

1 EXECUTIVE SESSION

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3 THURSDAY, AUGUST 2, 1979

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5 United States Senate

6 Committee on Finance

7 Washington, D.C.

8 The committee met at 10:15 a.m. in room 2221, Dirksen
9 Senate Office Building, Honorable Russell Long, chairman of
10 the committee, presiding.

11 Present: Senators Long, Talmadge, Byrd, Bentsen,
12 Matsunaga, Dole, Packwood, Roth, Danforth, Chafee, Heinz,
13 Wallop and Duronberger.

14 Also Present: Mr. Lighthizer, Mr. Stern, Mr. Shapiro,
15 Mr. Wetzler, Mr. Foster, Mr. Lubick and Mr. Sunley.

16 The Chairman: We decided that Senator Packwood has been
17 pressing for consideration of a proposal about the
18 reforestation of timber. I would like for us to just take
19 time to briefly discuss the situation and see if it is
20 something that we can handle today or if it has too much
21 controversy and will have to be deferred.

22 Mr. Shapiro, do you want to explain it?

23 Senator Packwood: I would be happy to explain it, but go
24 ahead, Bob.

25 Mr. Shapiro. The bill that is before the committee is

1 S. 100 that is on this agenda, although there are some
2 proposed changes in that. Let me just give you a brief
3 background on the problem.

4 Under present law, when you plant or reseed any of the
5 basic forestation costs, you have to capitalize those. What
6 that means is an individual or corporation which replants
7 timber lands does not get a write-off for any of the expenses
8 incurred in the early years until the timber is harvested.
9 Even the depreciation on equipment that is used for any of the
10 replanting is not allowed as a deduction currently.

11 That is capitalized, but once the timber is harvested,
12 you get to have a depletion write-off on these expenditures.
13 The fact that there is a long lead time for the harvesting,
14 and before any income comes about, essentially it is between
15 10, 15 and 20 years, and that is quite a few years down the
16 road.

17 Congress provided a capital gains as an incentive because
18 of the long lead time in that regard.

19 The problem that is occurring these days that prompted
20 Senator Packwood to introduce this bill is that there is not
21 as much replanting as would otherwise be the case, and he is
22 trying to encourage a significant amount of planting,
23 especially among the smaller individuals and corporations, by
24 providing an incentive for replanting.

25 The bill as was originally proposed to the committee has

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1 a \$10,000 deduction limit each year for replanting in
2 addition, and that would apply after 1979. So it is a \$10,000
3 deduction each year for reforestation expenditures by either
4 an individual or a corporation.

5 The second part of the bill would provide a trust fund,
6 the reforestation trust fund, which would have dedicated to it
7 \$30 million per year out of the tariffs on imported plywood
8 and lumber. These revenues in the trust fund would be used to
9 supplement other funds for the reforestation of publicly-owned
10 national forests, and this trust fund would be in existence up
11 until September 30th of 1985.

12 Senator Packwood, as I understand it, is interested in
13 modifying his bill right now to continue to allow \$10,000 to
14 be used as a deduction, but instead of having a current
15 deduction of that, it would be spread out over seven years,
16 which is a \$10,000 amount amortized over a seven-year period,
17 and in addition, to provide a 10 percent investment tax credit
18 on that \$10,000 which could be allowed each year.

19 So we are still talking about a \$10,000 limit on the
20 replanting costs, but it would be eligible for a 10 percent
21 investment credit on that \$10,000 and the deduction for it
22 would be spread out over a seven-year period.

23 The revenue loss in this as amended, as we understand it,
24 is somewhere in the neighborhood of \$30 million in 1980.
25 It goes up to \$40 million, \$38 million or \$40 million, in

1 1984. I must say that includes the trust fund. In other
2 words, it is the tax plus the trust fund. The tax cost of
3 this is below \$10 million. It starts off at \$4 million and
4 goes up to somewhere between \$6 million and \$8 million.

5 So \$30 million of the revenue costs which I just
6 indicated was the trust fund.

7 The Chairman: Senator Packwood, would you like to
8 comment?

9 Senator Packwood: Yes. Let me tell you why we would
10 like to do this today, first.

11 The Chairman: You don't need to tell us that. Tell us
12 about your bill.

13 Senator Packwood: But there is a reason. You should
14 know why. That is that room has been made for this by the
15 Budget Committee, and they are going to start what they call a
16 crosswalk procedure as we start voting on appropriation bills.
17 I want them to know the Finance Committee has taken action on
18 this and indeed we are responsible for it, or they will try to
19 do us in again.

20 Now, there are two principal kinds of lands in this
21 country: public lands and private lands. In the West, by and
22 large the best forest lands are public. In the East, the best
23 lands are private. That is the history of the country. The
24 trust fund is used to reforest all of the lands that have not
25 been reforested by the Forest Service.

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1 In 1976, we directed that be done by law by 1985. We
2 directed the President every year to tell us in the budget how
3 much money would be required to reach that goal of full
4 reforestation in 1985. In his budget this year, he said we
5 should have \$122 million, but he has asked for \$74 million,
6 despite the fact that the goal is there and we will only move
7 toward the goal if we have full funding for reforestation.

8 The trust fund is simply used to make up the difference
9 between what Congress finally appropriates and what the
10 President said is needed, not trying to go above his figure.

11 On private lands, and here it is so critical in the East
12 and in the South, 60 percent of the available commercial
13 timber in this country is on private land, and mostly
14 small wood lots. We are not talkig about Weyerhaeuser or
15 Georgia Pacific. It is the farmer, the New York City
16 resident who has 40 acres in Vermont. That is where a great
17 portion of the available commercial timber is, and there is
18 not a great incentive for the individual to reforest.

19 And make no question about it, the major timber companies
20 do not care about this bill one way or another. They have
21 great concern about timber and capital gains, and this bill
22 has nothing to do with timber and capital gains. For the
23 \$10,000 limit, you can reforest at today's prices on average
24 land about 100 acres.

25 It is obviously not something that Weyerhaeuser, Georgia

1 Pacific or Louisiana Pacific will get overly excited about one
2 way or the other. So that is the bill.

3 It has no opposition other than Treasury.

4 (Laughter.)

5 Senator Packwood: But the environmentalists have endorsed
6 it when they came to testify. The Society of State Foresters,
7 which are the public land forest management officers in the
8 different states, have endorsed it. There is no opposition to
9 the bill.

10 Senator Talmadge: Mr. Chairman.

11 The Chairman: Senator Talmadge.

12 Senator Talmadge: I very strongly support the bill. Of
13 course, the Committee on Agriculture and Forestry has
14 jurisdiction in general over forestry and agriculture. What
15 the Senator from Oregon has stated is true. He has not stated,
16 however, that this country is facing a timber shortage. We
17 have an oil shortage now. We have a shortage of many valuable
18 minerals now. More valuable minerals will be short in the
19 not-to-distant future.

20 The Committee on Agriculture and Forestry has worked
21 diligently in this field to try to see that we are not short
22 of timber. We have mandated, as the Senator from Oregon has
23 stated, reforestation on federal lands. It has not gone as
24 fast as we would like to see it go. It is a budgetary matter.
25 But we have accelerated the planting of trees on forest land.

1 We have passed a timber planting incentive program which was
2 originally sponsored by Senator Stennis of Mississippi, where
3 the government shares the cost with small private landowners
4 to plant trees. This would further aid in that effort.

5 The big problem about planting trees is it takes about 52
6 years. That is the life cycle of a pine tree in the
7 Southeast. It is probably greater than that in the Northeast
8 and probably greater than that in the Northwest. The Senator
9 from Oregon knows better about the Northwest than I do. I do
10 know what the situation is in the Southeast.

11 The only area of the United States now that is growing
12 timber faster than we are cutting it is the Southeast. We have
13 made enormous strides in that area in the last 25 or 30 years,
14 but we have not made the strides as fast as we should.

15 Now, Senator Packwood correctly stated it. A large
16 landowner in my area would be Union Camp and International
17 Paper. This wouldn't be of any benefit whatever to them. They
18 are not interested in reforesting 100 acres. It would be the
19 small landowner, the moderate-sized landowner. It will be of
20 tremendous help to him.

21 And it would be of tremendous help to the future of this
22 country in having available wood supply. Now, I think wood
23 offers short-range the greatest alternative source of energy
24 that we can possibly get. Wood can be not only made into
25 chips which can be used for energy, which is being done now in

1 many areas of the Southeast and other areas of the country,
2 but wood can be fermented and made into ethanol, and it is the
3 most competitive alternative source of energy price-wise that
4 we can get short-range.

5 In addition to that, it is the only alternative source
6 of energy in conjunction with biomass that we can have a plant
7 and be in it in a matter of months and start producing alcohol
8 that we could use in engines in this country instead of buying
9 the petroleum from OPEC.

10 Senator Packwood: I might say in the July 4th recess I
11 drove around in a methanol car driven by methanol made from
12 wood chips by Georgia Pacific.

13 Senator Talmadge: Georgia Tech is doing that now, and
14 they are producing alcohol, allowing amortization of the
15 plant, profit to the distributor, profit to the retailer, made
16 from wood at \$1.20 a gallon. Three dollar corn is \$1.32 a
17 gallon. But the beauty of our using these products of
18 biomass, such as agricultural products and wood, is that you
19 can get that plant into being in a matter of weeks or months.

20 When you are talking about shale and gasifying and
21 liquifying coal, you are talking about years in the future.
22 We have got to do all of these, but wood offers the best,
23 shortest alternative.

24 The Chairman: Now let's hear from the devil's advocate.
25 What does the Treasury think about this thing? Mr. Lubick.

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1 Mr. Lubick: Mr. Chairman, Senator Packwood did state
2 that there was no opposition. I guess that we cannot allow
3 that to happen, just lest you all get soft.

4 (Laughter.)

5 Mr. Lubick: He did point out one compelling argument
6 that I had not considered, which is the bill has 14
7 co-sponsors on the Finance Committee.

8 (Laughter.)

9 Mr. Lubick: He also pointed out that in light of our
10 proposal to enact a woodburning stove credit, that perhaps we
11 ought to encourage the production of the fuel for those
12 things. We did testify before Senator Byrd's committee and we
13 pointed out that there are already very substantial tax
14 subsidy positions for timber, and I think I will let Mr.
15 Sunley specify what some of them are for you briefly.

16 And there are other subsidies outside the tax system for
17 timber which we believe are adequate for reforestation, and
18 we will be very brief in stating the reasons.

19 We would also suggest that if the committee is disposed
20 for some reason to go along with those 14 members, that it
21 might be in order to amend the bill further to provide that if
22 the property is disposed of within a relatively short time,
23 that there ought to be a recapture to prevent the conversion
24 of ordinary income into capital gain.

25 It seems to me it ought to be subject to the provisions

1 of 1245. But let me call on Mr. Sunley to state some of the
2 benefits.

3 The Chairman: All right. Mr. Sunley.

4 Mr. Sunley: As you well know, in 1942 Congress
5 considered the timber capital gains provision. It was enacted
6 finally as part of the Revenue Act of 1944. At that time, the
7 timber industry had recommended expensing of reforestation
8 expenses and the capital gains treatment.

9 Since 1944, time and time again Congress has looked at
10 this issue of whether the reforestation expenses should be
11 written off as is the case of most of the costs incurred in
12 growing timber. It is my understanding that in the timber
13 growing business, the capital costs are essentially the costs
14 incurred in the first two years. After that point, most of
15 the costs are either written off over a very short period of
16 time or are expensed currently, although no income is
17 recognized for tax purposes until the trees are sold or
18 disposed of at some later date.

19 You can look at the current tax treatment of the timber
20 industry and break it down into sort of three pieces. First,
21 as is well known, they get capital gains treatment on their
22 income, whereas most products get ordinary income. And there
23 is a separate Code provision which provides that capital gains
24 treatment.

25 Second, as I said, most of the costs are currently

1 expensed in growing timber, except the reforestation costs are
2 capitalized. And third, as a result of this, since I am
3 writing off my costs against ordinary income, often the income
4 from logging, or later, manufacturing, I get a conversion of
5 ordinary income into capital gains.

6 In other words, the cost of producing this capital assets
7 are deductible, and they save your top marginal ordinary tax
8 rate, possibly 70 percent in the case of an individual. And
9 then when I later realize the gain, I pay tax, which is now
10 for an individual a top tax rate of 28 percent.

11 So an investment which is not profitable before taxes can
12 be made profitable after taxes as a result of these tax
13 subsidies. As you also know, in the case corporations -- and
14 this bill would not provide much benefit for corporations in
15 general -- but corporations also get some very special rules
16 under the minimum tax. They still get the full deduction for
17 their regular tax. They get the \$30,000 and they get the
18 carry-over rules which were removed from the other
19 corporations, in the case of the minimum tax on capital gains,
20 in 1976.

21 So it does seem to me that we ought to think carefully of
22 whether we want to further subsidize an industry which is
23 already, for its size, probably the best treated industry
24 under the Internal Revenue Code. But if we are going to move
25 in that direction, we really think that there ought to be

1 these recapture rules.

2 It is our understanding that S. 100 originally did
3 include recapture rules, but the version we have today does
4 not. It does seem inappropriate to take off deductions.

5 Senator Packwood: That is not changed in the bill.

6 Mr. Sunley: That is not changed.

7 Senator Packwood: No, that is still in the bill. What
8 you have is a list of changes, which I will explain in a
9 moment, but we have not changed the recapture provision.

10 Mr. Sunley: We would want to make sure that that was
11 still in the bill.

12 Senator Packwood: I will tell you the three changes I
13 have made. One is changing the deduction to the 10 percent
14 investment credit and the seven-year amortization, which
15 reduces the cost of the bill slightly and which, by general
16 consensus of everyone in the forest industry, small, big or
17 everyone else, would be a better incentive.

18 Two is a more specific definition of what reforestation
19 expenses are so we know what it applies to and what it does
20 not.

21 And three, I have deleted the appropriation for the trust
22 fund and instead have substituted an authorization for an
23 appropriation and a provision entitling the trust fund to the
24 appropriation, which treats it exactly the same way as revenue
25 sharing but avoids any fight therefor with the Appropriations

1 Committee. And they technically make the appropriations,
2 although it is an entitlement program.

3 The Chairman: Now that I have heard both sides of the
4 argument, could I be added as a co-sponsor of the bill?

5 (Laughter.)

6 Senator Packwood: I would be delighted to have the
7 chairman as a co-sponsor.

8 Senator Heinz: Mr. Chairman.

9 The Chairman: Yes, sir.

10 Senator Heinz: Do you think that we should give the
11 Treasury, in view of that, any more time?

12 Senator Talmadge: I want to make one more comment in
13 response to Mr. Sunley's argument. He is technically correct
14 in what he said, Mr. Chairman. When someone owns a piece of
15 paper with a stock certificate, he has to hold it only one
16 year and then he gets his capital gains. Meanwhile, he gets
17 his dividends during that one year. And the poor fellow who
18 plants these trees has to wait at least 15 years before he
19 gets one nickel in return.

20 Then, hopefully, if the insects don't eat up his trees
21 and if the storms and the tornadoes and the hurricanes and
22 things of that nature don't destroy his trees, and if a fire
23 doesn't get out and destroy his trees, he might get some
24 minimum return after 15 years.

25 But if he hopes to get a substantial return, in the

1 Southeast he has got to wait 52 years. So he would be an old,
2 old man at that time, probably planting the trees for his
3 children and grandchildren, and he cannot expect to get any
4 return during his lifetime. So that is what we are talking
5 about with this special treatment that Mr. Sunley addressed
6 himself to on the planting of trees.

7 Meanwhile, he is paying ad valorem taxes year after year
8 and squeezing the lifeblood out of him.

9 The Chairman: Meanwhile, the Treasury has had a chance to
10 get at him at the rate of 70 percent of his earnings.

11 (Laughing.)

12 Senator Heinz: Mr. Chairman, if Senator Talmadge
13 continues in this vein, tears will blind the eyes of every
14 member of the committee and the audience, and I suggest we
15 vote.

16 The Chairman: All in favor, say "aye."

17 (There was a chorus of "ayes.")

18 The Chairman: Opposed, "no."

19 (There was no response.)

20 The Chairman: The "ayes" have it.

21 Senator Stern: Is that a vote to order that bill
22 favorably reported even though it is a revenue bill, in the
23 same way you have done, say, on Senator Ribicoff's Child
24 Health Bill, to have it available?

25 Senator Packwood: To attach to a vehicle when they get

1 it.

2 Senator Stern: And then to be taken up at the
3 appropriate time. In other words, should we announce this as
4 the committee ordered favorably reported as 100 with
5 amendments?

6 Senator Packwood: That is what I would like to do, and
7 when we have an appropriate vehicle, we will attach it.

8 The Chairman: Why don't we say on there that we
9 understand that revenue bills must originate in the House and
10 that it is expected that this will be considered an amendment
11 to an appropriate revenue bill which has originated in the
12 House? I think we ought to add that to it just so there is no
13 doubt about it.

14 Senator Stern: We will say that in the press release.

15 The Chairman: So that there is no doubt that we are not
16 contending there is a constitutional problem involved.

17 Senator Heinz: Mr. Chairman, if that is disposed of.

18 The Chairman: Yes, sir?

19 Senator Heinz: At the appropriate time, I would like to
20 bring up an item for the consideration of the committee which
21 the staff is familiar with but which is not on the agenda
22 because it is fairly routine, I think, having to do with
23 Romanian MFN.

24 The Chairman: Do you want to bring it up? Go ahead.

25 Senator Heinz: Very briefly, Mr. Chairman, when Senator

1 Ribicoff, myself and the other members of the Subcommittee on
2 International Trade held a hearing on July 19th, we received a
3 considerable amount of testimony indicating that while
4 Romanian immigration to the United States and some other
5 nations have increased, immigration to Israel has declined and
6 procedures for immigrating are becoming increasingly complex
7 and subject to bureaucratic delay.

8 Accordingly, I propose to the committee that Senator
9 Ribicoff and I present to the full committee a statement for
10 adoption, and that the statement be transmitted to the
11 President noting the concerns expressed in the July 19th
12 hearing and indicating the committee intends to monitor the
13 situation most closely in the coming year, and that some
14 members of the committee expect to remain in close contact
15 with representatives of the Romanian Government as well as the
16 Department of State about the situation regarding freedom of
17 immigration.

18 It is proposed that the committee indicate its
19 expectation that the Department of State take a greater
20 initiative in monitoring, reporting on and making
21 representations regarding Romanian immigration as well as
22 initiate discussions with Romania intended to lead to more
23 specific assurances regarding immigration.

24 The statement itself, I believe -- Mike, do you also have
25 copies of the statement itself? The statement itself has been

1 looked over carefully by Senator Ribicoff's staff, by my staff
2 and myself and by just about everybody, and it is believed to
3 fulfill the intent of what we say. And I believe the State
4 Department feels it would be helpful to them in dealing with
5 this issue.

6 I know of no objection to the statement, and I hope that
7 the committee would see fit to adopt it and transmit it to the
8 President as suggested.

9 The Chairman: Do you want to talk about that, Mr.
10 Foster?

11 Mr. Foster: Mr. Chairman, as Senator Heinz indicated, I
12 would just point out that this letter would not affect the
13 most-favored-nation status of Romania, but in effect, it would
14 be an indication of the committee's continued interest in
15 freedom of immigration with respect to Romania, and, in
16 effect, a signal that next year there will be a very close
17 look taken at this again. That is all.

18 The Chairman: I had no prior notice that this matter was
19 going to be brought up. If there is no objection to it, it is
20 all right with me to vote on it. Do you want to vote on it?

21 Senator Danforth: All right, Mr. Chairman. As soon as
22 you finish with this --

23 The Chairman: I did not intend to have a session on
24 revenue bills. We did not have a notice of it, and we did not
25 agree to do that. Senator Packwood wanted to bring this

1 matter up and I agreed we would do that, but I haven't agreed
2 we would vote on all revenue measures.

3 Senator Heinz: Mr. Chairman, this is not a revenue
4 measure.

5 The Chairman: Does this have something to do with
6 Romania?

7 Senator Heinz: Jack, could you withhold until we get
8 this disposed of here?

9 Senator Danforth: Certainly.

10 The Chairman: I want to vote on this, but if we are going
11 to be asked to vote on first one and then another, of which we
12 were not aware we were going to be voting, I would have to
13 object. I am willing to vote on this but I am not willing to
14 go on other matters. If we can agree, we will vote on this
15 Romanian thing. Then we will not go to other matters other
16 than the windfall. I don't want to get into other things this
17 morning.

18 Senator Danforth: Mr. Chairman.

19 The Chairman: Yes?

20 Senator Danforth: Mine is a similar matter relating to
21 Hungary, and it is not suggesting anything pertaining to
22 legislation; only that the committee write a letter to the
23 Department of Commerce.

24 The Chairman: Okay.

25 Mr. Foster: Mr. Chairman.

1 Senator Danforth: And it would take half a minute to
2 dispose of.

3 The Chairman: Can we agree that that is all we are going
4 to do other than windfall?

5 Without objection, then, all in favor, say "aye."
6 (There was a chorus of "ayes.")

7 The Chairman: Opposed, "no."
8 (There was no response.)

9 The Chairman: All right. Mr. Danforth.

10 Senator Heinz: Thank you, Mr. Chairman.

11 Senator Danforth: In connection with hearings on
12 most-favored-nation status, testimony was presented with
13 respect to certain pirating of patents in Hungary, especially
14 patents relating to agricultural chemicals.

15 Therefore, the proposal now, and I think Dave Foster is
16 familiar with it, that the committee request by letter that
17 the Department of Commerce monitor for the next three months
18 activities by Hungarian firms and agencies with respect to
19 carrying out the Minute agreed to in the Hungarian-U.S. Ad Hoc
20 Working Group on Trade Facilitation.

21 This monitoring would include actions on pending
22 applications of U.S. firms for Hungarian patents, and actions
23 taken to not violate industrial property rights of U.S. firms
24 in third countries.

25 Senator Heinz: Mr. Chairman. Will you yield? I just

1 want to say something about Senator Danforth's statement.

2 The Chairman: Mr. Foster, do you want to talk about it?

3 Mr. Foster: Mr. Chairman, this is simply a question of a
4 problem which has been a continual problem with Hungary over
5 the last several years on the protection of U.S. patent
6 rights. There has been difficulty in resolving these issues.

7 What Senator Danforth is proposing is a letter that asks
8 the Department of Commerce to monitor this closely and come
9 back to the committee with a report in about three months on
10 the status of these disputes and on how well the Hungarian
11 Government and its agencies and firms are carrying out an
12 agreement they have entered into with the United States.

13 The Chairman: Is this a problem involving drug
14 manufacturers?

15 Mr. Foster: No. Basically, it involves agricultural
16 chemical manufacturers and their patent rights and their
17 industrial property rights. Essentially what has happened is
18 Hungary has its firms producing these products which were
19 developed by American firms, selling them within Hungary but
20 also selling them in third country markets without the
21 permission of the U.S. firms, and perhaps in violation of
22 these firms' patent rights.

23 That is the purpose of the monitoring, to see what
24 is going on, what Hungary will do about this and how the
25 dispute is being handled.

1 The Chairman: Any objection?

2 (There was no response.)

3 The Chairman: Without objection, agreed.

4 Senator Heinz: Mr. Chairman, may I just be heard? I
5 have no objection, but there is something I would like to
6 state for the record.

7 First, I want to commend Jack Danforth for this, and I
8 particularly want to bring to the attention of the committee
9 that the Hungarians really are being egregious and not acting
10 in good faith.

11 There was an agreed Minute on June 11th. There have been
12 meetings with the Hungarians since then as a result of which
13 one of our American companies has been told by the Hungarian
14 chemical company and representatives of the Hungarian
15 Government that if they will buy the production of these
16 Hungarian plants which are operating illegally -- at least
17 they would if they observed international patent law -- if
18 they would buy a very substantial quantity of the particular
19 chemical, in this case Furidan, then the Hungarians would be
20 law abiding.

21 I think that is nothing less than blackmail. It makes me
22 feel very reluctant, Mr. Chairman, to continue MFN with a
23 country that steals American patents and then, having agreed
24 to not steal them further, tries to coerce our American
25 companies into an arrangement which is clearly not consistent

1 with the Minute Number 4 of June 11th.

2 So I think Senator Danforth's action is the mildest that
3 we ought to take. I don't think it would be the end of the
4 world if Hungarians ended up without MFN, and I don't care who
5 knows that I feel that way, too.

6 Senator Danforth: I have already stated, Mr. Chairman,
7 my position, which is identical to Senator Heinz's on this
8 matter. Attempts have been made to negotiate in good faith
9 with Hungary. Nothing has come of it.

10 We are dealing in this matter not only with a source of
11 income from American exports and with a \$30 billion a year
12 trade deficit. I don't think we can be in a position of having
13 this kind of advantage taken of American industry too many
14 times. But also we are dealing with an area, namely,
15 agriculture, using American technology to increase
16 agricultural production where we really have something to
17 offer to the rest of the world.

18 If we want American know-how in agriculture to be made
19 available to developing countries, I think the least we can do
20 is say that our innovations in this country are not going to
21 be pirated by Hungary or anyone else.

22 The Chairman: Fine. That is taken care of. Now let's get
23 on to the windfall tax.

24 You were showing us a chart to show how the windfall tax
25 worked out. I think that was somewhat helpful. Mr. Lubick.

1 Mr. Lubick: Yes, sir. Yesterday at the end of the
2 session, Senator Danforth and I engaged in a colloquy, perhaps
3 rather an intense, searching cross-examination. I must
4 confess he caught me a bit unprepared. Since that time, we
5 have gotten some further material together to deal with those
6 significant questions which he raised, and we are continuing a
7 dialogue with him.

8 But I thought it might be appropriate if I could have a
9 couple of minutes just to go over that question because he did
10 raise what I think is an important question and I think there
11 is some misconception of some of the numbers that have been
12 used here.

13 The Chairman: Go ahead.

14 Mr. Lubick: The question was: Taking the increase in the
15 general corporate income taxes which arise as a result of
16 decontrol, those income taxes paid by oil producers and
17 royalty holders, isn't that enough to fund this entire program
18 and therefore there is no need for any separate windfall
19 profits tax?

20 We have a little paper here that Mr. Sunley has prepared
21 that we might distribute to you, and we will continue to work
22 on this general problem. But in brief, the figures which were
23 referred to as the increased income taxes paid by oil
24 producers and royalty holders are not the whole story.

25 As Mr. Wetzler mentioned yesterday, there are significant

1 offsets to it. I have for purposes of illustration some
2 figures on a different assumption from the 173 we referred to,
3 and I am not sure that the assumption is so significant as the
4 concept.

5 We have figures showing that oil producers and royalty
6 holders, on the assumption of no real OPEC increases, will pay
7 \$138 billion of increased income taxes through 1990, but that
8 does not mean that the federal income taxes are going to
9 increase by that amount. First of all, if individuals and
10 other users of energy pay more for oil, they necessarily have
11 to pay less for other things. So the increased income of oil
12 producers is to a great extent offset by reduced income of the
13 producers of other goods and services.

14 We have run the impact of decontrol using macroeconomic
15 models, and our simulations suggest that decontrol will lead
16 to somewhat higher inflation, somewhat lower growth, and the
17 figures are cited in this memo.

18 The net effect is a small increase in nominal GNP, but
19 that is much less than the increase in income to the producers
20 and royalty holders. So the net increase in income taxes paid
21 as a result of decontrol on the assumption of no real OPEC
22 increase and some of these other macroassumptions is only \$52
23 billion, which is \$86 billion less than the \$138 billion
24 increase paid by the producers and royalty holders.

25 On the other hand, when the windfall profit tax is in

1 place, if you look in the last paragraph of the handout, you
2 see that the increase in producers' income tax through 1990
3 because of the offset to the windfall profits tax is \$67
4 billion, and the gross windfall profits tax on that assumption
5 would be \$166 billion.

6 We have offsetting reductions from changes in prices and
7 economic growth coming to \$84 billion, so we have a total
8 change in liability over the period of about \$150 billion. I
9 think what this shows is that the income tax revenues are
10 rather an insubstantial and unreliable base on which to build
11 a foundation for the particular programs that we have been
12 proposing and that I think are a question of separate
13 discussion.

14 But the purpose of the tax is to do two things. It is to
15 provide a ready source of funding which I do not believe the
16 income taxes can provide; and second, there is also a question
17 of equity here, which is that as a result of decontrol, the
18 basic concept is that there are windfalls which have accrued
19 to the benefit of the holders of existing supplies of oil.
20 And to some extent in the future there may be further
21 windfalls.

22 Again, this gets into the cartel question we touched on
23 briefly. As a result of that, the windfall profit tax is
24 necessary to do some equity because those who benefit from
25 these windfalls ought to finance some of this development of

1 these alternative sources of revenue.

2 There are two questions. Is the revenue the assured
3 source of revenue? And the other is the equity argument.

4 The Chairman: Let's just deal with that for a second.
5 Now, what offends a lot of people, and it is going to be more
6 and more irritating as time goes by, is this suggestion that
7 there is some unconscionable profit being made here. Here is
8 a product in short supply. The government can take full
9 credit for that.

10 The government put 50 percent of the oil producers out of
11 the business during a 17-year period by electing not to
12 enforce that defense amendment to the Trade Act the way it was
13 intended when that became law.

14 So to hold the price, they used foreign oil. It made
15 this nation a nation at the mercy of that cartel by trade
16 policies contrary to the intent of Congress when we passed
17 that defense amendment.

18 Now, the Arabs then proceeded to raise that price and put
19 this nation on its knees for energy. At that point, then, the
20 price controls were placed on the companies and the producers
21 to keep them from getting the same price the Arabs were
22 getting.

23 Now, Texaco has been advertising that on one dollar of
24 sales of products, or about a dollar, for a gallon of products
25 they are making less than 2 cents profit on a gallon on

1 product. And the price is approaching about \$1 now. They have
2 been advertising that, and I assume that that is correct.

3 Now, I cannot recall exactly what the figure was, but
4 Exxon, you know, big, old, bad Exxon, that is where the Longs
5 came in business, fighting that company. We did pretty well
6 fighting that company. We made a success in politics, if we
7 couldn't make a success in business, fighting them.

8 They advertise that they are making 4 cents or 5 cents
9 profit on a gallon of product produced from petroleum in their
10 case. Now, are you in a position to tell us that that is an
11 unconscionable profit? My impression is that Sears makes
12 about 3 cents profit on volume, and Sears is about 3 percent,
13 about 3 cents on the dollar, maybe a little less. Around
14 3 cents. And Sears doesn't produce much. They produce a few
15 things, but most of that stuff is stuff that they are just
16 retailing for somebody.

17 The Washington Post is making 10 cents on the dollar.
18 Are you in a position to tell us that that is an
19 unconscionable gain?

20 Mr. Lubick: I am not sure that I can define what is
21 conscionable or unconscionable or where one would draw the
22 line. I think the objective of a corporation in business, and
23 properly so, is to maximize its profits. That is what I
24 always tried to do when I was representing companies.

25 On the other hand, I think the recent figures which show

1 oil company profits show that indeed they have a vastly
2 improved situation.

3 Mr. Sunley prepared a paper for you and testified before
4 this committee on what the profit situation was of the oil
5 companies, and certainly the figures that have been released
6 in the last few days, as well as those for the previous
7 quarter, indicate that indeed, the picture has turned around.
8 One can anticipate that as a result of decontrol, which is
9 part of this whole program -- we went ahead, we recommended
10 decontrol immediately in order to make the position of the
11 producers more profitable so they would have a greater
12 incentive to explore and to invest in energy, and that is a
13 part of the program which cannot be divorced from the tax that
14 is proposed here.

15 But as a result of that, there are very large amounts of
16 revenues that are going to accrue to the producers. And it is
17 only fair that since there are going to be a large number of
18 costs imposed on the users, that some of that revenue be
19 dedicated to developing the alternative sources of supply.

20 Senator Danforth: Mr. Chairman.

21 The Chairman: Mr. Lubick, I am going to vote for the tax
22 unless someone talks me out of it, like you, for example.

23 (Laughter.)

24 The Chairman: But I just think that we ought to look at
25 this thing on a fair, sensible basis, and we ought to relate

1 it to our objectives. And frankly, since the day we found
2 ourselves in a disastrous situation in 1973, I believe it was,
3 from that point forward I would think that any logical course
4 for government would be to say that those who are producing
5 energy in the energy-producing area should be making
6 substantially more profits than the average for all
7 manufacturing.

8 If they are not, then it is hard to see why capital would
9 be flowing into this industry. You would think it would be
10 flowing away from the industry. I believe the reports we were
11 getting in the early stages indicated that it took some time
12 to get it up to that point. I assume that now it is. But my
13 thought is the profits in this industry for the producers
14 ought to be substantially above the average for manufacturing.
15 Otherwise, why would you expect people to put their money into
16 it?

17 Senator Danforth: Mr. Chairman.

18 The Chairman: Yes, Mr. Danforth.

19 Senator Danforth: Mr. Chairman, granted, taxation is
20 more of an art than a science, but it seems to me that before
21 we pass a tax, we should have at least some ballpark notion of
22 how much revenue we are raising and what we are going to use
23 it for. I don't think that that is an unreasonable request to
24 make.

25 Now, the President tells us that we should be raising

1 \$142.5 billion by 1990 for the administration's energy
2 program. I don't know if that is a sensible energy program or
3 not. But let us assume for the sake of discussion that it is
4 and that we should be raising an additional \$142.5 billion to
5 finance the administration's energy program.

6 Now to review the bidding. Here is where we were
7 yesterday. Yesterday it was disclosed that by 1990, without
8 any windfall profits tax at all, additional federal revenues
9 by virtue of decontrol from income taxation and from
10 additional royalties would be \$173 billion. That is \$30.5
11 billion more than necessary to finance the President's
12 program.

13 Secondly, it was disclosed that over and above additional
14 revenues raised by income taxation and royalties, \$105 billion
15 would be raised by 1990 by a windfall tax, or a total
16 additional federal revenue of \$278 billion by 1990, \$278
17 billion of additional revenue to finance a \$142.5 billion
18 program, or \$135.5 billion additional revenue which has not
19 been accounted for.

20 Unfortunately, the Missouri press reported that I am now
21 against the windfall profits tax. I am not, necessarily. All
22 I am saying is I am not going to buy a pig in the poke and I
23 want to find out what the additional revenue is to be used
24 for.

25 Now, suddenly Treasury comes before us and says: Wait a

1 second. In the last 24 hours we have discovered that this
2 \$278 billion is inaccurate and that it is not \$278 billion
3 additional revenue but \$150 billion. Now, somehow we have
4 come up with a difference of opinion, in 24 hours, of \$128
5 billion. Even in Washington, that is a substantial sum of
6 money.

7 (Laughter.)

8 Senator Danforth: So, what I would like to do is to get
9 the best available thinking. As I understand it, Treasury's
10 assumption is that there is going to be no OPEC price increase
11 between now and 1990 other than inflation. That is the number
12 one assumption that Treasury has.

13 Mr. Lubick: That is the assumption on which that \$138 is
14 based. You can do it and should do it, presumably, on varying
15 assumptions. But what we are saying is that the numbers that
16 you come out with turn on the assumptions that go in. But we
17 are not saying that there will be none. I think we should
18 give you the figures on that.

19 Jim, was the \$173 billion based upon a 1 percent growth?

20 Mr. Wetzler: (Nods affirmatively.)

21 Mr. Lubick: There are figures based on 1 percent, there
22 are figures based on 2.5 percent, and we will show you the
23 figures based on each of those assumptions.

24 Senator Danforth: Here is what I would like, really. I
25 would like Treasury's estimate, the Joint Committee's estimate,

1 whoever else wants to give an estimate, as to total net gain
2 of federal revenues from income taxation and from royalties by
3 virtue of decontrol.

4 Then the second thing I would like is over and above
5 that, how much would a windfall profits tax produce?

6 Mr. Wetzler: We have given you our estimate of that,
7 which is the \$278 billion. I think the question is what other
8 claims on that \$278 billion are there other than the synfuels
9 program and the rest of the energy program?

10 Mr. Lubick: Wait. Isn't it crucial that the \$278
11 billion includes \$173 billion increase in producers' income
12 taxes, not increases in income taxes to the Treasury. That, I
13 think, is a crucial distinction. The question is: As a result
14 of decontrol, what will be the increase? I think that is what
15 Senator Danforth asked for, what would be the increase in
16 income taxes generated, giving effect to the increased taxes
17 paid by the producers, the reductions in receipts to the
18 Treasury for any other reason throughout the economy?

19 And the figures all along, I believe, stated the \$173
20 billion or the \$138 billion or whatever the equivalent is in
21 any assumption was referring only to the increase in income
22 taxes paid by the producers. It did not purport to be the net
23 increase in income taxes arising from decontrol to the
24 Treasury.

25 Senator Danforth: What is the Joint Committee's response

1 to that?

2 Mr. Wetzler: Well, I don't want to get into to much of an
3 argument. I am a little bemused by some of the number games
4 that are being played by both sides on this windfall. I
5 think, Senator Danforth, that the committee ought to try to
6 avoid projecting out for the next 11 years the entire federal
7 budget in trying to make a decision on windfall profits.

8 Senator Danforth: Jim, I don't want the federal budget.
9 I don't want any claims on it. I want to know how much
10 revenue is being produced. Then, after we get the best
11 estimate we can on how much revenue is going to be produced, I
12 would like the administration to commit itself on how it is
13 going to spend that additional revenue. That is all I am
14 asking for.

15 That, to me, is a policy decision. If we are going to
16 have x amount of additional revenue, and if \$142.5 billion is
17 to be spent for the President's energy program, then if there
18 is some amount left over, what are the claims on it? Is it
19 going to be used for a tax cut, which I advocate, or is it
20 going to be used for additional federal office buildings, more
21 sidewalk, new sidewalks around the Capitol complex? What are
22 we going to use the money for? That is a different question.

23 Mr. Wetzler: I think one point the Treasury is making is
24 that while it is true that decontrol raises profits of oil
25 producers and royalty owners, some businesses will lose from

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1 decontrol. There are a number of businesses which may, and it
2 is unclear to what extent this is occurring, which may be
3 actually profiting from decontrol.

4 People may argue, for example, that oil refiners receive
5 benefits from decontrol through the entitlements program. To
6 the extent that producers make additional profits but refiners
7 make lower profit, then you have to have an offsetting
8 subtraction from your income tax revenue.

9 We have looked into this problem in some detail, and we
10 have ended up concluding that we don't know, that probably
11 something less than 100 percent of the revenues from decontrol
12 will lead to additional income of businesses. But we are not
13 sure how much less than 100, and we don't know anyone who
14 really has been able to give us any
15 scientifically-based estimates to help us out.

16 I think that is the point that Mr. Lubick is making. But
17 I think as a working assumption, I think in other figures the
18 administration has assumed that 100 percent of decontrol is
19 passed on as higher producer and royalty holder profits. It
20 may be worthwhile to change that assumption, but that is what
21 we have been assuming to date.

22 Senator Danforth: Whatever assumptions we want to make,
23 all I would like to know is the estimated additional federal
24 tax revenues, income tax revenues, royalty revenues, and then
25 on top of that, windfall profits tax revenues. And as I

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1 understand it, your best judgment is that if there is a 1
2 percent increase of OPEC prices over and above the cost of
3 living increase, then the total increased federal revenue
4 would be about \$278 billion. Is that right?

5 Mr. Wetzler: That is right, over an eleven-year period.

6 Mr. Sunley: Would you yield?

7 Senator Heinz: I have been listening carefully to what
8 the Treasury was trying to say, which is that in some way, the
9 net revenues to the Federal Government of \$173 billion from
10 oil producer income taxes and royalties was overstated because
11 there might be some downstream -- it is not overstated? You
12 agree with the \$173 billion?

13 Mr. Lubick: The \$173 billion is the additional taxes in
14 the absence of a windfall profits tax, the additional income
15 taxes which would be paid by one segment of the economy. It
16 does not purport to be the net increase in taxes to the
17 Treasury.

18 Senator Heinz: That is exactly what I said.

19 Mr. Lubick: Then we agree.

20 Senator Heinz: You believe the \$173 billion represented
21 an overstatement of the net Treasury revenues from all sectors
22 of the economy.

23 Mr. Lubick: Right.

24 Senator Heinz: If you are going to attempt to reduce
25 that number by looking at, let's say, the refiners or the

1 gasoline dealers, well and good. There is nothing wrong with
2 doing that. But I would suggest at the same time that you
3 look at the increase in personal income taxes that is going to
4 be generated by the inflationary consequences of decontrol,
5 which are going to be very substantial.

6 Not only does it result, with everybody being on a cost
7 of living increase, practically speaking in our society, in
8 more revenue simply because of the cost of living increases
9 that will take place, but also, as we all know, as people move
10 up to those higher brackets, you the Treasury will benefit
11 even more.

12 So if you are going to make a net calculation, don't just
13 look narrowly at the oil industry side. I am convinced you
14 will find the net result of decontrol, if you look at this, is
15 going to be far more than \$173 billion just looking at the oil
16 producers and the royalties and personal income taxes and any
17 other taxes you want to define.

18 I think the Treasury is going to have a bonanza.

19 Senator Bentsen: Mr. Chairman.

20 Senator Heinz: Just as the American people are going
21 to reap a bonanza of inflation.

22 The Chairman: I would call Mr. Bentsen next and then Mr.
23 Roth.

24 Senator Bentsen: Mr. Chairman, there is no question but
25 what the estimates of the revenue to the Treasury are very

1 much on the low side. The OPEC countries are obviously going
 2 to increase prices faster than the projections that were used.
 3 They are already talking about having an additional meeting.
 4 They have a meeting scheduled for December in Caracas to talk
 5 about price increases, and maybe an interim one in the
 6 meantime.

7 My concern is the tax being a disincentive to find new
 8 oil and gas and raising it to a point where we have a
 9 diminishing return in finding new energy. I am concerned that
 10 the President is facing us with a Hobson's choice. Either we
 11 have synthetic fuel or we find new oil and gas.

12 I don't think we have to have that kind of a choice. I
 13 think we can do both. But I do believe you are seeing a
 14 disincentive unless we bring about some of these exemptions. I
 15 am very much disturbed over the President's answer at his
 16 press conference to a reporter. Barbara Strong asked the
 17 question of him concerning an exemption I had proposed, and
 18 this is his answer.

19 I frankly could not believe it when I heard it, but I got
 20 it word for word. As she asked about the exemption I
 21 proposed, he said: "But if these exemptions are made, it will
 22 be a grant of \$54 billion to the oil companies on top of
 23 greatly increased income to the oil company by phased
 24 decontrol."

25 Now get this. Then he said: And they will be able to

1 spend these new revenues which they have not earned in order
2 to increase production of oil and gas in our own country.

3 What is wrong with that?

4 (Laughter.)

5 So what you describe is a great threat to the very
6 program that is important to me and to the country."

7 Mr. Chairman. Mr. Lubick, can you explain that to me?

8 You know, Mr. Lubick, I think finding a barrel of real oil and
9 gas without serious disruption to the environment is just as
10 important to the country as a synthetic barrel of oil and gas
11 with all the environmental concerns attached to that. So if
12 you put on this tax, and it means then they don't spend that
13 money to find that oil and gas, why is that so much better?

14 The President himself says they are going to take that
15 money and go out and find more oil and gas, and that concerns
16 him.

17 Mr. Lubick: Senator, I did not read the particular
18 statement of the President, but when we sat down and designed
19 the program, it was our program.

20 Senator Bentsen: You did not design that statement, did
21 you?

22 Mr. Lubick: No, sir. When we sat down to design the
23 program, we were very concerned about preserving incentives to
24 increase supply and exploration, and we tried to draw the line
25 to walk a tight line between capturing the windfalls, to put

1 it in a shorthand way, and to preserve the incentives to
2 supply. And it has been our purpose in designing the tax to
3 lean, in cases of doubt, in favor of preserving the incentive.
4 For that reason, we proposed both a rated tax and decline
5 curves and so on in such a way that there would be the maximum
6 incentive consistent with increasing supplies.

7 Senator Bentsen: Let me ask you. Do you agree with the
8 President of the United States in his statement that that
9 would be bad for the country if they spent that additional
10 revenue to go out and increase the production of oil and gas
11 in our own country? Do you agree with the President?

12 Mr. Lubick: I agree with the President of the United
13 States, but I am not familiar with that statement. The
14 President wants the companies to invest and to explore for
15 domestic supplies of oil and gas, and he has so stated. And,
16 as a matter of fact, he has made legislative proposals to
17 assure that will take place.

18 So I am sorry. I will look at the statement.

19 Senator Bentsen: This is a newspaper called the New York
20 Times, and it is a verbatim quote of the questions and answers
21 at the President's press conference.

22 Mr. Lubick: I will take a look at that.

23 The Chairman: Mr. Roth.

24 Senator Roth: Mr. Chairman, one of my concerns is that in
25 looking at the windfall tax and the energy package, that we

1 cannot separate it from the general status of the economy as a
2 whole. And to carry a little further what Senator Heinz said
3 about taxes, I would just like to point out, and I would
4 request that we get up-to-date figures on all areas of
5 increased revenue to the government.

6 Now, I understand, according to the Joint Committee on
7 Taxation, and this is a memo dated August 2nd, that right now
8 the American people are facing tax increases of roughly \$50
9 billion by 1981. According to this Joint Committee on Taxation
10 paper, in 1980 the American people will be paying increased
11 income taxes in this calendar year of \$15.6 billion.

12 In 1981, due to inflation, it will be \$32.9 billion. I
13 would also point out that Social Security tax increases those
14 two years will increase \$80.6 billion, and \$14.7 billion in
15 1981.

16 Mr. Chairman, I have a specific request. I think that
17 when we return in early September, it is important that we
18 get guesstimates, if you want to call them that, not only by
19 the Treasury but by the Joint Committee on Taxation and CBO as
20 to what is going to be the increased revenue to the Federal
21 Government through 1990.

22 Senator Danforth has already spelled out with great
23 precision the problems with respect to increased taxes
24 resulting from decontrol, as well as the windfall profits tax.
25 But in addition, I think we need to have figures showing how

1 much additional revenue is going to be raised from the
2 increase in Social Security year by year, what will be the
3 increase by inflation, because I think when we act in
4 September, we cannot only look at it from the standpoint of
5 energy and the impact on that, but we have to look at the
6 impact on the economy as a whole.

7 So I would request that we secure this information as to
8 additional revenue from all of these different factors:
9 inflation, increases in Social Security, decontrol, windfall,
10 from these various sources so that we would have some basis
11 upon which to work.

12 The Chairman: We can ask the Joint Tax Committee to get
13 that information for us.

14 Mr. Wallop.

15 Senator Wallop: Thank you, Mr. Chairman.

16 Mr. Lubick, I want to deal just briefly with your equity
17 argument to see if we can't describe it. You were calling our
18 attention to the profit statements of the oil companies in
19 this last quarter. I think it is fair to say that those
20 profits that you called attention to will not be taxed by the
21 President's proposal.

22 Those are primarily profits on foreign crude. In fact,
23 the enemy, as the President has designated OPEC countries. It
24 is a tax on domestic production, but strangely enough, we do
25 not attack the enemy.

1 Mr. Lubick: They do not reflect decontrol, that is
2 correct.

3 Mr. Wallop: They do not. They reflect solely foreign
4 operations. As a matter of fact, we have been doing within
5 our office some investigation of the profitability of domestic
6 production, and it would appear that at this moment in time it
7 is still down, that it has not had any of the increase of
8 which you speak.

9 I think it is unfair in terms of equity because you are,
10 in fact, favoring those who broker enemy oil to the exclusion
11 of the domestic producer. And that is not equity. It may be
12 in the minds of demagoguing the American people, thinking that
13 somehow or another we are going to capture these mean bastards
14 out there who are trying to devise this insidious plot to make
15 everybody miserable, but it is not the truth.

16 And I just wish that we could get out of making those
17 kinds of statements and tell the truth about this thing. Then
18 maybe we could get a rational argument going and even perhaps
19 engage the oil and energy companies in some kind of a way of
20 some kind of joint endeavor to get us out of this problem.

21 But I just don't think it serves the purpose to describe
22 this as a question of equity when the thing you mentioned as
23 justifying the equity is not going to be touched.

24 Mr. Lubick: I don't think that was my justification for
25 the equity. I did not mean it to be. The justification for

1 the equity, I think, is the anticipation that very large
2 revenues and profits will inure to domestic production.

3 Mr. Wallop: But then don't call attention to the profits
4 that have inured as being the indicator by which the American
5 public can make that judgment, because it is not truthful.
6 You know, people are writing editorials every day calling
7 attention, and you see it on the evening news and everything
8 else, to the very kind of thing you are talking about. And it
9 will not be taxed.

10 We still retain the attractiveness of brokering and
11 dealing in foreign oil at the expense of domestic production
12 with the President's proposal.

13 Mr. Lubick: But decontrol should go a long way toward
14 redressing that imbalance.

15 Mr. Wallop: To the extent that anyone retains any. You
16 were talking about in your proposal that the President opted
17 in every instance in designing this for production. I just
18 want to read the statement. It says: "To prevent the tax from
19 burdening high cost properties, the bill also limits the
20 windfall profits subject to tax to 100 percent of the net
21 income of the property."

22 Now, I cannot for the life of me conceive of the
23 incentive in that.

24 Mr. Lubick: Basically, Senator Wallop, you are dealing
25 with a very exceptional situation. When you deal essentially

1 with old oil and upper tier oil, the prices without
2 significant increases in cost to produce that oil are going to
3 rise as a result of decontrol, in the case of the first
4 year, from \$6 on up, eventually to the world price.

5 In the case you are talking about when you cite the \$100
6 percent limit, it is dealing with the unusual case where the
7 well has about run down. But by and large, oil in tier one
8 and tier two is going to receive the world price, very large
9 increases in revenues and profits. And the tax is designed to
10 capture that.

11 The decline curves that we proposed are set in relation
12 to historical production so that there is every incentive to
13 produce additional barrels of oil from those wells without
14 them being subject to the tier one or tier two tax. And the
15 base price with respect to tier three is set at what was the
16 world price very recently adjusted for inflation.

17 So again, the purpose is to allow the producers to
18 receive world price revenues to equate the replacement cost of
19 oil, domestic or imported, with the price received. And that
20 should be a tremendous incentive to production.

21 Senator Wallop: To the extent that you do not have to
22 spend 100 percent of the property's income. It is typical.
23 But I will just make a comment, and perhaps you would care to
24 respond. My guess is the windfall profits tax was designed as
25 a political solution to passify the outrage that came with

1 decontrol; that the money, in fact, to produce the rest of
2 that program would have and probably still does exist in the
3 regular taxing mechanisms of the country.

4 Mr. Lubick: Well, it is true that one could maintain
5 general taxation at a given level, as Senator Danforth's
6 inquiry points out as well. But inasmuch as the decontrol is
7 going to provide this immediate special unforeseen source of
8 revenue to a given segment of industry which will profit
9 especially, it does seem that there is some special equity in
10 imposing a tax on those profits to pay for these programs.

11 Now, to that extent, to the extent that there is -- and
12 this is what we are trying to establish for Senator Danforth
13 -- to the extent there is some surplus, if there is any, and I
14 think we have got to try to establish that, then I think we
15 have to determine whether an income tax reduction is an order
16 of general applicability.

17 It is my understanding, and Mr. Sunley can verify this,
18 that the budget document which we are operating on includes
19 the effect of decontrol in all of the calculations. If you
20 want to look at the size of the federal deficit and the level
21 of taxation, it takes into account for the years which the
22 budget document is prepared the impact of decontrol. It does
23 not go out to 1990.

24 Senator Wallop: If you really are after these unforeseen
25 profits, why does the program designed by the President

1 maintain the attractiveness of the enemy's oil? Why doesn't
2 it seek to tax the unforeseen profit in sudden OPEC rises
3 while your ship is going across the sea? That is the kind of
4 thing you are using as an example to the American people as
5 what it will do, and yet it is not going to do that.

6 Why wouldn't it really be responsible, if you are going
7 to try to create a conservation ethic and pay for some of
8 these things, to attack consumption and not production? Then
9 you would get it all.

10 Mr. Lubick: Decontrol is a tax on consumption. It
11 raises the cost of it. Therefore, one of the significant
12 aspects of decontrol is that energy is going to cost the world
13 price. To the extent that you have decontrol, you will have --

14 Senator Wallop: But as a matter of equity, it is only on
15 our own domestic investors and producers, not those who deal
16 in foreign oil.

17 Mr. Lubick: No, because we have been offsetting, in
18 effect subsidizing, by keeping prices down in domestic
19 production. We have been, in effect, subsidizing the cost of
20 imported oil, and that will be eliminated by decontrol. So
21 that the cost of energy is now going to be the world price,
22 the market price, and that should have very significant
23 conservation effects.

24 Senator Wallop: But Arab oil is still a better buy, and
25 I will let it go at that.

1 Mr. Lubick: We also, incidentally I might point out,
 2 have a proposal made by the President with respect to income
 3 earned by the oil companies from foreign countries to close
 4 some of the escape hatches by which the foreign tax credit was
 5 allowed to shelter other types of income.

6 Senator Wallop: I might say in my opinion that is an
 7 equally ham-handed approach, but I guess we will deal with
 8 that when we get in.

9 Thank you.

10 The Chairman: I have myself marked down here because I
 11 want to have a turn at discussing this matter for a moment. I
 12 would hope, Mr. Lubick, that with the job you have, you will
 13 help to carry on a two-way conversation between the committee
 14 and the President of the United States. You are his chief tax
 15 advisor down there and I would hope that you will help to work
 16 out something where he communicates with us and we communicate
 17 with him.

18 Now, I think I have an idea about how much the President
 19 knows about the oil and gas industry.
 20 (Laughter.)

21 The Chairman: It was my privilege to go with the
 22 President out on a drilling rig. It was what we call a
 23 semi-submersible, and I might say at that particular time I
 24 didn't know what a semi-submersible was. And I suspect that he
 25 doesn't know what a semi-submersible is now. But at least the

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1 two of us went out on a semi-submersible and we saw them
2 drilling a well out there.

3 It turned out to be a dry hole, unfortunately, but we
4 both learned something. I learned a lot and he learned a lot.
5 And some of us went down because I thought it would be better
6 to learn more. And incidentally, if you have never been on one
7 of these off-shore drilling platforms --

8 Mr. Lubick: I was with you, Senator.

9 The Chairman: Oh, that is right, you were there. Well,
10 in my judgment at this point, Mr. Lubick, you know more about
11 that than the President does because you have not only been on
12 the most expensive drilling platform in the world, which is
13 taller than the Empire State Building, but you have also been
14 on a drilling ship, have you not?

15 Mr. Lubick: I have been on both and I was very, very
16 impressed. It was a fantastic engineering achievement.

17 The Chairman: And the President has not been on a
18 drilling ship. So you know more about it than he does at this
19 moment. And here is the point I am trying to get to.

20 Now, it seems to me, Mr. Lubick, that you and the
21 President and perhaps me have very much a vested interest in
22 getting something done in this matter, and we have an interest
23 in getting something done before the year 1990. If we have
24 people standing in line at this time next year, I think that
25 that is going to be very bad for the President. It might be

1 disastrous even for me, even though I can explain that I did
2 not plan it that way.

3 (Laughter.)

4 The Chairman: It is to our advantage to get some
5 production between now and the next election if we can.

6 I want to put this letter in the record. Here is what
7 Mr. Edwin Cohen sent to us to show us, assuming you want a
8 person to put money back in the ground and you had to do it
9 out of cash flow, and I think a lot of independents would
10 have to do it. You will see that. I will provide it. I
11 will ask this correspondence appear in the record to
12 illustrate the point.

13 (The letter referred to follows:)

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1 The Chairman: You see, there (indicating) is an
2 illustration of how it would work out on this blackboard on
3 the left if you had \$100 of additional income, one with no
4 windfall tax and the other with the windfall tax in the event
5 that that person were anxious to put back in the ground every
6 additional penny he could make to try to provide more energy.

7 Now, if you had no windfall tax, he could put \$31.90 into
8 intangible drilling costs, and then he could put \$31.90 into
9 tangible drilling costs. You have an asterisk there because
10 ordinarily the tangibles are about 70 percent and the
11 intangibles are about 30. But he is assuming you would have a
12 cost of a lease and some geological and geophysical costs, and
13 some other capital expenditures, some lease expense in
14 addition to the material in the well.

15 Under that circumstance, you see, the man could put about
16 \$64 in investment in drilling another well.

17 Now, if he were trying to operate out of his cash flow,
18 he wouldn't be able to put but about \$16 back into the ground
19 because it would have been taxed away from him.

20

21 It would seem to me that at a minimum, we ought to try to
22 put together an arrangement whereby the incentive is there for
23 this person to put to work all the equipment that we have.
24 Now, we have about 25 percent of the work-over rigs, I am
25 told, which are not active, and those rigs can bring in a lot

1 more energy in a hurry.

2 And I am not talking about finding oil. The oil is there.
3 It is just a matter of making the wells produce as much as you
4 can produce from those wells. Then in addition to that, we
5 have a lot of idle rigs in this country and we ought to be
6 building a great deal more. We ought to be building them as
7 fast as we can.

8 Now, the Governor of Texas came to see me the other day
9 and he said that as far as he is concerned, he would have no
10 objection to a 100 percent tax, provided that you would give a
11 person a credit for what he has put back in the ground to
12 achieve more energy. And incidentally, he said that he has
13 been explaining that to a great number of people and that he
14 finds that it meets with a high degree of support where he has
15 been explaining it to people.

16 His attitude is that over and above what it costs a man
17 to operate, to live, to eat and pay living expenses, that he
18 is assuming a person would make that out of his ordinary
19 income he is making before the decontrol that as far as he is
20 concerned take 100 percent, but permit the person to put back
21 into the ground that which he would like to put back in.

22 I am not asking you to commit yourself to that at this
23 moment or anything along that line. All I am saying is it is
24 something we should be thinking about. And Secretary
25 Schelesinger indicated a situation similar to that for

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1 independents, where these people are putting back into getting
2 more energy what they can; that that should be treated on a
3 better basis than a fellow who just takes the money and keeps
4 it for himself.

5 Now, if we have enough incentive in the bill, I think we
6 are going to get more production. And without incentive, I
7 fear we are going to have the same sort of dismal results we
8 have experienced up to now. But if people find enough
9 incentive here, I would think that they can be very active in
10 doing a lot more.

11 You have a lot of people who have gone back in business,
12 but it is my judgment that you still have a lot of situations
13 where a lot of equipment is idle that ought to be active, and
14 there ought to be a lot of additional equipment produced and
15 it ought to be active.

16 I hope what Senator Bentsen read is not indicative of the
17 President's view that a person does not serve the national
18 interest by producing more oil and gas, because in the short
19 run, that is all he is going to have to show between now and
20 the time he goes back on that ballot again.

21 I would hope that we would provide whatever incentive we
22 can to see that whoever is in a position to produce more
23 energy will do it. And I hope you will help us work that out.

24 Senator Dole: Will the chairman yield?

25 The Chairman: Yes.

1 Senator Dole: You mentioned the so-called plowback. I
2 think the one disconcerting note has been the lack of real
3 interest on the part of the industry in this proposal. I
4 heard Governor Clements on "Issues and Answers" or "Meet the
5 Press" suggest a 100 percent tax with a tax credit, but for
6 some reason there is no agreement within the industry on a
7 plowback. Maybe there will be.

8 The Chairman: Well, I don't think anyone up until now
9 has regarded the deduction for the intangible drilling costs,
10 for example, as a plowback. That has been regarded by Mr.
11 Lubick and others as a tax deferral. Rather than
12 capitalizing, you deduct it when you spend the money. You can
13 deduct it right then and there.

14 We all agree you can deduct it if it is a dry hole, but
15 if it is a successful well, that has been an incentive for
16 many years to encourage exploration, that you could write off
17 the intangible, which is basically the manpower, the labor
18 that went into it. You can write that off immediately. But I
19 don't know anyone who contends that that was a deferral. But
20 most people don't regard that as a loophole. Some do, but most
21 don't.

22 From the point of view of any person who is dedicated to
23 this business, that is the only business he knows, if the
24 price is right and they think they are getting a good price,
25 they are going to go ahead and produce. And everything they

1 can lay their hands on, they will put back in the ground.

2 Now, that is these old fashioned independents. But
3 mainly those are the ones who are working as individuals
4 trying to produce. They will put it back in. Some are putting
5 103 percent back in right now, and I would just hope that we
6 would give them the incentive. That is what I am seeking to
7 achieve.

8 Senator Chafee: Mr. Chairman.

9 The Chairman: Yes, sir.

10 Senator Chafee: I would like to ask Mr. Lubick a
11 question, if I might. Going to the charts we dealt with
12 yesterday, as I recall, on new oil you take the world price,
13 deduct the \$17 -- wasn't that the base price? Was it \$17? I
14 am talking the House bill.

15 Mr. Lubick: Under the House bill, it is \$17 plus an
16 adjustment for inflation.

17 Senator Chafee: Let's take a situation where everything
18 went wrong for the driller and, as a matter of fact, his costs
19 to produce, let's say, the world price is at \$22. Everything
20 went wrong and it cost him a considerable amount of money.
21 Let's say it cost him \$20 to produce this barrel of oil.

22 Could he under the House proposal, which the
23 administration seems to be supporting, end up, with so-called
24 windfall profits tax, owing the government a considerable
25 amount of money? Could he not? Is there an escape hatch in

1 there somewhere?

2 Mr. Lubick: There is 100 percent of income from the
3 property limit.

4 Senator Chafee: I must say I don't understand that very
5 well. If everyone else understands it --

6 Mr. Shapiro: Senator, the way it works is you do not pay
7 a windfall profits tax except to the extent that the windfall
8 profit is 100 percent of your income. In other words, you
9 have to have your income to be more than your cost. You don't
10 want the case where your windfall profits tax is more than
11 your net income to property.

12 In other words, if your windfall is \$10 and it costs
13 you \$11 in costs, I mean above that you are not going to be
14 paying any windfall profits tax.

15 Senator Chafee: Now let's take the situation where in
16 1979, let's say, you made a considerable amount of money, and
17 no, you had a lot of losses in '79, and in '80, things went
18 very well. Things went all right, with this tax now coming
19 into effect in '80.

20 Now, you cannot carry forward any of these losses, can
21 you? You can carry them on your income tax but they don't
22 apply to the windfall profits tax.

23 Mr. Shapiro: You are correct. You can carry forward the
24 losses on your income tax. You have a carry-forward, you have
25 a carry-back and a carry-forward. But they may not be used to

1 offset the windfall profit taxes.

2 Mr. Chafee: Does that make much sense? Suppose you had a
3 very bad year in 1979. And it is all well and good to be able
4 to offset it against your income tax in 1980, but why
5 shouldn't you be able to offset it against the so-called
6 windfall profits tax in '80?

7 Mr. Lubick: I think, Senator, the complexities of trying
8 to measure profit on a property-by-property basis are
9 difficult enough in any one year without trying to carry it
10 out on an historical basis. It is one of the reasons when we
11 studied this whole situation we decided not to go to an excess
12 profits tax based upon a base period profits, net profits, in
13 comparing the current year's profit.

14 The administrative complexity makes it a nightmare, and
15 some of the decisions made under it lead to bad economic
16 decisions. So I think what you are conjuring up is rather an
17 extraordinary case. There may be a few such cases, but by
18 and large, where we have exploration undertaken with the
19 incentive of the world price, it is quite unlikely that you
20 are going to have a situation where you are going to have a
21 loss situation.

22 Senator Chafee: I am talking about a carry-forward loss
23 from the past. But it seems to me this goes to a point that I
24 think Senator Wallop and others have made, that we are not
25 talking a profits tax. It is a wonderful word that you use,

1 but truthfully it is, as has been pointed out many times here,
2 an excise tax.

3 There is more mileage in calling it windfall profits, and
4 it sells better, but it is not accurate.

5 Mr. Lubick: Well, it is not a windfall net excess profits
6 tax. I think it is fair to say that by and large what we are
7 trying to get at is windfall profits by virtue of the excise
8 tax. But there are situations, and that was recognized in the
9 House bill, where you could indeed have a tax applicable in
10 the absence of a net income limitation.

11 Senator Chafee: Let me get back to my original question
12 again. Let's suppose oil is selling at \$22 a barrel and t
13 costs you \$20 to produce it. Now, you now have not been at
14 100 percent of your costs. So the tax will apply. In other
15 words, you deduct the \$17.

16 Mr. Lubick: Up to \$2, presumably.

17 Senator Chafee: That is right. But then when you apply
18 your income tax to that, your federal income tax --

19 Mr. Lubick: That would be zero then because the windfall
20 profits tax is deductible.

21 Senator Chafee: Prior to reaching your income tax. I am
22 sorry, Senator Wallop?

23 Senator Wallop: No, you make the --

24 Mr. Lubick: I might also point out that when you talk
25 about losses in the prior year, frequently that would

1 represent what Senator Long has referred to as the intangible
2 drilling costs which, under normal accounting principles,
3 would be capitalized and spread over the life of the well. And
4 that is a great incentive to exploration, to permit that.

5 So, what for tax purposes might be a loss from the
6 property might not in the normal case be a true accounting
7 loss from the property. And if we start making calculations
8 to recalculate the true net income based upon accounting
9 concepts, I think we would have just a horrendous source of
10 complexity.

11 Senator Chafee: You are confident that under the
12 proposals you have made here, let's take the house bill, that
13 in no way can a person end up bringing in oil and through taxes
14 have everything taxed away from him so he ends up with zero.

15 Senator Wallop: Oh, he can.

16 Mr. Lubick: I think it is theoretically possible to end
17 up with zero.

18 Senator Chafee: But the zero coming through the taxes.
19 When you take the 60 percent or the 50 percent on new oil,
20 that you can clean out whatever he was going to make because
21 he had high expenses and thus did not realize the profit he
22 hoped he was going to realize.

23 Mr. Wetzler: Senator, the way the House bill works is
24 what you say is true on a property-by-property basis. There
25 can be no property that would make money before a windfall

1 profit tax and would be put in a loss position by the windfall
2 profit tax because of this 100 percent limit. With a 60
3 percent rate, the most the House bill could do is reduce your
4 profit by 60 percent.

5 So in the example you gave where you had a \$22 price and
6 \$20 of cost, the windfall profit subject would have to be \$2
7 and the tax would be 50 percent of that newly-discovered oil,
8 or \$1. So the producer would still make a profit of \$1, which
9 would be subject to income taxes. So his after-tax income
10 might be, say, 50 cents, but he would still make something.

11 Now, the question arises when you have profits in some
12 properties and losses in others. If you, say, drill a dry
13 hole in one property so you have a loss, and you have a profit
14 in another property, under the House bill you might still have
15 no net income overall but you would be subject to a windfall
16 profits tax on your successful property.

17 Senator Chafee: So you could end up losing out.

18 Mr. Wetzler: And there are ways to amend the House bill
19 to eliminate that possibility as well.

20 Senator Chafee: Well, are you going to come forward with
21 those suggestions?

22 Mr. Shapiro: We are going to have a series of options
23 and alternatives for you when you come back after the recess
24 to reconvene on this, and that aspect will be included in
25 them.

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1 Senator Chafee: It seems to me, Mr. Chairman, one of the
2 objectives we are trying to meet, at least one which I have in
3 mind here and certainly others do, is to encourage the
4 production of new oil. And if we are going to do that, we are
5 going to be working in areas that are very, very high cost,
6 whether they are out with rigs the size of the Empire State
7 Building or whether they are off Georgia's banks in deep
8 water, or wherever it is.

9 I just don't think that the great profits on new oil
10 are going to be there to the extent they have been in the
11 past. The costs are going to be way up closer to the world
12 market than I think has been true in the past.

13 Thank you, Mr. Chairman.

14 Senator Danforth: Mr. Chairman.

15 Senator Dole: Mr. Chairman.

16 Senator Danforth: Go ahead, Bob.

17 Senator Dole: I just wanted to ask, following Senator
18 Chafee's questions, will any of these options be available
19 before we come back? Some of us are going to be out visiting
20 with people in our states. There are a lot of sensible
21 industry people who would like to know before the ax falls.
22 Would there be any possibility of getting any of the options
23 prior to our coming back?

24 Mr. Shaprio: We are planning to take the beginning part
25 of the recess to put these together. We have been talking to

1 the staffs of the senators and with some senators directly and
2 pursuing these, and we will try to make these available. We
3 will just try to talk to a number of people like you are to
4 have the various options being discussed presented before you,
5 but we will make them available to the extent we can to staff
6 so that they will be furnished to you.

7 The Chairman: Mr. Danforth.

8 Senator Danforth: Mr. Chairman, I am really pleased that
9 we are going to have a recess during which time we can come up
10 with further analysis of exactly what is involved here. And I
11 would like to make a request just for my own benefit, if for
12 no one else's, as to the kind of information I would find very
13 helpful.

14 I would like an analysis by the Joint Committee on
15 Taxation's staff as to federal revenue increases as a result
16 of income taxation and royalties by virtue of decontrol

17 Then I would like the windfall tax on top of that. You
18 have to make some assumptions on what is going to happen to
19 the OPEC price, and I don't know where you go make those
20 assumptions. Treasury has an assumption of zero percent real
21 increase. The Joint Committee is using 1 percent real
22 increase. So I would like to have some judgment as to what
23 rate of increase over the next ten years we are projecting
24 from OPEC; and then on the basis of that assumption, what is
25 going to happen to federal revenues.

1 I would like that with some variations, if possible, on
2 what exactly how we structure the windfall tax, that is, how
3 much revenue would be lost if we were to exempt
4 newly-discovered oil or if we were to exempt stripper oil or
5 tertiary recovery or whatever.

6 Is that possible to do?

7 Mr. Wetzler: Yes.

8 Senator Danforth: I am going to rely on the Joint
9 Committee and Treasury. What I would like from the
10 administration is, given those additional revenues, if they
11 exceed \$142.5 billion which the President wants for his
12 program, what does the administration intend to do with that
13 money? That is what I want to know.

14 What does the administration want to do? What are the
15 projections? Does it want to reduce taxes? Does it want
16 additional spending programs? What does it want to do with
17 that money?

18 Now, we have one month to work on that, but that is the
19 kind of information I would like.

20 The Chairman: Frankly, I think that is a fair
21 proposition, Senator. I think you have a right to ask that
22 question.

23 Senator Danforth: Thank you.

24 The Chairman: And you have a right to an answer to it,
25 also, provided that there is an answer. Now, maybe they don't

1 have one. But if they have one, they are sure to come up with
2 it.

3 Senator Danforth: Mr. Chairman, we operate here on any
4 kind of a tax bill on the basis of revenue projections. We do
5 it every month. We ask what is the revenue lost or what is
6 the revenue gained by virtue of some change in tax policy.
7 And the Joint Committee is in the business of making these
8 projections and they already have with respect to the windfall
9 tax.

10 But I would like for them to look it over again in view
11 of Treasury's position. I mean the difficulty is that the
12 Joint Committee has projected a revenue gain of about \$135.5
13 billion, whereas Treasury has projected about \$7.5 billion.
14 There is just an awful lot of difference between 135.5 and 7.5
15 when you are talking about billions of dollars.

16 So I would like to see if we cannot come up with good
17 projections, and then, assuming that there is an overage,
18 assuming that we are going to be raising more than \$142.5
19 billion which the President needs for his program, then I want
20 the administration to tell us what they intend to do with that
21 money.

22 Mr. Wetzler: Senator, it is even more complicated than
23 that because the amount you need for a given energy program
24 depends upon what you assume about oil prices. If the oil
25 price is high enough, you can achieve your synfuel goal

1 without any federal subsidies. So if you would like, we can
2 try to work up some assumptions on that.

3 On the other hand, the higher the oil price is,
4 presumably, the more you would want to provide in help for the
5 poor to take care of their needs.

6 So I think the \$142 billion is not a fixed figure. It
7 also varies with the oil price you assume.

8 Senator Danforth: Certainly we can narrow the
9 differences below what they are right now. I mean it is
10 impossible, I think, to come up with any kind of an estimate
11 as to what we are talking about. And what I don't want to get
12 involved in is just -- you see, the argument is made
13 repeatedly by Treasury that what we are talking about is
14 equity. Fine.

15 So, what Treasury wants to do is to shift resources,
16 shift money from the oil companies to somewhere else, and it
17 turns out where it wants to shift the money is from the oil
18 companies to government. Now, it is true that the oil
19 companies are not popular. And if you talk about taking
20 money from oil companies, everyone would cheer.

21 Senator Long might not, but a lot of people would cheer.

22 The Chairman: Oh, if it is Exxon, that is fine. I would
23 cheer for that.

24 (Laughter.)

25 Senator Danforth: But the thing is I think there might be

1 something even more unpopular than the oil companies, and that
2 is Washington. So if you are talking about transferring this
3 tremendous amount of wealth from the oil companies to
4 Washington for additional spending programs, then I think you
5 really have not made your sale.

6 In other words, frankly what I would like is a commitment
7 of the administration to some kind of tax cut in connection
8 with this bill. That is what I would really like.

9 Mr. Sunley: If I may say two things, Senator Danforth,
10 first I don't think that there is as much a difference between
11 the administration and the Joint Committee on some of the
12 basic types of estimates as you imply.

13 I am sure if Jim were asked the question, if you
14 decontrol, you ignore your windfall profits tax and let the
15 President make the decision to decontrol and then ask the
16 question of what impact will that have on federal income tax
17 revenues, you would not get the \$173 billion figure. It does
18 require that you make some assumptions about monetary policy
19 and fiscal policy and what impact it will have on inflation.

20 And Senator Chafee is quite correct that to the extent
21 that decontrol is inflationary, that tends to bring in income
22 tax receipts. But decontrol also acts like a tax increase
23 in the economy and will probably decrease the real growth of
24 the economy, and that has an impact, too.

25 But when you ask the macroeconomic question, decontrol by

1 itself, what kind of economic impact will it have, you do not
2 make the naive calculation of just how much higher will
3 producer revenues be as a result of decontrol and therefore
4 how much higher income tax will be.

5 You have to take into account other economic effects. We
6 have taken these into account in making our mid-session budget
7 projections. Any time we are doing a macroeconomic forecast
8 of the economy, we are taking into account the impact of
9 decontrol on inflation and real growth.

10 Second, your question on what will we do with the revenue
11 is a very important one, and I think always in the
12 administration planning, projecting out the next two or three
13 years, which is further than you ought to go in making
14 economic projections on how an economy is going to do, at
15 least we are required to do it under the Budget Act, you are
16 trying to see what is the appropriate level of taxes and
17 spending to meet national objectives.

18 This President has said a number of times when given a
19 choice between increased spending and reduced taxes, he comes
20 out on the side of reduced taxes. He has set a goal of holding
21 federal spending down as a percent of GNP. I don't know
22 whether there will be a surplus or not when the Joint Committee
23 does their assumption. It may vary by what oil price
24 trajectory they are looking at.

25 But I am certain that at any given point in time, if we

1 have a choice between cutting taxes or increasing spending, we
2 would like to see the taxes reduced, if possible.

3 Senator Danforth: Well, I have been waiting around for
4 2-1/2 years and I haven't seen it yet. I mean I hope you are
5 right. The question with Secretary Miller's nomination is
6 does this represent a change in the administration's policy?
7 So far for the last 2-1/2 years you have resisted any kind of
8 tax cut.

9 You have been the number one spokesman for doing this. I
10 mean we have gone through this over and over again, and I hope
11 you are right. I hope we are going to see a substantial tax
12 cut. When we look in the morning paper, projections by the
13 administration, unemployment going up to 8 percent, inflation
14 at 13.2, the supply side of the economy being stunted.

15 To me, it is called for. We have been asking for this for
16 a long, long time. That is exactly the point I am trying to
17 make. I believe we need a tax reduction, and I would like to
18 see some commitments from the administration for a tax
19 reduction.

20 But it looks to me, on the basis of the figures we have
21 now, that we are going in the wrong direction, not the right
22 direction. That is, we are going in the direction of a tax
23 increase in the amount of about \$278 billion over ten years,
24 part of it to be spent on an energy program and part of it to
25 be spent on who-knows-what.

1 I want to know what, because I do not want to sit here
2 and vote for a windfall profits tax if the effect of it is not
3 just to fund an energy program but to just further increase
4 the total tax bite on the economy.

5 If we were taxing the oil companies and having a
6 beneficial effect on the average citizen, we might be able to
7 make a sale on that basis. But when you are taxing the oil
8 companies, that really is an indirect tax on the consumer of
9 oil, namely, the public. He is the one who is eventually
10 paying out the money.

11 And if you are doing that and really transferring \$278
12 billion, roughly, to the Treasury of the United States to
13 spend as we in Washington like to spend it, then I think that
14 you have simply increased the percentage of the gross national
15 product that is being taxed by Uncle Sam and is being spent by
16 Uncle Sam.

17 I think that is fundamentally wrong and is a prescription
18 for further economic stagnation for many years to come.

19 Senator Chafee: Mr. Chairman.

20 The Chairman: Mr. Chafee.

21 Senator Chafee: Mr. Lubick, I have taken a new look at
22 you since the chairman said that you are consulting with the
23 President daily and are his advisor on tax matters.

24 (Laughter.)

25 Senator Chafee: So we look on you as a source of

1 conveying our thoughts to the President when you see him for
2 lunch or whenever you see him next.

3 (Laughter.)

4 Senator Chafee: Now, under this program which you are
5 espousing here, this \$142 billion program, \$88 billion is
6 going to this energy corporation which is going to produce new
7 oil through exotic means, synfuel and so forth, which, as I
8 understand it, is going to be 2.5 million barrels a day.

9 Am I being unfair in my description of this, \$88 billion?

10 Mr. Lubick: I think the objective was to reduce imported
11 oil by 2.5 million barrels a day, and not necessarily the
12 production of that volume of synthetic fuels.

13 Senator Chafee: It seems to me this program is very,
14 very weak on conservation. I would like you to convey to the
15 President one senator's thoughts on the fastest way to reduce
16 oil consumption or to net out a reduction, reducing
17 imports. Let's take reducing imports. It is through
18 conservation.

19 I would think, through some way of encouraging the
20 people, through price or through tax credits to a far greater
21 degree than we are doing now. Let's just take the home
22 insulation. It seems to me that price is going to be a factor
23 in encouraging people to insulate. But I would like to see an
24 increase in the tax credit. I think that would encourage
25 them, too.

1 And it seems to me that every barrel we save through
2 conservation is just as good as discovering a new barrel and
3 is far cheaper, and I can't understand why in this program
4 they have been so modest in their tax credits for taking that
5 one exemption.

6 Now, there may be other areas where, frankly, I would
7 like to see the price of gasoline be deregulated, and the
8 President has chosen that. I think the comment is we don't
9 want to fall on our swords. But I would like to see them get
10 rid of the allocations and the price controls on gasoline. If
11 the price went up, then maybe you would see some real
12 conservation.

13 Do you agree with that?

14 Mr. Lubick: The administration's position is that at
15 this time it is not appropriate, taking into account the
16 problem with inflation.

17 Senator Chafee: And the approaching election.

18 Mr. Lubick: And all of the various problems. That this
19 is not the appropriate time for that proposal.

20 Senator Chafee: Although I think it would be a tremendous
21 saver, right?

22 Mr. Lubick: Perhaps Richard Smith could address that
23 question of elasticity.

24 (Laughter.)

25 Senator Chafee: I know that they give this argument in

1 France, that the price goes up and it doesn't decrease
2 consumption, but I think there is a lot different situation
3 there than here because the elasticity is out of it over
4 there.

5 In other words, they are down to the cars that get a lot
6 of mileage. They are down to lightweight cars and they are
7 down to reducing their travel to a great degree. So that the
8 elasticity is not there. When the price goes up, it doesn't
9 reduce. But in this country, I am sure it would follow.

10 Have you got any suggestions on tax credits or something
11 that might encourage greater conservation?

12 Mr. Lubick: The program of credits to encourage
13 conservation was just enacted last year, and it really is just
14 starting to come into play.

15 Senator Chafee: It is at a modest rate, too. What is it,
16 25 percent?

17 Mr. Lubick: It is a pretty good rate. The residential
18 is 15 percent, is it not?

19 Mr. Smith: (Nods affirmatively.)

20 Mr. Lubick: I put in storm windows myself just recently,
21 and I am not sure whether I would or would not have anyway,
22 but the credit certainly was a factor I reckoned on and I
23 think more and more people are doing it. As you suggest, the
24 price of energy is going to increase. Where combined with
25 credits which are in effect now, there will be a significant

1 conservation response.

2 We will certainly be glad to explore with you the
3 economics of going further, but I would suggest that there
4 were substantial conservation measures enacted last year and
5 they are just beginning to come into play.

6 Senator Chafee: Thank you, Mr. Chairman.

7 What I would be asking you is some forecasts on loss of
8 revenue if we increased the tax credit substantially. I just
9 believe this whole conservation effort has been overlooked to
10 a substantial degree. And to spend \$88 billion to get 2.5
11 million barrels a day does not seem to me a very worthwhile
12 expenditure.

13 Thank you, Mr. Chairman.

14 Senator Matsunaga: Mr. Chairman.

15 The Chairman: Yes, sir, Mr. Matsunaga.

16 Senator Matsunaga: Senator Danforth has repeatedly,
17 yesterday and today, mentioned the figure of \$238 billion of
18 tax.

19 Mr. Lubick: \$278 billion.

20 Senator Matsunaga: A \$278 billion tax increase. That is
21 out of the oil companies because of decontrol.

22 Mr. Lubick: That is the combination of the net windfall
23 tax and the increased income taxes.

24 Senator Matsunaga: Right.

25 Mr. Lubick: On oil producers and royalty holders.

1 Senator Matsunaga: And of course he talked about the
2 lack of decrease in income tax: that is, no tax cuts. What
3 did the 1978 tax law provide?

4 Mr. Lubick: It provided for some substantial decreases.

5 Senator Matsunaga: Why don't you mention that every time
6 the question is raised?

7 Mr. Lubick: I believe I mentioned it yesterday, and this
8 is the first opportunity --

9 Senator Matsunaga: What are the figures?

10 Mr. Lubick: It was about a \$20 billion tax cut in --

11 Senator Matsunaga: In '79, isn't it?

12 Mr. Lubick: And the '77 Act was another \$10 billion
13 since the administration has taken office.

14 Senator Matsunaga: But as I recall, you had a definite
15 schedule of income tax reduction for '79, for '80, '81.

16 Mr. Lubick: Under the --

17 Senator Matsunaga: '78 Act.

18 Mr. Lubick: Under the '78 Act. I believe most of it
19 takes effect with respect to '79.

20 Senator Matsunaga: \$200 billion, as I recall. It goes
21 up to --

22 Mr. Lubick: The revenue effect of it increases each
23 year. But in terms of 1978 dollars, it was a \$20 billion tax
24 reduction.

25 Senator Matsunaga: I think you ought to have that handy,

1 because if you are going to have anyone support your position,
2 you are going to have to have these figures. And if you don't
3 have it, no one can use it for you.

4 Mr. Lubick: We will have the figures for you.

5 Senator Matsunaga: There is one question I meant to ask
6 yesterday but didn't have time to get around to. I propose
7 this question because it has been asked of me to raise this
8 question. Is there any objection to raising the Alaskan oil
9 base from \$7.50 to \$13, making it equal to your lower 48?

10 Mr. Lubick: That, Senator Matsunaga, is our proposal. We
11 recommend treating Alaskan oil as upper tier oil, which is
12 what it is under the DOE regulations. And we think that would
13 be appropriate.

14 Senator Matsunaga: So you are making the recommendation?

15 Mr. Lubick: The Secretary testified to that effect. It
16 is the administration's position.

17 Senator Matsunaga: I see. All right.

18 I have no further questions.

19 The Chairman: Well, let me just say this about your
20 program. I hope we can work out something that will be a good
21 law and will be well-received and will do a good job for the
22 country. I think that your idea of a permanent windfall tax
23 is going to be hard to sell, especially when you have these
24 tiers in it.

25 Here are two farmers who signed a lease on the same day,

1 but the company didn't get around to drilling one lease until
2 several years after the other one. So the fellow whose
3 property was drilled first finds that he is condemned to
4 forever selling his oil at a much lesser net gain than the
5 fellow down the road who may have signed the lease on the same
6 day but on whose property they didn't drill until later on.

7 It seems to me that that person is going to feel very
8 unhappy to be told that it would be an unconscionable profit
9 for him to be permitted to get the same consideration as the
10 other man who signed the lease the same day, the only
11 difference being that the company thought that it would have a
12 better chance of discovering oil in Location A than in
13 Location B, so it drilled in Location A first.

14 I would think that that is kind of like the snake being
15 condemned to crawl on its belly forever and he didn't even eat
16 the apple.

17 (Laughter.)

18 The Chairman: What is your reaction to the equities
19 involved there over a long period of time? Don't you think
20 that fellow would get tired of being told that he was
21 receiving an unconscionable profit although everyone else is
22 getting the price he is being denied by taxation?

23 Mr. Lubick: We are going to redeem him, Senator, because
24 we have proposed a phase-out of both tier one and tier two so
25 that all of this will phase into the tier three, the world

1 price adjusted for inflation as the base. The tier one, the
2 old oil, phases out by 1984.

3 I would like to point out that the fellow who was the
4 beneficiary of the early drilling, of course --

5 The Chairman: No, no. He was condemned because of the
6 early drilling. He gets the old price.

7 Mr. Lubick: Well, he has been getting his return faster
8 and earlier, and normally that is an advantage, to get your
9 money sooner.

10 Senator Matasunaga: I thought, Mr. Chairman, Treasury --

11 The Chairman: But it could be the difference of a single
12 day, where one has \$4 or \$5 oil and the other fellow has \$13
13 oil by the difference of a day.

14 Mr. Lubick: We had that problem when we reduced capital
15 gains taxes last year. If a sale took place one day before,
16 it had one rate; and if someone had waited, he had a different
17 rate. Whenever we try and correct our mistakes, we cannot
18 always go back to creation to do that.

19 The Chairman: But when you are paying a high price, when
20 you are paying that price to everyone else on God's green
21 earth and denying it to your own producers, and then proceed
22 to take his money and put the government in competition with
23 him with his own money, take his tax money and put a
24 competitor in the field with him, and then you say that is all
25 right for that competitor that you financed with your tax

1 money to get the same price you are getting, but you are a
2 crook, you are a bad guy because you are getting the same
3 price as this guy you put in competition with you, and
4 therefore we have to take it away from you, it doesn't set
5 well with people.

6 Mr. Lubick: One of the things we are doing is lifting
7 off of his shoulders the burden of controls which has been
8 holding the price which he received for his product down to \$6
9 a barrel.

10 The Chairman: And he will also be relieved of the burden
11 of making the decision of what to do with his money. That is
12 one more advantage he will get out of all of this.

13 (Laughter.)

14 Senator Matsunaga: Mr. Chairman.

15 The Chairman: But I think that fellow is going to ask
16 you, Mr. Lubick: Well, look here. Rather than the government
17 just taxing all this away from me so that the government
18 builds that synthetic plant, why don't you just let me keep
19 some of that money and I will invest it in a synthetic plant?
20 Where is it in the public interest that the government puts up
21 the synthetic plant rather than the individual whose money was
22 taxed away from him?

23 Mr. Lubick: Mr. Chairman, I don't think he has the
24 capacity to develop synthetic fuel. If it could be developed
25 without any government intervention at all in the same time

1 span, as effectively, I think that would be highly desirable.
2 But I don't believe that that is the situation.

3 But the objection you are raising is simply the one that
4 occurs every day. When someone makes a contract to do
5 something, one person gets the protection of the contract. He
6 gets the price for the supply of goods or what have you, and
7 the parties have made the bargain and that is the situation we
8 are under.

9 When the lease was entered into and \$6 was the price, the
10 controlled price for oil, he entered into that bargain
11 recognizing that controls were not forever and permanent and
12 that there would perhaps have to be changes. I don't think
13 we can go back. We have to deal with the situation as we find
14 it and make a reasonable set of rules. Anytime you draw a
15 line and one person is right up to the edge and the other
16 person is just on the other side, it is admittedly difficult
17 to distinguish those two cases.

18 But you have been very good at drawing lines in
19 legislating, and somehow it has to be done.

20 The Chairman: Well, it occurs to me that we might be
21 able to get together more effectively and support the same
22 thing more effectively if we could dispense with the idea of
23 some rich person getting richer and move toward the idea that
24 we are going to share this new income more evenly.

25 Now, I am an old share-the-wealth man myself, and I have

1 been trying to push employee stock ownership. It would be to
2 me a great improvement on the program if we could put a major
3 provision in here so that employees wind up owning some of
4 this. And so far, I regret to say, you have been the fly in
5 the ointment.

6 You have done more to stand in the way of employee stock
7 ownership than anyone around here even though you proclaim,
8 and I suppose you are sincere about it, that you really
9 believe in redistributing the wealth. I would hope that you
10 will give it some thought and see if you can't help us to come
11 up with a way that we can crank some employee stock ownership
12 into this picture.

13 With all of that money, there ought to be something for
14 the worker somewhere in that thing.

15 Mr. Lubick: I think we have some constructive
16 suggestions to encourage broader use of employee stock
17 ownership plans, Senator, and we will continue to work with
18 you toward that objective.

19 The Chairman: Well, it makes me wonder. Do you reckon
20 that fellow Lubick is just trying to louse me up in this
21 thing? Do you think he is sincere in being for employees?

22 Mr. Lubick: I would never try to do that, Senator.

23 (Laughter.)

24 The Chairman: Because some of these ideas you have had
25 have kept people from setting up these employee stock

1 ownership plans, when you tell me that you are for it. For
2 example, this thing of saying that the employee has to vote
3 that stock. I don't think there would be a problem about him
4 voting the stock if you wait until he retires. At that point
5 his interest is parallel to that of management.

6 But we have a lot of situations were the employers won't
7 set the employee stock ownership plans up because they, in
8 good conscience, are afraid that labor would not know how to
9 manage that investment. Some have come to me and said, just
10 for fear that their laboring people might not be that good
11 businessmen, they are afraid to put them in a position to take
12 control of those companies.

13 We need to get that straightened out.

14 Mr. Lubick: We have discussed that problem. Obviously,
15 there are many corporations where a vote is not particularly
16 relevant. I assume that Sears, Roebuck, for example, issues
17 voting stock and it is not a matter of great concern to Sears,
18 Roebuck whether the employees who own the stock vote or not.

19 Most frequently the problems involving voting rights
20 involve closely-held corporations, and in some of those
21 situations you have the situations where the employer is
22 perhaps less interested in the employees having a stake in the
23 business than in some other things.

24 The Chairman: Well, a man's son came to me and said that
25 his father would like to leave all of the stock in his company

1 to the employees but that he is not going to do it if they are
2 going to be voting all of that stock because he doesn't think
3 that they have that much business expertise.

4 This man also said that he himself, being the son of the
5 man who started the business, would like to consider leaving
6 either all or a major part of his stock to the employees when
7 he dies. And again, he said that what would keep him from
8 doing that is he is afraid they wouldn't know how to run
9 that business. They are good workers but he has some doubts
10 that business decisions would be made the right way.

11 I have had a number of people explain to me that they
12 would like to expand employee stock ownership within their
13 firms but that they just don't want to give away the voting
14 control of it. They don't mind employees having the money,
15 the income, the wealth. They just don't want to give away the
16 voting control of those corporations.

17 Unfortunately, your view and that of some of your
18 associates in the Treasury was that they had to vote that, and
19 Mr. Mondale has the same point of view. But the heck of it is
20 I am afraid they have done more harm than good with it by
21 denying those people stock I would like them to have.

22 Mr. Lubick: We may have some differences on the
23 significance of voting, but I think the voting is of less
24 consequence than the ability of the employee to be treated as
25 a shareholder is treated under normal corporate law of any

1 state with respect to the financial investment which he is
2 making. That ability to judge his investment is really more
3 important than the voting, and I think we can arrive at an
4 accommodation in the voting area.

5 I would like to see, however, that the ownership is what
6 it purports to be, a true equity investment by the worker so
7 that he has the opportunity to evaluate it and have the
8 incentive of ownership.

9 The Chairman: But you and your well-intentioned
10 associates down there in Treasury have been so anxious to
11 protect these employees against their bosses when their bosses
12 would be happy to make shareholders out of the employees that
13 you sort of put yourself in the position of the mother who was
14 so protective of her daughter she wouldn't let the daughter go
15 out on a date with a man, so the daughter wound up being an
16 old maid and never did know what the other sex was all about.

17 That was the end of the family line, the end of the
18 family tree. Now, at some point we are going to have to
19 realize that if you want the benefit of something, you have
20 got to take a chance.

21 (Laughter.)

22 The Chairman: Are there any further questions,
23 gentlemen?

24 (There was no response.)

25 The Chairman: Then I would like to ask the staff be

1 available to those of us who want to meet and talk further
 2 about this bill and discuss it for further education on this
 3 matter tomorrow. We will not be voting, so we won't call a
 4 committee meeting. But I would hope the Joint Committee staff
 5 would be available to us during the same time tomorrow
 6 morning. I, for one, would like to be educated further on the
 7 bill.

8 We will resume these sessions at 10 a.m., Thursday,
 9 September 6th.

10 (Whereupon, at 12:25 p.m., the committee adjourned.)

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