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STATE SEVERANCE TAXES

HEARING

BEFORE THE

SUBCOMMITTEE ON
ENERGY AND AGRICULTURAL TAXATION

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

S. 463

JULY 24, 1984

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STATE SEVERANCE TAXES

TUESDAY, JULY 24, 1984

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION,
Washington, DC.

The committee met, pursuant to notice, at 9:35 a.m., in room SD-215, Dirksen Senate Office Building, the Honorable Malcolm Wallop (chairman) presiding.

Present: Senators Wallop, Durenberger, Long, and Baucus.

[The press release announcing the hearing and the opening statements of Senators Wallop and Baucus follows:]

[Press Release No. 84-153, July 2, 1984]

FINANCE SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION RESCHEDULES HEARING ON S. 463

Senator Malcolm Wallop, Chairman of the Finance Subcommittee on Energy and Agricultural Taxation, announced today that the Subcommittee has rescheduled the hearing on S. 463, the Severance Tax Equity Act of 1982. The hearing which was originally scheduled to be held on Thursday, June 21, 1984 is now scheduled for Tuesday, July 24, 1984 at 9:30 a.m. in Room SD-215 of the Dirksen Senate Office Building.

The hearing will address S. 463, introduced by Senator Dixon. S. 463 would amend the Internal Revenue Code of 1954 to limit the amount of severance taxes imposed by States on oil, natural gas, and coal. In addition to S. 463, the general issues of State severance taxes will be discussed.

STATEMENT OF SENATOR MALCOLM WALLOP, CHAIRMAN, SENATE FINANCE COMMITTEE, SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

The purpose of this morning's hearing is to receive testimony on S. 463, introduced by Senator Alan Dixon of Illinois. It is the purpose of this legislation to impose a cap or limit on the rate of State-imposed mineral severance taxes equal to the amount necessary for the State to recover the direct costs associated with the production of the mineral. The notion of limiting State mineral severance taxes is certainly not new to the Senator from Illinois as this legislation is identical to legislation introduced by the Senator in the last Congress. Indeed, it seems that State mineral severance taxes have been the subject of annual congressional hearings since I was elected to the Senate nearly 8 years ago. These past hearings as well as the recent Supreme Court decision on the subject have focused the issues quite clearly and left the arguments well defined.

This legislation does not challenge the right of States, like my home State of Wyoming, to impose a mineral severance tax. When a mineral severance tax, or any tax for that matter is imposed, it is either absorbed by the producer or passed on to the consumer as part of the product or material cost. If you assume, as most people do, that taxes are passed on entirely to the consumer, then it is natural to assume that if the consumer resides in another State, the tax is exported. With a majority of Wyoming's mineral production being consumed to fuel the economies of other States, it is logical to assume that at least part of Wyoming's tax will follow that consumption. If you are talking about Wyoming coal, somewhere between 1 and 2 percent of the cost of electrical power produced from that coal typically comes from Wyoming's State coal severance tax. If the electronical power or coal is exported, the tax is exported, and now the Senator from Illinois whose State exports substantially more in taxes than Wyoming raises from all its severance taxes seeks to limit Wyoming's ability to provide services to its citizens and assist in establishing an economy that will endure in Wyoming after our energy resources are depleted. Under the "direct costs" test provided in S. 463, a State like Wyoming could build a highway to a coal mine, but not a school for the miner's children. New sewer lines needed to service an energy extraction facility could be run, but no hospital could be built to care for the miner's family. And while the Senator from Illinois has indicated some flexibility in defining this "direct costs" test, I am sure everyone can get a flavor of the problems such a test would create.

Despite the findings of the U.S. Supreme Court to the contrary, the Senator from Illinois has stated that mineral severance taxes are a burden to interstate commerce. The Senator has claimed that mineral severance taxes frustrate national energy policy, but I wonder if the Senator joined in the chorus calling for Jim Watt's head when it was claimed he was leasing Federal coal lands at too rapid a pace. In reality, I do not think it is an issue involving national energy policy or questions of whether Wyoming's or Montana's or any other energy State's severance tax constitute a burden to interstate commerce. The issue, when all is said and done, is that for this moment in time, the so-called energy producing States have something the so-called energy consuming States do not.

For a second in history, some States like Wyoming will have their entire social fabric ripped end to end, their scarce water resources extended to their limit, and their fragile environment tested on a daily basis. When their depletable mineral resources are exhausted, States like Illinois will go elsewhere for their energy, but their economy will continue. In my home State of Wyoming, if we don't take this time to plan, develop, and diversify for the future, the State will have very little of a future ahead of it. The accidents of nature have provided Wyoming with some temporary energy resources and Illinois with the Great Lakes and the Mississippi River. Wyoming probably covets the water of the Mississippi as much as Illinois covets our coal, and in reality both are taxed, although it is a little more obvious in one case than another. If we were now to allow some States to limit the legitimate rights of other States, we run the risk of creating a sense of regionalism which can only serve to plunge this country into one internal fight after another with no legitimate basis other than to get even. I am sure the Senator from Illinois does not intend that, and I look forward to hearing not only his comments, but the comments of the other witnesses who will be appearing here this morning.

Statement by Senator Max Baucus

INTRODUCTION

Thank you, Mr. Chairman. I'm glad you called this hearing. It gives us another chance to discuss severance taxes\ and the repeated attempts to limit states' rights to impose them.

THE DIXON BILL

This time the attempt comes in the form of Senator Dixon's so-called "Severance Tax Equity Act." This bill would drastically limit states' authority to impose severance taxes. It would accomplish this, in Senator Dixon's words, by "prohibit[ing] states from imposing severance taxes on coal, oil or natural gas, except to recover the public costs directly attributable to the energy extraction industries."

As I said on the Senate floor last year, this proposal "is one of the most pernicious attempts to divide the country that I've seen in a long time."

But it's not really surprising. Many times before, Eastern interests have treated Montana like a mere collection of exploitable resources that they can rip-off and leave behind.

Well, Montana is more than just deposits of copper, coal and oil. It's people, still struggling to develop our economy and institutions so that our children can prosper. As part of this process, we've decided to enact a reasonable severance tax. The Dixon bill would bring Uncle Sam in, to second-guess our decisions. That's unwise and unfair.

STATES' RIGHTS

Our constitutional system is a Federal system designed to delicately balance national powers and sovereign state's rights. Lately, the balance has shifted, more and more, towards national powers; fewer decisions are made in state capitals, more decisions are made in Washington. To prevent this shift from overwhelming us, we must zealously guard state sovereign powers. And the power to tax may be the most important state sovereign power of all. As Alexander Hamilton wrote in the "Federalist," "the individual States should possess an independent and uncontrollable authority to raise their own revenues for the supply of thier own wants * * * [and shall] retain that authority in the most absolute and unqualified sense."

One of our state taxes—the severance tax—is an especially important tool. In Montana, we've seen many extractive industries come and go—gold, silver, copper. When they go, they leave economic chaos, like exists now in Butte since Anaconda suddenly abandoned its mines and smelters.

Coal threatens the same chaos. It's a one-season harvest. So when we were asked to step-up development to help the nation overcome the energy crisis, we did. But we also enacted strong reclamation laws and a reasonable severance tax, designed to offset the massive current costs engendered by coal development, set aside funds to pay for future costs, like reclamation, engendered by coal development, and create a trust fund that helps develop and diversify our economy, so that our future generations don't someday become wards of the federal government, living on depleted land in a busted economy.

But people who want to pre-empt our severance tax argue that the tax is unfair, because it's passed along to energy consumers in Illinois and elsewhere. They imply that we're "Blue-eyed Arabs" holding other states hostage and coldly jacking up energy prices.

This is a gross exaggeration.

Montana doesn't have a captive market. Especially at a time like now when energy prices are falling, our coal competes against other coal and against other forms of energy. People buy Montana coal simpy because it's cheaper than other coal. In fact, even with the severance tax, Montana's coal is the cheapest around. That's why it sells as far east as Michigan and Arkansas, areas both close to Eastern coal fields. Had Detroit Edison purchased all Montana coal instead of mixing it with coal from other sources in 1979, it would have saved its consumers $111 million, Wisconsin Power and Light would have saved its consumers $52 million, and Central Illinois Power would have saved its consumers $3.9 million.

What's more, the tax does not even have a significant impact on consumer energy prices. For example, it's a lower percentage of an average Illinois utility bill (4.4%) than Illinois' own corporate and other taxes (6.6%). What does have a significant impact on consumer energy prices is transportation. Montana is far from markets and is monopolized by a single rail line. Because of this, transportation costs are a higher percentage of an average Illinois utility bill than anything else is.

REGIONAL DIVISION

And let's not limit our discussion to energy resources. Senator Dixon implies that energy resources are uniquely national resources, which should be available to the people of Illinois and elsewhere at the cheapest possible price.

But why only energy resources? Given the principle underlying the Dixon bill, there's really no reasoned basis for distinguishing between taxes on energy resources and taxes on other things. For example, Illinois has some of the richest farmland in the world—worth five times as much, on average, as Montana farmland. Illinois bestrides great waterways and rail lines. It's home to giant banks and agricultural commodity brokerage houses. All these resources are national resources—and certainly in Montana we know how valuable they are, because we don't have them. But we haven't suggested that Illinois can't tax these resources to pay for anything other than the "public costs directly attributable" to them.

Instead, we recognzie that different regions possess different resources, and that it's impossible to accurately calculate who has an advantage over whom.

What's more, it's divisive to even try to make such a calculation. It breeds resentment and bitterness, driving the different regions of our nation further apart.

FEDERAL INTERFERENCE

Perhaps most importantly, the Dixon bill injects the federal government and federal courts into areas where they just don't belong.

Ever since the Constitution was ratified 195 years ago, the Supreme Court has worked out a detailed set of standards for measuring whether a state tax restricts interstate commerce so significantly that it violates the Constitution's Interstate Commerce Clause.

For example, in *Commonwealth Edison v. Montana,* a utility company claimed that Montana's severance tax violated the Interstate Commerce Clause. The Supreme Court disagreed, saying that:

"* * * there can be no question that Montana may constitutionally raise general revenue by imposing a severence tax on coal mined in the State. The entire value of the coal, before transportation, originates in the State, and mining of the coal depletes the resource base and wealth of the State, thereby Diminishing a future source of taxes and economic activity."

But that's apparently not good enough anymore. The Dixon bill would enable federal courts to second-guess state tax decisions that do not impede interstate commerce within the meaning of the Interstate Commerce Clause. In other words, the bill throws 195 years of Constitutional development out the window, imposing a new, untested standard that limits state tax decisions that are within the accepted boundaries of states' rights.

This would set a precedent that ultimately affects all states. As I said before, there's no reason to limit the Dixon bill's principle to severance taxes. All state and local tax decisions could be limited the same way. A recent University of Wyoming study found that Eastern and mid-Western states that produce a lot of manufactured goods, such as Michigan, Wisconsin, Ohio, Pennsylvania, Indiana, New Jersey, and New York have been quite successful exporting taxes. For example, the Michigan single business tax will raise over one billion dollars a year and over $20 billion by 2000; a recent ACIR study stated that one of its benefits is its ability to be exported to other states.

Using Montana's Tax as the standard, any such tax which indirectly affects the cost of a product by more than 0.2 percent to 1.9 percent would become a target.

And the whole process would result in a lawyers' bonanza. The Dixon bill would limit state severance taxes to the costs "directly attributable to production." And it would give "any taxpayer," including corporations, standing to sue to enforce this standard. This invites endless litigation, dragging the states into protracted lawsuits over their every tax decision.

CONCLUSION

Mr. Chairman, you know as well as I do that, back home, the severance tax is not a simple issue. Some people think the tax should be higher. Others think it should be lower. The debate is serious and spirited.

But it's our debate. Like any other state, we want to run our own government, make our own decisions, and manage our own destiny.

The Dixon bill would prevent us from doing that. It's unwise. And it's downright unfair. I'll do all I can to see that the bill doesn't get an inch further.

Senator WALLOP. Good morning. The purpose of our hearing this morning is to receive testimony on S. 463, introduced by our colleague Senator Alan Dixon of Illinois. It is the purpose of this legislation to impose a cap or limit on the rate of State-imposed mineral severance taxes equal to the amount necessary for the State to recover the direct costs associated with the production of the minerals. The notion of limiting State mineral severance taxes is certainly not new to the Senator from Illinois, as this legislation is identical to legislation introduced by the Senator in the last Congress. Indeed, it seems that State mineral severance taxes have been the subject of annual congressional hearings, since I was elected to the Senate nearly 8 years ago. These past hearings, as well as the recent Supreme Court decision on the subject, have focused the issues quite clearly and left the arguments well defined.

This legislation does not challenge the right of States, such as my home State of Wyoming, to impose a mineral severance tax. When a mineral severance tax, or any tax for that matter, is imposed, it is either absorbed by the producer or passed on to the consumer as part of the product or material cóst. If one assumes, as most people do, that taxes are passed on entirely to the consumer, then it is natural to assume that if the consumer resides in another State, the tax is exported. With a majority of Wyoming's mineral production being consumed to fuel the economies of other States, it is logical to assume that at least part of Wyoming's tax will follow that consumption. If you are talking about Wyoming coal, somewhere between 1 and 2 percent of the cost of electrical power produced from that coal typically comes from the State's coal severance tax. If the electrical power or coal is exported, the tax is exported. And now the Senator from Illinois, whose State exports substantially more in taxes than Wyoming raises from all its severance taxes, seeks to limit Wyoming's ability and other States to provide services to its citizens and assist in establishing an economy that will endure in Wyoming after the energy resources are depleted.

Under the direct cost test provided in S. 463, a State like Wyoming could build a highway to a coal mine but not a school for the miners' children. New sewer lines needed to service an energy extraction facility could be run, but no hospital could be built to care for the miner's family. And while the Senator from Illinois has indicated some flexibility in defining this direct cost test, I'm certain that everyone can get a flavor of the problems such a test could create.

Despite the findings of the U.S. Supreme Court to the contrary, this legislation states that mineral severance taxes are a burden to interstate commerce. The Senator has claimed that mineral severance taxes frustrate national energy policy, but one has to wonder if the Senator joined in the chorus calling for Jim Watt's head when it was claimed he was leasing Federal coal lands at too rapid a pace. In reality I do not think it is an issue involving national energy policy or questions of whether Wyoming's or Montana's or any other energy State's severance tax constitutes a burden to interstate commerce. The issue, when all is said and done, is that for this moment in time the so-called energy producing States have something the so-called energy consuming States do not.

For a second in history some States such as Wyoming will have their entire social fabric ripped end to end, their scarce water resources extended to their limit, and their fragile environment tested on a daily basis. When their depletable mineral resources are exhausted, States such as Illinois will go elsewhere for their energy, but their economies will continue. In my home State of Wyoming, if we do not take this time to plan, develop, and diversify for the future, the State will have very little future ahead of it. The accidents of nature have provided Wyoming with some temporary energy resources and Illinois with the Great Lakes and the Mississippi River. Wyoming probably covets the water of the Mississippi as much as Illinois covets our coal, and in reality both are taxed, although it is a little more obvious in one case than another. If we were now to allow some States to limit the legitimate rights of other States we run the risk of creating a sense of regionalism which can only serve to plunge this country into one internal fight after another with no legitimate basis other than to get even. I am certain that is not the intention of my colleague from Illinois. And

I look forward to hearing not only his comments, but the comments of other witnesses who will be appearing here at the hearing this morning.

Senator Long, do you have a statement?

Senator LONG. No, Mr. Chairman.

Senator WALLOP. Senator Baucus.

Senator BAUCUS. Mr. Chairman, this hearing gives us another chance to consider severance taxes and the repeated attempt to limit States' authority to impose them. This time the attempt comes in the form of Senator Dixon's Severance Tax Equity Act, which would limit State severance tax revenues to the public costs directly attributable to the energy extraction industries.

As I said on the Senate floor last year, this proposal is one of the most pernicious attempts to divide the country that I have seen in a long time. Our constitutional system is a federal system designed to delicately balance national and sovereign States rights. To preserve the balance, we must zealously guard sovereign State powers.

The power to tax may be the most important State power of all. As Alexander Hamilton wrote in the Federalist: "The individual States should possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants, and shall retain that authority in the most absolute and unqualified sense."

One severance tax is an especially important tool. In Montana we have seen many extractive industries come and go—gold, copper, silver. When they go, they leave economic chaos like exists now in Butte, MT, since Anaconda suddenly abandoned its mines and smelters. Coal threatens the same chaos. It's a one season harvest. When we were asked to step up development to help the Nation overcome the energy crisis, we in Montana did so. But we also enacted a reasonable severance tax designed to cover current costs, like building roads, schools and sewers, to cover future costs, like reclamation, and to create a trust fund that protects our future generations.

But some people argue that our severance tax is unfair because it's passed along to consumers in Illinois and elsewhere. They imply that we are "blue-eyed Arabs" holding other States hostage. Mr. Chairman, that is patently untrue. It's a gross exaggeration and the sponsors of the bill know so.

Montana doesn't have a captive market. For example, our coal competes vigorously against other coal and against other forms of energy. What is more, the tax does not even have a significant impact on consumer energy prices. For example, it's a lower percentage of an average Illinois utility bill (4.4 percent) than Illinois' own corporate and other taxes (at least 6.6 percent). In fact, since Montana coal is itself captive to the railroad monopolies, transportation costs are a much higher percentage of an average Illinois utility bill than anything else is.

My good friend Senator Dixon implies that energy resources are uniquely national resources which should be available to the people of Illinois and elsewhere at the cheapest possible price. But why only energy resources? Given the principle underlying the Dixon bill, there is really no reasonable basis for distinguishing between taxes on energy resources and taxes on other resources. For example, Illinois has some of the richest farmland in the world. It bestrides great waterways and rail lines. It is home to giant banks and agricultural commodity brokerage houses. All of these resources are national resources. But we haven't suggested that Illinois can't tax these resources to pay for anything other than the public costs directly attributable to them.

Instead, we recognize that different regions possess different resources and that it's impossible to accurately calculate who has an advantage over whom. What's more it is divisive to even try to make such a calculation. It breeds resentment and bitterness, driving the different regions of our Nation further apart.

Perhaps more importantly, the Dixon bill injects the Federal Government and Federal courts into areas where they just don't belong. The Dixon bill would throw 195 years of constitutional development out the window, imposing a new untested standard that limits State tax decisions even when those decisions are within the accepted boundaries of State's constitutional rights under the interstate commerce clause.

This would set a precedent that threatens all States. A recent University of Wyoming study found that Eastern and Midwestern States that produce a lot of manufactured goods, such as Michigan, Wisconsin, Ohio, Pennsylvania, Indiana, New Jersey, and New York, have been very successful exporting taxes. Using Montana's tax as a standard, any such tax which indirectly affects the cost of a product by more than 1.9 percent will become a target. And the whole process results in a lawyers bonanza, dragging the States into protracted law suits over every tax decision.

Mr. Chairman, you know as well as I that, back home in our States, the severance tax is not a simple issue. Some people there think the tax should be higher. Others think it should be lower. The debate is serious and it is spirited. But it is our debate. Like any other State, we want to run our own government, make our own decisions, and manage our own destiny. The Dixon bill would prevent us from doing so. It is unwise, and it is down right unfair. I, Mr. Chairman, will do all I can to see this bill does not get any further.

Thank you.

Senator WALLOP. Thank you, Senator Baucus.

Senator Durenberger.

Senator DURENBERGER. I don't have any at the moment.

Senator WALLOP. I have a letter from the Governor of Wyoming and a Law Review article written by Donald Santa which I would ask be inserted in the record after the statements by the colleagues from both Houses.

[The letter and article follow:]

WYOMING
EXECUTIVE DEPARTMENT
CHEYENNE

ED HERSCHLER
GOVERNOR

June 14, 1984

The Honorable Malcolm Wallop
204 Russell Senate Office Building
Washington, D. C. 20510

Dear Senator Wallop:

Thank you for informing me about the upcoming Senate hearing on Senate 463. Due to scheduling conflicts I will not be able to testify at your Committee hearing.

As you know, I strongly oppose any type of federal legislation which interferes with or restricts a state's ability to set its own tax policies. The states of the west have labored long and hard against interference in our tax policies, and I would strongly urge your committee to let Senate 463 die a quiet death.

The real culprit in rising energy costs is not state severance taxes, it is the ever increasing costs of moving raw materials and the cost of money. As an example, Commonwealth Edison is planning a major shift from coal fired generation to a nuclear based generating emphasis. Commonwealth cites the reason as "the cost of delivering the coal cross country." If history repeats itself, enormous cost over-runs will accompany this shift to nuclear based load production and ultimately the consumer will have to pick up the bill. Other utilities cite the delivered costs as the main problem with the cost of coal based electricity. I guess it is easier to attack the tax policies of one or two states than it is to evaluate the whole spectrum of taxes on energy costs.

To add emphasis to the above statement concerning transportation costs, the Burlington Northern Railroad has applied to the Interstate Commerce Commission for a freight rate of $42.22 per ton for coal shipped from Gillette to Tupelo, Mississippi. On the other hand, coal near Gillette is selling at a contract price of $6.25 per ton, with spot prices as low as $5.75 per ton. Transportation costs are almost seven times as great as the price of coal at mine, yet the fifty eight cents the State of Wyoming will receive in severance taxes will be singled out as the reason for skyrocketing utility bills.

One final point on the issue of coal transportation costs. I believe that the State of Illinois has enacted legislation this year which prohibits utilities in Illinois from passing on to consumers the proposed rate hikes which result from increased rail transportation costs. While I am not sure of the workability or merits of Illinois law, the State of Illinois has recognized that transportation of coal does have a very heavy impact on their utility bills. I would hope that the Congress of the United States recognize this and seriously look into what has happened and will continue to happen as a result of the 1980 Staggers Rail Act.

Aside from the major problem of federal interference into state tax issues, this bill would amount to an administrative headache and a lawyer's gold mine. The "Judicial Review" process established appears to me to subject energy producing states to an unending round of litigation. Further, many states create a greater impact on the cost of energy by levying taxes, such as income tax, sales and property taxes, than do states that levy a severance tax. Illinois generates a greater amount of revenue from sales taxes on electricity from the energy produced from a ton of coal than does Wyoming's severance tax on the coal. Although Illinois based taxes have a greater impact on the end product, they are exempt from challenge.

If Congress wants to wade into the issue of taxes on energy and energy products, let's be fair and investigate the effect of all taxes on energy across the entire spectrum of energy production.

I would strongly urge the Subcommittee on Energy and Agricultural Taxation to let Senate 463 expire as an unwarranted intrusion into state tax issues and as an inequitable and unfounded attack on the State of Wyoming.

Please have this included as part of the record on Senate 463.

Yours sincerely,

EH/wwt

cc: The Honorable Alan K. Simpson
The Honorable Richard Cheney

ANDREWS & KURTH
ATTORNEYS
1747 PENNSYLVANIA AVENUE, N W
WASHINGTON, D.C. 20006
(202) 861-7400
TELEX 79-1208
TELECOPIER (202) 861-7437

TEXAS COMMERCE TOWER
HOUSTON, TEXAS 77002
(713) 220-4200

4400 THANKSGIVING TOWER
DALLAS, TEXAS 75201
(214) 979-4400

June 6, 1984

Roderick A. DeArment
Chief Counsel and Staff Director
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. DeArment:

It was with great interest that I learned that the Subcommittee on Energy and Agricultural Taxation has scheduled a hearing on the Severance Tax Equity Act on June 21, 1984. While a student at the Columbia University School of Law, I authored a case comment entitled "The Incomplete Complete Auto Transit Test: Commerce Clause Analysis in Commonwealth Edison Co. v. Montana," which was published in the Columbia Journal of Environmental Law. My comment examined the issue of severance taxes on energy resources in the aftermath of the Supreme Court decision in Commonwealth Edison Co. v. Montana. A copy of my comment is enclosed and I ask that it be included in the record of the hearing on the Severance Tax Equity Act. Thank you.

Sincerely,

Donald F. Santa, Jr.

Donald F. Santa, Jr.

The Incomplete *Complete Auto Transit* Test: Commerce Clause Analysis in *Commonwealth Edison Co. v. Montana*

I. Introduction

On July 2, 1981, the United States Supreme Court upheld Montana's thirty percent coal severance tax[1] in *Commonwealth Edison Co. v. Montana*[2] against challenges under the commerce and supremacy clauses of the United States Constitution. One observer stated that, as a result of the Court's decision, " 'we face economic Balkanization between the energy-rich and energy-poor regions of our country.' "[3] A study released by a coalition of members of Congress from eighteen northeastern and midwestern states referred to severance taxes as threatening to create " 'a kind of United American Emirates, a group of superstates with unprecedented power to beggar their neighbors in the federal system.' "[4]

By the confluence of several factors, the coal-producing states of the Rocky Mountains have the power to become, in the eyes of their critics, " 'our OPEC within.' "[5] First, Montana and Wyoming contain 40% of the nation's known coal reserves and 68% of low-sulfur coal reserves.[6] Second, these two states occupy a pivotal geographic position in relation to the midwestern and northwestern energy markets.[7] Third, as a combined result of the OPEC oil embargo, federal energy legislation encouraging coal consumption,[8] and federal environmental legislation encouraging the burning of low-sulfur coal,[9] the demand for coal from this region has

[1] MONT. CODE ANN. § 15-35-103 (1981).

[2] 101 S. Ct. 2946 (1981).

[3] N.Y. Times, July 3, 1981, at B12, col. 2.

[4] Washington Post, July 3, 1981, at A1, col. 4.

[5] *Wars Between the States*, TIME, August 24, 1981, at 19.

[6] H.R. REP. No. 96-1527, PT. 1, 96th Cong., 2d Sess. 3 (1980).

[7] *See* J. KRUTILLA, A. FISHER & R. RICE, ECONOMIC AND FISCAL IMPACTS OF COAL DEVELOPMENT: NORTHERN GREAT PLAINS 13-15 (1978).

[8] Energy Policy and Conservation Act of 1975 § 2(6), 42 U.S.C. § 6201(6) (1976); Powerplant and Industrial Fuel Use Act of 1978 § 102(b)(3), 42 U.S.C. § 8301(b)(3) (Supp. II 1978).

[9] Energy Supply and Environmental Coordination Act of 1974 § 7(a), 15 U.S.C. § 793(a)(1976).

dramatically increased.[10] Most significant for present purposes, since 1971 the coal-producing states have increased their severance taxes to unprecedented levels, bringing about a tremendous transfer of money from the coal-consuming states to the coal-producing states.[11]

Awareness of the market power wielded by the coal-producing states caused four Montana coal producers and eleven of their out-of-state utility customers to file suit challenging the constitutionality of Montana's coal severance tax. The Supreme Court evaluated the tax using a four-part test which examined the practical effect of the tax on interstate commerce.

This comment will examine the test employed by the Supreme Court in *Commonwealth Edison* to determine whether the Montana coal severance tax was an unreasonable burden on interstate commerce in violation of the commerce clause of the United States Constitution. In particular, the fourth prong of the test, whether the tax "is fairly related to the services provided by the State,"[12] will be examined.

Part II discusses severance taxes in general and the Montana tax in particular. Part III examines the *Commonwealth Edison* decision in detail. This part describes the four-part test enunciated in *Complete Auto Transit, Inc. v. Brady*,[13] and analyzes its application to the Montana coal severance tax. Part IV suggests an alternative application of the test. Part V delineates the prospects for congressional action on the severance tax issue.

II. SEVERANCE TAXES

A severance tax is a levy upon natural resources at the time they are severed or removed from the soil. The tax can either be a flat rate on the quantity of resource extracted,[14] or a percentage of the value of the resource extracted.[15] The first severance tax in the

[10] For example, in the nine years between 1971 and 1979 the amount of coal strip-mined in Montana rose from 6,983,186 tons to 32,545,071 tons. Commonwealth Edison Co. v. State, 615 P.2d 847, 850 (Mont. 1980), *aff'd*, 101 S. Ct. 2946 (1981).

[11] *See, e.g.*, N.D. CENT. CODE § 57-61-01 (Supp. 1979); MONT. CODE ANN. § 15-35-103 (1981); WYO. STAT. §§ 39-2-202, 39-6-302(a)-(f), 39-6-303(a) (1977 & Supp. 1981).

[12] Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

[13] 430 U.S. 274 (1977).

[14] *See, e.g.*, N.D. CENT. CODE § 57-61-01 (Supp. 1979).

[15] *See, e.g.*, MONT. CODE ANN. § 15-35-103 (1981).

United States was levied in 1846 when Michigan taxed minerals extracted in the state at a rate of 4% of their gross value.[16] Currently, thirty-three states have severance taxes covering the entire range of natural resources.[17] In 1980, $4,167,399,000 in severance taxes were collected by the states, accounting for 3% of total state tax revenues.[18] The range of individual state tax revenues attributable to severance taxes varies from 35.2% of total revenues in Alaska to less than 0.05% in Missouri, Nevada, North Carolina, Virginia and Wisconsin.[19]

The states use their severance tax revenues for a variety of purposes. The states have devoted these revenues to highway construction, support for schools and recreation, land reclamation in mining areas and a variety of other needs.[20] Some states have dedicated their revenues to trust funds for either specific purposes[21] or for general support of the state government.[22] Revenues have also been used to reduce or eliminate state taxes. For example, Alaska, Texas and Wyoming—all of which impose severance taxes—do not have state income taxes.[23] Louisiana has used severance tax revenues to reduce property taxes.[24]

Since mineral resources are nonrenewable, a state may find it prudent to use severance tax revenues to nurture a more permanent base of economic activity.[25] Unlike other economic resources whose production can be taxed more than once, natural resources

[16] *Wars Between the States*, *supra* note 5. *See* 1846 MICH. PUB. ACTS, c.78.

[17] Hagstrom, *The Severance Tax is the Big Gun in the Energy War Between the States*, 13 NAT'L J. 1544, 1545 (1981).

[18] BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATE GOVERNMENT TAX COLLECTIONS IN 1980, at 7 (1981) (Table III) [hereinafter cited as 1980 STATE TAX COLLECTIONS].

[19] *Id.*

[20] *See infra* note 38.

[21] *See, e.g.*, N.D. CENT. CODE § 57-62-02 (Supp. 1981).

[22] *See, e.g.*, COLO. REV. STAT. § 39-29-108 (Supp. 1981).

[23] *Wars Between the States*, *supra* note 5. *See also* N.Y. Times, June 5, 1981, at A10, col. 1.

[24] *Federal Preemption of State Energy Policies: Hearings Before the Subcomm. on Limitations of Contracted and Delegated Authority of the Senate Comm. on the Judiciary*, 96th Cong., 2d Sess. 23 (1980) (statement of Byron Dorgan)[hereinafter cited as *Federal Preemption Hearings*].

[25] One of the stated objectives of the Montana coal severance tax is " 'to invest in the future, when new energy technologies reduce our dependence on coal and mining activity may decline.' " Commonwealth Edison Co. v. Montana, 101 S.Ct. 2946, 2969-70 n.13 (Blackmun, J., dissenting) (quoting Joint Conference Committees, Montana State Legislature, Statement to Accompany the Reports of the Free Joint Conference Committee on Coal Taxation, at 1).

such as coal, petroleum and natural gas are nonrenewable and can be taxed only once. The severance of these resources is a permanent loss to the state, and this loss must be compensated for in severance taxes. With the revenues from severance taxes, a state can promote new economic opportunities to replace those irretrievably lost by the extraction of natural resources.[26]

In 1980, 90% of the nation's severance taxes were derived from energy-related resources and 88.6% of the nation's total severance tax revenues went to eight energy producing states—Texas, Louisiana, Alaska, New Mexico, Kentucky, Florida and Wyoming.[27] The highest severance taxes are levied by three coal-producing states in the Northern Great Plains region. Montana has a maximum 30% tax on coal.[28] Wyoming state and local ad valorem taxes on coal total 17.5%.[29] North Dakota has a flat rate tax on lignite which is the equivalent of between 14 and 17% of value.[30] However, the rate of the severance tax levied by a state tells only part of the story. While the rates at which Montana, Wyoming and North Dakota levy their severance taxes are the highest in the nation, the severance taxes on all resources collected by these three states accounted for only 6% of the nation's severance tax revenues in 1980.[31]

Montana has levied a coal severance tax since 1921.[32] Immediately prior to the enactment of the current severance tax schedule in 1975,[33] the severance of Montana coal was taxed at a flat rate of

[26] Note, *An Outline For Development of Cost-Based State Severance Taxes*, 20 NAT. RESOURCES J. 913, 926–27 (1980).

[27] Hagstrom, *supra* note 17, at 1545. These figures do not include West Virginia's gross receipts tax on coal which is not classified as a severance tax. The severance tax totals also do not include property, sales and income taxes derived from energy production.

[28] MONT. CODE ANN. § 15-35-103 (1981).

[29] WYO. STAT. §§ 39-2-202, 39-2-402, 39-6-302(a)-(f), 39-6-303(a) (1977 & Supp. 1981). *See* Commonwealth Edison v. Montana, 101 S.Ct. 2946, 2966 n.5 (19P1).

[30] N.D. CENT. CODE § 57-61-01 (Supp. 1979). By comparison, Alaska taxes oil at 12.25%, ALASKA STAT. § 43.55.011 (1962 & Supp. 1981), and natural gas at 10%, *id.* § 43.55.016, and Texas taxes oil at 4.6%, TEX. TAX CODE ANN. § 201.052 (Vernon 1979), and natural gas at 7.5%. *Id.* § 202.052.

[31] 1980 STATE TAX COLLECTIONS, *supra* note 18, at 7 (Table III). In comparison, Texas alone accounted for 36.6% of the nation's severance tax revenues in 1980. *Id.* In per capita terms, in 1980, Montana collected $129.30 in severance taxes per state resident and Texas collected $107.19 in severance taxes per state resident. *See id.*; BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, 1980 CENSUS OF POPULATION AND HOUSING: UNITED STATES SUMMARY, ADVANCE REPORTS (1981).

[32] Commonwealth Edison Co. v. Montana, 101 S.Ct. 2946, 2951 (1981). *See* 1921 Mont. Laws c.155.

[33] MONT. CODE ANN. § 15-35-103 (1981).

approximately $0.34 per ton.[34] Under the 1975 amendment, coal mined within the state is taxed at rates varying between 3 and 30% of the coal's value, depending upon the energy content of the coal and the method by which it is extracted.[35] A producer's first 20,000 tons of annual production are exempt from the tax.[36]

In the 1976 general election, Montana voters approved a constitutional amendment adding a new section to the 1972 Montana Constitution. This section provides that after December 31, 1979, at least 50% of the coal severance tax revenues will be deposited in a trust fund, the principal of which is to remain inviolate unless appropriated by 75% of each house of the state legislature.[37] The coal severance tax trust fund is not earmarked for any specific purpose, but rather is intended to support the state government in perpetuity. The remaining severance tax revenues are appropriated according to a statutory formula.[38]

In 1980, Montana collected $94.6 million from its combined severance taxes,[39] which represented 21.7% of the state's total tax revenues.[40] This amount was a marked increase over 1979,[41] and a phenomenal increase over 1970.[42] To date, $54 million has been

[34] Commonwealth Edison Co. v. Montana, 101 S.Ct. 2946, 2965 n.3 (1981) (Blackmun, J., dissenting). Even prior to 1975 Montana and its local governments imposed higher taxes on the production of coal than any other state. *Id.* at 2965 n.4.

[35] MONT. CODE ANN. § 15-35-03(1) (1981). Surface-mined coal is taxed at a maximum rate of 30% of its contract sales price, and underground-mined coal is taxed at a maximum rate of 4% of its contract sales price. *Id.* Contract sales price is defined as "either the price of coal extracted and prepared for shipment f.o.b. mine, excluding that amount charged by the seller to pay taxes paid on production, or a price imputed by the department [of revenue] under 15-35-107." MONT. CODE ANN. § 15-35-102(1) (1981).

[36] *Id.* § 15-35-103(3).

[37] MONT. CONST., art. IX, § 5.

[38] *See* MONT. CODE ANN. § 15-35-108(1981). Revenues from the Montana coal severance tax not dedicated to the trust fund are allocated in the following percentages of the remaining balance: 37.5% for the local impact and education trust fund; 4.5% for alternative energy research development and demonstration; 10% for state equalization aid to public schools; 5% for cultural affairs and parks; 2.5% for renewable resource development bonds; 1% for county land planning; and any remainder to the general fund of the state.

[39] Montana also levies a 5% severance tax on oil and a 2.65% severance tax on natural gas. MONT. CODE ANN. § 15-36-101 (1979).

[40] 1980 STATE TAX COLLECTIONS, *supra* note 18, at 7 (Table III).

[41] In 1979, $53.9 million in severance taxes were collected, representing 13.5% of the state's revenues. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE STATE GOVERNMENT TAX COLLECTIONS IN 1979, at 7 (1980) (Table III).

[42] In 1970, $4.73 million in severance taxes were collected, representing 3.6% of the state's revenues. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE STATE TAX COLLECTIONS IN 1970, at 7 (1970) (Table III).

deposited in the coal severance tax trust fund.[43] The severance tax is not the only tax levied on Montana coal production.[44] In addition to revenues generated by state taxes, Montana receives large amounts of coal mining revenue from the federal government under the Mineral Lands Leasing Act of 1920 ("MLLA").[45]

III. *COMMONWEALTH EDISON CO. V. MONTANA*

A. *The Decision*

In 1978, four Montana coal producers and eleven of their out-of-state utility customers brought suit in Montana state court challenging the Montana coal severance tax on grounds that it was invalid under the commerce[46] and supremacy[47] clauses of the United States Constitution. Prior to receiving evidence, the state district court granted Montana's motion to dismiss for failure to state claims upon which relief could be granted.[48] The producers and utilities appealed to the Montana Supreme Court, which affirmed the lower court's decision.[49]

The state supreme court rejected Commonwealth Edison's supremacy clause challenge, which alleged that the severance tax was preempted by the federal government and that it frustrated national policies contained in the MLLA. The court concluded that plaintiffs' mere statement that the Montana severance tax frustrated national policy was insufficient because plaintiffs failed to specify any federal statute substantially frustrated by the tax.[50] In response to the allegation that the severance tax frustrated national

[43] Hagstrom, *supra* note 17, at 1545.

[44] Montana imposes a gross proceeds tax of 33 or 45%, MONT. CODE ANN. § 15-6-132 (1981), a resource indemnity trust tax of 0.5% of the gross value of production in excess of $5,000, *id.* § 15-38-104, a property tax of 11% on the value of mining equipment, *id.* § 15-6-138(b), and a corporate license tax, *id.* § 15-31-101.

[45] 30 U.S.C. §§ 22, 48, 49, 171, 181-194, 201-209, 223-229, 229a, 241, 251, 261-263, 352 (1976 & Supp. III 1978). Under this statute, 50% of the royalties from in-state federal lands leased for mining is returned to the state and another 40% of the revenue from federal leases is returned to the state through a reclamation fund. Furthermore, areas affected by increased coal production are eligible for federal grants under § 601 of the Powerplant and Industrial Fuel Use Act of 1978, 42 U.S.C. 4 § 8401 (Supp. II 1978).

[46] U.S. CONST., art. I, § 8, cl. 3.

[47] U.S. CONST., art. VI, cl. 2.

[48] Commonwealth Edison Co. v. State, 615 P.2d 847, 848-49 (Mont. 1980), *aff'd*, 101 S.Ct. 2946 (1981).

[49] *Id.* at 863.

[50] *Id.* at 860-61.

policy under the MLLA, the court stated that the statute specifically allowed for state taxation[51] and that this allowance had been upheld by the United States Supreme Court in *Mid-Northern Oil Co. v. Walker.*[52]

The Montana Supreme Court also held that the tax was not subject to commerce clause scrutiny, reasoning that the severance of coal from the soil was an activity preceding the entry of the coal into interstate commerce.[53] The court relied on a trilogy of United States Supreme Court decisions[54] from the 1920's which employed similar reasoning to uphold state severance taxes against commerce clause challenges.[55] The court rejected the utilities' contention that the Supreme Court had retreated from these decisions, but, for the sake of argument, applied a test advocated by the utilities and enunciated in *Complete Auto Transit, Inc. v. Brady.*[56] That decision set forth a four-part test which evaluates the practical impact of a state tax on interstate commerce. The court found that the utilities could not have prevailed even under the *Complete Auto Transit* test.[57]

The leading case of the trilogy on which the Montana court relied was *Heisler v. Thomas Colliery Co.*[58] The case involved a Pennsylvania tax on anthracite coal, 80% of which was shipped out of state. The plaintiff challenged the tax on the grounds that by taxing anthracite coal and not bituminous coal the state was making an arbitrary classification in violation of the equal protection clause of the fourteenth amendment. Plaintiff also argued that because most of the anthracite coal was shipped out of state, the tax was a discriminatory burden on interstate commerce in violation of the commerce clause. The Supreme Court held that because anthracite and bituminous coal had different properties there was a rational basis for the tax's distinction. Consequently, the tax did not violate

[51] *Id.* at 862.

[52] 268 U.S. 45, 49-50 (1925).

[53] Commonwealth Edison Co. v. State, 615 P.2d 847, 857 (Mont. 1980), *aff'd*, 101 S.Ct. 2946 (1981).

[54] Hope Natural Gas Co. v. Hall, 274 U.S. 284 (1927); Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923); Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922).

[55] Commonwealth Edison Co. v. State, 615 P.2d 847, 851 (Mont. 1980), *aff'd*, 101 S.Ct. 2946 (1981).

[56] 430 U.S. 274 (1977). *See infra* text accompanying notes 81-91.

[57] Commonwealth Edison Co. v. State, 615 P.2d 847, 856 (Mont. 1980), *aff'd*, 101 S.Ct. 2946 (1981).

[58] 260 U.S. 245 (1922).

the equal protection clause.[59] The Court further held that no commerce clause claim could be made because the coal had not yet entered interstate commerce.[60] The Montana Supreme Court relied upon the latter holding in sustaining Montana's coal severance tax.

Commonwealth Edison appealed the decision of the Montana Supreme Court to the United States Supreme Court,[61] which granted review.[62] Although the Supreme Court upheld the Montana coal severance tax,[63] it rejected the Montana Supreme Court's reliance on *Heisler*. The Court agreed with appellants that *Heisler* had been undermined by more recent cases rejecting the notion that a state tax or regulation affecting interstate commerce was immune from commerce clause scrutiny because it attached only to a local activity.[64] Because the economic effects of a severance tax could not be distinguished from other taxes that had been subjected to commerce clause scrutiny, the Court held that the Montana tax must be evaluated under the four-part test of *Complete Auto Transit*. After conducting its own analysis of the severance tax under the criteria of the four-part test, the Court agreed with the Montana court's alternative holding that the appellants' commerce clause claim could not have prevailed under the *Complete Auto Transit* test.[65]

Turning to appellants' challenge under the Supremacy Clause, the Court held that while federal statutes encourage coal use, there

[59] *Id.* at 255.

[60] *Id.* at 261. *Heisler* remained the controlling case in the field of state energy resources taxation for 60 years.

[61] Pursuant to 28 U.S.C. § 1257(2)(1976), the Supreme Court will review decisions by appeal if a state court has upheld a state statute against a claim that it is repugnant to the Constitution, treaties or laws of the United States.

[62] Commonwealth Edison Co. v. Montana, 101 S.Ct. 607 (1980). Appeal to the Supreme Court under 28 U.S.C. § 1257(2) is ostensibly a matter of right. However, as with certiorari, it is essentially discretionary. "[I]n most cases'the Court summarily affirms, or dismisses the appeal for want of a substantial federal question. Thus while such dispositions represent decisions on the merits, they are of scant comfort to the appellant who has obtained no relief." C. WRIGHT, HANDBOOK OF THE LAW OF FEDERAL COURTS 551 (3d ed. 1976).

[63] Commonwealth Edison Co. v. Montana, 101 S.Ct. 2946, 2964 (1981). The Court affirmed the Montana Supreme Court in a 6–3 decision. Justice Marshall wrote the majority opinion, Justice White wrote a concurring opinion, and Justices Powell and Stevens joined in Justice Blackmun's dissent.

[64] *Id.* at 2952. The Court cited Hunt v. Washington Apple Advertising Comm'n., 432 U.S. 333, 350 (1977); Pike v. Bruce Church, Inc., 397 U.S. 137, 141-42 (1970); Nippert v. City of Richmond, 327 U.S. 416, 423-24 (1946).

[65] *Commonwealth Edison*, 101 S.Ct. at 2960.

was no proof that Congress intended to preempt all state activity in the area of coal development. To the contrary, the Court found that the MLLA and a Supreme Court decision established that Congress envisioned a role for the states.[66] In section 32 of the MLLA,[67] Congress had expressly permitted states to impose taxes on federal lessees. The Court in *Mid-Northern Oil Co. v. Walker*[68] had held that under section 32 the states could "levy and collect taxes as though the government were not concerned."[69]

The Court also held that the tax was not inconsistent with the Powerplant and Industrial Fuel Use Act of 1978.[70] Section 601(a)(2)[71] of the Act anticipated the continued existence of state severance taxes, and the legislative history shows that Congress enacted the statute with the Montana coal severance tax in mind.[72] Thus, the Court concluded that the appellants had failed to prove that the tax violated either the commerce or the supremacy clause, or that a trial was necessary to determine the constitutionality of the tax.[73]

Justice Blackmun's dissent was based on the premise that a "tailored tax"[74] deserves careful scrutiny and that because the coal severance tax was such a tax, the appellants deserved a trial on the facts.[75] Justice Blackmun recited several factors that vouched for the substantiality of the appellants' commerce clause claim. These

[66] *Id.* at 2961.

[67] 30 U.S.C. § 189 (1976).

[68] 268 U.S. 45 (1925).

[69] *Id.* at 49.

[70] 42 U.S.C. §§ 8301-8483 (Supp. II 1978).

[71] 42 U.S.C. § 8401(a)(2) (Supp. II 1978).

[72] *See* H.R. Rep. No. 95-1749, 95th Cong., 2d Sess. 93 (1978) (conference report), *reprinted in* [1978] U.S. Code Cong. & Ad. News 8760, 8786.

[73] *Commonwealth Edison*, 101 S.Ct. at 2964. Justice White's short concurring opinion stated that because Congress has the power to protect interstate commerce from intolerable burdens, he felt that "the better part of both wisdom and valor is to respect the judgment of the other branches of the Government." *Id.* White noted that Congress was aware of the problem, that it had not acted and that the Solicitor General had counselled against overturning the tax. However, he conceded that there was force to the argument that the tax was unconstitutional in light of the fact that most of the Montana tax was collected on coal mined on federal lands and that the federal government shared royalties with the state and returned money through the reclamation fund. *Id.*

[74] The term "tailored tax" is derived from a footnote in *Complete Auto Transit*, 430 U.S. at 288 n.15, which states that state taxes on interstate business are susceptible to tailoring to subject interstate business to effects forbidden by the commerce clause and therefore should be subject to careful scrutiny by the courts.

[75] *Commonwealth Edison*, 101 S.Ct. at 2964-65.

factors included the pivotal position of Montana in the low-sulfur coal market, the substantial revenues generated by the tax, the legislative history of the 1975 tax schedule and a congressional committee's finding[76] that the Montana severance tax revenues were far in excess of the cost of coal development.[77] He agreed that the *Complete Auto Transit* test was the correct standard to apply but argued that the Court had misapplied the test so as to make it ineffectual with regard to the coal severance tax.[78] Justice Blackmun observed that while a trial on the tax's validity would require complex factual inquiries, this was not beyond judicial competence.[79] He concluded that deference to Congress was an inadequate judicial response since the severance tax question involved the most serious issues of federalism.[80]

B. *The Complete Auto Transit Test*

In 1977, Justice Blackmun wrote a unanimous opinion for the Court in *Complete Auto Transit, Inc. v. Brady*,[81] which enunciated a four-part test for ascertaining whether a state tax was an unreasonable burden on interstate commerce. The case involved an action by a Michigan corporation, Complete Auto Transit, Inc. ("Complete Auto"), which transported motor vehicles, within the state of Mississippi, from manufacturers to dealers.

Complete Auto challenged the validity of Mississippi's 5% tax on gross income earned by doing business within the state.[82] The corporation claimed that transport of vehicles within Mississippi was part of interstate commerce, and relied on the rule set forth in *Spector Motor Service v. O'Connor*.[83] That rule held that a tax on

[76] H.R. REP. No. 96-1527, PT. 1, 96th Cong., 2d Sess. 2 (1980).

[77] *Commonwealth Edison*, 101 U.S. at 2965-67.

[78] *Id.* at 2968.

[79] *Id.* at 2971.

[80] *Id.* at 2971-72.

[81] 430 U.S. 274 (1977).

[82] 430 U.S. at 275-76. *See* MISS. CODE ANN. § 27-65-13 (1972).

[83] 340 U.S. 602 (1951). In *Spector*, Connecticut imposed a tax upon the privilege of doing business within the state measured by apportioned net income. Some of the shipments of Spector Motor Service, a Missouri corporation engaged exclusively in interstate trucking, originated or terminated in Connecticut. The company brought suit to enjoin the collection of the tax. The Supreme Court held the tax unconstitutional as applied to what was exclusively interstate commerce.

the privilege of engaging in an activity may not be applied to an activity that is part of interstate commerce.[84]

The *Complete Auto Transit* Court affirmed the decision of the Supreme Court of Mississippi,[85] thus upholding the privilege tax and overruling *Spector.*[86] The Court overruled the *Spector* rule because it rejected the premise that interstate commerce was absolutely immune from taxation: "the *Spector* rule [did] not address the problems with which the Commerce Clause is concerned."[87] The Court noted that the *Spector* rule bore no relationship to economic realities because it looked only to the fact that the incidence of the tax was the privilege of doing business rather than to the practical effect of the tax upon interstate commerce.[88]

In *Complete Auto Transit*, Mississippi's citation of decisions[89] applying a practical analysis proved persuasive. The Court viewed its holdings in these cases as having "sustained a tax against Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State."[90]

In deciding *Complete Auto Transit*, the Court did not apply its four-part test to the concrete facts of the case, because the appellant failed to allege that the criteria had not been met.[91] Thus, the

[84] In *Complete Auto Transit*, 430 U.S. at 279, the State of Mississippi cited a series of Supreme Court decisions for the propositions that the commerce clause was not intended to relieve interstate commerce of its just share of state tax burdens and that state taxes would be evaluated on the basis of their practical effect on interstate commerce rather than on the formal language of the tax statute. General Motors Corp. v. Washington, 377 U.S. 436 (1964); Northwestern Cement Co. v. Minnesota, 358 U.S. 450 (1959); Memphis Gas Co. v. Stone, 335 U.S. 80 (1948); Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940); Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938).

[85] Complete Auto Transit, Inc. v. Brady, 330 So.2d 268 (Miss. 1976), *aff'd*, 430 U.S. 274 (1977).

[86] *Complete Auto Transit*, 430 U.S. at 288-89.

[87] *Id.* at 288.

[88] Over the years the *Spector* rule had been narrowed to one of draftsmanship and phraseology, with the Court increasingly using a practical analysis of the impact a state tax had on interstate commerce. *See* Colonial Pipeline Co. v. Traigle, 421 U.S. 100 (1975); Northwestern Cement Co. v. Minnesota, 358 U.S. 450 (1959); Railway Express Agency v. Virginia, 358 U.S. 434 (1959).

[89] *Complete Auto Transit*, 430 U.S. at 279. *See supra* note 85.

[90] *Complete Auto Transit*, 430 U.S. at 279.

[91] In the opinion, the four criteria of the *Complete Auto Transit* test were spelled out twice: first, in stating that appellant had failed to allege that the criteria had not been satisfied, *id.* at 277-78, and second, in the aforementioned passage pertaining to the practical analysis of the effect of state taxes on interstate commerce. *Id.*at 279.

result in *Complete Auto Transit* is of little help in applying the four-part test to subsequent cases.

C. *The Complete Auto Transit Test and the Montana Coal Severance Tax*

Prior to *Commonwealth Edison*, the Court's decisions[92] applying the *Complete Auto Transit* test had focused on the threshold question of a state's right to levy any tax on the interstate commerce in question.[93] *Commonwealth Edison* was the first case in which the Court applied the fourth prong of the test to a claim that the rate of a tax exceeded the value of services provided by the state, and thus was not fairly related to them.[94] Appellants in *Commonwealth Edison* did not contest Montana's right to levy a coal severance tax. Rather they contested the rate of the tax as being discriminatory against interstate commerce and as not being fairly related to the services provided by the state.

Commonwealth Edison Co. ("the Company") argued first that the tax was discriminatory because its burden was borne primarily by out-of-state consumers,[95] an argument addressed to the third prong of the *Complete Auto Transit* test. The Court was unconvinced. It noted that appellants' argument ran counter to the premise underlying the Court's discrimination decisions, that "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States."[96] For purposes of interstate and foreign

[92] *See, e.g.*, Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980); National Geographic Society v. California Bd. of Equalization, 430 U.S. 551 (1977).

[93] In Maryland v. Louisiana, 101 S.Ct. 2114 (1981), appellants argued that there was not a sufficient relation between the services provided by the state and the Louisiana first use tax. However, because the Court found the tax to be discriminatory it did not have to address this issue. *Id.* at 2133 n.27.

[94] *Cf.* Japan Line Ltd. v. County of Los Angeles, 441 U.S. 434 (1979); Department of Revenue of Wash. v. Association of Wash. Stevedoring Cos., 435 U.S. 734 (1978); National Geographic Society v. California Bd. of Equalization, 430 U.S. 551 (1977).

[95] Appellants asserted that because 90% of Montana coal was shipped out of state under contracts that shifted the burden to out-of-state utility customers, the tax discriminated against interstate commerce. The Court treated appellant's discrimination theory as a variant of their claim under the fourth prong of the *Complete Auto Transit* test because, in light of the fact that appellants conceded that some severance tax could be levied, their claim pertaining to the excessiveness of the tax burden borne by out-of-state consumers was identical to a claim that the tax was not fairly related to the services provided by the state. *Commonwealth Edison*, 101 S.Ct. at 2954-55.

[96] *Commonwealth Edison*, 101 S.Ct. at 2954 (quoting McLeod v. J.E. Dilworth Co., 322 U.S. 327, 330 (1944)).

commerce, state borders are virtually irrelevant. Thus, to strike down the Montana tax solely because most of the state's coal was shipped out of state would be irreconcilable with the goal of promoting free trade which underlies the commerce clause. Furthermore, the Court stated that there was no basis for any claim that the commerce clause gives any state a right of access to resources of another state at reasonable prices.[97]

The Company's second claim, that Montana's coal severance tax revenues far exceeded the value of state services provided to the coal mining industry, was addressed to the fourth prong of the *Complete Auto Transit* test. Commonwealth Edison argued that it was entitled to an opportunity to prove that the tax was not fairly related to costs pertaining to mining.

The Court rejected this argument because it had accepted the Montana Supreme Court's characterization of the coal severance tax as a general revenue tax.[98] In so doing, the Court disregarded a separate body of case law involving state-imposed charges linked to the use of state-owned or state-provided services or facilities—user fees.[99] The states have considerable latitude in imposing general revenue taxes because there is no due process clause requirement that the amount of revenue generated by an activity must correspond to the value of services provided by that activity. In support of this proposition, the Court quoted from its decision in *Carmichael v. Southern Coal & Coke Co.:*[100]

> A tax is not an assessment of benefits. It is, as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes.[101]

[97] *Commonwealth Edison*, 101 S.Ct. at 2955.

[98] The Court stated, "appellants have completely misunderstood the nature of the inquiry under the fourth prong of the *Complete Auto Transit* test." *Id.* at 2956. In further response to appellants' argument that the fourth prong of the *Complete Auto Transit* test necessitated an inquiry into the relationship between coal severance tax revenues and coal development costs, the Court observed that tax rates were a matter for legislative determination and that it was unlikely a legal test could be devised for the determination of acceptable levels of state taxation. It was noted that under the federal arrangement it was up to the Congress to determine when state tax policies were adverse to the national interest. *Id.* at 2959.

[99] *Id.* at 2956.

[100] 301 U.S. 495 (1937).

[101] *Id.* at 522.

This great latitude in taxation, the Court reasoned, is not forfeited because the activity taxed is in interstate commerce.[102]

The majority determined that the fourth prong of the test derived from decisions holding that the controlling question was whether an activity was taxed in relation to the opportunities provided by the taxing state.[103] Clarifying the fourth prong of *Complete Auto Transit*, the Court held that the relevant inquiry was whether the measure of the tax was reasonably related to the taxpayer's activities in the state.[104] Under the Court's formulation, the inquiry under the fourth prong was a development of the inquiry conducted under the first prong, that is, whether the taxpayer had a substantial nexus with the taxing state. The first prong was satisfied because the operating incidence of the tax was on the mining of coal within the state; the fourth prong was satisfied because the tax was based on a percentage of the value of the coal extracted in the state, and, therefore, was clearly reasonably related to the taxpayer's contact with the state.[105]

Justice Marshall's opinion for the majority was quite broad and did not examine the motivation underlying the Montana coal severance tax. It glossed over the contradictions between the legislative history and the Montana Supreme Court decision and labelled, without independent analysis, the coal tax a general revenue tax. The majority failed to give any reason for so readily deferring to the Montana Supreme Court's characterization.[106]

The Court was under no obligation to accept the state court's categorization of the tax. In *La Costa v. Department of Conservation*,[107] the Court stated:

> This court will determine for itself what is the necessary operation and effect of a state law challenged on the ground that it interferes with or burdens interstate commerce. The name, description or characterization given it by the legislature or the courts of the state will not necessarily control. Regard must be had to the substance of the measure rather than its form.[108]

[102] *Commonwealth Edison*, 101 S.Ct. at 2956–57.

[103] *Commonwealth Edison*, 101 S.Ct. at 2958, n.14 (citing General Motors Corp. v. Washington, 377 U.S. 436 (1964); Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)).

[104] *Id.* at 2958.

[105] *Id.*

[106] *See id.* at 2956.

[107] 263 U.S. 545 (1924).

[108] *Id.* at 550 (citations omitted).

Yet, in *Commonwealth Edison* there is no evidence the Court considered alternative characterizations of the Montana coal severance tax, such as that of a user fee or, perhaps, a hybrid category blending elements of a general revenue tax with those of a user fee.[109]

Perhaps the Court's reluctance to address the substantiality of appellants' claims can be explained by the introduction in Congress of bills to address the issue,[110] and by the belief that the Court should steer clear cf the complex factual questions involved until it was clear that the legislative branch would not act on the question.

The Court's failure to account for the differences between a challenge to the rate of a tax on interstate commerce and a challenge to a state's right to levy any tax on interstate commerce, and its failure to adjust accordingly the analysis under the fourth prong of the *Complete Auto Transit* test, undermined its decision in *Commonwealth Edison*. Under the Court's formulation, the fourth prong collapses into the first prong whenever a state levies an ad valorem tax. How can this be called a test of a tax's practical effect on interstate commerce?

IV. The Blackmun Dissent and an Alternative Test

In his dissenting opinion, Justice Blackmun contended that the Court's application of the *Complete Auto Transit* test emasculated the test's fourth prong. Under the Court's reasoning, any ad valorem tax, no matter how high, would satisfy the "fairly related" test. This formulation, he observed, was just as "mechanical" as the discredited *Heisler v. Thomas Colliary Co.*[111] test.[112] Nothing in the Court's prior decisions dictated such a reformulation of the fourth prong. Justice Blackmun contended that the two cases relied upon by the majority[113] both dealt solely with the existence of a substantial nexus between the taxpayer and the taxing state, not with the "fairly related" question.[114]

[109] Furthermore, the Court failed to acknowledge that appellants' challenge was unlike any previous case in which the Court had applied the *Complete Auto Trcnsit* test.

[110] S. 2695, 96th Cong., 2d Sess. (1980), 126 Cong. Rec. S5306 (daily ed. May 14, 1980); H.R. 7163, 96th Cong., 2d Sess. (1980); H.R. 6654, 96th Cong., 2d Sess. (1980); H.R. 6625, 96th Cong., 2d Sess. (1980).

[111] 260 U.S. 245 (1922). *See supra* text accompanying notes 58-60.

[112] *Commonwealth Edison*, 101 S.Ct. at 2968.

[113] *See id.* at 2958 n.14 (citing General Motors Corp. v. Washington, 377 U.S. 436 (1964); Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)).

[114] *Commonwealth Edison*, 101 S.Ct. at 2968 n.12.

Justice Blackmun took issue with the majority's characterization of the Montana coal severance tax as a general revenue tax. Language in the Montana Supreme Court decision stated that the tax was intended partially to compensate the state for coal development costs;[115] in addition, the report of a conference committee of the Montana legislature listed support of the general fund as only one of three objectives of the 1975 amendment.[116]

Justice Blackmun noted that, in the past, the Court had looked behind facially neutral and properly apportioned state taxes, and that in *Michigan-Wisconsin Pipe Line Co. v. Calvert*[117] such a tax was invalidated. In *Calvert*, the Court responded to the state's argument that it conferred benefits on the taxpayer by saying that this was sufficient only to get the tax past the due process hurdle, and that the Court still must inquire into the impact of the tax on interstate commerce.[118]

While a trial on the validity of the Montana coal severance tax would involve "complex factual inquiries,"[119] Justice Blackmun believed such an inquiry to be within judicial competence. He suggested that the following test be applied:

> If the tax is in fact a legitimate general revenue measure identical or roughly comparable to taxes imposed upon similar industries, a court's inquiry is at an end; on the other hand, if the tax singles out this particular interstate activity and charges it with a grossly disproportionate share of the general costs of government, the court must determine whether there is some reasonable basis for the legislative judgment that the tax is necessary to compensate the State for the particular costs imposed by the activity.[120]

Justice Blackmun's dissent was correct in stating that the Court's formulation of the fourth prong of the *Complete Auto Transit* test "is no less 'mechanical' than the approach entertained in *Heisler*."[121] Under the majority's formulation[122] any ad valorem

[115] *Id.* at 2969 n.13 (citing Commonwealth Edison v. State, 615 P.2d 847, 850, 855 (Mont. 1980), *aff'd*, 101 S.Ct. 2946 (1981)).

[116] *Commonwealth Edison*, 101 S.Ct. at 2969 n.13.

[117] 347 U.S. 1954 (1954).

[118] *Id.* at 163-64.

[119] *Commonwealth Edison*, 101 S,Ct. at 2971.

[120] *Id.* at 2971-72.

[121] *Commonwealth Edison*, 101 S.Ct. at 2968.

[122] "When a tax is assessed in proportion to a taxpayer's activities or presence in a State, the taxpayer is shouldering its fair share of supporting the State's provision of 'police and fire protection, the benefit of a trained work force, and "the advantages of a civilized society," ' " *Id.* at 2959 (quoting Exxon Corp. v. Wisconsin Dep't. of Revenue, 447 U.S. 207, 228 (1980) (quoting Japan Line Ltd. v. County of Los Angeles, 441 U.S. 434, 445 (1979))).

tax would be upheld. So long as a tax is proportional, the inquiry under the fourth prong goes no further than the substantial nexus inquiry under the first prong of the *Complete Auto Transit* test. Furthermore, under the Court's formulation, so long as a tax is facially neutral the discrimination inquiry of the third prong of the *Complete Auto Transit* test will never be an issue.

Commonwealth Edison was the first case in which the Court applied the *Complete Auto Transit* test to a challenge to both a severance tax and to the amount of a tax. If the test is to be of any significance in addressing these issues, some refinement of the fourth prong is necessary. One possibility would be to discard the distinction between general revenue taxes and user fees when evaluating severance taxes. There is some evidence that abandoning the distinction is appropriate.

First, two user fee cases were cited in the *Complete Auto Transit* opinion in reference to the criteria of the four-part test. In *Ingels v. Morf*,[123] the Court struck down the California "Caravan Act," a statute requiring vehicles moving on state highways to obtain a permit, as an unconstitutional burden on interstate commerce. The Court held that for a state to justify exacting a payment which burdens interstate commerce. it must affirmatively appear that the payment is demanded as a reimbursement for the expense of facilities or regulations which the state is constitutionally empowered to provide. The fee was struck down because plaintiff had carried the burden of showing that the charge was excessive in relation to the value of the services provided.

In *Clark v. Paul Gray, Inc.*,[124] a subsequent enactment of the "Caravan Act" was upheld. The Court held that the state was not required to compute with mathematical precision the cost of services necessitated by caravan traffic. If fees do not appear manifestly disproportionate to the services provided, a court cannot say the fees are excessive.

Comparing the user fee decisions with the other decisions relied on to arrive at the tests in *Complete Auto Transit*,[125] it is apparent

[123] 300 U.S. 290 (1937).

[124] 306 U.S. 583 (1939).

[125] 430 U.S. 274, 278 n.6, 279 n.9 (1977). The Court cited Boston Stock Exchange v. State Tax Comm'r, 429 U.S. 318 (1977) (tax imposing greater liability on out-of-state sales than on in-state sales held to discriminate against interstate commerce); General Motors Corp. v. Washington, 377 U.S. 436 (1964) (tax on unapportioned gross receipts from wholesale sales to in-state dealers held reasonably related to taxpayer's in-state activities); Illinois Cent. R. Co. v. Minnesota, 309 U.S. 157 (1940) (tax on railroad's earnings from in-state

that the former were cited as challenges to the sufficiency of the relation between taxes and the services provided by the state. In *Ingels v. Morf* and *Clark v. Paul Gray, Inc.*, the Court inquired into the substantive relation between a taxpayer's in-state activities and the value of services provided by the state. At the very least, these two decisions show that the requirement set down by the fourth prong can be given a "narrow" interpretation as well as the "broad" interpretation employed by the Court in *Commonwealth Edison.*[126] Indeed, the majority's assertion in *Commonwealth Edison* that the "fairly related" test is derived from decisions in which the controlling test was whether commerce was taxed in relation to its presence in the taxing state[127] seems questionable when it is recalled that Justice Blackmun in *Complete Auto Transit* relied on two user fee decisions.[128]

In *Commonwealth Edison*, the Court cited *Interstate Transit, Inc. v. Lindsey*[129] to support its distinction between the test used to determine the validity of general revenue taxes and that applied to

operations upheld because it was evenhanded and bore a fair relation to property employed in state); Ingels v. Morf, 300 U.S. 290 (1937) (highway user fee struck down because it was excessive in relation to value of services provided by state); Standard Steel Co. v. Washington Revenue Dep't., 419 U.S. 560 (1975) (unapportioned gross receipts tax upheld because it bore a fair relation to benefits conferred, there was no showing of multiple taxation, and tax was exactly proportioned to activities taxed); Clark v. Paul Gray, Inc., 306 U.S. 583 (1939) (highway user fee upheld because fees did not appear manifestly disproportionate to services provided); Northwestern Cement Co. v. Minnesota, 358 U.S. 540 (1959) (tax on net income from intrastate operations valid so long as it was not discriminatory and properly apportioned to local activities forming sufficient nexus to support the tax); Memphis Natural Gas Co. v. Stone, 335 U.S. 80 (1948) (tax on capital used in state by corporation engaged solely in interstate commerce upheld because tax was not discriminatory, there was no possibility of multiple taxation, the amount was reasonable, and it was properly apportioned to in-state activities); Wisconsin v. J.C. Penney Co., 311 U.S. 345 (1940) (tax on dividends declared on income attributable to in-state activities upheld because of fair relation between benefits conferred and measure of tax).

[126] 101 S.Ct. at 2969 (Blackmun, J., dissenting). Broadly interpreted, the fourth prong permits a state to require interstate commerce to pay its proportional share of the costs of living in a civilized society; narrowly interpreted, the test permits a state to recover the costs attributable to in-state activities engaged in by interstate commerce.

[127] *See, e.g.*, General Motors Corp. v. Washington, 377 U.S. 436 (1964); Wisconsin v. J.C. Penney Co., 311 U.S. 345 (1940).

[128] Justice Blackmun's characterization of the inquiry under the fourth prong of the *Complete Auto Transit* test as including an examination of the relation between a tax and the value of the services provided by a state was demonstrated when in his *Commonwealth Edison* dissent he cited *Ingels v. Morf, Clark v. Paul Gray, Inc.* and other user fee decisions as examples of a narrow application of the "fairly related" test. 101 S.Ct. at 2969 n.13.

[129] 283 U.S. 183 (1931).

user fees.[130] An examination of *Interstate Transit*, however, reveals that its underlying premise is no longer valid. The distinction between user fees and general revenue taxes was made because of the then-prevailing doctrine that taxes on interstate commerce had to be evaluated as user fees. The discredited *Spector*[131] rule that a state could not tax an activity that was exclusively interstate commerce was based on this doctrine. If *Interstate Transit* is the only basis for this distinction, then the invalidity of the premise underlying *Interstate Transit* suggests that the distinction has become an artificial one.

In its user fee decisions, the Court has demonstrated great flexibility when evaluating state tax formulas. In *Capitol Greyhound Lines v. Brice*,[132] the State of Maryland exacted a toll of 2% of the fair market value of motor vehicles used in interstate commerce in addition to a standard mileage charge. Thus, the charge levied on interstate commerce arguably was not proportional to the mileage travelled in the state. Nonetheless, the Court upheld the tax, stating that it "should be judged by its result, not its formula, and must stand unless proven to be unreasonable."[133]

In *Evansville-Vandenburgh Airport Authority District v. Delta Airlines, Inc.*,[134] the Court stated the following standard for assessing the constitutionality of user fees under the commerce clause:

> So long as the [user fee] is based on some fair approximation of use or privilege for use, . . . , and is neither discriminatory against interstate commerce nor excessive in comparison with the governmental benefit conferred, it will pass constitutional muster, even though some other formula might reflect more exactly the relative use of state facilities by individual users.[135]

Thus, it seems a court would have sufficient flexibility evaluating a severance tax under the user fee standard.

In *Evansville-Vandenburgh*, the State of New Hampshire imposed a per passenger fee on commercial airline flights, with fifty percent of the revenues dedicated to the state aeronautical fund and the remainder going to municipalities and airport authorities own-

[130] 101 S.Ct. at 2956 n.12.

[131] 340 U.S. 602 (1951). *See supra* text accompanying notes 83-84.

[132] 339 U.S. 542 (1950).

[133] *Id.* at 545.

[134] 405 U.S. 707 (1972).

[135] *Id.* at 716–17.

ing public landing areas. The appellants claimed that the tax could not be upheld as a user fee because fifty percent of the revenue was allocated to the communities in the form of unrestricted general revenues. In upholding the tax, the Court stated that:

> so long as the funds received by local authorities under the statute are not shown to exceed their airport costs, it is immaterial whether those funds are expressly earmarked for airport use. The State's choice to reimburse local expenditures through unrestricted rather than restricted revenues is not a matter of concern to these appellants.[136]

Except in name, the Montana coal severance tax is not significantly different from the New Hampshire airport user fee. In both cases, significant portions of the revenues collected from activities were allocated to fund governmental operations other than the services provided to the taxed activities. This functional similarity indicates that in the area of severance taxes the line between a general revenue tax and a user fee is quite blurry.

There is an affirmative basis to argue that the Montana coal severance tax is closer to a user fee than a general revenue tax. Although the Montana Supreme Court described the coal severance tax as "imposed for the general support of the government,"[137] it also spoke of the tax in language that suggests a user fee: "Montana can require strip-coal mining to assume its just share of the cost of the state government that it enjoys, and for the governmental cost that has occurred, is now occurring, and will occur in the future as a direct result of such strip-coal mining."[138] The objectives of the 1975 tax schedule as stated in a report of a joint committee of the Montana legislature intimate that the coal severance tax was intended at least partially as a user fee.[139] Furthermore, representatives of the Montana state government testified before Congress that their goal in levying the severance tax was to recoup the costs

[136] *Id.* at 720.

[137] Commonwealth Edison Co. v. State, 615 P.2d 847, 856 (Mont. 1980), *aff'd*, 101 S.Ct. 2946 (1981).

[138] *Id.* at 855.

[139] *Commonwealth Edison*, 101 S.Ct. at 2969-70 n.13 (Blackmun, J., dissenting). Justice Blackmun quoted the Joint Conference Committees, Montana State Legislature, Statement to Accompany the Report of the Free Joint Conference Committee on Coal Taxation. The objectives were to "(a) preserve or modestly increase revenues going to the general fund, (b) to respond to current social impacts attributable to coal development, and (c) to invest in the future, when new energy technologies reduce our dependence on coal and mining activity may decline." *Id.* at 1.

of coal development.[140] These representations by Montana's legislative and executive branches should have been accorded great weight. Formally, they indicate that a user fee analysis would have been proper; in light of the Montana tax's functional likeness to a user fee, that result would have afforded a more sensitive treatment of the facts.

To encompass severance taxes, the concept of a user fee should be expanded to embrace the full range of impacts which resource development can have on a state. Rather than covering just the cost of the regulations and services for which user fees traditionally have been utilized,[141] the analysis of a severance tax should cover the cost of developing an infrastructure to cope with large-scale resource development. There is no reason why this analysis could not also make some provision for a reasonable trust fund to cope with the long-term costs of resource development. The Court's standard for assessing the validity of user fees has always been quite flexible, and there is no reason why the analysis cannot be expanded to cover the services demanded of a state to accommodate sudden, large-scale resource development. This inquiry would be more complex than that in traditional user fee cases. However, in light of the superficiality of the Court's analysis under the fourth prong in *Commonwealth Edison*, the threshold analysis under the "fairly related" test will have to become more substantial if the *Complete Auto Transit* test is to be a practicable gauge of a state tax's impact on interstate commerce.

Both the modified user fee standard and the formulation of the fourth prong of the *Complete Auto Transit* test in Justice Blackmun's *Commonwealth Edison* dissent attempt to forge a middle ground between the factual inquiry of a traditional user fee analysis and the ineffectual inquiry into proportionality of the Court's formulation of the fourth prong. Either of these alternative formulations of the examination of whether a tax "is fairly related to the services provided by the State"[142] is more effective than the Court's formulation in achieving the purpose of the *Complete Auto Transit*

[140] *Coal Severance Tax: Hearings on S. 2695 Before the Senate Comm. on Energy and Natural Resources*, 96th Cong., 2d Sess. 194 (1980) (statement of Thomas L. Judge, Governor of Montana) [hereinafter cited as *Hearings on S.2695].*

[141] *See, e.g.*, Ingels v. Morf, 300 U.S. 290 (1937) (road repairs and policing); Evansville-Vandenburgh Airport Auth. Dist. v. Delta Airlines, Inc., 405 U.S. 707 (1972) (airport administration and maintenance).

[142] *Complete Auto Transit*, 430 U.S. at 279.

test to be a "practical analysis"[143] of the effect of a state tax on interstate commerce.

V. FUTURE PROSPECTS

Despite the Court's hopes that Congress will resolve the severance tax issue, it is likely that as a result of its perfunctory analysis in *Commonwealth Edison*, the Court will have to readdress the severance tax issue. As discussed below, it will be difficult for Congress to overcome built-in obstacles to resolving the severance tax issue.

During the Ninety-sixth Congress four bills were introduced to place a cap on coal severance tax rates.[144] Thus far in the Ninety-seventh Congress two such bills have been introduced.[145] None of the bills proposed in the Ninety-sixth Congress was enacted. One proposal for a 12.5% cap on coal severance tax rates, H.R. 6625, was reported out by the House Committee on Interstate and Foreign Commerce in the final days of the Ninety-sixth Congress.[146] The full House never acted on H.R. 6625. Among the Committee's findings were the following:

> 5) Certain State coal severance tax rates in excess of 12½ percent are resulting in revenues being paid to those States far in excess of the direct and indirect impact costs attributable to the coal production while unreasonably increasing energy costs, including electric utility rates to out-of-State consumers;
> 6) A State tax unfairly skewed to elicit revenues from out-of-State residents who are denied a voting voice in determining such tax may polarize the Nation and promote fractiousness and regional divisiveness . . . .[147]

The opposing camps in the dispute over coal severance tax rates have yet to find a common ground on which to wage a meaningful debate. Until some consensus is reached on the function to be served by severance taxes, and until the scope of the debate is broadened to recognize the impact of severance taxes on natural resources other than coal, the prospects for congressional action on the severance tax question remain nil.

[143] *Id.*

[144] S. 2695, 96th Cong., 2d Sess. (1980),126 CONG. REC. S5306 (daily ed. May 14, 1980); H.R. 7163, 96th Cong., 2d Sess. (1980); H.R. 6654, 96th Cong., 2d Sess. (1980); H.R. 6625, 96th Cong., 2d Sess. (1980).

[145] S. 178, 97th Cong., 1st Sess. (1981); H.R. 1313, 97th Cong., 1st Sess. (1981).

[146] H.R. REP. No. 96-1527, PT. 1 (1980).

[147] *Id.* at 2.

Proponents of a ceiling on coal severance tax rates argue that the rates typically bear no relation to the cost of coal development and claim that the taxes are an effort by the coal-producing states to take advantage of the surge in demand created by the energy crisis.[148] They cite studies asserting that a tax of two to four cents per ton would cover the cost of coal development.[149] Advocates of a cap on severance tax rates point out that much of the coal extraction taxed by the producing states occurs on federal lands, yielding funds for reclamation[150] and a return of fifty percent of federal royalties to the producing states.[151] The allocation of a significant portion of severance tax revenues to state trust funds is taken as evidence that producing states do not need all of the revenues generated by severance taxes.[152]

Proponents of a severance tax rate ceiling also point to the potential adverse effects of severance taxes upon the federal system. Specifically, they predict an unprecedented transfer of wealth to the producing states, the distortion of federal revenue sharing alloctions, and the possibility of retaliatory taxes by the consuming states.[153] Advocates of the legislation dismiss their opponents' argument that a ceiling on severance taxes would set a dangerous precedent for federal limits on other exercises of state taxing power because, they claim, the severance tax situation is unique.[154]

Opponents of a ceiling on coal severance tax rates argue that the legislation would be an unconstitutional limit on state freedom to structure integral operations in areas of traditional governmental functions, citing the Supreme Court's decision in *National League of Cities v. Usery*.[155] It is argued that a cap on coal severance tax rates would create a dangerous precedent for federal limits on other forms of state taxation.[156]

[148] *Hearings on S. 2695*, *supra* note 140, at 247 (statement of William P. Rogers).

[149] *Id.* (statement of William P. Rogers, quoting from study prepared by National Economic Research Associates).

[150] 30 U.S.C. § 191 (1976). *See supra* note 45.

[151] *Hearings on S. 2695*, *supra* note 140, at 50 (statement of Sen. Durenberger).

[152] *Id.* at 250 (statement of William P. Rogers).

[153] *Id.* at 39 (statement of Sen. Durenberger).

[154] *Id.* at 39 (statement of William P. Rogers).

[155] 426 U.S. 833 (1976). In *National League of Cities*, the Court in a 5–4 decision held that the federal Fair Labor Standards Act was not applicable to the states and their political subdivisions so far as they are engaged in carrying out "traditional governmental functions." *Id.*at 852.

[156] *Federal Preemption Hearings*, *supra* note 24, at 32 (statement of Robert Hall).

Opponents of the legislation claim that the 12.5% ceiling in the proposed statutes is an arbitrary limit bearing no relation to the cost of coal development. They cite a Congressional Budget Office study of the costs of coal development[157] and a Los Alamos Scientific Laboratory study indicating that severance taxes on coal would not become a burden on interstate commerce until they reached the 35 to 40% range.[158] As for policy, severance tax defenders argue that free market principles require that energy customers be allowed to decide whether the tax is an unreasonable burden on interstate commerce.[159]

In answer to charges that severance taxes raise the cost of energy to end users, opponents of the tax limit point to the fact that severance taxes are a miniscule part of the final price of coal, far exceeded by transportation costs and state sales taxes on energy consumers.[160] They note that on a per-BTU basis the Montana coal severance tax is in line with the severance taxes levied by oil- and gas-producing states.[161]

Finally, opponents reject the premise that coal mined on federal lands should be specially shielded from state taxation. They would treat federal ownership as irrelevant in light of the legal recognition accorded private property rights[162] in coal on the leased federal lands.[163] Furthermore, defenders of the severance taxes claim that federal royalty refunds and reclamation funds are inadequate to cover the cost of coal development.[164] Severance tax trust funds are justified as an exercise of the state's freedom to dispose of its revenues in the best interest of the state.[165]

[157] *Id.* at 46 (statement of Ruth Towe).

[158] *Id.* at 32, 34 (statement of Robert Hall).

[159] *Id.* at 12 (statement of Joseph McElwain).

[160] *Hearings on S. 2695*, *supra* note 140, at 121 (statement of Sen. Melcher).

[161] *Id.* at 9 (statement of Sen. Wallop).

[162] *See, e.g.*, London Extension Mining Co. v. Ellis, 134 F.2d 405, 411 (10th Cir. 1943); Olson v. Pedersen, 194 Neb. 159, 172, 231 N.W.2d 310, 318 (1975); 58 C.J.S. *Mines and Minerals* § 177 (1948).

[163] *Hearings on S. 2695*, *supra* note 140, at 9 (statement of Sen. Wallop).

[164] *Federal Preemption Hearings*, *supra* note 24, at 25 (statement of Byron Dorgan).

[165] *Id.* at 23. This list of arguments for and against a congressionally imposed ceiling on state severance tax rates is by no means exhaustive. However, it does illustrate the lack of consensus on the basic facts necessary to reach a decision on reasonable severance tax rates. Part of the problem is that opposing sides in this debate are not speaking in the same terms. For example, advocates of the ceiling speak in terms of the absolute transfer of dollars from the consuming states to the producing states, while their opponents speak in terms of the added cost to the average utility customer. Advocates of the legislation speak in terms of the

Two developments are needed in order for the severance tax debate to be usefully resolved. First, some common denominators must be defined. For example, what is the purpose of a severance tax? What social and economic costs are attributable to energy resource development? Second, the focus of the debate must expand beyond the severance tax *rates* of coal-producing states to the more meaningful issue of the transfer of wealth occurring because of domestic energy resource development. It is at least misleading, and more likely hypocritical, to claim that Montana's thirty percent coal severance tax is bringing about an unjustifiable transfer of wealth. In comparative terms, oil and gas severance taxes imposed by other states are far more significant. It is ironic that controversy should have focused on the *rate* in Montana, where the tax yielded $94 million in 1980, while Texas's collection of more than $1.5 billion in oil and gas severance taxes[166] goes uncriticized.

At present, prospects for the passage of legislation imposing a ceiling on coal severance tax rates are not good. As a practical matter, the congressional committees and subcommittees to which such legislation is sent are dominated by Senators and Congressmen from energy-producing states and the West.[167] It is highly unlikely they will be receptive to legislation limiting coal severance taxes. In addition, although the proposed 12.5% coal severance tax rate ceiling would affect only the states of Montana, Wyoming and North Dakota, the debate must inevitably expand to the broader issue of the transfer of wealth between the states by means of severance taxes. While the severance tax rates of the coal-producing states are the highest in the nation, the oil- and gas-producing states are responsible for an overwhelming proportion of the transfer of wealth attributable to severance taxes.[168] Thus, the oil- and gas-

tax rates charged by the coal-producing states, while defenders of the tax rates speak in terms of how, on a per-BTU basis, coal severance taxes compare favorably with the oil and gas severance taxes.

[166] 1980 STATE TAX COLLECTIONS, *supra* note 18, at 7 (Table III).

[167] For example, of the 20 members of the Senate Energy and Natural Resources Committee in the 97th Congress, 11 members are from energy-producing states or the West: Senators McClure (Idaho), Hatfield (Oregon), Domenici (New Mexico), Wallop (Wyoming), Murkowski (Alaska), Nickles (Oklahoma), Jackson (Washington), Johnston (Louisiana), Bumpers (Arkansas), Ford (Kentucky), and Melcher (Montana).

[168] To illustrate, in 1980, Montana, Wyoming and North Dakota collected less than 6% of the nation's severance tax revenues; that same year the oil- and gas-producing states of Texas, Oklahoma and Alaska, the states with the largest severance tax yields, collected over 61% of the nation's severance tax revenues. 1980 STATE TAX COLLECTIONS, *supra* note 18, at 7 (Table III).

producing states cannot help but be drawn into the severance tax debate. The regional conflicts will not be confined to disputes based on the different energy production sectors. The energy producing states are in the West and to some degree in the South. The energy consuming states are in the Northeast and the Midwest.

Finally, there is the issue of the respective roles of the state and federal governments in the federal system. This state-federal dichotomy takes on added importance due to the Reagan Administration's intention of transferring government functions from the federal to the state level. These collateral issues could prevent consensus in Congress on the question of the need for ceilings on state severance taxes. In the event of a congressional stalemate, the debate will shift back to the judicial forum, and the Court will be forced to resolve the issue more clearly than it did in *Commonwealth Edison.*

If the Supreme Court is presented anew with the severance tax issue, the fourth prong of the *Complete Auto Transit* test again will be the tactical key to the litigation. While the superficial treatment given to the "fairly related" issue in *Commonwealth Edison* might be excused because the issue could be deferred to Congress, the Court's application of it was "mechanical" and for all intents and purposes emasculated its former substance.[169] If the *Complete Auto Transit* test is to be a useful device for evaluating the impact of severance taxes on interstate commerce, the Court must revitalize the analysis under the fourth prong to comprehend the relation between the tax schedule and the impact of resource development. Specifically, the adaptation of the user fee standard to the analysis of severance taxes under the fourth prong of the *Complete Auto Transit* test would lead to more satisfactory adjudications of the commerce clause issue.

Donald F. Santa, Jr.

[169] *Commonwealth Edison*, 101 S.Ct. at 2968 (Blackmun, J., dissenting).

Senator WALLOP. The next witness is Senator Pete Domenici, our colleague from New Mexico.

STATEMENT OF HON. PETE DOMENICI, U.S. SENATOR FROM THE STATE OF NEW MEXICO

Senator DOMENICI. Thank you very much, Mr. Chairman. I will be very brief.

I, too, used to be a friend of Senator Dixon's. [Laughter.]

I also note that he quite appropriately is wearing a black suit today. [Laughter.]

New Mexicans would clearly see that as an appropriate attire since he would see fit to totally destroy New Mexico. So, obviously, it is with significant relish that I oppose his measure today. You know, I used to wonder when I was growing up and I looked at my little State and it was so poor, second from the bottom in per capita income. Why were we so poor when we were so rich in oil and gas and coal? I used to look at these big manufacturing States which were offering salaries about six times greater than those being paid in Montana and New Mexico for the average working people. I wondered how in the world they were so rich. What I found out was they were exporting all their taxes to us because everybody in that State was making money from producing cars. And, in fact, pickup trucks is the real popular item in New Mexico.

I wanted to figure out before I came the tax on each one of those pickup trucks that we have been paying to those States for maybe 35 or 40 years. Those States were prospering until they got in financial trouble for reasons unrelated to New Mexico. They are not producing as many cars or trucks as they used to and they are not as rich as they used to be.

I looked at some of the major metropolitan areas—one in Senator Dixon's State in Illinois—and I wondered if we could just figure out what percent of the taxes collected in that city come from Wyoming, Louisiana, Montana, and New Mexico's taxpayers. Maybe we ought to do equity and limit the taxes these States can collect on business transactions in these States. If we are going to have a severance tax limitation bill, maybe we ought to investigate my suggestion and share that with everybody.

I have a lot of other information in my statement, but let me just suggest that New Mexico did not end up with over 50 percent of our land publicly owned for which we collected not 1 cent of taxes until about 6 years ago when the distinguished then Senator from Wyoming passed this miner bill that gave our counties a little revenue in lieu of taxes. We have more than 50 percent of our State's land that we can't even put an ad valorem tax on to help pay any of the burdens that ad valorem taxes pay. Maybe before we talk about equity we ought to go back to our date of statehood and see how much we should have collected in taxes from that land.

I'm reminded that maybe you ought to look at the hotel and room tax in the United States. I think it might be nice to just say we ought to all have the same and maybe it ought to be the law. If States have 2 cents, maybe you ought to just impose a limit saying every State has 2 cents. After all, all those tourists come from our States and we go in there and spend our money.

I'm reminded that some of the most expensive land in the world, yielding millions in ad valorem taxes to cities like Miami and those who are privileged to be resort facilities—maybe we ought to equalize that since that comes from all Americans who travel there. In a sense, they are exporting to us as this high burden of million-dollar-a-square foot land that obviously finds itself somewhere in the cost to tourists, I would assume. Certainly there is something inequitable and unfair about such taxes.

Timber—maybe we ought to look at it next. And we could go on and on. Basically in my State we have coal and we compete with Montana. We have a lower severance tax, and good coal, but they do a better job of selling theirs. I assume if we really got with it and increased our sales fourfold, they would have to look at their severance tax. And that's the way it ought to be. That's the marketplace.

From my standpoint, I have the greatest respect for the Senator from Illinois. I would just close by asking that my statement be made a part of the record and merely suggest to you—I see some very friendly faces—that I'm very pleased here today. [Laughter].

Senator Dixon is going to have a very difficult time, it appears to me. But in any event, it seems to me that what we ought to do—what you ought to know about my State is that if this bill became law while we are trying to diversify, our economic base we would have very heavy taxes on everything. We are not one of those States with no taxes that has acquired an industry as suggested by the distinguished Senator from Illinois by some unfair tax base that attracts them in droves. But, basically, you will be bankrupting New Mexico if this bill became law. You will leave New Mexico a ghost State with no money to pay for its educational sys'em and its children and for its future.

Clearly, we are trying to diversify, based upon this being a diminishing resource. But, frankly, it appears to me that as ideas go to proceed beyond coal now to natural gas and to petroleum products is about the worst proposal I have heard. And, indeed, it appears to me, is not necessary. I don't think there is any relevance over the long haul for the United States of America and its system of states, and its system of competition.

I thank you for giving me a few moments. I am scheduled to be at a leadership meeting in about 7 minutes and I would be glad to answer questions, but I would hope they would be brief, and if possible, easy. [Laughter.]

Senator WALLOP. Do you have a question?

Senator DURENI ERGER. I can't think of any easy ones, Pete. [Laughter].

Senator DOMENICI. I knew you would be generous.

Senator LONG. I'd be delighted to ask questions, but I will wait until we have more time.

Senator DOMENICI. Thank you, Senator.

Senator WALLOP. Thank you very much, Senator.

[The prepared written statement of Senator Domenici follows:]

STATEMENT OF PETE V. DOMENICI
BEFORE THE SUBCOMMITTEE ON AGRICULTURE AND TAXATION
LIMITING STATE SEVERANCE TAXES
JULY 24, 1984

Mr. Chairman, thank you for this opportunity to testify before the Senate Subcommittee on Energy and Agricultural Taxation. New Mexico has a severance tax on oil, gas coal and several other minerals. We do not get the publicity other states, like Wyoming or Montana get when conversation turns to severance taxes. However New Mexico's severance tax is very important because it has enabled my state to meet the infrastructure needs that were created in the first place by the energy activity within our state.

We all realize that coal, oil and gas development runs in cycles. But few of us really understand the magnitude of the demand for services that the boom brings with it or the adjustment and displacement problems that occur when the bust hits.

How do you build water systems, sewers and roads fast enough when the town is thriving? How do you adjust when 9/10s of the town moves on when the energy jobs are gone? How do you keep the infrastructure in mothballs until the next boom hits? The State has been the clearinghouse for this adjustment, and the severance tax has been the means to plan and implement the necessary adjustments.

I appreciate this opportunity to present my views on S. 463, a bill that would place very restrictive limitations on states. For the first time the federal government would limit the state severance taxes that could be imposed on oil, gas and coal mined on Federal lands. Let me be very clear that I firmly oppose the concept of limiting states' prerogatives to tax the resources found within its borders, and I am totally opposed to S. 463. I think this legislation unfairly singles out oil, gas and coal when every state imposes taxes on products it produces or manufactures. This is the "exporting of the tax burden" argument which is supposed to be a rationale for this legislation. It nonetheless ignores the fact that every state, to some extent, is a tax burden exporter.

ANOTHER PURPORTED RATIONALE FOR THIS LEGISLATION IS TO MAKE SURE STATES DON'T RAISE THEIR SEVERANCE TAXES TO AN UNREASONABLE LEVEL. WE DON'T NEED LEGISLATION TO MEET THIS CONCERN BECAUSE THE MARKETPLACE WOULD SELF-CORRECT. THERE ARE MANY PRODUCING STATES, AND THE COMPANIES WITHIN THOSE STATES ALL HAVE TO COMPETE WITH OTHER PRODUCERS FROM OTHER STATES AND FOREIGN COUNTRIES. IF A STATE WERE TO RAISE ITS SEVERANCE TAX TO AN UNREASONABLE LEVEL, ITS PRODUCERS WOULD BECOME UNCOMPETITIVE AND WOULD LOSE THEIR MARKETSHARE. THESE MARKETS ARE TOO IMPORTANT OVER THE LONG-TERM FOR A SHORT-TERM GAIN. I BELIEVE THAT IT IS UNLIKELY THAT THE SEVERANCE TAX LEVEL WOULD EVER BE ABUSED FOR THESE REASONS.

I AM GOING TO EXPLAIN WHY THIS LEGISLATION IS A VERY BAD PRECEDENT WHICH NOT ONLY THREATENS ENERGY PRODUCING STATES, BUT WHICH HAS THE POTENTIAL TO STAND FOR FEDERAL GOVERNMENT INFERFERNCE WITH HOW A STATE STRUCTURES ITS TAX BASE.

I AM GOING TO URGE YOU TO BE VERY CAUTIOUS AND TO VIEW THIS LEGISLATION FOR WHAT IT REALLY IS. WHILE THE FOCUS TODAY WILL BE STATES WITH NATURAL RESOURCES PRODUCTION AND SEVERANCE TAXES, THE IMPORTANT AND UNDERLYING ISSUE IS "SHOULD CONGRESS LIMIT THE WAY STATES RAISE REVENUE?"

CONGRESS PROBABLY HAS THE POWER TO LIMIT THE STATES' SEVERANCE TAXES, HOWEVER, TO EXERCISE SUCH POWER WOULD BE EXTREMELY UNWISE. NOT ONLY WOULD IT ALLOW OTHER STATES TO CONSUME NATURAL RESOURCES WITHOUT PAYING THE FULL COSTS OF THAT EXPLOITATION BUT IT WOULD BE AN EXTREMELY DANGEROUS PRECEDENT.

IF CONGRESS CAN LIMIT THE TAX ON OIL, GAS AND COAL TO PRODUCE CHEAPER ENERGY FOR THE REST OF THE NATION, IT CAN ALSO LIMIT THE TAX ON TIMBER TO PRODUCE CHEAPER LUMBER PRODUCTS AND MORE AFFORDABLE HOUSES. IT COULD LIMIT THE TAX ON TACONITE TO PRODUCE CHEAPER STEEL PRODUCTS AND COULD EVEN LIMIT MICHIGAN'S SINGLE BUSINESS TAX TO MAKE CHEAPER AUTOMOBILES FOR THE REST OF THE NATION. MANY EXAMPLES COME QUICKLY TO MIND BECAUSE A TAX ON A PARTICULAR PRODUCT IS NOT UNIQUE, YET THIS BILL PROPOSES TO LIMIT A STATE'S ABILITY TO TAX OIL, GAS AND COAL. OIL GAS AND COAL ARE NO DIFFERENT FROM ALL THE OTHER PRODUCTS THAT ARE

TAXED IN VARIOUS OTHER STATES.

THIS IS NOT THE FIRST TIME THIS ISSUE HAS BEEN THE SUBJECT OF A CONGRESSIONAL HEARING. THE SENATE ENERGY AND NATURAL RESOURCES COMMITTEE AND VARIOUS HOUSE COMMITTEES HAVE HELD HEARINGS ON THIS ISSUE. THE 1980 SENATE ENERGY COMMITTEE HEARINGS CLEARLY EXPOSED THE FACT THAT THIS REALLY ISN'T A CONSUMER ISSUE, AS THE PROPONENTS CLAIM BECAUSE THE ADDED COST THAT A SEVERANCE TAX IMPOSES IS NOT THAT SIGNIFICANT. WE SHOULD NOT LET AN EMOTIONAL PLEA FOR THE CONSUMER CONFUSE THE SUBSTANCE OF THIS ISSUE.

I HAVE ALREADY ALLUDED TO THE DANGER OF LIMITING A STATE'S AUTHORITY TO TAX. THIS LEGISLATION ALSO THREATENS ONE OF THE MAJOR INITIATIVES OF THIS ADMINISTRATION. PRESIDENT REAGAN HAS BEEN A STRONG ADVOCATE OF DEFEDERALIZATION. THIS ADMINISTRATION HAS GIVEN STATES ADDED FLEXIBILITY AND RESPONSIBILITY IN MANY AREAS. IT WOULD BE INCONSISTENT TO TAKE AWAY THE AUTHORITY TO CHOSE THE METHODS OF RAISING THE REVENUE TO MEET THOSE RESPONSIBILITIES.

SOME STATES DO NOT HAVE A DIVERSIFIED TAX BASE OR THE LUXURY OF SEVERAL OPTIONS TO RAISE REVENUE. NEW MEXICO DOES NOT HAVE A LARGE POPULATION. THE INCOME LEVEL IS RELATIVELY LOW WHEN COMPARED TO THE NATIONAL AVERAGE. IT IS NOT A FINANCIAL OR INDUSTRIAL CENTER, BUT IT IS AN ENERGY ENDOWED STATE. ONLY A FEW STATES POSSESS A GREATER ABUNDANCE OF ENERGY RESOURCES THAN NEW MEXICO, AND NO STATE HAS A GREATER VARIETY. NEW MEXICO HAS BEEN A MAJOR PRODUCER OF OIL AND GAS FOR DECADES AND THE STATE HAS VERY SUBSTANTIAL RESERVES OF COAL.

BEFORE I DISCUSS TAX POLICY AND THE PHILOSOPHY BEHIND SEVERANCE TAXES AND THE PERMANENT TRUST FUND, LET ME BE PRACTICAL FOR A MOMENT. THE REALITY OF STATE GOVERNMENT IS THAT A STATE TAXES WHAT IT HAS TO MEET ITS NEEDS. FOR NEW MEXICO IT IS NATURAL RESOURCES.

WASHINGTON AND OREGON HAVE A SEVERANCE TAX ON TIMBER AND NEW MEXICANS PAY A HIGHER PRICE FOR LUMBER BECAUSE OF THIS TAX. FLORIDA AND CALIFORNIA HAVE BEAUTIFUL BEACHES THAT ALLOW THEM TO LEVY PREMIUM PROPERTY TAXES. JUST AS UTAH AND COLORADO HAVE SPECTACULAR SKIING THAT ALLOWS THEIR RESORTS TO

LEVY PILLOW AND CHAIR TAXES TO PAY FOR THE IMPACT THAT THE OUTDOOR ENTHUSIASTS HAVE ON THE LIVES AND LANDSCAPE OF THEIR COMMUNITIES, NEW MEXICO HAS A SEVERANCE TAX THAT IT IMPOSES ON THE ENERGY THAT IS TAKEN FROM ITS STATE. IT TAXES THE RESOURCES THAT CANNOT BE REPLENISHED. AS FLORIDA BRAGS ABOUT ITS BEACHES, NEW MEXICO BOASTS ABOUT ITS ENERGY PRODUCTION. HOWEVER, UNLIKE THE FLORIDA BEACHES, OUR ENERGY PRODUCTION HAS AN ENVIRONMENTAL PRICE TAG.

IT IS A FUNDAMENTAL PRINCIPAL OF EQUITY THAT THOSE INDIVIDUALS WHO BENEFIT TO THE GREATEST DEGREE, AND IN THE MOST DIRECT FASHION HAVE THE RESPONSIBILITY OF ASSUMING THE BURDEN OF PAYING FOR THOSE BENEFITS. AN APPLICATION OF THAT EQUITABLE PRINCIPAL TO THIS SITUATION WOULD ASSURE THAT THOSE UTILITY RATEPAYERS IN THE MIDWEST AND OIL AND GAS CONSUMERS WHO BENEFIT FROM THE COMFORT MADE AVAILABLE BY THE CONSUMPTION OF THESE RESOURCES SHOULD ASSUME A PORTION OF THE COST OF PROVIDING FOR THESE RESOURCES.

S. 463 IGNORES THIS PREMISE. IT WOULD LIMIT THE SEVERANCE TAX TO AMOUNTS NEEDED TO RECOVER THE PUBLIC COSTS DIRECTLY ATTRIBUTABLE TO THE ENERGY EXTRACTION ACTIVITIES. ACCORDING TO THE SPONSORS OF THE BILL, IT WOULD PREVENT THE USE OF SEVERANCE TAXES TO RAISE REVENUES FOR GENERAL GOVERNMENT AND OTHER UNRELATED ACTIVITIES.

THIS IS 1984, AND THIS SOUNDS ALOT LIKE ORWELL BECAUSE THIS LANGUAGE OPENS THE DOOR FOR THE IRS TO COME INTO NEW MEXICO AND OTHER STATES AND DECIDE WHETHER A ROAD, SCHOOL, SEWER, OR HOSPITAL IS A "PUBLIC COST DIRECTLY ATTRIBUTABLE TO ENERGY DEVELOPMENT." THIS HAS THE POTENTIAL TO BE AN ADMINISTRATIVE NIGHTMARE, AND A LITIGATION MARATHON.

THIS BILL WOULD ELIMINATE NEW MEXICO'S PERMANENT FUND. WE FEEL THAT THE NATURAL RESOURCES WE HAVE ARE THE NATURAL HERITAGE OF ALL THE PEOPLE WITHIN THE STATE. THE PEOPLE IN MY STATE HAVE THE FUTURE GENERATIONS IN MIND, AND THEY ARE JUSTIFIED IN SAVING SOME OF THE COMPENSATION FROM THE CONSUMED OIL, GAS, AND COAL IN THE FORM OF THE TRUST FUND. NEW MEXICANS FEEL VERY STRONGLY, AND RIGHTLY SO, THAT WHEN THE RESOURCES ARE GONE, THEY SHOULD BE LEFT WITH SOMETHING BESIDES BANKRUPT COMMUNITIES AND DENUDED MOUNTAINS THAT WILL TAKE

DECADES, AND EVEN CENTURIES TO RESTORE. THEY WANT MORE FROM THE FUTURE THAN UNSIGHTLY AND HAZARDOUS MINING SCARS. THIS BILL WOULD DENY NEW MEXICANS THIS KIND OF LONG-TERM PLANNING.

MY STATE HAS BEEN PLAYING A MAJOR ROLE IN MOVING AMERICA TOWARD ENERGY SELF-SUFFICIENCY. IT HAS BEEN ACTIVELY EXPLORING FOR AND DEVELOPING ITS RESOURCES AND SHARING THEM WITH THE REST OF THE NATION. IT IS A GOOD ENERGY POLICY THAT SHOULD NOT BE DISTURBED BY A MISGUIDED ATTEMPT TO HELP CONSUMERS IN THE FROSTBELT. THE SEVERANCE TAX ADDS LITTLE TO THEIR MONTHLY BILLS BUT GUARANTEES THEM THE ENERGY TO MAKE THEM COMFORTABLE.

I APPRECIATE THIS OPPORTUNITY TO TESTIFY TODAY. THANK YOU VERY MUCH.

STATEMENT OF HON. ALAN J. DIXON, U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator WALLOP. The next witness is Senator Dixon. I can assure him that it is safe to approach the desk.

Senator DIXON. Good morning, Mr. Chairman, and former friends on this subcommittee. [Laughter.]

Mr. Chairman, and members of this subcommittee, S. 463, which I introduced earlier in this Congress, is designed to effectively prohibit States from imposing excessively high severance taxes on coal, oil or natural gas. The United States has witnessed a dramatic increase in the price of energy over the past 10 years. In spite of the current temporary price stability, energy costs are now a burden on American business and on the average working men and women of this country. Americans have to worry about whether they can afford the gas to commute to work, to look for jobs, or even to heat their homes in the winter. In my own State, for example, the recent recession meant that the State's infrastructure continued to deteriorate and that substantial increases of State taxes were needed.

Illinois needs over $1 billion more annually just to maintain its investment in highways and transit systems. Education and social services are increasingly jeopardized, yet eight States were relatively unaffected by that recession. In 1981, Alaska's tax revenue rose by 51.3 percent; New Mexico's by 30.3 percent; Oklahoma's by 24.2 percent; North Dakota's by 21.9 percent; Wyoming's, Mr. Chairman, by 19.2 percent; Texas by 17.9; and Louisiana by 17.5. These are all States with significant severance tax revenues.

Severance tax revenues currently accrue solely to the States where the tax is imposed. Unfortunately, this resource is not available to all States of the Union. In fact, 87 percent of severance tax revenues go to only 8 of the 50 States. For these fortunate few, severance tax revenues are a major component of State finances. Last year, 73 percent of Alaska's revenues came from severance taxes, with Wyoming receiving 53 percent of its tax revenues from severance taxes. The 6 other States—Louisiana, Montana, North Dakota, Oklahoma, and Texas—currently derive more than 25 percent of their revenue from this source. There has been a great deal of debate about the severance tax over the last several years. Those who support the tax claim that the States have a right to determine their own policies, and that the tax is a price producers must pay as a cost of doing business.

But does the price of producing the scarce minerals include forcing citizens of energy poor States to pay the costs of the local governments in the energy rich States? The continuing increase in the wealth of these States enables them to attract industry through favorable tax policy. Alaska, for example, was able to place revenues in a permanent trust fund and to give to each of the State's residents over $1,000 in cash.

All of this appears to be at the expense of energy consuming States who are losing industries and tax revenues which are desperately needed to support and maintain daily governmental operations. The burden of severance taxes seems to be shifted to the citizens of the States that buy rather than produce the energy. These natural resources, I would contend, Mr. Chairman, belong to our Nation; not just to the State where they happen to be located. We need to decide whether we are going to treat our natural energy resources as truly national resources or whether we are going to let them be controlled—because the power to tax is the power to control—by States which through an accident of geography are the sites of energy resources.

It's time for a national approach to be taken concerning this most vital issue. Illinois, Mr. Chairman, is a major coal producing State. It does not enjoy the luxury of a severance tax at the moment. However, evolving market conditions could soon make it very attractive for my State to impose a severance tax on coal. And coal is not the only resource on which a severance tax may be imposed. Governors in the Great Lakes States have been seriously discussing the imposition of a severance tax on Great Lakes' waters that could in the future be piped to water-starved Western and Southwestern parts of our country. I have seen newspaper accounts indicating that the Midwest could be the future OPEC of water.

I find that idea extremely disturbing. The United States is much more than a collection of 50 separate States. It is one nation. It cannot and should not let control of what are truly national, not just natural resources, be decided by the individual States.

I believe the States are entitled to tax economic activity that occurs within their borders. Our Constitution makes it clear that they have that right. I have no quarrel with the desire of States to impose limited severance taxes to compensate for the impact of energy production activities on the State. However, I do not believe States should be able to impose severance taxes that raise revenues far in excess of the amounts needed to recover those costs.

Severance taxes, in my view, can unduly burden interstate commerce, and are clearly subject to Federal jurisdiction. A 1981 Supreme Court decision, *Commonwealth Edison Company* v. *Montana,* restated that point, indicating that State taxes affecting interstate commerce are subject to commerce clause scrutiny. The Court concluded that a State severance tax is not immunized from commerce clause scrutiny, and that the tax must meet a four pronged test. Under the test, a State tax does not offend the commerce clause if it is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to services provided by the State. The amount of a tax must be reasonably related to the services provided by the State or the cost generated by the tax activity.

The majority opinion suggested that a uniform system of apportionment of income for State tax purposes would advance the policies that underlie the commerce clause. There is an urgent need to limit State taxes so that the total tax levy does not unduly burden commerce and the minerals so taxed. The congressional power under the commerce power is broad, and several Supreme Court cases appear to be inviting Congress to develop a uniform policy with regard to certain aspects of State taxation as a way of protecting and promoting commerce.

The constituents of the Midwest, Mr. Chairman, and other regions should not be forced to pay the cost of general government in energy producing States, especially since their interests are not represented in the taxing State. Taxation without representation may chill production activity, something they sought to control when they granted Congress power over interstate commerce.

Congress has acted in the past when State taxes appeared unduly burdensome and adversely affected interstate commerce. In 1976, for example, Congress enacted the Railroad Revitalization and Regulatory Reform Act, known as the 4R Act. One provision of that act overturned discriminating State property taxes on railroad property, including a discriminating property tax included in the constitution of the State of Tennessee. Congress decided that taxing railroad property at rates higher than other businesses was unfair and unnecessarily increased railroad rates across the Nation.

S. 463 provides a way for Congress to handle similar unfair discrimination in the energy tax area. It places reasonable limitations on State severance taxes by limiting severance tax rates to the levels necessary to recover the public cost directly attributable to the energy extraction activities. States would continue to be free to impose income taxes, sales taxes, and other taxes that other businesses pay on their energy industries. Further, this legislation does not effect in any way the State's right to coliect royalty income in appropriate situations. However, it will effectively prevent the use of the severance tax mechanism to raise revenues for general government and other unrelated activities. The bill does not establish a numerical test. It does not attempt to determine the particular level at which severance taxes are exceedingly high. However, it does establish a standard that is both flexible and reasonable. It permits States to impose severance taxes, to defer overall social, environmental, and economic costs that are associated with the production of the natural resource. For example, States would be able to impose severance taxes to recover the cost of necessary highway upgrading or of new sewer lines needed to service the energy extraction facilities.

I believe that energy severance taxes in some States have risen to such levels as to constitute a burden on interstate commerce. One of the major reasons the Thirteen Colonies came together to form the United States after the Revolutionary War was to form a customs union to ensure the free and unfettered flow of trade between and among the respective States to be.

I think that objective was a sound one. And that it remains a sound one today. Our forefathers saw this nation working as a unified body with a free flow of goods that would enable each and every State to prosper. We are a single nation, Mr. Chairman. Not a nation composed of separate and distinct commercial entities. Unrestricted severance taxes by the States have the potential to undermine the free flow of trade among the States, and to incite regional strife. Some have likened the controversy over severance taxes to a type of energy civil war. Our Nation should not have to sustain another civil war of any kind.

I think it's imperative to enact this legislation and to enact it quickly. Our energy resources are part of our national treasure and their benefit should not be shared by the entire Nation. Income from our energy sources should not be transferred from energy poor States to energy rich States.

I introduced S. 463, Mr. Chairman, because I think it's time for the Senate to begin to think seriously about this crucial issue. State severance taxes raise public policy issues of the greatest importance. We should begin the process of examining those issues in a comprehensive but expeditious manner.

I appreciate the opportunity to appear here today. I recognize the controversial nature of the issues involved, and I know many of my colleagues here today do not share my views. I'm realistic enough to know that this subcommittee will not act on S. 463 in the short time remaining in this Congress. However, I'm optimistic that today's hearing can serve to stimulate further discussion and debate on the severance tax issues. And I look forward to a continuing dialog with all interested parties on this crucial public policy concern.

Again, I greatly appreciate your consideration, Senator Wallop, as subcommittee chairman for scheduling this hearing and permitting me to appear, especially since we see this matter somewhat differently.

I want to thank you personally for your kindness and for your willingness to schedule this hearing in the face of so many competing considerations. Mr. Chairman, in conclusion may I say this. When the Supreme Court looked at the question of the *Montana* case, the decision was a 6-3 decision to support the tax, with a concurring opinion by Mr. Justice White, a friend of mine. I think it's interesting to note that that concurring opinion, which kept the decision from being a closely divided decision, 5-4, is one that troubled the justice. And because it is so very short, I would like to read that single page by Mr. Justice White.

He says:

> This is a very troublesome case for me. And I join the Court's opinion with considerable doubt, and with the realization that Montana's levy on consumers in other States may, in the long run, prove to be an intolerable and unacceptable burden on commerce. Indeed, there is particular force in the argument that the tax is here and now unconstitutional. Montana collects most of its tax from coal lands owned by the Federal Government. And, hence, by all of the people of this country. At the same time, sharing equally and directly with the Federal Government all of the royalties reserved under the leases the United States has negotiated on its land in the State

of Montana. This share is intended to compenstate the States for the burdens that coal mining may impose upon it. Also as Justice Blackman cogently points out in nis dissent, of course, another 40 percent of the Federal revenue from mineral releases is indirectly returned to the states through a reclamation fund.

In addition, there is a statutory provision for federal grants to areas affected by increased coal production. But this very fact gives me pause. And counsel is withholding our hand at least for now. Congress has the power to protect interstate commerce from intolerable or even undesirable burdens. It is also very much aware of the nation's energy needs of the Montana tax and of the trend in the energy rich states to aggrandize their position. And perhaps lessen the tax burdens on their own citizens by imposing unusually high taxes on mineral extractions. Yet, Congress is so far content to let the matter rest. And we are counseled by the Executive Branch to the Solicitor General not to overturn the Montana tax as inconsistent with either the commerce clause or federal statutory policy in the field of energy or otherwise. The constitutional authority and the machinery that thwarts efforts such as those of Montana if thought unacceptable are available to the Congress. And surely Montana and other similarly situated states do not have the political power to impose their will on the rest of the country.

As I presently see it, therefore, the better part of both wisdom and valor is to respect the judgment of the other branches of the government. I join the opinion and the judgment of the court.

And so what Mr. Justice White is saying is, look—and I think properly so—leave it to the Congress. And so I come to you in a humble way, Mr. Chairman, and to this subcommittee, seeing with my own eyeballs the division against me on the subcommittee, but in the hopeful thought that my friend from Minnesota will be my great champion to suggest to you that there are many of us—42 of us of the 50—who are energy poor, and for us, the burden of paying the taxes of your States is a burden that we find to be unacceptable. And so we come to you to suggest that we want equity. We don't say you shouldn't have a tax. I only suggest by this bill that your tax should be related to the extraction of the energy in your respective States. And I might say, as the chairman said before the testimony of my colleague from New Mexico, that the sponsor of this bill was flexible and I am flexible. If there was an opportunity to pass this bill with something more than just compensatory taxes to compensate you for the extraction of the energy, I'm sure this Senator would be inclined to accommodate the point of view of his friends from energy rich States. But I think that to permit this course to continue indefinitely so that whenever there is a shortage in the energy rich States in the future they will once again turn to the severance tax is a thing that those of us in the energy poor States ought to cry out against.

And I thank the Chair for his accommodation.

Senator WALLOP. Alan, thank you. I might just say that Mr. Justice White's opinion is a position not unknown to many in politics and that is sitting on the fence with both ears to the ground. [Laughter.]

Senator DIXON. A difficult position to say the least.

Senator WALLOP. A difficult position. Many of us have practiced it a long time. I see no need for the Supreme Court to do it, but nonetheless they sometimes fall into that.

You quote State tax revenues in 1981 as having risen. It might be interesting for you to know that those severance tax revenues in 1983 have declined due to the price of energy and to the lower consumption of energy and due to conservation measures passed in large measure by this Congress.

And then you go on to discuss severance taxes as a portion of State revenue. And it's true that in my State of Wyoming they probably do constitute 53 percent, though mineral production constitutes a great deal more than 53 percent of my State's commerce. And I would invite you to come out and show us what we can tax that we are not. We have no automobile factories. We have no great grain elevators. We have no waterways. We have nothing else. We tax our agriculture. We tax our tourism. We tax our sales. But we just don't have Xerox plants.

Senator DIXON. Do you have an income tax in Wyoming?

Senator WALLOP. We do not have a personal income tax in Wyoming. But what I am suggesting to you is that there is more than one area of taxation in Wyoming.

Senator DIXON. If you ever run for Governor, don't run on the basis of advocating an income tax. It's rather fatal.

Senator WALLOP. I would not run on that. [Laughter.]

The other thing you suggest is that you may be losing industry. We, frankly, don't want your damned automobile factories. We like our State the way it is. And we have done nothing to attract them, and we have succeeded. [Laughter.]

We have not conducted a raid on the rest of the Nation's commerce. We would very much like to have a broader base to our economy. And one of the things that we use that tax for is to try to establish a small industrial base. But it hasn't occurred for us.

You go on and say "however, the bill would effectively prevent the use of severance tax mechanisms to raise revenue for general government and other unrelated activities." I just have a hard time coming to grips with that as a concept. Is crime prevention and firefighting and hospital facilities and school facilities the other things of general government unrelated to commerce?

Senator DIXON. Well, I think actually what would have to occur is that courts would have to pass upon the question of what is sufficiently related to the extraction of the energy that is appropriate as an expenditure.

Senator WALLOP. We like to think that under the system that was established by the fathers that this is a republic, a confederation of States.

Senator DIXON. I don't have any quarrel with that.

Senator WALLOP. Generally, they are the ones who decide what Government relates to and not the courts, unless there is a clear invasion.

Senator DIXON. Well, certainly. Surprisingly the Chair—and I would have no differences about our general concept about this whole thing—the whole thing is a question of reasonableness. Nobody quarrels with your right to impose—or at least this Senator doesn't quarrel with your right to impose a severance tax. I have no difference with you about that.

I have a difference with you about the reasonable nature of severance taxes that might be imposed. As an example, I recall that my friend from Minnesota on a prior occasion—maybe it's not now pending, but once did—introduced a bill that put a certain percentage or price cap on severance taxes. You know, I could live with that solution as well. I mean no offense to my distinguished friend from Montana when I say the tax imposed there, I think, approaches the question of unreasonableness. But there are differences between the various States in how they approach these problems.

The thing I would suggest to you is that if in the future every one of the energy producing States is going to turn to severance taxes, which after all—let me tell you I was in the State legislature, Mr. Chairman, 20 years. Twelve in the house and eight in the senate. I was a leader in both places. And my respected friend here from Louisiana who is former chairman of the Finance Committee and in my view will be sometimes soon again has been into the question of taxes for many, many years. There isn't any easy tax. But I will submit it to the Chair that the easiest one of all is the severance tax. That's a pretty easy one to vote for if you are a State legislature in Wyoming or Louisiana. Pass it onto Illinois and Minnesota and New York and Ohio. That's an easy one.

Senator WALLOP. The problem that your concept gives is that in essence you are saying that the Congress should provide that level of government satisfactory to each State; that what we, Wyoming, can't pick up by severance taxes will force us to come hat in hand here. It greatly enhances congressional power, but it doesn't enhance our concept as a nation.

The only other way in which we would be able to deal with the ordinary obligations of Government, after taxing our business to the extent it could no longer exist, is to come here. And while it is intriguing to have States and people come trickling in and we can wheel our power, I just don't think it's good.

You say that income from energy sources should not be transferred from energy poor States to energy rich States. But carrying that concept on, damn it, we don't have a seashore, we don't have a growing season that compares to Illinois, we don't have lakes, we don't have the things that make other States wealthy. We have what we have. You have what you have, including energy, oil and coal and gas.

I mean there is a breadth to all of this that a nation of variety and vigor ought not to get involved with the idea of socializing the whole concept of government, resources, climatological, geological, geographical, et cetera. We don't have a harbor. It would be nice if we could establish ourself as a sort of tax free haven for imports from Bolivia or something and ship them out to the rest of the country, but we haven't got any way to get it in there. You, in fact, have all those varieties with the lakes, with the river. Others have it with harbors. Others have it with coasts. And others have it with all kinds of things.

This country is built on its variety, and for us in Congress to begin to select which variety is a blessing is a long, long road which carries with it an enormously slippery load. I don't think we want to get into that as a concept.

Senator DIXON. Well, I respect the chairman very much and hear everything he is saying, but one would have to understand that that applies with equal vigor to all parts of the country. Your friend from Louisiana not only has the energy, but he has the harbors and the rivers as well. I'm not quarreling those concepts with you at all. I'm saying that each of our States have the right to impose similar types of taxes. A careful analysis of the respective States will show that we are forced to impose taxes upon our citizens to support our State through revenues upon our citizens because we don't impose those energy taxes, those severance taxes, which are exported to other States.

Senator WALLOP. Are they not in the form of the industrial products that you ship out?

Senator DIXON. Well, you can argue that to some extent. I suppose it would be true of every State of the Union. But I would say that there is no clearer question of an unreasonable imposition of taxes on other States of the Union than the severance tax. Now again I say I don't argue here against the severance tax. In given amounts, in reasonable amounts, I say the severance tax is not an unreasonable one. But what I am here concerned about is what we perceive to have been in recent years the attempt of some of the energy rich States to continue to rely on the severance tax and to export to other States the responsibility to support their own institutions.

Senator WALLOP. I don't hope to persuade you. I do hope to defeat you. [Laughter.]

There is a concept here.

Senator DIXON. This Senator comes to the game comfortable that he has picked a tough fight. Don't worry about that. And I don't say that I can ever impress a majority of my colleagues to the reasonableness of my cause, but I think it's something we ought to talk about. I would hope, if nothing else, the fact that we discuss it in this place and ultimately on the floor of the Senate and then other places will put the energy producing States on notice that continual revisiting of this source of revenue has some degree of volatility to it. Nobody in this room represents the State of Alaska, but to impose taxes to the extent that you can redistribute them among your citizens in substantial sums is, to me, something rather difficult to accept when we come from States where we are facing rounds of tax increases almost every year on our citizens to support our institutions.

Senator WALLOP. Senator Long.

Senator LONG. I believe that you will find that a business has to pass along all taxes as a part of the cost of doing business, if it is going to stay in business. In other words, over any long period of time a business is going to have to pass along all of its expense to make a profit over and above that to stay in business at all. I don't think you and I have any difference of opinion about that, do we?

Senator DIXON. No, sir. We have no difference of opinion about that.

Senator LONG. These expenses that have to be passed along include all of your costs, including any tax. I don't care whether it's an income tax, a property tax or whatever. Whatever tax you pay, that's an expense of doing business.

It is truc, as you have suggested, that a severance tax could conceivably be exploited, particularly if one State had a monopoly on something. That State could put a very high tax on it, so that then they could perhaps victimize the rest of the Nation. I can see your fear.

But I would like to compare that for a moment to what the actual facts of life are. As far as the severance tax on oil is concerned, Louisiana has been the leader, you might say. That started many, many years ago. I believe my father was the leader in that area back in his days, and later on my Uncle Earl came along and played a part. But when they were doing it, they were taxing what amounted to roughly 10 percent of the cost of the product, and that was at a time when Louisiana was competing with the rest of the Nation for the market. In other words, Texas was producing five times the oil we were producing. We were putting our producers at a competitive disadvantage by taxing, let's say, 10 percent of the gross. We weren't imposing as much in property taxes as Texas was. They were taxing the oil rigs and the oil in place and things like that, but on the overall we were taxing the industry more heavily than they were.

At that time, the product was very much in a surplus. Later on when the price of energy went up, Governor Edwards saw—and I think wisely—that Louisiana ought to put that tax on a percentage basis. Previously, when Louisiana had what amounted to about a 10-percent severance tax, it was not levied on a percentage basis. It was levied on a basis of, I would say, about $0.25 a barrel. The industry itself indicated, to me, at least—I was involved in it at the time—that they would have preferred to have been taxed as a percentage of the price, on the theory that they thought the price might go down. If the price went down, they would rather be taxed at a percentage of the price than on a flat basis.

However, it didn't work out that way over a period of time. Governor Edwards then suggested that, for oil, the tax should be based on a percentage, and we arrived at what amounts to about 12½ percent, which is about the highest the tax had been, based on a flat dollar figure.

This was levied at a time when we had to compete for the market, and all States were required to pro rate. That is, you were required to tell a producer that he couldn't produce more than a certain number of barrels out of his well, because we had no place to put the oil. When you try to produce more, the well goes hollow. And then would come a big rain—and as you know, oil is lighter than water—so the water would just lift the oil right over the dam and down it would go, all the way down the Mississippi River and on into the Gulf of Mexico. To stop all of that type of thing, we had to pro rate to keep some fellow from taking advantage of his neighbor and from polluting our streams.

People feared that, during the energy crisis, the States were going to take tremendous advantage of severance taxes. I can recall some of the speeches made on the Senate floor by Senator Danforth and others, predicting that the producing States would take an enormous amount of money and use that to attract the other States' industries. During that debate when Bennett Johnston had the floor, I asked him a question. He was a former State senator. My question was: How much of this increased revenue do you think Louisiana will use to attract industry? He predicted they wouldn't use any of it. Frankly, I thought it would have made sense for Louisiana to use some of those revenues for that purpose. Do you know what actually happened? They didn't use any of it to attract industry. They used it for schools or various other expenses of State government. But none of it was used to attract industry. When oil price decontrol came, it was suggested that there ought to be a limitation on what the States could charge by way of a severance tax. The decontrol bill provided that if a State charged more than the 12½ percent, which is about our tax rate, it is not deductible under the windfall profits tax. It would be a tremendous burden on the producer to be taxed by the State when he couldn't deduct it for windfall profit tax purposes.

No one has raised their severance tax beyond that 12½ percent. It has, in effect, amounted to a limitation. One interesting thing has happened in Louisiana. A Republican Governor, and a good man, David Treen, saw the need of revenues, because the very revenues that people said were going very high went back down when the price went down. When the price went down from $40 down to $20, down came the revenue with it, because the tax was a percentage of the price. It was suggested that Louisiana could get that money back by increasing the tax on natural gas, which was being taxed at a rate that would work out to about a 3-percent tax. It was suggested that if we quadrupled that tax, which was well within the Federal limit on deductibility, that that would be a way to get the money back. The Governor, a decent, honorable Republican, proposed it, and couldn't pass it. People rose up all over the State and said, hold on just a minute; our own consumers are going to have to pay part of that. And, furthermore, it will cost us jobs in this State because we have to compete with others. Governor Edwards opposed it, taking this very view that it would impact on our own consumers as well as others and it would hurt our industries and that it shouldn't be done. So that effort failed.

Now that same man, Governor Edwards, had the same burden of trying to find how to make up these revenues. He did it, but practically all the new tax was on consumption and not on oil and gas. I really think as far as the oil and gas part of it is concerned the record proves that the States have not levied the kind of taxes that people feared.

When one talks about the high tax in Montana or Wyoming, which has a severance tax of about 30 percent on coal——

Senator DIXON. It's Montana.

Senator LONG. If you look at what that coal is selling for and you put that in there as part of the price of the electricity in its finished state as delivered to the consumer, it works out to a lesser percentage of the price than our tax on oil and gas. That would be less than our 12½ percent. So if you are thinking in terms of burden on the consumer, I really think that you have difficulty in making the case.

Let's talk about Alaska for a moment. It's true that they came up with the idea to give everybody $1,000 just for living in Alaska. If you can persuade somebody from Illinois to go live up there, let me know and I will try it in Louisiana. You might think that some of our welfare people would take us up on the $1,000, but you can't get them to go there for that much. They can do better than that living on welfare in Louisiana, and, I suspect, even better by living on welfare in the State of Illinois, where a generous government has looked at the needs of the less fortunate and said, let's help. I don't think that that $1,000 in Alaska and those cold winters is going to pay for the additional energy cost, much less the inconvenience and other living costs, of trying to live in Alaska, compared to Illinois. I know, compared to Louisiana with our mild climate, you would have one hell of a time persuading some old soul to go up there and live on that $1,000. [Laughter.]

Senator WALLOP. Senator Durenberger.

Senator DURENBERGER. Alan, I'm going to follow you as a witness so I'm not going to take much time, but I want to say to you that I will champion your cause but not the weapons that you have chosen in a sense. [Laughter.]

When we get into the problem of recovering the public cost directly attributable to energy extractions we really are letting ourselves in for some difficulties. But, with my colleagues here, I just want to find the common ground in the discussion that I have heard over the last hour here. And I think it is the Federal system that everybody agrees on.

I remember when I was selected to serve on the Finance Committee and Russell Long was the chairman, I got a wonderful letter in the mail from him. In the delightful way that only he can do, he traced the long traditions that have existed between Minnesota and Louisiana all the way back to 1803 in the Louisiana Purchase. And we haven't done much for Louisiana. We send them the flood waters and a Democratic politician now and then from our State. [Laughter.]

But I think you have come to the right place with a very important concern, which is that there are differences among the States' revenue rasing capacities and we have got to do something about it. I have enjoyed everything here. I wish Pete Domenici hadn't had to run away because whenever somebody from the Southwest walks in here and tells us that we have got all the riches in Illinois and Minnesota, I want to know why in the hell everybody leaves our States to go to the Southwest. [Laughter.]

And when they get there, nobody wants to tax them. They still want us to use the Federal tax in some way to tax all those unemployed workers, the ones that are working, tax all those farmers—the ones that are still in existence—to send money down to build the Phoenixes and to build the Albuquerques. I mean, in this committee a couple of years ago we sent a big pile of money to Houston to build a transit system in a city that has never controlled its growth. And the folks in Houston said we don't want it. They had to put some money up against it and it failed.

So, I think you point out the right qustions. And in a sense, asking the questions in a federalism context points toward the solution. Why is it not great to be the home of steel and auto and heavy industry and so forth? Because they are passé. All we have are the AFDC and Medicaid payments which are much higher than these other States because they are relative to those $22 an hour auto worker salaries. We have the cost of rehabilitating a lot of those people. We have the cost of finding ways to reemploy them. And so we raise the cost of State government to do that in reaction to our own past. And what happens? They don't go to Alaska, but they stop in Minnesota and Illinois on their way up from the South, or they have in the past.

Byron Dorgan is going to be on here. He is the Congressman for North Dakota. We have this constant debate. Our jobs go west and the folks that need public services come east between our States.

And this is a problem for the country that shouldn't pit one State against the other.

Senator DIXON. May I interrupt my friend?

Senator DURENBERGER. Yes. I just wanted to make that point to see if you agree with that.

Senator DIXON. I'm cochairman of the northeast-midwest coalition with my friend, Arlen Spector, of Pennsylvania. Incidentally, Pennsylvania and Illinois have almost parallel tracks on every problem if you ever look at those two States.

But I would want to say to the Senator that I agree with all his observations. My State last year sent $1 to Washington for every $0.71 it got back. It's one of the 15 loser States in this Nation that sends a dollar down and gets less than $0.90 back in return. We got $0.71 back on every dollar. And we pay the severance taxes besides. And so I'm sure my friend from Minnesota who is similarly situated would understand our concern.

Senator DURENBERGER. I think you very much for bringing this issue up. And I take the occasion to thank the subcommittee Chair in particular for having this hearing today.

Senator DIXON. May I inquire? Do you still have your bill pending that was pending earlier?

Senator DURENBERGER. S. 178? No, I have not reintroduced it in this Congress.

Senator DIXON. Thank you.

Senator DURENBERGER. You fairly accurately referred to its implications and I will discuss it further in my prepared statement. It limits severance taxes in approximately the way Senator Long described.

Senator DIXON. Has a percentage cap?

Senator DURENBERGER. Yes, on coal taken from Federal land.

Senator DIXON. I could live with that kind of a solution if we could ever persuade the Congress.

Senator WALLOP. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman. Alan, as I take it, you don't deny that the States should have the right to impose severance taxes, but you believe that, in some cases, a certain tax, perhaps including Montana's severance tax on coal, is unreasonable. Is that right?

Senator DIXON. Well, that's generally true. I want to say I'm not trying to pick on my friend's State. It only happens to be the opinion that excited this controversy. It was a closely divided opinion on the question of whether Montana's tax was excessive. And may I say that some on that court said that in their view the Montana tax was, in fact, excessive.

Senator BAUCUS. I don't want to get into an argument over that again.

Senator DIXON. No.

Senator BAUCUS. You see, the fact of the matter is that the Supreme Court held that Montana's tax is not unreasonable. That was pretty clear.

Senator DIXON. I would want to respectfully differ with you. The Court permitted the tax, but the Court, I think, said it's up to the Congress to decide whether that charge should be permitted in the future.

Senator BAUCUS. When the question was directly addressed, and the Supreme Court applied the interstate commerce clause standards, the Court did not strike down the tax. It upheld the tax.

Senator DIXON. That is correct.

Senator BAUCUS. They stated that the tax was reasonable. Let me read from the majority opinion. The Court said: "There can be no question that Montana may constitutionally raise general revenue by imposing a severance tax on coal mining in the State. The entire value of the coal before transportation originates in the State and the mining of the coal depletes the resource base and wealth of the State, thereby diminishing a future source of taxes and economic activity."

The Court is, therefore, stating a rationale why States may impose severance taxes. And, in this particular case, why Montana may impose a severance tax on coal. The clear holding of the court, by a 6 to 3 vote, was that the tax was valid.

Senator DIXON. That is correct. They held the tax was valid.

Senator BAUCUS. Second, I want to respond to the implication, made by some people in the Midwest, that Montana's coal severance tax is somehow gouging them. In fact, only about $0.05, $0.06, $0.07 of each dollar of a Midwest utility consumer's bill is attributable to Montana's coal severance tax. About $0.25 to $0.30—the figures vary depending upon the distance traveled and the circumstances in each State—is rail transportation costs. Again, only five cents is due to Montana's coal severance tax. The remainder, the approximate, say 60 to 70 percent, is due to other costs that those States impose or that other entities impose. So only about $0.05 on a dollar, 5 percent of the total bill, is attributable to Montana's coal severance tax. So, when we consider the reasonableness of what the State of Montana and what the State of Wyoming are doing, we see that there's no great burden. The Supreme Court has said so, and the facts are that a very, very small portion of the Midwest consumer's utility bill is attributable to severance taxes.

What's more, you're making an implicit assumption that Montana or Wyoming somehow have a monopoly, and are extracting monopoly profits from the rest of the country. The point is this: Lots of States produce coal. And if one has an unreasonably high tax that increases the cost of that coal to consuming States, the consuming State will shop around. They will go to another State to get the cheapest coal possible. And that's reasonable.

So Montana does not have a monopoly on coal. Nowhere close to it. So it seems to me that a State should make its own decision about how high the severance tax should be. If it sets the tax too high, it is going to tax itself out of the market. Because, and I said, the consuming States can shop around.

So it seems to me that the implicit assumption in your argument, that some of these States like Wyoming and Montana have a monopoly, is not true. We don't have a monopoly on coal or on the many other forms of energy that are substitutes for coal.

Senator DIXON. But my friend from Montana is aware that he and my colleague from Wyoming represent States that have certain environmental supportive laws that help them to sell their coal in interstate commerce in the country. And I would suggest that increasing the severance taxes to take advantage of those facts also is something that has been a benefit to the State of Montana. So it isn't just the fact that you export the tax, you also have an opportunity to sell your coal in an advantageous competitive position with sulphur coal and other things.

Senator WALLOP. If you would forgive me. That would be true if we passed clean air legislation that related to clean air and not regional economics. But as the Senator well knows, the requirement for scrubbers exists whether or not they are necessary. And so that particular environmental advantage is lost to us. Ours is a matter of geological advantage.

Senator DIXON. Well, I would argue that there——

Senator BAUCUS. The percentage reduction requirement runs exactly counter to what you are saying. It creates an economic incentive to buy coal that pollutes more rather than to buy coal which pollutes less.

Senator DIXON. You have got that one mixed up, I will tell you right now. In my State you can only burn coal up to a certain percentage of particulates. And that is the only reason you sell Montana and Wyoming coal in Illinois. I will guarantee you that is the fact. So that we are forced to buy your coal and we are forced to pay your tax.

And may I say to my friend to Montana that if he can make a case in Peoria that we ought not to worry because only a nickel on every dollar we pay on our utility bill goes to Montana, I want him to argue that in any hall in Peoria before the chamber of commerce or the UAW or anybody else he wants to listen. Now I like that argument if I am from Montana, but I don't like it too well if I am from Illinois.

Senator BAUCUS. Well, the point that I am trying to make, to be honest about it, is that the culprits are really railroads that charge such high transportation costs. If the politicians in the Midwest were to point that out, they would be serving their constituents better, because it's a bigger and more important target.

Senator DIXON. Montana understands that transportation cost has to be incurred. The cost of transportation is a cost we incur in interstate commerce. I would agree probably that the Senator from Montana's percentages are correct. But the cost the Illinosan does not have incur is the cost that the Illinosan incurs by virtue of the action of a Montana legislation he didn't vote for.

Senator BAUCUS. What bothers me even more, Alan, is that you seem to be saying that Illinois and many other industrial States can export taxes, but resource producing States cannot. It seems to me that the State of Illinois, with its Great Lakes, rich farmland, large brokerage firms and many other businesses, exports plenty of taxes.

Senator DIXON. Well, they do, but they pay a sales tax, they pay an income tax, they pay a property tax.

Senator BAUCUS. Montana does the same thing. But we just don't have the resources you have. The way our country developed, Chicago was a great economic hub. It still is. But States in the Mountain West did not develop until later. We ship our cattle to Illinois, we ship our grain into the Great Lakes and on down the Mississippi. As a result, Chicago and other ports have a great advantage. And, you because of this advantage, export many taxes. Montana does export some of its taxes too, but we tax all coal in Montana equally, so that Montana consumers pay the same price that Illinois consumers do.

All I am saying is that all States export taxes. Illinois does; Montana does. And it's not fair to single out resource producing States and exempt other States. Maybe we should look at all taxes that States imposed, as Senator Domenici suggested, and have a uniform system. I don't think we want to do that. Our country changes too much. It would be nonsense.

The real question is reasonableness, under the interstate commerce clause. It seems to me that if the Supreme Court decides a certain tax is reasonable, that's it. Now if a certain tax imposed by a State is unreasonable under the interstate commerce clause, then the Supreme Court is going to strike that tax down. And that's probably the best way to handle this problem.

But in this case, the U.S. Supreme Court expressly held that this tax in Montana is reasonable. And it seems to me it did so for the reasons I suggested. That is, we have no monopoly, other taxes are exported, and the tax is imposed evenly, on Montanans just like everybody else, so that it doesn't discriminate. And we, therefore, think it's a fair tax.

Senator DIXON. Well, I respect very much my colleague from Montana. His contributions here are known by all of us. I just want to say in final conclusion in response to what he says that the case that his State was responsible for bringing to the Supreme Court of the United States suggests both a majority in the concurring majority and in the three-man dissent that the Congress look at the question. That is exactly the sense of this opinion. And I'm suggesting to my friends here that we ought to look at the question, and we ought to put some kind of parameters, some kind of limits on what the States do with severance taxes. Now that is what I am saying. I say that without reference to what the States have done in the past, and without rancor toward what any of the States have done in the past and with the greatest affection for my colleagues from energy producing States. That it would be entirely probable or possible for the Congress to enter this field, to suggest what the future conduct of the respective States ought to be to protect the citizens of the other States while at the same time leaving the energy producing States the right to raise revenue in this manner.

I want to thank the Chair and the committee for their kindness. I greatly appreciate the opportunity of coming and presenting my case. I would suggest, Mr. Chairman, it's a case that from time to time we will take up again in the Congress. And I would hope that through the course of time possibly the alternative of my friend from Minnesota or others would be considered and that the Congress could find some solution to this problem. I thank the Chair very much. I thank my friend from Montana.

Senator WALLOP. The case is made. I guess in many respects it does us more good to appear as gladiators on behalf of our several interests than it would if we actually acted on this in the way in which you suggest.

[The prepared written statement of Senator Dixon follows:]

ALAN J. DIXON
ILLINOIS

COMMITTEES:
AGRICULTURE, NUTRITION, AND FORESTRY
BANKING, HOUSING, AND URBAN AFFAIRS
SMALL BUSINESS

United States Senate
WASHINGTON, D.C. 20510

Statement by Senator Alan J. Dixon

Before Finance Subcommittee on Energy and Agricultural Taxation

Hearing on S. 463, the Severance Tax Equity Act

June 24, 1984

Mr. Chairman and Members of the Subcommittee, S. 463, which I introduced earlier in this Congress, is designed to effectively prohibit states from imposing excessively high severance taxes on coal, oil or natural gas.

The United States has witnessed a dramatic increase in the price of energy over the past 10 years. In spite of the current temporary price stability, energy costs are now a burden on American business and on the average working men and women of this country. Americans have to worry about whether they can afford the gas to commute to work, to look for jobs, or even to heat their homes in the winter.

In my own state of Illinois, for example, the recent recession meant that the state's infrastructure continued to deteriorate, and that substantial increases in state taxes were needed. Illinois needs over $1 billion more annually just to maintain its investment in highways and transit systems. Education and social services are increasingly jeopardized.

Yet, eight states were relatively unaffected by that recession. In 1981, Alaska's tax revenue rose by 51.3%; New Mexico's by 30.3%; Oklahoma's by 24.2%; North Dakota's by 21.9%; Wyoming's by 19.2%; Texas' by 17.9%; and Louisiana's by 17.5%. These are all states with significant severance tax revenues.

Severance tax revenues currently accrue solely to the states where the tax is imposed. Unfortunately, this resource is not available to all the states of the Union. In fact, 87% of severance tax revenues go to only 8 of the 50 states. For these fortunate few, severance tax revenues are a major component of state finances. Last year, 73% of Alaska's revenues came from severance taxes, with Wyoming receiving 53% of its tax revenues from severance taxes. The six other states -- Louisiana, Montana, North Dakota, Oklahoma, and Texas -- currently derive more than 25% of their revenue from this source.

There has been a great deal of debate about the severance tax over the last several years. Those who support the tax claim that the states have a right to determine their own policies and that the tax is the price producers must pay as the cost of doing business. But, does the price of producing the scarce minerals include forcing citizens of energy-poor states to pay the costs of the local governments in the energy-rich states?

The continuing increase in the wealth of these states enables them to attract industry through favorable tax policy. Alaska, for example, was able to place revenues in a permanent trust fund and to give each of the state's residents over $1,000 in cash. All of this appears to be at the expense of energy-consuming states who are losing industries and tax revenues which are desperately needed to support and maintain daily governmental operations. The burden of severance taxes seems to be shifted to the citizens of the states that buy, rather than produce, energy.

These natural resources belong to our nation, not just to the state where they happen to be located. We need to decide whether we are going to treat our natural energy resources as truly national resources or whether we are going to let them be controlled -- because the power to tax is the power to control -- by states which, through an accident of geography, are the sites of our energy resources. It is time for a national approach to be taken concerning this most vital issue.

Illinois is a major coal-producing state. It does not enjoy the luxury of a severance tax at the moment. However, evolving market conditions could soon make it very attractive for my state to impose a severance tax on coal.

And coal is not the only resource on which a severance tax can be imposed. Governors in the Great Lakes states have been seriously discussing the imposition of a severance tax on Great Lakes water that could, in the future, be piped to water-starved western and southwestern parts of our country. I have seen newspaper accounts indicating that the Midwest could be the future "OPEC of water."

I find that idea extremely disturbing. The United States is much more than a collection of 50 separate states. It is one nation. It cannot and should not let control over what are truly national -- not just natural -- resources be decided by the individual states.

I believe the states are entitled to tax economic activity that occurs within their borders. Our Constitution makes it clear that they have the right. I have no quarrel with the desire of states to impose limited severance taxes to compensate for the impact of energy production activities on the state. However, I do not believe states should be able to impose severance taxes that raise revenues far in excess of the amounts needed to recover those costs. Severance taxes, in my view, can unduly burden interstate commerce, and are clearly subject to Federal jurisdiction.

A 1981 Supreme Court decision, Commonwealth Edison Co. v. Montana (101 S.Ct. 2946)(1981), restated that point, indicating that state taxes affecting interstate commerce are subject to Commerce Clause scrutiny. The Court concluded that a state severance tax is not immunized from Commerce Clause scrutiny and that the tax must meet a four-pronged test. Under the test, a state tax does not offend the Commerce Clause if it is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to services provided by the state. The amount of a tax must be reasonably related to the services provided by the state or the costs generated by the taxed activity.

The Majority Opinion suggested that a uniform system of apportionment of income for state tax purposes would advance the policies that underlie the Commerce Clause. There is an urgent need to limit state taxes so that the total tax levy does not unduly burden commerce in the minerals so taxed. The Congressional power under the Commerce Power is broad, and several Supreme Court cases appear to be inviting Congress to develop a uniform policy with regard to certain aspects of state taxation as a way of protecting and promoting commerce.

The constituents of the Midwest and other regions should not be forced to pay the costs of general government in energy-producing states, especially since their interests are not represented in the taxing state. Taxation without representation may chill productive activity -- something the framers sought to control when they granted Congress power over interstate commerce.

Congress has acted in the past when state taxes appeared unduly burdensome and adversely affected interstate commerce. In 1976, for example, Congress enacted the Railroad Revitalization and Regulatory Reform Act -- known as the 4R Act. One provision of that Act overturned discriminating state property taxes on railroad property, including a discriminating property tax included in the Constitution of the state of Tennessee. Congress decided that taxing railroad property at rates higher than other businesses was unfair and unnecessarily increased railroad rates across the nation.

S. 463 provides a way for Congress to handle similar unfair discrimination in the energy tax area. It places reasonable limitations on state severance taxes by limiting severance tax rates to the levels necessary to recover the public costs directly attributable to the energy extraction activities. States would continue to be free to impose income taxes, sales taxes and other taxes that other businesses pay on their energy industries. Further, this legislation does not affect in any way the states' right to collect royalty income in appropriate situations. However, it will effectively prevent the use of the severance tax mechanism to raise revenues for general government and other unrelated activities.

The bill does not establish a numerical test: it does not attempt to determine the particular level at which severance taxes are exceedingly high. However, it does establish a standard that is both flexible and reasonable. It permits states to impose severance taxes to defer overall social, environmental and economic costs that are associated with the production of the natural resource. For example, states would be able to impose severance taxes to recover the costs of necessary highway upgrading or of new sewer lines needed to service the energy extraction facilities.

I believe that energy severance taxes in some states have risen to such levels as to constitute a burden on interstate commerce. One of the major reasons the 13 colonies came together to form the United States after the Revolutionary War was to form a customs union, to ensure the free and unfettered flow of trade between and among the states-to-be. I think that objective was a sound one, and that it remains sound today. Our forefathers saw this nation working as a unified body where the free flow of goods would enable each and every state to prosper. We are a single nation, not a nation composed of separate and distinct commercial entities.

Unrestricted severance taxes by the states have the potential to undermine the free flow of trade among the states, and to incite regional strife. Some have likened the controversy over severance taxes to a type of "energy civil war." Our nation should not have to sustain another Civil War of any kind.

I think it is imperative to enact this legislation, and to enact it quickly. Our energy resources are part of our national treasure, and their benefits should not be shared by the entire nation. Income from our energy sources should not be transferred from energy-poor states to energy-rich states.

I introduced S. 463 because I think it is time for the Senate to begin to think seriously about this crucial issue. State severance taxes raise public policy issues of the greatest importance. We should begin the process of examining those issues in a comprehensive, but expeditious manner.

I appreciate the opportunity to appear here today. I recognize the controversial nature of the issues involved, and I know many of my colleagues here today do not share my views. I am realistic enough to know that this Subcommittee will not act on S. 463 in the short time remaining in this Congress. However, I am optimistic that today's hearing can serve to stimulate further discussion and debate of the severance tax issues, and I look forward to a continuing dialogue with all interested parties on this crucial public policy concern.

Again, I greatly appreciate your consideration, Senator Wallop, as Subcommittee Chairman, for scheduling this hearing and permitting me to appear, especially since we see this matter somewhat differently. I want to thank you personally for your kindness and for your willingness to schedule this hearing in the face of so many competing considerations.

Senator WALLOP. Senator Durenberger.

Senator DURENBERGER. Thank you, Mr. Chairman. I will ask that my complete statement be made a part of the record.

Senator WALLOP. By all means.

Senator DURENBERGER. As I indicated earlier, all of us are indebted to you for taking the time to hold this hearing, and many of us have participated in similar hearings in other committees. I come to this task in part as chairman of the Subcommittee on Intergovernmental Relations, and I have discovered there that severance taxes raise one of the more complex and controversial issues, in intergovernmental relations, as we see here this morning.

As I indicated earlier to our good friend from Illinois, while I champion his cause, I do not support the approach taken in S. 463—not because I believe severance taxes do not raise these kinds of federalism problems, and not because I believe that his approach is pernicious or whatever, but because I do think there are other solutions to this problem of the disparities that exist among our various States.

The problem here with S. 463, I think, is that it seeks to address the growing problem of the fiscal disparities among the States with a rather drastic solution. The authority to tax, is a very cherished right of the States. It has been restricted by Congress and the courts only in cases where the exercise of State taxing authority conflicts with the U.S. Constitution.

Under article 1, section 10, for example, States may not levy a tax on imports or exports except to cover the cost of carrying out their inspection laws. Everyone knows the famous case of *McCollough* v. *Maryland* and the supremacy clause, article 6, clause 2, which gives the Federal Government the right to limit or eliminate State taxes on the Federal Government. But despite that, the limitation on State taxing authority contemplated in S. 463 goes well beyond what I think have been established principles of the Federal-State tax relationship.

So I would just suggest for purposes of dealing with this problem that there are two or three solutions that come to my mind that are more appropriate. One has already been mentioned—S. 178, which is a bill that I have introduced and reintroduced several times which places a limit on the amount of severance tax a State may levy on an energy resource extracted from Federal land. That, again, was modeled on a piece of legislation that Senator Bentsen introduced in 1979 and was considered as part of the windfall profits tax, but not adopted.

The ability of States to levy a tax on these energy resources derives from an explicit statutory grant of authority contained in the Mineral Leasing Act of 1921. The explicit mention of the rights of States to levy these taxes in the 1921 act is clear evidence that Congress meant to forego its right to prohibit this taxation. Anyone who understands the history of the Federal-State controversy over the lands in question appreciates that that 1921 act was a compromise. The Federal Government retained ownership of the land and its mineral resources. But in exchange, Congress agreed to share with the States part of the Federal revenues generated from the land. And Congress agreed to permit States to levy their severance tax on the minerals extracted from that land. It was a carefully crafted compromise. And it was agreed to under the conditions that prevailed in 1921 for a lot of the reasons that the Senator from Montana indicated. I have been to his State arguing this with the leaders of his State on many occasions, and I am well aware of the depletion of one of the few resources or at least one of the richest resources that existed in that State at the turn of the century—silver and gold and other minerals.

Over the years, Congress has recognized changing conditions and periodically increased the State's share of the Federal royalties. It is entirely appropriate in light of the once again changed circumstances of the 1980's for Congress now to consider limiting the authority it granted almost 60 years ago, if the States insist on levying severance taxes which exceed what the Congress believes is a reasonable limit. And that, too, is well within the parameters of the Supreme Court decision in *McCullough* v. *Maryland.* Indeed it is the type of action the Court found well within the powers of Congress in the *Commonwealth Edison* case.

Another reasonable action Congress might take deals with the Federal royalties, to which I have just referred. Under the Mineral Leasing Act of 1921 not only were States granted the authority to levy severance taxes on resources extracted from Federal land within their boundaries, but they were also guaranteed a share of any royalties the Federal Government might collect on those resources. Some States receive significant revenues from these shared Federal royalties. Congress could, if it desired, reasonably withhold some part of a State's share of Federal royalties when that State insists upon levying excess of severance taxes on resources extracted from Federal land.

Another approach is to recognize that along with the shared royalties, States that contain Federal mineral lands, grazing lands, national park and forest lands, wilderness, water resource projects, also receive payments in lieu of taxes from the Federal Government. Such payments are made under the rationale that this type of so-called open-space Federal land is especially burdensome on State and local governments because it's neither taxable, as you have pointed out so well, so often, nor is it otherwise revenue generating, with a few exceptions such as the tourists that use some of the facilities.

Senator WALLOP. If I might just say it is revenue demanding.

Senator DURENBERGER. And it is revenue demanding.

Senator WALLOP. We do have to provide the police and fire protection and other services.

Senator DURENBERGER. That's right.

And the volume of these Federal holdings in some States and in many counties and other States—take my State as an example—are quite substantial. We are 26 percent publicly owned. That doesn't include any of the water in this land of 15,000 lakes. And some of our counties have a greater percentage of Federal and State holdings than the State of Wyoming or the State of Montana. All of that, as you point out, substantially raises the cost of public service to the citizens of these counties, in that case, or the State government.

If States insist upon levying excessive severance taxes on resources taken from these Federal lands, however, they become quite lucrative as revenue sources. Hence, it might make sense for Congress to withhold payments along with Federal royalties in those kinds of cases. I would not like to make this kind of a proposal, however.

I would like to deal with the issue raised by the Senator from Montana which is why limit the export of taxation unless it becomes unreasonable. States ought to be able to export taxes, and they all do; they all do. Certainly the State of Nevada lives off of people from all over the world. My State, the second largest industry is tourism, $4 billion a year in money brought into that State. And to that we apply a corporate income tax in the neighborhood of 17 percent and an individual income tax in the neighborhood of 12 percent, sales taxes in the neighborhood of 6 percent, and property taxes that are among the highest in the country. And we benefit from both those who provide service to tourists and to the traveling public in an export sense.

My suggestion, Mr. Chairman, when we get to the bottom line of this, if you don't like Senator Dixon's approach or the other two approaches that I have offered, is that this committee in particular give serious consideration to revising Federal aid formulas that would take better count of fiscal disparity. There are currently 25 allocation formulas distributing approximately $40 billion on that attempt to take State fiscal capacity into account. General revenue sharing, AFDC and Medcaid, which are all three in this committee, are the largest. And the problem is all of these formulas measure fiscal capacity in a very poor way by using the State's per capita income.

The shortcomings of using per capita income as a measure of the capacity of a State to meet its own public needs have all been well documented. And there is a readily available alternative to income that more accurately reflects States' true revenue raising capacities. It is called a "representative tax system." It was developed over 20 years ago by the Advisory Commission on Intergovernmental Relations. It has been found superior to per capita income by numerous people—the General Accounting Office, the Congressional Budget Office, the Congressional Research Service, and a variety of others.

And besides that, it's a tested system. It's in place in Canada. The Canadian Government already uses it to redistribute Federal aid to its provinces.

I have made this point repeatedly, Mr. Chairman, but I will reiterate it in conclusion. Formulas that employ per capita income neglect the ability of States to raise a significant portion of their revenues through severance taxes and other exportable taxes such as sales or gambling taxes on tourists. When capacity is measured by per capita income, energy rich States appear considerably less well off than they are, and thus receive more Federal aid than they should. But there is a flip side to that coin, as illustrated by my own State of Minnesota. We have taxed the minerals that largely built the country, largely the iron ore and now the taconite derivatives. But you reach a point in the market in which you can't be competitive with a tax on top of the cost of minerals.

The market then becomes your adjusting mechanism. And a fiscal capacity representative tax system formula helps the Federal Government adjust to these differences in the market.

One analysis that I saw last year, for example, shows that under representative tax system Texas would be better off than the State of New York. It came as a big surprise, especially to the people in Texas.

Senator WALLOP. It's a big surprise to the people in New York too. [Laughter.]

Senator DURENBERGER. I would finally say to you that I am pleased by the number of our colleagues that were here today and I'm pleased by your personal interest and that of Senator Dixon in finding a solution to this problem. I have found it unresolvable in any other context, as my friends from North Dakota and Montana and other proximate States will tell, because I can agree with everything they say. Max is right about being a captive of a railroad. At least it used to be a railroad. I don't know what they call themselves today. And he can think of two good arguments for every one good argument that I can think of, if you just look at it in terms of the way the marketplace works and the tools that we have available to us. And it's for that reason I don't think the problem is going to go away. You will not defeat all of the Alan Dixons of this world. And you will not defeat all of the Dave Durenbergers of this world. We will keep coming at this process because as I indicated to you earlier, this is a Federal system. You may not have auto plants, but you also don't have the legacy of those auto plants. You don't have $500 and $600 a month AFDC payments and large Medicaid obligations and a whole lot of those other things that plague certain parts of this country.

And if we as a nation with limited Federal resources, if you will, expect the States to carry a greater share of the burden, then we need to deal with the fact that there are differences among our States that reflect this. And to deal with them we must think in the larger context rather than in the specificity of today's coal, yesterday's oil, tomorrow's copper, nickel, zinc out of Minnesota. And for that reason, I thank both of you for your long time interest in this subject and hope that all of us can work together to find a solution that does not discriminate against any industry or any State in this country.

Thank you, Mr. Chairman.

Senator WALLOP. David, thank you.

[The prepared written statement of Senator Durenberger follows:]

Dave Durenberger news

U.S. Senator for Minnesota

STATEMENT BEFORE THE SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

Senator Dave Durenberger
July 24, 1984

Thank you, Mr. Chairman. I am pleased to be with you this morning to discuss S. 463, the Severance Tax Equity Act. As you know, severance taxation is an issue I have studied intently since I came to the Senate. As Chairman of the Subcommittee on Intergovernmental Relations, I have discovered that severance taxation raises one of the most complex and controversial issues in all of intergovernmental relations. There are no simple answers.

Let me state my position on S. 463 at the outset -- a position that may surprise you -- and spend the rest of my time explaining it. I oppose the approach taken in S. 463 -- not because I believe severance taxes do not raise intergovernmental problems -- but because S. 463 is a well-intentioned but inappropriate way to go about solving them.

The legislation before us today would prohibit States from imposing severance taxes on coal, oil and natural gas, except to "recover the public costs directly attributable to the energy extraction activities." What constitutes such public costs is left an open question. As drafted, the bill presumes that each State had already set its severance tax rates at precisely this point by 1978, a highly questionable assumption. Under this legislation, States would be prohibited from increasing their severance taxes on these energy resources above their 1978 level, as adjusted for inflation, unless the State could demonstrate that such an increase was necessary to cover "directly attributable costs."

Mr. Chairman, the reason I oppose the approach taken in S. 463 is simple. It seeks to address the growing problem of fiscal disparities among States with a drastic solution, while other more appropriate solutions are readily available. By now, everyone in this body should know of my deep concern with fiscal disparities. I know you do, Mr. Chairman. It is a disease of our Federal system of government that will incapacitate it eventually if not properly treated. However, the solution proposed by S. 463 is a cure with effects perhaps worse than the disease itself. In fact, the solution proposed by this legislation strikes directly at the roots of Federalism -- the unfettered authority of the States to tax.

This authority is a cherished right of the States and has been restricted by Congress and the Courts only in those cases where the exercise of States' taxing authority conflicts with the U.S. Constitution. Under Article I, Section 10, for example, States may not levy a tax on imports or exports, except to cover the cost of carrying out their inspection laws. Likewise, the Court held in the famous case of McCulloch vs. Maryland that the supremacy clause (Article VI, Clause 2) gives the Federal government the right to limit or eliminate State taxes on the Federal government.

The limitation on State taxing authority contemplated in S. 463 goes well beyond such narrow bounds. It runs directly counter to all our notions of the proper national-State relationship in the American Federal system. By adopting this approach we would be correcting a slow acting malady, which we have time to address by other remedial actions, with a radical solution that would do serious long term damage to our federal system of government. Federal preemption should be the last resort not the first option.

But, even if we can persuade our colleague Senator Dixon that the approach in S. 463 is unsound, we are left to face the very troubling dilemma of fiscal disparities -- the wide variability in the ability of States to raise revenue. I cannot overstress the dire consequences for our federal system if these disparities are left to grow unchecked. There are solutions to the fiscal disparities problem -- solutions that will have the effect of strengthening the federal system. No single solution is perfect or complete. Each is limited in its ability to address the overall problem, but taken together, there are a number of things that can be done to smooth out the worst of the disparities in revenue raising capacity. Let me go through a partial list at this time.

First, we could adopt the approach I proposed in the last Congress (S. 178) to place a limit on the amount of severance taxes a State may levy on an energy resource extracted from Federal land. The ability of States to levy a tax on these resources derives from an explicit statutory grant of authority contained in the Mineral Leasing Act of 1921. Few constitutional scholars doubt that a limitation of this authority falls well within the doctrine put forth in McCulloch vs. Maryland. In fact, the explicit mention of the right of States to levy these severance taxes in the

1921 Act is clear evidence that Congress meant to forego its right to prohibit this taxation.

Anyone who understands the history of the Federal/State controversy over this land appreciates the compromise struck in the 1921 Act -- the federal government retained ownership of the land and its mineral resources. But in exchange, Congress agreed to share with the States part of the federal revenues generated from this land. And, Congress agreed to permit states to levy their severance tax on the minerals extracted from it. This was a carefully crafted compromise agreed to under the conditions prevailing in 1921. Over the years, Congress has recognized changing conditions and periodically increased the State's share of the Federal royalties. It is entirely appropriate in light of the once again changed circumstances of the 1980s for Congress now to limit the authority it granted almost 60 years ago if states insist on levying severance taxes which exceed a reasonable limit.

Another reasonable action Congress might take in this regard deals with the Federal royalties to which I just referred. Under the Mineral Leasing Act of 1921, not only were States granted the authority to levy severance taxes on resources extracted from Federal land within their boundries, they also were guaranteed a share of any royalties the Federal government might collect on these resources.

Some States receive significant revenues from these shared Federal royalities. Congress might reasonably withhold a State's share of Federal royalties when it insists upon levying excessive severance taxes on resources extracted from Federal land.

Along with shared royalties, States that contain Federal mineral lands, grazing lands, national park and forest lands, wilderness areas, and water resource projects also receive payments in lieu of taxes (PILT) from the Federal government. Such payments are made under the rationale that this type of so-called "open-space" Federal land is especially burdensome on State and local governments because it is neither taxable nor otherwise revenue generating.

The sheer volume of federal holdings in some states, and in many counties in other states (like Minnesota) raises substantially the cost of public service to citizens of these governments. If States insist upon levying excessive severance taxes on resources taken from these Federal lands, however, they become quite lucrative as revenue sources, hence it would make perfect sense for Congress to withhold PILT payments along with Federal royalties in these cases.

A third approach to addressing the problem of fiscal disparities is one I have been advocating ever since I came to the Senate. We can revise Federal aid formulas to take better account of fiscal disparities. There are currently about 25 allocation formulas distributing approximately $40 billion that attempt to take States' fiscal capacity into account in distributing Federal aid. General Revenue Sharing, AFDC and Medicaid being the largest. The problem is, all of these formulas measure fiscal capacity in a very poor way -- they use the state's per capita income.

The shortcomings of using per capita income as a measure of fiscal capacity have been well documented, and there is a readily available alternative to income that more accurately reflects States' true revenue raising capacity. It is called the Representative Tax System (RTS). It was developed over 20 years ago by the Advisory Commission On Intergovernmental Relations (ACIR) and has been found superior to per capita income by numerous scholars, the General Accounting Office, the Congressional Budget Office and the Congressional Research Service. Furthermore, it is a tested system. The Canadian government already uses it to distribute federal aid to its provinces.

I have made the point repeatedly, but let me reiterate it. Formulas that employ per capita income neglect the ability of States to raise a significant portion of their revenues through severance taxes and other exportable taxes such as sales and gambling taxes on tourists. When capacity is measured by per capita income, energy-rich States appear considerably less well-off than they are, and thus received more Federal aid than they should. The RTS corrects this problem by giving a truer measure of States' relative revenue raising capabilities.

The beauty of these partial solutions to the fiscal disparities problem is that they do not interfere with the economies or the tax sovereignty of the various States. They permit the economy to evolve in a natural and efficient manner and seek only to correct any inequities that may result.

The final alternative I would like to suggest is that Congress create a State revenue sharing program designed specifically to reduce the worst fiscal disparities among States. I have already introduced a bill that would do just this, S. 700. I urge my colleagues to look closely at this legislation.

Not only would such a program address fiscal disparities, it would do so in a manner designed to lay the foundation for a genuine New Federalism. By establishing a State revenue sharing program that puts a fiscal base under every State, regardless of its fiscal capacity, it would be possible to design a federalism reform package that would permit a real "sorting-out" of responsibilities among levels of government.

Before closing, let me talk frankly to my colleagues from the energy producing States about this matter of fiscal disparities. If my friends from the West and Southwest would only recognize the legitimate concerns over fiscal disparities and would help us work toward some of the solutions I have suggested, the steam would go out of the efforts to impose drastic solutions to restrict States' taxing authority. I submit that fiscal disparities will continue to grow, and at some point the problem will become so severe that Congress will react. My fear is that we will overreact if the problem is left to fester unattended. The reaction will likely be closer to the approach put forward in S. 463 than the more modest solutions that I have suggested. This is not a prospect I look forward to. I value federalism too much as an overriding principle of government.

When Congress reauthorized the revenue sharing program last year, it directed the Treasury Department to undertake a comprehensive study of the fiscal relations in the American Federal system. A major part of that study will deal with fiscal disparities. I am looking forward to the results which will be available early next summer. I am confident the study will provide us with the direction for addressing this problem in a reasoned way.

We have a choice. We can address the problem of fiscal disparities in a prudent manner, and thereby strengthen our Federal system for years to come; or we can wait until the problem is of such magnitude that it calls forth a drastic solution likely to weaken or debilitate the Federal system. I think the choice lies really with the representatives of the energy-producing States. I extend an invitation to my colleagues from these States to work with me in this endeavor. Our common interests in preserving the Federal system far outweigh any regional differences we may have.

Mr. Chairman, at this time I have a variety of items I would like to submit for the record and ask the Subcommittee's indulgence to do so.

Thank you , Mr. Chairman.

Senator WALLOP. I would not want it to go unspoken that I agree with you that I am in some way trying to find a solution to the problem. I don't share with you the idea that it is a problem. It's a problem for Max and me and others because we always have to defend against it. It is a certain sort of envy syndrome abroad in the land that I think is inherently unfair. Nonetheless, I'm not so naive as to think that it will go away. But the problem is the envy, not the identification that has been placed on it by you all. And I don't really believe that the way to solve the problem that plagues other parts of the country is to reduce the remainder of the country to the lowest common denominator. Somehow or another it's probably better to raise those areas than to lower the others. And I happen to be one that thinks that that is a possibility.

Senator DURENBERGER. Well, I would urge you then, Mr. Chairman, to broaden your perception of the problem. The problem is not Alan Dixon's bill or my proposal that you constantly have to fight against. The problem is the $200 billion deficit. The problem is an inequitable tax system in this country. The problem is the fact that every time we try to do good, we have to spread it all over the country, including places that don't need all that good. That is the heart of the problem and that is what we are trying to deal with.

Senator WALLOP. I will join in that we are trying to deal with it, but not by cutting my own throat.

Senator DURENBERGER. Maybe we will find a way that you won't bleed so much.

Senator BAUCUS. Dave, I would like to point one thing out. You talk about Minnesota and other States that have similar problems with higher AFDC payments because industries have leveled off or declined. I don't think that you are implying this, but some others who make the same point imply that States like Montana or Wyoming are States in which everybody is wealthy and has a good time. The fact of the matter is, we have our declining industries, too. Take Butte, MT, for example. Our total population in the State of Montana is about 800,000 people. It wasn't too long ago, about 50 years ago, Butte had a population of 100,000 people. They were miners. Today Butte's population, I think, is around the high twenties. We have lost about 70,000 people in about 60 years. To say the least, it is a declining industry which creates high unemployment rates. So those problems exist all over the country. They exist in Montana as well as in Minnesota and other States.

In the same vein, Montana's per capita income is much lower than, say, Illinois or Minnesota. The Illinois per capita income is $12,000. In Montana, it's $9,000. So however you slice it, I think that the States have to cope with their own problems. They have to be reasonable in doing so. I think the record is clear that we in Montana and Wyoming and other States have been very reasonable.

But I grant you that there are some inequities in our national tax effort. But I also suggest that what seems inequitable to some is equitable to others. And, since we live in a very complex country, I don't think we can impose a uniform tax system that is going to solve all the problems. The more simplistic we try to get, the more inequitable it is going to be.

So there is a balance here, and it changes all the time. It seems to me that all of us have to do our best jobs as representatives of our States, to just work with what we have and be fair and reasonable.

I think we generally have done that during the 208 years of our country's history, and I suggest we will continue to do so. But we cannot impose a single uniform system because our country is just too complex and changes too quickly.

Senator DURENBERGER. I don't know that I would suggest that we already have a single system. The problem is that it is not uniform.

Senator BAUCUS. You want more uniformity. You want something more simple.

Senator DURENBERGER. All I am suggesting is that we substitute for one factor, which drives some of our largest programs, which is per capita income—that we substitute for that a measurement of the capacity of each State to tax its income, its property, its transactions and its resources. That's a relatively simple system of measurement.

Senator WALLOP. Relatively simple but it removes from the State legislature and puts in the hands of Congress the judgment as to what segment of their economy they wish to tax.

Senator DURENBERGER. It doesn't in any way limit the ability of anybody to raise any taxes. Just says at the Federal level we will assume that a tax on all of these, 1-percent tax on income transactions, raises *x* number of dollars.

Senator WALLOP. To the contrary, Dave. That is saying that we must tax as you must tax all the varieties of taxable items.

Senator DURENBERGER. No, it doesn't. It doesn't require anybody to tax anything.

Senator WALLOP. Clearly it does, and you know it does.

Senator DURENBERGER. Merely because of the withdrawal of Federal money. If you withdraw some money from a State that doesn't have an income tax, doesn't have a sales tax, doesn't have a property tax, can you argue to the State that does have a sales tax or property tax and income tax that somehow or other you shouldn't do that?

Senator WALLOP. Your State and Senator Dixon's State, and Michigan and a number of other States collect more off of Wyoming and Montana coal than do we by virtue of your utilities taxes. The argument goes too far when you begin to create ramifications. I think there may be a better way of figuring formulas, but I think it's unrelated to this issue.

Senator DURENBERGER. Zip, closed mind, thank you. [Laughter.]

Senator WALLOP. Thank you very much, Dave.

Senator Murkowski has requested that he be given a few minutes. And I have a Congressional Research Service study which Senator Stevens has asked me to insert in the record that shows that approximately 87 percent of the severance taxes are not shifted.

[The study follows:]

STATE TAXATION OF MONTANA COAL AND THE ELECTRICITY GENERATED BY MONTANA COAL: INCIDENCE ANALYSIS AND TAX PER KWH AND MILLION BTUs

(By Dennis Zimmerman,
Specialist in Public Finance)

1. INTRODUCTION

Taxes on the production of coal have become an important policy issue. Non-energy states are concerned that the energy-producing states are exporting their taxes to out-of-state residents. Policymakers concerned with moving the nation away from dependence on imported oil are concerned that the growth of state severance taxation may impede the development of the nation's coal resources.

The Congress has considered measures to control state coal severance taxes. Electric utilities that purchase Montana coal have appealed to the U.S. Supreme Court a decision of the Montana Supreme Court upholding a 30 percent severance tax on coal production, claiming the tax violates the Constitution's Interstate Commerce Clause.

This report is intended to provide some background on the economics of this issue. Section II presents estimates of the major taxes levied on the production of Montana coal and the production and consumption of electricity, the use to which 98.4% of Montana coal is applied. No attempt is made to include taxes on intermediate goods and services in the production process, such as transportation and capital equipment.

Section III discusses the economics of tax shifting. If the severance tax raises the selling price of Montana coal which is sold in interstate commerce, the tax (or part of it) can be said to be exported. If the severance tax does not raise the selling price, then the tax is exported only to the extent that coal operators, owners of mineral rights, and coal labor do not live in Montana. Thus, interpretation of the estimates presented in Section II depends upon the evaluation of the coal and electricity markets presented in Section III.

II. Coal and Electricity Taxation

Montana produced 37.349 million tons of coal in 1979, of which 98.4% was used for electric power generation. The sales of Montana coal by state are presented in Table 1. Eleven states purchased varying amounts, ranging from Minnesota's 11.4 million tons (30.5%) to Pennsylvania and Nebraska's 1,000

TABLE 1. Montana Coal Sales by State: 1979

State	Short Tons (millions)	Percentage
Illinois	6.701	17.9
Indiana	1.281	3.4
Iowa	.362	0.9
Michigan	4.359	11.7
Minnesota	11.410	30.5
Montana	3.519	9.4
Nebraska	0.001	0.0
Pennsylvania	0.001	0.0
Texas	1.797	4.8
Washington*	5.050	13.5
Wisconsin	2.868	7.7

Source: "Bituminous and Subbituminous Coal and Lignite Distribution: Calendar Year 1979. U.S. Department of Energy. DOE/EIA-0125 (79/4Q) tons (.003%). Pennsylvania, Nebraska, and Iowa are not considered in the remainder of the report because they each consume less than one percent of Montana's coal production.

States consuming Montana coal levy general sales and gross receipts taxes, property taxes, license taxes, and corporation income taxes. Even for one type of tax, tremendous variation exists among states in the base against which the tax is calculated. It is necessary to simplify the task.

First, non-production property taxes are eliminated. Very few states levy a property tax whose revenues accrue to the state. The state role in the taxation of electric utilities is usually restricted to imposing uniform assessment standards across local and county governments so that every utility is subject to the same assessment ratio. Some states require all localities to levy the same tax rate calculated as the average of all local and county rates in the state. Other states allow rates to vary across local and county governments. The average rate is not readily available and its calculation would entail identifying hundreds of rates in each state. Nor is it possible to calculate an effective property tax rate by dividing electric utility property taxes by gross receipts, either for the U.S. or by state, because estimates of electric utility property taxes are not available. It should be noted that excluding property taxes from the analysis is a quantitatively serious omission, for these taxes are much larger than the state corporation income taxes (which are included). This omission is balanced by excluding Montana property taxes on coal producers.

Third, special utility charges to cover regulatory costs, usually levied at nominal rates, are eliminated. And, fourth, license taxes are not considered.

At the coal production stage, Montana levies a severance tax on the gross value of coal production (30 percent), a resource indemnity trust tax on the gross value of coal production (1/2 of 1 percent), a property tax on the gross value of production (effectively 7.2 percent), a property tax on machinery and eqnipment, and a corporation income tax (6.75 percent). All except the property tax on machinery and equipment are included in the analysis.

Table .2 contains estimates of these Montana taxes per kilowatt hour (kwh)

TABLE 2. Taxes on the Production of Montana Coal: Per kwh and per Million BTUs

Tax Source	Tax per kwh (cents)	Tax per Million BTUs 7/ (cents)
Severance Tax 1/	.13 5/	13.4
Property Tax on Production 2/	.03 5/	3.2
Resource Indemnity Trust Tax 3/	.002 5/	0.2
Corporation Income Tax 4/	.01 6/	1.1
Total	.172	17.9

1/ 30% of gross value of production

2/ 7.2% of gross value of production

3/ $25 plus 1/2 of 1 percent of gross value

4/ 6.75% of taxable income

5/ $.0054 times tax rate

6/ Calculated as corporate tax rate times pre-tax income, the result divided by total kwh generated in the state.

7/ Tax per kwh times 100 (the number of kwh per million BTUs). The figures in the two columns may not differ by a factor of 100 due to rounding in both figures.

Source: Calculations by CRS. Basic data from Commerce Clearing House, State Tax Guide; Edison Electric Institute, Statistical Yearbook of the Electric Utility Industry/1979; price of coal per kwh--Cost and Quality of Fuels for Electric Utility Plants, Energy Information Administration, Dept. of Energy, Dec. 1980.

of electricity and per million BTUs. These estimates assume the cost of Montana coal as of December 1980 is .447 cents per kwh of generated electricity (or $7.59 per short ton). The total tax is .172 cents per kwh or 17.9 cents per million BTUs.

Table 3 identifies the relevant tax sources and tax rates in the consuming states. All states, with the exception of Texas and Washington, levy two of these taxes. The problem is to convert these tax sources to a common unit of measurement. This requires measures of the price of electricity per kwh in

TABLE 3. Tax Sources and Rates Applicable to Electric Utilities

State	General Sales and Gross Receipts Rate	Selective Sales and Gross Receipts Rate	Corporation Income Tax Rate
Indiana	.04	X	.03
Illinois	X	.058	.0685
Michigan	.04	X	.091 2/
Minnesota	.04	X	.12
Montana	X	.002	.0675
Texas	.04	X	X
Washington	X	.036	X
Wisconsin	.04	1/	.034

X - No tax

1/ .026 rate applied to electric cooperatives

2/ Represents conversion of Value Added Tax of .0235 to an income tax of .091. See Advisory Commission on Intergovernmental Relations, The Michigan Single Business Tax: A Different Approach to State Business Taxation. Report M-114, March 1978, p. 47.

Source: Sales and Gross Receipts Taxes—Lillian Rymarowicz, State General Sales and Gross Receipts Taxes on the Sale of Electricity in the 50 States, April 1980. Congressional Research Service, Library of Congress; Corporation Income Tax--Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism 1979-80. Report M-123, p. 134-138.

each of the consuming states. These are derived as total revenues for all electric utilities in a state divided by the total kwh generated in the state. The price estimates range from 1.1 cents per kwh in Washington to 4.3 cents per kwh in Michigan. The price per kwh is multiplied by the general or selective sales and gross receipts tax rate to obtain the estimated tax per kwh. This estimate is entered in column 1 of Table 4.

Estimates of state corporate income taxes per kwh are more complicated. It is necessary to approximate the state corporate income taxes paid by electric utilities in each state, and divide the estimate by total kwh. Net

TABLE 4. Tax per KWH and per Million BTUs for States Consuming Montana Coal

	(1)	(2)	(3)	(4)	(5)	(6)
	Per kwh			Per Million BTUs		
State	Sales and Gross Receipts Tax	Corporation Income Tax	Total	Sales and Gross Receipts Tax	Corporation Income Tax	Total 1/
	(cents)	(cents)	(cents)	(cents)	(cents)	(cents)
Indiana	.14	.01	.15	12.0	1.3	13.3
Illinois	.24	.03	.27	23.8	3.4	27.2
Michigan	.17	.05	.22	17.2	4.7	21.9
Minnesota	.07	.05	.12	7.3	5.2	12.5
Montana	.003	.01	.01	0.3	1.3	1.6
Texas	.14	X	.14	14.0	X	14.0
Washington	.04	X	.04	4.0	X	4.0
Wisconsin	.15	.03	.18	15.2	3.2	18.4

X - No tax

1/ Tax per kwh times 100 (the number of kwh per million BTUs). The figures in the columns may not differ by a factor of 100 due to rounding in both figures.

Source: Calculations by CRS. Basic data from Edison Electric Institute, Statistical Yearbook, 1979; and Table 3.

electric utility income is available for the entire industry. It is necessary to adjust this figure for various deferrals and allowances to obtain an appropriate pre-tax income estimate. This is divided by operating revenues to obtain the pre-tax net income share. This share (.1209) is then multiplied by electric utility revenues in each state to obtain estimates of the corporate income tax base. The corporate income tax rate is applied to this base, and divided by total kwh to obtain an estimate of the corporate income tax per kwh. These estimates are presented in column 2 of Table 4.

With the exception of Montana and Minnesota, the sales and gross receipts taxes are much larger than the corporate income taxes. The total tax in column 3 ranges from .01 cents per kwh in Montana to .27 cents per kwh in Illinois. The total tax ranges from 1.6 cents per million BTUs in Montana to 27.2 cents per million BTUs in Illinois.

The total tax as a percentage of the price of electricity is presented in Table 5 on the following page. The computations are made from the tax per million BTUs in Table 4 in order to reduce the influence of rounding error (though the tax per kwh in Table 4 is rounded, it was not rounded when used as an element in calculating the tax per million BTUs). The estimates in column 1 are derived by dividing the total tax in coulumn 6, Table 4, by the price of electricity produced with a million BTUs in each state. The estimates in column 2 are derived by dividing taxes on the production of Montana coal in Table 2 (17.9 cents) by the price of electricity produced with a million BTUs in each state.

The Montana production taxes are a higher percentage of the price of electricity than are the Sales and Gross Receipts Taxes plus Corporation Income Tax in five of the eight states. The exceptions are Illinois and Michigan, where the Montana taxes are lower by one and two percent, and Wisconsin, where they are almost equal.

TABLE 5. Total Tax as a Percentage of the Price of Electricity

	(1)	(2)
State	Tax in Consuming States	Coal Production Taxes in Montana
	(%)	(%)
Indiana	3.7	5.0%
Illinois	6.6	4.4
Michigan	5.1	4.2
Minnesota	3.5	5.0
Montana	1.0	11.2
Texas	4.0	5.1
Washington	3.6	16.3
Wisconsin	4.8	4.7

Source: CRS calculations based on Tables 2 and 4.

III. The Incidence of Montana's Coal Production Taxes

Severance taxation is believed by many to promote tax exportation and to slow resource development, even though the two goals imply very different and inconsistent beliefs concerning the incidence of severance taxes. Those touting severance taxes as a tax exportation vehicle assume consumers of electricity are not responsive to price. The tax can be passed forward without any significant offsetting reduction in the demand for electricity generated by coal, or any of the intermediate goods used in its production (coal, transportation, generating equipment, etc.). No decline in total revenues or profits occurs.

Those touting severance taxation as a device for slowing the rate of resource development and controlling growth and environmental degradation assume consumers of electricity are responsive to price. The tax cannot be passed forward without significant offsetting reduction in the demand for electricity generated by coal and the intermediate goods used in its production. Total revenues and profits decline. Coal development is slowed and the price rises by less than the the full amount of the tax.

The estimates in Table 2 represent the potential increase in electricity prices which would result if all Montana coal production taxes were passed forward to consumers. But it is not at all certain that these taxes are passed forward to consumers, particularly if a sufficiently long time period is considered. This section discusses the market conditions and institutional constraints which have a bearing on the incidence of coal production taxes.

There are several primary factors which affect a state's ability to export severance taxes. One of the most important is dominance of the taxing jurisdiction in the market--that is, are there alternative suppliers for Montana's current and potential customers? The more dominant is Montana, the less sensitive will its buyers be to price changes, and the smaller will be offsetting reductions in quantity sold and total revenues.

But defining the appropriate market is not easy. Montana produces a relatively small share of the national coal supply. But several factors may work to place Montana coal in a market much more restricted than the nation. First, electric utility access to Montana coal is dependent upon the transportation network. Some potential suppliers are eliminated because their transportation costs are higher by an amount that exceeds Montana's tax differential No savings would result from buyers switching to these suppliers--in fact, these alternative suppliers would cost more. Second, environmental constraints concerning sulfur emissions may precludo the use of coal with sulfur content greater than Montana's. It may cost more to remove sulfur from emissions than it does to pay a price differential for Montana coal. Third, boilers are built for fuels with particular physical characteristics in terms of impurities and energy content. The cost of altering the boilers to accommodate different types of coal may exceed the value of the tax differential. Finally, the existence of contracts extending 25 to 30 years effectively precludes most existing buyers from changing to an alternative source of supply, and usually guarantees a "pass through" of new production taxes. All these factors work to increase Montana's dominance of the relevant market and make the export of production taxes to consumers more likely in the short run.

What has been argued here is that, even though the coal extraction industry is a competitive industry and no state dominates production, a variety of institutional factors in effect dilute this competitiveness, reduce the price sensitivity of buyers, and allow forward shifting. But one cannot take this too literally, for it suggests that people do not respond to relative price differences. Several qualifications should be kept in mind.

First, the price responsiveness of buyers of Montana coal is dependent not only upon the difference in its price and alternatives, but also upon how important the cost of the taxed commodity is in the total cost of the final product. As the price of alternative fuels continues to rise--and therefore the price of coal continues to rise --and as production taxes in all coal producing states rise, coal will become a progressively more important component of electricity generation, and buyers will become more price-sensitive.

Second, some constraint is imposed by the presence of alternative fuels--electricity can be generated with different grades of coal, uranium, oil, and gas. Though a utility cannot switch fuel sources for a particular plant in the short run, new plants can be planned with alternative fuel sources and conversion of existing plants can occur as generating equipment wears out. In the long run, these responses to higher prices will reduce the demand for Montana coal below what it would otherwise have been, reduce the demand for labor, lower the return on capital, and reduce the rents being earned by owners of mineral rights. Thus, the taxes are not completely shifted to consumers, and the real incomes of owners of mineral rights and immobile labor and capital (if any) are reduced. Whether this portion of the tax burden is exported depends upon whether these groups of individuals reside in Montana.

Finally, if the institutional factors discussed above impose permanent constraints and Montana coal does occupy a monopoly position in a sufficiently narrow market, economic theory suggests profits are maximized by not passing the full amount of the tax forward in price. The extent of forward shifting varies directly with buyers' price sensitivity. Thus, even in the absence of alternative fuels, conservation efforts indicate price sensitivity and influence shifting over the long run. Though the regulatory process allows all cost increases (including production taxes) to be passed through in higher electricity prices, consumers respond by reducing electricity consumption. If this reduced consumption causes the utility to operate at less than full capacity, the resulting price increase may even exceed the tax increase, and the consumer response is even greater than expected. The utilities' demand for coal falls over the long run and part of the tax is borne by owners of mineral rights and immobile labor and capital.

Thus, one must be cautious in asserting that Montana's coal production taxes are and always will be shifted forward to consumers and exported from the state. Though it is true that transportation, engineering, and contractual arrangements appear to provide a degree of market dominance to Montana short run, new plants can be planned with alternative fuel sources and conversion of existing plants can occur as generating equipment wears out. In the long run, these responses to higher prices will reduce the demand for Montana coal below what it would otherwise have been, reduce the demand for labor, lower the return on capital, and reduce the rents being earned by owners of mineral rights. Thus, the taxes are not completely shifted to consumers, and the real incomes of owners of mineral rights and immobile labor and capital (if any) are reduced. Whether this portion of the tax burden is exported depends upon whether these groups of individuals reside in Montana.

Finally, if the institutional factors discussed above impose permanent constraints and Montana coal does occupy a monopoly position in a sufficiently narrow market, economic theory suggests profits are maximized by not passing the full amount of the tax forward in price. The extent of forward shifting varies directly with buyers' price sensitivity. Thus, even in the absence of alternative fuels, conservation efforts indicate price sensitivity and influence shifting over the long run. Though the regulatory process allows all cost increases (including production taxes) to be passed through in higher electricity prices, consumers respond by reducing electricity consumption. If this reduced consumption causes the utility to operate at less than full capacity, the resulting price increase may even exceed the tax increase, and the consumer response is even greater than expected. The utilities' demand for coal falls over the long run and part of the tax is borne by owners of mineral rights and immobile labor and capital.

Thus, one must be cautious in asserting that Montana's coal production taxes are and always will be shifted forward to consumers and exported from the state. Though it is true that transportation, engineering, and contractual arrangements appear to provide a degree of market dominance to Montana producers, it is also true that consumer sensitivity to higher electricity prices and buyer sensitivity to price differentials for alternative fuels will utimately constrain this forward shifting and distribute at least some of the tax burden to owners of mineral rights and immobile labor and capital. To what extent these constraining forces have taken effect in the Montana coal market remains an open question.

STATEMENT OF HON. FRANK H. MURKOWSKI, U.S. SENATOR FROM THE STATE OF ALASKA

Senator MURKOWSKI. Thank you, Mr. Chairman. I very much appreciate the opportunity to submit testimony on the pending bill, S. 463, which would impose Federal limitations on the States' authority to collect energy severance taxes.

I might add that the senior Senator from Alaska, Senator Stevens, would be at this hearing; however, he is detained at the White House this morning in preparation for our policy meeting this afternoon so he is unable to be with you. He wanted to express to you his interest as evidenced by what has been submitted into the record by his office.

As you might suspect, I am strongly opposed to this legislation for the very basic reason that it infringes upon State prerogatives. And in addition, I feel that it is totally unnecessary because there cannot be an equitable application of such proposed revenue sharing.

The bill cuts into the very heart of a State's right to exercise its authority and jurisdiction for levying taxes. Historically, the States have been given a wide latitude in the exercise of taxation powers, and the Congress has wisely been reluctant to interfere with the taxing power. We have sought to avoid conflicts between congressional action and the traditional methods used by the States to generate revenues, and I submit that now is not the time to alter this approach.

In addition, any action that reduces the ability of a State to generate revenues can severely jeopardize the necessary functions of that State's government and the welfare of its citizens. For this reason, Mr. Chairman, it is improper to legislate against a reasonable tax which rationally reflects the activities and needs—and I cite the word "needs"—of a certain State.

With the introduction of this bill, the Senator from Illinois is proposing that the Federal Government get into the business of dictating the parameters of a State's taxation privileges based on a very narrow set of largely geographic criteria. State taxes reflect the realities of our Nation's geographic diversity. Energy producing States use the severance tax to gather revenue on their most important source of wealth within their State.

It is inequitable to deny a State the ability to tax its principal economic activity. For example, if we choose to limit a State's ability to tax income from the production of manufactured goods, then States such as Illinois, where manufacturing accounts for most of the value of goods produced, would be effectively deprived of revenue from the centerpiece of their economic base.

Mr. Chairman, I also oppose S. 463 because it unfairly singles out the younger, the less developed States which also happen to be energy producing States. In our State, for instance, we have only been a State for 25 years and we have a lot of catching up to do. It is an incorrect presumption that because of the significant revenue potential presently being derived from oil and gas and other resources that this is a situation that is going to last.

Revenue from the taxation of energy production is the means by which our State and others hope to build the infrastructure and to provide the services that older industrialized States have had for years. That infrastructure has been built up—the schools, the highways, the various public institutions, the educational system—within those older States.

Alaska is one of the youngest and least developed States. Historically, outsiders have exploited our fish, our fur, our timber, and our gold resources. This wealth has been removed from our State and very little has been left in return. In the past, this exploitation has condemned my State to a boom or bust economic cycle.

Today in our State we have one of the highest unemployment figures in the Nation. Part of the reason is that our geography is such that our resource development is curtailed in the winter months—our construction, our fisheries and so forth—and as a consequence, it adds to these high unemployment figure.

As I have indicated, Alaska oil is not going to last forever. We are trying to build up the economic base which will diversify our economy and forestall yet another bust. I would remind you respectfully, Mr. Chairman, that it is appropriate that those States that are exploiting their nonrenewal resources should protect their renewable resources and invest for the prosperity of future generations. In our State, that prosperity will come from fish, timber, agriculture, and tourism.

Alaska deserves the opportunity to provide a decent standard of living for its citizens, and legislation of this type could condemn Alaska and some other States to a long-term boom and bust economy.

Finally, Mr. Chairman, I must reject the often heard argument that a State's mineral severance taxes somehow get passed along to consumers in nonproducing States. This simply hasn't been the case, particularly with regard to Alaska oil. Alaska oil is sold at a world market price, and it either competes or it doesn't compete. The world pricing structure prevents tax exportation to consumers. The burden of severance taxes is carried primarily by landowners and leaseholders who are forced to conform to the ultimate price dictated by that world market. The value of our oil is a value determined after transportation to market is deducted. That is the point at which the value is ascertained. And, again, Mr. Chairman, the fact remains that Alaskan oil is set at a world pricing structure.

To summarize, Mr. Chairman, this bill constitutes a dangerous and far-reaching precedent which will undermine our federal system of government and which will jeopardize the ability of a State or State government to provide for the welfare of its citizens. It represents a tremendous leap backward with respect to States' rights. It unfairly singles out a handful of energy producing States. It is based on the false premise that energy severance taxes are exported to consumers in nonenergy producing States. Any one of these reasons is sufficient to oppose the bill. Taken together, I would hope that they will persuade all of my colleagues that this legislation must be soundly defeated.

I did not have the privilege of hearing my friend from Illinois and his comment with regard to the permanent fund distribution in which my State dispersed to its citizens a significant amount of money. I would remind you that this was an effort to provide some sharing among the residents of the State of Alaska. These funds were accepted by those residents and expended within our State. And what better way, if you will, to distribute at a time when government had an excessive amount of money than dispersing it to the citizens because; after all, they represent and make up the government within any State. We know in the State of Alaska that our permanent fund dividend is not gcing to be with us forever. I think we are responsible in recognizing that government should not have more funding than it needs at any given time, and that if there is temporarily an excess amount of funds, then it is it quite appropriate that these funds be shared with the residents of the States.

Further, Mr. Chairman, I would remind my colleague from the State of Illinois that we in Alaska pay through the sales arrangement, from the standpoint of goods manufactured in the State of Illinois, taxes that are distributed and entitled to be distributed to the residents of Illinois. And I'm sure my colleague from Illinois is not suggesting that he would be willing to have those taxes which his State collects shared among the other States.

What we are working with here is obviously a matter of equity. And as I have indicated earlier, I don't feel that there is a practical and equitable solution to the sharing of revenue between the various 50 States.

I would be happy to respond to any questions you might have, Mr. Chairman.

Senator WALLOP. Thank you.

[The prepared written statement of Senator Murkowski follows:]

STATEMENT OF SENATOR FRANK H. MURKOWSKI
BEFORE THE SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION
COMMITTEE ON FINANCE
UNITED STATES SENATE

July 24, 1984

Mr. Chairman, I appreciate this opportunity to submit testimony on S. 463, legislation imposing Federal limitations on a state's authority to collect energy severance taxes.

I am strenuously opposed to this legislation for some very basic reasons; it infringes on state perogatives and it is totally unnecessary.

S. 463 cuts to the very heart of a state's right to exercise it's authority and jurisdiction to levy taxes. Historically the states have been given wide latitude in the exercise of their taxation powers. The Congress has wisely been reluctant to interfere with that taxing power, and we have sought to avoid conflicts between Congressional action and the traditional methods used by the states to generate revenues. I submit that now is not the time to alter this approach.

In addition, any action that reduces the ability of a state to generate revenues could severely jeopardize the necessary functions of that state's government and the welfare of its citizens. For this reason it is improper to legislate against a reasonable tax which rationally reflects the activities and needs of certain states.

With the introduction of this bill, the Senator from Illinois is proposing that the Federal government get into the business of dictating the parameters of a State's taxation privileges based on a very narrow set of largely geographic criteria.

State taxes reflect the realities of our nation's geographic diversity. Energy producing states use the severance tax to gather revenue from their most important source of wealth. It is inequitable to deny a state the ability to tax its principal economic activity. For example, if we chose to limit a state's ability to tax income from the production of manufactured goods, then states such as Illinois, where manufacturing accounts for most of the value of goods produced, would be effectively deprived of revenue from the centerpiece of their economic base.

Mr. Chairman, I also oppose S. 463 because it unfairly singles out the younger, less developed states which also happen to be energy producing states. Revenue from the taxation of energy production is the means by which these states hope to build the infrastructure and to provide the services that older, industrialized states have had for years.

Alaska is one of our youngest, least developed states. Historically, outsiders have exploited Alaska's fur, timber and gold resources, taking the wealth of those resources with them when they left. In the past, this has condemned my State to a "boom-or-bust" economic cycle.

Alaska's oil isn't going to last forever. We are trying to build the economic base which will diversify our economy and forestall yet another "bust". Alaska deserves the opportunity to provide a decent standard of living for its citizens. Legislation of this type may forever condemn Alaska to a "boom-and-bust" economy.

Finally, Mr. Chairman, I must reject the often heard argument that a state's mineral severance taxes somehow get passed along to consumers in non-producing states. This simply hasn't been shown to be the case, particularly with respect to Alaska oil. Alaska oil is sold at the world market price. The world oil pricing structure prevents tax exportation to consumers. The burden of severance taxes is carried primarily by landowners and leaseholders who are forced to conform to the ultimate price dictated by the market.

In summary, Mr. Chairman, this bill constitutes a dangerous and far-reaching precedent which will undermine our federal system of government and which will jeopardize the ability of state governments to provide for the welfare of their citizens. It represents a tremendous leap backward with respect to state's rights. It unfairly singles out a handful of energy-producing states. It is based on the false premise that energy severance taxes are exported to consumers in non-energy producing states. Any one of these reasons is sufficient to oppose the bill. Taken together, I hope they will persuade all of my colleages that this legislation must be soundly defeated.

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Senator BAUCUS. Frank, thank you very much for your support. I appreciate it.

Senator WALLOP. Senator Stevens has asked if he could make a comment.

STATEMENT OF HON. TED STEVENS, U.S. SENATOR FROM THE STATE OF ALASKA

Senator STEVENS. Thank you, Mr. Chairman. I won't be long. I have just been on the floor and I have just returned from Alaska overnight, so you know what the red eye flight is like. I'm not going to take too much of your time.

I think Senator Murkowski presented his position and I have been informed of what it was. I would like to ask that you include my statement in full in the record, and to make two major points.

We have had studies made that demonstrate that the Alaska severance tax is not shifted to consumers in other States. I understand you have put that study from the Congressional Research Service in the record, and for that I thank you.

But I think one of the things that we have to keep in mind more than anything else is that it is basically the newer States from the West, and particularly ours from the Northwest, that are involved that have used this taxing method. And it is fair. It is one that makes sense in terms of our resource base. It is a comparatively small tax on the whole process, if you look at the gasoline and other taxes that are charged in other States for the resources that are actually provided to the Nation due to development in our States. And I'm hopeful that we can reach a conclusion that the severance tax policy is one that has favored one of the strongest energy programs in the world, and ought to be continued. Without it, it would be impossible for a State like mine to meet the challenges of coming into the 21st century along with all the other States. Thank you for permitting me to be here.

Senator WALLOP. Thank you, Ted. And your whole statement will be made part of the record.

[The prepared written statement of Senator Stevens follows:]

Senator Stevens' Statement on the Severance Tax Equity Act of 1982

Mr. Chairman, thank you for the opportunity to remark on S. 463, the Severance Tax Equity Act of 1982.

As a representative of the State of Alaska , I feel that it is necessary to express my opposition to and concern with S. 463. The Severance Tax Equity Act of 1982, as presented before the Senate, places a cap on the severance tax rate that a State may charge private developers for the removal of energy resources. The bill is deficient in several respects:

- the limitation on a state's authority to set an appropriate severance tax rate geared to meet the future impacts of energy development will decrease an energy state's ability to provide necessary public services for its constituents;
- this type of federal intrusion in state taxing policies is contrary to the sovereign rights reserved to the states by the Constitution;
- the declaration of energy as a "national" resource is unprecedented in light of current national energy policy and is inapplicable to the present issue; and
- this bill will cause further "regionalization" among the states of this country, making the objectives promoted by the Administration's "new federalism" initiatives more difficult to achieve.

Severance Taxes Reduce the Need for Federal Impact Aid

The United States has made a national commitment towards decreasing our dependence on imported crude oil and increasing the recovery and production of our domestic energy resources. One of the by-products of this policy decision is the impact on local communities that accompanies this development stage. In the past, federal programs were designed to aid state and local governments that were affected by these impacts. Section 601 of the Powerplant and Industrial Fuel Act of 1978 (P.L. 95-620) was designed to protect states and localities affected by uranium and coal production activities. The present Administration has not requested funding for this program in FY 1985.

The Mineral Leasing Impact Assistance program, through the 1976 Federal Land Policy and Management Act (P.L. 94-579) has the potential to ameliorate some of the impacts caused by energy development on Federal lands in Western states.

This program is not funded in the FY 1985 Interior Budget. The Payment in Lieu of Taxes Act (P.L. 94-565) could have provided assistance to communities affected by energy development. This program has also not been funded in the Interior Department's FY 1985 budget.

Finally, the Coastal Zone Management Act Amendments of 1976 had provisions to provide for a Coastal Energy Impact Fund. The present Administration has proposed no new funding for this program.

The justification by the Administration in each of these cases has been that the impact mitigation is primarily the responsibility of state and local governments working in tandem with local developers. In other words, the state and local governments, through their police and taxing powers, have the responsibility for requiring that private developers account, not only for their economic costs, but also for the related "social" costs of their development projects.

The severance tax has been the energy producing states' answer to this serious and real problem. By increasing its revenue base, an energy producing state acquires the financial resources to minimize the environmental, economic, and financial costs that accompany energy development. The State of Alaska is presently engaged in using this revenue base to ease the impact of oil recovery programs and to develop its renewable resource industries such as the logging, fishing, and agricultural industries. These programs will aid Alaska in establishing a firm and stable economic base for future development when the state can no longer rely on the recovery of natural resources for its revenue.

Federal Intrusions into State Severance Policies are not Warranted under Our Federal System of Government

The Supreme Court in Commonwealth Edison Co. et al. v. Montana ruled that a state severance tax does not violate the U.S. Constitution's Interstate Commerce Clause. The Court went on to rule that Congress has the power to determine what constitutes an "excessive" severance tax margin.

Until the introduction of S. 463, the Congress has wisely decided not to place any limitation on state legislated severance taxes. In light of the current Administration's goals to institute a "new federalism" program, it is now more important than ever that Congress reaffirm a State's right to assert its sovereign authority in determining the tax rate that adequately provides for the needs of its citizens.

In recent years most of this Nation's leaders have recognized that there are State interests and powers that most be reserved for them to remain an integral part of our federal system. Among these powers are the right to tax businesses to assure that the social costs of development are adequately addressed by programs which respond to development. The severance tax has become one mode by which energy producing states have been able to provide for the welfare of its citizenry in response to a changing local economy and environment. Congressional intervention in this area can only lead to greater state-federal strife which Congress should be minimizing, not exacerbating.

The Severance Tax on Alaskan Crude Oil is not Passed on to the Consuming Public

Congressional intervention might be mandated if it could be proven that the effect of the severance tax was to pass on the additional costs of the private developers to the energy consumers of this country. But several studies, including one by the Congressional Research Service on Alaska's Severance Tax, have clearly shown that severance taxes on light crude oil are passed on to the ultimate consumer only to a limited extent. The Alaskan study demonstrated that imported oil is a complete substitute for Alaskan oil. As a result, approximately 87% of Alaska's oil severance tax is not passed on to the consumer. The study also concluded that the higher prices are costly to the State of Alaska because they reduce the level of output. Therefore, oil producers are required to absorb nearly the entire costs that are incurred by the severance tax and the resulting loss is accounted for as a loss in net profits.

Energy as a "National" Resource

There have been some proposals to declare energy a "national" resource to justify the policy behind S. 643. This is simply an inappropriate and unsatisfactory justification.

First, this bill is discriminatory against energy producing states, particularly western states where the use of the severance tax is most prominent. The negative effect that declaring energy a "national" resource will have on a state's incentive to continue to produce domestic energy is apparent. If the energy producing states do not feel that they can acquire sufficient revenues to cover the "costs" of energy development, then they will not seek out new development and energy sources. For a country that has a large interest in encouraging the production of domestic energy sources and discouraging the use of imported oil, this bill is inconsistent with the energy policy that the United States requires well into the next century.

Second, the ramifications of this proposed bill go far beyond a mere limitation on the severance rates of mineral resources. The logic could be applied to water resources, an area of traditional state sovereignty. We have seen the vigorous disputes over water resources in California and Arizona that have lasted since the 1900's. Because of several ongoing water projects, this issue is bound to reach national proportions in the next several years. Is the proper solution to this delicate problem to declare water in this area a "national" resource and cast aside state claims to the resource? I really do not believe that Congress is willing to countenance this overreaching on the part of the Federal Government at the expense of state authority and interests. In short, it is argued that this proposal is applicable to situations where one state or group of states believes that it can recapture part of the economic advantages earned by another state's better planning and foresight. This type of premise for decision-making is inappropriate for the federal government and unacceptable to me.

Finally, S. 463 would limit the severance tax that states can charge on crude oil produced on state land as well as Federal land. Whatever justification there might be for limiting state control over federal resources, this cannot be extended to energy development on state land. Particularly in the western states where such a large percentage of the land within a state is federally owned, it is important that states be allowed the freedom, within reasonable environmental constraints, to guide development on state owned land. Currently, the federal government owns 275 acres out of 375 acres in Alaska. The State is presently engaged in selecting the remaining lands guaranteed it under the Statehood Act of 1958. When Congress mandated that ~~the~~ State should be entitled to choose and own a certain percentage of the land, it seems reasonable to believe Congress intended the State to be able to assert its sovereign power over this land. This control should consist of the right to determine an appropriate severance tax. Under S. 463, the federal government intends to receive the benefits that arise from development on state land while at the same time not allowing the State government the ability to respond to the effects of resource development.

Effects of Enactment of S. 463

'It should be impressed upon the Congress the consequences that this bill will have upon my state and its constituents. If enacted, this bill will cause my state to lose eight (8) billion dollars in revenue over the next five years. Our state budget for the following fiscal years will be nearly cut in half. This revenue is critical not only for the short-term development problems that Alaska faces, but also for the long-term development problems that we foresee.

At this critical time in our history, Alaska must develop its infrastructure to accommodate the needs of its citizens. This includes the construction of sewage systems which are presently inadequate, or for another example, the construction of highways for a state one third the size of the United States. Few realize the tremendous costs incurred by Alaska for the construction of multi-million dollar schools for villages with twenty or so students. These are just a few of the services that must be delivered to the citizens of Alaska before Alaska can begin to be said to provide services analogous to its sister states.

This proposed bill strikes at the heart of the future economic development of Alaska and all energy producing states. The effects of this bill should be carefully considered, not only on state economy but also on the effect this bill will have on state legislatures who are currently grappling with the problems of shrinking federal assistance, increasing social service responsibilities and few revenue options available to deal with these new responsibilities.

Finally, it seems ironic that when a state attempts to look into the future and provide for its constituents against some of the negative effects of economic development, it is branded an exploiter rather than commended. The State of Alaska, as well as the other energy producing states, are embarking on a new mode of legislative thinking; rather than wait for the consequences of energy development to appear, they have attempted to plan to respond to the impact on their local communities before development begins. Alaska's actions represent a prudent manner of legislative thought that should be encouraged, rather than discouraged. Alaska is planning for the future of its citizens so that it will be able to meet the challenge presently placed in front of it by a more austere federal government, and by the need to develop an infrastructure lagging far behind the rest of the United States. It is for these reasons that this bill should be rejected by this Committee and the Senate.

Senator WALLOP. Now my patient friend and neighbor from the State of North Dakota, the Honorable Byron Dorgan. Thank you for indulging us.

STATEMENT OF HON. BYRON L. DORGAN, U.S. REPRESENTATIVE, STATE OF NORTH DAKOTA

Mr. DORGAN. Thank you, Mr. Chairman. I serve on the House Ways and Means Committee. From that vantage point, I see a lot bad legislation. And this fits very neatly into that category.

It stretches one's imagination to believe that the Federal Government under the best of conditions ought to be giving advice to State governments about how to run their fiscal affairs. I served in State government in North Dakota for a number of years before I came here, and let me tell you, as I am sure you know, Montana and Wyoming and North Dakota and the State governments of many other States in this country are in much better financial shape than is the Federal Government. I just suggest that it might not be in our best interest to be dispensing advice to State governments on how to handle their fiscal affairs.

But notwithstanding that, the previous speakers have indicated that this is to some extent a State's rights issue, and it is. You go back and take a look at what the Founding Fathers anticipated in this country. One of the things they anticipated was that the States would have the sovereign power to develop their own tax and revenue systems. They felt that there won't be any attempt to interfere with that. Of course, as time goes on, there is more and more of an inclination by some to want to interfere with the States' rights.

Fact is with respect to severance taxes on energy, most particularly coal—but the bill that is before you today includes oil and natural gas—the market itself will make some judgments about what State governments will do. Montana, Wyoming and North Dakota, just to mention three States that are involved in the Fort Union Coal Basin, would be very ill advised to develop coal severance taxes that would chase the coal industry out of their States. And that's why they don't enact coal severance taxes at that level of taxation.

None of the States that you have heard from today are very interested in driving the energy industry out of those States. That industry is a job creating industry. It's important to the States' economy. It's an important source of revenue. And the market itself will help determine what an appropriate level of taxation is.

When we had no severance tax in North Dakota at a time when no one was really interested in lignite coal, the coal industry, when it appeared that the demand for lignite would be present, the coal industry said, well, we would accept a $0.05 a ton severance tax. And everyone said, well, thank you very much; that's a very generous offer; $0.05 a ton is a tremendous amount of revenue. We went ahead, of course, and developed our own severance tax system, much in excess of $0.05 a ton, which was very inadequate.

The result of the development of the severance tax in North Dakota, a severance tax in Montana and other States on coal led some in other parts of the country to suggest, as Senator Baucus indicated, that we were attempting to pirate at the expense of other States' revenues that we should not have. That is simply not the case. It never was the case. This is a smoke screen that people raise. Particularly the energy industry raises this smoke screen; most particularly, the charges that are levied against the severance taxes. And let me deal specifically with coal.

Most specifically, those charges come from a bunch of self-serving interests who would like to see us have no severance tax. I read the advertisements, particularly, several years ago the advertisements put out by certain industries that indicated we were trying to develop severance taxes that were unreasonable. Well, the people who were making that case were people who stood to gain directly, industries that stood to gain directly, from reductions in the severances taxes that they could get the States to enact.

And North Dakota in fact did buckle under some pressure. Our State legislature did at one point reduce the severance taxes for a time. And interestingly enough one of the news organizations called one of the utility companies through whom the severance tax was passed and said now that the severance tax has been reduced, even though it's a small increment, now that it has been reduced will that reduction flow through to the consumer? Will the consumer actually experience a lower electric bill because of that reduction in the State severance tax?

Oh, no, they said. The severance tax is really an insignificant part of the cost of the kilowatthour. That's exactly the case. It's exactly the case with respect to coal severance taxes. The severance taxes enacted by the States that are in question here are a relatively insigificant part of the bill that is paid by the consumer in North Dakota, Montana, Wyoming, Chicago, Detroit, Minneapolis. A relatively insignificant part of their electric bill.

I think it's fine if they want to air-condition Chicago in the summer. If I lived there, I would want to do that as well. And heat Minneapolis in the winter. If I lived there, I would want heat as well. And it's also fine for them to find coal sources from Montana and sources for the electrical energy from North Dakota. But it's appropriate, and in fact it seems to me that history ought to tell us that it's imperative for States like Montana, North Dakota and Wyoming to pass along not only the blessings of energy to those consumer States, but also the cost of producing that energy and all of the costs of producing that energy. The scars of Appalachia, it seems to me, are reminder enough that when you don't plan development wisely you are stuck later when that development is finished with all the costs. You have no employment left. You have a scarred Earth. You have a ravaged economy. And you have no resources with which to deal with it. And we have learned that lesson, And I think about 6 or 8 years ago some States in this country were sending a message to the rest of the country that we are going to do it, but we are going to do it right this time. And I think that's progressive. And I think it's right, and I think it makes good sense.

So I think that the States that Senator Dixon and others complain about really ought to be lauded for what they have done. They have done the right thing. The State governments saying we are going to be the leaders. We are going to develop coal. We are going to develop oil and natural gas. But we are going to do it the right way. And we are going to plan for the future of our States.

Now if I might just make one additional comment, Mr. Chairman. Mr. Durenberger and I have had long, lively and interesting discussions about the role of North Dakota and Minnesota and about the relationship between Minneapolis, St. Paul and North Dakota.

When we extract a ton of coal from North Dakota, and put it from the mine mouth into a coal-fired electric generating plant, we produce in that kind of coal somewhere around 1,100 kilowatthours of electricity. And it sells over in Minneapolis, I think, as the chairman was alluding to earlier, it sells over in Minneapolis for $40 or $50 for that 1,100 kilowatthours.

And Minnesota will impose a sales tax. And Minnesota will reap a sales tax of 5 or 6 percent of that $40 or $50. So Minnesota will collect somewhere around $2, $3, $3.50 from a consumer tax on that product of that 1 ton of coal produced in North Dakota and sent in the form of electricity to Minnesota to provide air-conditioning or heat or whatever it is they want to do over there.

The point I'm making is that the severance tax that North Dakota would levy on that ton of coal, the coal that is achieved by strip mining, the electricity that is achieved by burning the coal in the plant, and sending up noxious emissions of sulphur dioxide and other things—we will bear all of the costs and some of the benefits, including jobs, and Minnesota will get the end product and tax that on a consumer tax and raise more money than we will with our severance tax at the point of origin.

Now I fail to understand how anyone could suggest that a producer State bearing those costs of development, levying the kinds of taxes we have been levying, is not doing precisely the thing it ought to do in the name of good government.

We had a politician in the Midwest—actually the southern part of the Midwest—run for office a few years ago. And he was successful. He has run twice now statewide. And it was successful and probably will be successful in the future. He was running against the coal severance taxes, and against the resource taxes enacted by some of our States. And that kind of division that is occurring more and more frequently, I think, is what is promoting the kind of legislation we are seeing from the Senator from Illinois, the Senator from Minnesota and others. The belief fostered, I think, principally by the industry, but also by some from consumer States that producer States are not being fair. The producer States are doing exactly what they have to do. They are doing exactly what they ought to do.

I think when I testified before a committee that Senator Baucus had some while ago, I talked about the Texas hog rule. And I might not want to do that today because now they have thrown oil and natural gas in with coal with powerful allies who are protecting the severance tax and oil and natural gas and appropriately so I might add this bill seems destined to serve as the role of the rug on the clothesline, and I expect will not go very far.

But we have had some hog rules among the States. You enact what you want, get what you can for yourself, and scream loudly when somebody else does the same. Again, having been a State tax official, having now served in the House on the Ways and Means Committee and having seen a lot of tax legislation, this ranks among the worst that I have seen in a good long while. And treads on, I think, constitutional prerogatives and authorities and just defies good sense.

So let me commend the chairman and Senator Baucus and others who will, I hope, take the lead in resisting ill-advised legislation of the type that is before you today

Senator WALLOP. Byron, thank you.

I don't know the history behind the severance tax in North Dakota, nor particularly that of Montana, but in Wyoming a significant portion of what is called our 17-percent severance tax is levied by the counties in lieu of ad valorem taxes. There is a well established principle in American law that a lease right gives a property right. It's established by law. It's established by decision. It's established by understanding. And we, as a matter of policy, decided not to place an ad valorem tax on minerals in situ. I think the country benefited from that enormously during the recent recession where those taxes would have been levied whether or not the coal was being produced from them, and would have driven some companies completely out of business, and added to the unemployment problems.

I suspect yours was not entirely different from that. There are States, Appalachian States who do tax the minerals in situ. And I think their mining industry has suffered from it. This is a better principle that you tax it as it is used, as the country benefits from it, as it attains real value, than to try in some way tax it whether or not the benefit is being derived from it. That would be, to me, the ultimate in blue-eyed Arabdom.

Mr. DORGAN. Well, again, speaking as a former State tax official, the difficulties of attempting to administer an ad valorem tax on coalbeds is just enormous. And I think a severance tax makes good sense.

But the point you raise is important. Some States have adopted State severanee tax and throw their money back to local governments through some apportionment formula. Other States have reserved a portion of that tax base for their counties, and the county makes the levy. And that's why it is difficult to make comparisons.

In almost every comparison I have ever seen of coal taxes is inaccurate. I mean I have never seen a good comparison that really describes what is the actual rate of taxation on a ton of coal among the various States.

And if I might make ohe other point. With respect to Montana, North Dakota, and Minnesota and the tax on a barrel of oil, it's interesting to note that if you are drilling a well on the North Dakota side of the border and drilling a well on the Montana side of the border, and the well is only, let's say, 15 miles from the other, when Montana had about a 13-percent total tax—that included State and local assessments on that extraction of oil—and North Dakota was around 6 percent—the wellhead price for that barrel of oil was identical when it was pumped out of that well. Now what does that say? It says that the tax on the Montana side, which is greater than the North Dakota side—it still is but only by a small margin at the present time—the tax was borne by the producer; not passed along to the consumer because they could only get the world price for that barrel when they raised it. The point that some have made about the tax on oil being borne at least in part by the producer is accurate, I think, and demonstrated so by the example I have just used with respect to Montana and North Dakota.

Senator WALLOP. Would you agree with me that if some kind of major restriction, such as proposed in this bill or others that you have seen, is imposed, that States would seek to recoup that money in one way or another? And one would be a reversion to ad valorem taxes.

Mr. DORGAN. Oh, sure. And that's why this whole issue is just a complete smoke screen. I mean when you buy a car from Detroit, you are paying the capital stock taxes levied in Michigan. How many times have you heard people complain about paying the Michigan capital stock tax? Most people don't know about it. But we have been paying Michigan's taxes for years when we buy those cars and tractors. And when you raise the severance, it's a convenient thing to beat the producing States with. But the fact is not too man years ago when Montana had enacted its 30-percent severance tax, the increase in freight rates by Burlington Northern hauling that coal from Montana to the East, just the increase—not the freight rate, the increase alone—on a ton of coal was more than the entire severance tax levied by Montana. I mean that just described again how insignificant the severance tax is, how insignificant it is as compared to other factors that some of these folks really ought to be going after.

I would join them if they wanted to talk about railroad rates. And I think they would probably have some powerful allies in the form of the gentlemen from Wyoming and Montana and others as well.

Senator WALLOP. Senator Baucus.

Senator BAUCUS. I want to thank you, Byron. You have studied this issue for a long time, and your position on the House Ways and Means Committee gives you an excellent opportunity to know what the incidence of taxes are and what the effects of taxes are. You have studied it in a very comprehensive and very thorough way.

As you might know, Mr. Chairman, Congressman Dorgan was tax commissioner in the State of North Dakota before he came into Congress, so he knows this issue very, very well. And I want to thank you, Byron, for all you have done.

Mr. DORGAN. Thank you.

Senator WALLOP. Thank you very much. And thank you as well for your patience.

[The prepared written statement of Congressman Dorgan follows:]

Testimony of

Congressman Byron L. Dorgan

submitted to the

Subcommittee on Energy and Agriculture Taxation
of the Senate Finance Committee

July 24, 1984

I appreciate the opportunity to present a statement on S. 463 to this Subcommittee.

This subject is not new to me. I have defended state severance taxes before congressional committees many times in the past years, and I suspect I will do so many times in the future.

Previously, I testified when the issue was limited to severance taxes on coal.

The bill under consideration today expands the issue to include oil and gas severance taxes.

Let me mention one specific aspect of this bill before I talk about severance taxes in general. S. 463 is a lawyer's delight. The key section proposes limiting revenues from state severance taxes so that they do not exceed the costs incurred by the state, during the year, of expenses directly attributable to mineral exploitation. What are those expenses? Some would argue that land reclamation, repairing lost ecological harmony, and smoothing out the boom-and-bust cycle associated with energy production are costs borne by the states and directly attributable to mining or drilling. If this turns out to be the correct interpretation, we won't have anything to worry about, for those are the reasons states like North Dakota have established severance taxes. In the meantime, lawyers will have a ball trying to figure this one out.

I, for one, side with the local taxpayers. We have given big energy companies enough tax favoritism to choke a horse. In 1981 the railroad companies, which own tens of billions of tons of coal in the United States, received a special, one-time change in their accounting rules estimated to save them some $7 billion in taxes. This came on top of the normal tax breaks available to large, profitable corporations. The oil companies, which own a sizeable portion of U.S. coal reserves, saw their effective tax rate drop from 31.1 percent in 1980 to 18.2 percent in 1982, according to a study done by the Joint Tax Committee for Rep. Pease and me. Yet, the tax burden on the average taxpayer has actually increased since 1981, as hefty increases in state income and social security taxes more than outweigh small decreases in federal income taxes. The average taxpayer has seen no reduction in tax burden, despite claims of lowered taxes. So I think it is especially important that we keep the debate clear: if severance taxes are limited, ordinary taxpayers will pay more.

Some would argue that severance taxes, paid by corporations, are simply passed along to consumers; in particular, coal severance taxes are paid by consumers of electricity. They would argue that taxpayers are set against corporations; rather, taxpayers in one state are set against rate payers in another. This case is stated by coal companies and utilities, true friends of the consumer they say. Clouds of confusion are created from this hot air.

It should be enough to recall that energy companies are the vociferous opponents of severance taxes. Their credibility is strained when we remember they spend millions in lobbying and legal fees against severance taxes for the benefit, they say, of the consumer.

There is a note of irony to this discussion. Those corporate defenders of consumers' pocketbooks should glance at recent Interstate Commerce Commission decisions on coal hauling rates. The ICC now permits coal haulers to increase their charges 15 percent annually after inflation. Costs of transporting coal might double within four years. And the costs of transporting coal are already much of the final price of coal to electric utilities, many times the costs of the highest severance tax imposed by any state on coal production, if those costs were indeed passed along to consumers.

If we were serious about helping rate payers, we would try to trim those transportation costs which, as production costs of regulated utilities, are indeed passed along as higher rates.

I would like to make one other point. Exploitation of natural resources imposes costs on states far beyond those imposed by other industries. These costs must be absorbed, and a severance tax is the best method designed to do so.

North Dakota sits on a vast tract of low sulfur, lignite coal. The coal might be sitting there yet were it not for OPEC and the energy crisis a decade ago. When the energy companies looked around for economically feasible substitutes for petroleum, they saw the Fort Union Basin. Three hundred and fifty billion tons of lignite are here, under North Dakota, Montana, and Wyoming.

This coal is obtained by strip mining. That means that, while jobs are created, as in other industries, severe environmental and social costs are imposed. Stripmined land must be reclaimed after the coal is depleted, at huge cost, otherwise the land is unusable. Natural environments are destroyed, with uncertain costs to damaged aquifers and restoring some ecological balance. Worker and community health may be impaired, due to mineral residues in the air and water.

Further, coal mining creates boom and bust cycles. Homes are built and bought, businesses started, schools expanded, highways constructed, all to service the population drawn to the region by the jobs available mining coal. These jobs do not last long, and when they are gone the economic base of the area is shattered.

The Northern Plains states are fortunate, in one regard: we were made mindful of the costs of coal exploitation by the example of other areas, where mineral companies had come and gone. Appalachia told us that poverty and despair could follow the tracks of the coal train, if land was not reclaimed and an economic base built independent of mineral extraction. Western ghost towns spoke of boom and bust cycles where no thought was given to the bust.

Mindful of this somber history, many states, including North Dakota, resolved to plan for the day when the coal trains did not run. This planning meant far more than a few consultants' studies gathering dust in state office buildings. It meant assessing the present and future costs imposed by resource extraction, and finding a method of equitably distributing the costs. Thus was born the severance tax in our region.

There is a common sense rule of accounting that the costs of a project are to be attributed to the time and location the benefits accrue. This is the basis for accrual accounting, which accountants agree most fairly allocates costs and benefits. Some of us have even tried to apply this rule to the federal budget, arguing that we should not saddle future generations with the high costs of enormous deficits while the present generation gets the benefits of lowered taxes and high spending. This same rule is used in allocating costs of resource extraction, when states impose severance taxes. By some interpretations, this rule is the basis for S. 463.

There is no fairer way. It is the present generation which enjoys the benefits of job creation and use of mineral wealth. When the coal is gone, future generations will have neither. It is just not fair to leave them, as well, a stripmine-scarred landscape.

Further, our mineral wealth is being used, and depleted. As industries responsibly depreciate their equipment, to hold a store of cash available when the equipment is replaced, so states must set aside resources for the day when mineral wealth is gone.

Severance taxes are a fair method of allocating today's benefits to today's costs, and of creating a reserve for when the coal is gone. This is responsible, prudent planning.

It also is a demonstration of the states' ability to act as social laboratories, testing different means of giving their citizens a better life, balancing the various political and economic interests. The different states employ different vehicles to achieve their goals. With these differences come checks and balances. An overly zealous state, imposing too rigorous a severance tax, will find energy companies disinclined to do business there. A state with no severance tax may have a high sales or property tax, to fund the costs of resource extraction. North Dakota, for example, levies a severance tax, but keeps mineral property taxes low. Alaska raises huge amounts from oil companies with its corporate income tax, rather than severance tax. Each state operates in its own way, and we have the opportunity and privilege to learn from what the states do.

For this reason, the federal government has been loathe to tell the states what they can and cannot do, insofar as the regulation of economic activities, unless the activities of one state are injurious to the economic or social interest of the country at large. This was affirmed in the 1981 Supreme Court decision upholding Montana's severance tax.

There must be a clear and present danger to the country before Congress decides to impose its will on the economic regulation of states.

There is no such danger with severance taxes. Arguments against severance taxes have amounted to a tempest in a teapot.

The issue is clear. Limiting severance taxes will result in a windfall for a few large energy companies. Limiting several taxes will force states into the unpalatable choice between present taxpayers or future citizens absorb the costs of resource extraction.

Senator WALLOP. Next is Senator Stan Stephens.

Senator BAUCUS. Mr. Chairman, before Senator Stephens begins, I would like to introduce him, if I might.

Senator Stephens is from Havre, MT. Havre is a part of Montana that is not directly related to the coal industry. But is indirectly related, because, as big as the State is, all of us from Montana consider ourselves Montanans first, regardless of where we are from. Stan owns a radio station and TV cable system in Havre. And he has been very active in State politics. He was a floor leader in the State senate, then whip in the State senate. Now, he is president of the State Senate of Montana. And he has been very, very active regarding the issue of our severance taxes. And, because of his communications business background, he knows how to communicate. He knows how to get a message across.

Mr. Chairman, Stan is a very fine Montanan. We are very proud of him.

Senator WALLOP. Thank you. And welcome.

STATEMENT OF HON. STAN STEPHENS, PRESIDENT, SENATE, STATE OF MONTANA, HELENA, MT

Senator STEPHENS. Thank you, Senator Baucus, and Mr. Chairman. I appreciate very much the opportunity to appear here today to discuss S. 463, Senator Dixon's bill to limit the right of States to impose taxes on the development of energy resources.

I am particularly pleased to have been here today to hear the remarks of Congressman Dorgan and others. I thought Congressman Dorgan, the previous speaker, was particularly knowledgeable and astute in his analysis of the issue before us.

The State of Montana is unalterably opposed to any limitation on State taxing authority. Like our neighboring State of Wyoming, and a number of other States, we raise revenues from a tax on the production of energy resources. Much of that revenue helps to defray the high public cost associated with the production now, and to provide for the future well-being of our State and citizens when that resource has been depleted. We think this is the action of a prudent and responsible government. And, moreover, we think it is the untestable right of each State to raise revenue as it may.

Now one of the essential aspects of State sovereignty is the power to raise funds by taxation. This power is critical to the very existence of a State. As Senator Baucus pointed out earlier this morning, Congress should exercise great caution in introducing upon this fundamental right of States. Any move in that direction starts down a very dangerous path which sooner or later leads to undermining the authority of all States to raise revenues. Why we must ask would Federal intrusion be limited to just energy derived taxes? Why not a Federal limitation on the tax the State might levy on forest lands or fisheries or recreation related activities or on State sales or income taxes?

Unfortunately, there are those who ignore the precedent of State sovereignty and seek Federal limitation on our means of taxation. Over the past several years, there have been repeated attacks on our coal severance tax. They have been inspired mainly by the Midwestern utilities, first alleging that it was unconstitutional and now claiming it is unfair. And that issue of its constitutionality carried up to the U.S. Supreme Court. And in a case that has been mentioned several times here this morning in 1981, the case of *Commonwealth Edison* v. *Montana,* the Court found in favor of the State expressing the opinion that there can be no question that Montana may constitutionally raise general revenue by imposing a severance tax on coal mined by the State. The entire value of the coal before the transportation originates in the State and mining of the coal depletes the resource base and wealth of the State, thereby diminishing the future resource of taxes and economic activity.

Applying four established tests, the Court determined the severance tax did not create an unconstitutional burden on commerce. The Court found that (1) the tax was substantially connected with the State; (2) it was fairly apportioned; (3) it did not discriminate in interstate commerce; and (4) it was fairly related to services provided. Thus, the Court not only supported the right of a State to raise general revenue with a severance tax, it also further established that the Montana tax was fairly related to the services the State provided.

Current and future costs to a State from major resource development are high. Massive public outlays for roads, for schools, sewage systems, health, police protection, and other related public services are required. There are also later costs for environmental protection and restoration of the surface mined areas. And here we are dealing with an area of great uncertainty.

As Montana's Governor Schwinden told a House subcommittee in hearings on severance tax measures 2 years ago, no one really knows what damage the mining might cause. No one knows the long-term consequences of strip mining in the semiarid West.

Coal is limited. It is a nonrenewable resource. And for this reason, a portion of our coal revenues is set aside in trust for the day when future generations of Montanans will no longer have these abundant resources at their disposal. What is mined today will never again be available to produce jobs or revenue. Our trust fund will soften the impact of these resources lost on future generations. The interest from the fund is being used today to assist in broadening and diversifying the Montana economy so that we will not repeat the dreary history of the boom and bust cycle of resource exploitation.

In Montana, we have seen the gold mines play out. And now the great copper mining and smelting operations that dominated the State's economy for nearly a century are totally closed. From experience we know that someday that coal will be gone too.

Some who would limit energy related State taxes advance another argument which is just as specious as the constitutional one. Proponents of this legislation assert that energy resources, because of their critical nature to U.S. domestic and international wellbeing, are public property. They argue that so critical are these resources that they should not be subject to taxation by any State or local jurisdiction. Support for this proposition rests mainly in the rhetoric of energy policy and has no real precedent in judicial decision or actual resource development policy. This country, in fact, has never treated its energy resources,.even those under Federal lands, as public property. Indeed, even those resources on Federal land are not developed by the Federal Government, but are leased to private companies. It is the return from the commercial exchange between the mining company and the purchaser that Montana and other States tax as the resource is severed from the land.

But beyond these fundamental arguments, the Dixon bill itself is a dangerously flawed legislative proposal. First, it would make the Federal courts responsible for setting State tax policy by encouraging the Attorney General of the United States or any taxpayer to challenge the level of the severance tax in court. A U.S. district court judge would set the level of the tax after hearing arguments about the cost of energy development. Neither the State legislatures nor the people they represent would have any real authority over the tax level.

Second, the bill would turn State energy taxation into a kind of users fee, in the process requiring these taxes to meet a test no others must now meet.

In the *Montana* case, the Supreme Court distinguished between the test of whether a tax is fairly related to the services provided and Court review of specific tax rates and corresponding services.

The Dixon bill would reverse the Supreme Court, and invite the taxpayers back into the Court to argue over precisely this point. Decisions on the appropriate level of the tax would be made in the isolation of the judicial proceeding, divorced from the realities of the political process and public involvement.

And, finally, it's important to remember that tax revenues based on resource production are neither dependable nor assured. Severance tax revenues are a direct reflection of the health and productivity of the resource market. The U.S. energy market, at least where coal is concerned, is far from healthy. Our coal tax revenues have declined rather than increased over the past year, and so have the resource related revenues of other States.

Together, State severance tax revenues were down by $433 million in fiscal year 1983 from the previous year. Because of a $124 million drop in severance tax revenues last year, Texas is looking at the need for major new taxes to support its educational system. Minnesota set up a special rainy day fund to cushion against the cyclical swings in State revenues brought on partly as a result of the drop in State revenues from taconite mining. While Montana enjoys revenues from energy production, we do not depend solely upon them, and recognize that other sources of revenue will be needed to support the governmental activities and needs of the state today and in the long run.

I appreciate this opportunity, Mr. Chairman, to express Montana's viewpoint. I know this committee will exercise the same caution that has been displayed in the Congress over the past few years regarding the intrusion on this aspect of State taxation. And if I may, in just closing, I was particularly impressed with the remarks by Senator Long here this morning when he very astutely analyzed the position of Montana's so-called onerous 30-percent severance tax in relation to the severance tax of 12½-percent in his own State. As he adroitly put it, the actual impact on the consumer, if that is what we are concerned with, is greater by the 12½-percent severance tax on oil in the State of Louisiana than is the 30-percent sales tax on a ton of coal in Montana that sells for less than $10 a ton. And I thought his analysis in that regard was not only fair, but I thought it was a very compelling argument on this whole issue.

Thank you very much, Senator Wallop. I appreciate being here today.

Senator WALLOP. Thank you, Senator Stephens. And thank you for your long journey here on behalf of this issue.

[The prepared written statement of Stan Stephens follows:]

Testimony of the Honorable Stan Stephens
Chairman, Montana Legislative Committee
on Coal Tax Advocacy
Before the Senate Finance Subcommittee
on Energy and Agricultural Taxation
Tuesday, July 24, 1984

Mr. Chairman, I am Stan Stephens, President of the Montana State Senate and Chairman of the Montana Legislative Committee on Coal Tax Advocacy.

I appreciate the opportunity to appear here today to discuss S. 463, Senator Dixon's bill to limit the right of states to impose taxes on the development of their energy resources.

The State of Montana is unalterably opposed to any limitation on state taxing authority. Like our neighboring state of Wyoming and a number of other states, we raise revenues from a tax on the production of energy resources. Much of that revenue helps to defray the high public costs associated with production now and to provide for the future well-being of our State and citizens when that resource has been depleted. We think this is the action of a prudent and responsible government. Moreover, we think it is the uncontestable right of each state to raise revenues as it may.

One of the essential aspects of state sovereignty is the power to raise funds by taxation. This power is critical to the very existence of a state. Arguing for the adoption of the Constitution, Alexander Hamilton wrote in the Federalist Papers, "The individual States should possess an independent and uncontrollable authority to raise their own revenue for the supply of their own wants and should retain that authority in the most absolute and unqualified sense."

That advice is as valid today as it was 200 years ago. And, as Senator Max Baucus warned during the Senate floor debate on this same legislation last year, Congress should exercise great caution in intruding upon this fundamental right of the states. Any move in that direction starts down a dangerous path which sooner or later leads to undermining the authority of all states to raise revenues. Why, we must ask, would federal intrusion be limited just to energy-derived taxes? Why not a federal limitation on the tax a state might levy on forest lands or fisheries or recreation related activities, or on state sales or income taxes?

Unfortunately, there are those who would ignore the precedent of state sovereignty and seek federal limitations on our means of taxation. Over the past several years there have been repeated attacks on our coal severance tax, inspired mainly by the Midwestern utilities; first alleging that it was unconstitutional, and now claiming it is unfair. The issue of its constitutionality carried us to the United States Supreme Court. In 1981, in the case of Commonwealth Edison vs. Montana, the Court found in favor of the State, expressing the opinion that:

> "...there can be no question that Montana may constitutionally raise general revenue by imposing a severance tax on coal mined in the State. The entire value of the coal, before transportation, originates in the State, and mining of the coal depletes the resource base and wealth of the State, thereby diminishing a future source of taxes and economic activity."

Applying four established tests, the Court determined that the severance tax did not create an unconstitutional burden on commerce. The Court found the tax (1) was substantially connected with the state; (2) was fairly apportioned; (3) did not discriminate in interstate commerce; and (4) was fairly related to services provided. Thus, the Court not only supported the right of a state to raise general revenues with a severance tax; it also further established that the Montana tax was "fairly related" to the services the state provided.

Current and future costs to a state from major resource development are high. Massive public outlays for roads, schools, sewage systems, health, police protection and other related public services are required. There are also later costs for environmental protection and restoration of the surface mined areas and here we are dealing with an area of great uncertainty. As Montana's Governor Schwinden told a House Subcommittee in hearings on a severance tax measure two years ago, "No one really knows what damage the mining might cause. No one knows the long-term consequences of strip mining in the semi-arid West."

Coal is a limited, nonrenewable resource, and for this reason a portion of our coal revenues is set aside in trust for the day when future generations of Montanans will no longer have these abundant resources at their disposal. What is mined today will never again be available to produce jobs or revenues. Our trust fund will soften the impact of this resource loss on future generations. The interest from the fund is being used today to assist in broadening and diversifying the Montana economy so that we will not repeat the dreary history of the boom and bust cycle of resource exploitation.

In Montana, we have seen the gold mines play out and now the great copper mining and smelting operations that dominated the state's economy for nearly a century are totally closed. From experience, we know that some day the coal will be gone too.

Some who would limit energy-related state taxes advance another argument which is just as specious as the conrtitutional one. Proponents of this legislation assert tha. energy resources, because of their critical nature to U.S. domestic and international well-being, are public property. They argue that so critical are these resources that they should not be subject to taxation by any state or local jurisdiction. Support for this proposition rests mainly in the rhetoric of energy policy and has no real precedent in judicial decision or actual resource development policy. This country, in fact, has never treated its energy resources, even those under federal lands, as a public property. Indeed, even those resources on federal lands are not developed by the Federal Government, but are leased to private companies. It is the return from the commercial exchange between the mining company and the purchaser that Montana and other states tax as the resource is severed from the land.

But beyond these fundamental arguments, the Dixon bill itself is a dangerously flawed legislative proposal.

-- First, it would make the federal courts responsible for setting state tax policy by encouraging the Attorney General of the United States or any taxpayer to challenge the level of the severance tax in court. A U.S. District Court judge would set the level of the tax after hearing arguments about the costs of energy development. Neither the state legislatures nor the people they represent would have real authority over the tax level.

-- Second, it would turn state energy taxation into a kind of user's fee, in the process requiring these taxes to meet a test no others must now meet.

In the Montana case, the Supreme Court distinguished between the test of whether a tax is "fairly related" to the services provided and court review of specific tax rates and corresponding services.

The Dixon bill would reverse the Supreme Court and invite the taxpayers back into court to argue over precisely this point. Decisions on the appropriate level of a tax would be made in the isolation of the judicial proceeding, divorced from the realities of the political process and public involvement.

Finally, it is important to remember that tax revenues based on resource production are neither dependable nor assured. Severance tax revenues are a direct reflection of the health and productivity of the resource market. The U.S. energy market, at least where coal is concerned, is far from healthy. Our coal tax revenues have declined rather than increased over the past year and so have the resource-related revenues of other states. Together, state severance tax revenues were down by $433 million in fiscal year 1983 from the previous year. Because of a $124 million drop in severance tax revenues last year, Texas is looking at the need for major new taxes to support its educational system. Minnesota set up a special "rainy day" fund to cushion against the cyclical swings in state revenues, brought on partly as a result of the drop in state revenues from taconite mining.

While Montana enjoys revenues from energy production, we do not depend solely upon them and recognize that other sources of revenue will be needed to support the governmental activities and needs of the State today and in the long run.

I appreciate this opportunity to express Montana's viewpoint. I know this Committee will exercise the same caution that has been displayed in Congress over the past few years in regard to intruding on this aspect of state taxation.

If there are any questions, I will be happy to respond.

Senator WALLOP. Senator Baucus.

Senator BAUCUS. Stan, I want to thank you again. Also for drawing out another point, which really hasn't been raised very much here yet, and that is that Senator Dixon's bill would basically leave it to the courts to set these rates. And it would be a very, very lengthy and involved process. And, second, you are giving the decision to people who are not elected officials but who were appointed officials for life. And I don't think most people in this country would want nonelected officials to be making these kinds of decisions. It's just another whole level of problems that will be created with these kinds of approaches that are contained in this bill. And I want to thank you for drawing that out.

Senator STEPHENS. Thank you very much, Senator.

Senator WALLOP. To conclude this morning's hearing, we have a panel consisting of Dr. Walter Hellerstein, professor of law at the University of Georgia School of Law in Athens; and Mr. George Rifakes, vice president, Commonwealth Edison, Chicago, IL.

STATEMENT OF DR. WALTER HELLERSTEIN, PROFESSOR OF LAW, UNIVERSITY OF GEORGIA SCHOOL OF LAW, ATHENS, GA

Dr. HELLERSTEIN. I appreciate the opportunity to present my views on State severance taxation to this subcommittee. I have been deeply involved over the past 6 years in controversies involving State severance taxes. I assisted the State of Montana in preparing its defense of its coal severance tax in the case that culminated in the Supreme Court's decision in *Commonwealth Edison* v. *Montana.* I have worked with other States and with private industry in matters involving State severance taxes, and I have spent the better part of the past 2 years completing a book on State and local taxation of natural resources in the federal system.

Needless to say, the views that I am presenting to the subcommittee are entirely my own and do not necessarily represent the views of any of the public or private parties with whom I have worked.

While there is much to divide the various constituencies with an interest in State severance taxes, it may be useful to begin with several fundamental principles that do command and, in my judgment, should command virtually universal support. First, few question the right of producing States to single out natural resources for special taxes. The diversity of the individual State's tax structures has been characteristic of the American tax system from the very beginning and it is taken for granted that it will remain that way.

Second, few question the right of the producing States to recover the reasonable costs that are imposed by the extractive industries on the State. These costs include not only the costs of schools, roads, hospitals and the like, but also the environmental and social costs that natural resource development may impose on the State.

Finally, few question the proposition that those who benefit from natural resource extraction should bear the burden of the costs it generates, even if those beneficiaries are not residents of the taxing State.

The list of shared assumptions is short by comparison to the list of issues that separate the producing and consuming States. Although these sources of conflict are considered in some detail in my prepared statement, I will touch only briefly on them today because other witnesses have focused on them, and I would rather devote my few minutes of oral testimony to issues that are less likely to be fully aired at this hearing.

In connection with the issues that divide the resource producers from the resource consumers, it is helpful, I believe, to distinguish between conflicts over premises and conflict over facts. In the first category are such questions as whether severance taxes should be limited to the reasonable cost imposed by production activities on the State, and whether the producing State has a special claim for taxing their resources because they constitute their so-called natural birth right.

In the second category are such questions as the estimate of costs attributable to natural resource production, the extent to which State severance taxes are exported to residents of other States, and the significance in relative terms of the burden of such taxes on nonresident consumers.

When we turn to the question as to what role, if any, the Federal Government should play in forging a uniform national policy toward State severance taxes, we find that opinions are colored by one's views on the merits of the issues to which I have just referred. Nevertheless, there are a few general observations about the wisdom and form of legislation in this domain that I would like to leave with the subcommittee.

First, in considering the question of whether to impose Federal restraints on State severance taxes, Congress ought to proceed, in my judgment, with more than the usual caution than it should ordinarily exercise when it legislates to impose direct restrictions on State power. Beyond the general questions of State autonomy that have been raised in connection with proposals to legislate in this area, there are very significant differences among the States' approach to natural resource taxation that Congress should recognize before it embarks on a particular legislative course.

Many States, for example, impose severance taxes in lieu of any property taxes on their natural resources, a point that has already been mentioned today. Thus, 5 of the Nation's top 10 oil producing States—namely, Alaska, Louisiana, Oklahoma, Florida, and Mississippi, and 4 of the Nation's top 10 gas producing States—namely, Louisiana, Oklahoma, Alaska, and Michigan, impose their oil and gas severance taxes in lieu of any property taxes on their resources. In the Rocky Mountain West—I know the Senators are familiar with this—most States, including the major natural resource producers of Montana, New Mexico, and Wyoming, impose local property taxes based on some percentage of the proceeding year's proceeds, which may be a small percentage of the value of the underlying reserve if it were assessed like other property on a fair market value basis.

In other States, mineral reserves, especially nonproducing reserves, are largely ignored by local property tax assessors because of the difficulty of valuing such reserves.

The point of all of this is to suggest that Congress would be shortsighted to focus only on severance tax rates in making national policy in this area, for severance taxes may be seen as a counter balance in State and local revenue structures that omit, limit or ignore the value of natural resources in their ad valorem property tax base. Broad based congressional legislation limiting State severance taxes that failed to take account of the fact that many States undertax their natural resources in their ad valorem property tax bases might well be unfair from the standpoint of interstate equity and undesirable from the standpoint of national policy.

Second, I believe that if Congress chooses to legislate with regard to State severance taxes it should be evenhanded in its legislation. In this respect at least, S. 463, which applies to oil, gas, and coal, is preferable to legislation that has been introduced into Congress in the past which has been directed specifically at coal alone.

Finally, before Congress does take the significant step of restraining State power to impose severance taxes, I think it would be worthwhile for it to consider less intrusive alternatives to achieving the same end. If Congress is concerned about the disparities in fiscal capacities that arise out of the adventitious location of our Nation's resources, it is certainly in a position to reallocate revenues disbursed to the States by various revenue sharing formulas that, in the eyes of some observers, presently favor the States with high severance tax yields.

Although the controversy surrounding these formulas may be no easier to resolve than the controversy surrounding Federal limitations on State severance taxes, it would be preferable, in my judgment, to reduce any perceived fiscal disparities between the States through modification of such formulas to take account of such disparities rather than by restricting State tax power in a way that could have unexpected and unwarranted consequences.

Thank you very much.

Senator WALLOP. Thank you very much, Dr. Hellerstein. We will have questions after Mr. Rifakes.

[The prepared written statement of Dr. Hellerstein follows:]

Prepared Statement of Walter Hellerstein Professor of Law University of Georgia

I appreciate the opportunity to present my views on state severance taxation to the Subcommittee. I have been deeply involved over the past six years in controversies involving state severance taxes. I assisted the State of Montana in preparing its defense of its coal severance tax in the case that culminated in the Supreme Court's decision in *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981). I have worked with other states and with private industry in matters involving state severance taxes. And I have spent the better part of the past two years completing the manuscript for a book entitled *State and Local Taxation of Natural Resources in the Federal System: Legal, Economic, and Political Perspectives*. Needless to say, the views that I am presenting to the Committee, which constitute a portion from the manuscript of my book, are entirely my own and do not necessarily represent the views of any of the public or private parties with whcm I have worked.

The following excerpt from my manuscript examines the political struggle over state severance taxes as it has surfaced in the interregional conflicts between resource-rich and resource-poor states and in the debate over the role, if any, that the Federal Government should play in forging a coherent national policy in this area. It is not offered as a policy tract. Rather its fundamental aim is to elucidate the critical political issues that have been raised in this context. It will have achieved its purpose if it has identified and clarified the questions that ought to be addressed by those who would make national policy toward state severance taxes.

CHAPTER 6

POLITICAL PERSPECTIVES ON STATE AND LOCAL TAXATION OF NATURAL RESOURCES

It is in the political realm that the issues of federalism raised by state and local taxation of natural resources have captured the popular imagination. Political rhetoric from the Northeast and Midwest invokes images of "blue-eyed Arabs" in the energy-rich states exploiting their locational advantages to exact tribute from shivering energy consumers in New York and Chicago. Political oratory from resource-producing regions responds with visions of scarred landscapes, abandoned mining towns, and irretrievable resource losses for which taxes are but small recompense. And forebodings of a second War Between the States over state taxation of natural resources preoccupy the news media.

It is in the political realm as well that these conflicts will have to be resolved, if they are to be resolved at all. Whatever possibility may once have existed for disposing of them through the judicial process has been foreclosed by the Supreme Court's decision in Commonwealth Edison, which permanently removed them from its docket. The Court instead consigned their resolution to the political process "by state legislatures in the first instance, and, if necessary, by Congress when particular state taxes are thought to be contrary to federal interests."[1]

This chapter investigates the questions that have dominated the political debate over state and local taxation of natural resources in the federal system. In so doing, it seeks to identify areas of consensus, to clarify points of disagreement, and to examine proposals that could provide a basis for reconciling the competing concerns. Part I briefly considers the issues as they arise "in the first instance," i.e., within the framework of the individual state. Part II is addressed to interstate and interregional conflict. Part III turns to the dialogue over the role, if any, that the federal government should play in mediating the disputes.

I. Intrastate Politics

With all the attention that has been directed to the specter of interstate economic warfare over natural resource taxation, it is easy to forget that the state legislation underlying the controversy is itself the product of fierce political battles waged in individual states. In Chapters 2 and 3, we examined these struggles in tracing the historical development of natural resource taxation in a number of jurisdictions. In this section, we focus on similar experiences in a contemporary setting.

The widespread impression that resource-rich states are political monoliths acting without internal opposition to maximize their resource tax revenue is tempered if not belied by the facts. As the Governor of North Dakota described the political controversy over his commitment to a substantial coal severance tax:

> We have been opposed by the energy industry; we have been admonished by special interest groups in our own state who express concern that if the severance tax goes too high energy development will be stymied and North Dakota will lose great economic opportunities; we have been cajoled by

our own energy consumers who worry that their industries, businesses and residences will have to absorb the cost of the severance tax through higher utility bills.[2]

The history of North Dakota's coal severance tax legislation reflects these pressures. In 1973, the legislature, with strong industry support, enacted a five cents per ton coal severance tax to become effective in July 1975. The Governor vetoed the bill on the ground that it was "unrealistically low"[3] and because of the postponement of the levy's effective date. In 1975, the Governor proposed instead a 33-1/3 percent coal severance tax. The legislature enacted a compromise bill of 50 cents per ton, with a one cent per ton increase for every three point rise in the wholesale price index. The base rate was increased to 65 cents in 1977 and to 85 cents in 1979, where it stands today,[4] still far below the value-based rate proposed by the Governor in 1975.

In Minnesota, political and economic pressures in the State combined to limit the power of the legislature to tax some of its natural resources. The demands of two world wars had taken their toll on the supply of iron ore from Minnesota's Mesabi range, and in the 1940's the iron mining industry undertook a world-wide search for alternative sources of supply.[5] Although Minnesota's iron ore industry still provided 83 percent of the nation's iron ore requirements in 1950, this percentage had fallen to 42 percent by 1960.[6] Moreover, the quality of Minnesota's iron ore (i.e., its natural iron ore content) was lower than that of competing foreign ores.

In addition to its iron ore, however, Minnesota possessed vast reserves of taconite, rock which contains iron-bearing particles but which is not merchantable as iron ore in its natural state and which requires extensive processing to make it merchantable.[7] Although development of Minnesota's taconite resources had become economically feasible, the State's historical pattern of heavy mineral taxation[8] was perceived as an obstacle to further development of its taconite industry. In 1961, a proposed constitutional amendment designed to create a healthier tax climate in the State by limiting taxes on taconite was introduced into the Minnesota Legislature. The amendment was defeated by the liberal majority.

The proposal for a taconite amendment soon became a major political issue in Minnesota. Conservatives argued that it was necessary to attract the taconite industry to the state. Liberals replied that such a restraint on the state's tax power would be selling its "birthright to its natural heritage."[9] In 1963, a conservative legislature adopted a proposed taconite amendment, and the following question was put to the voters of the State:

> Shall the constitution of the State of Minnesota be amended by . . . prohibiting the amendment, modification, or repeal for a period of 25 years of Laws of Minnesota 1963, Chapter 81 relating to the taxation of taconite and semitaconite, and the facilities for mining, production, and beneficiation thereof . . .?[10]

The liberal elements in the State represented by the Democratic Farm Labor Party initially opposed the amendment until Senator Hubert Humphrey induced the Party to change its stand. With both liberal and conservative backing, the amendment passed with a majority of over 80 percent. Within 24 hours after the amendment's approval, the United States Steel Corporation and the Hanna Mining Company announced that new taconite plants would be under construction within two weeks. Taconite has since become Minnesota's commercially most significant mineral. In 1981, Minnesota produced 49.4 million tons of taconite yielding $12.7 million in occupation taxes; it produced a mere 1.7 million tons of iron ore yielding $1.2 million in occupation taxes.[11]

The specific issues at stake, the varying configuration of political forces involved, and the different economic circumstances in which particular states find themselves make generalizations about the intrastate politics of natural resource taxation hazardous at best. One point is clear, however. The political opposition to natural resource taxes in most states is more than token, and stories similar to those recounted about North Dakota and Minnesota could be told about other states. In 1983, for example, increased oil production taxes were proposed in 20 states. In twelve states they were defeated, in five they were enacted, and three proposals were pending at this writing.[12]

II. The Politics of Interstate Jealousy

Despite substantial internal political opposition, it remains true that many resource-rich states in recent years have increased the scope and level of their taxes on natural resources. In this part, we examine the interstate conflicts that these taxes have generated.

A. The Scope of the Problem

The public debate over the regional issues raised by state taxation of natural resources has been directed largely at production taxes. To be sure, concern has been expressed over the efforts of some resource-consuming states to single out the energy industry in their income[13] and gross receipts[14] taxes. But the issues of interstate conflict that they raise have not been a subject of intense national scrutiny, even though they have caught the eye of the organized bar.[15] Property taxes, despite the unique features of their application to natural resources, have likewise been ignored in the political dialogue, perhaps because they are perceived to be inherently local in nature, perhaps because the issues of interstate conflict they raise are poorly understood.[16] The ensuing discussion is therefore addressed almost exclusively to production taxes.

B. Shared Assumptions

Although the acrimonious exchanges between representatives of producing and consuming states might lead one to wonder whether they share any common ground, there are in fact several fundamental principles that command universal support. First, no one questions the right of producing states to single out natural resources for special taxes. The diversity of the individual states' tax structures has been characteristic of the American tax system from the very beginning, and it is taken for granted that it will remain that way. Second, no one questions the right of the producing states to recover the reasonable costs that are imposed by the extractive industries on the state. These include not only the costs of schools, roads, hospitals, and the like, but also the environmental and social costs that natural resource development may impose on the state. Finally, no one questions the proposition that those who benefit from natural resource extraction should bear the burden of the costs it generates, even if those beneficiaries are not residents of the taxing state.

C. Sources of Conflict

The list of shared assumptions is short, especially by comparison to the list of issues that divide the producing and consuming states. For purposes of exposition, it will be useful to distinguish between disagreements over premises and disagreements over facts.

1. Conflicts Over Premises

a. Should a Natural Resource Production Tax Be Limited to the Reasonable Costs Imposed by Production Activities on the State?

Perhaps the most fundamental theoretical issue separating consuming and producing states is whether a natural resource production tax should be limited to the reasonable costs imposed on the state by production activities. Although the Supreme Court in Commonwealth Edison resolved the issue in favor of the producing states as a matter of constitutional law, it did nothing to solve the political question. In contending that resource production taxes are "excessive,"[17] "exploitative,"[18] and "exorbitant,"[19] consuming states' spokesmen implicitly or explicitly rely on the proposition that there is some level of taxation that would not inspire such epithets. Invariably this level is one that reflects a "fair return"[20] or one reasonably related to the "needs"[21] of the producing state, a standard defined in terms of the costs attributable to natural resource development. As the Mayor of Minneapolis put it in congressional testimony on coal severance taxes: "Our basic belief is that the levels of the severance tax are in excess of what is required to deal with the local impact of coal mining."[22] Indeed, spokesmen from consuming states consistently point to the allocation of production tax revenues to trust funds earmarked for future generations as irrefutable evidence that the production tax exceeds any justifiable norm.

Producing states' spokesmen reject this premise. In response to the Mayor of Minneapolis, the Governor of Montana replied: "I don't subscribe . . . to the arguments of Mayor Fraser that the only revenues we should derive from our severance tax is just to take care of the damage done to the State. . . . Every State that imposes a severance tax also gets money for the general support of government."[23] Producing state representatives claim that they are entitled to impose production taxes with the same freedom that they impose other taxes and that they may use the revenues not only for the general support of government but also for future generations who will populate the state when the resource is gone.

If framed as a general question of the appropriate limitations on state taxation in the federal system, the producing states would seem to have the better of the argument. One would be hard-pressed to find in the broad assumptions of economic and political unity underlying the federal system any commitment to the benefit principle[24] as a restraint on state tax power. This conclusion is reinforced when one recognizes the importance to the states' autonomy of the ability to fashion their tax structures to accommodate individual circumstances. As Alexander

Hamilton, writing in The Federalist, declared:

> the individual States should possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants . . . . I affirm that (with the sole exception of duties on imports and exports) they would retain that authority in the most absolute and unqualified sense.[25]

But one need not frame the question so generally. One might ask more specifically whether there is something distinguishable about special taxes on natural resources that might warrant the application of the benefit principle as a restraint on such taxes, even though as a matter of general policy one would not impose a like restraint on broad-based property, income, and sales taxes imposed on natural resources in common with other subjects of taxation or on special excises imposed on such items as motor fuel, alcohol, tobacco, and amusements. An answer to that question depends on the answer to a series of other questions to which we now turn.

b. Natural Resources and the Natural Heritage Theory: Whose Birthright?

One of the early predicates for the imposition of production taxes in addition to the general ad valorem property tax on natural resources was the notion that natural resources constituted part of the state's natural heritage.[26] This was said to justify the state's exaction of a special levy on behalf of the states' citizens whose collective birthright these resources were thought to represent. Although this theory has been discredited on its own terms,[27] it has not lost its force in the political arena. In the context of interstate conflict over state taxation of natural resources in our federal system, however, it is by no means clear which way the natural heritage theory cuts.

In most nations, underground mineral rights are retained by the sovereign with private parties owning only the surface rights associated with mineral lands.[28] In the United States, by contrast, private ownership of the surface typically carries with it a correlative claim to any minerals lying beneath the surface.[29] Nevertheless, except for the area of the original thirteen colonies, Texas, and Hawaii, the federal government once owned all of the land within its present borders.[30] Although it has given away much of the public domain to private owners and, to a lesser extent, the states, the federal government still retains title to about one-third of the nation's land area, and it owns an additional 60 million acres of reserved mineral interests in the Western states. Furthermore, it has now been established that the federal government has a controlling interest in the natural resources of the outer continental shelf,[31] an area of some 860,000 miles extending from three miles offshore seaward to the edge of the geographic shelf. The states, by contrast, with the exception of those noted above, own only those lands (and mineral rights) that have been granted to them by the federal government or acquired by them independently.

All this has some rather interesting implications for the relationship of the natural heritage theory to state natural resource taxation. First, to the extent that the state is taxing resources that are owned by the federal government and leased to private enterprise, the natural heritage theory supports a national rather than a state claim to collective ownership of the resource. This point has not been lost on spokesmen from resource-poor states who claim that producing states' taxing schemes are attempting to appropriate for their own citizens a resource that belongs to the entire nation. Thus, with respect to federally-owned minerals at least, the natural heritage theory lays the foundation for a externally-imposed limits on state natural resource taxation, perhaps related to the governmental costs attributable to resource development. The counter-argument of producing-state spokesmen that these minerals have been leased to private interests and therefore no longer carry a federal label does not undermine this position. After all, the natural heritage theory is only an inchoate claim to a collective popular interest in natural resources that is rooted in notions of sovereignty over such resources.[32] In this context, that sovereignty plainly must be regarded as more federal than state. Indeed, if the federal government had not leased its interest to private parties, the state would have been in no position to tax it in the first place.

With respect to privately-owned mineral lands acquired in fee from the federal government, the implications of the natural heritage theory are less clear. Although the birthright was initially a national one, the state might assert that, once property within its borders has been privatized, it possesses all the attributes of sovereignty with respect to such property, including the representative one of claiming the people's collective birthright. Such assertions of sovereign interests are somewhat attenuated, however, and may be accepted more readily as assertions of traditional police power over property within the state's jurisdiction.

With respect to privately-owned lands in the original thirteen states, Texas, and Hawaii, the state would be in a position similar to the federal government, except to the extent that private parties had directly succeeded to ownership interests of foreign sovereigns. Even with respect to those interests, however, the state might claim it succeeded to the sovereign claims of the foreign power to its natural resources, but here it might encounter a conflicting assertion of sovereignty by the federal government.[33] And if one really were interested in pursuing the natural heritage theory to its logical conclusion, one would have to take account of the claims of the Indian Tribes, a point that is more than academic.[34]

In sum, if the natural heritage theory proves anything, it proves that there is some basis for limiting state production taxes in the West where the nation can assert a common claim to hundreds of square miles of resource-rich lands that lie in federal ownership. On the other hand, the theory has uncertain implications for privately-owned lands originally acquired from the federal government, and it has some rather peculiar and complex implications for the original thirteen states, Texas, and Hawaii.

c. State Natural Resource Taxes in the Federal System: What Are the Criteria of Interstate Equity in State Tax Policy?

Few political questions raised by state natural resource taxation would not fit comfortably under this rubric, and it was chosen in part for that reason. Literally hundreds of questions, many of them related or overlapping, have arisen in the course of efforts to define interstate equity in state natural resource taxation. These questions have been debated in congressional hearings, in conferences of state officials, and in the national news media. This section attempts to distill these debates without stripping them entirely of their color.

A common charge emanating from states without significant resource endowments is that the resource-rich states are "profiteering"[35] from their happy circumstances with a "beggar-thy-neighbor"[36] policy inconsistent with the tenets of political and economic unity on which the federal system was founded. Many of these assertions are merely a restatement, without more, of the proposition considered above, namely, that citizens of resource-poor states may be asked to pay their fair share of the costs of producing the resources they consume but "they ought not be charged billions of dollars over a period of years to support general governmental programs for citizens in other states."[37] Some of the contentions go further, however, and attempt to provide a substantive rationale for so limiting the producing states' tax power.

First, it is argued that resource-rich states should not be permitted to exploit unreasonably the advantages that accrue to them solely by virtue of their geologic good fortune. The argument has historical support if one is willing to analogize between different types of locational advantages. As James Madison explained in his Preface to the debates of the Constitutional

Convention of 1787, which detailed various sources of dissatisfaction with the Articles of Confederation:

> The other source of dissatisfaction was the peculiar situation of some of the States, which having no convenient ports for foreign commerce, were subject to be taxed by their neighbors, thro whose ports, their commerce was caryed on. New Jersey, placed between Phila. & N. York, was likened to a Cask tapped at both ends: and N. Carolina between Virga. & S. Carolina to a patient bleeding at both Arms. The Articles of Confederation provided no remedy for the complaint: which produced a strong protest on the part of N. Jersey; and never ceased to be a source of dissatisfaction & discord, until the new Constitution, superseded the old.[38]

More than twenty years ago, the Editors of the Harvard Law Review seized on the analogy likening a severance tax to "a tollgate lying athwart a trade route . . . [that] conditions access to natural resources."[39] Northeastern and Midwestern political representatives continue to sound that theme today in suggesting that excesive taxes on natural resources violate first principles of federalism.

Producing-state spokesmen respond by echoing the Supreme Court's conclusion that the Constitution does not "giv[e] residents of one State a right of access at 'reasonable' prices to resources located in another state."[40] They contend that "[i]t would be very bad politics . . . to grant the residents of one State, or one part of the country, the right to control the terms and conditions of resource development and depletion in their sister states . . ."[41] They observe that the Framers adopted the Import-Export Clause and the related Duty of Tonnage prohibition---the only explicit limitations on state tax power in the Constitution[42]---to deal with the problem raised by Madison. And they claim that extending that principle to other special advantages the states may enjoy is not warranted by vague considerations of federalism. Moreover, they point out that the argument may prove too much. If the economic and political assumptions underlying federalism impose a benefit-related restraint on the states' power to tax activities associated with fortuitous locational advantages, it would cut a broad swath across state and local tax structures when one includes in the calculus such advantages as access to transportation, water, sunlight, and perhaps even skilled labor.

Retaliation, according to advocates from consumer states, is another likely consequence of unbridled natural resource taxation and one that in their view demonstrates the irreconcileability of such unrestrained tax power with the values underlying the federal system. The Northeast-Midwest Institute, the research arm of a congressional coalition representing that region, has warned of "a strong possibility that a dangerously divisive severance tax warfare will break out, with each state striving to tax a precious commodity just to preserve its competitive position."[43] In Iowa, reported a Congressman from that state, "there is talk of a severance tax on corn, soybeans, and other grain."[44] And Governor Byrne of New Jersey is said to have suggested in jest that "the Northeast can place a severance tax on Ivy League educations."[45]

However acute may be the theoretical dangers of the "economic civil war"[46] conjured up by such speculation, they are more a function of wishful thinking than of practical political concern. That is the lesson of Chapter 4. If Iowa were to impose a severance tax on corn, it would have no appreciable effect on the price of corn which farmers from Kansas and Nebraska would presumably continue to supply at the market price. The result would be an effective reduction in the income of Iowa farmers and, ultimately, of the value of corn land in Iowa. The enactment of a corn severance tax by Iowa would therefore be the legislative equivalent of shooting oneself in the foot. Similar consequences would ensue from Detroit's imposition of a "severance" tax on automobiles. This is not to suggest, however, that if permitted to tax without restraint (other than that imposed by the Constitution), consuming states might not identify some levies with which they can effectively retaliate against their sister producing states. Indeed, one can argue that they already do.[47]

In addition to arguments resting on the premise that the preservation of the Union depends on restraining "rapacious"[48] resource-rich states from acting in their narrow self-interest, there is a more positive strain of argument that stresses the collective self-interest of the nation. It relies on the premise well-expressed by Justice Cardozo that our "political philosophy . . . was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division."[49] Even assuming that producing states have a legitimate concern in providing for future generations, the question, from the standpoint of interstate equity, thus becomes whether "the present generation of people in Michigan and Illinois and Minneosta and Texas . . . [should] provide a trust fund for future generations of Montanans."[50] More generally, the question is whether the federal system can or should tolerate the massive shifts of wealth from one region to another that such tax policies will induce, a question to which we return in Part III below.

Finally, we return to a central theme in the historical development of natural resource production taxes, yet one which has maintained its significance in the interstate conflicts over such taxation, the exhaustibility issue. Defenders of producing states' severance tax policies constantly remind us that their resources are a "one time harvest"[51], which, when mined, will be lost forever. They vow not to repeat the "mistakes of the past,"[52] when, in the words of a representative of the Montana Democratic Party, "the state was exploited by the mining interests who removed enormous amounts of wealth from the state leaving little but the ruins of the Copper Kings' Mansion, and a shrunken boom town."[53] They also point to Appalachia for contemporary illustrations of the failure to provide adequately for the departure of the natural resource industry.

Although advocates for consuming state interests are not wholly unsympathetic to these considerations, they counter that the producing states ignore the benefits of economic development that will accrue to the states from exploitation of their resources. As Congressman Sharp of Indiana put it:

> We understand the costs. We understand the reclamation prob-

> lems, the development costs, but we also know that enormous wealth comes with that. There are new incomes that pay income taxes. There is new value to land that pays automatically without the government having to make tough political decisions about raising the tax rates. It is not as if it is a one-way proposition and the only way it can be corrected is by taxing the coal shipped out of State.[54]

Moreover, some spokesmen for the industrial regions have questioned the very concept of a trust fund to tide the state through future bad times when its economic base may have lost its lustre:

> Should Detroit have established a trust fund, *in advance*, to mitigate the boom-town effects of unemployment and urban blight that are accompanying the failing automobile industry . . .? The answer of course is "no." A "contingency fund" in advance of unknown environmental or social impact costs suggests that we don't have adequate mechanisms at the national level to deal with these contingencies when they arise.[55]

2. Conflicts Over Facts.

a. What Are the Costs Reasonably Attributable to Natural Resource Production in the State?

Few questions stir more bitter controversy than those bearing on the scope and magnitude of the costs imposed on producing states by natural resource development. Consuming-state spokesmen, armed with economic studies, contend that such costs amount to only a small fraction of the enormous tax revenues that the producing states are collecting from natural resource production. Even while protesting the relevance of the inquiry, producing-state representatives fiercely dissent from these assessments. Without rehearsing every point and counterpoint in this dialogue, the following discussion seeks to identify the principal issues that divide the contending parties over what constitutes a fair estimate of the costs that natural resource development imposes on a state.

First, there is the pedestrian but often critical question of assigning a dollar figure to costs that everyone agrees should be included in the analysis. An economic consulting firm hired by the plaintiffs in Commonwealth Edison attempted to measure in dollar terms the local impact costs of coal mining in Montana. It concluded that these impact costs amounted to two cents per ton---a "fact" that was said to demonstrate the excessiveness of Montana's tax which in some cases was 100 times the amount of such costs.[56] A state senator from Montana did the arithmentic differently:

> Based on five years of actual experience in Montana and figures used by the Congressional Budget Office . . . , I have compiled the actual costs of the limited impacts [the economic consulting firm] attempted to measure. They understated the impacts by a factor of 53 to 1.[57]

Second, there is the question of what impacts one should measure in assessing the costs that natural resource production imposes on a state. In criticizing the study referred to in the preceding paragraph, the same senator contended that it did not even "include any impacts for mine mouth generating systems, conversion facilities, synthetic fuel plants, construction work on both plants and mines, and roads."[58] A spokeswoman for the consulting firm took issue with this assertion,[59] but who is right is not the point. It is rather that in any debate over the measurement of impact costs, there will invariably be disputes over which costs should be embraced within the determinination and perhaps over whether they have in fact been accounted for at all.

Third, the claim is often made that producing states cannot justify production taxes to compensate them for the environmental damages allegedly caused by natural resource development because producers are already required by federal and state law to minimize environmental impacts and ultimately to restore the land to its original condition. As one witness testified before Congress:

> To open and operate a mine in Montana, thirty environmental laws must be complied with, and mining plans must be submitted and approved before mining begins . . . If any damage to the environment is suspected, mining plans are rejected. State mine inspectors, all environmental scientists, visit the mines every two weeks; federal inspectors come quarterly. Mines are required to install weather stations with air monitoring devices, stream gauging stations, and observation wells to monitor water quality. The soil is tested repeatedly by the U.S. Forest Service. If it appears that mines will threaten existing wells, plans are disapproved. If a well on someone's property is destroyed, the mining company is required to dig another. Mine operations must reclaim the land mined within two years after completion of mining activities. In 1979, reported reclamation costs averaged $5,000

> per acre. . . . Two federal taxes levied on coal production provide funds that are funnelled back to states to offset potential deleterious effects of mineral production. The Surface Mining Control and Reclamation Act of 1977 levies a 35 cent tax on each ton of strip-mined coal and 50 percent of this money is returned to the state from which it originated for the purpose of reclaiming strip-mined land. An additional 20 percent of fees may become available to states under the Rural Abandoned Mine Program.[60]

As the witness succinctly concluded: "It appears that all of the known potential environmental damages that may occur as a result of strip mining have been subjected to a regulatory climate that has left 'no stone unreturned.'"[61]

The predictable rejoinder from defenders of the producing states' tax policies is that the unknown and presently unknowable environmental damages of mineral extraction are potentially of much greater magnitude than those we can currently identify. It is responsible fiscal policy, they maintain, to provide for these eventualities now before the source of revenues to deal with such problems have been exhausted. "The fact is," declared Governor Schwinden of Montana, "no one really knows the true cost of development. . . . No one can calculate the impact of soil loss, of erosion, of loss of habitat for wildlife."[62]

The point is by no means limited to environmental costs. "No one can put a real price tag on the social costs that are associated with the development of of the Powder River Basin, and the other mineral fields in the West. It is the same with the boom town atmosphere and increases in crime and domestic problems."[63] There is the countercharge that "the tears shed by some legislators for boom towns are crocodile tears"[64] because most of the revenues from state production taxes go into the state's general fund. Western state spokesmen insist, however, that the states through their general funds will inevitably bear the brunt of the massive burden of "human reclamation"[65] that will be thrust upon them when the mines are depleted. And, like Wyoming's Senator Wallop, they ask: "Who makes the judgment that it exceeds legitimate social costs? Have you been to Wyoming and seen those social costs?"[66] Furthermore, if production taxes are objectionable both because they are earmarked for the needs of future generations and because they are not earmarked for the local impact needs, the freedom of producing states to shape their own fiscal policy would be narrow indeed.

b. To What Extent Are State Production Taxes Exported to Nonresident Consumers?

Having considered this question at some length in the two preceding chapters,[67] we are now in a position to place the political debate over state tax exportation in some perspective. The battle lines over the issue have been drawn in familiar fashion. Consuming-state advocates routinely assume that natural resource production taxes are borne by the ultimate consumers of those resources. The complaint of Senator Bumpers of Arkansas, an energy-importing state, is typical: "All across the country, States are moving to enact new taxes on energy production . . . [and] to stick consumers in other States with the bill."[68] Proponents of producing states' interests, while not seriously denying the assertion that their jurisdictions export their taxes, are quick to point out that tax exporting is a universal phenomenon in the federal system and that producing states are by no means the worst offenders. "I find it fascinating," observed Senator Simpson of Wyoming relying on figures prepared by the Department of Commerce, "that those states which have been the most successful . . . in exporting their tax burden to nonresidents are composed of those states [Illinois, Michigan, and Wisconsin] which rely chiefly on the coal from the states of Wyoming and Montana."[69] It is also observed that the issue is so mired in economic and factual complexities that it offers no guidance for sound interstate fiscal policy.

In the end, both sides are right in their allegations regarding the nature of state tax exportation in the federal system. The resource-rich states _do_ export their tax burdens through production taxes, but so do other states through other taxes. The issue _is_ complex, although perhaps less complex than meets the eye when one considers such institutional arrangements as long-term contracts with pass-through clauses and federal regulatory schemes that place the burden of production taxes squarely on the energy consumers' shoulders. The real issue, of course, is not tax exportation, but "excessive" tax exportation, which takes us back to the questions we have addressed above and anticipates the question we will address below, namely, whether natural resource tax exportation should be viewed as a discrete "problem" demanding a national solution or an endemic feature of our federal system whose fabric would be destroyed by serious efforts to curb it.

c. How Significant Is the Producing States' Tax Burden on Nonresident Consumers?

Although this is more an issue of characterization than of fact, the extensive and heated interchanges between spokesmen for consuming and producing states over this question may conveniently be considered at this juncture. Even if the producing states' severance taxes are in fact exported, the question is sometimes raised whether the amounts involved are of sufficient proportion to warrant our attention. It is suggested that there are so many other factors of greater individual and collective significance entering into the final price of the consumer product that production taxes are not worth our time, at least as compared to such other factors.

Transportation costs, for example, commonly dwarf production taxes as a percentage of the price of the delivered coal, oil, or, gas to the energy consumer. In 1981, Montana's 30 percent severance tax on coal amounted to about $2.30 per ton compared to rail rates of more than $20.00 per ton to Illinois and Texas, $17.50 to Iowa, and nearly $12 to Wisconsin.[70] Such taxes generally amounted to between two and three percent of a consumer's utility bill, which translates into no more than a few pennies a day, often substantially less than the sales tax imposed by the consumer's own state on his purchases of electricity.[71] The Congressional Research Service of the Library of Congress prepared a study that showed the impact of severance taxes on oil, gas, and coal on the cost of various end products to the consumer.[72] Employing March 1981 data and utilizing the highest severance tax rates then prevailing for the resources in question

(Louisiana's twelve and one-half percent rate for oil, Alaska's ten percent rate for natural gas, and Montana's 30 percent rate for coal), it found the following:

End product	Price at point of taxation	Amount of severance tax	End-use cost	Percentage of end-use cost as tax
Oil-fired powerplant (electric)	$38.00/bbl	$4.75/bbl	$.84/kw	11.8%
Home-heating oil	$38.00/bbl	$4.75/bbl	$1.30/gal	12.0%
Gasoline	$38.00/bbl	$4.75/bbl	$1.35/gal	8.1%
Residential Gas	$1.60/mcf	$0.16/mcf	$4.10/mcf	4.0%
Coal-fired powerplant (electricity)	$12.00/ton (F.O.B. MT; 9300btu.lb	$2.64/ton	$.046/kw	3.5%
Gas-fired (electricity)	$1.60/mcf	$0.16/mcf	$.058/kw	3.2%

One partisan observer concluded from all of this that "[t]he severance tax is peanuts, absolute peanuts."[73] What drives up the cost of the resource to the consumer "are items like mining costs, revegetation, reclamation, Federal taxes, labor contracts, labor pensions, freight rates, black lung payments, [and] return on investment."[74]

Politicians from consuming states prefer to focus on their constituents' aggregate severance tax bills, which can scarcely be characterized as de minimis. The Mayor of Minneapolis complained that consumers in his city paid $1.246 million in 1980 "in tribute to the State of Montana."[75] The Co-Chairman of the Northeast-Midwest Congressional Coalition's task force on energy taxation warned of the massive shifts of wealth from the energy-consuming to the energy-producing regions, with projected energy-tax revenues in the hundreds of billions of dollars, much of it derived from the pockets of energy consumers.[75] And energy consumers deny that they ignore the non-tax contributions to the increase of energy prices: "I would say to my friend," declared Senator Benstsen of Texas, whose oil-rich state is nonetheless a major consumer of Western coal, "I have been just as diligently fighting [the railroads]. They have done a job of raising the rates to an exorbitant level and we passed legislation here to put a limitation on that."77

III. The Federal Role in Limiting State and Local Taxation of Natural Resources

The interstate conflicts over state and local taxation of natural resources have stimulated pleas for a federal solution to the problem. Legislation has been introduced in Congress to impose a ceiling on state severance tax rates and to limit state severance taxes to costs imposed upon the state by natural resource production. Broader proposals have been advanced for a national severance tax and for a revision of revenue-sharing formulas to counterbalance the "fiscal disparities"78 emerging from the shift in tax and economic wealth from resource-poor to resource-rich jurisdictions. These proposals have encountered predictable hostility from spokesmen for states well-endowed with natural resources. They accuse their proponents of disrespecting state sovereignty, creating a dangerous legislative precedent, and waging a "war on the West."79

In this section, we review the considerations supporting and counseling against federal intervention in this area, and we explore the merits of the various forms of intervention that have been proposed. The fundamental positions that the contending parties have staked out on these issues have been shaped in large part by their perspectives on the interstate conflicts we examined in the preceding section, and we will not retrace that discussion here. We will focus instead on questions we have yet to consider bearing specifically on whether and how the federal government should limit state and local taxation of natural resources.

A. The Advisability of Federal Intervention

The case for a federal solution to the problems raised by state and local taxation of natural resources rests on the grounds that they are significant in magnitude, national in character, and incapable of resolution by other means. The magnitude of the problem is reflected in the numbers associated with state natural resource taxation. State severance taxes, which amounted in 1972 to $758 million or 1.3 percent of state tax collections, had increased more than ten-fold by 1982 to $7.83 billion or 4.8 percent of state tax collections.[80] The United States Treasury Department estimated that the tax and royalty revenues accruing to states from oil-price decontrol alone could be as great as $128 billion from 1979 through 1990.[81] And the United States Advisory Commission on Intergovernmental Relations found that natural resource revenues were contributing to increasing disparities in the states fiscal capacities which in 1980 ranged from a low of $817 per capita in Mississippi to a high of $6,161 per capita in oil-rich Alaska.[82]

The problems spawned by state and local taxation of natural resources are also national in scope. The bulk of the revenue in question is derived from oil, gas, and coal, and the states' tax policies therefore implicate national energy policy. Indeed, the alleged "windfalls"[83] that the states are now reaping from taxes on increased energy resource values are attributable in part to federal energy policy. For example, federal oil price decontrol created a dramatic increase in domestic oil prices, and Congress contributed to the demand for coal by requiring its use by certain industrial and utility consumers.[84] It is only just, the argument continues, that the federal government limit the extent to which a few states are permitted to benefit from the federal government's own regulatory policies at the expense of their sister states.

The national character of the problem is reinforced by the fact that a substantial portion of the nation's natural resources are located under federal lands or have been reserved by the federal government. Wholly apart from technical questions of title to the resources at the moment they are severed and taxed, there is a federal interest in the revenues generated by such "national resources"[85] that may justify federal restraints on the states' power to tax them.

The political and economic Balkanization caused by state taxation of natural resources is a further matter of national concern. If the nation faces "economic warfare among the states"[86] over state and local natural resource taxation, it is certainly within the federal government's purview to attempt to prevent it. Indeed, one can argue that the federal government would be reneging upon its essential responsibility by failing to do so. Moreover, the fiscal disparities attributable to the differential access to natural resource tax revenues raise additional questions of national dimension.

Finally, proponents of federal action insist that there is no other avenue of relief from the problem. The judicial door was tightly shut by Commonwealth Edison. Despite the difference of opinion over the extent of intrastate political restraints,[87] the trend toward increased state revenues from natural resources is unmistakable, a fact that spokesmen from energy-poor states ascribe to "taxation without representation."[88] Only at the federal level, they contend, are the interests of all concerned parties adequately represented. As for economic constraints on state natural resource taxation, advocates of federal legislation point to the market dominance of the producing states, long-term contracts, and regulatory mechanisms that jointly and severally deprive the market of whatever restraining force it might otherwise exercise in this context.

There is nevertheless a case to be made against federal intervention in this domain. First, it is vigorously asserted that a federal limitation on state severance taxes would violate basic principles of state sovereignty thereby upsetting the settled relationship between state and national power in the federal system. Although there are some who regard invocations of state sovereignty as empty rhetoric, it is no mere shibboleth in many states, especially in the South and the West where the federal presence is often viewed with a jaundiced eye. Nor does anyone deny that the state's taxing power is critical to their independent existence in the federal system. One cannot wade through the volumes of testimony directed to this question without appreciating the sensitivity of the issue and the intensity of feeling surrounding it in states whose taxing authority is imperiled by federal legislation. The prediction that the passage of such legislation will make the Sagebrush Rebellion[89] "look like a garden party"[90] is no idle threat.

Opponents of federal legislation also point to the dangerous precedent it would set.

> [I]f Congress is able to restrict the amount of taxation which the mining States are able to levy . . . then why should not Congress also act under its commerce powers to restrict the level of State taxation in the farm belt States, in the manufacturing States, the timbering regions of America, and any other State which sustains within its borders a regional or national center of production.?[91]

Moreover, it is suggested that there is no equitable basis for limiting such a restriction to natural resources. If Congress is concerned about excessive state tax exportation based on locational advantages, why not impose like restrictions upon Florida's taxation of the tourist industry , Washington's taxation of stevedoring, and, perhaps, New York's taxation of stock transfers?

Opponents of federal restrictions on state natural resource taxation further assert that such a restraint is mischievous on its own terms, even assuming one were not concerned about its implications for state autonomy. They argue that the proposed legislation is an ill-conceived effort of the energy-poor states to reverse the market verdict against them through the political process.[92] They claim that imposing artificial restrictions on the energy-rich states' tax power or, worse yet, redistributing their revenues to the decaying cities in the industrial heartland is to impede the adjustments that the nation must make in confronting the economic realities of the late twentieth century. They observe that South and the West have long consumed the products of the Northeast and the Midwest largely contributing to the once flourishing economies and ample tax bases of those regions. And they resent what they perceive to be the efforts of those regions to change the rules of the game now that resource-rich states are having their economic day in the sun.

Finally, opponents of congressional legislation limiting state natural resource taxes express their doubts about the constitutionality of such legislation. Such reservations are usually based on the Supreme Court's opinion in National League of Cities v. Usery[93], which held that Congress lacked the power under the Commerce Clause to prescribe minimum wages and maximum hours for state employees pursuant to the Fair Labor Standards Act. The Court's opinion was rooted in the constitutional policy, which is reflected in the Tenth Amendment,[94] that "there are limits upon the power of Congress to override state sovereignty, even when exercising its plenary powers . . . to regulate commerce."[95] The Court concluded that in attempting to exercise its commerce power to prescribe minimum wages and maximum hours for the states in their sovereign capacities, Congress had "sought to wield its power in a fashion that would impair the States' 'ability to function effectively in a federal system,'"[96] and that Congress may not exercise its commerce power "so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made."[97]

It might be maintained that the states' ability to employ severance taxes to finance their integral governmental functions is essential to their separate existence and that any interference with such taxing power would impermissibly trench on state sovereignty under National League of Cities. After the Court's decision in Commonwealth Edison, however, it is difficult to credit such a contention, at least if Congress did not absolutely prohibit such levies. In Commonwealth Edison, the Court gave every indication that Congress possesses the power to limit state severance taxes without hinting that National League of Cities constitutes a roadblock to federal legislation. In declaring that the appropriate level of state taxes may be established "if necessary, by Congress, when particular state taxes are thought to be contrary to federal interests,"[98] the Court explictly noted that "the controversy over the Montana tax has not escaped the attention of Congress."[99] and referred to legislation that has been introduced in Congress "to limit the rate of state severance taxes."[100] Serious questions have been raised, however, whether Congress possesses the power under the Commerce Clause to impose an absolute ban on state severance taxes.[101]

B. Proposed Federal Legislative Responses to State and Local Taxation of Natural Resources

1. Limiting State Severance Tax Rates

The most widely supported form of federal intervention into the controversy over state and local natural resource taxation is a specific percentage limitation on state severance tax rates. A number of bills have been introduced into Congress embodying such a limitation.[102] Indeed, a bill limiting coal severance taxes to 12.5 percent of the coal's value was approved by the House Subcommittee on Energy and Power in 1980,[103] but never went to the House floor for a vote. It was trapped in the backlog of legislative business that preceded the presidential election of 1980.[104]

If one is persuaded of the overall wisdom of a federal legislative solution to the problems raised by state and local natural resource taxation, a limitation on the rate of such taxation has several appealing features. The most prominent is its simplicity. A ceiling on tax rates requires little explanation and can be judicially enforced without difficulty so long as the definition of value to which the ceiling applies is clear and is pegged to readily accesssible data. Another virtue of a rate limitation is its relative lack of intrusiveness into state fiscal affairs, at least by comparison to the proposals we shall consider below. While the state's tax power is restricted, no additional federal aparatus need be created to administer the restriction. Finally, by placing the ceiling at an appropriate level, one can soften if not satisfy objections based on a state's right to recover the costs imposed on it by natural resource development.

Criticisms of the principle of a fixed rate limitation are usually leveled on two grounds. First, as is often the case with simple solutions, they are also arbitrary. The choice of a single rate as an approximation of a state's legitimate claims, however defined, to its natural resource tax base cannot conceivably account for the variations in the nature and extent of the costs imposed by different kinds of natural resource production. The costs of schools, roads, and hospitals, of environmental impacts, and of social services will vary dramatically depending on whether they stem from the extraction of oil from the fields of east Texas, the gathering of gas in the Louisiana wetlands, the production of coal from the underground mines in West Virginia, or the strip-mining of coal on the plains of eastern Montana.

Second, the use of a percentage limitation keyed to the value of production arguably bears unfairly on states with relatively low-value resources. For example, coal from coal Eastern and Midwestern states has been priced three times higher than Western coal because of its higher energy content or lower transportation costs.[105] Eastern and Midwestern coal producing states are therefore in a position to raise substantially greater revenues under a fixed ceiling than are their Western counterparts. Yet it is hard to see why the former should effectively be permitted greater taxing power than the latter. Moreover, in terms of the burden of the production tax on the ultimate consumer, which is a central concern of many legislators favoring federal legislation, the implications of an across-the-board rate limitation are unsettling. As the table reproduced on page ____ above demonstrates, a twelve and one-half percent severance tax on oil valued at $38 per barrel will comprise about twelve percent of the cost to the consumer of electricity generated by an oil-fired power plant or of the cost of home heating oil. A 30 percent coal severance tax,[106] on the other hand, will comprise a mere three and one-half percent of the cost to the consumer of electricity generated by a coal fired powerplant. Yet a flat fifteen percent limitation on the rate of production taxes based on the value of production at the well head or mine mouth would leave the oil severance taxes undisturbed while cutting the coal severance tax in half.[107] Such an outcome is hard to square with a concern for the ultimate resource consumer, let alone with notions of interstate equity.

The proposed legislation embracing a severance tax rate limitation that has actually been introduced into Congress raises further questions still. Most of the bills, including the one endorsed by the House Subcommittee on Energy and Power, have taken the form of an amendment to the Powerplant and Industrial Fuel Use Act of 1978.[108] The Act was a centerpiece of President Carter's National Energy Plan to achieve energy independence. As President Carter described that Plan:

> Coal, the nation's most abundant fossil energy resource, should be used in place of oil and gas wherever economically and environmentally feasible. Programs that increase the use of coal as a substitute for oil will receive the highest priority.[109]

In implementing this policy, the Act, among other things, called for the conversion of existing electric utility powerplants and major fuel burning installations to switch from oil to coal and for new plants to be built so as to utilize coal as the primary energy source. The severance tax limitation to be appended to the Act was couched in the following terms:

(a) LIMITATION.---Notwithstanding any other provision of State or Federal law, with respect to any coal which is destined for shipment in interstate commerce for use in any powerplant or major fuel-burning installation, the sum of all severance taxes or fees, in respect of the any fiscal year, levied upon or collected from any taxpayer, by a State or any political subsdivision thereof on such coal or on any improvements or other rights, property, or assets produced, owned or utilized in connection with the production of such coal shall not exceed a total of 12-1/2 percent of the value of such coal produced during such fiscal year at the time it has been extracted and prepared for transportation free on board the production site, exclusive of all State and local taxes and fees.

(b) SEVERANCE TAXES OR FEES DEFINED.---For purposes of subsection (a), "severance taxes or fees" includes any tax or fee, by whatever name called, levied, or collected upon coal or upon any improvements or other rights, property, or assets produced, owned, or utilized in connection with the production of coal except for income, sales, property, or other similar taxes or fees of general application which are not disproportionately imposed thereon.[110]

Federal legislation narrowly directed at a particular resource plainly violates the concept of evenhandedness in restricting the states' power to tax natural resources. Still it may be be justified by the fact that it is rooted in a specific federal policy to encourage the use of that resource. The determination whether evenhandedness toward the states, on the one hand, or the effectuation of specific energy policies, on the other, should be the overriding objective in designing federal legislation limiting state and local natural resource taxation is, of course, a value judgment about which reasonable people will differ. There are two additional considerations, however, that ought to give us serious pause before adopting such a course.

First, in light of the general recognition that any federal limitation on state tax power should be viewed as matter of the greatest delicacy, we should view with more than the usual caution any legislation that singles out the taxes or resources of just a few jurisidictions that may lack the political muster to resist it. One wonders, for example, whether spokesmen from Texas who so avidly supported a limitation on coal severance taxes,[111] would have been as enthusiastic in their support of a limitation that included oil and gas.[112] And, if they would not have been, can we confidently assume that the difference is attributable to their commitment to a national policy to encourage use of coal rather than to the traditional political objective of looking out for one's own? Second, if there is to be a significant incursion on the states' power to tax natural resources, perhaps we should be reluctanct to predicate it on something as uncertain as national energy policy. With the weakening of OPEC, increased conservation efforts, and the impact of oil price decontrol, the national energy picture looked quite different in late 1983 than it did in 1980 and 1981 when efforts to impose restraints on state coal severance taxes may have reached their high water mark. Indeed, the National Energy Policy Plan sent to Congress in the fall of 1983 reflected a softening of the commitment to energy self-sufficiency, a de-emphasis of fossil fuels as the sole source of domestic energy, and reliance on a a more "'balanced' mix of resources, including solar, wind and hydroelectric energy and other renewable sources of power."[113] If excessive state taxation of natural resources is a threat to the federal system, a limitation upon it should be rooted in firmer soil than the shifting sands of national energy policy.

2. Limiting State Severance Taxes to Costs Incurred by the State Attributable to Natural Resource Production

The fundamental position that state taxes on natural resource production are excessive in relation to the costs that such activities impose upon the state is reflected in the proposed Severance Tax Equity Act introduced into Congress in 1982 and 1983 by Senator Dixon and Representative Hyde of Illinois.[114] The proposed legislation is more broadly based than that considered above, as it applies to oil, gas, and coal. It also comports more comfortably with the underlying rationale for such legislation, as it eschews arbitrary percentage limitations and instead limits state severance taxes to the "costs incurred by the State (and any political subdivision thereof) . . . which are directly attributable to the production within the State of crude oil, natural gas, or coal, as the case may be."[115]

At the same time, however, the proposed legislation is considerably more complex than the virtually self-executing percentage limitation. It would establish elaborate federal enforcement machinery, authorizing the United States Attorney General or an aggrieved taxpayer to bring suit in federal court against any state in violation of the statute. It would generally place the burden of proof upon the plaintiff to prove that the aggregate revenue from the state severance tax exceeded the costs incurred by the state that are directly attributable to natural resource production. In the event, however, that a state's severance tax exceeds either its "adjusted 1978 State tax rate for such State for such fiscal year" [116] or the "adjusted 1978 national average tax rate for such fiscal year,"[117] terms defined with the labyrinthine detail we have come to expect from draftsmen of federal tax provisions, the burden of proof shifts to the defendant state.

In short, the legislation proposed by Messrs. Dixon and Hyde appears to offer gains from the standpoint of both interstate equity and consistency with legislative purpose by comparison to the simple rate limitation considered above. These gains must be weighed against the manifest losses it would entail, again by comparison to the simple rate limitation, in ease of understanding and implementation. Nor should one underestimate the increase in federal-state friction that might be occasioned by permitting taxpayers ready access to federal court to challenge state taxes, a practice contrary to general congressional policy in this area.[118]

3. A National Severance Tax

When we move beyond the concept of a federal restraint on state production taxes to the broader proposals that have been advanced for dealing with the fiscal disparities that are due to state natural resource tax revenues, we confront a vast array of legislative possibilities. Most of these have retained their character as casual suggestions. One exception is the proposal for a national severance tax levied either in conjunction with a limitation on state severance taxes or as a replacement for such taxes. Revenues from the federal tax would be earmarked for distribution in a manner more consonant with its proponents' views of national priorities than are revenues from existing natural resources taxes. For example, legislators from the Northeast-Midwest Congressional Coalition introduced a bill in Congress in 1982 proposing a federal severance tax on crude oil as well as a limitation on state severance taxes based on the "adjusted 1978 State tax rate"[119] or the "adjusted 1978 national average tax rate"[120] alluded to above. A portion of the revenues was to be allocated to the states under a complicated scheme designed to assure that a goodly portion of the funds made their way to the beleaguered economies of the Northeast and Midwest.

Columbia Law School Professor Lewis Kaden has suggested that Congress

> might consider replacing state severance taxes and royalties with an national levy on energy extracted from the mines, with the revenues shared nationally on a basis of a formula designed to serve the goals of fiscal balance, payment for impact costs, energy independence and rehabilitation of public infrastructure in the consuming regions.[121]

Mere statement of such an agenda for legislative consideration is sufficient to demonstrate why more suggestions of this kind have been advanced informally than have been articulated in the form of a legislative proposals.

The concept of a national severance tax is not solely a child of the energy crisis. The idea was actually put forward in 1969 before energy independence had become a national priority. Ironically in light of recent history, it was offered by Senator Metcalf from Montana for the purpose of encouraging states like his own to impose reasonable taxes upon their natural resources.[122] Senate Bill 910 sought to impose a five percent federal severance tax on the gross income from mining, with amounts paid as state severance taxes available as credits against the federal tax.[123] As Senator Metcalf explained his proposal on the Senate floor, many resource-rich states had failed to impose reasonable severance taxes upon mineral producers because

> [a] State acting alone runs the risk of placing some mining companies operating within the State at a competitive disadvantage relative to companies operating where there are no severance taxes. . . . Interstate competition, in other words, acts to keep severance taxes low.[124]

The purpose of the bill was therefore to encourage state legislatures to enact severance taxes at the minimum rate of five percent, which they could do without fear of offending local industry. Local producers would simply credit the tax against their federal severance tax liability. A virtually identical scheme has existed for years in the state death tax field, which has encouraged states to impose death taxes up the the limit of the maximum federal credit allowable.[127] There is a broader point suggested by this proposal than its particular merits: In considering both the wisdom and direction of federal legislation in this area, it is worth recalling that just fifteen years ago the issue was whether there should be a floor not a ceiling on state severance taxes.

4. Fiscal Disparities and Federal Revenue Sharing Formulas

Although it does not involve taxation as such, there is one final matter that merits brief attention here because it relates to the problem of fiscal disparities created by state natural resource revenues. This is the matter of the formulas that are employed by the federal government to allocate general revenue sharing and other federal funds among the states. The general question, whose scope extends far beyond the narrow issue addressed here,[126] is whether these formulas fairly reflect the fiscal capacities of the states to which the funds are being allocated. For our purposes, the particular question is whether these formulas adequately account for the massive influx of natural resource revenues enjoyed by a number of states.

Federal grants to state and local governments amounted to about $95 billion in fiscal year 1980.[127] Many of these grants are made pursuant to programs that recognize the differences among these jurisidictions in their ability to finance public services and are designed in part to equalize their post-grant fiscal condition. In allocating federal revenues among states and localities, the formulas therefore take account in many cases of the fiscal capacity (or the lack thereof) of the recipient state or locality. Fiscal capacity has always been measured by personal income in the federal grant programs that rely on such capacity as a guide to allocation of funds.[128] Another factor that has been employed for this purpose, most notably in allocating the four to five billion dollars of general revenue sharing funds, is the state's general "tax effort," defined as "total state and local tax collections divided by the state's personal income."[129]

The critical issues raised by these allocation factors in light of the access of some states to substantial natural resource revenues are not difficult to appreciate. Under most circumstances, per capita income is an acceptable measure of a state's revenue-generating ability because tax yields tend to be dependent on the income of residents in the taxing state. Hence a formula that equates fiscal capacity with personal income and distributes federal funds in an inverse relationship to such capacity would appear to be unobjectionable. However, as Robert Rafuse of the United States Treasury Department has observed,

> the link between the availability of natural resources and the income of a State or locality is tenuous at best. The exploitation of such resources generates a potential source of revenues, but the demand for energy production depends largely upon national rather than State markets. This is one of the reasons it has been argued that the measure of fiscal capacity in the Revenue Sharing formula is imperfect. That is, it does not allow for the potential yield of severance taxes in the minority of States that are exceptionally endowed with natural resources, whose exploitation creates an unusually lucrative base for taxation.[130]

Natural resource revenues have an even more dramatic---some would say perverse---impact on federal revenue allocation formulas that take account of tax effort in the equation. Tax effort, which reflects the ratio of tax collections to per capita income, is assumed to be a proxy for the tax burden borne by residents of a particular state. The higher a state's tax effort (and the implied tax burden on state residents), the greater is that state's share of federal funds.[131] When natural resource production tax revenues increase the ratio of state tax collections to per capita income, the result is to allocate additional federal revenues to that state because of the assumption that such revenues reflect the residents' own tax effort. As we learned in Chapter 4, however, natural resource taxes are often exported to residents of other states. To the extent that they are, the tax effort factor has the bizarre effect of allocating revenues to some states on the basis of the tax effort of residents of other states. Of course, the same point can be made with respect to any tax that is exported, but the phenomenon appears to be particularly widespread in the context of natural resource taxation.

Identifying the problems associated with the impact of natural resource revenues on federal revenue allocation formulas is easier than identifying the solutions. If one were to abandon per capita income and tax effort as allocation factors, the question is what would replace them. The United States Advisory Commission on Intergovernmental Relations has developed an alternative measure of fical capacity, denominated the "representative tax system."[132]

> The representative tax system defines the tax capacity of a State and its local governments as the amount of revenue they could raise (relative to other State-local governments)

> if all 50 state-local systems applied the *identical tax* rates (national averages) to their respective tax bases. Fiscal capacity is thus viewed as an attribute of government derived from the economic strength inherent within a State's jurisdictional boundaries. The system is "representative" in the sense that potential revenues are determined by applying a uniform taxing systgem in a State which represents a cross section of State and local tax practice currently affecting most citizens.[133]

Even the Commission, which has advocated implementation of the representative tax system for years, recognizes that there are serious technical and political problems in its adoption. As the Commission's Assistant Director John Shannon has stated: "The replacement of the traditional per capita income measure with the tax capacity estimates is bound to be highly controversial because it would create a new set of winners and losers."[134]

There is no end is sight to the national debate over the question whether Congress should modify the traditional formulas for allocating the billions of dollars in federal revenues that are distributed to state and local governments. The possibility that it may do so, however, should alert us to the opportunity for reducing the fiscal disparities created by the states' power to tax natural resources without tampering with such power in restrictive federal legislation.

NOTES TO CHAPTER 6

1. Commonwealth Edison Co. v. Montana, 453 U.S. 609, 628 (1981).

2. Arthur A. Link, "Political Constraint and North Dakota's Coal Severance Tax," National Tax Journal, 31 (September 1978): 263. The following discussion of the development of North Dakota's coal severance tax legislation is based on this source.

3. Ibid., p. 264.

4. N.D. Cent. Code § 57-61-03 (Supp. 1983).

5. George F. Weaton, "A History of Minnesota Mining as Influenced by Taxation," Symposium on Mine Taxation (Tucson, Ariz.: University of Arizona College of Mines, 1969), p. 7-26. The following discussion of the political background to Minnesota's taconite amendment is based on this source.

6. Ibid.; Howard D. Hamilton, "Taxes and Taconite: Iron Ore Tax Legislation in the Lake Superior Region," National Tax Journal, 7 (December 1954): 342.

7. Minn. Stat. § 298.23 (1982).

8. See Chapter 3, pp. ___-___ above.

9. Weaton, "A History of Minnesota Mining," p. 7-28.

10. Ibid., p. 7-29; see Minn. Const., art X, § 6.

11. Minnesota Department of Revenue, Minerals Tax Division, Minnesota Mining Tax Guide (Eveleth, Minn.: Minnesota Department

of Revenue, Minerals Tax Division, 1982), p. 11.

12. Highway Users Federation, *1983 Legislative Action* (Washington, D.C.: Highway Users Federation, 1983), p. 3.

13. See, e.g., Russell J. Adams, "State 'Oil-Only' Taxation: New Dangers in an Energy Troubled Society," *Oil and Gas Tax Quarterly*, 31 (December 1982): 413.

14. William M. Bloss, "Gross Receipts Taxes: Toward Parity in State Energy Taxation," *American University Law Review*, 32 (Spring 1983): 873.

15. See Chapter 5, pp. ___-___ and ___-___ above.

16. See Chapter 4, pp. ___-___ above.

17. See, e.g., *Coal Severance Taxes: Hearings on H.R. 6625, H.R. 6654, and H.R. 7163 Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce*, 96th Cong., 2nd Sess. (Washington, D.C.: United States Government Printing Office, 1980), p. 19 (testimony of Senator Riegle (D-Mich.))[hereinafter cited as *1980 House Coal Severance Tax Hearings*].

18. Ibid., p. 12 (testimony of Representative Samuel L. Devine (R-Ohio)).

19. *Coal Severance Tax Limitations: Hearings on H.R. 1313 Before the Subcomm. on Fossil and Synthetic Fuels of the House Comm. on Energy and Commerce*, 97th Cong., 1st & 2nd Sess.

(Washington, D.C.: United States Government Printing Office, 1982), p. 19 (testimony of Representative Sam Gibbons (D-Fla.))[hereinafter cited as 1981-1982 House Coal Severance Tax Hearings].

20. 1980 House Coal Severance Tax Hearings, p. 25 (testimony of Representative James L. Oberstar (D-Minn.)).

21. Fiscal Disparities, Part 2, The Commerce Clause and the Severance Tax: Hearings Before the Subcomm. on Intergovernmental Relations of the Senate Comm. on Governmental Affairs, 97th Cong., 1st Sess. (Washington, D.C.: United States Government Printing Office, 1982), p. 17 (testimony of William P. Rogers, Rogers & Wells)[hereinafter cited has Senate Fiscal Disparities Hearings, Pt. 2].

22. Coal Severance Tax: Hearing on S. 2695 Before the Senate Comm. on Energy and Natural Resources, 96th Cong., 2nd Sess. (Washington, D.C.: United States Government Printing Office, 1980), p. 173 (testimony of Donald M. Fraser, Mayor of Minneapolis)[hereinafter cited as 1980 Senate Coal Severance Tax Hearing].

23. Ibid., p. 235 (testimony of Thomas L. Judge, Governor of Montana).

24. See Chapter 4, p.___ above.

25. The Federalist No. 32 (Alexander Hamilton), Benjamin F. Wright, ed. (Cambridge, Mass.: Belknap Press of Harvard University Press, 1961), p. 241.

26. See Chapter 2, p. __ below.

27. Ibid.

28. John H. Ashworth, "Continuity and Change in the U.S. Decision-Making Process in Raw Materials," in E. Beigie and Alfred O. Hero, Jr., eds., *Natural Resources in U.S.-Canadian Relations*, vol. 1 (Boulder, Colo.: Westview, 1980), p. 70.

29. Ibid.

30. George C. Coggins and Charles F. Wilkinson, *Federal Public Lands and Resources Law* (Mineola, N.Y.: Foundation Press, Inc., 1981), p. 1. The balance of this paragraph relies on this source.

31. See United States v. California, 332 U.S. 19 (1947).

32. George Elian, *The Principle of Sovereignty over Natural Resources* (Alphen aan den Rijn, The Netherlands: Sijthoff & Noordhoff, 1979), pp. 1-26.

33. Cf. United States v. Maine, 420 U.S. 515 (1975).

34. See generally "Symposium on Indian Law," *Oregon Law Review*, 62 (1983): 1-144.

35. *1980 House Coal Severance Tax Hearings*, p. 255 (testimony of Representative Thomas A. Tauke (R-Iowa)).

36. Ibid., p. 277 (testimony of Irwin M. Stelzer, National Economic Research Associates).

37. United States Senate, *Senate Report No. 127*, 97th Cong., 1st Sess. (Washington, D.C.: United States Government Printing Office, 1981), p. 369 (statement of Senator Durenburger (R-Minn.)).

38. James Madison, "Preface to Debates in the Convention of 1787," in Max Farrand, ed., *The Re ds of the Federal Constitution* (New Haven, Conn.: Yale University Press, 1966), p. 542.

39. "Developments in the Law---Federal Limitations on State Taxation of Interstate Business," *Harvard Law Review*, 75 (April 1962): 970.

40. Commonwealth Edison Co. v. Montana, 453 U.S. 609, 619 (1981).

41. *Senate Fiscal Disparities Hearings, Pt. 2*, p. 81 (testimony of Senator Max Baucus (D-Mont.)).

42. See Chapter 5, p. ___ and note ___ above.

43. Tom Cochran and J.R. Prestidge, *The United American Emirates: State Revenues from Non-Renewable Energy Resources* (Washington, D.C.: Northeast-Midwest Institute, 1981), p. 16.

44. *1981-1982 House Coal Severance Tax Hearings*, p. 14 (testimony of Representative Thomas J. Tauke (R-Iowa)).

45. Ibid., p. 22 (testimony of Representative Sam Gibbons (D-Fla.)).

46. Ibid., p. 14 (testimony of Representative Anthony T. Moffett (D-Conn.)).

47. See p. ___ below.

48. 1981-1982 House Coal Severance Tax Hearings, p. 21 (testimony of Representative Sam Gibbons (D-Fla.)).

49. Baldwin v. G.A F. Seelig, Inc., 294 U.S. 511, 523 (1935).

50. 1980 House Coal Severance Tax Hearings, p. 94 (testimony of William P. Rogers, Rogers & Wells).

51. Link, "Political Constraint and North Dakota's Coal Severance Tax," p. 264.

52. 1980 House Coal Severance Tax Hearings, p. 374 (testimony of Dorothy Bradley, Montana Democratic Party).

53. Ibid.

54. Ibid., p. 247 (testimony of Representative Philip R. Sharp (D-Ind.)).

55. Ibid., p. 290 (testimony of Irwin M. Stelzer, National Economic Research Associates, Inc.).

56. 1980 Senate Coal Severance Tax Hearing, pp. 417, 420 (testimony of Sally Hunt Streiter, National Economic Research Associates, Inc.).

57. Ibid., p. 329 (testimony of Thomas E. Towe, Montana State Senator).

58. Ibid.

59. Ibid., pp. 433-435 (testimony of Sally Hunt Streiter, National Economic Research Associates, Inc.).

60. _1980 House Coal Severance Tax Hearings_, pp. 286-288 (testimony of Irwin M. Stelzer, National Economic Research Associates, Inc.).

61. Ibid., p. 288.

62. _1981-1982 House Coal Severance Tax Hearings_, p. 47 (testimony of Ted Schwinden, Governor of Montana).

63. Ibid.

64. David A. Gulley, "Severance Taxes and Market Failure," _Natural Resources Journal_, 22 (July 1982): 614.

65. _1980 House Coal Severance Tax Hearings_, p. 201 (testimony of Senator Malcom Wallop (R-Wyo.)).

66. _1980 Senate Coal Severance Tax Hearing_, p. 175 (testimony of Senator Malcom Wallop (R-Wyo)).

67. See Chapter 4, pp. ___-___ below; Chapter 5, pp. ___-___ above.

68. _Senate Fiscal Disparities Hearings, Pt. 2_, p. 213 (testimony of Senator Dale Bumpers (D-Ark.)).

69. 1980 House Coal Severance Tax Hearings, p. 171 (testimony of Senator Alan K. Simpson (R-Wyo.)).

70. 1981-1982 House Coal Severance Tax Hearings, pp. 54-55 (testimony of Ted Schwinden, Governor of Montana); Ibid., pp. 100-101 (testimony of Senator John Melcher (D-Mont.)).

71. Ibid., pp. 100-103 (testimony of Senator John Melcher (D-Mont.)).

72. Larry Parker, Energy: Limiting State Coal Severance Taxes, Issue Brief No. IB80060 (Washington, D.C.: Library of Congress Congressional Research Service, 1981), p. 6

73. 1980 House Coal Severance Tax Hearings, p. 168 (testimony of Sentator Alan K. Simpson (R-Wyo.)).

74. Ibid.

75. Senate Fiscal Disparities Hearings, Pt. 2, p. 273 (testimony of Donald M. Fraser, Mayor of Minneapolis).

76. 1981-1982 House Coal Severance Tax Hearings, pp. 170-171 (testimony of Representative Howard E. Wolpe (D-Mich.)).

77. 1980 Senate Coal Severance Tax Hearing, p. 12 (testimony of Senator Lloyd Bentsen (D-Tex.)).

78. The term "fiscal disparities" has become somewhat of a code word for the issues associated with the differentials in wealth and tax capacity of states and regions, particularly those arising from access to natural resources and natural resource

revenues.

79. *1980 House Coal Severance Tax Hearings*, p. 36 (testimony of Representative Ron Marlanee (R-Mont.)).

80. United States Bureau of the Census, *State Government Tax Collections in 1972*, GF 72, no. 1 (Washington, D.C.: United States Government Printing Office, 1973), pp. 5, 7; United States Bureau of the Census, *State Government Tax Collections in 1982*, GF 82, no. 1 (Washington, D.C.: United States Government Printing Office, 1983), p. 5.

81. Peggy Cuciti, Harvey Galper, and Robert Lucke, "State Energy Revenues," in Charles E. McLure, Jr., and Peter Mieszkowski, *Fiscal Federalism and the Taxation of Natural Resources* (Lexington, Mass.: D.C. Heath and Co., 1983), p. 13.

82. United States Advisory Commission on Intergovernmental Relations, *State Taxation of Energy Resources* (Washington, D.C: United States Advisory Commission on Intergovernmental Relations, 1983)(mimeographed) pp. 4-7, 4-14.

83. *1980 House Coal Severance Tax Hearings*, p. 21 (testimony of Representative Bruce F. Vento (D-Minn.)).

84. Powerplant and Industrial Fuel Use Act of 1978, Pub. L. No. 95-620, 92 Stat. 3289, 42 U.S.C. § 8301 *et seq.* (Supp. V 1982).

85. *1980 Coal Severance Tax Hearings*, p. 21 (testimony of Representative Bruce F. Vento (D-Minn.)).

86. 1980 Senate Coal Severance Tax Hearing, p. 41 (testimony of Senator David Durenburger (R-Minn.)).

87. See pages ___-___ below.

88. 1980 House Coal Severance Tax Hearings, p. 14 (testimony of Representative Samuel L. Devine (R-Ohio)).

89. The Sagebrush Rebellion is a political movement with widespread support in the Western states that seeks to force the transfer of federally-owned public lands to the states in which the lands lie. See Richard W. Mollison and Richard W. Eddy, "The Sagebrush Rebellion: A Simplistic Response to the Complex Problems of Federal Land Management," Harvard Journal on Legislation, 19 (Winter 1982): 97.

90. 1980 House Coal Severance Tax Hearings, p. 36 (testimony of Representative Ron Marlanee (D-Mont.)).

91. Ibid., p. 18 (testimony of Senator Alan K. Simpson (R-Wyo.)).

92. Christopher K. Leman, "Comparing Canadian and U.S. Regional Energy Conflicts: Contexts and Lessons," in Christopher K. Leman, ed., Regional Issues in Energy Development: A Dialogue of East and West (Cambridge, Mass.: University Consortium for Research on North America, 1981), p. 19.

93. 426 U.S. 833 (1976).

94. The Tenth Amendment provides: "The powers not delegated

to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. Const., amend. X.

95. 426 U.S. at 842.

96. Ibid., p. 852,

97. Ibid., p. 855.

98. 453 U.S. at 628.

99. Ibid., p. 628, note 18.

100. Ibid.

101. Michael B. Browde and Charles T. DuMars, "State Taxation of Natural Resource Extraction and the Commerce Clause: Federalism's Modern Frontier," Oregon Law Review, 60 (1981): 54-56.

102. See, e.g., S. 178, 97th Cong., 1st Sess. (1981); H.R. 1313, 97th Cong., 1st Sess. (1981).

103. H.R. 6625, 96th Cong., 2nd Sess. (1980); see United States Congress, House of Representatives, Committee on Interstate and Foreign Commerce, Limitation on Coal Severance Taxes, H.R. Rep. No. 96-1527, Part. 1, to accompany H.R. 6625 (Washington, D.C.: United States House of Representatives, 1980)[hereinafter cited as H.R. Rep. No. 96-1527].

104. Cuciti, Galper, and Lucke, "State Energy Revenues," p. 15.

105. H.R. Rep. No. 96-1527, p. 22 (dissenting views of Representative Timothy E. Wirth (D-Colo.)).

106. The nominal rate of 30 percent employed in the Montana coal severance tax was adjusted for the credits for other taxes as permitted by the Montana statute. Parker, Energy: Limiting State Coal Severance Taxes, p. 5; see Chapter 5, note 35 above; Appendix (Montana) below.

107. To the extent that the effective rate of the tax was less than 30 percent of the tax, see note 106 above, the reduction effected by the fifteen percent limitation would be less.

108. Pub. Law No. 95-620, 92 Stat. 3289, 42 U.S.C. § 8301 et seq. (Supp. V 1982).

109. H.R. Rep. No. 96-1527, p. 3.

110. H.R. 6625, 96th Cong., 2nd Sess. (1980). H.R. 6654, 96th Cong., 2nd Sess. (1980), H.R. 7163, 96th Cong., 2nd Sess. (1980), and H.R. 1313, 97th Cong., 1st Sess. (1981) were identical to H.R. 6625. S. 2695, 96th Cong., 2nd Sess. (1980) and S. 178, 97th Cong., 1st Sess. (1981) were limited to "coal produced on Indian lands or lands owned by the Federal Government" but were otherwise identical to H.R. 6625. S. 1778, 96th Cong., 1st Sess. (1979) proposed a broader limitation in the following terms:

> [N]otwithstanding any other provision of law, with respect to coal, oil, natural gas, oil shale, or other energy re-

sources mined or produced from Indian lands or lands owned by the United States, the sum of all taxes or fees levied or collected by a State or within a State on such energy resources or on any improvements or other rights, property, or assets produced, owned, or utilized in connection with the production of such energy resources, shall not exceed a total of 12-1/2 percentum of the value of such resources at the time they have been extracted and prepared for transportation free on board the production site, exclusive of all State and local taxes and fees, unless such taxes or fees collected within that State are fairly related to services (1) provided by said State or its local authorities in connection with the production of such resources and (2) for which royalties under section 35 of the Mineral Leasing Act of 1920 do not provide adequate compensation.

111. See, e.g., 1980 Senate Coal Severance Tax Hearing, pp. 6-8 (testimony of Senator Bentsen (D-Tex.)); 1980 House Coal Severance Tax Hearings, pp. 85-91 (testimony of Mark W. White, Attorney General, State of Texas); 1981-1982 House Coal Severance Tax Hearings, pp. 172-178 (testimony of Representative J.J. Pickle (D-Tex.)).

112. In fairness to Senator Bentsen, see note 111 above, it should be pointed out that he introduced S. 178, quoted in note 110 above, that included oil, gas, and other energy resources within the scope of the rate limitation.

113. "Reagan Says Renewable-Energy Projects and Conservation

Are Vital in Long Term," The Wall Street Journal, p. 2 (Oct. 5, 1983).

114. S. 2890, 97th Cong., 2nd Sess. (1982); S. 463, 98th Cong., 1st Sess. (1983); H.R. 2690, 98th Cong., 1st Sess. (1983).

115. S. 463, 98th Cong., 1st Sess. § 3(a) (1983).

116. Ibid., § 3(b)(3)(B)(i).

117. Ibid., § 3(b)(3)(B)(ii).

118. The Judicial Code of the United States provides that "[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." 28 U.S.C. § 1341 (1976). As the Supreme Court has observed, the statute has its roots in equity practice, in principles of federalism, and in the recognition of the imperative need of a State to administer its own fiscal operations. Tully v. Griffin, 429 U.S. 68, 73 (1976).

119. H.R. 6330, 97th Cong., 2nd Sess. § 301(1) (1982).

120. Ibid., § 301(2).

121. Senate Fiscal Disparities Hearings, Pt. 2, p. 69 (testimony of Professor Lewis B. Kaden, Columbia University Law School).

122. Franklin Jones, "The Struggle for Equitable Taxation of Mines---The New Mexico Example," Proceedings of the Sixteenth

Annual Rocky Mountain Mineral Law Institute (New York, N.Y.: Matthew Bender, 1971), p. 479.

123. S. 910, 91st Cong., 1st Sess. (1969).

124. 115 Cong. Rec. 2583 (Feb. 4, 1969).

125. Jerome R. Hellerstein and Walter Hellerstein, State and Local Taxation, 4th ed. (St. Paul, Minn.: West Publishing Co., 1978), pp. 819-820.

126. See Fiscal Disparities, Part 1, Federal Allocation Formulas: Hearing Before the Subcomm. on Intergovernmental Affairs of the Senate Comm. on Governmental Affairs, 97th Cong., 1st Sess. (Washington, D.C.: United States Government Printing Office, 1981)[hereinafter cited as Senate Fiscal Diparities Hearings, Pt. 1].

127. United States Advisory Commission on Intergovernmental Relations, Tax Capacity of the Fifty States: Methodology and Estimates (Washington, D.C.: United States Advisory Commission on Intergovernmental Relations, 1982), p. 3.

128. Ibid.

129. Senate Fiscal Disparities Hearings, Pt. 1, p. 94 (testimony of Robert W. Rafuse, Jr., Deputy Assistant Secretary (State and Local Finance), United States Department of the Treasury).

130. Ibid., p. 95.

131. Ibid., p. 94.

131. Ibid., p. 94.

132. United States Advisory Commission on Intergovernmental Relations, Tax Capacity of the Fifty States, pp. 11-12.

133. D. Kent Halstead, Tax Wealth in Fifty States (Washington, D.C.: United States Government Printing Office, 1978), p. 4.

134. Senate Fiscal Disparities Hearings, Pt. 1, p. 61 (testimony of John Shannon, Assistant Director, United States Advisory Commission on Intergovernmental Relations).

STATEMENT OF MR. GEORGE RIFAKES, VICE PRESIDENT, COMMONWEALTH EDISON, CHICAGO, IL

Mr. RIFAKES. Thank you, Mr. Chairman.

Although my statement is short, I would ask that it be transcribed into the record in its entirety, and I would just like to stress a few points that were just discussed here.

Senator WALLOP. By all means, it will be.

Mr. RIFAKES. Since I am representing Commonwealth Edison, I guess it's expected that I would be in support of any bill that limits severance taxes. One of the statements that has been made over and over again is that this tax is not directly borne by the consumer. In the case of Commonwealth Edison at least, and in the case of most electric utilities with automatic fuel adjustment clauses, this isn't the truth. The fact is that all the costs of our fuel, increases in these costs, and decreases in these costs, are passed through directly to the consumer. This tax, over the years, has been an add-on to our fuel costs, and that has been passed directly through.

About 50 percent of the electricity we produce comes from coal and currently we are burning about 14 million tons of coal and about 11 million of these tons come from the States of Montana and Wyoming. Up until the late 1960's, most of the coal we burned was Midwestern coal, and the bulk of it was from Illinois. Because of sulfur dioxide concerns, we had to look for other means to generate electricity. Illinois coal averages about 3½ percent sulfur. And we studied a lot of alternatives, two of which were scrubbers and the use of Western coal. And Western coal proved to be the most economic answer to the problem.

Unfortunately the conditions that existed back in the late 1960's changed significantly. For example, back in the 1960's we were looking at long-term contracts with base prices of between $3 and $5 a ton. We were looking at severance taxes of from $0.10 a ton in Montana to 1 percent in Wyoming. Those severance taxes alone today account for nearly $5 a ton of the cost of the coal; $4.94, I believe, the Montana number is and $4.70 the Wyoming number. That's an increase of fiftyfold. I agree the economics have changed in other ways too. Reclamation laws became stiffer and the cost became higher. The railroads extracted their pound of flesh. And everybody came in with it's just a nickel out of the dollar, it's just a dime out of the dollar. But with the dollars we are talking about, to paraphrase Senator Dirksen, a nickel here and a nickel there and even at those small levels and our way of talking about things, you are talking about a lot of money.

From 1978 to 1983, Commonwealth Edison alone paid $97 million in severance taxes to the State of Montana and $143 million to the State of Wyoming. Now we believe that is a significant number. And at nearly $5 a ton, we are looking at about, on the total, $50 million a year. Roughly 3½ million tons of the 11 million tons will be coming out of Montana and the balance out of the two mines in Wyoming.

Now as I sit here and listen, I sympathize with the problems that the Western States have. I believe that if we are going to derive a benefit for the citizens of Illinois we should contribute something to these State economies. I think our presence as buyers of Montana and Wyoming coal in fact does make significant contributions. For example, in Montana there are about 460 additional miner and mine related jobs as a result of our contract alone. The State of Wyoming, there are about 815 such jobs. And this does not include any of the additional employment that is brought about because of the doctors and the bankers and all the other infrastructure that is necessary.

Furthermore, in addition to the severance tax, we are paying about $3.7 million a year in other State and local taxes in the State of Montana and about $2.4 million in the State of Wyoming. And, finally, and most importantly, we have been spending and will spend—and, again, this is a direct pass through to us to our customers—hundreds of millions of dollars in the form of reclamation costs in order to not repeat the mistakes that were made in Appalachia and that were mentioned here. Now to the extent that our contributions in the form of reclamation costs, jobs, and other State and local taxes don't meet fully the needs of the States, clearly it's fair that a severance tax or some other form of compensation is warranted.

Our belief is that the taxes, as they stand today, are excessive. And, of course, we support anything that would reduce those. We recognize the local political realities. I have discussed this with the Governor of Montana, and I understand exactly where he is coming from, and if I were in his position, I would do the same thing. And that's why we are looking now to the Congress for some relief.

Finally, I think I would like to make one last point. The analogy has been used here with oil and the way oil is priced. It is really not appropriate. Oil is fungible. A gallon of gasoline is a gallon of gasoline. That's not the case when we are talking about coal. All of the coal we are using is being used in boilers that were designed to burn Illinois coal back when Illinois coal was in favor in the State. It takes a unique, special type of coal to operate those boilers. We can't go to just anybody and buy the coal that we need. Now I know that's our tough luck, but we are, in effect, captives to certain types of coal that comes from certain areas and certain States. Not all Montana coal nor all Wyoming coal, for example, is usable by us. When we feel that we are in a manner of speaking captive of a monopoly, this is what we are talking about. And we feel we are captive to the States that happen to have the types of coal we need. We feel we are captives to the railroads. And I agree if the time comes when there is more legislation on the railroads, we will be here fighting that one too.

Thank you for this opportunity.

Senator WALLOP. Thank you, Mr. Rifakes.

[The prepared written statement of Mr. Rifakes follows:]

TESTIMONY BY
GEORGE P. RIFAKES
VICE PRESIDENT
COMMONWEALTH EDISON COMPANY
BEFORE THE
SENATE FINANCE COMMITTEE
SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXES
July 24, 1984

Mr. Chairman and Members of the Committee. My name is George P. Rifakes and I am a vice president at Commonwealth Edison Company of Chicago. I would like to thank you for the opportunity to testify today in support of Senate Bill 463.

Commonwealth Edison serves the electrical needs of approximately three million customers located in the northern quarter of the State of Illinois. About forty-four percent of the electricity we produce comes from nuclear power, about six percent from oil and gas and the remaining fifty percent from coal. We currently operate 19 coal-fired generating units with a rated capacity of 6955 megawatts. All but two of these generating units currently burn coal which is mined in the states of Montana and Wyoming. We currently import about 11 million tons of coal a year from these two states.

Until the late 1960s our principal source of coal was from mines located in the State of Illinois. Although Illinois has among the most abundant coal resources in the nation, most Illinois coal has a relatively high sulfur content. During the late 1960s and early 1970s we began to study alternative means of meeting increasingly stringent clean air requirements. Among the alternatives studied were various sulfur removal devices and switching to low sulfur coal. As a result of our studies we concluded that switching to low sulfur coal from Montana and Wyoming offered the most cost effective means of supplying our customers reliable electric service in an environmentally acceptable manner.

When these decisions were made, the economic factors were significantly different than they are today. Specifically related to the subject of this hearing was the fact that the level of severance taxes in Montana was 10¢ per ton and in Wyoming 1% of the price of coal or about 4¢ per ton with respect to coal we were buying. Citing the costs of housing, roads, police protection, etc., the coal-producing western states argued that increased severance and other taxes were required to meet the costs of supporting coal mining operations in these states. The legislatures of Montana and Wyoming, for example, passed laws that ultimately raised the level of their severance taxes to 30% of the price of coal and 17% of the price of coal, respectively. As a result, we currently pay severance taxes of about $4.90 per ton of coal from Montana and $4.70 per ton from Wyoming. During the period 1978 through 1983, Commonwealth Edison paid about $97 million in severance taxes to Montana and over $143 million to Wyoming. These amounts are ultimately paid for by the users of electricity in our service territory.

While we agree that states like Montana and Wyoming are entitled to some compensation for our use of their resources, we believe that the current levels of taxation are unwarranted and excessive. There are many benefits that inure to these states as a result of our purchase of coal mined there. I would like to cite some examples: As a result of coal being mined in Montana and Wyoming on our behalf, 459 additional miner and mine support jobs have been created in Montana and 814 in Wyoming; this does not include other infrastructure jobs created due to the presence of the mine personnel. Furthermore, in addition to severance taxes, we estimate we are paying about $3.7 million in Montana and $2.4 million in Wyoming, annually, in other state and local taxes, and this is without regard to the millions of dollars these states have received in federal royalty payment refunds. Finally, we will be spending many millions of dollars for reclamation of the land from which coal being delivered to us is mined.

We believe that even excluding the severance taxes we pay, we are making significant contributions to the producing state's economic welfare. We feel, therefore, that the current level of taxation by these states is not only excessive but unjustified. Certainly, we can not expect relief from state officials. The political realities are such that no state official can be expected to oppose a tax that produces more revenue than his state requires almost entirely from out of state commerce. This matter has been taken to the courts which have ruled that it is a matter best handled by the Congress. Absent Congressional action, those of us who have been forced by national policy to import coal to our states are powerless to defend against this exploitation.

It is for these reasons we support Senate Bill 463. However, we would like to recommend one modification to the Bill: With respect to the "Relief" granted under Section 3(b)(2), we urge that the relief be as a minimum a refund of all taxes collected in excess of the amount that would have been collected had taxation been imposed at the 1978 National Average Tax Rates from the date of payment to the date of such refund. This is intended to help prevent states from imposing excessive tax rates in the belief that at most they will be allowed to retain sufficient funds to cover their public costs.

I would like to conclude by urging you to pass Senate Bill 463 with the modification we recommend. Thank you again for giving us this opportunity.

Senator WALLOP. I have to take some issue with your premise that a gallon of gas is a gallon of gas, and a ton of coal is different. You have gotten to the final product in each instance without making a judgment. And a barrel of oil is not a barrel of oil. Some of it is high in parafin. Some of it's high in sulfur. Some of it's high in specific gravity. Middle Eastern crude, the world standard of excellence, hardly exists in this country. And the refining process creates the product. Somewhere along the line that difference between the two is picked up by someone.

Mr. RIFAKES. I agree with that. And your point is not—and my point, I don't believe, are in contradiction. A statement was made that there was a 12-percent tax in the State of Montana and a 6-percent tax in the State of North Dakota, and yet the barrel head, the oil well price was the same for the oil. The reason for that is because they were selling similar oils. Now when you have differences such as paraffins, sulfur content, clearly, then you have price differences.

If the North Dakota oil were significantly lower in sulfur, for example, than the Montana oil, it would command a much higher price. But when you are talking about a product that is so closely colocated and is only separated by a governmental boundary, then you are talking about a fungible good, much like wheat. But coal, because of its end use as coal, aft characteristics, Btu content, carbon content, volatiles, sulfur content, and a whole host of other things, effect its value and its usefulness to the consumer.

Senator WALLOP. But you are on the refining end as the refiner is on the refining end, being to the consumer. The kilowatt of electricity is the same as to the consumer of a gallon of gasoline.

Mr. RIFAKES. But the cost of that kilowatt is tied directly to the type of product you are using.

Senator WALLOP. True. It's also tied to the tax structure of the State of Illinois or Michigan or New York or other places where Commonwealth Edison exists.

Mr. RIFAKES. I think Mr. Stevens stated that the average price of Montana coal is about $10 a ton. We are playing two and a half times that. Not because we were not aware of cheaper Montana coal, not because we are not aware of all the coal that is available in the Powder River Basin, but none of that coal is usable by us. And the only way to use it would be to scrap our electrical system, our coal-fired generation system, and start over.

Senator WALLOP. That's the same if you own a refinery that can only process light specific gravity crudes. And all you can have available to you—which is becoming the case more and more in this country—is the heavy crude.

Mr. RIFAKES. Not totally.

Senator WALLOP. It's getting close though.

Mr. RIFAKES. Refineries lend themselves to modification relatively easier than large combustion boilers do. For example, you can put sulfur removal units on refinery streams. You can add cap crackers. You can do a lot of things. A boiler just sees coal and it burns it. And the solution is a new boiler.

Senator WALLOP. I understand it. But it's one of the problems we all share. I think Professor Hellerstein pointed it out quite eloquently that the tax structure is changeable to achieve the same dimensions. And I'm not certain where that leads you. In the case of Wyoming, it clearly would have been an awkward situation for the coal companies, including, I suspect, Commonwealth Edison, had we had an ad valorem tax on the in situ values of minerals while your consumption was down during a recent recession. Then the price to your consumers would have risen substantially more than it did.

Mr. RIFAKES. I don't think that's the case.

Senator WALLOP. Why would it not be the case? The tax level would remain the same regardless of the consumption of the mineral. And so if you are being taxed on 100 million tons of coal in place of whatever the value of that tax was, that 100 million would have been in place whether or not you had removed 1 million tons of it or stood there and had no market for it. So that dollar figure would have been higher to you than it was by assuming that you produced 3 million tons in the last year of the business cycle and 1 million in the recession. Your tax revenue to your consumers was based on the 1 million and not on the undeclining 100 million in place.

Mr. RIFAKES. I really don't want to argue this point, but I just have to say one thing. We are in a rather unique situation, and I would be glad to take this up with one of your staff members at some point in time to show you that the amount we are going to pay in taxes to the State of Wyoming as a result of the recession is a matter of indifference. In fact, a short piece of history. We had under contract more coal than we required. Part of it because of the recession. We have made payments to the coal company to defer that coal. And all the coal we have under contract will be taken. And I assume all of it will be subject to soverance tax. And all of it will also carry the reclamation payments and anything else it has. So it's a question of timing; not amount.

Senator WALLOP. There are, I think—the Oklahoma Public Service, or something of that nature, is a company which owns its own coal in the State of Wyoming and, I think, Montana. Under those circumstances—and that's the problem that you get into. Commonwealth Edison's situation is quite different from that of utilities situated in other dimensions around the country. Some have long-term contracts from which they have benefited, and some have them from which they have hurt. Others weren't able to get the long-term contracts and benefited by the declining price of coal. And the fact that they didn't have to take or pay on its delivery.

But Congress cannot be expected to walk through every thicket.

Mr. RIFAKES. And we are not asking you to. And, in fact, we also have large coal interests in the State of Wyoming through a subsidiary company. Whether we ever mine those or not is——

Senator WALLOP. But if those were being taxed not because they were being mined but because they were in existence, you would be scambling for a way out of that, and your decision would have long since been made for you. If they were taxed as a property right in situ, I assume that you would forego your property right rather than continue to pay taxes on it.

Mr. RIFAKES. Well, we have substantial costs in that property right right now.

Senator WALLOP. But I think Professor Hellerstein's point—and correct me if I am wrong, sir—is that these disparities exist not only between States but between companies, and the circumstances which they have developed for themselves. And all of the country over the course of a decade or five decades or a century runs through cycles in which certain of its assets are in high demand and there is high prosperity in one segment of the country. I mean we have done it with gold. We have done it with oil. We have done it now with coal. We have done it with farming cycles, We have done it with the timber cycles. The Senator from Minnesota was pointing out the Great Masabi iron range provided enormous prosperity to his State until that world came down.

What are we going to do? We cannot, in my estimation, as a country always seek to throw a blanket over this diversity and somehow equalize it in changing economic circumstances.

Mr. RIFAKES. Well, I would submit that if producing States try to protect against the bust by taking all they can during the booms, that they will kill the goose that laid the golden egg.

Senator WALLOP. Clearly, that's the one dimension that works against taking all they can. As a matter of fact, I think, since you operate in the State of Wyoming you are aware that as soon as our production reaches a State, which it is expected to next year, the severance tax goes down 2 percent.

Mr. RIFAKES. I'm aware of that.

Senator WALLOP. It has to have some affect on it.

Mr. RIFAKES. That's laudible. But there are also differences between States and how the tax operates, just as there are differences between companies and their——

Senator WALLOP. Clearly, there are, but if you want to take the total tax burden on a ton of coal, go to West Virginia for the highest in America.

Mr. RIFAKES. That could well be.

Senator WALLOP. I'm talking the total tax burden. My point is that while I sympathize with you and your company's long-term contract and a number of other things—does Illinois have a sales tax on utilities?

Mr. RIFAKES. Yes. And there is also a use tax on the coal. But it's not 30 percent. It's more like 4 percent.

Senator WALLOP. It's more. It's a lower figure but a higher dollar. What do we do about that? Do we say Illinois can't do that on its utility bills?

Mr. RIFAKES. On the coal, the State use tax, I believe is 5 percent now contrasted with 30 and 17. There is a franchise tax on utilities by municipalities.

Senator WALLOP. And a sales tax on the——

Mr. RIFAKES. The city of Chicago has a revenue tax, but that's not universal throughout our service territory. I'm not sure what percent of the municipalities——

Senator WALLOP. Again, it displays a dimension of our problem, does it not? You get all of those things added up and you keep taxing more for a ton of Wyoming coal in Illinois than we are.

Mr. RIFAKES. Well, I——

Senator WALLOP. I don't want to go in there and take that from the State of Illinois, which has need for it. But I would prefer if the

State of Illinois wouldn't come into Wyoming and take it from us who have need for it too.

Mr. RIFAKES. Well, as I said, we are not proposing to take it from you. The fact is we add jobs, we add taxes, both direct and indirect, through the people who have work in your State. We are taking care of the reclamations problems directly so this is not in anyway connected with reclamation. And, in fact, since reclamation is part of the price of coal, the tougher the reclamation laws, the higher amount we pay in severance taxes because that's part of the value of the coal. So it's kind of a self-perpetuating thing.

And we are willing to pay our fair share. We just don't feel that that's the case right now.

Senator WALLOP. We are willing to extract it.

Mr. RIFAKES. At least our fair share. [Laughter.]

Senator WALLOP. Dr. Hellerstein, do you quarrel with my thoughts?

Dr. HELLERSTEIN. Certainly not, sir. My main plea was one of recognizing the diversity that I know you recognize. You cannot, I think, simply legislate with a broad brush, not only in this area, but in any area regarding State taxes. The systems are complex. They grew up differently. And just to try to compare, I think, a 4-percent sales tax to a 30-percent severance tax, you can't do it. A 4-percent sales tax on what base? A base that includes not the value of the coal at the mine mouth, but the value of the coal after it has been transported and processed? I think just the effort to try to make a comparison demonstrates the complexity. I'm not sure, assuming that one determined that there were fiscal disparities that needed some kind of remedying, whether it would be any easier to do it through modification of revenue-sharing formulas, at least whether it would be any easier politically. My own feeling is that if one is going to take that course, better to do it that way than through tampering with a very complex and diverse State tax structure when you really don't know what the implications of what you do will be. I think it's very clear that the States are protean in their ability to put a tax on another related activity when they are prevented from imposing a tax on a particular activity. I once tried to help the State of Louisiana impose a tax on gas coming from the Outer Continental Shelf after the Supreme Court said that the tax it had imposed before was unconstitutional. We thought that the tax that we were proposing was constitutional. The Louisiana Legislature defeated it. I also think it is a bit of an overstatement to assume that the energy rich States are political monoliths that can without any opposition at all enact energy tax after energy tax. I think there has been a trend toward increased energy taxes, but there is also substantial political opposition, as I am sure you are aware, in many of the energy rich States to increased energy taxes. And, again, I'm talking from anecdotal evidence, but it's my understanding that the higher tax in Montana as compared to Wyoming has induced at least some producers to produce in Wyoming rather than in Montana.

It is alleged that the higher Montana tax has had an economic impact in allowing the market to induce coal producers to look to a more favorable tax climate in Wyoming when you are talking about the same coal. I have no firm factual foundation for that, but it would not be illogical if that were true.

Senator WALLOP. There is some evidence of that. I think Max may agree with it. But the one problem that I have too is that when enacting ceilings, Congress does such a thing, you also create floors that are immediately that same level. Take away the one thing that the marketplace might do to change that circumstance. Play one off against the other. A better deal. It happened with oil and gas in our State. It has happened with coal in our State. There is a problem of which Mr. Rifakes speaks, one area in which the Government might be able to do something about that. And I say "might" because it has its problems. You can lease more coal, federally owned coal, in States which have lower severance taxes. It doesn't do anything for long-term contracts. But it certainly does something for the prospective ones.

Max.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Rifakes, could you apportion the costs that Commonwealth Edison incurs when it charges your customers' utility bills? How much of it is caused by Montana's severance tax, how much by Federal taxes on fuel utilities, how much by State income and property and other taxes, and how much by State and city sales taxes? Could you allocate that for me, please?

Mr. RIFAKES. I'm not sure I have those figures with me, Senator. If I don't, I will be glad to send them.

Senator BAUCUS. Could you right now do the best you can?

Mr. RIFAKES. We had revenues in 1983 of about $4.6 billion. And of that, our fuel costs or fuel revenues were $1.3 billion. And of that, severance taxes between the two States was about $50 million. So the $50 million translates to about 1 percent of our total revenues.

Senator BAUCUS. About 1 percent?

Mr. RIFAKES. Right.

Senator BAUCUS. Does that mean that the average Illinois consumer can look at his bill and figure out that $0.01 on a dollar is due to severance taxes?

Mr. RIFAKES. Roughly, that's correct.

Senator BAUCUS. What are the other 99 cents due to?

Mr. RIFAKES. They come from—I have to correct that a little bit. The other 99 pennies come from the fact that, first of all, only half of our electricity is generated by coal. We produce about 43 percent by nuclear and 6 percent oil and gas. So there are pieces of those 99 pennies attributable to the nuclear oil and gas. There is the cost of the coal. There is the cost of transporting the coal. There is depreciation on the plant. There are operating and maintenance expenses. There are taxes. There are general and administrative costs, advertising and all the other things that it takes to run a business, which is part of this.

Senator BAUCUS. Now let's assume——

Mr. RIFAKES. There are clearly—a large part of this is interest because of our construction program.

Senator BAUCUS. Let's assume the Dixon bill becomes law, which it never will. But let's assume that it does. What will the severance taxes be as a percent of the Illinois consumer's utility bill? How much will that one cent be reduced?

Mr. RIFAKES. I can't tell you. But if it were halved, the penny would——

Senator BAUCUS. Let's say it's half a cent.

Mr. RIFAKES. Half a cent.

Senator BAUCUS. Would that one-half of 1 cent be passed onto your consumers?

Mr. RIFAKES. Clearly.

Senator BAUCUS. You mean that, if this bill were to become law, every consumer in Illinois would receive a one-half of 1 percent automatic reduction?

Mr. RIFAKES. The reduction—if it's $50 million—would be $25 million, and it would immediately be passed through to the consumers.

Senator BAUCUS. You mean you won't find some rationalization to do something else with it?

Mr. RIFAKES. It's illegal to keep it. We have an automatic fuel adjustment clause in the State of Illinois. We file all our fuel expenses and changes in expenses monthly. It has got a 3-month lag. That is, take a 3-month average and it just flows right through the bill.

Senator BAUCUS. I wasn't born yesterday. I've seen utilities find all kinds of ways to rationalize. There are all kinds of ways to skin a cat.

I will tell you what I honestly think about all of this. I think that your company doesn't like hearing your customers complain about rising utility bills. If I were in your shoes, I wouldn't like it either. So what does your company do? You try to find some way to pass the blame onto somebody else. And so the scapegoat you found is a convenient one. It's out of State. It's those blue-eyed Arabs in Montana.

That way, you divert public attention from the real problems. The fact of the matter is that the severence tax accounts for no more than about one-half a cent. The real problems are State taxes, city taxes, Federal taxes, transportation costs, interest rates. So you are doing your customers a disservice. You are directing attention away from the real problems by focusing attention on Montana's severance tax. As if, without the severance tax, everthing would be hunky-dory.

Mr. RIFAKES. No, sir; it wouldn't be hunky-dory.

Senator BAUCUS. You are wasting your consumers' time. You should be focusing attention on the real problems—mainly getting interest rates and budget deficits down.

Mr. RIFAKES. We do that also. But with all due respect, you are dead wrong as to our motives. And I would like to cite some examples. We have, first of all, the only costs of our service that flows directly through to our consumer without prolonged hearings before the public service commission, are fuel costs, the only cost. So why do we protect it? We protect it because it is so volatile that when States like Wyoming and Montana come through and ding us with severance taxes, if we had to eat that, it would be disastrous for the company. So, consequently, we do everything in our power to protect that clause, and therefore, to protect the consumer. We have sued large corporations when we felt we were being gouged, recovered many millions of dollars which flow through to the consumer automatically by law through the fuel adjustment clause.

Whenever there is a doubt with regard to an expense, whether it flows through or whether it is eaten by the stockholder, the company has bent over backward and stuck attorneys and stuck it to the stockholder. We are not playing games. We are not wasting anybody's time. We are talking about many millions of dollars. You can look at it as half a cent per bill, but it's close to $300 million in 6 years spread over 3 million customers. That's $100 a customer. And if you take it down to the residential customer, it is probably somewhat less. But even though it is less, it has a greater impact. There is a large concern in this country and in our area about the rising cost of utility bills. And utility management, we will do everything we can to keep those bills as low as we can. As I said before, a nickel here and a nickel there, if we listen to the railroads, their change is only $1. This is only a nickel.

Senator BAUCUS. No it's not. It's one-tenth of a nickel. You just said so yourself.

Mr. RIFAKES. Whatever the number is, we are still talking $50 million a year. Now I realize in the context of a $4 billion revenue or in the context of Government spending, $50 million isn't a lot of money. But it's still $50 million. It's big to me. It's big to me as a consumer. And if the utility company can cut a dollar off my bill here and a dollar off my bill there, that's significant. And that's the name of the game. We are dealing with the individual consumer. We are not dealing with these large governmental enterprises or when we relate to the consumer in the context of our huge revenue base, that just doesn't hold water.

Senator BAUCUS. Well, those are nice words. The fact of the matter is I think it's pretty clear—it was established earlier, and I think you would agree—that this is essentially a question to be worked out in the large complex diverse country that we have. And that States should have the right, as the U.S. Supreme Court has said in Montana's case, to set the level of taxes as long as they are reasonable. And I think States, if they set taxes too high, are going to price themselves out of the market. Most States in this country produce recoverable coal. And it just seems to me that it is basically a State's right to impose the tax as long as the of tax is reasonable.

Mr. RIFAKES. I believe the court said it was "valid," Senator. I don't know whether they ruled——

Senator BAUCUS. The decision is that it's a reasonable tax. And I just think that we will work it out over time the best way all of us can in State legislatures, in Congress, and in businesses. But I think you miss the target when you try to reduce States' severance taxes. If you really want to lower your consumers bills, the real targets are elsewhere.

Mr. RIFAKES. I might just conclude by saying we are here also—we do appear before all kinds of committees. We talk with administrative agencies. And this is one of many places where we are doing what we can to keep the utility bills as low as possible.

Senator WALLOP. We react legitimately when people impugn our motives for levying the tax. I think that it doesn't add to the dialog to impugn the motives of the people present here.

Senator BAUCUS. I just call it as I see it. If I were in their shoes, I might do the same thing.

Senator WALLOP. It's unnecessary to mention——

Senator BAUCUS. Mr. Chairman, I very much disagree with you. I'm just trying to——

Senator WALLOP. That's your privilege.

Senator BAUCUS. I'm trying to expand the dialog so that people have a better perspective about what actually is going on here. It's not a matter of impugning or not impugning motives. It's just a matter of saying what I think is really going on, so that more people understand.

Senator WALLOP. We thank you for your testimony and your patience. You have been here a long time waiting, and I appreciate it very much. And I appreciate the chapters from your book, Dr. Hellerstein. I look forward to reading those.

Thank you, Mr. Rifakes.

Mr. RIFAKES. Thank you, Senator.

Senator WALLOP. The subcommittee stands adjourned.

[Whereupon, at 12:35 p.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

MARTHA LAYNE COLLINS
GOVERNOR

GARY W GILLIS
SECRETARY

REVENUE CABINET
OFFICE OF THE SECRETARY
FRANKFORT KENTUCKY 40620

July 13, 1984

Mr. Roderick A. DeArment, Chief Counsel
Committee on Finance
Room SD-219
Dirksen Senate Office Building
Washington, DC 20510

Subject: Hearing on S. 463, The Severance Tax Equity Act of 1982 July 24, 1984

Dear Mr. DeArment:

I have been advised that the Finance Subcommittee on Energy and Agriculture Taxation has set a hearing for July 24, 1984 on S. 463, The Severance Tax Equity Act of 1982.

On behalf of Governor Collins and this Cabinet, I would like to go on record as being opposed to S. 463 and any restrictions of a state's taxing authority, particularly to its natural resources.

Based on a review and our interpretation of the bill, it appears that the enactment of such legislation would cause the Commonwealth and the local governments to suffer substantial revenue losses as a result of a rollback of the severance tax levies.

Several of the details of the bill are also troublesome. For example, the inclusion of the GNP implicit price deflator does not reflect the impact of inflation on the cost of government as well as the price deflator for government services.

S. 463 also suggests a cost-revenue analysis or fiscal impact analysis as the primary evaluation tecnnique and states that costs are limited to those, "directly attributable to the production........". This will ignore external costs resulting from production. For example, one of the largest external costs of producing coal is water pollution.

Direct public sector cost of producing coal would be concerned with the net quantitative difference in cost with and without coal production. Cost-revenue analysis evolved to evaluate the public sector cost of "developments" such as subdivisions and shopping centers. The with and without in these cases is more easily determined. This task would be much more difficult in the case of coal mining which has been in place for dozens of years.

As you are aware, Kentucky is the leading producer of coal in the United States. Severance taxes collected on the extraction of coal in Kentucky is a major source of revenue both for the state and the local governments. Currently, a portion of severance taxes collected on minerals is returned to the counties where the minerals were extracted. Any restriction or rollback of these taxes would greatly harm the budgets of both the state and the local governments.

In the case of coal, the southeastern counties of the state rely heavily on the coal industry. In many of the counties, coal is the predominant source of all incomes and revenues. The rebate of the taxes to the local governments is statutorily designed to improve the environment for new industry and the quality of life for the residents. Any curtailment of the rebates would be detrimental to such communities.

Like many states, Kentucky is presently attempting to cope with a restricted budget that makes is difficult to meet all the services demanded by its citizenry. The severance tax as presently levied is an important part of our tax base.

In summary, restrictive federal legislation would deprive Kentucky of badly needed revenue. I would respectfully urge that Congress not preempt sources of state revenue, state tax bases or state taxation methods, especially in the areas of its irreplaceable natural resources.

Sincerely,

Gary W Gillis

Gary W. Gillis
Secretary of Revenue

Western Governors' Association
3333 Quebec Street
Suite 3000
Denver Colorado 80207
(303) 399-9957

George R Ariyoshi
Governor of Hawaii
Chairman

Richard D Lamm
Governor of Colorado
Vice Chairman

James D Wadley
Executive Director

Statement on behalf of the
Western Governors' Association
to the Senate Finance Committee
Subcommittee on Energy and Agricultural Taxation
July 24, 1984

We are pleased to have this opportunity to present our views on the proposed severance tax limitation bill, S 463. The bill would establish a limit on the amount of severance tax a state could collect. We are opposed to this legislation. Our opposition is based on constitutional and economic grounds. It is also based on our belief that the severance tax is a uniquely appropriate public policy tool in managing the fiscal and natural resources of many of our states. We believe that the severance tax — because it is a one-time, up-front, and highly visible tax — has been unfairly singled out for special treatment, different from the treatment accorded all other state taxes.

State taxing authority is guaranteed by the U.S. Constitution. In particular, the right of states to levy severance taxes was upheld by the U.S. Supreme Court in a 1981 decision in a case involving the Montana coal tax. The Court found that the tax neither obstructs the national goal of increased energy independence nor does it impede the flow of interstate commerce. We believe that each state's taxing authority should be preserved, whether it be a tax in Connecticut on the insurance industry, a tax in Florida on stock and document transfers, or a tax on the manufacture of automobiles in Michigan.

Decisions on who and what and how much to tax are among the most carefully considered and heavily debated topics faced by state legislators. Each state must remain competitive with its neighbors and with other states having similar tax bases. Tax rates and other tax policy questions are usually examined annually and are adjusted as necessary to reflect current economic conditions.

We would like to remind the Subcommittee that economic conditions in the energy and minerals industry fluctuate drastically and suddenly. A few years ago, when the first severance tax limitation bills were before the Congress, state revenues from severance taxes were much higher than they are today. Total tax revenue increased more than 5 percent from 1982 to 1983. Severance tax revenues decreased 5 1/2 percent during that same period. Governors and other state officials predicted in the late 1970's that those revenues were temporary, the "boom" phase of an inevitable boom-bust cycle. None of us realized then just how rapidly those revenues would level off and then decline, but we did know the volatile and transitory nature of severance tax revenues.

Our past experiences have taught us that the magnitude of severance tax revenues cannot reasonably be measured by a one or two year revenue profile — that to get an accurate and realistic view one must look at a longer time frame. The revenues of some of the severance tax states in the late 70's really were a bubble of prosperity, not the steady and predictable source of income that all states need in order to provide essential services.

During those boom years some states were fiscally prudent and economically stable enough to set aside a portion of their severance tax revenues for rainy day funds — to help offset the inevitable decline. Rarely have those set asides proved adequate, but they do point up the importance of approaching severance tax policy from a longer range perspective.

Many of our states' economies are reliant on natural resource development. Oil, gas, and coal production are important economic activities and, as such, are logical sources of revenue for state government operations. Severance tax revenues are used for a variety of purposes. Some are dedicated to trust funds for reinvestment in more permanent assets. Some are used to pay for direct costs of energy development: environmental mitigation and regulation, and for housing, infrastructure, and social services for the so-called boomtowns. Some revenues are also used to support general government services throughout the state — services which are not directly or necessarily linked to the mining or energy industry.

It is not uncommon for a portion of the revenues from a particular tax to be dedicated by state legislatures for a special purpose or purposes. However, we are unaware of any situation in which the amount of revenue from an individual tax is restricted by the costs created by the taxed activity. We believe it is important that states — all states — retain the authority to select the kinds of taxes it levies and the rate at which those taxes are set, and to decide how and where its revenues should be spent.

During past debates on state severance taxes, some members of Congress have suggested that energy is a national resource and, as such, decisions regarding its development, taxation, and use of its revenues should be decided by the Congress. That assumption is similar to claiming that the vast stands of timber in the southeastern states and the Pacific Northwest are really national resources. Or that the fertile farmlands of the Midwest, or the harbors and ports of the East Coast, or the freshwater resources of the Great Lakes states are national resources. We suspect that the residents of those states would challenge that view in much the same way that we would challenge the treatment of energy as a national resource.

We believe that the primary motivating force behind this legislation is not to claim national ownership of any one state's resources or to restrict what some states can do with their taxes. Rather it is a frustration over the cost of energy to the consumer. We share that frustration. Severance taxes account for literally pennies on a homeowner's monthly utility bill. In fact, state and local taxes on electricity generated from local utilities cost the consumer far more than the severance tax on the fuel. However, there are other components of energy costs that do need to be examined.

We suggest that one of those cost components is transportation. Coal is especially burdened by high transportation costs. In a study conducted a few years ago, we found that rail rates accounted for 63 percent of the delivered price of western coal to midwestern utilities. That is a major cost element and one which clearly affects consumers everywhere.

The Western Governors' Association is currently undertaking a study of energy transportation issues. We hope to gain a better understanding of why rail tariffs are set at their present levels and what steps can be taken to assure that those rates are reasonable and equitable. In that process we will examine the Railroad Revitalization and Regulatory Reform Act, the Staggers Act, and recent Interstate Commerce Commission rulings.

We may find that there are issues which need to be addressed by Congress — issues which could have a major effect on energy prices. Those members of Congress who geniunely want to redress energy cost inequities — including Senator Dixon and other proponents of S 463, may have an opportunity to do so. We would look forward to working with you in seeking those solutions.

We remain ready to work with all members of Congress to minimize the inequitable effects of energy costs, and to support changes in existing federal law and policy which are fair to both producing and consuming interests. We are opposed to severance tax limitations. We believe they are unfair to energy producing states and would yield little on no benefits to the consumers they are aimed at helping.

Thank you for this opportunity to present our views.

GOVERNOR BILL SHEFFIELD
STATE OF ALASKA

HEARINGS ON S. 463, A BILL TO IMPOSE
FEDERAL LIMITATIONS ON TRADITIONAL STATE AUTHORITY
TO COLLECT SEVERANCE TAXES ON ENERGY PRODUCTION

Before the

SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION
COMMITTEE ON FINANCE
UNITED STATES SENATE

July 24, 1984

Mr. Chairman and members of this distinguished Subcommittee, I appreciate the opportunity to submit testimony on behalf of the State of Alaska on S. 463, a bill pending before this Subcommittee which is characterized as the "Severance Tax Equity Act of 1982".

S. 463 raises a number of gravely serious issues which deserve the careful consideration of the Members of this Subcommittee. These issues and my concerns about this measure include, but are not limited to, the following:

-- S. 463, if enacted, would establish a dangerous precedent for Federal legislative intervention in all aspects of traditional State tax policy and authority;

-- S. 463 would reverse a growing trend toward enlarging State rights and responsibilities and mandate fundamental and, I believe, harmful changes in the historic Federal-State relationship;

-- S. 463 is based, in the case of Alaska, on the fallacious premise that Alaska's severance tax on oil is somehow "exported" to consumers outside the State;

-- S. 463, if enacted, would divert State severance tax revenues into corporate profits and thereby create a major financial windfall for the major oil companies operating in Alaska;

-- S. 463, if enacted, would eliminate a major portion of my State's tax base and the revenues needed for vital public services and would provide no corresponding benefit for the energy consuming states or their citizens;

-- S. 463, if enacted, would unfairly penalize producing states like Alaska whose major source of tax revenue is energy production and would deny Alaska an opportunity to provide its citizens a level of public services and public infrastructure equivalent to other states; and

-- S. 463 proposes the radical and dangerous notion that the taxable benefits of natural resource development activities in a State may be appropriated by Federal fiat if the natural resource is simply characterized as a "national" resource in Federal legislation.

Background

Following the Supreme Court's decision in Commonwealth Edison Company v. Montana, 101 S. Ct. 2946 (1981), upholding the constitutionality of Montana's coal severance tax, some

Members of Congress have advanced proposals to limit state severance taxes through direct Federal legislative action. Some of these proposals would impose limits on coal severance taxes alone; others would impose a new Federal or national severance tax on energy; and some, like S. 463, the pending bill, would severely limit the power of State government to place severance taxes on oil, natural gas and coal produced in that State.

S. 463 proposes an unprecedented, complex and, in my view, unworkable set of judicial and administrative standards and procedures to limit State and local tax authority on energy development and production.

The State of Alaska and the nation as a whole have a tremendous stake in the outcome of this matter. Because of my State's increasing role as a major energy producer for consumers in the rest of the country, and because of the singular importance of our nonrenewable energy resources to our economy and in financing state government, Alaska strongly opposes this effort to undermine precedent and to limit traditional authorities for states' taxing powers.

In the past, Congress has wisely refused to exercise whatever Commerce Clause powers it may have to regulate state taxation. Congress has, instead, left such regulation to the constitution and to the courts to exercise on a case-by-case basis. The provisions of S. 463 which impose legislative limits on states' taxing powers would, if enacted, be the most ambitious and far reaching Federal intervention and regulation of states' rights ever adopted. Enactment of S. 463 would severely and profoundly alter the relationship of the states to the national government in our Federal system.

Tax Exportation Issue

The central issue in past debates over legislative proposals to limit or nationalize traditional State tax authority has been the claim of the sponsors that energy severance taxes enable producing states to "export"--or shift forward--disproportionate amounts of their energy severance taxes to out-of-state energy consumers. Some have also claimed that exporting of taxes occurs and that this creates inequitable "fiscal disparities" between energy-producing and energy-consuming states. A separate claim made by the proponents of legislation to limit traditional state tax authority is that the revenues generated by energy severance taxes exceed the amount needed by producing states to provide the essential public services required for energy development.

Tax Exportation Depends on Market Structure

A number of independent economic studies have been done on a wide variety of state taxes on energy and other commodities, as well as on manufacturing and other services. These studies demonstrate that each commodity, service, or activity being taxed must be carefully examined individually in the context of relevant markets, market power, and competition to determine whether any portion of a particular state tax is being "exported."

Pricing System for Alaskan Oil Precludes Tax Exportation

Economic analysis has repeatedly confirmed, because of the manner in which Alaska oil is priced, that Alaska's crude oil severance taxes are not "exported" to out-of-state consumers. Prices for Alaska crude oil--like those of essentially all other crude oil--are determined internationally in the world oil market. This market is heavily influenced by the pricing policies of the Organization of Petroleum Exporting Countries (OPEC)--an economic force independent of all U.S. domestic factors, including state severance taxes.

Since the decontrol of U.S. domestic oil prices in 1981, the price of all domestic crude oil--including Alaska oil--has risen to meet the world price. But crude oil prices cannot rise beyond this price, no matter what charges are imposed, including state taxes, on production costs. Alaska and the major oil companies which produce its crude oil lack the market dominance necessary to impose a higher cost than world prices on consumers.

Only The Producing Companies--Not The Consumers--Can Benefit From Imposing Limitations On State Energy Severance Taxes

The dynamics of the production and marketing system for Alaska crude oil dictate that out-of-state consumers are and will be insulated from the incidence of Alaska oil and gas severance taxes. (Alaska does not have a severance tax on coal or other minerals or timber.) Because of these dynamics, the oil companies who produce Alaska crude oil bear the cost of Alaska's severance tax, not the ultimate consumer.

The State of Alaska's severance taxes fall squarely on the producer. They are a fixed cost which--like the transportation costs involved in moving Alaska oil to market--the Alaska producer must absorb within the price ceiling established by world markets. Under these circumstances, if Congress were to reduce--as is proposed in S. 463--or totally eliminate crude oil severance taxes, there would be no benefit to consumers. The major North Slope producing companies would simply continue to sell at the same uniform world price. These companies would retain for their own profits any savings from a Federally imposed severance tax reduction.

As a result, S. 463, and any other legislative proposal to cap or limit state severance taxes on crude oil, will not benefit consumers. Such proposals can and would, however, if enacted, directly benefit the producing companies. In Alaska's case this means the direct beneficiaries of S. 463 will be the oil companies operating in Alaska.

In all fairness to Senator Dixon, the primary sponsor of S. 463, I should note that he recognized when he introduced this measure on February 3, 1983, that the bill's provisions could not be justified on a theory of shifting or exportation of the tax. Instead, Senator Dixon advanced the novel theory that energy resources are "national" resources, the taxation of which must somehow be controlled by the Federal Government.

I have reviewed the record on this matter and it appears that the only justification for declaring energy a "national" resource and enacting special Federal tax laws for such resources lies in some apparent desire to level off all fiscal differences between the states. Mr. Chairman, I reject this approach. It ignores history and factual reality. It ignores Alaska's great need for basic public services and infrastructure if it is to meet the human needs of its citizens. It also ignores the requirements of the American public for domestic sources of energy. If enacted, this measure would deny my State an opportunity to achieve some degree of parity in basic public services with the other states of the nation. No other natural resource is treated in this discriminatory fashion.

Underdeveloped Status of Alaska's Economy

Alaska has yet to develop the basic public service and infrastructure systems that the other states take for granted. For example, Alaska has less than half the national average of hospital beds per capita. In 1982, seventeen percent of Alaska's homes were substandard or overcrowded, as opposed to a national average of 7.7 percent. The U.S. Environmental Protection Agency estimated in 1980 that it would require per capita expenditures of $783 to bring Alaska's publicly owned sewage treatment works up to secondary treatment standards. The national average per capita cost was $128, and no other state had per capita costs over $300. Alaska has only 103 physicians per 100,000 residents. This compares with a national average of 163 per 100,000 residents. Less than 1 percent of Alaska's area is accessible by road.

The underdeveloped state of the Alaskan economic and social environment render its population especially vulnerable to damaging impacts resulting from energy development. The fact that the population--especially the rural population where energy development is likely to occur--is already undergoing rapid social change underscores the fragile setting in which development must take place.

Impact of Energy Projects on Alaskan Economy and Society

The socioeconomic impact of the TransAlaska Pipeline System (TAPS) is a concrete example of the effects of large-scale energy development in Alaska. The TAPS project graphically illustrates the demographic, economic, cultural and social change, the social problems, and the shortage of goods and services associated with large-scale energy development.

Alaska, as an essentially rural state, can expect a major in-migration of energy-project workers and their families, as well as others providing ancillary services and others who may remain unemployed, whenever a large energy project is announced. This was Alaska's experience with the TAPS project, when the population of many communities surged by as much as 270 percent. The rapid growth of high density population led to added tensions and, in some cases, to a breakdown of some basic services. Perhaps the biggest problem was that the pipeline lured to the State thousands of persons for whom there was no work.

The TAPS project, of course, brought with it many benefits, but it also brought a major wave of inflation to a

State already plagued by an excessively high cost of living. The appearance of a wage economy in parts of rural Alaska also resulted in reduced subsistence activities. In general, the sudden surge of intense economic activity which was to last for only a few years introduced all the defects associated with a cyclical or "boom-or-bust" economy.

Costs to the State of Energy Development

Based on the TAPS experience, the State will clearly incur social and infrastructure costs as a result of ongoing and future energy development. Many of the costs are incurred not just during the development project but continue on a long-term basis, thus making it impossible to calculate the costs on a one-time basis. Moreover, many of the social and cultural changes associated with development cannot be mitigated, are long-term or irreversible, and cannot be measured in dollar figures alone.

The proportion of these costs borne by the State may vary from one project to another, depending on such factors as the magnitude of the workforce and the geographic setting. The projected Alaska Natural Gas Transportation System (ANGTS) might be used as an example. One State budget estimate of the cost of providing socioeconomic services connected with the construction of ANGTS totals $224.3 million. Another estimate places the costs of providing such services at over $250 million. It must be noted, furthermore, that these estimates of costs are concerned principally with the additional services necessary due to increased population during project construction. However, the State will face additional costs during the "bust" part of the development cycle, after the completion of the project. These costs will include unemployment benefits, welfare, and the full spectrum of government services provided to in-migrants who remain in Alaska.

Severance Tax Enables Alaska to Advance The National Interest In Secure Sources of Domestic Oil Production

In Alaska we are financing these very real social and environmental costs through a fair system of traditional state taxes. Our severance tax plays a major role in that system. Our contribution to the national interest in having secure sources of domestic crude oil production is, in major respects, financed by our State severance tax. Capping or limiting our severance tax will cap and limit our ability to contribute to the national interest.

STATEMENT OF THE IOWA FARM BUREAU FEDERATION
TO THE SENATE FINANCE SUBCOMMITTEE
ON ENERGY AND AGRICULTURAL TAXATION

STATE SEVERANCE TAXES -- S. 463

Hearing Date: July 24, 1984

The Iowa Farm Bureau Federation is a voluntary, general farm organization with a membership of 150,000 families. In December of 1981, representatives from the 100 county Farm Bureaus in Iowa discussed the severance tax issue and adopted the following resolution:

> "A recent United States Supreme Court decision (Commonwealth Edison Co. v. Montana) has declared that Montana's 30 percent severance tax on coal is lawful, despite the financial burden this tax may place on the ultimate out-of-state consumer. While recognizing the right of a state to protect its valuable natural resources, we believe congressional action is necessary to determine the maximum amount of tax permissible."

Severance taxes are indeed a burden to Iowa farmers and all citizens of our energy-dependent state. Iowa imports approximately 98 percent of the energy it consumes. Figures obtained from an Iowa utility indicate that Iowans have paid $85 million in severance taxes in this decade alone.

Limitations on, or a determination of the amount of severance tax a state may impose, is a proper subject for congressional action. The impact of these taxes crosses state lines, yet the interest of Iowans are not effectively represented in the political decision making process in western coal-producing states.

The Supreme Court in Commonwealth Edison agreed that the tax imposed on coal mined in Montana was subject to Commerce Clause analysis. Although upholding the constitutionality of the tax, Justice Marshall for the majority of the Court stated,

> "The simple fact is that the appropriate level or rate of taxation is essentially a matter for legislative, and not judicial resolution." 69 L Ed 2d at 901

More than three years have passed since the Commonwealth Edison decision. We do not question a state's right to impose a reasonable severance tax on the extraction of its natural resources in order to cover the "external cost" associated therewith (land reclamation, distribution facilities, etc.). However, we must question the reasonableness of a severance tax passed through to Iowa consumers to finance nonrelated projects in these energy-producing states.

The total revenue provided by severance taxes increased dramatically during the 1970s. (See: State Mineral Taxes, 1982; by Thomas F. Stinson and George S. Temple, USDA Rural Development Research Report No. 36.) This trend is continuing, and Iowans are paying even greater amounts of severance taxes in the 1980s.

We are a union of 50 states with common interests. It is imperative that a national approach to this issue be fashioned, so that severance taxes no longer serve as an income redistribution tool of states blessed with great pools of natural resources at the expense of those less fortunate.

We are hopeful this committee will take action so that the interests of energy-consuming states and energy-producing states will be equitably served.

WyFB
WYOMING FARM BUREAU

July 23, 1984

The Honorable Malcolm Wallop
Senator, State of Wyoming
452 Russell Senate Office Building
Washington, DC 20510

SUBJECT: July 24, 1984 hearing on S. 463

Dear Malcolm:

We have learned that S. 463 is going to be the subject of a hearing on July 24 before the Finance Subcommittee on Energy and Agricultural Taxation which you chair. This bill would amend the Internal Revenue Code to limit the amount of severance taxes imposed by states on oil, natural gas and coal. It is also our understanding that the subcommittee will receive testimony on the general issue of state severance taxes.

WyFB has the following policy on these issues:

Severance Tax Limitation
[1980-We oppose any government limitation on state severance taxes.]
[1981-We believe that the federal government should have no role or influence in determining "state severence taxes." Each state should have this right, exclusively, in order to calculate a tax level. We also believe that Wyoming should acquire data, thereby building a record to defend any legal challenge to the tax.]

Minerals severed from the state are taxed only once while renewable resources are taxed each year. Over a period of years the actual value of non-mineral property could be collected in taxes and the tax continued, thus mineral severance taxes cannot be said to be excessive in that light. I suspect that some land in Wyoming has already paid over 100% of the actual value in taxes during the nearly 100 years since statehood.

The WyFB does not believe the federal government should be concerning itself with this issue and we hope the subcommittee will defeat the bill.

Sincerely,

Larry J. Bourret
Executive Vice President

LJB/je

cc: Rod DeArment
Governor Herschler
County Farm Bureau Presidents
Ag Tax Committee
Board of Directors