across the board—specifically in 1975–76. In important respects, the tax proposals are an open invitation for Congress to jump back into controversial areas of foreign source income taxation that we thought were settled, at least for some time, by the major tax legislation last year. Furthermore, we do not agree with the justification for the Administration's proposals even applied narrowly to the petroleum industry. They appear to be punitive and unrelated to performance in providing the U.S. economy with additional energy.

This is not the occasion for a long discourse on our international investment position or its tax treatment. I believe this Committee and Congress have been made fully aware of the benefits to the U.S. domestic economy from our international stake abroad. Through the 1970's, a number of authoritative studies were conducted demonstrating the positive relationship between foreign source income, exports, and domestic production and employment.

I will not attempt to restate the results of these studies now but I would like to emphasize once again the most critical factor of all—the important contribution of foreign earnings to capital supplies for the domestic economy. The flow of repatriated earnings from direct investment abroad has consistently outpaced the transfer of investment funds overseas. In the last four years, the surplus of repatriated earnings over outflow of funds cumulated to over $25 billion. This has been a crucial plus factor in our otherwise disappointing balance of payments position; and, just as important, a crucial source of domestic capital investment. Not so incidentally a number of major petroleum companies would not be able to maintain their U.S. exploration and development programs without the contribution of earnings from overseas production.

The foreign tax credit mechanism is vital in avoiding confiscatory double taxation of these foreign earnings. Most all tax policy authorities, including those at the Treasury, recognize the importance of the foreign tax credit structure. There does seem to be increased awareness now, too, that the foreign tax credit does not in any way reduce U.S. income tax on income earned in the U.S. It only serves to avoid double taxation of foreign source income.

But that unfortunately has not stopped attempts to erode the value of the foreign tax credit. In the current situation, with regard to the petroleum industry, the Treasury has proposed: (1) not allowing foreign tax credit from extraction income to

apply to allegedly lower taxed foreign shipping and refining income—thereby further splintering the availability of the credit for different classes of income; (2) recapture of the effect of taking an extraction loss in any country upon realization of future income; and (3) limiting the foreign tax credit to the lesser of the per country or overall limitation. These changes generally would be effective for 1979 and afterwards but would apply retroactively with respect to recapture.

These are technical concepts and their interplay is difficult to trace. Also, there is some disagreement as to the facts of the situation—as to how the credit is now used. But the net effect of the proposals would be substantial additional tax at up to $800 million in 1980.

The Administration's justification for their proposals is that the present system, despite tightening in 1975 and 1976, still constitutes an incentive for foreign investment relative to domestic. It also assumes that to a significant extent the foreign extraction income taxes against which credits are taken are not really creditable taxes but royalties entitled only to a deduction. This has been argued for decades without resolution. The regulatory treatment, however, has gradually tightened culminating in new proposed reuglations laying out more specific guidelines on what qualifies as a creditable tax. Despite the thrust of the new regulations, Treasury says it needs more legislative muscle as well.

The proposals raise important questions of economic effect in dealing with the energy shortage, of equity and competitive position, and carry serious ramifications for all multinational business abroad.

1. According to the Joint Committee on Taxation the existing loss rule on extraction income, which the Treasury attacks as a "loophole" in present treatment, is designed to encourage exploration and development in countries where the companies "do not presently have significant production," i.e., the non-OPEC countries. Without the extraction loss rule, heavy expenses in developing non-OPEC oil reserves would reduce the companies' net extraction income and reduce the allowable foreign tax credit. This could discourage further investment in these areas. While domestic sources of new oil certainly would be preferable to foreign sources, non-OPEC foreign sources certainly would seem preferable to OPEC areas. In fact, it has been argued forcefully by some that any increase supply anywhere in the non-OPEC world will effectively diminish OPEC influence.

2. The proposed restrictions on U.S. based petroleum companies would not apply to foreign petroleum companies which could obtain a significant competitive advantage in serving other industrial countries and U.S. markets. Again, as distasteful as our large bill for imported oil is, we have to rely on it in part for the foreseeable future. Our dealings with foreign sources of oil and foreign-based national oil companies, such as in Mexico and elsewhere, should be better served through American-based enterprise regardless of its public image in times of energy shortage.

3. The Administration claims its proposals conform to, and strengthen, Congressional intent in the 1975–76 legislation. Certainly they would make the treatment "tougher" if that were the only intent. But the new proposals hardly follow a consistent path. In 1975, the option to use the per country limitation in computing the credit on foreign oil income was repealed putting all the multinational oil companies on the overall limitation. In 1976, this treatment was extended to all multinational companies. It was said that the overall limitation is the only fair way to figure it. Now that the Administration proposes to apply the lesser of the two in terms of tax savings, whipsawing the taxpayer whatever his loss or net income abroad. Whereas through most of the postwar period it was deemed proper to use either of the two methods to achieve the best result for the taxpayer, now precedent would be set for mandating the worst result. The proposal for retroactive application of the recapture rule seems most inequitable, too, and another unfortunate precedent.

Stepping back from the specific tax policy questions, we might ask what really would be accomplished by such changes in the foreign tax credit at this time. The administration says that the present system discriminates against domestic investment. But it presents no evidence or analysis as to what the actual economic impact would be with the credit restrictions or, considering the billions already invested abroad in expectation of reasonably stable tax treatment, how this investment could be rerouted for domestic purposes.

In our view, restriction of the foreign tax credit in the manner proposed by the Administration is ill-conceived. It doesn't seem likely to have any positive effect on our energy supply situation and it could have serious adverse repercussions for our competitive position and entire investment stake abroad. We strongly urge this Committee not to adopt the proposals.

Senator TALMADGE. Next and our final witness today is Mr. John J. Schmidt, president, Santa Fe Industries, accompanied by James L. Burkhart, president, Santa Fe Natural Resources.

Mr. Schmidt, you may insert your statement in the record and summarize it, please. Before you get started, I may have to leave. I am late for a luncheon engagement.

I have seen a portion of your statement. Would you please tell me exactly what heavy oil is?

Mr. SCHMIDT. Heavy oil in our experience is oil which has a gravity point of 16° API or lower. I say based on our experience, which is extensive, going back to 1907. It takes heat to get it out of the ground, at least in the State of California, and it takes considerable application of heat, effort, and money to get it out of the ground.

Senator TALMADGE. That is oil which is in the ground?

Mr. SCHMIDT. Yes. It is a viscous tar-like, molasses-like substance.

Senator TALMADGE. It requires a special effort to get it out of the ground?

Mr. SCHMIDT. That is correct.

Senator TALMADGE. Thank you. I notice the distinguished former chairman of the Ways and Means Committee accompanying you. I think you probably have the most expert legal counsel in the United States. I have often stated that Wilbur Mills is the most able man I have ever seen in Government, Federal, State, or local.

Mr. SCHMIDT. Bob Casey who is accompanying me says if Wilbur does not know it, he does.

Senator TALMADGE. You may proceed, sir.

STATEMENT OF JOHN J. SCHMIDT, PRESIDENT, SANTA FE INDUSTRIES

Mr. SCHMIDT. I would like to start by emphasizing our long-term and total commitment to the domestic energy field. I emphasize domestic. Please be advised that.

One, we have been producing crude oil continuously since 1907;

Two, since 1973, 1974–78, despite a 5-year cumulative net income of $192 million in Santa Fe Natural Resources, capital expenditures for exploration and production development totaled $268 million. The difference came from cash flow items such as depreciation and not from drilling funds;

Three, approximately $100 million are allocated for 1979 for these purposes;

Four, for the 1980–83 period, we were considering spending up to $500 million for these purposes; and

Five, we expect to increase this budget in response to the President's renewed call for energy self-sufficiency if market forces permit.

Senator DOLE. Excuse me. As I understand from the material we received after the speech, he recommends an exemption from the windfall profit tax. Is that accurate?

Mr. SCHMIDT. The President did not state what he meant by heavy crude oil.

Senator DOLE. He talked about heavy oil but no definition. You want to be certain you are within the definition?

Mr. SCHMIDT. Yes.

I would like to emphasize that Santa Fe opposes the windfall profit tax which in reality of course is an excise tax. This tax is unjustified given the Nation's need for increased oil production and its escalating cost. The tax aggravates 6 years of chaotic and wasteful regulation of this industry, regulation which resulted in unrealistically low domestic oil prices, thus depressing domestic production, while encouraging domestic consumption and subsidizing foreign crude oil importation through the entitlements program.

Knowing that Congress may feel compelled to enact an excise tax, I suggest four provisions which will promote its announced objective, energy self-sufficiency.

First, Santa Fe endorses President Carter's request for an exemption for heavy crude oil. Second, Santa Fe advocates a dollar-for-dollar energy production credit against the excise tax liability for qualified investment in domestic energy projects.

Third, we urge that qualified investment include investment in domestic exploration and enhanced recovery operations. Fourth, all oil made recoverable through enhanced recovery projects should qualify for the lower tax burden the House bill places on newly discovered oil.

Heavy crude oil represents a significant oil resource which has not been fully developed in the past. It is viscous like heavy molasses or tarlike and is difficult to produce because it flows slowly, if at all, through its host reservoir.

Significant production of this oil in California depends on the application of thermal recovery techniques which involve substantial investment in steam generators, steam delivery systems, increased well density and oil preparation facilities.

A thermal recovery project is costly to operate because we must burn part of our production to keep the reservoir hot and the oil flowing. Santa Fe produces 21,000 barrels per day of heavy crude oil in California. More could be brought to market from presently producing and undeveloped properties in California through additional enhanced recovery projects.

Present regulation and the proposed excise tax, however, render investment in many of these projects economically unjustified. The key to full production of such oil is total decontrol of price and an exemption from the tax.

Although President Carter did not define heavy crude oil, based on our experience in California, oil having a gravity of 16° API or less requires substantial heat, effort, and expense to produce. The exemption therefore should cover such oil in order to promote its optimum development.

If America is to realize the full benefit of its own reserves, this tax cannot be allowed to create a massive disincentive to high risk exploration and costly enhanced recovery operations. Enhanced recovery operations are necessary to recover more than the 20 to 30 percent of oil in place which generally flows into a well under natural forces. Therefore, Santa Fe urges the Congress to provide for a credit against the excise tax for investments made in such projects. The credit should be available to a producer on a commitment basis; the producer should be able to declare its intention to expend the funds and defer payment of the tax for a realistic

period during which the producer would carry out the commitment. At the end of this period, which should be no shorter than 3 years, the producer should remit any deficiency in tax payment to the United States. The essence of the credit should be its simplicity; it would be available for all types of exploration and enhanced recovery techniques including tried and true technology not just for exotic or experimental techniques. Right now America needs to encourage proven techniques which can bring known deposits of crude oil to market rapidly.

Qualified investment should also be defined to encourage investment in all domestic energy projects. For example, if feasible, Santa Fe would like to invest in a coal-fired steam project for the Midway-Sunset Field in California in which coal would replace crude oil as the fuel for the steam generators. We estimate that millions of barrels a year of crude oil could be saved by this project. We feel this kind of project should qualify for the energy production credit because it would replace scarce domestic crude oil with abundant coal.

Parenthetically, we burn 3,000 barrels a day of crude to produce our crude now. I understand that Getty burns 30,000 barrels a day. The figures for Santa Fe and I am sure for Getty are projected upward to increase production. This is the type of thing we are talking about.

I thank you for this opportunity. Mr. Burkhart and I will be glad to answer any questions you have about our proposals or the operations of Santa Fe and to work with you or your staff in supplying any additional information. Thank you.

The CHAIRMAN. If we should decide to exempt tertiary recovery and define tertiary in a way that it included most of these enhanced recovery methods, would that take care of your problem?

Mr. SCHMIDT. I think it would except I have not seen a definition of tertiary that includes waterflood but this would take care of our California problem and the heavy crude oil problem with one exception. We use thermal techniques. I think we have one waterflood recovery project.

The CHAIRMAN. Waterflooding is regarded as secondary recovery, is it not?

Mr. SCHMIDT. That is correct.

The CHAIRMAN. Thank you. Senator Dole?

Senator DOLE. As I pointed out earlier, under the President's statement, he refers to heavy oil without definition. Maybe there could be a suggestion by the chairman to broaden the definition of tertiary and waterflooding.

Mr. SCHMIDT. I believe the less definitions we have, Senator, the better off we will be.

Senator DOLE. We have new oil, heavy oil, old oil, new, new oil.

Mr. SCHMIDT. Being armed with counsel here reflects the complexity of all this law. I am a little frightened of it myself as it stands. If it gets any more complex we may have more lawyers than witnesses.

Senator DOLE. Where is the principal base of Santa Fe Industries?

Mr. SCHMIDT. Santa Fe Industries is based in Chicago. The corporate headquarters are located in Chicago. We are the owners of the

Santa Fe Railway as you probably know and several other companies. Our operating oil companies are headquartered in Amarillo and in Santa Fe Springs, Calif. Mr. Burkhart who heads the whole operation is in Chicago.

Senator DOLE. How good is heavy oil for industrial use?

Mr. SCHMIDT. It is very good. It is very high in Btu. It is somewhat difficult to refine because it has to be coked generally. There are many refineries in California set up specifically for it. We have increased heavy oil production. We would have to have more sophisticated refining capacity added onto in the State of California.

The good thing about producing heavy oil is the process comes on rather slowly. There is a lot of drilling and a lot of presteaming and pilot work as they call it. The leadtime for getting refinery capacity would be there. When you have good secondary recovery projects in California, they go on for years. The Midway-Sunset Field I believe has been producing for us for 70 years and we are projecting 40 to 50 years more.

Senator DOLE. Are you in the synfuel business?

Mr. SCHMIDT. We are not in the synfuel business. I echo the sentiments of many of the witnesses I have heard here this morning and the Senators' comments. We do not think the manufacturer of any fuel should be subsidized when we have a better alternative available and at hand.

I have no objection to a reasonable sum being put aside for research or for programs to get ready for the long distance future as we have in space and many other things but I do not believe in direct subsidy of a manufacture of a form of fuel which would cost the American taxpayers many dollars.

Senator DOLE. Wilbur, is everything they said accurate?

Mr. MILLS. Yes, sir.

The CHAIRMAN. I am glad to see my dear friend, Wilbur Mills, back in the committee room. It seems like old times sitting across the table from Wilbur. I am pleased to see you also, Mr. Casey. We appreciate your presentation. Thank you.

Mr. SCHMIDT. I appreciate the opportunity to express our views and we thank you.

[The prepared statement of Mr. Schmidt follows:]

STATEMENT OF JOHN J. SCHMIDT, PRESIDENT, SANTA FE INDUSTRIES, INC.

SUMMARY OF PRINCIPAL POINTS OF TESTIMONY

Development of domestic energy resources is the only way to overcome the problems of dependence on foreign crude oil.

A crude oil excise tax will burden development of vital domestic crude oil resources.

Heavy crude oil, defined as crude oil with a gravity of 16° API or less, should be exempt from the crude oil excise tax.

An energy production credit for qualified investments in domestic energy projects should be available.

Qualified investment should include all expenditures on enhanced recovery projects for domestic crude oil.

Additional reserves created by enhanced recovery should be treated as newly discovered crude oil.

Conservation of energy and the development of alternative energy sources should be promoted by free market forces, not a crude oil excise tax.

Mr. Chairman and Members of the Committee, My name is John J. Schmidt, I am President of Santa Fe Industries, Inc. ("Santa Fe"). Santa Fe is a diversified transportation and natural resources company. Through a subsidiary, Santa Fe Natural

Resources, Inc., we engage in domestic oil and gas exploration and production. We are classified in the petroleum industry as an independent domestic producer and with an average daily production in 1930 of 44,700 barrels, we are representative of medium-sized companies in the petroleum industry. I am accompanied today by Mr. James L. Burkhart, President of Santa Fe Natural Resources, who will be able to answer your questions about that company's operations.

I am here to speak in opposition to the Windfall Profits Tax which passed the House and to urge the inclusion of the following provisions in any crude oil excise tax legislation in the event Congress chooses to enact this measure:

(1) An exemption from the application of the crude oil excise tax of all heavy domestic crude oil with a gravity of 16° API or less;

(2) An energy production credit for qualified investment in domestic energy;

(3) A definition of qualified investment for the purposes of the energy production credit which includes all enhanced recovery projects and all other expenditures which make domestic energy available for use; and Myers No. 67336 Date 8/23/79 J. 49-945 F. 1710-1717 a945c.041

(4) A definition of newly discovered crude oil which encompasses crude oil made recoverable through investment in enhanced recovery projects.

We agree with President Carter that the level of this country's current reliance on foreign energy sources must be drastically reduced. There can be no doubt that the existing price levels and shortages of petroleum products in the United States and the inflation which they feed are exacerbated by our dependence on foreign sources of oil beyond the control of this nation.

After all is said and done, the only way that this country can reduce its dependence on foreign oil is to produce domestically enough oil and gas and other energy to meet its needs. Therefore, increased domestic production of oil and gas and other forms of energy must be encouraged and efforts must be made to conserve on energy usage.

We oppose the crude oil excise tax because like the Department of Energy's regulation of the price and allocation of crude oil, it does exactly the wrong thing—it places a burden on domestic production. Instead of encouraging increased production, it takes away the money needed for investment in producing properties in the United States. Moreover, in our view, this tax is an unjustified attempt to blame and punish domestic oil producers for the surge in the price of gasoline, the lines at the gas stations, and inflation. The problem, however, is excessive reliance on foreign crude oil and as a domestic producer, Santa Fe believes that it is properly part of the solution, not the problem. Given the nation's need to provide every possible incentive to domestic producers to expand the production of domestic energy, the imposition of this punitive tax is unjustified and illogical.

The crude oil excise tax threatens to weaken the domestic crude oil industry by siphoning off revenues from properties which are approaching the economic break-even point and thereby forcing the premature abandonment of these properties and their included reserves. The proposed tax continues the regulatory bias of the past six years against development of known crude oil deposits and will divert domestic investment into riskier exploration efforts. It also creates a disincentive for any type future investment in domestic crude oil production because many investors in the petroleum industry may choose foreign opportunities which are not subject to the crude oil excise tax rather than domestic opportunities which are. With the domestic crude oil industry in critical need of capital a disincentive for investment in domestic production would be extremely counterproductive.

This tax will amount to another burden on the domestic oil and gas industry which has already been weakened by six years of stifling, inefficient regulation. As the chairman of this Committee stated on June 29, 1979, at the inception of crude oil price and allocation regulations, 75% of the oil consumed in the United States was produced domestically. Since the imposition of regulation, domestic crude oil production has dropped to 50% of our needs. Sante Fe has suffered a restriction of operational flexibility as well as reduced revenues under these regulations and as a result has been forced to forgo (1) investment in domestic refinery capacity which we actively sought, (2) investment in enhanced recovery projects which would have turned known crude oil deposits into recoverable reserves, and (3) investment in domestic exploratory programs.

Although Santa Fe is opposed to all controls on domestic production whether in the form of price and allocation regulations or a tax, we urge that heavy crude oil with a gravity of 16° (API) or less be exempt from any crude oil excise tax. Earlier this week President Carter announced that he is directing the Department of Energy to decontrol heavy crude oil immediately and recommending that heavy crude oil be exempt from the crude oil excise tax. As a major independent producer

of heavy crude oil in California, where many of the country's heavy crude oil reserves are located, Santa Fe fully agrees with the President that the incentives of price decontrol and exemption from the crude oil excise tax are needed to stimulate full development of these heavy crude oil reserves.

Sante Fe's heavy crude oil reserves are highly viscous, almost tar-like crude oils which must be heated in the ground to temperatures in the range of 250° Fahrenheit in order to cause them to move to the wellbore to be pumped out. The primary thermal recovery method in California is steaming either cyclic or continuous drive which requires steam generators, steam injection equipment, wells drilled on close spacing, fuel, and labor. The life of a thermal recovery project for heavy crude oil is characterized by substantial initial investment, progressive decline in production, and progressive increase in operating costs as more and more fuel and labor are required to produce a barrel of oil.

Because the price received for heavy California crude oil has been controlled, the economic justification has not existed for investment in the equipment and facilities necessary to develop and produce fully the potential of heavy crude oil properties. As a case in point, we believe that the Midway-Sunset Field contains significant heavy crude oil resources in the range of a billion barrels. An exemption from the crude oil excise tax and price decontrol are necessary incentives to enhance the economic feasibility of fully producing this heavy crude oil.

Incentives to produce heavy oil are needed for heavy oil properties already being produced as well as for those properties where production has yet to begin. At Santa Fe's properties in the Midway-Sunset Field for example, when cyclic steaming operations no longer can recover economic quantities of crude oil, a shift to steam drive operations would require capital outlays on the order of $50 million and substantially increased operating costs for fuel and project monitoring.

We agree with those who advocate defining heavy crude oil to mean crude oil with a gravity of 16° (API) or less. This definition will assure that the incentive of the tax exemption is available to those properties requiring thermal recovery applications. To fix the definition at any lower gravity would restrict the availability of the incentive provided by the exemption, which is counter to the goal of encouragement of as most domestic production as possible. A significant increase in heavy crude oil production will only be assured if the incentive provided by the exemption is made available to all properties which require thermal recovery techniques.

In addition to our suggestion of an exemption for heavy crude oil, we urge Congress to include in any crude oil tax legislation an energy production credit for qualified investments in domestic energy and a definition of newly discovered crude oil which encompasses crude oil made recoverable through investment in enhanced recovery projects. The energy production credit would represent a dollar-for-dollar credit against the crude oil excise tax for commitment to expend such funds for qualified investment in domestic energy projects. The energy productions credit would channel the investment of available cash into the development of domestic energy resources. In effect, any amount set aside and committed to investment in qualified energy products would reduce the crude oil excise tax otherwise payable to the government. The amount so earmarked would have to be expended within a reasonable period of time but that period should not be less than three years. If the amount of the credit was not properly expended within the required period, the deficiency would be repayable to the government.

Since the crude oil price rise in 1973, Santa Fe Natural Resources' net income has amounted to $191.8 million while for the same five year period (1974-1978) capital expenditures for exploration and production development have totaled $267.6 million. As you can see, we have expended $75.8 million more this period than reported net income. This difference was made up from cash flow items such as depreciation, deferred income tax, and some borrowings. Moreover, we are planning to increase our capital expenditures in exploration and production development. For 1979, approximately $100 million are allocated for exploration and production development; and for the four year period 1980 to 1983, as much as $500 million have been considered for exploration and production development before President Carter announced his program of decontrol of domestic crude oil prices. We expect to increase this budget in response to the President's program.

However, Santa Fe's investment in exploratory and enhanced recovery projects is principally dependent upon internally generated cash flow. Thus, imposition of a crude oil excise tax without provision for an energy production credit will reduce the amount that can be added to our exploratory and enhanced recovery budget. It is a fact of life that Santa Fe, like any other company, budgets for such projects those funds remaining after provision for fixed and variable costs, including taxes, are provided for. Thus, a crude oil excise tax with no energy production credit will

result in a reduction in funds available for investment in exploration and enhanced recovery projects. Applying the tax as passed by the House, Santa Fe estimates that for the four years of 1980 through 1983 it would pay a crude oil excise tax of at least $70 million. We urge this Committee to provide an energy production credit which would permit us to earmark these funds for investment in areas designated as qualified investments. Santa Fe has several projects to increase domestic production on which it could beneficially use an energy production credit. If the Committee feels some limitation on the amount of energy production credit than can be taken in any one year is necessary or desirable, we would not oppose a reasonable upper limit on the amount such as $100 million in any taxable year.

In the interest of maximizing the incentive for the recovery of the United States crude oil resources this Committee should provide that all investment in enhanced recovery projects will be qualified investment for earning the energy production credit. The best available knowledge about the domestic situation in crude oil reserves indicates that the likelihood of locating many new major fields in the United States is relatively low. The greater hope for American crude oil production is intensive development of known crude oil accumulations because a very large percentage of crude oil, perhaps as much as 80 percent, will remain in the ground after the dissipation of the natural energy which would force it to the wellbore. The secret of bringing forth this crude oil which would otherwise remain in the ground is the application of enhanced recovery techniques.

Santa Fe claims expertise in the field of enhanced recovery, and ample evidence supports this claim. Currently we produce over 80 percent of our crude oil by the application of enhanced recovery techniques. For example, in May of 1979, 21,000 barrels per day came from the Midway-Sunset Field in California which has been in production for over 70 years but which has the potential for yielding another billion barrels if proper enhanced recovery operations are undertaken. In 1977 Santa Fe acquired the oil and gas properties of Westates Petroleum Company for approximately $70 million for the express purpose of putting our expertise with enhanced recovery techniques to work in the development of these domestic resources. To date we have spent over $12 million more on these properties and raised their output by 500 barrels per day or 20 percent. Overall, for the 10 year period 1969 through 1978, Santa Fe has produced and added to proved reserves 250 million barrels of crude oil, over 80 percent of which would not have been made available without enhanced recovery techniques.

Enhanced recovery projects require substantial expenditures at the outset and throughout their lives. Initially, in addition to traditional field development costs, investment must be made in injection wells, steam drive or other equipment and facilities and technology. As the property becomes further depleted additional investment is needed and operating costs per unit of production increase. The analogy of wringing oil out of the ground is very apt with regard to enhanced recovery; the producer must expend tremendous amounts of his efforts and his money to get out the last increments of production from a known crude oil accumulation. The crude oil excise tax proposal will have the unavoidable effect of reducing the number of enhanced recovery projects Santa Fe may undertake or maintain because it will tax away revenues which Santa Fe critically needs for enhanced recovery projects. Right now, Santa Fe is contemplating numerous enhanced recovery projects in the State of California which have the potential for bringing on production reserves of several million barrels of crude oil. In particular, we have recently obtained a permit which will allow us to proceed with a proposed project to develop a deposit of ultra-heavy crude oil near Oxnard, California, which could yield about 20 million barrels. If Santa Fe runs out of internally generated funds for these projects, and internally generated funds are Santa Fe's only source of funds for these projects, then many of them simply will not be undertaken and the nation will lose whatever production they could have yielded. As a case in point, Santa Fe is the operator of an enhanced recovery operation in the City of Torrance, California. At least 2.5 million barrels of crude oil exist underneath this property but to get them out requires a substantial investment by Santa Fe and its partners. Up to now the controlled price of oil has been insufficient to generate the funds needed to invest in the enhanced recovery operations needed for this property. If the funds from the sale of crude oil at market prices were available, the project would be more feasible. However, if the crude oil excise tax takes over half of these increased revenues away from Santa Fe and its partners, then the property could of necessity be shut in and over 2.5 million barrels of crude oil will remain in the ground and out of the hands of American consumers. Santa Fe does not want to leave this crude oil in the ground, but it cannot justify the investment or the continuing level expenses needed

to extract it in the face of price controls followed by a heavy excise tax such as that proposed by the House of Representatives.

Not only do enhanced recovery projects save crude oil that would otherwise be unrecovered, they also permit the more rapid development of crude oil deposits within conservative development practices. As President Carter's recent commitment to sole reliance on domestic energy sources for all future energy increments emphasizes, there is a need for immediate mobilization of America's productive resources for crude oil. Enhanced recovery operations will speed the delivery of America's crude oil resources to the American marketplace and in many cases such as those with which Santa Fe is familiar in California will make available these resources at a rate several times greater than under primary production.

By providing for an energy production credit which must be invested in qualified energy projects, Congress can avoid stifling the vital investment needed in enhanced recovery operations for domestic crude oil and ensure that investments are made which will increase our domestic resources. Any funds earmarked for expenditure on enhanced recovery operations should qualify for the credit. This tax credit will give domestic producers an incentive to develop their properties by enhanced recovery techniques and to continue in operation those enhanced recovery projects which are now underway. The energy production credit provision, I should add, should be simple and should not include any elaborate qualification of a project with some bureaucratic agency and, above all, should not apply, as the House bill does, only to projects deemed "uneconomic." Part of the simplicity that I urged would be a definition of enhanced recovery as meaning any process applied for the recovery of crude oil in which substances or energy are injected into a reservoir to supplement or augment the energy required to move the crude oil through the reservoir. A worthwhile enhanced recovery project does not have to be exotic, nor does it have to employ an experimental technique. On the contrary, what the country needs now is the application of proven enhanced recovery techniques such as waterflooding, cyclic steam injection, steam drive, and gas reinjection, to stimulate the recovery of the known crude oil accumulations in the United States.

By providing an incentive for investment in enhanced recovery projects Congress will be encouraging the deployment of the skills of American producers for the most complete recovery of our domestic crude oil resources.

In addition to providing an energy product credit for all investments in enhanced recovery projects qualified investment should be broadly defined to include expenditures for the development of alternative domestic energy resources such as research in the gasification and liquefaction of coal, the mining of coal, research and development of shale oil, the exploration and development of geothermal resources, and the construction or modernization of domestic refining capacity. Qualified investment should also include investment in projects which have the effect of saving oil and making it available for other uses. For example, Santa Fe is studying a proposal which would substitute coal for millions of barrels of crude oil now being burned each year in steam generators in California. Santa Fe and most other operators burn crude oil to produce steam to be injected in the oil properties in conjunction with enhanced recovery operations. Under the proposal, coal would be burned in a facility which produce both steam and electricity. The steam would be piped to the oil properties replacing the steam generators and saving the crude oil used as fuel. In 1975 in Kern County alone the amount of crude oil burned by all producers to generate steam exceeded 12,000,000 barrels. This crude oil would be freed for the uses for which coal is not a ready substitute for crude oil. The project as proposed would require the investment of hundreds of millions of dollars. If that investment qualified for an energy production credit, the feasibility of the project would be enhanced because the feasibility depends upon the amount Santa Fe can realize from the sale of the crude oil made available by the substitution of coal as generator fuel.

Just as the crude oil excise tax should allow an incentive for investment in the development of known domestic crude oil deposits, it should also contain provisions to encourage additions to domestic crude oil reserves. In recognition of this principle, the House placed a less onerous crude oil excise tax burden on newly discovered domestic crude oil. Although Santa Fe feels that the crude oil excise tax should not apply in any way to newly discovered crude oil, we certainly agree with giving relief from the crude oil excise tax for finding new deposits of crude oil thereby adding to domestic resources and relieving our dependence on foreign sources. For the same reason, the definition of what constitutes newly discovered domestic crude oil should be broad enough to encompass oil made recoverable by enhanced recovery techniques. Whether crude oil in the ground is considered a reserve depends mainly on economic factors; that is, if the cost of recovery including a reasonable return on the

capital invested exceeds the price of crude oil, the deposit will not be considered a recoverable reserve and will not be produced. The costs of enhanced recovery projects are substantial but the benefits of those costs in terms of domestic crude oil reserves can be dramatic. For example, when Santa Fe began a program of enhanced recovery projects in 1964 it had total reserves of 43 million barrels. As a result of that program we have not only been able to produce for 15 years but we have increased our reserves to 131 million barrels. The increase attributable to enhanced recovery alone is the equivalent of a significant oil field. We believe that the producer which makes crude oil available through investment in enhanced recovery projects should be entitled to the same economic rewards as a producer which discovers a deposit of crude oil. Therefore, in addition to a provision for an energy production credit, we urge the amendment of the House bill to treat crude oil, except heavy crude oil, produced from expanded reserves through enhanced recovery projects as newly discovered crude oil to be taxed to a lesser degree and for a finite period only.

Almost without regard for the effects on the production of domestic crude oil, the crude oil excise tax appeals to many persons as a way of funding research in, and manufacture of, what are loosely categorized as synthetic fuels. The issue of synthetic fuels has been distorted to the detriment of domestic crude oil producers. A synthetic fuel is nothing more or less than a different form of refinery feedstock. Whether the synthetic fuel comes from the liquefaction of coal or the extraction of hydrocarbon molecules from oil shale, the end product is a substance which can be fed into the existing energy supply chain in place of crude oil. We favor research leading to the perfection of processes for the production of synthetic when they become economically feasible but we do not support the subsidization of the manufacture of synthetic fuels with crude oil revenues. Santa Fe sees little reason to sacrifice production of naturally-occurring domestic crude oil for uneconomic acceleration of the manufacture of synthetic fuels. Quite simply, it is a fundamental rule of life that you do not overlook your first choice to pursue your second choice. If the revenues of domestic crude oil producers are diverted to synthetic fuels manufacture, we will be pursuing the second choice and the money that could have gone for the development of the first choice, naturally-occurring crude oil reserves, will no longer be available.

Santa Fe is not currently involved in the synthetic fuels industry and cannot provide this Committee with specific data about the processes involved in their manufacture. I can, however, remind you that the manufacture of synthetic fuels will take energy, much of which during the early stage of development will come from natural crude oil. Prior to producing a single drop of synthetic fuel, machinery and installations will have to be built and operated, activities which will devour substantial amounts of petroleum products. The net effect will be increased demands for natural crude oil at a time when funds for replenishing these supplies of natural crude oil are being diverted. Substantial amounts of time are necessary to bring a synthetic fuels project into commercial production so the period of net drain upon the nation's natural crude oil supplies will be a lengthy one. Moreover, once a synthetic fuel plant begins operation, it consumes a great amount of the energy it produces simply in its operation; efficiency measured as net output of energy is relatively low. Therefore, over the long term, we very well may expend more of our energy on the development of synthetic fuels than we would have spent had we concentrated on traditional sources of crude oil and the direct use of naturally-occurring fuel supplies.

Traditional sources of domestic crude oil are finite and dwindling, and economic forces will mandate that the crude oil of the future will probably come from alternative sources. There is no need to forsake traditional crude oil sources now by a massive government program of diversion of funds away from development of the traditional sources. The market place will divert resources to the manufacture of synthetic fuels when they become economically feasible. As natural sources of crude oil continue to dwindle, alternative sources will become more attractive and will be brought into production at a pace necessary to meet overall market demand. By permitting economic factors in the market place to dictate the time of development, full exploitation of natural crude oil supplies would occur, the changeover to alternative sources would be gradual and orderly, and a massive Federal bureaucracy to effect the changeover would be avoided. In summary, Santa Fe believes that the market is an efficient allocator of resources and would allocate resources to the production of synthetic fuels on a more rational basis than would a forced program of government investment at the expense of known domestic crude oil deposits.

The suggestions Santa Fe has offered in this testimony for provisions in the crude oil excise tax should not be construed by this Committee as an acceptance by Santa

Fe of the concept of an excise tax on domestic crude oil. The tax amounts to additional tampering on the part of the government with the operation of the free market for energy resources and quite possibly represents an overreaction to the shortages of petroleum products which we now are experiencing. The last period of acute shortages, the winter of 1973-74, produced another experiment in government tampering with the free market for petroleum. At the time the tampering took the form of the Emergency Petroleum Allocation Act and the regulations promulgated under that Act. Since that time the country and domestic crude oil industry in particular have suffered under those regulations and numerous people both in and out of government have highlighted the deficiencies of that governmental intervention. Those deficiencies are in very large part a cause of our present problems. When the government artificially depressed the price of domestic crude oil, it provided an immediate disincentive which limited investment in the production of domestic crude oil, while simultaneously encouraging demand for petroleum products in the United States through depressed prices. The regulatory program then compounded the problem by subsidizing foreign crude through the entitlements program. By not permitting free market forces which would have priced domestic crude oil at its true economic worth to work, Americans were not encouraged to change their habits of energy consumption and as a result the country became dependent upon foreign sources of crude oil. To avoid a repetition of the illogical and counterproductive regulatory environment that has existed for the past six years, further tampering with the free market for petroleum should be avoided and no further unnatural burdens should be placed on that market in the form of a crude oil excise tax. We have already wasted six years in avoiding a true lasting solution to our energy problems. Congress should not through the imposition of this crude oil excise tax delay further the establishment of a realistic national energy policy predicated on meeting our energy needs through the utilization of our own resources.

Santa Fe also encourages this Committee to let market forces achieve the benefits of conservation which are also an important part of the nation's move away from dependence on foreign crude oil. Conservation of petroleum will be encouraged by the economic force of higher prices for domestic crude oil which will result from decontrol. Indeed, conservation by economic force is preferable to governmental fiat or penalty. Price, however, is not the only economic force at work with large users of petroleum and natural gas. Such large users are also concerned about the security of their investment in the plant and equipment needed in any change-over of fuel. To encourage large users away from petroleum and natural gas, the governmentally imposed uncertainties and time lags surrounding alternative fuels must be removed. In addition, incentives such as tax credits, should be made available to encourage the investment in plant and equipment necessary to switch from petroleum and natural gas to alternative fuels such as coal or uranium.

In sum, we oppose the Windfall Profits Tax because it will not lead to the production of one additional barrel of domestic crude oil. In fact, the tax will burden domestic production and create an incentive for foreign investment. However, if a tax is passed, at a minimum it should provide an exemption for heavy oil (16° gravity (API) or less), an energy production credit for qualified projects as well as a definition of newly discovered domestic crude oil which encompasses oil produced by enhanced recovery means. By enacting these measures, Congress can feel confident that it has provided realistic incentives for increased domestic production.

Thank you for your kind attention. Mr. Burkhart and I would be pleased to answer any of your questions concerning my testimony or our company.

The CHAIRMAN. We will adjourn until 2:30 p.m. this afternoon.

[The committee adjourned at 1:20 p.m. to reconvene this same day at 2:30 p.m. at the call of the Chair.]

AFTERNOON SESSION

Senator BOREN. We will proceed with the hearing. There may be other members of the committee, some others have indicated they will be with us at that time, but I think we should go ahead and commence.

This is a continuation of the public hearing of the Finance Committee on H.R. 3919: the crude oil excise tax. And the first witness that we will hear from at this time is Mr. Robert A. Hefner, Jr., of

the Hefner Co. and we will be operating under a 10-minute limitation for the benefit of all the witnesses. There are lights here at the front. The yellow light will come on when you have about 1 minute left and then if you can try to summarize, and the red light will then come on and will indicate that time has expired. We will try to accommodate you. We don't expect you to finish in midsentence. But this will help us so we can proceed to hear all the witnesses this afternoon.

The Chair would tell you how happy we are to have you here and we are delighted to have this opportunity to hear your testimony.

STATEMENT OF ROBERT A. HEFNER, JR., HEFNER CO.

Mr. HEFNER. Thank you, Mr. Chairman.

I am most happy to be here. I want to thank you and the committee for the opportunity to be heard on behalf of the public. I am particularly happy you have a light here because, as I said, I ran hurriedly through what I was going to say last night and I was appalled to find out I used up 40 minutes. I spent all the time on the plane coming up to see if I couldn't boil it down and at least get something for you to consider that might in some way be helpful to the committee for the problem in the short time we have.

My name is Robert A. Hefner, Jr., of Oklahma City, Okla. I do not represent any lobby group, organization, corporation, or any other association. And I am happy that I am here simply as a citizen and a taxpayer and I hope my status under the current problems we have, I think they reflect the status of thousands upon thousands of the citizens of this country and their well-being. Their well-being might be the same as mine as a citizen and taxpayer. I am a rancher, a landowner, a mineral owner, a royalty owner, and I am an independent producer in a small way.

In commenting on the tax before the committee today, perhaps I should give you some background of my family history. It just happens to exactly equal the timespan of the energy age of the United States. When the first Lucas well at Spindletop near Beaumont, Tex., came in at 10:30 in the morning on January 10, 1901, my father, a lawyer just graduated from Texas University at Austin, decided that Beaumont was where he would make his home. He went there and joined forces with men like Pattillo Higgins, the Hamill Brothers, Captain O'Brien, Captain Lucas, and those original rugged independent operators who got that well down in spite of untold difficulties, and despite the opinion of the 1-barrel-a-day Pennsylvania oil group and in spite of the U.S. Geological Survey's bulletin to the effect that there will never be a barrel of oil discovered in Texas, which goes to show that we can all make a mistake. And I might even point out that some of the Senators who feel they represent a nonproductive State may be in error.

As far as that is concerned, who would have thought only a few years ago of Alaska as being a great producing State and important in our energy age as such. So, we can't tell what might happen.

I tried to follow in my father's footsteps. Although I hate to say it, I was born just 6 years after that No. 1 Lucas well came in at Spindletop near Beaumont in 1901. It was a real gusher, flowing

wild over the derrick at an estimated 100,000 barrels a day. And that is when our energy age was born. It is my hope that I will not live so long as to see the end of our energy age.

My son, following me, has been for 19 years a pioneer in the deep Anadarko Basin of western Oklahoma and the Texas Panhandle. And my two grandchildren, his sons, Charles Hefner and Robert Hefner IV, are a combination of oil field workers and geological students at Oklahoma University. So four generations of our family have been closely connected with or actually involved in the production of oil in the United States, and it is from this background that I attempt to speak today. I make no claim to being an economist or geologist or an engineer. But all my life I have been, as I said, in addition to being a landowner, I have been an independent oil producer.

I may have said that as such, I feel my status and the effect of the current tax laws on me will be very similar to the effect upon thousands and thousands and maybe even millions of landowners in this country.

I would first like to point out a fact which I assume the committee is thoroughly familiar with and that is the public image of the tax being considered today. I have listened carefully to the national broadcasts, several of them, and I would like to quote what the public has been told as close as I can make it, as to the tax we are considering today. They have been told and they believe that it is a windfall profits tax to be levied on excessive, unearned profits accruing to oil companies as the result of decontrol of the price of crude oil. A tax to prevent a ripoff of the consumer to the tune of billions of dollars. I believe this committee knows that there is not one word in this bit of fiction that could possibly apply to the tax we are talking about today. In the first place, the tax has no relation to profit. It is a strict excise tax based on a barrel of crude oil. I pay the tax whether I am losing $1 million or whether I am making it. I still pay the tax.

In the second place, I say the tax, the revenue on that barrel of crude oil is well earned. In my case, the reserves which we have are the results of two generation of effort on our part to develop this barrel of crude oil. And I feel any fair-minded man would say we have earned the right to it.

Now, that brown light means I am half through?

Senator BOREN. It means you are supposed to have about 1 minute.

Mr. HEFNER. I am just getting started.

Senator BOREN. Go ahead. Continue.

Mr. HEFNER. As far as oil companies, as concerns the tax on oil companies, the public thinks of them as multiheaded monsters, the multinational monsters awaiting to rip off the public and to chew up the profits. When in fact they are simply an organization of businessmen and stockholders much like you and me.

As to the actual tax which I pay under current income tax law, I had Authur Young examine my tax status for the year 1978, and I find I pay under current tax laws 62½ percent of my gross revenues from oil and gas.

May I continue?

Senator BOREN. Yes, continue.

Mr. HEFNER. This gross revenue is made up, of course, by practically all of my income being in the 70 percent bracket for Federal income taxes. In addition to this there is the state excise tax which runs from 7 percent in Oklahoma to 12½ percent in Louisiana. Most of my production is in Oklahoma, Louisiana, and Texas. We pay ad valorem taxes in these three States on our property. We pay an ad valorem tax on the value of producing minerals in Texas. In one instance there are as many as four separate taxing entities paid on the same barrel of crude oil.

In any event, due to the time limit, all I can say is under current tax laws it is 62½ percent of my gross. If an additional 60 percent excise tax is added to this as is currently being considered on every barrel of crude oil, my auditors tell me I will pay 80 percent of my gross revenues in taxation. I do not mean a rate on my profits, but 60 percent of my gross revenue before I can buy lunch or pay my secretary, much less think of generating a fund for use in the search for new reserves.

I have some specific production that I would like to call to the attention of the committee, if I may have time, that shows the inequity of the current price control, which is followed and directly linked to the inequities of the tax which will occur when we have decontrol. I refer to the Tatums unit, in Carter County, Okla., a secondary recovery unit. I drilled 14 wells in that pool some 30 years ago. They were fine wells. They all produced 300 to 500 barrels a day. They are producing today. Can you believe it, they average 19 barrels per day per well today. This was because I went to the expense of going into the risky and expensive course of joining a secondary recovery unit for that oil, and I am being paid $5.40 a barrel, which is some one-fourth of its actual value and is less than one-fourth of its cost of replacement. Mobil has just posted a current price for uncontrolled oil or for stripper well oil of $22.62 for the same kind and quality of oil. [See correction letter of July 24, 1979, to Mr. Michael Stern—copy attached.]

If I had a $17 per barrel increase, this excise tax would take 60 percent of that and I would receive $6.80 a barrel for the increase. And the Government would take, the Federal Government under the excise tax would take $10.20 a barrel.

So the windfall runs to the Federal Government if there is a windfall.

The inequity of the price control, that is my reward for having produced all of this oil—this one pool I am discussing, the Tatums pool is a good example. It for more than 30 years supplied energy to this Nation. Now, it is for my benefit, yes, but also it goes to supply a vital necessity of the Nation and its standard of living. And what is my reward? On the one hand, I am paid something like one-fourth of what I would have gotten if I had let my wells go and be strippers instead of getting into a secondary unit and less than one-fourth of the price of the true value of that oil. And that is my reward. And if we have decontrol, the same thing happens. The Federal Government might give me decontol on the one hand, but they take away the benefits on the other at times when we must have this value of oil if we are to be able to supply the vitally needed crude oil reserve and go out and search and find them to

serve this Nation's needs during the interim period while we are trying to develop synthetic fuels, which will take 10 years.

Senator, I am going to continue on until you stop me.

Senator BOREN. Why don't you continue for 5 minutes and then we will have to let the others have an opportunity.

Mr. HEFNER. I think the Anadarko Basin where my son is involved is a perfect example of what can happen when you do have decontrol. He drilled his No. 1 Green well. He completed at total depth of some 22,000 feet and it cost him $6½ million. The Federal Power Commission gave him a price of 35 cents per thousand for his gas and it has now produced 9 billion cubic feet of gas, and is only one-fourth paid out. He will never recover his investment in this fine well, which was a bonanza from an energy standpoint, but a catastrophe from a financial standpoint. As a result, there was little or no drilling activity in the basin.

Now, the Congress in its wisdom has decontrolled deep gas—below 15,000 feet—as of November of this year. And the companies are currently spending in the area of $1 billion per year in that basin for development of these deep costly reserves.

Incidentally, 120 wells are currently drilling in that basin: 110 by independents and 10 by major oil companies, which I think clearly shows that independents still maintain their historical average of finding some 90 percent of the new reserves in the lower 48 States. And I know I must conclude, but I would like to say that the royalty owner has nothing to sell but a barrel of crude oil. There is no way you can pass anything on to the public. The same is true of the independent operator. The major integrated oil company has centers of profit in transportation, in refining, in marketing, and I think—and rightfully so—that they will pass any added burdens on to the public. But the small independent producer and royalty owner and mineral owner bears the brunt of the tax. We are mainly mineral owners—but throughout the years we have invested every cent we could get in new search for reserves.

So I would say that I don't know how I can stay in business and pay 80 percent of my gross income in taxes. I think the tax will put me out of business much less leave me where I can search for new reserves.

Senator BOREN. Well, I want to thank you for your testimony. I want to follow up on what you said about it, Tatum's field in this example you have given us for the record.

Mr. HEFNER. I think those things can be checked.

Senator BOREN. One of the things that has concerned me, and I read the figures from the congressional Office of Technology Assessment recently and they have indicated that we know that we have 289 billion barrels of oil still in the ground if we had the technological ability to recover it all through enhanced recovery; that there is 289 billion barrels still there that is potentially recoverable in the existing fields. And the same report also estimated, I think conservatively, that at $30 a barrel or less, somewhere around 50 billion barrels is recoverable and now with the state of art we have right now. I think that is probably a very conservative estimate of what is recoverable.

I said in the hearing this morning it is hard for me to figure out—we have seen estimates that an exemption from the tax on

stripper oil and an exemption on enhanced recovery projects or tertiary projects could yield probably another 2½ million barrels of production a day before 1980, and the cost in terms of the lost revenue would be somewhere around $10 billion or something like that. On the other hand, the President is proposing that we collect $140 billion, and bring it to Washington, have a bureaucracy give it back to some of the producers with the hope that by 1990 we will be able to produce 2½ million barrels a day additional production through synthetic fuels.

It seems to me as far as the taxpayers and the consumers of the country are concerned, that is an awfully poor bargain to pay well over $100 billion for the same amount of production we could through $10 billion in tax incentives to get that same amount of production in half the time at one-tenth the cost. And listening to your experience in Tatum field, as I understand it, because you went in and spent the money for enhanced recovery and you increased the production of the wells so they were no longer 10 barrel wells or less, they went above that mark so you no longer got the stripper price—

Mr. HEFNER. Never did get it. We have maintained the production about that level. And I neglected to say, Senator, that in that same field, Shovel-tum, producing from the same formation, there are a lot of stripper wells getting $22.62 for the same oil.

Senator BOREN. So if you had not spent that money on your 14 wells in order to get that production, you would be getting—say you had 10 barrels per well instead of 19 and were getting 4 times the price—you would be making twice as much more because of present government policy to produce half as much oil for the American people; isn't that right?

Mr. HEFNER. I thought that was a good example to bring up.

Senator BOREN. I think it is an excellent example and shows exactly what happens when the Government helps private enterprise solve the energy crisis.

What would you think about the possibility, in order to encourage people to go ahead with enhanced recovery projects, of considering exempting from any kind of increased tax additional oil that could be gained from producing from enhanced recovery projects? Do you think that would be a significant incentive in terms of the development of these projects?

Mr. HEFNER. I find it would be significant. It is something I didn't have time to say because I was rushing so. I don't want to appear stupid. I have been an oil man all my life. And as far as I am concerned, there is not a bit of difference between secondary recovery and tertiary recovery. I have enhanced recovery going on in my land at "Wildcat Jim." They call it a fire flood—classed as tertiary, I think. I have it going on in one south, three west, in the same county, and they call it secondary. But for my book any kind of enhanced recovery is going to cost lots of money. It is going to be risky like drilling a new wildcat as to whether it is going to work. But it should have the incentive—it is inequitable to distinguish between tertiary and secondary.

Senator BOREN. Let me ask you this question. In terms of the cost of what is called secondary and what is called tertiary, is the cost that different or it will vary on every project?

Mr. HEFNER. I don't know who makes the decision to call it tertiary or secondary. The problem is we do anything we can to get that small globule of oil after Mother Nature quits pushing it out by flowing or we quit getting it by pumping. We do anything we can think of to get it loose from that little imprisoned place down in the rocks. I have even used seltzer water to see if it will work.

Senator BOREN. Well, I appreciate your testimony very much. I will certainly call it to the attention of the members of the committee because one of the areas in which I intend to propose amendments is the area of enhanced recovery of all kinds. I think your testimony and this example of the Tatum's field is an excellent example to show that unless we change the law, unless we change the pricing structure, unless we change the tax structure, that you are actually losing significant amounts of money to yourself as a producer by going in and getting the country more oil.

Mr. HEFNER. That is an absolute tragedy when it is so badly needed. I hope my facts are accurate. I got them from George Martin of Koch Oil who buys production at that unit. I joined the Tatum's unit and paid the price, but it is being operated by Mobil. I am not operating it. But those are the facts I was given. This statement is incorrect. I find on return to my office the production figures are only available to working unit owners.

Senator BOREN. Well, I appreciate your testifying. I might mention Senator Dole has joined us. And Mr. Hefner just gave testimony explaining that he has one field in which he had some wells that the production was going down so he went in with enhanced recovery.

Now, they are producing 19 barrels instead of 10, but because they are no longer stripper, he gets only one-fourth the price he used to get. So by producing twice as much he only gets half the money, so he has lost in getting the country more oil.

Senator DOLE. That is the problem you have, an arbitrary cutoff?

Mr. HEFNER. Senator, I am from Oklahoma and feel like a neighbor. Nice to see you.

Senator DOLE. Do you have any production up in Kansas?

Mr. HEFNER. Not very much. We are mostly in Oklahoma, Texas, and Louisiana.

[The prepared statement and letter of Mr. Hefner follows:]

THE HEFNER Co.,
Oklahoma City, Okla., July 24, 1979.

Mr. MICHAEL STERN,
Staff Director, Committee on Finance,
Washington, D.C.

DEAR SIR: I testified before the Senate Finance Committee on Thursday, July 19, 1979, and also filed the appropriate hundred copies of my written statement prior to that date with you. I wish to again thank you and the Committee for the opportunity to be heard as a member of the public. At the time of the preparation of my written statement and of my testimony before the Committee, my Office Manager and Chief Accountant was on vacation. He is in the office today and I find upon checking with him that one of the figures which I gave the Committee relative to the price of stripper oil in Oklahoma was slightly incorrect. The figures appeared in my written statement as well as in my oral testimony under discussion of "The Tatums Secondary Unit: Proof of Gross Discrimination in the Application of Price controls to 'Old Oil' and the Application of the Proposed Windfall Tax after Decontrol". The figure of $5.50 per barrel for Tatums Secondary Unit (lower tier) crude oil is approximately correct, but the figure of $24.50 per barrel for stripper oil applies to 40° gravity Oklahoma sweet crude as of the current date while I thought it

applied to 26° Oklahoma sour crude as of the same time which we were receiving the $5.50 per barrel from Tatums Secondary Unit crude.

The substance of my argument relative to the gross discrimination resulting from the price controls figures remains accurate but I do want the Committee to have the exact figures. The figures quoted below are based on Mobil's posted price as follows for the periods indicated, to wit:

(a) Month of April 1979 (26° gravity Oklahoma sour):	
Stripper (uncontrolled)	$16.77
Lower tier (Tatums)	−5.53
Increase (complete decontrol)	11.24
60 percent Federal windfall excise tax	−6.74
40 percent producer's share	4.50
Differential in amount per well received by producer from:	
10 bbl/d stripper	167.70
19 bbl/d Tatums secondary unit	−105.07
Total	62.63
(b) Month of May 1979 (26° gravity Oklahoma sour):	
Stripper (uncontrolled)	17.47
Lower tier (Tatums)	−5.57
Increase (complete decontrol)	11.90
60 percent Federal windfall excise tax	−7.14
40 percent producer's share	4.76
Differential in amount per well received by producer from:	
10 bbl/d stripper	174.70
19 bbl/d Tatums secondary unit	−105.83
Total	68.87
(c) Month of June 1979 (26° gravity Oklahoma sour):	
Stripper (uncontrolled)	22.62
Lower tier (Tatums)	−5.61
Increase (complete decontrol)	17.01
60 percent Federal windfall excise tax	−10.21
40 percent producer's share	6.80
Differential in amount per well received by producer from:	
10 bbl/d stripper	226.20
19 bbl/d Tatums secondary unit	−106.59
Total	119.61

I also stated in my oral testimony and written statement that this discrimination occurred in the pricing of oil in the same field and from the same formation. This is a correct statement but I did not intend to imply that any wells in the Tatums Unit were classified as strippers. The Tatums Unit, however, is simply a small part of a field known as the Sholem-Alechen.

Sincerely,

ROBERT A. HEFNER, Jr.

In response to a statement by Senator Boren to the effect that the Tatums situation should be investigated, I made the statement that the unit is operated by Mobil and production figures might be difficult to obtain. Upon my return here, I find that this statement is incorrect and that the figures as to unit production are readily available to working interest owners.

STATEMENT OF ROBERT. A. HEFNER, JR.

Mr. Chairman and members of this distinguished Committee, My name is Robert A. Hefner, Jr., and I reside in Oklahoma City, Oklahoma. I appear before you today to discuss our nation's energy crisis, particularly as it relates to crude oil. I thank you for the opportunity to appear in my individual capacity. I represent no lobby group, corporation or other group or entity. I appear simply as an interested citizen

and taxpayer in this great country of ours. I am in my individual capacity a taxpayer, rancher, land owner, royalty owner, mineral owner and an independent producer. Every land owner in this nation is a potential royalty owner and independent producer and, hence, I feel, that the facts which I present to you today relative to my own situation are also applicable to thousands upon thousands and even millions of other citizens of our nation. I beg of you to bear in mind that such meager statistics as I present today are not estimates but known facts as represented by my books and certified to me by my auditors.

Mr. Chairman, I commend you and the Committee for making time available to hear the views of members of the general public. As aforesaid, I am a member of that general taxpaying public, together with thousands of other citizens and taxpayers who happen also to be risk takers, shareholders, investors, small independent business people and holders of interests in land, minerals and royalty who own this nation's natural resources just like other forms of private property. The fact that I own land and mineral interests and royalty interests in oil and gas, and invest my family's money and my own in the high risk but successful endeavor to find and capture that oil and gas, and to make it available by sale to the nation, does not mark me (nor those thousands of others) as a participant in any cabal, conspiracy or combine to gouge my fellow citizens, to shirk my responsibilities as a taxpayer or to act contrary to the interest of my nation. The ownership of private property and the freedom to develop it for utilization in the economy remains a fundamental concept in the social contract by which this nation is organized and conducts its affairs. The act of participating in that system does not justify punitive or discriminatory treatment at the hands of this government.

Indeed, I wish to compliment the President on the decision he has taken which is fundamental to the concept of private property and to private initiative to develop that property. I refer to his decision to propose permitting the marketplace to set the price for energy commodities. That decision to adopt the free economic device for eliminating waste and extravagance in consumption of energy resources, (or, as in some countries, government ownership of those resources), will some day be recognized as a historic milestone in our history. Such will be true, however, only if the Congress resists the momentary winds of passion and implements that decision to use the free economy—and implements the decision without confiscation by so taxing the economic result of the decision as to constitute a taking of private property or to eliminate the incentive for private development of that property.

BACKGROUND AND EXPERIENCE

In order to weigh my comments on the proposed tax, you should know more of my background and experience. For more than 70 years, my father and I have been in the business of taking risks and enjoying the benefits, as royalty owners and independent operators, of finding and producing oil and gas. We have done it exclusively with our own money. No promoted or outside capital has been involved. We have acted as individuals in a small business enterprise which has succeeded, not only for us, but for the benefit of our fellow citizens. The only thing we own or have to sell is a barrel of oil or a cubic foot of gas. We have never at any time been engaged in transportation, refining or marketing of products. Our family's life span and association with the oil and gas industry coincide with the "The Energy Age" of our nation to date. Our family has over the years developed what I would consider significant reserves of oil and gas. I beg the opportunity to impose on the Committee briefly to outline our relation to the development of energy in this nation.

The energy age was born at 10:30 AM on January 10, 1901, when the No. 1 Lucas Well, drilled on a salt dome called "Spindletop" near Beaumont, Texas, came in blowing oil wildly over the derrick at an estimated 100,000 barrels of oil per day. Pattillo Higgins, Captain Lucas, the Hamill Brothers and Captain O'Brien, the first rugged independent producers of our nation, successfully completed this well despite what seemed unsurmountable obstacles, despite the opinion of the one-barrel-per-day oil fraternity in Pennsylvania, and despite the remarks of the United States Geological Survey in a bulletin on the subject to the effect that "There will never be a barrel of oil produced in texas". I hasten to add that we all make mistakes and that opinions are often proven to be wrong. Members of Congress who feel that they represent non-productive states should bear this in mind. As an example, I might ask who of you thought only a few years ago that Alaska would be a prolific producer of oil and gas and would occupy a most significant place in the energy future of our nation. Ever since that date in 1901, we continue to receive opinions by expert geologists and engineers to the effect that we are running out of oil and gas.

When my father, a new graduate of the Law School at the University of Texas, saw a picture of oil flowing wildly over the derrick of the No. 1 Lucas on the front page of the Austin, Texas, newspaper, he immediately decided to make Beaumont, Texas, his home and to join company with those rugged independent operators in their search for additional oil reserves. It is interesting to note that many of the great multi-national oil corporations of today had their beginning at Beaumont at this time—the Sun Oil Company, the Gulf Oil Company, the Texas Company, and the Humble Oil Company (Standard of New Jersey) to name only a few. He worked with the men in the founding of these companies either as attorney, or, in some cases, as a participant. He was the holder of a considerable block of the stock of the Humble Oil Company, and we still retain stock in major oil companies as a result of this beginning. I state this merely to emphasize that what I have to say in this memorandum could bear no prejudice against the great multi-national oil corporations and in favor of the royalty owner and small independent operator. It should be pointed out that my father, "The Judge", as he was affectionately called, despite his participation in the founding of many of the major oil companies, remained strictly an independent until the day of his death a few years ago at the age of 97. I was born in Beaumont just six years after the No. 1 Lucas blew in. I have tried to follow in his footsteps and our operations remain entirely that of royalty owner and independent operator to this day.

My son, Robert A. Hefner, III, independently of our operations, has for the past 19 years pioneered development in the Deep Anadarko Basin of Western Oklahoma and the Texas Panhandle, probably the deepest and most prolific producing sedimentary basin in the world. My grandson, Charles Hefner, is currently working on the deep wells of the Anadarko, and my other grandson, Robert A. Hefner, IV, is a senior student in Geology at the University of Oklahoma. So we have four generations, all strictly independents, whose search for energy reserves spans the time field of the energy age of our nation. It is my wish to address you from this background without bias of any kind or character and to say that we are far from ready to sound the death kneel of our nation's energy age.

PUBLIC IMAGE OF THE EXCISE TAX

The following remarks which I make are made with the utmost respect for the Administration, the members of Congress and the media; but I feel that the time has come when we must call a "spade a spade". The American public has been told, and apparently believes, and perhaps a majority of Congressmen in the House of Representatives as well, that the tax presently being considered by Congress is "a windfall profits tax to be levied on the excessive unearned profits accruing to oil companies as a result of decontrol of the price of crude oil; a tax to prevent a 'rip-off' of the consumer to the tune of many billions of dollars". Let us examine the public image of what this so-called "windfall profits tax" is supposed to do:

(1) It will punish a group of multi-national monster oil companies who are in a conspiracy to "rip off" the consumer for billions of dollars.

(2) It will punish them for withholding gasoline, heating oil and other vital products essential to the health, comfort and standard of living of the American public and for creating lines at filling stations; with a greedy motive of holding out for even greater profits.

(3) It will punish them for making "excessive profits" wrongfully obtained by willfully gouging the consumer.

ACTUAL FACTS REGARDING THE EXCISE TAX

(1) *Profit.*—With the exception of the word "Tax"—not one word in the foregoing bit of fiction is correct. The tax is an "excise" tax, having no relation whatsoever to "profits".

(2) *Windfall.*—The only "windfall" is to the federal government, which under current tax law will take 70 percent of any increase in "profits" which the royalty owner, the independent operator, and the individual taxpayer might receive as a result of decontrol, and at least 42 percent of any increase any corporation might receive.

(3) *Unearned.*—The barrel of crude oil which I have to sell is the product of two generations of effort and the investment of our family funds and my own in the high risk but successful endeavor to find and capture that barrel of oil and to make it available by sale to the nation. How could any fair-minded person say that the payment to me of the "true value" of the end result of two generations of dedicated effort is "unearned"?

(4) *Oil companies.*—Am I and thousands like me to be classed as a multi-national monster endowed with unlimited funds—special tax loop holes—tax credits for foreign operations—opportunity to pass on costs of operation to the consumer at the filling station and elsewhere? To ask the question is to answer it—"no way". It should also be noted that individual income is taxed by federal government at 70 percent, while the top corporate rate is 42 percent. Moreover, are the oil companies who are in essence merely a consolidation of small business men and private individual citizens of our nation who own the stock of such companies to be classed as "multi-national monsters"?

(5) *Excessive profits.*—The profits of the "oil companies" are much less than those of many other leading industries in our country and are in fact about equal to the average of all industrial corporations in the nation. The independent operator's profit is of course much smaller than that of the integrated oil corporation.

ACTUAL EFFECT OF PRICE CONTROLS AND EXCESSIVE TAXATION UPON THE LAND OWNER, MINERAL OWNER, ROYALTY OWNER AND INDEPENDENT PRODUCER

At the outset of this section, in order to avoid any confusion as to definition, I would like to state that "independent producer" is defined as a man whose only business is to search for reserve of crude oil and whose only asset is a barrel of crude oil. He has no centers of profit in transportation, refining, marketing or otherwise.

I wish to point out the status of my situation under current tax laws. I feel that it is representative of thousands upon thousands of land owners, mineral owners, royalty owners, and independent producers. Generally speading, all of these peoples operate as individuals and pay the tax rates imposed upon the individual in this nation. In order that I might have a report covering a full calendar year, I have asked my auditors to examine my income and tax situation for the year 1978. I find that I pay to federal, state and local taxing authorities a total of 62½ percent of my gross revenues derived from the sale of oil and gas. That 62½ percent is not the rate paid on my profits but on my gross revenues. To avoid repetition, I wish to point out that I am referring to percentage of gross revenues throughout this portion of this memorandum. Under the Administration's proposed excise tax, had it been in force in 1978, I would have paid 78 percent of my gross revenues in taxes; under the bill recommended by the House Ways and Means Committee, I would have paid 81¼ percent of my gross revenues; under the bill as it passed the House of Representatives, I would have paid 80 percent of my gross revenues. In more detail, that 62½ percent of gross revenues was paid out as follows:

Under existing federal income tax laws, almost all my taxable income is taxed at the rate of 70 percent. Most of my production is located in the states of Oklahoma, Texas and Louisiana. I pay income tax to the states of Oklahoma and Louisiana on the income which I produce in those states; I pay ad valorem taxes based on property owned in all three states; I pay an excise tax running from 7 percent of my gross sales of oil in Oklahoma to 12½ of gross sales of oil in Louisiana.

When the proposed federal tax is heaped on top of the taxes paid to the states in which you produce, we reach the percentage of gross sales which I have previously given you. Under our present tax laws, it is almost impossible for the land owner, mineral owner, royalty owner, and the independent producer to generate a fund with which to continue in his search for new reserves. Most of us are the owners of what has geen classified as old oil or lower tier oil. I make reference to the discriminatory nature of price controls on this oil at a later point in this memorandum. Even though over the past years since price controls were adopted I have invested every dollar which I could generate from our operations in the search for new reserves, I find that my average price for oil sold during 1978, being a combination of old oil, new oil, stripper oil, and goodness what other kind of oil, was $8.00 per barrel. When you couple these price controls with current tax laws, I think you can readily see why it is most difficult for the land owner, the mineral owner, the royalty owner and the independent producer to make any search for new reserves. When you add on the so-called "windfall" tax, the task becomes impossible. In fact, it becomes most difficult to simply remain in business and pay ones taxes and current operating expenses. I ask you gentlemen, do you wish to place this burden upon the mineral owner and the independent producer who have over the years discovered 85 percent to 90 percent of the on-shore total reserves in the lower 48 states?

THE TATUMS UNIT: PROOF OF GROSS DISCRIMINATION IN THE APPLICATION OF PRICE CONTROLS TO "OLD OIL" AND THE APPLICATION OF THE PROPOSED WINDFALL TAX AFTER DECONTROL

Some forty years ago I drilled fourteen fine producing wells in what is known now as the Tatums Secondary Unit of Carter County, Oklahoma. These wells encountered anywhere from 20 feet to 70 feet of productive sand in the Deese formation and were completed at potentials of somewhere from 50 to 500 barrels of oil per day. As production declined, we incurred the cost and took the risks of joining a secondary recovery unit. This operation is not only expensive but it also includes a high rate of risk. It is somewhat like drilling a wildcat well. This particular water flood secondary unit proved successful. I am happy to report that the wells have continued to produce throughout this long period of 40 years and are at the present time producing an average of approximately 19 barrels per well per day. What is our reward for this long and significant supply of crude oil for the vital needs of our country and its standard of living? Our oil is classified as old oil and we receive a price of approximately $5.50 a barrel while owners of wells in the same pool and producing from the same sand have been allowed to decline to stripper state and are bringing under a price posted by Koch Oil, the largest purchaser of crude oil in Oklahoma, the sum of $24.50 a barrel. This, to me, is discrimination in its most cruel state. As was said by Mr. Blumenthal in his testimony before this Committee only a week ago, "The quickest way to an increase in the price of your crude oil is a rapid decline curve." An equally cruel discrimination occurs when this old oil is relieved of price controls and it climbs to the uncontrolled price of $24.50 posted by Koch Oil Company for similar oil in this pool. Under the so-called "windfall" tax bill passed by the House, I would pay federal excise taxes of $11.40 per barrel on the $19.00 increase in price, and I would receive for my part of the increase $7.60, while, as I understand it, the owner of a nearby stripper well continues to receive the full price of $24.50. I ask you gentlemen, is this fair and equal treatment of the American citizen before the law of our land?

DISCRIMINATION IN THE APPLICATION OF PRICE CONTROLS AND WINDFALL TAXATION TO SECONDARY AND TERTIARY PRODUCTION

Federal regulation applies the same discrimination mentioned under Tatums Unit above in its application of price controls and proposed windfall taxation to secondary oil and allowing tertiary oil to remain free of such controls and taxes. While I am not a technician nor an engineer, and make no claim to such, I have been in the oil business all my life and I think I am speaking for most of us when I say that I don't know the difference between secondary and tertiary production. A "FIRE FLOOD" has been in operation on our land at "Wildcat Jim" in Carter County, Oklahoma, being in Section 9, Township 2-S, Range 2-W, for many, many years. This, I assume, is what is called tertiary production. I believe that it was the first of its kind in the United States and that it has proven successful, but the point I want to make is that, as an oil man, I can see no reasonable justification for a distinction between what might be termed secondary recovery and what might be termed tertiary recovery. They both involve high cost and high risk in order to be successful. They all involve the same thing: that is, some method of combating Mother Nature and freeing the globules of oil from their captive cells in the minute porous spaces in the rocks below ground. Sometimes we use a salt water flood; sometimes we use a hot water flood; sometimes we use fire; sometimes we use seltzer water or anything else we think might work. They all involve some workable method, if successful, of an enhanced recovery of the oil normally left in place by primary methods such as flowing and pumping of the crude oil.

THE ANADARKO BASIN: THE PROOF OF THE CAKE IS IN THE EATING

We can find positive proof of what happens when the price of the product is completely decontroled and the oil and gas operator is allowed to do business in a climate where he can reasonably expect to pay his bills and make at least a small profit from the operation, assuming he is so fortunate as to encounter reasonable productive reserves in his search. In this case, we are referring to gas in the Deep Anadarko Basin where, as I have previously noted, my son, Robert A. Hefner, III, has for the past 19 years pioneered development. One of his first producers in the basin was his No. 1 Green Well. In 1967, his company, strictly an independent producer, began drilling the No. 1 Green in Beckham County, Oklahoma. The Green was completed in 1969 as a natural gas well at a reservoir depth of 21,600 feet, more than four miles beneath the surface. At that time it was the world's second deepest natural gas well. The natural gas from this well created the highest pressure ever

recorded at the surface of the earth—more than 15,000 pounds per square inch. A single piece of wellhead equipment required to contain the high pressure gas cost $150,000—which was more than the entire cost of the average gas well that year. The Green cost $6½ million. After seven years of production, the Green has produced more than 9 billion cubic feet of gas—the equivalent of more than a million and one-half barrels of oil. Thus, the Green is an extremely valuable energy resource but it is an economic disaster. Government has regulated the price at $.35 per thousand cubic feet, and today he has recovered only about one-fourth of his investment. The well will never pay out and the high potential acreage surrounding the well can never be tested until natural gas prices are deregulated because only in an unregulated market can the risk capital be formed to finance this high-cost, high-risk exploration. The Congress, in its wisdom, will, as of November 9, 1979, fully decontrol the price of gas produced from a depth below 15,000 feet. Competent engineers estimate that between 70 and 360 trillion cubic feet of gas reserves are contained in this basin between the depths of 15,000 and 40,000 feet. The basin has 22,000 cubic miles of sediment below 15,000 feet and only 1.5 percent of it has ever been touched by a drill. The proven reserves from this limited exploration are over 3 trillion cubic feet.

The deep wells in the Anadarko Basin cost from $4 to $6 million each. Many vexing problems are encountered such as excessively high temperatures and pressures so high that they crush ordinary well casings and hydrogen sulfide that can cause drilling pipe to crumble, but these problems can and have been overcome. Bob's company has drilled over 30 successful deep wells in this Basin and participated in many others—two of them below 30,000 feet. A successful well in this deep basin will have reserves in the area of 40 billion cubic feet and a potential open flow of 22.5 million cubic feet per day. As of this time, some 120 deep wells are drilling in the basin—110 by independents and ten by major oil companies.

It should be noted that even in this deep and expensive area the independent producer continues to maintain an exploration ratio of 90 percent to 10 percent over the major oil corporations in the search for new reserves. Bob estimates that by 1991 the deep basin's output will reach over 4 trillion cubic feet per year, an amount equal to the energy of 720,000,000 barrels of oil—oil that we will not have to import. All of the early indicators such as leasing and seismic activity show that an expected increase in deep drilling is just getting started. In Bob's case, he currently has $100,000,000 in drilling planned on his acreage this year primarily financed by joint ventures with other independent companies. He has just started two 24,000 foot deep wells at a cost of $6,000,000 each. He plans to start four additional deep tests this fall which would make his total drilling for the year in excess of $125,000,000. Over-all drilling costs in the basin are currently running at $750,000,000 per year and this expenditure will increase from year to year. None of these wells could have been drilled nor their contribution to our vital needs and standard of living come about but for the drastic increase in the price of gas and in anticipation of the aforesaid decontrol of the deep gas production. Over all, a sum of $1 billion will be spent in exploration, seismic work, lease acquisition, etc., this year, and this sum will increase, of course, from year to year as the basin is developed.

THE INTEGRATED OIL COMPANY

As I have previously indicated, the integrated oil company is not necessarily a multi-national corporation poised to gobble up the energy resources of the world here at home as well as abroad. It should be kept in mind that it is actually an entity composed of many individual stockholders, businessmen, taxpayers and other citizens of our nation just as you and I, but the Congress should also keep in mind the fact that the integrated company has centers of profit, not only in production, but also in transportation, refining, and marketing. It is in a position, and I think properly so, where it can pass on to the consumer many of the burdens of high operating costs, high taxes, and other such burdens which the land owner, the mineral owner, the royalty owner, and the independent producer must sustain in his individual capacity. He will have the doubtful privilege of paying any windfall tax which might be imposed on his barrel of crude oil twice—once at the wellhead and once at the filling station.

THE BASIC FACTS—OUR PHILOSOPHY OF GOVERNMENT

My concept of the most important factors in the growth of our nation to a position of leadership in the world and to the stature of its citizens as free men is our right to fair and equal treatment before the laws of our land; the right to accumulate and own property in compensation for our efforts; the right to "free enterprise"; the

right to compete in a "free market"; the right to retain at least a fair portion of the fruits of our labor. These are the things which distinguish us from the nations dominated by Communism and Socialism. Could it be possible that we have reached the point where taxation is imposed as a penalty for making a profit; where profit is an obscene thing; where it is imposed not for the purpose of furnishing funds to government for the performance of essential government services, but rather for the purpose of taking from the producer and giving to the non-producer? Surely not.

Surely calm consideration of our current energy problem would lead a fair-minded man to conclude that the oil industry must be given the funds to continue the search for new reserves, that the producer of "old oil" has just as much right to receive "true value" for his product as does the producer of new oil. The owner of old oil should not be the subject of discrimination in taxation—paying many times the amount per barrel paid by the producer of new oil. I believe you will find the old oil producer's "know-how" and "success ratio" will be even greater than that of the newcomer. But he cannot continue in business when his capital is taken away by an excessive and discriminatory excise tax. Should he be penalized because he has spent a lifetime searching for and providing the nation with ample energy reserves? Should his product be called "old oil" and subjected to excessive taxation because he has for many years provided his nation with this most vital resource? Should the rancher—the land owner—the roaylty owner (and there are millions of them) be subjected to a federal excise tax which confiscates some ¾ths of his royalty simply because through foresight or otherwise he is the owner of a barrel of royalty oil? Is this our concept of political and economic freedom in this great nation?

THE ROYALTY OWNER

The royalty owner and independent producer have suffered through years of rigid price controls and a mass of conflicting and complicated regulations imposed apparently with the mistaken idea that the consumer was being protected. The opposite result has occurred. Public demand for the abnormally cheap fuel increased to an extreme—depleting our domestic supply of crude oil—striking down the supply of capital necessary to find new reserves and increasing the necessity for high priced imported crude—Result: The consumer pays the price and puts the blame on the oil producer. Now the Administration proposes a removal of controls and substitution of an excise tax which prevents the producer from realizing at long last the "true value" of his product and from generating the capital necessary to make the search for the crude reserves essential to our well-being and security during the transition period to new and unconventional sources of energy.

The fact that the royalty owner's property is particularly valuable of course does not give the government any right to treat it in a confiscatory manner any more than if it was an apartment building or any other form of private property. It is not that anything is being taken away from the public, it is simply another form of private property that we recognize in our economy and always have. The simple fact that it is valuable does not make it the public's property to take any more than if it were a gold mine, an apartment building, or anything else. It should also be realized that those who derive their income from their mineral interest are also quite commonly in the business of plowing that same money back into energy investments. Mineral owners participate in the business of finding more minerals. That has been our policy throughout the years. We dedicate every dollar from our profits which we are able to segregate to the acquisition of new minerals and the drilling for and recovery of oil reserves. Hence, it seems clear that the imposition of a so-called "windfall profits" tax on the land owner and roaylty owner not only amounts to a confiscation of that portion of his property but also creates an impediment to his ability to invest his funds in the search for new oil reserves.

I should like to call to the Committee's attention again the fact that practically every land owner in the United States is also a mineral owner and a potential royalty owner and anything which adversely affects the property and rights of the mineral owner stands to affect the rights and property of millions of American citizens.

CONCLUSION

Mr. Carter made what he called one of the most important speeches of his administration on national television on Sunday, July 15, 1979. He stated that our current energy crisis was the fundamental cause of all of our current problems including inflation and recession. He indicated again that the cure of the problem would require the effort and cooperation of all of our citizens and that we must make sacrifices and pull together as in war. We commend him for his courage. We get the impression, however, that he feels that the oil and gas industry should bear

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the entire tax burden for the program which he recommends. He simply stated that the windfall profits tax must be passed, but did not elaborate. We respectfully state that now more than ever before in our history the oil and gas industry must be allowed to retain the funds necessary to develop our conventional reserves to sustain our nation during the interim shift to synthetic and exotic energy sources. It would be unthinkable to hobble the industry with a federal excise tax right at the time when the public demands an all-out expenditure of funds in the search for new oil and gas reserves. I beg of you—give us immediate and complete decontrol together with freedom from any special excise or other purported windfall profits tax in order that we may have the funds to do the job, and it will be done. If Congress and the Administration should see that the job is not being done, then is the time to consider the adoption of some punitive form of taxation.

Our energy crisis did not develop overnight and it cannot be cured overnight. It started more than 20 years ago with the adoption of legislation to control the price of interstate gas and the unbelievable decision of the Supreme Court of the United States to the effect that this legislation gave the FPC power to control the price of intrastate production at the wellhead in the event any portion of such gas should eventually move into or become comangled with gas which moved interstate. Since that time, states' rights have been eroded from year to year until at this time we have outright federal control of intrastate commerce. Federal laws and confusing regulations adopted pursuant thereto have made it extremely difficult for the industry to do its job. Rigid price controls were placed on oil in 1973 with all oil discovered prior to that time being called old oil and its price fixed at something in the area of one-fourth of its cost of replacement. (I hope it is not presumptuous to remind you that a barrel of old oil will produce just as much gasoline and other products as the newest barrel of new oil.) This placed the royalty owner and the small independent producer where it was difficult if not impossible to generate funds with which to make a search for new reserves. Phased out deregulation currently taking place and being linked with a purported windfall profits tax leaves the experienced mineral owner, royalty owner, and the independent producer in almost the same position as before.

As the President said in his July 15th speech, the need for cooperation of the entire public is necessary in the fight to make our nation independent in the energy field, which I might add must be done to keep us independent as a nation of free men.

I have carefully listened to our President's speech before the National Association of Counties on July 16, 1979. He reiterated a large part of his July 15th speech. He stated that we must get ourselves into a position where we as a people can meet all our energy needs from our own resources through conservation and new production. The startling thing that did not appear from his July 15th address was the immediate need for an expenditure of $140 billion for American energy security and that this total sum of money must come from the so-called windfall profits tax. I can only repeat what I have already said—the job of making our energy secure is the job of all of the citizens of this country, and all of the citizens of this country should bear the burden of the taxes necessary to create the funds representing billions upon billions of dollars which the government proposes to spend in research, plants and other forms of exploration necessary to the development of synthetic fuel required for the purpose. In the meantime, the American people should understand that this cannot be an immediate development and that it will probably take at least ten years to get this job done. The burden is not one to be placed on a single industry at a time when it is being called upon to develop the conventional reserves necessary to make us free from foreign domination and control during the interim period while we are developing synthetic fuel requirements. The President also added in his speech of July 16th that he already has authority to require the oil companies to meet the basic needs of our country * * * so, surely, if the Congress, in its wisdom, feels, as we do, that the industry should not be hamstrung by a federal excise tax at this time, then it should feel free to refuse passage of the tax act which you are considering today.

Mind you, I have no objection to paying my full share of the cost of maintaining this society from which my family and I benefit. It is simply the truth that I am not one of those anonymous characters who are so popularly thought to make much and pay little. I have paid taxes equal to at least 50 percent of my gross revenues for more than 20 years. Since 1973, I have silently abided federal government regulations which said that I must sell my old oil at an average price drastically lower than either its market value or the cost of finding another barrel of oil to replace the one sold. The President proposes to end that regulation. Some in Congress hope to stop him from doing so, but it is not the Committee's purpose no mine to spend

time deliberating the basic inequities of regulating crude oil prices when no other costs are regulated nor the fundamental economic disruptions and inequities that always attend price regulation. Rather, it is my purpose to plead with this Committee not to substitute the inequities and discrimination of an additional excise tax on oil or the inequities of regulation.

I plead this case, Mr. Chairman, not only for myself but for the national interest. An uncontrovertible case can be made for the proposition that price regulation of natural gas produced a supply shortage of that important domestic energy source, throwing into imbalance the nation's reliance on oil. We were thus made unnecessarily vulnerable to political interruption of foreign oil supply to the degree that interruption threatens our way of life. Continued regulation of domestic crude oil prices will aggravate that unnecessary degree of vulnerability and so will imposition of the proposed new excise tax on oil.

The excise tax concept and the taxing levels proposed are, in fact, confiscatory of gross revenues badly needed for reinvestment in the search for the significant additional domestic reserves of oil and gas in the ground. No one argues the need for additional exploration and development. Surely no one can argue that vast amounts of risk capital are needed for that purpose. Additionally, no one can question the urgent need that our economy ventures of all kinds—new refineries, a $14 billion gas pipeline from Alaska, coal gasification, and liquification plants at multi-billions of dollars each, research into new energy technologies and industrial modernization and retrofitting to conserve energy, but this is the obligation of all the people of the nation. None of these vital objectives can be served if additional taxes on gross resource revenues are taken out of the hands of those who own the resources. They are the same investors who must supply that needed new capital.

Make no mistake; these new capital requirements suggest strongly that there is no such thing as "excess profits" to result from the deregulation of crude oil prices. But, Mr. Chairman, if political passion of the moment must overcome sound judgment for the future and requires an additional tax now, it must be, in fact, a tax on "profits" and not an excise tax on the sale price of the oil.

Finally, Mr. Chairman, if, in the wisdom of the Congress, such an excise tax is to be imposed—or even a profits tax—do not impose it on the owner of the land and mineral interests and royalty interests or on the independent producer. Unlike the integrated oil companies with additional profit centers in transportation, processing and marketing, those such as I who own only the minerals in the ground have only a single profit center for the generation of that needed capital. We will not be able to participate in meeting the energy requirements of this country if the taxation of our gross revenues from our only property is increased. I take no pleasure in arguing for exemption. I do so only as a last resort, as defense against a step which would disable me and others like me who are proud—not ashamed—of the contributions we have made to the supply of cheap energy which has fueled the economic growth of this nation.

With respect to the proposal that gross income for purposes of determining percentage depletion be reduced by the amount of "so-called windfall profits" subject to the tax: the debate over the economic and equitable justification of percentage depletion as applied to nonrenewable resources has occupied this Congress longer than any issue since the tariff debates of the late 19th and early 20th centuries. I will, therefore, take little more of your time. It should be sufficient to point out that the economic justification for depletion is the enhancement of ability to generate capital for new investment. For the same purpose, we permit the landlord to depreciate his apartment building so he can replace it with new housing units when its economic life is gone. The function of depletion as applied to nonrenewable resources is precisely the same. The need for "replacement" of the nonrenewable energy resource is as great and must result from reinvestment in either the same or a new source of energy. To propose an excise tax on gross revenue from oil sales and also to deny depletion is to aggravate both the economic and discriminatory effect beyond either sense for the future or justice for the present.

Mr. Chairman, my views of my economic role, my own financial well-being, and my duty as a citizen is not so myopic as many passonate critics of my business would insist. I fully recognize that individual citizens, and particularly the poor, did not design the patterns of life nor the standard of living in which they must exist and with which they must contend. Particularly since World War II, ready supply of cheap energy fueled affluence and such ease of personal mobility that the landscape of the nation, the design of its cities and the distribution of its people was completely altered. I have no sympathy for those persons of harsh and elitist judgment who now make it fashionable to criticize their fellow Americans whose lives have con-

formed to that pattern. I have every sympathy for the poor, for whom that pattern and standard of living is still an unachievable expectation. The resulting passions and fears of energy shortage and cost require little compassion to recognize. The well-being of all Americans is ill served, however, if those understandable passions and fears are today translated into decisions by government which disable our operating economy by denying it the ability to do what it has so successfully done before, and can do again. That is to generate the capital necessary to adjust our economic life to meet the challenges of the remainder of this century. If left alone to do that job, the free economy will continue to serve the interests of this nation in ways none of us are smart enough to plan or to predict. That is the genius of the system. In testimony for that genius, I appear today.

Thank you, Mr. Chairman.

Senator BOREN. Thank you very much for appearing before the committee. Our next witness is Mr. William Cleary, the president of Boswell Energy Corp. of Oklahoma City. And I might mention that during the time I served as Governor, Mr. Cleary served as the chairman of my Energy Advisory Council. He has made a great contribution in that capacity as the past president of the Oklahoma Independent Petroleum Association. And is extremely knowledgeable in the energy field.

Mr. Cleary, we are very happy to have you testify here before us today.

Senator DOLE. I might just say, I am certain Senator Boren knows that the latest announcement on the cabinet is that Mr. Miller replaced Blumenthal.

So you may want to change your testimony here.

STATEMENT OF WILLIAM CLEARY, PRESIDENT, BOSWELL ENERGY CORP.

Mr. CLEARY. I appreciate the opportunity to talk to you today. I am a native Oklahoman, and I have been in the oil business all my professional career. I worked on a drilling rig, bought leases, started a small company in 1950 and merged it, with remarkably poor timing, in 1973, with W. R. Grace. We had about 10,000 barrels a day of production, equivalent oil production when I left as chief executive officer in 1976. My new company Boswell Energy has three employees. It has a lot of enthusiasm and very little production. We have 25 barrels a day perhaps, but we will have more.

I served on the National Petroleum Council for about 10 years, missed the cut last fall when the council was reduced in size and when individuals were brought on to the council who were not part of the oil industry.

My testimony today concerns a small producer exemption, but since I have been given the opportunity to speak to you, I would like to give you a couple of new thoughts. Why do we have any new tax? If we had an outbreak of bubonic plague, it would certainly be a poor time to run off or even disenchant any of the doctors unless we had a better way to handle it. And I submit we have an energy problem now that is comparble to an outbreak of the plague.

The men and women of the oil industry in the United States are technically the best qualified and most efficient oil finders in the world. In the frontier areas, the offshore plays and in the development of advanced energy technologies, our major oil companies have the skills, the capital, and cash flow to help this Nation solve its energy problems—and the cash requirements are enormous.

Exploratory offshore wells often cost $10 million or more and $100 million is a low figure for an offshore producing platform. Synthetic fuel and oil shale plants will cost around $2 billion for each 50,000 barrels of capacity. It will taken over $150,000 billion of capital to add one-half again as much domestic liquid hydrocarbons as we are presently producing, that is, from synthetics.

Senator BOREN. Would you state that again?

Mr. CLEARY. It will take $150 billion of capital to add half again as much domestic liquid hydrocarbons, that is, 4 million barrels a day, as we are presently producing. And even if the spending started tomorrow on new oil exploration or synthetic fuel plants, we would have no benefits from them for at least 5 years.

A Federal corporation has been proposed to fund and supervise these expenditures. I submit there is a better way to do it.

You will remember that in the 1950's we developed a uranium industry from scratch using private capital and Federal market guarantees. I believe that in 5 years or more we could develop an alternate fuel industry in this country using the same proven system. We might even be able to borrow back some of our dollars from the OPEC group to help fund the new plants—and certainly the initiation of such a project would create a vast number of new jobs at a time when there is some indication that our economy is faltering. And this would be done with private capital. Realistically, however, we can only rely on domestic oil production, plus imports, to get us through the next 5 years.

The best hope for adding oil production in the short term lies with those producers who operate onshore in the lower 48 States. Who are they? The 10,000 or so independent producers who drill 85 percent of the new tests and add more than one-half of the new production in the lower 48. They have no control over the price they get for the oil and gas they discover. For the most part they don't refine or market their oil, and they get just as mad as the fellow in the next car when they have to wait in a gasline. As far as I know, no one is mad at them.

Let me give you a little ancient history. When I entered the oil business in the late 1940's there were a lot of eager entrepreneurs in it and business was flourishing, with twice as many active drilling rigs as we have working today. The economics of the business became marginal in the 1960's when crude prices stabilized and finding costs continued to increase; and the independent group was very substantially reduced through attrition. Through luck, agile management, and hard work, the much smaller group of survivors are now reasonably well off and a lot better oil finders, but their median age is probably close to my own, 58. They love the business and if the numbers are right as they perceive them, they will continue to make use of 30 or more years of accumulated skills in finding new oil and gas.

If the numbers are not right they will be less aggressive in the search, and will be more content to produce their remaining reserves, pay off the bank and retire. I submit the country can't afford to let that happen. With world price crude and no excise tax, this group would maintain all-out efforts to find new oil and gas and attract many newcomers to the business. Again, decontrolled prices help but any additional taxes or any additional uncertainty

will hurt. And I might say that right now, principally because of the uncertainty, we have about 220 rigs idle out of a total of around 2,200. Ten percent of the rigs are not working now. And I am not in that business. The roles played by the major oil companies and the independents are not the same. I have great respect for the major oil companies, their technical skills and their cash flow. I have hired a number of technicians from the majors and I can tell you that the independent oil industry simply could not exist without them.

The majors are at their best where vast amounts of capital are acquired for problem solving, as in offshore operations and the North Slope. They are particularly well equipped to develop alternate fuels provided they have adequate cash flow, and provided they have a reasonable certainty of the market price.

The independents play a different game, and they do it well. I have been an independent producer for more than 30 years and I can tell you that our game is adding new reserves in the onshore areas where there has usually already been a lot of drilling. To do it, we plow back all the cash flow our wells will generate, all we can borrow, and in many cases as much as we can raise from outside investors. The cost of adding a barrel of new reserves continues to go up. It costs about seven times as much today to find a barrel of domestic oil as it did 15 years ago. At present finding costs of around $7.50 per barrel of reserves, we calculate that the wellhead price should be around $22.50 in constant dollars in order to achieve a 15-percent rate of return on our investment. When the finding cost hits $10 that wellhead price will have to be around $30 for a 15-percent return, and I think we will be there in less than 5 years.

For every $7.5 billion spent now we can expect to find 1 billion barrels of new reserves, which translates to around 200,000 barrels a day of new production.

Whatever your decision is on taxes, the cost of finding a barrel of oil in the lower 48 is going to continue to increase, because we operate in a mature, much drilled province, and the remaining targets, although there are many of them, are smaller and more elusive. Inflation is a factor in the increased costs, but the biggest factor is that the big fish in the pond or at least most of them have already been speared and it is a lot tougher to spear the remaining small ones. The more spears we throw, however, the more fish we get.

The remaining onshore reserves in the United States are substantial, but they are elusive and are best found by the small producer, who is uniquely equipped because of his accumulated knowledge of a very well-defined geological area. When one of my associates spends 30 years working the geology of one productive oil county in southern Oklahoma, I can assure you that his chances of finding the remaining oil there are a good deal better than are the chances of the largest major.

A new tax would have two effects on these small producers, and both of them are negative. The first, of course, would be to reduce available cash flow for investment, and the second would be to require additional staffing as well as adding confusion and discouragement because of new bureaucratic compliance requirements. I

spent a good part of last Saturday trying to understand the provisions of House H.R. 3919 and I can't do it. It would take more study or somebody smarter than I. Let's get specific. I propose that if you must tax any portion of the cash flow from crude sales, that you exempt the first 3,500 barrels of oil production per day from any producer. Such an exemption would cover virtually all royalty owners, the operators of most stripper wells and most secondary recovery projects and, in fact, would exempt all but 30 or so of the larger oil companies.

The exemption I am suggesting is equal to about 1 percent of the average daily production of our 10 largest oil companies. The effect of the exemption would be to eliminate an onerous new bureaucratic load on a very substantial number of oil finders who are singularly ill-equipped to handle it, and would dramaticaly increase the intensity of the search for new domestic oil reserves. Remember, those new reserves become new crude oil supply for our Nation's refineries within 3 months of discovery, as opposed to the 5 years or so that we have to wait for new offshore discoveries or alternate fuel plants to help our Nation's crude shortage. I believe it is critical to get them onstream as rapidly as possible in the next 5 years.

Why 3,500 barrels per day? There is nothing magic about that number. I picked it because some years ago the Federal Power Commission defined a small producer of gas as one that produced less than 10 billion cubic feet per year. Using the prices that we are currently getting for gas and oil, that small producer definition translates to about 3,500 barrels per day. From the Nation's standpoint I think it is foolish to impair the cash flow of the 10,000 barrel per day independent producer or the 20,000 barrel per day producer, but 3,500 barrels per day fits a small producer definition already established by the Federal Government.

I would also urge an exemption for the first 3,500 barrels a day produced by any individual or operator for simplicity's sake, and to avoid building in a disincentive to continue exploring when an operators' production reaches 3,499 barrels per day.

Senator DOLE. If you are going to do that, you will have the same problem the last witness has just explained. If you produce more energy, you pay a penalty.

Mr. CLEARY. The small producers of this Nation are best equipped to help this country buy time, by maintaining and increasing domestic production. I urge you not to tie the hands of these producers by imposing additional taxes or bureaucratic loads on them, but to exempt the small producer from the provisions of any tax you may enact.

Thank you very much.

Senator BOREN. Let me ask you this. Do you have an estimate of what you think the additional production would result from the capital that would go into the independent sector from a 3,500 barrel exemption?

Mr. CLEARY. Senator, I would have to work backward from numbers that I think Senator Bentsen had on the amount of dollars that would be lost in taxes. I assume those same dollars would be reinvested. The number is in the $7 to $8 billion category. And that figure comes back to 1 billion barrels of new reserve for each $7 or

$8 billion, 1 billion to 1.5 billion. And that also translates I believe to about 200,000 barrels a day plus or minus, of daily production.

Senator BOREN. Let me ask you something regarding your concept of the guaranteed price which I think was used in the early uranium development. What I hear you saying is that if the President wants to produce 2 million barrels a day of synthetic oil or liquid by the year 1990 and if that is going to cost $80 billion roughly to produce that much—and I notice there is an article here from the New York Times of today—and that is the administration's estimate of $80 billion and you used the same figure $150 billion if we are going to 4 million barrels, so $80 billion for 2 million barrels. And the article today says cost overruns of two or three times are not unusual in this kind of production.

So we may well be dealing with even twice the cost to do that. Do we need to collect that kind of money—which is $80 billion or $100 billion—in actual tax revenues, put it into the budget of some new massive bureaucracy in order to get that much synthetic fuel produced? Or could we follow the guaranteed price route and do it without having the Government having to collect huge sums of money?

Mr. CLEARY. I am saying Government funding I think is the worst way of doing it because you have no guarantee of no cost overruns. Under the other system where private capital comes in and says we will negotiate with you to deliver X barrels at Y price and it is up to you to see we make a profit, that puts the risk in the private sector. It keeps the dollars in the Federal Treasury instead of out financing a guaranteed project.

Senator BOREN. What size fund would you establish for a price guarantee where if you had to pay the total amount, which of course certainly wouldn't be true because presumably you would only pay the margin? If the market price was—say you guaranteed $35 and the market price was only $30, you would only be out $5 as far as the Government. It is almost like an insurance type of funding. What kind of reserve in terms of total dollars would be necessary to actually bring into the Treasury, or would you just advocate not necessariy building a reserve at all?

Mr. CLEARY. I don't think it necessary to establish a reserve. We already have authority, I believe, to set aside 3½ billion barrels of emergency fuel. Some 60 million barrels of that has been purchased by the Federal Government and put in storage. So that could be the repository if you will——

Senator BOREN. We have a strategic reserve of 3½ billion barrels and we have only purchased 60 million. So we could have well over 3 billion, which would be a massive amount. That is approximately 1 year's total production, crude production, or something like that. So we could simply use that authority with the funds already there as the guarantee. And if the market did not assume that synthetic fuel at that price, it could go under the emergency reserve.

Mr. CLEARY. Under the authority already established.

Senator BOREN. So that would not require the Federal Government then to collect any massive amount of Federal money at all, not even a dollar under your concept to bring it into the Treasury or bring it into a trust fund. Might you couple with that additional

investment tax credits or other kinds of incentives to cause people to go into these kinds of projects?

Mr. CLEARY. Yes, I think the market price will be controlled by whatever investment tax credits go along with investment by the bidder or negotiator or the company that is going to put in the plan. And if there are investment tax credits, then the price agreed to would be lower.

Senator BOREN. Let me ask you this. If you were devising the energy policy of this country at this time, would there be any other proposals that you would make if you had a free hand—I gather you would go ahead with decontrol, you would not apply this kind of tax which would drain the industry of needed capital and you would follow the guaranteed price route for synthetic fuels with perhaps an investment tax credit, you would at the very least exempt the first 3,500 barrels—are there any other proposals you can make in terms of what we can do in the next 5 or 10 years to significantly increase domestic energy production?

Mr. CLEARY. I would dismantle or largely reduce the role of the Department of Energy which is a great deterrent presently on producers. I would favor a board that you suggested that has overriding authority to determine priorities. I would favor the President's suggestion of limiting imports because that forces us to face the problem. I think there are some substantial dangers in the absolute limit because any of these programs are going to take a while to gear up. And the loss of 500,000 barrels a day or 1 million barrels of domestic production, a shortfall, let's say, would be disastrous.

Sir, I think you have covered it very well.

Senator BOREN. Well, I appreciate your taking the time to come and testify very much. And I would tell you that I think there are several people that are becoming interested in the guaranteed price concept. And the way in which you have outlined it is very interesting, indeed, and particularly the idea of using the emergency petroleum reserve that we already have established this authority to proceed with that kind of program without the need for any additional tax receipts to finance it.

Thank you very much.

[The prepared statement of Mr. Cleary follows:]

TESTIMONY OF WILLIAM B. CLEARY, INDEPENDENT PRODUCER

SUMMARY

Alternate fuels including sythetics and oil shale cannot be developed in any meaningful quantity for least five years.

The nation's 10,000 or so small producers are best equipped to sustain and increase domestic onshore production in the lower 48 states during those 5 years.

Small Producers typcially reinvest all available cash flow, as well as funds obtained from borrowing and funds from outside investors, in the search for new domestic reserves. Any reduction of cash flow from production, as a result of new taxes, will reduce the intensity of the search.

There are many remaining onshore reserves but the targets are small and harder to find. The big fish in our pond have largely been speared, and although there are still lots of small fish, they are hard to hit, and we have to throw a lot of spears to harvest them—the more spears, the more fish.

A "Small Producer" of gas, as defined by the Federal Power Commission, producers less than 10 billion cubic feet of gas per year. An equivalent oil figure is approximately 3,500 barrels of oil per day. (That amount is approximately 1 percent of the average daily oil production of the 10 largest oil companies.)

I recommend that the first 3,500 barrels of production per day from any operator be exempt from any new tax you may see to entact. This exemption will cover most royalty owners, stripper operators, and most independent operators whose cash flow from production goes directly into the search for new reserves. Those reserves generally are supplying crude to our refineries within 3 months of discovery.

The small producer exemption will have a positive direct effect on the development of reserves needed in the short-term to maintain this nation's crude oil supplies.

TESTIMONY

My name is William B. Cleary and I'm a native Oklahoman. During my oilfield career I have worked on a drilling rig, as a lease broker, and have been responsible for the drilling of a couple of thousand tests for oil and gas during the past 30 years. I started an oil company in 1950 with very little production or money, and merged it with W. R. Grace in 1973. We had about 10,000 barrels a day of oil equivalent production and over 400 employees when I resigned as Chief Executive Officer in 1976. My new company, Boswell Energy Corporation, has 3 employees, a lot of enthusiasm and little production. I have served as head of our State's Independent Producers' Association and served two governors as Vice-Chairman of the Governor's Energy Advisory Council. I served on the National Petroleum Council for 10 years but missed the cut last fall when the Council membership was reduced in size, and members were added from outside the industry. I believe I'm qualified to talk about the independent sector of the oil and gas business.

My testimony concerns a Small Producer exemption but while here I'd like to give you a couple of other thoughts which I believe are in context. Why do we have any new tax? If we had an outbreak of bubonic plague it would certainly be a poor time to run off or even disenchant any of the doctors unless we had a better way to handle the plague. The men and women of the oil industry in the United States are technically the best qualified and the most efficient oil finders in the world. In the frontier areas, the offshore plays and in the development of advanced energy technologies, our major oil companies have the skills, the capital and cash flow to help this nation solve its energy problems, and the cash requirements are enormous. Exploratory offshore wells often cost $10 million or more and $100 million is a low figure for an offshore producing platform. Synthetic fuel and oil shale plants will cost around $2 billion for each 50,000 barrels of capacity. It will take over $150 billion of capital to add one-half again as much domestic liquid hydrocarbons as we're presently producing. And even if the spending started tomorrow on new offshore exploration or on synthetic fuel plants, we would have few benefits from them for at least five years.

We developed a uranium industry in the 1950's using private capital and federal market guarantees. I believe that in five years or more we could develop and alternate fuel industry in this country using the same proven system. We might even be able to borrow back some of our dollars from the OPEC group to help fund the new plants—and think of the thousands of new jobs created by these vast new industries, at a time when our eonomy is faltering!

Realistically, however, we can only rely on domestic oil production, plus imports, to get us through the next five years. The best hope for adding oil production in the short-term lies with those producers who operate onshore in the lower 48 states. Who are they? The 10,000 or so independent producers who drill 85 percent of the new tests and add more than one-half of the new production in the lower 48. They have no control over the price they get for the oil and gas they discover. For the most part they don't refine or market their oil, and they get just as mad as the fellow in the next car when they have to wait in a gas line. As far as I know, no one is mad at them.

Let me give you a little ancient history. When I entered the oil business in the late 1940's there were a lot of eager entrepreneurs in it and business was flourishing with twice as many active drilling rigs as we have working today. The economics of the business became marginal in the 1960's when crude prices stabilized and finding costs continued to increase; and the independent group was very substantially reduced through attrition. Through luck, agile management and hard work, the much smaller group of survivors are now reasonably well-off and a lot better oil finders, but their median age is probably close to my own, 58. They love the business and if the numbers are right as they perceive them, they will continue to make use of 30 or more years of accumulated skills in finding new oil and gas. If the numbers are not right they will be less aggressive in the search, and will be more content to produce their remaining reserves, pay off the bank and retire.

I think the numbers must be sufficiently attractive for this group to maintain all-out efforts to find new oil and gas, and to attract many newcomers to the business. Decontrolled prices help, but any additional taxes will hurt.

The roles played by the major oil companies and the independents are not the same. I have great respect for the major oil companies, their technical skills and their cash flow. I've hired a number of technicians from the majors and I can tell you that the independent oil industry simply could not exist without them. The majors are at their best where vast amounts of capital are acquired for problem solving, as in offshore operations and the North Slope. They are particularly well-equipped to develop alternate fuels provided they have adequate cash flow, and provided they have a reasonable certainty of the market price.

The independents play a different game, and they do it well. I've been an independent producer for more than 30 years and I can tell you that our game is adding new reserves in the onshore areas where there has usually already been a lot of drilling. To do it, we plow back all the cash flow our wells will generate, all we can borrow, and in many cases as much as we can raise from outside investors. The cost of adding a barrel of new reserves continues to go up. It costs about 7 times as much today to find a barrel of domestic oil as it did 15 years ago. At present finding costs of around $7.50 per barrel of reserves, we calculate that the wellhead price should be around $22.50 in constant dollars in order to achieve a 15 percent rate of return on our investment. When the finding cost hits $10.00 that wellhead price will have to be around $30.00 for a 15 percent return, and I think we'll be there in less than five years.

Whatever your decision is on taxes, the cost of finding a barrel of oil in the lower 48 is going to continue to increase, because we operate in a mature, much drilled province, and the remaining targets, althouth there are many of them, are smaller and more elusive. Inflation is a factor in the increased costs, but the biggest factor is that the big fish in the pond have largely been speared, and it's a lot tougher to spear the remaining small ones. The more spears we throw, however, the more fish we get.

The remaining onshore reserves in the United States are substantial, but they are elusive and are best found by the Small Producer, who is uniquely equipped because of his accumulated knowledge of a very well-defined geological area. When one of my associates spends 30 years working the geology of one productive oil county in southern Oklahoma, I can assure you that his chances of finding the remaining oil there are a good deal better than are the chances of the largest major.

A new tax would have two effects on these Small Producers, and both of them are negative. The first, of course, would be to reduce available cash flow for investment, and the second would be to require additional staffing as well as adding confusion and discouragement because of new bureaucratic compliance requirements. I spent a good part of last Saturday trying to understand the provisions of House Bill No. 3919 and I can honestly tell you that I don't have the foggiest notion what my tax might be under that bill.

Let's get specific. I propose that if you must tax any portion of the cash flow from crude sales, that you exempt the first 3,500 barrels of oil production per day from any producer. Such an exemption would cover virtually all royalty owners, the operators of most stripper wells and most secondary recovery projects and, in fact, would exempt all but 30 or so of the larger oil companies. The exemption I'm suggesting is equal to about 1 percent of the average daily production of our 10 largest oil companies. The effect of the exemption would be to eliminate an onerous new bureaucratic load on a very substantial number of oil finders who are singularly ill-equipped to handle it, and would dramatically increase the intensity of the search for new domestic oil reserves. Remember, those new reserves become new crude oil supply for our nation's refineries within 3 months of discovery, as opposed to the five years or so that we have to wait for new offshore discoveries or alternate fuel plants to help our nation's crude shortage. I believe it is critical to get them on stream as rapidly as possible in the next five years.

Why 3,500 barrels per day? There's nothing magic about that number. I picked it because some years ago the Federal Power Commission defined a "Small Producer" of gas as one that produced less than 10 billion cubic feet per year. Using the prices that we're currently getting for gas and oil, that "Small Producer" definition translates to about 3,500 barrels per day. From the nation's standpoint I think it's foolish to impair the cash flow of the 10,000 barrel per day independent producer or the 20,000 barrel per day producer, but 3,500 barrels per day fits a "Small Producer" definition already established by the Federal Government.

I would also urge an exemption for the first 3,500 barrels a day produced by any individual or operator for simplicity's sake, and to avoid building in a disincentive to continue exploring when an operator's production reaches 3,499 barrels per day.

The Small Producers of this nation are best equipped to help this country buy time, by maintaining and increasing domestic production. I urge you not to tie the hands of these producers by imposing additional taxes or bureaucratic loads on them, but to exempt the "Small Producer" from the provisions of any tax you may enact.

Senator BOREN. Our next witness will be Dr. Michal K. Evans of Evans Economics, Inc. We are glad to have you with us today.

STATEMENT OF MICHAEL K. EVANS, EVANS ECONOMICS, INC.

Mr. EVANS. Well, thank you very much, Mr. Chairman. I appreciate the opportunity to present my views here. I would like to really discuss the economic impact of oil decontrol and the windfall profits tax today. I think we have to distinguish between two issues: One is the benefits due to decontrol and the other is the disappearance of those benefits which would occur under the windfall profits tax as presently structured.

The decontrol of oil prices will have several positive effects on the U.S. economy between now and 1985. The rate of inflation will be 0.5 percent per year higher from now until 1981, but then will be 0.2 percent per year lower starting in 1982. Real GNP will be slightly higher and unemployment slightly lower by 1985 than would be the case with no decontrol. Net exports will be approximately $33 billion in 1985 instead of the −$21 billion which would occur under continued controls. Assuming that the oil industry invests 67 percent of their after tax profits stemming from decontrol, investment would increase by an incremental $61 billion in the 1980-85 period.

With decontrol, domestic supply would average 10.9 million barrels per day in 1985, compared to 9.2 million barrels per day with continued controls. Because of somewhat higher oil prices under decontrol, demand would be 0.3 million barrels per day less. Hence imports of crude oil in 1985 would be 8.8 million barrels per day, compared to an 10.8 million barrels per day figure without decontrol.

The lower rate of inflation after 1981 is due to several factors. First, an increase in domestic oil production will tend to moderate the rise in OPEC oil prices by lessening the demand for imported oil. Second, the resulting strengthening of the dollar will lead to lower prices for all imports. Third, the greater stability of worldwide oil prices in real terms will also reduce inflation worldwide, thus providing less upward pressure on commodity prices.

The results are not as positive under the assumption of a windfall profit tax with no plowback provision. Real growth is slightly lower than would be the case without decontrol, while the rate of unemployment is some 0.4 percent higher. The net foreign balance, while showing some improvement relative to decontrol of oil, is just barely positive by 1985. Because the windfall tax reduces cash flow to the oil industry, the incremental increase in investment over the next 6 years is only $28 billion, compared to the $61 billion figure without any windfall tax.

The lower level of investment means that less new oil is found in the Unites States and OPEC oil prices rise faster. In particular,

supply is 0.7 million barrels per day less and imports are 0.4 million barrels per day higher with the windfall profits tax. Furthermore, by 1985 oil prices are 5.8 percent or $1.85 per barrel higher than under the pure decontrol case, and the overall rate of inflation is 0.1 percent per year higher.

The windfall profits tax generates about $6½ billion per year in Federal tax receipts for the 1981-85 period. However, it results in less investment in the oil industry, higher OPEC prices, a faster rate of domestic inflation, more oil imports and less domestic supply than would be the case with decontrol but no such tax. While it is important that the additional revenues received by the oil companies be used for further exploration and drilling, that aim can be effectively accomplished by a plowback provision.

In preparing these results, we have compared the state of the economy under alternative assumptions that: (*a*) Decontrol does not occur at all; (*b*) decontrol continues in effect as scheduled, with a 60 percent windfall profits tax; and (*c*) decontrol and the windfall profits tax are accompanied by a plowback provision. We have simulated the CEAI model to determine the effect of decontrol both with and without the plowback provision. This provides us with a direct measure of the incremental economic effect of the windfall profits tax.

OVERALL ECONOMIC IMPACT

The economic impact of oil price decontrol, if coupled with a plowback provision, would be quite favorable. While inflation would be about 0.5 percent higher during the next 3 years, it would then be about 0.2 percent lower in 1982 and later years. This lower inflation would be caused by slower increases in imported oil prices, which in turn is a direct result of higher domestic production. As a result of a more modest increase in inflation, real growth would expand at a slightly faster rate and hence the rate of unemployment would be about 0.1 percent lower by 1985. The decline in consumption stemming from higher oil prices would be more than offset by the increased investment in the oil industry.

If a plowback provision is added, however, the benefits of decontrol disappear—but not the penalties. The rate of inflation remains higher because imported oil prices rise at a faster rate; OPEC nations have less incentive to curtail price increase because domestic production does not rise. However, the penalty of higher consumer prices are still with the economy. Thus the decline in consumption stemming from lower real income is not matched by the increase in investment in the petroleum industry. Consequently economic performance in 1985 under the scenario of decontrol and a windfall profits tax with no plowback provision is actually somewhat below the case of continued controls. Details of these alternative simulation are given in table I.

TABLE 1.—ECONOMIC EFFECTS OF DECONTROL AND WINDFALL PROFITS TAX

	1979	1980	1981	1982	1983	1984	1985
GNP in 1972 dollars, percent change:							
No decontrol	1.4	−.3	3.7	3.8	3.8	2.8	2.9
Decontrol and plowback (difference)	0	−.1	−.4	−.2	.2	.3	.1
Decontrol and no plowback (difference)	0	−.3	−.5	−.2	.1	.2	.1
Index of industrial production, percent change:							
No decontrol	2.8	−3	5.7	6.1	4.2	3.7	3.6
Decontrol and plowback (difference)	.1	−.2	−.5	−.2	.4	.4	.1
Decontrol and no plowback (difference)	0	−.2	−.7	−.3	.3	.3	.2
Unemployment rate, percent:							
No decontrol	6.3	8.4	7.9	6.9	5.9	5.5	5.2
Decontrol and plowback (difference)	0	−.1	.1	.2	.2	.1	0
Decontrol and no plowback (difference)	0	0	.1	.2	.2	.3	.4
Consumer price index, percent change:							
No decontrol	10.5	8.2	7	7.1	6.5	6.4	6.5
Decontrol and plowback (difference)	0	.8	.6	0	−.2	−.3	−.3
Decontrol and no plowback (difference)	0	.8	.6	.1	−.1	−.2	−.2
Wholesale price index, percent change:							
No decontrol	11.6	7.7	6.7	6.6	6.1	6.2	6.2
Decontrol and plowback (difference)	0	1.4	.8	−.2	−.5	−.6	−.6
Decontrol and no plowback (difference)	0	1.4	.8	0	−.3	−.4	−.4
Federal funds rates, percent:							
No decontrol	10	7.2	6.5	6.6	7.1	7.2	7.1
Decontrol and plowback (difference)	0	.7	.4	−.1	−.3	−.2	−.2
Decontrol and no plowback (difference)	0	.6	.4	−.1	−.4	−.3	−.3
Net foreign balance, current dollars:							
No decontrol	.7	2.8	−8.9	−14.8	−9.2	−12.9	−21.4
Decontrol and plowback (difference)	.9	2.5	12.9	20.2	28.8	38.5	54.1
Decontrol and no plowback (difference)	.5	3.4	10.6	15.1	18.8	24.9	32.1
Fixed business investment in 1972 dollars, percent change:							
No decontrol	3.1	−6.6	4.7	8.4	4.4	3.4	3.2
Decontrol and plowback (difference)	.3	2.1	.1	−.9	−.1	.5	.3
Decontrol and no plowback (difference)	.1	.9	−.6	−.9	0	.4	.1
Price of imported oil (in dollars per barrel):							
No decontrol	18	22.82	25.09	27.59	30.35	33.38	36.70
Decontrol and plowback (percent difference)	0	−2.3	−3.3	−6	−8.6	−11.1	−13.5
Decontrol and no plowback (percent difference)	0	−2.3	−3.3	−4.6	−5.9	−7.2	−8.4
Average price of crude oil (in dollars per barrel):							
No decontrol	14.13	17.46	19.38	21.63	24.02	26.70	29.63
Decontrol and plowback (percent difference)	.8	14.7	22.9	19.9	15.5	11.2	7.2
Decontrol and no plowback (percent difference)	.8	14.7	22.8	21.6	18.9	16	13.4
Imports of crude oil, MMBD:							
No decontrol	8.6	8.9	9.2	9.8	10.1	10.5	10.8
Decontrol and plowback (difference)	−.4	−.4	−.6	−1.1	−1.4	−1.6	−2
Decontrol and no plowback (difference)	−.4	−.6	−.5	−.9	−1	−1.2	−1.3
Domestic supply, MMBD:							
No decontrol	10.2	10.1	10	9.8	9.6	9.4	9.2
Decontrol and plowback (difference)	.1	.2	.5	.8	1.1	1.3	1.7
Decontrol and no plowback (difference)	.1	.1	.2	.4	.6	.8	1

Note.—These results calculated using the Chase Econometric Associates, Inc., Macro Model.

OIL PRICE INCREASES

The principal assumptions underlying the calculations for the demand, supply, and price of oil from now until 1985 are given in table 2. These assumptions may be summarized in the following categories:

(1) INCREASES IN THE PRICE OF OIL

Under the case of no decontrol, we assume that both imported and domestic oil prices will increase at an average rate of 10 percent per year through 1985. With decontrol, the windfall profits tax and plowback provision—referred to as plowback—OPEC prices are assumed to rise only about 7 percent per year from now until 1985, roughly equal to the average rate of inflation. Domestic prices would, of course, increase much faster. they have already

started to move toward world prices on June 1, 1979, and will reach that level by October 1981. Because of the slower growth in worldwide oil prices, however, the differential between the average price of oil in the no decontrol and plowback scenarios narrows after 1981. The average price of oil in the United States is assumed to be $31.76 per barrel by 1985 in the plowback case, compared with $29.63 per barrel under the no decontrol scenario. Hence oil prices would be only 7 percent higher by that date.

With decontrol, the windfall profits tax and no plowback provision—referred to as no plowback—OPEC prices would rise about 8½ percent per year. this would push oil prices up to $33.61 per barrel by 1985, compared to $31.76 per barrel in the plowback case. Oil prices would rise somewhat faster with the windfall profits tax because domestic production would be lower, thus encouraging OPEC nations to step up their price increases.

TABLE 2A.—AVERAGE PRICE OF OIL UNDER VARIOUS ASSUMPTIONS

[No decontrol]

	1979	1980	1981	1982	1983	1984	1985
Imported price (dollars per barrel)	18	22.82	25.09	27.59	30.35	33.38	36.70
Domestic price (dollars per barrel)	10.86	12.74	14.12	15.66	17.37	19.25	21.34
Total demand (million barrels per day)	19.1	19.1	19.3	19.7	19.8	20	20.2
Domestic supply (million barrels per day)	10.2	10.1	10	9.8	9.6	9.4	9.2
Stocks (million barrels per day)	.3	.1	.1	.1	.1	.1	.2
Imports (million barrels per day)	8.6	8.9	9.2	9.8	10.1	10.5	10.8
Average price (dollars per barrel)	14.13	17.46	19.38	21.63	24.02	26.70	29.63
Percent change, average price		23 6	11	11.6	11	11.2	11

TABLE 2B.—AVERAGE PRICE OF OIL UNDER VARIOUS ASSUMPTIONS

[Decontrol with plowback]

	1979	1980	1981	1982	1983	1984	1985
Imported price (dollars per barrel)	18	22.30	24.25	25.94	27.75	29.69	31.76
Domestic price (dollars per barrel)	11.27	18.21	23.40	25.94	27.75	29.69	31.76
Total demand (million barrels per day)	18.8	18.9	19.2	19.4	19.5	19.7	19.9
Domestic supply (million barrels per day)	10.3	10.3	10.5	10.6	10.7	10.7	10.9
Stocks (million barrels per day)	.3	.1	.1	.1	.1	.1	.2
Imports (million barrels per day)	8.2	8.5	8.6	8.7	8.7	8.9	8.8
Average price (dollars per barrel)	14.25	20.03	23.82	25.94	27.75	29.69	31.76
Percent change, average price		40.6	18.9	8.9	7	7	7

TABLE 2C.—AVERAGE PRICE OF OIL UNDER VARIOUS ASSUMPTIONS

[Decontrol with no plowback—baseline]

	1979	1980	1981	1982	1983	1984	1985
Imported price (dollars per barrel)	18	22.30	24.25	26.31	28.55	30.97	33.61
Domestic price (dollars per barrel)	11.27	18.21	23.40	26.31	28.55	30.97	33.61
Total demand (million barrels per day)	18.8	18.7	19.1	19.3	19.4	19.5	19.6
Domestic supply (million barrels per day)	10.3	10.2	10.2	10.2	10.2	10.2	10.2
Stocks (million barrels per day)	.3	.2	.2	.2	.2	.2	.2
Imports (million barrels per day)	8.2	8.3	8.7	8.9	9	9.1	9 2
Average price (dollars per barrel)	14.25	20.04	23.79	26.31	28.55	30.97	33.61
Percent change, average price		40.7	18.7	10.6	8.5	8.5	8.5

TABLE 3.—AVERAGE ANNUAL INCREASE IN ENERGY PRICE AND USAGE

[In percent]

Time period	Real price of energy	Industrial energy use per unit of output	Residential/commercial energy use per capita	Total energy use per GNP ($72)
1948 to 1960	(0.2)	(1.9)	2.0	(1.2)
1960 to 1972	(1.5)	(2.0)	3.0	.1
1972 to 1978	4.0	(3.5)	1.4	(1.4)

ELASTICITY OF DEMAND AND SUPPLY—CHANGES IN THE DEMAND FOR PETROLEUM PRODUCTS [1]

We have assumed that the price elasticity of demand is rather small, but that it increases over time. Thus for the 6-year period 1980 to 1985, we have estimated that the elasticity figures are −0.025, −0.05, −0.075, −0.1, −0.125, and −0.15 for each year respectively. Long-term estimates of the price elasticity are largely guesswork, only since 1972 has the real price of energy increased. However, the figures in table 3 show the long-term relationship between changes in the relative price of energy and the use of energy relative to GNP.

In this table we have chosen to divide the postwar period into three segments. The 1948-60 period was one of essentially no change in the real price of energy, the 1960-72 period was one in which real energy prices rose 4 percent per year.

A fairly close correlation exists between the change in the real price of energy and its usage during these three periods. When energy became relatively cheaper, its use increased faster than GNP; when it became more expensive, its relative use diminished. Indeed, since 1972 the amount of energy consumed per constant dollar of GNP has fallen 8 percent. If that decline had not occurred, we would currently be importing oil at the rate of 11.6 million barrels per day instead of 8.5 million barrels per day—an incremental cost of over $20 billion.

If we use the figures in table 3 to compare the difference between the pre- and post-1972 period, we find that a 5.5 percent increase in the real price of energy resulted in a 1.5 percent decline in energy usage per unit of real GNP, or an implied elasticity of −0.27. Hence our estimate of price elasticities, which average −0.1, are seen to be quite conservative.

Under the plowback scenario, demand would decline by 0.3 million barrels per day by 1985. Under the no plowback case, the decline in demand is estimated to be 0.6 million barrels per day by 1985. This number is somewhat larger because the price of oil rises more rapidly in the no plowback case. However, neither number is very large, since total demand for petroleum products remains at about 20 million barrels per day through 1985. Had we used the −0.27 elasticity estimate, the decline in demand relative to no decontrol would have been twice as great.

[1] These next two sections prepared in association with John C. Zamzow of CEAI.

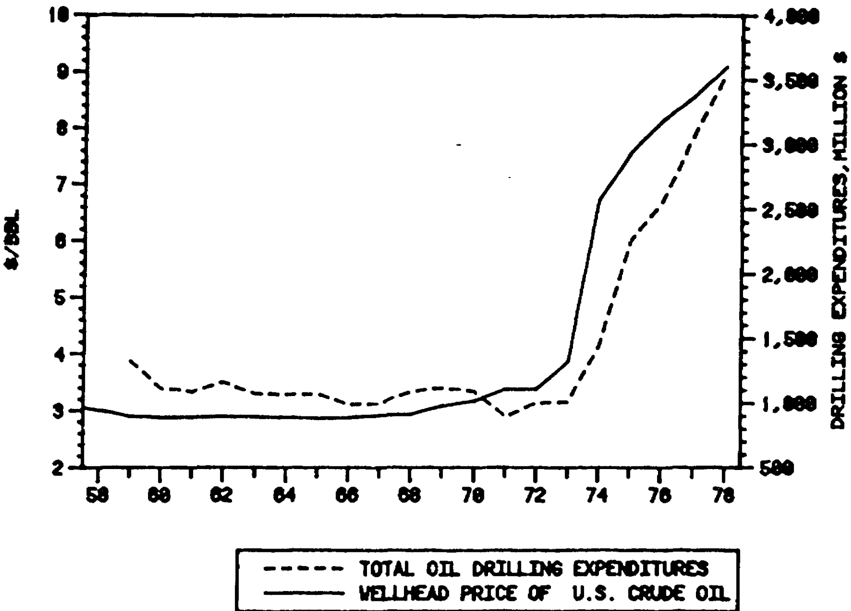
CHANGES IN THE SUPPLY OF PETROLEUM PRODUCTS

Under the plowback assumption, we assume that the real price of domstic crude oil will increae 80 percent over the next 3 years, after which it will rise at the overall rate of inflation. This 80 percent increase is assumed to result in an incremental gain in supply of only 1.7 million barrels per day by 1985, which represents about 16 percent of total domestic production. Hence the implied price elasticity of supply is +0.2.

The conservative nature of this assumption can be seen by glancing at the close correlation between the wellhead price of U.S. crude oil and drilling expenditures for oil, as shown in figure 1. From 1972 to 1978, the average price of U.S. crude oil at the wellhead has risen from $3.27 per barrel to 49.10 per barrel while drilling expenditures have increased from $1 billion to $3.5 billion. Some of this common upward movement has clearly been due to the high rate of inflation. Adjusting for this factor, we find that the real price of crude oil increased by 72 percent from 1972 to 1978, while the amount of drilling expenditures in constant prices rose by 38 percent. Hence the implied elasticity of supply is 0.5. This figure somewhat overstates the true elasticity, since it does not take into account the increaed cost of finding each new barrel of oil. However, it does indicate that our assumed estimate of 0.2 is probably quite conservative.

Figure 1

SUPPLY RESPONSE TO CHANGE IN OIL PRICE



Further evidence of the substantial value of the elasticity of supply can be seen by considering the recent change in the number of drilling rigs and wells drilled. Between 1968 and 1973, when real oil prices were falling, the number of rotary drilling rigs fell from 1,300 to 1,200. Between 1973 and 1978, however, the number increased to 2,250. In 1973, 1,900 workover rigs were in operation; these are drilling rigs designed to extract marginal, low volume production from wells after they have been largely depleted. This number has now risen to approximately 3,000. Finally, we point out that the number of wells drilled has risen from 27,000 in 1973 to 47,000 in 1978.

CHANGES IN IMPORTS AND THE VALUE OF THE DOLLAR

Under the assumption of no decontrol, imports of oil would continue to rise steadily, reaching a level of 10.8 million barrels per day in 1985. At an average price of $36.70, this translates into an oil bill of some $145 billion. Under the plowback case, however, imports rise only to 8.8 million barrels per day at an average price of $31.76, or a total import bill of $102 billion. This $43 billion saving will be offset to a certain extent that oil-producing countries import less from the United States, but the strengthening dollar, as discussed next, will help improve net exports even further. Under the no plowback case, the figures are not as favorable, since the U.S. imports more oil at a higher price. However, the swing is still clearly in the right direction, and the net foreign balance does turn positive by 1985.

Over the past 5 years, a $10 billion change in the U.S. net export balance has eventually resulted in about a 5 percent change in the trade-weighted average of the dollar. Adjusting for inflation, we estimate that a $30 billion saving in net exports will cause the dollar to appreciate about 7½ percent over the 1980–85 period, or about 1½ percent per year.

Since a 10 percent change in the value of the dollar affects domestic inflation by about 1 percent, it is reasonable to assume that this 1½ percent per year appreciation in the dollar lowers domestic inflation by about 0.15 percent per year. This serves as a partial offset to the higher rate of inflation generated by the increase in domestic oil prices.

INCREASED INVESTMENT BY THE OIL INDUTRY

This is the most difficult area to estimate empirically. By 1981 the average price of domestic oil will be about $9 per barrel higher under decontrol than would otherwise be the case. Production of crude oil will be about 10 million barrels per day which means that gross revenues received by the oil companies should be some $34 billion higher. After payment of royalties, operating expenses, severance taxes, and Fedeal, State and local income taxes, the oil industry should be left with about 43 percent of these increased gross revenues, or about $15 billion. With a plowback provision, we estimate that about $10 billion would actually be used for new exploration and drilling in 1981. Similar calculations apply to the other years in the forecast period. The assumptions for increased investment generated by oil price decontrol are given in table 4.

With no plowback, oil producers would probably end up with about 24 percent of the increased revenue, or about $8 billion. Thus $7 billion less per year would be available to spend on further development of supplies. In addition, however, the incentives would be smaller because of the effective marginal tax rate of between 60 percent and 70 percent. Thus we estimate that only $4 billion would be used in 1981 for additional capital expenditures with no plowback, with other years being scaled back accordingly.

Windfall profit tax revenues are estimated to average about $6½ billion per year starting in 1981. The Treasury has indicated that these figures would be much lower, but we assume that OPEC oil prices would rise 1½ percent per year faster than the rate of inflation under the no plowback scenario. Thus the so-called third tier of the windfall profits tax, namely the difference between the current OPEC oil price and $16 per barrel adjusted for the rate of inflation, would provide most of the additional tax revenue. Yet according to our calculations, the additional rise in OPEC prices would not even occur if it were not for the windfall profits tax.

TABLE 4.—INCREMENTAL INVESTMENT UNDER DECONTROL AND WINDFALL PROFITS TAX

[In billions of current dollars]

	1979	1980	1981	1982	1983	1984	1985
Plowback:							
Additional gross revenues generated by higher oil prices	2.1	20.4	34.5	38.3	38.6	38.9	39.2
43 percent left after taxes and other expenses	.9	8.8	14.8	16.5	16.6	18.7	16.9
Increase in investment in the petroleum industry	.8	5.9	9.9	11	11.1	11.2	11.3
No plowback:							
Additional gross revenues generated by higher oil prices [1]	2.1	20.4	34.5	39.7	41.6	43.6	45.6
24 percent left after taxes and other expenses	.5	4.9	8.3	9.5	10	10.5	10.9
Increase in investment in the petroleum industry	.3	3.4	4.2	4.7	5	5.2	5.4
MEMO: Windfall profits tax	.4	3.9	6.5	7	6.6	6.2	6

[1] These figures are higher than the plowback case because it is assumed that OPEC prices rise faster.

The effects of oil price decontrol itself are almost entirely beneficial. While the rate of inflation is 0.5 percent per year higher for the 1979–81 period, it is then 0.2 percent lower for the next 4 years. Real growth is higher and the unemployment rate lower by 1985. Net exports are +$14 billion instead of −$21 billion by that date. Furthermore, total investment in the oil industry is some $16 billion higher over the 1980–85 period.

If we assume that the windfall profits tax does go into effect, but no plowback provision is included, much of the positive results disappear. The windfall profits tax adds an additional 0.1 percent per year to the rate of inflation. Real growth is lower in 1985 and the unemployment rate is 0.4 percent higher. Oil imports decline only to 9.2 million barrels per day instead of 8.8 million barrels per day. The net foreign balance is $2 billion instead of $24 billion in 1985. In addition, incremental investment in the petroleum industry is only half as great as in the plowback case.

Thus the 6½ billion per year extra that the Federal Government would collect from the windfall profits tax is seen to be counterproductive in nature. It raises the rate of inflation, lowers real growth,

increases our dependence on imported oil, and substantially reduces the amount of investment in domestic petroleum drilling and exploration. I can understand President Carter's desire to see that the additional funds which accrue to the oil industry as a result of decontrol are used for further investment in that industry. However, a plowback provision effectively accomplishes just that goal without penalizing any other sector of society.

Senator BOREN. Thank you very much. Could you for the record state something of the business enterprise in which you are involved and the kinds of operations that you have at Evans Economics?

Mr. EVANS. I would be glad to. We are involved in economic consulting and forecasting. We are right now primarily engaged in trying to estimate the effects of productivity and regulation at the industry level in a number of industries. The oil industry is one. We are trying to understand what the Government has done with respect to productivity changes and regulation in a number of industries and show the effects of this on inflation and the amount of real growth.

Senator BOREN. You have mentioned in the past that we have been paying more for foreign oil than we have been paying our own producers. I think it is the first time in the history of the world of any product in any country in which the Government has followed a policy of paying someone in another country more than our own people. I don't think this has ever happened anywhere in the history of the world, which shows the ingenuity of the American process at the Federal level. But it seems to me that we are still, from what you said, by applying a 60 percent tax, if that is the decision that is made, we are still making foreign oil production significantly more attractive than we are domestic oil production because you could really in effect have a significantly higher price being paid to the foreign producer because he gets, whether it is $24 a barrel or whatever it is, he doesn't have to pay a tax on that. Wouldn't that be still true, in other words, still be following the same basic policy, because of the imposition of the tax, even with decontrol of paying a foreign producer, an OPEC producer more to produce oil than we are paying our own people.

Mr. EVANS. There are two parties that benefit because of the windfall profits tax: One is the Treasury and the OPEC nations who both get more money.

Senator BOREN. They become the principal beneficiary of the higher price at the gasoline pumps that the American consumer has to pay?

Mr. EVANS. That is right.

Senator BOREN. Now, do you have estimates as to the amount of decrease in production that would be caused by imposition of the tax as compared to the situation that would be the case that would be if we had no windfall profits tax imposed?

Mr. EVANS. Well, we estimate the domestic supply in terms of a million barrels per day would be approximately—well, right now it is running about 10.2 million barrels a day. Under continued controls completely it would go down to about 9.2 million. We decontrol, but with no plowback we estimate it would stay at 10.2. And

with the decontrol and the plowback it would rise to 10.9 million barrels a day.

Senator BOREN. With a windfall profits tax and this plowback it would decline about 2 million barrels a day.

Mr. EVANS. About 1 million barrels a day.

Senator BOREN. Of a decline.

Thank you very much. I appreciate your testifying before the committee today. And I think you made some excellent points.

Mr. EVANS. Thank you.

[The prepared statement of Mr. Evans follows:]

Evans Economics, Inc.

THE ECONOMIC IMPACT OF OIL PRICE DEREGULATION AND THE WINDFALL PROFITS TAX

By Michael K. Evans

President, Evans Economics, Inc.

EXECUTIVE SUMMARY

The decontrol of oil prices will have several positive effects on the U.S. economy between now and 1985. The rate of inflation will be 0.5% per year higher from now until 1981, but then will be 0.2% per year lower starting in 1982. Real GNP will be slightly higher and unemployment slightly lower by 1985 than would be the case with no decontrol. Net exports will be approximately $33 billion in 1985 instead of the -$21 billion which would occur under continued controls. Assuming that the oil industry invests 67% of their aftertax profits stemming from decontrol, investment would increase by an incremental $61 billion in the 1980-1985 period.

With decontrol, domestic supply would average 10.9 MMBD in 1985, compared to 9.2 MMBD with continued controls. Because of somewhat higher oil prices under decontrol, demand would be 0.3 MMBD less. Hence imports of crude oil in 1985 would be 8.8 MMBD, compared to an 10.8 MMBD figure without decontrol.

The lower rate of inflation after 1981 is due to several factors. First, an increase in domestic oil production will tend to moderate the rise in OPEC oil prices by lessening the demand for imported oil. Second, the resulting strengthening of the dollar will lead to lower prices for all imports. Third, the greater stability of worldwide oil prices in real terms will also reduce

inflation worldwide, thus providing less upward pressure on commodity prices.

The results are not as positive under the assumption of a windfall profits tax with no plowback provision. Real growth is slightly lower than would be the case without decontrol, while the rate of unemployment is some 0.4% higher. The net foreign balance, while showing some improvement relative to decontrol of oil, is just barely positive by 1985. Because the windfall tax reduces cash flow to the oil industry, the incremental increase in investment over the next six years is only $28 billion, compared to the $61 billion figure without any windfall tax.

The lower level of investment means that less new oil is found in the U.S. and OPEC oil prices rise faster. In particular, supply is 0.7 MMBD less and imports are 0.4 MMBD higher with the windfall profits tax. Furthermore, by 1985 oil prices are 5.8% or $1.85/bbl. higher than under the pure decontrol case, and the overall rate of inflation is 0.1% per year higher.

The windfall profits tax generates about $6½ billion per year in Federal tax receipts for the 1981-1985 period. However, it results in less investment in the oil industry, higher OPEC prices, a faster rate of domestic inflation, more oil imports and less domestic supply than would be the case with decontrol but no such tax. While it is important that the additional revenues received by the oil companies be used for further exploration and drilling, that aim can be effectively accomplished by a plowback provision.

In preparing these results, we have compared the state of the economy under alternative assumptions that (a) decontrol does not occur at all, (b) decontrol continues in effect as scheduled, with a 60% windfall profits tax, and (c) decontrol and the windfall profits tax are accompanied by a

plowback provision. We have simulated the CEAI model to determine the effect of decontrol both with and without the plowback provision. This provides us with a direct measure of the incremental economic effect of the windfall profits tax.

OVERALL ECONOMIC IMPACT

The economic impact of oil price decontrol, if coupled with a plowback provision, would be quite favorable. While inflation would be about 0.5% higher during the next three years, it would then be about 0.2% lower in 1982 and later years. This lower inflation would be caused by slower increases in imported oil prices, which in turn is a direct result of higher domestic production. As a result of a more modest increase in inflation, real growth would expand at a slightly faster rate and hence the rate of unemployment would be about 0.1% lower by 1985. The decline in consumption stemming from higher oil prices would be more than offset by the increased investment in the oil industry.

If a plowback provision is added, however, the benefits of decontrol disappear - but not the penalties. The rate of inflation remains higher because imported oil prices rise at a faster rate; OPEC nations have less incentive to curtail price increase because domestic production does not rise. However, the penalty of higher consumer prices are still with the economy. Thus the decline in consumption stemming from lower real income is not matched by the increase in investment in the petroleum industry. Consequently economic performance in 1985 under the scenario of decontrol and a windfall profits tax with no plowback provision is actually somewhat below the case of continued controls. Details of these alternative simulation are given in Table I.

Table 1

Economic Effects of Decontrol and Windfall Profits Tax

	1979	1980	1981	1982	1983	1984	1985
GNP in 1972 Dollars, % Change							
No Decontrol	1.4	-0.3	3.7	3.8	3.8	2.8	2.9
Decontrol and Plowback (Difference)	0.0	-0.1	-0.4	-0.2	0.2	0.3	0.1
Decontrol and No Plowback (Difference)	0.0	-0.3	-0.5	-0.2	0.1	0.2	0.1
Index of Industrial Production, % Change							
No Decontrol	2.8	-3.0	5.7	6.1	4.2	3.7	3.6
Decontrol and Plowback (Difference)	0.1	-0.2	-0.5	-0.2	0.4	0.4	0.1
Decontrol and No Plowback (Difference)	0.0	-0.2	-0.7	-0.3	0.3	0.3	0.2
Unemployment rate, %							
No Decontrol	6.3	8.4	7.9	6.9	5.9	5.5	5.2
Decontrol and Plowback (Difference)	0	-0.1	0.1	0.2	0.2	0.1	0.0
Decontrol and No Plowback (Difference)	0	0.0	0.[illegible]	0.2	0.2	0.3	0.4
Consumer Price Index, % Change							
No Decontrol	10.5	8.2	7.0	7.1	6.5	6.4	6.5
Decontrol and Plowback (Difference)	0.0	0.8	0.6	0.0	-0.2	-0.3	-0.3
Decontrol and No Plowback (Difference)	0.0	0.8	0.6	0.1	-0.1	-0.2	-0.2

Table 1 (continued)

	1979	1980	1981	1982	1983	1984	1985
Wholesale Price Index, % Change							
No Decontrol	11.6	7.7	6.7	6.6	6.1	6.2	6.2
Decontrol and Plowback (Difference)	0.0	1.4	0.8	-0.2	-0.5	-0.6	-0.6
Decontrol and No Plowback (Difference)	0.0	1.4	0.8	0.0	-0.3	-0.4	-0.4
Federal Funds Rates, %							
No Decontrol	10.0	7.2	6.5	6.6	7.1	7.2	7.1
Decontrol and Plowback (Difference)	0.0	0.7	0.4	-0.1	-0.3	-0.2	-0.2
Decontrol and No Plowback (Difference)	0.0	0.6	0.4	-0.1	-0.4	-0.3	-0.3
Net Foreign Balance, Current Dollars							
No Decontrol	0.7	2.8	-8.9	-14.8	-9.2	-12.9	-21.4
Decontrol and Plowback (Difference)	0.9	2.5	12.9	20.2	28.8	38.5	54.1
Decontrol and No Plowback (Difference)	0.5	3.4	10.6	15.1	18.8	24.9	32.1
Fixed Business Investment in 1972 Dollars, % Change							
No Decontrol	3.1	-6.6	4.7	8.4	4.4	3.4	3.2
Decontrol and Plowback (Difference)	0.3	2.1	0.1	-0.9	-0.1	0.5	0.3
Decontrol and No Plowback (Difference)	0.1	0.9	-0.6	-0.9	0.0	0.4	0.1

Table 1 (continued)

	1979	1980	1981	1982	1983	1984	1985
Price of Imported Oil, $/bbl.							
No Decontrol	18.00	22.82	25.09	27.59	30.35	33.38	36.70
Decontrol and Plowback (Percent Difference)	0.0	-2.3	-3.3	-6.0	-8.6	-11.1	-13.5
Decontrol and No Plowback (Percent Difference)	0.0	-2.3	-3.3	-4.6	-5.9	-7.2	-8.4
Average Price of Crude Oil, $/bbl.							
No Decontrol	14.13	17.46	19.38	21.63	24.02	26.70	29.63
Decontrol and Plowback (Percent Difference)	0.8	14.7	22.9	19.9	15.5	11.2	7.2
Decontrol and No Plowback (Percent Difference)	0.8	14.7	22.8	21.6	18.9	16.0	13.4
Imports of Crude Oil, MMBD							
No Decontrol	8.6	8.9	9.2	9.8	10.1	10.5	10.8
Decontrol and Plowback (Difference)	-0.4	-0.4	-0.6	-1.1	-1.4	-1.6	-2.0
Decontrol and No Plowback (Difference)	-0.4	-0.6	-0.5	-0.9	-1.0	-1.2	-1.3
Domestic Supply, MMBD							
No Decontrol	10.2	10.1	10.0	9.8	9.6	9.4	9.2
Decontrol and Plowback (Difference)	0.1	0.2	0.5	0.8	1.1	1.3	1.7
Decontrol and No Plowback (Difference)	0.1	0.1	0.2	0.4	0.6	0.8	1.0

These results calculated using the Chase Econometric Associates, Inc., Macro Model

OIL PRICE INCREASES

The principal assumptions underlying the calculations for the demand, supply, and price of oil from now until 1985 are given in Table 2. These assumptions may be summarized in the following categories:

(1) Increases in the price of oil.

Under the case of no decontrol, we assume that both imported and domestic oil prices will increase at an average rate of 10% per year through 1985. With decontrol, the windfall profits tax and plowback provision (referred to as "plowback"), OPEC prices are assumed to rise only about 7% per year from now until 1985, roughly equal to the average rate of inflation. Domestic prices would, of course, increase much faster. They have already started to move toward world prices on June 1, 1979 and will reach that level by October 1981. Because of the slower growth in worldwide oil prices, however, the differential between the average price of oil in the no decontrol and plowback scenarios narrows after 1981. The average price of oil in the U.S. is assumed to be $31.76/bbl. by 1985 in the plowback case, compared with $29.63/bbl. under the no decontrol scenario. Hence oil prices would be only 7% higher by that date.

With decontrol, the windfall profits tax and no plowback provision (referred to as "no plowback"), OPEC prices would rise about 8½% per year. This would push oil prices up to $33.61/bbl. by 1985, compared to $31.76/bbl. in the plowback case. Oil prices would rise somewhat faster with the windfall profits tax because domestic production would be lower, thus encouraging OPEC nations to step up their price increases.

Table 2A

Average Price of Oil Under Various Assumptions
(No Decontrol)

	1979	1980	1981	1982	1983	1984	1985
Imported Price, $/bbl.......	18.00	22.82	25.09	27.59	30.35	33.38	36.70
Domestic Price, $/bbl.......	10.86	12.74	14.12	15.66	17.37	19.25	21.34
Total Demand, MMBD..........	19.1	19.1	19.3	19.7	19.8	20.0	20.2
Domestic Supply, MMBD.......	10.2	10.1	10.0	9.8	9.6	9.4	9.2
Stocks, MMBD................	0.3	0.1	0.1	0.1	0.1	0.1	0.2
Imports, MMBD...............	8.6	8.9	9.2	9.8	10.1	10.5	10.8
Average Price, $/bbl........	14.13	17.46	19.38	21.63	24.02	26.70	29.63
% Change, Average Price.....		23.6	11.0	11.6	11.0	11.2	11.0

Table 2B

(Decontrol With Plowback)

	1979	1980	1981	1982	1983	1984	1985
Imported Price, $/bbl.......	18.00	22.30	24.25	25.94	27.75	29.69	31.76
Domestic Price, $/bbl.......	11.27	18.21	23.40	25.94	27.75	29.69	31.76
Total Demand, MMBD..........	18.8	18.9	19.2	19.4	19.5	19.7	19.9
Domestic Supply, MMBD.......	10.3	10.3	10.5	10.6	10.7	10.7	10.9
Stocks, MMBD................	0.3	0.1	0.1	0.1	0.1	0.1	0.2
Imports, MMBD...............	8.2	8.5	8.6	8.7	8.7	8.9	8.8
Average Price, $/bbl........	14.25	20.03	23.82	25.94	27.75	29.69	31.76
% Change, Average Price.....		40.6	18.9	8.9	7.0	7.0	7.0

Table 2C

(Decontrol With No Plowback) Baseline

	1979	1980	1981	1982	1983	1984	1985
Imported Price, $/bbl............	18.00	22.30	24.25	26.31	28.55	30.97	33.61
Domestic Price, $/bbl............	11.27	18.21	23.40	26.31	28.55	30.97	33.61
Total Demand, MMBD...............	18.8	18.7	19.1	19.3	19.4	19.5	19.6
Domestic Supply, MMBD............	10.3	10.2	10.2	10.2	10.2	10.2	10.2
Stocks, MMBD.....................	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Imports, MMBD....................	8.2	8.3	8.7	8.9	9.0	9.1	9.2
Average Price, $/bbl.............	14.25	20.04	23.79	26.31	28.55	30.97	33.61
% Change, Average Price..........		40.7	18.7	10.6	8.5	8.5	8.5

Table 3

Average Annual Increase in Energy Price and Usage

Time Period	Real Price of Energy	Industrial Energy Use per Unit of Output	Residential/ Commercial Energy Use per Capita	Total Energy Use per GNP($72)
1948-1960	(0.2%)	(1.9%)	2.0%	(1.2%)
1960-1972	(1.5%)	(2.0%)	3.0%	0.1%
1972-1978	4.0%	(3.5%)	1.4%	(1.4%)

ELASTICITY OF DEMAND AND SUPPLY

Changes in the demand for petroleum products.*

We have assumed that the price elasticity of demand is rather small, but that it increases over time. Thus for the six-year period 1980 to 1985, we have estimated that the elasticity figures are -0.025, -0.05, -0.075, -0.1, -0.125, and -0.15 for each year respectively. Long-term estimates of the price elasticity are largely guesswork, since only since 1972 has the real price of energy increased. However, the figures in Table 3 show the long-term relationship between changes in the relative price of energy and the use of energy relative to GNP.

In this table we have chosen to divide the postwar period into three segments. The 1948-1960 period was one of essentially no change in the real price of energy, the 1960-1972 period was one in which real energy prices rose 4% per year.

A fairly close correlation exists between the change in the real price of energy and its usage during these three periods. When energy became relatively cheaper, its use increased faster than GNP; when it became more expensive, its relative use diminished. Indeed, since 1972 the amount of energy consumed per constant dollar of GNP has fallen 8%. If that decline had not occurred, we would currently be importing oil at the rate of 11.6 MMBD instead of 8.5 MMBD--an incremental cost of over $20 billion.

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*These next two sections prepared in association with John C. Zamzow of CEAI.

If we use the figures in Table 3 to compare the difference between the pre- and post-1972 period, we find that a 5.5% increase in the real price of energy resulted in a 1.5% decline in energy usage per unit of real GNP, or an implied elasticity of -0.27. Hence our estimate of price elasticities, which average -0.1, are seen to be quite conservative.

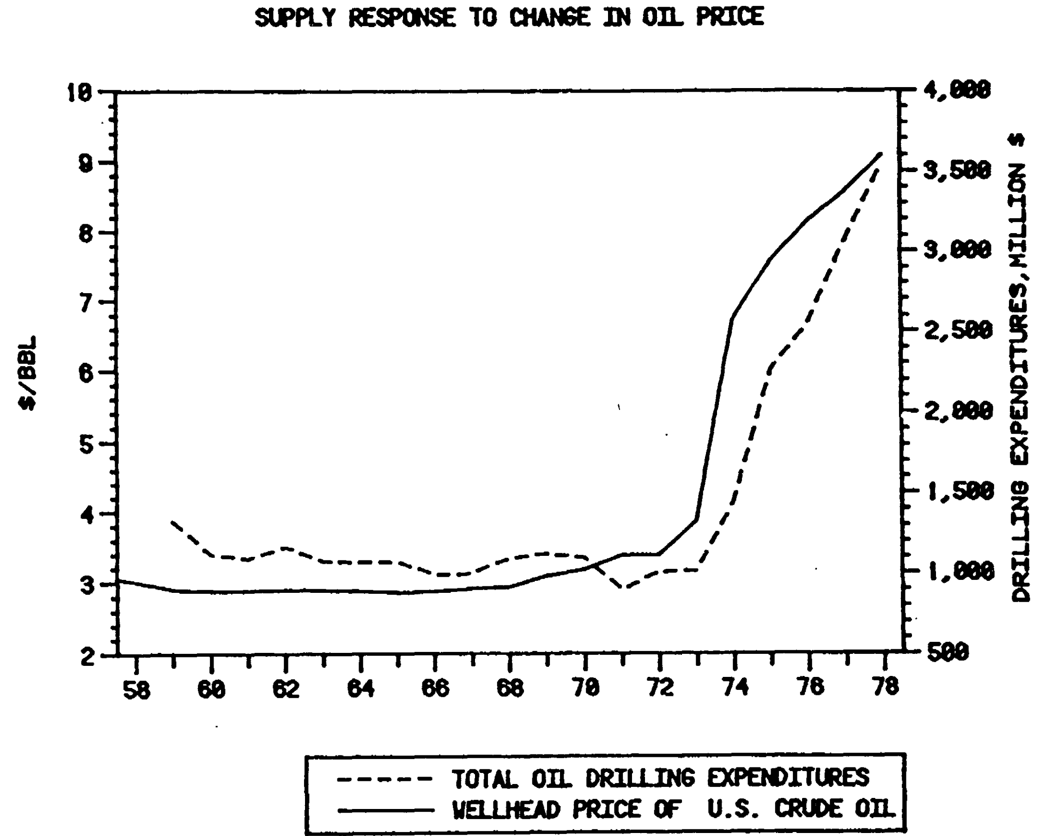
Under the plowback scenario, demand would decline by 0.3 million barrels per day (MMBD) by 1985. Under the no plowback case, the decline in demand is estimated to be 0.6 MMBD by 1985. This number is somewhat larger because the price of oil rises more rapidly in the no plowback case. However, neither number is very large, since total demand for petroleum products remains at about 20 MMBD through 1985. Had we used the -0.27 elasticity estimate, the decline in demand relative to no decontrol would have been twice as great.

Changes in the supply of petroleum products

Under the plowback assumption, we assume that the real price of domestic crude oil will increase 80% over the next three years, after which it will rise at the overall rate of inflation. This 80% increase is assumed to result in an incremental gain in supply of only 1.7 MMBD by 1985, which represents about 16% of total domestic production. Hence the implied price elasticity of supply is +0.2.

The conservative nature of this assumption can be seen by glancing at the close correlation between the wellhead price of U.S. crude oil and drilling expenditures for oil, as shown in Figure 1. From 1972 to 1978, the average price of U.S. crude oil at the wellhead has risen from $3.27/bbl. to $9.10/bbl. while drilling expenditures have increased from $1.0 to $3.5

Figure 1



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billion. Some of this common upward movement has clearly been due to the high rate of inflation. Adjusting for this factor, we find that the real price of crude oil increased by 72% from 1972 to 1978, while the amount of drilling expenditures in constant prices rose by 38%. Hence the implied elasticity of supply is 0.5. This figure somewhat overstates the true elasticity, since it does not take into account the increased cost of finding each new barrel of oil. However, it does indicate that our assumed estimate of 0.2 is probably quite conservative.

Further evidence of the substantial value of the elasticity of supply can be seen by considering the recent change in the number of drilling rigs and wells drilled. Between 1968 and 1973, when real oil prices were falling, the number of rotary drilling rigs fell from 1300 to 1200. Between 1973 and 1978, however, the number increased to 2250. In 1973, 1900 workover rigs were in operation; these are drilling rigs designed to extract marginal, low volume production from wells after they have been largely depleted. This number has now risen to approximately 3000. Finally, we point out that the number of wells drilled has risen from 27,000 in 1973 to 47,000 in 1978.

Changes in imports and the value of the dollar

Under the assumption of no decontrol, imports of oil would continue to rise steadily, reaching a level of 10.8 MMBD in 1985. At an average price of $36.70, this translates into an oil bill of some $145 billion. Under the plowback case, however, imports rise only to 8.8 MMBD at an average price of $31.76, or a total import bill of $102 billion. This $43 billion saving will be offset to a certain extent that oil-producing countries import less from

the U.S., but the strengthening dollar, as discussed next, will help improve net exports even further. Under the no plowback case, the figures are not as favorable, since the U.S. imports more oil at a higher price. However, the swing is still clearly in the right direction, and the net foreign balance does turn positive by 1985.

Over the past five years, a $10 billion change in the U.S. net export balance has eventually resulted in about a 5% change in the trade-weighted average of the dollar. Adjusting for inflation, we estimate that a $30 billion saving in net exports will cause the dollar to appreciate about 7½% over the 1980-1985 period, or about 1½% per year.

Since a 10% change in the value of the dollar affects domestic inflation by about 1%, it is reasonable to assume that this 1½% per year appreciation in the dollar lowers domestic inflation by about 0.15% per year. This serves as a partial offset to the higher rate of inflation generated by the increase in domestic oil prices.

Increased investment by the oil industry

This is the most difficult area to estimate empirically. By 1981 the average price of domestic oil will be about $9.00/bbl. higher under decontrol than would otherwise be the case. Production of crude oil will be about 10 MMBD, which means that gross revenues received by the oil companies should be some $34 billion higher. After payment of royalties, operating expenses, severance taxes, and Federal, state and local income taxes, the oil industry should be left with about 43% of these increased gross revenues, or about $15 billion. With a plowback provision, we estimate that about $10 billion would actually be used for new exploration and drilling in 1981. Similar calculations apply to the other years in the forecast period. The assumptions for increased

investment generated by oil price decontrol are given in Table 4.

With no plowback, oil producers would probably end up with about 24% of the increased revenue, or about $8 billion. Thus $7 billion less per year would be available to spend on further development of supplies. In addition, however, the incentives would be smaller because of the effective marginal tax rate of between 60% and 70%. Thus we estimate that only $4 billion would be used in 1981 for additional capital expenditures with no plowback, with other years being scaled back accordingly.

Windfall profit tax revenues are estimated to average about $6½ billion per year starting in 1981. The Treasury has indicated that these figures would be much lower, but we assume that OPEC oil prices would rise 1½% per year faster than the rate of inflation under the no plowback scenario. Thus the so-called third tier of the windfall profits tax, namely the difference between the current OPEC oil price and $16/bbl. adjusted for the rate of inflation, would provide most of the additional tax revenue. Yet according to our calculations, the additional rise in OPEC prices would not even occur if it were not for the windfall profits tax.

Table 4

Incremental Investment Under Decontrol and Windfall Profits Tax

	1979	1980	1981	1982	1983	1984	1985
Plowback							
Additional Gross Revenues Generated by Higher Oil Prices...	2.1	20.4	34.5	38.3	38.6	38.9	39.2
43% Left After Taxes and Other Expenses..................	0.9	8.8	14.8	16.5	16.6	18.7	16.9
Increase In Investment in the Petroleum Industry..............	0.8	5.9	9.9	11.0	11.1	11.2	11.3
No Plowback							
Additional Gross Revenues Generated by Higher Oil Prices*..	2.1	20.4	34.5	39.7	41.6	43.6	45.6
24% Left After Taxes and Other Expenses..................	0.5	4.9	8.3	9.5	10.0	10.5	10.9
Increase in Investment in the Petroleum Industry..............	0.3	3.4	4.2	4.7	5.0	5.2	5.4
MEMO: Windfall Profits Tax......	0.4	3.9	6.5	7.0	6.6	6.2	6.0

*These figures are higher than the plowback case because it is assumed that OPEC prices rise faster.

All figures in billions of current dollars.

CONCLUSION

The effects of oil price decontrol itself are almost entirely beneficial. While the rate of inflation is 0.5% per year higher for the 1979-1981 period, it is then 0.2% lower for the next four years. Real growth is higher and the unemployment rate lower by 1985. Net exports are +$14 billion instead of -$21 billion by that date. Furthermore, total investment in the oil industry is some $61 billion higher over the 1980-1985 period.

If we assume that the windfall profits tax does go into effect, but no plowback provision is included, much of the positive results disappear. The windfall profits tax adds an additional 0.1% per year to the rate of inflation. Real growth is lower in 1985 and the unemployment rate is 0.4% higher. Oil imports decline only to 9.2 MMBD instead of 8.8 MMBD. The net foreign balance is $2 billion instead of $14 billion in 1985. In addition, incremental investment in the petroleum industry is only half as great as in the plowback case.

Thus the $6½ billion per year extra that the Federal government would collect from the windfall profits tax is seen to be counterproductive in nature. It raises the rate of inflation, lowers real growth, increases our dependence on imported oil, and substantially reduces the amount of investment in domestic petroleum drilling and exploration. I can understand President Carter's desire to see that the additional funds which accrue to the oil industry as a result of decontrol are used for further investment in that industry. However, a plowback provision effectively accomplishes just that goal without penalizing any other sector of society.

Senator BOREN. We are happy to have you, Mr. Buttram. We appreciate your taking the time to do so.

STATEMENT OF DORSEY BUTTRAM, VICE PRESIDENT, OKLAHOMA INDEPENDENT PETROLEUM ASSOCIATION

Mr. BUTTRAM. Thank you. I am here to represent the over 1,000 members of the Oklahoma Independent Petroleum Association. But since their record is so similar to most of the other evidence that has been given here and especially so elegantly described by Dr. Bill Talley, I feel that all that is necessary here will probably be to present the written record for the files.

However, as an independent, I do feel that I have a couple of points that I have not discussed. And I feel they should be brought out. I am a small operator. I am a practicing geologist for over 30 years. I believe that is all the qualification I need to give at this time. I have others, but they are not relevant. As such, I must represent myself as a one-person operator. I can visualize that there are a lot of us independents like that. We don't have these floors of lawyers or accountants as the majors do. I hire my ac-

countants and I hire my attorneys. Therefore, what affects me affects a lot of us. It has been testified adequately and proven adequately that we drill 91 percent of the wells and 75 percent of the reserves and on and on. And I won't repeat them.

But, on the other hand, over half of us have disappeared in this industry of us independents. Now, there is a reason. Now, if we look backward and see what has been done to us, that may explain why half of us have gone broke, and it might also explain what this new regulation will do to us, which will, of course, put more of us out of work and of course to the United States detriment.

So I would like to, if you would please, to review a few minor details, some of which haven't been mentioned but that certainly affect me. We all know we had oil and natural gas prior to 1953 when the price was regulated. And we know the price that came up in the last winter when the interstate gas lines went dry. We also know because of that crisis the National Gas Petroleum Act of 1978 was affected with rather serious consequences. It was so serious to all of us, particularly those of us who don't have lawyers, that actually our IPA had to send out teams of authorities around the United States to explain to oldtime lawmen what had been done to us. We couldn't even understand the law.

Finally, it has been done. I still hire attorneys to interpret it for me. I hope I don't find too much gas because of one simple thing, that I have yet to find anybody knows about in this country: Ignoring the $65 a day I would have assessed on me for each and every day and a penalty of 2 years in the penitentiary for each day I might violate 26 different price categories in this gas.

Like most laws in this country, if my attorneys or my accountants advise me incorrectly, they don't go. I go. Now, I admit that so far to my knowledge, this has not been done but I cannot forget a Miss Hollis of the Federal Energy Commission who told a bunch of us oil people in Denver that she was going to make very specific examples of some of us to prove that her organization meant business.

Now, with that kind of threat over my head do you think I am going to gamble the rest of my life's independence for such a cause?

Senator BOREN. Do you think that perhaps that has something to do with the fact that the number of operating rigs went up by about 300 in anticipation of the hoped-for decontrol, deregulation of natural gas and hoped-for reduction in the kinds of controls, other kinds of controls you are talking about, and that the rig count has gone down by about 300 after this kind of law was enacted?

Mr. BUTTRAM. Sir, I do know that after these different groups have gone around to the various States trying to explain this NGPA more than a few oil people I knew said they were drilling for no more gas. I believe that has been changed a bit maybe as we begin to understand more about this NGPA regulation. But that does not alleviate that penitentiary offense of 2 years for violating 26 price categories which are so ambiguous in between their price categories. There is no way you can be right. I cannot take that chance with my family. My family has nobody else but me to look at.

So then comes the oil deregulation bill recently. And during a

symposium that was held also to try to understand it more recently, I asked a moderator if there was such a penalty on oil. He said, Oh, no, we are a lot better off. There is only 1 year per day for each and every day you violate this pricing law. Now we are a lot better off because instead of 26 categories there are only 8. But believe me, under this windfall tax, the excise tax, this severance tax, whatever you want to call it, the difference between the oil pricing and gas pricing, the definitions are even different between various categories such as new gas.

Now, how am I—and look, the good Lord knew better than we do. He put oil and gas together. I can't separate them. So if I drill a well and I find oil and gas there, and the regulations have gas under one pricing and oil under another and a penitentiary offense, what am I to do?

There is one other point. While these regulations have been going—I found this in traveling around the country. I think it important. We have talked about billions up here. I have heard it bandied around the room until I can't understand it. But I tell you what I can. I have seen the price of our oil imports go from 36 billion in 1977 to 48 billion in 1978 to an estimated 55 billion this year. When I talk to groups of people that doesn't mean nothing. But do you know what gets across to them? $55 billion a year to oil imports is $152 million every day we are giving to those foreigners, which will drill over 700 wells every day in this country and our Government has exported those wells to the foreigners.

Now, if the Senate or some way this world could be passed out to the average citizen, they would understand what this windfall profits tax means because this is what we are giving to our foreigners; taking out of our country. But there is one more point. That now directly after we have seen what has happened to us in the past we come now to this. And there is one thing I must bring up. I have not heard it mentioned. Let me bring up one point.

The depletion allowance has been a debatable issue ever since it has been in existence. The IRS identifies 122 natural resources that get depletion, some more than oil, but only is oil perpetually disputed and argued over. Yet the survival of our Nation depends on it. So what do the opponents do? They put this law in where we don't get that depletion allowance on this tax. And therefore we lose the thing that they have tried to take from us from the beginning.

Senator BOREN. That is a very good point and in fact some of those who have argued most strenuously for doing that in the Congress represent States that are the beneficiaries of similar allowances on other products that are not in such critical shortage in this country.

I am going to have to conclude here because that was a message for a record vote, but we have about 7 or 8 more minutes to get over there. Let me say that I really appreciate your testimony. The full testimony will be entered into the record. I know that the members of the committee are going to study this testimony and the testimony of all of those given today before we begin marking up the excise tax bill.

Let me ask you one quick question. Do you know, at the so-called Camp David summit have you heard were there any independent

oil producers whatsoever represented in that discussion in the formulation of America's energy policy?

Mr. BUTTRAM. That has been caused in Oklahoma and we know of none. I would like to say one final thing. If this tax bill goes through, four-fifths of the money I am spending to find oil and gas will be taken away from me. Four-fifths of the income today that I use will be lost to me.

Senator BOREN. Well, it is a tragedy and it is a tragedy that in formulation of policy that the people who find 91 percent of the energy we are using in this country, the petrochemicals and fossil fuel and the oil and gas, it is absolutely inconceivable to me that they have been totally left out of the deliberative process in the formulating of this policy and not even mentioned in terms of the plan itself when we have the critical need in the next 5 years to significantly shift this balance away from imports. And I appreciate your testimony and that of the others that are here today. I think you have made a real contribution.

I think the tone of your testimony has been that you want to make a contribution to the good of the country. And that is something else that I personally am sick and tired of hearing about—and that is the patriotism of people who sincerely want to make a contribution to their country consequently denigrated because they happen to have some expertise in the energy field. And we are never going to solve the problem when we refuse to talk to people who are going out and making 91 percent of the new discoveries of oil and gas. That is a cinch.

I do appreciate your being here and I do appreciate the other statements that have been made.

[The prepared statement of Mr. Buttram follows:]

STATEMENT OF DORSEY BUTTRAM, BUTTRAM ENERGIES, INC.

Mr. Chairman, I am Dorsey Buttram of Oklahoma City, Oklahoma and I am an independent oil and natural gas producer, having production in some ten states within our country. I am a geologist having practiced this profession for over 30 years as my sole source of income. I am also the Vice President of the Oklahoma Independent Petroleum Association (OIPA) that is made up of a thousand members. I am representing both them and myself but if I could use myself as an example I might better explain the difficulties of our oil industry, only one of which will be the so-called Windfall Profits Tax now being considered by this Committee. I feel that an individual example would be more important to you because various state organizations have well documented their presentation with Oklahoma not being too different from them. Even so a well written statement from the OIPA will be included.

Knowing that we independents drill some 91 percent of all wildcats drilled in this country and discover 75 percent of the reserves, we become a vital part of the current energy crisis in that we could solve it if we were just left alone to do so. But let's look at what's happened to the independent producers within these 48 contiguous states. Until 1953 this nation was abundant in oil and gas. Even during the second War we produced enough energy to supply virtually the entire free world. In 1953 regulation of natural gas use recommended by Congress for the purpose of creating "an adequate supply of this product at a fair price to the consumer". We well remember the resulting crisis of the past few winters when the interstate pipelines carrying natural gas, ran desperately short of this energy. To "alleviate" this problem the Natural Gas Policy Act of 1978 came out of Congress and was so incomprehensible by even the smartest of those in our industry that it took teams of specially informed oil people and related industries to travel throughout the producing states, at their own expense, to try to tell the rest of us what Congress had just done to us independents. It is very appropriately called a retirement fund for accountants and petroleum engineers. Even though most of the complaints center

around the interpretation of these regulations, the ambiguity of "definitions", and not only the mountains of paper work to be filled out but even understanding how to fill them out, I have yet to find the first person outside of my industry that knows the one "statement" in the NGPA that scares me beyond belief, namely, the penalities inflicted upon this industry. Ignoring the fines which can be levied against me by this Act amounting to $65,000 per day under the maximum penalty, which after all is only cash, I can not forget that I can be sent to the penitentiary two years for each and every day I supposedly violate this Act. Just 15 days would put me in the penitentiary for the rest of my life. Realizing that the energy advisor of the then Governor of Oklahoma, Dr. Bill Talley, identified 17 different price catagories which were later upgraded to 26 after the law was passed and examined, I have been unable to find anybody who would guarantee me the proper classification of gas pricing. And the consequences to error—the penitentiary. Forget not that Ms. Hollis of the Federal Energy Regulation Commission stated to a group of oil people in Denver, Colorado that she was going to make examples of some of us to prove her organization meant business in its enforcement.

Then came the different pricing categories of the new "deregulation" of oil. This didn't have the 26 catagories as does natural gas, only 7. During a recent symposium the new pricing and definitions were being discussed. At the appropriate time I asked the Moderator if there were any criminal penalities such as in the NGPA. He sarcastically answered me that we were better off this time since there was only one year imprisonment for each and every day we violated the pricing classifications—again ignoring the fines as inconsequential compared to the imprisonment. When you consider the penalities pressed upon us independents in both the NGPA and the oil "deregulation" and then realize that definitions of certain items between these two laws are not even the same, as an example the definition of new gas and new oil, it makes me wonder how I can even comply with one or the other of these Bills—always remembering imprisonment if I make a mistake. After all, oil and gas invariably come together in nature in spite of the fact that Congress has made definite laws for each.

And now comes what is called the Windfall Profit Tax. It has been amply defined by other witnesses as anything but a windfall, more often called an excise tax than anything and is just one more example of the federal government putting its hands in my pocket and taking away more of the money that I would use to find more oil and natural gas this country so desperately needs. Don't forget that the independent has consistently reinvested back into the ground more than his net profits. There is also an insidious side of this tax that is completely ignored. The matter of the depletion allowance has been debated pro and con ever since its inception, with it being decreased in recent years. Even though the IRS recognizes some 122 natural resources given a depletion allowance, some more than oil and natural gas, it is only our industry that is under continuous attack in trying to eliminate this item. If this tax passes, our opponents will have succeeded in eliminating the depletion allowance completely in this particular catagory since depletion is not computed above base price. Specifically it means that four-fifths of the money I now have to reinvest in finding new oil and gas will be taken by the government and I will only have one-fifth left. To me, a small operator, that would hardly be enough to justify staying in business. If this tax is permitted to be passed, and public opinion and preassure certainly currently indicates this, I am only one who will have just that much less money for energy this nation so desperately needs at a time when President Carter just made his most dramatic appeal for more energy.

It is an absolutely facinating study to me in illogics that Carter is asking for 142 billion dollars in tax money to make this country self sufficient in energy when in reality the oil and natural gas industry has done exactly this for over 100 years without taxing anybody until the government stepped in and started regulating us. Not for one second am I speaking against all other sources of energy that this country may need in the future and will come in time; but the 142 billion dollars proposed by Carter would be taken from my industry to try and fill this energy gap, if in fact it even can. Most certainly it cannot do it as efficiently as a free enterprise system has and can if just left alone.

Obviously this tax should be defeated but todays reality seems otherwise; for if it must be, please, gentlemen, bear in mind the plight of us independents and also that we do have the solution to this energy problem as proven by past experience. Further, there is much talk that this excise tax, to make it acceptable to our industry, will be accompanied by a plow-back feature. Such a plow-back currently being discussed in Washington is totally unacceptable to us independents. It is so impossible to cut through the red tape that as a whole we independents will never see anything from the currently proposed plow-back. If one must be, make it simple

and easily understood to a small operator and one that will be available immediately instead of taking years of petitions and filings through a mess of bureaus in trying to get our refund.

Again, I sincerely thank you for your attention, time, and favorable consideration—not for us but for the future of the great nation.

Senator BOREN. The committee will recess until 9:30 tomorrow morning when we will hear further testimony.

[Whereupon, at 3:35 p.m., the committee recessed, to reconvene at 9:30 a.m., Friday, July 20, 1979.]

CRUDE OIL TAX

TUESDAY, JULY 31, 1979

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

The committee met, pursuant to notice, at 10:10 a.m., in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Talmadge, Ribicoff, Byrd, Bentsen, Matsunaga, Baucus, Boren, Dole, Packwood, Roth, Danforth, Wallop, and Durenberger.

The CHAIRMAN. This morning we will hear the Honorable James Schlesinger, Secretary of Energy; Assistant Secretary of Energy Alvin Alm; and also Mr. Emil Sunley of the Department of the Treasury and Mr. Elliot R. Cutler, Associate Director for Natural Resources, Office of Management and Budget. We would like to talk about how this money is going to be used.

Mr. Secretary, please proceed.

STATEMENT OF HON. JAMES R. SCHLESINGER, SECRETARY OF ENERGY

Secretary SCHLESINGER. Mr. Chairman, I think my purpose here this morning is to represent the administration with regard to the general position over the next decade on energy matters in which the responsibility lies before this committee. I will not repeat the testimony that I gave on my prior visit to this committee that occurred 3 weeks ago, save to emphasize the prospective worldwide limitation on petroleum production of about 65 million barrels.

We have left over from the national energy plan certain unfinished business, primarily in the area of oil pricing, and associated with it is the windfall profits tax.

Into the windfall profits tax has been built a substantial incentive, and we believe that that tax balances the need for increased incentives and the accumulation of resources to build the new technologies that increasingly this country will have to rely on as we approach the decade of the 1990's.

I believe that flexibility must be built into the tax because over the course of the next 10, 15, 20 years, we do not know what the cost of oil production will be. We do not know what the cost of production will be in Alaska or in the Beaufort Sea when we begin to explore those areas.

Right now, for the present, it is plain that the increase in the direct receipts per barrel for the producers from about $14 a barrel

at the start of this year to $19 a barrel represents a substantial increase in incentives and the kind of balancing that is necessary.

We must have, in addition, the resources to bring in the new technologies gradually, to introduce infant industries in the area of synthetic production and the unconventional production of natural gas. The volume of resources that is intended to be gathered through the windfall profits tax is intended to finance a whole array of instruments, many of which have been of concern to this committee.

Let me make two points. First, that in order to achieve these results, we are going to have to have an Energy Mobilization Board with teeth in order to clear away the debris, the redtape, the conflicting objectives among State, local, and Federal bodies—frequently, the conflicting objectives between two local bodies—in order to reconcile the differences.

The purpose of the Energy Mobilization Board is to provide some consistency among the laws that the Congress has passed over the course of the last decade.

Second, the resources that will be provided on a national basis through the windfall profits tax is necessary to fund a whole variety of instruments. Prominent amongst them is the shale oil tax credit.

This committee, and Senator Talmadge in particular, played an instrumental role 18 months ago in starting that process in order to have the resources on a national basis to fund the shale oil tax credit as well as other tax credits, on woodburning stoves, agricultural and industrial process heat, solar, residential construction, and unconventional gas.

We will need to have the resources represented through the windfall profits tax.

The problems that we face today are very serious. The developments in Iran have brought the problems of the mideighties down to 1979, 1980. We face near-term oil shortages over the next 2 or 3 years.

Generally speaking, we face shortages that will be tempered by intermittent periods of recession.

The President's latest proposals are ones that you are familiar with. I will not review them at this time, save to point out that through those proposals, we can save an additional 4.5 billion barrels a day by 1990 and that, in addition to the savings already made, will be a touchstone as to whether or not this country will be able to live with the pending oil stringencies.

We cannot afford to do anything less. We are going through a difficult transition. There will be no comprehensive plan, Mr. Chairman. There is no comprehensive energy plan.

What we must do in this country——

The CHAIRMAN. Even today?

Secretary SCHLESINGER. Even today.

Even today, I think that we recognize that what we are doing is achieving incremental approaches through administration and through legislation, each of which gradually makes the contribution to the solution of our problems, but that a comprehensive energy plan is difficult to achieve simply because energy touches everybody in this country. It touches every interest group; it touch-

es every reason and to put through a massive, comprehensive plan, if the mind of man can effectively design it, is, I think, politically impossible.

We must proceed by increments. A major increment lies before this committee. The tax credits, the so-called phase III that you will be examining in association with the windfall profits tax.

We are running out of time, Mr. Chairman, as a Nation, on energy matters, and the help of this committee will be appreciated by the entire American people.

Thank you, sir.

The CHAIRMAN. Do you other gentlemen have prepared statements?

Mr. CUTLER. I have a prepared statement which I can either read a part of now or wait until you have questioned Dr. Schlesinger.

The CHAIRMAN. Secretary Schlesinger has another appointment. Perhaps we should ask Secretary Schlesinger questions first.

Does Mr. Alm have a prepared statement?

Mr. ALM. I do not.

The CHAIRMAN. Let's question the Secretary first, please, so we can excuse him to attend his meeting. Then we can get to the other witnesses.

Is that all right with the members here?

Senator DOLE. If I could just make one comment, I want to thank Secretary Schlesinger, from all of us on this side of the aisle for your dedication and assistance and courage. We wish you the best.

Secretary SCHLESINGER. Thank you, Senator. I am very appreciative of those comments.

The CHAIRMAN. Let me join in saying, Mr. Secretary, that I echo those sentiments. I think your successor is a good man. He appears to be a fine person, but he is going to have a lot of learning to do. Even recognizing that he is a talented man, I really do not see any reason to think that by the time he gets through learning that he is going to be any better at the job than you are, and I am dismayed to see you leave.

I think I made my views clear to you and the President and everybody before that happened. We do appreciate your service to the country.

Now, let's call on Senator Packwood.

Senator PACKWOOD. Mr. Secretary, if we accept the administration's synthetic fuel program and the tremendous use of coal, can we do it without any lowering of the present environmental standards?

Secretary SCHLESINGER. I think that it can be done without lowering standards, because the environmental standards are specific to regions.

I think there are environmental risks. One of those risks is that involved in the accumulation of carbon dioxide in the atmosphere, but in terms of the specific environmental standards regionally applied, or locally applied, I think that we can, indeed, achieve these results without any major adjustment.

Senator PACKWOOD. By that, you mean we can burn a lot more coal in and around New York City but not change the air quality standards in New York?

Secretary SCHLESINGER. We would not be burning more coal. We would not, under these standards, necessarily be increasing coal use in nonattainment areas.

Senator PACKWOOD. If they were using oil or gas to fire generators you would be changing boilers.

Secretary SCHLESINGER. By 1990, for example, we could be using SRC-1, which is a solid. We could be using methanol in those powerplants if, indeed, an environmental problem continues.

Your question was, could we do this without affecting the environmental standards? The answer to that, I think, is yes, but it may be that the Congress will want to examine the balance between the environment and energy over the course of the next 5 years.

Senator PACKWOOD. What you are suggesting is that synthetic fuels plants can be located in an area where the air quality standards will not be endangered and the product can be shipped to New York or Pittsburgh and be used as a fuel there without any significant change in the air quality standards?

Secretary SCHLESINGER. That is correct.

If we are to avoid additional loads on the nonattainment areas, then, quite apparently, additional facilities must be in other areas.

Senator PACKWOOD. Second, the Harvard Business School's Energy Task Force Study, headed by Dr. Robert Stobaugh, has been played up substantially. I read the book. It is persuasive in indicating that, indeed, we can make it, if that is the right word to use, on conservation and solar energy, although they use solar in the broadest sense of the word—not just the Sun shining on the Earth and the direct use of its energy.

The study indicates that we could be producing 20 to 25 percent of our energy needs with solar by 2000 and another substantial amount by conservation. They seriously question the move toward the synthetic fuels and the size of the commitment of the administration and the quantity of money involved in synthetic fuels.

Would you comment on their conclusions?

Secretary SCHLESINGER. I think conservation continues to be a most attractive low-cost area. The problem is not the attractiveness. The problem is, of course, persuading industries and individuals to conserve to the extent that means real curtailment.

Frequently, it means large, front-end investments, but conservation is very attractive and we have, in recent years in this country, achieved major results. We should continue to strive for maximum conservation. I do not think that there is any difference in view across this land about the advantages of conservation.

With regard to solar energy, as you know, the President has established a target of 20-percent solar by the year 2000. That is, admittedly, an ambitious target. It will require major efforts outside of the Federal Government. It will require luck in technical breakthroughs.

At the moment, since there are uncertainties, one cannot chart a clear path to that result, but we should press ahead with solar energy wherever it is reasonably cost effective and among the items that the committee is examining in phase III, the solar residential construction credit of 20 percent, agriculture process heat, solar tax credit, which would be an additional 15 percent and

we think industrial process heat is one of those solar activities that is near cost effective.

Commercial passive solar construction, gasohol, woodburning stoves—all these fall under the heading of solar. Once again, if we are going to achieve an overall goal in the solar area, it is going to be by these increments that, over time, become cost effective.

Obviously, we can do anything with money if we are prepared to pay the equivalent of $100 a barrel of oil. There are many things that we can do right now in the solar area.

I think that before we plunge ahead, we can be sure that solar substitutes are reasonably cost effective on an overall national standpoint.

With regard to the costs that you mentioned, the $88 billion estimate, I think that is a rough and ready estimate which is based upon very conservative assumptions. It is based upon the assumption that the world's oil prices will not increase and will turn from their present level and I think that is a very conservative assumption. Some might say that it is too conservative, even dubious.

To the extent that world oil prices continue to rise and the gap between world oil prices and the cost of synthetics diminishes, the cost will descend from the $88 billion mark to something much lower than that.

Senator PACKWOOD. Can you tell me a little bit about the arrangement that the Department of Energy has worked out with South Africa on their gasoline-producing plant, producing gasoline from coal?

Secretary SCHLESINGER. We have not worked out an arrangement with South Africa. We have been aware—we have been interested—in contacts between American firms and SASOL to acquire these technologies. In my judgment, we should be prepared to acquire technologies from the South Africans, from Libya, from the Russians, from the Chinese, Iran, anywhere.

We have been interested in the American firms making those contacts.

Approximately a year ago, we had arranged that one of our laboratory teams would visit South Africa and begin to get into the detailed specifications for the operation of these plants.

For international policy reasons, that trip was deferred or canceled, so there has been no direct contact between DOE and the South Africans for the reasons that I mentioned.

Senator PACKWOOD. Thank you.

The CHAIRMAN. Senator Bentsen?

Senator BENTSEN. Let me follow up on that.

On the South African SASOL process, do we have full knowledge of the technology that is used? Do we fully understand the process?

Secretary SCHLESINGER. I think we fully understand the process. It is the technical details, the design of the plant. Seventy to eighty percent of that information, Senator Bentsen, can be obtained through industry contact.

I think the final information will depend upon Government contact.

Senator BENTSEN. I hear it is a proprietary thing. It is something that is kept in confidence and they have not passed on to others, and they guard it very jealously.

Is that true, or not?

Secretary SCHLESINGER. I think the answer to that is yes, sir, but there is a concern on the part of the American Government that the South African Government might be interested in linkage of nonenergy issues if they were to pass this on.

Senator BENTSEN. I understand that. I am just trying to find out if there is such a process that we do not know.

Secretary SCHLESINGER. Yes, sir.

Senator BENTSEN. I would like to pursue another point made by Senator Packwood, and that is to get to this greenhouse effect. I recall Dr. Gordon McDonald, a former member of the Council on Environmental Quality, said our biggest problem in going to synthetic fuels would be the carbon dioxide blankets that would not allow the full diffusion of heat from the Earth and bring about substantial climate changes.

Has the Department of Energy given substantial consideration to that effect and that result?

Secretary SCHLESINGER. Yes, sir. We have a massive research program directed toward the greenhouse effect. It is a technical, scientific program.

With regards to the issue of the synfuel plants, because the volume involved is relatively small, they would only make a marginal contribution towards increasing carbon dioxide in the atmosphere.

Senator BENTSEN. As it is now?

Secretary SCHLESINGER. If you go ahead with the 1.5 or 2 million barrels for 1990.

Senator BENTSEN. Do you think it would be small, marginal? We hear a lot of it in Europe. They seem to be more concerned than we are.

Secretary SCHLESINGER. I think that Chancellor Schmidt has emphasized this, but it is, in part, I think his own view that nuclear power should be pushed and that nuclear power has a great advantage since it does not put new contaminants in the atmosphere.

Senator BENTSEN. I see.

Do you have the price per barrel of oil, synthetic oil, through liquefaction that South Africa is producing? Do you know how much it is costing?

Secretary SCHLESINGER. Yes, sir. We have those numbers. It looks to be something on the order of $25 or $30 a barrel.

Senator BENTSEN. Based on what?

Secretary SCHLESINGER. Based upon the adjustments of the price of coal to the American standards. They are pricing their coal at $9 a ton, I believe, as opposed to the much higher price in the United States.

We would have to make adjustments to the very low labor costs as well as the low coal costs.

Senator BENTSEN. That carries through the adjustments. When you are giving your price at $25 or $30, that correlates to our situation here.

Secretary SCHLESINGER. Yes, sir.

Senator BENTSEN. Last year we had a trade deficit of some $34 billion.

Secretary SCHLESINGER. Sir, may I make one comment?

A large question with respect to the pricing here is what price credit one gives for methane? In earlier years, the methane credit was very low. Now, if we price it at $2.50 to $3 per Mcf, it brings down the cost of the fuel liquid.

Senator BENTSEN. Can you give me the cost of our imported oil in 1978 and an estimate of what you think it will be for 1979 based on current OPEC prices?

Secretary SCHLESINGER. Yes, sir.

In 1978, our oil import bill was $42 billion. In 1979, our oil import bill should be close to $60 billion. In 1980, our oil import bill will be close to $70 billion.

Senator BENTSEN. In the book, "Energy Future," from the Harvard Business School, they estimate that unless conservation becomes our way of life, oil imports will grow from the present level of 8½ million barrels a day to 13½ million barrels a day by the late 1980's.

What is your reaction to that kind of limitation and these kinds of projections that we see in this Harvard Business School report?

Secretary SCHLESINGER. Senator Bentsen, it is going to require very vigorous efforts at domestic production, a great deal of luck in terms of new discoveries, the breakthroughs in technical areas, as well as constraint on the demand for petroleum and petroleum products to stay at the 8.5 billion barrel-a-day level.

It is going to be touch and go at best. It is an ambitious target that has been set. It rests upon assumptions of oil production in the United States based on economic models, not necessarily based on reserves.

Consequently, I think that that is a very optimistic goal.

Senator BENTSEN. One of my concerns is on the stripper well which averages some 2.9 barrels a day, and you can have a workover job that can cost as much as $10,000 and if you put these additional regulations, redtape and tax on stripper wells, my concern is that an awful lot of them would just be closed down, and certainly we do not want to do that.

I do not want to trade a barrel of real oil for a dubious barrel of synthetic oil, so you do have these trade-offs that are involved.

Secretary SCHLESINGER. Yes, sir.

Senator BENTSEN. Do you share that concern?

Secretary SCHLESINGER. I share the concern. I think it will have to be watched with great care. In the course of the last few months, the returns to producers of stripper oil have increased from $13 to $14 a barrel to $22 a barrel. The effect of the windfall profits tax would be to reduce that to $19 to $19.50 a barrel.

There still would be a substantial rise in price as compared to 6 months ago and I think that that would add to the incentives to keep those wells in production, but it is a balancing act as you indicated.

I would hope that the amount of redtape and paperwork would not be great in this case, because the tax would be uniformly applied and that that particular cost would not be significant.

Senator BENTSEN. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Roth?

Senator ROTH. Thank you, Mr. Chairman.

Mr. Secretary, the President's energy package has been severely criticized from a number of directions. You said in your opening statement that time is running out. Yet I note the New Republic, hardly a Republican magazine, I might point out, says the President's program is a failure and a cowardly failure at that.

It attacks the administration's energy package from several directions. First, I would like to ask you a couple of questions about the oil companies. There are basically two points of view: Those who think they are bad guys and that they have not been cooperative with the Department of Energy, that their profits are obscene, they are too big, that we should not let them get involved in other energy areas.

Others take another point of view and go back to World War II, for example, and say when President Roosevelt proposed that 1,000 planes a week, or whatever it was, be manufactured, that he did not say: "We cannot depend on the aircraft industry. They will make too much money." These people want private industry, not the Government, to work our way out of this problem.

I wonder what has been the record of the oil companies as far as your administration of the Department of Energy is concerned, and what in your opinion should be their role? Should they not play an important role in developing these other sources? Are their profits obscene?

Secretary SCHLESINGER. Generally speaking, I lean to the latter of the two views that you mentioned.

Obviously, standards have changed with regard to conflict-of-interest issues since World War II, but the oil industry, the companies in the oil industry, are the only instruments that we have for the production of critical materials from the standpoint of the American economy, and simply bashing them around because we are in some degree of difficulty with regard to energy matters serves no special purpose.

The profits of the industry have been marginally below the general average in industry. I suspect they are now going to go somewhat above the general average in industry.

Most of the increase in profits of late have come from the international operations of the companies. They have not come from the domestic operations of the companies, and that is something to be kept in mind.

Without the technical capacity of these companies, we are simply not going to be able to achieve the objectives of producing additional synthetic fuels. The Government, within itself, does not have that kind of technical capacity, but because of growing inflexibility of the Civil Service and the like, the Government at this juncture of history is not capable of obtaining that kind of capacity.

Senator ROTH. If I understand you, then, you would agree with the statement in the New Republic which says most of the money to finance the synthetic fuels program will go into the coffers of the big energy companies for the reasons that you are spelling out, that they have the expertise?

Secretary SCHLESINGER. I think that there will be a pass through unquestionably. I do not expect that the movement into synthetics will be uniquely profitable for the industry. Therefore, I would put aside that phrase, "going into the coffers of the industry." But,

generally speaking, that is where the technical expertise lies, and consequently, we will have to turn to them if we are to be successful.

Senator ROTH. In the article, it says:

The centerpiece of any sensible energy program will be decontrol of gasoline prices and elimination of the arbitrary allocation system that has exacerbated the current shortage. Carter should speed up the removal of price controls.

Rumor has it that this is very close to your recommendations to the President. Would you care to give your personal comments as to the validity of that statement?

Secretary SCHLESINGER. I have generally been on the side of decontrol. I think the President has had a variety of advice and that there are a number of different objectives that he must reconcile. From an energy standpoint, that is clearly an advantageous route to follow, but he must balance that against his other goals such as the anti-inflation policy.

It is clear that I think that price controls imply allocation systems and no allocation system can work effectively. No allocation system can work effectively, simply because the very act of starting to allocate brings about a shift in the pattern of demand, so that a historical basis for allocation thus leads to misallocation of resources.

In recent months, the allocation system has resulted in placing gasoline where automobiles are not, and that is less than ideal in terms of maximizing the efficacy of the available supplies of fuel.

Senator ROTH. There also has been a great deal of criticism of the President's import quotas. It has been pointed out that, by using 1977 as a base, that was the year where we imported more than we currently are using, that it will have no real bite until after the next Presidential election. Then the question, is going to be, what are we going to do once the economy begins to move upward?

Are we going to refuse to import more oil if it means that the economy cannot grow, cannot develop more jobs for the unemployed? Are we going to reject oil imports. Does that make economic sense?

Secretary SCHLESINGER. The first point, that it will not bite because we are using 1977 levels, I think is probably true except it may bite into the accumulation of the strategic petroleum reserve which I would regard as most regrettable due to the potential emergencies we face.

The second point, this is going to be a very tough target to make. It is going to require vigorous action to constrain demand in ways that will not result in downward pressure on the economy. We can only do that if we have other sources of energy available. That implies vigorous use, not only of solar that Senator Packwood has mentioned, which will provide some small increment, but coal and nuclear which are technologies available today.

Unless we are able to substitute in that manner, we will have precisely a downward pressure on the economy.

Senator ROTH. No one, Mr. Secretary, is claiming that these alternate sources will supply a substantial amount of energy over the next 18 months or 3 years, are they?

Secretary SCHLESINGER. If we are lucky, if NRC does what I regard is its job, we will have a significant number of nuclear plants on line. Through additional wheeling of power, we can reduce the amount of oil that is consumed in our oil-fired power plants.

Senator ROTH. In nuclear, for example, if they are on-line, you mean they are in the process of being constructed?

Secretary SCHLESINGER. They have been—the construction is complete, or virtually complete. The question is the licensing at NRC. We have six or seven new plants. Each nuclear plant will save 35,000 to 40,000 barrels of oil a day, if we get those online. That is a significant savings, and those plants are coming online in the Eastern part of the country and indeed, to some extent, in the Southwest, which are the heavy oil consumers.

There is one coming on-line in California, the other area where oil is typically burned for the production of power. So I think that we have the opportunity of making some substitutions at the margin, but you are quite right that in the short run, the possibilities of substitution are limited. On the other hand, the growth and demand for energy will also be limited. We are going to have to make a step-by-step adjustment during the course of the 1980's in order to live with this 8.5-million-barrels-a-day target.

Senator ROTH. My time is up.

I must say that I am hopeful that our economy will begin growing and I just do not see where this artificial limitation is very realistic, if we are going to have the growth in jobs needed for this economy.

Secretary SCHLESINGER. It will be a very difficult task, Senator. The better the job we can do in moving coal and getting nuclear plants on-line, the less will be the downward pressures on income and employment.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. Mr. Secretary, I am having a difficult time coming to grips with how we make decisions on how to solve the energy problem. You stated in your opening comments that we do not really have a comprehensive energy plan. It is a series of incremental approaches.

Secretary SCHLESINGER. We cannot have a comprehesive energy plan for a variety of reasons and inevitably, we are going to have to proceed 3 years with a cloud of dust, as it were.

Senator DANFORTH. I want to ask you who "we" is.

Secretary SCHLESINGER. The Nation.

Senator DANFORTH. More specifically?

Here in the synthetic fuel area, we were told a day after the President's Sunday night television message a couple of weeks ago that we were going to set up an energy security corporation, that over 10 years the Energy Security Corporation was going to spend $88 billion—note the figure was not $90 billion, or $85 billion, but $88 billion—that the way we were going to spend this money was on synthetic fuel, not some other form of energy production or energy conservation, but specifically synthetic fuel, and that the details were going to be worked out by a board consisting of seven people, three of whom are Cabinet members, four of whom are other people. What other people? Do you know?

Are we going to have consumers and minorities or are we going to have real experts? I do not know.

I am far away from making my own mind up as to whether synthetics or solar or nuclear or conservation is the way to go, because I have not even decided who decides.

Now, it seems to me that there are a couple of conceptual ways to go about this. One way is to say we in Washington do not know how to decide. When we start making decisions, we do the kind of thing we did in the natural gas bill, that is, the committee designs a camel, that is we have a complex scheme and nobody knows, when it is all over, what happened.

So we can say, well, we cannot make these decisions centrally and therefore we are going to let the marketplace make the decisions. We might sweeten the marketplace a little. We might provide guarantees of one kind or another, but basically, what we are going to say to people, if you produce so many Btu's you will be paid at such and such a rate. No matter how you produce it, you make those decisions.

Or, in the alternative, we could say, we in Washington really do know how to decide these things. We could do it centrally and the way to do it centrally is in the political process, 535 Members of Congress plus the President torn apart by various considerations within his own administration, energy, inflation, environmental, and somehow it is all going to work out. In the alternative, we can say, well, we will delegate such a decisionmaking responsibility to a group of experts. We are going to set up a real panel of experts, scientists, economists and so on, make it an odd number of people, five or seven or nine.

Let them make a decision and we will set aside a pot of money and let them spend it in any way they want to spend it. So I really do not know how to go about making the decisions, but I do know that somehow we have kind of fallen apart. The natural gas bill kind of collapsed, and then somebody made a decision that an energy security corporation with $88 billion is the way to go.

I would very much like your comments on how these decisions should be made.

Secretary SCHLESINGER. Senator Danforth, I think that in your comments, you point in a direction, and the direction is that the political process is basically the wrong way to go, that what the Government can do is to provide incentives as you have through the Tax Code and through ancillary mechanism to the private sector. But going directly through the political process will lead to all of the problems that you have mentioned. It will lead to the compromises, to the trade-offs, to the pork barreling and the like.

The great advantage of the natural gas bill is that gas is flowing. It is not perfect. It falls far short of perfect, but it is simply better than what we had as a result of prior politicizing by the Supreme Court decision of 1954.

I think that your remarks point out the fact that we want to go to the marketplace to maximize our reliance on the private sector, upon the firms in the private sector that had the expertise through the use of various sweeteners, such as loan guarantees, and other mechanisms.

The purpose of the President's plan is to take these issues out of the political process and to place it as a responsibility of this group of individuals whose chief function will be to provide the incentives to motivate the private sector to start these infant industries.

We do not know whether it would be $88 billion. Indeed, that is just an estimate, as I indicated earlier to Senator Bentsen. It is based upon all sorts of general assumptions that are very conservative and probably invalid.

Senator DANFORTH. Mr. Secretary, it has not been taken out of the political process. It is a seven-man board. Three of them would be Cabinet members; all of whom would be appointed by the President, serving at his pleasure, and confirmed by the Senate, so it is not out of the political process at all. I am not saying it is a bad idea, but somebody, for example, has made the decision we are going to pursue synthetic fuels to the tune of $88 billion, or in that area. How was that decision made?

Secretary SCHLESINGER. The Energy Security Corporation has a production of 2.5 million barrels of oil equivalent mixed between unconventional gas and synthetic fuels and given the Nation's needs in 1990, that represents a very significant program. It does not however resolve the levels of imports for oil that may or may not be available.

The most fundamental point about our energy problem is that there is no single solution. Those who come forward and say solar will do it all are wrong. Those who say nuclear or coal will do it all are wrong.

We are going to have to have small solutions which cumulatively resolve our national energy problem. Among those elements will be synthetics and unconventional gas, which will be the responsibility of the Energy Security Corporation, and I underscore that. It is designed to provide as close a substitute for the marketplace as we possibly can achieve. Over the course of the next decade, or a decade and a half, if oil prices rise, we will find that these synthetics, for the most part, will become cost-effective and will provide the Nation with the energy resources particularly in the fuel liquid area in which we will be desperately short in the next 25 years.

I think that this adjustment comes as close as we can come towards depoliticizing, which is the objective that you stress.

If every facility is going to go through a process of review, I am preparing for a meeting with Government Operations and Senator Ribicoff this afternoon. The Department of Energy reports to 34 congressional committees. Each member of these committees—that is just committees, not including subcommittees—each member of each committee has a point of view and if all of those viewpoints are reflected in the compromising process for each individual energy facility, indeed we will be in trouble.

Civil Service, as I mentioned earlier, is not, at this point, capable of pulling in the technical and scientific talent that we need, so we are trying to depoliticize this thing, hold out incentives, get as close a facsimile for the marketplace as we can. I think, Senator, that this plan goes in the very direction that you intuitively would like.

The CHAIRMAN. Senator Byrd?

Senator BYRD. Mr. Secretary, you mentioned earlier that the total oil import bill for 1978 was $42 billion and you estimated that it would be $60 billion for 1979?

Secretary SCHLESINGER. Near $60 billion, yes, sir.

Senator BYRD. That is almost a 50-percent increase.

Are we importing more?

Secretary SCHLESINGER. No, sir. We have had a 60-percent rise in the price of oil internationally in terms of official prices since December 31, 1978. Our oil imports are slightly up from last year, but it is that rise in international prices.

Senator BYRD. The recommendation has been made to have an increase in taxes which will bring in a tremendous sum of money. When will the plan be developed and be sent to the Congress as to how that money will be spent?

Secretary SCHLESINGER. I do not intend to be facetious, Senator Byrd, but the detailed questions will be answered later on by Mr. Cutler and by others.

Mr. CUTLER. Senator Byrd, I will address that question in my testimony and would be happy to pursue it further in response to your question.

Secretary SCHLESINGER. I should underscore that there are uncertainties as to what the international prices will be and the gap between synthetic costs and the international prices. The $88 billion figure, I believe, is very conservative.

Senator BYRD. The retail pump price of gasoline in the United States is roughly 88 cents.

Secretary SCHLESINGER. Yes, sir.

Senator BYRD. Most countries have a very much higher price. Some run up to $2.79, $2.58. Most of that difference, though, as I visualize it, comes from a very heavy tax on gasoline.

Does that not account for the basic difference?

Secretary SCHLESINGER. Yes, sir.

Basically the international price of oil will price gasoline at something under $1.

Senator BYRD. It is because of the heavy tax on gasoline that the price is so high in foreign countries

Secretary SCHLESINGER. Yes, sir.

Senator BYRD. In the United States, the tax on motor fuel in round figures is 13 cents, as I recall. Is that about right?

Secretary SCHLESINGER. Yes, sir. It depends on the State, but it runs from 12 to 15 cents.

Senator BYRD. Thank you, Mr. Secretary.

The CHAIRMAN. Mr. Secretary, you have an appointment that you need to attend elsewhere. At what time do you need to depart from here to make that appointment?

Secretary SCHLESINGER. I will have to skip the appointment, Senator, because it was at 11. If you want me to go on——

The CHAIRMAN. I am willing to cooperate, if you want to leave right now, Mr. Secretary.

Secretary SCHLESINGER. Are there any other questions any of the members have?

The CHAIRMAN. Other Senators have questions, and I have questions myself. If you want to come back, we will try to cooperate with you.

Secretary SCHLESINGER. I think it is up to you. If you want to go through one round of questions, Mr. Chairman——

The CHAIRMAN. Then I will take my turn now.

Mr. Secretary, any dollar that we raise in taxes with this tax is fungible. In other words, it could be used for anything. It does not necessarily have to be used for energy?

Secretary SCHLESINGER. Yes, sir.

The CHAIRMAN. For example, the New York Times wrote a very thoughtful editorial a few days ago, about Sunday, and they said that if the Congress could not measure up to the challenge that the State Legislature of New York ought to do it. They said that New York ought to just substitute a 50-cent-a-gallon gas tax for its sales tax and people would not use so much gasoline, that that would solve the problem.

Secretary SCHLESINGER. That was a most invidious comparison, Mr. Chairman.

The CHAIRMAN. Well, I am sure that they were sincere. I do not say that they are wise, but they are sincere. For that big a newspaper, I cannot afford to say anything less.

But when we are looking at the power to tax, it makes me think of what my Uncle Earl said one time, that a politician should not lie unless it is absolutely necessary. I feel the same way about taxing people, that you should not be taxing people unless it is really necessary.

If they are convinced that we do not tax unless it is necessary, then they will be more considerate of us than they would otherwise. We have some Senators on this committee, Senator Roth, Senator Byrd and others, who feel that whenever we can cut taxes, we should try to do it—income taxes, social security taxes, you name it—and we really need to be convinced that this $88 billion—I think that is the figure that needs to be put in synthetics—that that would be the best investment to make.

I am one of those who needs to be convinced. I am a prospect at this moment. I have my doubts about the matter. It is my impression as chairman of the Commerce Committee's Surface Transportation Subcommittee, that if I could be the complete czar—not the kind of czar you are where you go around begging someone to cooperate—I mean if I could be the kind of czar where I could say, this is how it is going to be, the kind of czar that Ivan the Terrible was supposed to have been——

Secretary SCHLESINGER. I dream about that, Mr. Chairman.

The CHAIRMAN. If I could be that kind of czar over the transportation system, that I could move things around this country and use only 50 percent of the energy that we are now using. In terms of the energy it takes to move a train around, how does the amount of energy you need to move a ton of cargo by rail compare to what it takes to move it by truck, for example?

Secretary SCHLESINGER. It is much less to move by rail.

The CHAIRMAN. Can you give me a figure?

Secretary SCHLESINGER. We will supply that for the record, but it is certainly 50 percent or less.

The CHAIRMAN: Right.

[The following was subsequently supplied for the record:]

Not all aspects of trucking and railroading are competitive. Therefore, comparisons should not be made on an aggregated basis. Instead, the two modes need to be looked at as they would function between the same origination and destination points, carrying the same commodities, etc. Some examples, by commodity class, by great circle ton miles are as follows:

ENERGY INTENSITY IN BTU PER GREAT CIRCLE TON-MILE

Commodity	Truck	Railroad
Farm products	2,630	680
Primary metal products	2,720	670
Electrical machinery	4,130	4,220
Basic textiles	3,630	3,350
Transportation equipment	3,970	2,740

The CHAIRMAN. Right there, there is an enormous savings. I have seen an invention that moves stuff around on rails at a much lighter weight than a car. Those cars they tow around are enormously heavy and they do not have to be that heavy I am convinced, to do the ordinary job. They are hauling a huge amount of unnecessary weight around.

In other words, I am convinced that we could move our transportation system with 50 percent of the energy that we use right now. If I were a czar—not your kind of czar, but the old Russian-style czar—I do not have any doubt that I could save that much energy, just ordering that that be done.

You are nodding assent at that. You know of the enormous savings possible in transportation.

All right. Now, let us take the energy used for heating a house.

A lot of houses are heated, like my little place down in Baton Rouge, by electricity. They generate the electricity, then they move the electricity through a wire, and then you use that wire inside the house to heat, but you have lost two-thirds of your power by the time you get it inside the house. You are only getting one-third of it on the output end.

If somebody would just design me a little device where I could generate that electricity in my home, in effect a smaller generator where I could have the fire inside the house and have a filter on the smoke stack, then two-thirds of the heat being lost would be captured right inside the house to begin with, if the electricity was generated in the house.

I am not sure it should be all that complicated. Several years ago, Hubert Humphrey showed us a little radio which someone operated off a lamp. You just put the heat of the lamp underneath it and somehow or other it would capture electricity and make the radio work.

Now, if those types of approaches could be designed, you would get three times the mileage. In this case, it is not mileage, but three times the Btu's inside the house, just because you are capturing the initial Btu's.

Let's take the third situation. Instead of taking coal and making that into liquid, where you use a lot of energy, we could avoid that. About what percentage of your energy do you use making the coal into electricity?

Secretary SCHLESINGER. Twenty percent, Mr. Chairman.

The CHAIRMAN. Twenty percent gone, right there.

Instead of doing it that way, if you start using the coal-burning trains again, that type of approach, I think they are better perfected than they were then, all you need to make that work is a filter to filter the smoke so it does not drop the smoke all over the countryside and you would save 20 percent of your energy right there, just to use crushed-up coal rather than using some different system.

And even with an automobile, theoretically we are going to have to make all this coal into a liquid in order that the automobile will move on the liquid just as it does on gasoline.

Those people act as though they never heard of the old Stanley Steamer. Have you ever heard of the old Stanley Steamer that they had at one time?

Secretary SCHLESINGER. Yes.

The CHAIRMAN. In that case, you just carry the fire around with you, so you simply use the coal rather than hauling gasoline around with you.

I am just saying that there is more than one way to solve the problem, and it may be that research would show that that $88 billion would be a lot better invested otherwise. That works out to be $4,000 a family. You might show that that would be better invested in ways in which people consume the coal inside the premises, rather than making the coal into liquid and then delivering the liquid to them.

What can you tell us about that?

Secretary SCHLESINGER. Mr. Chairman, I make the following observations.

First, the last of the Romanov czars wound up in a bag with a bullet in his head.

Second, the American people do not take well to real czars. I am not sure that they take particularly well to spurious czars either.

Third, the 1.5 to 2 million barrels a day of synthetics is a substitute for the importation of the oil from the Middle East, oil that may or may not be available at that time.

We should push ahead with all of the mechanisms you describe in terms of alternatives to imports. All of the things that you described are not only alternatives to synthetic production, they are alternatives to imports as well. Many of these things we should do, and we are proceeding to do.

Coal is an excellent substitute for oil in boilers. It is a mediocre substitute for oil in the transportation sector unless we can convert the oil into fuel liquids. In the next century, we are going to have to have liquids from coal—no alternative. We might as well get started in the 1980's. I doubt if this is going to cost us $88 billion or anything like that, if the world price of oil rises.

This is only one element of many programs that we should have as a country that will help us provide the degree of independence.

I am now talking about national energy independence, reduced vulnerability, so that we have assurance that the economy will survive through the eighties and nineties, in particular in the nineties, and that we will have an adequate degree of flexibility in our foreign policy and our national security requirements.

These are not substitutes, one for the other. It seems to me that the measures that you point to, I think that we should examine with great care. We will not save a great deal of diesel oil in the railroad system, and I doubt that we want to go back to steam engines, but I do think that we can substitute very readily for oil usage in industry in industrial boilers and in utility boilers. There we can save millions of barrels of oil a day and that is the target that we should go after.

And those are the kinds of devices that indeed are incorporated in the plan, 750,000 barrels a day savings that the President specifies along with the 2.5 million barrels a day of additional production from unconventional gas and synthetics.

I think that this Congress, this country, will want to move ahead on several fronts—the synthetic front among them.

The CHAIRMAN. Senator Durenberger?

Senator DURENBERGER. Thank you, Mr. Chairman.

I will have another crack at the Secretary this afternoon in Government Affairs, so I would like to ask only one question. But first, I would like to take this occasion in this committee to compliment Senator Ribicoff in his initiative in the area of CO_2, the issue that you raised earlier, Senator Bentsen.

I think it was both a welcome from the standpoint of both the scientific community and certainly a very welcome effort on the part of all of us who are trying to deal with the public policy issues involved with synthetic fuels.

My question goes back to the issue that Senator Danforth, and I think everyone else has raised, that is, who makes the decision. I think I heard you say something that I agree with—that is, in effect, that people ought to make the decision. We should not make the decisions, you should not make the decisions, no czar, President, or whatever should make the decisions.

The role that we have to play it seems to me, is to be sure that they can make knowledgeable decisions, that we do not establish public policies that distort those decisions in one way or the other.

That, for example we let the marketplace decide the cost of alternatives; that we do not make it more attractive to waste fuel than to conserve fuel. I could obviously go down the line on a lot of these issues. In response to the chairman's question, I do not have a Hubert Humphrey radio to hold out here in front of everybody, but there is a house in Northfield, Minn., where the temperature varies from 35° F. below in the winter to 100° F. above in the summer and that house is between our mandatory thermostat setting, and it costs $16 a year to heat that house.

Those people are making decisions, but when they come to Government, one of the things they need out of Government is information. If everybody could see that house when I held it up like Senator Long remembers Hubert Humphrey's radio, there would be a lot of people out there doing that sort of thing.

The CHAIRMAN. What did you say?

Senator DURENBERGER. A $16 per year total electric bill.

We had some people at the University of Minnesota do some innovative Earth shelter work. They came to the Department of Energy because they were getting $1,000 worth of phone calls per

week because there was an article in the paper describing what they were doing.

Everybody wanted to know about Earth shelter homes. They came to the Department of Energy and said, can we get $10,000 from you so we can reprint this little thing and hire somebody to answer the phone calls and somebody at DOE looked through the charter of responsibilities and grant programs and could not find anything that fell into that category.

So fortunately, the person from the University of Minnesota said he would leave DOE's telephone number with the rest of the people that call. That is the information connection.

My question really deals, basically, with the function of the energy security fund. When we were all down seeing the President last week one of the points I tried to make is that I do not think that any special tax fund, dedicated fund, ought to dictate our energy policy.

I think it is a horrible mistake for us to create this little pot of money from the windfall profits tax or whatever and then have the political process dictate how much we put into income security, how much we put into synthetic fuels, how much we put in conservation, all that sort of thing.

If our goal is to let the people decide and our job here is to try to do those things legislatively that makes that a knowledgeable decision on their part, why in the world can we not do that out of general revenue? Why can we not do that out of the regular revenue process? Why in the world do we need an energy security fund?

Secretary SCHLESINGER. The administration has, in the past, taken a flexible approach on that. The energy security fund was not originally designed as a trust fund. Some of your colleagues on the House side felt that it should be a trust fund.

A trust fund does create some of the problems that you mentioned, Senator—undeniably so.

I think that the approach that we should take is to establish a target of 2.5 million barrels a day for 1990 and if that comes in at $5 billion of expenditures rather than $88 billion, well and good. The money can be used for other purposes and I am sure that it will be used, including the possibility, if the cost is favorable, for general tax relief.

So I think that we should not anchor ourselves on very uncertain estimates as to levels of expenditure for synthetic production.

With regard to the more general point that you make, Senator Durenberger, markets splendidly allocate resources if there is an extended period of time to make adjustments. Our problem in the energy area is that the time for adjustment, the time for transition, is relatively brief.

Therefore, we must find some facsimile of a market process not departing too much from the discipline it imposes in costs and outputs, and that what we are suggesting is that because of the rising world price of conventional energy that we are simply bringing into play infant industries through a variety of techniques, departing very little from the marketplace, we trust.

If, over a period of 50 years we were to make this transition, this committee would have many years in which to put it into place, to decide whether it wanted to use loan guarantees, tax credits.

We are trying to do this in 10 years. Therefore, you must delegate, it seems to me, responsibility to a body that will be established in accordance with legislation drawn up by this Congress that will have the discretion to make these judgments and I trust that they will make them anyway that this committee would find responsible.

It is designed to be a facsimile of the market process, but compressing what would otherwise be a very long period of market experimentation into a brief period.

Senator DURENBERGER. Thank you.

The CHAIRMAN. Senator Dole?

Senator DOLE. I have a couple of questions. Is there a 10-year plan on how the money will be spent? I note that $173.5 billion will be generated in new revenues to the Federal Government without the windfall tax. I ask that a chart indicating the revenue be placed in the record.

[The chart follows:]

INCREASE IN FEDERAL REVENUE AS A RESULT OF DECONTROL WITHOUT A WINDFALL PROFITS TAX

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Federal Income Tax Revenue	3.0	8.1	11.3	12.5	13.9	15.0	16.5	18.1	20.1	22.0	23.9
Federal Royalty Payment Increase	.2	.5	.6	.7	.8	.8	.9	1.0	1.1	1.2	1.3
TOTAL	3.2	8.6	11.9	13.2	14.7	15.8	17.4	19.1	21.2	23.2	25.2

TOTAL 11 YEAR INCOME IN REVENUE WITHOUT WINDFALL PROFITS TAX 173.5 BILLION

Prepared by Minority Staff Senate Finance Committee
from information supplied by Joint Committee
July 26, 1979

Senator DOLE. In other words, if we pass the Energy Security Corporation, are we going to have a 10-year plan or are we going to make decisions on an ad hoc basis?

Secretary SCHLESINGER. I would hope that it is not an ad hoc basis. I would hope that it is a discipline process that the Energy Security Corporation would employ, gathering the technical data, measuring costs. But we have no 10-year plan. The technical and economic uncertainties are too large now to draw up a preordained plan.

I think that that is the greatest of the dangers. If we did so, we would fall into the greatest of the dangers that Senators Danforth and Durenberger have specified. We do not know enough yet.

Senator DOLE. I watch television occasionally and see things that are happening. I notice everybody has turned up their thermostats to 78 degrees, but people are all bringing fans to work, and there is some question whether they have a right to plug in their fans.

Second, if everybody plugs in their fan, do we save energy? Are we winning or losing the battle?

Secretary SCHLESINGER. The onward thrust of the regulatory process, Senator Dole, has not yet reached the fan. So one is perfectly free to go ahead. Fans are very energy-efficient as compared to air-conditioning.

On balance, I think we can optimize comfort by some mixture of fans and higher levels of household and work temperatures.

Senator DOLE. Do you think we may break even in the process?

Secretary SCHLESINGER. I would think we would come out well ahead.

Senator DOLE. We are considering about 165,000 barrels per day.

Secretary SCHLESINGER. I think that we come out well ahead. I think it is about 300,000 barrels a day on average for the year, but let us make the calculations and insert them into the record.

[The following was subsequently supplied for the record:]

TEMPERATURE RESTRICTION PROGRAM AND FANS

The Argonne National Laboratory has performed an energy comparison of the use of fans versus refrigeration systems (temperature settings) within a commercial office building. Based on their analysis, it is believed that the use of circulating fans can be equated to about a 2° F rise in the comfort temperature range, i.e., higher thermostat setting. It appears also that the energy required to drive fans is approximately one-half that which would be saved by a 2° F rise in thermostat settings.

Considering the spectrum of building types and configurations involved in the temperature restriction program, these conclusions are fairly general and should not be considered definitive for any specific building. However, they are a reasonable guide with respect to the temperature restriction rules. They would indicate that a 76° F temperature limit without fans will consume approximately twice the energy as the present 78° F limit with fans.

The Department of Energy has estimated the savings from a 78° F instead of 76° F setting—without fans—to be 200,000 to 400,000 barrels a day. Therefore, we could say that even with the maximum use of fans, the savings would be 100,000 to 200,000 barrels per day.

If you assume the mid-range of compliance, with a savings of 300,000 barrels a day without fans, then even with a maximum use of fans, savings would be 150,000 barrels.

In short, even with a maximum use of fans we come out ahead. With a more realistic assumption, we should do much better.

Further, it should be noted that the original saving estimates are relatively conservative, assuming that commercial building were set at 76° F prior to the mandatory restriction program. In fact, many buildings were set at a temperature much lower than 76° F.

Senator DOLE. I assume that that depends on how many fans are being used. That probably could be estimated by the Department of Energy with some accuracy.

Secretary SCHLESINGER. We may have to get out an emergency rulemaking that prohibits the electric fan and permits only the hand-waved fan.

Senator DOLE. I think that could happen. I think that is one question that the people are concerned about. They really do not understand this Energy Security Corporation and we may not either. People are concerned about working conditions; they are concerned about a shortage of gasoline.

It is fair to say that gasoline is probably no longer a problem for the remainder of the summer.

Secretary SCHLESINGER. The situation continues to haze. We are now receiving something on the order of 6.9 million barrels a day of crude. I think that problem is disappearing. I suspect it will be back next summer, though.

Senator DOLE. Finally, you indicated that there is some problem with any allocation system. Would you have the same view of rationing gasoline or a rationing system?

Are we going to have the same problems, the same disparity, in rationing?

Secretary SCHLESINGER. The problems will be somewhat different, but it will be very inconvenient. It will be, in its own way, far more costly. I think rationing systems have an allure of being equitable and fair the farther away you are from them, but as you approach them, you discover they do convey the same kinds of problems that any allocation system will convey.

Senator DOLE. I think that you have indicated support for standby rationing.

Secretary SCHLESINGER. Yes, sir.

I think that the world now depends for 60 percent of the oil that moves in international commerce on the Persian Gulf. There have been terrorist threats against the straits recently.

We must have in place, it seems to me, a standby rationing plan to deal with the national security issues, but that is a sudden and temporary—we hope temporary—interruption in supply rather than living with a chronic shortage of 3 percent or 5 percent, which we ought not to deal with, it seems to me, through rationing or through allocations, if possible.

Senator DOLE. Thank you.

The CHAIRMAN. Mr. Wallop?

Senator WALLOP. Thank you, Mr. Chairman.

Mr. Secretary, I was glad to hear you say that the public recriminations on the energy companies serve no useful purpose because I, for one, hope that the President would take his own advice and cool the rhetoric. I think it does absolutely nothing but convince everybody that there is a political solution to an economic problem.

I think there are two results that come from that assumption, and while they may fit the designs of some, are badly serving the country. The public has no confidence in an energy shortage when they are continually told that the shortage is controlled by some diabolical group of plotting corporations to maximize their profits

at the public's misery and personal expense. The public cannot be expected to believe that.

Second, by creating this adversary condition between politics, the public and the oil companies, we do not receive the benefit of corporate expertise or advice in a cooperative way. Everybody has pulled back.

I point out to you that some of the companies who operate in this country also operate in Europe. One of the pieces of advice that British Petroleum has given to the British Government is that they ought to freeze their consumption in place right now for the rest of this century in order to provide for a gross national product increase and economic stability.

Shell Oil Co. has even gone further in their recommendations to Europe, that they cut their net consumption by 30 percent.

These are the same ones who have been cast into an adversary position by the President and other people who take advantage of public misery. I think it is true to say that the public is not aware that the profits they are reading about in the paper these days will not be taxed by the windfall profits tax.

Those are essentially, as you pointed out, profits from brokering international oil.

It is also fair to say that the windfall profits tax does everything to enhance the stature of foreign oil inasmuch as it is only attached to domestic production.

The other point is, there is nothing provided in the way of an incentive to conservation.

You indicate that conservation has a large role to play in solving our energy problems, but the Harvard Energy Group pointed out that the incentives provided to American industry have been totally inadequate, not large enough to encourage energy savings investment needed by the industry.

Do you agree that there is a need for additional incentives, such as tax credits, for energy conservation?

Secretary SCHLESINGER. The Congress last year passed an additional 10-percent tax credit. I think that I would not like to say that that is sufficient. I think that there should be further examination whether accelerated depreciation or the like is necessary to pull many projects across the line, but we certainly have moved in the right direction in the National Energy Act that this committee has been instrumental in passing.

Senator WALLOP. Is it really and truly possible, in your opinion now, that you are no longer a Czar, to create a conservation ethic by taxing production and not consumption?

Secretary SCHLESINGER. No; you are not going to create a conservation ethic in that way. Taxing consumption may provide the enforcer, as it were, to a conservation ethic but not taxing production. It makes no contribution in that direction.

Senator WALLOP. It may make a contribution by reducing production, but I think it might be an unintended one there.

Let me ask you, if the increase in the world price of oil is going to continue, there should come a time when the market price will make synthetic fuels attractive all on their own?

Secretary SCHLESINGER. Yes, sir.

Senator WALLOP. Will there be, at that time, a need for an energy security corporation and should we be contemplating establishing any kind of permanent bureaucracy or permanent tax along these lines?

Secretary SCHLESINGER. The requirements for funding will disappear for the reasons that you indicated. The Energy Security Corporation is designed as a transitional device that would bring into play infant industries and, as world prices rise, the need for any ancillary support for such a corporation will disappear and the corporation will then disappear.

This is only a way of compressing processes that would normally take place in the market at a normal period of time.

Senator WALLOP. We should not contemplate making it permanent, or the tax permanent.

Secretary SCHLESINGER. Well——

Senator WALLOP. I know what Mr. Cutler's view is. I am searching for yours.

Secretary SCHLESINGER. The intent is to have the corporation phase out in 10 years. As I indicated in my response to Senator Bentsen, there will be a need for flexibility with regard to the tax. We cannot, at this time, tell what the future will bear. We do not know what future costs will be.

Therefore, I fully agree that we must retain flexibility irrespective of the legislation that the Congress passes.

Senator WALLOP. Let me ask you one last thing.

In the House's bill and the President's windfall profits bill, but in either case, there is one statement that causes me concern. It says, the "rules applicable to all three tiers"—I am quoting from the Joint Tax Committee's report—"to prevent the tax from burdening high-cost properties, the bill also limits the windfall profits subject to tax to 100 percent of the net income of the properties."

Is that likely to become a production incentive?

Secretary SCHLESINGER. No, sir.

If there is no incentive, there is no incentive.

Senator WALLOP. Thank you.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. Thank you, Mr. Chairman.

Mr. Secretary, I want to associate myself with the remarks of the distinguished Senator from Kansas and the distinguished Senator from Louisiana, our chairman, that were made earlier in this hearing.

You will recall, during the last Congress, this committee decided that we wanted to stimulate alternative sources of energy by production tax credits. This committee agreed to it and the Senate agreed to it and we met with the conferees on the part of the House, and met a stone wall of resistance at that time.

I am delighted that the House has changed their minds, except they are taking a different alternative. The direction that we went, which was to tell private enterprise, if you would produce the energy, we would give you a tax credit.

Now, the idea of the House is to extend the credit and hope they produce the energy. In any event, I want to welcome them to the fold because, as you pointed out in your remarks, it is absolutely

essential, in my judgment, that this country do whatever it can, in every way it can, to produce every alternative type of energy.

Do you agree with that, sir?

Secretary SCHLESINGER. Yes, sir.

Senator TALMADGE. You have been down at Georgia Tech. You have seen what they are doing there in the area of wood and solar energy and other things. They are doing that on the basis of an appropriation from the State government of $1 million. It has been estimated that we have enough wood in this country to produce about 10 percent of the energy needs in America from waste wood.

Do you agree with that?

Secretary SCHLESINGER. Something in that ball park, yes, sir.

Senator TALMADGE. That is a clean-burning alternative that would give no problem environmentally, is that correct?

Secretary SCHLESINGER. That is a little strong. Any combustion products in the atmosphere creates some problem. We would have to look at the details, but generally speaking——

Senator TALMADGE. Cleaner than other alternatives?

Secretary SCHLESINGER. Yes, sir.

Senator TALMADGE. I have introduced two bills, as you know, S. 847 and S. 848, relating to biomass. At Georgia Tech they are producing alcohol from wood, also alcohol from other biomass products, and it is getting close, now, to what we are paying for imported petroleum.

The beauty about that is the jobs would stay in the United States, money would stay in the United States, and energy would be in the United States.

Do you agree with me that we should have, as the President recommended, a production tax credit for shale—and I am delighted he has—and certain types of gas? Would you agree that we ought to extend the production-type credit for biomass also?

Secretary SCHLESINGER. Sir, we have tax credits, of course, that apply to gasohol, which is one of the things that the committee would be considering; also that the President has suggested that the Energy Security Corporation provide some of these authorities.

I would hesitate on how much biomass would be produced out of that 2.5 million barrels a day. That is something that the Energy Security Corporation would have to decide. I would hesitate at this juncture to give a categorical answer to your direct question. I think that the tax credit for biomass deserves examination.

Senator TALMADGE. I know of six operating plants in this country who are currently producing wood pellets, an ideal fuel. The sulphur content is less than .1 percent. Ash content ranges between 1 and 3 percent and conerific value approximates 8,000 Btu a pound.

The fuel pellets burn extremely well with each ton equivalent heatwise to about 2.3 barrels of No. 6 fuel oil. I would like to see a massive commitment to the developing alternative sources of energy, such as this product, which appears to be environmentally sound as well as energy efficient, and do you not concur that the production tax credit ought to be applied to products like that?

Secretary SCHLESINGER. I think that deserves careful examination. I think, as you indicated, this is a very promising area. I think that the administration will review this area and come back

to this committee later on with regard to these kinds of additional credits.

Senator TALMADGE. Most of what we were talking about in the alternative sources of energy development, we are talking about long lead time, years in the future, some 10 years, in many instances.

Developing alcohol from biomass and wood can be done in a matter of months. We can have thousands of little plants throughout the United States that could go in production in a matter of months and producing that energy right here in this country and beginning to make progress shortly, not at some distant time in the future.

Do you not think that is desirable?

Secretary SCHLESINGER. The $16.80 per barrel credit that resulted from the passage of the National Energy Act has led to a very rapid expansion of distillery output of ethanol at this juncture. I think that that is probably sufficient in terms of the work that this committee has already done is sufficient incentive for gasohol at this juncture.

Whether additional tax credits should be given for wood pellets and some of the other items you mentioned is a subject we ought to review with great care.

Senator TALMADGE. Thank you, Mr. Chairman. My time has expired.

Thank you, Mr. Secretary.

The CHAIRMAN. I would like to ask that we include an ad sponsored by Louisiana Pacific, associated with Georgia Pacific, related to the same point.

Senator TALMADGE. A spinoff from the Georgia Pacific.

The CHAIRMAN. With the main offices there in Atlanta, I guess it is.

[The material referred to follows:]

BEST COPY AVAILABLE

In every dead tree he sees bundles of energy.

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The CHAIRMAN. Senator Baucus?

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, as I understand the administration proposal, with approximately $88 billion that you hope to achieve 2.8 billion barrels of synthetic fuel production. That would include, I guess, coal, oil shale and biomass production. Is that correct?

Secretary SCHLESINGER. It is based upon very tenuous assumptions, Senator. It is based upon the assumption that the world price of oil will not rise in real terms from its present level. That is a very tenuous decision.

Senator BAUCUS. Given that assumption, my question is, how much can we produce with $88 billion invested in conservation, solar?

Secretary SCHLESINGER. I am sorry?

Senator BAUCUS. What would the yield be with $88 billion invested, not in synthetic fuels, but instead invested in conservation, solar, in that area?

Secretary SCHLESINGER. Well——

Senator BAUCUS. What do the DOE projections show?

Secretary SCHLESINGER. I think that we would have to give a breakdown, but the potential savings are very substantial in that area, but we have already had programs in place designed to move conservation, including tax credits.

Senator BAUCUS. Do you have a total, not a breakdown, but just a total of how many barrels would be produced?

Secretary SCHLESINGER. No, sir. We can produce that for you and submit it for the record.

[The material referred to follows:]

The Administration estimates that the Energy Security Corporation (ESC) coupled with its proposed tax credits could assure production of 2.5 million barrels per day (MMB/D) of synthetic fuels and unconventional gas by 1990. The Energy Security Corporation would be authorized to spend up to $88 billion for synfuels development. The $88 billion estimate is based on extremely conservative cost and world oil price assumptions. It is very possible that a program to produce 2.5 MMB/D could cost considerably less than the $88 billion authorized for the Corporation, so that any comparison of synfuel investments with solar and conservation investments using the $88 billion figure would not be fair.

The amount of energy that could be saved or produced with an investment of $88 billion in solar energy and conservation could range between 1.2 and 4.5 MMB/D. The maximum value assumes that all investments would be at a minimum in cost at a 50 percent subsidy.

The assumptions used above be varied. Other assumptions would yield different results. It is important to note, however, that solar and conservation investments may not directly reduce oil imports by the quantities shown above. To the extent such investments reduced consumption of electricity produced from coal or nuclear power, or heat produced from coal, there would be little or no oil import reduction.

Senator BAUCUS. The question obviously therefore becomes, if DOE has figures for synthetic fuels, why do they not have them in conservation and solar?

Secretary SCHLESINGER. Conservation takes place in a variety of activities, a heterogeneous collection. We can aggregate that for you and insert it into the record, but it is a very heterogenous collection.

Senator BAUCUS. If you could.

[The material referred to follows:]

In aggregate, the Administration's energy programs proposed since 1977 could save 8.5 MMB/D of imported oil by 1990. The savings would be derived as follows:

Fuel switching, 1.1 MMB/D; conservation, 2.4 MMB/D, and new supply, 5.0 MMD/D. The conservation savings result from a variety of tax, regulatory, and price driven programs which comprise a vast number of separate activities. Overall, the Administration program is a balanced one, with emphasis placed on new supply and conservation.

Senator BAUCUS. Obviously, the development of synthetic fuels is not certain, either. There are an infinite number of complicated factors. As you so stated, the production is very tenuous. It is based upon very tenuous assumptions. So if you would try to answer the same kind of question on the other side in conservation/solar, it would have been more helpful to this committee and Congress. DOE should have similar kinds of projections in respect to the amount of savings we could achieve with solar.

After all, an $88 billion investment is an investment, and hopefully we act somewhat like businessmen in trying to maximize the rate of return on various alternative forms of investments.

Secretary SCHLESINGER. Understood.

What we are providing there is basically fuel liquids as a substitute for imports. In our transportation sector, we are going to be using 11 or 12 million barrels a day and there is no way of conserving effectively in the transportation sector without shifting to mass urban transportation, changing the mix, and I think that that is somewhat different from what is normally described as conservation, which is greater fuel efficiency.

Senator BAUCUS. I asked the question because, as you know, the Harvard Business School study group, which has become somewhat famous these past few days, generally concludes that through conservation and solar efforts and with investment of approximately $50 billion, the country can achieve approximately 2 billion barrels of oil in fuel efficiency. I am curious.

Secretary SCHLESINGER. I am sure we should pursue this. The National Energy Plan was very heavy on conservation measures. We have now reduced our energy coefficient from 1.0 to .5, approximately. That is a great accomplishment.

We should strive, wherever we can, to achieve the results in the energy area that we can through intelligent conservation, fuel efficiency, and not curtailments.

I am fully sympathetic, and the Department is fully sympathetic to that.

Senator BAUCUS. I agree. I do not know if they are right or not right, but it would be helpful to us and enable us to more likely reach a more reasonable and proper solution the more the Department of Energy can do.

Secretary SCHLESINGER. We are in the process of doing that. We will do that and make the results available to you.

Senator BAUCUS. I was also struck with the statement—I do not know whether Elliot Cutler read the statement or you did, Mr. Secretary—on the first page, you state, of the prepared statement, "With or without the proposed exemptions, at best domestic production maintains a stable and perhaps a decline."

Secretary SCHLESINGER. We would expect domestic production to decline. That is quite regrettable.

Senator BAUCUS. With or without the exemptions we were talking about?

Secretary SCHLESINGER. Yes, sir.

If one observes what has been happening in recent years, we have been producing, in this country, 3.1 billion barrels of oil per year. The discovery rate has been on the order of 1.3 billion barrels of oil per year. That is a drawdown of proven reserves of 1.8 billion barrels a year. If we take a 10-to-1 reserve to production ratio, that would deploy a reduction of production each year of 180 million barrels a year or 500,000 barrels a day. We hope to attenuate that, but we will not be able to maintain our present production.

Senator BAUCUS. Could you state that more precisely? Many in the industry disagree with that conclusion. Many in the oil industry feel that with decontrol and with a modest windfall profits tax, that the industry will be able to not only find new discoveries of oil but, with enhanced recovery techniques, produce between—I have heard as high as 500 million barrels of additional domestic production by 1990.

What is the basis of the disagreement?

Secretary SCHLESINGER. The industry, just as ourselves, are saying that the production would be greater than it would otherwise be in 1985 or 1990. If one examines the projections of major companies in the industry, such as Exxon, they are even more bleak in their projections than we are.

Exxon, for example, projects 8.2 million barrels a day in 1985. We are projecting something on the order of 9.3.

The American Petroleum Institute says that decontrol will provide 2 million barrels a day more than it would otherwise be, but generally speaking they are expecting projection to fall. There is a difference between some of the independents who are basically people who are optimists. They have to be optimists to go out and take the risks that they do, who look at what they, as independents, think they may be able to find, and they come to conclusions far more optimistic than the majors or the API or ourselves.

I think, generally speaking, that we should start as an approximate target to find additional reserves equal to the 3.1 million barrels a day that we are drawing down. That is better than we have done in 20 years and if we can maintain production at the present level, we are doing very well, and far better, than the present projections suggest.

Senator BAUCUS. Thank you.

The CHAIRMAN. Senator Boren?

Senator BOREN. Mr. Secretary, we are dealing, ultimately, of course, with the people's money, the money consumers have paid. When we have talked about funds that have come about as a result of decontrol, people pay the money, and now we are talking about what would be the most cost-effective use of that money.

It would seem to me that our goal should be—I realize that this is not absolute, without some exceptions—that our goal should be to determine how we can invest that money and get the most additional units of energy either produced or saved, because they both have the same effect per dollar spent, or per dollar invested.

So I would say that the goal of our program ought to be the most Btu per dollar invested.

I realize that that is not an absolute, because you have to look at the long term, and so we look at renewable resources and some

other things and there are some other values other than the short-term value dollar of short-term resources.

At least I would say a major thrust of the program ought to maximize Btu per dollar spent.

Have we, in developing this program and the $88 billion that have been talked about, have we developed figures that compare the various mechanisms that can be used—the tax credit, the exemption from the tax, the guaranteed price, and expenditure for demonstration projection—have we developed comparative figures for these various modes of production or conservation that would tell us how much we are getting back, units of energy saved, or produced per dollar invested in each one of these energy sources?

Secretary SCHLESINGER. I do not think we are capable of doing that at this stage, because the parameters, as it were, the cost parameters, economic parameters and technical parameters, remain too uncertain, but what we are attempting to do is to provide an array of tools for the Energy Security Corporation so I can choose among the tools for just the purpose that you mentioned.

Senator BOREN. I think that Senator Baucus was getting at the same thing. I think Chairman Long earlier.

How much would it cost us to save 2 million barrels a day through conservation measures as compared to how much it is going to cost us to produce 2 million barrels a day through synthetic fuels?

I would think that while we cannot come up with an exact figure, we need to go in this direction. It may be unfair to question you on the chart here in Mr. Cutler's written testimony, but let me ask you about this.

If you would turn over to this chart, which is the third chart past page 15, headed "Impacts to Extensions to the Windfall Profits Tax," I would just like to take one, for example, incremental tertiary oil exempted.

If you have—and we can take any of these assumptions—but if you take the zero real growth in annual OPEC price increase under the administration bill, yield $166 billion in taxes. Over the 10-year period, the cost of an exemption for incremental tertiary oil would be $6.8 billion.

Over the 10-year period, according to this chart, if we use column 1 figures, and they are roughly proportionate if we use the other columns. According to CRS, we have 287 billion barrels of oil in this country. If we have the technique and the economic incentive, potentially recoverable through enhanced recovery, 270 billion barrels.

Again, according to CRS, at $30 a barrel or less we can retrieve 50 billion barrels through tertiary recovery; at $30 a barrel or less at current prices, 50 billion barrels.

Now, if we got a million barrels a day additional production from that source, my calculations indicate that would be 150 years of production at the rate of an additional million barrels a day. Again, according to CRS, we could, by 1984 or 1985 through this method get approximately 1 billion barrels a day additional production by exemption of tertiary recovery and this exemption.

My question is this, if for $6.8 billion we can get 1.2 million barrels additional production that we are otherwise not going to

get, why in the world when we compare the figures we are talking about, $88 billion in terms of development of synthetics with the combinations of this 2.5 million barrels?

We are talking about many, many times the cost in terms of units of energy produced and in terms of Government dollars. How does that make sense?

Secretary SCHLESINGER. I think your question is very well taken, Senator. This is one of the most delicate areas, and I think that incremental tertiary production is that area that the committee will have to examine most carefully for the reasons you underscore. There is a delicate balance between cost and production in that area.

Senator BOREN. I just wanted to make one concluding comment. I do not want to be understood as making this comment to you, because it is not directed to you.

This is why I get frustrated when, for example, the other night, looking at the evening news, I heard the President use the words, the oil companies are trying to rob—this was the word used; "rob"—the tax in terms of creating exemptions.

If, for $6.8 billion we can produce for the American people—and it is originally their money and ultimately their money; it came out of the pockets of the consumer—if for $6.8 billion with an exemption that I suppose that the administration, at least, has not come forward here and endorsed as yet, we can produce 1 million barrels a day, how in the world—to state how I feel about it—are we robbing the American people, when instead of doing what the administration proposes we use $88 billion to get 2 million barrels a day?

That is something like seven times the cost per energy unit produced, and that is the reason I have such strong feelings about the kind of rhetoric that is being used. That is the reason that I hope that the administration will concentrate less on rhetoric, talk about who is robbing the American people's dollar, and for what purpose, and get us down to a program that will get the American people the most energy saved or produced per dollar invested as is taken out of their pockets.

I know it is easy to say, well, we are robbing if we are creating an exemption, but I think we ought to take the rhetoric out of it and look at this whole thing and say where, for $166 billion the American people have paid to the oil companies, where can we get them the most energy in return.

At the same time, I realize that we have to make some exemption for some short-term higher cost alternatives, like renewables, that are going to pay off in the long run in diversifying our energy sector.

I do not address this comment at you. That has really stuck in my craw and I take it personally, and any member of this committee who sits here from a patriotic motivation of getting their people most of their money have been accused of being a robber, when I think the shoe is on the other foot, to put it bluntly.

The CHAIRMAN. Senator, if I could just put your calculation down so one can understand it, in terms of the amount of money you have to invest to get one barrel of oil, that would clearly work out in one instance. You would have to have an investment of $44,000

to get the equivalent of one barrel of oil compared to an investment of $6,600.

Is that the way those figures come out, Mr. Secretary?

Secretary SCHLESINGER. I think, Mr. Chairman, I cannot confirm those figures at this juncture, but I think Senator Boren's point that we should examine with great care the marginal cost of producing oil through incremental tertiary production is a well-taken point and I think we should address those issues.

I think that is an area of great potential. Whether it is 1 million barrels a day, I do not know what it is going to be. We have been counting on tertiary recovery as one of our major areas for the future. I think that we can bring additional data to that problem.

The CHAIRMAN. Senator Matsunaga?

Senator MATSUNAGA. Thank you, Mr. Chairman. At the outset let me say, Mr. Secretary, that as a Senator from Hawaii, I do appreciate the initiatives you have started in my State. New projects begun by your administration have been advanced to the extent that we can hold up Hawaii as a model for the rest of the Nation. The experience in Hawaii proves that energy self-sufficiency can be attained, even in an area such as Hawaii which was 100-percent dependent upon imported oil.

As you know, under programs initiated by the DOE, Hawaii has been very successful in reducing our dependency on oil. On the island of Hawaii, which we agreed would serve as the national laboratory to prove energy self-sufficiency, we are now producing 40 percent of the island's electricity through biomass—through the burning of sugarcane waste. We expect within the next 6 months or so to increase that figure to 50 percent.

By the production of electricity through use of this and other resources which are readily available in the islands—resources which are replenishable—we will reduce our dependence on imported oil.

By August 1 of next year the island of Hawaii will have an operational geothermal electric generator producing about 3½ megawatts. The potential of that well discovered at Puna is about 500 megawatts. Within a few years OTEC, energy from the ocean will add to this. When you consider that the total need on that island is right now only 100 megawatts, the potential for new industry is tremendous there, and new industry is desperately needed, since that island's unemployment is about 10 percent now. So I want to thank you for giving us a helping hand, and express my deepest regrets that you have decided to resign from your present position.

Mr. Secretary, you earlier stated that the Nation presently uses about 12 million barrels a day for transportation. Am I correct?

Secretary SCHLESINGER. It is about 10 million barrels a day at the present time, Senator.

Senator MATSUNAGA. This 10 million barrels a day is what we hope to replace by producing synthetic fuel?

Secretary SCHLESINGER. What we hope to do is to reduce consumption in nontransportation areas such as industrial and utility boilers through greater home efficiency and the like. An increasing share of the available oil is going to go to transportation for which there is no easy substitute. But over the course of the next decade

we hope that the fuel liquids for transportation will be in part produced from synthetics.

Senator MATSUNAGA. Won't electric motor vehicles bring down the amount of oil consumption in transportation? If so shouldn't we provide tax incentives (1), to manufacturers, and (2), to purchasers to encourage the use of electric motor vehicles?

I have driven electric motor vehicles. They have good acceleration and good speed. Some vehicles can reach 60 miles an hour and have a range of as much as 150 miles without having to recharge. I think there is a great potential in this.

Secretary SCHLESINGER. Fully agreed, Senator.

Senator MATSUNAGA. Would you agree that we ought to provide tax incentives for the manufacturers and for the buyers of electric motor vehicles? We must help create a market, because unless we have purchasers the manufacturers will not manufacture electric motor vehicles.

Secretary SCHLESINGER. Yes, sir. You will recall that we did provide such tax incentives in the National Energy Act. Perhaps they were insufficient tax incentives, but we wanted to provide some small inducement to move toward electric vehicles.

Senator MATSUNAGA. Another potential solution to deal with transportation fuel needs is gasohol. According to the administration's proposal gasohol will enjoy nontax status; that is no Federal tax will be imposed on the ethanol part of gasohol. Why not go beyond exempting ethanol from the excise tax and provide a tax credit for use of ethanol?

Secretary SCHLESINGER. What we have is in effect a 4-cent credit if you are producing gasohol through the remission of the Federal excise tax. That amounts to $16.80 a barrel subsidy for gasohol. As a result of that subsidy there is a very significant expansion of gasohol production activities going on now.

We think that that subsidy is in the right range. It may need, after some years experience down the line, a little fine tuning. But as a result of the response that we have already had I think that that may well be adequate, and we do not have information at the moment that suggests that it is not adequate.

Senator MATSUNAGA. I am inclined to think that it is not adequate. Ethanol from corn, for example, costs $1.50 to $1.80 per gallon. Ethanol from sugarcane I am told, if all parts of the cane plant are used, will cost as low as 55 cents a gallon. I think this is the area in which we can make the fastest contribution toward transportation fuel.

Secretary SCHLESINGER. We will look at the numbers, Senator Matsunaga. If indeed a $16.80 subsidy is about 4 cents per gallon subsidy, and that should bring a fair amount of gasohol.

Senator MATSUNAGA. Mr. Chairman, if I may ask one more question about transportation, I will ask for the Secretary's comment. The president of ARCO Solar Inc. told me that in my lifetime I will be driving a motor vehicle, an electric motor vehicle, powered by solar photovoltaic cell. He said that the technology is here today, but he cannot get people in our Government to believe it, and he cannot get Americans to believe.

Do you have any knowledge as to whether he is talking through his hat or whether he is in fact making a true statement?

Secretary SCHLESINGER. Senator, I think he may have been wishing you a very long life. [General laughter.]

Senator MATSUNAGA. Did you attend that demonstration project he had right here? I was one of the sponsors of that demonstration where a one-bedroom home was completely powered by a solar photovoltaic cell.

Secretary SCHLESINGER. Yes, sir; I think that photovoltaics will contribute in a major way in the later part of the 1980's and in the early 1990's to production of electric power for certain uses. But I do not think we are going to power our automobiles at that time by photovoltaics.

Senator MATSUNAGA. I think photovoltaic will make a major and visible contribution by 1986. You say that he wished me a long life. As a matter of fact people do live longer in Hawaii, as statistics show, and Hawaii has a lot of sunshine for photovoltaics. I am a little more optimistic than you are, Mr. Secretary, so I am going to invite you to ride in my electric motor vehicle powered by solar photovoltaic cells in the not-too-distant future when you are vacationing in Hawaii.

Secretary SCHLESINGER. I look forward to that at an early date, Senator.

Senator DANFORTH. Mr. Chairman, may I ask one additional question?

Mr. Secretary, it is frequently said the world price of oil is not really a market price, it is a cartel price. I wonder if there is any estimate anywhere or any way of making an estimate as to what the world price of oil would be on a free market, that is, absent a cartel and absent domestic controls?

Secretary SCHLESINGER. Senator Danforth, I think that the relevancy of observation that you quoted disappeared once demand overtook supply. Two years ago one could well say that in something like a competitive market the price of oil would have fallen to $8.50 or $9 a barrel. We cannot say that anymore simply because the excess capacity that 2 years ago would have driven prices down is no longer there.

If anything, at the present time a strictly free market might raise rather than lower the price of oil internationally.

Senator DANFORTH. At the present time a strictly free market for oil——

Secretary SCHLESINGER. Competitive market, yes, sir.

Senator DANFORTH [continuing]. Might raise rather than lower the OPEC price?

Secretary SCHLESINGER. The posted price, yes, sir. I say that with a great deal of regret.

Senator DANFORTH. Can you estimate how much it might raise it?

Secretary SCHLESINGER. I think that one would find that the Saudi posted price would rise toward the ceiling price. The Saudi posted price is $18 a barrel, the ceiling is $23.

Senator Durenberger knows the Canadians who are not part of the cartel have just raised the price of oil exported to the northern tier to $25 a barrel, and there has been no diminution in demand at that price. I think that it reflects the very great tightness of the market.

Cartels are useful instruments when there is an excess of capacity. But the need for the cartel instrument disappears when there is no excess capacity.

The CHAIRMAN. Some of our colleagues in the Senate were shocked when they discovered that this is not a tax on income. This is not really a tax on profits. It is more in the nature of an excise tax. The thought occurs to me, particularly with regard to these independents in here showing that they are spending 103 percent of the cost, 103 percent of the gross income in trying to obtain energy.

It is really questionable whether we should tax from the money that they themselves would spend in energy, especially if they pretend to get us energy at a lesser cost than the Government could provide it through these Government programs. Now that causes me to ask the question, why shouldn't we permit these individuals who are putting everything they make out of it back into trying to get more energy, why shouldn't we permit them to at least deduct their drilling expense?

For example, we have a 70 percent tax on an individual drilling for oil. But he is permitted to deduct from that the intangibles, not the materials, but the manpower that went into drilling that hole. Why should not we permit these same individuals to deduct that cost of drilling a well from the so-called windfall tax?

Secretary SCHLESINGER. That is permissible to deduct that from the income tax, Mr. Chairman. I think your underlying point that we should operate in such a way that an unincorporated enterprise, such as independent driller, is treated on the basis of equity with the incorporated enterprise that ranges up to the size of Exxon. And that was the purpose of the administration in supporting the intangible drilling cost relief last year, simply because that brought equity to the independent producer.

I cannot give you a response with regard to the proposal you have thrown out. I think that we are prepared to examine these kinds of devices if they will lead to greater equity.

The CHAIRMAN. Well the problem involved here, Mr. Secretary, is that the reason most of these independents are selling their leases, selling the oil in the ground without ever taking it out is not that they really want to do that, it is just that to find the money to go out and drill additional wells, they do not have much choice about it.

They do not have that much credit, as a major company does. So they sell what they have to a major company in order to get the money to go out and drill more.

Now they are subject to a 70 percent tax, and the only way they can avoid paying that 70 percent tax is to drill more wells. And that promotes a national interest. Just as Adam Smith's initial theory of a comparative system would indicate that you should, they are advancing their interests by keeping their taxes down by drilling more wells. And we ought to want them to do that.

The thought that occurs to me is that as long as they are putting this additional income in the ground, drilling holes that produce more oil, why don't we encourage them to do it? It seems to me as though they would be advancing our interests to do that.

Secretary SCHLESINGER. I make two comments, Mr. Chairman. First, I think your point is very well taken that we are going to have to be very careful to insure some degree of equity between the unincorporated enterprise and the incorporated enterprise. And that will be something that this committee will want to attend to, and I am sure that the people in the administration will be delighted to work with you to assure that degree of equity.

Second, we have a long historical process which is beneficial to the country in which independents who are good at finding oil, indeed are a lot better at finding that oil than are the majors, proceed to find that oil, then sell it off to the majors, and with the additional resources, go out and find additional oil. I think that that is what we call gains from trade or the advantages of specialization.

We want the independents to have their resources. And one of the ways that they have historically gotten resources is by finding oil and then selling it off so that they can go into additional exploration. That is not necessarily a process that we want to see suppressed.

Once that equity is assured for the independent, I do not know that one wants to arrest the process in which these kinds of transfers occur.

The CHAIRMAN. It seems to me, Mr. Secretary, that the fellow who has the best case against this tax is a farmer who is producing from his own property. In other words, assuming that rather than to sign a lease with somebody for them to drill, he would hire himself a contractor to drill on his own property. So he is producing his own resources from his own property, and he is separating himself from a part of the realty when he sells it.

Now we tell that fellow that world market oil was used to hold his price down, and then later on we are told, now the world market has gone up. And so to keep him from getting too much profit, we are going to put these controls on him. Then we are going to take the controls back off but we are going to tax his excess profit. That fellow is going to find himself saying:

> Well look, I own this. This is mine. And as far as I am concerned, if you are going to put an 80 percent tax on me, I am not going to sell it at all.

He is not permitted to take a capital gain on that part of his realty which has minerals beneath it. If he is going to produce it himself with an 88 percent tax, the tendency would be to say:

> Well if what I sell that is a part of my resource here, a part of my real estate that is going to be taxed at 88 percent, I am just going to keep it. I am just going to sit here on it until I get better tax treatment.

In that case it seems to me that if that person were permitted the same tax deductions against a 60 percent tax that he was permitted against that 70 percent income tax, he would be tempted to go on ahead and produce. But I know of at least one case, and I am sure that there must be others, where landowners are sitting there. And they just plan to sit you out. They have enough land, they have enough money and enough resources. They do not have to produce any more. And if that is the case, they will just sit there.

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Now in terms of equity, they feel they are being done an injustice. And it seems to me that when we tax to the point that the tax defeats its own purpose, we ought to take another look at it. I think the most inefficient tax that there is and the the greatest violation of public interest in taxation is the counterproductive tax, the tax that actually defeats its own purpose.

I do not know whether we will find out why this Government is taking in about $4 billion more revenue this year than it thought it was going to take in with the income tax system. It has been pointed out to me that it may be for just the reason I was contending last year with the capital gains tax. I was contending that if you cut the capital gains tax you are going to receive more tax money, not just on the initial sale but on the secondary and tertiary effect of that reduction that did not meet the eye.

We are trying to find out why is it that we seem to be getting more money out of income tax than we anticipated, and that might be the reason. But I would like to ask that you take a look at this situation to the extent that it might be counterproductive.

And furthermore, I think you would agree that in terms of justice and fairness and equity, that between taxing the money away from a citizen to make that money available for someone else to do what you would like to do, as compared with leaving it with the citizen if he himself does what you would like to do to achieve the same result, it would be preferable to leave it with him.

Secretary SCHLESINGER. That is with the objective of minimizing any adverse effects of taxation.

The CHAIRMAN. I think that counterproductive taxation discredits government and it discredits everybody that has anything to do with it, even those who are trying to apply it and administer it—even the tax lawyers. The question is this: If they see something is defeating its own purpose, why don't they report that to Members of Congress and demand that we do something about it? And in turn, why don't we do something about it when we find that we are passing a tax that tends to defeat its own purpose?

If it is a productive tax, fine. But an inefficient counterproductive tax is something that ought to be corrected to the extent that we can.

Senator Durenberger stuck it out all the way through. Senator Durenberger, do you want to ask a question?

Senator DURENBERGER. I am anxious to have the Secretary go to lunch so we can come back in the Governmental Affairs Committee.

The CHAIRMAN. All right.

Senator DANFORTH. Can I ask one more question, Mr. Chairman?

The CHAIRMAN. Yes, sir.

Senator DANFORTH. What sort of price would it take to make it commercially attractive to produce synthetic fuel? Without any subsidies or guarantees, if you could be sure of a certain price, what kind of price?

Secretary SCHLESINGER. It depends on the type of synthetic. We believe that methanol will come in at $25 to $30 a barrel. When oil prices hit $30 a barrel, people will start building methanol plants. For some of the direct processes such as SRC-2, then it probably is

on the order of $40 a barrel. So these processes will come on as oil prices rise.

I think that what we are trying to do, and I must underscore this, is to save time, that the market would do these things. But there would be a great deal of pain inflicted in the period before market did it, simply because the long leadtimes involved in getting these facilities on line. And that what we are trying to do is for short, help along market processes. We do not want, I think, to do things that are not going to be cost effective in the intermediate term. And I think that that should be the charge to the Energy Security Corporation by the Congress.

Congress quite clearly does not want to get a plan going here for energy. It wants to provide an instrumentality that has some tools that are a substitute for market forces are rapidly applied.

The CHAIRMAN. Thank you very much, Mr. Secretary.

The Senate is in session this afternoon. It will be voting on several major bills. We are not going to be able to have more than one or two Senators here if we come back for an afternoon session. What I would suggest is that Mr. Elliot Cutler's statement be submitted for the record. I would hope that all Senators will read it during the afternoon, and perhaps we can arrange a suitable hour when we can interrogate Mr. Cutler on his statement.

In acting on this bill we may have to go about it the way that we were going with the health bill that we act, vote for a while and then if we think we need more information, hear some more witnesses and then do some more voting. But we will move along as expeditiously as we can.

[The prepared statement of Mr. Cutler is as follows:]

FOR RELEASE AT 10:00 A.M.
TUESDAY, JULY 31, 1979

REMARKS OF ELIOT R. CUTLER
ASSOCIATE DIRECTOR FOR NATURAL RESOURCES, ENERGY, AND SCIENCE
OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE SENATE FINANCE COMMITTEE

Good morning, Mr. Chairman and members of the Committee. I appreciate the opportunity to discuss with you the Administration's Energy Program and the proposed uses of the Windfall Profits Tax.

Over the course of the last 2 years, Administration officials have discussed with this Committee on several occasions the future prospects for world oil production and demand. Developments over that period of time give us little assurance that world oil production will ever exceed 65 million barrels per day -- little more than present levels. The shock of events in Iran has both reduced near-term supply projections and, simultaneously, has made a problem that once loomed in the future appear dangerously close at hand.

The long-term oil supply outlook _is_ grim. We have become too reliant on unstable supplies of imported oil and the demands placed on us and other importing nations by the producers of that oil. The time has come to implement a major national effort to reduce our reliance on oil imports. At the same time, the Department of Energy estimates that with or without the additional proposed exemptions to the House-passed Windfall Profits Tax measure, domestic oil production will, _at best_, stay roughly constant over the next decade. It is now clear that if we are to prosper and grow we must do so without increases in oil consumption.

It is in this context that we must view the issues of decontrol, the Windfalls Profits Tax, the Energy Security Corporation, the Energy Mobilization Board and the other initiatives proposed by the President.

The Windfall Profits Tax, which you now have under consideration, is the critical part of the President's program. The Windfall Profits Tax, coupled with the Energy Security Trust Fund, the Energy Security Corporation and the Energy Mobilization Board are the mechanisms which can allow us to achieve a national goal of a 50% reduction in oil imports by 1990. Simply providing incentives to domestic producers will not and cannot achieve this import reduction, because our country no longer has the resources to sustain domestic oil production at such levels. We must face this fact and pursue a balanced program of conservation, increased production of conventional fuels, the development of a synthetic fuel industry and conversion of oil users to more plentiful domestic fuels such as coal. Without these mechanisms, if we allow domestic oil producers to keep all or most of the windfalls from the OPEC cartel price increases, we can expect little or no additional domestic oil production over that included in Administration estimates. We will face the decade of the 1990's in substantially worse shape than we enter the 1980's because we will be even more dependent on foreign oil.

Other fundamental elements of the President's energy program -- some of them already enacted by the Congress -- include:

- The Natural Gas Policy Act
- The Fuel Use Act

- The Energy Tax Act
- The Public Utilities Regulatory Policies Act
- The National Energy Conservation Policy Act
- Exemption from federal excise taxes for gasohol
- The Solar Bank -- financed by the Windfall Profits Tax
- Tax credit programs to encourage the use of renewable resources, including wood stoves, passive solar energy, and agricultural and industrial uses of solar energy -- all financed by the Windfall Profits Tax
- A program to remove the barriers which now prevent utilities from investing in energy conservation and to achieve large and inexpensive import reductions from conservation improvements in existing buildings and conversion from oil space heat -- financed partially by the Windfall Profits Tax
- A combined regulatory and incentive program to reduce utility oil use -- financed by the Windfall Profits tax
- Tax credits for oil from shale and unconventional natural gas -- financed by the Windfall Profits Tax

We estimate that the combined effect of this program will be to cut our Nation's dependence on foreign oil imports in half -- to less than 5 million barrels per day by 1990. We can achieve this goal, building on the programs already enacted by the Congress, only if the Congress now enacts a Windfall Profits Tax as strong and as fair as that proposed by the Administration and passed by the House.

The Windfall Profits Tax is directly linked to the phased decontrol of crude oil prices announced by the President on April 5.

The President announced that beginning on June 1, he would use his discretionary authority under the Energy Policy and Conservation Act to gradually lift price controls on crude oil. The President's decontrol program permits crude oil produced in the United States to sell at gradually increasing prices until it is fully decontrolled on September 30, 1981, the date upon which statutory authority to control prices expires. At the same time, the President proposed to Congress the Windfall Profits Tax, in the form of an excise tax, which was carefully designed to fit with the decontrol schedule and to transfer to the government and to American consumers a part of the very substantial increase in oil industry revenues which would result from phased decontrol. The Administration continues to believe that decontrol coupled with the Windfall Profits Tax is essential to:

- end the complex and distortion-causing system of price controls and entitlements which have disguised the true cost of oil to all American consumers;
- provide U.S. oil producers with necessary new incentives to maximize production from American resources;
- end the system which subsidizes the cost of imported oil, thereby increasing U.S. vulnerability to production and pricing policies of foreign producing nations; and
- provide maximum incentives for energy conservation and efficient use of this premium energy resource.

The President proposed a gradual rather than an immediate system of decontrol, recognizing the impacts which this action would have on the economy. Under this system, decontrol and its impacts can be carefully monitored and our economy is given time to prepare for these price changes. In addition, we felt it important to give the Congress time to consider and enact a Windfall Profits Tax before all of the impacts of decontrol are felt.

Particular attention was given to the relationship between the decontrol schedule and the Windfall Profits Tax. The first steps of the President's decontrol program were carefully targetted to those categories of oil for which new incentives were needed to increase domestic production. For example, the price of newly discovered oil, and incremental production from tertiary recovery was decontrolled effective June 1 in order to provide strong incentives for early investment in these areas. Similarly, 80% of the oil classified as marginal was allowed to move from the lower tier price level (about $6 per barrel) to the upper tier (about $13 per barrel) in order to stimulate maximum production from these resources. This kind of targetted approach permits the benefits of decontrol to be felt early in the program, while price increases for categories of oil which do not require special new incentives occur after the Windfall Profits Tax is in place. The general price increases for upper tier oil and for lower tier oil which does not qualify for special marginal or tertiary recovery incentives do not begin under

the President's program until January 1, 1980. This is the date on which we have proposed that the Windfall Profits Tax become effective.

This carefully phased relationship between the decontrol schedule and the tax will give U.S. producers strong incentives where they are needed to stimulate new production, while at the same time not permitting unearned profits to accrue simply through a change in government policies. For reasons of basic equity, as well as to fund the new programs which the President announced on July 16, we believe that the Windfall Profits Tax is needed. It will assure that the oil industry does not reap unwarranted profits which would be out of proportion to increased production of U.S. oil resources.

In addition to making the transition from a controlled to an uncontrolled pricing system fair to both consumers and producers, the Windfall Profits Tax has a second very important purpose. It is designed also to protect against unwarranted increases in producer revenues due to actions of the OPEC cartel. As events of the last seven months have shown so dramatically, the price of oil is set not by what it costs to produce oil, but by what the cartel believes it should be after assessing demand and their own revenue needs. The average cost of a barrel of oil imported into the United States was somewhat less than $16 per barrel in April when the President proposed the Windfall Profits Tax. Many thought that was at least high enough, if not too high. The average price of imported oil today -- just four months later -- has increased to about $22 per barrel, a 37% increase.

I know of no argument which states that the cost of producing oil in the U.S. has experienced a similar increase over such a short time period, yet according to some, the magic number which is needed to provide a "fair" incentive is suddenly $22 per barrel.

The President's Windfall Profits Tax recognizes that a decontrolled oil market will follow the world price. It also recognizes that equity and the overriding national interest in developing alternatives to imported oil require that a substantial part of the cartel increases which accrue to domestic producers be recaptured for the American people. For this reason, the Administration strongly believes that all oil -- including newly discovered oil and other special incentive categories should be subject to this OPEC tax on a permanent basis. We strongly oppose any amendments which would exempt one category of oil or another from the windfall tax at this tier. A windfall due to OPEC price actions is every bit as much a windfall as increases which come about as a result of removing price controls from categories of oil where no special incentive is needed for production.

Our goal, Mr. Chairman and members of the Committee -- a goal I know we all share -- is to ensure America's long-term energy security by reducing our dependence on imported oil and developing alternatives to it.

As a result of realistic domestic oil prices -- based on the world market price -- and a rising world price for oil, U.S. dollars will be spent in increasing amounts to procure that precious resource.

To the extent those dollars stay in the U.S., they will be reinvested either by the oil companies on behalf of their shareholders or by the government on behalf of all citizens. Each potential investor -- the industry or the government -- has a different set of rules; one must and should make a profit and can take few risks, the other must and can take risks when they are necessary to the Nation's security.

The Windfall Profits Tax revenues will be used for three purposes which only the government, not the industry, can and should have: helping lower-income families bear the burdens of rapidly rising oil prices, increasing our public transportation capacity, and investing in the development of alternatives to oil which have little near-term profit potential.

The government can and must shoulder those responsibilities and bear those risks. The industry ought not and will not do so.

The President's program for the investment of the Windfall Profits Tax revenues is carefully balanced and takes advantage of all significant opportunities for import reduction. Energy conservation is supported by three new programs announced on July 16: the residential commercial conservation retrofit program, mass transit, and fuel efficiency initiatives. Use of renewable resources would be stimulated by the Solar Bank and four renewable resources tax credits which were delivered to this Committee last Friday. These credits provide significant new incentives for the use of residential and commercial passive solar energy, agricultural and industrial solar

process heat applications, and wood stoves. In addition the President has proposed the permanent exemption of gasohol from the federal excise tax on motor gasoline.

Domestic production of fossil fuels will be substantially increased under the President's program. Direct use of coal to generate electricity will be significantly increased through the President's recently announced program to cut the use of oil in utility boilers in half by 1990 -- for a saving of 750,000 barrels of oil per day.

In order to protect lower-income Americans from the higher oil prices associated with decontrol, the President has proposed that $24 billion of windfall profits be used over the period 1980 to 1990 to assist them.

Two types of assistance would be provided. First, $400 million of the $2.4 billion would be used to provide crisis intervention and emergency assistance grants to the States. Although the permanent program would be administered by HEW, the program would be administered this winter by CSA so that a program could assuredly be in place. Governors would be able to use State welfare offices, or the network of community action agencies, or both. With a maximum amount of assistance per household of $500, the emphasis of this program would be on meeting severe hardships. The eligible population would include those with incomes up to 150% of the poverty level as well as SSI recipients. $1.9 billion would be available to be administered by the

States for cash grants to SSI, AFDC, and -- beginning next year -- Food Stamp populations and others with incomes under 125% of poverty. This would permit average payments of $190 for couples and families. In FY 1980, the program would be phased in at the $1.6 billion level.

Finally, in order to tap all available means of reducing imports, the President has proposed that $88 billion of Windfall Profits Tax revenues be committed to an independent, Congressionally chartered Energy Security Corporation, to develop our vast coal, oil shale and unconventional gas reserves to produce a total of 2.5 MB/D in import reductions by 1990. This Corporation unencumbered by the usual constraints on government entities, will provide the needed financial incentives and risk-sharing to the private sector to let our American free enterprise system get the job done.

I have included with my testimony today copies of the specifications proposed for the Energy Security Corporation and the Energy Mobilization Board, which is the Corporation's necessary complement. I will simply summarize the key features of the Corporation and the Board for the Committee.

- The Energy Security Corporation would be a federally-chartered, independent Corporation with authority to use up to $88 billion of Windfall Profits Tax receipts from the Energy Security Trust Fund in order to produce 2.5 MB/D of synthetic fuels, oil shale, and unconventional gas by 1990.

- The ESC's financing would be in the form of borrowing authority from the Treasury. The loans would be liquidated by Energy Security Trust Fund receipts.
- The ESC would be given a wide array of financial tools to accomplish its goals. Price guarantees, purchase agreements, direct loans, loan guarantees would be available for use at the ESC's discretion. In addition, the Corporation will be authorized to own and contract for the operation of a limited number of facilities. We have expressly limited the ESC to three such corporation-owned contractor operated plants in order to prevent massive government intrusion into the alternative fuels industry.
- The ESC would be controlled by a seven-member board of directors. The chairman and three members would be appointed by the President with the advise and consent of the Senate. The remaining three members would be the Secretaries of Energy, Treasury, and the Interior.
- The ESC would be strictly limited to its $88 billion resources. Every ESC contract would be matched by a reservation of funds in the Energy Security Trust Fund equal to the upper limit on ESC liability under the contract. The ESC may not revolve its debt or use similar devices to extend the $88 billion in borrowing authority which we propose to give it. This program is designed to ensure, consistent with the need for federal assistance in sharing private sector risks, that the

government, through the Corporation, does not become the dominant force in the post-1990 development or ownership of these oil alternatives.

- The ESC would have a life of twelve years, after which its remaining obligations would be transferred to the Treasury or liquidated.

The accomplishment of commercial production of synthetic fuels on a commercial scale will require that substantial economic risks be undertaken. The purpose of the Energy Security Corporation is to take those risks -- with Windfall Profits Tax revenues. These are risks that no oil company can or would undertake alone, but which are necessary risks if we are to move America away from our reliance on imported oil. Their magnitude is best illustrated by calculating the costs of one possible program the Corporation might undertake.

Assume that the ESC decides to produce 1.1 MB/D of coal and biomass liquids and gases, 0.15 MB/D of oil shale, and 0.25 MB/D of unconventional gases. Assume further that the ESC successfully negotiates contracts with private firms providing for:

- A price guarantee of $38/B, stated in constant 1979 dollars, for the coal and biomass liquids and gases.
- A price guarantee of $30/B for the unconventional gas.
- A price guarantee of $32/B for the oil shale.

The cost of these contracts over their lifetimes would obviously be heavily dependent on the future course of world oil prices. For

example, if the contracts were run out to the year 2004, and if very aggressive deployment is assumed, the total costs would be $603 billion, if oil prices remained at their current $22/B in real terms and rose only with inflation. If oil prices rose 1% per year in constant dollars, the cost would be cut to $369 billion. If oil prices rose at 2.4% annually, stated in constant dollars, the cost of the program would be cut to $88 billion.

The Energy Security Corporation might select an entirely different set of mechanisms to reach its goal within its budget limit. In the example above, of the $88 billion program cost, $83.3 billion would be spent on payments under the $38/B price guarantees for coal and biomass liquids and gases. Alternatively, the ESC might select front-end capital support in the form of loans and loan guarantees, or might negotiate limits on contractual obligations through buy-out clauses. The construction of 1.1 MB/D of such capacity would be unlikely to cost more than $50,000 per barrel of installed daily capacity, for a total of $55 billion, stated in 1979 dollars. Adjusting for inflation through 1990 would increase this to no more than $100 billion. The ESC would have access to $83 billion -- roughly 80% of the total capital involved in this illustrative approach.

I hasten to repeat that this is only one illustration of the choices that the ESC Board of Directors might make. However, it does illustrate the truly important features of the ESC design. The ESC, as proposed by the President, would have up-front access to resources

adequate for the job, and sufficient flexibility to select the most cost-effective mechanism in each individual negotiation. This flexibility rests on three critical features of the ESC design:

-- unencumbered access to $88 billion in resources

-- independence from numerous restrictions which apply to government agencies, particularly the Civil Service System and government procurement restrictions

-- independence from most political pressures.

It is simply not possible to build these features into a government agency, and they are critical to the achievement of the ESC's massive task. The accomplishment of this task is the last necessary step in the establishment of a responsible national energy policy. The policies established and proposed by this Administration sum to a balanced program of energy conservation, renewable resource use, increased domestic production through price decontrol, protection for low income households from OPEC monopoly rents and the production of synthetic fuels from the vast domestic coal, biomass, oil shale, and unconvention gas resources.

The Windfall Profits Tax is the cornerstone of this policy. The tax and the Energy Security Trust Fund extract a portion of the windfall which would otherwise accrue to domestic producers as a direct result of OPEC monopoly price increases. If oil prices rise only with inflation, the tax would reduce the increase in industry profits from decontrol by 51%. Even if we liberally assume that the industry might invest sufficiently to produce 100,000 B/D of oil shale by 1990 and 300,000 B/D of conventional oil, the President's program

of government investments of the windfall revenues will produce ten times as great a reduction in oil imports.

This is the principal advantage of the Tax and the President's proposed uses of those revenues. The government will make investments which the private sector would defer until world oil prices had risen sufficiently to ensure their profitability -- too late to meet our 1990 goals. The President's proposals can provide substantially increased benefits to the nation in the form of reduced dependence on foreign oil, reduced payments to foreign producers, and reduced economic vulnerability to further oil price increases.

THE WHITE HOUSE

July 30, 1979

WINDFALL PROFITS TAX RECEIPTS, OIL INDUSTRY
PROFITS AND IMPACT OF EXEMPTIONS
(Assuming the House-passed windfall profits tax)

	% REAL INCREASE IN OPEC PRICES		
	0%	1%	2.4%
RECEIPTS FROM WINDFALL PROFITS TAX 1980 - 1990	142.8	186.0	253.9
RECEIPTS FROM WINDFALL PROFITS TAX 1980 - 1990 WITH EXEMPTIONS	43.1	49.2	57.8
% Reduction in receipts	70%	74%	77%
1979 - 1990 OIL INDUSTRY PROFITS WITHOUT EXEMPTIONS	96.3	104.4	117.4
1979 - 1990 OIL INDUSTRY PROFITS WITH EXEMPTIONS	150.9	179.4	224.7
% increase in profits from exemptions	57%	72%	91%

THE WHITE HOUSE

July 30, 1979

OIL INDUSTRY PROFITS UNDER HOUSE-PASSED BILL WITH AND WITHOUT EXEMPTIONS

OIL INDUSTRY PROFITS 1979 - 1990*	% ANNUAL OPEC Price Increase (% real growth) ($ in billions)		
	0%	1%	2.4%
UNDER HOUSE-PASSED BILL IF AMENDED TO INCLUDE ADMINISTRATION PROPOSALS			
Before windfall profits tax	171.7	203.2	252.6
After windfall profits tax	83.9	93.6	107.1
UNDER HOUSE BILL AS PASSED			
Before windfall profits tax	174.4	206.2	256.1
After windfall profits tax	96.3	104.4	117.4
UNDER HOUSE-PASSED BILL WITH EXEMPTIONS			
Before windfall profits tax	174.4	206.2	256.1
After windfall profits tax	150.9	179.4	224.7
Increase in profits from exemptions	54.6	75.0	107.3
% increase in oil industry profits due to exemptions to House-passed bill	57%	72%	91%

* Net of federal income tax, state income and severance taxes, production expenses

THE WHITE HOUSE July 30, 1979

IMPACTS OF EXEMPTIONS TO THE WINDFALL PROFITS TAX UNDER VARIOUS OPEC PRICE ASSUMPTIONS

WINDFALL PROFITS TAX REVENUES 1980 - 1990	% ANNUAL OPEC PRICE INCREASE (% real growth) ($ in billions)		
	0%	1%	2.4%
HOUSE PASSED BILL IF AMENDED TO INCLUDE ADMINISTRATION PROPOSALS	$166.3	$208.4	$274.4
HOUSE BILL AS PASSED	142.8	186.0	253.9
LOSS OF REVENUES FROM HOUSE BILL IF:			
1. Stripper wells exempted	32.7	40.8	53.2
2. Marginal oil from lower to upper tier exempted	6.9	7.9	9.5
3. Incremental tertiary oil exempted	6.8	11.8	19.5
4. Alaskan oil exempted	18.8	24.6	33.5
5. Production below 3,000 bpd exempted	41.4	54.0	73.6
6. Newly discovered oil exempted	18.6	33.5	58.9
REVENUE LOSS IF ALL EXEMPTIONS ADOPTED*	$99.7	$136.8	$196.0
ACTUAL RECEIPTS FROM WINDFALL PROFITS TAX IF ALL EXEMPTIONS ADOPTED	$43.1	$49.2	$57.8
% REDUCTION FROM HOUSE PASSED BILL	70%	74%	77%

* Note: totals do not add due to interaction and overlap between exemptions.

SPECIFICATIONS July 30, 1979

Energy Security Corporation

Purpose/Scope

A major part of the President's import reduction program is the establishment of an independent, government-sponsored Corporation with authority to provide incentives to private firms to produce 2.5 million barrels per day of substitutes for oil imports. The Corporation will not be an instrumentality of the Federal Government but rather a federally-chartered corporation sponsored by the government with a 12 year life. The Corporation will be given broad financial authority to use in encouraging the development in the United States of synthetic fuels and unconventional natural gas. As a private Corporation, it will function under laws governing such entities; it will be exempt from most restrictions governing Federal agency operations. Projects sponsored by the Corporation may be given priority treatment by the Energy Mobilization Board to assure that regulatory and judicial actions are administered expeditiously. The combination of incentives provided by the Corporation, expedited regulatory decisions under the Energy Mobilization Board and reliance on private sector firms to design, construct and operate plants is essential to achieving the 2.5 million barrels per day goal. Only in a very limited number of cases where special circumstances may arise will the Corporation be involved in government-owned contractor-operated plants.

The Goal: 2.5 Million Barrels Per Day by 1990

The Nation's dependence on imported petroleum has reached 8.5 million barrels per day, making our Nation vulnerable to OPEC decisions to reduce production, or raise prices. We have lost a degree of independence because of our dependence on OPEC oil. The Nation has abundant coal, shale oil and natural gas reserves that can be developed with existing or refined technology if

developers can be assured of a price and timely regulatory decisions. Other measures--including reducing utility oil consumption, reduced consumption by residential and commercial dwellings, increased auto fuel efficiency and mass transit use, and greater production of heavy oil--will result in further reductions of oil imports. In total, 4.5 MB/D of reductions are anticipated by 1990. This will result in imports that are about 50% lower than in 1978--or than would be in 1990--thereby substantially reducing U.S. dependence on OPEC.

The Corporation will be given $88 billion in financial authority to provide necessary incentives to private and public entities to develop:

- liquids and gas from coal;
- oil from shale;
- liquids and gas from biomass;
- unconventional sources of gas such as tight sands, devonian shale, methane from coal seams and methane from geopressured acquifers.

The following describes the Corporation's structure, financial and administrative powers, and exemptions from limitation on executive agencies.

II. Structure

The Corporation will be an independent, government-sponsored enterprise that will be incorporated under a Federal charter for 12 years. It will be located outside the Executive branch, independent of any governmental agency. The Corporation will be managed by a 7-person Board of Directors. A chairman and three other outside directors will be appointed by the President and confirmed by the Senate. In addition, the Secretaries of Energy and Treasury and Interior will sit on the Board. Other features include:

- Chairman serves as full-time Executive Officer.
- Chairman and three public members will serve staggered five-year terms and be appointed by the President with the advice and consent of the Senate.
- Three members of the Board are ex officio members, including the Secretary of Energy, the Secretary of the Treasury and the Secretary of Interior. They will have voting power.
- The chairman serves as the Chief Executive Officer of the Corporation. The Board would delegate substantial authority to the chairman subject to its policy mandates. Certain major actions would be reserved to the Board, such as approval of annual operating plans or other matters.
- Compensation for the chairman and public members of the Board and for other officers and employees of the Corporation would be set by the Board. No statutory limits would be set on salary and other compensation, but salary and

expenses would be subject to the limits set by the annual operating budget described in Section III.

- The Board would determine the internal structure of the Corporation itself.
- The Board or the chairman would determine the size of the Corporation's staff as an incident to its own planning and budgeting, but subject to the limits set by the annual operating budget in Section III.

III. Financial Structure/Authorities

The Corporation will have the financial authority as provided below to achieve production of 2.5 million barrels per day of substitutes for imported oil by 1990. The corporation will only be authorized to support projects located in the United States. The Corporation will have authority to borrow from the Treasury not to exceed in the aggregate $88 billion. This authority will be sought in advance but with staggered availability subject to Presidential decision. Initially, $22 billion would be available. Every 18 months thereafter an additional $22 billion would become available until the $88 billion limit is reached. At each interval the President would have the option of postponing availability depending on progress of the Corporation.

The Corporation will have the authority to borrow from the Treasury on an as needed basis up to the limit in effect. Interest and principal on these loans shall be paid from the Energy Security Trust Fund.

The Secretary of Treasury would be authorized to purchase from the Corporation its total stock in the amount of $100 million dollars. This will be accomplished by an appropriation for the purchase to be available at the time the Corporation is established. The Corporation will use the proceeds to meet administrative expenses.

The Corporation would be authorized to issue and guarantee loans. Any defaults on guaranteed loans would be backed by the Corporation's borrowing authority; the Corporation will establish a reserve for defaults for this purpose and be permitted to charge a fee to recover costs of administrative and expected defaults.

To assist in financing the Corporation's goal and to provide an opportunity for every American to contribute to the effort, the Secretary of Treasury will issue bonds up to $5 billion in small denominations. The Secretary would use the proceeds to help finance the borrowing of the Corporation or for other needs depending on bond sales and revenue needs of the United States Government.

The Corporation will not be treated as a budget entity. Financing authority, outlays and receipts will not be shown directly in the totals of the President's Budget. However, the payment for the Corporation's stock by Treasury will be on-budget and all payments to the Corporation from the Energy Security Trust Fund will be on-budget. This treatment will assure that outlays by the United States Government to the Corporation are shown within the totals of the President's Budget. The Corporation will not seek annual appropriations since necessary authority would be provided at the time of establishment. The Energy Security Trust Fund revenues will be used as needed to reimburse the Corporation's borrowings from Treasury.

Other financial authorities and responsibilities of the Corporation will include:

- The authority to invest revenues to the extent not needed to meet expenses in securities of the United States Government. Investments in securities or indebtedness not issued by the United States Government would not be permitted.

- Reporting to the President and the Congress on its financial operations on an annual basis or more frequently if necessary. This report shall be based on an audit by the General Accounting Office, which shall include an assessment of the accuracy of the financial records and reasonableness of the estimates of the Corporation's operations, assets, liabilities and use of Federal funds.

- A limitation on administrative expenses of $35 million annually increased by the GNP deflator on an annual basis. Administrative expenses shall include personnel, space, consultants, computers, etc. Government-owned production facilities are not included in this limitation.

All payments by the Corporation will be reimbursed from the Trust Fund except for the equity investment by Treasury and any amounts collected by the Corporation as a result of its operations.

Trust Fund receipts will be reserved in amounts up to $88 billion to be available to offset potential costs that may be incurred. As the Corporation incurs contingent and noncontingent obligations as a result of signing contracts (price guarantees, purchase agreements, loan guarantees, GOCOs) an estimate of the potential cost to the Corporation of such contracts will be made and recorded as a drawdown of the Corporation's budget authority as well as an obligation against Trust Fund receipts. Contract payment estimates will be based on reasonable assumptions regarding world oil prices and the terms of the contracts to ensure that an adequate reserve is

established to meet future payments and to avoid overspending. This is necessary because Trust Fund receipts are substantial in the early years, whereas Corporation payments may be substantial after 1985 unless oil prices rise sharply. Trust Fund revenues will be available for this purpose up to $88 billion. As cash payments are made to the Corporation from the Trust Fund, outlays will be recorded in the President's Budget. Appropriations from the Trust Fund to the Corporation will have priority over all other Trust Fund spending except for low income assistance and tax expenditures offsets for tax credits.

IV-A. Financing Mechanisms of the Energy Security Corporation

The Corporation will have the authority to make loan guarantees, price guarantees, purchase agreements and direct loans for production facilities in the United States, and up to three government-owned contractor-operated or contractor-owned contract or operated plants. The Corporation will not be permitted under its charter to make any other type of contractual agreement for petroleum substitutes. The types of contracts or agreements not permitted include, but are not limited to; equity investments, joint ventures, lease, lease back agreements, and grants. Firms which accept ESC support for oil shale or unconventional gas will not be allowed to take advantage of the oil shale or unconventional gas tax credits. The sum total of the Corporation's contingent and noncontingent obligations shall not exceed $88 billion.

Loans and Loan Guarantees

The Corporation will be authorized to issue loans and loan guarantees, in accordance with such rules as the chairman may prescribe, consistent with criteria stipulated below. A guarantee will include the payment of principal and interest on obligations issued by, or on behalf of, any corporation, firm, partnership or consortium for the purpose of providing incentives of the construction of commercial size facilities which produce synthetic fuels from coal, oil share and unconventional gas resources. Loans shall be made on such terms as the chairman may prescribe. Loan guarantees will be eligible for purchase by Federal Financing Bank.

The loan guarantee shall be subject to the following requirements.

- No guarantee shall be extended unless the chairman of the Corporation finds that credit is otherwise unavailable to carry out the project on reasonable terms and conditions and that adequate provision is made for servicing the loan on reasonable terms.
- The guarantee shall not exceed 75 percent of the project costs as estimated at the time the guarantee is issued. The guarantee amount may be increased, at the discretion of the chairman, to cover 60 percent of that portion of the actual total projects costs which exceeds the project costs of such facilities as estimated at the time the guarantee is first issued.
- The chairman will seek to the maximum extent practicable to grant guarantees on a competitive basis.
- The chairman shall charge and collect fees for guarantees in amounts sufficient in his judgment to cover applicable administrative costs and probable losses on guaranteed obligations but in any event not to exceed one percent per annum of the outstanding indebtedness covered by each guarantee; Provided, That, the Board may at any time waive any fees with regard to specific projects.
- the loan to be guaranteed shall be secured by such collateral and additional security as may be reasonably required by the chairman for the protection of the Corporation.

- The chairman may provide for the payment to holders of the obligation guaranteed, for and on behalf of the borrower, of principal and interest which become due if the chairman finds that the borrower is unable to meet such payments, it is in the interest of the Corporation to permit the borrower to continue to pursue the purposes of such project and the proable net benefit to the Corporation in paying such principal and interest will be greater than that which will result in the event of a default, and that the borrower agrees to reimburse the Corporation for such payment on terms and conditions, including interest, which are satisfactory to the chairman.

- With respect to any obligation which is guaranteed under this title the interest paid on such obligation and received by the purchaser (excepting tax-exempt entities) shall be included in the gross income of such purchaser for the purpose of Chapter 1 of the Internal Revenue Code of 1954, as amended.

- The chairman shall consult with the Secretary of the Treasury as to the timing, rate, and terms of loans and loan guarantees.

Price Guarantee Authority

The Corporation will be authorized, in accordance with such rules as the chairman may prescribe, to contract with corporations, firms, partnerships consortia or state or substate governments which will construct and operate commercial size facilities for the production of synthetic fuels to guarantee a price for the synthetic fuel produced by such facilities. The price guarantees will be subject to the following requirements:

- The duration of the guarantee will be no longer than the useful life of the facility.

- The chairman will seek to select projects for price guarantees on a fully competitive basis to assure the minimum cost to the Corporation. However, the chairman's selection of a project shall be made taking into account other aspects of the proposed projects such as, the project's technical merits and feasibility, the experience of the proposer, degree of risk sharing by the applicant and other criteria determined by the chairman to assure the achievement of the Corporation's ultimate objectives.

- The price guarantee levels will be fixed at the time of the Corporation enters each contract for the life of the contract subject to any exceptions determined necessary by the chairman to encourage the construction of synthetic fuels projects while maintaining an appropriate sharing of financial risks between the corporation and the contractor. However, no exceptions will be permitted which will in any way guarantee profits to the contractor.

- The chairman may provide for the renegotiation of the contract in the event that the contractor in the judgment of the chairman cannot continue the project to completion and the chairman determines that it is in the best interests of the Corporation to have the project completed.

- If world oil prices are higher than price levels, guaranteed by the corporation, the Corporation may require at the time of the contract that a pro rate share of the higher price be paid to the Corporation by the firm for every unit of production.

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Purchase Guarantees

The Corporation will have the authority to contract for purchases of or commitments to purchase synthetic fuels and unconventional gas which may be used as fuel for government use or resale in order to encourage the construction and operation of commercial scale unconventional gas and synthetic fuels production facilities. This authority will be subject to the following requirements:

- Payments may be made for these purchases on such terms and conditions, including advance payments, as determined by the Chairman.
- Purchases or commitments to purchase cannot be made at prices above currently available or estimated future market prices unless the Chairman determines that the differential price is necessary in order to increase the production of synthetic fuels.
- Purchases or commitments to purchase shall be made by sealed competitive bidding with the exception that if the Chairman determines that no such bids have been submitted or no such bids are acceptable to the Chairman he may negotiate contracts for such purchases and commitments to purchase.
- Contracts for the purchase or commitment to purchase synthetic fuels may be entered into only for synthetic fuels or synthetic chemical feedstocks which are produced in facilities which are located in the United States.

Construction Authorization

The Corporation will be authorized to construct up to three synthetic fuels projects as government-owned, contractor or government-operated facilities. Additional GOCO's (or GOGO's) could be undertaken if:

- The chairman has determined that all other financing mechanisms available to the Corporation have already failed or would fail to encourage the construction of a synthetic fuels project where that project is determined to be essential to the Corporation's meeting its goals and objectives.

- The chairman shall assure maximum participation in the project by corporation, firms or partnerships that are likely to be interested in building such a project on their own in the future.

IV-B. Patent Policy

The Corporation shall have title to all patents and discoveries generated by the projects and activities to which the Corporation has granted loan, price or purchase guarantees, has made direct loans, or has contract with for any service. The chairman will have the right to waive such title at the point of contracting. The Corporation, however, may retain royalty free rights to the use of the patents and discoveries for which title has been waived, or may waive those rights.

IC-C. Other Administrative Authorities/Constraints

The Corporation in addition to authorities provided uner its state charter would have the following special authorities or restrictions.

Non-Financial Authorities and Constraints

Location -- Corporation shall maintain its headquarters in the District of Columbia or greater Washington area--as decided by the Board. The Corporation may establish offices or other facilities elsewhere within the U.S., as decided by the Board. Final decisions on location of headquarters and other offices will be left with the Board to give some flexibility, while removing the choice from congressional politics.

Property -- The Corporation may acquire and hold title to and lease real and personal property, including inventory of raw materials or finished products. It may also dispose of such property under terms and conditions as it sees fit.

Sue and Be Sued -- The Corporation shall be entitled to bring suit and shall respond to suits filed against it. The governmental immunity does not apply.

Employment -- The Corporation may hire persons, set working terms and conditions, and provide for their compensation including salary, pension benefits, health benefits, paid vacation and sick leave. These arrangements are not subject to laws and regulations governing Federal employees. The Corporation is, however, subject to laws governing private employment, including the EEO Act, NLRA, OSHA and others. The corporation will be subject to the Davis Bacon and Service Contract Acts on the same basis that these statutes are applicable to Federal Government Agencies.

Directors and other officers will be required to declare their financial assets and liabilities, and will be required to divest themselves of holdings that conflict with their position with the Corporation, in accordance with rules to be established by the Board.

Federal employees may accept employment with the Corporation with the express waiver of the post-employment constraints in the Ethics in Government Act (so that persons in government can compete for positions in the Corporation). The Corporation may advertise, price its products or other property for sale, and do related things normally permitted to private corporation.

Information -- In accordance with applicable law, the Corporation can request information or data held by Federal agencies or obtainable by them. This is to assist it in its planning and decisionmaking on matters such as how much production to plan from the several technologies it is to work with. The Departments of Energy, Interior, Agriculture, Commerce, Treasury or others may have useful information.

NEPA -- Only those decisions of the ESC with respect to broad program definition are exempt from the requirements of the National Environmental Policy Act. The ESC shall be obliged to assess the environmental impact of such generic or programmatic decisions in annual reports to the Congress.

V. Exclusions

The Energy Security Corporation (ESC) would be an independent, government--sponsored enterprise with a Federal charter. It will be located outside the Executive branch, independent of any governmental agency. As such, the ESC should be able to staff, operate and take action unlike agencies of the Executive branch. It should be able to act quickly and decisively consistent with its broad charter and goals. It must work with private industry and should not be hobbled by time-consuming and burdensome provisions of law which might increase the reluctance of business to become ensnared with another Federal agency. Accordingly, the Corporation would not be subject to those provisions of law which govern the administration and operation of government agencies and government employment.

VI. Relationship to DOE

The Corporation will maintain a relationship with the Department of Energy to help assure that its policies and decisions are compatible with national energy policy and objectives and to avoid unreasonable duplication of effort and confusion as to respective responsibilities. The Corporation:

- may utilize R&D performed or sponsored by DOE relating to the technical feasibility and basic processes for Synfuel production and for the management of associated environmental impacts.

- may request and the Department shall to the extent permitted by law make available such statistical information and technical assistance as required by the Corporation in planning and implementing its programs.

- the Corporation shall provide EPA and DOE full prompt access to all the information and facilities it controls or supports that they request for use in environmental research and evaluation subject only to existing statutory trade secrecy constraints.

The Department is authorized to collaborate or cooperate with the Corporation in achieving common objectives and in minimizing expenditures, however the Corporation may not engage in research and development activities.

THE WHITE HOUSE

WASHINGTON

July 19, 1979

Specifications for Establishment of Operation of an Energy Mobilization Board

Set forth below is a description of specifications for use in drafting legislation to establish and to set forth the power and duties of an Energy Mobilization Board (EMB).

I. Statement of Purposes

- To assist in accelerating development of non-nuclear domestic energy resources.
- To eliminate or modify procedural impediments to the construction of non-nuclear energy facilities that would, in the judgment of the EMB, contribute to the achievement of national oil import reduction goals without altering substantive Federal, State or local standards established prior to the commencement of construction.
- To foster appropriate coordination and integration of local, State and Federal actions necessary for the approval of energy facilities that would contribute to the achievement of national oil import reduction goals.

II. Definitions (listed below are key terms that will require definition)

- "Commencement of construction" of a critical energy facility -- this will determine the date

for "grand-fathering" critical energy facilities to protect them from the impact of future substantive and procedural requirements. (Use the definition in the EPA indirect source regulations.)

- "Energy project" -- should include all nonnuclear physical structures that the EMB determines are necessary for the construction and operation of a project for which application to be designated a critical energy facility has been made (e.g., refineries, Pipelines, fuel conversion plants, transmission lines, etc.)
- "Critical energy facilities" -- energy projects determined by the Energy Mobilization Board to contribute to the achievement of national petroleum import reduction goals pursuant to the procedures set forth in the legislation.

III. Establishment of EMB

- An EMB would be established in the Executive Office of the President. It would consist of three members appointed by the President with the advice and consent of the Senate and the members would serve at the pleasure of the President and under his direction.
- The Chairman of the EMB would be appointed by the President and would have the authority to appoint an Executive Director, as well as other necessary staff to carry out the Board's responsibilities.
- The EMB would have the authority to make rules and regulations and take other actions necessary to

carry out its functions including the authority to direct agencies to submit (1) proposed schedules for completing critical energy facilities and (2) relevant records when the EMB makes a decision for an agency.

- The EMB would be exempt from the Advisory Committee Act and Sections 553-559 of 5 U.S.C. (the rulemaking and adjudicatory provisions of the Administrative Procedure Act) although it would take appropriate actions to complete the record supporting any decision it makes for an agency.
- Decisions of the EMB would not be "major Federal actions" within the meaning of Section 102(2) of the National Environmental Policy Act of 1969.
- The EMB would be authorized (1) to designate a single agency to prepare a single environmental impact statement for any critical energy facility and (2) to the extent that the EMB finds it necessary to orderly completion of a critical energy facility, to waive or modify all or part of any Federal, State or local environmental impact statement requirement provided that the EMB establishes alternative procedures for the assessment of the environmental impacts of the facility.
- The EMB would be authorized to designate no more than 75 critical energy facilities at any one point in time.

IV. Authority to Designate Critical Energy Facilities

- The EMB would be authorized to designate certain non-nuclear energy facilities as "critical" when

it finds that an energy facility would contribute to the achievement of national oil import reduction goals established by the President. In making such a determination, the EMB would consider:

(1) The extent to which the facility would reduce the nation's dependence upon imported oil.

(2) The need for the facility in terms of meeting present and future energy requirements of the nation taking into account overall national economic, environmental, social and security goals.

(3) The extent to which establishment of the facility would advance needed scientific, technical, engineering and practical expertise needed to reduce the nation's dependence on imported oil.

V. Procedures for Designating Critical Energy Facilities Would Include the Following:

- Any person planning or proposing an energy facility could apply to the EMB for designation. Within a specified time after receiving an application, EMB would issue a decision on the designation request. Prior to its decision, EMB would obtain public comment on the proposed designation.
- The EMB would be required to establish procedures to ensure that as a condition for designating a critical energy facility, the EMB would have adequate and timely access to information necessary to grant or maintain the designation.
- A decision by the EMB designating a critical energy facility would not be subject to judicial review.

VI. Establishment of Project Decision Schedules

- The EMB would be authorized to establish binding decision schedules of not less than one year for any actions necessary at the Federal, State or local level for approval of a critical energy facility.
- The EMB could waive or modify procedural requirements imposed on critical energy facilities by Federal, State, or local law including but not limited to timetables and requirements for hearing and notice.
- Decisions by the EMB establishing project decision schedules would not be subject to judicial review.

VII. Substantive Decisions by EMB

If a Federal, State or local agency fails to comply with a Project Decision Schedule, the EMB would be empowered to make the decision and, where necessary, to take whatever additional action is required to develop a record adequate for decision. In making any such decision, the EMB would be required, except as provided in section VI, to apply applicable Federal laws, and the substantive requirements of applicable State and local laws.

VIII. Waiver of Post Construction Requirements

The EMB would be empowered to waive on an individual basis the application of substantive and procedural requirements that are enacted or established after construction has commenced on a critical energy facility. Such a waiver could be granted when the board finds (1) the waiver is necessary to ensure timely and cost-effective completion and operation of the facility and (2) the waiver would not unduly endanger public health or safety.

IX. <u>Judicial Review</u>

Decisions of the EMB and actions of Federal, State and local agencies necessary for the approval of critical energy facilities would be subject to judicial review only (1) after the EMB determines that the permitting process for a critical energy facility has been completed or (2) if the EMB determines that earlier review of an agency action is necessary to expedite completion of the project approval process or is necessary to assure fairness to the parties involved.

- Such actions challenging the granting or denial of approvals must be brought within 60 days in the Federal Court of Appeals for the Circuit in which the facility involved is located (if a transportation facility is involved, the relevant Circuit would be that in which the terminus of the facility is located).
- Reviewing courts would be required to render their decisions within 90 days, except where the Constitution requires a longer period.
- Any petition for review to the Supreme Court would have to be submitted within 30 days and the Court would be directed to expedite action on the appeal.

X. <u>State Assistance</u>

Technical assistance would be made available to State and local agencies to assist them in expediting actions affecting critical energy facilities and in complying with Project Decision Schedules established by the EMB.

XI. <u>Appropriations</u>

Such sums are authorized to be appropriated as may be necessary to carry out the purposes of this Act.

The CHAIRMAN. I want to thank the Secretary for his very thoughtful and forthright answers to the questions that were posed to him today, and for his cooperation. And I want to extend the apology of the committee, Mr. Secretary, that you were not able to be at the other meeting that you had hoped to attend at this point.

The committee will meet tomorrow morning at 10, at which time we will vote, hopefully on the Miller nomination and then we will proceed to vote on matters relating to the crude oil tax.

Thank you very much, gentlemen.

[Thereupon, at 12:25 p.m., the hearing in the above-entitled matter was recessed, to reconvene at 10 a.m. on Wednesday, August 1, 1979.]

[By direction of the chairman the following communications were made a part of the hearing record:]

RESOURCE ANALYSIS & MANAGEMENT GROUP,
Oklahoma City, Okla., July 24, 1979.

Hon. RUSSELL LONG,
Russell Office Building,
Washington, D.C.

DEAR SENATOR LONG: As outlined in Exhibit II of my Testimony before the United States Senate Committee on Finance on July 18, 1979, the following paragraph delineates the investments which I believe should be considered on plowback credit. You will note that it not only includes appropriate crude oil and natural gas investments but also investments in other alternate energy form.

Qualified investment includes amounts expended for intangible drilling and development costs, lease acquisition costs, geological and geophysical expenses, dry hole costs, depreciable assets (whether constructed or purchased) use in the exploration, development or production of domestic crude oil or natural gas, field gathering facilities, secondary or tertiary recovery of crude oil or natural gas, domestic coal and lignite mining and processing facilities, domestic coal gasification and liquefaction facilities, domestic tar sands and oil shale, development and processing facilities, domestic uranium and thorium, exploration, mining and processing facilities, energy-related research and development expenditures and investments in solar, wind and other alternative sources of energy and other facilities as defined by the Secretary of Energy.

Sincerely yours,

WILLIAM W. TALLEY II, PH. D.

STATEMENT OF B. R. STOKES, EXECUTIVE VICE PRESIDENT, AMERICAN PUBLIC TRANSIT ASSOCIATION

My name is B. R. Stokes. I am Executive Vice President of the American Public Transit Association. We are a voluntary association of operators of public transportation, as well as other elements of the public transportation community, including state and local governments, planning agencies, manufacturers, suppliers, universities, etc. Our operating members transport almost 95 percent of the more than 20 million public transit trips made each day, using some 53,000 urban buses, 11,000 rail transit vehicles, 5,000 commuter railroad cars, 55 ferryboats, 39 cable cars and even 4 inclined planes.

Mr. Chairman, since 1973, transit ridership has been increasing after a 28-year decline. In fact, for the past 22 months, ridership has increased over the same month in the previous year. Last year, transit carried more than one billion more trips than in 1972, the year before the oil embargo. Today, transit ridership is higher than it was at the peak of the 1973-1974 gasoline shortage and shows signs of a significant upward surge as a result of changing commuter attitudes, increasing energy costs and spot shortages of gasoline.

Our problem is very simple: Despite increasing Federal, State and local funding to reverse three decades of decline, our public transit systems do not have the resiliency and extra capacity to respond to quickly changing American transportation habits.

President Carter has called upon Americans to conserve energy, to use less gasoline, to change their travel habits, and to take the bus: As our petroleum crisis

of supply, demand and cost deepens, public transit must be available to maintain our mobility, to conserve petroleum, to contribute to changing our transportation habits. To meet this challenge, transit operators are gearing up; emergency planning for gasoline shortages is taking place throughout the country; bus and rail rolling stock is being inventoried to determine what the reserve fleet consists of, what is our actual ability to handle increased ridership, and what our immediate bus replacement and expansion needs. We are facing great odds to meet this vitally important challenge because the funds necessary to expand transit service are just not there.

An adequate, long-term windfall profits tax can assist the United States in maintaining our mobility and conserving petroleum by financing an adequate trust fund for public transportation investment.

I submit that we have a unique opportunity to achieve complementary objectives, to enact a tax based on a conservation incentive, realistic pricing of oil, and then to use a portion of the tax receipts to improve our public transportation systems—as proposed by President Carter in his speech last week calling for an additional $10 billion for this purpose.

We support a windfall profits tax, but we believe it must raise an adequate amount of revenue so that the public shares with the oil companies in the impact of higher prices. It must not be terminated too quickly, but remain in place as long as the revenues are needed.

And its revenues must support an energy security fund which would include a long-term trust fund for public transportation.

We urge this committee to include public transportation as a major receiver of windfall tax revenue. In order to prepare for the future and to respond to immediate and short-term demand increases, public transportation needs 25 percent of the energy security fund.

I will be happy to give the committee any material you might need to amplify this brief statement.

Thank you for this opportunity.

Government Research and Development Corp.

An Agency of the Individual American Citizen

P. O. BOX 786 • 309 NORTH MAIN STREET • BLANCO, TEXAS 78606

cc: All Congressmen
All Senators
The President
The Vice President
All Cabinet Members
All Treasury Officials
involved in Tax Matters

JUL 28

HON. RUSSELL B. LONG
RUSSELL HOB (LA)
WASHINGTON DC 20510

OPEN LETTER NO. 41

One statement sometimes made with respect to our present NIT (Net Income Tax) system is the conscious effect it has on individuals when money is with-held from paychecks. It is said that such consciousness makes the individual more cognizant of his financial input to our government and hence a braking effect if too much money is raked in. However, *it seems to us* (and this has been supported by interviews) *that making 85 million citizens miserable on April 15* every year is a *poor way* to make the individual conscious of his government. Also, it is highly debatable whether the individual actually carries much weight in the spending habits of the government.

There is a way for the individual taxpayer to *feel the effect* of his input without all of the April 15 *misery* and that is to go from a NIT system to a GIT (Gross Income Tax system. The *Principal of Allocation* (see Open Letter No. 6) could then be applied. Under practical operation the IRS would send a statement to each IWE (Individual Wage Earner) informing him of his share of individual taxes paid, FICA and other applicable with-holdings. There would be no extra work for the IRS. They would actually be doing the same amount, or less, record-keeping than they do now.

Much spending is a built-in procedure as a result of congressionally passed laws and regulatory proliferations of the bureaucracy. In the case of our NIT system this is because Congress simply cannot get a handle on the system. *Congress is the only agency* which *can control* this situation and obviously this has been impossible under NIT.

There is a way Congress can control our tax mess. That is to go from NIT to a GIT system. Referance to our letter No. 19 will show how this could be done in an efficient and simple manner.

We hope some statesmen in our Senate and House of Representatives preceive these simple truths at an early date and get legislation passed which will give them the *control* they need.

With best regards, I am

Very truly yours,

Jim Jones

Jim Jones
Managing Director

OUR INCOME TAX - Isn't it time for the system to grow up to maturity? Our present "System" is such a mishmash of arbitrary laws and regulations that it borders on infantilism in its logic. A Gross Income Tax system would provide the needed maturity. Note the simple tax form below

This ID number would cover every tax paying entity whether a corporation division of a corporation a professional investor or an individual operating as a free enterpriser

When this return is filed and paid a business operating entity (company) can spend its money any way it sees fit It will not have to be examined by or get permission from the government on how its money is spent This will free the BOE (Business Operating Entity) from the massive overhead costs of seeking deductions or other tax avoidance devices businesses could operate freely on an economic basis rather than a tax consequent basis

Gross Income Tax Return

Name ____ Type of Business Entity ____ (1)
Address ____ City ____ State ____ Zip ____ (2)
Taxpayer ID No ____ Period of Return From ____ to ____ (3)

Gross Income
- Sale of Goods $ ____ (4)
- Sale of Services ____ (5)
- Sale of Combination of Goods and Services ____ (6)
- Rentals of Real Estate ____ (7)
- Sale of Real Estate ____ (8)
- Rentals of Other Chattels ____ (9)
- Dividends from Stocks ____ (10)
- Sale of Stocks ____ (11)
- Interest from Bonds ____ (12)
- Sale of Bonds ____ (13)
- Interest Received on Loans ____ (14)
- Interest Received on Savings Accounts ____ (15)
- Inheritances (market value) ____ (16)
- Gifts (market value) ____ (17)
- All other income not reported above ____ (18)
- Salaries or Wages (record only amount received above $25 000 00) ____ (19)

Total Gross Income $ ____ (20)

Gross Credits
- Investment ____ (21)
- Employment ____ (22)
- Export Sales ____ (23)
- Other Approved Credits ____ (24)

Total Gross Credits $ ____ (25)
Taxable Income (deduct total Gross Credits from total Gross Income) $ ____ (26)
Total Tax Due (1% of Taxable Income) $ ____ (27)

Total Wages Paid to Employes for Year of Return $ ____ (28)
Total Number of Employes ____ (29)

FOR IRS USE ONLY

Allocation for Employee Tax Contribution $ ____ (30)
Allocation for FICA $ ____ (31)
Allocation for Health Care $ ____ (32)
Allocation for General Revenue $ ____ (33)

These two lines whenever either is applicable to an individual would put that individual in the category of a BOE (Business Operating Entity) The application of the OIT principal would then allow the government to collect taxes readily without the present equities of the inheritance and gift tax "System"

This line provides for the cases where an employee is paid an amount far in excess of what could be expected in wages for ordinary manual or mental input by that employee Such cases would be considered "Sale of Expertise" and would then come under the concept of a BOE Any amount above $25 000 00 per year would be considered "Sale of Expertise"

This section provides the means for inducing those national goals which make our nation more economically and socially productive

Because this tax is taken right of the top the so called "Double Taxation" is eliminated

If OIT is adopted it is estimated that the tax rate would be nominal for every BOE (Business Operating Entity) and would not be burdensome to any one probably 1% or less of gross income

This section would be used in making the allocations for employees tax contributions and FICA In practice it would be reported on a separate sheet to account for partial years employment and raises during the year for individual employees

This section would be used by the Internal Revenue Service in making the allocations as shown in the box These allocation percentages would be monitered and changed on a yearly basis by Congress

This section would
1. Eliminate the necessity for making out millions of W 2 (and related support paper work) forms by all BOE s (Business Operating Entities) in the country
2. Would eliminate millions of income tax returns by individuals each year
3. Would finance the Social Security Program out of the same fund from whence it now comes but by a more direct and less costly route These funds are the gross income which a BOE uses to pay his share and also the wages from which the wage earner pays his share It all comes from the same pot
4. Would give our Congress complete control and efficiency in any social system which must be separately funded

This type of tax system would allow at least ten times as many audits by our government as our present system allows An audit would be simple and would not make the taxpayer dependent on the subjective and arbitrary decisions now necessary with our present NIT (net income Tax) System

Gross Income Tax

1. It is fair and equitable to every taxpaying entity whether it be a corporation, an individual business man an investor or a wage earner
2. It is a progressive tax based strictly on the ability to pay
3. It is easy to administer, with no large software overhead requirement
4. It is a true and equitable way for companies to accumulate capital This encourages retainage of funds for expansion investment, thereby creating more jobs
5. It would eliminate the so called "Double Taxation of corporations This would again encourage retainage of funds for expansion because there would be no conflict between paying out for dividends versus retaining money for internal use
6. It would eliminate 90% of the paper work for business entities
7. It would eliminate 100% of the paper work for individuals
8. It would allow business entities to operate on an economic basis rather than on a tax consequent basis
9. It would raise more revenue than our present "system" allows, without substantive objections from the general public
10. It would give equal opportunity to all business taxpayers Large firms can employ lawyers and accountants to circumvent the present system OIT would eliminate this discrimination without penalizing either the large or the small company

BEST COPY AVAILABLE

Statement of IU International Corp.

The Tax Reduction Act of 1975 imposed limitations on the use of foreign tax credits from foreign oil extraction and oil-related income (§ 907 of the tax law), which the Administration is proposing to modify. The general rule, which was designed to apply to the foreign tax credits of large, multinational, integrated oil companies, limits the amount of foreign tax on foreign oil extraction income that is treated as creditable for U.S. tax purposes. However, its scope far beyond this. For example, the 1975 limitation also applies to a regulated public gas utility operating in a foreign country even though the U.S. parent of this foreign utility is not an oil or gas company.

IU International Corporation (IU) is a publicly held, diversified, U.S. corporation primarily engaged in land transportation (trucking), utility services, industrial products and services, distribution services, and agri-business markets. It owns 60.366 percent of Canadian Utilities Limited (CUL), a Canadian corporation (the balance of CUL's stock is publicly owned) whose Canadian utility subsidiaries include Canadian Western Natural Gas Company, Limited (CWNG) and Northwestern Utilities, Limited (NUL), two 95 percent owned gas utilities.

CUL through these two subsidiaries distributes natural gas to approximately 457,000 customers in 265 communities throughout Alberta and in Dawson Creek, British Columbia. In 1978, over 90 percent of CUL's natural gas was purchased from suppliers the remainder being obtained from its own properties. In addition, there are instances when it cannot conveniently use part of its own production in sales to customers. In these situations it sells such production to third parties at market rates. Since CUL's subsidiaries are regulated public utilities (in a manner similar to the regulation of such corporations in the United States), it gains no benefit from the fact that it has its own wells. In either case, whether its production is used for sale to utility customers or it is used for sale to third parties, the benefit is passed on to the utility customers through the mechanics of the regulated return on investment and the rate base. In other words, the production and sale of such gas is not a commercial free market transaction insofar as CUL is concerned. Any profits and costs are simply taken into consideration in determining the regulated rate to be paid by the utility customers. This is the same result as where the gas is purchased from other suppliers and then sold to CUL customers. No net profit is derived in either situation.

As in the United States, the utility operations in Canada are allowed to earn fair rates of return calculated on average net plant and working capital. Specifically, this means that the investment in the wells and other property, plant and equipment related to extraction are included in the utility investment rate base. Similarly, all proper expenses incurred in the extraction activities and any income earned from the sale of production to third parties are included in the computation used to determine the return permitted to the utility on its investment. The result is that whatever saving is obtained by a utility from having access to its own wells is passed on directly to its customers in the form of lower rates. There is no positive economic effect to the utility relating to its sales of gas and no net profit in an absolute sense.

Again, the reason for the enactment of the extraction credit limit, section 907(a), can be gathered from the following statement from the House of Representatives—Ways and Means Committee Prints on the 1976 Tax Reform Act. "A special situation exists in the case of oil companies which are presently making up to 90 percent of their payments to the OPEC countries for producing and selling oil through what are called taxes but what in reality may in part be royalty payments. The capability of companies to use these credits, in effect, to shelter low-tax foreign income led to the Congress' decision in the TRA of 1975 to limit the amount of payments for oil and gas extraction which would be treated as creditable taxes . . ."

Under the law as currently written, IU considers part of the dividend it receives from CUL to be attributable to the dividends CUL receives from the gas companies as being foreign oil-related income because a dividend retains the income characterization of the corporation paying the dividend. Foreign oil-related income includes the income derived from sources outside of the U.S. from the extraction of minerals from oil and gas wells, the processing of these minerals into their primary products, and the transportation, distribution, and sale of these materials or primary products. Because a gas utility obviously transports and distributes gas, the rules intended to apply to multinational oil companies treat it as having foreign oil-related income.

Furthermore, the portion of gas company's gross revenues earned on its extraction assets are considered foreign gas extraction revenues even though the utility's income is adjusted downward to reflect the extraction revenues. Accordingly, part of

the dividend which IU receives can be attributable to that income and is considered extraction income.

The Administration has proposed modifications of the foreign tax credit rules concerning foreign oil-related and foreign oil extraction income.

Under current law, foreign oil related income is defined to include the transportation and distribution of gas. Because a gas utility does exactly this, the present rules sweep them into the limitations designed for multinational oil companies. This problem is solved by the Administration's proposal to eliminate the special rules for foreign oil-related income.

In addition, where a gas utility has obtained permission from its regulator to use utility customer income to find gas (which maximizes supply sources at reasonable costs) and is required by the utility regulatory commission to reduce its rate of return or rate base by any income from the sale of gas to outsiders, the present rules put the utility into the extraction income limitations even though this extraction income has been eliminated by adjustments by the utility commission. This has the effect of increasing the U.S. parent's tax on its foreign income even though the extraction income itself has been eliminated. This second problem is not addressed by the Administration proposals.

CUL's gas utility situation in Canada as regulated public utilities is entirely different in a number of significant respects from that of the oil companies operating in the OPEC countries.

1. CUL's gas utilities are neither the types of companies nor engaged in those activities originally intended to be covered under the § 907 rules. Neither company is a large multinational, integrated, oil company engaged in vast petroleum exploration or refining activities.

2. Canada does not tax the gas producing activities of CUL's gas utilities separately or even at an exceptionally high rate so as to permit sheltering benefits to other foreign source income.

3. CUL's gas utilities derive no net profits in situations where they produce gas that is sold to unrelated third parties, because of adjustments made to their rate bases or rates of return.

Consequently, IU International Corporation respectfully requests that the Administration's proposal relating to oil-related income be adopted and that, in addition, the foreign extraction income limitations to the foreign tax credit be amended in such a manner as to make them inapplicable to situations where a foreign public utility reduces its rate of return or rate base by any extraction income it might otherwise generate. This second change reflects the fact that realistically the utility has no extraction income and therefore should not be made subject to the multinational oil company limitations.

Comments of the Chemical Manufacturers Association

The Chemical Manufacturers Association (CMA) is a nonprofit trade association having 188 United States company members representing more than 90 percent of the production capacity of basic industrial chemicals in this country. The company members, as participants in basic industry, are substantial energy consumers, and many use petroleum products as feedstocks for their chemical products. The members of the Association therefore share the vital concerns of all citizens with ensuring adequate supplies of energy for the continued growth of the American economy.

In testimony before the Committee on Finance on July 10, 1979, Secretary of the Treasury W. Michael Blumenthal stated, in connection with his comments on the Windfall Profit Tax, that the Administration was also proposing certain changes to the foreign tax credit limitations applicable to oil and gas extraction activities. Those changes consisted of proposals in two areas: (1) the credit for taxes paid with respect to oil and gas extraction income would be limited to the U.S. tax on net extraction income; and (2) the United States tax benefit theoretically attributable to extraction losses incurred in a particular country would be later recaptured.

Many of the company members of CMA are extensively engaged in international trade on a worldwide basis. Because of the multinational involvement of its company members, the Association has long supported an effective foreign tax credit. The foreign tax credit has been the mechanism used by the U.S. to prevent double taxation of the U.S. companies operating in other tax jurisdictions. Without relief from double taxation, U.S. business cannot effectively compete with foreign companies whose home countries protect them from double taxation through credits or other mechanisms.

It is the view of the Association that the overall limitation reflects the realities of the marketplace. The overall limitation alleviates the harsh effects that can arise in

computing the taxes of a particular foreign country based upon the apportionment and allocation of operations among many geographic areas. Certainly, the application of the lower of the two limitations would involve the worst effects of each limitation. The Association therefore believes that the Administration's proposals with regard to the foreign tax credit for taxes paid with respect to oil and gas extraction income treat oil companies unfairly. Oil and gas extraction activities should not bear a higher overall tax burden, the total of both United States and foreign taxes, than do other activities, particularly at a time when we want to encourage the development of new oil and gas resources.

Finally, the Administration's proposal for the recapture of United States tax benefits arising from losses in a particular country is a proposal that should be rejected. By increasing the burden of overall taxation, the recapture rule would damage further the ability of United States companies to compete abroad. The proposal would also add new complexities in an attempt to recapture a theoretical benefit that arises unintentionally—companies do not incur losses voluntarily. The retroactive effect of the Administration's recapture proposal is an unconscionable and unfair effort to penalize a particular industry. The economic stability of this or any other industry could be jeopardized if reliance cannot be placed on current law.

The Chemical Manufacturers Association accordingly opposes the Administration's proposals with respect to the foreign tax credit for oil and gas extraction taxes.

TRW, INC.,
OFFICE OF THE CHAIRMAN OF THE BOARD,
Cleveland, Ohio, July 20, 1979.

Hon. RUSSEL B. LONG,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I had hoped my schedule would permit me to testify before the Senate Finance Committee this week on behalf of The Tax Council and in opposition to proposed changes in the foreign tax credit applicable to the oil industry.

Unfortunately, because a meeting of TRW's Board of Directors in Cleveland conflicted with your hearings, I was unable to appear before the Committee. I would, however, appreciate the opportunity to submit the attached statement on behalf of TRW for the record.

While TRW is not in the business of producing oil, we do feel this legislation which is directed at the oil companies is contrary to the national interest for reasons provided in the attached statement, and, if the record for the Finance Committee's hearings on this subject is not closed, I would appreciate having my statement be made a part of that record.

Kindest regards and best wishes.

Sincerely,

R. F. METTLER.

Attachment.

STATEMENT OF RUBEN F. METTLER, CHAIRMAN, TRW, INC.

TRW Inc. is a diversified manufacturing firm with substantial participation in markets for transportation and communication equipment, spacecraft and propulsion products, advanced electronics and information systems, capital goods, and energy systems. Our sales for 1978 were $3.8 billion, and we have approximately 93,000 employees. Of TRW's business last year, 33 percent was derived from international markets.

Although TRW is not a petroleum company, we think that the issues under consideration are very important to all business, and especially to all companies with a substantial stake in international markets. Our objective in this respect is to encourage tax policy that does not encumber the ability of the private sector to provide energy or weaken the international operations of U.S. companies. We believe that the changes proposed in the foreign tax credit computation do not serve this objective and should be discarded.

It is not the purpose of this statement to be a long discourse on the United States' international investment position or its tax treatment, since it is our belief that this Committee and Congress are fully aware of the benefits to the U.S. economy from our international investments abroad.

A brief restatement of the principles might, however, be helpful. Through the 1970's, a number of authoritative studies were conducted demonstrating the positive relationship between foreign source income, exports, and domestic production and employment. These studies emphasized that foreign earnings of U.S. companies are crucial to capital formation in our domestic economy. The flow of repatriated earnings from investments abroad has consistently outpaced the transfer of investment funds overseas.

In the last four years, the surplus of repatriated earnings exceeded funds flowing abroad by more than $25 billion. This has been a bright spot in our otherwise disappointing balance of payments position; and, just as important, a critical source of domestic capital investment. According to research by The Tax Council, a number of major petroleum companies would not be able to maintain their U.S. exploration and development programs without the contribution of earnings from their overseas production.

In TRW's case, we have repatriated in recent years more earnings from our foreign operations than we have invested abroad from U.S. funds.

The foreign tax credit mechanism is vital to avoiding confiscatory double taxation of their foreign earnings. Nearly all tax policy authorities, including those at the Treasury, recognize the importance of the foreign tax credit structure. There seems to be increased awareness now, too, that the foreign tax credit does not in any way reduce U.S. income tax on income earned in the U.S. It serves only to avoid double taxation of foreign source income.

Unfortunately, that has not stopped attempts to erode the value of the foreign tax credit. In the current situation, with regard to the petroleum industry, the Treasury has proposed: (1) Not allowing foreign tax credit from extraction income to apply to allegedly lower-taxed foreign shipping and refining income—thereby further splintering the availability of the credit for different classes of income; (2) recapture of the effect of taking exploration losses in any country upon realization of future income; and (3) limiting the foreign tax credit to the lesser of the per-country or overall limitation. These changes generally would be effective for 1979 and afterwards, but would apply retroactively with respect to recapture.

These are technical concepts and their interplay is difficult to trace. Also, there is some disagreement as to the facts of the situation—as to how the credit is now used. The net effect of the proposals would be a substantial additional tax burden, estimated at up to $800 million for the companies affected in 1980.

The Administration's justification for their proposals is that the present system, despite tightening in 1975 and 1976, still constitutes an incentive for foreign investment relative to domestic. It also assumes that, to a significant extent, the foreign extraction income taxes against which credits are taken are not really creditable taxes, but royalties entitled only to a deduction. This has been argued for decades without resolution. The regulatory treatment, however, has gradually tightened, culminating in new proposed regulations laying out more specific guidelines on what qualifies as a creditable tax. Despite these stringent proposed regulations, Treasury says it needs more legislative muscle as well.

According to the Joint Committee on Taxation, the existing loss rule on extraction income, which the Treasury attacks as a "loophole" in present treatment, is designed to encourage exploration and development in countries where the companies "do not presently have significant production," that is the non-OPEC countries. Without the extraction loss rule, heavy expenses in developing non-OPEC oil reserves would reduce the companies' net extraction income and reduce the allowable foreign tax credit. This could discourage further investment in promising new areas. While more domestic sources of new oil certainly would be desirable, development of new non-OPEC foreign sources certainly would seem advantageous to the United States. In fact, it has been argued forcefully by some that any increase in supply anywhere in the non-OPEC world will effectively diminish OPEC influence.

The proposed restrictions on U.S.-based petroleum companies would not apply to foreign petroleum companies, which could obtain a significant competitive advantage in serving other industrial countries and U.S. markets. Again, as distasteful as our large bill for imported oil is, we have to rely on it for the foreseeable future. Our dealings with foreign sources of oil and foreign-based national oil companies, such as in Mexico and elsewhere, would be better served through American-based enterprise, regardless of its public image in times of energy shortage.

The Administration claims its proposals conform to and strengthen Congressional intent in the 1975-76 legislation. Certainly they would make the treatment "tougher" if that were the only intent. But the new proposals hardly follow a consistent path. In 1975, the option to use the per-country limitation in computing the credit on foreign oil income was repealed, putting all the multinational oil companies on

the overall limitation. In 1976, this treatment was extended to all multinational companies. It was said that the overall limitation is the only fair way to calculate it.

Now the Administration proposes to apply the lesser of the two in terms of tax savings, thus whipsawing the taxpayer whatever his loss or net income abroad. Whereas, through most of the postwar period, it was deemed proper to use either of the two methods to achieve the best result for the taxpayer, now precedent would be set for mandating the worst result. The proposal for retroactive application of the recapture rule seems most inequitable and another unfortunate precedent.

Assistant Secretary of the Treasury for Tax Policy, Donald Lubick, stated recently that the Administration proposals were conceived to apply only to the petroleum industry and they did not represent "an assault on the foreign tax credit generally." We believe the Secretary is sincere in this statement, but it does not relieve our grave concern over the implications of the proposals for all business engaged in international operations.

The record indicates that restrictive provisions aimed originally at the petroleum industry have been extended across the board—specifically in 1975-76. In important respects, the tax proposals are an open invitation for Congress to re-enter the controversial areas of foreign source income taxation that we thought were resolved, at least for some time, by the major tax legislation over the last few years.

Stepping back from the specific tax policy questions, we might ask what really would be accomplished by such changes in the foreign tax credit at this time. The Administration says that the present system discriminates against domestic investment. On the other hand, it presents no evidence or analysis as to what the actual economic impact would be with the credit restrictions, or, considering the billions already invested abroad in expectation of reasonably stable tax treatment, how this investment could be rerouted for domestic purposes.

In our review, restriction of the foreign tax credit in the manner proposed by the Administration is ill-conceived. The rules appear punitive, unrelated to providing the U.S. economy with additional energy, and could have serious adverse repercussions on our competitive position and entire investment stake abroad. We strongly urge this Committee not to adopt the proposed changes to the foreign tax credit.

STATEMENT BY THE BUSINESS ROUNDTABLE ON THE FOREIGN TAX CREDIT

SUMMARY OF STATEMENT

The Business Roundtable opposes the Administration's proposals to amend Section 907 of the Code. The proposals would further curtail the effectiveness of the foreign tax credit in preventing double taxation in the case of foreign oil and gas income.

The Business Roundtable generally does not take a position on legislation affecting only a single industry. However, the principle involved here would have far reaching and adverse effects if extended to the entire business community.

These fears of extension of the principle to other industries are not unfounded as is illustrated in the history of prior legislation. In 1975 Congress repealed the alternative "per country" limitation for the oil industry. In 1976, the "per country" alternative was repealed for the remainder of the business community.

The foreign tax credit provides necessary relief against the burden of double taxation for income earned abroad. It is not an incentive.

The foreign tax credit is too important to the conduct of U.S. business overseas to be subjected to constant tinkering.

The Rostenkowski Special Task Force thoroughly reviewed the foreign tax credit in 1976 and concluded that no further changes in existing rules were warranted.

Congress fully debated the issue of the "per country" limitation versus the "overall" limitation in 1976. While the Business Roundtable believes that the former rule of permitting the taxable to elect the applicable limitation was more equitable, certainly the effectiveness of the credit should not be further weakened by applying dual restrictions. The "overall" method is the most equitable and reasonable of the two methods. Taxpayers should not be forced on the the "per country" limitation.

Regulations recently proposed by the Treasury contain a host of new foreign tax credit rules which may totally nullify the credit for income taxes paid to many foreign countries. Coupled with the proposed regulations, this foreign tax credit legislation would be clearly punitive and would result in double taxation.

At a time when both the Congress and the Administation are concerned with international economic relationships it is incongrous to propose further limitations on the foreign tax credit which would weaken the ability of U.S. industry to compete in world markets.

Our energy needs are too important to make the U.S. oil and gas industry noncompetitive in its search for new sources of supply. The proposed amendments would discourage oil and gas exploraton in new areas of the world at just the time when such exploration should be encouraged.

Our interdependence on world trade—both exports and imports—is an established fact today. A significant percentage of our domestic economy is dependent on world trade.

Of our total exports, approximately 25 percent goes to U.S. affiliates overseas.

Today, U.S. companies face competition from foreign companies whose governments provide special incentives and benefits for export and foreign investments. The United States has generally been unwilling to provide similar benefits for U.S. companies.

Weakening of the foreign tax credit will lead to increasing instances of double taxation and further impair the ability of U.S. companies to compete overseas.

The detailed statement of The Business Roundtable on the foreign tax credit follows.

IMPORTANCE OF THE FOREIGN TAX CREDIT

Although the foreign tax credit provision has been an integral part of the U.S. tax law for over sixty years, it remains one of the most misunderstood aspects of our tax system. Contrary to the views of those who would label the provision an incentive for foreign investment, it is intended to and, in fact, does serve only as a relief measure to protect against double taxation. At most, it does no more than provide some semblance to tax neutrality with regard to the taxation of earnings from foreign and domestic operations.

The foreign tax credit provision, since its first enactment as part of the U.S. tax law in 1918, has served as the fundamental protection against the double taxation of foreign source income derived by U.S. taxpayers. It is premised on the principle recognized by all major industrial nations that the country in which income is earned has primary tax jurisdiction over that income. However, where the home country of the recipient of income also reserves the right to tax that income, as is the case under the U.S. tax system with regard to domestic taxpayers, the credit mechanism is necessary to eliminate double taxation. In recognition of these principles, all major industrial nations, wether through a foreign tax credit provision or by not taxing foreign income at all, have in effect the necessary legal mechanics to avoid double taxation.

Double taxation is confiscatory in nature. As Secretary of the Treasury Blumenthal noted in his statement before this Committee on June 19th, to the extent it is permitted to occur, double taxation raises serious barriers to international free trade and investment. Accordingly, any attempt to modify the existing tax structure for the sole purpose of restricting the availability of double taxation relief should be recognized by this Committee as an issue which goes beyond purely technical tax considerations and should be examined in light of all of the relevant economc and international policy implications. The fact that the instant proposal is directed at only one particular industry does not provide justification for deviating from the basic structure of the foreign tax credit provision which Congress after an exhaustive examination determined to be the appropriate rule of law.

Congress has through the years recognized and accepted the importance of the foreign tax credit provision to the American economy, especially with respect to the ability of American businesses to effectively compete in the world market. The current problems faced by the United States in international trade and commerce make these considerations especially significant. In a world where most of the industrialized nations are seeking ways to liberalize their foreign tax credit provisions so as to encourage foreign investment, the attempt by this Administration to build in further restrictions on the availability of such relief could have serious repercussions for the entire economy.

The economic issues go far beyond the question of the encouragement of foreign versus domestic investment. It is well established that foreign investments of U.S. businesses:

Promote the development of new sources of oil and gas supply as well as other strategic raw materials;

Favorable impact the U.S. balance of payments;

Generate exports of U.S. manufactured products which otherwise would not be made;

Create U.S. employment arising from the manufacture of such products as well as in related research and development and service functions.

More than 25 percent of all U.S. exports are being made today to affiliates of U.S. companies located abroad. If the foreign tax credit provisions are weakened, then the ability of those U.S. companies to export American-made goods and services must necessarily suffer.

The importance of the foreign tax credit provision to U.S. industry's place in the world economy should be well established. It should be equally apparent that the structure of those provisions should not be continually tinkered with nor should their basic purpose be subverted to accomplish short-term goals of the current administration. It is within this frame of reference that The Business Roundtable offers the following comments as to the Administration's proposed legislation.

LIMITATION PROVISIONS

The proposed amendment to Section 907 of the Internal Revenue Code would create a special limitation provision applicable to the oil and gas industry which would limit the foreign tax credit with respect to oil and gas extractive income to the lesser of the overall limitation or the per-country limitation. As part of that proposal, the Administration would require that the computations be made in a manner which segregates oil and gas extractive income and the foreign tax credits attributable to it from all other types of income derived by the taxpayer. Lastly, more onerous rules as to recapture of foreign losses would be enacted with regard to those extractive operations.

The Business Roundtable believes that as a matter of sound tax policy the law should permit all taxpayers to choose which limitation should be applicable, based on the nature of their business and the particular attributes of their own organization and operations. Also, the method so elected should be applied to each taxpayer in a fair and consistent manner. That, of course, was the policy adopted by the Congress in 1960 which, as the Joint Committee Staff indicated in connection with an explanation of this proposal, was intended to accommodate differing types of foreign ventures. Whether the multinational company functioned as a single integrated business enterprise in a number of countries or whether it conducted its business through independent units within each country, the taxpayer, it was recognized, should be the one to select which limitation method would best serve to provide relief against double taxation. As long as that limitation method once chosen was applied in a consistent manner for all future years, the objectives of the foreign tax credit limitation provision would be more likely to be achieved.

As indicated previously, the foreign tax credit provision is purely a relief measure to minimize instances of double tax exposure. The purpose of the limitation is to assure that foreign income taxes which were actually paid are allowed only as a credit against the U.S. income tax attributable to foreign source income. Where the mechanics of the limitation fails to allow a full credit for foreign income taxes, the burden of double taxation could seriously impair the taxpayer's ability to conduct those activities in a competitive environment. Based on the current state of the U.S. economy and the desire to promote international trade and commerce, it is submitted that the reasons for having an elective limitation provision are even more compelling today than when that provision was first enacted in 1960.

If only one limitation is to be allowed, however, The Business Roundtable believes that the overall method is most appropriate. The original foreign tax credit limitation which was adopted by Congress in 1921 was the overall method. In 1932 the per country limitation was also adopted, as the House of Representatives' report stated, to: Increase revenues and provide equity between taxpayers who paid taxes to only one foreign country and those who paid taxes to two or more countries.

In 1975 the Staff of the Joint Committee on Internal Revenue Taxation in papers prepared for the House Ways and Means Committee stated that in many cases the overall limitation would be appropriate. "Many businesses do not have separate operations in each foreign country but have an integrated structure that covers an entire region (such as Western Europe). In these cases a good case can be made for allowing the taxes paid to various countries within the region to be added together for purposes of the tax credit limitation."

In his statement before the House Ways and Means Committee on June 19, 1979, Secretary Blumenthal said that the overall basis of limiting the foreign tax credit "may be acceptable as a general rule, but when we are dealing with oil income * * * the averaging permitted by the overall limitation is inappropriate." "The Business Roundtable respectfully disagrees with the Secretary's statement and supports the overall limitation for all industries operating abroad."

The proposal to amend Section 907 appears to be a step backward, discouraging the international activities of a segment of U.S. industry at a time when economic conditions appear to warrant the encouragement of overseas activity. That portion

of the business community which is not involved in oil and gas extraction finds little comfort in the fact that this proposal relates only to the oil and gas industry. Our desire is for uniform tax laws that apply to industry as a whole. Our fear is that this principle of uniformity may well be later adopted by the Treasury Department in an attempt to have the current Section 907 proposals applied to the remainder of the industrial community.

[American Petroleum Institute, News Release]

WASHINGTON, July 18.—A petroleum executive testified today that this country's dependence on foreign oil "is the result principally of the onerous price controls and other government restrictions that the U.S. oil industry has labored under for the last quarter century."

The assessment came from Jerry McAfee, Chairman of the Board and Chief Executive Officer of the Gulf Oil Corp., who appeared before the Senate Committee on Finance in behalf of the American Petroleum Institute, the Mid-Continent Oil & Gas Association, the Rocky Mountain Oil and Gas Association, and the Western Oil and Gas Association.

"Price controls," he explained "have not been the only Federal impediment to domestic oil and gas production. Access to Federal acreage has been severely restricted, lease sales have been unduly limited, and unrealistic environmental stringencies have been imposed."

McAfee, who appeared before the committee to testify on behalf of decontrol of domestic crude oil prices, emphasized that President Carter's proposal for a so-called "windfall profits" tax on oil companies is "counterproductive and unnecessary."

"For one thing," he said, "more than half of any incremental increase in domestic petroleum prices would be returned to governments in the form of existing income taxes, severance taxes, and royalties; for another, the increased earnings accruing to oil companies would provide cash flow to finance increased domestic exploration for and production of oil and gas.

"The industry should be given the chance to employ this revenue in energy development because that is what it intends to do, knows how to do, and is better at doing than the government or any other entity."

The U.S., McAfee said, does have many unexplored areas which have significant potential for additional oil, provided that market incentives are available.

"Additionally, we have substantial known reserves that can be recovered through the use of enhanced recovery techniques—again requiring market incentives," he noted. "And finally, we have extensive known resources of other conventional energy supplies such as coal and uranium, and of alternate energy forms such as shale oil and solar energy in its various forms.

"If the nation's energy needs are to be met, an orderly and long-range transition to increased use of these alternate fuels will have to take place."

NATIONAL FOREIGN TRADE COUNCIL, INC.,
New York, N.Y., July 12, 1979.

Mr. MICHAEL STERN,
Staff Director, Finance Committee,
Dirksen Senate Office Building, Washington, D.C.

DEAR MR. STERN: The National Foreign Trade Council, a non-profit organization whose membership comprises a broad cross-section of over 600 U.S. companies with highly diversified interests engaged in all aspects of international trade and investment, is pleased to submit comments on the Administration's proposal to amend Section 907 of the Internal Revenue Code, and requests that this communication be incorporated in and made part of the record of the hearings.

Commencing with the Tax Reduction Act of 1975, Congress has imposed increasingly severe economic burdens on foreign investments by U.S. companies, principally by restricting the relief from double taxation on foreign source income afforded by the foreign tax credit. The Council notes with dismay current efforts to further restrict the availability of credits for taxes paid by U.S. businesses abroad, by limiting the credit on a per country basis in addition to the overall limitation now imposed, together with a complex, theoretical recapture rule and unnecessary limitation on foreign losses.

The overall limitation on computation of the foreign tax credits was enacted in 1960. Public Law 86-780 allowed a taxpayer to use either the per country or overall limitation for taxable years beginning after December 31, 1960. The purpose of the

overall limitation was set forth in Sen. Rep. No. 1393, 86th Congress, 2d Session, pp. 876–877 which states:

"These two limitations represent basically different concepts of the relationship between domestic and foreign income. The overall limitation in effect, treats the taxpayer's income as being divisible into two parts, domestic and foreign. Thus under this limitation a foreign tax credit is allowed for any foreign income taxes so long as these taxes do not represent more than the U.S. tax rate applied to the taxpayer's total foreign income. The per country limitation, on the other hand, treats the taxpayer's income as being divisible into many parts, his domestic income and his income from each foreign country, and applies the limitation separately to each."

"In most cases American firms operating abroad think of their foreign business as a single operation and in fact it is understood that many of them set up their organizations on this basis. It appears appropriate in such cases to permit the taxpayer to treat his domestic business as one operation and all of his foreign business as another and to average together the high and low taxes of the various countries in which he may be operating by using the overall limitation."

We believe the Senate Report correctly sets forth the way that the petroleum industry treats its international operations. Its foreign operations consist of producing, transportation, refining and marketing. These operations are not separate businesses but are part of one integrated operation.

Contrary to the original concept behind enactment of the overall limitation, Congress fragmented the foreign tax credit limitation for petroleum companies in the Tax Reform Act of 1976 by imposing an additional limitation on credits generated by oil and gas extraction income. The Act was designed to prevent the use of excess foreign tax credits from countries producing oil and gas to offset the U.S. tax on other foreign source income. At page 250 of the "General Explanation of the Tax Reform Act of 1976" (December 29, 1976), the intent of Congress is clearly set forth: "The Act limits the allowable foreign tax credit on foreign oil and gas extraction income to an amount equal to the average U.S. effective rate on that income. Thus, in any case there will be sufficient tax credits to offset the U.S. tax on foreign oil and gas extraction income but no excess credits to offset U.S. tax on other foreign source income. The Act achieves this result by limiting the taxpayer to a separate overall foreign tax credit limitation for foreign oil and gas extraction income."

The Administration's proposal would limit the foreign tax credit for oil and gas extraction taxes to the lesser of the credit computed with respect to overall foreign oil and gas extraction income (net of losses) or the credit computed with respect to such income calculated on a country-by-country basis. The proposal, coupled with the recapture of tax benefits attributable to per country extraction losses, will prevent excess credits or losses from foreign oil and gas extraction activities in one country from offsetting U.S. tax with respect to oil and gas income in other countries and the U.S. tax on other oil related activities. More specifically, the proposal requires the recapture of foreign extraction losses on a per country basis against extraction income generated in that country in later years. In this regard, foreign extraction income would, to the extent necessary to recapture a theoretical tax benefit generated by a prior year's loss, be treated as U.S. source income thereby denying the creditability of foreign taxes imposed on such income.

We believe that the Administration's effort to further limit the foreign tax credit generated by one part of the integrated business is contrary to the original purpose of the overall limitation. It also discriminates against the petroleum industry, since other industries can continue to utilize tax credits generated by one part of an integrated business against other component parts.

Moreover, in 1976, Congress recognized that it was necessary to provide tax incentives to encourage worldwide exploration for oil and gas. For this reason, Congress enacted a special per country extraction loss rule. This rule, as the Staff of the Joint Committee on Taxation noted in a recent "Committee Print", was designed to encourage the development of non-OPEC petroleum sources by stimulating worldwide exploration. The "Committee Print" reads, in pertinent part, as follows: "This special per country extraction loss rule is designed to encourage the exploration for and development of new oil reserves in countries where the companies do not presently have significant production (countries which generally are not OPEC members). During the period in which a company undertakes exploration and development activities in a new area in which it is not already producing oil income, the company will ordinarily incur substantial tax losses (in part because of the election to deduct intangible drilling costs). Most oil companies pay foreign oil taxes at an overall rate substantially higher than their aggregate U.S. tax on their net income from foreign extraction activities. Without this special per country

extraction loss rule, any expenses incurred by a company in exploring for and developing new oil and gas deposits would reduce the company's net extraction income and this would reduce its allowable credits. In order to preserve the incentive for such exploration and development of new deposits, this special per country extraction loss rule was adopted to permit the companies to use these losses * * *"

Even taking into account this exploration incentive, the 1976 changes made U.S. law stricter than the law of any other foreign country with a similar tax system. It is not wise to further restrict the foreign tax credit rules at a time when we are experiencing escalating petroleum prices and worldwide petroleum shortages. Greater price pressure and diminished foreign exploration activity by U.S. corporations will result if the use of extractive losses is limited as proposed and if the loss recapture rules are enacted.

In lieu of a proposed tightening of the foreign tax credit rules, the Council urges that consideration be given to liberalizing such rules through reinstatement of taxpayer elections of the per country or overall limitations by repealing the foreign tax credit provisions of the Tax Reform Act of 1976.

After enactment of the 1976 legislation the foreign tax credit situation was further exacerbated by Internal Revenue's publication of Revenue Rulings denying the creditability of taxes paid in foreign countries and by the publication of proposed regulations. It is against this backdrop of foreign tax credit turmoil and uncertainty that the Administration's proposal is being offered.

Even though the Administration's proposal is applicable only to the petroleum industry, it erodes the concept of foreign tax credits serving to protect U.S. companies from double taxation on foreign source income. The effect of this erosion is increased exposure of all U.S. companies to double taxation. When this increased exposure is considered along with the negative effect of the administrative rulings and proposed regulations, it must be concluded that the Administration's proposal would be harmful to U.S. companies engaged in international trade. We urge the Committee to reject this proposal in its entirety.

Respectfully submitted.

CARTER L. GORE, *Director.*

SONOSKY, CHAMBERS & SACHSE,
Washington, D.C., July 9, 1979.

GENTLEMEN, on behalf of the Shoshone Indian Tribe of the Wind River Reservation, Wyoming and the Assiniboine and Sioux Tribes of the Fort Peck Reservation, Montana, we urge that H.R. 3919 be modified to insure that the United States does not inadvertently impose a federal tax on the trust interests of Indians and Indian tribes in oil held in trust for them by the United States.

The United States has never imposed a federal tax on the Indians' trust property including the oil production from land held in trust by the United States. Such a tax would be inconsistent with the Government's trust responsibility to the Indians and the Government's policy extending back to the beginning of the Nation. (See 25 U.S.C. 177.)

H.R. 3919 contains no mention of Indians or Indian tribes. Nevertheless it might be read as requiring taxation of Indian trust oil income. This should be corrected—and we suggest language to do so.

A simple way to accomplish our objective is to add as the last subsection of Section 4992 a new subsection (g) reading as follows: (g) *Exemption for trust interests of Indians and Indian Tribes.*—No tax shall be imposed under this Act on the interests of Indians or Indian tribes held by the United States in trust for such Indians or Indian tribes.

Another section of the Act which concerns the Tribes is the severance tax adjustment provided by Section 4992(b).

Some Indian tribes have passed severance taxes. The legislative history should show that the term "severance tax" in this Act includes Indian severance taxes as it does in the Natural Gas Policy Act. Indeed as there is no definition of severance tax in the bill the Senate might want to add the definition used in the NGPA.

That the proposed tax not limit Indian income from trust land is a matter of great importance to Indian tribes throughout the country. The tribes would deeply appreciate consideration of the suggested amendment.

With best personal regards,

Sincerely,

HARRY R. SACHSE.

STATEMENT OF THOMAS K. WILLIAMS, COMMISSIONER OF REVENUE, STATE OF ALASKA

MR. CHAIRMAN AND THE HONORABLE MEMBERS OF THE COMMITTEE, thank you for this opportunity for the State of Alaska to present to you our comments regarding the windfall profits tax on crude oil. Although we must confess a measure of disappointment at being denied the opportunity to testify personally before the Committee, nevertheless we do appreciate your affording us this more limited means of presenting our views, a courtesy which the House Ways and Means Committee did not extend to us at all when it significantly altered the President's Bill.

Alaska is vitally concerned about the windfall profits tax as passed by the House. We have more proven oil reserves than any other State, and more potential oil reserves. With production from the Prudhoe Bay field now over 1.33 million barrels a day, and with over 100,000 barrels a day of low-sulfur, high API gravity crude oil from the Cook Inlet area suppling the refineries in Puget Sound, Alaska has moved slightly ahead of the Chairman's home State in terms of current production, behind only Texas. Some 99 percent of this production is from leases issued by the State of Alaska, thus making us by far the largest single royalty owner in the United States. More than any other State, Alaska has an interest and a stake in how the tax will operate.

Alaska accepts some form of windfall profit tax as part of an overall energy program that incorporates the decontrol of crude oil prices. Price controls, and their corollary, the entitlements program, have spawned a nightmare of bureaucracy, paperwork and confusion. In addition, they have subsidized and perpetuated economic waste and inefficient consumption. The degree of their failure is evidenced by the fact that controls, which were set up to shelter us from the effects of the high prices charged by OPEC, have led us to an unprecedented dependance on continued supplies from members of that cartel.

Yet, while Alaska applauds the decision to phase out the crude oil price controls and recognizes the consequent impetus for a windfall profit tax on the price increases that result from decontrol, we are deeply concerned about a number of features of the tax as passed by the House. We see one reservoir from one field singled out from all the fields and reservoirs in the country for unique and adverse treatment. We see exemption from the tax, properly used as an incentive for the high-cost, high-risk Arctic region, but see it unused for other frontier areas with equal risks and possibly even greater costs. We see the federal government attempting to tax the royalties of the several States in derogation of federalism, while unconstitutionally discriminating between States that support education through dedicated royalties and those that support it from their general funds. We see the tax, through apparent inadvertence, impacting Alaska's Native peoples by further protracting the time for fully paying the Native Claims Settlement Fund from Prudhoe Bay royalties and also by exposing the lands of every Native regional corporation but one to the operation of this tax. Let me briefly explain these concerns.

First, the House version, unlike the President's singles out Prudhoe Bay's main reservoir for unique tax treatment: all other Arctic production will be exempt from the tax to allow the maximum economic incentive for getting that additional production on stream. But as the major owners at Prudhoe Bay have already testified to this Committee, the main reservoir there is by no means close to being fully developed. Only a third of the producing wells have been drilled that will ultimately be needed. New drill sites will have to be put in, which requires moving enormous amounts of gravel for work pads on the swampy ground. The secondary recovery project for the reservoir, which will cost 3 to 4 billion dollars, is only in the design stage. The decision to develop the estimated 800,000,000 barrels of recoverable reserves in the west end of the reservoir has not yet been made; and because of the thinner pay and lower productivity per well, the economic prospects are every bit as marginal as they are for the Lisburne or Kuparuk reservoirs. In all, some 12 to 15 billion dollars remain to be invested in the development of this single large reservoir, compared to the $4 billion or so that has already been put into that development.

Arco, Exxon and Sohio have already told you these things and have explained how the remaining investment decisions (and, consequently, the ultimate amount of oil recovered) will have to be made on their own merits and not the merits of prior investments. What I would like to do is emphasize to the Committee that what they told you is the truth. I personally have worked with these companies' engineers and managers and with our own engineers and consultants as early as 1975 in assessing the reserves of the Prudhoe Bay field. The magnitude of the task to bring the main

reservoir of that field into full oil development has not changed from what was said to me then.

Since the majority of the development investments for this reservoir remain to be made and since its operating conditions are as difficult and costly as anywhere else on the North Slope, we fail to see any justification for denying this reservoir the same incentive afforded all other Arctic development through an exemption from this tax. The field is not spectacularly profitable, but only moderately so: at least one other field in Alaska is far more profitable, and so are a great many fields in the Lower 48. The only unusal thing about the Sadlerochit reservoir is its magnitude, and that in itself is not reason to penalize it.

If, however, the Sadlerochit reservoir is to be subjected to this tax and the economics of its complete development thereby jeopardized, then at least it should be treated on a somewhat equal footing as other upper tier oil. Measuring the windfall from an arbitrary $7.50 figure makes no sense. The purpose of the windfall profit tax is to tax the windfall caused by decontrol of oil prices. Sadlerochit oil has not had a controlled price of $7.50; it was lawful to sell it for $12.91 this May. The reason the ceiling price has not been realized for this oil until only very recently is remoteness of the field. This remoteness means that transportation costs to a refinery in the Lower 48 are very great—so great in fact that, to be competitive, Sadlerochit oil was sold for prices that netted back to the wellhead at levels much below the legal ceiling. The recent increase in the wellhead price to levels at or near the ceiling would have happened even without decontrol, and therefore there is yet to be any windfall resulting from decontrol. Hence, if this tax is applied to Sadlerochit oil, the windfall should be measured from the ceiling price, as it is for all other upper tier production.

One further point, if the tax is applied to Sadlerochit oil: The House Ways and Means Committee refused to allow any severance tax adjustment for Sadlerochit oil. The Committee's reason for this was the lower tax rate on Sadlerochit oil (50 percent, versus 70 percent for ordinary oil). But since the full House lowered the 70 percent rate to 60 percent, the rate differential is no longer great enough to justify the disallowance of Alaska's 12.25 percent severance tax.

Our second major concern with the tax is that, while it prudently exempts Arctic production to provide an incentive for development, it fails to do so for other areas with comparably high costs and risks. In the deep-water OCS off Louisiana, a single production platform may run into hundreds of millions of dollars. One exploratory well in the Baltimore Canyon may cost over $20 million, while a well in the Gulf of Alaska can easily be even more expensive.

Similarly, interior Alaska is an extremely high-cost frontier. The lack of a basic ground transportation network means all equipment, facilities are supplies must be flown in, as well as the work force. Unlike Prudhoe Bay, production facilities will not be able to be prefabricated into large modules in the Lower 48 and barged up to the site; rather, they will have to be assembled and installed in the field at greater cost. Efficiency drops with the temperature, and in the winter interior Alaska can often get to −60 and sometimes below −70, measured by the thermometer, not a wind-chill chart.

These areas—the deep-water OCS off the Atlantic, Pacific and Gulf of Mexico, the western Gulf of Alaska, the Bering Sea and interior Alaska—are all south of the Arctic Circle and therefore exposed to this tax. Oh, it's true that newly-discovered oil will be exempt after 1990 and possibly little production could be had from these areas before that time. But our energy shortage is real and with us today. Can we be sure that production couldn't start before 1990 in any of these areas? Alaska submits that it is unwise to rely on the exemption in 1990 to provide an incentive for their exploration and development. These areas should be exempted now so that, if production could begin earlier, there is every incentive available to ensure that it does start earlier.

Our third concern is with the proposed treatment of State royalties. We believe it to be unconstitutional on several grounds: first, that it is inconsistent with our system of federalism, under which the States have reserved all powers not specifically conferred to the Federal government; second, that it arbitrarily and unreasonably discriminates between the people of those States that support education through the dedication of a specific revenue source (namely, royalty) and the people of the other States, which support education from their general funds; and third, that it imperialistically intrudes into each State's decisions about how best to use its oil royalties for the benefit of its citizens.

Alaska also opposes on policy grounds the narrowness of the exemption of royalties dedicated to education. We fail to see why education is more worthy of windfall

profits than, say, administering justice, providing health care and facilities, giving police protection or conducting elections.

Alaska further opposes the taxation of State royalties out of self interest. We stand to lose over $300 million in the first year alone under this tax. Contrary to the image we have of being fabulously rich because of all the oil in our State, this money is critical for Alaska's future well-being. While we are entering a time (perhaps as long as a decade) in which our revenues will exceed our immediate budgetary requirements, Alaska must prepare for the time when the petroleum reserves are no longer available in such abundance.

The non-petroleum sector of Alaska's economy contributes roughly one-third of the money to sustain the cost of State government. This has not resulted from low taxation. Real estate is assessed at 100 percent of full market value, and our personal income tax goes up to a 14.5 percent bracket—to give just two examples. And, published statistics show Alaska to have more taxes per capita than any other State. Nor is the imbalance between our expenditures and our sustainable revenues due to a "spendthrift" government. Our State budget has grown because of inflation that at times exceeded 25 percent and because of a tremendous growth in population. After inflation effects are taken out, we spent less per capita in 1975 than in 1970. This year's budget is actually smaller than last year's, despite double-digit inflation.

The imbalance is a chronic problem for Alaska. The lack of a major socioeconomic infrastructure to support State government was one of the arguments given by those who opposed Alaska's Statehood. It was a major reason why Alaska was given the right to select over 100 million acres under the Statehood Act. (The continued lack of an adequate infrastructure is one reason why many responsible Alaskans are so concerned about the Alaska land use issue and H.R. 39.) After a few rather grim years in the early 1960's, this basic problem was canceled by oil revenues, first from Cook Inlet, now from Prudhoe Bay. But the problem remains: What will support the State government when the oil starts running out?

Finding more oil postpones the need to answer this question, but it is not itself an answer. Rather, the answer lies in developing the missing infrastructure while preserving an environmental heritage for the future. Our petrodollars are the key to this. Already 25 percent of our royalty income is constitutionally dedicated to a Permanent Fund to serve as a hedge against the time when the oil is gone. In addition, our temporary surplus will be available for the capital projects that government must make in building up the infrastructure. And, the surplus will bridge the gap until sustainable reserves can catch up to our ongoing revenue needs.

Doing this is a difficult task. We must discipline ourselves to a tight budgetary policy in the midst of surplus. The political pressures to succumb to temptation are great, indeed, but Governor Hammond and his administration are committed to holding the line. A two percent real growth rate in the budget and 3 to 5 percent real growth in the non-petroleum sector will let us get by, but we will use up practically all of our "surplus" petrodollars to do so. Thus, in different but related ways, the singular challenge facing both Alaska individually and the United States as a whole is the task of freeing ourselves from an excessive dependence on oil.

Alaska's fourth concern pertains to the effects of the windfall profits tax on the Alaska Native Claims Settlement. These effects take two forms. First, the Native Claims Settlement Fund receives a direct royalty of 2 percent from the Prudhoe Bay field, taken from the State's one-eighth share, until a total of $500 million is paid into the Fund. When the Settlement Act was passed in 1971, the Natives, Congress and we expected this obligation to be fulfilled in the middle of the decade. As you know, other events delayed the start of production until June 20, 1977. Consequently, less than $80 million has been paid into the Fund. The windfall profits tax will delay yet again the time when the Natives finally get all the money they were provided 8 years ago.

The other impact of the tax is on the potential development of the frontier areas selected by the Native regional corporations as part of the 40 million acres they received under the Settlement Act. Except for the Arctic Slope Region, these lands are all south of the Arctic Circle and suffer from the disincentive already described with respect to high-cost, high-risk areas outside the Arctic.

Before concluding this statement, I would like to offer two comments of a fairly technical nature. First, sec. 4991(b)(3) defines "Sadlerochit oil" as "crude oil produced from the Sadlerochit reservoir in the Prudhoe Bay oil field". In point of fact, however, some production of this reservoir comes from the Shublik sand as well as the Sadlerochit sand. To avoid any ambiguity (in the event Sadlerochit oil remains unexempted from the tax), it might be better to use the term used by the oil companies themselves in forming the Unit: the "Prudhoe Bay (Permo-Triassic)

Reservoir" as defined in the Prudhoe Bay Unit Agreement. Second, if "Sadlerochit oil" is treated as Tier 2 oil, the provisions of sec. 4990(d)(2) and (3) must be modified to avoid an unintended hardship. Sec. 4990(d)(2) provides for a phased release of Tier 2 production into Tier 3. As now written, sec. 4990(e) provides that the base price for Tier 3 is "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 were $16 a barrel." With transportation costs of $6.20 for the pipeline and about a dollar for tankering to the West Coast, the Tier 3 base price for Sadlerochit oil would be about $9 a barrel, as opposed to its current ceiling price (and its base price as Tier 2 oil) of $13. We would suggest that any Tier 3 price for such oil be the landed price of imported oil in December, 1979, minus the average transportation cost to the refinery gate for all uncontrolled production during that month in the Lower 48.

thank you once again for your consideration of this statement and for the opportunity to submit it.

STATEMENT OF LOUIS W. RITZ, PRESIDENT, INDEPENDENT OIL PRODUCERS ASSOCIATION, TRI-STATE, INC.

The Independent Oil Producers Association, Tri-State, Inc., represents some three hundred independent producers who explore for and produce oil and gas from the Illinois Basin, in southern Illinois, southwestern Indiana, and northwestern Kentucky. This is an area in which more than ninety per cent of all properties have qualified for stripper status, and the average well produces about 2.6 barrels per day (although production from the three states is close to fifty million barrels per year). Exploration remains at a substantial level, with more than 2,800 wells drilled in 1977.

Our members would therefore be principally affected by the proposed excise tax on stripper oil, and on oil produced from wells drilled after January 1, 1979. We therefore propose to limit our comments to the Tier Three tax, as it would affect the production of stripper oil and the drilling of additional wells in the Illinois Basin.

We doubt the wisdom of imposing an excise tax on stripper oil, because each dollar paid in taxes will cause the demise of additional wells. As production drops, the cost per barrel of producing oil increases. This is especially true of the many waterfloods in our area which have passed their peak, and which require the injection, recovery and disposition of one hundred or more barrels of water for each barrel of oil recovered. As expenses have increased with inflation, lifting costs of from $15 to $20 per barrel are not uncommon. The recent increases in the price of oil have consequently given a new lease on life to many wells and units which had been scheduled for abandonment. The reduction of this price, by the imposition of an excise tax, will again condemn them.

This will have consequences beyond the immediate loss of production. Even after secondary recovery operations have become uneconomic, from a third to half of the oil originally in the flooded formation remains unrecovered. As yet, in the Illinois Basin, tertiary recovery techniques, to recover the remaining oil, have not proven economic. We hope that a combination of new procedures, reduced prices of chemicals, and increased prices for oil will change this; and properties are today being operated at costs near or above the break-even point in this hope. Once such operations have been discontinued, the costs of obtaining new leases, combining them into new units, and drilling new wells would increase the set-up cost of tertiary production sufficiently to make it prohibitive. One effect of an excise tax on stripper oil would therefore be to add substantially to the cost of recovering, and perhaps to lose forever, known reserves in such well-developed areas as the Illinois Basin.

So long as we are required to import oil to meet national demand, we cannot afford to cause leases to be abandoned which could produce oil at less than the cost of imported oil. Congress recognized this, in freeing stripper oil from price controls. Placing an excise tax on stripper oil reimposes a form of price control. We submit that the revenue gained would not compensate the country for the production thereby lost.

The proposed imposition of an excise tax on oil from newly drilled wells also raises a problem for the producers of our area. The cost of drilling such wells in the Illinois Basin has never been financed by banks, and only partly paid for out of profits from previous wells. Most of the money has come from investors whose principal source of income is not petroleum, and who have risked surplus capital in oil ventures in order to realize the profit therefrom permitted by out tax structure.

Our operators, in seeking such capital, must compete against other forms of investment, such as tax free municipal bonds. They are hampered by a negative investment credit unique to the oil industry (since deductions of intangible drilling costs by new investors constitute tax preference items), and by the prospect of eroding percentage depletion rates. They must comply with increasingly rigorous regulations by the Securities Exchange Commission, and by the state agencies supervising the sale of "securities".

Facing these obstacles, our operators have been able to maintain and even increase their exploration programs in recent years only because of the increases in the price of oil. As that price is arbitrarily reduced by an excise tax, which increases as the price goes higher, the incentive to invest will decline. When tax-free bonds become more profitable, after consideration of relative risks, than drilling deals, the rate of drilling in our area will drop, as it did fifteen years ago. More than thirty million barrels of reserves were discovered in the Illinois Basin in 1977. We cannot afford to discontinue any substantial portion of this effort.

We wish also to point out that operators who obtain funds for exploration from outside of the industry would receive no relief from proposed "plowback" provisions, excusing the tax on amounts invested in excess of a "threshold" based on prior levels of investment. To explain to an investor that his profit will be reduced by an excise tax unless he invests a greater amount in drilling next year will be to discourage him; he can invest any amount his circumstances next year may dictate in competitive forms of investment. We believe that in the Illinois Basin, a plowback provision would inhibit, rather than increase, the total investment in new drilling, and would therefore defeat its purpose.

We are aware that the problems arising out of the proposed excise tax which have been outlined in this statement may be peculiar to the Illinois Basin, and other areas where relatively low-cost operations are conducted almost exclusively by independent producers. We can, of course, only testify concerning the circumstances with which our members are familiar.

We wish to suggest, however, that these problems arise primarily out of the imposition of a tax designed to limit the profits of the major integrated international oil companies upon small independent operators, whose holdings are principally of stripper oil, rather than lower and upper tier oil, and who finance new drilling in an entirely different manner. Such problems could be eliminated if the tax were to be imposed only upon the parties at whom it is directed.

An exclusion from tax liability for those producers whom Congress has already recognized as being in a different category, by permitting them to retain the right to claim percentage depletion (under Section 613A(C)(2) of the Internal Revenue Code), would eliminate all of the difficulties which we have attempted to bring to your attention in this statement. We therefore recommend such an exclusion for your consideration.

We wish to thank the Finance Committee of the United States Senate for having been permitted to file this statement.

Comments of the National Oil Jobbers Council

The National Oil Jobbers Council is a federation of 44 states and regional trade associations representing thousands of independent small business petroleum marketers. Members include gasoline and diesel fuel wholesalers, commissioned distributors of gasoline, gasoline reseller-retailers and a large number of retail fuel oil dealers. Members also wholesale or retail many other petroleum products, including kerosene, LP gas, aviation fuels and motor oils as well as residual fuel oil. Together our members market approximately 25 percent of the gasoline and 75 percent of the home heating oils sold in America under either their own private brand or the trademark of their supplier.

These comments on the Windfall Profits Tax legislation are made on behalf of the National Oil Jobbers Council (NOJC), a federation of 44 state and regional associations (see Attachment 1) representing thousands of independent petroleum product marketers. These marketers sell approximately 25 percent of the gasoline and 75 percent of the home heating oil consumed in the nation today.

NOJC appreciates the opportunity to present our views to the committee and to discuss the President's windfall profits tax as passed by the Ways and Means Committee and the concept of an Energy Security Trust fund. Gasoline and heating oil marketers are generally supportive of actions which will enhance the supply of crude oil and refined petroleum products. We, therefore, support the President's decision to phase out controls on domestic crude oil. If this action coupled with

deregulation of motor gasoline, had occurred two years ago, the current supply problems we are now witnessing would not be as severe.

WINDFALL PROFITS TAX

While we support increased incentives for domestic production, marketers are very cognizant of the impact of rising prices on American consumers. We are the frontline in the petroleum industry. We deal directly with the consumers. We hear their frustrations, their complaints, and their accusations against both big government and big oil. Marketers have consistently responded to this pressure by holding down the only aspect of the price of a gallon of refined product they control—their profit margins. Heating oil and wholesale gasoline distributors are still working on basically the same cents-per-gallon profit margin as they were five years ago. This is despite the fact that their costs have nearly doubled during that period. Jobber gasoline margins are controlled by the federal government while heating oil margins have been held down as a result of competition. The DOE's Office of Hearings and Appeals found that heating oil prices have only increased four-tenths of a cent per gallon above what the price would have been under continued control. A later study by DOE confirmed no difference between controlled and decontrolled prices.

NOJC has some grave concerns with the windfall profits tax proposal. Because it is an excise tax, there is no direct incentive to companies to place the untaxed portions of the profits into additional domestic exploration. A company which uses the increased profits to invest in hotels, chain stores, circuses or direct marketing operations pays the same tax as a company which uses the additional revenue to expand crude oil production. Windfall profits should be viewed as those profits not reinvested into additional domestic crude oil production.

NOJC, therefore, recommends that this committee amend the President's plan and enact a true windfall profits tax, one which provides direct incentives for production by taxing heavily those profits not used for production.

This proposal should not be viewed as a subsidy to the oil industry. It is instead a club held over the oil industry's head which in effect says: You cannot use these profits to vertically integrate into other aspects of the petroleum industry; you cannot use the profits to horizontally diversify into other energy sources; and you cannot use the profits to enter into other industries such as transportation or manufacturing. You must use the profits to find additional domestic supplies of crude oil or else have the resulting windfall taxed.

While Secretary Blumenthal may be correct in saying that the mechanics of such a plan might result in complex implementation procedures, this is no reason not to approve such a tax. As small businessmen who struggle almost every year with the Internal Revenue Code, marketers have discovered that complexity has apparently never been an excuse for not enacting something previously.

Furthermore, we understand there is some precedent for the concept of a "plowback" provision. In 1974, the House Ways and Means Committee reported two bills H.R. 14462 (H. Rpt. No. 93-1028, 93rd Cong., 2nd sess.) and H.R. 17488 (H. Rpt. No. 93-1502, 93rd Cong., 2nd sess.). These bills would have taxed the difference between a base price of oil and the selling price of that barrel. Producers, however, would have been able to receive a credit against the windfall profit tax for 100 percent of qualifying investment above a threshold level.

NOJC's members are not producers, nor do we represent their interests. We are concerned, however, that every incentive be given to find additional domestic supplies of crude oil so that we can reduce our dependence on imports and guarantee consumers an adequate supply of home heating oil and gasoline. Major companies should not be left with a choice of several options for which to utilize these funds.

Where discretion has been left to some segments of the petroleum industry previously the result has not always been in the best interests of the country. Consider the small refiner bias. Small refiners have been beneficiaries of as much as a $2.00 per barrel subsidy under the crude oil entitlements program. DOE has recently reduced that entitlement. This subsidy has not been used, however, to expand refinery capacity as would clearly be in the national interest. It has instead been used on many occasions to subsidize a small refiner's entry or expansion in direct product marketing.

It would be unfortunate, indeed "obscene", if the end result of crude oil decontrol and the windfall profits tax is not additional crude oil production. The only way to guarantee that production is to provide the necessary plowback incentives to producers.

ENERGY SECURITY FUND

When the Natural Gas Policy Act was approved in the last session of Congress, one section provided that residential consumers would be sheltered from higher prices through incremental pricing. Under this plan industrial an commercial users would bear the full impact of gas price increases, up to the price of competing fuels, defined in the bill as No. 2 fuel oil or home heating oil.

The Congress during its consideration of the crude oil equalization tax recognized that similar relief should be provided residential users of home heating oil and consequently the House approved a heating oil rebate and the Senate approved a refundable tax credit.

Unfortunately, that sense of equity has been lost this year during consideration of crude oil decontrol and the windfall profits tax. The sixteen million families who use home heating oil throughout this country must bear the full costs of crude oil decontrol while their friends who use natural gas benefit from direct subsidies, subsidies provided not only by industrial users of natural gas but by residential heating oil users as well. As natural gas supplies become tight, industrial and commercial users switch to fuel oil thus driving up demand and forcing higher prices on residential heating oil users.

Aside from the negative impact on the consumer, consider the competitive disadvantage at which a heating oil marketer finds himself. He, as a small businessman, is competing against a regulated utility with a fixed rate of return. That alone would be difficult but when the regulated utility benefits from artificially low prices which are 16 cents per gallon below, on a BTU equivalency basis, the price of the fuel oil supplied by the small businessman, there is little chance for true competition. Such a policy, absent similar relief for home heating oil, is likely to drive middle distillate, the most efficient home heating fuel, out of the residential market.

The windfall profits tax is the only opportunity the Congress will have to consider any adverse consumer impacts of decontrol. While it may not be appropriate to discuss fully, as part of tax, how all the revenue generated from increased producer income taxes and any windfall profits tax will be spent, it is appropriate to discuss immediate relief for those consumers most directly impacted by the rising prices. After all, natural gas consumers did not have to wait until after the gas bill was passed to work on incremental pricing. The two were done together and so should it be for heating oil consumers also.

Unfortunately, the oil and gas distribution processes are quite different and the incremental pricing concept that is part of the gas bill would create chaos in fuel oil distribution. Fuel oil dealers are not regulated utilities.

The most appropriate fashion to provide relief is through a refundable tax credit enacted as part of the windfall profits tax. If the tax is not made refundable it would be of little benefit to low income families.

Several bills have been introduced along these lines. Senator John Durkin has introduced legislation which would provide a 25 percent tax credit up to a maximum of $200 for residential heating oil users. He sponsored a similar amendment which passed the Senate last year. An identical bill has been introduced in the House by Rep. Silvio Conte.

Senator Abraham Ribicoff has also introduced a bill (S. 822) which would provide a direct consumer rebate of the amount of increase in the price of heating oil as a result of decontrol. Under this bill Treasury would calculate the cents per gallon increase and mail checks quarterly to consumers. The consumer would therefore not have to wait until the end of the year to receive relief. NOJC estimates that the revenue loss as a result of the Ribicoff bill assuming heating oil prices rise by 10 cents per gallon is approximately $2.5 billion.

The Ribicoff, Durkin and Conte bills all phase out the credit for families with incomes in excess of $35,000. Therefore, wealthy persons could not be the recipients of the refunds.

We would like to head off one argument against the idea of residential heating oil relief. This is not just a regional issue. While a higher percentage of homes in the Northeast use home heating oil, middle distillate is a major home heating source in many areas of the South, including North Carolina and South Carolina, the Midwest, and the Northwest. In addition, the credit should probably be expanded to include residential users of liquefied petroleum gas who will also face rising costs as crude oil decontrol is implemented. Equity requires this committee to seriously consider this idea.

We appreciate the opportunity to comment on these proposals.

ATTACHMENT 1

NOJC represents these member associations—Alabama Petroleum Marketers Association. Arizona Oil Marketers Association. Arkansas Oil Marketers Association. California Independent Oil Marketers Association. Colorado Petroleum Marketers Association. Independent Connecticut Petroleum Association. Petroleum Association of Delaware. Oil Heat Institute of Greater Washington (D.C.). Florida Petroleum Marketers Association. Georgia Oilmen's Association. Illinois Petroleum Marketers Association. Indiana Oil Marketers Association. Intermountain Oil Marketers Association. Iowa Independent Oil Jobbers. Kansas Oil Marketers Association. Kentucky Petroleum Marketers Association. Louisiana Oil Marketers Association. Maine Oil Dealers Association. Petroleum Council of Maryland. Better Home Heat Council of Massachusetts. Michigan Petroleum Association. Mississippi Oil Jobbers Association. Missouri Oil Jobbers Association. Nebraska Petroleum Marketers, Inc. Independent Oil Men's Association of New England. New England Fuel Institute. Better Home Heat Council of New Hampshire. Fuel Merchants Association of New Jersey. New Mexico Petroleum Marketers Association. Empire State Petroleum Association, Inc. North Carolina Oil Jobbers Association. Northwest Petroleum Association. Ohio Petroleum Marketers Association, Inc. Oklahoma Oil Marketers Association. Oregon Oil Jobbers. Pennsylvania Petroleum Association. South Carolina Oil Jobbers Association. Tennessee Oil Marketers Association. The Texas Oil Marketers Association. Virginia Petroleum Association. Washington Oil Marketers Association. West Virginia Oil Jobbers-Distributors Association. Oil Jobbers of Wisconsin, Inc. Wyoming Petroleum Marketers Association.

STATEMENT OF PATRICIA R. LYKOS, PRESIDENT OF GOOD SENSE FORUM

My name is Patricia R. Lykos, I am President of Good Sense Forum, 609 Fannin, Suite 1317, Houston, Texas 77002. GSF is a citizens organization, it is a public interest and consumers group. I am a lawyer, testifying on behalf of Good Sense Forum.

Good Sense Forum submits to this Honorable Committee that the number one priority for consumers (all Americans are consumers, we may not all be productive but we all certainly consume) is to make certain that the nation has an abundant, uninterrupted and expanding supply of energy, at a reasonable cost (fair market value).

Accordingly, Good Sense Forum urges this Honorable Committee to share this priority sentiment when considering the "Windfall Profits" Tax.

We, as a nation, are at a critical juncture and this Committee's action can be determinative of whether we take the path that leads to an egalitarian forced sharing of scarcity or whether we take the avenue that leads to energy abundance and self sufficiency.

Thus we respectfully request this Honorable Committee to consider the following issues:

1. Windfall profits tax could trigger a massive recession

Table 1 of H.R. 3919 calculates the gross receipts of the tax to be $6.2 billion in 1980, $12.9 billion in 1981 and in excess of $16 billion for succeeding years through 1984.

The President estimates, receipts of 146 billion dollars to 270 billion dollars over the ten year period from 1980–1990. (See p. 5 of White House's Press Release of July 16, 1979 regarding President's latest energy proposals).

In 1981, H.R. 3919 will cost the consumers $12.9 billion. In 1981 payments to Social Security will remove $18 billion additional dollars from taxpayers—combined with the "windfall profits" tax take, this equals $30.9 billion.

The present economic indicators do not look good. The automotive industry is ailing and when it hurts, the nation aches. A recession later this year or early in 1980 appears inevitable.

Capital is a scarce commodity. Can we afford to remove in 1981, an additional $30.9 billion from the private sector?

To engage in some rhetoric, Americans are the victims of a double rip-off as by-product of inflation. First, inflation is a hidden tax erroding the value of the dollar and secondly without indexintg federal income tax brackets to compensate for the puffing of income by inflation, the taxpayer pays more taxes on less real income. Inflation and the loss of this $30.9 billion in 1981 can have very grave consequences for this country and can irretrievably shred our social fabric.

2. H.R. 3919 will reduce oil production

H.R. 3919 states (See Revenue Effects) that the bill will reduce oil production, according to the Joint Committee on Taxation and the Committee of Ways and Means.

A tax that suppresses crude oil production in these times is the prescription for chaos and the moral equivalent of reckless conduct.

3. Windfall profits tax mandates OPEC cartel prices for domestic oil

Because domestic oil has been subjected to price controls for eight years, we do not know what a fair market price would be. (Unlike natural gas, because the intrastate production thereof was unregulated, thus its pricing reflected the market place until the passage of the Natural Gas Policy Act, A.K.A. the Attorneys and Accountants Full Employment Bill).

What is the replacement cost of domestic crude oil?

H.R. 3919 repeatedly refers to the OPEC cartel pricing; which is artifically valued. In fact, H.R. 3919 bases its calculations on OPEC prices, euphemistically called world prices.

True value is the replacement cost plus a reasonable profit.

With the excise tax siphoning of so much capital, there are few market place constraints on the price of domestic crude oil. As has been stated previously, the authors of H.R. 3919 admit that the imposition of the "windfall profits" tax can be expected to cause a "modest" reduction in oil drilling and production.

Thus the "windfall profits" tax encourages OPEC prices and discourages oil exploration and production.

4. It does not make good sense to consider an excise tax, separately from the trust fund to which the tax proceeds are dedicated

To mandate a massive transfer of money from consumers to the government for unknown purposes is a very unsound practice.

There should be no bifurcation of legislative deliberations between the tax and the trust fund.

We urge this Honorable Committee to delay reporting the proposed crude oil excise tax bill until your have also considered the trust fund, its precise provisions and purposes and the probable effects of both.

5. "Windfall profits" tax will create a Federal energy consortium

A review of the tables of H.R. 3919 reveal that 12.9 billion dollars will be paid into the federal trust fund, but that the net receipts to the federal government would be 7.3 billion dollars. A review of the calculations contained in H.R. 3919 conclude that without a "windfall profits" tax, the government would net 5.8 billion dollars in 1981. Is creating this huge federal infrastructure worth $7.2 billion in 1981, or the $9 billion net for succeeding years?

What H.R. 3919 is, is a bill creating a federal energy consortium, building a brand new federal energy infrastructure. It removes huge amounts of money from the private sector and pays it into the special trust fund. Yet the government take (net) is a mere seven to nine billion dollars a year. H.R. 3919 shall cause a short fall of general government tax receipts for the general purposes of government, because of reduction in income taxes due to the excise tax. Yet the trust fund coffers will be swollen.

The energy infrastructure is already in place. Free enterprise vis-a-vis statism clearly reveals that American private enterprise has provided more and better goods and services and greater freedom of choice to a broader spectum of people that the world has ever seen.

The record of government controlled economies is one of abysmal failure. Government controls are not only massively depressive economically, they severely limit freedom of choice and do violence to our western concept of limited government. Tragically, under government controls, the disadvantaged are condemned to an ever lowering of lifestyle and subjected to government paternalism.

The "windfall profits" tax is an extension of government control over our economic life. It is government intervention through the mechanism of taxation to determine how revenue should be spent on exploration, production, research and development, social goals or social equities.

6. Windfall profits tax is a tax on consumers

H.R. 3919 is a crude oil excise tax imposed upon consumers, collected by private enterprise and paid into a federal "energy trust fund" for purposes as yet unkown.

The proposed "windfall profits" tax is the crude oil equalization tax dressed in "drag". That is to say the nature of the tax has not changed only the outer trappings have.

The only redeeming virtue of the crude oil equalization tax proposal is that it was openly and honestly, a tax on consumers.

The plan called decontrol coupled with the "windfall profits" tax is an imagerist's dream. The plan disguises an excise tax measure, it is accompanied by rhetoric that pins the blame for all energy related woes on the oil industry, higher prices are perceived to be the fault of the "oil-oligopoly", higher prices will lead to some conservation, higher prices assessed by regular taxes plus the additional "windfall" tax will pour a windfall of money into governmental coffers and best of all is the smug, self-serving assertion that the "windfall profits" tax will insure the American people are treated fairly. (If we could tax the rhetoric and demagoguery swirling around the energy situation, we could retire the national debt.)

In the final analysis the consumer always pays the tab, this is the immutable factor in any business tax.

7. What is the need for a windfall profits tax?

The Committee on Ways and Means stated in its text of the reported H.R. 3919 which was later amended by the full House, states that decontrol and the revenues resulting from higher prices would provide income to oil producers far in excess of what most of them originally anticipated when they drilled their wells and in excess of what they might now be expected to invest in energy production and thus that the additional revenues received by oil producers and royalty owners, both as a result of decontrol of oil prices and as a result of increases in oil prices substantially above those prevailing in 1978, are an appropriate object of taxation. That the "windfall profits" tax would tax away a fair portion of these additional revenues.

That is a very remarkable concept. I guess the way to cure our housing shortage, is to impose a "windfall profits" tax on the sales of old homes because certainly old homes today are selling for higher prices far in excess of what the homeowner had anticipated when he or she bought the house.

It is fatuous to base the tax on the fact that a commodity is selling for far more now than the producer had originally anticipated when the investment was made. What is a profit in today's market? Inflation has more than doubled in the past ten years. We are presently experiencing double digit inflation.

There in fact is no need for a "windfall profits" tax. The only windfall involved is that which will be reaped by the special interests cliques gathering the bonanza poured into the Trust Fund.

The Trust Fund will be engorged by $6 billion to $16 billion annually, yet the net tax receipts will be $3+ billion to $9 billion annually. (See Table 1, H.R. 3919 Summary)

8. Decontrol plus no (or minimal) crude oil excise tax equals sound economic practices

Should price controls be removed, the revenue thereby derived would go to companies and to entrepreneurs—such profits would be spent for increased exploration and production development of alternatives energy sources, salaries and wages, dividends, and taxes; the multiplier effect would be wonderous to behold.

Producers would answer to the people and the market place. Free competition will keep energy prices in line, although there will be period of painful adjustment. Higher prices will stimulate innovativeness: fuel-efficient engines will be developed, drastically reducing the demand for gasoline; alternative sources of energy will come on-stream providing abundant, relatively inexpensive energy and most importantly we shall once again strive to be energy independent.

9. Should there be a crude oil excise tax to fund energy projects?

It is fatuous to try to determine whether there should be a crude oil excise tax without the purposes of the trust fund.

Under no circumstances should the trust fund be used for social purposes.

A flat excise tax of 5 to 10 percent on all oil and a removal of the tortuous three tier definitions of oil will pour a fortune into the trust fund and certainly simplify the red tape for the oil and gas producers.

The income generated by this excise tax could fund a tremendous amount of research.

The additional taxes, gathered through the conventional taxing mechanism, on the increased revenues derived by oil and gas producers through decontrol will be paid into the general fund. Using H.R. 3919 figures, these revenues should be $5 billion in 1981 and $7 billion in succeeding years.

Regarding the impact of decontrol on poor people, the Department of Health, Education and Welfare already has the apparatus in place to assist these people and by reducing the $7 billion admitted waste in that department, they could easily provide the relief to the poor. Additionally, the increased tax revenues mentioned hereinabove would be ample to cover any shortfall.

The excise tax should cease completely by 1985.

CONCLUSION

Good Sense Forum on behalf of the consumers earnestly requests this Honorable Committee to provide incentives to insure the nation an abundant, uninterrupted and expanding supply of energy. Please do not foster upon us another federal boondoggle and its concomitant massive transfer of money from the private sector into the federal sector.

OWENS-ILLINOIS,
Toledo, Ohio, July 20, 1979.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: It is a privilege to provide the attached Testimony to the U.S. Senate Committee on Finance from Owens-Illinois, Inc. I appreciate this opportunity to express our views regarding the incentives which are required to initiate solar utilization for process heat applications and for applications in commercial buildings.

Owens-Illinois, Inc. manufactures and sells an evacuated tubular collector. This collector delivers useful heat up to 240° F in cloudy, cold weather as well as sunny, warm weather. As the developer of this technology, we are demonstrating the application of solar energy across the Nation—not merely in favorable climates. The temperature capabilities of the collector provide opportunities to address a broad cross-section of our National needs to replace the non-renewable fuels of oil and natural gas. Applications include process heat and commercial heating and air conditioning, and not merely domestic hot water heating. The O-I SUNPAK™ collector is demonstrating these capabilities in thirty (30) installations across the United States. The technology is here and it is proven. The opportunities for replacing quantities of fuel oil and natural gas are large by encouraging these applications. In addition, business applications are more likely to improve the technology for all applications.

Present legislative emphasis—through tax incentives, demonstration grants and R. & D. support have been largely aimed at residential projects and at the less effective flat plate technology. Unfortunately, tax incentives for process heat and commercial solar applications are grossly inadequate in relation to making solar cost effective for these applications. In 1978 Congress provided only an additional 10 percent tax credit. This credit increase is insufficent and Federal policy continues to motivate businesses to use fuel oil and natural gas.

The business purchasers of oil and gas expense this fuel cost in the current tax year. As a result, a dollar saved in fuel leaves only 54¢ after taxes as Federal tax revenue increases by 46 cents.

In light of the critical and complex energy problems and economic consequences confronting the Nation, I believe it is more urgent than ever to encourage business applications of thermal solar energy. This fact becomes more apparent when we recognize that the technical capability exists today for thermal solar energy to supply energy for industrial process heat and for heating, cooling and service hot water applications in commercial buildings. That these applications require the equivalent of 10 million barrels of oil per day means that the readily achievable, practical replacement of only 20% leads to a savings of the equivalent of 2 million barrels of oil per day. It is merely a wish, however, for solar energy to address 10 to 25% of our energy demand by the year 2000 or even 2020 without providing the essenial economic incentives for thermal solar energy applications in the 1980's

By providing the motivation to businesses, the Federal government will be aided in overcoming the many cultural barriers facing solar energy. The Federal goal of reducing our dependence on oil and gas will become a national priority. I respectfully urge that you consider implementing in total one of the two Incentive Packages outlined in the attached Testimony. Without this minimum level of incentive, investments in solar energy systems will not overcome the minimum financial

criteria of businesses and Federal policy will continue to motivate businesses to burn our non-renewable fuels of oil and natural gas as it has in the past.

Our people are available to meet with your designates at any time for full discussions on this issue.

With high regards,

T. R. SANTELLI, *Vice President.*

STATEMENT OF OWENS-ILLINOIS, INC.

SOLAR ENERGY INCENTIVES FOR PROCESS HEAT AND COMMERCIAL APPLICATIONS SHOULD BE INCREASED.

TO

THE UNITED STATES SENATE COMMITTEE ON FINANCE

WASHINGTON, D.C.

REGARDING

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

JULY 20, 1979

SUMMARY. The testimony which follows introduces Owens-Illinois and the SUNPAK™ solar energy program. It presents our view of the potential for solar energy utilization. It recommends that the windfall profit tax revenues be used to provide solar energy incentives for process heat applications and for heating, cooling, and service hot water applications in commercial buildings. The technical capability exists today for thermal solar energy to supply energy to these applications which is equivalent to 10 million barrels of oil per day. The more practical view of replacing only 20% of these needs with solar energy means that the equivalent of 2 million barrels of oil per day can be saved. This represents 25% of our present oil imports. The testimony demonstrates that existing and proposed incentives for these applications are insufficient for solar energy investments to overcome the minimum financial criteria of these potential buyers. It demonstrates that one incentive package which would allow solar energy investments to overcome the minimum financial criteria of businesses is:

Incentive Package #1

A. A 25% solar energy tax credit as proposed by President Carter on June 20, 1979 (This includes the 10% tax credit now allowed for all manufacturing equipment)

B. A loan program with a subsidized interest rate at 6% below present market interest rates as proposed by the Solar Energy Development Bank Bill

C. A 1 year tax life

AND

D. An accelerated depreciation method, such as double declining balance, as now allowed by existing tax code for all manufacturing equipment.

An alternative incentive package which would provide an equivalent financial motivation for solar energy process heat applications and for solar energy heating, cooling, and service hot water systems in commercial building would be as follows:

Incentive Package #2

A. A solar energy tax credit of 50%

AND

B. A one year tax life

In addition to either the total of Incentive Package #1 or the total of Incentive Package #2, Owens-Illinois supports the duration of this first legislation to 12/31/89 as proposed by President Carter on June 20, 1979. This duration takes into account the long lag times of the construction trade from the investment decision, through construction, to actual start-up. These lag times are typically 2 to 4 years.

Implementation of Incentive Package #1.

To implement Incentive Package #1, the following steps are required.

1. Implement the 15% solar energy tax credit for process heat applications as proposed by President Carter. At the present time U. S. tax code allows a 10% tax credit for all manufacturing equipment and a total of 25%

tax credit would apply to process heat for agricultural and industrial applications.

2. Extend the scope of the solar tax credits by allowing solar energy heating, cooling, and service hot water systems for commercial buildings to be included. As "comfort control" systems are not eligible for the base 10% tax credit mentioned above, the solar tax credit for commercial building applications would have to be 25%.
3. Extend the scope of the Solar Energy Development Bank Bill to include process heat systems. The Solar Energy Development Bank Bill now states that solar energy systems in commercial buildings are eligible for loans with interest rates at 6% below market interest rates, but it does not include process heat applications.
4. Implement legislation which allows a 1 year tax life and an accelerated depreciation method for solar energy systems both for process heat and commercial buildings.

OWENS-ILLINOIS and its SUNPAK™ Solar Energy Program. Owens-Illinois is one of the world's leading and most diversified manufacturers of packaging materials in glass, metal, plastic, and paper. Additionally, Owens-Illinois manufactures a wide variety of consumer and technical products. In the United States, Owens-Illinois employs 51,000 persons in more than 100 manufacturing and related facilities. Internationally, Owens-Illinois has world-wide operations employing an additional

32,000 persons. Owens-Illinois served its customers with $3.1 billion of goods and services in 1978. Owens-Illinois has outstanding research and development capabilities.

As an outgrowth of Owens-Illinois' technology, an advanced solar collector has been developed which uses specially designed glass tubes, a high vacuum, and selective coatings to convert sunlight into useful heat energy. This collector delivers useful heat up to 240°F in cloudy, cold weather as well as sunny, warm weather. As the developer of this technology, we are demonstrating the application of solar energy across the Nation -- not merely in favorable climates. The temperature capabilities of the collector provide opportunities to address a broad cross-section of our National needs to replace the non-renewable fuels of oil and natural gas. Applications include process heat for agricultural and industrial applications and heating, cooling, and service hot water for commercial buildings -- and not merely domestic hot water heating. The O-I SUNPAK™ collector is demonstrating these capabilities in 30 installations across the United States which include process heat for beer pasteurization at Anheuser-Busch in Jacksonville, Florida and heating and air conditioning at the General Services Administration office building in Saginaw, Michigan. GSA has credited its solar energy system with 50% energy savings despite its adverse weather. As an extreme example, one installation in Saskatoon, Saskatchewan reported that the Owens-Illinois SUNPAK™ collector was providing hot water at 180°F when the temperature was minus 43°F. The technology is here and it is proven. Owens-Illinois

has worked closely with its clients over the past four years to develop its product. We now stand ready to meet higher product demand which will provide a broader base of applications. In addition, increased volume is expected to encourage prices which are more competitive with fuel oil and natural gas.

The Role of Small Businesses in the Solar Energy Industry.

Owens-Illinois continues to support the role which small businesses play in the solar energy industry as suppliers, manufacturers, and distributors/installers.

Suppliers. As a manufacturer of the SUNPAK collector module, Owens-Illinois purchases components from over 40 suppliers which make up approximately 50% of the cost of the SUNPAK solar energy collector module. Most of these suppliers are classified as small businesses.

Manufacturers. Owens-Illinois competes with over 150 firms who also manufacture solar energy collector modules. Approximately 2000 businesses provide a variety of components to solar energy installations. Most of these businesses are classified as small businesses.

Owens-Illinois has established licensing and supply relationships with several small firms. As an example, Owens-Illinois supplies collector module components including the basic evacuated tube assembly to SUNMASTER corp. in Corning, N.Y. They in turn provide collector modules and complete systems of their design for many types of applications, including domestic hot

water systems for the residential market and turn-key responsibility (including total system design) for commercial buildings. Owens-Illinois continues to seek out and encourage the involvement of small businesses as collector module manufacturers, as well as providing the variety of other services from design engineering through installation and start-up assistance to assure superior performing solar energy systems.

Distributors/Installers. The heating, ventilating, and air conditioning (HVAC) industry may well become the host industry for solar energy as it matures. It is important to recognize that the HVAC industry favors small businesses by 2 to 1. In 1975, the HVAC industry sales were $14 billion. Of this amount, $4.5 billion or approximately 1/3 went to approximately 25 manufacturers of equipment and $9.5 billion or 2/3 went to the distributors and installing contractors. Within this industry, large businesses tend to concentrate on the manufacture of equipment where they offer the benefits of mass production-i.e. economies of scale, quality control, and RD&E to provide continued product improvements. Small businesses tend to concentrate on the distribution and installation of this equipment where they offer the benefits of meeting the specific needs of end applications - installations tailored to maximize the operation of this equipment. About 22,000 installing contractor firms are in this industry. These firms are typically family-owned businesses with 60% having sales under $500,000 and with less than 12 employees.

Within the solar energy industry, Owens-Illinois is finding the same dollar distribution between equipment manufacturers

and distributors/installers. That is, for every $3 spent on solar energy installations, the distributors/installers are receiving about $2 while equipment manufacturers are receiving about $1.

The Importance of Businesses as Potential Solar Energy Users. Solar energy application for process heat and for commercial buildings have many benefits. The potential replacement of non-renewable energy sources is very large. Addressing such large potential markets is expected to decrease the price of total solar energy systems for all potential users. Process heat and commercial building applications are more apt to be well engineered. Business users are very cost conscious and their sites are more likely to be well monitored. Solar energy equipment placed in service in a business is likely to be improved incrementally each year, as is the case for most capital equipment in the business sector. This will accelerate the development of solar energy technology for all applications. Businesses also are better able to select equipment based upon quality -- that is, performance, reliability, and durability. In short, it is expected that prices will become more competitive with fuel oil and natural gas and that the technology will improve. Incentives to facilitate solar energy utilization for process heat and commercial buildings will advance the day we can all enjoy it.

Despite the advantages of businesses utilizing solar energy, the present structure of tax codes, capital formation, and solar incentives promotes solar energy utilization first by homeowners and by institutions -- such as schools,

hospitals, and government agencies. Fuel costs in businesses are legitimate business expenses, which reduce their tax liability; for every one dollar saved in fuel, businesses receive only 54 cents after taxes. The higher cost of capital funds for businesses also add to this imbalance. Tax credits for residential domestic hot water systems in the residential market now total 50 to 60% in some states. An incentive program can be designed to motivate businesses to utilize solar energy but this thrust has to be a conscious goal of legislation.

DEMONSTRATED TECHNICAL READINESS. Today, several installations are demonstrating the technical readiness of solar energy applications for process heat and for commercial buildings which have been funded by the Federal government and by businesses.

Process heat applications should not be confused with high temperature applications. Process heat applications include paint and plastic curing as low as 80°F, ore extraction applications below 200°F, and food processing. Anheuser-Busch in Jacksonville, Florida has installed SUNPAK™ collectors to pasteurize beer at 140°F. Another installation of SUNPAK collectors by Coca Cola will provide heat for container washing operations as well as warehouse heating -- other examples of low temperature industrial applications.

The potential market for these applications below 600°F is sufficient to provide a large established industry with mass produced and distributed products and the promise to reduce the price of thermal solar energy products for other

market segments. In addition the number of process heat applications increases as the temperature of heat from solar energy collectors increases.

Battelle Laboratories[1] has identified the potential replacement of conventional fuels by solar energy for processes operating up to 600°F as 4.6, 5.6, and 7.7 million barrels of oil equivalent per day in the years 1979, 1985, and 2000 respectively. It is strongly emphasized that two-thirds of these process heat needs can be readily met with established, off-the-shelf thermal solar energy collector systems. The remaining one-third of these needs can be met with solar energy collectors presently in the late stages of development. Although collector modules which operate throughout this temperature range are technically feasible, the lack of economic feasibility is retarding the implementation of effective, cost-cutting production techniques.

Owens-Illinois has participated in several demonstration projects which demonstrate the heating and cooling of commercial buildings with readily available, off-the-shelf absorption air conditioners. Examples of these installations are listed in Exhibit I.

Exhibit I

INSTALLATIONS USING OFF-THE-SHELF ABSORPTION AIR CONDITIONERS WITH O-I SUNPAK™ COLLECTORS

O-I INSTALLATION	QTY.	ABSORPTION A/C EQUIPMENT
SAGINAW	1	100-TON CARRIER
YELLOW FREIGHT	2	3-TON ARKLA
TERRASET	2	25-TON ARKLA
BONNEVILLE	1	EXPTL. 15-TON CARRIER
IRVINE	1	100-TON ARKLA

[1] Solar Age, 3/79, p. 19-21.

Commercial heating and cooling requirements double the potential replacement of conventional fuels mentioned above. If a more realistic estimate of only 20% of these needs are serviced by thermal solar energy collectors, then solar energy could have been contributing the equivalent of 2 million barrels of oil per day in 1979 and has the potential of contributing 2.3 million barrels of oil per day by 1985 and 3 million barrels of oil per day by the year 2000. This potential for replacing oil represents about 25% of our total oil imports.

ECONOMIC READINESS. Even with the demonstrated technical readiness of the SUNPAK evacuated tube collector as well as other technologies, solar energy is not yet ready to compete with fuel oil or natural gas on a head-to-head basis.

There are many reasons why solar energy is relatively expensive. Not the least important is that existing Federal policy has heavily favored other non-renewable energy sources which artificially has kept the price of these fuels low. Substantial tax advantages have been provided for mining and drilling operations. Although some of these policies are being revised, they continue to be very effective in keeping prices low which continues to motivate the business sector to burn fuel oil and natural gas. Solar energy does not benefit from such subsidies now enjoyed by these energy sources.

Solar energy equipment also is relatively expensive because the industry is small. Less than one-thousandth of one percent of our total energy requirements now are being supplied by the combined average output of all solar collectors presently installed in the United States. At these industry

volume levels, mass production and smooth distribution channels are not established and the promise of prices of solar energy system which would be closer to parity with burning fuel oil and natural gas remain evasive.

Present and Future Costs of Solar Energy Systems. Solar energy systems for process heat and for HVAC (heating, ventilating, and air conditioning) systems in commercial buildings are now costing end-users about $80-$100/square foot of collector area. All incremental costs of the solar energy system are included in this figure; that is, engineering, plumbing, controls, storage tanks, installation, and startup, as well as the collectors. These systems typically have a collector array of 5,000 to 10,000 SQ.FT. Present solar projects involve a team of five to six principal parties: the mechanical contractor who is responsible for purchasing, installing, and starting up the equipment; the architect/engineer who is responsible for the design, selects the equipment, and follows the project through startup; and several OEM's (original equipment manufacturers) who supply major components to the system. The solar collector manufacturer is one of these OEM's and receives about 15% to 25% of the total project cost, that is $12 to $25 of the $80-$100/square foot. These parties are attempting to recover their costs on each of these projects as they are undertaken.

As the same team undertakes additional solar projects, their costs reflect their past experience. At Owens-Illinois we have seen significant cost reductions as teams initiate their second and third solar projects. We have concluded

that the incremental cost of the solar energy project can be reduced to $50/SQ.FT. (in 1979 dollars) as the team undertakes its third to fifth project. Another method of achieving the $50/SQ.FT. figure it to take advantage of an existing solar installation of 5,000 to 10,000 square feet and expand it to 25,000 - 50,000 square feet of collector once the smaller system has been in operation for one or two years.

As experience of the team builds and as larger solar collector arrays are considered (100,000 to 500,000 square feet), costs of $25/SQ.FT. (1979 dollars) are entirely feasible.

Unfortunately, with the present cost of solar energy systems, few teams can afford to proceed along this learning curve and costs are remaining high.

THE ROLE OF FEDERAL INCENTIVES. Federal incentives can play a role in assisting cost reduction of solar energy systems. If the Federal government can provide the economic motivation (through incentives) so that solar energy systems costing $50/SQ.FT. can be justified, then the industry can be expected to build a sufficient number of systems to achieve the $50/SQ.FT. project cost. As experience is accumulated and as larger systems are installed, costs are expected to be reduced to $25/SQ.FT. (in 1979 dollars) and Federal incentives can be reduced accordingly, probably in the late 1980's and into the early 1990's.

Once the Federal government plays its role of providing incentives, the corresponding role of businesses which provide products and services with the solar energy industry would be to collectively meet the cost of $50/SQ.FT. shortly

after the initial incentives were offered and to diligently proceed along the learning curve.

What Can Various Types of Buyers Now Justify Paying for a Solar Energy System?

Exhibit II lists the prices which can be justified for a solar energy system in four sample locations by various types of buyers within their existing tax and capital structure.

Fuel oil was used for comparison to solar energy because it is widely used by businesses, because of its National interest as a major fuel to be replaced, and because its price is relatively uniform across the country. Other assumptions appear in Exhibit III.

Two applications are listed under the "Business" category in Exhibit II. Under existing legislation, Manufacturing Process equipment is allowed a 10% investment tax credit, a reduced tax life, and an accelerated depreciation method for tax purposes. On the other hand, Comfort Control equipment, such as HVAC equipment, is allowed no investment tax credit, a tax life equal to physical life, and a straight line depreciation method. The impact of extending the same tax treatment for solar energy Comfort Control equipment that now applies to Manufacturing Process equipment is 32% and it is recommended. Examples of Comfort Control Equipment are HVAC equipment for office buildings, convention centers, hotels, and motels.

EXHIBIT II

Justifiable Incremental Price ($/SQ.FT.)
Solar System vs. Fuel Oil System

Location of Buyer	Type of Buyer			
	Institutions	Homeowners	Businesses	
			Mfr'g Processes	Comfort Control
Dallas	$36.81	$92.23	$15.73	$11.93
Washington	27.72	69.45	11.85	8.98
Denver	26.64	66.75	11.38	8.63
Boston	22.59	56.60	9.65	7.32

EXHIBIT III

Assumptions Used for Exhibit II

Assumptions Common to All Types of Buyers:

Year of Installation: 1979

First Year of Operation: 1980

Heat Content of Fuels: 154 MBTU/gal. for No. 6;
140 MBTU/gal. for No. 2.

Utilization Efficiency for Both Fuel Oils: 65%

Inflation Rate for Fuel Oil Price: 8%.

Usable Solar Energy Delivered by O-I's SUNPAK™ Evacuated Tubular Collector:

Boston	251 MBTU/SQ.FT. YR.
Denver	296 MBTU/SQ.FT. YR.
Washington, D.C.	308 MBTU/SQ.FT. YR.
Dallas	409 MBTU/SQ.FT. YR.

Assumptions Which Vary Among Buyers:

		Homeowners	Businesses	
	Institutions	Domestic Hot Water	Mfr'g Process	Comfort Control
Type of Fuel Oil	No.6	No. 2	No. 6	No. 6
1978 Price	37.0¢/gal.	48.0¢/gal.	37.0¢/gal.	37.0¢/gal
1980 Price*	42.8¢/gal.	70.0¢/gal.	42.8¢/gal.	42.8¢/gal
Tax Life	n.a.	n.a.	15 yrs.	20 yrs.
Book or Physical Life	20 yrs.	20 yrs.	20 yrs.	20 yrs.
Tax Depreciation Method	n.a.	n.a.	Double Declining Balance	Straight Line
Investment Tax Credit**	0%	30%	20%	10%
Acceptable (Minimum) Rate of Return	6.5%	6.7% (After Taxes)	15%	15%

n.a.: Not Applicable
* First year of operation
** Tax credits include those allowed for all manufacturing equipment as well as the additional tax credits allowed by the National Energy Act of 10/78

<u>The Impact of Different Levels of Incentives</u>. Putting it simply, incentives must be sufficient to financially motivate businesses to use solar energy. If incentives are insufficient, Federal policy will continue to motivate businesses to burn fuel oil and natural gas as it now motivates businesses.

It is recommended that the Federal government offer an incentive package to businesses which would allow them to justify the incremental cost for a solar energy system of $50/square foot of collector (1979 dollars) as the 1980's begin. Two such incentive packages are provided for consideration:

<u>Incentive Package #1</u>

A. A total tax credit of 25%, compared to the 10%-20% total tax credit presently allowed (10% tax credit allowed for all manufacturing process equipment but not for comfort control equipment; plus an additional 10% credit allowed for solar energy equipment by the National Energy Act of 10/78.)

B. A tax life of 1 year

C. A tax depreciation method of double declining balance, as now used for manufacturing equipment

<u>AND</u>

D. A subsidized loan program at 6% below the present market interest rate on long term debt for business.

This package would provide the following discounted cash flow (DCF) rates of return on solar energy projects:

Location of Business	DCF Rate of Return on Project
Boston	12.9%
Denver	13.6%
Washington, D.C.	13.9%
Dallas	15.4%

Incentive Package #2

A. A tax credit of 50%

B. A tax life of 1 year

C. A tax depreciation method of double declining balance

AND

D. No subsidized loan program

This package would provide the following discounted cash flow (DCF) rates of return on solar energy projects:

Location of Business	DCF Rate of Return on Project
Boston	12.9%
Denver	14.1%
Washington, D.C.	14.5%
Dallas	16.8%

As the number and size of installations increase, the incremental cost of a solar energy system is expected to reach $25/square foot of collector (1979 dollars) and Federal incentives can be reduced accordingly. Continued upward pressure on the price of non-renewable fuels also will reduce the need

for incentives.

The rates of return provided by these incentive packages range from 13% to 7%. Solar energy projects are classified as a cost saving project by businesses. Typically, businesses will not invest in this type of project unless it passes a minimum rate of return - or "hurdle" rate - which ranges from 10% to 30% depending upon the industry as well as the individual company committing to the project. The incentive packages provided as examples would meet the minimum financial requirement for several businesses. On the other hand, businesses typically have a variety of cost saving projects from which to choose and the rates of return of these competing projects can exceed 40%. In short, the incentive packages provided as examples allow a solar energy project to meet minimum rates of return, but may not be considered due to the competition for capital dollars from other cost saving projects.

Because of the existing small base of solar energy utilization by businesses, it is difficult to predict the market volume of solar energy systems which would result from the recommended Federal incentive program. However, it is significant that the minimum financial requirements will be met for a large cross section of projects.

Discussion of Incentives. The incentives of tax credit and reduced tax life are now used to encourage capital investment in manufacturing processes. As a result, these incentives are the easiest for potential buyers to understand and may be the easiest for the Federal government to administer.

A tax depreciation method of double declining balance is

also being used and would provide the same administrative benefits. With a tax life of 1 year as incorporated in Packages #1 and #2, accelerated depreciation methods have a minimal impact compared to the straight line depreciation method. However, the initial incorporation of accelerated depreciation methods allows a smooth transition to existing tax treatment as incentives are reduced in the future.

A subsidized loan program may be more difficult to administer than the other incentives. The loan required to achieve the indicated rates of return is a bond-type loan; that is, interest payments are paid each year over the 30 year term and the principal is paid in the 30th year. A mortgage-type loan where period payments include both interest and principal would require lower interest rates to achieve the same impact. A subsidized loan program carries an additional penalty of risk: the business must be in existence in the 30th year in order for the financier to obtain his principal.

The Benefits to the Federal Government of Solar Energy Incentives Provided for Businesses. The Federal government benefits from the incentive packages recommended in this report. Savings in fuel oil or natural gas by businesses increase taxable earnings and thereby increases income tax revenues collected by the Federal government. For every one dollar saved in fuel expense, Federal tax revenues increase by 46 cents. Just as a business user benefits from solar energy, so does the Federal government through these increased tax revenues. Reduced oil consumption leads to

reduced oil imports, an improved Balance of Trade, a stronger dollar, more jobs in the United States, and other economic benefits for the Nation. Precedent for Federal incentives have been adequately described in the Battelle Report of 12/78.

The impact of incentives will be measured by the number of installed solar energy systems which are installed under the incentive program. As stated before, overcoming the minimum financial criteria of business users is expected to initiate demand and to provide a widespread base of applications for future growth. If these minimum financial criteria are not met, businesses will continue to be motivated to turn fuel oil and natural gas - as they are without any incentives- and the number of solar energy installations will remain insignificant from the standpoint of National benefits.

Because of these issues -in particular, the expected volume of purchases - the benefits of solar energy incentives is unknown. However, the National penalties of continued, long-term reliance on natural gas and fuel oil also is unknown and may be far greater without the insurance of solar energy as an additional energy source for the future.

Because solar energy provides conservation of non-renewable fuels, is non-polluting, and is environmentally responsible, tax incentives are totally justifiable. There is precedent in prior and current tax law for providing special tax incentives in times of National need. Section 168 of the Tax Code, which was repealed by the Tax Reform Act of 1976, provided reduced tax lives for facilities (plants and equipment) which were

constructed for the purpose of producing designated emergency defense items.

Reduced tax lives had its counterpart in World War II tax legislation and was re-enacted during the Korean War of the 1950's. The provision was very effective in stimulating the desired activity. Reports received by the Joint Committee on Defense Production of Congress indicate that the accelerated tax amortization program (Section 168) was particularly effective in enabling the government to meet its goal for the elimination of critical deficiencies by encouraging industry to expand supplies of strategic materials for defense production and stockpile acquisitions. From the beginning of the program through June 30, 1958, certificates of necessity issued to industry for accelerated tax life covered capital investments of $38.2 billion, of which $23.1 billion was eligible for fast write-offs.[2]

CONCLUSION. We view the energy position of the United States as critical. Unfortunately, the Federal Government is now saddled with the energy crisis more so than other sectors of the economy. The crisis is reflected by net energy imports, a severe Balance of Trade deficit, and a weak U. S. dollar. However, end-users of energy are buffered by existing Federal policy. More conventional fuel sources have received $217 billion[3] over the past 60 years ($101 billion dollars for oil alone) which has only encouraged their utilization. Recent increases in fuel prices have been institutionalized within the economy as they have been passed through with the all-

[2]Eighth Annual Report of the Activities of the Joint Committee on Defense Production, S. Rept. N. 1, 86th Cong., 1st Sess., January 9, 1959) page 83.

[3]An Analysis of Federal Incentives Used to Stimulate Energy Production, Battelle Northwest, rev. 12/78.

too-accepted incremental price increases of all goods and services.[4]

Even if it makes up only a small part of the total energy we use, solar energy can make an important contribution toward solving the energy crisis and strengthening our National economy. Five percent, for example, may seem to be a small share of our total energy supply, but it is equivalent to 25 percent of our energy imports in 1976 and exceeds the 1976 trade balance deficit. The degree to which solar energy can contribute to National energy needs and economic objectives depends in large part on the establishment of goals by the Federal government for solar energy use and the implementation of proper incentives to achieve those goals, especially in the business sector of the economy as this sector is a large user of energy and provides the economic strength of the Nation.

The suggested incentives create the financial motivation for businesses to initiate solar energy utilization. These incentives are designed to place solar energy on par with non-renewable energy sources and to translate the Federal energy goals into a National priority for the U. S. economy.

Technology has demonstrated what can be done. The state of the economy illustrates what should be done, Federal policy determines what will be done.

As you review the proposed incentives for businesses, your comments are appreciated and we are eager to continue this exchange of information.

[4] Business Week. 1/29/79, p. 72.

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7/20/79

SUTHERLAND, ASBILL & BRENNAN,
Washington, D.C., July 24, 1979.

Mr. MICHAEL STERN,
Staff Director, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. STERN: This letter is submitted on behalf of the Texas Scottish Rite Hospital for Crippled Children ("Hospital") for inclusion in the printed record of the Senate Finance Committee's hearings on H.R. 3919, the so-called "Crude Oil Windfall Profit Tax Act of 1979".

The Hospital, which is located in Dallas, Texas, is a nonprofit Texas corporation and is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code as a charitable organization. The Hospital is involved solely in the providing of medical care for children from infancy to age 16. The Hospital has 140 beds and also serves 5,000 to 6,000 out-patients. It has a working relationship with the Southwestern Medical School in Dallas, which is a branch of the University of Texas System. The Hospital is funded solely by private charitable contributions, and receives no Federal or State governmental funding of any kind.

As its name implies, the Hospital is sponsored by the Texas Scottish Rite, which appoints the Hospital's Trustees and administers those of its nonroutine business affairs relating to expansion and the securing of financial support. Of special importance are the facts that the Hospital's services are provided without charge to the child, his or her parents, or any other party, and are made available without regard to sex, race, creed, or national origin.

A major portion of the Hospital's financial support consists of crude oil royalties. As passed by the House and referred to the Senate Finance Committee, the proposed "Crude Oil Windfall Profit Tax Act of 1979" (H.R. 3919) would impose a substantial tax upon the royalties received by the Hospital. This result follows because the House bill imposes the tax upon all owners (including otherwise tax-exempt organizations) of economic interests in oil. Thus, if the tax is adopted without change, the Hospital will have less funds than it otherwise would have to provide medical care to children.

We respectifully submit that imposition of any windfall profit tax on the Hospital is wholly inappropriate. To the extent the proposed tax has a valid rationale at all, it is simply a vehicle for assuring that some portion of the increased income resulting from deregulation and OPEC price increases will be used for public rather than private purposes.

When the proposed windfall profits tax is so viewed, it is apparent that exempting the Hospital from the tax is in no way in inconsistent with the objectives of the tax. There is no question but that the providing of no cost medical care to children without regard to sex, race, creed or national origin is a "public" activity and not a "pricate" one. In the case of an organization such as the Hospital, the tax need not be imposed in order for the above-described legislative objective to be achieved. To the extent the Hospital receives a so-called "windfall", those funds must, under State law, the Hospital's charter, and its Federal tax exemption, be devoted exclusively to its public purpose activities. The actual imposition of the tax in such a case would be superfluous.

Accordingly, we urge the Committee to adopt an amendment under which the Hospital would be exempted from the tax provided it continues to (1) be exempt under section 501 (c)(3) of the Internal Revenue Code, (2) have as its principal purpose the providing of medical or hospital care, and (3) furnish such care without charge and without regard to sex, race, creed, or national origin. The proposed amendment should of course be applicable to all hospitals which satisfy these three standards.

The proposed amendment is quite specific and leaves no room whatsoever for manipulation. A tax-exempt hospital may qualify for exemption under the amendment only if it furnishes medical or hospital care free of charge and without regard to sex, race, creed or national origin. In light of these two requirements the amendment closely parallels the "public education" exemption contained in the House passed bill, and the dedication of the funds to wholly public purposes is both evident and guaranteed.

Finally, it is apparent that taxing the Hospital (and other similarly situated hospitals) would be at odds with the purposes which underlay the Finance Committee's continuing efforts to develop both hospital cost containment and catastrophic illness legislation. The imposition of the windfall profits tax upon the Hospital (which is unnecessary given the purposes of that tax) would tend to reduce the Hospital's ability to meet the very objectives which have prompted the Finance Committee to consider health legislation. Medical care, like energy, is a pressing

national problem. The proposed amendment responds to this latter problem in a fashion which is entirely consistent with the objectives of the windfall profits tax.

Respectfully submitted.

DONALD V. MOOREHEAD.

NATIONAL LP-GAS ASSOCIATION,
Arlington, Va., July 20, 1979.

Hon. RUSSELL B. LONG,
Chairman Finance Committee,
U.S. Senate, Washington, D.C.

SIR: This request is being conveyed to the Committee for consideration in its deliberations on Phase III of the President's energy program, with particular reference to assistance to low-income householders. It is presented by the National LP-Gas Association. We request that it be made part of the record. The association represents retailers of liquefied petroleum gas, (LP-gas) more commonly known as propane or bottled gas, in its membership of 4,000, including 45 affiliated states.

LP-gas is a fuel used in over 10 million homes and on farms for cooking, water heating, and/or space heating. Its use is predominately in rural areas and its users include a large number of low-income and retired person householders. It is for the protection of these persons, who have suffered most seriously from inflation, that we present this plea.

We urge that on any tax credit or related relief to be provided out of the funds arising from tax-related legislative proposals of the President's energy program that provision be made for low-income householders using liquefied petroleum gas (propane and/or butane) as well as other fuels. This action could be consistent with Presidential statements on use of trust fund monies.

In further support of this request, we mention that Congress in its earlier deliberations on the crude oil equalization tax recognized that similar relief should be provided to residential users and the House approved a rebate and the Senate approved a refundable tax credit. We suggest comparable treatment in consideration of the tax aspects of the President's energy program.

This recommendation, which we consider vital in the protection of the low-income householders, should not be viewed as affecting our equal concern with the need to stimulate and provide incentive for domestic exploration and development that will protect future domestic supply for this householder and other LP-gas energy users. We urge that this Committee provide this incentive through an equitable "plowback" provision.

NLPGA members, and the many low-income users of LP-gas will be greatly appreciative of Committee consideration and action in providing this necessary and justifiable relief for the low-income household.

Sincerely,

ARTHUR C. KREUTZER.

54-217 0 - 79 - 19

JUL 17 1979

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July 19, 1979

Honorable Russell B. Long
Chairman, Senate Finance Committee
217 Russell Senate Office Building
Washington, D. C. 20510

Dear Chairman Long:

The oil windfall profit tax could be rendered a rational measure by one amendment--presently sponsored by at least five members of the Senate Finance Committee. This is the independent production exemption, a copy of which is attached.

Also attached is an example of one typical independent oil and gas company, Magnatex Industries, Inc., of Midland, Texas, which demonstrates why the exemption would immediately and substantially increase the domestic production of oil and gas. It explains how many old "abandoned" oil fields will be revitalized.

The direct result of this one amendment will be the production of millions of additional barrels of United States oil.

Very truly yours,

Michael Waris, Jr.

Michael Waris, Jr.

Enclosures

Amendment to Windfall Profit Tax--H.R. 3919--
Congressional Record, July 16, 1979, S9527--
submitted by Mr. Bentsen (for himself, Mr. Dole,
Mr. Baucus, Mr. Bellmon, Mr. Boren and Mr. Gravel):

AMENDMENT NO. 336

On page 3, line 14, after "TAX" insert ": EXEMPTION FOR INDEPENDENT PRODUCTION".

On page 3, between lines 10 and 11, insert the following new subsection:

"(d) Exemption for Independent Oil Production.—

"(1) General rule.—There shall be exempt from the tax imposed by section 4987 so much of the production for the taxable period as does not exceed the product of—

"(A) 3,000 barrels, multiplied by

"(B) the number of days in the taxable period.

"(2) Rules for determining ownership shares.—

"(A) In the case of a taxpayer holding a partial interest in the production from a property, including an interest in a partnership, the taxpayer's production shall be an amount which bears the same ratio to the total production of the property for the taxable period as the taxpayer's participation in the revenue from the property bears to the total revenue from the property for the taxable period.

"(B) For the purpose of applying paragraph (1) to a business under common control, the Secretary shall prescribe rules similar to the rules under section 613A(c)(8).

"(C) In the case of a partnership, the amount of the exemption under paragraph (1) shall be computed separately by each of the partners, under rules similar to the rules under section 613A(c)(7)(D), and not by the partnership.

"(D) In the case of a transfer of an interest (including an interest in a partnership or trust), paragraph (1) shall be applied in accordance with rules similar to the rules under section 613A(c)(9).

"(3) Ordering rule where production exceeds exemption.—If the amount of a taxpayer's production for a taxable period exceeds the amount of the taxpayer's exemption for that period under paragraph (1), the excess shall be attributed to that part of the taxpayer's production for which the removal price per barrel is lowest.

"(4) Retailers and refiners excluded.—This subsection shall not apply in the case of a taxpayer who is excluded from the application of section 613A(c) under paragraph (2) or (4) of section 613A(d).

Statement of

CHARLES H. PRIDDY
President, Magnatex Industries, Inc.

to

The Senate Finance Committee

regarding

The Proposed Windfall Profit Tax on Crude Oil
As Contained in H.R. 3919

My name is Charles Priddy. I am President of Magnatex Industries, Inc., a small, independent oil and gas producer in Midland, Texas. This statement is being filed with your Committee as part of its record of the hearings on the windfall profit tax in order to express my company's deep concern over those provisions which would impose an excise tax on each barrel of crude oil produced by small independent oil and gas producers.

Our concern would be removed, and the best interests of our country would be served by substantially increasing the immediate supply of domestic oil and gas, if the Congress were to adopt a small producer exemption from this self-defeating tax.

Senators Bentsen, Dole, Baucus, Bellmon, Boren and Gravel have submitted as an amendment to H.R. 3919 a short, simple and very effective exemption for independent production. A copy of the exemption is attached hereto, together with Senator Bentsen's explanation thereof. Magnatex earnestly endorses this excellent proposal.

The remainder of this statement, using specific examples and the actual facts of Magnatex's economic life, demonstrates why Congress should adopt this independent production exemption.

Midland is located in the Permian Basin, which covers 100,000 square miles in 27 counties in central west Texas and four counties in southeastern New Mexico (total population of approximately 500,000). The 109,000 wells in the Basin produce some 2,000,000 barrels of oil per day and approximately 8.5 billion cubic feet of gas per day. Obviously, this is a significant portion of the nation's daily production of oil and gas.

The oil and gas exploration of Magnatex accounts for some $3,000,000 of drilling activity per year in the Permian Basin. Magnatex also has drilling operations and producing operations in parts of Louisiana, Wyoming, Oklahoma and Texas. The funds for these operations are raised from corporate and individual sources, both within and without the industry.

Our great concern is that in the crisis atmosphere surrounding the energy problem the critical role of the independent oil and gas producers in the discovery and production of energy in the United States is being deliberately jettisoned or sacrificed in a panicked effort to find immediate solutions through scientific miracles in the form of synthetic fuels and solar energy. These "solutions" are at worst mere political cosmetics and at best longer-range answers which simply cannot fill the nation's present needs for energy. This will become acutely apparent

when the effects of the Presidentially declared lower imports of foreign oil begin to impact directly on our economy. Accordingly, the purpose of this statement is to urge each member of the Senate Finance Committee to take a moment to focus on the true significance of our company (as a typical independent producer)--as it affects the immediate future of increased domestic production of oil and gas. We ask that you make that analysis in the context of the windfall profit tax act as passed by the House of Representatives to see just what that legislation, if left unchanged by the Senate, would do to us--and to the country as a whole.

A glaring blind spot emerges from H.R. 3919 as passed by the House of Representatives, and from the President's energy proposals to date: Both completely fail to separate the small, independent domestic oil companies such as ours (numbering about 10,000) from the seven major multinational oil companies. The importance in differentiating between these two groups of oil companies lies in the radically different role which they play in the discovery of new sources of domestic oil and gas. Almost all (90%) of the exploratory drilling in the United States is done by us domestic independents (not the major multinationals). It is this domestic drilling which will most immediately

and effectively fill the additional domestic energy supply gap that will be created by President Carter's newly promised restrictions on the importation of foreign oil.

One of the primary weaknesses of President Carter's new energy proposals is that they totally lack an "immediate punch." Shale oil, coal, synthetic fuels and solar and nuclear energy will all play an important future role--but it will take considerable time before these alternate sources of energy will be available in sufficient quantities. The only immediate useable and large domestic source of energy to fill the current--and growing--gap is oil and gas.

It should be obvious to everyone that everything possible that can be done, should be done, to maximize the production of this source of domestic energy immediately. However, the House-passed bill cuts in exactly the opposite direction. Instead of maximizing the incentives to independents, it, in a very real economic and practical sense, imposes a direct disincentive upon independents by subjecting us to a "windfall profit tax." This presupposes that independents will pocket a "windfall" from deregulation of oil prices when in reality expendable funds are definitely needed to continue operations. Why, then, are we small

independent oil and gas operators being subjected to this tax? It simply defies common sense to impose such a tax on the very companies who are conducting almost all of the domestic oil and gas exploratory and drilling activities.

The decrease in domestic production and the concomitant increase in importation of foreign oil over the past decade are the direct result of a U.S. governmental course of action: The control of domestic prices coupled with a number of increasingly repressive tax changes (made in the name of tax reform), such as repeal and reduction of intangible drilling expense deductions and percentage depletion allowances on domestic oil and gas. The combined effect of these deliberate legislative actions, plus the increased costs of drilling and production caused by inflation, has been to make it uneconomic for domestic drillers to search and drill for those domestic deposits of oil and gas which are deeper, lower in quantity and otherwise more costly to retrieve. Consequently the United States has literally forced itself into a corner--making us so seriously dependent on foreign oil and gas that now we are literally at the mercy of those in control of those foreign deposits.

How does the President plan to solve this crisis? By perpetuating and fertilizing the very roots of its causes. While loudly announcing that the ill-fated control of oil prices is finally being removed, the President in the same beath takes back the economic benefit of such a price rise with an excise tax on the proceeds generated by the very same increase in prices.

Not only is the President urging the imposition of this ill-conceived "windfall profit" tax--but he is making it the keystone of his energy program, the source of most of the funds for the new programs he is recommending as the solution to our energy problems. The magnitude of the tax---$142 billion--speaks for itself. It is patent that the so-called decontrol of oil prices is nothing more than an illusion: "What the right hand giveth the left hand taketh away."

The adoption of the President's windfall profit tax may provide temporary funds for costly bureaucratic experiments on a short-term basis, but it will also inexorably drive the independent domestic oil and gas producers further down the road to extinction. Rather than stimulating the earlier discovery and production of known large domestic reserves of oil and gas, enactment of the windfall profit

tax will push those reserves further and further onto the back burner of domestic exploratory activity.

Perhaps the President's failure to be more discriminating in his choice of targets for imposition of the windfall profit tax stems from the widely-held feeling that all oil companies are inherently avaricious and have unjustly benefited from the machinations of OPEC, to the great detriment of the American public. Such feelings should not be permitted to blind our people, and particularly you, their elected representatives, to the critically basic fact that our domestic independents have not enjoyed these benefits; indeed, we are gradually being put out of business because the regulated prices at which we've been required for so long a period of time to sell our production has made us less and less able to compete.

The plea being made here is that the Congress not tar all oil companies with the same broad brush. The true role of the independents in producing new sources of domestic oil and gas must not be covered up and lost sight of. Indeed, it must be highlighted and brought into sharp focus.

One Concrete Example of the Immediate Increase in Domestic Oil and Gas That Will Result If Independents Are Not Subjected to the Windfall Profit Tax

The energy crisis is a national problem of such great scope that it tends to be treated in equally broad generalities. In contrast, I would like to submit a specific example which directly affects my company's activities (typical of the situation of thousands of other independents). This example demonstrates simply and concretely exactly how and why the increased funds which decontrolled oil prices, undiminished by a windfall profit tax, would at once be applied to the increased production of domestic oil and gas.

The Permian Basin is one of the nation's older major producers of oil and gas. Substantial production was first initiated in approximately 1926 and the development of oil and gas reserves has been continuous since that time. There have been few major discoveries of oil or gas in the Permian Basin in the past five years; however, the accumulation of petroleum products in marginal reservoirs is widespread. The cumulative oil and gas reserves available in the vast number of small reservoirs is truly substantial in terms of the nation's overall reserves.

Notwithstanding these substantial reserves, Federal controls and the constant uncertainty of the legislative climate have led to a drastic reduction in the number of businesses in the industry and the abandonment of oil and gas production and exploration projects. For example, in west Texas alone, some 80 drilling rigs are idle due to the industry and investors' feelings that further government intervention will additionally penalize those of us engaged in oil and gas production. This type of legislative activity must be seen as counterproductive even by the blindest of people.

The small independent oil and gas producer, in order to effectively operate, is faced with substantial administrative and technical overhead. Most small companies, such as ours, have staffs of geologists, engineers, landmen, accountants and administrative people. These are the minimum needs for the logical exploration of petroleum products. When the cost of such essential personnel is prorated over a small number of barrels produced daily, it creates an exceptionally high per unit cost to the small producer. This, in effect, means that the economic expenditures of the small producer are much greater per barrel of new oil discovered than that of the major producers. Accordingly,

small producers are faced with the serious threat of economic destruction unless their revenues are allowed to materially increase. Most small producers simply do not have the financial capacity of investing the vast funds required for the discovery of offshore reserves or international reserves and, thus, we are restricted to continued efforts to produce marginal reserves.

A specific example of one such marginal (but substantial) reserve is an old field known as the Jameson Field in Nolan County, Texas. We have strongly desired to rework this field but have repeatedly found it uneconomic to do so. The Jameson Field was originally drilled on 80-acre spacing and it has subsequently been observed that one well on each 80 acres did not completely drain the reservoir. Indications are that additional in-fill drilling on 40 acres would be desirable. We have drilled three such wells in the past 12 months; however, the rate of oil production (18 barrels per day) and gas production (200,000 cubic feet per day) per well is not adequate to encourage further drilling, even though additional reserves are definitely known to be present.

<u>The release of crude oil prices to the free world market price would cause substantial drilling in this immediate area within the next 12 months</u>. Each of the new

wells in the area will probably recover about 30,000 barrels of new oil and it is anticipated that some 100 wells would be drilled in a 12-month period and 200 wells in a 24-month period. This would mean that 6,000,000 barrels of presently unavailable crude would be placed on the market. (Significantly, this particular example can be multiplied hundreds of times.)

The present estimated recovery from the Jameson Field of 30,000 barrels per well would be materially increased (to about 40,000 barrels) if the price is allowed to reach the world price. This is due to the fact that the limit of economic productivity is stretched from approximately 10 years to 20 years and the additional recovery per well would amount to approximately 10,000 barrels. The 200 old wells, plus 200 new wells to be drilled if the price is allowed to escalate to world price, would mean an additional 4,000,000 barrels of ultimate oil recovered, beyond the 6,000,000 to be recovered by new in-fill drilling. Thus, 10,000,000 barrels of additional oil would be produced.

An additional example of the effect price has on crude oil availability is found in the old oil fields near Duncan, Oklahoma which have been producing for over 50

years. One small area of approximately 400 of these old producing wells is constantly in threat of being abandoned due to the fact that the fields and wells are approaching their economic limit, i.e., the cost of production is very close to the sale value of the product. These wells, as is the case with thousands of wells throughout the country, have reached the stripper category and are capable of producing for many years in the future (probably 50 years or more). Should the price of oil not be allowed to escalate substantially, the economic limit will be reached in the immediate future and the wells will have to be abandoned. An exemption from the windfall profit tax for the oil produced from these wells will extend the economic limit of this production indefinitely and would make available approximately 800 barrels of crude oil daily that would otherwise be lost to the market place. This 800 barrels of crude oil translates into approximately 25,000 gallons of gasoline per day. This would be enough to run 8,000 automobiles for an indefinite period. The above examples deal with only very small areas in Texas and Oklahoma but they are representative of hundreds of such cases throughout the United States, especially the old oil fields of Pennsylvania.

In this regard your attention is directed to the testimony before this Committee on July 12, 1979 of Jack M. Allen, President of the Independent Drillers Petroleum Association, an organization of independent petroleum explorer-producers having some 5,100 members in every producing area of the nation. Contrary to the apparently widely-held misconception that the reserves of oil and gas remaining in the United States are negligible, Mr. Allen points out that the known reserves are huge--totaling 400 billion barrels of oil. Between 100 billion and 200 billion barrels of those reserves are recoverable by presently known techniques and the only reason for not developing these reserves is that the independent oil producers do not possess the funds necessary to engage in such production techniques. Hopefully, technological advancements will enable us to recover an even greater portion of these known reserves. Mr. Allen's observation regarding this vast proven domestic source of energy bears repetition:

> An increase of [only] one percent in recovery would mean an addition of four billion barrels of domestic oil, with no finding costs. The most pro-

> mising future enhanced recovery techniques involve very high cost tertiary processes. These systems will simply not be widely developed so long as the resulting production is subjected to price controls or prohibitive taxes. Production from such projects therefore ought to be permitted at market prices because each barrel not produced is a barrel which must be imported on OPEC's terms.

We are discussing here an area of major importance to the solution of the present energy crisis when we focus on the relationship of the independent operator to the discovery and production of domestic oil and gas. We are not talking about a "marginal" element in the energy crisis, as Secretary Blumenthal suggested to this Committee when he testified against any exceptions to the "windfall" tax. On the contrary, we are dealing with an aspect of key importance which, if recognized by the Senate after it finishes with H.R. 3919, will give the law the reasoned balance of (1) freeing from the tax that segment of the oil industry which will by its very nature and entire history use the bulk of its sales proceeds in further very extensive domestic exploration and drilling, while (2) subjecting to the tax that part of the oil industry which has profited most from foreign oil price increases and which has used very little of those proceeds in searching for new sources of oil and gas in the United States.

The further balance which such legislation would achieve is that it would permit a portion of the funds generated by price decontrol to be utilized for increased domestic exploration by the acknowledged world's experts in that activity--the independent operators of the United States. This would be done without government direction or intervention--a process which, while sometimes necessary, is seldom as economic or efficient as when the matter is left in avowedly expert private hands. The other portion of the funds resulting from the lifting of price restraints (the lion's share) would go into the proposed trust fund to be used for many worthwhile purposes in our battle for energy self-sufficiency.

We find it difficult to believe that upon mature reflection both Houses of the Congress, and the Administration, will not agree with the views expressed herein. Providing an exemption for domestic independent oil and gas producers makes such obvious good sense.

The Negative Impact Which The Proposed Windfall Profit Tax Has Already Had On Domestic Exploration and Drilling

If the simple economics above discussed are not sufficient to make our case we would like to call the Committee's attention to three recent developments actually experienced by Magnatex, directly attributable to the

impending enactment of a windfall profit tax, which are real life evidence of the destructive consequences that will befall the domestic independents if their operations are not exempt from the tax.*

1. Magnatex has suffered a dramatic decrease in available venture capital with which to engage in further oil and gas exploration

Magnatex is currently in the process of raising funds for drilling exploration from sources outside of the

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* It is very interesting to note that the Treasury Department at this very time is advocating to another Senate committee that an exemption from certain Federal excise taxes acts as a direct incentive for production of gasohol. Assistant Secretary of the Treasury Richard J. Davis stated before the Senate Energy Research and Development Subcommittee of the Committee on Energy and Natural Resources on July 12, 1979 as follows:

> Permanent extension of the gasohol exemption from the Federal gasoline tax . . . could significantly increase the incentive for production of this fuel by providing the continued demand for the product that new investors need. It is hoped, therefore, that this proposal will further assist in the development of our capability to produce gasohol.

This is precisely the point that we seek to make herein. By exempting the small independent oil and gas producers from the windfall profit tax, Congress will be providing a direct incentive for increased domestic production. Treasury employs an intriguing form of logic, I submit, by seeking an exemption from an excise tax on gasohol to stimulate production while simultaneously advocating an increased excise tax on a more important and abundant form of domestic energy (in order to decrease production thereof?)

industry and we have been very dismayed as prospective investors have told us that the proposed windfall profit tax causes them to have doubts about the economic validity of such an investment. We have also been distressed to hear from prospective investors that they are concerned about the overall reputation of the petroleum industry as expressed by the government and perceived by much of the public. These investors are not sure that they wish to be a part of an industry that has been painted as being so greedy and avaricious. Thus, we will be able to raise some 20% less outside capital this year than last year, even though our economic success last year was well within the parameters expected within the industry.

2. Decrease in drilling rig utilization

As mentioned above, currently in the Permian Basin of west Texas some 80 drilling rigs are idle due to the industry and investor feeling that further government intervention and taxation will additionally penalize those of us engaged in oil and gas production. The idling of such domestic drilling capacity is the sheerest type of counterproductive inaction.

3. Industry fears of even more complicated regulations

The instigation of crude oil and gas price controls has caused the creation of an enormous bureaucracy in the form of the Federal Energy Administration which is both an

unbelievable expense to the taxpayer and a direct hindrance to the orderly and economic development of additional crude oil and gas supplies. In our small company the overhead necessary to pursue oil and gas exploration and development has been increased some 17% merely through the addition of personnel to diagnose, understand and comply with the various Federal regulations imposed upon this industry. Therefore, the nation's crude oil and gas producers have been forced to suffer substantial additional expense in their operations merely for the purpose of submitting to controls which are neither needed nor desirable. As indicated, the overall effect of such controls has been a material reduction in oil and gas exploration, as well as an increase in cost to the operator and, therefore, to the ultimate consumer. Any additional industry controls will simply add to the present overhead, further reduce exploration and production, and force still more small independent companies out of the oil and gas business. Government controls have played a large part in centralizing much of the industry in the hands of a few major producers. Only they can survive such controls.

Conclusion

The President in his recent address to the nation spoke of a crisis of the American spirit--the lack of confidence in the direction of our future. He mentioned voter apathy, dropping productivity, unwillingness to save for the

future and growing disrespect for institutions. I believe that one reason for this is the growing perception among Americans that they are unable to shape their own destinies. I submit that not the least reason for this perception is the ever-increasing government control in all areas of life and business. H.R. 3919 is an example of such control. It diminishes incentive and initiative right when we need them most. The American spirit is still alive, but it did not develop in an atmosphere of government control. It thrives on freedom and incentive.

As for ourselves, I am in a position to say with authority that Magnatex Industries really needs the additional revenue that will result from the deregulation of crude oil prices. These added revenues will permit us to materially expand our efforts to discover new domestic oil and gas reserves. This new source of funds will enable us to drill reservoirs that previously were uneconomic. The added proceeds from the sale of oil will in turn give us the power to attract additional capital from outside sources to continue, on an increased scale, our domestic oil and gas exploration efforts.

[From the Congressional Record, Senate, July 16, 1979]

WINDFALL PROFITS TAX—H.R. 3919

AMENDMENT NO. 336

(Ordered to be printed and referred to the Committee on Finance.)

Mr. BENTSEN (for himself, Mr. DOLE, Mr. BAUCUS, Mr. BELLMON, Mr. BOREN, and Mr. GRAVEL) submitted an amendment intended to be proposed by them, jointly, to H.R. 3919, an act to impose a windfall profit tax on domestic crude oil.

Mr. BENTSEN. Mr. President, not since the Second World War has the security of the United States been so threatened as it is today. In the past decade the leaders of our Nation have pursued energy policies that have restrained domestic energy production and subsidized foreign imports. We are now beginning to pay the full price for these ill-conceived policies. The OPEC nations repeatedly have demonstrated their ability and willingness to demand ever-increasing prices for their oil. According to the best estimates available the recent OPEC price increase will force inflation 2 percent higher in the United States next year and throw a million U.S. workers out of their jobs.

Our dependence on unreliable and increasingly costly foreign oil has doubled since the 1973 embargo while domestic production in the lower 48 States is in its 9th year of decline. It would be a tragic miscalculation for Congress to take action that would add to this decline. We need greater energy independence not more dependence.

For this reason, I intend to sponsor an amendment to H.R. 3919 which will exempt from the windfall profits tax the first 3,000 barrels of daily production by independent producers. This amendment would provide the capital requirements and drilling incentives needed by that segment of the petroleum industry which does nearly 90 percent of the Nation's exploratory drilling and accounts for 75 percent of the recently discovered oil and gasfields.

By exempting most independents from the tax, we can be assured that their increased earnings will be plowed back directly into exploration for additional domestic energy resources. Over the past 5 years, independents have received gross revenues of $33.3 billion but have spent $34.9 billion for drilling and exploration. The evidence is clear that independent producers are reinvesting everything they earn and then borrowing more money on top of that to explore for oil and gas. If we permit the independent producer to keep these tax dollars rather than the Government, he will use it to do what he does best—produce more energy.

Without this type of exemption I am concerned that the windfall tax will continue to erode the number of independent producers who can successfully compete with the major oil companies in the risky and increasingly technical business of oil exploration. Since the Mid-1950's, the ranks of independents have been slashed in half from over 20,000 to 10,000 today. Because independents derive income only from the discovery and production of oil, they will be much harder hit by this tax than the major oil companies which also earn income from refining, marketing, transportation, and overseas operations.

Although there remain approximately 10,000 active independents in the petroleum business, most of our domestic oil reserves are held by the slightly more than 30 major integrated companies. Preliminary estimates indicate that this amendment will release only 15 percent of the oil subject to the windfall tax, but it will exempt greater than 99 percent of the producers from the need to comply with paperwork and redtape burdens of the tax.

Because I am deeply concerned that imposing the House version of the windfall tax on independent producers might discourage desparately needed new exploration, I am offering this amendment to exempt from the tax the first 3,000 barrels a day that the independent produces. I ask unanimous consent that the text of my amendment be printed in the Record.

There being no objection, the amendment was ordered to be printed in the Record, as follows:

AMENDMENT NO. 336

On page 2, line 14, after "TAX" insert "; EXEMPTION FOR INDEPENDENT PRODUCTION".

On page 3, between lines 10 and 11, insert the following new subsection:

"(d) Exemption for Indpendent Oil Production.—

"(1) General rule.—There shall be exempt from the tax imposed by section 4987 so much of the production for the taxable period as does not exceed the product of—

"(A) 3,000 barrels, multiplied by

"(B) the number of days in the taxable period.

"(2) Rules for determining ownership shares.—

"(A) In the case of a taxpayer holding a partial interest in the production from a property, including an interest in a partnership, the taxpayer's production shall be an amount which bears the same ratio to the total production of the property for the taxable period as the taxpayer's participation in the revenue from the property bears to the total revenue from the property for the taxable period.

(B) For the purpose of applying paragraph (1) to a business under common control, the Secretary shall prescribe rules similar to the rules under section 613A(c)(8).

"(C) In the case of a partnership, the amount of the exemption under paragraph (1) shall be computed separately by each of the partners, under rules similar to the rules under section 613A(c)(7)(D), and not by the partnership.

"(D) In the case of a transfer of an interest (including an interest in a partnership or trust), paragraph (1) shall be applied in accordance with rules similar to the rules under section 613A(c)(9).

"(3) Ordering rule where production exceeds exemption.—If the amount of a taxpayer's production for a taxable period exceeds the amount of the taxpayer's exemption for that period under paragraph (1), the excess shall be attributed to that part of the taxpayer's production for which the removal price per barrel is lowest.

"(4) Retailers and refiners excluded.—This subsection shall not apply in the case of a taxpayer who is excluded from the application of section 613A(c) under paragraph (2) or (4) of section 613A(d).

Statement of Edwin C. Prasuhn, President, Illinois Oil & Gas Association

My name is Edwin C. Prasuhn. I own the Midwest Oil Producers Company, an independent oil producing company in Fairfield, Illinois. I testify now as President of the Illinois Oil & Gas Association, a State Organization of Petroleum Explorers-Producers having some 1,200 members engaged in Illinois operations.

The Crude Oil Windfall Profits Tax Act appears to us as an effort on the part of some factions of the United States Government to keep in step with OPEC oil producing nations by increasing the price of crude oil by government taxation. It is incredible that this country which was born and flourished under the free enterprise system should be so envious of a tax source that it would wish to follow the governmental edicts of non-democratic forms of government in order to achieve fleeting goals.

History has shown that in the long run more tax dollars will actually be received from a strong and uncumbered industry than by a burdensome taxation which cripples the industry. It is our hope no Windfall Profits Tax will be adopted.

In consideration of the President's Energy Policy requests, some form of Windfall Profits Tax is under consideration by this Committee. We would like to point to four areas where changes from HB 3919 could greatly improve the President's other request for increased domestic production. The four areas are: (1) treatment of new oil; (2) treatment of "Stripper" and enhanced recovery oil; (3) treatment of marginal wells; (4) permanency of any tax. Suggestions in detail for the treatment of each of these areas are as follows.

1. Since all oil wells eventually go dry, the ability to increase domestic production must lie primarily with new oil discoveries. The chief deterrent to the drilling of wildcat wells is economics. Persons who are willing to invest high risk capital look for situations which have been large profitability if successful and minimum taxation thereon. If either element is missing, high risk capital goes elsewhere. We urge that no Windfall Profits Tax be placed on this category.

2. In recent past history, Congress has recognized the need for "stripper" production to be encouraged. These wells which remain unplugged are far cheaper to use in tertiary or enhanced recovery activities than requiring new holes to be drilled. In Illinois alone, 8 billion barrels of oil in place have been discovered. We have produced since 1905 about 3 billion barrels. There remain about 5 billion barrels in known areas in the ground. Encouraged enhanced recovery activities could produce at least another 1½ billion barrels. For Congress to adopt the provisions for "stripper" taxation and discourage continued "stripper" production is a complete reversal of its previous actions. To make this a permanent tax is unconceivable. We recommend "stripper" production and enhanced recovery oil be treated the same as new oil production.

3. Marginal well properties are similar to "stripper" production. They are properties which for reasons of the depth of hole, exceptional water production or other mitigating circumstances are producing at their economic limit. Without some form of economic encouragement these wells will be prematurely abandoned. We urge these properties be treated in a like manner to "stripper" properties.

4. In 1975 the Energy and Conservation Act promised the domestic oil industry only 40 more months of temporary price controls. Taxation is certainly a form of price control. The tax legislation before this Committee represents an Act of broken commitment with the domestic oil industry. Nevertheless, we believe in the democratic political process, and that justice will eventually prevail if present actions by Congress don't bind the future too severely. We strongly urge that a misnomered "Windfall Profits Tax" be not made permanent.

STATEMENT OF COMMITTEE ON FEDERAL FINANCE, COUNCIL OF STATE CHAMBERS OF COMMERCE TO THE SENATE COMMITTEE ON FINANCE, WITH RESPECT TO PROPOSED CHANGES IN THE FOREIGN TAX CREDIT AND PROPOSALS RELATING TO THE CRUDE OIL WINDFALL PROFITS TAX

The Council of State Chambers of Commerce is a federation of 33 State and regional business associations. The Federal Finance Committee is one of several standing committees of the Council which develop and recommend policies on legislative issues to its member organizations and to the Congress. Normally, the policy proposals submitted to Congressional committees are first referred to the member organizations for endorsement, but in this instance that procedure was impractical because of the short lead-time available. Accordingly, this presentation is being made only on behalf of our Federal Finance Committee.

FOREIGN TAX CREDIT PROPOSALS OPPOSED

We have for many years held steadfastly to the position that so long as foreign source income is subject to U.S. tax, the foreign tax credit is absolutely essential if American business is to compete successfully in world markets. Likewise, we have consistently opposed proposals which would erode the foreign tax credit because the increased tax burdens caused by such erosion would make American business less competitive abroad. On each occasion that we expressed these views before your Committee over the years, we had the endorsement of a great majority, if not all, of the member organizations in the Council. Accordinlgy, we welcome this opportunity to comment on the Administration's proposed changes in the present limitation on the tax credit for foreign oil and gas extraction taxes.

We are opposed to the Administration's proposal for several reasons—namely, its further erosion of the foreign tax credit, the purpose of which is to prevent double taxation of foreign source income; its effect of discouraging U.S. oil exploration and development in non-OPEC countries; its unfair provision for retroactivity; and its precedent for later application to U.S. multinational businesses generally.

During the last ten years or so the foreign tax credit has been under intermittent attack by proposals to limit or even repeal the credit. At the heart of the more radical proposals has been the fallacious belief that the tax credit is a tax incentive that favors foreign investment, and that such investment results in exporting of U.S. jobs and the importing of products which would otherwise be produced in the U.S. The less radical proposals, by both legislation and regulation, have been made on the premise that some loopholes existed in the tax credit system and should be closed. Following the OPEC oil embargo in 1973, attacks on the foreign tax credit were directed to foreign oil and gas income rather than foreign income generally. Thus, in 1975 the option to use the per-country limitation in determining the credit was eliminated with respect to foreign oil and gas income. From 1960 to 1975 an election to use either the per-country or the overall limitation was available for all foreign source income. In the very next year, 1976, the per-country limitation was repealed for all foreign income.

Now the Administration proposes a special limitation for foreign oil and gas extraciton income. The credit would be the lesser of the credit computed on the overall basis and the credit computed on a country-by-country basis. If this provision should be enacted, will the next step be application of a similar provision to all foreign source income? It is certainly a prospect of serious concern to all U.S. companies operating abroad. It is especially serious in light of the fact that U.S. treatment of foreign operations and income of American firms is currently no more favorable than any of our principal competing countries treat their companies operating abroad. To the contrary, they generally treat their companies more favor-

ably than does the U.S. There can be no doubt that increasing the competitive disadvantage of American firms abroad would have adverse effects on our domestic jobs, on U.S. exports, and on the U.S. balance of payments.

In his appearance before the House Committee on Ways and Means on May 9, 1979, Secretary Blumenthal stated that the finding of more petroleum anywhere in the world is a benefit to the United States. We certainly concur. Unfortunately, however, the Administration's foreign tax credit proposal relating to oil and gas extraction income would discourage U.S. exploration for and development of oil reserves in countries which are not a part of the OPEC cartel. Given the serious world shortage of oil that is not controlled as to supply and price by OPEC countries, a proposal that would discourage exploration and development elsewhere can hardly be deemed in the best interest of this country.

But that would be the effect of one of the changes the Administration proposes in the foreign tax credit. Calling it a loophole, the Administration calls for repeal of a provision which permits deduction of exploration losses in currently non-producing countries from total oil-related income. It would require that such losses be deducted from extraction income in existing profitable producing countries. Under current law exploration and development losses in a profitable producing country are deductible only from extraction income in that country.

After the 1973-74 OPEC embargo, the Congress recognized the need to encourage U.S. exploration in non-OPEC countries and in 1975 it specifically provided for deductibility of exploration and development losses in non-producing countries from total oil-related income. As the Staff of the Joint Committee on Taxation noted in its recent report explaining foreign tax credit rules, "This special per-country extraction loss rule is designed to encourage the exploration for and development of new oil reserves in countries where the companies do not presently have significant production (countries which generally are not OPEC members)."

But despite the clear intent of Congress, the Administration calls the provision a loophole and wants it repealed. The effect would be the equivalent of taxing these exploration losses and obviously discouraging such exploration. Moreoever, the proposal seeks retroactively to tax such exploration losses incurred in the years 1975 through 1978. This would be accomplished by recapturing the tax benefits from losses in a country in those years to the extent of 50% of the extraction income arising in that country in 1979 and subsequent years.

To repeat, we have two main concerns about the Administration's proposal. One is the further erosion of the foreign tax credit and its adverse implications for U.S. multinationals generally, and the consequent adverse effects on U.S. jobs, exports, and balance of payments. Our other concern is this proposed punitive taxation of an absolutely essential, although currently unpopular, industry even though it would have the effect of discouraging the much needed discovery and development of additional world petroleum resources. To us, such action does not make sense.

NEW OIL SHOULD BE EXEMPT FROM WINDFALL TAX

Our committee has not met specifically to consider the President's crude oil windfall profits tax proposal or the provisions in H.R. 3919 as passed by the House. We have, however, discussed this legislation with some of our committee members and we feel confident that the one recommendation we make here would have the support of the committee and a substantial majority of the member organizations in the Council.

We preface our recommendation by first questioning the whole concept of a windfall profits tax on crude oil. Proponents of the tax argue that the removal of price controls on domestic oil and gradually allowing oil prices to rise toward world market levels will give oil producers an unfair windfall at the expense of consumers. They then assert that an additional heavy tax on the windfall portion—beyond existing Federal, State and local taxes—is appropriate and equitable. Their concept of equity with respect to the old oil is based on the ground that its cost of production is so far below the price to which it could rise under decontrol that an unreasonable profit would accrue to producers. For new oil, all above a predetermined price set by the government would be considered a windfall subject to the additional tax.

The Administration has recognized that oil should be priced at approximate replacement cost. That cost has risen rapidly during recent years, not only because of inflation but even more so because of the high cost of exploration for new reserves and of secondary and tertiary recovery of existing reserves. But insofar as the producers are concerned, the President's proposal and the House bill consider a price based on replacement cost as providing a windfall even though an extended

period of price controls caused the windfall. In our view any additional tax on such a windfall is the equivalent of taxing capital, not profits.

If we must accept a windfall tax, we urge at least one significant change in the House bill. That is the exemption of all newly discovered oil from the windfall tax. Such an exemption would greatly encourage exploration and development and thus enhance the basic purpose of decon ol.

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DENTON I. HOWARD
Vice President - Corporate Affairs

August 6, 1979

Honorable Russell B. Long
United States Senate
217 Russell Office Bldg.
Washington, D. C. 20510

Dear Senator Long:

On July 18, 1979, the Senate Committee on Finance heard testimony relating to oil pricing and the "windfall profits tax". At the request of Senator Boren (Oklahoma), Dr. William Talley, II, appeared before the Committee and presented extensive material in opposition to the windfall tax. A copy of the summary of his statement is attached and a copy of his complete statement was filed with the Committee on that date.

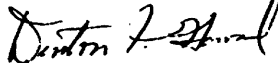
In addition, I have enclosed a copy of written testimony submitted at the same time to the Committee by John W. Mason, President and Chief Executive Officer of Amarex, Inc., an independent gas and oil producer located in Oklahoma City. Mr. Mason's testimony complements Dr. Talley's presentation and submits a very realistic case of producing properties which qualify as "stripper" or marginal producers and the adverse effect a windfall tax would have on those properties for future production.

I realize you and your staff have a heavy burden of reading material but I hope you will take time to review the enclosures since they are timely and pertinent to the resolution of additional tax burdens on production in the domestic U.S.

Currently Amarex's drilling activities are principally in the deep Anadarko Basin of Western Oklahoma and the Texas Panhandle. We also have interests, however, in Southern Alaska, Louisiana, Arkansas, Wyoming, and Colorado.

Sincerely yours,

AMAREX, INC.



Denton I. Howard
Vice President
Corporate Affairs

DIH/mt
Enc.

COMMITTEE ON FINANCE
2227 Dirksen Senate Building
Washington, D.C. 20510
Attention: Michael Sterns, Staff Director

WRITTEN COMMENTS OF
JOHN W. MASON
PRESIDENT AND CHIEF EXECUTIVE OFFICER OF AMAREX, INC.
(Independent Gas and Oil Producing Company)
Oklahoma City, Oklahoma
H.R. 3919
"Crude Oil Windfall Profits Tax Act of 1979"
as amended

INTRODUCTION

Let me first say that I fully support the statement of William W. Talley, II, Ph.D., managing partner of the Resource Analysis and Management Group of Oklahoma City, Oklahoma, presented to the committee Wednesday, July 18, 1979.

The potential loss to the nation due to the crippling effect upon independents of the proposed "windfall profits" tax is so staggering that one hardly knows where to begin in order to convincingly demonstrate it. Other experts, such as Dr. Talley, will present the broad picture; so, I thought it might be helpful to the committee to see the impact of the proposed tax on just one small project of one small company. Since Amarex is one independent among many hundreds, and the field I will discuss is only one among tens of thousands, the impact here shown can be multiplied by thousands to get the order of magnitude of the nationwide effect.

AMAREX BACKGROUND

Because of favorable price trends for hydrocarbons since the beginning of 1974, Amarex Inc. has expended over $100,000,000 for exploration and development drilling in the continental United States, all on-shore, and mostly in the mid-continent, that is, West and North Texas, and Oklahoma. During this time we have produced about 2.5 million barrels of crude oil and 58 billion cubic

feet of natural gas, and currently have remaining proved reserves of about 5 million barrels of crude oil and 110 billion cubic feet of natural gas to our affiliates for whom these monies were spent.

During our current fiscal year, from April 30, 1979 to April 30, 1980, we expect to spend some $60 million in further exploration and development. About $27 million of this comes from outside sources and approximately $33 million from our company. Of the $33 million about $8 to $10 million will come from internally generated funds and about $23 to $25 million from bank borrowings. I mention this proposed budget to drive home two facts: (A) There is no need for any incentive other than price to encourage independents such as Amarex, Inc. to "plow back" their "profits" and a good deal more besides; and, (b) that since the oil business is extremely capital intensive, most independent or growing companies operate in a highly leveraged environment. In other words, we operate on borrowed money.

IMPACT ON ONE AMAREX PROJECT

Amarex, Inc. and its affiliates own the majority working interests in some 33 producing oil wells in southwestern Arkansas in the Dorcheat-Macedonia Field of Columbia County, Arkansas. All of these wells will qualify as either "stripper" or "marginal" producers. We are currently reviewing a project to recomplete most of these wells at a total estimated cost of $5,351,000. Our independent engineering report estimates that for this expenditure we will bring into production approximately 1,834,000 additional barrels of crude oil. Dividing this out, it amounts to a cost per barrel of about $2.92.

...without windfall profits tax

Now, where do we get the money? Because of the risks involved in this type of project, our banks will lend us about 35 percent of the discounted present worth of the crude oil we hope to produce as the result of these recompletions.

Our current reserve report, based on the best estimates we and our banks can make of the future price of crude oil, values this additional crude oil at about $27.50 per barrel over the productive life of the reserves. Of this amount, about 49 percent goes to pay the royalty and overriding royalty owners' share, plus state production taxes and lifting costs. Computing the discounted present worth at 10 percent of the remaining 51 percent that belongs to Amarex and its affiliates and reducing the result to the 35 percent that our banks will lend us, we arrive at a "borrowing power" of about $2.85 per barrel. This means that, disregarding the effect of federal and state income taxes, this development is financible; requiring a cash outlay of about $130,000 from Amarex and its affiliates, with the balance borrowed.

...with windfall profits tax

Now let us consider the economics of the same project if the effect of the proposed "windfall profits" tax is taken into account. The proposed tax will take away about $7.00 of our estimated $27.50 average value per barrel, and if we subject the remainder to deletion of 49 percent for royalties, state production taxes and lifting costs and discount the balance for present worth and bankers' risk estimates, we arrive at a borrowing power of $2.13 per barrel.

This means that, in addition to what can be financed, the project will require somewhat more than $1,400,000 of internally generated capital from Amarex, or almost 20 percent of our risk capital for the year. Simple prudence dictates that our available risk capital is better expended in the search for potentially higher rewards, as for example high-cost, unregulated gas.

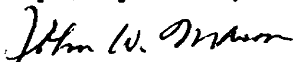
As a result, with the imposition of this completely counterproductive tax, these wells could be plugged, leaving 1,834,000 barrels of recoverable crude oil by primary means, left in the ground. This says nothing of the potential loss of oil that could be recovered by secondary or tertiary recovery methods that might be applicable to these reservoirs at a future date.

As I stated at the beginning, this small example could be expanded to include thousands of fields in the heartland of the United States, fields that produce the most environmentally acceptable type of crude oil for refining purposes.

CONCLUSION

The way to avoid these potentially disasterous consequences is to exempt marginal and stripper production from any so-called "windfall profits" tax.

Respectfully submitted,



John W. Mason, President
Amarex, Inc.
P. O. Box 1678
Oklahoma City, Oklahoma 73101

EXECUTIVE SUMMARY OF THE
STATEMENT OF WILLIAM W. TALLEY, II, P.H.D.
BEFORE THE
UNITED STATES SENATE
COMMITTEE ON FINANCE
July 18, 1979

INTRODUCTION

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, his proposed "windfall profits tax" and H.R. 3919, "Crude Oil Windfall Profits Tax Act of 1979" as amended.

I have confidence in the American private enterprise system and energy industries. America's energy industries through competitive markets can best meet the President's goal of increasing domestic energy production and reducing oil imports by one-half by 1990. The positive proposals regarding the "windfall profits tax" contained in my statement should increase domestic crude oil deliverability by more than 1.4 million barrels per day by the end of 1984 --- 35% of President Carter's stated 1990 goal.

I do not believe that a windfall profits tax or an excise tax, however structured, is needed to protect the consumer. Without any new taxes, the third estate stands to collect more than $.50 in taxes of every dollar increase in domestic crude oil prices.

The United States Senate sits as the citadel of our economy, our government and our American enterprise system. As the vanguard of the American people, you must carefully weigh the consequences of actions taken based on substituting government involvement for competitive enterprise.

The proposed "windfall profits tax", either the President's or H.R. 3919, are, in my opinion, structured to substitute political expediency, for competitive enterprise and to use oil revenues to subsidize grand government programs.

THE OKLAHOMA EXPERIENCE

I base my conclusions on The Oklahoma Experience. The Oklahoma Experience summarized on the chart on page 5 has shown the positive responses of Oklahoma's energy industry to positive crude oil pricing policies:

- Stripper remaining oil-in-place has been escrowed for future enhanced recovery projects;
- Substantial new oil production has resulted from increased cash flow to the operator;
- Stripper economic well life has been lengthened; and,
- Well abandonments have dropped to one-fifth the 1968 level.

SUMMARY AND CONCLUSIONS

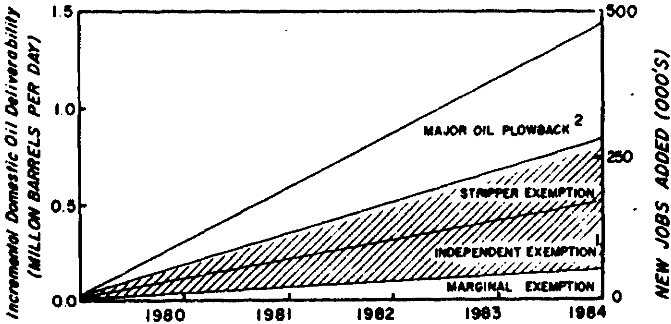
However, if a tax must be passed for political reasons, then that tax should be applied only to the largest international oil companies with a plowback provision to force them to spend the revenues derived from their U. S. oil production into the development of new domestic energy sources. If a tax is enacted, the following exemptions must be given:

- Crude oil and condensate production from stripper wells;
- Crude oil production from marginal wells (expand the stripper well definition);
- The first 3,500 net barrels per day of domestic crude oil and condensate production by any person;

- Crude oil production from enhanced recovery projects recognized by state regulatory bodies; and
- Crude oil and condensate production from properties from which no crude oil production occurred in 1978.

POSITIVE RESPONSE

The estimated industry response --- more than 1.4 million barrels per day of incremental crude oil production in 1984, more than 1.25 billion barrels of incremental domestic oil production between 1980 and 1984; and more than 469,800 new jobs created --- from the increased cash flow from these proposals are shown in the Figure below.



1. 3,500 Net BPD or Less
2. Greater Than 3,500 BPD

RESPONSE FROM EXEMPTIONS

The effects of these exemptions (stripper, marginal and independents) would be to incrementally increase domestic production by approximately 808,710 barrels per day in 1984, to reduce foreign oil imports by more than 723,100,000 barrels of oil between 1980 and 1984, and to add approximately 269,570 new jobs to our economy.

Action	Positive Response		
	Incremental 1984 Production[1] (BPD)	Incremental Cumulative Production 1980-1984[1] (BBls)	New Jobs Added[2]
Exempt Stripper	307,580	275,000,000	102,530
Exempt Marginal	219,240	196,000,000	73,080
Exempt Independents	281,890	252,100,000	93,960
TOTAL	808,710	723,100,000	269,570

[1]*Assumes a twelve-month time lag from when revenues are received and the effect of the revenue is realized in increased production. therefore only after-tax revenues received from 1980-1983 are included. Assuming a 10-year productive life and a 12% annual decline, the first year's production from a well is 15% of its new primary reserves.*

[2]*Three BPD of domestic production equals one new job.*

RESPONSE FROM PLOWBACK

The effects of a plowback provision on major oil companies would be to incrementally (in addition to the levels outlined above)

- increase domestic oil production by approximately 600,750 BPD in 1984;
- reduce foreign oil imports by more than 537,200,000 barrels of oil between 1980 and 1984; and
- add approximately 200,250 new jobs to our economy.

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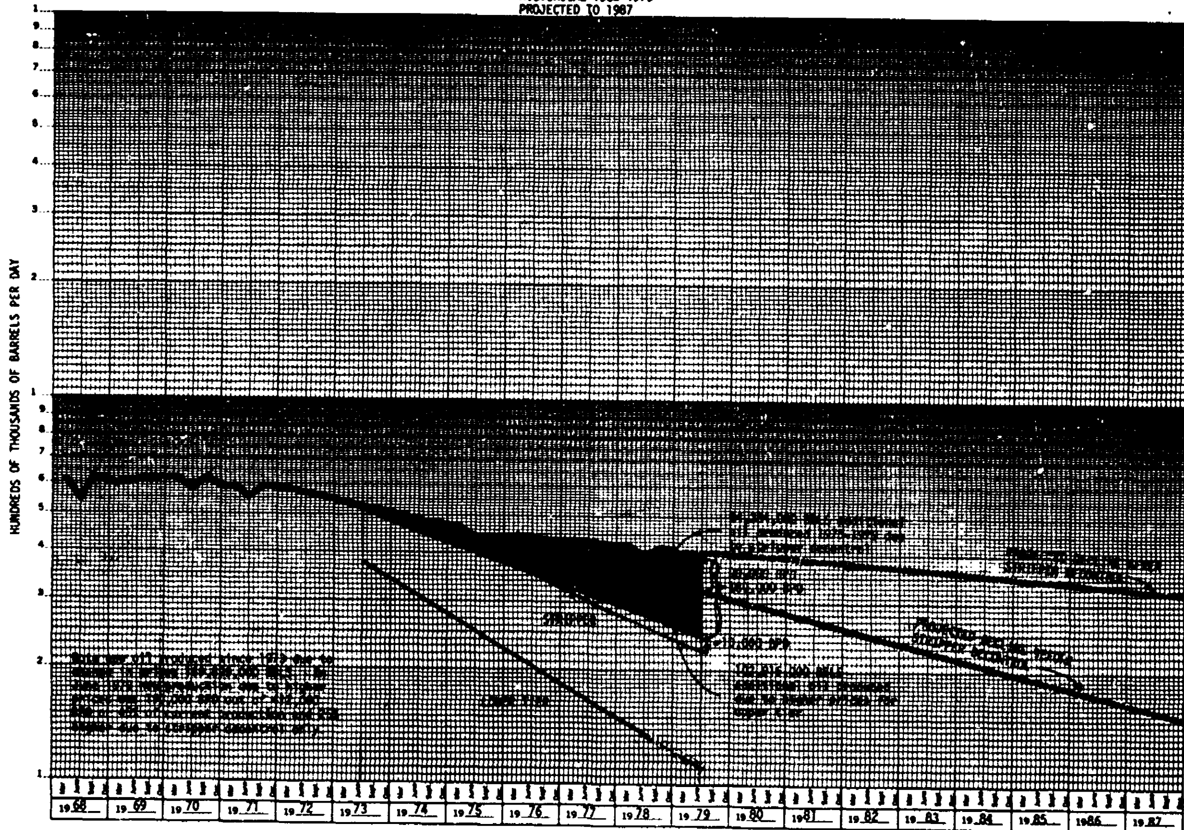


14 August 1979
404 Kimblewick Drive
Silver Spring, Maryland
20904

Chairman
Senate Committee on Finance
Room 2227
Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

We take exception to the Crude Oil Windfall Profit Tax Act of 1979 (H.R. 3919) as it applies to Tier Three Stripper Oil. We feel that stripper oil producers should be exempted from this tax.

We are a marketing representative, a farmer and two engineers, each of whom grosses less than $50,000 per year from his primary source of employment. Four years ago we established a partnership to develop an oil lease in Southeastern Kansas, not for the purpose of seeking a tax shelter, but for the genuine purpose of making money on oil production.

With an initial out-of-pocket investment of $6,500 risk capital from each partner and a continually re-financed bank loan of $90,000 plus other short-term loans, through 1978 we managed to put in twenty-three wells at a cost in excess of $300,000. In 1978 we averaged 23.5 barrels of oil per day from these wells; not a very impressive average and declining at that. Only since 1 January 1979 when the price of oil started to climb from its seventeen-month level of $14.78 per barrel to its current level have we been able to plan and implement the drilling of more wells. This we are doing now at the rate of one well every other month. Three new wells put into production this year have increased our output, at least temporarily, to some thirty barrels per day. Cost of these wells has actually exceeded the net income realized from the lease this year to date!

Our production, as well as that of others like us, is helping to alleviate our country's oil shortfall. We alone are producing 8,500 barrels per year of domestic oil, doing our share to slow down the outflow of American dollars to the OPEC countries. Furthermore we are returning approximately 85% of our entire partnership gross income to the local Kansas economy. It is significant to note that in four years of operation we have each taken out a total of only $13,238 from the partnership, which equates to $275 per month per partner. We definitely could not retire on that!

We do not believe that you intend to discourage stripper well producers from drilling more wells; yet, in essence, that is what H.R. 3919 will do. Our experience has shown that for a stripper well we are hardpressed to maintain a production rate of two barrels of oil per day after an initial surge. This surge, incidentally, rarely, if ever, has exceeded 10 barrels per day for more than a day or two before falling off to a slowly declining level of less than two barrels per day.

As suggested in H.R. 3919, ours is a type of operation for which price increases will encourage additional oil production. Such increases have, in fact, been the only means for our securing the additional capital we need to do more drilling. Therefore, we propose that you consider exempting stripper well producers from the provisions of the Crude Oil Windfall Profit Tax Act of 1979. This would be consistent with the Energy Conservation and Production Act which provided exemption from price controls for properties with average per well production of crude oil not exceeding 10 barrels per day.

As a minimum, we believe you should consider some method of exempting from taxation those monies received in excess of the base price for Tier Three Stripper Oil which can be shown to have been invested in the production of additional oil.

Other precedents exist for special treatment of stripper well production. For instance, in spite of the freeze on crude oil prices under President Nixon's general wage-price freeze of August 1971, Congress deregulated stripper oil. Pursuant to the Energy Policy and Conservation Act of 1975 the President in February 1976 set stripper oil prices at $11.47 per barrel. Later in the year, however, Congress in its wisdom once again deregulated stripper oil. This was a sure indication that you recognize the special situation stripper well production represents.

We trust that you will again take recognition of this special situation in your consideration of H.R. 3919. Thank you.

Very truly yours,

Wilfred W. Reisinger

Copies: The Honorable Lloyd Bentsen
The Honorable Robert Dole
The Honorable Nancy L. Kassebaum

UNITED STATES INDUSTRIAL COUNCIL
Chauncey W. Lever, Chairman
Statement on
"Windfall Profit's" Tax
Before
Committee on Finance
United States Senate
July 30, 1979

Mr. Chairman:

Thank you for the privilege of testifying before your Committee. I value this privilege and want to fight to preserve it for every citizen.

My name is Chauncey W. Lever. I am the Chairman of the United States Industrial Council--an organization of nearly 5,000 business and professional members employing more than 4 million people. Since 1933, we have been fighting to safeguard free enterprise, fair competition, and individual initiative.

We believe both industry and government are essential to the formulation of energy policy but each has a particular role. Both will function best within their own areas, except in the event of serious national crisis, such as Congressionally-declared war.

We believe, and all evidence supports our belief, that excessive taxes, regulations and paperwork diminish incentive and productivity in any business. Extraordinary taxes and restrictions are particulaly devastating to high-risk and high investment industries such as energy development and production.

Energy production is our preeminent goal. Energy independence from unstable foreign sources cannot be achieved too quickly. Adequate investment and the best technology are essential. The incentives, energies and ideas of the private sector need only be loosed. Government needs do little more than free the vast and eager forces of the free market and private enterprise. Genuinely free enterprise is a far more effective force for preventing monopolies and alleviating individual economic hardship than government. Government must permit the entrepreneurs, innovators and risktakers to function as freely as possible; it should intervene only if abuses occur.

USIC therefore, specifically opposes any "windfall profits" or "excess profits" tax as discriminatory and counterproductive. Excess taxes stifle innovation and risk taking. We particularly oppose any such tax upon a particular busines or industry such as domestic oil production.

The so-called "windfall profits tax" is not a tax on profits, but a tax on production. When a barrel of oil is pumped out of the ground and sold, the government will subtract an official base price from the sale price and tax the difference at a rate of 50 percent or higher, depending on the bill that emerges from Congress.

The brunt of the tax will fall on the more than 10,000 independent producers in this country. These are companies that find the oil and pump it out of the ground.

First, the windfall profits tax will take a big bite out of their incomes. What remains will then be subject to state and federal corporate taxes. This will leave them with barely enough to keep their rigs in operation, much less to explore and develop new reserves. Furthermore, high taxes will also discourage investors from putting money into their enterprises.

The result could spell disaster for all of us. Independent producers have played a major role in maintaining domestic crude oil supplies. Historically, they have been responsible for 90 percent of the oil exploration in the United States. They have found 75 percent of the new oil fields, and account for more than half of all discovered oil and gas reserves.

If the windfall profits tax becomes law, this record could be reversed. The independents are no longer finding oil at depths of 4,000 to 6,000 feet. They must dig wells as deep as 15,000 and even 20,000 feet to tap new sources. Digging deeper naturally costs more, and if the money is not forthcoming because of punitive taxation, output will fall.

Wyoming's Sen. Malcolm Wallop predicts that the windfall profits tax will reduce domestic output by 700,000 barrels of oil a day by 1985. However, decontrolling oil prices without the windfall profits tax would mean an increase in domestic production of 2 million barrels of oil a day by the same year, according to the Independent Petroleum Association of America.

It is obvious that our government is once more pursuing conflicting energy goals. President Carter has vowed to liberate us from OPEC by freezing imports. Yet he has proposed a tax that will hamstring domestic production and ensure a massive oil deficit in the next decade.

Windfall profits taxes punish and discourage, not only the industry directly involved but all businesses and industries. If the government can arbitrarily declare profit margins "excessive" in the domestic oil industry today, it can do likewise to any other industry tomorrow.

An analogous situation occurred in the beef production business only a few years ago, when the government imposed price controls on beef. Results were predictable. We are still suffering from that mis-adventure: beef production decreased almost immediatly, demand at deflated prices increased, herds were depleted, and cheap imports increased. Prices and profits increased in fish and poultry and soybeans--profits, which of which under the standards Congress is considering for oil, could have been called "windfall." When the beef prices were "decontrolled," beef prices shot up; and higher profits accrued to some beef producers, but no one then suggested a "windfall profits" tax. We did not define or tax those increased profits as "windfall" then. We should not do so now. Government intervention caused the problem then with beef, as now, with oil.

Full and immediate decontrol of domestic oil prices would lead to expanded supplies of oil, but continued federal price and allocation regulation will create future shortages. Rejection of politically expedient but excessive taxes on profits will free the energies of the American industry. Out nation's entrepreneurs would then have the incentive to produce our nation into energy independence, and end our vulnerability to foreign oil embargoes and price piracy.

Conversely, more regulation and more taxation will project an image of negative leadership by the Congress. Every public opinion poll confirms this observation. Reduction of excessive regulation, red tape and taxes would project a positive leadership image of Congress—the unmistakable conviction that Congress is willing to let the American people solve their energy problems without more government interference.

We need increased energy production and enhanced leadership. Both can be accomplished at once--by immediate legislative decontrol of domestic oil and gas prices without extraordinary taxes on those who would produce the energy we so urgently need.

Any excess profits tax also invites wasteful government spending. This excess profits tax on oil production contemplates the establishment of at least two new federal agencies--which would guarantee more employees, controls, regulations and costs.

The proposed Energy Security Corporation would be a goldmine for unscrupulous speculators who have far-fetched schemes for new energy systems. The waste of the taxpayers money would be unparalleled.

The panic spending of the Energy Security Board would be profligate to produce something quickly. Funds and skills would be siphoned from other national needs. The resulting distortions will have a ripple effect throughout our economy.

With import quotas, stifled domestic crude production, and only remote future synthetic fuel expectations we can be certain of further shortages, eventual rationing, higher fuel prices, and higher taxes. The taxpayer will rebel—and the Congress must accept the responsibility.

Our horizons must extend past the next election; our social and political decisions must be based on sound business and economic principles.

Please vote as if the future of our nation depends upon your vote.

Your thoughtful consideration of our position and your favorable vote will be greatly appreciated.

Again, Mr. Chairman and members of the Committee, thank you.

Shell Canada Limited Chemical Department
Box 400, Terminal A,
Toronto, Ontario M5W 1E1
Telephone (416) 597-7111

June 12, 1979

Banco Hipotecario y de Fomento de Chile
Santiago
Chile

Attention : Mr. Alfredo Vidaurre V.
Director
Study Department

Dear Sir:

I wish to acknowledge receipt of your May 22, 1979 letter regarding conversion of wood wastes to densified wood fuel pellets by means of WOODEX technology. I apologize for what may seem a delay in responding, but the letter actually only arrived on my desk last week.

The licensor of the WOODEX process is Bio-Solar Research & Development Corp. of Eugene, Oregon, U.S.A. However, we are authorized to act on behalf of Bio-Solar on inquiries of this nature, and in actual fact, are doing so at the present moment with Mitsui (Canada) Limited regarding possible licensing interest on Mitsui's part in the Far East.

After a 15 month evaluation of the WOODEX process and the availability of waste woods in Eastern Canada, Shell Canada negotiated a license with Bio-Solar for the provinces of Quebec and Ontario. We are presently finalizing arrangements for our first prototype plant wherein 400 tons/day of pellets will be manufactured at the sawmill community of Hearst, Ontario with the product being shipped 165 miles to a large pulp and paper plant as fuel in their steam boilers. In the United States, other major licensees are Phillip Morris Industries, a subsidiary of Phillip Morris Tobacco and Pullman-Swindell, a subsidiary of the Pullman Corporation. At the moment in North America, there are six operating WOODEX plants and several under design or construction.

You may consider it strange that a major oil company would become involved in waste biomass fuels. However, you must appreciate that large areas of Eastern Canada are dependent upon off-shore crude sources for their energy requirements while at the same time, vast quantities of sawmill wastes are disposed off as landfill or incinerated in inefficient "teepee" burners. We consider ourselves to be a company engaged in the business of supplying energy to Canadian market needs, and whose growth horizons do not stop at a barrel of crude oil. We find the renewable aspect of wood pelletizing to be very attractive.

..... 2

Environmentally, WOODEX is almost an ideal fuel. The sulphur content is less than 0.1 percent, during combustion in a reasonably designed solid fuel boiler particulate emissions are minimal, ash content ranges between 1 to 3 weight percent, and calorific value approximates 8000 BTU's per pound. The fuel pellets burn extremely well with each ton equivalent, heat-wise, to about 2.3 barrels of No.6 Fuel Oil.

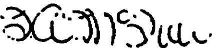
In the process, waste woods, mainly sawdust and bark, are dried to about 10 to 15 percent moisture in a rotary kiln drier, pulverized to 1/8 inch fibres in a hammer mill, and then fed to pellet mills for high pressure extrusion to 1/4 inch by 3/4 inch fuel pellets. Rollers in the pellet mill force the fibres through dies where pressures exceed 10,000 psi and temperatures reach the order of 300°F. Under these conditions, natural lignins and sugars in the cellulose mass are caused to reflow and rebind the fibres.

The main commercial advantage of the process is that the bulk density of the waste wood is increased from the order of 15 to about 40 lbs/cu.ft. and the moisture content is reduced from about 45 to 15 weight percent. These changes greatly reduce the trucking costs of moving carbon to the marketplace thereby providing an economically viable alternate fuel at very acceptable returns on investment.

For the harsh winter conditions in Northern Canada, extended periods at minus 40°F, winterization requirements adds considerably to the capital cost of a plant. For a 300 ton/day installation, we estimate capitalization at about $3.5 million Canadian. Company owned trailers, about 13 per plant, moved by contract truckers will add another $0.5 million Canadian. Warmer winter climates where all equipment could be located outdoors could reduce plant costs by about $0.5 million. In Canada we will pay $2.00/bone dry ton for sawdust and bark wastes. Total manufacturing costs inclusive of labor (18 employees), utilities, and maintenance approximates $15/ton for a total gate cost of $17/ton. About 60 miles is our ideal trucking distance. At a unit cost of 5 cents/ton mile this results in a delivered price of $20/ton. If No.6 Fuel Oil sells at say $15.00/bbl., this equates to about $35 per ton of pellets. Returns on investment considerably above 15 percent should be expected.

In the foregoing, I have only tried to present a thumbnail sketch of a typical wood pelletizing venture. Naturally, there is much more to say and if you should develop an interest, I would be only too pleased to expand on the concept. However, I would like to say that if Chile is dependent upon foreign crude to supply domestic energy needs, WOODEX appears to be an extremely viable renewable energy alternative.

Yours very truly



T.A. McIver, Manager
New Ventures

[From the Oregon Journal, July 14, 1979]

PRODUCERS ARE SOLVERS OF ENERGY PROBLEM

(By John Chamberlain)

It is easy to see why Jimmy Carter has had such difficulty in finding his tongue in this business of coping with the energy crisis. He is, first of all, a politician who wants to be re-elected. The presidential primaries, in which he may be forced to fight for his life, are less than a year away. They will open in the snows of New Hampshire, where any failure to suppy heating oil could be fatal. Yet anything the government can do to create more energy is considerably more than a year away.

The gap into which Jimmy Carter is staring would unnerve anyone who is committed to office-holding as a way of life. And the same gap unnerves a few hundred congressional office-holders, who are clutching at straws in their rush to subsidize synfuels for a decade hence.

In the end, it will be the producing, not the governing, type of mind that will save us. The governing mentality can't get beyond ideas of seizure, rationing or allocation. The producer works around the difficulties interposed by the governor. He is having to work overtime these days, but he is still on the job.

Any time this columnist takes notice of what one producer is doing in one section of the country, he gets a response from other inventive characters in other areas. A column on the creative adaptation of forest product waste to the business of producing electricity in New England brings a fascinating story of similar activity in the Pacific Northwest.

The story comes to me from Bill Dawkins of the Bio-Solar Research and Development Corporation of Eugene, Ore. It is accompanied by a sideswipe at the Federal Department of Energy in Washington, which is appropriating $49 million for 1980 to study the possible uses of "biomass" for energy. Dawkins doesn't object to DOE's intentions, but he points out that much of that $49 million (which comes from your pocket and mine) will go to study problems that Bio-Solar has already solved.

What Bio-Solar has done has been "private enterprise all the way." Two years ago the company began producing a "Woodex" pellet that can be refined from practically any fibrous material of organic origin. The pellet burns with the intensity of oil or coal, and can produce gas comparable to natural gas. A ton of Woodex has a generating capability of .4 MW of electricity at a cost comparable to low grade coal and "far less than oil or natural gas." Six commercial Woodex refineries are now in operation in the United States and one in Canada, each capable of producing 300 gross tons of pelletized material a day.

The kind of wood waste utilized for making the pellets is immaterial. The Edward Hines Lumber Company (Burns, Ore.) uses western pine. In Brownsville, Ore., Douglas fir bark supplies pellets that are sold to Western States Hospital near Tacoma, in Washington, and to Kingsley Air Force Base and two Klamath Falls, Ore., schools. The Pullman Woodex plant at Goldston, N.C., uses southern pine sawdust and hardwood wastes for a pellet that, like Woodex from Douglas fir bark or western pine, is free of sulfur and other pollutants.

In Tennessee a plant supplies pellets for the Union Carbide company, which mixes it with coal to reduce pollutants and ash. The details of the Bio-Solar Research and Development operation are important—they show that pelletizing wood can be invoked anywhere there is forest waste.

Since forests, on a sustained yield basis, take time to reproduce themselves, wood waste is no universal panacea. The energy crisis will not be resolved by dependency on any single type of fuel. The important thing is that the "bits and pieces" approach goes on while Washington talks. We will be saved by what goes on outside of the capital, but it won't be in Jimmy Carter's time.

The best thing that Washington can do is to emulate Diogenes, who (if I remember the story correctly) told his emperor to stand aside from between him and the sun. But only an occasional politico such as Jack Kemp (see his recent book, "An American Renaissance") understands this. Kemp quotes James Schlesinger of the Department of Energy as saying "the tool of politics (which frequently becomes its objective) is to extract resources from the general taxpayer with minimum offense and to distribute the proceeds among innumerable claimants in such a way as to maximize support at the polls."

Schlesinger knows what Kemp knows. Why, then, didn't he storm into the White House two years ago, when it would have given Jimmy Carter time to see common sense about allowing the "general taxpayer" enough energy "resources" to live? Obviously, the "tool of politics" can't "extract" what isn't there.

TELEPHONE (503) 686-0765
TWX 510 597-0390

BIO-SOLAR
RESEARCH & DEVELOPMENT CORP.

1600 VALLEY RIVER DRIVE • SUITE 102 • EUGENE, OREGON 97401

WOODEX®: The Process & Derivative Fuels

WOODEX: A Refined Biomass Fuel

WOODEX is a biomass fuel refined by a process developed and patented in the U.S.A. and other countries by Rudolf W. Gunnerman and assigned to BIO-SOLAR RESEARCH & DEVELOPMENT CORP. This clean-burning, pelletized solid fuel is manufactured from any fibrous organic material such as wood waste, agricultural waste, peat or refuse. An estimated 1.5 billion tons of such biomass is available in the U.S. each year -- most of it heretofore incinerated, buried, otherwise discarded or left unused. Converting only a fraction of this renewable resource to energy can make a substantial contribution to U.S. and world energy needs, conserving more expensive non-renewable fossil fuels -- coal, oil and gas.

WOODEX is refined biomass, not simply compressed biomass. It represents the first major breakthrough in refining biomass for energy on a large commercial scale. It may be burned in its solid state as pellets in stoker-fired equipment or pulverized for suspension burning as an

economical substitute for traditional gaseous fuels, and most oil or gas-fired furnaces can be converted to its use at low cost.

The company has also successfully converted WOODEX to a gas (not yet in commercial production), which burns with the characteristics of natural gas. This gas, in turn, has been liquified in laboratory tests and all indications are that it can be produced in liquid form on a commercial scale, at a cost lower than current gasoline costs. Patents are pending on this product, called "Monozine," and the Department of Defense has suggested that the company apply for Defense research and development funds to perfect the new liquid fuel. (Ref.: George Marienthal, Deputy Assistant Secretary of Defense.)

To date, the company has received no government funding of any nature, (with the exception of an SBA loan). It has been financed to this stage by Mr. Gunnerman and a small group of associates.

Seven Commercial-Scale Plants In Operation

The WOODEX process was patented April 5, 1977. At that time, only a Research and Development plant at Brownsville, Oregon, was in operation. Since then five plants, each capable of producing 250-300 tons of WOODEX per day, have gone into commercial production in the United States and another is operating in Canada:

– WOODEX #1: Brownsville, Oregon. Owned by BIO-SOLAR RESEARCH & DEVELOPMENT CORP. Principal users of product: Western State Hospital, Steilacoom, WA; Klamath Falls schools; Kingsley Field Airbase; major asphalt manufacturer. Ref: Rudolf Gunnerman, Eugene.

Hines Lumber Co, Hines OR: Licensed to Hines Lumber. Used by Hines to generate steam for company operations. Ref: Paul Ehinger, Hines Lumber, Eugene.

Pullman Woodex, Goldston, N.C.: Licensed to Pullman Swindell, division of Pullman Incorporated. Principal users: North Carolina ceramics industry. Ref: Robert Hood, Pullman Swindell, Pittsburgh, PA.

Tennessee WOODEX, Knoxville, TN: Principal users: Union Carbide plants which mix the fuel with coal and cut coal pollution omissions substantially. Ref: Jeff Galyon.

Western Energy, Trail, B.C., Canada: Licensed to S. Madill, Ltd. Principal users: zinc, lead, silver smelters. Ref: C. Madill, Nanaimo, B.C.

Western Power, Redding, CA: Licensed to Digby Logging. Ref: Glenn Howard.

Sierra Power, Fresno, CA: Licensed to Sierra Power Corporation. Ref: Glenn Howard.

In addition to these operating plants, WOODEX of Michigan, owned by BIO-SOLAR, is scheduled to go on line in August. Principal users: major paper manufacturers. Two plants are under construction in Florida: major users, state institutions.

Breaking ground in August: Wisconsin WOODEX. Licensee: Philip Morris Industrial, division of Philip Morris Corporation. Ontario WOODEX. Licensee: Shell Canada, Ltd. Idaho WOODEX. Licensee: Day Resources & Development Corp.

In Design Stage: Plants for South Carolina, Hawaii (where bagasse will be the raw material), Pennsylvania, Montana and Vermont in the United States, and Finland. Many other licensing or joint-venture agreements are in the process of negotiation in the U.S. and abroad.

WOODEX Refining Process

WOODEX fuel pellets are refined from any fibrous material, such as biomass wastes, which are available almost everywhere in some form. In this material is the energy stored and continuously renewed by the sun in all growing matter. After this raw material is pulverized to a desirable particle size, "free" water is extracted or added to give the fibers the correct moisture content. The unrefined fibers are then extruded under high pressures and temperatures. In the process, the cell structure of the fibers is changed; the lignins, waxes, sugars and the cellulose they represent are separated.

Through the process, the cell structure is almost completely destroyed. Changing the cell structure of the cellulose material creates voids which allow combustion air to unite with oxygen contained in the WOODEX pellets and promotes the rapid burning of the pellets' volatiles, which have separated from the remaining fiber and its carbon.

It is this "separation" which forms the adhesive and holds the finished pellet together without the use of any binders or additives. It is this same separation

which allows the volatiles of WOODEX to make almost all the carbon available and almost completely combustible, reducing the pellets to less than 3% organic ash (an excellent soil conditioner).

WOODEX differs from other fuel pellets because of its patented refining process. Other pellets, which are simply densified through compression, burn with little more efficiency than does the unrefined biomass from which they are made.

The National Bureau of Standards, U.S. Department of Commerce, has revealed in tests that a pound of WOODEX produces 8,500 Btu or more of heat energy. Since WOODEX burns so completely and with so little ash as compared to coal, more of its heat value is utilized in burning, producing more steam per pound of fuel than coal in some coal-fired equipment -- but discharging only trace amounts of sulphur or other pollutants.

WOODEX Economies

A "standard" WOODEX plant manufacturing approximately 300 tons of pellets per day, or 100,000 tons per year, may be built for as little as $1.5 million, excluding land

costs. To recover the same amount of energy by starting a coal mine or drilling for oil would cost much more.

Packaged WOODEX plants, as designed and engineered by BIO-SOLAR, can be installed in six to eight months after site preparation. They produce no air or water pollution, require no costly pollution control systems, create no unusual safety hazards or solid waste problems, and require no significant water input. WOODEX plants may be located anywhere an adequate supply of biomass is available.

WOODEX pellets can be shipped safely by rail, truck, or barge, and handled mechanically with existing equipment. They may be stored outdoors under cover, or in bins or silos, with very minor moisture absorption probability.

The plants are thermal energy self-sufficient. A small amount of the total production of each WOODEX plant is burned to generate the required heat energy for its own production process. WOODEX plants fuel themselves.

<u>Advantages to users</u> of WOODEX are many and varied.

The pellets burn so completely and cleanly that no costly

control equipment, such as scrubbers or bag-houses, are necessary, as they are with coal. Ash residue from WOODEX is far less than from coal (less than 3% as against approximately 13%) and contains no contaminants.

When all factors are considered, WOODEX is competitive with coal and [illegible] less expensive than oil or natural gas.

Refined WOODEX burns far more efficiently than the raw biomass from which it is made. An independent study made by Nicolet Paper Co., De Pere, Wisconsin, proved that one pound of WOODEX produces 7 to 7.5 pounds of steam. Another independent study made by Washington State University showed steam production from one pound of hog fuel to be only 1.6 to 1.7 pounds.

Most coal-fired furnaces also require oil or gas overfires. WOODEX does not. This obvious steam production/cost advantage led Edward Hines Lumber Co. to begin manufacturing WOODEX from its own wastes, for use in its Hines, OR, plant. A number of other major forest products companies in the U.S. and abroad are planning to install WOODEX plants for this reason, as well as the product's built-in anti-pollution factor.

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This plant was dedicated 5/11/79

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perspective

Summer/Fall 1978

Employee Magazine of Pullman Incorporated

Pullman Woodex

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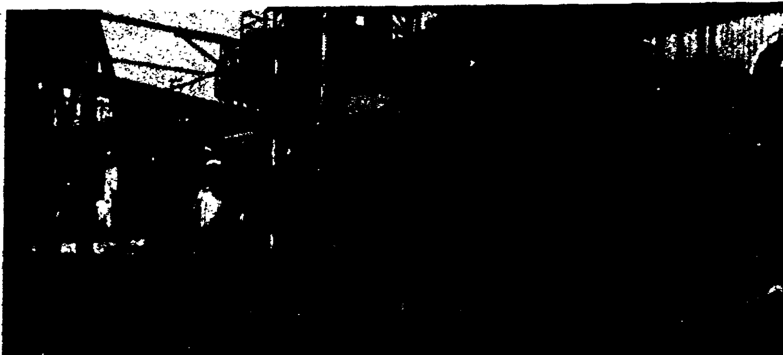

Rudolf Gunnerman, president of Bio-Solar Research Corporation, and Plant Manager Norm Norton stand near the pulverizing section of the Woodex plant in Brownsville, Oregon. A vibratory feeder at the top of the unit drops wood waste into a pulverizer below the green platform. It is later dried, then compressed into pellets.

Pullman Woodex

A company to produce fuel from wood waste launches Pullman Swindell's latest advance on the energy front; a pellet plant is planned

Wood pellets for fuel represent the latest advance in Pullman's ever-growing role as a developer and supplier of products and processes to help meet America's energy needs.

In May, the Pullman Swindell division and Bio-Solar Research & Development Corporation of Eugene, Oregon, announced formation of a joint-venture company, Pullman-Woodex Corporation, to convert forest wastes into fuel for industry. Before the end of June, a plant site was selected; management was appointed; plans were under way for production facilities in North Carolina, and a test of wood pellets (Woodex*) as a substitute fuel had succeeded in a potential customer's plant.

The pellets, produced by a patented manufacturing process, are far more economical than oil or gas. They leave only three percent ash after burning, compared with 13 percent when coal is burned. They produce no sulfur fumes at all, eliminating an expensive part of

Davis Walker, general manager of Pullman Swindell's solid fuels group (seated) and Pullman Woodex managers discuss layout plans for the plant to be built in North Carolina. Standing, left to right, are Project Manager Rege Hennigan, Plant Manager Raford Elkins and LaVerne Thornton, manager of Woodex marketing and operations.

*Registered U.S. trademark

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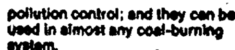


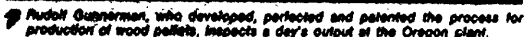
pollution control; and they can be used in almost any coal-burning system.

PLANS FOR PLANT

The first Pullman Woodex plant, costing about $1,000,000, will be built on a 20-acre site at Goldston, North Carolina, the geographic center of the state. Construction has begun and is expected to be completed later this year. The plant will employ 15 people, will operate around the clock and will have a production capacity of 300 tons a day. Most of the raw material will come from the scrap piles of nearby lumber yards.

LaVerne Thornton, former vice president for manufacturing and engineering for a clay pipe manufacturer, has been appointed manager, Woodex marketing and operations, and is now recruiting a work force for the plant. He has lived in Chatham County, where the Pullman Woodex plant site is located, for about 20 years.

Pullman Woodex extends the capabilities of Pullman Swindell's rapidly-expanding solid fuels group. After three years of research and development, this group recently installed combustion systems in several brick kilns that brought customers major cost reductions and solution of fuel supply problems through use of pulverized coal instead of oil and gas. (See Winter 1977-78 *Perspective*.) The group also is involved in coal gasification and now offers a multi-solid fuel combustion system that can burn Woodex, sawdust or coal.



Rudolf Gunnerman, who developed, perfected and patented the process for production of wood pellets, inspects a day's output at the Oregon plant.

Davis Walker, general manager of the solid fuels group, calls Woodex an "exciting" product with "tremendous" possibilities for solving fuel and pollution problems. He emphasizes the fact that the technology is available now, not a long-range hope, and offers a new energy source rather than conservation alone. What about potential markets? "Fabulous."

WOODEX MARKETS

The first customers of Pullman Woodex will be ceramic industry plants in North Carolina—"the state with the worst fuel situation in the country," according to Walker. But he quickly adds that use of Woodex is expected to spread into other states and other industries. Textile plants are among immediate prospects, and several educational institutions "are showing a lot of interest."

Woodex can be made from almost any organic fibrous material (bio-mass) such as wood waste, straw, bagasse or peat. The manufacturing process is basically simple and efficient, using machinery and technology already available from the agriculture industry. The wood pellets can be converted to a new type of combustible, stable chemical gas, if desired, by a unit called the Woodex gas generator.

The price of Woodex is expected to be $30 a ton, and a ton will provide BTU output equivalent to that from about three-and-a-half barrels of oil. The economic significance of this comes with conversion of figures to comparative energy costs. For example, the approximate cost of producing 1,000,000 BTU's of energy with either oil or gas in North Carolina is about $3.00, compared with $1.70 for the same power from Woodex. The cost of energy from medium-grade coal in the Southeast is about the same as that from Woodex, but the low-ash content and absence of sulfur give Woodex advantages over coal.

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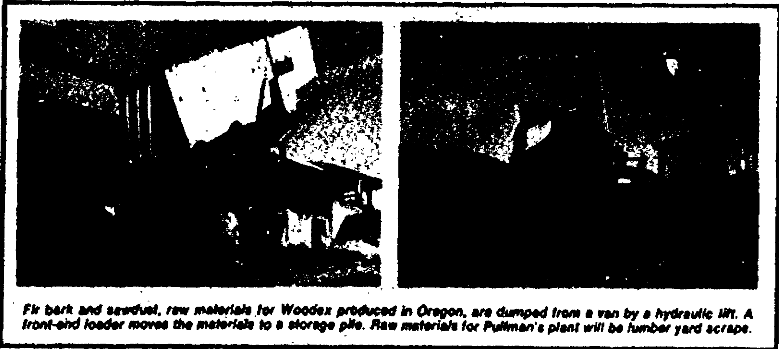

Fir bark and sawdust, raw materials for Woodex produced in Oregon, are dumped from a van by a hydraulic lift. A front-end loader moves the materials to a storage pile. Raw materials for Pullman's plant will be lumber yard scraps.

To describe potential use of wood pellets, Davis Walker estimates that 50,000,000 to 100,000,000 tons of bio-mass waste are currently available in North Carolina, and this waste could be converted into 600 trillion to 1,200 trillion BTU's. The total energy consumption of the entire state in a year is about 1,400 trillion BTU's, he says.

PULLMAN'S PARTNER

Rudolf W. Gunnerman, president of Bio-Solar Research & Development Corporation, developed, perfected and patented the process for production of Woodex. His firm's plant at Brownsville, Oregon, produces wood pellets from fir bark and sells them to customers in Oregon and Washington. Several licensees also use the process for production of their own fuel.

In January, 1978, Oregon Senator Mark Hatfield had a *Christian Science Monitor News Service* article about Gunnerman and his company inserted in the Congressional Record. Commenting on "this remarkable company, begun and operated by an enterprising scientist," Senator Hatfield said, in part:

"The energy produced by bioconversion may be electricity, gas, liquid or solid fuel. The obvious advantage of the process, in addition to the fact that capital fuel resources such as oil and coal are conserved, is that waste products are being disposed of and recycled at the same time that energy is produced."

The three main sources of U.S. energy present major problems. The supply of natural gas is subject to interruption. Oil, though now available, continues to increase in price, and the whim of foreign nations can affect its supply and cost. Coal is a good alternate source but often entails environmental control expenses.

A RENEWABLE RESOURCE

Davis Walker reminds customers that new fuel sources, as well as conservation of current fuels, are an urgent need. He points out that bio-mass for Woodex is not only immediately available but also a renewable natural resource. Discussing production in North Carolina, Rudolf Gunnerman said, "When we run out of trash wood, farmers will start energy plantations."

Walker adds another point: "Woodex rechannels money that was going out of the community back into the community by creating jobs and additional revenues for the community and the state."

The theme, "Energy Independence: Solid Fuel Firing from Pullman Swindell," has been adopted for a promotional program of the division. Establishment of Pullman Woodex is an innovative step toward fulfillment of that goal.

A superintendent monitors control panels for the automated Woodex plant in Oregon.

For more information contact:

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APPENDIX A

MATERIAL REQUESTED IN PART 2 OF THESE HEARINGS OF MR. JACK M. ALLEN OF THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

PRICE INDICES FOR ITEMS
INCLUDED IN THE COST INDEX OF DRILLING & EQUIPPING WELLS
(1974 = 100)
(Unadjusted for Depth)
(All Indices Are Averages for the Year)

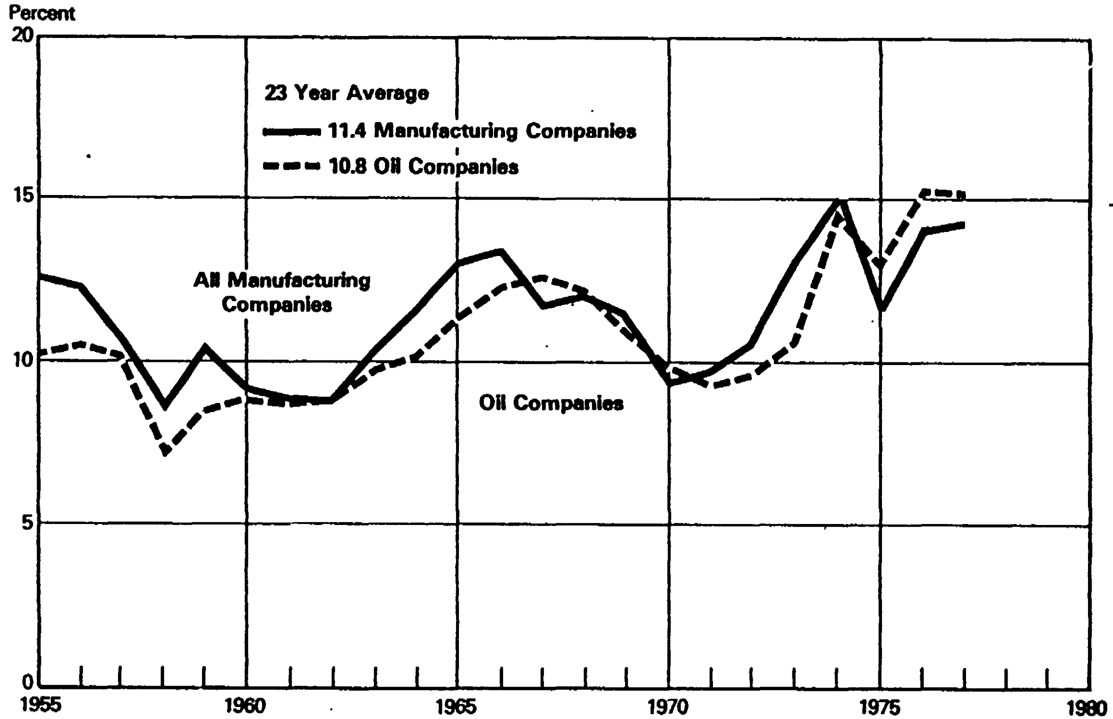
	WEIGHT (% of Total well Cost)	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	Prelim. 1978	Percent Increase 1968-1978
Payments to Drilling Contractors	36.6	53.6	58.1	60.6	62.8	70.7	76.9	100.0	114.8	131.1	157.1	178.6	233.2
Purchased Items													
Road & Site Preparation	4.1	68.5*	72.4*	76.6*	82.8*	87.7*	93.2	100.0	110.8	119.4	128.7	133.8	95.3
Transportation	3.9	75.9	76.7	80.0	85.1	87.4	90.1	100.0	108.8	115.4	123.6	140.6	85.2
Fuel	1.1	44.0*	44.4*	47.8*	49.5*	50.1*	57.2	100.0	121.6	141.3	171.4	183.3	316.6
Drilling Mud & Additives	6.9	61.5	63.7	69.4	75.1	75.2	84.4	100.0	127.7	143.4	151.1	179.1	191.2
Well Site Logging and/or Monitoring System	1.2	77.6*	85.3*	86.8*	87.7*	87.7*	87.7	100.0	117.5	126.1	136.2	154.5	99.1
All Other Physical Tests	0.7	69.0*	73.8*	76.5*	84.9*	84.9*	88.4	100.0	120.3	135.4	148.7	163.5	137.0
Logs & Wireline Evaluation Services	3.2	69.1*	73.5*	79.7*	86.9*	86.9*	89.8	100.0	118.1	137.9	152.5	175.0	153.3
Directional Drilling Services	0.6	71.5	72.7	76.0	82.6	84.5	87.7	100.0	106.6	116.3	126.2	141.3	97.6
Perforate	1.1	74.6*	79.2*	86.5*	89.6*	89.9*	89.8	100.0	118.3	131.0	143.1	155.2	108.0
Formation Treating	3.0	78.9	82.6	85.0	90.4	90.8	93.4	100.0	126.6	137.3	144.0	154.3	95.6
Cement & Cementing Services	3.7	69.6	72.7	77.4	86.5	88.0	92.1	100.0	124.6	133.7	137.1	152.4	119.0
Casing & Tubing	17.5	51.8	52.0	54.8	65.1	73.8	73.6	100.0	111.2	120.3	132.6	147.6	184.9
Casing Hardware	0.7	51.8	52.0	54.8	65.1	73.8	73.6	100.0	111.2	120.3	132.6	147.6	184.9
Special Tool Rentals	3.1	75.6*	78.7*	86.3*	88.4*	88.4*	89.8	100.0	115.0	127.2	139.1	153.1	102.5
Drill Bits & Reamers	1.6	68.7	74.4	80.0	81.0	85.8	87.7	100.0	124.3	134.3	147.9	165.6	141.0
Wellhead Equipment	1.8	69.1*	72.4*	76.0*	79.7*	80.9*	85.6	100.0	120.5	141.5	165.2	184.2	166.6
Other Equipment & Supplies	2.0	67.4	71.4	75.0	77.7	80.7	84.4	100.0	124.4	138.0	149.9	165.7	145.8
Plugging	0.5	62.6*	67.4*	74.2*	83.3*	89.3*	93.1	100.0	115.0	122.0	128.0	140.3	124.1
Supervision & Overhead	2.1	66.6	71.0	74.1	77.8	82.4	87.8	100.0	110.8	119.5	129.3	143.8	115.9
All Other Expenditures	4.6	66.6	60.9	71.5	74.1	76.7	81.9	100.0	111.5	118.5	126.9	136.1	104.4

*Consider as approximate since figures were derived by rebasing previous composite index (from 1969 = 100 to 1974 = 100). Changes in the number, types and weights of the elements comprising this composite precluded more exact calculations; i.e., extending the current index (1974 = 100) for each element back to 1966 and applying the appropriate weights.

Sources: Weights from IPAA Cost Study Committee Survey of distribution of expenditures in drilling and equipping wells in 1974. Index of payments to drilling contractors from IPAA Annual Survey. Price indices from Bureau of Labor Statistics and other government publications, industry publications, and data provided IPAA Cost Study Committee by service and equipment companies

IPAA COST STUDY COMMITTEE
October 1979

RATES OF RETURN
OIL COMPANIES vs. ALL MANUFACTURERS



Source: Securities & Exchange Commission, Chase Manhattan Bank.

ADMINISTRATIVE AND LEGISLATIVE CHANGES TO

ONSHORE OIL AND GAS LEASING SYSTEM

SUMMARY OF CONSENSUS

Proposed Changes to Regulations:

1. Quarterly, rather than monthly, lease sales: Administratively infeasible for a BLM staff already straining to handle the smaller number of parcels available in the monthly sales. Extra time will not provide an incentive for the uneducated public to become better educated. The administrative burden will create chaos in BLM field offices and enduce further delays in leasing which is counterproductive to increased domestic activity.
   Recommendation: Retain monthly lease sales; require field offices to offer leases within 30 days after they become available.

2. Extension of filing period from five to fifteen days: IPAA supports an extension of the filing period to (1) compensate for time lost during entry cards mailing, and (2) reduce the number of contested drawings due to questions about timely filing. However, a 15-day filing period could overlap the previous month's drawing and could cause confusion and an administrative burden.
   Recommendation: The filing period should be extended to 10 days.

3. Expand maximum allowable size of non-competitive leases from 2,560 acres to 10,240 acres: Expansion of parcels will not encourage earlier drilling or eliminate speculators. It will create significant work for BLM field staffs who would have to redefine the areas. An earlier experiment of this nature tried in Colorado resulted in a substantial increase in contested drawings and confusion in the private sector due to imprecise area descriptions. Colorado reverted to the current system. Additionally, the increased amount could encourage delays as available leases are held until neighboring leases become available, putting BLM in the position of delaying exploration. Larger parcels require proportionally larger initial capital expenditures which many smaller companies cannot afford and which could be better spent on exploration and production. At the same time, smaller parcels provide more opportunities for more companies to explore in an expeditious fashion since the initial costs are lower and the operator must make a diligent effort to produce in order to retain his lease beyond the original term.
   Recommendation: The current maximum size of non-competitive leases should be retained.

4. Require hand written signatures and personal or business addresses on entry cards and successful applicants to sign lease forms: Will (1) significantly reduce "rubber stamp" entries by filing services, (2) require the applicant to become more directly involved in the lottery, (3) provide a disincentive to unscrupulous participants in the lottery, (4) allow direct contact between the government and the successful drawee, (5) make location of the successful drawee possible, and (6) substantially reduce opportunities for unscrupulous middle-men to subvert the system.
   Recommendation: These changes should be adopted.

Page Two

5. Prohibit legally binding agreements or options to sell or assign leases or interests in leases written prior to lease issuance: Designed to provide all interested parties an equal opportunity to approach the successful drawee. The purpose of the change is valuable to an equitable system. It could permit the company most interested in developing the lease an opportunity to acquire the lease. However, due to current wilderness inventories, delayed EIS's,and other programmatic restrictions, some leases are not issued for as long as three years -an unnecessarily long period for interested and qualified parties to wait to deal with the successful drawee. Also, establishment of priority does not occur until the lease is issued, making pre-sales or assignments illegal.
Recommendation: Establish a "cooling off" period by prohibiting legally binding agreements or options to sell or assign leases or interests in leases until 30 days after establishment of priority, such determination to be made within 30 days from date of drawing.

6. Require all corporations participating in a non-competitive lease sale to file a list of its officers to be checked against the successful drawee: Designed to prohibit possible duplicate filings.
Recommendation: This change should be implemented.

7. Increase rentals during second five years of a ten year lease if no exploratory drilling occured during first five years: Designed to discourage lessee's from "sitting on" non-producing leases, and to tighten requirements for diligent exploration and production of public lands. Objective is desirable, but remedy must consider economic and technological factors which may render development of a lease impractical. The existence of an oil and gas lease, even where there is significant interest by companies in a "hot" area, does not prove the presence of oil and/or gas. It is simply evidence that the area may have potential; only actual drilling will determine the presence and quantity of the oil and/or gas. The decision to drill is made by the company after analyzing the geology, to guess what might be in the ground, where it might be, what formation may be encountered by the drill bit, and the chances of finding it; engineering, to estimate the best way to look for it and plan all the necessary equipment from construction of the drill pad to the choices of drill bits; economics, including estimated costs of drilling to estimated returns on yet undiscovered oil and/or gas, costs of environmental assessments, archaeological reports, the current price of the resource; the operating requirements, such as special environmental restrictions and a myriad of permits from federal, state, and local authorities; and availability of capital. Operating restrictions on federal lands are actually impeding diligence by delaying issuance of leases and drilling permits because of wilderness studies, incomplete land management plans and conflicting instructions to federal field staffs.
Recommendation: Retain the current ten-year term.

8. Recommendation: Return to prior system of requiring advance rental to be submitted at time of filing, with such rental to be paid only by cash, U.S. postal money order or bank cashier's check.

9. Recommendation: The Bureau of Land Management should be instructed to monthly cash a minimum of 10% of all advance rental checks.

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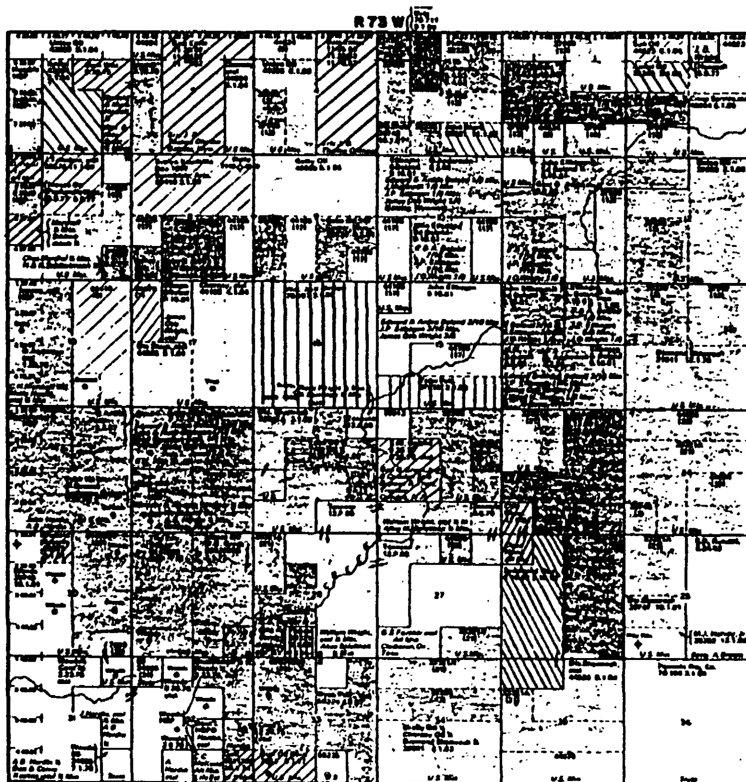

- UNION OIL
- HUMBLE
- INEXCO
- CHORNEY
- BASS INTER.
- MICH — WSC
- PHILLIPS
- ASHCRAFT
- AMINI OIL
- DIA SHAMROCK
- ELLBC 'N-ANDERMAN
- MARSHALL
- KOUDELKA
- J BEARD
- MID-AMER. DRLG.
- CITIES SER
- WENDELL — HALEY
- GULF
- JACK MC CAW
- GETTY OIL
- SUN OIL
- HANCOCK
- ECHO OIL
- TENNECO
- J TALLADERA
- ERVING WOLF
- YATES PETR
- CONTINENTAL
- WOODS
- WESTERN RES
- E.M BOLAND
- SOUTHLAND ROY
- S R RATCLIFF
- PHOENIX RES
- PICKETT
- DYCO PETR
- CLIFF DEVEL

POMCO LEASE AND OWNERSHIP MAP
CAMPBELL COUNTY, WYOMING
SCALE: 1" = 3000'

AVERAGE DAILY PRODUCTION OF INDEPENDENT CRUDE OIL PRODUCERS

Records on volume of crude oil production identified by individual producers are not readily available. Information compiled from 1972 production data indicates that for that year the 100 largest domestic producers had average daily production in excess of 3000 barrels a day. The producers ranked 101 through 200 in size had average daily production between 1000 barrels per day and 3000 barrels per day.

The cumulative production of the 200 largest producers equaled 7,402,029 barrels per day representing 78.4 percent of total U.S. average daily crude oil production. Dividing the remaining U.S. crude oil production of 2,038,971 barrels per day by the approximately 10,000 independent producers gives an arithmetic average of approximately 204 barrels per day.

In 1972 it is estimated there were approximately 10,000 total domestic producers. It is estimated that in 1977 the number of domestic producers was in excess of 11,000. Total domestic production in 1972 averaged 9,441,000 barrels per day and had declined by 1977 to 8,244,000 barrels per day.

Based on the above data it is reasonable to assume that the average daily production of the more than 10,000 independent domestic producers is considerably less than 1,000 barrels per day.

APPENDIX B

INFORMATION NOT RECEIVED BY THE COMMITTEE

(At presstime the information requested by the committee was not received)

Part 1 of the hearings:
Page 61: List of questions submitted by Senator Durenberger.
Page 77: Questions submitted by Senator Nelson.
Page 84: Analysis requested by Senator Dole.
Page 157: Material requested by Senator Heinz that was not completed will be supplied at a later date.

APPENDIX C

Question submitted for the Record by Senator Max Baucus to DOE Secretary James Schlesinger

Question. How does the Administration account for the revelation in recently printed articles that the estimated cost of synthetic fuel seems to rise proprotionately with each rise in OPEC oil prices?

Please furnish past and current estimates of synfuel costs (per barrel) as reflected in those articles.

Please identify the necessary price scenario which would make synfuels competitive. How high must OEPC oil prices rise before synthetic fuels are truly competitive? (Senator Max Baucus)

Answer. It has been stated on many occasions that the predicted price of synthetic liquid fuels from coal and oil shale always seems to stay ahead of the increasing price of conventional fuel. There are several reasons for this increase in the projected costs of synthetic fuels and these are discussed briefly in the following paragraphs.

A recent study was made for DOE by the Rand Corporation to examine the cost extimating of "first of a kind" major energy facilities. This study found that even in constant dollars the early designs of such projects provided estimated capital costs less than half of those indicated by late detailed and definitive studies. This cost increase is often due to such factors as intitial uncertainlty about the plant and process and how it scales with such factors as size and to the methodologies used in estimating these first of a kind systems. As the designs get pregressively more detailed the potential problems are examined more closely and a more expensive solution than originally assumed is some times required.

The decade of the 1970's has also been a period of significant inflation. For major construction projects the construction costs have risen by a factor of 2.03 between the years 1970 and 1978. The costs of coal, gas and crude oil have also risen rapidly during this period as shown in the Table below:

Ratio of 1978 to 1970 fuel costs

Crude oil	1.78
Natural gas	3.25
Anthracite coal	2.07
Bituminous coal	2.30

These figures show that the feedstock cost for synthetic fuels has been rising somewhat more rapidly than the price of crude oil itself. The same has been true for contruction costs in general, even when no allowance is made for the uncertainties of pioneering projects.

In light of the above factors it is not surprising that projected costs for synthetic fuels have more than kept pace with crude oil costs. It is worth noting, however, that once a synthetic fuels plant is built, its capital cost is no longer subject to change and hence the impact of inflation is limited to that of escalating coal and oil shale prices. because the production of synthetic fuels is very capital intensive the effects of rising coal costs for an existing conversion plant will have a reduced impact on the costs of the synthetic fuels produced.

As quoted in the Wall Street Journal (August 16, 1979) synthetic fuels were estimated to cost about $3 per barrel when crude oil was $2 or less per barrel. Now with OPEC crude oil landed in the U.S. at an average cost of $21.50 per barrel synthetic fuels are estimated to cost in the range of $25 to $35 depending upon the feedstock and process.

The factors giving rise to the escalating estimated costs for synthetic fuels will continue to exist in coming years. It is therefore not possible to give a scenario that would make synthetic fuels competitive at the time a commitment is made to build a plant. On the other hand, once a plant is built, the cost increases of the synthetic fuels produced would be less than the rise in crude oil costs and a cross over point would be reached, usually witin the first three years of plant operation. This would depend, of course, on the actual crude oil prices established by OPEC and the general rate of U.S. inflation.

APPENDIX D

Procedural Leasing Flow Chart for Outer Continental Shelf Oil and Gas Production

(Referred to on July 11, p. 142 of P. 1 of these hearings)

Variations to the Procedural Leasing Flow Chart For OCS Oil and Gas Production

The accompanying chart of the procedural steps involved in the OCS leasing process was prepared prior to Conference Committee action on the 1978 Amendments to the OCS Lands Act of 1953. On the whole, it remains an accurate representation of the changes made by Public Law 95-372 to the leasing process that had evolved pursuant to the OCSLA of 1953; however, as noted below there are twelve (12) differences worthy of mention between the legislation as represented on the chart and the law as enacted. Note that the points outlined below correspond to the numbers placed under the appropriate box on the chart.

Before going into the differences, some initial points should be made. First, neither the chart nor this accompanying memorandum fuly cover all the steps involved in the OCS process. This is due to the fact that neither of the two documents described every step which is requried by regulation. In fact, such would be impossible to accomplish at this point and time—of the some 29 new regulations called for by the legislation only 3 have been promulgated in final form to date, almost 10 full months after the President's signature was palced on the statute.

Secondly, the chart can not reflect all the effects that collateral legislation might have on the OCS process. For example, although federal District Court has dissolved the injunction against the Georges Bank lease sale, environmental groups have requested the National Oceanic and Atmospheric Administration to designate the entire area as a marine sanctuary under the Marine Sanctuaries legislation. Obviously, if this request is granted, the "enabling regulations" could interject delay into the process at any point along the continuum.

The chart also fails to completely incorporate the steps involved with respect to reviews mandated by the Coastal Zone Management Act. In this regard, note that an April 20, 1979 memorandum of opinion from the Department of Justice has held that § 307(c)(1) of that Act applies to pre-lease activities of the Department of Interior that directly affect the coastal zone of a state with an approved CZM program. D.O.I. has stated that it does not "at present anticipate that the opinion will result in any delays", however, this is obviously not a certainty. Of course, activities by lessees and permittees must also undergo state reviews pursuant to § 307(c)(3) of the CZMA.

Finally, it is anticipated that an updated version of the chart will be prepared at the end of the year—once most of the final regulations are in place. What follows, then, are the above mentioned differences between the present chart and the 1978 Amendments as signed into law.

(1) Conference Report deleted this requirement. The Conferees decided "to retain the exact language of section 11 of the 1953 OCS Act [with respect to the issue of on-structure drilling] . . . [specifying that] the conferees' action does not indicate any particular interpretation of existing law." (See p. 100 of S. Conf. Rpt. 95-1091.) Note that in proposed regulations issued February 9, 1979, the Department of Interior announced its intentions to encourage and allow on-structure drilling upon request. Such drilling would not be restricted to frontier areas as specified in §11(g) of H.R. 1614.

(2) This provision, *i.e.*, § 11(h) of H.R. 1614, was deleted during Conference Committee consideration of the legislation.

(3) The only substantive changes to the five year lease sale program was the deletion of provisions which established and provided for the review of various actions by regional advisory boards; hence comments on the proposed program were received only from interested federal agencies and governors of affected states. Note that the proposed program was submitted to the Congress as scheduled on June 18, 1979. Note also that the D.O.I. has decided to prepare an E.I.S. on the entire lease sale schedule as does not anticipate that such will delay final approval within the 18 month deadline.

(4) Again, as mentioned above, the participation of regional advisory boards was deleted. Also the environmental studies provisions were slightly altered so that development plan approval should not be delayed if the studies are not completed. Section 20, as enacted, specifies that the environmental studies are to be commenced within six months of enactment with respect to any areas or region where a lease sale has been held or announced by publication of a notice of proposed sale prior to enactment or not later than six months prior to the holding of a lease sale with respect to areas where no sale has been held prior to enactment.

(5) Section 21 of the Amendments granted primary jurisdiction for the promulgation and enforcement of safety regulations with the Coast Guard and Department of Interior. Additionally, a specific requirement for diving regulations was deleted. The statement of managers makes it clear that OSHA's only authority is pursuant to the residual authority contained in § 4(6)(1) of its enabling legislation. A further clarification of this issue was recently accomplished through the adoption by the full House of an amendment to the Labor-HEW appropriations measure which essentially restated the above rule.

(6) Again, participation by regional advisory boards was deleted from the legislation.

(7) The 1978 Amendments specify that the fixed case bonus bidding system are to be applied "to not less than 20 per centum and not more than 60 per centum of the total area offered for leasing each year during the five year period beginning on the date of enactment."

(8) Section 19 of the Amendments provides that "any governor of any affected state or the executive of any affected local government in such state may submit recommendations to the Secretary regarding the size, timing, or location of a proposed lease sale" provided local government executives first forward their recommendations to the governor of his state.

(9) Multiple bids may be required during the five year period commencing on the date of enactment as to no more than 10 per centum of the tracts offered for sale each year "in order to obtain statistical information" to determine which bidding system best accomplishes the purposes and policies of the Act. "Majors" are prohibited from bidding unless te Secretary finds, on the record after an opportunity for agency hearing that "such lands have extremely high cost exploration or development problems" *and* "exploration and development will not occur on such lands unless such exemption is granted."

(10) In all provisions relating to antitrust review actions, the Conference Committee made the Justice Department the lead agency and specified that its review should be conducted "in consultation with the Federal Trade Commission".

(11) Rather than make lease issuance dependent upon "due diligence" findings of the Secretary, the Amendments specify that "no bid for a lease may be submitted if the Secretary finds, after notice and hearing, that the bidder is not meeting due diligence requirements on other leases."

(12) Again, the Department of Labor's authority over enforcement of safety and health regulations is dependent upon its residual powers under the OSHA enabling legislation. Thus, as long as the Coast Guard and D.O.I. are actively enforcing safety and health, OSHA is precluded.

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S361-74 ①

54-217 O (Chart No. 1)

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PROCEDURAL LEASING FLOW CHART FOR O.C.S. OIL AND GAS PRODUCTION

ADDITIONAL REVIEWS AND PROCEDURAL STEPS CAUSED BY H.R. 1614

Civil Suits may stop procedure at any point indefinitely.

ENVIRONMENTAL BASELINE STUDIES ⟵ | ⟶ MONITORING STUDIES BEGIN

Civil Suits may stop procedure at any point indefinitely.

LEGEND

BS	Baseline Studies
BLM	Bureau of Land Management
CEQ	Council on Environmental Quality
Corps	Corps of Engineers
CFR	Code of Federal Regulations
CZM	Coastal Zone Management
DEIS	Draft Environmental Impact Statement
DOI	Dept. of Interior
DandP	Development and Production
EBMS	Environmental and Baseline Monitoring Studies
EIS	Environmental Impact Statement
FEA	Federal Energy Administration
FEIS	Final Environmental Impact Statement
FTC	Federal Trade Commission
FWL	Fish and Wild Life Service
Governor	Governor of Costal or Affected State
ICC	Interstate Commerce Commission
"Majors"	As Defined by Energy Conservation and Policy Act of 1975.
NEPA	National Environmental Protection Act (1969)
NOAA	National Oceanic and Atmospheric Administration
OCS	Outer Continental Shelf
PDOD	Program Decision Option Document
PH	Public Hearing
RAB	Regional Advisory Board
Secretary	Secretary of the Interior
USCG	United States Coast Guard
USGS	United States Geological Survey
* NPS	National Park Service

S = State Input

I = Industry Input

P = Public Input

* : Each EIS is considered a Major Federal Action (NEPA Sec. 102)

● : OIL WELL

☼ : GAS WELL

Ø : DRY HOLE

[solid box] = Current Reviews and Procedural Steps

[dashed box] = Special Circumstances (Sometimes Done)

[heavy dotted box] = Additonal Reviews and Procedural Steps caused by H.R. 1614

Cancellation of Lease at any time may stop procedure. (H.R. 1614 Sec. 5, Par. 2)

Cancellation of Lease at any time may stop procedure (H.R. 1614 Sec. 5, Par. 2)

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JUNE 1, 1977

PROCEDURAL LEASING FLOW CHART FOR O.C.S. OIL AND GAS PRODUCTION (H.R.1614)

A.P.I.

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