EXECUTIVE SESSION

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SEPTEMBER 26, 1979

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

The Committee met, pursuant to notice at 10:20 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long, Chairman of the Committee, presiding.

Present: Senators Long, Talmadge, Ribicoff, Byrd, **Nelson**, Bentsen, Moynihan, **Boren, Bradley, Dole, Packwood, Roth, Heinz, Wallop, and Durenburger.**

The Chairman: This committee will come to order.

The first order of business that I would like to submit, item 1(a) on our list, lower tier oil, Tier I, would you explain that to us, Mr. Shapiro?

Mr. Shapiro: All right, Senator.

Each of the Senators have before them a list, an outline that the staff passed out dated September 25th. Point number one on that is the lower tier, or Tier I, oil.

The House bill has a definition of old oil, the oil that is produced on a nonmarginal property below a quantity represented by a one-and-a-half percent decline curve. Anything above that one-and-a-half would be trated as upper tier oil.

The decline curve is phased out so that in July, 1984, all oil that is in Tier I would go up to Tier II, which means that the base price moves an average of $6 up to what the upper tier base price would be, $13, whatever that level is, in July, 1984.

The tax rate in the House bill for Tier I oil is 60 percent. You get a deduction for the state severance taxes. The base price is $6 and there is an inflation adjustment. In other words, under the House bill, the tax on Tier I is a 60 percent rate times the selling price of the oil, less the base price, which is $6 and less a deduction of a state severance tax.

The administration position is in their testimony before this Committee, supported the House bill. The original administration position was for a one-and-a-half percent decline curve in 1979 before the windfall profits tax was to apply.

As to you know, the tax takes effect in January, 1980, a 2 percent decline curve after 1979. Also, the administration originally proposed a 50 percent tax rate and no severance tax adjustment. It appears that the options and the decisions that the Committee has with regard to the Tier I oil first is the decline rate, whether or not you want the 1.5 percent decline rate that is in the House bill or a 2 percent rate, which is the original administration proposal, or something in between, one-and-a-quarter, one-and-three-quarters, what the decline rate is, a decision that some of the Senators have indicated they would like to have discussed.

A second decision you have to make is the rate. The House bill, a 60 percent rate; the original administration position was 50 percent. They now support the 60 percent, so the Committee would have to make a decision on the rate. It appears that those are two of the major decisions.

Let me make another observation with respect to the decline curve. The decline curve has the effect of phasing out the Tier I oil at a fast or slower rate. For example, when you had a 2 percent decline curve, it phased out -- I think it was in May, 1983. In other words, phase-out means you would not have a lower tier tax. All the oil that is old oil, lower tier oil, would then be taxed as upper tier oil or Tier II oil.

So when you have a slower decline curve, a slower main 1 percent rate rather than 2 percent, it has an effect of having the tax phase-out at the full rate in July, 1984 rather than in, I think it is May, 1983.

The revenue figures, we have on the page right behind that page one, it has the revenue effects of the whole series of alternatives that the Committee could consider. What this is based on is the House bill.

Senator Dole: What are those revenue figures?

Mr. Shapiro: On the page right behind the page that says, the outline says Tier I oil. The very next sheet.

Senator Dole: Behind that is Tier II oil. Oh, I see. The next page. Revenue effects.

Mr. Shapiro: What it should have, Revenue Effects of Windfall Tax Proposals - Tier I.

The first one, one-and-a-quarter percent decline curve, 60 percent rate, and you see 1980. I think the column that may be most helpful to the Senators, you are looking at the full effect from 1980 to 1990 as a column, righthand column, next-to-the-last column, 1980 to 1990.

If you see the one-and-a-quarter percent decline curve and 60 percent rate, you pick up $1.2 billion. That is, because the House bill has a 60 percent rate, the one-and-a-half percent decline curve, so you have more of the oil that is taxed.

If you keep going down the proposal column you will see all the various assumptions. For example, if you have a 2 percent decline rate with a 60 percent tax rate, you lose $1 billion. As you go down there, you can see all the various categories of proposals that you can have.

The Chairman: The 2 percent decline rate was the original administration proposal that is phased out at what time? That would phase Tier I oil or Tier II oil. What time would that occur?

Mr. Shapiro: It would phase out by May, 1983. What that means is that oil would still be subject to tax, but would not be taxed in Tier I. There would no longer be a Tier I after May, 1983 under a 2 percent decline curve or after July, 1984 under a 1 percent decline curve.

The effect of that, that oil will be treated as Tier II oil.

What would happen there, the base price, instead of being $6 -- in other words, instead of the selling price being, for example, $14 minus $6, it would be $14 minus $13. Of course, by 1984, the $14 is going to go higher. The $13 is adjusted for inflation. The real effect is the windfall is reduced, because the base price, instead of being $6, goes up to $13. That is the effect of the phase-out, using the decline curve at a faster or slower rate.

Senator Ribicoff: Is the first proposal one-a-and-a-quarter or 60 percent? Is that the House?

Mr. Shapiro: The House bill is a 60 percent rate with a one-and-a-half percent decline curve. On this basis, it would be zero.

We are working from changes from the House bill, so the House bill being a one-and-a-half percent decline curve and a 60 percent tax rate, we are showing you that is zero and all of these changes are either pluses or minuses to the House bill.

Senator Bradley: The House bill is not shown on there.

Mr. Shapiro: The House figure is shown on the last sheet that you have. The last page in the entire packet shows you the revenue effects of the House-passed bill.

On that sheet, you will see Tier I oil raises about $4.5 billion. Now the reason that that is not larger than that is twofold. One is the tax is phased out in 1984 so that it is not in existence for very long.

Second, marginal oil, which includes a lot of what is otherwise Tier I oil, is in Tier II. That was the administration proposal, and the House agreed to that. It was a House Floor amendment.

You put marginal oil in Tier II and you have a short life on the Tier I is phased out and you do not have much oil in Tier I and subsequently, it does not raise as much revenue, so it is $4.5 billion total.

Senator Dole: If you change the decline curve to two and cut the tax the same, how much would we raise?

Mr. Shapiro: A 2 percent decline curve with the 60 percent tax rate, that is the next alternative proposal on the revenue sheet there and that loses $1 billion.

Senator Bradley: No money is actually raised?

Mr. Shapiro: No money raised. Instead, what the House bill raises is $4.5 billion. That proposal would raise $3.5

billion over present law.

The windfall would raise $3.5 billion in Tier I.

Senator Dole: $1 billion difference between what w woud do and what the House would do?

Mr. Shapiro: That is correct.

Senator Dole: Over a five-year period?

Mr. Shapiro: For the period 1980.

Senator Bradley: Not $1 billion, it is $5.5 billion.

Mr. Shapiro: The total tax under the House bill raises $4.5 billion in Tier I. What Senator Dole is suggesting, where the House has a 1.5 percent decline curve, if you incrase the decline curve to 2 percent and keep the House 60 percent rate, the effect of that is that you reduce $1 billion from the House figure.

Where the House raised $4.5 billion, the proposal that Senator Dole is suggesting would raise $3.5 billion.

The Chairman: In the first year, it only costs $71 million.

Mr. Shapiro: Very little effect in the first year.

The Chairman: I want to vote for the 2 percent rate. I would be willing to just leave the 60 percent rate where it is for the time being and just wait and see where we stand when we get to the squeezing out process.

Senator Ribicoff: The thing that bothers me, Mr. Chairman, it becomes very apparent that we are going to be cutting revenues very, very substantially before we get through. We are going to have a substantial number of credits, as Senator Danforth indicated.

I think somewhere along the line, we are going to have to make a position where we are going to bring in revenues, not keep cutting them at every phase.

So I would amend your proposal to stay with the House language.

The Chairman: We can vote either way.

Senator Chafee: Mr. Chairman?

The Chairman: Yes, sir.

Senator Chafee: Yesterday, we voted to exempt new oil. I voted for that. I think it is right. I certainly would support the exemption of tertiary as well. It just seems to me if we are going to have to raise some revenue, we have to go into this home heating oil problem very shortly tomorrow, and I personally would like to see the tax as 75 percent instead of 60 percent and stay at the 1.5 percent decline rate.

Furthermore, go to have the whole thing phase out by 1990. When we get through with his, I think there is going to be some sentiment in this committee for a complete phase-out of this very unusual tax that we are involved in.

In the meanwhile, we ought to go to good stiff rates on the old oil because this is truly a windfall, it seems to me, when the price ups to $22 to $28 a barrel.

The Chairman: In terms of constant dollars, as I understand it, the producers are getting the same thing as the people who had oil at the time of the Arab boycott are getting the same thing that they are getting now, in terms of discounted for inflation, people who are producing oil. When that boycott occurred, I am told they are getting $3.18 in terms of constant dollars.

Yes, sir, Mr. Lubick?

Mr. Lubick: Mr. Chairman, the base under the tax is adjusted upward for inflation. In other words, start with $6. That is to be adjusted upwards for inflation.

The Chairman: Which means in terms of 1973 dollars, they will have the great benefit of continuing to get the $3.18 that they were getting back at that time.

I know as far as producers are concerned, most of them are putting back in the ground most of what they receive. When they are denied the income that that oil brings, they are selling oil for $6 and buying it back for $42 as diesel fuel. That is a pretty tough thing for anyone to do.

The administration started out recommending the 2 percent decline curve. They come out and recommend the House figure. What is the logic of that?

Mr. Lubick: Well, Mr. Chairman, one of the things we have to take into account are the other decisions that are being made by the Committee to the extent that the Committee goes along with our recommendations with respect to newly-discovered and all other kinds of oil.

We believe that we should not be tougher at other phases to the extent that there is a relaxation with respect to windfall profits that we think should be taxed in other areas.

We reluctantly come to the conclusion that it is necessary to finance the programs that we do think are essential. To that extent, we are willing to accept the 60 percent rate which the House put in and the 1.5 percent decline curve, although we thought our original proposal was better with respect to supply effects, not acting as a disincentive.

To the extent that the Committee is voting exemptions, we think it is creating a problem. We would not like to see the decline curve reduced from the 15 percent because we think that is getting below the level where it can safely maintain the supply.

The Chairman: Let me just make this point. For 17 years the American petroleum industry was gradually going out of business. I know as far as most independents, 50 percent of all the independents did go out of business during that 17-year period and for the most part in this country it had gotten down to where companies were just producing out of inventories, and the reason they were doing that was because they could not compete with $1 a barrel oil over there in the Near East. You drill a well over there in Saudi Arabia, drill down 4,000 or 5,000 feet, you have something flowing 5,000 barrels. That is an average well over there, 5,000 barrels. They did not even have to pump it and the stuff would flow downhill right down into the ship.

Meanwhile, some guy goes and drills them a little well over here in the United States. The average well bringing him about ten barrels. He could not compete with it.

A place like Freeport, Louisiana, the capital of the independents for Louisiana, they just have to go tack all their rigs and just go out of business.

So it was a going out of business price. It was the price they were getting at the time of the Arab boycott.

Well, then, when the Arabs increased their price four or fivefold, eventually tenfold, then they say it is a windfall to let our own producers get the price that the Arabs are asking for theirs.

But to hold them to the price they were getting, which was the going out of business price is really a pretty rough thing to do to those people.

So the suggestion is, well, why do we not phase out that thing? If they made a big gain immediately, if they were getting what the Arabs are getting, that would be too much.

At some point they should not be penalized because they committed the original sin to drill a well before the Arabs raised their price.

It is sort of hard to explain to somebody, especially some fellow living out there on his land why he should be condemned forever because he signed a lease prior to the boycott, or because he let them drill on his property prior to that boycott, and he has a friend down the road whose property they did not drill until after the Arabs had come out with their boycott. At some point, you ought to move them to parallel treatment, it would seem to me.

All we are talking about here is what the Administration suggested.

Yes, sir?

Senator Dole: Let us get back to the basic question, what will it do to our energy supply? Will it increase it or decrease it, if we have more incentive? I think we also have to face up to the question raised by Senator Danforth yesterday. Some of us from oil-producing areas have different priorities from others, so we may get into a little intramural problem later on.

It is my understanding that lower tier oil has been declining at a rate of 14 to 15 percent per year. There also has been DOE testimony and testimony before this Committee, will decontrol help, and then you turn around and impose a heavy tax of one-and-a-quarter decline curve. Then you are not going to ---you are going to hasten the decline instead of slow the decline.

My question is, if we change it to 2 percent and keep the 60 percent tax rate at a 65 percent tax rate, do we end up with more oil? As I understand, that is the purpose of the whole exercise here, to try to find more oil or at least to slow the decline of old oil.

Do you have any figures on that?

Mr. Shapiro: I think DOE may have something in tht regard.

Senator Dole: I understand it is up to $2 billion barrels we could recover if we did not hasten the demise of the company because of lack of profits.

Senator Long is correct. The price, in real terms, has dropped to $3.06 a barrel, a decrease of $1.97, 40 percent in the last couple of years.

Mr. Smith: That is correct. For regulatory purposes, of course, there is a 3 percent decline curve in place already. Anything above that 3 percent level, it phases out completely in 1981. Any production above that 3 percent decline rate, even with the windfall profits tax, would receive a net price, in today's oil prices, at $12 a barrel.

So we are not talking about $5.25 essentially for that oil, particularly after 1981. We are talking about the $12 price, then, with the 1.5 percent rate only for approximately three-and-a-half years more.

So the adverse production impact we are dealing here with very small amounts, in my judgment. We are dealing on the margin. We estimate that the difference between 1.5 percent and 2 percent between now and 1981, '82, '83, may be 20,000 to 30,000 barrels a day.

There is not going to be any impact, essentially, after 1985 because the decline rate issue disappears in 1984.

Senator Dole: If we use your figures, what are we talking about per barrel?

Mr. Smith: In terms of per barrel --

Senator Dole: I assume you are on the low side. You are looking for money; we are looking for oil.

Mr. Smith: A billion dollars for --

Senator Packwood: How much?

Mr. Smith: A billion dollars for 35 million barrels of oil, total cumulative between now and 1980.

The Chairman: Senator Bradley?

Senator Bradley: The objective is not simply just to look at oil, but to look at all sources of energy, and one of the purposes of the exercise is it generates sufficient revenue so that other sources of energy can be encouraged and be brought on line so they will be competitive.

It seems to me, if oil is being produced now at a price of $6, as we discussed yesterday, a guy does not keep his well in operation unless he is making money. And if he is not making any money, he will not continue to do it.

He is obviously making it at this price.

If we allow it to go to the world price, I think that is clearly a windfall, and I think we are really talking about nibbling here, nibbling at the piece of cheese. It is $71 million in '80 and a total of $1 billion lost by '85. Instead of nibbling away, why do we not add a little to the cheese and go with Senator Chafee's suggestion that we increase the rate to 75 percent which would add $1 billion to the total revenue and give us $5 billion that we could begin, at least begin, to generate some revenue for these other sources of energy.

It seems to me that is a very good suggestion that I would support.

Senator Long: Senator Moynihan?

Senator Moynihan: Mr. Chairman, on the same theme and in response to Senator Dole's -- you know, genial remark that they are looking for money and we are looking for oil --

Senator Dole: Energy.

Senator Moynihan: That may not be entirely so. At least, I think it is not. We are looking for money too, at least for two reasons: one is to share some of the burden of these price increases that is going to be very heavy across the country; two, to make some investments in our future enegy position.

The synthetic fuels are one, obviously. Senator Bradley's proposal on conservation, other proposals have been made by Senator Danforth and Senator Chafee.

Yesterday in New York, President Carter spoke at some length, and with great force, with respect to the commitment to mass transit and his hope to fund this commitment from monies obtained by the windfall profits tax. He had Secretary Goldschmitt from Portland describing that they had done in Portland on mass transit.

Mass transit is an investment in energy conservation, properly done. We are looking for some money to make those investments.

While I have been with you on most things, I would be with Senator Ribicoff on this occasion very much. I would only say to Senator Chafee it seems to me that the 75 percent tax rate on top of the 48 percent tax rate is getting close to a negative return.

Anyway, I just want to make that general point.

Senator Chafee: Mr. Chairman, that does not work out that way.

The Chairman: I have Senator Chafee, then Senator Packwood.

Senator Chafee: You do not get a 48 percent. These are deductible. These other taxes you are paying. We are exactly chasing these people to the poorhouse.

They are getting what they have been making a profit on right along plus an inflation factor, plus they are going to the world price with the tax applied to that. We are not taking it all away. Plus the 1.5 percent decline curve that is effective there.

We have all had a great time in this committee voting for every possible kind of credit and I have participated enthusiastically in the exercise and made my contribution.

But it seems to me that we have to look at the other side of the ledger. The Chairman has proposed a 2 percent decline rate with a 60 percent tax and that, as Senator Bradley pointed out, cuts the House bill back by $1 billion.

I think at some point we have to draw the line and say we cannot have it both ways. Everybody wants alternate sources of energy. I am for elimination of the tax on new oil. I voted for that, and voted for it enthusiastically and will do the same for the tertiary.

I will do the same for the elimination of the same tax by

1990. We ought to get out of this business.

But meanwhile, we have the poor that we want to look after tomorrow, or whenever that is. There are going to be substantial expenditures there, and rightfully so.

You have to have some income on that side of the ledger. So I think that this 1.5 percent decline with the 75 percent tax is not exorbitant on these people.

As you know, there has been testimony. Some prominent oil companies have said it should be a 100 percent tax, or, in effect, keep the price controls on, which is in effect the 100 percent tax.

Senator Packwood: Mr. Chairman?

The Chairman: Senator Packwood?

Senator Packwood: It seems to me we are coming down to this, and I am going to side with Senator Chafee and Senator Bradley and Abe. There are still credits we have not considered. Abe has one on cogeneration that I share which is an absolute gem of an energy saver. It takes money.

The question comes down to if we exempt small producers, or tertiary producers and it costs $1 billion and it raises 35 million barrels of oil, it produces more, are we better off to tax and lose the 35 million barrels, if, indeed, the money can be used to offset credits? It will save more energy than the 35 million barrels.

That is going to come down, to some people, to an issue if you come from an oil-producing state or not. If your constituency wants to produce that oil, we can all understand that, but the function of this committee, as we finish this bill, is to save energy, not necessarily to produce oil, but to save energy or produce it in some other form.

I am going to come down on the side of sufficient taxes to fund the reasonable credits that we rationally think will save us energy. All we can do is take the best evidence we have.

One, what do the credits cost?

Two, how much will the tax raise?

Three, if we have the tax on the oil, how much oil will it discourage from being produced?

We must try to balance those three and say, where are the better equities.

The Chairman: Why do we not vote on it.

Those in favor -- does Treasury want to say anything more about this?

Mr. Lubick: No, sir.

Senator Chafee: I would like to have a vote on mine at some point on here. Where do we stand?

Senator Bradley: You offered it as a substitute, did you not?

Senator Chafee: I would like to offer it as a substitute for your amendment, your proposal.

The Chairman: I would like to just vote on it one by one.

Senator Packwood: What are we voting on?

Mr. Shapiro: The substitute that Senator Chafee is suggesting is the House set a 1.5 percent decline curve, but with a 75 percent rate.

The Chairman: Let me suggest, we will vote on both of them. I would appreciate it, Senator, if we would vote on my suggstion, which was the original administration suggestion, and then we will vote on those.

Senator Packwood: What is your suggestion?

Which one of yours are we voting on?

The Chairman: I am proposing a 2 percent decline rate, the original.

Senator Packwood: What tax rate?

Mr. Shapiro: The 60 percent rate, number two on your list.

The Chairman: No change in rate. This would amount to a 2 percent decline curve without changing the rate.

Senator Packwood: This is the one the House did?

Senator Ribicoff: I would like to make a point against the Chairman's position. He is for the administration when it does Louisiana good, but is against the administration when it does Louisiana harm, with all good respect.

The Chairman: Is there anything unusual about that?

Senator Ribicoff: I think, with all due respect to you, Mr. Chairman, we are working in this committee on a very serious problem and the serious problem is independence of the United States and the entire world.

There are people around this table who have been for controls, who have been restrictive and now are trying to look at the national interests as we vote on what will produce more energy in our taxes, and I think those of us who are doing that can expect the same attitude from those who are just from oil states. It is a question of the national interests against the local interests, because we have too much at stake here, and I just want to make that point, with all due respect to the Chairman.

Senator Packwood: Are we voting on the 2 percent decline rate, 60 percent tax rate that loses $1 billion? Is that what we are voting on?

The Chairman: Over a ten-year period.

Senator Chafee: Yours is the same tax as the House but increases the decline rate from 1.5 to 2.0?

The Chairman: I withdraw the motion. As of now, I do not see much support in the room. I will just withdraw it. I might offer it again when I hae more troops around. For the moment, I will withdraw it.

If you want to, we will vote on yours, Senator Chafee. Do you want to vote on the 75 percent rate?

Senator Chafee: Right, 1.5 decline.

The Chairman: All right. That is what the admnistration ---that is what the House bill vote, thus an increase from 60 percent to 75 percent.

Senator Packwood: How muchmoney does that raise?

Mr. Shapiro: That raises a billion dollars, the third from the bottom on the sheet. It raises approximately a little over a billion dollars.

The Chairman: Even a billion dollars, that is all you pick up?

Mr. Shapiro: There is not much oil in that category and it is phased out in 1984. It is not like it is there for the full ten-year period. It is only there for the first four or so years.

When a lot of the lower tier oil is moved up to another tier, there is not much oil. No matter how high you raise the rate, you do not pick up that much more.

Senator Packwood: Are there any statistics, Bob, at that rate, how much oil will not be produced? How much do we discourage by that?

Mr. Shapiro: We do not have that information, and I do not know if DOE has.

Senator Packwood: Say that is 600 million barrels at 75 percent, 1.5 percent decline rate.

The Chairman: Do you mean 673,000 barrels per day, is that not right?

Senator Dole: That may be a little high.

Senator Packwood: Tell me that figure again.

Senator Dole: This is based on the decline, not on the tax.

Mr. Shapiro: This is a decline rate of 1.5 percent with a tax rate of 75 percent.

Senator Packwood: I want to know how many barrels of oil that will discourage from being produced, if we have that.

Mr. Lubick: Senator Packwood, our estimates are that if you keep the decline curve the way it is, the change in the rate will have minimal effects.

Senator Packwood: On production?

Mr. Lubick: On prodution, that is right.

Senator Packwood: Let me ask this, then.

Senator Chafee's proposal will raise roughly an additional $1 billion and the cogeneration credits that Abe and I are talking about will save about a half a billion barrels of oil a day, cause a loss of about $600 million. You could literally fund those credits out of this tax, and Treasury is saying there is no loss in production.

Mr. Lubick: I think that is a separate question.

Senator Packwood: I realize it is a separate question. You are not going to be with me when we get to the cogeneration probably.

All I am saying is I am on Abe's side of this. I like these credits; I think they work, and there is going to have to be money for them someplace.

Senator Ribicoff: I think that we are going to be forced for a reconciliation and everything on the taxes and on the credits to add them up and have the staff indicate which programs on either side of the ledger produces the most energy for the country.

Senator Packwood: I agree.

One of the reasons I would hate to forego Chafee's 75 percent tax rate, if indeed, it does not lose any production or negligible production and it produces $1 billion that can be used in other ways to produce or save close to a half a million barrels of oil.

The Chairman: Well, now, let me ask you, I assume that Treasury would estimate the same at 100 percent tax. That would not lose any production either. I assume that would be the assumption?

Mr. Lubick: I do not know that that is true, Senator. 100 percent?

Mr. Smith: No. We are talking, as I indicated earlier, very small amounts of oil being affected here. We are talking 10,000, 20,000, 30,000 barrels a day at that 75 percent rate. At 100 percent it would be somewhat greater still.

The Chairman: With that kind of mentality, that 100 percent tax will not lose you any production. I think it is sort of typical of what we have got over there in the administration these days, the idea of a 100 percent tax that will not lose you any money. Tax it all the way.

Senator Chafee: Mr. Chairman, that is not quite accurate, because they were producing at $6 a barrel up to a short while ago. It is not a 100 percent tax on everything they make. It is a 100 percent -- set aside the 100 percent. It is a 75 percent tax at over the $6 plus the inflation factor, plus the 1.5 percent curve. They just may not be discounted.

The Chairman: You may not have the study over there; you may not have put your stamp of approval on it. But I know from the other end of it that DOE asked a committee to make a study of how much additional production you could get. People produing wells as efficiently as they can produce them, that they are putting those workover rigs to work and producing as efficiently as they could.

I talked to the chairman of the committee working on it. He is in that business. His estimate was you come up with 600,000 barrels a day if those people were producing those wells as hard as they could.

I heard another estimate that came from another source, arrived at by projecting the experience that company had into other areas. That estimate was 800,000 barrels a day.

So the 600,000 barrels is low, compared to the other estimate. That is the range at which you are talking.

If you had all of the incentive that people would like to go all out to make the existing wells produce as efficiently as they could produce, that you would produce somewhere between 600,000 and 800,000 of oil a day. Let's take the low figure. That is about the amount of oil you are getting out of Alaska.

They get about 700,000 barrels a day, is it not?

Mr. Smith: Approximately 1.3 million barrels a day.

The Chairman: That is 50 percent of it, then. 50 percent of the oil you are getting out of Alaska. That is the estimate I have seen on what is available by people producing as much as they can.

When you are talking on the area of natural gas, you have a situation. If people do not produce their wells to the extent that they can, there are other people producing out of that same area who tend to drain their wells. The pressure declines on their wells.

But when you are talking about old oil wells, when you put a hole in the ground and you are sucking oil through sand, and where you suck on it, you tend to suck the salt water up from the bottom. You do not have the same drainage problem that you have. Generally speaking, people sort of sit there and take the view that they are getting the worst of it. It does not pay to work over the wells and that type of thing. Maybe you do not know it over there, but I think people who are in the business of producing would have to advise you that you are leaving a lot of oil. At least, you are just losing a lot of production by not having it produced efficiently.

Mr. Smith: There is no question that our future depends in large measure on our existing reserves. Conventional production techniques, I think, have been exploited pretty heavily. We are producing our lower 48 reserves at a reserve production ratio of 15 percent, roughly 14 percent, a year, which is pretty close to what one would conceive as a maximum physical limit.

I would make the additional point that any increases in production over and above that 1.5 percent linear decline rate which is a pretty fast decline for the vast majority of properties overrides the actual physical decline of the vast majority of properties, any increase of profits will be increased at an upper tier rate.

Even if it were at 100 percent, your increased production would still be subject to the rate applicable to the upper tier. So that we think the administration's program provides very substantial incentives and that is why the computed decline rate was adopted, for regulatory and tax purposes, to provide those incentives for increased production from existing wells.

We do not believe that the change in the tax rate on the small amount of oil that is left below that decline line is very significant in relation to what the overall production potential is.

Senator Wallop: Mr. Chairman?

The Chairman: Senator Wallop.

Senator Wallop: I just wonder what kind of position and what it takes to have the administration come to roost?

When he was testifying in front of this committee on the 9th of May, the Treasury Department news release -- this is Secretary Blumenthal's statement on the decline curve. He said, thus a 2 percent decline was selected for tax purposes as being closer to historicla experience. Using a lower decline rate than 2 percent for tax purposes would obviously increase the amount of old oil subject to the tax, but would risk discouraging production.

The 2 percent decline for tax purposes represents a reasonable balance between capturing windfalls and assuring maximum production.

I do not understand what takes place. Presumably this was a thought-out position at one time. On the 9th of May, it was a thought-out position. What has happened between the 9th of May and now and the Secretary presumably testifying with the President's blessing and with conversations with DOE, thought differently.

Mr. Smith: The Secretary's statements, as Mr. Lubick pointed out, were made in the context of an overall administration program, taxing newly-discovered and incremental tertiary as well.

Senator Wallop: What are the present things being talked of, not in terms of an overall program?

Mr. Smith: It had a different tax rate than even the House adopted.

Senator Wallop: A lower one?

Mr. Smith: We acknowledged that there is a modest adverse production impact on the margin with any of these taxes, but it is very small in relation to the amount of revenue that you lose.

Senator Moynihan: If the Senator would yield, that is why Secretary Blumenthal lost his job.

Senator Wallop: That may not be. I did not notice anybody from the White House or Department of Energy coming to contradict that testimony at that time. Indeed, the Department of Energy was right here on their tail* suggesting that the program --

Senator Moynihan: You got the 2 percent decline rate, wrong. That was fatal.

Senator Heinz: Either that, or he told the truth.

The Chairman: Is there further discussion of the Chafee motion? Let's call the roll on it.

Senator Bentsen: What are we doing now?

Senator Heinz: What are we voting on?

Mr. Stern: 75 percent on Tier I oil instead of 60 percent.

Senator Heinz: We are through with Secretary Blumenthal's testimony? There is going to be no further discussion of it?

All of a sudden, we hear the Energy Department say that there was a production response at the margin. They just said that a second ago. Two minutes before, they were saying there was no discernible change in production attributable to practically anything on this exhibit.

I would like to know what they are talking about, what they mean, what the figures are.

Mr. Lubick: Senator Heinz, when we originally set the 2 percent decline rate, 50 percent tax, it was on the basis that we wanted to err on the side of not discouraging any additional production. Most wells decline at a rate that is less than 1.5 percent, but when we originally designed the program because we were concerned with maintaining the supply incentive, we proposed a 50 percent rate and a 2 percent decline because we were sure that in virtually all cases that would leave the incentive to produce the additional barrels above that decline.

When the House went to a 1.5 percent decline rate, it was our view that while that would have some disincentive for those few properties that were experiencing an actual decline at between 1.5 percent and 2 percent, that the effect was still minimal, although there is some effect. I do not think anyone cannot say that.

The question is the same question that we put yesterday in measuring the effect of the exemption for newly-discovered, what is the production effect versus the change in the revenue rates by the whole program and by going to a 1.5 percent decline rate there is some minimal reduction in production.

As I understand it, Richard -- correct me if I am wrong -- it is about 10,000 to 20,000 barrels a day and you have to make that decision evaluating what the revenue difference is, because you have adopted a large number of expenditure programs here that are going to have to be funded somehow.

Senator Heinz: Let me ask you this. Blumenthal said that a 3 percent decline rate exceeds the actual decline rate observed in most other oil fields. Thus, the 2 percent decline rate was selected, as Senator Wallop said, as being closer to historical experience.

You say that you chose that because you wanted to err on the safe side. You say that 1.5 percent is about right. Does that err in the safe side, or on the unsafe side?

Mr. Lubick: I think 1.5 percent is still on the safe side.

Senator Heinz: What would 1 percent be? Would that be on the safe side?

Mr. Lubick: I think that would be on the dangerous side.

Senator Heinz: The dangerous side. Someplace between 2 and 1 percent we get to the dangerous side. Where?

Mr. Lubick: I will let Richard address that. It is my understanding somewhere in the neighborhood of 1.245 percent comports with actual historical experience.

Mr. Smith: The decline rate on an actual well is exponential. It is 10 percent, 12 percent, 15 percent of a declining balance in essence each year.

What we are talking about is a linear declining rate, a straight line. It goes down to the end in 1984 and as a result the vast majority of properties is going to benefit from this rule within a very short time during their ife, if not immediately. We estimate that approximatley 75 percent of the old oil properties -- at least 75 percent -- would benefit immediately and each month, as the linear decline rate moves at a faster effective rate than the exponential, it is going to pick up more and more properties.

A 2 percent might pick up 80 percent, or 85 percent immediately. 85 percent, I guess, would be our figure.

Senator Heinz: 1.5 percent picks up what percentage?

Mr. Smith: 75 percent.

Senator Heinz: 1.25 percent picks up what?

Mr. Smith: 1.25 picks up -- that would be near 50. That would be the average, I would guess. You get to 1 percent, as Mr. Lubick says, and you are on the dangerous side of it. You are not talking about affecting large numbers of properties, or large amounts of production, with these decline rates, once you establish that it is a substantial linear dcline rate.

Senator Heinz: Thank you.

Senator Durenberger: Mr. Chairman?

The Chairman: Yes, sir.

Senator Durenberger: This may have been covered before I got here. I apologize for being late. I heard the production effect of 75 percent on 1.5 percent compared to the present proposal. What would the production effect be of 75 percent on a 2 percent decline?

Mr. Smith: The 2 percent, that would probably be my guess, I guess, that would be about the same as the 1.5 percent, 60 percent rate. Probably a trade-off. You would lose a little with the 2 percent 75 percent rate.

Senator Durenberger: Does that mean that the rate and the decline curve are awash?

Mr. Smith: In that particular instance.

Senator Durenberger: Between 1.5 and 2 percent?

Mr. Smith: That would be my judgment, yes, sir.

Senator Bradley: On the sheet, does it not say you lose 551?

Mr. Shapiro: That is the revenue. Senator Durenberger is trying to get a supply response. The revenue is $550 million.

The Chairman: Call the roll.

Mr. Stern: Mr. Talmadge?

Senator Talmadge: No.

Mr. Stern: Mr. Ribicoff?

Senator Ribicoff: Aye.

Mr. Stern: Mr. Byrd?

Senator Byrd: No.

Mr. Stern: Mr. Nelson?

Senator Chafee: Mr. Nelson, aye by proxy.

Mr. Stern: Mr. Gravel?

(No response)

Mr. Stern: Mr. Bentsen?

Senator Bentsen: No.

Mr. Stern: Mr. Matsunaga?

(No response)

Mr. Stern: Mr. Moynihan?

(No response)

Mr. Stern: Mr. Baucus?

(No response)

Mr. Stern: Mr. Boren?

(No response)

Mr. Stern: Mr. Bradley?

Senator Bradley: Aye.

Mr. Stern: Mr. Dole?

Senator Dole: No.

Mr. Stern: Mr. Packwood?

Senator Packwood: Aye.

Mr. Stern: Mr. Roth?

Senator Roth: Aye.

Mr. Stern: Mr. Danforth?

Senator Danforth: Aye.

Mr. Stern: Mr. Chafee?

Senator Chafee: Aye.

Mr. Stern: Mr. Heinz?

Senator Heinz: Aye.

Mr. Stern: Mr. Wallop?

Senator Wallop: No.

Mr. Stern: Mr. Durenberger?

Senator Durenberger: Aye.

Mr. Stern: Mr. Chairman?

The Chairman: No.

Senator Moynihan: Mr. Chairman?

Mr. Stern: Mr. Moynihan?

Senator Moynihan: Aye.

The Chairman: The yeas are ten and the nays are six. The amendment is carried, but the absentees are entitled to be recorded. I think, as we usually do, we should let the be recorded before we finally settle this issue.

It may wind up being a tie vote.

Senator Chafee: If I could ask, Mr. Chairman, when the absentees are reported, they are permitted to be reported even though it can change the result? What is the system?

The Chairman: You cannot assume. The way we have been doing business around here for a long time is we will let the absentees record themselves because otherwise someone comes in and makes a motion to reconsider and we are back to the same thing all over again.

Ten is not a majority. If all of the absentees record themselves against the motion, then the motion would fail on a tie vote, which is always a possibility. There is no way you can speak for those people until they record themselves.

Senator Heinz: Mr. Chairman, I do not know. On the Senate Floor, can an absentee move to reconsider a vote? I thought that you had to be recorded on the prevailing side in order to move to reconsider.

Senator Packwood: Mr. Chairman?

The Chairman: You can check those rules, if you want to. I know from experience, I have been the guy to do it, that an absentee can move to reconsider.

Senator Heinz: In your committee.

The Chairman: In the Senate. That is the rules of the Senate.

Senator Heinz: That is what I am asking.

Senator Packwood: Mr. Chairman, let me say in the Chairman's defense, although I voted against him, as long as I have been on this committee we have allowed absentees to vote and, on occasion, it has changed the outcome.

The Chairman: That is the only way we can do it. Otherwise, we have to go back and go through the whole thing all over again.

Frankly, some of those absentees, I know how they are going to vote. The others, I do not know how they are going to vote. You just have to wait and let them record themselves.

Incidentally, I am pleased to see Governor Carey here. Governor, we are delighted to see you on the premises. I hope you are not in any trouble.

Governor Carey: No, sir.

Senator Dole: I wonder if we could move to a little amendment that Senator Byrd and I have.

The Chairman: The carryover basis?

Senator Byrd: Yes. Senator Bentsen is very much interested in it, too.

Senator Dole: We could take care of it in a minute or two.

Senator Byrd: It will not take long.

The Chairman: What is the will of the Committee to vote on carryover basis?

Senator Dole: Do you want to start?

Senator Byrd: Senator Dole and Senator Bentsen and Senator Wallop and myself on the Committee present an amendment at this time to repeal the carryover basis provisions of the 1976 tax law.

I think all of the members of the Committee are thoroughly familiar with it. I shall take only a minute or two.

First, I would like to receive a letter I received from the Chairman of the Taxation Law Section of the Louisiana State Bar Association, signed by Michael E. Guarisco. It says:

"The Tax Section of the Louisiana Bar Association recently took a poll of its members with repect to the carryover basis rules enacted into law by the Tax Reform Act of 1976.

"Of 198 members responding to the poll, 195 favored repeal of the carryover basis provisions and a eturn to the law prior to 1976. Of the thee members who were not in favor of repeal of the carryover basis rules, two were in favor of modification so as to make the law more workable.

"It seems apparent that those persons who must deal with the carryover basis provisions in their everyday practices recognize the problems inherent in attempting to conform to the very technical rules brought about by the carryover basis changes. We feel it would be safe to say that, in most instances, practitioners feel that the carryover basis provisions are unworkable and in almost all cases will prove costly.

"Therefore, the Tax Section of the Louisiana Bar Association urges you to vote to repeal the carryover basis rules enacted into law by the Tax Reform Act of 1976."

I will read into the record those who are sponsoring repeal legislation: Senator Dole, Senator Byrd, Senator Zorinsky, Senator Bentsen, Senator Jepsen, Senator Wallop, Senator Ford, Senator Morgan, Senator Tower, Senator Kassebaum, Senator Lugar, Senator Stone, Senator Hatch, Senator Young, Senator Exon, Senator McClure, Senator Pressler, Senator Cochran, Senator Melcher, Senator Helms, Senator Schmitt, Senator Humphrey, Senator Goldwater, Senator Boschwitz, Senator Simpson and Senator Holings.

The Chairman: They are the co-sponsors?

Senator Byrd: They are the co-sponsors.

The Chairman: Did you read my name?

Senator Byrd: May we do that?

The Chairman: Would you please.

Senator Byrd: And Senator Long of Louisiana.

Senator Dole: And Senator Lubick.

Mr. Lubick: You have been making me a lot of good offers lately, Senator Dole.

Senator Byrd: I have a letter from Mr. Shapiro dated April 5, 1979 which I would like to read.

It says: "The repeal of carryover basis will reduce budget receipts as follows: fiscal year 1980, negligible; fiscal year 1981, negligible; 1982, $36 million; 1983, $95 million; 1984, $163 million; and in the longrun, after 20 years, the figure of $833 million will be reached.

"These estimates take into account both the three-year postponement and the change in capital gains taxation under the 1978 Act. Under present law, heirs of post-1979 decedents would be subject to capital gains tax upon realization of gains accrued after the December 31, 1976 fresh start date. Because the estate is allowed nine months to file and because we assume heirs woul pay cpaital gains tax only in final payments, there is a negligile revenue effect (less than $1 million) in both fiscal years 1980 and 1981. However, these are definitely greater than zero because technically an heir could quickly dispose of an inherited appreciated asset and report it on an estimated payment in 1980 or early 1981.

"The long run estimate of $833 million at 1978 level is reached in approximately 20 years. This is the period of time required for the effect of 'fresh start' to wear off."

Senator Dole: If the Senator would yield?

Senator Byrd: I will yield to Senator Dole.

Senator Dole: I will just take a minute. I think Senator Byrd has presented all the facts. I think there probably may be some opposition to this. I am not certain how many will have votes, but I would just say, as I said a day or two ago, this is about the only opportunity we have to properly present repeal of carryover basis; as everyone probably knows, it was added to the 1976 Tax Reform Act without hearings in the conference.

Many of us -- well, I was not at the conference at the time, but there has been, as Senator Byrd indicated, a good deal of opposition to it and I understand the opposition of the Treasury, I just do not agree with it. It is an opportunity, on the windfall profits tax, I think, to reflect the concerns of the numbers that Senator Byrd expressed plus the thousands and thousands of others that we have not heard from.

I would just like to put in the record some talking points in favor of the amendment without reading it to the Committee. I think there will be a minor clarification offered by Senator Packwood at this point.

(The material referred to follows:)

COMMITTEE INSERT

Senator Packwood: Mr. Chairman, this is on behalf of both Senator Nelson and myself, although I wanted to address this general subject.

This was an amendment that we had two years ago. You recall there were some people who got caught in the whipsaw here. They were under the carryover basis from January 1, 1977 until the Revenue Act of '78 when we postponed it.

They filed in good faith, and now are in limbo.

Don Moore made an able case before this amendment a year and a half ago. We put it in the bill; it was dropped in conference. You recall very specifically, Harry. It was not dropped on its merits, it was dropped --

Senator Byrd: If the Senator would yield, it was dropped because the Treasury Department testified that they could not administer the law, they could not administer it as it stands.

Senator Packwood: I want to put that amendment back in. Bob, you know the one I am talking about, the election one. The Committee had no objection to it a year and a half ago. I would assume they would have no objection to it now.

I do want to address the general subject of carryover basis after this amendment.

Mr. Lubick: Senator Packwood, does that amendment include as a tax adjustment the marginal rate, or the inadministerable average rate?

Senator Packwood: Don, I am not sure. Maybe Bob can tell you.

Mr. Lubick: I would hope it would include the marginal rate. Otherwise, it would require us to get out regulations.

Senator Packwood: The amendment is exactly the one that we had in the Committee the last time we had a goaround on the '78 Revenue Act.

Mr. Lubick: I had sort of forgotten.

The proponents of the amendment agreed with us that it was perfectly satisfactory to do it on the average rate. If it is to be administered, it seems to us that that is a more generous adjustment for the taxpayer, but it avoids our getting into all of these difficult questions of interlocking calculations that were, indeed, the subject of Senator Byrd's criticism of the existing law.

Senator Packwood: I want to stick with this amendment that we had when we had the revenue act last year.

Bob, is your memory good enough to remember?

Mr. Shapiro: I cannot remember specifically. I think it did most of what the Treasury is concerned about. It had two basic adjustments, one on basis modifications, second on the rate, although my recollection back then is not good.

Mr. Lubick: At that time, we are talking about 175 exemptions not necessary for this particular problem.

Senator Packwood: Let me read you the specific amendment: In the event of a decedent's dying after December

31, 1976 and before December 6, 1978 the exector, within the meaning of Section 2203 of the Internal Revenue Code of 1954, such decedent's estate may irrevocably elect within 120 days following the date of enactment of this act in such manner that the Secretary of the Treasury shall prescribe, have the basis of all assets acquired from, or passed from the decedent within the meaning of Section 1014(b) of the Code determine for all purposes under such Code is that Section 1023 of such code apply to such decedents."

Mr. Lubick: In that regard, I think that that does not make the tax adjustment correction. I would request if the amendment is adopted that we have no objection to the amendment in the context of the repeal of carryover basis which, of course, we do strenuously oppose. If that adjustment could be made, it could make it at least something that we could administer.

I do not think there should be any serious objection.

Senator Packwood: I would move the adoption of the amendment, Mr. Chairman.

Senator Byrd: I second it.

The Chairman: All in favor, say aye.

(A chorus of ayes)

The Chairman: All opposed?

(No response)

Senator Packwood: The carryover basis, I think it is a game of chicken. Two people drive down the road. The President says he will veto any bill that has carryover basis on it. I do not know if there are the votes to override the veto or not, or if it is going to pass or not.

It would seem to me that as I have looked at carryover basis, it could have been made workable. You could write a law that would work.

I think one day the philosophy of carryover basis will probably pass.

If we repeal it now, and the President repeals it or not, and we override the veto, we are back where we were prior to 1976 and one day somebody will take a whirl at it again and something bad may pass.

Several times I have suggested to Treasury -- although they have never been enthusiastic about it -- that if you wanted to reach a national compromise -- I have even talked to practitioners -- that you write a rational carryover basis law and make its effect prospective, make a date, 1985, and have it apply only after acquired property that you have a reasonable sized exemption and index the exemption. I have never gotten any response from Treasury whether they were interested in that or not.

That is a way that you could make it workable, so nobody would have to worry about what is the basis of their property that their father acquired in 1945. It will not apply to any property acquired prior to the effective of the act. I would throw that out as a possible compromise. Treasury has never expressed any interest in it before.

Senator Byrd: I might say to the Senator from Oregon, I proposed that last year or the year before -- I forget which -- and Treasury opposed it.

Senator Packwood: I do not know what Treasury's position is now. That would be a workable way to do it.

The Chairman: What is that you say?

Senator Packwood: What you would do, Mr. Chairman, you would say, all right, we would write a rational carryover basis rule. We will sit down at Treasury, figure out what most people consider fair and say it will not go into effect until January 1, 1985, and it will not apply to property acquired prior to January 1, 1985.

And then you would exempt the estates, and you could pick the ie, pick the estates that we agree on and index that so inflation does not eat that. So it only applies to relatively small numbers of larger estates in this country; two, it applies on prospectively. That means anyone in the business of estate planning knows what the law is, what goes into effect to know that it only applies to property acquired after a certain date.

Senator Byrd: Once this was repealed, the Committee, next year or the following year, whenever it wishes, could take up something like that.

Senator Packwood: What I am suggesting, when you say once this is repealed, if this is not repealed, we are going to live under it.

Senator Byrd: It will not make any difference because it cannot be administered. The Treasury Department has admitted that. They cannot even be complied with by the practitioners so it has to be repealed, or else ignored.

Senator Bentsen: What is the procedural situation Do we not have the amendment of the Senator?

Senator Dole: We have taken the amendment.

Senator Bentsen: Did we take it? Did we act on it?

Senator Dole: Yes.

The Chairman: He has modified it to include that amendment.

Senator Bentsen: Mr. Chairman, I would like to speak to the point.

Senator Dole: Repeal with the amendment.

Senator Bentsen: I would like to speak to it.

The Chairman: Would you like to speak to it?

Senator Bentsen: Yes.

Senator Byrd: If you would yield just a moment.

Senator Bentsen: Yes.

Senator Byrd: I have word Senator Nelson would like to be a cosponsor of this. I would like the record to so show, that he is a cosponsor of the repeal.

The Chairman: Mr. Bentsen?

Senator Bentsen: Mr. Chairman, let me express my feelings concerning this particular issue. I have listened to the Treasury talk about this. The fact they do not pay a capital gains tax and an estate tax, as being a loophole. Frankly, I do not consider death a loophole and normally I do not consider it a voluntary conversion.

When we talk about the estate tax to the United States we are talkinga about an estate tax of a maximum of 70 percent. Someone dies who is in that tax bracket. Then you add some of the state taxes on it, some of the other problems you run into, and you are getting above 70, get up as high as 80 percent.

Now, you ought to compare that to Western Europe.

When we talk about the direct heirs, when you are talking about the children or the spouse, the estate tax in the United States is higher than all of Western Europe with the exception of only one country, that is Britain.

Now they are talking about changing theirs, so we are paying a very substantial tax in this country now, estate tax.

We read what the American Bar Association stated. We believe that this part of the legislation is a public disaster. The carryover basis provisions have created an administrative nightmare of increasing complexity, delay and expense in processing estates.

Frankly, I think that the logic is so overwhelmingly on the side of repeal, I hope we carry this by a large margin this morning.

The Chairman: Mr. Lubick, go to it.

Mr. Lubick: First of all, I might state that this is a problem that we have worked on very hard. We had some hearings before Senator Byrd's subcommittee a few months ago. he asked us to come back with some statutory language so that there could be some hearings on that. Indeed, we have since come back with some statutory language which will address some of the administrative problems and we would urge that hearings be held on that.

The New York State Bar Association Tax Section indeed voted to repeal and go back to prior law would not be the right course and voted its opposition to us. The Institute of Certified Public Accountants has indicated that the fix-up measure that we have proposed would, indeed, be workable.

I think I agreed with Senator Byrd some years ago that the law as passed in 1976 was not appropriate and that changes ought to be made to make it administerable. I do not think there is any difference between Senator Byrd and Senator Dole and us on that particular question.

I think the basic question is one that Senator Bentsen has posed and this is not a revenue measure. Essentially it is a question of a fundamental structural problem in the income tax.

If we can assume that we had no estate tax whatsoever, hypothetically -- I am not suggesting its repeal -- but if we had no estate tax whatsoever, I cannot believe that anyone would be opposed to carryover basis or some substitute like it. If an individual bought an asset for ten dollars and, at the date of his death, it was worth $110 and you had a capital gains tax and no estate tax, I do not think anyone would say that the income tax on the appreciation, capital gains tax, ought to be completely forgiven.

The question that Senator Bentsen proposes is whether the interposition of an estate tax on the assets of the decedent at the time of his death alters that result and we suggest that it does not, because the estate tax is applicable to the assets transfered by the decedent -- indeed, the decedent who sells his assets during his lifetime pays the income tax and pays the estate tax on the balance that is left over, and he has a substantial, greater burden on his death, estate tax and income tax wise, than the person who pays the estate tax on the total amount of his appreciated assets.

The estate tax does not substitute to equalize those two situations.

If the estate taxes are too high -- and indeed, I am not really enamored of 70 percent rates, no matter where they apply, be it windfall profits or income taxes or estate tax rates, 70 percent is a pretty stiff rate. But if the estate tax rates are too high it seems that relief ought to be given equally to all taxpayers who are subject to the estate taxes whether they are persons who have paid income taxes or who have not paid income taxes on appreciation on their estate. That is another question.

If there is $800 million of revenue involved, it would be a much fairer tax system if that $800 million were introduced into general estate tax reduction for all taxpayers.

The fact of the matter is, because of the old rule of step-up basis, you have, as any practitioner in the area can testify, constant manipulation, constant incentives to avoid disposition. The result is you have persons, illustrations that we have given to the Committee, of persons of great wealth owning $5 to $6 million of marketable stock listed on the stock exchanges with a basis of $1,500. By virtue of their death, they are able to pass this on completely free of income taxation.

That represents a fundamental structural defect in the income tax.

We came up with a proposal that simplifies the administration and exempts the small estates, those who are not in the Federal estate tax system. It gets at the problem where the problem is persons with large amounts of appreciation which are manuveuring to avoid the income tax. It protects the equity and integrity of the income tax system in a way that can be administered. We provided relief measures for farms, small businesses so anyone who stays in farming and stays in small business would not be subject to taxation.

This particular measure has been the subject of intense pressure from those persons who are involved, and that is perfectly natural. They have a good thing, and they want to keep it.

The measure is inherently a very complex measure. You do not have a great, grass roots campaign from thousands of thousands of taxpayers.

Senator Dole: They are all dead.

Mr. Lubick: The problem is, those who are still living, you do not have organized forces who can get up and be eloquent in favor of the complexity of estate and income taxation, but there is a fundamental question of fairness here. As far as we are concerned, we have come up with proposals that will make it administerable in working with the various groups. They have agreed with that.

There are Bar groups who have testified that going back to the prior law is not proper. As far as the question in material effect is concerned, clearly there is a lot that can be said for that.

Senator Ribicoff: May I ask at that point, your proposal, sir, did you ever submit your proposals to Senator Byrd?

Mr. Lubick: Yes, we have, Senator Ribicoff. We have been awaiting hearings on it.

Senator Ribicoff: Has Senator Byrd rejected your proposal?

Mr. Lubick: No, he has not.

Senator Ribicoff: Are his proposals acceptable to you?

Senator Byrd: They are totally unacceptable. The same proposals that came before this committee last year, no fundamental difference.

I set a hearing on this question in January. Mr. Lubick and the Treasury Department came in without any precise proposal whatsoever, so I cancelled the hearings. Just a few months ago -- you may have in mind an exact date. I do not. It was probably a month or two ago, a proposal was sent to me. I would be glad to hold hearings on that proposal next year sometime.

After we get this thing off the books, we have got to repeal this law. It is ridiculous to keep this law on the books. It cannot be administered. It is totally wrong.

If you want to present your proposals next year, I will hold hearings on it, and the Committee can make whatever decision it wishes, but I think the time has come to get this law off of the books.

You mentioned the New York State Bar Association, the Tax Section. I spoke to the Tax Section of the New York State Bar Association in New York and I denounced this bill a half a dozen times and I got three standing ovations every time I mentioned repealing this provision.

Now, let me mention another thing. This letter was written -- when I wrote Mr. Shapiro, it had nothing to do with carryover basis, and his reply had nothing to do with carryover basis, but here is the situation. This is Mr. Shapiro's reply in part to me. This is in response to your letter of August 22 which asks several specific questions about inflation and taxation.

The current consumer price index forecast through 1990 ranges from 6-1/2 to 7-3/4 percent. After 6 percent inflation for the next 40 years, an asset worth $70,000 today would be $720,000 with no change in real value.

A house bought today by a young couple for $70,000 when the husband dies 40 years from now, according to the figures submitted by Mr. Shapiro, the value of that property will be $720,000 and if that property has to be sold by the widow to pay taxes, she will pay a tax based on $650,000 or in that general area.

So the whole philosophy is wrong. Besides the philosophy being wrong, the law as it now stands, is admitted by everyone to be unworkable.

The Chairman: Let me try to recognize the Senators who raised their hands. Senator Moynihan had his hand up, Senator Bentsen and Senator Nelson.

Senator Moynihan: Briefly, Mr. Chairman, I would like to say I have, on first encounter, sensed the concerns that Treasury had, and indicated my support. But, since then, I have spoken at some length with a succession of persons in New York City whose work is managing trusts and estates, persons of transparent professional integrity with no personal involvement as such.

They say that this is not workable. They cannot make it work.

Therefore, I would like to associate myself with Senator Byrd, and if he would list me as a cosponsor, I would be pleased.

Senator Byrd: All right.

Senator Moynihan: I believe I heard Sentor Byrd respond positively to the proposal of Senator Packwood that we take this up and recognize that we do have a problem and that it can be addressed in an orderly way.

You are always open to suggestions like that. I would like to associate myself -- perhaps you might like to say something about that.

Senator Byrd: Thank you, Senator Moynihan.

If the Treasury Department wishes the Subcommittee to hold hearings on the proposal submitted a month or two ago I should be glad to do that sometime next year and the Committee can debate the issue then and decide whether it should be reinstated and, if so, in what form. But I would hope that we could repeal it and next year we could take a look at it and decide whether you wanted to reinstate it.

The Chairman: Senator Bentsen?

Senator Bentsen: Mr. Chairman, Mr. Lubick was referring to the fact that you had an estate in stocks of whatever the number was, $5 million, $10 million, and that estate would not pay an income tax or a capital gains tax. That is right, but it would pay something that approaches a 70 percent tax, an estate tax.

I am not here asking that we reduce the estate taxes. I have supported the 70 percent tax and I voted for it. I am not asking for a reduction. I want it understood how we stand relative to the rest of the world on estate taxes.

Let me give you some of the numbers in Austria. The tax, if you leave it to your children or your spouse, is 2 to 15 percent. In Belgium, the tax is 3 to 17 percent. In Denmark, the tax is 2 to 32 percent. In France, the tax is 5 to 20 percent. In Germany, the tax is 3 to 35 percent. Only in Britain do we see it as high as ours, and there the tax can be as high as 75 percent.

So ours is 70 now. I really do not think that is a big loophole. I think that is a substantial tax. It is paid at the time of death. It is an escalating tax, a progressive tax. I frankly think that the idea of having to pay a double tax is outrageous.

The Chairman: Senator Nelson?

Senator Nelson: Mr. Chairman, first let me say that I think there are some changes in the law that ought to be made. I would agree with Mr. Lubick on that question, but I do think that it ought to be heard here.

The history of this is that the Small Business Committee, in conducting a whole series of hearings -- and Senator Dole is on the Committee, I think Bob probably was ---and explained the problems of small buisness. We hit the estate tax question. There was a $60,000 exemption.

I checked in my state. In my state, in 1940, I believe, when the $60,000 went in, 99.9 percent of all the farms in my state were worth $60,000 or less. Today the average farm, the same farm is worth $225,000. Nothing has changed. It is the same land. So we are paying heavier estate taxes.

I think it is a very important human instinct, and has been all through the history of mankind, to try to leave something for your children. Every tribe, even if it was just a tent and two horses. So the exemption was unfair.

We raised it to $175,000. When we made that proposal that came out of the Finance Committee, we had not addressed the question, the issue was not raised, about the carryover basis. There were no hearings on it, nothing.

We adopted the provision. It goes to the House and in conference, this provision was put in and it was horrendous. I went into several banks in my state. Every time I showed up the trust department wanted to see me, so they pull out their sheets, and you would have somebody with 120 stocks with quarterly dividends and you had to make these entries. I could not believe it.

A law school classmate of mine who practices in Wisconsin and has practiced there since 1942 said he was going to have to get out of the estate tax business. He did not have the computers and he said he could not manage the damn thing.

That went on for a long time, because it was an ill-handled composition. It was not carefully designed in the first place.

I might say Treasury opposed increasing the exemption at the time. I wanted to go to $200,000. We finally compromised at $175,000.

I just want to say I think we ought to go ahead and repeal it. We ought to have hearings. I am inclined to agree with Senator Packwood. I have discussed it with my staff. Pick a realistic figure of some kind, at $250,000, $300,000. That is not a huge estate. You ought to be covering the small businesses, the garages, the small farms and let the kids have them without being heavily taxed.

Then let's tackle the tax question, have a good hearing on it. This whole thing came about because it was done in conference and it should not have been.

Senator Wallop: Mr. Chairman?

The Chairman: Senator Wallop.

Senator Wallop: This whole thing brings up a matter that estate taxes are due to the country which appears to run totally contrary to what appears to be national policy to avoid urban sprawl and to revitalize the inner cities and the urban areas of the country.

What has happened because of the tax rates that Senator Bentsen is talking about, and the additional taxes that are contemplated by the Treasury Department in this area, is people are being forced to subdivide perfectly decent land they could otherwise stay on to satisfy the demands of the estate.

It just cannot be in the national interest as a policy to do that.

If we are going to have hearings, as Senator Byrd suggests on this thing, we really ought to take a look at what the tax structure is doing to the rest of national policy. In the interests of usurping the savings and collections of a lifetime of a family, we are creating circumstances in which subdividers are the prime beneficiaries. I think we really ought to look at that.

Senator Dole: May I just say one word? I think there may be some compromise after we repeal it, a fresh start rule somewhere. Get a fresh start next year on the problem.

The American Bankers Association -- I have not read it fully -- has put out a 65-page analysis of what the administration considers to be a reasonable, workable, simple and administerable bill. Their conclusion is, that is not a fact. We are talking about H.R. 4694 introduced on the House side.

I would underscore what has been said by everyone here, that there probably is need for some adjustment. The best way is to adopt the repeal with the Packwood-Nelson amendment attached and take a look at it.

The Chairman: Is there any further discussion? Let's call the roll.

Mr. Stern: Mr. Talmadge?

Senator Talmadge: Aye.

Mr. Stern: Mr. Ribicoff?

Senator Ribicoff: Aye.

Mr. Stern: Mr. Byrd?

Senator Byrd: Aye.

Mr. Stern: Mr. Nelson?

Senator Nelson: Aye.

Mr. Stern: Mr. Gravel?

Senator Byrd: Aye by proxy.

Mr. Stern: Senator Bentsen?

Senator Bentsen: Aye.

Mr. Stern: Mr. Matsunaga?

(No response)

Mr. Stern: Mr. Moynihan?

Senator Moynihan: Aye.

Mr. Stern: Mr. Baucus?

(No response)

Mr. Stern: Mr. Boren?

Senator Boren: Aye.

Mr. Stern: Mr. Bradley?

(No response)

Mr. Stern: Mr. Dole?

Senator Dole: Aye.

Mr. Stern: Mr. Packwood?

Senator Packwood: Aye.

Mr. Stern: Mr. Roth?

Senator Roth: Aye.

Mr. Stern: Mr. Danforth?

Senator Danforth: Aye.

Mr. Stern: Mr. Chafee?

Senator Chafee: Aye.

Mr. Stern: Mr. Heinz?

Senator Dole: Aye by proxy.

Mr. Stern: Mr. Wallop?

Senator Wallop: Aye.

Mr. Stern: Mr. Durenberger?

Senator Durenberger: Aye.

Mr. Stern: Mr. Chairman?

The Chairman: Aye.

The yeas are 17, the nays are 0. There are three absentees. The motion carries and let the absentees record themselves.

Senator Dole: Mr. Lubick votes no.

Senator Packwood: Mr. Chairman?

The Chairman: Yes, sir.

Senator Packwood: Are we back on the bill now?

The Chairman: We are.

Senator Packwood: I have a series of business tax credits. I do not know if the sheets have been passed out or if they are still around, dated September 20, 1979. I do not know. As I have indicated, day by day by day, the figures that I have are as good as anyone can get. You can see the per barrel savings on the righthand side, revenue loss.

Senator Nelson: What piece of paper is this?

Senator Packwood: Summary Analysis of S. 1760, dated September 20, 1979 and Mike passed them out from time to time, although I am not sure we have got them now.

Senator Nelson: I do not have any.

Senator Packwood: Here he comes.

I also indicated that I realize when I get to our reconciliation this Friday next, or whenever we get to it, that many of these credits may have to be dropped, some may have to be paired, effective dates changed. Some I hae stronger feelings about than others.

However, on all, I repeat again, on all of the business credits, you can see the savings, you can see the costs. They are all worthwhile, if those statistics are accurate.

Mr. Chairman, I do not know if you want to talk about them one at a time or adopt them and see what we do when we get to the reconciliation, or what. I will be happy to go through them one at a time.

Senator Nelson: Where does the Senator start? What are you talking about? Page 2?

Senator Packwood: Page 1, II, business cogeneration, the first item under it.

Those cogeneration figures, by the way, the middle column on the per barrel savings, I now have updates on that, substantial increases in the savings, $9,000 to $23,000. The figures should read $73,000, $187,000. The no estimate on mechanical cogeneration should read $97,000, $268,000.

No change in the revenue estimates.

Senator Chafee: Could you give them once again?

Senator Packwood: $9,000 and $23,000 should read $73,000, $187,000. The second one would be where there is no estimate. That should read $97,000 and $268,000.

The Chairman: In the short run, that would be another $1,320 billion out of the bill by way of these credits. In the long run, that is estimated to be $4.6 billion, $4.7 billion roughly.

What is the Treasury attitude about this matter?

Mr. Lubick: I beg your pardon, Senator?

The Chairman: What is the Treasury Department's position on these proposals?

Mr. Lubick: Some of these have already been adopted, Mr. Chairman, but, of course, generally speaking in each case, we believe that the rise in the world price of oil has made it economical for these processes to be used now and business in particular has been very conscious about the cost-effectiveness problem. We do not have the difficulty that you have that Senator Packwood talked about last week of the inability of the average homeowner to compute his payback and his economic viability of his investment over a period of time because businesses do that. They actually make these calculations and determine whether it is going to be worthwhile.

As far as businesses are going to be concerned, they are, indeed, turning to these alternative processes and to these ways of saving energy because they pay. They are economic. They are being done today and to provide additional tax credits for these is simply to give money where it is going to be spent anyway and to that extent we are using precious revenue that is needed for these other purposes.

Senator Packwood: Mr. Chairman, I will say it again. Those figures in the center column, rate of oil saved per day, those are the estimates of how much additional will be saved beyond what otherwise would be saved if we do not enact the credits.

When you say business will do it anyway, those statistics do not reach that conclusion.

Senator Ribicoff: If the Senator would yield, my feeling has been you have been conservative on what your estimated savings are. I know the Mellon Institute in a study indicated that by 1990 it would save a half-million barrels of oil a day and a study by the Dow Chemical Company for the National Science Foundation concludes cogeneration can save $750,000 barrels of oil a day by 1985.

I think that one of the intriguing factors is a comparison of cogeneration in this country and, let's say, Germany. In 1973, we were only cogenerating 5 percent of our electricity and 27 percent of all West Germany's electric power was produced by cogeneration through industrial firms.

So you have a situation where potentially the electric energy companies can be producing steam that they can sell and industry in producing steam can produce electricity.

Senator Packwood: Which they used to do.

Senator Ribicoff: Which they used to do and then fell away from.

Senator Packwood: Professor Stoebbel refers to as the North Slope. The cogeneration savings are the biggest of all the industrial potential.

Senator Wallop: Mr. Chairman?

I wonder, Senator Packwood, if you would be willing to accept an amendment to that which is in line, and in the spirit of it exactly, which would be essentially my S. 1659, cosponsored by Senators Bentsen, Talmadge, Moynihan and Danforth. It simply provides a transition rule to the provisions of the Energy Tax Act of 1978 whereby we provided a 10 percent investment credit for qualified energy projects. What has happened, the timeframe that was put in there was simply not possible for anybody to take advantage of it, and the transition rule would simply move it out to December 31, 1982.

Senator Packwood: I would accept that, as long as you understand that when we get to the reconciliation there may be some dates that have to be changed generally because of revenue loss.

Senator Wallop: I would say that I have a letter from

Mr. Shapiro that indicates that the '80, '81 revenue losses are less than $5 million, a little greater later on.

Senator Packwood: I will accept that amendment.

Senator Danforth: Mr. Chairman?

The Chairman: Yes, sir.

Senator Danforth: Yesterday, I do not know where these figures came from. I guess they came from the Joint Committee.

There were other estimates on revenue loss from these tax credits that were substantially different from the ones that are on these sheets. As I recall, here the residential total revenue loss, as I understand it, over this period of time, is only $3.5 billion, over a ten-year period of time.

Mr. Wetzler: The figures we are talking about on the residential are not only Senator Packwood's residential provisions that already have been agreed to but also Senator Chafee's amendments that also lost revenue.

Since we gave these original figures to Senator Packwood, they have re-estimated a number of these things. Senator Packwood's residential solar credit, insulation credit; Senator Chafee's adding heat pumps and oil and gas furnaces and woodburning stoves.

Senator Danforth: I want to find out how much total revenue loss we have so far in the tax credits that we already have agreed to, and then the second question is, how much additional revenue loss is there in these tax credits.

Mr. Wetzler: I can give you the up-to-date revenue loss. This is for fiscal years --

Senator Danforth: I would like it as total, over the whole period of time.

Mr. Wetzler: Over the fiscal years 1980 through 1990 the total is $56 billion. That will be a little bit higher if you look at calendar '80 through '90.

Senator Danforth: A ten-year period of time. That is $56 billion on the residential. Correct.

Mr. Wetzler: And what the Committee has done today.

Senator Danforth: How about these additional credits we are talking about here?

Mr. Wetzler: I do not have those figures with me. They are back at the office. We can check on that.

Senator Danforth: Can you recollect roughly?

Mr. Wetzler: I think Senator Packwood's business credits built up to $6.5 billion by 1990.

Senator Packwood: The business, $4.6 billion.

Senator Danforth: The sheet I saw had $56 billion residential and an additional $37 or so billion.

Senator Packwood: Residential.

Senator Danforth: No.

Mr. Wetzler: We will call over to the office and try to get that figure for you, Senator.

Senator Dole: Does that include the Danforth umbrella?

Senator Danforth: That was another $14 billion or $24 billion or something like that.

Mr. Wetzler: The $56 billion includes your $3 credit. That accounts for $13 billion of the $56 billion.

Senator Dole: Everything we have done to date is only $56 billion.

Senator Packwood: Does that count in adding that because that $3 a barrel is an offset? Are you grossing that, or netting that?

Mr. Wetzler: Senator Packwood, your business credits have not yet been agreed to, so they are not in the $56 billion. Your bill provides, in order to get your additional business credits, you have to forego Senator Danforth's and Senator Talmadge's $3. The overlap there is relatively small. The only area where we think there is a significant overlap would be on the wood.

There, you would be providing a 40 percent additional business credit and Senator Danforth provides $3. That overlap would not reduce your figure all that much.

Senator Packwood: That overlaps from hydromass, does it not?

Mr. Wetzler: Not that much revenue loss in that area.

In the hydro, Senator Danforth's hydro is not all that big, it does not have all that much effect.

The Chairman: Mr. Lubick?

Mr. Lubick: Senator Danforth, we have the revenue from '79 through '90 on production credits. It shows a gross of $14 billion on the residential, a gross of $54 billion. The credits interact so we have, after interaction on the residential credits, about $47 billion for that period. Add $47 and $14 and you come to about $61 billion for calendar year basis in '79 through '90.

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The Chairman. Mr. Danforth.

Senator Danforth. How about this addition? How about what we are talking about here?

The Chairman. Mr. Wetzler.

Mr. Wetzler. Yes, sir.

Our problem, Senator, is that we expected the windfall profits tax. We are sort of all loaded up with windfall profits tax estimates but do not have the business credit stuff with us.

Senator Danforth. I was just wondering if anybody had had it. I think it is clear that eventually we are going to have to make a choice between the Energy Security Trust Fund or Corporation and the credit idea that there is no way that it is possible to have both unless we have a substantial increase revenue from some source other than the whittled down windfall tax which we are not whittling down.

Senator Packwood. Today we took a vote and whittled it up.

Senator Danforth. We whittled it up with just a tiny sliver. When you are talking about $60 billion plus in credit versus the Energy Security there is no way you can have it both ways. I am talking about my own credits as well as Senator Packwood's.

I think we are just going to have to take a look at it.

It is an either/or situation. It is like the man who has got two suits in his closet. He wakes up in the morning and he has got to get dressed and put on one of them. They might both be good looking suits. If he puts on both of them at the same time it gives a somewhat bulky appearance. I think that we have got the same sort of situation here. We have got a somewhat bulky legislative proposal.

Senator Packwood. That is where we are going to come down this Friday or next week when we decide how much revenue we are going to try to raise the windfall profits tax.

The Chairman. What bothers me about it is that if you put it in, I think you have you got to squeeze it back out when you come down to the reconciliation process because you have already voted on the ones that you think are your best cases. And when we have to start squeezing down, you are going to have to squeeze this back out. It looks to me, most of it. So you better keep up for a big letdown, I am afraid.

But thinking you are going to get all of this, and then when you start squeezing down it gets squeezed back out again.

Senator Danforth. Mr. Chairman, just to try to simplify the question, it seems to me that the basic issue that we are going to come down to is whether or not we want to use money either in setting up an Energy Security Corporation essentially for new technology or for pilot projects or exotic forms of energy, or in the alternative whether we want to go the tax

3 credit route for basically conservation and production that people now pretty well know about. And that is essentially the issue that we are coming into.

Senator Danforth. I do not know whether that is a misstatement or the issue of not.

Senator Packwood. I do not agree with his phrasing of the issue. And I do not think it is an either/or between the Energy Security Corporation and the credit. I am perfectly aware they are going to be phased down.

I have got some preferences where I would rather keep some at 50 percent and drop others instead of putting them all down to 25 percent.

But when you are talking about solar and wind and geothermal and biomass and gasohol, you are not talking about things that the bulk of business, let alone homeowners are doing now. And if these figures are right they are not going to do them unless they have a significant incentive. Now that is all I can say.

Senator Ribicoff. If the Senator would yield. Senator Danforth may be entirely correct, but there is an alternative. What you are getting involved in is using up through the decline of the windfall profits tax proceeds and the expenditure through tax credits, other alternative sources of taxation to make this work in the energy field.

I wonder what Mr. Shapiro could tell us would be brought in if we levied a straight tax of 25 cents a barrel on all oil

4 produced or imported. What would that bring in?

Mr. Shapiro. The revenue that is on each 25 cents is roughly $1.5 billion a year.

Senator Ribicoff. It is $1.5 billion?

Senator Packwood. That is at two bits a barrel.

Senator Dole. On imports and domestic oil.

Mr. Shapiro. On all oil produced.

Senator Ribicoff. You are talking about total oil produced in the United States and imported in the Unites States.

Senator Chafee. At 18 million barrels a day divided by 4, that is 25 cents. That is per day.

Mr. Wetzler. That is 6 billion barrels a year, so 25 cents tax is about 1 billion and a half.

Senator Ribicoff. In other words, we might be forced to look at that. It depends again on what are the objectives? It is apparent that this committee is tearing the President's program to tatters. And maybe that is where it should be. I do not know. But if we are doing that, I think we have got the obligation to come up with an alternate program.

I think that is what we seem to be inching towards here. So it is a question of acting responsibly. Where do we go to try to save an energy program for the country?

Senator Bradley. Mr. Chairman, I think that the committee should also consider the other purposes to which the windfall profits monies are to be put. I happen to think energy is one of our central priorities as well. There should at least be a discussion, I think, in the committee as to how much would this committee like to see spent on mass transit or rebates to the poor. And I think that in our consideration of the tax credit for alternate energy, which I strongly support, we have not yet had that discussion. And therefore again we are at a point where we have not seen what the total might be that we would like to spend when we consider a tax credit and rebates to the poor and mass transit.

And I would hope that we would have that discussion as well so we could begin to set the final revenue goal.

The Chairman. Why do we not vote on this matter? If it is agreed to it is going to have to be sent into reconciliation process anyway.

Those in favor, say "Aye."

(A chorus of Ayes.)

The Chairman. Those opposed, say, "No."

(No response.)

The Chairman. The Ayes have it. We will agree to it subject to the reconciliation process later on.

Senator Chafee. I think your recommendation is pretty wise. People better not run out in anticipation of this all remaining in the bill.

The Chairman. I think we better not make the expenditure just yet. They better wait and see how the final wrap-up comes

6 out.

Senator Dole. I also think Senator Ribicoff put forth interesting ideas that one, we may have to consider if we are going to follow through.

The Chairman. I would like for us to consider the incremental and tertiary oil . We might talk about it some and maybe vote on it when we come back in here tomorrow. But I think that is one issue that should be considered.

It cannot be disposed of today but it is definitely an item that we are going to have to vote on here. I think that we ought to consider it. We should at least talk about it.

My understanding is that the President came up with his estimate, his recommendation that we exempt this heavy oil. Basically what he is doing when he does that is to recommend that you exempt the tertiary recovery. High cost oil is tertiary. You are going to have to heat in order to get it out.

Now what is the difference between that and the other tertiary recovery, Mr. Lubick?

Mr. Lubick. We have already exempted that.

The Chairman. We voted. We went along with you on that. Maybe we ought to reconsider it. But what is the difference between that heavy oil and the other tertiary recovery? Does it not present the same problem that it is high cost energy that requires a lot more than just drilling a well?

You have got tertiary recovery which means you have not only got to pump water down but you detergents down there and try to wash the oil out of the hole. It is high cost oil. Why do you think we ought to exclude the heavy oil and not the other oil that can be recurred by tertiary methods?

Mr. Smith. I think the principal basis part is the fact that the heavy oil typically involves the recovery process that we have a pretty good handle on the costs of. We believe that the exemption will have a very substantial and desired impact on a known technology. In the case of incremental tertiary oil, generally, however, I think that the future certainly is substantial. But there is still a great deal of uncertainty on the marginal technologies in terms of their costs and their availability.

As a consequence, we have much greater confidence in being able to recover substantial incremental amounts of additional amounts of oil by exempting the heavy oil. We have much more confidence than we do with respect to the impact of an exemption of all tertiary projects. Because once you get beyond the heavy oil category it is much more technology dependent. It is much more certain therefore.

It is possible, of course, that a higher price would spur the development of the technology to such a degree that there would be substantial supply response. But we do not have the capability at this juncture of making any prediction or assessment of that with respect to incremental tertiary, generally. So that we believe that there is a distinction. It can be drawn.

8 Senator Danforth. Mr. Chairman, this really is a case where the revenue loss is directly related to new production, is it not?

Mr. Smith. No, because there is a substantial base of tertiary production that we predict will come on with the tax.

Senator Danforth. Do you think it will be done anyhow?

Mr. Smith. We believe that the technologies that are known and useable at the present time will enable a substantial amount of incremental tertiary under the basic program to be brought on. If you exempted all, then obviously you do have a very substantial base case that is receiving windfall, if you will.

The Chairman. Here is the way that I understand this particular problem. You drill down in to structure. Then when you are down in it, about one third of that oil comes out easy. It either comes out under pressure or you pump it out.

When you cannot pump it anymore, what they usually go forth with is what they call secondary recovery. That is the point that they take some of the wells that are out in the planks and they pump water into it. And they have to pump how many barrels? They have got to pump more than one barrel down into it to push one barrel of oil out of there.

Mr. Smith. I would say up to nine barrels.

The Chairman. About nine barrels of oil. Is it nine barrels? They try to push one barrel out to try to displace one

9 barrel of oil and push that over to the hole. That is what you call secondary recovery. You are pumping water down there.

In most instances the difference between secondary and tertiary recovery is that in tertiary recovery you put the detergents down there. It really is the same difference as if you took a pair of dirty, old overalls that was saturated with oil and you tried to wash some of it out with water. And you would get some of the oil out. If you put detergents in there you could wash a lot more oil out of those dungarees than you can if you tried to with water.

The estimates are that when you deplete the average field, the average old, depleted oil field, you have got two thirds of oil spilled down there. Now you can get to some of it by secondary recovery, but you are not going to get near as much of it that way as you do if you use detergents to wash it out with. That is expensive, that is very expensive oil to get that way. But the estimate is that you could probably get half of that which is still left down there by using detergents and tertiary.

It seems to me that if you do not do it now, somebody is going to have to do it in the future. Somebody is going to have to make it profitable for people to engage in tertiary recovery. Otherwise, they are just going to leave a huge amount down there to recovery.

In other words, the average depleted field in this country

10 has as much oil that can be recovered by tertiary methods down there as has been produced from it. Is that not right?

Mr. Smith. At least, yes, in theory. But the technology for that high level of the reserve is still present near detergent. I do not think we will do it in most settings. And the tertiary projects have to be carefully tailored to the precise field. It is a long-term process. They are now moving toward **the** CO_2 and polymer type injections to try to enhance the recovery. But the application of the technology is still -- the technology to recover that additional 30 percent is still, I think, a long way from being in hand.

In the case of the heavy oil it is basically a heating process that we do. **The** technology is available. It is simply a question of applying cost to it.

In the case of incremental tertiary it is a question of applying both price cost and the development of the technology that is not yet at hand.

Senator Bentsen. Mr. Chairman, I assume we will not be voting on this until tomorrow. If you want a better attendance for this, I have an amendment that I will be proposing when we can get a quorum here. But I certainly concur with you.

I think you have explained in in very basic terms. But tertiary, of course, is after you get all of the oil pumped out under the process. And even after you have done all of your water flooding, it is oil that you get beyond that. It is the

11 outer limits of the technology. It is trying to figure out the appropriate makes of chemicals to go into the old Bradford field up on the Pennsylvania-New York border or it paying for the cost of finding CO_2 in its natural state in Colorado and transporting it hundreds of miles to New Mexico, Texas and other states to try to put it back down in the ground and to cleanse those formations of the additional oil that would not be found.

The figures that we were talking about is the present reserves being in this country in the area of recoverable reserves, 30 billion barrels. But we are talking here an additional -- and I am talking about not the industry's figures, I am talking about what the Department of Energy testified, as I recall. It was 25 to 45 billion barrels more of oil that could be recovered.

I said 25 to 45 billion, I am not talking about millions, more of oil that could be recovered by tertiary processes. And we are talking about investments in one particular location of hundreds of millions of dollars. And we are talking speculative investments. Because many of these processes have not really been fully proven yet.

We are talking about very major investments that have to be made. So that means that we really have to have the incentive there. In addition to that you must have the certainty insofar as the regulatory agencies. The fact that this process has been approved and this is considered

12 a tertiary recovery, reasonable process to be pursuing. And therefore that they are going to be able to look to a particular price. And I think it is terribly important that we have full incentives there to bring it about.

We have all of this testimony and the agreement that it is cheaper in general to bring on the new barrel of oil than it is to bring on the new barrel of synthetic oil. I hope that we do some things here to try to assist in really encouraging tertiary recovery. I am not talking about a great deal beyond what the House did, but a better definition of what constitutes the process, and then, I think, some additional incentive, too.

But I will be proposing that tomorrow, if I might.

Senator Boren. Mr. Chairman, I am going to be offering this with Sentor Bentsen, supporting his effort very strongly. And I recall the last day that the former Secretary Schlesinger testified before this committee. We had a discussion of tertiary production.

I recall then that the figures were given. I remember the Office of Technology Assessment has talked in terms of **of this** and earlier the Department of Energy's testimony itself, 2 million barrels a day production by 1990, and with the kind of additional reserves that we know we have down there we could produce that amount for 50 years roughly. Is that right.

We have already paid many of the environmental costs. We

13 know right where that oil is. It is the largest untapped reserve that we have. So I am very, very hopeful that we will do all that we can to encourage this production in support of Senator Bentsen's effort.

The Chairman. The thing that is sort of amusing to some of us is that the President thought enough of it that he went on television and told the American people he had found how you are going to get a lot of oil, exempt this heavy oil. You have to heat that stuff down there to get it out.

It is exactly the same principle involved in the tertiary recovery. It is expensive oil. Now there is another method we have not discussed but I guess I ought to mention that it is a technique they call fire flooding. That is something that maybe the Senator from Oklahoma understands better than I do.

I am not very familiar with it. Can somebody here explain that technique to us? How does fire flooding work?

Mr. Smith. Well basically it involves pumping oxygen into the reservoir and lighting a fire down there and heating and forcing it toward the center. It is something I guess you would call an enhanced water flood. It is something along that line. But it is a technique that is being used to a degree in California and some other states on the very heavy oils.

The Chairman. They have used some in Louisianna.

I know that apparently it is one more way, but again it is an expensive way. It is not cheap. But there is a great

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amount of oil down there that can be recovered. In other words, using tertiary technques you get twice as much oil out of the ground, or put it this way, assuming you did not find another field anywhere in America, for every barrel you produce you could produce another barrel if you use the tertiary technique.

Senator Boren. We are talking about the huge reserve being found is about the same size as all of theirs put together still here in the United States to recover.

The Chairman. We cannot go into depth today because we would like a quorum. So we will come back and resume consideration of the bill tomorrow at 10:00 a.m.

(Whereupon, at 12:25 p.m., the hearing in the above-entitled matter was recessed, to reconvene at 10:00 a.m. on Thursday, September 27, 1979.)

end bdm
3:55