EXECUTIVE SESSION

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TUESDAY, OCTOBER 2, 1979

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United States Senate,

Committee on Finance,

Washington, D. C.

The Committee met, pursuant to notice, at 10:15 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (Chairman of the Committee) presiding.

Present: Senators Long, Talmadge, Ribicoff, Byrd, Nelson, Bentsen, Baucus, Boren, Dole, Packwood, Danforth, Chafee, Heinz, Wallop and Durenberger.

The Chairman: I am going to ask the staff to seek to contact the Republicans on the Committee, Senator Dole, that we have a representative number of Democrats here, that we would appreciate that they get some of their people on over here.

(Pause)

Let us call the Committee together. Why do you not explain what the first item on the agenda here is, Mr. Shapiro?

Mr. Shapiro: We find ourselves in the situation where the Internal Revenue Service is scheduled to begin the printing of the 1979 tax forms by October 10th in order to have them available for distribution at the first of the year.

There are several provisions that were passed in the 1978

Revenue Act that require some technical corrections that affect the form.

Now, the House has already passed the Technical Corrections Bill. It will not be possible for the Senate to pass it and send it to the President in order to meet the Internal Revenue Service October 10th deadline. Therefore, a suggestion has been made to accommodate the Internal Revenue Service that they can have the forms printed that are consistent with the intent of Congress, to take eight provisions that affect the 1979 tax forms that are in the House-passed technical corrections bill which, as far as we know are noncontroversial -- meaning that there are no questions raised about them in the House or in the Senate, as we know about it now, and bring it to the Committee's attention.

These matters have been discussed with staff. We discussed it with Ed Hawkins and other members of the Minority and Majority staffs. They are listed on the sheet before you.

The first five items deal with provisions on the alternative minimum tax and any time you have a new tax and a new form, generally it is a case that you have technical corrections problems that deal with situations that are completely new situations, so that the first five items on the form on this list deal with the alternative minimum tax.

The first one is a zero bracket amount. The way the statute was technically drafted, it was said that if a taxpayer did not itemize his deductions, he did not get credit, which was in the previous case of the standard deduction. As a practical matter, all taxpayers involved in the alternative minimum tax itemize their deductions. That was why it was generally focused on.

For the few cases that may exist where they do not itemize deductions this technical change allows them to take what is referred to as the zero bracket amount, which is the old standard deduction.

The second change, number two there, is the net operating loss, and this change is to deal with the case where you may have a potential double benefit, where you can take a deduction that may exceed gross income and have that as a deduction for the alternative minimum tax, and then have that same deduction reduce taxable income in the future years.

The proposed changeisto disallow the net operating loss in computing the alternative minimum tax but only when the net operating loss be carried to another year, so it is dealing with a double deduction situation.

The third one on the list is to offset certain taxes. Under present law, there are certain types of penalty taxes that do not reduce the alternative minimum tax. One of them not on the list last year which is proposed to be added is the penalty tax proposed on premature redemptions of retirement bonds. This would also be a technical change for purposes of the form.

The fourth item on your list deals with estates and trusts.

This proposed change would clarify situations where certain deductions could only be taken once, but not twice, dealing with the alternative minimum tax. Again, these are types of changes that deal with situations that are not always brought to our attention or focused on in the drafting session during the time when you have a whole new system.

These changes I am referring to now are typically the type of changes occurring in drafting changes, not taking a committee decision to change it, but the consistent type of technical provisions done in the drafting session.

The fifth one on the list deals with the alternative minimum tax and provides a change dealing with the foreign taxes and it said that the foreign taxes, like the state and local taxes, which were in the bill last year, are not to be taken into account.

Now, the next three items do not deal with the minimum tax. The first one is the WIN and jobs credit.

This is saying when the technical corrections bill will allow a WIN or jobs credit that is not used by cooperatives to be flowed through, that is the patrons of the cooperative would be eligible to get the credit if it is not otherwise used.

The seventh item, on page 2, deals with a change dealing with the foreign earned income provision. As you know, prior to the 1976 Act, individuals working abroad were eligible for a $20,000 or $25,000 exemption. The Tax Reform Act of 1976 removed that exemption and made a number of modifications, but also to the extent that there was an exclusion said the exclusion was off the bottom.

What that means is the first amount of exempt income, the first earned income -- as you know, the rates are lower at the bottom, so that had an effect of taking something away from those, whereas, at the old law, the exemption could be off the top, which means it could be at the higher income rates.

The foreign earned income act of 1978 reversed a number of provisions that were done in the 1976 Act. One of them is to say that an exclusion was off the top, meaning that a higher amount of income was excluded, which means that it was at the higher marginal rates.

Under the old act, the correction being made is that the taxpayer because of the change in 1976, the draft said that you could not use the tax tables under the technical modification being consistent with the '78 act. That is to say, individuals would be permitted to use tax tables where they have an exclusion of foreign income.

The eighth item, the last one on page 2, deals with a refund of excise taxes. The Energy Tax Act of 1978 dealt with the refund which was in prior law allowing a 2 cents a gallon refund on certain excise taxes on gasoline, diesel fuel, so forth. The Excise Tax Act eliminated that refund as a part of the Energy Act but did not limit the tax of sales.

The Energy Act said you could not get an exemption, but you could not get a refund, that is, but certain taxes on sales generally where they are used in commercial fishing vessels, that was not changed.

The problem that occurred, you had a problem when you made a sale. You do not always know whether it is going to be used for a commercial vessel, fishing vessel, and therefore you do not know whether to collect a tax so that this technical correction would resurrect the direct refunds, so you could now get direct refunds, but only in the cases where you have tax-free sales. That is to take care of administrative problems.

These, then, are the eight technical provisions that are in the Technical Corrections Act that deal with the tax form. The suggestion is that the Committee may want to approve these and then when the technical corrections bill comes formally before the Committee, these could just be traded as having been already approved. They would not go to the Senate Floor prior to the technical corrections bill.

If the Committee approves these, the Internal Revenue Service feels these provisions have already passed the House and with the Finance Committee approval, it would give them the authority to print their new forms.

The Committee would not make any commitment and you cannot say the Senate will pass these, but you are giving your approval at this stage.

The Chairman: Senator Byrd, have you studied this matter?

Senator Byrd: Yes, Mr. Chairman.

As I understand it, these changes are necessary before the forms can be printed and time is of the essence to the Internal Revenue Service in the printing of these forms. As I understand it, it makes no change in the tax law, but merely permits a clarification of the law. Would that be the way to express it?

Mr. Shapiro: That is correct. It does not make any substantive change. The type of change that is made in the law is a technical change to conform with what was the intent of Congress in providing for the changes in the '78 Act. Typically, these are the type of changes done in drafting sessions. None of these on this list are the type of changes that would require the approval of the Committee.

Senator Byrd: By approving these changes, the Internal Revenue Service can go ahead in printing the forms. The legislation itself would remain in committee and continue to be a part of the technical corrections bill when it is being considered.

Mr. Shapiro: That is correct.

Senator Byrd: Could I ask you one question about number three? I do not understand what number three does when you get down to the last two sentences of number three.

Mr. Shapiro: The way the alternative minimum tax works, you compute the alternative minimum tax by taking the taxable income that is under it and then apply the alternative minimum tax rates.

After you compute that, you reduce that amount by the regular income tax, and under the provision that was adopted there are certain types of so-called penalty taxes that do not reduce the minimum tax. We say you reduce the minimum tax by your regular income tax, that is regular income tax on your regular income.

The tax law includes certain provisions that are referred to as penalty taxes. These deal with certain things that early distribution from qualified pension plans, or individual retirement accounts. These are types of things, if you do one of these transactions you have what is referred to as a penalty tax, and one of the items that was left off in the drafting was on the premature redemption of retirement bonds.

Senator Byrd: What are retirement bonds? Individuals?

Mr. Shapiro: Yes. Certain types of bonds that you can purchase as a part of the retirement program, and are called retirement bonds. That is a part of the pension programs, and you are supposed to keep those for a certain amount of years, as well as the same thing, like IRA and some of your pension plans. You are supposed to keep. Each of these have certain requirements as to when you are allowed to dispose of them.

If you dispose of these prior to that certain date, then there are so-called penalty taxes because the taxpayer has been given a benefit by the Congress. For example, you can set up an IRA. You can put up $1500 or $750 in IRA, but you have to abide by the rules Congress has set, one of them being you have to keep your IRA to a certain age.

If, however, you change your IRA at an earlier date, you have to pay what is referred to as a so-called penalty tax, taking away part of that benefit that Congress has granted for them to keep in requirement.

One of these provisions that relate to that, the retirement bond that has the same type of requirement that you keep it for a certain amount of years to a certain age, if you have a premature redemption of that, then there is the same type of penalty tax by Congress, taking away a little of the benefit that it granted, if they were to abide by the requirements.

Senator Byrd: I would think the proposal would be all right, Mr. Chairman.

The Chairman: Let me ask Mr. Hawkins to come up here and take Mr. Stern's microphone there. Let me just ask you a question.

Mr. Hawkins, we want the Finance Committee staff to look at these various things that come over from the House and have been worked on by the Joint Committee staff and also by the Treasury. Have you studied these technical corrections?

The Chairman: Do they qualify as purely technical corrections or are they substantive?

Mr. Hawkins: I believe they qualify as technical corrections.

The Chairman: Do you think we ought to agree to them?

Mr. Hawkins: Yes, I think they ought to be approved this morning.

The Chairman: Well, is there any further discussion?

Then if there is no objection, I take it what we are being urged to do here by the Treasury is to agree to these particular technical corrections on the theory that these should be agreed to now, and when the technical corrections bill comes over here, they will be a part of it.

Mr. Halperin: That is right.

The Chairman: With that assurance you think you can go ahead and incorporate these technical corrections into the tax form?

Mr. Halperin: That is correct, Mr. Chairman. If the Committee approves it this morning, the IRS will incorporate these changes.

The Chairman: I will suggest that, since some of the members were not here at the beginning that we approve this tentatively and that all of the members who were not present to hear the discussion study it. If they want to have some second thoughts about it, they can notify us tomorrow.

So far as I know, these are all appropriate technical corrections. When we act on the technical corrections bill, I would expect to support them. I would expect those of us who heard the explanation would expect to go along with them.

If anyone finds any reason why he does not think that we should agree to this, I wish you would let us know tomorrow.

Without objection, we will agree to this, subject to that reservation, unless someone notifies us tomorrow that someone finds this objectionable, or ask that they have it looked into, or thinks we should not agree to it, then we will agree to consider it.

All right, now. Let us talk about the crude oil tax.

Senator Bentsen: Mr. Chairman?

The Chairman: Senator Bentsen?

Senator Bentsen: Mr. Chairman, at this point I would like to submit an amendment for the independent producers.

Mr. Chairman, this exemption would be for the first 3,000 barrels and the royalty owners.

Now, the independent producers, the man who drills over 80 percent of the exploratory wells, let me give you an example of what happens to him on the wellhead revenue. Of the revenue that he received in the five years 1973 through 1977, he expended 105 percent of that money -- 105 percent of that -- on exploration.

There are some people who will say, well, we have given exemption for new oil. Does that not take care of the incentive profit? Well, it certainly helps. But in this kind of a situation the independent operates on the revenue that he derives generally from the oil production.

When we talk about 3,000 barrels, we are not talking about a Mom and Pop operation, obviously. You are talking about some $22 million of revenue. But let me make a very clear distinction. You are not talking about net income, you are talking about revenue, and $22 million when you are talking about wells can cost $5 or $6 million a piece, does not drill a lot of oil wells.

$22 million worth of revenue is a drop in the bucket as compared to what the major oil companies receive.

I well understand that the major oil companies have lobbied very hard and assidulously against the independent producers amendment. They have contacted a lot of members of this committee, opposing the independent producers amendment. But in this situation, the independent is a man who, when drilling in '78, of 49,931 wells drilled in '78, the independent drilled 42,048 of them. The major corporations drilled 7,883 wells.

So to the extent that you put this tax on and you reduce the income for the independents, it is that many fewer wells that we are going to produce. I know that there is a political liability these days in voting for anything that is going to increase domestic production of oil and one way or the other, that is going to be talked about as a loophole or a rip-off. Therefore, politically, it is best not to vote for it, but I think we ought to be looking at where this country is going to be five years from now. We are going to have a situation where we are going to have -- Iraq deciding what our Middle East policy is, Nigeria deciding what our African policy is, we have to do all we can to produce their production here.

This Committee has already recognized the fact from the testimony that to develop synthetic fuels will cost us on the order of $35 in tax money as compared to $18 and $20 on natural oil, bringing it onto production.

One of the other problems that you are going to run into here is the regulatory problems. One of the arguments would be well the producer really does not have that problem because the first purchaser is going to have to pay that tax and he is going to have to keep those records.

That does not tell the rest of the story. The producer has to certify as to the tax classification, as to the classifications of oil. Even when you have finished with the deregulation, that independent producer is still going to have to keep records on the tax part of it in order to take care of his tax returns and certify as to what kind of oil he has produced.

It gets so complex with the decline curves and the different classifications of oil that out of one well you can have three different classifications and that producer is going to have to continue to certify to those.

Obviously, he has to keep the records.

In 1950, you had 20,000 independent producers; today, you have approximately 10,000 independent producers. Put this kind of a tax on top of what they are already going through and the red tape and regulation, I think you are going to see a further decline in the independent producers in this country.

The Chairman: How many did you say you had in the base period?

Senator Bentsen: In 1950, approximately 10,000. Today you have approximately 10,000. The independent normally does not have the kind of staffs of accountants and lawyers that the big major does, who can handle the sophisticated accounting procedures that have to be undertaken. You are going to put an additional drag on his being in the business, and to that extent, once again, I think that you cut back on production in this country and you are going to have less oil.

We are talking about a lot of money. We are talking about what will be about $22 billion over the ten-year period. That is after you take out for the new oil, and take out for the heavy oil, the things we have already passed in this committee.

In turn, I think it means that you are going to have these people who operate on the margin usually, who are people who go all out looking for the big strike, who will continue to pour back into production and drilling and not be buying department store chains or circuses, but because they think that they can find it and bring it in.

They will continue to spend 105 percent as they did in the past of whatever they have left, but if you subject them to this tax, obviously they are going to have that much less left. It is going to be 105 percent of whatever that residual is.

Frankly, I think that is a policy that is shortsighted for our country, as we try to encourage drilling and exploration in this country.

Senator Ribicoff: I am just wondering, Lloyd. You say these independents, who produce 80 percent of the oil?

Senator Bentsen: No. I say that they drill -- the wildcat wells, actually it is 90 percent drill the wildcat wells. 75 percent of the new fields found, but only 50 percent of the oil and gas discovered.

The reason is, once again, that they get out and drill a lot of smaller fields, a lot of marginal fields, and bring them on into production.

Senator Ribicoff: Would these people generally be the main beneficiaries of the exemption for new production and tertiary?

Senator Bentsen: No. You are right in the first instance. They will on new oil. They will not on tertiary, because in tertiary you are talking about projects involving normally hundreds of millions of dollars and these people would not be participants in that.

My concern is, Senator Ribicoff, that these people spend all of their oil income generally, the numbers show on wellhead revenue for the five years they spend 105 percent of it.

Senator Ribicoff: I know. What will they pick up from the exemption for new production.

Senator Bentsen: It will be in the future, but what they are spending now is the oil that they have found, you see. And they are going to spend that much less whatever the tax cuts them back to, and it seems to me that it is a shortsighted policy when these types of people who go out and spend it in trying to find that new production, to the extent that the tax affects them, they cut back that much.

Senator Packwood: If I could ask a question -- I came in late. At what level of exemption are you advocating?

Senator Bentsen: I am advocating 3,000 barrels with full knowledge, when we get all through with all of these reconciliations there will be an adjustment. We are talking about that with Senator Packwood, and I am sure this and the rest of them.

Senator Packwood: Lêt me ask you this. Take 3,000, 2,000, 1,000 and 3,000 or 1,000. How much revenue loss are we talking about by the exemption at 3,000 and 1,000?

Senator Bentsen: I do not have this number. It is not that major of a figure, I believe.

Senator Packwood: The revenue loss at 3,000 and then at 1,000.

Senator Chafee: Could we have the estimate on that?

Mr. Shapiro: That 3,000 is approximately a little over $23 billion in the 1980-1990 period.

Senator Packwood: $23 billion in the 1,000?

Mr. Shapiro: $1,000 would be $20 billion.

Senator Packwood: $20 billion? There is only $3 billion difference between 1,000 and 3,000?

Mr. Shapiro: That is what we understand.

Senator Bentsen: Not a lot of difference.

Senator Packwood: Let me ask you this, if it is possible to indicate how much either additional production the producers, or the other way around, how much it stops from losing, if that is the direction we go if we have the tax.

Is there any way to prove that? Does anybody know?

Senator Bentsen: If we did not make the exemption?

Senator Packwood: If you did not make the exemption.

Senator Bentsen: All I can say, I do not have that number, other than to say they have been spending 105 percent and whatever the tax reduces their income. If they follow the same percentages out, one would assume they would spend that much less in drilling.

The Chairman: Mr. Lubick, I will get you in turn, Mr. Lubick. You will have a full opportunity to make your case. The more you hear at the beginning, the more you will be in a position to respond when your turn comes.

Go ahead, Mr. Dole.

Senator Dole: I just wanted to check the revenue loss. The proposal, as I understand it, Senator Bentsen, is 3,000 and that includes royalty owners?

Senator Bentsen: That includes the royalty owners.

Senator Dole: What is the cost, if you eliminate royalty owners and nonrisk takers?

Senator Bentsen: It cuts it just about in half.

Mr. Shapiro: Approximately $13 billion.

If you allow the independent producers the exemption of up to 3,000 barrels without any exemption for royalty holders, it is $13 billion compared to $23. That is the reason why going from

3,000 to 1,000 does not have more of a significant revenue difference, because the royalty holders will still get theirs, and the $3 billion difference essentially comes from the producers where the royalty holders generally do not have much more than that.

Senator Dole: On the 2,000 barrel, you give an estimate on that with and without royalty owners?

Mr. Shapiro: We have not run 2,000 yet, but it will not be. It would probably be roughly halfway between the 1,000 and 3,000.

Senator Dole: Your 1,000 was $20 billion.

Mr. Shapiro: $20 billion. The 3,000 was $23 billion. So your 2,000 is between $20 and $23 billion.

Senator Dole: Without the royalty owners you are talking about?

Mr. Shapiro: Without the royalty owners you are talking about approximately $10 billion, about $10.6 billion. This is producers without royalty holders. Then you have approximately $13 billion if it is just 3,000.

The Chairman: I have Mr. Heinz who asked to be recognized, then Mr. Chafee.

I will call on Mr. Heinz. Mr. Heinz?

Senator Heinz: Thank you, Mr. Chairman.

Lloyd, what is the rationale -- at least let me back up. As I understand it, your amendment exempts both the royalty holders as well as the producers. What is the rationale for including the royalty owners?

Senator Bentsen: The problem you run into if you decide to cut out the royalty owners, you are talking about tens of thousands of people. Normally you are talking about farmers, ranchers, who have leased a piece of land and this is a supplement to their income. If you start taxing them, obviously they are going to be asking for higher royalties in the future leasing that you see. As far as individuals, you are not talking about individually a lot of money but obviously it is important to them. They average five barrels daily apiece in royalty participation. That is what you are looking at, and we chose -- if you recall in the 1975 Act, when we dealt with a depletion question, we decided to include both producers and royalty owners in bringing it down, ultimately, as I recall, to a thousand barrels.

Senator Heinz: In terms of production response, it does not make much difference, I gather --

Senator Bentsen: I do not see much there.

Senator Heinz: Whether to include the royalty owners or not?

Senator Bentsen: No.

The Chairman: Mr. Chafee?

Senator Chafee: Mr. Chairman, I have considerable trouble with this. As you pointed out, we have been spending a good deal of money around here in the proposals for the credits and other forms. We got into providing some fuel for the poor and some money for the poor and the situation there was that we had spent so much that the only people we could give a hand to were the very poor apparently.

We have already passed exempting new oil. We have exempted heavy oil. We have exempted incremental tertiary. We have the strippers at 16. They have gone up from where they were some six months ago, maybe at $13 a barrel.

The lower is known as 6+, inflation plus one-and-a-half. The upper is at $13 plus inflation plus one-and-a-half, whatever we agree on.

I am personally in favor of the phase-out. I suspect many here will be for a phase-out in 1990. So it seems to me that we are going pretty far when we take this group of small producers.

If you work out the figures -- and these the Treasury has handed out -- a small producer at 3,000 barrels a day times 365 is 1,100,000 barrels a year. At $20 a barrel makes $22 million.

I just think, Mr. Chairman, we have to draw the line somewhere, particularly if we are going along with the phaseout, as I think we should, a phaseout of the whole tax.

So I would not -- I would have great difficulty going along with Senator Bentsen's proposal. As a matter of fact, I guess you could put me down against it.

Senator Bentsen: I had rather come to that conclusion.

The Chairman: Mr. Lubick?

Mr. Lubick: Mr. Chairman, our chief problem, of course, is that our figures indicate that this exemption, by 1985, would result in a change of induced production of only about 30,000 barrels a year.

Senator Packwood: A change in induced production?

Mr. Lubick: That is right.

Senator Packwood: What is the basis of that 30,000 figure?

Mr. Lubick: Mr. McGregor is taking Mr. Smith's place from the Department of Energy.

Mr. McGregor: The 30,000 barrel supply-response figure is promised on no other exemptions from which the independents or small producer --

Senator Heinz: Per day, or per year.

Mr. McGregor: 30,000 barrels per day.

Senator Wallop: Mr. Lubick said per year. I thought that was a magnificent display of micro-economics, that you could get down to 30 barrels a day across the whole country as a supply response.

Mr. Lubick: Yes, sir.

Mr. McGregor: However, when you factor in the effect of the committee's action to exempt newly discovered oil and incremental tertiary discovery production from the windfall profits tax, that basically flattens the 30,000 barrel per day supply response down to zero.

Senator Bentsen: Let me ask you, do you seriously contend that these are the fellows that are going to be doing the tertiary recovery? Will that be the major oil companies?

Mr. McGregor: I would think much more done by the majors, However, there would be some marginal interplay by the small producing sector.

Senator Dole: How do we arrive at 30,000 barrels?

The Chairman: Are you talking about 3,000 or 30,000?

Senator Dole: 30,000.

Senator Bentsen: 30,000. I do not want to interrupt.

I think the point is the past track record is these fellows are spending 125 percent of the well revenue in drilling and the nature of that kind of an operator is that he spends at full tilt. If he does not have it, he is not going to spend it and if he reduces his income by whatever the windfall profits tax is, and we are showing here it is a net of around $23 million, to that extent, I think you have less drilling. I think it has to follow.

I must say I was very careful, Senator Chafee, not to say from the small producers. I said very clearly this is not a Mom and Pop operation. They go out and drill a $5 million well. You are talking about $22 million worth of income. You do not drill many of them on that basis.

Senator Baucus: Mr. Chairman?

The Chairman: Are you through, Mr. Lubick, or do you want to go ahead?

Mr. Lubick: I think the basic point is a simple one. Having already exempted newly-discovered incremental we do not get any measurable additional supply response. Therefore, it is important for all the reasons we have supported that tax in the first place, to apply it in this situation.

The Chairman: Senator Baucus?

Senator Baucus: I have a question to ask staff. The Department says there is no additional supply response promised on the other activity taken thus far. I wonder whether the revenue estimates are based upon that same premise. Are they assuming no other action?

Mr. Wetzler: Senator Baucus, the DOE's model assumes you only get a supply response from changes in the price of newly-discovered oil and therefore that is once you have exempted newly-discovered oil, there is no more supply response.

As we explained earlier, our revenue-estimating model makes essentially the same assumption. We have some feedback built in only with respect to the price of newly discovered oil. It is not. We do not believe there will not be supply responses in other areas, but simply that those supply responses would be associated with high costs. They would not affect the revenue estimates very much.

The answer is no, we have not built in any supply response in the model from areas other than newly-discovered oil because, while there may be a big supply response, that supply response would not affect the revenues very significantly. You would have high costs and also, you would have associated with the additional oil, there would not be much additional taxable income.

Therefore, you would not affect revenues very much.

Senator Baucus: I have a hard time understanding. Do you agree that the revenue effect is basically what staff has suggested it would be? $23 billion?

Mr. Sunley: The estimate, the $23 billion assumes you have exempted newly-discovered oil.

Senator Baucus: If that is the case, as far as the supply response is zero, that ups the revenue the producer is going to have. Perhaps if I am wrong, more inclined to drill deeper or to take greater risks than otherwise would be the case. I have a hard time understanding why, if there is additional revenue in this respect what it does to the supply response.

Mr. Wetzler: One of the problems is in terms of the analysis, you have several models some of which, including DOE's model, assume that the amount of revenue that oil producers get does not affect the drilling at all, the drilling is simply affected by the price they receive for the oil they are expecting to get from this additional drilling; the argument would run, even though an individual producer may drill more if he himself gets more money in the aggregate, the overall amount of drilling that will get done by the industry as a whole will simply be a response to the price they are going to get, the net of any applicable windfall profits tax.

Other people think differently. Other people think --

Senator Bentsen: That is right.

Mr. Wetzler: -- with a given level of price, if you give more revenue to the industry, they will do more drilling. Some models have drilling responding both to price and to revenue. That is another difficult question.

I think DOE has done some studies on that. They may want to give the committee the benefit of their analysis, but that is one controversial issue on which DOE takes the position that drilling responds to price, not revenue.

In other words, if you gave the oil industry a billion dollars revenue and did not change the price they got for their oil, they would not do any additional drilling. They would do something else with the money.

It is basically a question of just how efficiently you think the capital markets function.

Senator Bentsen: I think that is absolutely right, that analysis, if you are taking about the major oil companies. I think the independents are a different kind of character.

He cannot go down to the bank and finance a wildcat. He has got to talk somebody into taking that risk and he has to use his oil revenue to try to take that risk, and that is what he traditionally does. He spends 105 percent of it.

If you cut back his revenue by $13 billion and he has been spending 105 percent of whatever his revenue was, I think it follows that you cut back drilling by that amount.

Mr. Wetzler: Senator Bentsen, I think the issue is everybody agrees that if you get the independents more revenue they will do more drilling.

The question is to what extent will that be offset by less drilling from other sectors? I do not think anybody really knows the answer to that.

The Chairman: Is there any further discussion? Mr. Heinz?

Senator Heinz: Mr. Chairman, as I understand it, your proposal includes, among other things, most, if not all, strippers.

Senator Bentsen: You made the very good point, Senator. Approximately 60 percent of the strippers are owned by the independent operators. Approximately 60 percent.

Senator Heinz: This would include 60 percent of the strippers?

Senator Bentsen: That is right.

Senator Heinz: I would like to ask the Department of Energy a question. As I understand it, your model in terms of production response relates only to market price. Is that correct?

Mr. McGregor: Market?

Senator Heinz: It does not take into account cost factors.

Mr. McGregor: In terms of what a given factor of oil is?

Senator Heinz: A given supply response.

Mr. McGregor: It sets the pace for the supply response.

Senator Heinz: Bear with me if you will. Thinking of stripper production, where the production per day is very low, I gather -- although, to become a stripper, you have to produce ten barrels or less a day for a year. In fact, the average stripper production is four or five barrels a day, is that not correct?

Mr. McGregor: I would have to check that, Senator Heinz. Certainly many stripper wells are producing below ten barrels a day. However, a good many stripper wells are currently producing above ten barrels a day.

To qualify for stripper well treatment, a well must produce that ten barrels a day for one year under the Department of Energy regulations and, after that time, increased production would also benefit.

Senator Heinz: I am told that the reason we originally exempted stripper wells from price controls is that they are, in essence, super marginal wells. They have high-cost structures in relation to other wells. Is that generally true?

Mr. McGregor: That is correct. That is the logic behind the exemption.

Senator Heinz: As I further understand it, the windfall tax on stripper production would amount to a substantial increase in cost to the stripper producer.

Let me give you a hypothetical example and tell me if it is wrong. If a year or two from now, the price of oil is at $30 a barrel and under the House bill the $16 base, let us say, moves to $20, there will be a $10 taxable difference under the House bill. That would be taxed at $60 percent. That amounts to a $6 payment that the producer must make, or forego, as the case may be, to somebody.

Is it accurate to say, therefore, that his cost structure has been increased under those circumstances by $6 a barrel?

Mr. Sunley: $6, Senator Heinz, would be deductible for income tax purposes. His net increase is only 60 percent of that, or $3.60.

Senator Heinz: Assuming that he makes money?

Mr. Sunley: That is right. There would be no tax.

Senator Heinz: It is something that he must pay. It is like any other cost. It is a cost of production.

He can deduct any cost of production.

Mr. Sunley: Under the House-passed bill, there is only a tax imposed if the property has net income, so it would be deductible for income tax.

Senator Heinz: I understand you do not tax more than 100 percent of net income and that is of great comfort to know that people will not be taxed at 105 percent of net income.

Senator Wallop has enjoyed quoting that particular footnote many times. My point is, do we really expect somebody to produce a well if, in fact, their income from it is zero? That is the first question.

Mr. Sunley. That is zero on the increment on price, I hear, but I think the important thing to remember, Senator Heinz, last year this well was getting $16. It has had a doubling in your hypothetical, practically a doubling of its price.

Senator Heinz: I understand what the situation is today. I frankly concerned about what happens, not today, not tomorrow or next year; I am concerned about what happens to stripper production in 1983, '84 and '85, because there is some evidence to suggest that the cost will be imposed in the form of an excise tax and will be substantial.

I have pulled a number through some calculations that amounts to $6. It could be $5, it could be $10. My question is, what do we know, and if the answer is nothing, please say so, about the effect of that increment of cost on production, how many wells in '83, '84 and '85 might we expect would be shut down as a result of costs equalling revenues?

Mr. Sunley: Senator Heinz, we do not have the most precise number. We think that the production response is essentially zero and there are clearly some offsetting factors here. I think that we should clearly remember that one of the reasons we are going through the whole decontrol and hoping to get rid of the stripper exemption is that the stripper exemption has built in it a production disincentive under current controls.

There is a real incentive to hold back your production, get under ten barrels of oil per year for one year, and then you qualify. Then you do some secondary recovery or whatever, get up above ten barrels a day and that extra oil counts as stripper. We have a stripper exemption in this tax. We will have that kind of incentive still. You will have an incentive to get yourself classified as stripper. Whatever you will have to do to hold down your production, ten barrels is the magic number. You will do it, because you will save some taxes. The amount of taxes you save is not quite as large as the $6. As I say, that tax payment is deductible for income tax purposes.

We are talking about a net increase in taxes of $3.60 as a result of the windfall profits tax when their gross income has increased from $16 to $30. I recognize that is still a tax increase. I think that they have done very well.

Senator Heinz: I understand as someone from the Treasury Department, you are focusing on total revenues to the Treasury. I am just asking the Energy Department to examine what the windfall profits tax does to the cost structure of marginal wells and whether they have answered my question. The answer is, they do not have much information because they do not have an analytical model that works on it.

Mr. McGregor: Right. I would be pleased to go back to the analytical staff at the Department of Energy and see if they can use a cost factor.

Senator Heinz: I think that is a central thing to do.

I suspect that there is an effect -- I cannot prove it. Maybe someone else can.

Senator Bentsen: On the question you asked, staff tells me that the average production for stripper is now at 2.91 barrels a day.

The Chairman: I just want to ask about one item involving me individually. I do not want to be benefitted by this amendment. I do not want to be exempted.

I am a royalty owner. In any event, whether as a royalty owner or as a producer, I do not want to be exempted by this amendment.

Senator Bentsen: I am in the same position, if this happens to pass. I would like the legislation drafted where perhaps no member of this committee -- maybe we should phrase it that way -- can profit by it. I certainly want to make sure that I do not profit by it.

The Chairman: The only way I know to be sure I am not voting to benefit myself or my children or grandchildren would be for the staff to prepare an amendment to say no member of this Congress, nor any of his direct descendants -- I do not have any ascendants -- that no member of this Congress or any of his direct descendants or their spouses would be exempt. I think that would take care of it.

I just wanted to be sure.

Senator Bentsen: I had not expected to visit that on my descendants. I want to be sure that I do not profit by it.

The Chairman: Can we agree that this is so modified and, if agreed, the staff will prepare an amendment to this amendment.

Senator Nelson: That is a very bad principle. Either it stands on its merits or it does not. If we start passing legislation that says any member of Congress or his spouse or his children or something like that, the law does not apply, it is just nonsense. If you do not want to vote on it, do not vote on it, but let us not start saying --

The Chairman: I am going to have to vote on this amendment. I represent Louisiana. We have an awful lot of producers down there a lot of oil.

Senator Nelson: If it is a good amendment, vote for it.

Senator Bentsen: I am going to have to represent my state, and I am going to do that. But I would like to be, in some way, precluded from benefitting.

The Chairman: We have precedent for this. Some years ago Mr. Dole had an amendment that would have favorably involved some of my children and I offered an amendment, and the Senate went along with that, that it would not apply to them.

Senator Heinz: Mr. Chairman, I happen to agree with your amendment. If it is presented up or down, I will vote for it. But what you could do, Mr. Chairman, is you could give people the right to make an election, which would solve Senator Nelson's problem.

Senator Wallop: You always have that right.

The Chairman: The Senator can so modify his own amendment. Frankly, I cannot make an election on behalf of my direct descendants.

Senator Bentsen: Mr. Chairman, I modify my amendment and ask the staff to so do it if it passes, that I be precluded from benefitting from it.

The Chairman: I do not care how closely you draft it, as long as it takes care of one thing, that I am not favorably affected by that amendment.

Senator Packwood: One, I agree with Gaylord on his conclusion. I am still frustrated by his figures.

I have two things from stripper producers that make some statements that I am not quite sure I follow.

If I add up the barrels per day, they are coming up to an infinitely greater number of barrels per day than the testimony just had. I cannot get any evidence from anybody on these sheets, whether what it is based on or how they got there.

If you are telling me 30,000 barrels per day is all we are going to produce at a cost of $2 billion a year and we are using 18 million barrels a day in this country now, it is a ridiculous amendment, if that is all it produces.

But --

Senator Bentsen: I would agree, Senator, that if that is true it is a ridiculous amendment. I do not agree at all that it does. Knowing the nature of these people and the way they operate and they use all of their cash flow that they possibly can get their hands on to go out and drill more and hit the big ones, hopefully.

The Chairman: Mr. Boren?

Senator Boren: Mr. Chairman, I think it is quite obvious that the supply-response figures given are not accurate. If you have someone investing 105 percent, as Senator Bentsen said, you are going to have a supply response and given the nature of the independents' financing structure, they are not investing dollars they can earn in any other kind of operation. They do not have refineries, they do not have overseas operations. Their capital comes 70 percent self-generated from oil production, which they have gone out and discovered.

Look, newly-discovered is included in this because independents get part of newly-discovered stripper production, as we have heard. They have part of stripper production.

We know from CBO and estimates what the stripper supply response is, somewhere between 200,000 and 300,000 barrels a day, newly-discovered supply response.

The Department of Energy itself says it is 180,000 barrels a day. The other estimates range as high as 500,000 barrels a day.

So when you begin to get into all of these features and you make some assumptions about what they are going to do with their dollars, I think that we can make a very strong argument that there will be a far greater supply response and the other thing that I think Senator Bentsen has touched upon which is very important is the fact that it will relieve the independents of much of the paperwork that they are now doing.

I know when I talk to them, the reason a lot of them are leaving the business, the very small operator -- I am talking about people who have very few employees, they say they just cannot cope with it, you know? They cannot even read the regulations, let alone understand them.

Senator Packwood: Mr. Chairman?

The Chairman: Yes, sir.

Senator Packwood: Stripper production from the people who want the exemption.

Senator Dole: Not this particular amendment.

Senator Packwood: It is in the best interests of the consumers and the nation's economy to produce every last barrel of oil from existing domestic oil wells. I do not necessarily agree with that conclusion. The question is, at what price?

Lloyd says they are investing 125 percent of their income. That is a non sequitur. That is not how much energy or oil.

I will say again as far as I am concerned, I am not concerned about producing an oil tax bill for the fun of an oil tax bill, but I would like to know how much revenue might be produced that could be offset other things that will produce anything.

If we can produce more oil through the exemption then we can use the money for saving energy and some other credit. I will vote for the exemption. I do not see the evidence, yet.

Senator Bentsen: Let me get back to these points, then, that will help some but not totally answer your question. They are drilling 90 percent of the wildcats; they are finding 75 of the new fields. They are discovering 54 percent of the oil and gas.

That does not give you a final dollar per barrel, but they are finding over half of the oil and gas and they are drilling 90 percent of those exploratory wells.

The Chairman: Mr. Lubick?

Mr. Lubick: Mr. Chairman, I would like to make a couple of points. I am not sure, Senator Packwood, whether the industry figures take account of the fact that you have already voted to exempt newly-discovered or incremental tertiary, but it seems, as a matter of intuitive judgment on top of the DOE model that if the incentive has been given by a pre-decontrol price for newly discovered and incremental tertiary, that is what we need the exploration for.

Once you have already exempted, newly-discovered incremental tertiary is not going to have a significant supply response.

Second, in referring to the administrative problem, you are going to have a very difficult administrative problem if you have a barrel per day exemption.

It is not going to be possible to ascertain at the time that the oil is produced at the wellhead whether this particular oil is exempt or not exempt. I think you are going to continue to have your administrative difficulties perhaps even compounded, unless you impose a tax and have them wait until the end of the year to go for a refund.

The Chairman: If you buy the figures that they testify to that they are putting more than 100 percent -- I am not talking about the royalty owners. I do not think you are going to get much result from the royalty owners. The average farmer, if he gets more income, he is going to buy some farm machinery rather than drilling a well.

But if you assume that they are putting more than 100 percent now into production, it would seem to me fair to assume that the $13 billion net that you would have if you leave out the royalty owners would almost all be put back into more production and into more drilling. And if you just assume -- mind you, there is no condition on this -- that it be put back in, that is what they are doing with it.

If you assume they put that back in to more drilling, more production, you ought to get at least that much more in terms of dollars in new production, otherwise it would not be a good investment, so that I think that your supply response should assume that, whatever the going market price is you are going to get at least $13 billion worth of oil for $13 billion worth of drilling.

Otherwise, it would not be economical to put it back in.

Mr. Lubick: They are totally exempt on the new exploration.

The Chairman: You are talking about incentives, yes. A man may have a lot of incentive, but if I do not have any money, the incentive is not going to do me any good.

The question is, incentive backed up with money will do a lot of things that incentive will not do, if it is not backed up with money.

That is where I think where you would have to make and where I would be making the case if that were my amendment. I think the Senator has a point in saying that you have a right to assume with that $13 billion that it would go into more drilling and $13 billion would produce more.

Senator Baucus has had his hand up for some time.

Senator Baucus: I tend to agree, but I am a little concerned with the difference in revenue between the amendment as offered and the amendment that might exclude royalty owners. It seems to me that it might make more sense that we would have more additional revenues for the tax credits than whatever we have in mind.

If we exclude royalty owners, it seems to me the money they are getting will not go into additional production. We have so far agreed it will have virtually no effect on additional production.

If you exclude royalty owners, it will give us double the revenue. At least it will cut the loss by half.

I suggest that the amendment be modified to exclude royalty owners. I do not know whether Senator Bentsen would agree to do that. If he does not, I will move to amend the amendment.

It seems to me we are getting closer to where we want to go if it is modified in that form.

The Chairman: Why do we not vote?

Senator Baucus: I move to amend the amendment to exclude royalty owners.

Senator Packwood: Can I ask a question on that? Who are the royalty owners?

Is there a generic class of them? Is there any description of them? Are they relatively small landowners in bulk or lawyers in Boston?

Senator Bentsen: That is a tough one to really give you a total answer on, but there are tens of thousands of people. In the first instance, they are generally farmers and ranchers or that type of thing, that someone may have gone in and bought royalty interests.

Of course, again, I do not know anyone who can give you a total breakdown on it, though, but in general, certainly they start out generally as farmers and ranchers.

Senator Packwood: Question. If they are, as you describe them, farmers and ranchers and if most of yours are like most of mine, they are not particularly liquid or wealthy people.

Senator Bentsen: No. The average is five barrels a day of royalty interest, approximately.

Senator Packwood: They are mainly, Lloyd, not people who have bought royalties in the sense of a lawyer or a doctor buying a share; they are landowners who have accepted a royalty in exchange for allowing drilling on their land, or something like that.

Senator Bentsen: That is generally the case. Certainly you find the exception where someone else has bought.

Senator Ribicoff: I would like to make a comment. I do not know how small all of them can be if you are talking about $23 billion, Mr. Chairman.

The Chairman: You are talking about a $10 billion difference.

Yes, sir, Mr. Wallop?

Senator Wallop?

Senator Wallop: One thing that has not been brought up, everybody is talking supply response and figures are raised, and they belong to one side or the other. Has the Department of Energy done anything about the reserve response -- reserve that will not be lost by being able to produce?

It is a given on this kind of marginal property, once you abandon it, you pretty well abandon it. You are not going to go back in and recover any reserves that might be remaining in the ground once you stop producing.

Mr. McGregor: Senator Wallop, you are addressing existing production and rather than new production that might be brought about by a small producer exemption, is that correct?

Senator Wallop: Yes, that is right.

I assume that the other will take care of itself under the new oil exemption.

Mr. McGregor: There are existing incentives to keep older fields continually producing included, or the incremental tertiary proposals of the administration, and indeed the action of this committee on incremental tertiary recovery, also the stripper well treatment which currently allows world price levels for stripper production is addressed directly at existing production from older properties in an attempt to keep those properties in production.

Another example would be the heavy crude decontrol action of President Carter of last August.

Senator Wallop: With all due respect, that is a very specific type of production. It is not the basis of the question I have. I am talking about existing general reserves I run into, the proposition of being abandoned.

Let me ask you one other thing. Mr. Wetzler made a statement that puzzled me. You assume that because there will be an increase in drilling on the part of the independents there will be a decrease in drilling on the part of the majors?

Mr. Wetzler: I am saying that is an assumption that underlies models like DOE's models that relate drilling only to the price, not to the cash flow.

Senator Wallop: The problem I have with that, from the very beginning, the administration has made the argument that decontrol, all by itself, is enough to trigger substantial drilling activity on the part of everybody involved. Why would they stop drilling if the benefits of decontrol are so great?

Why would the majors stop? After all, they are interested in producing, exploring.

Mr. Wetzler: Well, the way an economist would look at the problem is to say at a given price there are a certain number of areas of leases that are worthwhile drilling at that price.

Senator Wallop: How would an oil man look at the problem. He, after all, is going to be the one. The economists are not going to make the decision as to whether to drill or not. How would an oil man look at it?

Why would he stop drilling?

Mr. Wetzler: Some of the majors say that they look at it precisely the way I am describing it, that they have the capital to drill any prospects that they think are going to be profitable, you know, at the prices they expect. Other companies say no, that is not true. They are really concerned about cash flow and they do not.

Senator Wallop: If they have not, Mr. Wetzler, why are they going to stop drilling because the independents are drilling more? Why is there going to be a decline in that if they have the capital to drill what they want?

Mr. Wetzler: I am not saying that which of these theories is correct. I am just trying to outline to the committee the two ways that the analysts who have looked at this problem, the two ways that they analyzed it and the theory -- one theory is if the independents do more drilling, they will be drilling more of these desirable prospects and therefore, either outside investors or major oil companies will do less drilling because there will be fewer desirable leases left to drill.

Other people, you know, think the theory is wrong and we just do not know which theory is correct.

Senator Wallop: I will tell you where I would come down. I just do not believe that they are going to stop drilling in a program in this country, especially when the administration with the other side of its mouth says that they have so many attractive leases out that they are not drilling them.

The Department of Interior is criticizing everybody under the sun because they are not drilling the lease prospects that they have. An inducement to drill more is going to discourage people who are going to be criticized for drilling as much as they do? It just escapes me.

I can see how an economist comes to that conclusion, but I cannot see how a person in the industry would.

The Chairman: I am prepared to vote, and Senator Bentsen is prepared to vote, on the Baucus amendment. First, I would like to make it clear, you have amended your amendment?

Senator Bentsen: That is correct. He has an amendment to mine.

The Chairman: Let's call the roll.

Senator Packwood: His amendment is to exempt the royalty owners.

Senator Bentsen: Right.

Senator Packwood: We do not have a particular idea of what they are and who they are.

The Chairman: Generally speaking, it is whoever owns the land wherever the oil is drilled.

Senator Boren: Mr. Chairman, one quick answer. In Oklahoma, for example, we have 2,800,000 people; we have roughly 300,000 royalty owners.

Senator Packwood: I do not think a case has been made to exempt them. Frankly, I am not sure I like the whole amendment. I am not sure why we are picking on these people. It does not look to me as if there are a half a dozen multimillionaires --

The Chairman: The proposal is to drop out all royalty owners and limit this to producers, right?

Mr. Shapiro: That is right.

The Chairman: Call the roll.

Mr. Stern: This is Senator Baucus's amendment to strike the provision from Senator Bentsen's amendment that affects royalty owners.

Mr. Talmadge?

(No response)

Mr. Stern. Mr. Ribicoff?

Senator Ribicoff: Aye.

Mr. Stern: Mr. Byrd?

Senator Byrd: Aye.

Mr. Stern: Mr. Nelson?

Senator Nelson: Aye.

Mr. Stern: Mr. Gravel?

(No response)

Mr. Stern: Mr. Bentsen?

Senator Bentsen: No.

Mr. Stern: Mr. Matsunaga?

(No response)

Mr. Stern: Mr. Moynihan?

Senator Ribicoff: Aye, by proxy.

Mr. Stern: Mr. Baucus?

Senator Baucus: Aye.

Mr. Stern: Mr. Boren?

Senator Boren: No.

Mr. Stern: Mr. Bradley?

(No response)

Mr. Stern: Mr. Dole?

Senator Dole: No.

Mr. Stern: Mr. Packwood?

Senator Packwood: No.

Mr. Stern: Mr. Danforth?

Senator Danforth: Aye.

Mr. Stern: Mr. Chafee?

Senator Chafee: Aye.

Mr. Stern: Mr. Heinz?

Senator Heinz: Aye.

Mr. Stern: Mr. Wallop?

Senator Wallop: No.

Mr. Stern: Mr. Durenberger?

Senator Durenberger: Aye.

Mr. Stern: Mr. Chairman?

The Chairman: No.

Senator Bentsen: Now, Mr. Chairman, as amended, we may vote on that?

The Chairman: All right. The yeas are ten and the nays are six. Let me see.

As of now, the amendment carries. We have four absentees. They can be recorded however they want to.

All right.

Mr. Stern: Do you assume, for purposes of the next vote, that the royalty owners are not included?

The Chairman: The Baucus motion carries. We will have to do business with what we have here. If the Senators want to change the result, they can come back in and notify us. We have to proceed on the assumption that that motion carries.

Senator Packwood: Are we not talking, therefore, at the 3,000 level, roughly an $11.5 billion loss over the ten-year period?

Mr. Shapiro: $13 billion.

Senator Packwood: A $13 billion loss, and these widely varying estimates, in my mind, with no particular support of whether we are talking about 30,000 barrels a day or several hundred thousands barrels a day.

I am going to vote against it, Mr. Chairman. There might come a day when I would vote for it. I do not see enough evidence to exempt it yet, and it may be there. I do not see the evidence to exempt the strippers.

Senator Chafee: Mr. Chairman, to repeat one point, there has been an incentive when the price was at 13. The price is higher under any system we go to, particularly, of course, when new oil is exempted and incremental, and the strippers are treated differently.

But I would also like to ask the staff, what are the incentives now that go to independents? Are they not treated differently under the depletion allowance?

Mr. Shapiro: Under present law, they get percentage depletion. This was done in the last several years when percentage depletion was available across-the-board and it was cut back. Only available to independents, not available to the major oil companies.

Other than percentage depletion, those in the oil industry do get some of the other tax benefits, for example, intangible drilling expense.

Senator Chafee: Intangible drilling. So the independents are now treated differently -- we could well say favorably.

Mr. Shapiro: With regard to percentage depletion, that is the case. However, intangibles is available to both.

Senator Chafee: Forget intangibles, but with regard to depletion, they get a benefit or break, however you want to phrase this.

Mr. Shapiro: Yes. They are still eligible to get percentage depletion where the majors are not.

Senator Dole: On the other hand, for the most part, they are not corporations. They are paying higher tax rates, about 70 percent, rather than 46. I am not so certain that the independents have any advantage.

Again, making the same argument that Senator Bentsen made I do not know where they even get 30,000 barrels a day. It seems to me there has been no satisfactory answer to that question.

If we just want to produce taxes, we are going to do that.

I asked Mr. McGregor earlier where he got 30,000 barrels. Do you pull these out of the hat somewhere?

Mr. McGregor: No, the 30,000 barrels, although I did not conduct the analysis, I am informed that that is the volume of daily production that would be attributable to small producers in the 3,000 barrels per day range under the exemption for newly-discovered oil.

To state that conversely, if the newly-discovered oil category had not been exempted from the windfall profits tax.

Senator Packwood: I am confused about that answer. I thought you just tied that figure to the newly-discovered exemption?

Mr. McGregor: That is correct.

Senator Packwood: There will not be any?

Mr. McGregor: A negligible supply response.

The Chairman: Basically you are saying --

Mr. McGregor: Excuse me, Mr. Chairman.

The Chairman: It seems to me as though you have got to be assuming that they are not going to put any substantial part of that $13 billion back in the ground when the evidence is that they are putting over 100 percent back in the ground the way it is now.

Mr. McGregor: If the argument is that increased cash flow acts to back up the incentive that is already existing for the production of newly-discovered oil, I would say at the margin you are correct, and perhaps it would be a small supply response. It is in a range that is not quantifiable.

However, as Senator Bentsen has so correctly pointed out, it is the small producer who is the wildcatter in the business. He is the person, or the company, who goes out and drills the new wells and the new properties, the exploratory wells, and the exemption of newly-discovered oil from the windfall profits tax certainly creates the appropriate incentives for his going out to do that.

And also it enhances his ability to go to the capital markets if it is not internal cash flow to raise the capital for drilling those new wells.

The Chairman: Well, now, I can understand how people in business can come to absolutely despise some of you in government either for your ignorance or just for intellectual dishonesty.

You have a situation where, when people receive this income, the government is going to take 70 percent of it in taxes unless they go put it back in the ground and do more drilling. Now, often in the situation, you have a state tax that applies as well. So the only way they keep any of this money, or any substantial portion of it, is to spend it doing more drilling.

I have had explained to me how some people go about deciding how much drilling they are going to do. They just put on the wall the prospects that they have to look at and they try to rate them one through twenty, one through a hundred, depending on how big the company is.

Basically what they do is to evaluate those prospects and they drill as many of them as they have the money to drill.

Now, you are preceding on the assumption that they are not going to put just money in the ground and that is completely contrary to the testimony, Mr. McGregor. Do you assume that they are not going to put the money back into doing more drilling?

Mr. McGregor: I would anticipate that some of that money would appear as internal cash flow and would be put into the ground in terms of new, exploratory drilling. However, I am saying that the incentive environment, going ahead for drilling those wells, already exists with the exemption of newly-discovered oil.

The Chairman: Please understand, with the resumption of newly-discovered oil yes, you have an incentive to drill, but even though the bill may lead there, if you do not have the money to do it with then you just do not do it. You do not have the money to pay for it.

Senator Chafee: If they have not had the money at $13 a barrel, Mr. Chairman, now things are going to be better, even under the 75 percent tax, or whatever it is, they are getting additional incentives. The new is exempt. The incremental tertiary is exempt. Plus there is an inflation factor, plus there is a 1.5 percent plus there is a 25 percent, or a 50 percent, or whatever the balance of the tax is between the world price and the $13.

The Chairman: I am not arguing about the fact that there is an incentive. What I am talking about here, if you have an incentive but do not have money, then the incentive does not mean that much. Obviously to the extent they have money, I would anticipate that they would drill.

Senator Chafee: They have the money at $13, Mr. Chairman. They are going to have more money under this.

The Chairman: The point is whatever level you think they have more money you would expect them to do more drilling. It is just that simple.

Let's call the roll.

Senator Heinz: Mr. Chairman?

The Chairman: Yes.

Senator Heinz: I think that at least one of the problems some of us are wrestling with, we do not know what we get for this

3,000 barrel exemption. We do not know whether we get 30,000 barrels a day; we do not know whether we get 300,000 barrels a day, none, or what.

It also seems to me that the 3,000 barrels a day is arbitrary. I do not know why it should be 3,000 as opposed to 5,000 or opposed to 1,000. Now, one way of solving would be, I suppose, without really resolving the arbitrariness of the 3,000 is to write for this particular section only, a plowback provision, which in other words, you would get -- and we can decide later whether it should be 1,000 or 3,000 -- but write a plowback provision so at least we know, and we can say to everybody whatever is spent is going to go into production.

I do not want to do it for all the other categories, but in this one category it seems to me that a plowback as a means of saying if you plow it back, as we are talking about here, you get your exemption we are talking about here. Or if you do not, you do not.

The Chairman: Do you want to incorporate that in an amendment?

Senator Bentsen: Mr. Chairman, let me say that the record is that they are spending 105 percent of the wellhead revenue now. We have been up and down this plowback situation trying to find a way to do it that does not complicate it and does not become extremely difficult to administer and result in serious tax controversies.

I think that the track record is there, when they are doing 105 percent, and they did that without coercion. I think that is good enough.

I would like to get a vote on this amendment as it is, if we can.

The Chairman: Is there any further discussion?

Let's call the roll.

Mr. Stern: Mr. Talmadge?

(No response)

Mr. Stern: Mr. Ribicoff?

Senator Ribicoff: No.

Mr. Stern: Mr. Byrd?

Senator Byrd: No.

Mr. Stern: Mr. Nelson?

Senator Nelson: No.

Mr. Stern: Mr. Gravel?

Senator Boren: Aye by proxy.

Mr. Stern: Mr. Bentsen?

Senator Bentsen: Aye.

Mr. Stern: Mr. Matsunaga?

Senator Matsunaga: No.

Mr. Stern: Mr. Moynihan?

Senator Ribicoff: No, by proxy.

Mr. Stern: Mr. Baucus?

Senator Baucus: Aye.

Mr. Stern: Mr. Boren?

Senator Boren: Aye.

Mr. Stern: Mr. Bradley?

(No response)

Mr. Stern: Mr. Dole?

Senator Dole: Aye.

Mr. Stern: Mr. Packwood?

Senator Packwood: No.

Mr. Stern: Mr. Roth?

Senator Roth: No.

Mr. Stern: Mr. Danforth?

Senator Danforth: No.

Mr. Stern: Mr. Chafee?

Senator Chafee: No.

Mr. Stern: Mr. Heinz?

Senator Heinz: No.

Mr. Stern: Mr. Wallop?

Senator Wallop: Aye.

Mr. Stern: Mr. Durenberger?

Senator Durenberger: No.

Mr. Stern: Mr. Chairman?

The Chairman: Aye.

The yeas are seven, the nays are eleven. The motion does not carry. I will ask that the absentees have a right to record themselves. It would not change the result.

Senator Ribicoff: Mr. Chairman, if I may take about two minutes of the Committee's time, Senator Moynihan and myself consider that there has been some confusion with action taken on Thursday and the staff has to file a report today. I hope to clear it up.

That is whether the Finance Committee, in addition to changing to the 60/40 formulat on the child care deduction also intends to change the current law as to the placement of the child care deduction. We now have child care expenses deducted before taking the 40 percent offset instead of after.

We thought to save some money as required by the Budget Committee and our proposal -- Senator Moynihan's and mine -- would save $177 million.

As the press release went out, it would save $205 million. The staff is somewhat concerned because they feel there is a sense of unfairness and the staff suggested that the formula be changed to $70 plus 40 percent, which would be acceptable, and I hope that we can clarify that confusion.

The Chairman: It is all right with me. I am willing to hear the other side of the argument. Is there any objection?

Without objection, it will be so modified, that that will be $70 disregard of earned income, $70 plus 40 percent instead of $60 plus 40 percent.

All right. Thank you.

Mr. Boren?

Senator Boren: Mr. Chairman, I have an amendment I would like to offer at this time. It relates, at least indirectly, to the amendment offered earlier by Senator Bentsen.

I would like to move that we exempt stripper production from the windfall tax -- stripper production, of course, defined as ten barrels a day production or less as it is defined in the current law.

I would point out that in offering this amendment, really, all I am asking is that current law be retained.

As you know, the current law, prior to the President's move to decontrol already recognized the position of stripper production and exempted stripper production from price controls. That is existing law.

Stripper production is now receiving something in excess of $20. per barrel. So that the effect of the bill that is before us would be to roll back the price currently received for stripper production.

Now, I am sorry that Senator Packwood is not here at this moment. We are dealing here with a case where the figures are very well documented. We are not dealing in terms of a hypothetical supply response.

Here we have a long history that we can clearly look at that indicates what kind of supply response we have to a stripper exemption and to higher prices for stripper production. Nothing hypothetical about it.

I would urge the committee to consider this. From 1962 to 1973, before stripper production was exempt from price control, the total number of wells in this country dropped from 596,000 to 497,000 wells. In other words, we had a loss of wells in this country during that decade of some 100,000 wells.

After the stripper exemption was written into law -- by the way, by an overwhelming 57 to 29 vote of the Senate, the last time the stripper exemption was considered -- the number of wells in this country increased by 19,000. The number of well abandonments in this country, the abandonment rate dropped by 500 percent.

In other words, the well abandonment rate today is one-fifth the well abandonment rate prior to the exemption of stripper production. So I think I could say, with all honesty, to Senator Packwood and others, here is a clear-cut case. We are not dealing with any theories of production response. We are dealing with facts as to what has happened in the past.

CBO at my request some time ago estimated that we would get by exempting stripper from this tax, 235,000 barrels a day of additional production by 1985. Dr. William Talley is a person I respect, Director of the Department of Energy in Oklahoma when I was Governor, a Ph.D. in this field, leading management and petroleum analyst who continues to be Chairman of the Governors' Advisory Council on Energy in Oklahoma has estimated that by 1990 -- I think this makes sense -- he goes right along with the CBO estimate. It would be in the neighborhood of 310,000 barrels a day production response from a stripper exemption. That works out in a price range of somewhere between $13 and $19 a barrel. That is very much in the ballpark with the new production exemption that we gave.

The other thing that I would point out is that there has been an argument. I read the administration -- not to anticipate what they are going to say, but I did read the sheet that they handed out. They raised the argument again on the net income. They said, well, my goodness, we provided you cannot have a net loss -- this has been talked about several times -- that is all you need to protect stripper production.

First of all, that net loss applies to property. It does not apply to an individual well, so you may well have an individual well on a property that loses money that will be shut down. Of course, the stripper production is the type of production that does tend to lose money and does get shut down.

The other thing is this. It is not so much that you are not going to lose, it is how long is it going to take you to get back what you have spent? Strippers are the kind of production, again, that gets shut down, things go wrong. They have to be shut down, they have to have workovers.

So you have an individual well -- let's say three or four barrels a day and it is shut down. You have to have a workover. These figures have been presented before. That costs about $3,000 on the average for a well that is 3,000 feet deep for a well that is 3,000 feet deep for a workover. If you have to, for example, put in for a new surface pump -- Senator Bentsen has pointed this out -- currently it is about $17,500. When you begin to look at the likelihood that you will run into further problems in producing the well in the future, I think that you can see that to get your money back on any kind of situation where you do have to shut it down, you are going to have to have some profit margin to be able to get that money back in a reasonable time in order to do it and keep that well in production.

I do not think that really provides the kind of production that is necessary, from a conservation point of view. Even more than newly-discovered, we are dealing here in terms of the supply response in the same ballpark. We are talking about saving production that we now have.

Senator Packwood: Let me ask a question I was going to ask. Are almost all stripper wells, per force, existing wells?

Senator Boren: All stripper wells are existing wells. To be a stripper, you have to be producing. By definition, you are producing ten barrels or less.

What happens is that you hit a new well. Over time, its production will decline. So you can almost say if you trace the life story of a well, almost every well, sooner or later, will become a stripper near the end of its life, as we recall from primary production.

What happens -- and this is an important point, too -- as that well gets old, as its production goes down, and gets down to the three, four, five barrel a day category, it becomes extremely important to keep that well alive, because if you keep it alive, it then becomes a prime candidate for secondary and tertiary recovery, for enhanced recovery, which we already have acted upon in this committee.

Senator Packwood: I am impressed with that figure you have, the 235,000 barrels a day by 1985. That is the kind of evidence I have been asking people for.

Does that presume an exemption for newly-discovered oil or was it written without that presumption?

Senator Boren: I do not believe it makes a bit of difference in terms of newly-discovered. Newly-discovered -- I do not know the answer to that question -- newly-discovered would not impact the stripper numbers. What you are dealing with in the next ten years, the wells that are likely to fall into the stripper category that are not there now; by the way, in terms of numbers of wells, I think there are 390,000 stripper wells if you take all the wells in this country.

The vast bulk of this production comes from 150 barrels a day. The number of wells -- not total production, the number of most of them -- are down, many are down in the stripper category. Of course, they are old.

Here is the important thing about it, though. If you let that well be prematurely plugged, it gets down to two or three barrels, you have to have a workover. You have to spend $2,000 or $3,000 on it. You are trying to decide, is it worth it or not? You decide it is not. You plug that well prematurely, I would say, because it is still producing, wasting that oil.

That oil would tend to go back into the formation, tend to be lost. You cannot really come along five years later and say, let's try a water flood on that. Let's try CO_2, some tertiary process. What tends to happen when you prematurely plug those wells, it is gone. It's back into the formations in a way that is not economic to come it and use it in enhanced recovery.

I think that special treatment for stripper, an exemption for stripper, when you understand the life cycle of a well and keeping alive these billions of barrels of potential reserves for enhanced recovery, that becomes a very critical thing and without special treatment, that is a weak link in the chain that we have talked about.

Going out on newly-discovered, yes. We put incentive into that. We put incentive into tertiary. I think it was proper in both those areas. I think they are cost-effective.

But the weak link is stripper, if you do not keep the well alive during that period of its life.

Senator Packwood: What is the revenue loss?

Senator Boren: The total revenue loss, if you provide a total stripper exemption, according to the Joint Committee is $24 billion, if we provided an outright total exemption.

Senator Packwood: 24.

Senator Boren: Yes.

Senator Packwood: Ten-year period?

Senator Boren: Yes.

Senator Packwood: 2.4 if you flatten it out?

Senator Boren: Yes.

The Chairman: Senator Durenberger, you have eloquently described the depletion factor that causes a well, a producer, to to into the stripper category.

What other factors might cause, say, a premature decision on the part of a producer to take his well into the stripper category?

Senator Boren: You are already in the stripper category. There are several factors, of course, that affect the cost, to make these wells high cost. They produce a high volume of water, generally, in terms of the oil that they produce.

Mechanical breakdowns are not at all unusual. To keep an oil well going, occasionally you have to go out, in essence, to clean it out, using the chemical process, do a workover. Many of these things that hit you may well make you decide, well, heck, if I spend $5,000 on this well at this particular point in time, how long is it going to be before we can get it back? That really affects whether or not you decide to go ahead and plug it.

Are you going to take the risk, if you are sitting there looking at it, well, it has to produce at that rate another ten years to get it back. What is the likelihood that it will do that?

Maybe we will have some other problem that will come up.

This is the kind of thing that causes it.

I think the history of showing how the abandonment rate went down by 500 percent in terms of raising the price of stripper indicates the kind of supply response that you have in terms of price. I think the record is clear on that.

Senator Durenberger: My question is slightly different. The question simply is, are there factors other than the depletion of the oil which would cause the producer.

Senator Boren: Yes, there are factors. That would cause production to go down. That would be the most significant one.

I cannot tell you all of the factors that would cause it. I am not a geologist or petroleum engineer. There are factors, for example, which will reduce pressure in a formation that might cause a well to drop precipitously. You might have a good-producing well and it may drop off. If you have a well you can bring back, particularly with the incentive that we have given for enhanced recovery, what you would do in that situation, if you knew you could go in there and use some enhanced process or something else to get the pressure in that formation back up and get your production back up to 50 or 100 barrels a day, you are certainly going to do that; no problem whatsoever.

But if you are looking at mainly a normal life cycle decline then when you have to face a workover, then you are looking at a very different situation.

I do not think what we are talking about here, the history of it, has certainly not indicated that, particularly what we are doing with enhanced recovery. You are tying the two together effectively.

You would not have any disincentive, in other words, to go back in and approve the production of that well in order to get full price, especially with our tertiary production exemption.

Senator Durenberger. Let me ask you another question.

I think we heard earlier from Senator Bentsen that the average stripper well production is 2.91.

Senator Boren: That is correct.

Senator Durenberger: Do you have figures on the average per stripper producer production?

Senator Boren: I do not except that I do know that the vast majority of stripper production is held by independent producers. This is the kind of property -- I can tell you, for example, I know in my home county that has a lot of stripper production, it is an old field, discovered back in the 1920's. Those wells produced for years a decline down, most of them, into stripper category.

What happens is the major oil company might start off producing that field. They do not want to be bothered with this kind of production so they will pump it off until finally when you get down to these smaller stripper wells, many of them are run by your very smallest operators, the kind of guy who has his own little operation, or maybe he is retired, even, from a major oil company. He will buy some of the stripper production.

He will go out there and try to do a lot of the work himself, literally, sort of the baling wire stuff on the pump and that kind of thing so he can save money and make this a productive property. He will do things like giving of his own labor, a small operator will, that will make that well last longer than, say, a major company.

There is not a single major company operation in this county I am telling you about, not a single one left. Every one of them now is an independent operation and those stripper projects are 100 percent in that situation.

Senator Durenberger: It is those kind of little folks that I was concerned about. I was impressed by the production figures that Senator Packwood had, also shocked by the $24 billion figure. I do not know if anybody else shares that.

If the exemption were other than a blanket exemption and went down to 1,000 or 2,000 barrels a day, what kind of impact would that have?

Senator Boren: On the revenue.

Senator Durenberger: Yes.

Senator Boren: You could do it differently. I support total exemption because I think the supply response per dollar, going back to the cost-effectiveness per dollar, would prove it out. If you want to drop down, you could drop down, for example, to take the first three barrels a day of production -- you would phrase it that way. Instead of 1,000 barrels of production, you would say your incentive is to that individual well, which is the high cost profit.

If you drop it from the first three barrels production per day, the cost would drop to something a little less than $10 billion and that is because your volumes of production, while meeting this 2.9, on the average your volumes of production are significantly higher.

You add in the number of wells, half the wells are making 2.9 or less but the volumes are higher above.

So it is about a little less than $10 billion and --

Senator Durenberger: In terms of incentives, back to the arguments that were being made on behalf of the independent producer, are we better in terms of incentives going to a three barrel per day exemption or a 1,000, 2,000 so that we are providing the incentive to that producer?

Senator Boren: I think that is very hard to say. We are talking about -- I supported what Senator Bentsen tried to do. I think what we are dealing with here is perhaps a little more easily understandable, in terms of getting data. Congress has recognized the stripper problem before. We have data and we know what has happened in terms of the number of wells, we know what has happened to abandonment rates. Perhaps it is a little easier to explain.

I would say this, that you are talking about the economics of stripper production are stripper well economics. That is the reason I say net loss and profit and so on does not really help. They are individual well economics.

If we are talking about conservation, it seems to me tragic if we would lose -- here is a well that has produced. We are getting that oil out of the ground. We have paid the environmental cost and we do not have any doubt that is there.

To lose something that we have, to me, from the conservation point of view, is the worst possible policy.

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Senator Bentsen. We are also talking about a lot of oil. We are talking about 369,000 wells which represents about $73 percent of the nation's oils wells. It represents 14 percent of the nation's oil. And this is something that, as Senator Boren has very ably stated, is extremely cost sensitive.

That is why the big company with their administrative costs cannot manage these wells. They close them down or they sell them. And they sell them to the fellow that has himself a very thin administrative staff in order to be able to handle it.

There are two assumptions which you can generally arrive at when you bring in an oil well. One is that over the years your production is going to go downhill. And the other is that your expenses of operation is going to go uphill. And when those two finally cross is when you close down the well. And what we are trying to do is to delay the closing down of the well.

And as far as comparing this cost of bringing on synthetic fuel, it still is a better purchase for the taxpayers.

The Chairman. I want to try to recognize Senators in the order in which they raise their hands. I believe Senator Chafee had his hand up some time ago and just about gave up. Let me get back to the Senator, then I will come back to Senator Baucus and Senator Packwood.

Senator Chafee. Thank you very much, Mr. Chairman. I would just like to say in connection with this that the strippers have been going very, very favorably, as Senator Boren pointed out, that many have come back into production under the $16 a barrel.

Now under the proposal, and we are working from the House bill on this, that is what the statistics of the $24 billion loss revenue comes from, if we stuck with the House bill we have got to recall that the strippers will get the $16, get the inflation factor and they also will get the 40 percent of the difference between $16 and the world price.

In other words, it is a 60 percent tax, leaving them the 40 percent.

I think there is another very point, Mr. Chairman, that we are going to come to wrestle with eventually here. The House bill, as you know, does not provide for a phase-out. As I have mentioned, I am in favor of a phase-out. I think we should have one. And that is a very, very significant factor as revenue goes, goes the long run if we have a phase-out.

And here we have a proposal by Senator Boren that just in the 10 years, loses its $24 billion.

Previously, from the House bill we have exempted heavy oil which the Administration came in with. There is $5 billion. We exempted newly discovered oil for $14 billion. We exempted tertiary at $10 billion. And now comes forward a proposal of $24 billion. The only thing we have done to add to the House bill is in Tier I we have raised the tax from 60 to 75 percent, which brought us $1 billion. But we are not making up the revenue.

We all have had very fine ways of spending up the money.

And, Mr. Chairman, I feel very strongly that we should stick with the House bill on this. We should stick with the Administration's position of $16 with the things that go along with it, the inflation. But most of all, keep in the back of our minds that we are probably going to vote for the phase-out which is a very significant step.

The Chairman. Senator Baucus.

Senator Baucus. I have a question on the supply response. I asked Senator Boren privately but he does not have the information. The question was the three barrels exemption supply response.

On the question of the three barrels a day, apparently, we do not have that information.

Mr. Shapiro. Let me make some further estimations on your estimate as we understand it. By 1985 they have estimated that of the -- they give a range of between hundred and seventy-five and two hundred and thirty five thousand barrels per day. In that range, they say fifty-five thousand would come from strippers being shut down. They say that represents somewhere from between twenty-five thousand and thirty thousand wells. That is the shut down problem that Senator Boren and other senators concerned feel that because of the expenses it would not pay for them to do it. That is the shut-down situation. The remainder, approximately in the range the CBO uses which is one hundred and twenty thousand to one hundred and eighty thousand barrels per day would be newly discovered oil. And that the additional revenues meaning that those who are the stripper would have would be put into more money into more drilling newly discovered oil.

So the range the CBO has has been 175,000 and 235,000. Fifty-five thousand represents shut-downs, and between 120,000 and 180,000 represents additional revenue going for newly discovered oil.

Senator Boren. Let me ask this. Would it not be reasonable to assume that as our production grows and we know the general fall out of production back into the stripper category, as the present oil ages, the stripper category historically has grown and would be likely to continue to grow.

The Chairman. Senator Packwood.

Senator Packwood. I want Bob to hear this, please.

Mr. Wetzler. Our figures on stripper assume that a lot of the old fields in Oklahoma and Kansas and Texas will over the next 10 years decline down below 10 barrels a day. So we have built in a growth in the stripper category simply as a result of the natural decline of the old oil fields.

Senator Boren. It would be pretty hard for more of them to get into it because the percentage is so high, at least in the state of Kansas and probably Oklahoma next after that. But the point is that these fields in other states are more likely to decline into that category as they get older.

Senator Wallop. Would you yield on that? Something is puzzling me about the assumptions that were made, and perhaps I missed something. But it sounds to me like you -- one was the abandonment and the second was new oil. It does not seem to me that there can be a revenue loss on the basis of both an exemption of new oil and an exemption of stripper if you are assuming some of that is entering into the picture. I do not know which side.

But on one side or the other the revenue loss figure has to be substantially inflated.

Mr. Shapiro. These are CBO's figures.

Senator Wallop. I realize that. I am not in challenge with you. But it seems to me that they are taking that out of the new oil and then there is bound to be a relative revenue increase. You cannot lose it in both categories at the same time.

Mr. Shapiro. We have done that in our estimates, for example, on your, on the vote that you had independent oil, and in regard to those estimates we had those taken into account. The committee already exempted this newly discovered oil.

It is not clear whether or not those who are making estimates in CBO are following the committee's decisions. So that when they make any of their estimates on revenue or otherwise or on the supply response, they are aware of the committee's early decision to take that into account.

Senator Wallop. I understand that, but the point that I am making is that if they are right on that, then the revenue loss so-called on the new that we are looking at, has got to be lower.

We cannot assume one set of figures on one side and another set of figures on the other side, and not come out with an inflated concept if you are operating on two different sets of assumptions.

I guess what I am saying is that we have to look at each of these individually internally as to what it does and not compare them. The revenue loss that might otherwise be assumed by the new oil already exempted.

Senator Packwood. Let me follow up on your question. I think it is my turn next. Bob, I cannot quite hear or see what you are saying. Did you say that that CBO estimate that Senator Boren referred to, one, in a range of 185,000 to 235,000, that they presumed that 55,000 of the shut down, if you do not have a stripper exemption, would be old wells? And that 120,000 to 180,000 would be wells that would not be drilled? What was it you said?

Mr. Shapiro. As I understand it, and I just have not seen a letter with this information my staff has put together of what was in the letter that was sent to Senators Boren and Bellman, is that they are saying that total increased production by an exemption for strippers, this is the so-called supply production response, would be between 175,000 and 235,000. They get that by saying 55,000 barrels per day would be additional oil that otherwise be stripper wells that would be shut down.

Senator Packwood. That is if we exempt the strippers all together. Fifty-five thousand would otherwise be shut down.

Mr. Shapiro. That is right.

Senator Packwood. Now what is the other figure?

Mr. Shapiro. They say their supply response from those who would have more revenue because of being exempt from tax would reinvest that money for new drilling, that additional drilling would produce between 120,000 and 180,000 barrels per day by 1985.

Senator Packwood. But these are not necessarily wells that would be exempt from tax because we are exempting new oil. Those are not new wells we are talking about.

Mr. Shapiro. These would be newly discovered wells as a result of the additional cash flow. But they would also be exempt under the committee's decision.

Senator Packwood. But they would be exempt by the action we have already taken?

Mr. Shapiro. Correct.

Senator Packwood. But there is a fundamental difference between what you just said and what he just said about whether or not the stripper wells are new oil. Are you saying stripper wells are new oil?

Mr. Shapiro. No. What CBO is saying is that the additional revenue cash flow that would be gained by not paying the windfall profits tax would be reinvested by those who own the stripper wells, be reinvested in new drilling. And the additional cash flow would produce a supply response of approximately 120,000 to

180,000 barrels per day.

Senator Packwood. Let me rephrase the question because I do not understand your answer. If I do not phrase it right, then correct me. Is the CBO study concluding that with the action that we have taken to exempt new oil that we would get roughly 120,000 to 180,000 more barrels from stripper wells?

Mr. Shapiro. This is one of the things I was talking to Senator Wallop about. It is not clear that CBO took into account your earlier decision on newly discovered oil and to what extent any of that 120,000 to 180,000 would be part of the supply response to your earlier decision. It may be that your earlier decision to exempt newly discovered oil would account for some part of this 120,000 to 180,000. That incentive is there. We just do not know to what extent CBO took that into account.

Senator Packwood. It is a world of difference. You round it off at 200,000 barrels, but if only a quarter of that is going to be shut down if we exempt strippers. And there is another possibility of 120,000 to 180,000 that may or may not produce because of the new exemption, or at least money that they will have that they can put into new wells. We are talking about the difference between the \$24 billion revenue loss for 50,000 barrels and the \$24 billion revenue loss for 200,000 barrels a day.

And what you are saying is that you are not sure of what the study concludes.

Mr. Shapiro. We do not know when they did the assessment and whether or not they looked at it as isolated or just looking on it as a stripper, or whether they took account the committee's early decision to exempt newly discovered oil.

Senator Wallop. The supply response in the CBO only goes to 1984. You are not talking about the $24 billion loss between now and 1984, you are talking about a much smaller portion.

Senator Boren. And the supply response which Dr. William Talley, who is head of the Department of Energy in Oklahoma when I was governor, provided for me, and I think highly of his expertise. And I think that what he has done is he has taken the abandonment rate, he has plotted the abandonment on wells as compared with in terms of the change of price and made assumptions about what happens to abandonment rates with price.

I think that is a valid way of doing it too. So that his estimate, as I understand, is strictly related to what he thinks are stripper abandonments through 1990. Now the CBO figures only through, it says by 1985, but the beginning of 1985.

We can argue back and forth on this. I am not trying to utilize figures to show something that I do not sincerely believe is there. I think that that response is there. I think that the well abandonment figures that I gave earlier, in terms of reducing the abandonment rates by 5 percent would certainly ducktail along with what the other supply response has been.

And I think if you read again what CBO is saying, I think they are making other assumptions. I think they are assuming that you would take the additional revenue of stripper production and go out and explore for some more.

You are talking about newly discovered there. There is an assumption made, if you give the producer so much more revenue -- and the administration made its own assumption. You know, it is kind of funny to me that they do not make it any more on anything else. When they talked about decontrol, when they said that we are going to get 3.5 billion additional barrels a day of production because of decontrol, how did they come up with that figure?

Well I will tell you how they came up with it? They came up with an elasticity of additional production based upon the facts . So that you have so much additional revenue going to the producers, and then you are going to have so much more additional oil produced. And the elasticity that they used was one and a half. That was their elasticity factor. That is pretty easy to track down.

When you turn around and ask for exemptions, they do not seem to apply the same elasticity figures in terms of what will a producer do with the revenue he puts in his pocket.

So with all due respect, they themselves say that there is a difference, that 1.3 million barrels a day of production between the House bill and what it would be if the House bill was not imposed. They are doing a little bit of, Well on exemptions we --

I do not know what elasticity figure they are using a lot lower--- but when we made our arguments for decontrol for the present we said there is going to be whale of a production response.

I think there is a little bit of gangsmanship. I guess there is in all of us. I am presenting the figures in the most favorable line from my point of view. But I think we have to bear that in mind. We are talking about cost effectiveness and conservation. And I think the special treatment for strippers makes sense.

The Chairman. Let me call Mr. Dole and I will call Mr. Wallop after that.

Senator Dole. Well I guess anybody who produces oil should speak at these meetings, but I think we ought to focus, I can see a classic vote shaping up . Those without oil, vot no, and those with oil, vote yes. Now if that is the way we are going to address the energy crisis, I guess we will always have one.

But I have got sort of a bottom line proposal. There are 28 states in this country that produce stripper wells. Virginia has 4, Missouri has 161, Pennsylvania has 28,000. They get a quarter of a barrel a day, the average production of wells in Pennsylvania. They get a lot of water. It costs a lot of money to get rid of that water. They do not really make a great profit.

I am just talking about Pennsylvania and the great stripper area, they have 28,000 oil wells producing about a quarter of a barrel per day.

New York has 4,000 stripper wells. They get about a half a barrel per day average per well. In the state of Kansas we get up into the big numbers. We get up to 2.8 barrels per day per well.

And I make all those arguments, certainly it has been pointed out here that Senator Bentsen said that 73 percent of the wells are stripper wells, 14 percent of the production. If we took the bottom line and we accepted everything that we are told by anybody they send up here from the Energy Department or anywhere else, and we are supposed to believe all that. The press writes it all down. We do not know where they got their figures, and we do not know how to change the figures.

We are talking about a stripper production, trying to save a resource, and whether we are going to abandon the resource. That is really what we are talking about. In the stripper production you cannot make it because of additional cost, you are going to abandon it. And I do not know who to believe.

We have had testimony before this Committee that said that what we have done, in effect, if we do not act on strippers we could lose as much as 8 billion barrels in reserves. Now that is a fairly substantial sum of oil. I would guess that, we have also had testimony that we say in effect, 73,000 stripper oil wells.

Now if we took the Boren Amendment, I am not suggesting that

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that is what should happen, but stripped it, stripped the strippers and left it only for the independents and excluded royalty owners, then we are talking about a cumulative cost of 10 years of $9 billion as compared to $24 billion.

Now it would seem to me that if we are concerned about saving a resource and not spending a lot of money out trying to find those additional barrels that we already have in the ground and the reserves that we can rely on, you know then whether we come from producing states or not we ought to take a look at the facts.

Senator Packwood. What were those figures, $9 billion?

Senator Dole. That is right.

Senator Packwood. Independent. What is an independent?

Senator Dole. Independents, defined in the tax code ---

Mr. Shapiro. It is the same definition as generally given for pecentatage depletion someone that is not an intergrated oil company.

Senator Packwood. How many barrels does that reduce it, Bob, from, roughly, 175,000 to 235,000 range in the CBO study?

end bdm

Senator Boren: Sixty to sixty-five percent is independent.

Senator Dole: Forty to forty-three percent would be independent, so there would be a reduction of half, if we accept the CBO and don't take into account early abandonment and loss of reserves and a number of other factors. I cannot testify to anything here and swear to it. I don't think anybody knows.

In addition, I might mention such things as jobs and taxes. We have all been assuming here that there isn't any other tax paid except this windfall tax. You have all been trying to figure out how we are going to get everything done in $105 billion. We have forgotten about the $175 billion in additional income tax.

If any of us from oil producing states raise the question, we are suspect. But we are very proud of that little bit of production we have in Kansas. You can put it in your coffee cup, and we would like to have more. But that is all we have and we would like to keep it. It means about 20,000 jobs in my state.

I don't really see any problem there with that if we narrow the exemption, and I don't know whether the Senator from Oklahoma would have any objection to that, but if we would limit it to independents and exclude royalty owners who aren't risk takers. There are a lot of them in my state.

If we are talking about preserving a resource and preventing abandonment, then we ought to take a look at this narrow version.

Senator Boren: Of course, I would prefer to try for the whole thing. We might do like we did a while ago and see what happens. I think that what we are arguing about here is cost effectiveness, a matter of how much you want to do. You get half the supply response with half the money. I know we have got to weigh these concerns and dollars.

I would point out, you know, that the current situation in terms of giving incentives to these people is much better even before -- you know, when you look at the stripper producer, he is decontrolled under current law before the President ever acts. I think that is one thing we ought to realize.

He is getting $22 a barrel or something like that now, and he is going to go back to $16 under the bill. There are two figures. Senator Dole said if you gave a total exemption for stripper, which is ten barrels or less under current law, the same definition as current law, if you gave it only to independents, the cost would be $9 million, right?

Senator Dole: If you take out royalty owners.

Senator Bowen: Right. If you gave it on the first three barrels of strippers, the cost is about the same. It is about $9 million or $10 million. Both of those would cut the costs.

Senator Dole: Then you would create another category of oil. Then you have got free barrels. Then you have got another disincentive to keep it below that. It seems to me we ought to stick with the historical definition of stripper and work from that rather than trying to create another category of substrippers or whatever.

The Chairman: I will call on Senator Wallop and then I will come back to Senator Danforth.

Senator Danforth: Thank you, Mr. Chairman. I will be brief.

I want to begin by saying that stripper is a relatively insignificant proportion of the production in my state. But I think that Senator Boren -- and I have asked to be listed as co-sponsor of his amendment -- touched on something that we keep mentioning.

The Administration has made the point from the beginning that the windfall profits tax, they have argued, is to be placed on these things for the government to recapture increases that result from the decontrol of crude oil. And there is no recapture. They have been decontrolled since 1973. So there is no justification to be made on that basis for the imposition of a windfall profits tax.

For Senator Chafee, who says that we are losing money, I would still point out the government doesn't have any money until it has it. It is seeking to take it from a situation that does not exist yet. We don't have that money right now. We wouldn't have it under any such circumstances without we impose it. So we are not losing any money.

And then Senator Chafee made the point about this mysterious number of stripper wells that have come back. I doubt that he can justify that, but if he can, it is an absolutely perfect argument for continuing the decontrol without a windfall profits tax.

If these things are coming back because of the increased price, then America is getting just what she ought to be getting, and that is an increase in production.

Senator Chafee: They came back in $16.

Senator Wallop: The argument is splendid for the rest of it. If they can come back on line profitably, why in the world is it in the interest of the United States to leave that oil in the ground and perhaps never be able to recover it?

The Chairman: Mr. Danforth.

Senator Danforth: Mr. Chairman, I would like to ask Senator Boren a question or two. I think he is the one who has really marshalled the facts for his argument. My understanding of the thrust of your argument is that it is more likely that producers from stripper wells will keep their wells in production if, after taxes, they can show a good, fair return.

Senator Boren: That is correct.

Senator Danforth: Therefore, there are two things involved, it would seem to me. One is the rate of tax, of course, what we are talking about now. The other is the price that they are receiving before consideration of the tax.

Senator Boren: That is right.

Senator Danforth: The two have to be melded together.

Now, my question to you is: What do you assume to be now the price per barrel of stripper oil?

Senator Boren: The price per barrel now under existing law is decontrolled, as you know. So there have been no price controls on stripper oil ever since the Congress acted, and that price is somewhere around $22 a barrel, $21 or $22 a barrel, something like that.

Senator Danforth: Isn't there a spot market, so to speak, for stripper oil at about $28?

Senator Boren: Well, spot market can go out of sight. You are talking about margins of oil there, and that, of course, primarily comes into play in overseas purchases. But I would say that on the average, it is about $22, something like that.

Senator Danforth: For stripper oil.

Senator Boren: For domestic stripper oil, correct.

Senator Danforth: Now, in projecting the price increases in the future -- because that is, unfortunately, what we have to do -- what are you assuming about future increases of prices?

Senator Boren: The same assumption that was made by the Joint Committee in estimating revenue, which was what, 1 percent real increase?

Mr. Shapiro: Inflation plus 1 percent.

Senator Boren: Inflation plus 1 percent.

Senator Danforth: Inflation plus 1 percent.

Senator Boren: Yes, which is the same assumption we have used on all estimates we have talked about here.

I don't know. These things are hard to break down. It is hard to say how much of your supply response would you get for a lesser portion of exemption and so on. This is what makes it rather hard.

Senator Chafee said these prices have gone up substantially. That is true. The current law does recognize the value of not putting a price lid on it, and in essence, this bill is rolling it back. So you are significantly reducing what your production would be otherwise.

We know -- and this is what I have been trying to get us on all the time -- that per dollar expended you get a good supply response that is cost effective. I guess it just depends on how much you have to spend, on how much you want to spend in terms of encouraging the production.

But I genuinely think we are dealing here with something that ought to receive this kind of treatment. Now, we may all differ on how much you want to put into it, but I think the principle is a sound one.

The Chairman: I would hope the Senator doesn't modify his amendment to discriminate against land owners. When someone seeks to get a contract with that land owner, and I am talking about the ordinary situation, usually the oil company or whoever is much better advised as to what price he ought to offer than that farmer is when that farmer puts his name on the contract.

So to start with, he is far better advised. And the contract used to say, all right, we will pay you $5 an acre, and if we find some oil down there, you can have one-eighth of it. And that was the deal. That was the contract that the fellow signed.

He had the right to drill his own property. He had the right to hold out. And oftentimes they said, well, if you hold out, we are not going to drill this area. If we can't get it all under our lease so that if we find something we get to produce all of it, we are not going to drill to prospect.

So the farmer is limited to that to begin with. So he has got a contract that says he gets one-eighth. I am told more recently it is one-sixth.

It seems to me as though when you exempt the producer and you put the tax on that farmer -- and he is not represented up here, by the way. Those independents are pretty well represented. The majors are a lot better represented. He had no chance to be heard at all. When you put the tax on him and then you don't put the tax on the producer, he is being discriminated against and it has the effect of altering his contract.

It seems to me as though that is unfair, and I don't think, Senator, it is going to make that much difference in the votes you get for your amendment anyway.

Senator Boren: If Senator Dole or others want to offer others, I would prefer to ask, Mr. Chairman, if perhaps we could just go ahead and do it -- I think we have rehashed the arguments -- to get an up or down vote on my proposal as it is. I hope we can marshal the votes. I think we should. I think it is right.

If that doesn't happen to be the case, then others could offer alternatives, but I would like to have a vote on this amendment first.

The Chairman: Mr. Nelson.

Mr. Nelson: I would like to see the arguments and responses. Mr. Boren has made some strong arguments. I would like to see on paper the responses.

I am not interested in taxing for the purpose of taxing. We are all interested in getting more resources, interested in the result. So, I would wish, Mr. Chairman, that we would delay the vote, and give us a piece of paper to look at.

I say that for two reasons. I hold three proxies with instructions to vote no. They may wish to have the benefit of the argument that is being made here. Of course, they can change their vote, but I have been asked to cast their vote no.

I think in fairness to the proponents we should have, in writing, their arguments, and the argument of the Administration, and see which one on the paper is more persuasive. Then, at least, we can look at it and vote on it without any problem, without any time limitation.

The Chairman: Mr. Gravel.

Senator Gravel: I do not have a drop of stripper oil in Alaska, and I would like to be a co-sponsor of this amendment. I find it difficult. I had renewed the request earlier and now I want to renew it again, as my colleague Senator Nelson, who has stated the same thing.

We have been voting on exceptions. We have been voting on credits. And right at the beginning, we asked what does it cost per dollar of unit involved? In other words, if this is going to cost $24 billion in a decade and it is going to produce more unit of energy measured in barrels than will a solar credit, than will a tier two change, than will anything else, we should know that.

Regardless of what is involved, whether we come from a production state or a consumption state, we should be at least intelligent enough to vote for the cheapest unit of energy in terms of a barrel. So without that, how can we make any comparison, how can we make any intelligent vote on either side of the aisle on this subject?

I am persuaded that oil that is in the ground of this quantity is cheaper to get to the surface and cheaper to get to market than anything else we can do. That is the reason I would vote for it. But I am sure other members must have the question in their votes, that they are just voting political, regional reaction as opposed to voting for a process that will solve the energy crisis in this country.

So I would hope -- and this was a request that I had lodged some two weeks ago, that I would like to see from staff or from Treasury or from somebody in this country to tell us that if we spend a dollar for a tax credit on geothermal and we spend a dollar to get stripper oil, that measuring the production response, tied to a formula with that cost, we then can simply say here is our goal and we are going to vote for the things that bring about the most energy.

Senator Packwood: Mike, that is the most frustrating thing I have found on voting on these today. When we went down the list of all the tax credits I had before I brought them here, I went to the Department of Energy and said: this is the methodology that we went through to get to this conclusion. Is it right, is it wrong, do you agree with it, do you have a better methodology.

We used the Joint Committee's revenue estimates. But today when we get to, for example, this Congressional Budget Office study, there is some question as to whether or not in their study they included the factor that we have exempted new oil. My gosh, that is a big factor. Nobody knows.

Mr. Wetzler: Senator Packwood, we have called up the CBO while the committee was talking. Their estimate was done before the committee exempted newly-discovered oil, so that is not taken into account. But again, it is not clear to what extent that fact would affect their results at all.

Senator Packwood: I grant you that, and it may not at all. But I find us going down exemption after exemption here. And many of them may be good. I am with Gaylord. But we have something that some trade association gives us that doesn't have a name on it, that has figures with no methodology and may or may not disagree with the figures that a proponent says. We have nothing concrete to go on.

Senator Boren: Mr. Chairman, I appreciate what Gaylord has said, and if he doesn't feel comfortable, maybe the roll could be left open. I think I would rather go ahead and take a vote on my amendment.

Senator Danforth: I don't know what the Chair will rule with respect to the timing of the vote. If we are to delayit, I would like to find out more definitive facts on the current price of strippr oil. That obviously figures into the equation.

I don't know where this information that I get comes from, but the indication is that in August the stripper price was about $28.50 per barrel and that in Kansas the stripper price in September is about $30.00 per barrel.

Senator Boren: Well, you are talking about the spot market. I think we are in agreement. I think the Department of Energy and I are in agreement. I think both parties are in agreement here.

Senator Danforth: I don't know enough about the market for stripper oil to have an opinion one way or another. I think that it is an important consideration. I must say that on the general theme of it, I am all for producing energy. That is what we are here for. It seems to me the basic question is how many eggs do you put in the oil basket?

The whole point of the Administration's approach, as I understand it, is that in addition, you are relying on the production of oil. Oil is going to run out. It is something that is going to be a wasting asset.

Therefore, we are going to have to proceed on various alternative kinds of energy, whether it is synthetic fuels, whether it is the kind of thing Senator Packwood has been talking about on conservation and alternative sources of energy and so on. We are going to have to be proceeding with something other than oil.

To the extent that we exempt all kinds of oil from the tax, if we are going to provide for these alternative sources, it is going to have to come from something else. Maybe that is a good idea, but it doesn't strike me as one.

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Senator Boren. The average price, the going price of stripper is approximately $22 a barrel. Now the spot market is something very different. Spot market prices, you have had them, you've had prices where you have had them up to $40 a barrel.

What happens is you hear the spot market has gone to $40 a barrel or $31 a barrel. That doesn't mean that most oil in this world or in the country is selling for that. What that means is that you have got a special bidding situation at the margins. They literally get into bidding wars over tankers in the Mediterrean for a particular spot, for a particular time, for a particular incremental amount of oil.

But that doesn't mean that your whole buy is going to go to what the world spot market is. There are two different markets. I think we're probably in agreement as to what they are.

Mr. McGregor. The explanation is absolutely right. I would like to see the prices you have. I imagine they are spot prices that were reported in one of the trade reporting journals, whether it's Platts or some other documents, but stripper oil under contract goes at a world price.

The Chairman. Let me show you how bad tnese administration estimates appear to be to me. Now let me put my pencil to it and try to figure this thing out.

The Administration estimates, when we are exempting the independents, that we were going to only get 30,000 barrels a day and costs $23 billion to do it and I guess that would be $23 billion over a ten year period. All right, now you just space that $23 billion out and make it $2.3 billion a year then the way I read that they would be estimating that if you assume the independents are putting it all back in the ground, which the testimony was, and include their leasehold expenses in that figure.

Now if you are assuming that $23 billion put back in the ground, that would get you $219 million worth of oil so they would assume that every dollar invested only gets ten cents worth of oil and to me that is a patently -- if you assume they are going to put it back, which is their testimony -- then to me that is a patently ridiculous conclusion that they are only going to get ten cents worth of oil for every dollar they put back in the ground.

That is the kind of estimate we have been hearing here and acting on.

Senator Heinz. No offense to your math, but you are including the royalty holders there.

The Chairman. Yes, I know, but the testimony includes an item for leasehold expense. I would assume therefore that they are counting the royalty in it, but even if they are not, you would still be coming up with about a seven to one ratio as though a dollar expended would only get you maybe 17 cents, even if you want to take the royalty income out of it.

Senator Nelson, did you want to be heard further?

Senator Nelson. No.

The Chairman. Senator Gravel wants to be heard and then Senator Matsunaga.

Senator Gravel. I just wanted to focus on two statements that were made by Senator Danforth. That was that whether or not we want to put all our eggs in the oil basket. I thought that the purpose of the exercise was to do what is cheapest and most efficient way to the American people, whether that is the oil basket or the nuclear basket or the solar basket. That is the basket I'm going to put my eggs in. Now maybe you don't want to put your eggs in that basket.

Maybe we are all believing what the government says and the executives -- we are running out of oil and gas. I find it difficult because everytime they tell me that argument that we are running out of oil and gas and then they take out of inventory 40 million acres of sedimentary basin in Alaska particularly, when on 190 thousand acres we got one-third of all the U.S. oil reserve, I just find it a self-fullfilling prophesy.

If the government won't release the land or locks it up, then of course there is no oil. You can't even reach for the egg. But I would hope and I certainly don't mean this as a correction, but I can only state my personal view. That I don't care what eggs we are putting in, I want the cheapest eggs and

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if its a gas egg I'm for that and if its an oil egg, I'm for that.

I would hate to see us get into a situation where we are locked under not the cheapest source of energy because the industry within your constitutency won't be able to compete with the industries in the rest of the world and that's going to put a lot of your people unemployed and I don't think I want to do that and I know you don't want to do that.

Senator Matsunaga. The windfall profits tax as I understand it, is that which is imposed on profits which would come about merely by the increase of price of deregulation and I was prepared today to vote against the proposal to exempt stripper oil wells, but then I hear now that stripper oil has been decontrolled and has been selling for as much as $22 a barrel, it would mean a roll-back to $16 underthe House bill.

My question is if anyone can answer is, since when has the stripper oil wells been decontrolled?

Senator Wallop. Since 1973.

Mr. Wetzler. Mr. Matsunaga, stripper wells have been in and out of controls. It was deregulated the last time in 1976. It was deregulated I think in 1973, back under controls I think in 1975 and deregulated again in 1976.

Senator Matsunaga. Since when has the stripper oil been selling for $22 over in excess of $16?

Mr. Wetzler. It got up to about $16 earlier this year.

Senator Matsunaga. Just this year?

Mr. Wetzler. Yes, I can get you the exact --

Senator Gravel. When the Iran situation occurred, that is when it all started.

Senator Boren. Mr. Chairman, if I can refute the argument made by staff against the amendment, I think that the point is this: that the Congress in 1976, long before the President ever made his decision to decontrol oil, did decontrol stripper oil to the world price, whatever the price was. And then there is an argument being made that as the result of decontrol, well, it was already decontrolled.

But there were inventory profits made as a result of the President's own action which he therefore advocated then of taking some of that back. But there can't be that profit as a result of the President's action, because it is already decontrolled.

The Chairman. May we hear from the staff?

Mr. Wetzler. Stripper prices got up above $16 in April of this year. In March it was $14.88, the average price, in April it was $16.71 and by May it was $17.54 and those are the latest data that have been collected, or at least published.

The Chairman. I have heard of situations where they are getting substantially more.

Mr. Wetzler. Currently the people are getting as much as $28 or even some cases higher prices for stripper. The question is, to what extent, that may be just a lingering effect of the shortage experienced earlier in the year and in which case you would expect the price to settle back down as the year progresses.

But basically if you are looking at what the stripper prices in 1980 or 1981, its basically going to be whatever the world price of oil, whatever that is and as was discussed earlier by the committee that was just a great deal of uncertainty.

The Chairman. Yes, Senator Heinz?

Senator Heinz. I have a question for the staff. As Senator Dole mentioned what I can best describe as a sub-stripper exemption and then indicated that it would be regardless of whether its five barrels, two barrels, it is administratively complex.

I don't want to leave it quite that simple, because as I understand it, they are probably two ways you can handle a sub-stripper exemption. You could either exempt wells three barrels a day or less or you could exempt the first three barrels of production of any well.

My question is what are the revenue losses for either -- for that, what difference is there and what do we think is the difference for production?

Mr. Wetzler. Senator Heinz, there is a big difference between those two because if you exempt only those wells producing less than three barrels a day, you give people an

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incentive to drop down below three. Now its hard to say just how much that would create disincentives to production.

Senator Heinz. I would assume that since the average stripper is producing 2.91 barrels a day that if you exempted the first three barrels of production, you would not exempt about half the oil.

Mr. Wetzler. You would exempt all of the oil from the half of the wells that are less than three and you would exempt some of the oil from the remaining wells, so the revenue effect would be somewhere around -- I guess we would have about -- the first three would be about ten billion out of the --

Senator Dole. How much was that?

Mr. Wetzler. Ten.

Senator, we are going to have to work on this a little more.

Senator Heinz. All right. Maybe we can get that information. I think the number would be interesting to have, the exemption for the first three barrels done that way rather than less than three and what the revenue effects would be with and without the royalty owners. It may be a small amount and it may be a large amount, I don't know.

My reason, Mr. Chairman, for asking for this is I suspect and I want to put this on the record so that staff or DOE anybody else can shoot holes in it if I'm wrong. I suspect that the way that you get a close-down of stripper wells is that production begins to decline, costs don't get any less, indeed inflation takes them up,that the wells that shut down in fact, are probably wells that are producing three barrels a day or less and therefore if you want the most efficient possible incentive to keep those wells from shutting down -- there is general agreement, they do shut down, that is one thing we have agreed on here -- is that the best most efficient way to do that therefore would be to give those wells that break below three barrels so that there was no disincentive unnecessarily to shut down a well prematurely.

But I hope that we can be smarter on that or that my assumptions can be proven or disproven by the time we get around to voting on that.

Thank you, Mr. Chairman.

The Chairman. Why don't we vote on it.

Now, let's vote on the Boren amendment and then if anybody would want to withhold or change his mind later on they can but sometimes we debate around here on something that when you get around to voting its not closed anyway and it would not have made a difference in how you modified it.

So if we vote on it, at least we will have some idea where we stand and you could consider some more alternatives if you want to later on. Call the role.

The Clerk. Mr. Talmadge.

(No response)

Mr. Stern. Mr. Ribicoff.

Senatro Nelson. No, by proxy.

Mr. Stern. Mr. Byrd.

(No response.)

Mr. Stern. Mr. Nelson.

Senator Nelson. No.

Mr. Stern. Mr. Gravel.

Senator Gravel. Yes.

Mr. Stern. Mr. Bentsen.

Senator Bentsen. Yes.

Mr. Stern. Mr. Matsunaga.

Senator Matsunaga. No.

Mr. Stern. Mr. Moynihan.

Senator Nelson. No., by proxy.

Mr. Stern. Mr. Baucus.

Senator Baucus. No.

Mr. Stern. Mr. Boren.

Senator Boren. Yes.

Mr. Stern. Mr. Bradley.

Senator Nelson. No, by proxy.

Mr. Stern: Mr. Dole.

Senator Dole. Yes.

Mr. Stern. Mr. Packwood.

Senator Packwood. No.

Mr. Stern. Mr. Roth.

Senator Danforth. No, by proxy.

Mr. Stern. Mr. Danforth.

Senator Danforth. No.

Mr. Stern. Mr. Chafee.

Senator Chafee. No.

Mr. Stern. Mr. Heinz.

Senator Heinz. No.

Mr. Stern. Mr. Wallop.

Senator Wallop. Yes.

Mr. Stern. Mr. Durenberger.

Senator Durenberger. No.

Mr. Stern. Mr. Chairman.

The Chairman. Yes.

All right. The yeas are six and the nays are twelve. We will let the absentees record themselves when they are available and I think that most of the absentees are going to be against the amendment.

Senator Dole. I understand we come back at 2:30. Maybe at that time we could get additional information.

The Chairman. 2:30? Yes. I plan to come back here at 2:30 and I hope there is no objection in coming in at 2:30 because we ought to be able to vote on other matters.

Senator Dole. If I could just have the attention of the committee. I would hope at that time to offer the stripped-

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down stripper amendment and I would hope Senator Heinz would be prepared to offer the up to three barrels a day exemption.

The Chairman. Let me add that everybody that can't be here at 2:30, put a proxy with some one so that we will try to record as many absentees as we can.

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(Whereupon, the Committee recessed at 1;45 p.m. to reconvene at 2:30 p.m. the same day.)

AFTER RECESS

(The Committee resumed at 2:55 p.m., Hon. Russell B. Long, Chairman of the Full Committee, presiding.)

Chairman Long: The meeting will come to order.

I assume some Senators have some proxies. Why do we not move on?

Mr. Stern, do we have an amendment pending now?

Mr. Stern: At the time you broke up, Mr. Chairman, Senator Dole was talking about offering exempting stripper oil owned by independents and not exempting royalty owners. Senator Boren did not want to accept that as an amendment to his amendment. He wanted to vote on his complete amendment.

I believe you would say that was the pending matter, Senator Dole's suggestion at the time you broke up.

Senator Dole: It is what I consider to be a stripped down version. I am not so certain about the wisdom of excluding royalty owners. If we limit it to independents and then with another technical change we have made in the amendment, I think we could get the costs down over a ten year period below $10 billion.

It would provide an exemption for windfall profits tax up to 1,000 barrels a day of stripper oil. We are talking about stripper oil. It is not as broad as the Bentsen Amendment. It is not as broad as the amendment of the Senator from Oklahoma.

I prefer the Bentsen Amendment first and the Boren Amendment second. This is a third position. It would be limited to stripper oil produced by an independent producer.

I would just go over again some of the highlights. We tried to put together the fact sheets that Senator Nelson indicated he would like to have.

We have taken our fact sheet and secondly tried to respond to some of the Administration's arguments. We therefore have two sheets of paper.

I will go back to the argument I made earlier on, not very effectively obviously. What we are concerned about are concerns and abandonment and the high cost of production of stripper oil. As I said earlier on, not that it makes any great difference but there are 28 states that produce some of the stripper category and some of these wells are very small and I cited New York and Pennsylvania. I do not know what the ratio of water to oil is in Pennsylvania. It must be very high. It costs much more to produce that oil.

The exemption of stripper oil has a significant production response. This would be hopefully in response to the question Senator Packwood properly raises each time.

We received testimony. I cannot prove it. We had testimony which would indicate it would produce about 497,000 barrels per day by 1990. The other figures have been gone over this morning. The average stripper well produces only about less than three barrels per day.

It just seems to me if we want to restrain abandonments this is one thing we can do to prevent that.

In response to the Administration arguments, they indicated strippers were uncontrolled producing wells and currently receive the world price regardless of their level of production. We feel that stripper under any form of increased taxation will not receive world price. In fact as the tax is currently structured in the House bill we have in effect a permanent price rollback. Any exemption for stripper oil simply preserves the status quo.

I would just hope that we would take a realistic look at this one area. We are talking about independents. We are talking about stripper production only. We are talking about a cost depending on whether with or without royalty owners, either $7 billion over a ten year period without royalty owners and maybe $10 billion with.

We also have the provision that majors could not unload a lot of stripper production. Independents could not buy it up and claim the exemption on that basis. We have added that provision in the bill.

I believe it is two steps back from the Bentsen proposal. It is not what we believe will produce more energy but it is I would think a fallback position that hopefully the majority of this Committee can support.

I would say to my friends on the Republican side that we are talking about the small producer and the small businessman, those who are paying a 70 percent tax rate. They are not for the most part paying the corporate rate. They are in the high cost recovery areas, high cost development.

It would seem to me we are talking about a rather small amount. Seventy-three percent of the wells, fourteen percent of production. We are talking about an investment of $10 billion over a ten year period and again according to some of the testimony could increase production by half a million barrels per day by 1990.

Senator Bentsen: Mr. Chairman?

Chairman Long: Yes?

Senator Bentsen: Let me just say in support of what Senator Dole has said, what we are trying to decide here is where we can best spend our money and where we get the most for it, whether we are spending it on trying to save production that is already in being and not having plugged those wells because once you plug them you are not going to be doing a tertiary recovery there and certainly a barrel of real oil is certainly as valuable to us as a barrel of synthetic.

You are talking about $35 a barrel if you go to the synthetic. You are talking about $20 a barrel if you are talking about this.

You are talking again about marginal production. If you are talking about a 3,000 foot well, the work over will cost you $2,500 to $3,000. That is if everything goes right. If it does not the costs escalate substantially.

A casing break could cost $25,000. A tubing failure could cost $15,000. A lifting rod failure can exceed $7,000. A new surface pump costs you $17,500.

This is one part of the business that is highly cost sensitive. Unless they can keep their administrative costs down and unless they have everything working, they are going to plug that well. It averages as we pointed out to 2.91 barrels a day.

I know it is not a popular vote for anything that increases domestic production in this country. If there is anybody who has terrible P.R. it is the oil industry.

Dollars and cents dictates this I believe. I would urge support of Senator Dole's amendment.

Chairman Long: Is there further discussion?

Senator Packwood: I am impressed. If these figures are right I would vote for this. The 497,000 barrels, whose testimony was that? How did they reach that conclusion?

Mr. Lighthizer: That was Mr. Talley's testimony. He was the man who ran the Energy Department in Governor Boren's Administration in Oklahoma.

Senator Packwood: That is even substantially higher than Senator Boren said this morning.

Mr. Lighthizer: Senator Boren's figure this morning was a 1985 figure I believe. This is a 1990 figure.

Senator Packwood: His figure this morning was for 1990.

Senator Boren: I think I was incorrect. I quoted him as 307,000 and that was for 1985.

Senator Packwood: That is relatively cheap oil if indeed it would do that. Does anybody have a copy of his method of how he got it?

Mr. Lighthizer: I can give you a copy of his testimony.

Senator Packwood: All right.

Senator Heinz: Mr. Chairman?

Chairman Long: Yes, sir.

Senator Heinz: I find this a very difficult decision because there is so little information. I am thinking of possibly offering a substitute for Senator Dole's proposal which would be an exemption for the first three barrels of stripper well produced.

Let me see if we can isolate so that we can all have some facts and a few numbers. The one piece of information that I have which I feel pretty confident about is the Congressional Budget Office letter of September 20th to Senator Boren. In that letter on page three it says that with the respect to an exemption for stripper wells, they would expect an additional 55,000 barrels per day of production as a result of the non-abandonment of some 25,000 to 30,000 wells by 1985.

The production figure of an incremental 55,000 barrels a day would be a 1985 figure. The number of wells that would not be abandoned would be between now and 1985.

As I understand the 1,000 barrels per day exemption, according to this letter if you just look at the effect on strippers the 1,000 barrels per day exemption would result in between and I quote "40,000 and 50,000 barrels per day of stripper oil," which is 5,000 to 15,000 barrels per day lower than if you just exempt stripper oil in some way, shape or form.

I recognize these numbers do not take into account what might be produced from new drilling and new wells because of incremental revenues. I am trying to stay away from those numbers for the moment so we can analyze one portion of the problem.

The seoond set of numbers I have relate to the revenue losses. Since we have numbers regarding production in incremental production from strippers in 1985, I have tried to match those with the appropriate revenue losses in 1985 and as I calculate it with the help of various documents we have received from the staff, the revenue loss in 1985 if you cut out the royalty owners would be $500 million for the first option that I mentioned and that is the exemption for the first three barrels of stripper well production.

If I divide the amount of additional production in 1985, 55,000 barrels a day or roughly almost precisely 20 million barrels in that year I get a so-called cost per barrel of $25. If I cost out the 1,000 barrels per day of stripper well production per producer, my understanding is the cost again leaving out the royalty owners would be in the neighborhood of $700 million with slightly less production as I indicated and those numbers work out between $38 and $48 per barrel "cost" per barrel.

The final piece of information I have for 1985 is the numbers with which we are dealing provided by the Joint Tax Committee and partly estimated by the Joint Economic Committee is the price of oil that they perceive based on inflation of one percent is $35.82 in 1985.

If you believe it is always worth to pay up to $35.82 for domestically produced oil but not more than that, the logic of that would lead you to believe, again if my numbers are correct, that an exemption for the first three barrels of stripper well production would be not only more efficient but would produce more stripper oil than Senator Dole's proposal which would be slightly more expensive and produce slightly less stripper oil.

I would welcome the views of staff and my colleagues or anybody else to help enlighten what I hope would be a rational discussion.

Senator Boren: Are you talking about the first three barrels for independents, the first three barrels period on a stripper well?

Senator Heinz: The numbers I have are only really for the first three barrels of stripper oil production. I have not segregated it between independent and anybody else. I did not have that information. I was working with your C.B.O. numbers and the cost developed from the staff.

Does the staff have a copy of this?

My interest, Mr. Chairman, is in trying to do the right thing if the right thing is getting the most oil for the least money or the least cost per barrel.

Senator Bentsen: I find it a lot easier to follow what you have said if I have this in front of me which I now have. Would you like to try once more?

Senator Heinz: All right.

Look at number one and number four. Number one is an exemption for the first three barrels of stripper well production which if you leave the royalty owners out has a revenue lost in 1985 of about $500 million. According to the C.B.O. letter which is attached to what you have, it would produce 20 million barrels of oil in 1985. You divide them and come up with $25 per barrel.

Going down to number four, 1,000 barrels a day of stripper oil only per producer, the cost as I work it out is $700 million. The production is stated in number three, between 40,000 and 50,000 barrels per day. That is also from C.B.O. in the letter to Dave Boren. Those numbers work out when divided to between $38 and $48 per barrel.

Senator Boren: I would like to raise one point again on the estimates. I am looking at what Dr. Talley says on page four of his testimony when he talks in terms of lengthening economic well life. What he has done is project out from the Oklahoma experience where they have gone through a computer run of every well, when we built out data base there and he also points out and makes this statement, "Provide more than 275 million barrels of incremental domestic oil production over the next five years." That is total aggregate which C.B.O. did not figure in.

That is one of the things I think you have to consider that when you lengthen the economic well life and he points out that will escrow 70 to 80 percent of the original oil in place for recovery by tertiary and enhanced recovery methods.

I just want to make the point again that I think probably the C.B.O. estimate if you want to take away the effects which I think the Administration is putting in elasticities based upon dollars for newly discovered and not putting them on other things and so on, using different elasticities.

I think that estimate is low.

Senator Heinz: Let me point out so there are no elusions, I am using the C.B.O. production numbers just for stripper wells and which result in fact from stripper wells not being abandoned.

Senator Boren: You are not even considering the impact it has on increased drilling or the impact it has particularly to escrow that resource for incremental tertiary?

Senator Heinz: That is right.

The next question and the one I would tend to pose to the staff after whether or not these numbers are accurate is what have we been able to learn over lunch time about the new production estimates by the C.B.O.?

When we adjourned we had discovered C.B.O. had not taken into account the fact that we had since freed new oil from taxes. Do we have any additional information on that?

Mr. Wetzler: No, we do not, Senator. I am not sure we agree with your estimate that the revenue fact is $500 million a year.

Senator Heinz: Not $500 million a year but $500 million in 1985. Let me tell you how I got there. The minority staff prepared an options paper this morning where the revenue loss in 1985 or a total stripper exemption from the tax would be $2 billion.

You take out the royalty owners and I gather that cuts it just about in half.

Mr. Wetzler: For strippers it would only cut it by about 13 percent.

Senator Heinz: In that case my numbers are way off if it only cuts it by 13 percent.

Mr. Wetzler: I think our estimate is that number one would be about $1 billion a year. It would be just about half of a total exemption.

Senator Dole: What about number four?

Mr. Wetzler: Number three is in agreement with our figure for the 1,000 barrels a day. Number four, we have about 1,000 barrels of stripper only as about $1 billion a year in 1985.

Senator Dole: It is about the same.

Mr. Wetzler: The two proposals are about the same revenue effect in the year 1985. Over a longer period Senator Heinz' proposal would be more expensive than Senator Dole's.

We are assuming in our revenue estimate -- Senator Dole's proposal has a rule similar to what is now in the law for percentage depletion saying you cannot get this exemption for properties that have been transferred from someone else. That is to prevent the major oil companies from divesting themselves of their stripper properties and therefore proliferating exemptions.

Senator Dole, I think that is part of your amendment.

Senator Dole: That is included in my amendment.

Mr. Wetzler: That means that over time the revenue loss from Senator Dole's amendment declines because it basically applies to the existing stripper properties to the extent the independents acquire more and more stripper properties from the majors and these acquisitions would not be eligible for the exemption. Over the eleven year period I think Senator Dole's amendment is less expensive than Senator Heinz'.

I think Senator Dole's is $7 billion and Senator Heinz' is $13 billion. In 1985 they happen to be the same.

Senator Heinz: By that measure, since the production at least in 1985 of stripper is more or less the same, Senator Dole's proposal could be assumed to be a better proposal, in terms of more production for the buck. Is that right?

Mr. Wetzler: I did not say that.

Senator Heinz: I am asking you.

Senator Dole: I will say that.

Mr. Wetzler: There is some advantage to having a proposal phased in terms of the first "x" barrels a day from your wells simply because you do not have the same incentive to decline below a certain level that you have for example under the present price control definition of "stripper properties."

Senator Heinz: The only problem with that is if C.B.O. is right, I really do not think I can make a very good argument that the cost is justifiable in terms of cost per barrel.

You are saying the revenue loss would be about $1 billion in 1985. Just taking that slight time I divide one billion dollars by 20 million barrels and I get $50 a barrel which is a high price to pay.

Mr. Wetzler: I think C.B.O.'s production estimate was for an outright stripper exemption. The question is assuming that production response is correct to begin with, how much of it do you lose by going from a complete exemption to either of these two narrower proposals?

For Senator Dole's you could probably assume it is roughly proportionate. If he exempts about 40 percent of the stripper oil he probably ought to get 40 percent of the production response. Yours may do a little better if you assume for properties that would otherwise be abandoned are the ones with very small barrels per day. You would not lose any production response from going down from 10 to 3 but you do save revenue.

I guess it depends on how much faith you put in C.B.O.'s estimate in the first place and where do you think they are getting the abandonments.

Senator Heinz: Mr. Chairman, may I ask the Department of Energy the question I posed earlier which I asked them to be prepared to answer which is what is the scenario under which stripper wells go out of production? Is it as their production tails off, their revenues go down to meet their costs? Is that basically a production tailing problem?

Mr. McGregor: When costs exceed revenues on a given property the well will be abandoned.

Senator Heinz: We know that. What is the linkage with production history? Is it generally true that stripper wells do not get abandoned unless they are producing less than let us say three barrels a day or "x" barrels a day, "x" being a relatively small number?

What are the characteristics of abandoned stripper wells? When they are abandoned apart from the fact we know costs will exceed revenues, what is their production as a matter of fact, what is the last known production? If the number is a low number that tells us something.

Mr. McGregor: I have not checked into your question. I think I understand what you are asking, Senator Heinz, which is what causes a well that is producing five barrels a day to be abandoned versus a well that is producing a half a barrel a day and being abandoned, what are the characteristics that drive the abandonment.

Senator Heinz: My question is a matter of fact and not speculation on the characteristics. My question is what has been the production rate of the strippers that have been abandoned?

Mr. McGregor: I believe quite low.

Senator Heinz: "Quite low" being one barrel or two barrels?

Mr. McGregor: It would be in the range of one barrel or less. I am speaking intuitively. To give you an answer supported by fact I would want to dig a little further.

Senator Heinz: I would appreciate it.

Thank you, Mr. Chairman.

Senator Matsunaga: Does the Administration have anything to say about the proposal?

Mr. Lubick: Senator Matsunaga, there are a number of reasons why we think no exemption for strippers is justifiable. First is the question of the revenue cost which varies depending on what the proposal is. I think the revenue estimates speak for themselves. The windfall profit tax already starting with a house base of $104 billion for the period from 1980 to 1990 has been cut back to $79.5 billion. I think that is a serious problem.

I think it is important to deal with this question of what the supply response is and the fact that the Committee has already exempted newly discovered and incremental tertiary production seems to us to have meant that the further exemption of stripper production will not produce any significant supply response.

First of all dealing with the question of abandonments which we have been dealing with recently, it is hard to see how an exemption will have any effect upon abandonment because by hypothesis the House bill already provides that the tax does not apply in the case where the tax plus the costs would exceed the revenue from the well.

Senator Heinz: Could I respond to that?

Senator Matsunaga: I would like to have Mr. Lubick finish.

Senator Heinz: I am sorry. Go ahead.

Mr. Lubick: In other words, if we start with the proposition that a well is abandoned when it becomes a loser the tax does not apply in that case. Obviously I suppose if the well is going to make two cents and the tax is two cents, it gets to that point.

You are dealing with a very small number of wells at that margin.

Basically it has been our assumption that the basic decisions on going ahead to drill new wells are based upon the profitability of those wells, the profitability of drilling. That is what is the incentive to produce. Newly discovered production is exempt from the tax. Incremental tertiary is exempt from the tax.

It is the profitability of those things that is our principal concern.

Third, in the supply area, if we are giving a special incentive for stripper production we have a built in factor that encourages those who are operating at above stripper capacity to hold back their production so they can qualify for this particular exemption because once they have qualified for stripper they can then boost their production and still be eligible for the exemption.

We have the question of the element of windfall in the prices received from stripper production. Most of the stripper production as has been indicated by Senator Boren is in fact old oil and that old oil has benefited from the rapid rise in world oil prices and in fact has not been subject to control.

At the time the tax was first proposed the price was $16 a barrel which was some six months ago. That was an adequate price. In the last six months the price has gone to $22 or more on the spot market. That represents an increase in price as a result of the OPEC cartel and not the operation of the free market. It is the very sort of windfall we are attempting to capture to use the resources to develop these alternative sources.

Senator Matsunaga: Your concern about the producers limiting to ten barrels or less a day for a year, how real is that concern? If you have an experience with producers who have done this in order to qualify a well for the control under existing law then this worries me because this would be a disincentive for production rather than an incentive to produce.

Mr. McGregor: Senator, the law and the regulations implementing the law do indeed contain a built in and totally legal economic incentive in certain instances to bring a well production rate down to ten barrels a day. It is a simple discounted cash flow analysis that has to be done based on the participated producing life of the property which the well or wells are producing.

I have seen on paper presented to me where it is lucrative to shut in a well that is capable of producing up to 20 barrels a day for one year to qualify assuming the present value of your ten barrel per day production at $10 or more per barrel above what you were receiving for say a lower tier type of well or production from a lower tier type of well just made it economically sound to go ahead and do that.

There is some emperical evidence that indicates that is going on.

The decline rates that we would anticipate for lower tier oil would normally be in the range of roughly 10 to 12 percent per year for total U.S. Lower 48 production. Recent trends are indicating that lower tier production is declining at a somewhat higher rate say in the range of 15 and maybe as high as 18 percent.

That data is subject to various interpretations by geologists, economists and attorneys.

It does show a trend that producers are shifting from a lower tier category of roughly $6 and some cents per barrel to a stripper category which is as Senator Boren pointed at is at the world price level today.

Looking at the 55,000 barrels number in the C.B.O. letter which I have asked my staff to inquire of the C.B.O. staff as to what that means, does that mean production currently at ten barrels a day or less which will stay on line up until 1985 or does that imply producers are going to continue and this economic behavior to take more crude production from lower and even upper tier and turn it into stripper oil production?

Senator Heinz: As I understand what C.B.O. means is it means 25 to 30 more wells will not be abandoned between now and the end of 1985 with the result that there will be 25 to 30,000 more wells in production, which will be producing in the year 1985 an average of 55,000 barrels a day.

The answer to your last question I guess is since this number is derived from wells that will not be abandoned it is not likely to be some fairly good sized well that comes down to ten barrels a day for awhile and then goes back up.

Mr. McGregor: It is a slightly ambiguous statement and can be read several ways and I would just like a little more clarification.

Senator Bentsen: We were talking about an incentive to lower production to ten barrels to qualify as a stripper, would that not be a violation of law and that person who is found to do it would be subject to some penalties if that could be proven that is what they have done?

Mr. McGregor: I think if an economic justification could be made for lowering that production, Senator Bentsen, it would be allowable under the law.

Senator Bentsen: Not just to make a few more dollars as a stripper. If we are talking about bringing it down just for that purpose where it could be economically produced above that, would that not be a violation of the law?

Mr. McGregor: I would have to seek counsel's advice as to our regulations. I think the regulations are broad enough that it may be a surmountable legal obstacle. It may be a violation of state conservation laws.

Senator Bentsen: I think it is more than that. I would appreciate the Department checking that out. I think it is a violation of the law and they are subject to some serious penalties if it is proven they have done it just for the purpose of qualifying as a stripper to get the additional funds.

Senator Dole: Mr. Chairman?

Chairman Long: Senator Dole.

Senator Dole: On that very point we would draw the amendment to make it clear that a stripper certification could be withdrawn where production was withheld to qualify for the exemption. I do not think anybody is trying to set up some sort of a scheme where you can manipulate your production to qualify for the exemption. I think that there is some evidence that has been going on and if so we should have the evidence and some hearings and not just statements to indicate everybody in the oil business to trying to figure out some way to take advantage of certain rules and regulations.

I find that hard to believe. There is always some who do not follow the rules.

I think there is a total misconception about who is involved in the production of these very small wells. We talk about small farmers and small sugar producers and small everything else. This is about as small as you can get to produce an average of a quarter of a barrel of oil per day as they do in Pennsylvania and a half a barrel of oil per day as they do in New York and less than three barrels per day as they do across the board in all the 28 states as the average production of strippers.

We have set about trying to find some way if nothing else to preserve that oil. It is not speculation. We have the facts. We go back to the year 1968. We had 21,000 wells abandoned in that year. It went to 15,000. It then went to 18,000 in 1971. It went to 13,000, 13,000, 13,000 and down to 7,500.

You had a price increase and the abandonments dropped to around 9,000 wells per year. It is holding steady at 9,000. To me that is a savings. Maybe it is 55,000 barrels or maybe it is some greater amount.

I will go back to the basic facts that are uncontraverted. We are talking about fourteen percent of the production. We are talking about 73 percent of the wells. We are talking about a total of 70,000 small oil wells, not corporate oil wells where they pay 70 percent marginal tax rate.

For the impression to be left that somehow we are giving this big bonanza to some big oil is not accurate. It is not fair to make that charge or to even make that argument. We are talking about very small producers; high costs to lift the oil. It costs a lot of money.

It seems to me there cannot be any windfall profits on stripper production. They have been decontroled since 1973. It was my impression we are talking about a windfall profit tax.

We have testimony where they were talking about an eight billion barrel reserve. I have faith in the man from Oklahoma. I guess it is not illegal for somebody who understands the business to testify. I do not know how many people are up here telling us the answers now who have ever visited an oil well let alone dealt with the numbers.

It is a little frustrating to just accept blindly any figure the Energy Department drops out or the Treasury Department and we quote a figure that you can produce almost a half million barrels a day by 1990 and somehow that has to be disregarded. We cannot take the man's figure from Oklahoma because he knows something about the oil business. That is tainted because he has an interest in producing energy.

We are talking about an amendment that with the royalty owners is costing $8.5 or $9 billion and without the royalty owners is $7 billion. We have taken out all the majors. We are talking about only independents and only their stripper production. We are not talking about upper tier or lower tier but only stripper production.

It seems to me it might be time to take a look at what we may be doing to a very important segment of the industry. There may be some other way. I do not know how we can have it both ways. We cannot have the oil in some cases and still produce a lot of revenue.

This is option number six. We have worked on six different options trying to figure out one that would cost the least amount of money and still preserve stripper production, slow down abandonment and somehow find an answer and to increase production.

We believe the 1,000 barrel a day exemption of stripper by independents meets that answer. If someone has a better answer I think we ought to adopt that version.

To disregard every figure we have had in hearings, what do we have the hearings for? I do not think the witnesses lied. They gave us their best information. I would hope we do not just say that is not accurate and it should be something else.

I think we have a fair amendment that does not do violence to what we are doing.

Chairman Long: What is your estimate on the cost of that amendment? What is your estimate on the revenue cost?

Mr. Shapiro: On Senator Dole's amendment?

Chairman Long: As it stands right now.

Mr. Shapiro: Senator Dole's amendment provides an exemption from the tax of up to 1,000 barrels a day of stripper oil produced by independent producers and it would not make that available to royalty holders, only the producer.

Senator Dole: I think I would make it available to the royalty holders. What would it be if you add royalty holders? That would add about 13 percent.

Mr. Shapiro: A total of $9 billion. The amendment on the sheet you passed out without royalty holders has $7 billion. If you say royalty holders will be exempt as well it would be $9 billion instead of $7 billion.

Senator Dole: That contains a provision that you cannot transfer production in an effort to take advantage. We are not trying to take advantage of anything. We are trying to preserve what may be in my state and in Oklahoma, Texas, Illinois, Ohio and Pennsylvania.

Senator Chafee: Could we have a correction on that figure? On option six, on the sheet which came out, without royalty holders it says $9 billion.

Mr. Shapiro: The Joint Committee changed that estimation, Senator.

Senator Dole: We made another modification and reduced it to $7 billion.

Senator Heinz: Was not the reason for that change that it applied to all producers and this is only independents?

Senator Dole: There was another change where there might have been transfers of property to take advantage and we prevented that from happening. It gives us a substantial saving.

Senator Heinz: Could I inquire as to what cost estimates you had on the first three barrel exemption?

Mr. Shapiro: If you do not make it available to royalty holders it is $13 billion. If you allow the exemption for royalty holders it would be $15 billion.

Senator Dole, with regard to your proposal and to royalty holders, you are talking about the royalty holders only on the land on which we have independent producers?

Senator Dole: I do not know of any other way to do it.

Mr. Shapiro: The majors. If you are not making it available to the majors you could have the royalty holders of those if you had majors. It would cause some potential administrative problems.

You are talking about only in the case where you have royalty holders where you have independent production?

Senator Chafee: It seems to me that the object of the exercise as outlined by Senator Dole is to get more production from these old wells. Why does he restrict it to independents? I do not agree with his thesis. I do not see why he is making the difference.

Senator Dole: The majors might not agree but I think some of us would say that they have a way of passing on costs and the independents do not have it. They go out and find the capital and they invest it. They do not have any marketing or processing facilities. That is the end of the line. Once they have disposed of the oil that is it. Maybe that is not a good argument.

We are trying to strip it down to the point of preserving the non-corporate part of the oil industry paying a 70 percent tax rate as opposed to a lesser rate by the corporations. I guess maybe selfishly because there are 28 states that have this production and 90 percent of all wildcatting is done by independents and 80 percent of the oil discovery is done by independents.

Fourteen percent of the oil we have now domestically is stripper production. Seventy-three percent of the wells. It seems to me there is justification just as there was justification for incremental tertiary and new oil.

I would base my argument on the fact of trying to protect the reserves of seven or eight billion barrels and stop the abandonment. It has gone down from 20,000 to 9,000 in the past ten years because there has been a little better price. It does cost more.

If we are going to freeze the price on what everybody else is going to charge for services to oil wells maybe we could not make this argument. I am certain the costs are going to go up. Maybe that is not an important segment of the industry.

Senator Chafee: Of course they are getting $16 per barrel.

Senator Dole: That is a price rollback.

Senator Chafee: Nonetheless that was an adequate incentive for all of these people to stay in the business in the figures cited to you and Senator Boren earlier this morning plus there is an inflation factor inserted in there plus there is this phase out which I think is terribly important and I think we ought to consider that is going to come along later on.

If I might just set out some figures. They want $24 billion for low income. That is what the President asked for. Transportation is $15 billion. Synfuel, let's say $12 billion. The President is somewhere between 3 and 88. The

President asked for 88. We approved alternate fuels of $14 billion and if Senator Danforth wants to cut that down to $7 billion and if approved conservation of $90 billion in Packwood and other amendments and cut that down to $17 billion, it all adds up to $85 billion.

The way we are going and we have made lots of cuts in heavy oil and newly discovered oil and tertiary oil, we are way below that figure. We are dealing with a group here that has found adequate incentive at the $16 plus the inflation factor. I think there is a limit as to how far we can go.

Senator Dole: You are only considering less than one-third of the total tax bite we are going to have on the industry. We all appear to be hemmed in. How much windfall tax can be raise and we cannot spend anything other than the windfall tax.

What about the figures we started off with three weeks ago which Senator Danforth alluded to, up to $400 and some billion in increased revenues?

I do not know why we have to be constrained to say we have to take so much away from the industry. We have to do all these other things with that portion of the total revenues. We are talking about billions and billions of dollars and more than the $105 billion that was in the Administration's bill.

I would hope we would have a right to distribute some of that if we found something worthwhile. Why should we be prevented from exempting these very small independent producers and not corporations who pay 70 percent tax rate but small independent producers who produce three barrels or less on average per day because we may exceed some arbitrary set of figures someone has.

Chairman Long: Senator Boren and then Senator Matsunaga.

Senator Boren: Mr. Chairman, I do not want to belabor the point that has already been made but before we vote I would like to appeal to the Committee again to really consider what we are dealing with.

I know all of us have our parochial interest but I support special treatment of this kind for the stripper and of course I tried for the total exemption this morning. I think the Committee clearly was alarmed by the amount of revenue loss that would have been involved with the total exemption.

I want to say with all sincerity that I support this not because it is going to benefit producers in my part of the country which it will but I truly believe in this.

I have been through the Committee meetings. I have supported Senator Danforth in his efforts in terms of trying to save energy through conservation. I am convinced it will be cost-effective. I supported Senator Packwood in his efforts. Subject to later reconciliation I think we all know we are dealing with that. I felt that was going to be cost-effective even though in both of those cases we are dealing in terms of these conservation credits and we are dealing with hypotheses about what may happen in the future.

In this situation we are dealing with something that we do not have to hypothesize about. We do not have to have our experts tell us what is going to happen or what kind of response we are going to have in terms of what will happen in reduction of abandonments and increased and prolonged production by treating stripper favorably.

You are going to do better at $14 or $10 than you did at $5 but the fact there is a response as we went up in price from $5 to $16 should not be used as an argument against doing something for stripper. It is the clear case where something has worked.

I simply cannot believe my ears that people who argued before the Committee and said we need figures and we need to talk in terms of cost-effectiveness would turn around because we are dealing with oil and I would hope we could view these things in an unbiased way and I have tried to. I have tried through the conservation credits.

We cut the abandonment rate by 500 percent. We know what the increased production is. Dr. Talley and his methodology took the response in terms of prolongation of production and in terms responding to price and he figured the elasticity and he figured what that supply response would be. Those are facts. That is history. That is not hypothesis about what might happen with insulation or something else.

I would urge the Committee with all sincerity do not fail to take an action. We know we are going to have to come back and we are going to have to reconcile all these figures. I agree with Senator Chafee. We cannot do everything that everybody wants to do.

We lost the stripper exemption this morning. It has been cut back from $22 billion to $7 billion even before we go into a reconciliation process.

All I can say is let's not say because we have adopted other amendments with hypotheses that are not even proved as yet about potential future conservation or supply or the savings or the incentives, let's not throw out of the whole mix something that we know works. It is sound conservation policy. Let's do not forget what I tried to say this morning. Dr. Talley makes this point in a footnote in his projections.

We are not only preserving production but we are also greatly increasing the reserve available for enhanced and tertiary recover later on. I do not care how much incentive we give to tertiary. If that well dies before it ever gets to the point of going to tertiary because you have a work over where the fellow says why spend that $3,000 or why buy that new pump for $17,000, I do not care how much incentive we give the tertiary production, that well is not going to be there to practice tertiary techniques.

With all sincerity and I know the Administration has a position and I know there are those in the Committee that want to follow that position as much as possible but I would urge you to look at the facts as they are.

We are not dealing with hypotheses and to give this thing a chance to work and to at least before we go into the reconciliation process throw this as one of the elements into the process that should deserve consideration on the basis of cost effectiveness.

Chairman Long: Senator Matsunaga?

Senator Matsunaga: Senator Boren makes a very persuasive argument by pointing to the fact that there has been a decrease in abandonment of wells by 500 percent yet we have testimony to the fact that because of the exemption under the existing law granted to strippers that there is evidence that producers are in fact reducing production down below ten barrels per day for a year in order to qualify as strippers.

This means while the abandonment may have been reduced the production may not have been increased. What I want to know is whether there has been in fact an increase in production even with the reduction in the abandonment of wells?

Senator Boren: The answer to that is yes. I do not have the exact figures here. I think if we can pull it out of

Dr. Talley's model we could find it. That is part of the way in which he projected additional production. I would point out also that we have not had the incentives in the past for tertiary production that we are now going to have if we prolong the lives of these wells. You have the additional incentive to go on and expand their production in the future.

I do not know if we have heard evidence. I think we have heard assertions. I have not heard any evidence presented. I think that is the difference. A person could say it might happen and you could hypothesize.

Senator Matsunaga: Does the staff have any figures on this in response to my question? Does the Administration?

We hear on the one hand there has been a reduction of abandonment of wells. That is good. On the other hand we are hearing in order to qualify for stripper we have a lowering of the production of individual wells in order to qualify which means a reduction in production.

What has been the balance? That is what I would like to know. By knowing the answer I could determine which way to go.

Chairman Long: Mr. McGregor, you are the guy who made the statement. What evidence do you have to back it up?

Mr. McGregor: Mr. Chairman, let me address a point. I would agree with Senator Boren in saying surely when you take a well that would otherwise qualify at $6 a barrel and allow it to qualify at $16 and you have certainly provided an economic incentive to keep that well in production. Even lower levels than $16, I think there is good evidence that the stripper treatment that has been attributed to Lower 48 production to date has prevented some abandonment from occurring.

There is also built into the stripper incentive this pernicious economic incentive to quality ten barrels a day rather than say 12 barrels a day.

Chairman Long: Mr. McGregor, if that is going on and you indicated that, have you people brought a recommendation up here to prevent that from happening?

Mr. Sunley: Senator Long, I do not think there would be any way to prevent that.

Chairman Long: There are ways to prevent it. You can put people in jail for doing that if you want to pass a law that says they go to jail for doing it.

Mr. Sunley: It is awfully hard for the I.R.S. agent to go out there and look down a well and say you should have pumped more water down there this year and maintained your production. I do not have any idea how we can make Senator Dole's amendment work if they did it on purpose. I do not know how we can define what a producer should be doing at every moment in time.

Chairman Long: You have witnesses here representing the Department of Energy and representing the Treasury Department. Most of this regulation program I admit is a great big fiasco and cannot be administered and it is a mind boggling monstrosity that is wrecking this country.

We should be able to all agree on that. It is a great big mess and you people helped to make it that way.

Let's us assume that what you are saying represents your sincere belief and Mr. McGregor is representing his sincere belief that people are holding back production to qualify their wells as stripper wells. Let's assume that is correct.

If you are a responsible Government official trying to make a law work and you see a 20 barrel a day well being cut back either taken offstream completely or cut back to ten, you should be coming in here asking for a change of the law. Why have you not done that?

Senator Bentsen: Mr. Chairman, I am advised by staff that it is against the law.

Chairman Long: I would like to ask Mr. McGregor why have you not done that?

Mr. McGregor: I cannot address that. I am told staff has advised Senator Bentsen that it is against the law. I do not know what type of enforcement activities have gone on if any. I agree with Mr. Sunley that the administrative difficulty or the enforcement difficulty of actually effecting that is almost impossible.

Chairman Long: I heard the President on television. He said he was going to put 300 more auditors in those peoples' office. They tell me they have agents crawling all over those officers before they put the 300 or 600 more agents inside.

If you just take out the laws on any wells and you know what you are talking about, if it is offstream for a year or if it is not producing -- the law is supposed to be if it is producing less than ten barrels per year that it qualifies as a stripper well. Is that correct?

Mr. Shapiro: That is correct. It has to have been produced at its maximum efficient means of production.

Chairman Long: The law said it must have been produced at its maximum efficient rate for a solid year and be producing less than ten barrels to qualify?

Mr. Shapiro: That is correct.

Chairman Long: If the fellow is not producing what that well could produce then he does not qualify for being a stripper. It would seem to me you people should be watching it.

I heard your boss on television. I heard Mr. O'Leary on television on public education say that people think this is a great big ripoff going. He said he has had his people over in the Department of Energy combing their books and going over all their operations trying to find all this. Although he is convinced these people did what other folks do, they try to make as much money as they can but at the same time it is his estimate that the best you people have been able to find on people chiseling on the program works out to be one percent.

Did you hear your boss talk on television nationwide on the public broadcasting system?

Mr. McGregor: I did not observe that particular session.

Chairman Long: Why do you not get a copy? They will probably sell it to you for $1.00.

We have a credibility problem. Who are we going to believe? Are we going to believe the guy who is retired and therefore free to say whatever he pleases or somebody coming in here trying to suggest that something completely contrary to the law and these people are getting away with murder when best I can make out you do not have the evidence to support that.

I have been reading about once a month about this release. It started out saying the DOE charges companies with ripping the public off for $3 billion. The next thing I know here is DOE charging that the public is being ripped off for $3.5 billion. Then DOE charges that the public is being ripped off for $4 billion and so forth.

Each time you read that you would think it was a new ripoff. Here you have a law that is so complicated that all

20 Senators could read the law and come up with a figure on how much you are entitled to make and no two people out of 20 would arrive at the same figure. That being the case it is not difficult to understand why your people in DOE think these people should have been able to make "x" amount of money and they say they read the same law and they are entitled to make "y" amount of money and they are going to court with you. They say let the judge tell us how much we are entitled to make.

To come out with a press release once a month although here is a new ripoff when it is the same lawsuit we have been talking about all the time leads to this confusion. People think the whole problem is because somebody in the industry is holding back something to try to rip the public off and it is completely contrary to fact.

Your boss, Mr. O'Leary, went on nationwide television to tell the American people that at most you are talking about one percent. Your statement would lead us to believe it is a great deal more than one percent.

Treasury is doing the best they can to try to collect the money that the Government has owed us and he issued a press release saying the public is not paying five percent of the money they owe us. I guess the general taxpayers are up to about five percent or let's say 20 percent of what you are charging the industry with.

It would seem to me if you do not have any evidence to back something up you should not make the statement.

Senator Bentsen: Mr. Chairman, let me make the point that under the emergency petroleum allocation regulations it is absolutely a violation of the law to manipulate production to try to get down to stripper. Under the Department of Energy's pricing regulations I am told again that is an absolute violation of the law.

Chairman Long: Did you know that, Mr. McGregor?

Mr. McGregor: I did not know the precise content of the regulations. If they are premised on reaching a maximum efficient rate of production I would still say it is a broad regulatory standard that is based on any number of assumptions that would go into it.

Senator Bentsen: Mr. Chairman, considering the public relations image of the industry, if you found any evidence and you took them before a jury of twelve I would not want to bet much on their coming out of it without some severe penalties.

I really think they have the law there. If there is that violation they should be pursuing it and trying to do something about it. They have many ways they can approach it.

The I.R.S. says when you get an undue accumulation that does not show up on your tax return then you have a presumption. If you had a stripper operator that just happened to have all of his strippers producing nine barrels

I think you would have a presumption there and you would be able to move in those kind of cases.

Chairman Long: Senator Matsunaga?

Senator Matsunaga: Mr. Chairman, I had intended to elicit more light than heat by my question.

Senator Dole: May I respond to the question?

Chairman Long: Yes, sir.

Senator Dole: I might say in response and the Administration says they could not administer but there is an amendment that goes along with the stripped down version of the stripper amendment which clearly indicates you cannot withdraw production to qualify for the exemption. If they do not have the law now they are going to have it there.

I also wanted to touch on whether or not there had actually been an increase in production. In 1974 we had 366,000 stripper wells and almost 412 million barrels of production. In 1975 the stripper wells were 367,000 or almost 368,000 but production dropped to about 394 million barrels. It dropped again in 1976 to 392 million barrels but in 1977 it started back up again. I do not have the 1978 figures.

I think the answer is yes, there has been after the decline and after the decline in abandonments 20,000 down to 9,000, we are starting back up slowly in increasing production.

Chairman Long: Senator Bradley?

Senator Bradley: Mr. Chairman, I just want to address the enforcibility of the suggestion Senator Dole has made.

How many stripper wells are there in the country?

Senator Dole: 360 some thousand.

Senator Bradley: The Assistant Secretary for Auditing in the Department of Energy who has these auditors and have gotten the additional 300 bringing the total up to about 600 are auditing basically company books across the country. If you are trying to determine whether a well should have produced more than ten but did not then you have the job as an auditor to look at every well that reduced its production under ten. That requires a physical presence.

My question is do you think that is really enforcible with 600 auditors? Can you look at 350,000 wells?

Chairman Long: Senator, I can give you a better answer than that just from personal knowledge. I do not have an interest in the Pine Island Field. I know what the Pine Island Field is. It is north of Shreveport, Louisiana. You have people right here in this room who can tell you.

Let me ask if someone is here from LAIPO, Louisiana Association of Independent Petroleum and Royalty Owners, who knows anything about that field?

Is there a well in the Pine Island Field that will produce more than ten barrels a day?

Mr Short: I do not know, sir. I am on the Board. I think if Mr. Jones has a well and Mr. Smith has a well, it is very unlikely that they are going to be in cohoots together. If Mr. Jones closes his well down and Mr. Smith is getting it from the same source and Mr. Smith continues to get revenue and Mr. Jones does not get any at all, I think it is impossible to say you would intentionally get your production down.

Chairman Long: There is your answer. You have your well here and the other guy has his well over on the next 48 acres. Why is it he is producing 15 barrels and you are only producing eight?

Senator Dole: Plus 73 percent are already stripper wells. We are only talking about 43 percent of the remaining 27 percent so we get it down to a relatively small number.

Senator Boren: That is the whole point. What we are dealing with in the main is stripper production. It means we are in formations that if you wanted in the worse way to produce 30 or 40 or 50 barrels from that well you cannot produce it except through one way. If you prolong that stripper long enough and you finally find an economic means to go back in with enhanced recovery or tertiary recovery, then you can go back in and do it.

I think the only place where we have encouraged strippers to be prolonged and then nothing else happen is the fact that we have not exempted tertiary recovery in the past which this

Committee has now taken care of. You cannot produce more of it in the vast majority of these cases unless you go in with enhanced recovery. As we prolong the life of these wells we now with the tertiary exemption give them an incentive to do that.

Chairman Long: Senator Heinz?

Senator Heinz: Thank you, Mr. Chairman.

As I understand the industry it is the smaller stripper wells, those with three barrels or less that are most likely to be abandoned. You do not know if it is at one barrel or two barrels or three barrels but it is the smaller production wells that are likely to be abandoned.

It seems logical to the extent we target relief to strippers that we should try to target most of our relief exemptions toward the smaller wells.

I said tc the Joint Tax staff, what would be the cost or what would be the revenue loss of limiting Senator Dole's proposal to the first three barrels of production per well?

Mr. Shapiro: That would be approximately $5.3 billion if you allow the exemption for the royalty holders. If you exclude the royalty holders it is approximately $4.6 billion.

Senator Heinz: Mr. Chairman, I so move.

Chairman Long: Let me make a point which appears from Senator Dole's information on this chart which I assume he got from the same source the Administration got theirs from.

In Louisiana we have 13,185 strippers. In Pennsylvania they have 31,000 strippers. You say why is that? We just produce a great deal more oil. We have deeper sands and better fields. We just produce a great deal more energy and more oil and our fields are mainly younger fields.

You look out and take Oklahoma. We produce a great deal more oil than Oklahoma but Oklahoma has 53,000 stripper wells and Louisiana has 13,000.

You would be able to go into a lot of fields in Oklahoma but there is not a well up there producing ten barrels. They are going at about one barrel a day or something like that. When a barrel comes out you get about nine barrels of salt water with it and they have to pump the salt water back into the ground and that is life thanks to people like Gaylord Nelson who want to protect against pollution. They do not want all that salt water. That contamination will wash down the stream and they are right about that.

This thing about saying what is a stripper well and what is not, you might have a few borderline situations. I would submit the idea of saying you have a great big ripoff when you look at just the figures on their face that it looks like what you have is a pretty honest presentation. You may have a situation where somebody might have been able to get 11 and instead he had been producing less than that hoping to be classified down to eight or nine.

As the wintess in the back of the room said, just look at the other wells in the field. You can tell what that particular well should be producing.

Senator Matsunaga: Mr. Chairman, the abandonment of wells seems to have been a major issue. I wonder if the Administration has some proposal? As I understand it they have some proposal to deal with abandonments. Has that been made known to the Committee?

Mr. Lubick: No, Senator Matsunaga. In thinking about the problem that has been raised here we tried to think of ways that could deal with this issue of abandonment and the problem of the high cost wells.

Our argument to you and Senator Heinz was going to try to respond to me at some stage when I said since the windfall profit tax does not apply when you reach the 100 percent net income limitation, abandonment cannot be a problem. I suppose your response was going to be when you get down very close to that margin it is hardly an incentive to keep going.

Senator Heinz: More importantly there are a lot of things that you do not get compensated for such as your time. If economically it costs you $100 and you get revenue of $100 and it takes you a couple hours out of the day or a couple days out of the year, it is not worth it.

Mr. Lubick: If you wanted to deal with that situation, it seems to me within the framework of the existing bill you could change the 100 percent of net income limitation to some figure say 90 percent.

Senator Wallop: I have a proposal for 75, Mr. Lubick.

Mr. Lubick: I am not quite sure how the numbers work out and what the incentive is. If you determine in order to prevent abandonment you have to assure a margin of profit and make sure the windfall tax is not applied in there, you have an existing framework within the bill and if you change the 100 percent to whatever the appropriate number might be and let's say it is 90 percent, you would know if the tax plus the deductions got to be 90 percent of the revenues then the tax would be shaved off at that spot, I think that would focus on the high cost wells and deal with that particular problem in a narrow direct way.

Senator Heinz: I think that is a constructive proposal.

Senator Matsunaga: Does the Senator from Wyoming intend to propose that?

Senator Wallop: I do but not right now. I assume we are going to be on this bill a day or two.

Mr. Chairman, I would like to bring up something with regard to Senator Heinz' motion. It seems to me what this country really does not need now is one more category of oil.

If Senator Bradley has a problem with auditing as he described it with the stripper exemption and the cheating as Mr. McGregor has suggested took place but is unwilling to charge, to get down to another category which is the first three barrels will really require an auditing mechanism. This way all you are going to have to do is to audit those entering the stripper category and not those already there. It is an established category of oil. Everybody knows what it is. We have been living with it.

What we really do not need to do is establish one more and make this an evermore complicated mess and discourage production at every level.

Senator Heinz: Mr. Chairman, just so everybody is clear, this is not a sub-stripper category. This is not the wells that produce three barrels or less. This is simply an exemption from the windfall profits tax for the first three barrels per day produced. It therefore does not create a category. It creates an exemption of the first three barrels in the same way that the personal exemption does not create a special category of person but it creates an exemption for the first $100.

Senator Wallop: Senator, it creates havoc. If the independent people are having trouble meeting the accounting mechanisms that are in place now to add one more like that is simply just to drive people from the business. I do not think it is in the interest and it does not take care of enough of what you are worried about to make it worth the offer.

Senator Dole: I just want to say a word because we just had a client come in, Senator Roth. I would hope we would go back to the amendment I originally offered. I wanted Senator Roth to understand what we have before us is a stripped down version of the stripper amendment.

We tried first with the Bentsen amendment and that failed. We moved to the total exemption of all stripper production by Senator Boren. That failed. The Senator from Kansas offered this slimed down version which applies only to independents. That would cost if you exclude royalty owners about $7 billion and if you include royalty owners it would cost about $9 billion over the next ten years.

Mr. Shapiro: With the royalty holders only on the independents it is only about $7.7 rather than $9 billion.

Senator Dole: It is $7.7 billion over a ten year period?

Mr. Shapiro: It is approximately $6.7 for your amendment so it is about $1 billion that goes to royalty holders so it is $6.7 to $7.7 billion.

Senator Dole: It is a steal at this price. It is $6.7 billion or $7.7 billion. The point I wanted to make is let's recognize that we have had testimony from a credible witness who said in effect that we can increase production by the year 1990 of 497,000 barrels. I do not think the man deliberately came before the Committee and just dreamed up some figure and dropped it on us and left town.

In addition we have reduced the abandonments of stripper production or stripper wells from around 20,000 high in 1969 or 1970 down to about 9,000 and maybe less than that in 1978. Production is on the increase. The figures indicate production is on the increase. We are protecting a reserve of seven or eight billion barrels. We also have a chance to increase production at a very low cost. I think the cost has been estimated by the staff to be $7.7 billion.

I would hope we could adopt this amendment. We are talking about small operators and not major corporations and not major anything. We have had historically or we have protected the small independent producers. We did it in the depletion debate several years ago. It took seven or eight votes on the Senate Floor but they finally prevailed and next year I think it levels off at 1,000 barrels where you are entitled a depletion allowance on 1,000 barrels.

It fits that pattern. It was done not to give the small producers a preference but it is done like we do anything else that is very small whether it is small farmers or small oil producers or small businessmen, there is always a little preference given to preserve that resource.

I would hope we could adopt the amendment without establishing whether it is a new category or not and just changing the pattern.

I appreciate very much Senator Heinz' recommendation. I think we have a responsible amendment and not that it is mine but I think --

Chairman Long: Is this the first three barrel amendment?

Senator Heinz: I have an amendment to Senator Dole's amendment.

Chairman Long: To restrict that to the first three barrels?

Senator Heinz: Yes.

Chairman Long: Shall we vote on the Heinz amendment first? If you object we will vote on yours first.

Senator Dole: Let's vote on the Heinz amendment first.

Chairman Long: Call the roll on the Heinz amendment.

Senator Danforth: Mr. Chairman, if we are voting on the Heinz amendment and he prevails then do we vote on Senator Dole's?

Chairman Long: Some people may be against the whole idea but if it is between the two if they are going to exempt them they would rather exempt three barrels than ten. You are voting on two different propositions.

Senator Heinz: I want everyone to be clear on what my amendment is, Mr. Chairman. It is an amendment to Senator Dole's amendment. Everything in his amendment is in. The only difference is I limit the exemption in his amendment to the first three barrels a day thereby cutting the cost of the amendment.

Mr. Shapiro: It would be approximately $5 billion, from

$7.7 billion to approximately $5.3 billion.

Mr. Stern: Senator Heinz, this does not affect the royalty holder provisions of Senator Dole's amendment?

Senator Heinz: It does not.

Chairman Long: Call the vote.

Senator Dole: What does it do to my amendment?

Mr. Shapiro: All he does from what we understand is to say that you get it for the first three barrels of oil per well per day.

Senator Heinz: The reason for that is to target.

Chairman Long: Independent stripper only.

Senator Heinz: Yes.

Chairman Long: Call the roll.

Mr. Stern: Mr. Talmadge?

(No response.)

Mr. Stern: Mr. Ribicoff?

(No response.)

Mr. Stern: Mr. Byrd?

(No response.)

Mr. Stern: Mr. Nelson?

Senator Nelson: Aye.

Mr. Stern: Mr. Gravel?

(No response.)

Mr. Stern: Mr. Bentsen?

Senator Bentsen: No.

Mr. Stern: Mr. Matsunaga?

(No response.)

Mr. Stern: Mr. Moynihan?

(No response.)

Mr. Stern: Mr. Baucus?

Senator Baucus: No.

Mr. Stern: Mr. Boren?

Senator Boren: No. I should have voted no for Senator Gravel by proxy.

Mr. Stern: Mr. Bradley?

Senator Bradley: No.

Mr. Stern: Mr. Dole?

Senator Dole: I think we should have reversed it. Is it too late to ask unanimous consent we vote on my amendment first?

Chairman Long: Is that all right with you?

Senator Heinz: Certainly.

Chairman Long: Let's start over.

We will vote on the Dole amendment without the Heinz amendment and if that fails we will vote on the Dole amendment as amended by the Heinz amendment.

We will vote on the ten barrels first.

Mr. Stern: Exempt the first 1,000 barrels per day of stripper oil produced by an independent producer and exempt royalty holders related to this oil.

Mr. Talmadge?

(No response.)

Mr. Stern: Mr. Ribicoff?

Senator Nelson: No by proxy.

Mr. Stern: Mr. Byrd?

(No response.)

Mr. Stern: Mr. Nelson?

Senator Nelson: No.

Mr. Stern: Mr. Gravel?

Senator Boren: Aye by proxy.

Mr. Stern: Mr. Bentsen?

Senator Bentsen: Aye.

Mr. Stern: Mr. Matsunaga?

Senator Matsunaga: No.

Mr. Stern: Mr. Moynihan?

Senator Nelson: No by proxy.

Mr. Stern: Mr. Baucus?

Senator Baucus: Aye.

Mr. Stern: Mr. Boren?

Senator Boren: Aye.

Mr. Stern: Mr. Bradley?

Senator Bradley: No.

Mr. Stern: Mr. Dole?

Senator Dole: Aye.

Mr. Stern: Mr. Packwood?

Senator Packwood: Aye.

Mr. Stern: Mr. Roth?

Senator Roth: Aye.

Mr. Stern: Mr. Danforth?

Senator Danforth: No.

Mr. Stern: Mr. Chafee?

Senator Chafee: No.

Mr. Stern: Mr. Heinz?

Senator Heinz: No.

Mr. Stern: Mr. Wallop?

Senator Wallop: Aye.

Mr. Stern: Mr. Durenberger?

Senator Durenberger: Aye.

Mr. Stern: Mr. Chairman?

Chairman Long: Aye.

The ayes are ten and the nays are eight. You have two Senators we have not heard from. We have Senator Talmadge and Senator Byrd who have not voted. If either one of those two voted for the amendment, the amendment would carry.

As of this moment this amendment carries. It might not carry when you hear from the other two Senators.

Senator Danforth: Mr. Chairman, may I inquire of the Joint Committee staff where we stand now with respect to what we have spent and with respect to what we are taking in after the amendment?

Mr. Shapiro: If you include this amendment as having passed it would be you have $72 billion that is raised over the period 1980 to 1990.

Senator Danforth: Without any other changes? If we do something for Alaska which I understand the Administration supports that would reduce that further?

Mr. Shapiro: You would have several options. One is to exempt Alaska entirely and second is to treat Alaska in the second tier.

Senator Danforth: What is the most modest loss on Alaska?

Mr. Shapiro: It is approximately $7 billion which is putting it in the second tier as the Administration proposes and that would take it down from $72 billion to $65 billion.

Senator Danforth: That would be $65 billion. Are there any other potential revenue losses to be considered?

Mr. Shapiro: There are some other amendments, some marginal oil, depending on what the amendments are in the net income limitation and severance taxes and any other exemptions that may come up for certain categories of individuals or taxpayers.

Senator Danforth: Any other known exemptions that would look like they have a pretty good evolvement?

Mr. Shapiro: It is hard to say. We are still getting information. There is an exemption that we understand may be proposed to exempt Indians.

Senator Wallop: Indian tribes.

Mr. Shapiro: Charitable organizations, Section 501(c)(3) organizations.

Senator Bradley: What is the charitable organizations worth?

Mr. Shapiro: We are still working on that. It is very difficult for us to get the information as to the oil that is owned by charitable organizations. When the Committee dealt with this earlier the Committee had certain specific cases in mind and we knew how much oil they owned. We knew how much the revenue effect would be to that particular institution.

When you say a blanket exemption for all tribal organizations the data is not as complete as to who the specific tribal organizations are that own the oil. We have been trying to get that information and we are still doing so. We do not have an estimate for you as of yet on the magnitude of that revenue.

We also know some Senators and Senator Chafee in particular has an amendment for a phase out. I am not sure exactly which one he is going to propose. At one time he and some other Senators talked about phasing out the upper tier tax with a higher rate phase out and depending on how that is proposed that may have a revenue effect.

Senator Danforth: In any event as of now we have it down to about $65 billion.

Mr. Shapiro: As of now it is $72 billion.

Senator Danforth: The Administration I am told supports something for Alaska.

Mr. Shapiro: If the Committee agrees to what the Administration supports for Alaska which is to put Alaska in the second tier then it would have a revenue effect of approximately $7 billion and therefore would take the revenue from $72 billion that is raised so far down to approximately $65 billion.

Senator Danforth: If we go the more generous route on Alaska where would that get us?

Mr. Shapiro: That would be almost $13 billion. That would reduce it another $6 billion which would get you down to approximately $59 billion.

Senator Danforth: How much have we spent so far?

Mr. Shapiro: Technically the way the Committee's slate now stands is you have reconsidered the amendments for spending so the Committee does not have anything on the spending side. Previously before that reconsideration it was very close to $100 billion. That has now been reconsidered and that is no longer a tentative decision.

Senator Danforth: Is everything being reconsidered or just those credits?

Mr. Shapiro: As we understand it all the credits have been reconsidered, all of your amendments you have agreed to so far are like tentative agreements on all of these amendments.

Senator Bradley: That includes exemptions also subject to reconciliation?

Mr. Shapiro: The way the Committee generally makes its decision as has always been the case is anything the Committee has decided can be reopened for reconsideration at any time. That is the way the Committee does business. You can have either a reconciliation or any previously decided amendment could be reconsidered at the time the Committee reviews it or at any time it is appropriate to come up before the Committee.

Senator Danforth: Mr. Chairman, I have an amendment that I would like to offer. I suppose it would take the reconsideration to do it.

I think it would at least restore a little bit of what we have undone of the Administration's program. That is the exemption with respect to political subdivisions which Senator Bentsen and Senator Wallop offered very early in our proceedings. I think the House has at least a version of it.

It is my understanding that particular exemption for political subdivisions amounts to a loss of $6.5 billion. That is without adding all of these charitable matters and Indian tribes and what not we are thinking about.

Here is an area, Mr. Chairman, where if it is $6.5

billion it has either no production effect whatever or is certainly I would think a very marginal production effect. It would seem to me that those political subdivisions which would have oil producing properties would be highly regional. I would doubt for example that Joplin or Cape Jordo would have much revenue from oil producing properties.

It seems to me at a time when revenue sharing is under attack and when people are raising questions as to its future, it is a little bit dubious to carve out certain political subdivisions who are lucky enough to have oil properties and to say they are going to be treated specially under the windfall tax particularly when there is absolutely no oil production involved.

I do not know what the proper procedural step would be, if it would be to move to reconsider that is what I will do. To raise again the question of this exemption for political subdivisions is what I would want to do.

Chairman Long: Does the staff estimate or the Joint Committee estimate of the $6.5 billion involve his amendment?

Mr. Shapiro: Yes, sir. Let me give you a little background. In the House side they had a provision which exempted the oil that was owned by the state or local governments or public education institutions as long as the net income was dedicated to public education.

When this amendment was agreed to in the House side the staff for revenue purposes assumed if this were to be passed in this form all the states would revise their treatment of that income and have that oil income dedicated to educational institutions because that would be exempt and would just switch the money around.

We allocated an entire $6.5 billion to what the House had done. Senator Wallop and Senator Long and other Senators in this Committee just broadened it in the Committee.

Our revenue effect assumed what the House had done would be done by the states in any event and the effect of Senator Wallop's and Senator Long's amendments and other amendments was just to say the states did not have to shuffle their money around and they could just keep it the way they had it.

Senator Danforth is now reversing the House position and would move to strike the House provision as well as the previous Committee action just to say state owned oil or public educational institution owned oil would not be exempt from tax.

It is really going further than just the Committee decision ending or repealing the House passed provision as well.

Senator Bentsen: As I recall, Mr. Chairman, when this started out we were talking about the House provision costing some $257 million in 1980 and $409 million in 1981. That was the revenue loss under the House provision according to the numbers I had received.

That is what I originally proposed. Some of my colleagues on this Committee felt we ought to expand that. I had limited it to those as you say, those public lands that were dedicated to education.

In my own state we have a situation where the state has set aside its land for the benefit of education and of course the cost of education has expanded substantially. What we are trying to do with the windfall profit tax as I understand it is to keep the private sector from having a windfall. That is what we were trying to do.

This is not the private sector we are talking about. If you are talking about revenue sharing here is a situation where in effect you are asking the state to share its revenue with the Federal Government. You have reversed revenue sharing that you are trying to put into effect if you reverse what we have already done in this Committee.

I think this Committee did the proper thing in trying to say where it is dedicated to that purpose off the public lands that is a benefit to the students in that particular political subdivision and they are dependent on it and in turn it helps meet the increased cost of education.

To try to confuse that with revenue sharing, you are really turning it around because you are then trying to take part of the revenues of the state itself. Frankly I hope this

Comittee will not reverse what I think was a wise decision on its part.

Chairman Long: The minerals that a state has under the mineral law are part of the real estate. When you go to taxing the state's minerals beneath the state's property, that is their property and when part of it is severed that is state property. They have a contract with somebody that they get one-eighth or one-sixth of what comes out of there.

Up to now there has not been any effort to tax so far as I know state property. Basically this is a tax on state property. You have just as much right to tax the State Capitol Building itself or any state land or the state highways.

I would hope we are not going to start down this procedure of trying to say we are going to tax the income of a state government, the income on that property. That is just like you were selling "x" number of acres from land that the state owns. To me I think when the Federal Government starts trying to tax state property it will be a very bad mistake.

The one bad thing about it is when you get it started it is difficult to reverse it. A Senator sits here and it seems like a great idea to tax Louisiana or to tax Texas or California or the State Government.

When you start that it is just a matter of time before someone figures out a way to tax the state that guy represents. When that happens one will say I am sorry I started all this foolishness and I now see the states have to exist and I am sorry I started. Once it gets started people tend to react and say if that is how it is going to be we should all share the burden. I hope we will not get started in taxing the state governments. That is what this amounts to.

Senator Bradley: Mr. Chairman?

Chairman Long: Yes, Senator Bradley.

Senator Bradley: I think the whole idea of reversing the Committee's decision comes from these revenue figures that we see slipping out of our grasp. We are down to $72 billion now. It could be $65 billion or $59 billion. I think every Senator here has in mind spending windfall profit tax in ways either that cushion the price of decontrol on low income people or improving the energy efficiency of our homes and commercial dwellings or spending it on mass transit or producing alternate energy sources that are equally effective as production of new oil.

I think the idea of grasping the exemption for state controlled land precedes from that. I think we clearly have in the Committee an idea that we would like to spend close to $85 to $90 to $95 billion that we can account for. We see revenues here of $59 billion. You begin to say where is the revenue going to come from to accomplish the public goals that you want to accomplish.

Frankly in the event of anything else coming I think you do grasp out for that because in the debate on low income we just had a few days ago the question of regional differences arose and whether we are really by this tax attempting to lighten the burden of energy costs for all the poor in the nation, for nuclear decisions that were made ten years ago in other parts of the country or whether we indeed are trying to lighten the burden for the high price of oil that is the result of OPEC pricing decisions.

That is a regional issue. I think the Committee deliberated on that and did not reach a conclusion.

I would venture to say that is no more regional in issue than the issue of whether you tax those states that have oil wells as opposed to those states that do not. It precedes I think from this basic imbalance between revenues and expenditures and speaking for one Senator not seeing how that is going to balance out.

Chairman Long: Let me say this. An amendment was agreed to by the Senator from Rhode Island, Mr. Chafee, that would rate about $1 billion on old oil or on what is second tier, the same thing applied to the other tier. I get these tiers confused. It would raise $9 billion. He had not offered that but I assume the likelihood is those who endorsed that would probably vote for this also.

I have been counting about $9 billion from that Chafee amendment assuming the same Senators that voted for it applied to the one tier would vote for it applied to the other tier.

That money would cushion what you are talking about.

Senator Bradley: It depends on what the bottom line figure is.

Chairman Long: Insofar as this tax we passed along to all consumers to share. insofar as this is a tax on producers, that is a tax those of us from producer states will pay and our citizens will pay it and our producers will pay it and the citizens of fifty states will share in it and we are happy to share it.

When you start taxing the state government itself that gets to be sort of a horse of a different color.

I would hope we do not get to that point. I would hope we do not get so desperate for revenues that we have to start taxing the state government itself and that is basically what the Senator proposes.

Senator Bentsen: Mr. Chairman, it is much more than a regional question if you start taxing a state. As I stated earlier we have been talking a long time up here about revenue sharing and sending it to the states which frankly I think we have overdone.

This is going far beyond what I have talked about. This is talking about not only not sending it to the states but taxing the state itself on its own property. That is a very major question of principle if you do that. I think we are setting a precedent that we will very much regret if we do that type of thing.

Chairman Long: Senator Wallop.

Senator Wallop: Mr. Chairman, I would go along a little farther with what Senator Bentsen is saying. A great many states operate businesses. It is not so much that some states have forests and some states have factories and some states have farms. South Dakota has a cement plant which brings them a significant amount of revenue.

All of Nebraska runs off a state owned utility which is a privately run business but belongs to the state.

I do not think we here are after doing that kind of thing. I would point out to my friend from Missouri that the revenue effects of Senator Bentsen's amendment and my addition to it are zero as the bill came to us from the House. All in effect we did was to say it was not the business of the Congress to direct the revenue habits of the states. That is in essence what we did.

The House said we had to spend it on public education. I pointed out my state runs its prison system off of those and also its services for the retarded and services for the handicapped among other public purposes.

We are not talking a net revenue effect of anything as it came from the House. The argument here is not restoring something that the House took for us but a totally new departure for the Congress of the United States to undertake.

Senator Chafee: Mr. Chairman, if you would just as soon adopt my amendment by voice vote of the 75 percent rate on the upper tier oil, that would give us considerably more revenue and then we could move on and consider some of these other matters.

Chairman Long: We cannot vote on that until we dispose of the Danforth amendment unless the Senators are willing to agree to that.

Senator Danforth: I would be willing to put it aside, Mr. Chairman, and come back to it at some later point. I would like to find out for example whether there is some precedent with respect to this kind of situation.

It seems to me to be a little bit unfair really to allow some states tools or some states efforts to receive a special kind of benefit of this sort and particularly when there is a very substantial amount of revenue to be lost.

I want to pursue it for a few minutes and we are doing a little bit of research right now. I would be happy to step aside and let Senator Chafee proceed.

Senator Chafee: Mr. Chairman, I do not know what your time schedule is. We seem to have run out of people to some degree.

Chairman Long: We can find Senators. The Senate is still in session. Some Senators have proxies. I am not holding any proxies at the moment. We can go ahead and act.

Senator Wallop: Mr. Chairman, while we are here and while Senator Danforth is researching this I would like to bring up the Indian tribe amendment right now. It is the least expensive of all the things anybody has been talking about. It is $328 million over the ten year period.

Even more than the state thing it is a departure from standard. For example we have never in this country under the Indian trust resources and under any established Federal policy taxed anything that belonged to tribal resources.

I point out on my Indian reservation that the average per capita income is $1,216 on the Wind River Reservation. I suggest it is probably not different than that in most other people's tribal reservations.

I think if we want to get in the business of putting a tax on the tribes it is contrary to the spirit of the Indians Self Determination Act which passed this Congress a few years back and in essense all I am doing is trying to treat the tribes the way they have always been and these are their resources and primarily by treaty.

Chairman Long: This is proposed to exempt Indian tribes?

Senator Wallop: That is right, Mr. Chairman.

Chairman Long: Is the Administration opposed to it?

Mr. Lubick: We are opposed to it, Mr. Chairman. We think the argument applies equally to the Indian lands and to the charitable organizations and all of these exemptions are simply ways of transferring proceeds of our windfalls and in most cases you are dealing with royalty owners and you are not talking about increasing any production. You are saying these particular classes of holders are entitled to retain their windfalls which are being paid for in higher prices.

We are not talking about an income tax. You are not talking about anybody's income. This is an excise tax on the windfall aspect of the revenues as a result of the price rises. That should be put into this general fund for the use of all the American people.

The argument we made on 501(c)(3) applies equally to the Indians when they are royalty holders.

Senator Wallop: Mr. Lubick, other than by theft, what has the United States Government ever taxed the tribal possessions other than just confiscation? We are paying a price for that as the Senator from Minnesota can tell you and other Senators.

Tell me one resource of tribes that we have ever taxed?

Mr. Lubick: I cannot answer that, Senator Wallop. I will have to look into it.

Senator Wallop: These are theirs by treaty negotiation, Mr. Lubick. These are not properties of the United States

Government.

The court tests have proven that right now. They have not only proven it with regard to resources but they are proving it with regard to lands and I think all you are doing for $328 million is buying a lawsuit that will cost you $5 billion to settle.

Mr. Lubick: I will be glad to look into it in the legal aspect. I do not have knowledge of the precedent.

Senator Wallop: We have never taxed their resources.

Senator Bradley: May I ask the Senator how much is this? $328 million?

Senator Wallop: Yes.

Senator Bradley: Where are the Indian tribes that hold this resource?

Senator Wallop: They are scattered here and there. There are some in Arizona, Colorado, Florida, Michigan, three tribes in Montana, four tribes in New Mexico, one in North Dakota and Oklahoma, South Dakota, two tribes in Utah and one tribe in Wyoming.

Senator Bradley: No tribes in Alaska?

Senator Wallop: This includes the Alaskan Native Claims Settlement Act. There is no argument there. That claim is not going to go to the United States Government no matter what it wants to do. It is providing for the treatment of the rest of the Indian people in America, the same treatment under the

Alaskan Native Claim Settlement Act.

Senator Bradley: Does the staff have any further analysis on the proposed amendment?

Mr. Shapiro: We have a listing of what we understand the amendment to be. It would exempt the tax on oil produced from tribal trust lands and on oil produced from mineral interests held by the Indian tribe eligible for services provided by the Secretary of the Interior to Indians or individual members of such tribe, subject to a restriction against the alienation proposed by the United States and third --

Senator Bradley: Subject to what?

Mr. Shapiro: Subject to a restriction against alienation proposed by the United States.

Senator Bradley: What is that?

Mr. Shapiro: In other words Indians cannot sell it elsewhere.

Senator Wallop: They cannot sell it to somebody else and have it come out as exempt.

Mr. Shapiro: Third, oil proceeds from which are paid into tribal or native trust funds in the United States Treasury. The exemption would not apply to production received by non-Indian lessees of Indian mineral interests. They cannot lease it. They have to do it theirself.

Senator Wallop: In other words only their royalty if they had somebody operating on a lease, only their royalty which is the section that comes back to them would be exempt, that which was produced by the lessee would be taxed as whatever classification oil it was.

We are only dealing strictly and 100 percent with Indian properties.

Chairman Long: Up to this point and I hope I can maintain this position I have been hoping we could avoid exempting charitable organizations. What section is it?

Mr. Shapiro: 501(c)(3).

Chairman Long: It seems to me when we start exempting individuals we get into a great deal of revenue loss. I have a lot of sympathy for the Indian tribes. To some extent at one time Indian tribes were like separate nations where you had treaties and that sort of thing.

Mr. Lubick: We do tax the commercial activities of foreign nations, Mr. Chairman.

Senator Wallop: Mr. Lubick, I would invite you out to a pow wow on the Wind River Reservation and have you make that statement.

Chairman Long: I do not want to commit myself to vote for the tax exempt organizations. It seems that will involve a lot of money.

Yes, sir?

Senator Danforth: I do feel insofar as possible we should at least try to mitigate some of the regionalism that obviously is a part of this kind of bill and try to create a sense of fairness and we are all in this together.

The fact of the matter is treating Indian tribes differently and treating charities differently, some states have Indian tribes and some do not. I would doubt that a single educational or charitable organization holds any oil property and I might be wrong. That would obviously be the kind of thing that just changes with region. Some states are more fortunate than others.

I remember one time Senator Duey Bartlett said to me, my Missouri has just great apples. I said you must have wonderful soil in the State of Missouri. I said I would be willing to swap with you.

I think there is the revenue loss question with all of these items. It just seems to me that we just cannot exempt everything and have credits for everything.

I do not mind newspaper editorials but they are going to be coming fast and furiously if we continue to follow that route.

Whatever we come out with in this Committee it seems to me that I have to go back to my constituents and say you still count for something in the United States Senate too. The hospitals that we have in our State of Missouri and in the State of New Jersey, they still count for something. The schools do. The local governments do. To be carving out really what amounts to special treatment and let's call it what it is, I think it is a pretty raw thing.

Oil producers are going to do very well no matter what we do in the Senate Finance Committee or on the Floor of the Senate or what comes out of the conference. They are going to do very well. They just do not happen to be located where I live or where Senator Chafee lives or where Senator Bradley lives.

I really think when we get down to these exemptions for Indian tribes and for schools or colleges or local governments and so on, you get down to regionalism in kind of a raw form. I would hope we could avoid it.

Senator Bentsen: Mr. Chairman, if I may respond.

Chairman Long: Senator Bentsen.

Senator Bentsen: I look with some concern on the idea that the way we do away with regionalism is dividing up somebody else's property. You have a well established doctrine of implied constitutional ammunity from taxation with respect to certain activities of the state. That has been repeated time and time again in court decisions.

I will give you an example. New York versus the United States, Federal tax which is not discriminatory as to subject matter may nevertheless so affect the state merely because it is a state that is being taxed as to interfere unduly with the state's performance of its sovereign functions of government.

Obviously this tax which is the Federal Government coming in and taxing state property because the royalty that is received by the state and court decision after court decision has termed that as property so you are going in to tax that and they further say the test of that case which was recently restated by the Supreme Court in Massachusetts versus the United States and it stated that the purpose of the implied constitution restriction on the national taxing power is to protect the states from undue interference with their traditional government functions.

We have ourselves a long time principle. We are talking about a major change in direction for this country of ours if we are now going to say that the Federal Government can come in and tax the state functions.

I think it would be a very serious mistake. There are some states that are going to be more bountiful in one resource than in another, whether it be coal, oil or climate. We never are going to be able to equate all of these things across this nation.

Senator Danforth: Mr. Chairman, just so we can have the staffs look at the law, I have just been handed a couple of pages. I will read this paragraph. "The Supreme Court has sustained the application of various Federal excise taxes to activities of the states. South Carolina vs. the United States, 199 U.S. 437 and Ohio versus Heterling, 292 U.S. 360.

Liquor tax on retàil dealers applicable to state liquor stores, Allan vs. Regions, the University System of Georgia, 304 U.S. 439, admissions tax applicable to State University football games, New York vs. the United States, 326 U.S. 572, soft drink excise tax applicable to state manufacturing mineral water."

There are cases which hold that the application of Federal taxes to states and particularly Federal excise taxes to states that is a constitutional exercise.

Senator Bentsen: Let me respond by saying this does not fall into any of the well recognized exceptions to the doctrine of the implied congressional immunity. This tax would not be a tax on a business revenue generating activity of the state which is of the same nature and as in competition with other commercial enterprises that are subject to the tax.

The collection of royalties on a lease of state lands is not the equivalent of a state operation of a commercial enterprise. It does not come under the kinds of classifications you are talking about.

This is not something that can be passed on directly to the public either, this kind of an excise tax.

Chairman Long: For a long time the Treasury has been wanting to contend and have been trying to get a law through that gives them the right to go into court and claim the Federal Government can tax the income on state bonds or the interest on state bonds. They have been trying to do that around here for 30 years. Mr. Lubick said not now.

Mr. Lubick: Not us, Mr. Chairman.

Chairman Long: We have seen a lot of proposals which in one way or another would seek to make the entering wedge to tax the income on these state and municipal bonds. I have been on the Committee. Not many of us were on the Committee when we had the last showdown on that.

I know it was my privilege to be at a meeting of the Chamber of Commerce of one of our cities just after we voted to say they could not do it. It got a rousing standing ovation to say we were not going to give them the entering wedge to start taxing the income on the state and municipal bonds.

I hope the Treasury is not going to come in here trying to make a breakthrough toward taxing states in other areas where it has not been done in the past.

I see Mr. Lubick shaking his head which means either that he does not understand me or he is not going to try to do that.

Senator Dole: You are on our side.

Mr. Lubick: Absolutely.

Senator Danforth: On this issue?

Mr. Lubick: No, not on this issue but we are not going to try to start doing what the Senator just said.

Senator Danforth: What is your view of this particular issue?

Mr. Lubick: On this excise tax we are in accord with the precedents you cited and we think your argument is absolutely correct.

Senator Danforth: Would it be possible and I do not know what our timetable is, Mr. Chairman, I do not know if people are burning the midnight oil but would it be possible to get up a little Memorandum of Law from Treasury as to the constitutionality of this and get your views of the various precedents cited by Senator Bentsen and me?

Mr. Lubick: We will undertake that. Could we have your list of authorities as a starter?

Senator Danforth: Yes.

Chairman Long: Up to now I thought this bill was going to pass. I am beginning to develop some doubts about it. We will discuss that as time goes on.

Senator Bentsen: You have yourself a very major constitutional question.

Senator Wallop: Mr. Chairman, if you want to start looking up things, in Squire vs. Capiman in 1956 it said that under the General Allotment Act it precluded Federal taxation of Indian lands and natural resources. That is a pretty clear statement. These are presumably Indian lands and natural resources that you seek to take from them.

For $328 million it seems absurb to argue.

Senator Danforth: We all agree as a matter of policy that we want to do it. It is just as a matter of law as if it is possible.

Senator Wallop: I do not want to do it. Let me just make one other argument. They are not constituents of mine but they depend for 90 percent of their mineral resources and for the Federal Government to march in there and start taking that away and then only to supply it back through the Bureau of Indian Affairs which will cost you $11 for every $1 you appropriate that gets to an Indian, it just seems absurb.

This is an opportunity to give them some self help that they have had coming. Mostly they got those lands because the United States Government thought it was the worse in the world. They knew they would not be able to live off of it so they gave them all of it. No white man can live on it. We gave it to the Indians. They have a little mineral now and we want it back.

Senator Bradley: Mr. Chairman, let me again say that I think this whole thing comes from looking at the expenditure and revenue side and wondering where the revenues are going to come from. The interjection of regionalism in this debate would not be the first time it has ever been interjected in a debate before.

The idea of approaching public institutions and state governments, I think in part derives from the arguments made on the general revenue sharing issue by Senators who claim that the states are in surplus and in many cases the states that are in surplus are specifically those states that have severence taxes.

If the Federal Government is supposed to look at national issues then I think you have to look at a national scope and you recognize certain areas of the country are different from other areas of the country and in part you try to equalize. That is in fact what the Federal Government has done for 30 years except now the regional balance has shifted and we have a readjustment necessary.

I think in part this amendment of Senator Danforth springs from that fact. I would hope we would not have to get to it frankly. I would hope we would have enough revenues to take care of low income people and mass transit and alternate energy sources and conservation.

Senator Bentsen: Let me ask a question on that very point. Are we assuming on these figures each time and Senator Danforth has asked how much has been raised or how much is left are we still using the GNP deflator plus one percent?

Mr. Shapiro: Yes.

Senator Bentsen: Does anyone seriously believe that is going to be all the oil will go up in price? We have had all kinds of estimates and one of them showed GNP deflator plus four percent would be raising almost $500 billion as I recall.

I really do not think and no one can tell you but from past behavior and what we have seen out of the Middle East it seems to me they are going to put on all the traffic can bear and it is going to be more than any GNP deflator plus one percent.

Senator Bradley: I would suggest that if the Senator's interest or if you do not have an objection about the need to raise $90 billion and you expect that is going to be raised much sooner, then I would suggest we go with fewer exemptions and provide a mechanism that if we reach that number because the real increase in price is four percent above inflation that you have an opportunity after you have accumulated that amount to return the result to the producer or to the oil company or to the American people.

Senator Bentsen: The problem you run into is trying to finance it and trying to get yourself a hard figure and we do not have it as I said earlier. You are not going to be able to bring on the kind of production you want on nebilous figures which I admitted at the very beginning.

It is my personal belief it is going up substantially more than that.

What you are getting to here again is a major question of principle and constitutional law if you decide you are going to start taxing the state and not taxing them on something that in effect is a commercial enterprise under the well known exceptions. When you finally get down to the last argument and I will save that until tomorrow, I will bring up the agreement under which Texas became a state.

Senator Bradley: New Jersey did not have that agreement.

Chairman Long: Shall we call the roll on the Indian thing?

Senator Danforth: Since there are so few people here and it seems to me that all these issues, the Indians, the charitable organizations and the states are really special exceptions and I wonder whether or not they could be considered tomorrow morning one after another?

I think we have pretty well debated it and understand what the issues are and the staffs are here and they will be able to look up particularly the constitutional question along with Treasury which obviously is going to put a cloud over one of the roads but it seems to me and you are the Chairman but it seems it would be something that might well be worth putting off a day.

Why do we not make them both the same standard instead of tyring to put one on and one off in conflict with each other?

Chairman Long: One good reason about voting now is some of us begin to get a little dense at this moment.

Senator Wallop: Mr. Chairman, I just as soon have a vote on my Indians.

Chairman Long: As far as I am concerned I am ready to vote. If there is an objection it can be postponed.

Senator Danforth: I really do not object to it because we sort of have a looser rule of conduct in the Committee but it just seems to me that it is after 5:00 and there is such a small number of people here.

Chairman Long: If someone wants to insist we wait until tomorrow we will wait until tomorrow. We will do whatever you want.

Senator Dole: Let's wait until tomorrow.

Chairman Long: I want to wait until tomorrow. All it takes is for someone to say they insist and that is it.

I insist it wait until tomorrow.

Senator Wallop: I have already been through that.

Senator Dole: Maybe we could offer another amendment while we are thinking about that.

I do have an amendment that does not cost anything on expensing.

Chairman Long: Why do we not wait and vote tomorrow morning if that is the case. What do you have?

Senator Dole: My amendment has to do with injections that are used in tertiary recovery. We did tertiary recovery but now they have to capitalize the injections they use and the taxpayers have consistently expensed the cost of injections. Many of the taxpayers have been subjected to an audit which the Service has accepted this practice.

A couple of Government studies conducted in 1978 by the Office of Technology Assessment and D.O.E. Task Force explicitly state that the current tax practice permits expensing injections.

We are trying to make certain that is the law so there is no question about it later in tertiary recovery projects.

The O.T.A. estimates that if taxpayers are required to capitalize injections there will be a 30 percent loss in expected tertiary production.

Mr. Shapiro: Senator Dole, this was brought up on the last session on Friday when you were not here. We got into some questions on that. We had decided to withhold that until you came back. I have not had a chance to pursue it with the Treasury. The revenue is not great. It starts out at $13 million in 1980 and it levels off to about $5 million in the middle 1980's, $5 to $6 million. It is not a large revenue item.

I have not had an opportunity to discuss the matter with Treasury. They objected to it at that point and we had some confusion.

Senator Dole: I will withhold it. I think at the outside it is $13 million.

If we are trying to find oil I think it is something we can consider.

Chairman Long: I am informed Senator Heinz has changed his vote from no to aye and therefore our latest count of the votes is 11 ayes and 7 nays. The amendment is agreed to. That is the Dole-Boren stripped down stripper amendment.

I think we have done about the most we can do for today. We will come back tomorrow at 10:00 a.m. I would hope the Demoncrats would caucus at 9:00 a.m.

(Whereupon, the Committee was adjourned at 5:15 p.m.)