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EXECUTIVE SESSION

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WEDNESDAY, AUGUST 1, 1979

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United States Senate
Committee on Finance
Washington, D.C.

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

Present: Senators Talmadge, Ribicoff, Byrd, Nelson, Gravel, Bentsen, Matsunaga, Baucus, Dole, Packwood, Danfort, Chafee and Wallop.

Also Present: Mr. Lighthizer, Chief Minority Counsel, Committee on Finance; Mr. Stern, Staff Director, Committee on Finance; Mr. Shapiro, Chief of Staff, Joint Committee on Taxation; Mr. Wetzler, Chief Economist, Joint Committee on Taxation.

The Chairman: Let me call this meeting to order.

The first order of business is the nomination of G. William Miller to be Secretary of the Treasury. Is there any objection or any discussion with regard to Mr. Miller?

Senator Dole: I move the nomination be reported.

Senator Packwood: I second it.

The Chairman: Moved and seconded the nomination be reported.

All in favor, say "aye."

(There was a chorus of "ayes.")

The Chairman: Opposed, "no."

(There was no response.)

The Chairman: The "ayes" have it.

Now we are in a position to consider the crude oil tax. I asked Mr. Shapiro and Mr. Stern and their associates to help us to get up some charts which would help us understand this tax a little better. I think there is some need to more thoroughly understand just exactly what the tax is and how it would apply, and I guess I will just call on you, Mr. Shapiro, to try to explain this tax in a way an average person in the room can understand it.

Mr. Shapiro: There are copies of each of these charts in the material you have in front of you, as well.

Senator Dole: I think before Bob starts on this, and I know this is going to be very interesting, I would assume we are going to meet today and tomorrow. It would be my hope that we do not start making any hard and fast decisions until after the recess.

I think many of us want a chance to have this presentation and, not only that, to get back home and visit with some of our constituents and be in a position when we come back in September to move as quickly as we can to report some appropriate measure to the Senate floor.

The Chairman: I don't challenge that.

Senator Packwood: Mr. Chairman.

The Chairman: Yes, Mr. Packwood.

Senator Packwood: I would echo that for a slightly different reason. I think during the month of August we are going to have a lot of independent analysis of the President's program. I am just taking a guess. From Brookings, American Enterprise Institute, several universities, and maybe the Library of Congress. I would like to see what they conclude before we leap ahead.

You will recall two years ago when the House had passed the President's energy program and we recessed. And during the recess, the Library of Congress, the GAO and the Office of Technology Assessment all studied the program and concluded that if we passed it as introduced, we would end up importing more oil than if we did not pass it at all. And that effectively finished that program.

I would just be curious what they have to say about this one.

The Chairman: Well, there is no doubt about it. When thoughtful people across the country, the Brookings Institute being one good example, but there are others, various think-tanks and economic writers and anyone who is in a position to analyze investments and things of that sort, have an opportunity to read what is presented about the tax, to read the hearing and to study what is being said in all the media about the matter, they react and they sort of cross-fertilize another. One has a thoughtful contribution to make, someone else builds on it, and the first thing you know, you have a lot of constructive suggestions both pro and con.

When a bill takes its ordinary course through the legislative mill, that develops, and it is good for the country that it would. So we will have the benefit of that during the course of this recess. But meanwhile, I think that we can make a contribution by exploring this a little better, and I think we might want to vote on some aspects of it.

I, frankly, would prefer not to vote on the very big amendments, the ones involving large amounts of money, until we get back. I do think that the nation is going to tend to react both to the hearings and to the communications of the President and the Executive Branch, as well as the contributions which are made by those in industry and those who think about matters like this in academia.

So with that indication of opinion, let us move forward now, Mr. Shapiro, and get better in mind what it is we are voting on. We might do some voting today. We can just let time tell.

Mr. Shapiro: I think what I would like to do is outline very broadly the basic format of the House-passed bill on the windfall profits tax. As you know, it is a three-tiered tax, meaning there is a tax on oil that is included in three different tiers.

I think the easy way to explain it is to look at the blackboard on the left first. It is the one which says "Calculating the Tax," and it is the one at the top. The reason for this is the basic format is the same for all three tiers. It is determining which categories in which tier that makes the difference.

For example, where it says tax equals 60 percent, that is the basic format for the entire structure for all three tiers. The amount of the tax equals 60 percent of the actual selling price. That means that after decontrol, that would be the world price, $23, $25 or $30 or whatever it is is the actual selling price for oil.

And remember, after October or September of 1981, all oil is world price. There are no differences for lower tier, upper tier, stripper, Alaskan. It makes no difference. All of the oil will be selling at the world price, so the actual selling price will be the same.

So it would be 60 percent of the actual selling price minus the adjusted base price. The adjusted base price is the main difference in the three tiers. Each of the three tiers would have a different base price, and it would determine which oil is in which tier as to what that base price is. So that is the major difference in the three tiers under the House bill.

You also subtract a severance tax deduction, and that would depend upon what the severance tax is in each state.

Senator Talmadge: Bobby, would you yield at that point? That adjusted base price is the price under controlled conditions that that particular crude sells for, is that right?

Mr. Shapiro: Adjusted for inflation. That is correct. It is the adjusted base price under controls as of now.

Senator Talmadge: What does that vary; from what to what? What is the minimum and what is the maximum?

Mr. Shapiro: That is what I am going to get to.

Senator Talmadge: All right.

Mr. Shapiro: We have three tiers. In tier one, that adjusted base price is approximately $6.00. That means all oil that would be taxed in tier one would have a base price of approximately $6.00. And each year that base price would be adjusted for inflation. That $6.00 would increase each year for inflation.

So in tier one, the base price is approximately $6.00. In tier two, the base price is approximately $13.00. That is the approximate level that the tier two oil is selling for under controls. Also, that is being adjusted for inflation each year. In tier three, the adjusted base price would be $16.00, and that also is adjusted for inflation.

Now, that is the basic format of the House bill. It is a percentage tax of 60 percent, and there are certain special rules, of course, but the basic format is 60 percent times the actual selling price minus the adjusted base price. That is the only variant in each of the three tiers, minus the severance tax deduction.

Now, we have a separate chart to show each tier and how that works, but I think it is helpful to show you the basic format first. When I talk about the three tiers, let me describe very briefly what is in each tier.

In tier one, essentially, it includes lower tier oil or old oil. Before the price control, that oil was selling for approximately $6.00. Decontrol has taken that $6.00 oil up to the world price. But for the base price, for purposes of the windfall the base price is the price that oil is selling for before the phased decontrol started, and that is why it is $6.00.

Tier two includes the upper tier oil, which is new oil, essentially, oil that was discovered after 1972. It also includes marginal oil. Marginal oil is a new category of oil under the new regulations, which provides a formula by which the deeper you drill, you can take out more oil at an upper tier price.

If you did not have a category for marginal oil, all of that oil would be treated as old oil and would otherwise be controlled at a $6.00 price. But if you drill, for example, 2,000 feet deep, you can get as much as 20 barrels a day production. And the way the formula works is that you can go up to 8000 feet deep or more and then you can take up to 35 barrels a day. That is marginal oil because the deeper you drill, you may get more, but it is going to cost you more.

So that would be in tier two. So tier two would include new oil or what is referred to as upper tier oil, and marginal oil.

Tier three has a category that has a series of special rules. The basic format for tier three is stripper oil, and that would have a base of $16.00. Stripper oil is not defined in the regulations. It has been enacted into law by Congress.

Stripper oil is defined as any property that has a production of 10 barrels or less over a 12-month consecutive period per well per day. So ten barrels per day per well, if you have less than ten barrels per day for a 12-month consecutive period, you are defined as a stripper well.

The way the statute works is that once you are a stripper, you are always a stripper well, even if production goes up to 40, 50, or 100 barrels a day. Once you have met the basic rule, meaning ten barrels or less for a 12-month consecutive period, then you are always a stripper well.

So the basic format for a stripper well is that you have a 60 percent tax on the actual selling price, which is the world price, which is approximately $22 today, minus the adjusted base price of $16.00. Of course, minus the severance tax. As I indicated, the severance tax will vary in each state.

Senator Packwood: Excuse me. That is the world price less $16.00.

Mr. Shapiro: That is correct.

Senator Packwood: And is that $16 adjusted for inflation?

Mr. Shapiro: The $16 is adjusted for inflation. All of the tiers, which means the adjusted base price, would be adjusted each year for inflation. That is what "adjusted" means for the base price.

Senator Packwood: So on stripper oil, if the world price is $20, you subtract the $16 plus inflation from June 1, 1979 on, plus whatever severance tax they may be paying in their state.

Mr. Shapiro: Yes.

Senator Packwood: Which could come very close, then, to no tax.

Mr. Shapiro: The stripper oil on world price today is a little over $22, so there would be a tax today.

Senator Packwood: There would or would not?

Mr. Shapiro: Let me say that the severance tax is only on the $6 difference. That is, the $22 is world price, the $16 is the base price. We are only talking about a severance tax on the $6 difference, the so-called windfall element.

Senator Packwood: You lost me there. I thought the severance tax was a state tax.

Mr. Shapiro: It is a state tax but the deduction of the severance tax is only on the windfall profit element. That means the difference between $22 and $16, or $6.00.

Senator Packwood: So if the state --

Mr. Shapiro: If the state has a 10 percent severance tax, the deduction would be 60 cents.

Senator Packwood: Okay.

Mr. Shapiro: Now, it may be helpful, since there is a lot of discussion of newly-discovered and incremental tertiary, to point out the formula on the board. That is number 2 there. And after going over this, I will go over the charts to show you how it actually applies.

First of all, newly-discovered oil is defined as a property on which there is no production in 1978. That is by regulation. So newly-discovered oil is any property on which there is no production in 1978. Incremental tertiary oil is a property where they use a tertiary recovery method, which is generally a chemical-type recovery, heat and so forth, to try to encourage the flow of the oil in the well, to encourage the incremental production.

So where there are tertiary recovery methods and you get the incremental portion of that oil, for example, the well without the tertiary could be producing 100 barrels a day. But with the tertiary recovery methods, they would be producing 150 barrels a day. That 50 barrels is the incremental part. That 50 barrels would get the world price and has a special treatment under the House bill.

Under the House bill, the formula, as you see in the bottom of that chart on the left, is a tax of 50 percent, not 60. It is a 50 percent tax times a selling price minus the base price. In this case, the base price is $17. There are two adjustments.

The first one is for inflation, like all other tiers. The second is a special 2 percent increase, which has been referred to as the 2 percent "kicker." That means that if inflation is 10 percent, the adjustment to the $17 would be the 10 percent plus the 2 percent kicker because there would be a 12 percent adjustment to that $17 price.

So that newly-discovered oil and incremental tertiary have a special formula. First, it is a 50 percent rate rather than a 60 percent rate. Second, it is a $17 base price rather than a $16 base price. And third, the inflation adjustment is increased by 2 percent above the inflation level.

Also, that special treatment in the House bill is that it terminates after 1990. In other words, there will no longer be a tax on newly-discovered oil and incremental tertiary oil after 1990.

The next chart on the blackboard is Alaska, which also has special treatment. The situation with Alaska is that Alaskan oil has very large transportation costs because of the pipeline charges. As a result of that, even though Alaskan oil is treated as upper tier oil, meaning that it could otherwise get approximately $13 a barrel for its oil, because of the transportation costs prior to the recent OPEC increases, no refinery would pay $13 for Alaskan oil because if you add the transportation costs, which are approximately $9, then the $13 controlled price plus $9 for transportation would equal a price of $22.

A refiner could go abroad and buy oil abroad for what used to be $16 or $18. So no one would pay $22 for Alaskan oil if they could buy imported oil for $16.

Senator Talmadge: Bob, that transportation charge is from where to where?

Mr. Shapiro: It is from the pipeline.

Senator Talmadge: That would include the transportation charge from Alaska to the West Coast or to the East Coast?

Mr. Shapiro: The pipleline doesn't. The pipeline is $6.25, and there are charges above that.

Senator Talmadge: What is the total cost, say, to land it in New Orleans?

Mr. Shapiro: It could be between $8 or $8.50, in that range. That is the problem.

So let's assume the world price. When the world price, for example, in 1978 or early 1979 was $16, because the transportation cost was $9, no one would pay more than $7 for Alaskan oil because they could buy imported oil for $16. So they are not going to pay more than $16. And if transportation is $9, $9 from $16 is $7. So that is all a refiner would pay for Alaskan oil, $7, because the transportation costs were on top of that.

The Chairman: Let me see if I understand that. I am not sure that I do. Are you saying that before the OPEC price increase, that we had a price control on the Alaskan oil which, when taken in connection with the transportation expense, meant that they could not sell Alaskan oil at a price that would make a profit?

Mr. Shapiro: It could make a profit. They could not get their controlled price. They could not get their ceiling price. In other words, under the regulation, they were allowed to get $13. But the market price in 1978, for example, was only $5.50. Even though they were allowed to get $13, no refiner would pay more than $5.50.

The reason for that is that the transportation costs were approximately $8.50. So if a refiner was willing to pay the world price, the world price was $14.00 So they could buy oil abroad for $14. For Alaska, transportation was $8.50. IF you subtract $8.50 from $14, they would only be willing to pay the producer $5.50. They are not going to pay for Alaskan oil any more than they would pay for imported oil; hence, the transportation costs had caused that difference.

The Chairman: So before the price went up, Alaskan oil could not be sold in the United States. Is that right.

Mr. Shapiro: It could be sold, but it would only get $5.50.

The Chairman: Legally you could sell it, but economically you could not.

Mr. Shapiro: They were making money at $5.50. Not as much as they would have at $13, clearly, but they had profits on $5.50, so they did make a profit on Alaskan oil.

The Chairman: Well, I won't push it any further. I still don't understand it, but go ahead.

Mr. Shapiro: I think it may be helpful here to say that because of the special situation for Alaskan oil, the House bill has a special rate of 50 percent, and it is 50 percent of the selling price minus the adjustment. This is on the blackboard to the right up there.

Senator Packwood: Fifty percent of what, did you say?

Mr. Shapiro: Fifty percent of the selling price. The basic difference in the format is that the base price is $7.50. That is approximately what the Alaskan oil was selling for when the House passed the bill. It was selling for possibly a little more than that, but with the inflation adjustment and the pipeline tariff adjustment, which means that as the tariff is reduced in real terms, they increase the base price of the Alaskan oil. So they would not have to pay a windfall profit on the pipeline tariff adjustment. That increase is $7.50.

So, in effect, it would mean that it would not be a rollback in the price on Alaskan oil. The House designed it so that they would be paying a tax on the increases in price above what the level of it was when the House passed this bill.

Senator Byrd: Could we clear up one point, Mr. Chairman?

The Chairman: Yes, sir.

Senator Byrd: You mentioned that a profit could be made of $5.50 on Alaskan oil. Now, was that several years ago or is that the case now?

Mr. Shapiro: What happens is that every time the world price of Alaskan oil goes up, you have to subtract the transportation cost from the world price. That is what someone is willing to pay Alaska. For example, the world price today is approximately $22. When you subtract transportation costs, which average roughly $9, a refiner will pay $13. And that is the level of the ceiling price.

So today, Alaskan oil is getting its controlled price.

But prior to the recent OPEC increases, Alaskan oil was selling below its world price.

Now, the difference, I think, that is a potential problem is that that does not mean they were making money. It means they were not getting as much as they otherwise could if they were allowed to under the regulations.

Senator Byrd: But you figure they could make a profit now at $5.50 even though they are getting $13?

Mr. Shapiro: In 1978, they were getting approximately $5.50 a barrel, between $5.25 and $5.50 a barrel. So they were making money that year. But let me point out that even though they may be making $13 today, the costs are going up. They are drilling more wells. And therefore, it is not like they are making the difference between $13 and $5 all profit.

Senator Byrd: That is what I am getting at. I thought you said they could make a profit at $5.50 a day today.

Mr. Shapiro: That was in 1978.

Senator Byrd: But not today?

Mr. Shapiro: Today the costs go up. They are drilling more wells and I am assuming that they will be making more money. Clearly, they could be making more profit at $13 than they are making at $5.50.

Senator Byrd: I understand that. But the point I am trying to get clear is in 1978 they could make a profit at $5.50 a barrel?

Mr.Shapiro: That is the selling price they were able to get.

Senator Byrd: At what point can they make a profit today?

Mr. Shapiro: We are trying to get information. We are corresponding -- there are three major companies that own Alaskan oil. Sohio owns approximately 50 percent of the Alaskan oil. The other half is owned approximately 21 percent by Arco and 21 percent by Exxon, and the other 4 percent is owned by a large number of producers.

So there are three major oil companies that own almost 96 pecent of Alaskan oil. We are discussing with them what their profit figures are to have that information available to the committee. We do not have it available as of right now.

Senator Talmadge: Is it true that Alaska can pump more crude than they are now pumping?

Mr. Shapiro: The problem today is the pipeline constraint, meaning if the pipeline could take more oil, they could pump more. But they are constrained by how much the pipeline can take. So you are correct. They can produce more but the pipeline cannot take any more.

Senator Packwood: Bob, I thought the situation was we couldn't refine more on the West Coast but that the pipeline could carry more.

Mr. Wetzler: Senator Packwood: There is a limit on how much you can refine on the West Coast, but they are shipping that Alaskan oil not only to the West Coast; they are shipping a lot of it around South American to the Gulf refineries, and they are even shipping some of it, apparently, to the New Jersey refineries.

Senator Packwood: The capacity of the pipeline is about 2 million barrels a day, is it not?

Mr. Wetzler: No, the capacity has been about 1.2 million barrels a day, and that has been the constraint on production. They recently expanded it to about 1.35, and I think they are trying to get it up to about 1.5 million barrels a day by the end of the year.

But right now, that is the constraint on production.

Senator Wallop: That requires an additive to get it up there. You have to put something into the oil to make it more liquid.

Mr. Wetzler: The recent increase has been as a result of the use of some additive to make the oil flow faster. I think they are putting in more pumping stations, which will be responsible for increasing the flow.

Senator Baucus: What is the reasonable maximum capacity of the pipeline?

Senator Wallop: One and a half.

Senator Chafee: In this chart over here, the $7.50 adjusted for inflation. That is the transportation cost?

Mr. Shapiro: The pipeline tariff is the transportation cost.

Senator Chafee: What is the $7.50?

Mr. Shapiro: That is a base price. It is an arbitrary figure the House put into the bill. In other words, each of the tiers has a base price. In other words, you have an actual selling price minus a base price. For Alaskan oil, since Alaskan oil was not selling for $13, which was the base price of upper tier oil, the House picked $7.50. It was just an arbitrary figure the House picked.

Let me point out that the administration has requested the Finance Committee to increase that to the $13 level, so they would have a much higher level.

Senator Ribicoff: Mr. Chairman, I wonder if there are any figures anywhere of what you can anticipate production levels of first tier, second tier, stripper oil, Alaskan oil, and newly-discovered oil and incremental tertiary oil? Are there any figures at all on what we could anticipate?

Mr. Wetzler: Senator Ribicoff, don't we have some assumptions about what they are going to be? I cannot promise you they will turn out to be correct.

Senator Ribicoff: Where do these assumptions come from?

Mr. Wetzler: Well, our revenue estimators have come up with some of them after talking to DOE, the Treasury, and some people in the oil industry. We have a table here we can hand out, which is what we are assuming is the quantity oil taxed in the different tiers. It shifts over time.

Initially, most of the oil is in tier two, which is the upper tier. And that starts out in 1980. Let me start. Tier one starts out small because that is only being released. Oil is only being released from price controls slowly. So in tier one in 1980, it is only about 200,000 barrels per day.

By 1982, it goes up to about 800,000 barrels a day. This is tier one, the most heavily taxed tier.

Then tier one phases out. So after 1984, there is no oil left in tier one.

Tier two is the oil where initially you pick up most of the oil. That is the oil discovered after 1972, and also the so-called marginal oil. And that starts out at 3.8 million barrels a day in 1980.

By 1982, that is 3.6. And then that gradually phases down as these old reservoirs deplete themselves. So by 1990, tier two is down to about 900,000 barrels a day.

Now, stripper oil is another large category. That starts out at 1.4 million barrels a day. That gradually increases as the old oil fields gradually decline and descend into stripper status because their production in more and more properties gets below ten barrels per day.

So by 1990, stripper, we predict, will be up to about 1.7 million barrels a day.

Newly-discoverd oil, the oil discovered after 1978, starts out small. In 1980 we are assuming that is about 400,000 barrels a day, and that gradually grows as more and more of the oil is accounted for by oil discovered after 1978. So by 1982, that is 1.1 million barrels a day, and by 1990 it is up to 4.3 million barrels a day.

So you can see out in 1990 most of the oil, or almost half of your production, will be accounted for by oil discovered after 1978, or so-called newly-discovered oil.

Senator Ribicoff: Can you put together a chart lumping them all together through all the years between 1980 and 1990 and see what the composite would be estimated for the United States of all the oil put together?

Mr. Wetzler: We have a chart they are handing out which gives it to you for three years, 1980, 1982 and 1990. We can give you the information for the other years. I might say we are not entirely confident of our quantities in the years after 1985. There is a good deal of guesswork involved with just how much oil is really going to be discovered and what is going to happen to the decline of the existing reservoirs, and how much oil is going to decline into stripper status, how much tertiary recovery there is going to be.

We are engaging in quite a bit of guesswork. So while we have hard numbers here out to the nearest 1000 barrels per day, I don't want you to be deceived that we really know what the answers are.

Senator Ribicoff: How about natural gas from conventional and unconventional sources? Are there estimates for production during these periods of time?

Mr. Shapiro: You know, that is not involved in anything the committee is considering.

Senator Ribicoff: No, but it is involved in this respect. You are trying to put in place a synthetic oil program to make up for a deficiency. You are going to collect a huge tax on it. Now, the question comes with all of the problems with sythetics, what will conventional gas and oil and unconventional bring without synthetics, so we can make judgments as to what we want to do, the Congress and the people of the country?

Mr. Wetzler: We can show you some projections on that, Senator Ribicoff. I don't have them with me now, but basically, the projections show that conventional natural gas is supposed to decline in production gradually over the next ten years. Now that, I think, is a somewhat controversial prediction because no one really knows the extent to which gas production is going to increase in response to the incentives provided by the natural gas bill last year.

People are guessing at it. I don't think they really know. But right now we have been discovering only about two-fifths or one-half of a cubic foot of gas for each cubic foot of gas we consume each year. So you would have to pretty much double the rate of discovery of conventional natural gas even to hold production constant, much less have it increase.

Senator Ribicoff: But the testimony in front of the Government Affairs Committee yesterday from geologists and scientists was that there were huge sources of gas that have been undiscovered. And you know, you can grab at these figures. So it makes a lot of difference. If there is that gas, which is the cleanest type of fossil fuel you can have, and if there is any indication, what we have to ask is what is the basic reserve or reservoir of all types of energy in the United States.

So I think the question of gas and oil becomes very important before you embark on a huge synthetic program.

Mr. Wetzler: I might say there is also so-called unconventional gas which includes tight sands in the West and the geopressured methane gas in Louisiana and Texas, devonian shale in the Appalachians, and there is a potential to produce a substantial amount of that sort of gas. It generally requires higher prices.

Senator Ribicoff: That is right. Now, the thought that we have to address ourselves to is if unconventional gas will be able to produce and give the country its energy supply in substitution for synthetics, whether we shouldn't be going that way and using various incentives to get that out. And it might be at a lower cost overall than the amount of money you are going to spend for synthetics with the problems of synthetics.

Mr. Wetzler: The administration has proposed some tax credits for the production of unconventional gas which are before the committee and which you will want to act on. Last year the committee agreed and the Senate passed some tax credits for certain categories of this unconventional gas, so this is going to be before the committee after Labor Day when you look at some of these tax incentives.

Senator Ribicoff: The only thing, Mr. Chairman, that I think we are trying to do here is an overview on a policy to see whether the proposal for synthetics is really sound, and you cannot tell whether it is sound unless you know what the alternatives are available. This is why, to the fullest extent possible, if the staff during August could get an update on the overall estimates of all types of conventional and unconventional fossil fuels outside of synthetics.

If you are aiming at 1.5 million barrels per day by 1990, can you get the equivalent or more by other methods or other incentives in other types of fossil fuels? I don't think we have those figures or anyone has tried to make a comparison in the Executive Branch. Maybe they have, Mr. Chairman, but I am not aware of it.

The Chairman: Let me just give you one simple point that is relevant in connection with all of that, Senator Ribicoff.

I made this point when the Secretary was here yesterday. You see, these synthetics are directed toward making coal into a liquid and using the conventional way of doing these things.

Now, it may be that as you go along, you might find that rather than making the coal into a liquid, that it might be more practical to use the coal as coal. For example, Senator Talmadge pointed out to me that in 1935 or 1939, he saw the Japanese using charcoal to drive automobiles. Now, if the Japanese can do that in 1935, I am sure it could be done now.

But as a practical matter, it may very well be that they could develop vehicles. It wouldn't take much doing to drive a train that way. That is how they used to drive them. But you would need something for pollution, a better filter, but we have better filters which have been developed.

It may be that a great deal of this coal, when you lose 20 percent of energy in converting it to a liquid, it may be that by the time you get through with it, if you want to use it in a locomotive or even a truck, that it may be more worth your while to find a way to burn it as coal rather than to burn it as a liquid.

Senator Ribicoff: Of course, there is another problem, too, we are in the process of developing, which is a real serious problem. The utilization of coal for synthetics doubles the amount of carbon dioxide in the air that you would use just by burning coal. So it is not a question of additional cost but it is a very serious problem for climate, agriculture, the change of world temperature.

So you do have a large problem involved, and that is why I don't know that anyone has given us the overview of all of the various problems, whether there should be priorities, what goes in, this Energy Production Corporation, the Energy Mobilization. I don't know whether anyone else is doing it, but I think what we are addressing ourselves to here in many ways could find the answer to many of these problems right in the tax program.

The Chairman: One additional point is this program envisions spending about $88 billion or more to build conversion plants to convert.

Senator Ribicoff: For 1.5 million barrels a day by 1990.

The Chairman: I think 40 enormous plants to convert coal or shale into liquid or gas. Now we are told, just in conversion, that they have five different methods that different advocates contend is the best way to do it. If you look at the shale conversion, the difference in the way Occidental would do it and the way the other companies, Union, would do it, it is as different as night from day.

There is hardly anything in one plant that could be used in the other. So if one proves to be the superior method and the other proves to be the inferior method, everything you have invested in one of them has gone down the drain because it would not prove to be the economic way to do it.

That would suggest what you ought to do is go ahead in the pilot stage and see which one is the most effective, which one does the best job, and do that before you start piling the tens of billions of dollars into doing it, whichever way appears to be the better.

And if you wind up going down one path and everything you do in that area happens to be junked because it does not prove to be the better way to do it, it would amount to an enormous amount of resources, which argues for what Mr. McAfee was saying here when he testified for the Gulf Company.

He said that you ought to make your start in synthetics but that you ought to reserve judgment on where you are going to commit most of your money until you see which one is going to work the best or which would be the most technically, economically feasible way to do this job.

Then when Secretary Schlesinger came up yesterday, what he said was -- I wish I could recall his exact words. Who can recall his exact words? He said, basically, that there is no specific plan to any of this. Who recalls that?

Senator Dole: I asked him whether he had a ten-year plan, and he said there was none and he didn't think there should be a ten-year plan.

The Chairman: He said they don't have a plan and never have had one. That is what he said. So what you are talking about is just the general concept. It is sort of like shooting a shotgun out the window and hoping a bird passes by.

Senator Matsunaga: Mr. Chairman.

The Chairman: Mr. Matsunaga.

Senator Matsunaga: I note that on Alaskan oil, you have 1980, 12.2 million; 1982, only 1.2 million; and in 1990, only 1.5 million. Yet, if I recall correctly, on the floor just a few days ago, one Alaskan senator said right now they have the ability to produce an additional 700,000 barrels per day if allowed to. We have an Alaskan senator here. Maybe he can speak to that.

Senator Wetzler: Senator Matsunaga, we have been using a computer model to do the estimates, and the estimates on Alaskan oil are now obsolete. They are now higher than 1.2 million. They are up to 1,350,000 and are soon to go to 1,500,000. We have not changed the figures in our model because we don't want to be changing the estimates every month or so.

I think over the August recess we are going to program in what we now learned about the increase in the Alaskan production that is scheduled and a number of other things and come up with some revised revenue estimates.

Senator Matsunaga: I note this says July 26h. That was only five days ago. Has it changed that much since?

Mr. Wetzler: No. We knew our figures on Alaska were somewhat understated. We just haven't changed the assumptions yet. We are going to shortly. This chart is just an estimate. It is a statement of what quantities are assumed in this model we have been using to do the revenue estimates.

Senator Matsunaga: I wish you would give us up-to-date figures because we are depending upon you. We cannot be operating on last year's figures.

Senator Gravel: Would the Senator yield, though? It does demonstrate the degree of imperfect knowledge we have. When you see a figure of 1990, 1,500,000 barrels a day, we in the last six months have been taking it as a given that in 1979 at the end of this year, with the possible use of slickum, a new chemical you put in the pipeline, that the oil will flow faster; that you can put more oil in the pipe because it is moving faster and also increasing presures on the pipe; that without any big deal, by the end of this year we are probably going to be up to 1.4 million, or possibly even close to 1.5 million at the end of next year.

That would be 1980. The figures we are given here as a legislative body is this would happen by 1990, so we are off a literal decade. Now, with the other two fields we have, all the money that you have heard of that was going to be spent, that is going to spend somewhere between $12 billion and $19 billion in order to bring to the oil from the bottom of the ground to the head of the pipe.

But that does not speak at all to the Lisburne and Kuparuk fields, which are on either side of it, in which they have done no exploration because they have been so strapped money-wise in getting this project going. What they are going to do with the profits they have made is step up. Thus, we have another sail upon Beaufort Sea in December.

If that were to hit a strike, even if the other two fields could do it, we would be up to a capacity of 2 million barrels a day within three or four years.

Senator Matsunaga: I bring this up, Mr. Chairman, because it is so important. Yesterday Secretary Schelesinger testified that the synfuel program is an attempt to replace about 12 million barrels of oil per day. Now, if we can get Alaskan oil at $7.50 per barrel and synfuel would cost $35 per barrel, well, heavens, it would be foolish for us not to develop the Alaskan resource and, just as the chairman suggests, go into pilot projects looking into the distant future as to what can be done with shale, coal and other things, but not going in and spending $80 billion.

Senator Gravel: Mr. Chairman, just briefly to underscore this, the pipeline, you know, goes all of the way to Prudhoe Bay, just South of Prudhoe Bay. The President took out 56 million acres of sedimentary basin, or 56 million acres, and placed it into monuments. He took out essentially all in Pet 4 and it is blocked in by the monuments.

So even if you found oil in Pet 4, you can't get it South. You must come across the the pipeline, and that is where I put forth the figures that with the stroke of a pen, we have taken out of inventory sedimentary basin, 40 million acres of land in Alaska that has potential oil and gas.

Let me just add insult to injury and say that right next to Prudhoe Bay we have what U.S.G.S. has told us is probably the best possible oil find on the North American continent. The Secretary of Interior says there is no way, that is the last place on earth he will drill. So what we know is we are now moving out in the Arctic Ocean with the Beaufort Sea sail to go ahead and drill in the ice, make ice islands. God knows what we are going to do, and the costs are just horrendous.

That is the sail we are going to do because right next to Prudhoe Bay we won't sink a drill bit and see if there is oil there. Now, these are things the government has done. We are not talking about the private sector.

The Chairman: Maybe you could amend it by saying if the people would dress up in polar bear costumes, they could go in there and drill and find some oil as long as they disguised themselves as polar bears.

Senator Gravel: Mr. Chairman, your statement is correct. I only want to make one observation, very briefly. We have more oil and gas than we can say grace over, but when the government insists it doesn't even want to look and it wants government gas rationing plans or wants to go for syncrude for $30 or $40 or $50 a barrel, I think we all appear a little nuts.

The Chairman: Senator Dole.

Senator Dole: Maybe you could have a town meeting up there or something.

Senator Gravel: I tried to get the President to have one, but he was not too interested in it.

Senator Dole: I just wondered, Bob. Maybe this isn't the right place to ask the question, but we have been told by many people in and out of the administration that just say we didn't have a windfall profits tax. Do we have an estimates on, if there wasn't a tax, how much, if any, we could add to our domestic production?

Mr. Shapiro: I think we should let DOE respond to that as far as production is concerned. Let me make one observation before Richard Smith responds for DOE. We have put together production figures because you need that in order to make determinations with regard to revenues. If you want to know how much revenue in the windfall profits tax, you have to know the amount of oil in each tier before you make your revenue estimates.

We have made our production estimates along with the DOE. They have not necessarily been independent, because as Jim pointed out earlier, we are guessing on the oil in the late eighties and the 1990's, but we need to make some assumptions in order to determine what the revenues are. We don't know exactly how much oil is in the ground. We don't know, with price incentives, how much drilling could be increased and how much they could find with that drilling. But we have to make some estimates for the revenues.

One other comment that was made before Senators Matsunaga and Gravel came in that might be helpful is in the chart that was handed out. This is the oil that was taxed in the tiers. We are not saying this is only the oil you are going to have, but we were asked the question of how much oil would be taxed in these tiers in 1985.

We recognize there would be about 1500 barrels a day in Alaska, 1.5 million, and that chart just went to 1990. We were not saying tht it took up to 1990 to get to 1.5 million. It is just that that is the way this table is presented. It was about a month or two ago that we found out about these techniques in the pipeline that were put in here.

Also, the Alaskan oil from the two reservoirs that Senator Gravel referred to, Lisburne and Kuparuk, are exempt from tax. So those figures are not in here. Even when the oil starts to come on line from Alaska in these two reservoirs, they would not be subject to tax. So that is outside of this.

Senator Dole: I wondered about that. You understand, of course, the oil companies would rather not pay any tax, and their argument is that it is going to slow down exploration and development and production, or whatever, and that is why I think it is important.

I think the President said we will be lucky to maintain present production over the next several years. I think that, coupled with -- and it may become a factor before we decide on what we do -- how much new revenue will be generated just because of increased taxes on increased revenues, or taxes on increased revenues and increased royalty payments.

It is my understanding between now and 1990, that in itself will total about what?

Mr. Lighthizer: 173.

Senator Dole: $173 billion without a windfall profits tax. We are talking about additional revenues from oil sources of $173 billion. I don't know. When you add to that, if there is a windfall profits tax, we are talking about a rather substantial sum of new taxes.

Do you have the same figures?

Mr. Shapiro: Yes, those are our figures. The $173 billion would be without any windfall profits tax. It would be the amount of net revenue increase to the Federal Government as a result of the individual and corporate income taxes on the increased revenues plus the price going up.

Senator Ribicoff: Let me go another step. I don't know if there are any figures now. Secretary Schlesinger said yesterday that basically the synthetic fuel plants would have to be operated by the oil companies anyway because they are the ones who know the energy business.

Are there any estimates or any figures that if you gave a credit to anyone producing this oil against a windfall profits tax, of all the money and all the investment and capital they put in to either fossil, synthetic or renewable energy sources, would these companies invest that money for those purposes instead of paying the tax? And how much do they estimate they would put in?

Mr. Shapiro: There are a lot of variables here, and that is as to what the qualified investment would be, what the various thresholds might be. In other words, it would appear that they would make investments where they would get the best returns.

Senator Ribicoff: Yes.

Mr. Shapiro: And they may spend some money in some of the areas where it is riskier. But if they had more assurance that an investment would make a return for them, they may put more of the money in that area.

Senator Ribicoff: Even in the synthetics they contemplate guarantees of purchases by governmental agencies, Defense and something else. If it costs $35 a barrel, they are going to pay $35 a barrel. So if you are going to give the same guarantees and they are going to operate these plants anyway, do we get as much if we do not have the intervention of a governmental agency to do this?

Would the same investments be made if they were able to plow back that $88 billion in all types of energy? And would they be able to produce for that $88, 1.5 barrels of energy a day?

Mr. Shapiro: Well, there is a question as to whether some of the areas would get explored and new research and development and results, depending upon how great the risks are. For example, because of the price of oil the way it is, there is much more drilling than there was several years ago. However, there is not as much oil being discovered. All of the easy oil has been found. And it is becoming more and more difficult to find oil these days.

That does not mean there is a lack of drilling. There is a tremendous interest in drilling and there is a lot of drilling, but there is not as much oil being found.

Senator Ribicoff: I think I read in either the New York Times or the Wall Street Journal this morning that Texaco was making a deal with some California electric company to develop synthetic oil from coal somewhere in Wyoming, so apparently here is one electric company and one oil company going into synthetics themselves.

And there is a contract between Texaco. Evidently they must have some way they are going to pipe that from Wyoming down to somplace in California. I don't know the location. I think I noticed it in the paper today. So apparently there is a market and there is an opportunity for private companies.

Now, suppose you encourage the utilization of that $88 billion to be used that way instead of being intervening through a government corporation and without the bureaucracy and everything that is involved to put such an operation into place. I mean there are these questions floating around for which we do not have answers.

I am sort of fishing myself for a possible solution that will be meaningful and will produce more energy for us.

Senator Talmadge: If you would yield at that point, Senator Ribicoff.

Senator Ribicoff: Yes.

Senator Talmadge: I can give you only a fragmentary answer. When we authorized in the committee and passed through the Senate the $3 tax credit for shale during the last Congress, Atlantic Richfield and their associates had committed to spend $1,200,000,000, and Union Oil Company, $100,000,000 on that instance alone. I think it does offer possibilities.

The Chairman: Well, let's move forward and see if we can understand this tax.

Now, I am looking at this chart you have here. This is oil taxed in various windfall profits categories. That is prepared by the Joint Committee. And tier one, the first year, 215,000 barrels. And in 1982, 782,000 barrels. In 1990, zero.

Mr. Shapiro: Senator, this is a chart of just the oil that would be taxed in each of those tiers. The reason it is zero in 1990 is that the tier one tax terminates under the House bill. The tier one tax after July --

The Chairman: There wouldn't be any oil in tier one?

Mr. Shapiro: There wouldn't be any oil taxed under tier one. The oil that is taxed would be taxed in tier two. After 1981, all oil that would otherwise be taxed in tier one moves to tier two. Could I explain the chart on the board there?

The Chairman: You have taxed very little of it in 1980 and not a great deal in 1982. I guess that is because so very little is released. It is phased out. It is only taxed to the extent -- I guess that is that gray area you are talking about on that chart.

Mr. Shapiro: Yes. Let me go up there and show that chart to you. It may be helpful to you.

Senator Matsunaga: Isn't that the same chart as here that we have?

Mr. Shapiro: Yes, it is the same chart that you have there. What this is going to show you is a production on a property, and it will show you how the oil is taxed. It takes into account two things: one, the new pricing regulations, as well as the tax. We are going to assume we are talking about a property that has 100 barrels a day for purposes of the phased decontrol, and as you now, there are two ways to have phased decontrol.

One way is to let the price gradually go up to the world price, and the second is to use a decline curve to release oil to another tier. For lower tier oil, what the administration has chosen is a way to release the oil to an upper tier, and it works this way.

Starting in January of 1979, there is a 1.5 percent per month decline curve. That means it is oil that is controlled as old oil at $6 per barrel. That means all the oil in this category (indicating) is oil that is lower tiered oil, that prior to phased decontrol would not get a price higher than $6 per barrel.

The Chairman: Let's get that straight now. That part you are pointing at there in that area doesn't pay the tax because it gets no increase in price.

Mr. Shapiro: That is correct. It is still under controls. Now, what is happening is that the administration has a line that they have as 1.5 percent per month, this oil that is being relased to the upper tier. That means it would no longer be controlled at $6 but would go to $13 and then would be going up to the world price from tehre.

As you can see, it is a 1.5 percent per month decline curve up until January of 1980. In January of 1980, that 1.5 percent becomes 3 percent. As you can see, it is a steeper curve.

So it is 3.5 percent up until September of 1981. At the end of September 1981, there is still 19.5 percent oil, which is about 19 barrels. That means this much (indicating) oil which is under control at $6. But on October 1, 1981, all oil is immediately decontrolled and therefore immediately you go down to no oil under control, which means there is no oil with a controlled price. But in October of 1981, in September, you have 19 barrels in this property still under control. The rest of the oil has been released to the upper tier, and that is by way of decline curve.

This is not for taxes. This is for phased decontrol, because the President has said phased decontrol will release all the oil controlled at $6 per barrel under a decline curve where it can get $13 per barrel. So all oil produced above this level (indicating) is getting a higher price.

Now we must determine how much that oil is taxed, because the tier one tax is the tax that is imposed on the oil that is lower tier oil. That means oil discovered prior to 1972. That oil is being taxed in tier one. The difference between the controlled price, which is $6, and the price it is getting, which is $13, and both of those are adjusted upward for inflation, and what you have here (indicating) is the tax line.

It starts in January 1980. That means before 1980 there is no tax. In January 1980 this decline curve is 1.5 percent per month. For tax purposes you can see it phases out July 1984, at which time there is no tax. So the tax is in this category right here (indicating), and that means oil taxed in the tier one level of $6 base price. All the oil above this line (indicating) is getting $13.

But the tax on it between these two (indicating) is $6. Now, if it is above this line here (indicating), it would be in the tier two tax range. In other words, you have an incentive to have more than 1.5 percent, which means it would use the base price of $13.

So what we are saying is oil between these two lines (indicating) is in tier one. It is going to get a $13 price. But it is going to have a tax on an amount between $13 and $6, so it is, in effect, a 60 percent tax on that $7 difference.

The Chairman: But it doesn't phase out, I guess; it just moves into tier two. Is that right?

Mr. Shapiro: That is right. After July 1984, all the oil that otherwise would have been in tier one gets into tier two. It is still taxed. The difference there is that the base price becomes the $13 rather than the $6.

The Chairman: And as I understand it, when it gets to the tier two, it continues to be taxed. The windfall tax is considered to be the difference between $13 and what they are getting.

Mr. Shapiro: And the world price.

The Chairman: The President wants that permanently, so theoretically it goes on as long as we have any oil.

Mr. Shapiro: This particular tax becomes permanent. Tier two actually phases out as well in 1990, but the oil in this category is permanently taxed. The only oil that is not permanently taxed is newly-discovered oil and incremental tertiary oil.

The Chairman: But the President wants to tax that, too.

Mr. Shapiro: Yes, he wants that to be taxed too. The House bill terminates that at the end of 1990. The administration has proposed that that be taxed permanently.

The Chairman: Now, look. Where is that chart that showed -- because I think we ought to see it in context. Where is that chart that I asked Mr. Cohen, who used to serve up here in the same job Mr. Lubick has now, to show us how much tax that is when you put that tax on top of the other taxes that they pay?

Mr. Shapiro: I think that chart has been supplied here.

The Chairman: We should know that, because if you cannot see what that works out to be on top of the other taxes you are paying, it is totally illusory.

Mr. Shapiro: Yes. That is being distributed to you now.

The Chairman: Do you have that big enough so that the audience can see it? That is a chart, and he had a letter there that undertakes to show how that works out.

Mr. Shapiro: Let me point out that this is a chart that was prepared by Edwin Cohen on behalf of the Chamber of Commerce. The source, it says, is the Tax Policy Center, the Chamber of Commerce of the United States. It is dated July 25, 1979. It is their chart. Let me explain it.

The Chairman: Now, he does it two ways. In one, he assumes that you are not putting your money back in the ground. In the other case, he assumes that you are.

Mr. Shapiro: In this particular chart here, we are talking about a case where there is an assumption that there is no reinvestment. This half is the individual producer, and this side is the corporate producer. The difference is that with an individual producer, it is assumed that individual is in a higher bracket, where the corporate producer is at the 46 percent level. But then it is made in dividends. There would be a second tax at the shareholder level.

What is being assumed here (indicating), the key to the chart, is that in a white space, each time he assumes there is no windfall profits tax. In this case we are showing that if there is no windfall profits tax, just the federal income tax on that amount, for each $100 additional income from decontrol, there would be a $45.02 tax that the Federal Government would realize even if there were no windfall profits taxes.

This is just the corporate income tax. The state share, which would include the severance tax and any individual income tax in that, would be in the range of $13.68. This would leave the individual, in the case of no windfall profits tax, with $41.30. That is the difference between $100 and the $45 that the Federal Government gets and the $13.68 the state gets.

So therefore the individual would get the difference, which is $41.30. That means out of each $100 the individual would get $41 if there were no windfall profits tax.

The Chairman: Now, you are assuming he is getting a depletion allowance in that case.

Mr. Shapiro: Yes, this is a depletion allowance. This is both for the individual share and the state share, but we are assuming no reinvestment, in which case there would be intangible drilling deductions.

The second case in the bar chart would show that if there were a 60 percent windfall profits tax on old oil --

The Chairman: In other words, that is a 60 percent tax on top of the other taxes.

Mr. Shapiro: Yes. This is assuming that we have old oil, meaning this individual. The federal share of that would be

$75.56.

The Chairman: $76.56.

Mr. Shapiro: That would include the windfall profits tax and all other taxes on that oil. So it is $76.56. The state's share of that would be $13.13. Thus, on that $100 that would be realized as additional income from the decontrol of old oil, the individual would get $10.31. That is just the difference between the federal share and the state share.

The next bar here at the bottom is assuming a 50 percent windfall profits tax on new oil, so this is new oil. And the federal share would be $75.77. So on each $100 additional income from decontrol, there would be $75.77 the Federal Government would get.

The state would receive $13.18, and this would leave the individual with $11.05. So these are the three cases for individuals.

The one in the white share would be on no windfall profits tax. The second case would be a 60 percent windfall profits tax, and the third case would be a 50 percent windfall profits tax on new oil.

Senator Packwood: May I ask a question there? And I am sorry, I missed just for a moment. Why do you assume a 60 percent windfall profits tax on old oil in the second example, and 50 percent on new oil?

Mr. Shapiro: We are talking about the House bill. This is just an example, as I understand it, of the House bill here.

Senator Packwood: I heard what you said.

Mr. Shapiro: The House bill has a 50 percent tax on newly-discovered oil.

Senator Packwood: And what do they have on old oil?

Mr. Shapiro: Sixty percent. This is taking the House bill and showing the effects of the House bill.

Senator Packwood: Oh, I see. All right.

Mr. Shapiro: What I am trying to show you is under the House bill, what would an individual producer receive as a result of each additional $100 of income.

Senator Packwood: What the individual will receive if he has old oil is $10.31, and if he has new oil, $11.05.

The Chairman: Out of $100.

Mr. Shapiro: Out of $100, yes.

Senator Gravel: A question here, too, Mr. Chairman. It is just judgmental. If a person had old oil, he would have to hide it. I mean he would be having the government confiscate 90 percent of his property. He couldn't even keep abreast of inflation if we had double digit inflation.

The Chairman: He would make a little more. He would make what he would have made to begin with.

Mr. Shapiro: Yes. This is on top of what he would have gotten today. In other words, if he is selling oil today, he is making a profit today, and this is what he would get on top of what he is making today as a result of decontrol.

The Chairman: It seems to me that the point is that out of the additional money that is to be made under the overall proposal, the Federal Government gets $77 out of $100. The state would get the additional 13 percent. That is on Louisiana based on severance tax. Other states have lower severance tax but higher income taxes.

That would be the situation in Louisiana and Alaska. Texas would probably come in at a lower state share there because there is no state income tax in Texas, I don't think, and a lower severance tax.

Mr. Shapiro: Yes. The state share would probably be less as a result of that and therefore the individual would get a little more.

The Chairman: Well, the federal share would be more. The federal share would be -- if the state gets less, that means the Federal Government takes roughly 80 percent of the additional income that the state would have had, and the individual gets 12 or 15 percent of the increase, the part that the state does not get.

Now, to show how it works out, can you give us the figures. If he did a lot of drilling, he would save not against a windfall tax. He would pay just as much. No matter how much he drilled, he would still pay the windfall tax but he would save against the existing tax. Show how that works out.

Mr. Shapiro: Jim has the figures.

Mr. Wetzler: I have the figures in front of me. This is assuming he takes his cash flow after taxes and reinvests it all, and half of what he reinvests is immediately deductible as intangible drilling or dry hole costs.

The Chairman: And he puts all of that in also.

Mr. Wetzler: He puts that into the ground. That means he won't have any cash. He will have profits but they will be in the form of oil wells. If they are all dry, he doesn't have anything. If they are successful, he has a producing oil well.

The Chairman: Yes. All right.

Mr. Wetzler: If that is the case, for an individual producer, non-corporate, when there is a no windfall profits tax and he reinvests under this system, reinvests all of his cash flow, the producer would net $63.79. That is compared to $41.30 if he does not reinvest. If there is a 60 percent windfall profits tax, the non-corporate producer would get $15.92. That is instead of $10.31.

With a 50 percent tax and reinvestment, the individual producer would get $17.07 instead of $11.05.

Now, for the corporate producer, the comparable figures are: with no tax, the producer keeps $60.48 as opposed to

$46.21. With a 60 percent tax and reinvestment, the producer gets to keep $24.20 out of $100, compared to $18.48 without reinvestment. And then with a 50 percent tax, the producer gets to keep about $25.92 as opposed to $19.82.

The Chairman: Well, it seems to me that you ought to get a chart on that because I think it helps make the point, and the point should be made and people ought to understand it, as far as an individual or independent producer is concerned. In his case, if you assume that everything he makes he puts back in the ground, then anything he is permitted to keep, he puts back in the ground.

In this case, even though he puts back everything he is permitted to keep, he would only be permitted to keep $15. So that out of $100, he would only be permitted to keep $15, is that correct?

Mr. Wetzler: That is right.

The Chairman: So here is a fellow who comes and tells you, for the independents, all right, our group of 10,000 producers have put back 103 percent of what we have made. We have put it back into trying to get more energy. That can only be done by borrowing money. But we will put 103 percent of our gross income back, and we are pleading for you to let us keep some of this so we can put it back into drilling more wells.

Now, this provision would let them keep something, $15 out of $100, to put back into drilling more wells. And their argument is that that is a very modest amount to let them put back into drilling more wells. You ought to let them keep more of it if they put it in the ground, which is parallel somewhat to what the governor of Texas came up with.

He made a proposal somewhat similar to what Senator Gravel proposed some years ago. His suggestion was this. Let a fellow keep the same amount of money he was keeping before, enough to feed his family and to pay his living expenses, and over and above that, take it all except the part that he put back in the ground.

But the part that he put back into producing more, let him keep that much because you need the energy, the idea being that a 100 percent tax would be all right as far as he is concerned over and above what it takes the person to hold hide and hair together to pay living expenses based upon what his expenses were before. But insofar as he puts it back into getting more energy, you should let him keep that much.

Now, the administration bill here would let him keep 15 percent, $15 out of $100, assuming he puts back everything that he is permitted to keep, which is a minimal incentive. Now, Secretary Schlesinger, when he testified, indicated he had a lot of sympathy for that type of situation, that that person ought to be able to keep more than $15 out of $100.

Now, of course it looks better if you put it on a corporate producer, because the corporate income tax is lower.

It looks like he is keeping $19 in, what, 1982?

Mr. Shapiro: He is keeping $46 at no windfall profits, $18.48 on a 60 percent tax on old oil, and he is able to keep $19.82 with regard to a 50 percent windfall profit.

The Chairman: But if he declares any of that as dividends --

Mr. Shapiro: Then there is a second tax.

The Chairman: It is taxed all over again. And by the time they get through taxing that, he winds up with less than the individual.

Mr. Shapiro: But I should point out on these charts that we are talking about oil on which a windfall profits tax is imposed, meaning that some of the price will go to the effect that there will not be a tax on some of the oil. There are some exemptions under the House bill. There is also the case of price adjustments which are allowed, but in cases where there is a windfall profits tax, this represents the total impact.

The Chairman: But actually, if you look at what the Federal Government takes plus what the states take in their taxes, insofar as this windfall bill permits somebody to get any additional income, the government is taking 90 percent of it. That is what it amounts to roughly, is it not?

Mr. Shapiro: Well, in the case of an individual, that is correct. It is taking approximately 90 percent.

The Chairman: Well, now you take the corporation. It is taking only 80 percent up until you tax the dividend. But assuming that the income is paid on through to the individual --

Mr.Shapiro: If you assume that income is passed on completely, then there is a tax at the shareholder's level on top which will take a good portion of that from the individual as well.

The Chairman: So he winds up about the same as an individual if he is that fortunate.

Mr. Gravel: Worse. It has to be worse.

The Chairman: You are assuming the individual is in a 70 percent bracket. If you assume the shareholder is in a 70 percent bracket, he would wind up with a lot less than that. He would wind up with -- what is 30 percent of 20, roughly? That is what he would wind up with, $6 out of $100.

Senator Packwood: Well, not really, because the individual has already paid his tax once and there is going to be a dividend to the individual after he has paid his individual tax. If you are talking about the corporation, you are right. If they pay out 40 percent in dividends or 50 percent in dividends to Mike Gravel, they are going to pay a tax on that and the corporation has less to invest.

The Chairman: The chart you are looking at is what the individual left after he has paid his tax on the left side, the individual producer. That is what he has left.

Senator Packwood: $41.30 if there is no tax.

The Chairman: So of the additional money he has left, let's say he has $10.00.

Senator Packwood: Okay.

The Chairman: Now, if all the income on the same category is paid out as dividends and then taxed at 70 percent, you are assuming the individual is in a 70 percent bracket or a shareholder rather than a private operator. By the time he pays his 70 percent tax on the $19.82, let's rough it out to $20 for calculations, he would have $6 left.

Senator Packwood: Unless I misunderstand what this chart is, when you talk about an individual producer you are talking about a non-corporate producer, are you not?

Mr. Shapiro: That is correct.

Senator Packwood: So there is not going to be a further tax on the private share on the bottom part.

Mr. Wetzler: Senator Packwood, I think Senator Long is referring to the $18.48 corporate producer. If that $18.48 were paid out as a dividend, the shareholder would pay an income tax on the $18.48 dividend.

Senator Packwood: That is correct. I am with you on that.

Mr. Wetzler: Depending on the tax bracket.

The Chairman: So if you assume two individuals in the 70 percent tax bracket, that is where they wind up. Now, most of your independents are in a 70 percent bracket. If they are successful, they are in a 70 percent bracket. If they are not successful, they are broke.

Mr. Wetzler: Well, a number of the independents are corporations. Not all of the independents operate as individuals. And usually if it is an individual producer operating as a corporation, he would pay himself out a salary and try to have that classified as earned income. So it is 50 percent.

So you cannot, I think, draw too many generalizations about how these companies are actually structured. Maybe the Treasury has looked at this.

Senator Matsunaga: Mr. Chairman, of course we need to remember, in looking at these small figures, that this would be income which the individual, the corporation would enjoy merely out of decontrol, not because of additional production but out of mere decontrol. In other words, he doesn't have to produce one additional barrel of oil. He gets this additional income.

The Chairman: That is right. But you ought to read the statement. I would like for every senator to read the statement these people made before us when they came here representing those in the investment community to discuss their view of this windfall philosophy.

It is parallel to Senator Gravel's statement. What you are basically going to say is you put government price control on something, and with government price controls, you hold the price down very low. And then when eventually you let some of those controls go off, you take the view that it is a windfall.

But that is hard to sell to anyone who is affected by it.

Senator Gravel: But, Mr. Chairman, let's put ourselves in the same position. We all own property here in town. It all appreciates as a result of inflation. So therefore, when we sell it we make maybe $50,000 on our property. Then the government ought to come in and take away 90 percent of it. I mean it is the same principle.

So if you are going to do this to the energy industry. A person owns a pool of oil. He is in the business. He has to replace that pool of oil at higher cost to stay in business. So all of a sudden the government comes on in 1971, clamps on controls, and it lifts the controls off in 1979 and says all of the appreciation that took plac during that period of time belongs to the government and not to you.

Well, we did lift the controls in other parts of the economy, so I would say this is the same principle. If I have a house and you have a house that appreciates in value, we would just love to sell it and take capital gains on that. And we turn around and fix it so you can shelter $100,000 of that, or if you buy another house, you can shelter that. But you are increasing your wealth.

That is exactly the same principle here. That is confiscation.

The Chairman: It is not fair to say it is confiscation. The government has a right, because you are being paid something for it. But if you looked at a parallel situation, the government put export controls on wheat at one time, didn't it? I know it put export controls on soybeans.

Senator Packwood: It put it on soybeans on '74.

The Chairman: Now, when the government took those controls off of soybeans, it did not say that they were going to put an excess profits tax on the producers of soybeans. It just took the controls off. As a matter of fact, my impression was that President Ford had to put some such controls on, and when he took them off he went to the farmers and promised he would never do anything like that again. It was a mistake to have done it in the first instance.

So when you are talking about a person producing from his own property, it is hard. I would suggest that you not use the word "windfall" talking to him because he would resent it. Now, when you are talking about windfall under a federal lease or on federal property, I think you have a better case. There he had a lease and he went out there and produced, and he found something and he sells it and it never was his. It belonged to someone else and he is permitted to keep a share.

Then you have a better case. But even so, he will contend that he was by right entitled to his share of the energy that was produced and he was entitled to the market price on it. And if the government controls the market price, he is not getting a fair return. But you have a better argument there than you do when you have a farmer who is looking at his own energy which is a part of his own real estate.

From his point of view, that would be parallel to an increase in the value of property.

Mr. Gravel: Mr. Chairman, the government does not do anything to add value. It is the economy which has added value. What about a situation where people own property and a highway is put through and it causes the appreciation of value to quadruple on a piece of property. Then we do not impose an excess profits tax on all of those people who benefit from government actions.

We have come a long way in our thinking in loss of faith in free enterprise when we assume that this belongs to the government and not to the individuals who invested money to discover it and have it, and now we confiscate it.

The Chairman: Well, that points out, I think, what I think we ought to understand about what the tax really is. If you add one to the other, you are talking about some very heavy taxes. You are talking about a tax of somewhere from 80 to 90 percent when you add them together, what the overall tax burden is.

And if he puts it all back in -- give us those figures again. If he puts it all back into the ground, a corporate individual, how does that work out?

Mr. Wetzler: If it is a corporation if there is no windfall tax and the corporation reinvests, it gets to keep about $60.50, $60.48, out of $100 of so-called windfall.

The Chairman: Do you mean the corporation, if it puts its own money back in, can keep $60.48 out of $100?

Mr. Wetzler: Yes. He still has to pay the state severance tax. And the corporation, essentially, would be paying the state severance tax and the income tax on half of the investment. Mr. Cohen assumed that in this reinvestment, half of this reinvestment is intangible drilling costs which are immediately deductible. The other half is depreciable property which is only deductible over the life of the asset.

The Chairman: Based upon what he gave you there after he pays on $100 of additional income, after he pays the corporation tax and after he pays the state severance tax and after he pays the other state taxes he is looking at, and after he pays the windfall tax plus the ordinary income tax, how much does he have left?

Mr. Wetzler: With the windfall tax, Mr. Cohen's figures indicate he gets to keep $24.60 with a 60 percent windfall tax.

The Chairman: So after taxes, he could keep $24.60. How much did you say he would keep as an individual, $15?

Mr. Wetzler: $15.92.

Senator Matsunaga: Are you talking about old oil or new oil?

Mr. Wetzler: This is on a dollar of something which is assumed to be taxed as a windfall profit. Under the House bill for oil in tier one, that is all price increases above $6 a barrel. And for tier two, it is above $13 a barrel. For stripper oil, it is $16. So it is whatever is assumed to be a windfall tax in the legislation.

Senator Matsunaga: But then you have two different figures here on this chart (indicating) under both private share, individual producer, and corporate producer. You have for old oil $18.48, and new oil, $19.82.

Mr. Wetzler: Yes. The new oil here assumes newly-discovered oil or Alaskan oil, which under the House bill is subject to a 50 percent tax rate, not a 60 percent rate. But as you can see, there is not much difference between the 50 percent and the 60 percent.

The reason there is so little difference is because under the House bill, under the 60 percent rate, the oil in tiers one and two, subject to a 60 percent rate, get a deduction for severance taxes. The newly-discovered and tertiary oil, subject to a 50 percent rate under the House bill, does not get a reduction for severance taxes.

In Louisiana, which is the state where this calculation assumes the production is taking place, there was a very high severance tax, 12.5 percent, and the deduction for severance tax is worth almost as much to the producer as he loses from going from a 50 percent to a 60 percent rate. That is why there is a so little difference between a 50 percent and 60 percent rate on this table here.

You are probably as well off just looking at the 60 percent.

The Chairman: I would like to ask that that same thing be done assuming it is in Texas.

Mr. Wetzler: I think the Treasury may have that.

The Chairman: Do you have that?

Mr. Lubick: (Nods affirmatively.)

The Chairman: The point I think is relevant here is if you assume that the individual is not putting his money back in, he gets roughly $10 out of $100; and if you assume he is putting it all back in, he gets $16 out of $100. That is about what it amounts to.

Mr. Lubick: Mr. Chairman, what we have here is a series of four charts. The first one you have before you deals with the State of Texas on $100 increased producer income from decontrol. The first corporate producer where there has been no reinvestment, no drilling at all, and we have the same $100. We subtract the severance taxes in Texas, the 4.6 percent.

In the first column you do not have a windfall profits tax, so the federal taxable income is $95.40. We applied a 46 percent federal income tax rate to that, leaving after tax $51.52. In the second column, the first two steps are the same, leaving you the windfall profit of $95.40. Applying the 60 percent tax, it is $57.24, which leaves you federal taxable income of $38.16, to which we apply the 46 percent. You end up with $20.61.

The second sheet shows, for comparison, the same assumptions that Mr. Cohen has been using, that we have the after-tax income invested in oil production activities with 50 percent of that being currently deductible in the form of intangibles.

And again, without the windfall profits tax, going through the same exercise, we start with $100 of income, we subtract the 4.6 percent severance tax, we subtract the deductible investment expenditures of $33.45. It leaves you with federal taxable income of $61.95, to which we apply the 46 percent rate.

The federal taxable income less the income tax was $33.45, and we added back the deductible portion of the capital expenditures, $33.45. So the after-tax income is

$66.90. But there are $33.45 of capital invested in the ground.

Senator Packwood: Explain to me why the figure is $33.45. I don't follow the tax law that well.

Mr. Wetzler: Senator Packwood, it is just an assumption that the producer reinvests that much. If you want to assume he reinvests all of his after-tax income, I think the Treasury had to use an equation to get that.

Mr. Lubick: They are simultaneous equations because we had to assume that half of what was left after taxable income was invested. In order to know what the taxable income was, you had to know what was invested and deduct.

Senator Gravel: But you have not assumed they have invested all of it.

Mr. Lubick: Yes.

Senator Gravel: That they have invested every penny they have?

Mr. Lighthizer: No, they still have enough money left to pay their taxes.

Mr. Lubick: Yes, that is correct.

Senator Gravel: After taxes, they have invested everything.

Mr. Lighthizer: Everything they could and still have enough money to pay their taxes.

Senator Gravel: Pardon me?

Mr. Lighthizer: They still have enough money left to pay their taxes.

Senator Gravel: They obviously have to pay their taxes. But after they pay their taxes, which would be what?

Mr Wetzler: $28.50.

Senator Gravel: If they take that entire $28.50 and reinvest that.

Mr. Lubick: $28.50 is the federal income tax.

Senator Gravel: Oh.

Mr. Lubick: $33.45 is the federal taxable income less the income tax. You get the federal taxable income, you pay your income taxes out of that, and you have $33.45 left.

Senator Gravel: In your pocket.

Mr. Lubick: And instead of leaving it in your pocket, you put it in the ground.

Senator Gravel: Okay.

Mr. Lubick: You have no cash.

Senator Gravel: All right.

Senator Packwood: I am sorry, I don't follow it. Please run it by me again. I got the $100 part.

(Laughter.)

Mr. Lubick: All right.

Senator Packwood: And I think I understand the severance tax.

Mr. Lubick: Then you make out a check for $4.60. Then you are going to plow into the ground $33.45.

Senator Packwood: All right.

Mr. Lubick: And that is deductible.

Senator Gravel: You lost me there.

Mr. Lubick: Well, I am investing a number by looking ahead.

Senator Gravel: I see.

Senator Pakwood: You are investing $33.45, and that is a deductible business expense, and you are substracting it from your income, is that right?

Senator Bentsen: Your $33.45 is your additional cash flow from your IDC.

Mr. Wetzler: What Treasury is assuming is they are investing $66.90, of which half is capitalized and half is deducted immediately, to get deduction of $33.45.

The Chairman: You see what is being done here is to think in terms, assuming that you take your additional income and invest it in drilling, where are you going to come out? So that if you assume that, anyone who is familiar with his business knows he is going to have a big tax savings because he does more drilling.

So you get with your accountant and figure out how much you are going to save on your taxes by doing more drilling, and you put that much more into drilling. Now, people who get big enough to do a substantial amount of drilling think in terms of how much they are going to drill by how much money they are going to have. They look at their cash flow and their cash flow involves predicting what your taxes are going to be.

When you do that, you say here is how much I save if I am drilling. Then I put that back into the ground. And then you come out to the bottom line and say, all right, now, assuming you put everything you make back into the ground so you don't have cash, you have a hole in the ground, then what do you have to show for it?

By the time you get through you have, out of $100, $26.76 worth in the ground.

Mr. Lubick: With the windfall profits tax, you have a hole which, for accounting purposes, is valued at $26.76.

Senator Gravel: You have a hole. It only has value if there is oil at the bottom. If there is nothing in the bottom of that hole, you have just go nothing. You just blew your money.

Mr. Lubick: It is probably worth more than that if it is in there, but I said for accounting purposes, $26.76.

Senator Gravel: I don't even see $26.76 on this.

Mr. Lubick: That is with the windfall profits tax.

Senator Gravel: Oh, yes, I see. But even after-tax income income is a deceptive statement because it isn't income. You have nothing to spend. You have a hole.

The Chairman: Let's think of it this way, Mike. It is like having a roll of the dice when you have $26.76 on the table.

Senator Gravel: Say that again.

The Chairman: You have got that much. That is what your investment is on the additional $100 of income.

Mr. Lubick: We have assumed a 46 percent tax rate. We have disregarded the investment credit and depreciation, things like that. We are assuming the marginal rate is 46 percent. That is probably slightly on the high side.

Senator Gravel: Mr. Chairman, I still have the question that after-tax income is not after-tax income. You have a hole in one case if you reinvest.

The Chairman: Do you have the same charts for individuals in Texas?

Mr. Lubick: Yes, I have the same chart for individuals.

Senator Gravel: Is there a chart down the road that will show how much more oil this will bring in when they do these things? Does someone have a chart?

Mr. Lubick: That is Mr. Smith's department, here, to prepare that chart.

Senator Gravel: We should do that chart to.

Senator Matsunaga: This chart is simply that extra $100 he would get merely because of decontrol. That is all. So don't confuse that with additional production. This is merely additional money.

Senator Gravel: No, he has just made the assumption.

Senator Matsunaga: No, just by decontrol, by increasing the price, that is what he gets.

Senator Gravel: I know that, but if you are reinvesting that, something is happening.

The Chairman: This is showing you, assuming he takes whatever net he has and puts that in the ground to try to get more energy, this is how much he can put in.

Senator Matsunaga: Only of the additional $100 he gets out of the increase in price because of decontrol. So he gets an additional $100 to begin with, and then he puts $33.45 of it -- what was that, $33? Yes, $33.45 of that additional $100 he gets because of the higher price that he sells his oil at. Then he puts that into the ground.

The Chairman: Senator, that is understandable.

Senator Matsunaga: That is my understanding. Is it correct?

Mr. Lubick: (Nods affirmatively.)

The Chairman: Well, let's understand that he does. Under the proposal he is left with something. We all understand that he does get something. If it offends you that he gets anything, even a penny, then maybe you would want it at 100 percent. But he is left with something.

Mr. Lubick: I think Senator Matsunaga's point is we have extracted out completely that portion of the price for the barrel of oil which represents the control price element, $6 in the case of the first tier, $13 in the case of the second tier, and we have not taken into account a profit or any reinvestment on that portion.

Senator Matsunaga: I understand what you are trying to say, Mr. Chairman.

The Chairman: The point is the government doesn't take it all, but it doesn't miss much. That is the point.

Senator Danforth: Mr. Chairman, may I just make a comment which I am sure will betray my ignorance? It seems to me that there are two ways to look at taxation, two ways to approach the subject. One way is to say how much can we tax those people out there without them really screaming? Then, after we figure how much we can possibly tax them, then let's decide what we are going to spend the money on.

We can spend it on anything: AMTRAK, which we are going to spend it on today, a new office building, more police officers for the capitol, all kinds of things we can spend the money on. That is one approach, and I think that is the approach we are taking today.

We are deciding how much we can tax people as an abstract proposition.

Now, the other way to go about it, as I understand it, is to ask what you want to spend the money for and how much money you want to spend. Now, it is my understanding that the administration wants to spend over a period of ten years $142.5 billion on an energy security corporation, solar energy, various energy production initiatives that the administration wants to get into.

Now, given that $142 billion, it seems to me that the right question is how do we go about raising $142 billion, rather than starting out with the windfall tax.

Now, what puzzles me is, if decontrol by itself would produce $173 billion in income taxes and in leases -- is that right, lease revenues or royalties?

Mr. Wetzler: You have federal royalties and corporate income tax revenues. But I should say, Senator Danforth, that that $173 billion figure is not a hard number.

Senator Danforth: Nothing is a hard number. I realize that. But what we are trying to do is figure out how you raise -- am I wrong, that we should be trying to figure out how to raise $142.5 billion by 1990?

Now, what I would like to know is, on a variety of assumptions, how do you get to that figure of $142 billion? How much can you raise by income taxation assuming no windfall tax? How much would you raise by income taxation with a windfall tax? We see from each of these charts the Treasury has handed out that income taxes go down with a windfall tax.

But can we project total federal revenues without windfall tax, with windfall tax, and on various assumptions about what a windfall tax is going to be? If you take this tier one, tier two, stripper oil sheet, can you project out on a variety of assumptions what is covered by the taxes, how much total revenue, income and excise tax and royalties would be produced on these various assumptions?

Mr. Wetzler: Yes, we can do that, Senator. I think, though, before you spend the corporate income tax that we are saying you raise, you ought to remember that later on in the year we are going to worry about income tax cuts, I think, or next year, and you are going to look at the income tax increase caused by inflation.

There are a number of proposals to index the tax system to cut individual income taxes for inflation. So, to the extent tht decontrol raises prices, which it will, you are then going to have to, if you want to keep the income tax neutral for inflation, you are then going to want to cut income taxes.

So you would have to charge that.

Senator Danforth: That is great. I think that is wonderful. Now, let's find out from the administration what kind of tax cut we want. Is that an unreasonable request or are we just going to concentrate on how much revenue the windfall tax will produce and then how we are going to spend it? It seems to me that this is a terribly backward exercise.

Mr. Lubick: I think basically, Senator, what we have is a situation where, as a result of the action taken by the President in decontrolling the prices, as a result of rises in prices, which are attributable to the prices set by the OPEC cartel, we have a substantial influx of revenues to the producers. We tried to come up with a program that said that we have to preserve the incentives for these producers to produce energy in a sufficient amount.

But to the extent there are these windfall revenues that are due to a very unusual situation, I don't believe it is the situation of a normal inflation of a house that Senator Gravel talked about, or fluctuations in an agricultural market. Here are prices imposed by a foreign cartel. And you have situations where you have a government falling in Iran. They are unique situations.

Senator Danforth: Mr. Lubick, let me just say in response to that that that is your opinion. That opinion was not shared by Secretary Schlesinger yesterday. Secretary Schlesinger expressly said yesterday that at a time when demand exceeds supply, a cartel does not have that kind of effect.

When he was asked if we didn't have any controls and if there were no OPEC cartel, what would be the effect on oil prices, he said they would go up as a result of that combination. So the Secretary of Energy testified yesterday that it was not the cartel that was going to create the increased price.

Now, what I want to know is why are we raising this revenue? We are going to raise $142 billion. That is fine, I guess. We can spend that. But why, other than trying to get to $142 billion, are we raising this tax? Is it for a tax reduction or what? What are we going to do with it?

Mr. Lubick: Well, essentially, there are three elements in the President's program that we call for the use of the revenue.

Senator Danforth: $142 billion. And I just asked the staff if they could give me figures on how to get up to $142 billion. Now, without any windfall tax at all, they have got up to $173 billion.

Mr. Lubick: Are you asking me --

Senator Danforth: Why?

Mr. Lubick: You are asking me what are the uses of this money.

Senator Danforth: I know how you are going to use $142.5 billion. That is very debatable. Some people say we are going to get cooked as a result of this synthetic fuel. But I am giving you the benefit of the doubt and saying if the President wants $142.5 billion for enery, I assume for present purposes that that is fine.

Now, when you address tax policy, it seems to me that the whole point of it is to decide how you raise the revenue needed to get to $142.5 billion, not just trying to decide how you are going to sock it to some people and then spend it somehow.

Now, they tell me, and maybe you have different figures, that without any windfall tax at all, we are going to have an increase in federal revenues by $173 billion over the next decade. By my calculation, $173 million is $30 billion more than the President needs. Now, what are you going to do with the $30 billion and how much more do you need?

Mr. Lubick: Well, we think the figure is correct on the combination of royalties and income taxes.

Senator Danforth: Then why does that not take care of the problem? What are we doing here? I have previously gone on record, I have told Treasury, I have told the Department of Energy, I have told my constituents that I would be willing to support a windfall tax because I think we need a fund of money to put into other forms of energy other than oil. But I am asking you, if we are trying to raise $142.5 billion, why do we need a windfall tax? You have already raised it.

Mr. Lubick: I think one of the problems is, if you look, as I think Mr. Wetzler points out, the income tax is problematical. This is a projection on the basis of present rates out through 1990. Once you get more than a short distance out on a corporate income tax to earmark those particular general revenues is simply highly questionable.

Senator Danforth: Mr. Lubick, it is not just earmarking $142.5 billion. It is giving you a $30 billion cushion on top of it. You are saying you want a windfall tax. What I would like to know is how much total revenue -- we know that the income tax and royalties are going to produce $173 billion by 1990. Now, how much total revenues would your windfall tax plus income tax plus royalties produce?

Mr. Wetzler: It would be about $80 billion more.

Senator Danforth: So that $80 billion, you are talking about $250 billion.

Mr. Wetzler: I am sorry, Senator. It is about $105 billion more.

Senator Danforth: So you are talking about $105 billion more than the $173 billion, so you are talking about $278 billion of additional federal revenue that we are raising for $142.5 billion program. Now, where is that money going and who is going to spend it? Congress is going to spend it, but what is the administration proposing for an additional $105 billion of revenue? And, let's see: 278 subtract 142. You are almost doubling what you need. You are almost doubling what you need for the President's energy program.

Mr. Lubick: The general revenues, Senator Danforth, are available for general budgetary purposes, for tax reduction, for all of those things you normally do.

Senatr Danforth: Tell me what the things are. These are a lot of things. This is $136 billion worth of "things." We, a number of us on this committee, have been pleading with the Treasury Department now, and with the administration, for 2-1/2 years to give us some kind of tax reduction. We have been stonewalled for the last 2-1/2 years on some kind of tax reduction. The policy of this administration is inflexible opposition to tax reduction. At least that is the policy to date. We hope that the administration is about to change its point of view.

What is it going to spend $136 billion for?

Mr. Lubick: Senator, I don't think we can tell you going out to 1990. One of the important --

Senator Danforth: If you cannot tell us, why should we buy this pig in a poke?

Mr. Lubick: You are not buying a pig in a poke. Decisions are going to be made if we can close the budget deficit and if we can hold spending down and if we can get inflation under control, that money is available for tax reduction.

Senator Danforth: You are telling me the windfall profits tax is not, in fact, a tax to create money for energy production or for an energy trust fund or anything of the kind; that it is way over and above what is necessary for energy; that the income tax itself would produce not only all the President is proposing for energy, but $30 billion more to boot, and that that is not enough; and that you are raising an additional $105 billion over a ten-year period for something else and we don't know what the something else is.

Mr. Lubick: Well, I don't think that is correct, Senator.

Senator Danforth: Then tell me what it is.

Mr. Lubick: The general revenues, the general income tax revenues, would be used to meet the general needs of the government.

Senator Danforth: What needs of the government?

Mr. Lubick: The whole budget, Senator.

Senator Danforth: What are we going to throw the money around on? Do we have more programs? Most of my constituents tell me we have too many programs now, now that the federal budged has exceeded one-half a trillion dollars a year. They tell me we are expending too much money. They say that federal spending, the percentage of gross national product is too high now, and I agree with them.

Now, you have a case to make, as far as I am concerned, as to why you want to spend $136 billion a year over and above what the President's program calls for.

Mr. Lubick: I believe it has been the President's announced goal to get the percentage of taxation as a percentage of gross national product down.

Senator Danforth: Have I lost my mind or are we going in the wrong direction?

(Laughter.)

Senator Danforth: Does this program get federal taxation as a percent of GNP down, or does it move it up?

Mr. Lubick: This program does not. You are perfectly right. This is an excise tax that is being proposed to set up a fund to meet these particular national goals.

Senator Danforth: What particular national goals?

Mr. Lubick: Energy security.

Senator Danforth: That is absolutely false. You have already made the case that we are trying to raise $142.5 billion and that income taxes alone will raise $173 billion. What goals is this going to meet?

Mr. Lubick: The income taxes that you are projecting out through 1990 are on the assumption that we are going to continue to have existing rates of income tax. I don't know that one can make that assumption.

Senator Danforth: Mr. Lubick, for 2-1/2 years, we have been pleading with the administration to lower income taxes. Now, you are saying, without any pledge to lower income taxes, that we are going to raise total tax revenues.

Mr. Lubick: We did lower income taxes in the Revenue Act of 1978. That was a significant reduction.

Senator Matsunaga: That is the question I have. Now, the $105 billion which staff predicts over and above existing income tax, that is, additionally in the next ten years, does this take into account the 1978 tax reductions that the Congress passed?

Mr. Wetzler: Let me say I think there is some confusion, Senator. You essentially have two things happening here. One is that because you have higher oil prices, you have a transfer of income from the consumer to the oil producers, which one hopes is justified on the grounds that it will increase oil production and decrease oil consumption and make the general system more efficient.

But you have a transfer of income. Because of this transfer of income, the additional income the oil producers get will mean they will pay additional taxes, which we have estimated to be about $170 billion over this 11-year period. However, the real income that the consumers lose will mean that they will pay less tax than they would.

So you have to deduct out the reduced taxes that the consumer pays because of his reduced income. Now, how much that is going to be will depend upon the extent to which Congress indexes taxes over the next 11 years.

Senator Danforth: Now, you just tell me how that works. What reduced income?

Mr. Lubick: The user's energy, the industrial user's, will get increased tax deduction because of their higher costs.

Senator Danforth: You said consumers.

Mr. Lubick : THey are consumers of energy.

Senator Danforth: Provided it is a deductible business expense.

Mr. Lubick: Right.

Senator Danforth: Now, let's compute that. How much does that come to?

Mr. Wetzler: I am not saying that they will pay lower taxes, but if Congress over the next ten years keeps the general tax burden adjusted for inflation as Congress has done, more or less, in the last ten or fifteen years, then you are going to need tax cuts to offset a larger portion of the $170 billion.

Senator Danforth: I am going to tell you this, for whatever it is worth. Maybe you don't care, but I am falling off of your wagon. I think that this country should start trying to draw together. I, frankly, do not like the idea of everybody in the Congress picking apart the President's program every time he unveils it.

I myself have been willing to give him the benefit of the doubt to try to get behind this program insofar as I possibly can, to be supportive of him, to agree that we are going to have to spend substantial amounts of money for non-fossil fuels. I am perfectly in agreement with that whole concept.

But when you show me something like this (indicating) and say that we have to raise here not $142.5 billion, but we have to raise $278 billion for reasons unknown, on some speculation that maybe we will need some tax adjustment, then I say that you absolutely have failed to make your case. You have not even come close.

Mr. Lubick: Senator, we clearly do not want you off the wagon.

(Laughter.)

Mr. Lubick: I would like to sit down with you and we will try to explore these figures. What we were dealing with were the revenues to the producers. And as Mr. Wetzler has pointed out, there are a number of offsetting items. It gets to be very speculative when you are dealing with the general corporate income tax.

We will try to carry out the concentric circles as far as we can and see if we cannot satisfy you that the windfall profits tax focuses on the windfall revenues which the producers are receiving because of the rapid increases in prices, and it is a vehicle for returning for these energy-related purposes some of those windfall profits.

Senator Danforth: It is a vehicle for raising taxes and putting more funds in the hands of Uncle Sam so he can do something with it, and you don't know what he wants to do with it.

The Chairman: Could I get in on this for a moment? I think the Senator has made a strong point. Here is something that occurs to me about all of this.

We had before this committee the representatives of small producers, royalty owners, big producers, people in the investment world who represent money that they think they can attract from the markets to this industry into production. And among other points they are making, they are making the case of saying you are holding the price of world oil, that is, domestic oil, below the world price. And that is one of the reasons you have all of those people in lines out there.

So the administration and everyone recognizes the price is going to have to go up to meet the world price. The administration says let's tax it away, let's tax away whatever profit is made out of that and let the government use that to produce more energy.

Now, these people who are producing energy now are saying, now, before you tax it away from us so the government can do this, isn't it fair that we should be permitted to keep at least a major portion of that which we can put back into the ground and produce energy ourselves?

Now, let's assume the government can produce energy as efficiently as private industry can do it. The fellow who is in the business says in either event the consumer is not going to get the money. Either the government is going to do it or we are going to do it, and all things being equal, why won't you let me keep some of this money and let me do what you think the government should do? You think the government should produce more energy? Why don't you let me produce more?

Now, how are we supposed to answer that fellow, Mr. Lubick? He says: Look, if you let me keep a little more of this money, I can produce more than the government can produce for the same dollar.

Mr. Lubick: Senator, in trying to design the program, we made a recommendation which, in our judgment and based upon the figures as best we were able to estimate them, left adequate funds in the hands of the producers so as not to discourage supply to any unreasonable extent. Obviously, any tax is going to have some discouraging effect and you must evaluate how much.

But the reduction in supply induced response as a result of the tax revenues which we propose was minimal. Now, to the extent that we want to provide incentives to producers to produce more, those incentives ought to be available generally to all of those who want to enter the field of producing more energy, whether they happen to be the persons who have some windfall profits or those who don't happen to have windfall profits.

That is one of the reasons why we proposed the plowback provisions. I think it is a separate question as to whether you want to provide incentives to increase supply response. WE have proposed a number of tax credits which we think will induce that supply response, including the incentives for unconventional gas and shale oil and some of the other uses.

The Chairman: Let me just hope that the administration's estimates and its projected policies will be better guided for the future than they have been during the past year, because when we were voting on that gas bill, we were told that if we went beyond a certain price on gas -- and I was trying to recall the price, but they had an arbitrary price, in my judgment -- and if we went beyond that price as an incentive to produce more gas, they contended you would not get one additional cubic foot of gas if you paid more than that.

Then we later found out tht that was based on the estimate that at that price, you would have every drilling rig opeating. And they did not even take into account the rigs then under construction, nor did they crank into their estimate the fact that you could build a great number more rigs and you ought to be building them.

Then we passed the bill. I voted against it because I saw all the confusion that would be created. They were saying at that point, with all the bureaucratic and governmental confusion that will be created by this bill, there will be less drilling rather than more. They have been proved right.

We now have about 200 good rigs which ought to be operating which are just sitting there because of the uncertainties and confusion created by that gas bill that was passed.

The President thought it was a good bill, but people in the industry don't seem to think so. They think you should have done a lot better than that, something which would have created a good deal less confusion.

I am told that right now, 25 percent of those work-over rigs are not active, 25 percent of all the work-over rigs. Without exception, every one of those rigs can bring in more oil just by making the wells produce more efficiently. I am told there is a potential of producing about 600,000 barrels a day more than we are getting just by putting those work-over rigs to work.

We are not using the equipment that is available to produce more energy now. We are doing it in the oil area just like it is not being done in the gas area. And I would hope that when we get through with this exercise, that we will arrive at a combination of policies which will efficiently put all of the resources we have to work producing energy as well as doing something over on the conservation side of making better use of what we can produce.

Now, I would be very disappointed if, having voted for a bill, it winds up being counterproductive, as I am told our gas bill was. About all we achieved with that was to take the gas that was being produced in Louisiana, Texas and Oklahoma, which the intrastate market was not regulating and where you had a surplus of gas, to simply take that and make that available to the interstate market.

When we get into passing a bill here, and of course there will be bills out of the committees, I just hope -- and I would be ashamed to vote for it if it didn't work out that way -- that we are going to have a combination of regulation plus taxes. Whatever the changes may be in the regulation, I cannot see, but in the tax area, I would hope that on the whole, the balance will encourage more production and provide adequate incentive so that anyone who is interested in doing it can get into it and help us produce more energy.

It seems to me you ought to be trying to help us do that, Mr. Lubick. I think Mr. Schlesinger wants to do that. He is the outgoing secretary, but I think that that is his intention. And whether we succeed or not, I have no doubt his intentions are correct. Do you, Mr. Smith?

Mr. Smith: No, sir.

Mr. Lubick: We certainly share that objective, Senator, and our whole program and the reason for moving to decontrol immediately as we have started to do already was to get that incentive to production. We will be supplying you with the figures that we think this total program will show.

Senator Danforth: Mr. Chairman, just to sum up the numbers as I understand them at the present point, the administration's energy program calls for $142.5 billion by 1990. $173 billion would be raised by 1990 simply by income taxes and by royalties without a windfall tax. $105 billion additional revenues would be raised if we imposed the windfall tax by 1990.

That would be $278 billion by 1990 total additional revenue raised by income tax and windfall taxes, which is $135.5 billion more revenue than the President's energy program calls for. Now, that is my understanding of the situation. If that is wrong, I would certainly like to be corrected.

Mr. Lubick: I do believe, Senator, that there are offsets to the income tax revenues. What I would like to do is provide you with the information. I think your points obviously deserve a thoughtful answer, and you will get it.

Senator Danforth: Thank you.

The Chairman: I want to ask that you look at the record, Mr. Stern, and put these charts in that Mr. Lubick has provided for us. I would suggest that you put (Texas) in here because it works out a little differently, not a great deal differently, but a little differently, depending on what state one is producing is.

It produces the same pattern, but it works out a little different in the numbers. You come out to $11.45 on the bottom line for individuals on Texas, where you come out with $11.05 in Louisiana. So that is a 45 cents difference. But considering the fact that the calculations were not done in the same shop, that one was done in Treasury and one was done in Mr. Cohen's office or somewhere, I would think that you would almost think that the same accountant did it because they came out very close.

It sounds like they analyzed it close to the same way. See if there is any difference in the way Mr. Cohen analyzed it and the way Mr. Lubick analyzed it.

Mr. Lubick: We did agree. We conferred.

The Chairman: You did confer. So you think his figures would come out the same as yours, and vice-versa, the severance tax, the state taxes being what made you come out differently?

Mr. Lubick: It is a joint effort.

Mr. Stern: Mr. Chairman, if it is all right with the committee, we will print them in the hearing record, not just in the record of this session, so they would be more widely available.

Mr. Lubick: There is a fourth Texas chart which I will give to Mike.

The Chairman: Please provide that, yes, because I would like to get them on a comparable basis.

Now, I admit it makes a difference sometimes whether you are looking at it from one end or the other. It is like looking at a mountain from two different sides. But we should try to look at it from all points of view before we reach our final conclusion on this thing. This, I think, is helpful.

Senator Matsunaga: Do you have any charts on the projection of plowbacks with you today?

Mr. Lubick: No, we do not, Senator Matsunaga.

The Chairman: Well, without objection, then, we stand in recess until 10 o'clock tomorrow.

(Whereupon, at 12:30 p.m., the committee recessed.)