# INCENTIVES FOR DOMESTIC OIL AND GAS PRODUCTION AND STATUS OF THE INDUSTRY

## HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

FEBRUARY 25, 1999

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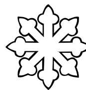

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# INCENTIVES FOR DOMESTIC OIL AND GAS PRODUCTION AND STATUS OF THE INDUSTRY

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**THURSDAY, FEBRUARY 25, 1999**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 9:05 a.m., in room 1100, Longworth House Office Building, Hon. Amo Houghton (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

# *ADVISORY*

FROM THE COMMITTEE ON WAYS AND MEANS

## SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE CONTACT: (202) 225–7601
February 17, 1999
No. OV–2

# Houghton Announces Hearing on Incentives for Domestic Oil and Gas Production and Status of the Industry

Congressman Amo Houghton (R–NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on current law incentives for domestic production of oil and gas, and the status of that industry in light of current economic conditions. The hearing will take place on Thursday, February 25, 1999, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:00 a.m.

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Invited witnesses include officials from the U.S. Department of the Treasury and the U.S. Department of Energy, economists with insights on the industry, and independent producers from across the country. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

**BACKGROUND:**

Current tax law provides several incentives for the domestic production of oil and gas including: (1) expensing of exploration and development costs, (2) a deduction for excess of percentage over cost depletion, and (3) a tax credit for enhanced oil recovery costs.

Over the past year, crude oil prices have fallen from about $20 per barrel to less than $10. According to independent, domestic producers, the cost for them to produce each barrel has remained constant in the mid-teens. As a result, producers must consider whether to cap marginal wells. Because of the difficulties inherent in reopening capped wells at a later time, many are concerned about the potential for worsening domestic economic impacts and increasing U.S. dependency on foreign supplies of oil and gas.

In announcing the hearing, Chairman Houghton stated: "It appears that current tax incentives may be ill-suited to stem the current problems faced by the domestic oil and gas industry, especially small, independent producers. I am concerned about the hardships they are facing in light of falling prices over the past year. The time is ripe to review our laws to ensure that they are adequate to meet the needs of an important national industry."

**FOCUS OF THE HEARING:**

The hearing will focus on how current law affects the domestic production of oil and gas, the status of the industry in light of current economic conditions, the long-term ramifications for the economy and national security, and possible policy options.

**DETAILS FOR SUBMISSION OF WRITTEN COMMENTS**

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the close of business, Thursday, March 11, 1999, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, by close of business the day before the hearing.

**FORMATTING REQUIREMENTS:**

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at "http://www.house.gov/ways__means/".

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

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Chairman HOUGHTON. Good morning, ladies and gentleman. Great to have you here at this hearing on domestic oil and gas production.

It is no secret that domestic oil and gas industries is in the midst of a severe downturn. Oil prices are down 55 percent over the last 15 months. It is not clear when they will rebound.

The good news is that this means lower gas prices at the pump. The bad news is it also could put small producers in many regions of the country out of business. One estimate is that more than 42,000 jobs have already been lost in the United States, including 12,000 last month alone.

The Members of this Subcommittee will be joining the Trade Subcommittee this afternoon to discuss the crisis affecting the steel industry. I am sure everyone has heard about this. The problems in the domestic oil and gas industry have not garnered the same media attention, but you don't have to be a three-story mind to see parallels that will come out in today's hearings.

We will focus this morning on the state of the industry, both short and long term, and also on the tax laws which affect the industry. Many domestic producers are small businesses. They risk shutting down their companies if the downturn is severe and prolonged.

The members of the first panel can explain the problems that these businesses face with statistics and predictions. And the members of the second panel can help us understand their problems in real terms.

Now, in the past, Congress has passed tax laws to encourage the domestic production of oil and gas. But it is now time to examine whether these laws are adequate to support the U.S. industry in light of the current circumstances. We will also examine some possible solutions proposed by Members of this Subcommittee.

I would like to yield to our Ranking Democrat, Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Today's Subcommittee on Oversight will review issues of concern to the domestic oil and gas industry. Specifically, the Subcommittee will review: One, the current tax laws' effects on domestic oil and gas production; two, the state of the industry in light of the current economic conditions; three, the long-term ramifications of a downturn in the industry, on the economy, and on national security, as well; and, number four, and possible policy options.

My colleague on the Oversight Subcommittee, Congressman Watkins, has urged that we conduct oversight review of issues facing the domestic oil and gas industry, and I support that effort. Similarly, I appreciate receiving the support of Oversight Subcommittee Chairman Houghton and the Members of the Subcommittee for my request to conduct oversight review of similar issues facing the steel industry and its workers on a priority and expedited basis today.

As a result, the Subcommittee's official agenda for the 106th Congress highlights the Oversight and Trade Subcommittees' extensive interest in reviewing the steel crisis, and a hearing on the steel crisis will be this afternoon, as we all know.

I would hope that the entire Oversight Subcommittee will join the Trade Subcommittee Members and participate in this session here today and this afternoon. I am pleased that the Department of Treasury is represented here today, and I welcome Don Lubick as the Assistant Secretary for Tax Policy. I will be interested in learning whether Treasury believes the Tax Code needs to be changed to improve the financial health of the domestic oil and gas industry. I will also be interested to learn what tax relief the ad-

ministration would recommend for the American steel workers who have been laid off as a result of the recent surge in steel imports. I also look forward to hearing what our other witnesses have to say about these very important, national industries.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you, Mr. Coyne.

Would Mr. Watkins like to make an opening statement?

Mr. WATKINS. Mr. Chairman, I definitely would and would say a big thank you to you and Mr. Coyne in working and agreeing to have these particular hearings. They are very much needed. And let me say to a lot of our friends, there are a lot of things on the agenda—it is very difficult getting different topics their needed hearings, and we are making a lot of people aware of what is going on out there.

We are in a crisis in the oil patch. As someone said, Mr. Chairman, "We are hemorrhaging." Mr. Chairman, it is worse than hemorrhaging. We literally have an artery that has been cut, and we are gushing, and we are going to lose, if I may make a point, over 50 percent of our marginal wells will be gone between now and Independence Day if we don't turn this thing around, and we will become more dependent on Independence Day on foreign oil than ever before in the history of our country.

So, we have a crisis there. I want to say, again, thank you to the first panel. I look forward to hearing from you and also a lot of the folks that I know on the second panel. I just want to say, welcome, and we are glad this day has finally arrived. Maybe we don't have awareness, but we can create some solutions.

Thank you.

[The opening statements follow:]

**Opening Statement of Wes Watkins, a Representative in Congress from the State of Oklahoma**

Mr. Chairman, first I would like to commend you for holding this very time sensitive important hearing on the state of the domestic oil and gas industry. As you are very aware our domestic industry is in turmoil and we are losing our valuable domestic production because of the continued low prices.

Adjusted for inflation, world prices are at levels not seen since 1933. This price slide threatens 1.3 million barrels of daily production—equivalent to the amount of oil the United States imports from Saudi Arabia daily. Losing our domestic production will increase the nation's dependency on already record high levels of oil imports. The domestic oil industry cannot sustain itself if these prices continue. In January and February 19,000 jobs have been lost in the industry and since October of 1997 52,300 have been lost according to the Bureau of Labor Statistics. What we are talking about is not only the thousands and thousands of jobs that are at stake or the thousands and thousands of jobs that have all ready been lost, but our National Security.

The impacts to this situation could become irreversible if Congress does not take action expeditiously. I have introduced H.R. 53, the Marginal Well Tax Credit Bill, which is not the sole answer to this question, but should assist in keeping our marginal wells from being plugged. In Assistant Secretary Lubick's testimony, he states that my legislation would not benefit marginal well owners, because they were not paying taxes. I would like to know where he got this misinformation, because every independent producer that testified at the hearing stated that H.R. 53 would help them. I trust the producers keeps up with the taxes they pay and are aware if these credit are of benefit to them. H.R. 53 would provide a tax credit up to $3 dollars a barrel for oil and $.50 per 1000 cubic feet of natural gas when prices drop to $14 for oil and $1.56 for natural gas. The credit is phased out when oil hits $17 and gas hits $1.89. It allows the producer to take the credit on the first 3 barrels of production a day, not to exceed 1095 barrels per year or barrel equivalents. One barrel of oil equals 6,000 cubic feet of natural gas. The credit can be used on regular and

minimum tax, and there is a 10 year carryback provision to be used on past tax liability, and a 30 year carryover. Mr. Chairman, I understand that this legislation is not a miracle cure to our ailing domestic industry, but it will prevent many of our marginal wells from being plugged.

As the U.S. continues to import over 50 percent of its oil consumption, we are enjoying a very robust economy, nationally. However, the oil patch is the one paying the price. Soon the entire country will be paying the long term price for the U.S. not having strong energy policy. I assume the only energy policy that the Department of Energy has come up with is support for Iraqi production and destruction of the United States domestic production. This is a death wish for our economy. It is time that the Congress act to rectify this situation and hold the Administration responsible for its lack of attention to this crisis. It is time that Congress and this great Nation we represent, start asking ourselves some very tough questions. Are we going to continue to let our domestic industry become extinct and risk our national security? Are we going to continue to turn a blind eye at this problem and become solely dependent on OPEC? My answer is no! I am willing to work until this problem is solved, and I invite my colleagues to join me. Mr Chairman, again I want to thank you for holding this hearing and look forward to the dialog and state of the industry it has produced.

---

**Opening Statement of Bill Thomas, a Representative in Congress from the State of California**

Mr. Chairman, I thank you for the chance to share my concerns about the California oil industry and my constituents in California's 21st District which includes Kern County, one of the largest oil producing counties in the U.S. As you know, the Clinton Administration recently announced tax relief for the American steel industry because steel producers are suffering from huge levels of imported steel, resulting in the recent loss of 10,000 steel jobs. However, the oil industry has lost jobs nationally in the last year and more are expected. These workers from a vital U.S. industry have been hit hard by increases in imports and also need our help.

Earlier this month you heard me ask Secretary of the Treasury Rubin about this glaring discrepancy in the Administration's policy. Mr. Rubin vaguely mentioned the need for a "dynamic economy" to "embrace change." In short, this Administration has paid no attention to America's energy needs and is doing nothing to help the thousands of people out of work from that industry. This Congress should not be so short-sighted. Our "dynamic economy" needs energy every bit as much as steel to keep it running.

Before I address solutions, let me provide some background on this crisis. California's oil and gas industry provides $10 billion to the California economy. We have been especially hard hit by the collapse of crude oil prices in recent years. Since most of California's onshore oil is heavy (i.e., viscous) compared to other oil on the market, it costs more to produce and refine and thus sells for less in the marketplace. So, last month when Texas crude oil sold for a very low $13.50 per barrel, oil from Kern County sold for $7.00 per barrel. The result: large scale lay-offs and shutting-in of wells. Nationally, almost 49,000 wells were idled or shut-in during the first half of 1998.

There are long-term consequences from allowing this trend to continue. One can not simply "turn off the key"of a heavy crude oil well and wait until prices rise. Such fields require a huge amount of time and money to heat the field with steam. For example, four major California fields required over $5 billion in the past 30 years to keep these fields operational. Closing wells can take them out of production for years; yet, this is precisely what many oil producers are doing.

Consequently, we risk becoming even more dependent upon foreign oil imports every year. Since 1990, as U.S. production sagged by over 4 million barrels per day, world production increased by 5 million barrels per day due largely to OPEC countries increases. Those of us who remember being at the mercy of such foreign producers—the gas lines, the high heating bills, and the recession resulting in part from inflated energy costs—should better appreciate the need to protect our domestic oil supply. Low energy costs are contributing to our current low inflation and strong economic environment, but history repeats itself and I fear Congress will remember the oil shocks of the 1970s too late.

We need stability so low oil prices caused by the Asian economic slowdown and cheap oil imports do not cost America resources in the long run and leave us vulnerable to oil shocks in the future. I encourage the Committee to consider two pieces of legislation to aid this industry. H.R. 423 is a bill I introduced to allow a 5-year

net operating "carry-back" for losses attributable to operating mineral interest of oil and gas producers. Oil producers could reduce their taxes by using net operating losses during the past five years. This is similar to the relief being offered to the steel industry. H.R. 53 is a bill sponsored by our colleague Wes Watkins to allow a tax credit of up to $3 per barrel of oil produced from marginal wells during low price periods. Passage of these bills will be a good first start in helping oil workers get through these tough times while also helping ensure domestic energy supplies for America.

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Chairman HOUGHTON. Thank you very much.

Well, I would like to introduce Mr. Lucas of Oklahoma, Mr. McCrery, and Mr. Stenholm of Texas.

I would like to call the first witness, Hon. Don Lubick, the Assistant Secretary at the U.S. Department of Treasury.

Thank you very much for being here.

**STATEMENT OF HON. DONALD C. LUBICK, ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF TREASURY**

Mr. LUBICK. Thank you, Mr. Chairman and Members of the Subcommittee.

I am pleased to be here today to discuss current tax incentives for the domestic production of oil and gas. We have long recognized the importance of maintaining a strong, domestic energy industry, and, to that end, the Internal Revenue Code includes a variety of measures to stimulate domestic exploration and production.

The tax incentives contained in present law address the drop in domestic exploratory drilling that has occurred since the midfifties, and the continuing loss of production from mature fields and marginal properties. The current tax incentives are generally justified on the ground that they reduce vulnerability to oil supply disruption by stimulating increased production reserves and exploration.

Oil, of course, is an internationally traded commodity with its domestic price set by world supply and demand. Domestic exploration and production activity is effected by the world price of crude oil. Historically, world oil prices have fluctuated substantially. From 1970 to the early eighties, we saw a fivefold increase in real oil prices. World oil prices became relatively more stable from 1986 through 1997, but recently, as you have pointed out, they have declined to historic lows. And last year, about $13.50 at the refiner, their lowest level in 25 years in real terms.

Despite increasing oil prices in the seventies and early eighties, domestic oil production declined during that period, and it has continued its downward trend during the more recent period of relatively stable, but generally declining, prices.

From the late seventies to the mideighties, oil consumption in the United States declined, but in the last decade, oil consumption has risen by 12 percent. The decline in oil production and the increase in consumption have led to an increase in oil imports. Net crude oil imports have risen from approximately 38 percent of consumption in 1988 to 58 percent in 1998.

The fall in crude oil prices over the past year has focused attention on the economic condition of the oil and gas industry and its potential for increasing U.S. dependence on foreign oil and gas sup-

plies. The concern raised by the Chairman, in announcing this hearing, is that current tax incentives may be ill suited or inadequate to address the problems of the domestic oil and gas industry, particularly in the case of small, independent producers.

My prepared statement, which I assume will be presented for the record, outlines in detail those tax incentives for oil and gas production, but let me refer to them briefly.

Preferential tax treatment is an important source of assistance provided by the Federal Government to the domestic oil and gas industry. Incentives for oil and gas production in the form of tax expenditures are estimated to total $7 billion for fiscal years 2000 through 2004. Approximately half of these expenditures, or $3.5 billion, are for the nonconventional fuels-production credit. The statement states in detail the terms of that.

The next largest expenditure is $1.9 billion for the enhanced oil recovery credit. The allowance of percentage depletion for independent producers and royalty owners, including increased percentage depletion for marginal wells, results in a tax expenditure of $1.4 billion.

Oil and gas producers are also allowed to expense their intangible drilling and development costs, or IDCs. And in the case of independent producers, a 100-percent deduction is allowed.

In addition, working interests in oil and gas properties are largely exempt from the passive-loss limitations, a tax expenditure of $190 million, and they have largely been eliminated from the alternative minimum tax.

To give you some idea of the magnitude of tax preferences for this industry, Mr. Chairman, for the year 1996, when oil prices were $18.46 per barrel, 75 percent of corporate firms engaged in oil and gas production paid no Federal corporate income tax at all. Thus, it appears unlikely that tax incentives will significantly address the problems of this industry when the problem is historically low prices.

With that introduction, Mr. Chairman, I would be pleased to respond to questions that you or other Members have.

[The prepared statement follows:]

**Statement of Hon. Donald C. Lubick, Assistant Secretary for Tax Policy, U.S. Department of Treasury**

Mr. Chairman and Members of the Subcommittee:

I am pleased to discuss the current tax incentives for the domestic production of oil and gas.

The importance of maintaining a strong domestic energy industry has been long recognized and the Internal Revenue Code includes a variety of measures to stimulate domestic exploration and production. The tax incentives contained in present law address the drop in domestic exploratory drilling that has occurred since the mid-1950s and the continuing loss of production from mature fields and marginal properties.

The current tax incentives for oil and gas are intended to encourage exploration and production. They are generally justified on the ground that they reduce vulnerability to an oil supply disruption through increases in production, reserves, and exploration and production capacity. U.S. vulnerability to oil supply disruptions also has been reduced by the growth of oil production outside the Middle East, the establishment of the Strategic Petroleum Reserve, and measures that promote energy conservation and alternative energy sources.

Before I turn to my discussion of the present tax treatment of oil and gas activities, I would like to provide a brief overview of this sector.

## Overview

Oil is an internationally traded commodity with its domestic price set by world supply and demand. Domestic exploration and production activity is affected by the world price of crude oil. Historically, world oil prices have fluctuated substantially. From 1970 to the early 1980s, there was a fivefold increase in real oil prices. World oil prices were relatively more stable from 1986 through 1997. During that period, average refiner acquisition prices ranged from $14.76 to $23.25 in real 1992 dollars. In the last year, however, oil prices declined to about $13.50 at the refiner, their lowest level in 25 years in real terms, and they are somewhat lower today.

Despite increasing oil prices in the 1970s and early 1980s, domestic oil production declined during that period, and has continued its downward trend during the more recent period of relatively stable, but generally declining, prices. From the late 1970s to the mid 1980s oil consumption in the United States declined, but in the last decade oil consumption has risen by 12 percent. The decline in oil production and increase in consumption have led to an increase in oil imports. Net crude oil imports have risen from approximately 38 percent of consumption in 1988 to 58 percent in 1998.

The fall in crude oil prices over the past year has focused attention on the economic condition of the oil and gas industry and its potential for increasing U.S. dependence on foreign oil supplies. The concern raised by the Chairman in announcing this hearing is that current tax incentives may be ill-suited to address the problems of the domestic oil and gas industry, particularly in the case of small, independent producers. In reviewing possible policy options to relieve the hardships confronting the oil and gas industry as a result of falling oil prices, the Subcommittee should consider whether additional Federal tax subsidies for the oil and gas industry can adequately address this situation or whether other measures would be more cost effective.

I would now like to discuss the tax incentives for oil and gas in more detail.

## Tax expenditures

Preferential tax treatment is an important source of assistance provided by the Federal government to the domestic oil and gas industry. Incentives for oil and gas production in the form of tax expenditures are estimated to total $7.0 billion for fiscal years 2000 through 2004.[1] They include the nonconventional fuels (i.e., oil produced from shale and tar sands, gas produced from geopressured brine, Devonian shale, coal seams, tight formations, or biomass, and synthetic fuel produced from coal) production credit ($3.5 billion), the enhanced oil recovery credit ($1.9 billion), the allowance of percentage depletion for independent producers and royalty owners, including increased percentage depletion for stripper wells ($1.4 billion), the exception from the passive loss limitation for working interests in oil and gas properties ($190 million), and the expensing of intangible drilling and development costs ($40 million). In addition to those tax expenditures, oil and gas activities have largely been eliminated from the alternative minimum tax. These provisions are described in detail below.

## Present law tax incentives for domestic oil and gas production

### *A. Percentage Depletion*

Certain costs incurred prior to drilling an oil-or gas-producing property are recovered through the depletion deduction. These include costs of acquiring the lease or other interest in the property, and geological and geophysical costs (in advance of actual drilling). Any taxpayer having an economic interest in a producing property may use the cost depletion method. Under this method, the basis recovery for a taxable year is proportional to the exhaustion of the property during the year. The cost depletion method does not permit cost recovery deductions that exceed the taxpayer's basis in the property or that are allowable on an accelerated basis. Thus, the deduction for cost depletion is not generally viewed as a tax incentive.

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[1] *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2000. U.S. Government Printing Office,* Washington, DC, 1999, p. 117. These estimates are measured on an "outlay equivalent" basis. They show the amount of outlay that would be required to provide the taxpayer the same after-tax income as would be received through the tax preference. This outlay equivalent measure allows a comparison of the cost of the tax expenditure with that of a direct Federal outlay.

### INDEPENDENT PRODUCERS

Independent producers and royalty owners (as contrasted to integrated oil companies)[2] may qualify for percentage depletion. A qualifying taxpayer determines the depletion deduction for each oil or gas property under both the percentage depletion method and the cost depletion method and deducts the larger of the two amounts. Under the percentage depletion method, generally 15 percent of the taxpayer's gross income from an oil-or gas-producing property is allowed as a deduction in each taxable year. The amount deducted may not exceed 100 percent of the net income from that property in any year (the "net-income limitation).[3] Additionally, the percentage depletion deduction for all oil and gas properties may not exceed 65 percent of the taxpayer's overall taxable income (determined before such deduction and adjusted for certain loss carrybacks and trust distributions).[4]

A taxpayer may claim percentage depletion with respect to up to 1,000 barrels of average daily production of domestic crude oil or an equivalent amount of domestic natural gas. For producers of both oil and natural gas, this limitation applies on a combined basis. All production owned by businesses under common control and members of the same family must be aggregated; each group is then treated as one producer for application of the 1,000-barrel limitation.

### SPECIAL RULES FOR MARGINAL WELLS

Special percentage depletion provisions apply to oil and gas production from marginal properties. The statutory percentage depletion rate is increased (from the general rate of 15 percent) by one percentage point for each whole dollar that the average price of crude oil (as determined under the provisions of the nonconventional fuels production credit of section 29) for the immediately preceding calendar year is less than $20 per barrel. In no event may the rate of percentage depletion under this provision exceed 25 percent for any taxable year. The increased rate applies for the taxpayer's taxable year which immediately follows a calendar year for which the average crude oil price falls below the $20 floor. To illustrate the application of this provision, the average price of a barrel of crude oil for calendar year 1997 was $17.24; thus, the percentage depletion rate for production from marginal wells was increased by two percent (to 17 percent) for taxable years beginning in 1998. In addition, the 100-percent net-income limitation has been suspended for marginal wells for taxable years beginning after December 31, 1997, and before December 31, 2000.

Marginal production is defined for this purpose as domestic crude oil or domestic natural gas which is produced during any taxable year from a property which (1) is a stripper well property for the calendar year in which the taxable year begins, or (2) is a property substantially all of the production from which during such calendar year is heavy oil (i.e., oil that has a weighted average gravity of 20 degrees API or less corrected to 60 degrees Fahrenheit). A stripper well property is any oil or gas property for which daily average production per producing oil or gas well is not more that 15 barrel equivalents in the calendar year during which the taxpayer's taxable year begins.[5] A property qualifies as a stripper well property for a calendar year only if the wells on such property were producing during that period at their maximum efficient rate of flow.

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[2] An independent producer is any producer who is not a "retailer" or "refiner." A retailer is any person who directly, or through a related person, sells oil or natural gas or any product derived therefrom (1) through any retail outlet operated by the taxpayer or related person, or (2) to any person that is obligated to market or distribute such oil or natural gas (or product derived therefrom) under the name of the taxpayer or the related person, or that has the authority to occupy any retail outlet owned by the taxpayer or a related person. Bulk sales of crude oil and natural gas to commercial or industrial users, and bulk sales of aviation fuel to the Department of Defense, are not treated as retail sales for this purpose. Further, a person is not a retailer within the meaning of this provision if the combined gross receipts of that person and all related persons from the retail sale of oil, natural gas, or any product derived therefrom do not exceed $5 million for the taxable year. A refiner is any person who directly or through a related person engages in the refining of crude oil, but only if such person or related person has a refinery run in excess of 50,000 barrels per day on any day during the taxable year.

[3] By contrast, for any other mineral qualifying for the percentage depletion deduction, the deduction may not exceed 50 percent of the taxpayer's taxable income from the depletable property.

[4] Amounts disallowed as a result of this rule may be carried forward and deducted in subsequent taxable years, subject to the 65-percent taxable income limitation for those years.

[5] Equivalent barrels is computed as the sum of (1) the number of barrels of crude oil produced, and (2) the number of cubic feet of natural gas produced divided by 6,000. If a well produced 10 barrels of crude oil and 12,000 cubic feet of natural gas, its equivalent barrels produced would equal 12 (i.e., 10 + (12,000 / 6,000)).

If a taxpayer's property consists of a partial interest in one or more oil-or gas-producing wells, the determination of whether the property is a stripper well property or a heavy oil property is made with respect to total production from such wells, including the portion of total production attributable to ownership interests other than the taxpayer's. If the property satisfies the requirements of a stripper well property, then that person receives the benefits of this provision with respect to its allocable share of the production from the property for its taxable year that begins during the calendar year in which the property so qualifies.

The allowance for percentage depletion on production from marginal oil and gas properties is subject to the 1,000-barrel-per-day limitation discussed above. Unless a taxpayer elects otherwise, marginal production is given priority over other production for purposes of utilization of that limitation.

EFFECT OF PROVISIONS

Because percentage depletion, unlike cost depletion, is computed without regard to the taxpayer's basis in the depletable property, cumulative depletion deductions may be far greater than the amount expended by the taxpayer to acquire or develop the property. The excess of the percentage depletion deduction over the deduction for cost depletion is generally viewed as a tax incentive.

### *B. Intangible Drilling and Development Costs*

In general, costs that benefit future periods must be capitalized and recovered over such periods for income tax purposes, rather than being expensed in the period the costs are incurred. In addition, the uniform capitalization rules require certain direct and indirect costs allocable to property to be included in inventory or capitalized as part of the basis of such property. In general, the uniform capitalization rules apply to real and tangible personal property produced by the taxpayer or acquired for resale.

DEDUCTION FOR INTANGIBLE DRILLING AND DEVELOPMENT COSTS

Special rules apply to intangible drilling and development costs.[6] Under these special rules, an operator (i.e., a person who holds a working or operating interest in any tract or parcel of land either as a fee owner or under a lease or any other form of contract granting working or operating rights) who pays or incurs IDCs in the development of an oil or gas property located in the United States may elect either to expense or capitalize those costs. The uniform capitalization rules do not apply to otherwise deductible IDCs.

If a taxpayer elects to expense IDCs, the amount of the IDCs is deductible as an expense in the taxable year the cost is paid or incurred. Generally, IDCs that a taxpayer elects to capitalize may be recovered through depletion or depreciation, as appropriate; or in the case of a nonproductive well ("dry hole"), the operator may elect to deduct the costs. In the case of an integrated oil company (i.e., a company that engages, either directly or though a related enterprise, in substantial retailing or refining activities) that has elected to expense IDCs, 30 percent of the IDCs on productive wells must be capitalized and amortized over a 60-month period.[7]

A taxpayer that has elected to deduct IDCs may, nevertheless, elect to capitalize and amortize certain IDCs over a 60-month period beginning with the month the expenditure was paid or incurred. This rule applies on an expenditure-by-expenditure basis; that is, for any particular taxable year, a taxpayer may deduct some portion of its IDCs and capitalize the rest under this provision. This allows

[6] IDCs include all expenditures made by an operator for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil and gas. In addition, IDCs include the cost to operators of any drilling or development work (excluding amounts payable only out of production or gross or net proceeds from production, if the amounts are depletable income to the recipient, and amounts properly allocable to the cost of depreciable property) done by contractors under any form of contract (including a turnkey contract). Such work includes labor, fuel, repairs, hauling, and supplies which are used in the drilling, shooting, and cleaning of wells; in such clearing of ground, draining, road making, surveying, and geological works as are necessary in preparation for the drilling of wells; and in the construction of such derricks, tanks, pipelines, and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of oil and gas. Generally, IDCs do not include expenses for items which have a salvage value (such as pipes and casings) or items which are part of the acquisition price of an interest in the property.

[7] The IRS has ruled that if an integrated oil company ceases to be an integrated oil company, it may not immediately write off the unamortized portion of the IDCs capitalized under this rule, but instead must continue to amortize those IDCs over the 60-month amortization period.

the taxpayer to reduce or eliminate IDC adjustments or preferences under the alternative minimum tax.

The election to deduct IDCs applies only to those IDCs associated with domestic properties.[8] For this purpose, the United States includes certain wells drilled offshore.[9]

EFFECT OF PROVISION

Intangible drilling costs are a major portion of the costs necessary to locate and develop oil and gas reserves. Since the benefits obtained from these expenditures are of value throughout the life of the project, these costs would be capitalized and recovered over the period of production under generally applicable accounting principles. The acceleration of the deduction for IDCs is viewed as a tax incentive.

*C. Tax Credits—Nonconventional fuels production credit*

Taxpayers that produce certain qualifying fuels from nonconventional sources are eligible for a tax credit ("the section 29 credit") equal to $3 per barrel or barrel-of-oil equivalent.[10] Fuels qualifying for the credit must be produced domestically from a well drilled, or a facility treated as placed in service, before January 1, 1993.[11] The section 29 credit generally is available for qualified fuels sold to unrelated persons before January 1, 2003.[12]

For purposes of the credit, qualified fuels include: (1) oil produced from shale and tar sands; (2) gas produced from geopressured brine, Devonian shale, coal seams, a tight formation, or biomass (i.e., any organic material other than oil, natural gas, or coal (or any product thereof); and (3) liquid, gaseous, or solid synthetic fuels produced from coal (including lignite), including such fuels when used as feedstocks. The amount of the credit is determined without regard to any production attributable to a property from which gas from Devonian shale, coal seams, geopressured brine, or a tight formation was produced in marketable quantities before 1980.

The amount of the section 29 credit generally is adjusted by an inflation adjustment factor for the calendar year in which the sale occurs.[13] There is no adjustment for inflation in the case of the credit for sales of natural gas produced from a tight formation. The credit begins to phase out if the annual average unregulated wellhead price per barrel of domestic crude oil exceeds $23.50 multiplied by the inflation adjustment factor.[14]

The amount of the section 29 credit allowable with respect to a project is reduced by any unrecaptured business energy tax credit or enhanced oil recovery credit claimed with respect to such project.

As with most other credits, the section 29 credit may not be used to offset alternative minimum tax liability. Any unused section 29 credit generally may not be carried back or forward to another taxable year; however, a taxpayer receives a credit for prior year minimum tax liability to the extent that a section 29 credit is disallowed as a result of the operation of the alternative minimum tax. The credit

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[8] In the case of IDCs paid or incurred with respect to an oil or gas well located outside of the United States, the costs, at the election of the taxpayer, are either (1) included in adjusted basis for purposes of computing the amount of any deduction allowable for cost depletion or (2) capitalized and amortized ratably over a 10-year period beginning with the taxable year such costs were paid or incurred.

[9] The term "United States" for this purpose includes the seabed and subsoil of those submerged lands that are adjacent to the territorial waters of the United States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources (i.e., the Continental Shelf area).

[10] A barrel-of-oil equivalent generally means that amount of the qualifying fuel which has a Btu (British thermal unit) content of 5.8 million.

[11] A facility that produces gas from biomass or produces liquid, gaseous, or solid synthetic fuels from coal (including lignite) generally will be treated as being placed in service before January 1, 1993, if it is placed in service by the taxpayer before July 1, 1998, pursuant to a written binding contract in effect before January 1, 1997. In the case of a facility that produces coke or coke gas, however, this provision applies only if the original use of the facility commences with the taxpayer. Also, the IRS has ruled that production from certain post-1992 "recompletions" of wells that were originally drilled prior to the expiration date of the credit would qualify for the section 29 credit.

[12] If a facility that qualifies for the binding contract rule is originally placed in service after December 31, 1992, production from the facility may qualify for the credit if sold to an unrelated person before January 1, 2008.

[13] The inflation adjustment factor for the 1997 taxable year was 2.0331. Therefore, the inflation-adjusted amount of the credit for that year was $6.10 per barrel or barrel equivalent.

[14] For 1997, the inflation adjusted threshold for onset of the phaseout was $47.38 ($23.50 x 2.0331) and the average wellhead price for that year was 15.98.

is limited to what would have been the regular tax liability but for the alternative minimum tax.

### EFFECT OF PROVISION

This provision provides a significant tax incentive (currently about $6 per barrel of oil equivalent or $1 per thousand cubic feet of natural gas, or roughly half the wellhead price of gas) for production of nonconventional fuels. Coalbed methane and gas from tight formations currently account for most of the credit.

### ENHANCED OIL RECOVERY CREDIT

Taxpayers are permitted to claim a general business credit, which consists of several different components. One component of the general business credit is the enhanced oil recovery credit. The general business credit for a taxable year may not exceed the excess (if any) of the taxpayer's net income over the greater of (1) the tentative minimum tax, or (2) 25 percent of so much of the taxpayer's net regular tax liability as exceeds $25,000. Any unused general business credit generally may be carried back three taxable years and carried forward 15 taxable years.

The enhanced oil recovery credit for a taxable year is equal to 15 percent of certain costs attributable to qualified enhanced oil recovery ("EOR") projects undertaken by the taxpayer in the United States during the taxable year. To the extent that a credit is allowed for such costs, the taxpayer must reduce the amount otherwise deductible or required to be capitalized and recovered through depreciation, depletion, or amortization, as appropriate, with respect to the costs. A taxpayer may elect not to have the enhanced oil recovery credit apply for a taxable year.

The amount of the enhanced oil recovery credit is reduced in a taxable year following a calendar year during which the annual average unregulated wellhead price per barrel of domestic crude oil exceeds $28 (adjusted for inflation since 1990).[15] In such a case, the credit would be reduced ratably over a $6 phaseout range.

For purposes of the credit, qualified enhanced oil recovery costs include the following costs which are paid or incurred with respect to a qualified EOR project: (1) the cost of tangible property which is an integral part of the project and with respect to which depreciation or amortization is allowable; (2) IDCs that the taxpayer may elect to deduct;[16] and (3) the cost of tertiary injectants with respect to which a deduction is allowable, whether or not chargeable to capital account.

A qualified EOR project means any project that is located within the United States and involves the application (in accordance with sound engineering principles) of one or more qualifying tertiary recovery methods which can reasonably be expected to result in more than an insignificant increase in the amount of crude oil which ultimately will be recovered. The qualifying tertiary recovery methods generally include the following nine methods: miscible fluid displacement, steam-drive injection, microemulsion flooding, in situ combustion, polymer-augmented water flooding, cyclic-steam injection, alkaline flooding, carbonated water flooding, and immiscible non-hydrocarbon gas displacement, or any other method approved by the IRS. In addition, for purposes of the enhanced oil recovery credit, immiscible non-hydrocarbon gas displacement generally is considered a qualifying tertiary recovery method, even if the gas injected is not carbon dioxide.

A project is not considered a qualified EOR project unless the project's operator submits to the IRS a certification from a petroleum engineer that the project meets the requirements set forth in the preceding paragraph.

The enhanced oil recovery credit is effective for taxable years beginning after December 31, 1990, with respect to costs paid or incurred in EOR projects begun or significantly expanded after that date.

### EFFECT OF PROVISION

Conventional oil recovery methods do not recover all of a well's oil. Some of the remaining oil can be extracted by unconventional methods, but these methods are generally more costly and uneconomic at current world oil prices. In this environment, the EOR credit can increase recoverable reserves. Although recovering oil using EOR methods is more expensive than recovering it using conventional methods, it may be less expensive than producing oil from new reservoirs. At present world oil prices, this credit is fully available.

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[15] The average per-barrel price of crude oil for this purpose is determined in the same manner as for purposes of the section 29 credit.

[16] In the case of an integrated oil company, the credit base includes those IDCs which the taxpayer is required to capitalize.

### *D. Alternative Minimum Tax*

A taxpayer is subject to an alternative minimum tax ("AMT") to the extent that its tentative minimum tax exceeds its regular income tax liability. A corporate taxpayer's tentative minimum tax generally equals 20 percent of its alternative minimum taxable income in excess of an exemption amount. (The marginal AMT rate for a noncorporate taxpayer is 26 or 28 percent, depending on the amount of its alternative minimum taxable income above an exemption amount.) Alternative minimum taxable income ("AMTI") is the taxpayer's taxable income increased by certain tax preferences and adjusted by determining the tax treatment of certain items in a manner which negates the deferral of income resulting from the regular tax treatment of those items.

#### AMT TREATMENT OF DEPLETION

As a general rule, percentage depletion deductions claimed in excess of the basis of the depletable property constitute an item of tax preference in determining the AMT. In addition, the AMTI of a corporation is increased by an amount equal to 75 percent of the amount by which adjusted current earnings ("ACE") of the corporation exceed AMTI (as determined before this adjustment). In general, ACE means AMTI with additional adjustments that generally follow the rules presently applicable to corporations in computing their earnings and profits. As a general rule a corporation must use the cost depletion method in computing its ACE adjustment. Thus, the difference between a corporation's percentage depletion deduction (if any) claimed for regular tax purposes and its allowable deduction determined under the cost depletion method is factored into its overall ACE adjustment.

Excess percentage depletion deductions related to crude oil and natural gas production are not items of tax preference for AMT purposes. In addition, corporations that are independent oil and gas producers and royalty owners may determine depletion deductions using the percentage depletion method in computing their ACE adjustments.

#### AMT TREATMENT OF IDCS

The difference between the amount of a taxpayer's IDC deductions and the amount which would have been currently deductible had IDCs been capitalized and recovered over a 10-year period may constitute an item of tax preference for the AMT to the extent that this amount exceeds 65 percent of the taxpayer's net income from oil and gas properties for the taxable year (the "excess IDC preference"). In addition, for purposes of computing a corporation's ACE adjustment to the AMT, IDCs are capitalized and amortized over the 60-month period beginning with the month in which they are paid or incurred. The preference does not apply if the taxpayer elects to capitalize and amortize IDCs over a 60-month period for regular tax purposes.

IDCs related to oil and gas wells are generally not taken into account in computing the excess IDC preference of taxpayers that are not integrated oil companies. This treatment does not apply, however, to the extent it would reduce the amount of the taxpayer's AMTI by more than 40 percent of the amount that the taxpayer's AMTI would have been if those IDCs had been taken into account.

In addition, for corporations other than integrated oil companies, there is no ACE adjustment for IDCs with respect to oil and gas wells. That is, such a taxpayer is permitted to use its regular tax method of writing off those IDCs for purposes of computing its adjusted current earnings.

#### EFFECT OF PROVISIONS

Absent these rules, the incentive effect of the special provisions for oil and gas would be reduced for firms subject to the AMT. These rules, however, effectively eliminate AMT concerns for independent producers.

### *E. Passive Activity Loss and Credit Rules*

A taxpayer's deductions from passive trade or business activities, to the extent they exceed income from all such passive activities of the taxpayer (exclusive of portfolio income), generally may not be deducted against other income.[17] Thus, for example, an individual taxpayer may not deduct losses from a passive activity against income from wages. Losses suspended under this "passive activity loss" limi-

[17] This provision applies to individuals, estates, trusts, personal service corporations, and closely held C corporations.

tation are carried forward and treated as deductions from passive activities in the following year, and thus may offset any income from passive activities generated in that later year. Undeducted losses from a passive activity may be deducted in full when the taxpayer disposes of its entire interest in that activity to an unrelated party in a transaction in which all realized gain or loss is recognized.

An activity generally is treated as passive if the taxpayer does not materially participate in it. A taxpayer is treated as materially participating in an activity only if the taxpayer is involved in the operations of the activity on a basis which is regular, continuous, and substantial.

A working interest in an oil or gas property generally is not treated as a passive activity, whether or not the taxpayer materially participates in the activities related to that property. This exception from the passive activity rules does not apply if the taxpayer holds the working interest through an entity which limits the liability of the taxpayer with respect to the interest. In addition, if a taxpayer has any loss for any taxable year from a working interest in an oil or gas property which is treated pursuant to this working interest exception as a loss which is not from a passive activity, then any net income from such property (or any property the basis of which is determined in whole or in part by reference to the basis of such property) for any succeeding taxable year is treated as income of the taxpayer which is not from a passive activity.

Similar limitations apply to the utilization of tax credits attributable to passive activities. Thus, for example, the passive activity rules (and, consequently, the oil and gas working interest exception to those rules) apply to the nonconventional fuels production credit and the enhanced oil recovery credit. However, if a taxpayer has net income from a working interest in an oil and gas property which is treated as not arising from a passive activity, then any tax credits attributable to the interest in that property would be treated as credits not from a passive activity (and, thus, not subject to the passive activity credit limitation) to the extent that the amount of the credits does not exceed the regular tax liability which is allocable to such net income.

EFFECT OF PROVISION

As a result of this exception from the passive loss limitations, owners of working interests in oil and gas properties may use losses from such interests to offset income from other sources.

*F. Tertiary Injectants*

Taxpayers are allowed to deduct the cost of qualified tertiary injectant expenses for the taxable year. Qualified tertiary injectant expenses are amounts paid or incurred for any tertiary injectant (other than recoverable hydrocarbon injectants) which is used as a part of a tertiary recovery method.

EFFECT OF PROVISION

The provision allowing the deduction for qualified tertiary injectant expenses resolves a disagreement between taxpayers (who considered such costs to be IDCs or operating expenses) and the IRS (which considered such costs to be subject to capitalization).

Mr. Chairman, this concludes my prepared testimony. I will be pleased to answer any questions you or other members of the Subcommittee may have.

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Chairman HOUGHTON. Thank you very much, Mr. Secretary.

I am going to pass on my questions and turn it over immediately to Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Lubick, does the Treasury Department believe that the Tax Code needs to be changed to improve the financial health of the domestic oil and gas industry?

Mr. LUBICK. Mr. Coyne, as I have indicated, the Tax Code already, as far as the independents are concerned, has resulted from an exemption from taxation of probably more than 75 percent of persons involved.

It seems to us, therefore, that since the dominating problem of the industry is low prices, we ought to explore whether there are more effective, more cost-efficient methods of dealing with the problem of the industry and the people in the industry. We recognize this has an impact not only on the producers of oil and gas, but the ripple effect to all the persons in the community that have established businesses and whose occupations depend upon the well-being of that industry. They are in distress. We recognize that the State and the local governments that are dependent upon revenues that are generally associated with production are being hard pressed.

It is a very serious problem when the economy generally is doing very well that here is an area, as we have found in the case of steel as well, that is seriously at a disadvantage. But the problems seem to us to be of a magnitude that goes beyond a ready solution through changes in the tax law when most people, those who are most adversely affected are not paying taxes, it seems to us the solution does not lie in additional tax incentives. This is an industry that probably has larger tax incentives relative to its size than any other industry in the country.

Mr. COYNE. Well, to what extent is the Asian financial crisis responsible or does it have any responsibility for the lower worldwide demand?

Mr. LUBICK. It certainly is a factor that was unexpected. The weakened demand for petroleum products has been a factor depressing oil prices.

At the same time, there are other factors affecting demand. For example, we have had, in the Northern Hemisphere for the last two winters, unusually warm winters. What has perhaps been a blessing to people in your community and my community further North, in terms of lower fuel bills, has been somewhat of a disaster for oil producers.

At the same time, not only is there a weakened demand, but on the supply side, since this is a commodity produced worldwide, there has been excess supply. That combination of excess supply and weakened demand has been responsible for the crisis which affects this industry which is a crisis dominated by weak prices.

Mr. COYNE. Thank you very much.

Chairman HOUGHTON. Mr. Watkins.

Mr. WATKINS. Mr. Chairman, I am so thankful for these hearings. Mr. Coyne and I would like for all of our staff and others— I cannot believe my ears. I cannot believe my ears. You say about the conditions and the tax incentives that are out there today, you have got to explore for more effective ways, Mr. Lubick.

Your administration, that, by the way is to allow Iraqis to produce 2.5 million barrels of oil today are 2 million more than what they did have. Senator Lugar pointed out, a year or two ago, that in order to protect the Middle East and have that oil supply, we are paying up to $100 a barrel. That is your solution to our problem, paying a whole lot more. I cannot believe how un-American it is, to be very honest with you.

What we have on our hands is, yes, a crisis. But in my ear, I hear kind of a gleeful attitude. It pains me in my heart to think this administration is taking that kind of attitude to where their

domestic oil economy that keeps our country going—yes, we are importing more every day, and we are going to pay the price one of these years, big time. But the American people are the ones that are going to end up suffering later on.

Yes, we are hemorrhaging in the oil patch. It is a lack of policy, a lack of energy policy.

What measures does this administration have? Does it have any suggestion? Or is this important? Is this important? Is the domestic oil economy important, Mr. Lubick, do you think at all?

Mr. LUBICK. Mr. Watkins, you have misconstrued me completely if you think we are gleeful about the situation in the oil industry. We recognize—and I want to emphasis my complete agreement with you with the importance of this industry and our feeling of distress——

Mr. WATKINS. All I heard was cold heartedness. I didn't hear any empathy and saying that we were going to do something about it.

Mr. LUBICK. Well, Mr. Watkins, the question which I have been addressing is what is the most efficient way to deal with the problem. I have not in any way denied the problem, nor in any way indicated that something shouldn't be done to alleviate the distress, not only by the producers, but by people whose livelihoods depend upon the producers. There are other pockets in our economy today that are suffering similarly, I think as Mr. Coyne is aware of as well.

The question that lies within my field of competence, or minimal competence, at any event, is the tax system and efficient way to address the problem. And that, I think, if one looks at the situation——

Mr. WATKINS. If you would yield, Mr. Lubick?

Mr. LUBICK. Surely.

Mr. WATKINS. I think this Subcommittee would welcome any suggestions you have that are constructive that would be more efficient that address this problem if we think a domestic oil supply is important for this country.

Mr. LUBICK. There certainly have been some measures that have been taken.

The Department of the Interior, for example, has announced it is allowing stripper oil well producers, producing on public lands, to suspend their operations for up to 2 years without losing their leases. There is some relief for them.

The budget has requested $364 million to fund fossil energy research and development activities at the Department of Energy to develop technologies, among other objectives, that will reduce the cost of domestic oil and natural gas production.

There are other proposals to improve the Nation's energy security.

But I think that this is——

Mr. WATKINS. Let me ask another question.

Let me say on a couple of things right there that we are going to have a lot of funerals out there in oil patching because most of them will be dead and buried before those come about.

In 1994, the administration's National Petroleum Council, concerning margins of wells, reported and recommended a margin wells tax credit, and we have introduced that in both areas. And

I understand the Energy Secretary has also met with the Treasury Secretary about this. Could you shed some insight, some light, on that? How did they feel about the tax credit?

Mr. LUBICK. Well, the problem we have with the marginal well tax credit—we met with Secretary Richardson on this—is that it won't benefit the most unprofitable firms because they have no tax liability. Again, as I stated in my opening statement, over 75 percent of corporations in the oil and gas extraction industry did not pay any domestic, corporate income tax.

A more serious problem for the producers is severance taxers, and I understand that some States are producing some relief in that area, but, again, the problem that is the cause of all of this, and I think as everyone recognizes, is the historically unusual, or record depression of prices. It seems to us that if one considers the efficiency of a tax credit, it is not going to go to those producers most in distress.

Mr. WATKINS. Mr. Chairman, I will have a second shot, maybe, to talk? I know we have a special guest and good friend of yours and the Subcommittee's from Texas here, and he wants to say something, too, so I will just take my second turn here in 1 minute.

Mr. Chairman, thank you.

Chairman HOUGHTON. Mr. Stenholm, would you like to——

Mr. STENHOLM. Thank you, Mr. Chairman, and I thank the Members of the Subcommittee for allowing a Member from the Agriculture Committee to come and be here today.

And I appreciate the opportunity to follow up, Mr. Secretary, on your comment that we need to look at a more efficient way to deal with the problem. I agree with your assessment that the problem is price. I also agree with Mr. Coyne's comments concerning other industries. The steel industry has a similar problem, as does the agriculture industry. And all of us, as policymakers, are struggling, as you are, Mr. Secretary, with how to we deal with this problem. And the fundamental question for us to consider here today is, Should we deal with the oil price crisis? And here, I would like to hear your answer to this question, because clearly our country has been benefiting with cheap oil. My constituents like to pay 82 cents for a gallon of gasoline. My farmers like to pay 38 cents a gallon. In the short term, low prices are benefiting the economy.

But we now see some very real storm clouds gathering. We are about to do some irreparable harm to the infrastructure of an industry that will not come back if protections are not created. Allowing other governments to set our prices in this country is now beginning to pose a national security problem. We must ask whether we are willing to allow our inaction to hand control of our economic well-being to other countries.

You are right on the price.

One suggestion I am looking at very seriously, and this applies to all industries, is whether or not we should establish a minimum price in the United States. We can examine whether to do it through the Tax Code, as Mr. Watkins suggests, or whether to do it through what used to be called an oil-import fee. I suggest that, this year, we examine an environmental-equalization fee. When we recognize that other countries, who are now enjoying the benefits of our markets, have, I am told, a $4 to $4.50 advantage over our

producers in environmental compliance costs. Because imported oil does not carry an environmental premium, our producers are at a disadvantage in the marketplace. Would seeking to level the playingfield for domestic producers with such a fee be something that would make economic sense? Is this something the administration is looking at, has looked at, or would be interested in looking at? And examining whether or not a floor price would, in fact, put money into the pockets of the producers that you say a Tax Code change will not assist. Is this something that has some merit?

Mr. LUBICK. Mr. Stenholm, I think you are dealing with an area that is obviously not one of my areas of competence or experience. I was here recently before this Subcommittee when Chairman Archer admonished some other member of the administration from my department that you shouldn't be giving answers in areas where you don't have competence, and he said to me, "I like the way you testify because you stick to areas that you purportedly know something about." He may be wrong on that. But at least he is right that I try not to get beyond my areas.

I think all of the things you suggest are things that should be considered. There are obviously problems under trade agreements as to what you can do, and, again, I come to the conclusion, along with my colleagues who have tax expertise, both economic and legal, that the tax route doesn't leave much wiggle room to do anything in an efficient way, and it is not that I don't agree with you that this is an important industry that we need to have in this country, and I think the points that you make about its plight are perfectly correct, but I would hope you would consult with my wiser and more experienced colleagues to discuss some of these other solutions.

Mr. STENHOLM. Mr. Secretary, you don't have to worry about that. I think this is a subject that all of us take seriously, and, again, Mr. Chairman, the fact that you are holding these hearings indicates that more and more people outside of the oil patch are recognizing there is a problem.

I hope as we pursue the solution to the oil crisis, we recognize the problems of the steel industry, of agriculture and of other industries caught in crisis. We must examine whether our policies are in the best interests of the United States. We need to look at executive branch policies, as well as legislative branch policies, and we have some work to do there.

I appreciate your answer, Mr. Lubick. I probably would be better off sticking back with the Agriculture Committee myself at this stage, but the oil and gas industry is awfully important to my district, to my State, and, I believe, to the Nation. And I really believe that, as you say, if there are more efficient ways to deal with the oil crisis, I hope that we will pursue them will all haste before we pay a very dear price.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you.

Mr. Lucas.

Mr. LUCAS. Thank you, Mr. Chairman, and I appreciate the indulgence of you and the Ranking Member to participate in this hearing.

I guess I really have one question for the Secretary. Last year, the administration signed a bill that provided a net operating loss carryback period for agriculture, a very meritorious action in an industry that is under stress and deserves—in this budget, I understand, they proposed the same or similar type of net operating loss carryback period for the steel industry.

I suppose my question is this, If the administration signed a bill that provided this kind of language for one industry that deserved it and was under duress, has proposed it for another industry that is also under duress, why do we not see the same kind of proposal for the oil and gas industry which is under just as much strain as both agriculture and steel?

Mr. LUBICK. Congressman, we think the steel situation was a somewhat different situation because of the great danger of dumping, and that is why we recommended, somewhat reluctantly, this net operating loss carryback provision in the steel area.

Now, the problem in replicating that in other industries is that it would benefit only those producers or companies that can use net-operating losses more rapidly if carried back an extra 3 years. Again, that tends to be firms that only recently have become unprofitable, or firms that expect to face serious losses in the near future but are currently or are recently profitable. It seems to us that the data we have examined—and we are continuing to try and analyze cases in this industry, unfortunately we haven't had sufficient time to compile all of the economic data that we need, but the data for which we have information indicates that the stock of unused net-operating loss carryovers is concentrated in corporations without income in 1996, which was the highest oil price year after 1990. It seems unlikely that those that are most seriously affected by the low oil prices are unlikely to be helped in any significant way by an extension of the carryback period.

Now, just 2 years ago in this Subcommittee, you made a decision, with our recommendation, that the carryback period be shortened from 3 years to 2 years. If we start responding in every situation without regard to whether there is going to be a serious, significant benefit from it, it seems to me we do violence to the complexity that we were trying to avoid in the restructuring act recently by setting up a series of industries, each receiving its own, separate carryback period.

Again, I think this would help so few firms that it is not going to provide any significant solution to the problem we are facing.

Mr. LUCAS. But, Mr. Secretary, if we go back to the basic premise, which I think is appropriate in the steel industry, that there is predatory dumping going on, that there are countries out there systematically trying to disrupt and destroy our steel production industry, a very strong case can be made that that is going on in the energy exporting business. There are countries out there moving crude oil in volumes that they know will destroy the domestic production in this industry in this country. Thereby, ultimately this enables them to totally dominate the market here. That is the same basic premise. And it is a technique that the Federal Government went after at the turn of the century in a particularly large national oil company now being practiced against us.

I look forward to the next round, Mr. Chairman.

Chairman HOUGHTON. Thanks.

Mr. LUBICK. I am not aware it is a dumping problem. My understanding, not based on my knowledge, but in talking to the Department of Energy, is that in most foreign producers, the world price is far above their costs of the extractions, so they are not dumping oil below their costs. There are so many producers in a worldwide competitive market that it is market forces that are determining the price. But if there is evidence of that that is brought forward, well, then, I think that we would have to take another look at it.

Chairman HOUGHTON. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman, and I want to thank the Chairman of the Oversight Subcommittee for having this hearing today, particularly for someone coming from New York which is basically a consuming State. I want to thank you for having the foresight to call this hearing and to focus attention on what I think is a real crisis in this country.

Mr. Stenholm talked about this becoming a national security issue. I agree with him 100 percent. And Mr. Lucas expounded on that by carrying through the logic of what is happening. If foreign producers continue to gain market share and eventually render useless our domestic production capabilities, then we are at the mercy, from a security standpoint, of foreign countries. I hope that that is not desirable for this administration.

I know that you are not responsible for the whole budget, but do you know of anything in the President's budget that provides relief for the oil and gas industry?

Mr. LUBICK. Well, Mr. McCrery, I already cited the two things: One, the Interior announcement, and the other the research for more efficient technologies to lower the costs. The Department of Energy has recently announced plans to add 28 million barrels to the Strategic Petroleum Reserve. And, again, has requested $838 million for energy conservation grants to improve energy efficiency which is a problem, as you cite, of energy security.

Mr. MCCRERY. Frankly, we need people to use more energy, not less. We don't need to be much more efficient, or the price will go through the floor.

But I appreciate those items in the budget, and while they are positive, I would submit that they are negligible. It doesn't do someone much good to shut down for 2 years if they are not making any money.

And, Mr. Lubick, I have heard you give criticisms of Mr. Watkins' proposals for marginal wells tax credit and reasons why you can't apply the net-operating loss provision that you put in your budget for the steel industry to the oil and gas industry, and it reminds me of the Titanic. And if you had been on the deck of the Titanic in charge of the lifeboats, I think that you might have said, "Well, gosh, most of the people out there are dead already, so let's don't throw out the lifeboats, that is a waste of energy." Come on, now. Do you want to wait until not 75 percent, but 100 percent of independent producers are out of business? Let's get real here. What we want to do is try to throw some lifelines out there to help those that are still in business and have a hope of remaining in business to get through this. But if we just say, "Oh well, most of them aren't making a profit anyway, so let's don't do anything."

Well, pretty soon none of them will be making a profit, and we will surrender even more market share to foreign producers.

I would urge you to reconsider your rationale for not supporting any tax credits or any other tax measures to help the oil and gas industry. There are a few people out there still making a profit, although they are getting fewer and fewer. So, we need to help those folks to try and maintain their businesses for just a few more months, we hope maybe a couple of years, until prices recover.

Do you get the analogy there?

Mr. LUBICK. I guess I would rather see if I can't steer the boat to avoid the iceberg rather than toss one lifeboat out.

Mr. MCCRERY. Well, by the time you do that, Mr. Lubick, you are going to have so many more people drowning. You are going to have them freezing to death out in the ice water. You don't have time to do that. Throw them a lifeboat. It doesn't take that much effort. And if what you say is true, it won't cost us that much money.

Mr. LUBICK. The basic problem is that the Code has gone almost as far as it can go, and each marginal tax reduction is, as you point out, probably—I don't have a revenue estimate on this, as yet, but it probably is not very high. But that means it is not going to help very many people, and, generally speaking, we already had a problem of tax sheltering in this industry where the benefits were flowing not to the people in the oil patch, but to others. And it seems to us that, given absolute recognition to the seriousness of the problem—and I don't want anyone to think that we don't recognize the seriousness of the problem and recognize the seriousness of the distress that it has caused here—it seems to me it is time to give some thought, perhaps as Mr. Stenholm suggests, to ways that will address the real problem.

Mr. MCCRERY. Well, I would appreciate that, too, but we would also appreciate your reducing or eliminating your opposition to some of these small, minor things in the Tax Code that we could do to help.

Chairman HOUGHTON. All right, thanks very much.

Mr. Watkins.

Mr. WATKINS. Thank you, Mr. Chairman, for letting me have a second round.

Mr. Lubick, some things from the bank of knowledge or being around here—I know that you were here 20 years ago and that administration—you were a part of advocating the windfall profit tax when it was going the other way. And I think that it is a sure place that you can repent a little bit today, and if you try to work with us and try to plug the hemorrhaging that is going on out there. You say you are not gleeful and that you share pain, but I don't know if you have ever been broke or if you have ever seen people who are going bankrupt, that is going to be very costly also.

Let me say, concerning some of your suggestion, I made a couple of notes. We have thousands of small, independent producers that are not corporations. You said that for corporate firms, 75 percent would not benefit. There are a lot of them out there. And let me also say, we are going to hear from a person, a lady, later on, a royalty owner, a mineral owner, and there are hundreds of thousands of them that their several hundreds of dollars of checks have

been cut in half or down to about one-third of what they—so, we are not talking about the major Exxons and British Petroleums and all of those, who, by the way, have overrides in a lot of foreign countries that are receiving revenue from what is happening in other countries at really the expense of the small, independent producers. I think it is something we might have to address—we were talking to about it with Congressman Stenholm and all.

But I want to mention that about the individual tax, a lot of them out there have—also, under the current tax law, it is appropriate that you have a tax credit in the secondary and tertiary methods of recovery, yet the Internal Revenue Service has refused to apply this in the secondary methods, such as water flooding, as approved tax credits under the enhanced oil recovery. Why is that? Can you give me a short answer to that, because I have a couple of other things.

Mr. LUBICK. I am not familiar with the Service's action on that, Mr. Watkins. I will be glad to look into it and see if I can't find out what the Service has done.

As far as the enhanced oil recovery credit, the language of the statute applies to a specified tertiary recovery method.

Mr. WATKINS. And, true, it should, but they are not applying it to water flooding projects out there, and it should be. It should be allowed there. I just want to ask you, if you don't mind, to provide us with an answer as to why this is not done. It should be done. If you can make the decision to make that, you would.

Mr. LUBICK. Let us communicate with you on that.

Mr. WATKINS. I would appreciate that.

[The following was subsequently received:]

Section 43 of the Internal Revenue Code (the "Code") provides a 15% credit for certain costs associated with qualified enhanced oil recovery projects. "Qualified enhanced oil recovery projects" are defined, in part, as projects involving the application of one or more tertiary recovery methods defined in section 193(b)(3) of the Code. Section 193(b)(3) defines "tertiary recovery method" to include the methods described in subparagraphs (1) through (9) of section 212.78(c) of the June 1979 energy regulations (as defined by section 4996(b)(8)(C) as in effect before repeal)—which do not include waterflooding—as well as immiscible non-hydrocarbon gas displacement. Treasury Regulation § 1.43–2(e)(3)(i) specifically provides that waterflooding is not a qualified recovery method for purposes of the enhanced oil recovery credit.

When Congress enacted the enhanced oil recovery credit in 1990, it was very specific as to the types of recovery methods that were intended to qualify for the credit:

Nine *tertiary* recovery methods were listed in the June 1979 Department of Energy Regulations (section 212.78(c)). The conferees intend that a project employing one of these listed methods generally be considered a qualified enhanced oil recovery project. In addition, for purposes of the enhanced oil recovery credit, immiscible non-hydrocarbon gas displacement generally is considered a qualifying *tertiary* recovery methoda. The Secretary of the Treasury is granted the authority to clarify the scope and parameter of the listed *tertiary* methods for application of the enhanced oil recovery credit (e.g., the Secretary may re-examine the use of polymer augmented water flooding and may distinguish situations in which this method is appropriately treated as a *tertiary* recovery method from situations in which it is not). In addition, the Secretary is given discretion to add to the list of qualifying methods to take into account advances in enhanced oil recovery technology.

H.R. Conf. Rep. No. 964, 101st Cong., 2d Sess. 124–25 (1990) (emphasis added).

Waterflooding was and is widely understood in the industry to be a—in fact the *only—secondary* recovery method. Tertiary methods typically are used only after waterflooding already has occurred. In light of Congress' specificity about which methods qualified for the credit, its repeated references to *tertiary* methods, and its understanding that waterflooding was a secondary recovery method, it was reasonable to conclude that Congress did not intend for waterflooding to be eligible for the

credit, and the regulations were drafted accordingly in 1992. If Congress now wishes a different result, a legislative change is necessary. However, we believe that expansion of the credit to waterflooding, a commonly employed method of oil recovery, would be inappropriate.

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Mr. WATKINS. I saw that the Chairman raised the gavel, and I don't want him to use it on me, so I think that I better yield to my Chairman.

Chairman HOUGHTON. I just have one quick question, and I thank you very much for your time, Mr. Secretary.

Let me just make clear that clearly there are remedies here. They may not be tax remedies. They may be trade remedies such as section 201. There may be subsidy remedies.

However, let me understand what you are saying that in terms of carryback provisions, in terms of completion allowances, in terms of accelerated depreciation, or what have you—what you are saying, and from what I understand, correct me if I am wrong, is that for those people who we are talking about, the small, independent gas and oil producers, that there is no significant tax remedy. Is that what you are saying?

Mr. LUBICK. I am saying that so far, we haven't identified on, Mr. Chairman. I think that is correct.

Chairman HOUGHTON. All right.

Mr. McDermott, did you have anything you wanted to ask?

Mr. LUBICK. And I emphasize significant and efficient.

Chairman HOUGHTON. To have an impact on the state of the industry.

Mr. LUBICK. Yes, that is exactly right.

Chairman HOUGHTON. Do you have anything?

Mr. MCDERMOTT. I would like to ask a question.

Chairman HOUGHTON. Yes, go ahead.

Mr. MCDERMOTT. I confess that I don't understand everything about the free enterprise system. And I don't understand why oil prices are as low as they are today. Some people say that this is going to last for some period of time. Is that true? Please explain to me what is going on. I am buying gas at 99 cents per gallon which is about where it was when I was in high school——

Mr. LUBICK. I bet it is less.

Mr. MCDERMOTT. Probably. I remember 20 cents a gallon, so I figure it is somewhere in there.

What is happening?

Mr. LUBICK. Well, I stated earlier, Mr. McDermott, that we have had a confluence of weakened demand and excessive supply. Weakened demand, in part, because of Asia, in part because of weather for a couple of years. And coupled with that, you have had international production, with which you are doubtless familiar—the Department of Energy, of course, is in a better position to prognosticate prices than I am. The next panel will include a witness from the part of the Department of Energy that deals with the statistics of prices, and I think that that question should be addressed to them as well.

But it is my understanding that we are probably at the bottom of the trough and that the forecast is perhaps for price increases to commence relatively soon at the rate of about 6 percent per year.

But, again, that is not my bag to predict oil prices.

Mr. McDERMOTT. Well, the reason I ask the question is that I was in Sicily at Christmas time where gasoline was $4 a gallon. What is the difference in the way that Italy taxes gas and the way we tax it?

Mr. LUBICK. In where?

Mr. McDERMOTT. Sicily. Italy.

Mr. LUBICK. Italy. Well, I lived in France for a couple of years before coming back here where it was $4 a gallon. But that is all taxes. The world price is the world price, and they buy oil at the same prices that we buy oil. They impose very, very heavy, heavy taxes on gasoline as do most countries in the world, other than places like Saudi Arabia and the United States, and so forth.

Mr. McDERMOTT. There is no real reason why we couldn't have a carpet tax to deal with the deficit or to deal with trying to get people to change their behavior with respect to global warming and a few other things?

Mr. LUBICK. Well, I think there are at least 218 reasons in this body, 51 in the other.

Mr. McDERMOTT. But there is no economic reason why we couldn't?

Mr. LUBICK. Well, one could put a tax on most anything, I guess.

Mr. McDERMOTT. Well, I find this whole business of us trying to prop up the oil industry when they like the free-enterprise system on the way up, but when it gets tough, we have people coming in here saying that we have to save them. And I am not sure what our responsibility is for doing that. What do we lose?

Mr. LUBICK. You are getting into questions of philosophy. I think this is getting to be personal now—I think that is maybe not relevant to anything, but the government does have a function to aid those of its citizens for whom the market works harshly. I think that we apply that in a lot of areas, and I think that this is an industry where people are suffering from dislocations, and I think the Secretary testified at the original hearing here that we have to deal in an efficient way with dislocations caused by these economic changes.

But beyond that, there is a national security element to maintaining a domestic oil industry. I think you probably remember when you were at the mercy of OPEC in the midseventies. It caused a very severe dislocation to our economy.

Mr. McDERMOTT. Only for a short time. We modified things and then things got better——

Mr. LUBICK. But it was quite painful at the time in many parts of the country. I think that there is a case that we want to both protect this industry which has been historically important to this country and beyond that, the people that are in a very painful, distressed situation just as we are concerned with the steel workers, and we have been concerned with textile workers—I started out here in 1961 when we had some very severe problems there. I just don't think it has been our general practice to say, "Well, let everybody fend for themselves." There are difficulties, and I think there

is a basis for at least, if there are to be dislocations, providing some help that can't be done——

Mr. MCDERMOTT. Is there any difference between oil and steel policy?

Chairman HOUGHTON. The gentleman's time is pretty close to up.

Mr. MCDERMOTT. Is there any difference between oil and steel in this regard?

Mr. LUBICK. Well, I think that there are, as we indicated, some differences in the steel situation because we have some indications that there is significant dumping from abroad, and I think that question has been raised as to whether that exists in oil. To my knowledge, I don't believe that it has. There may be some difference, but I don't know that there is a difference in the distress felt by the individual steel worker and the individual oil worker.

Chairman HOUGHTON. OK, well thanks very much, Mr. McDermott.

Mr. Secretary, as you can see here, we are obviously trying to get the facts here, but also we are trying to save an industry, an industry that has permitted us to do things that no other country in this world, other than the oil-producing nations, can do. If you can help think through the Tax Code, along with our other deliberations in terms of trade remedies, we would certainly appreciate it.

Thanks very much for being with us.

Mr. LUBICK. Thank you, Mr. Chairman and Members.

Chairman HOUGHTON. OK, now we are going to have the first panel. Jay Hakes, Administrator of the Energy Information Administration, U.S. Department of Energy; and also Constantine Fliakos, managing director of the fundamental Equity Research, International Oils, Securities Research Division of Merrill Lynch.

OK, are you all ready? Mr. Hakes, we would like to have your testimony.

Thanks very much for being with us.

**STATEMENT OF HON. JAY HAKES, ADMINISTRATOR, ENERGY INFORMATION ADMINISTRATION, U.S. DEPARTMENT OF ENERGY**

Mr. HAKES. Mr. Chairman and Members of the Subcommittee, in the time allotted, I would like to present the views of the EIA, Energy Information Administration, on how oil prices got so low, what the major impacts of the decline have been, what the prospects appear to be in the coming year.

As of EIA's most recent report on Monday, retail prices for regular gasoline now average about 91 cents a gallon. Figure 1 shows the historical significance of low prices in annual averages through 1998, but today's prices are even lower than last year's average. When controlled for inflation, current gasoline prices are the cheapest in official records and probably the cheapest ever.

Prices of all petroleum products have fallen as a result of a 55-percent decline in crude oil prices since December 1996. The fall in crude oil prices, which can be seen in figure 2 of my testimony, has been gradual, but the prices have dropped very substantially and stayed low longer than previous price collapses in 1986 or in 1993.

The decline in world oil prices has been associated with the buildup in world oil inventories. Figure 4 in my testimony shows

the stock build for the world's major economies. The level of world inventories is slowing substantially, a return to more normal price levels. The EIA is currently projecting moderate increases in oil prices in 1999, but not back to the historic range.

The reasons for excess supply and low prices seem relatively clear. First, the return of Iraq to world oil markets in January 1997 boosted supplies substantially. Iraqi petroleum production increased from 0.7 million barrels per day in the fourth quarter of 1996 to 2.5 million barrels a day in the fourth quarter of 1998.

Second, other increases of world supply, OPEC and non-OPEC, had occurred earlier in this period of price decline and further increased world supplies.

Third, the economic collapse in Asia stopped the rapid growth in oil demand that many suppliers had hoped would soak up the increase in supplies. From 1990 to 1997, Asian oil demand grew by an average of 800,000 barrels per day each year. But in 1998, demand actually declined by about 70,000 barrels per day, and it is not expected to reach precrisis growth until sometime after the year 2000.

Fourth, as was mentioned previously, consecutive mild winters reduced the need for heating oil in North America and Europe.

Worldwide imbalances between supply and demand and depressed prices have had several major impacts. Some can be seen as positive for the economy, and many as negative. For instance, inflation has been restrained by low-energy prices. A large 7.7-percent decline in the energy category of the consumer price index in 1998 reduced the overall index by 0.7 percent from what it would have been without the energy price decline. In other words, instead of inflation being about 2.3 percent in 1998, we saw an increase of only 1.6 percent.

Another impact has been a steep drop in U.S. production, as seen in figure 5. A decline in domestic production seemed to have finally stopped in 1995 and production remained fairly flat in 1997. The apparent stabilization was the product of technology-driven cost reductions, developments in the Gulf of Mexico, and the relatively higher prices in 1996 and early 1997. But the recent price declines are taking their toll on production once again. Preliminary EIA data suggests that the decline in production, like the drop in prices, began in earnest during the second quarter of last year. By December 1998, production had fallen by about 500,000 barrels per day lower than it was 1 year earlier, despite an increase in production in the Gulf of Mexico.

As exploration and development slowed, U.S. onshore areas see the effects first since U.S. offshore drilling projects are much longer duration and, therefore, trail off more slowly. Production shut-ins are more likely onshore as well, since this area contains more marginal wells with high lifting costs such as those associated with enhanced oil recovery, heavy oil production, and smaller volume wells.

Since independent producers account for the majority of the lower 48 onshore production, they are likely to bear a larger portion of U.S. production decline than the major oil companies. Import dependence would rise even with stable domestic production

given the steady rise in U.S. oil consumption. But the drop in domestic production is pushing imports even higher.

The oil business is cyclical, and today's low oil prices are planting the seeds of later price increases. But world oil stocks and uncertain world demand lead us to believe that the bounce back will be slower than in previous periods of decline.

That concludes my testimony, Mr. Chairman, and I will be glad to answer any questions.

[The prepared statement follows:]

**Statement of Hon. Jay Hakes, Administrator, Energy Information Administration, U.S. Department of Energy**

CRUDE OIL PRICES

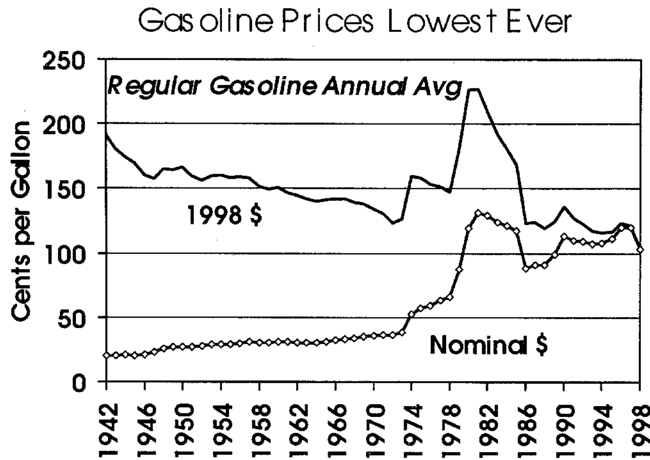
I wish to thank the Committee for the opportunity to testify today on the state of the petroleum industry, which is experiencing unusually low crude oil prices. As Administrator for the Energy Information Administration (EIA), which is an independent analytical and statistical agency within the Department of Energy, I have been asked to focus on what is behind the low prices, and on some of the effects we are already seeing in the United States—both good and bad.

For example, inflation has benefited from low energy prices. Declining energy prices, particularly in the oil sector, have been a significant factor contributing to the low inflation rate during the past several years. Inflation can be measured from changes in the Consumer Price Index (CPI), which is calculated from data representing a wide variety of goods and services across the nation. As of December 1997, "Energy" was calculated to represent approximately 7 percent of the overall CPI. Energy prices rose less than other prices in 1994 and 1995, reducing the inflation rate by about 0.2 percent. In 1996, when energy prices increased substantially, they boosted the inflation rate by about 0.2 percent, but when energy prices began to weaken during 1997, they lowered the rate by 0.2 percent. But a large 7.7 percent decline in the energy category of the CPI in 1998 reduced the overall index 0.7 percent from what it would have been without the energy price decline. Thus, instead of inflation being about 2.3 percent in 1998, we only saw about a 1.6-percent increase.

GASOLINE PRICES LOWEST EVER (FIGURE 1)

Today, the cheapest liquid you can buy at a service station is gasoline. Figure 1 shows that in 1998, consumers enjoyed the lowest gasoline prices in inflation-adjusted terms since at least 1942, and possibly the lowest ever. Regular gasoline prices averaged only $1.03 in 1998, but this obscures the fall off at the end of the year. In November and December gasoline prices averaged less than $1.00 per gallon ($0.995 and $0.945 per gallon respectively), and the latest weekly Energy Information Administration (EIA) data shows them at $0.907. This is about $1.36 per gallon less than we paid in 1981 in inflation-adjusted terms, and $0.40 cheaper in nominal terms. That 30-cent-per gallon gasoline that some people may recall buying in the 1950's and 60's is equivalent to about $1.50 in today's dollars. Or put differently, gasoline prices in 1998 were about 35 percent lower than those of the 1950's, adjusted for inflation.

**Figure 1**



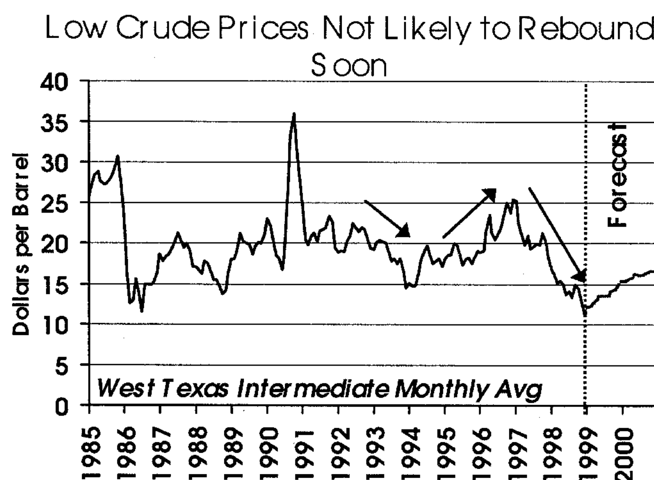

Source: Energy Information Administration (Form EIA-878), Bureau of Labor Statistics, and *Oil and Gas Journal.*

All petroleum products have fallen in price as a result of a 55-percent decline in crude oil prices since December 1996 (West Texas Intermediate monthly averages). Crude oil is the raw material from which gasoline is made, and in 1998, represented about 30 percent of the retail price of gasoline. Taxes (federal and state) on average represented over 35 percent; although, taxes vary significantly from state to state and even among localities within states. The remaining one-third of the price represents refining, marketing, distribution costs and profit margins. When petroleum product prices move as much as they have recently, it is primarily due to changes in crude oil prices.

LOW CRUDE OIL PRICES NOT LIKELY TO REBOUND SOON (FIGURE 2)

Figure 2 provides a perspective on the recent decline in crude oil prices relative to other recent declines and increases. Monthly average crude oil prices fell about 55 percent ($14 per barrel) from about $25 per barrel in late 1996 to just over $11 in December 1998. The West Texas Intermediate (WTI) crude oil price shown in Figure 2 is not what all producers receive for their crude oil. Heavier crude oils normally sell at a discount. EIA data are showing many transactions for low quality crude oils at less than $6 per barrel.

**Figure 2**




Source: History - DRI Platts monthly average spot prices for West Texas Intermediate Crude Oil. Forecast – Energy Information Administration's Short Term Energy Outlook, January 1999.

The decrease in price since 1996 occurred in two steps. The first $5–6 per barrel drop represented a retreat from unusually high prices at the end of 1996 before Iraqi crude oil returned to global markets. By spring 1997, prices settled briefly into the typical historical trading range of $17–$21 that has existed since 1986 (excluding the Gulf War). The second $8–9 decline began at the end of 1997 with the drop in demand caused by the Asian financial crisis, and continued through 1998 as Iraqi production increased even more after UN Security Council limits were raised. Annual average refiners' crude oil prices have not been this low in real terms since 1972, and in nominal terms since 1978.

The current decrease approaches the size of the drop in prices experienced in early 1986, but there are differences in the factors driving the decline. At the end of 1985, Saudi Arabia was no longer willing to be the major swing producer, reducing its production to balance worldwide markets as demand declined in the early 1980's and non-OPEC [1] production increased. Saudi Arabia therefore announced a new pricing regime and increased production. In the four months from November 1985 through March 1986, prices plunged about 60 percent (over $18 per barrel) from almost $31 to about $12.50. In contrast, the current $14 per barrel decline occurred over 24 months. In 1986, prices didn't bottom out until July when they averaged $11.60; however, they rebounded fairly quickly and settled into a $17–$21 trading range by January 1987. A quick rebound may not occur in the current situation. EIA projects WTI oil prices reaching $15/barrel by the end of 1999, but they may not return to the historical $17–$21 trading range before 2001. I will explain shortly why the recovery could take some time.

The 1986 price drop marked the transition from a world dominated by long-term contracts and official prices to one driven by spot and futures trading and of supply (production) and demand imbalances driving immediate price responses. We now see crude oil supply and demand moving in cycles like other commodities—shifting from too little supply to too much relative to demand, with prices reflecting the changes. Figure 2 shows the shift from a weak price market in 1993, to a strengthening one through 1996, ending with our current weak-market cycle.

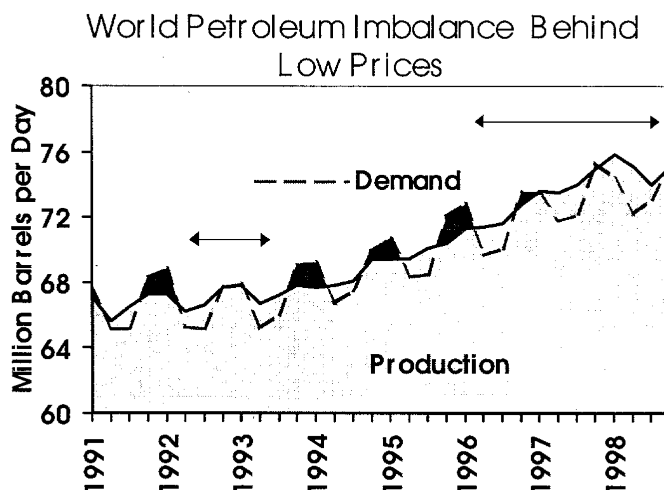
WORLD SUPPLY/DEMAND IMBALANCE BEHIND CURRENT LOW PRICES (FIGURE 3)

This cyclic effect is demonstrated more directly in Figure 3, which shows quarterly world petroleum production (in gray shading) and world demand (the dotted

[1] OECD—Organization for Economic Cooperation and Development

line). Normally world petroleum demand is seasonal—being higher than production in winter when heating needs increase, and lower than production in summer. As a result, petroleum stocks normally build in summer and are then drawn down in winter (black areas) when demand exceeds production, as seen in 1994–1996.

**Figure 3**




Source: Energy Information Administration, *International Petroleum Statistics Report* and EIA estimates.

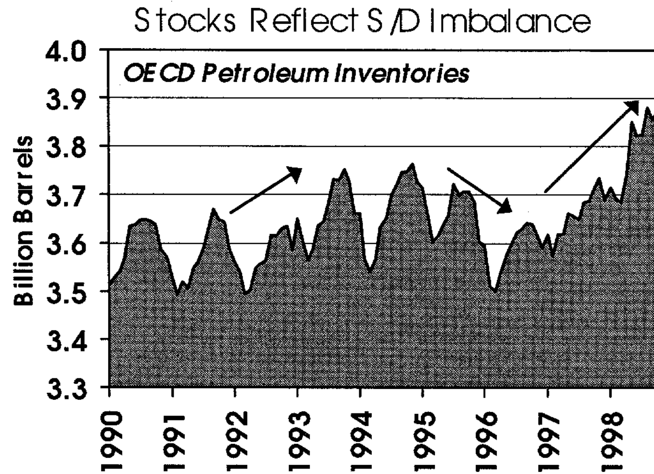
As with other commodities, longer-term supply/demand cycles are overlaid onto this seasonal pattern. When production exceeds demand for petroleum worldwide for a year or more, prices weaken. Since early 1997, we see little or no seasonal stock draws, mostly stock builds, a pattern that is due to both supply and demand factors. We had a similar pattern in 1993 when the lingering effects of the 1991 world recession and the collapse of the former Soviet Union's economy, coupled with a warm winter, kept demand below supply all year. During that period, crude oil prices also fell, but only about $7 per barrel. That weak cycle ended when increased demand from a cold first quarter and renewed economic growth removed the surplus supply. The current market imbalance is larger than that in 1993, as shown on the next chart.

STOCKS REFLECT THE SUPPLY/DEMAND IMBALANCE (FIGURE 4)

The present oversupply cycle has resulted in an unusually long interval of building stocks. OECD[2] country stocks are now at very high levels, as seen in Figure 4. OECD stocks generally follow the seasonal patterns just discussed. But this chart shows very small winter inventory reductions during the last two years. There are mainly four reasons behind the oversupply and weak prices:

[2] OECD—Organization for Economic Cooperation and Development

**Figure 4**




Source: OECD Monthly Oil Statistics Data Base and International Energy Agency estimates for last three months.

• the return of Iraq to oil markets in January 1997, without OPEC or other producers reducing production to make room for the extra supply (Iraqi petroleum production increased from 0.7 million barrels per day in the 4th quarter 1996, to 1.3 million in 4th quarter 1997, to 2.5 million barrels per day in 4th quarter 1998.

| 1996 | 1997 | | | | 1998 | | | |
|---|---|---|---|---|---|---|---|---|
| Qrtr 4 | Qrtr 1 | Qrtr 2 | Qrtr 3 | Qrtr 4 | Qrtr 1 | Qrtr 2 | Qrtr 3 | Qrtr 4 |
| 0.7 | 1.1 | 1.1 | 1.3 | 1.3 | 1.6 | 2.1 | 2.5 | 2.5 |

Source: Energy information Administration, 1996–3rd Quarter 1998, Monthly Energy Review, Table 10.1, 4th Quarter, EIA estimate.

• the economic collapse and reduction in demand from Asia (From 1990 through 1997, Asian oil demand (including China and Japan) grew by an average of 800,000 barrels per day each year, but in 1998, this region's demand actually declined by about 70,000 barrels per day, and is not expected to reach pre-crisis growth until sometime after the year 2000.);

• two warm winters worldwide in a row; and

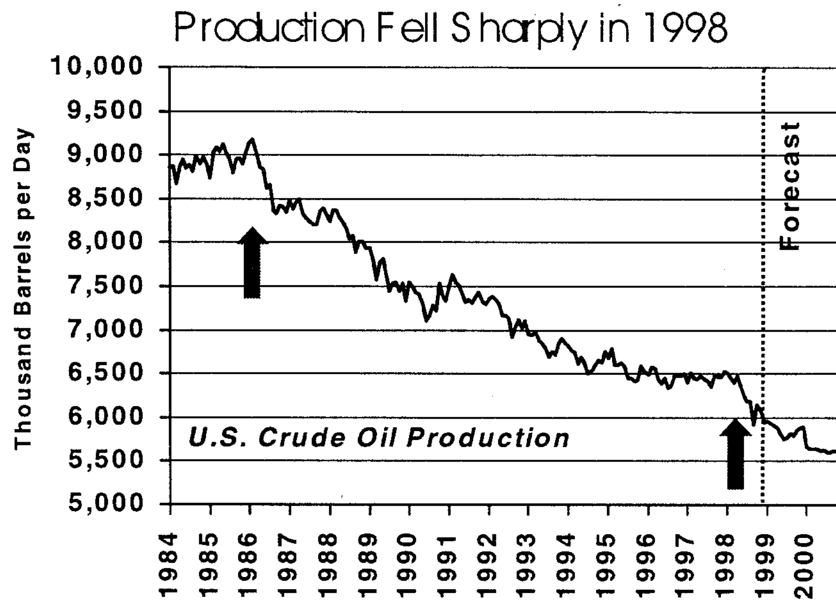
• non-OPEC supply growth and other OPEC supply growth on top of Iraq (OPEC petroleum production excluding Iraq is estimated to have increased by over 0.5 million barrels per day since 1996, in spite of agreed-upon production cuts, on top of Iraq's 1.6 million barrel per day increase, while non-OPEC production increased by 1.1 million barrels per day.).

Until the large stock overhang is eliminated, prices are not likely to return to the historical $17–$21 trading range. We may be seeing recent signs of both a more normal seasonal demand-supply cycle and the beginning of a reduction in the surplus inventories, but the EIA sees that erosion occurring slowly and projects that prices may not return to the historical trading range before 2001. But keep in mind that any re-balancing of production and demand that removes excess inventories depends on the four highly uncertain factors just discussed. EIA's high and low price ranges encompass credible scenarios that could result in a more rapid return to higher prices, or an even weaker market.

LOW OIL PRICES REDUCE PRODUCTION AND INCREASE IMPORTS (FIGURE 5).

Low oil prices stimulate higher demand growth and a steeper U.S. production decline. Imports must increase to meet both higher consumption and the loss of higher cost domestic production. Figure 5 shows that, following the price drop in 1986, U.S. crude oil production declined about 2.5 million barrels per day or 28 percent, falling from 8.9 million barrels per day in 1985 to 6.4 million barrels per day in 1997. Alaskan production accounted for about 0.5 million barrels per day of that loss. During this same time, imported crude oil grew 5 million barrels per day (from 3.2 million barrels per day in 1985 to 8.2 in 1997) to replace the lost production and to meet growing petroleum demand. The decline in domestic production seemed to have finally stopped in 1995 and remained fairly flat through 1997. The apparent stabilizing was the result of technology-driven cost reductions, developments in the Gulf of Mexico, and relatively higher prices in 1996 and early 1997.

**Figure 5**




Source: Energy Information Administration.

But the recent price declines are taking their toll on production once again. Preliminary EIA data suggest that, while first quarter production was relatively flat, a steep decline began in the second quarter. By December 1998, production had fallen about 500 thousand barrels per day from year-ago levels, despite an increase in production in the Gulf of Mexico. If prices recover only slowly as shown in our current base case forecast, the cumulative loss in production between 1997 and 2001 would be another three-quarters to 1 million barrels per day, on top of the 2.5-million-barrel decline we have seen between 1985 and 1997. Under these circumstances, imports would increase at least another 1 million barrels per day over the 5-million-barrel-per-day increase that occurred between 1985 and 1997.

We see the industry responding in a number of areas. From December 1997 through December 1998, operating oil rigs have fallen 57 percent and gas rigs 24 percent. Exploration and production expenditures are also falling. According to Salomon Smith Barney's expenditure survey, total U.S. exploration and production expenditures planned for 1999 are 21 percent below 1998 expenditures, following a 0.2 percent decline in 1998.

Production exhibits inertia, responding slowly to oil price changes. Price declines tend to retard exploration and development plans to a greater extent than current production; although, marginal wells begin to be shut in as prices decline. Generally, significant production changes lag large price changes, which is why aggregate production only began to show substantial declines in the second half of 1998.

As exploration and development slow, U.S. lower 48 onshore areas see the effects first, since U.S. offshore and frontier area drilling projects are of much longer duration and therefore trail off more slowly. However, low oil prices have even delayed projects on the Alaskan North Slope that earlier had been expected to stabilize or increase production there. Additionally, U.S. onshore (lower 48 onshore) activities contain more small firms that have fewer resources to continue operating during a price downturn. Production shut-ins are more likely in the lower 48 onshore as well, since this area contains more marginal wells with high lifting costs, such as those associated with enhanced recovery, heavy oil production, and small volume wells. Since independent producers account for the majority of lower 48 onshore production (almost 60 percent in 1997), they are likely to bear a larger portion of the U.S. production decline than the major oil companies.

In conclusion, oil prices may not return to the $17–$21 trading range before 2001, but there is much uncertainty in price forecasts. The factors depressing today's prices are highly unpredictable. Global demand growth is highly uncertain, given Asian economic problems and slowing economic activity elsewhere; future OPEC production behavior is unknown; and the full impact of today's low prices on non-OPEC production is also difficult to assess.

Continued low oil prices are good news for consumers and the general economy. Imports will likely rise with declining domestic production as the domestic oil industry reduces costs, increases productivity, or contracts. However, regional economic impacts, including job losses, business losses, and reduced severance tax revenues will accompany these production declines.

This concludes my testimony before the Subcommittee. I would be glad to answer any questions at this time.

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Mr. WATKINS [presiding]. Thank you.

The Chairman, Congressman Houghton, went over to cast that vote and will be returning shortly. So, we will proceed and not lose any particular time.

I would like to take a personal privilege right fast, if I could. From the State of Oklahoma, an elected official from the Corporation Commission, Denise Bodie, used to be the head of the Independent Petroleum Association of Americas, is in the audience. And Denise, we are pleased you are hear with us.

All this information, as we look at it—oh, Mr. Fliakos, would you like to testify at this time?

**STATEMENT OF CONSTANTINE D. FLIAKOS, MANAGING DIRECTOR, FUNDAMENTAL EQUITY RESEARCH, INTERNATIONAL OILS, SECURITIES RESEARCH DIVISION, MERRILL LYNCH & CO.**

Mr. FLIAKOS. OK. Fine.

I was asked to talk about the causes of the price collapse, and I don't want to be repetitive. I would just point out that clearly what we have witnessed for the last several years in the oil business is a very powerful inventory cycle. Oil is a commodity. It is susceptible to an inventory cycle. It has been a pretty powerful one with a lot of extremes.

In 1996, not long ago, inventories were very low, and the price of oil was over $35 a barrel. And those low levels of inventories were caused by just-in-time inventory management by the oil industry. It was caused by the absence of the Iraqi oil exports. It was caused by a cold winter 2 years ago. Since then, inventories have

recovered to excessive levels because of the resumption of Iraqi oil, the slowdown in Asia, and two warm winters. It has been an inventory phenomenon that has caused the decline in the price of oil.

What I would like to highlight, however, is a very disconcerting complacency that I see not only in the public, in the press, but also in the government about the current level of oil prices. And I say this because I think that in the oil business, and for that matter, I imagine, in any commodity, we have to be able to distinguish between price gyrations that are caused by inventory phenomena, which are temporary, and price effects that are caused by underlying, secular dynamics which have a much more lasting influence. I believe the current complacency is not really justified from a long-term perspective, and I think that the complacency is, in fact, very dangerous, not only for our economic well-being in the future, but also for our national security.

I think that today's situation is dramatically different than the situation that we had, for example, in the mideighties, the last time the price of oil collapsed. Back then, there was a lot of surplus capacity in the world. In fact, the surplus was nearly 25 percent of the demand. Back then, the industry was in secular abundance, and the price collapse was inevitable.

I would point out that following, today, notwithstanding the inventory glut, there is very little surplus capacity in an industry which is very susceptible to politically induced supply interruptions. Even with the cutbacks that OPEC has implemented, I reckon that the surplus capacity is less than 8 percent of demand, in contrast to the nearly 25-percent surplus that we had back in the mideighties. This is hardly a comforting thought in an industry that, as I said before, is so susceptible to politically induced supply interruptions.

I am convinced that the problem is temporary because the glut is going to disappear and the demand for oil will begin to recover—I think with the underlying growth in demand is about 2.5 percent a year once we return to a more normal, economic environment around the world. We may, in fact, overshoot because there is likely to be in the meantime a lot of devastation on the supply side of the equation.

Today's low oil price and the sharply lower capital spending by the oil industry is going to have a very negative impact on supplies, and I believe that in the future we are going to become more and more dependent on OPEC oil, on Middle Eastern oil, on oil that is politically vulnerable.

In assessing the implications for the future, and in trying to find solutions to the problem, I think it is important to keep in mind that there are certain peculiarities and idiosyncracies in the oil industry. I'll mention two of them.

One peculiarity is the geological fact that most of the world's oil resources, the low-cost oil resources in particular, are in politically vulnerable countries. The economic cost is low, but the political cost is very high. As we seek an adjustment process, we have to recognize that there is a divergence between economic costs and political costs in the oil business.

There is another peculiarity in the oil industry that has to do with the enormous lead times entailed in developing projects from

the planning process to the implementation and their ultimate commissioning. It takes a long, long time to move projects forward.

There is, in other words, a big divergence between the price of oil in the short term, which is caused by temporary phenomena, such as weather, and the price in the long run which should be high enough to ensure that we have adequate supplies in the future at reasonable prices. We need, therefore, some adjustment mechanism that will reconcile the discrepancy that exists between short-term price and long-term price.

And let me point out that the oil industry, like corporate America in general, is so preoccupied with the near-term financial performance in response to the demands of the financial markets that I believe that the pendulum in tilting against a focus on long-term growth. Therefore, the reaction by the industry, even those that are financially strong companies in the industry, is to retrench, to cut down spending, to lower production, to lower development, and I believe this is going to have serious, negative implications down the road.

Let me conclude, therefore, by expressing my very strong feeling that even though today we are enjoying lower prices and lower oil prices are contributing to the economic well-being of our Nation and the world, I am afraid that these gains are being achieved at the expense of a very, very high price that we may have to pay in the future, unless things improve and they improve soon.

Thank you very much.

[The prepared statement follows:]

**Statement of Constantine D. Fliakos, Managing Director, Fundamental Equity Research, International Oils, Securities Research Division, Merill Lynch & Co.**

EXCESSIVE INVENTORIES HAVE BEEN THE CAUSE OF THE OIL PRICE COLLAPSE

Oil, like any other commodity, can exhibit wide inventory swings influenced by near-term factors including weather, economic conditions, political developments and miss-judgements by both the oil companies and governments. We have witnessed a major shift in inventories from very low levels in 1996 to adequate in 1997 and to excessive levels in 1998. Inventories remain very high today.

The factors that contributed to the low level of inventories in 1996 included just-in-time inventory management by the oil industry; the absence of Iraqi oil exports; and unusually cold weather during the winter of 1995/1996.

Following delays throughout 1996, the UN and Iraq finally agreed on a plan of limited oil sales for humanitarian purposes and oil exports began in December of 1996. Oil exports from Iraq coincided with a fairly mild winter throughout the Northern Hemisphere in the winter of 1996/1997. Those factors contributed to the replenishment of inventories to normal levels at the end of 1997 from very low levels in the beginning of 1997.

As we headed into 1998, there were clear signs that inventories would become excessive. And yet OPEC agreed to increase production when it met in November of 1997 resulting in higher output by Saudi Arabia, Kuwait and the United Arab Emirates in the beginning of 1998.

In the meantime, the economic slowdown in the Far East and another unusually mild winter lowered the growth in oil demand substantially in 1998. Iraqi oil exports also expanded in 1998 because of an increase in the oil-for-food program. All these factors converged to raise inventories to very high levels in 1998.

The oil price extremes we experienced in the last two and a half years have been caused by the extreme changes in inventories. Unusually low inventories in 1996 drove oil prices sharply higher—they reached more than $26 a barrel in the beginning of 1997. Excessive inventories caused oil prices to collapse to the low teens in the beginning of 1998—which is where we are today.

The only way the oil price slide could have been reversed within a relatively short period was to curb oil production. OPEC, in cooperation with some non-OPEC coun-

tries, agreed, in fact, to curtail production last year and reductions of more than 2.0 million barrels a day were implemented since the middle of 1998.

The production cuts occurred, however, at a time when market conditions were deteriorating rapidly. In addition to weakened oil demand, production and exports rose very substantially in Iraq. The output restrictions by oil producing countries proved to be inadequate to reduce excessive inventories.

### Complacency Is Unjustified . . . We Should Be Concerned

Despite low oil prices there is considerable complacency about the outlook. The widespread belief seems to be that oil supplies will remain abundant, and oil prices will, therefore, remain weak for a long time.

When oil prices were strong in 1996 and in early 1997, the inclination was to argue that oil prices would never again fall to low levels because there was presumably a secular tightness. Now we are told we are entering a period of secular weakness.

Today's complacency is, in my judgment, unjustified and dangerous. Unless the current trend is reversed soon, we may be heading inexorably toward another energy crisis sometime in the next five years.

The oil situation today is, I believe, quite different than it was in the mid-1980s—the last time we experienced a major collapse in oil prices.

Leading up to the price collapse of the mid-1980s, the oil industry was in a major secular decline. Oil demand was declining; OPEC's share of total supplies fell sharply; Saudi Arabia's oil production fell to unsustainably low levels; and surplus production capacity amounted to nearly 25% of demand and was clearly excessive. The secular weakness was the main underlying cause for the 1986 oil price collapse, and the collapse was unavoidable.

As I indicated earlier, the recent oil price collapse was caused by excessive inventories rather than by a secular weakness. The price collapse was, in fact, avoidable.

Despite abundant inventories and very low oil prices, the underlying conditions in the oil business are much tighter now than they were in the 1980s—and they are likely to get even tighter—and should be cause for considerable concern.

Because of growing demand, surplus production capacity globally has been limited to about 5% of total demand during most of the 1990s and is now 7–8% of demand despite the cutbacks that have been implemented by oil producing countries. This is in contrast to the mid-1980s when surplus capacity, as I mentioned earlier, amounted to nearly 25% of demand.

Once the economic problems are solved around the world, global oil demand should begin to grow once again by 2.5% a year which will be equivalent to about 2.0 million barrels a day of incremental demand each year.

I expect that supply sources outside of OPEC will be able to satisfy only a small portion of the projected growth in demand. In fact, one of the most devastating consequences of low oil prices will be the very negative impact that they are likely to have on non-OPEC supplies. Low oil prices has already led to the shutdown of some high-cost production—and the shutdown is likely to be permanent. Moreover, sharply low levels of capital spending will curtail the development of new supplies as well.

We will have to depend more and more, therefore, on OPEC supplies in order to satisfy growth demand. But even within OPEC, capacities may erode because the budgets of producing countries are strained and not enough money is being spent to maintain let alone to increase capacities.

The amount of surplus oil capacity is limited and could become even more limited if oil prices remain low for a while longer. It is a disquieting phenomenon for a commodity such as oil that is so susceptible to supply disruptions that can result from political and social upheaval, as well as accidents.

### Timely Adjustments Are Difficult To Achieve In The Oil Business

Because of the idiosyncrasies of the oil industry, it is almost impossible to ensure a continuing flow of oil supplies at reasonable prices by relying exclusively on conventional, market-related adjustment processes.

An important characteristic of the oil business is the geological fact that a major portion of the world's low-cost oil supplies are located in parts of the world that tend to be politically vulnerable. The "economic" cost of those supplies is indeed low but their "political" or "national security" cost can be quite high. Any adjustment process must, therefore, take into account the large discrepancy that can exist between economic and political costs if resources are to be allocated optimally from both an economic as well as a political perspective.

Another important aspect of the oil business is the long lead-times entailed in the capital investment process—from the planning of capital prospects to their implementation and their ultimate commissioning.

Because of the long lead times, supply and demand adjustments in response to signals given in the marketplace through the price mechanism are not instantaneous. Adjustments ultimately do occur, of course, but in the meantime there can be severe dislocations that may be unacceptable for a commodity that is so essential for our nation and the world's economic well being.

Another way to view this dilemma is to point to the divergence that sometimes exists in the price of oil—as it does today—from a near-term versus a longer-term perspective. The near-term price of oil can be depressed, as it is today, because of the influence of temporary factors. In the longer-term, the price needs to be high enough to ensure continuing the availability of supplies at reasonable prices.

The dilemma that stems from a possible divergence between the price of oil in the short-run and the appropriate price in the long-run is exacerbated by the changes that have occurred in the attitudes of the managements of the major oil companies as they try to be more responsive than they have been in the past to the near-term demands of the financial markets.

It is fair to say, I believe, that in trying to reconcile immediate financial performance with longer-term growth considerations the pendulum has probably tilted in the oil industry—as is probably the case for "Corporate America" generally—in favor of immediate financial performance.

The immediate response to lower oil prices, therefore, tends to be to retrench, to restructure and to curtail capital spending in order to protect profits. For some companies, of course, particularly the smaller ones, retrenchment is a necessity dictated by cash flow considerations and by the need to survive financially.

The inevitable consequence of such retrenchment is lower future growth—and in the oil business, in particular, it means lower oil supplies in the future.

If oil prices were to recover, the industry will no doubt accelerate capital spending and will focus on growth once again. But the adjustment is likely to be slow. And in the meantime, the consequences for our nation and the world could be quite severe because we are so dependent on supplies that are susceptible to politically induced supply interruptions.

Today's low oil prices are no doubt contributing to today's unprecedented economic prosperity by keeping inflation low. Unfortunately, however, we may have to pay a high price in the future for the benefits we are enjoying today.

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Chairman HOUGHTON [presiding]. Would you like to ask a question, Mr. Watkins? Are you going to vote?

Mr. WATKINS. Mr. Chairman, in order to indicate the significance and the problems of this entire problem, I am going to miss this vote because I am going to be here with you. And I appreciate you having these hearings, and I appreciate everyone being here. I am going to stay here and miss that vote. I would like to ask some questions.

I wanted to try to follow up on—you indicated that we have about 8 percent surplus, if I understood correctly here. And that was compared to 25 percent surplus back in 1985. So our little margin of difference today is by far a whole lot less. With any interruption around the world, we could be in a very undesirable spot as far as the Nation goes, but a situation that could really be a catastrophic problem, to say the least, for our country. Is that the interpretation I have received? Is that correct?

Mr. FLIAKOS. That's very much the point I was trying to make, and, also, I think we should bear in mind that this surplus can very easily dissipate if you consider that the demand for oil under normal circumstances—if the world returns to normality, if the problems in the Far East are resolved—the world can grow at 2 million barrels a day every year.

And in the meantime, because of lower oil prices, capacities which we thought a few years ago were going to rise, capacities to produce oil may not rise because of lower oil prices. In this country, capacities are eroding for economic reasons. But the producing governments within OPEC, because of budgeting constraints, they are not expanding capacity either.

The 8-percent surplus that I talked about could become even less down the road, so any politically induced supply interruption could have a devastating effect.

I am actually amazed that we have forgotten that in the last 25 years we have had several major supply shocks at times when capacities were greater. We had the Arab embargo of 1973. We had the Iranian revolution in 1979. We had the Iran-Iraq war in 1980 and beyond. We had Iraq's invasion of Kuwait in 1990. These were supply shocks that caused a sharp rise in oil prices.

And even today, as we look around the world, we can see the potential for social upheaval in Nigeria. There are potential problems in other oil producing countries such as in Indonesia, and many other trouble spots could surface. We cannot be complacent.

Mr. WATKINS. It seems like the administration's policy, or lack of a policy, has forced us to become more dependent on all of these foreign sources. It is not just a free situation. It is forcing us to move in that direction. Chairman Greenspan was sitting there at the panel, and I asked the question about the fact of what is the benchmark to cap the levels that we are not going to be penalized when—the oil patch is not going to be penalized later on when prices are going up because, you are right, the economy, the overall major economic climate that we are in today is largely the result—and I've said we should thank the energy industry because the lower the oil prices the less inflation—or the less likelihood that any inflation is, so Chairman Greenspan can make a decision on whether to keep interest rates low or to do different things. It is the price that we are paying in oil patch.

I wish that my colleague, Jim McDermott, were here, because, as we talked about it awhile ago, there are policies happening. And that's our policy to Iraq. Iraq has increased from 500,000 barrels just a short few years ago to now over 2.5 million barrels today. And we are bombing Iraq. We are over there putting our troops in jeopardy and lives in danger while allowing him to go from on the black market, so to speak, to selling over 2 million barrels of oil per day. That is quite significant.

We also have changed our dependence since the end. And I think that this is something that a lot of people don't realize that would change a great deal from the Arab countries, but we have in Venezuela, Mexico, and Canada increased. Like in Venezuela, about 490 million barrels a year and somewhere in that neighborhood in Mexico, and Canada is about 420 million barrels a year.

We changed the dynamics, and it seemed like our administration would prefer to go in either that direction of depending more on foreign oil or—and a lot of people need to understand this, environmentally speaking—offshore, or into public lands. And our domestic production in the lower 48 States—which has produced 60 percent of the oil in the past—is the area that is being jeopardized.

Mr. Chairman, I just wanted to make those points.

You have made a couple of good points, and we will get back to some of yours after awhile.

Thank you.

Chairman HOUGHTON. All right, thank you very much.

Mr. Lucas, have you got any that you would like to ask?

Mr. LUCAS. I think that I would just address—thank you, Mr. Chairman—a couple of general questions to the panel about the effect that these energy prices have not only on the United States but what is the impact in places like Russia and other countries around the world who may not be, perhaps, considered to be major oil exporters by the average citizen, but nonetheless, a substantial portion of their operating budget, cash, hard dollar currencies, come from oil sales. What is the effect this situation is having on those kind of countries?

Mr. HAKES. Well, there is both the loss of revenues that results from decreased demand, and, as was mentioned by the other witness, there is a dropoff in investment. It is interesting how these cycles go. In 1996, I was testifying before another House Committee on the high price of oil. And, through 1997, we were seeing a very healthy, positive investment climate in the United States, and in some high-cost areas—the Gulf was quite dynamic—and in places like the Caspian Sea area and in Russia. And, so now, in the current environment, the interest with the investment community has dropped substantially, so they are getting hit several ways from these lower prices.

Mr. LUCAS. Their production tends to be more from State-controlled entities. They have to have the cash flow. They are going to continue to sell their crude at whatever the price may be, I would assume. Which means that ultimately, because we have a production capacity in this country, an exploration that is based on individual companies and individual nongovernment entities, that downward price pressure, then, disproportional, isn't it a fair statement that impacts our producers? Because they are not backed up by the king, the czar, the President or whatever. They go it on their own. So, in this environment, they disproportionately suffer more than other entities around the world. Is that a reasonable statement?

Mr. HAKES. I think the evidence is that people tend to produce oil as long as they are recovering their operating costs, and, if they don't recover operating costs over some period of time, then they would probably shut in.

I think the difficulty is for someone who might keep producing, but they have also invested capital in that which they are losing.

OPEC itself has tried to restrain production. We have done some analytic work that shows what the impacts are in dollars on their budgets, and they are huge.

OPEC and non-OPEC have been sort of cutting back at a somewhat similar rate for a year or two, perhaps for different reasons. But both have been cutting back.

Mr. LUCAS. Thank you.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you.

Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Fliakos, economic analysts report that the oil and gas industry's current flow crisis will experience a small rebound in 1999 but will not reach normal prices until 2001. Is that pretty much what your analysis would indicate?

Mr. FLIAKOS. Well, I think that in terms of this year, unless OPEC acts to lower production—OPEC is supposed to meet on March 23—unless they act to lower production, the inventory glut is going to continue, and the price of oil is going to be under pressure. It could go under $10 a barrel. This is a very severe inventory problem.

My point is that the worse it gets today, in terms of low oil prices, the better it is going to get tomorrow, in terms of oil prices. Depending on whether you are a consumer or a producer, and what is better or worse from that perspective, conditions can change materially.

Today's low oil prices are having, in my opinion, a devastating impact on supplies. In 1 year from now, 2 years from now, a combination of erosion of supply with a recovery in demand because of an economic recovery in the Far East, and maybe, statistically at least because of a cold winter, the price of oil could explode. Most forecasts assume smooth increases. We see charts, for example, suggesting that the price of oil is going to go up by 2 percent a year. It doesn't work this way. We are likely to go from $10 oil to $25 oil, and if there is a political crisis somewhere, it will be higher. I think that the situation is very serious.

Chairman HOUGHTON. I just have a single question. You have brilliantly outlined the problem and the issue, but I sure want a solution. That is what we are looking for here. We all understand the conditions around this, but what are the solutions?

Now, maybe each one of you could tell us specifically the most important single area that should be worked on in order to protect this industry. One suggestion.

Why don't you start, Mr. Hakes.

Mr. HAKES. Well, the Energy Information Administration tries to stay away from policy recommendations, but one of the things that you could look at—I would make clear that I am not recommending any policy—is how the Strategic Petroleum Reserve could be used in perhaps a more expansive way than it is now. There are some States, for instance, that get involved in the heating oil market. They try to buy low and sell high. Again, I am not advocating that, but there are ways, and the Western economies have had some discussions among themselves about how the Strategic Petroleum Reserve can be used. Under the current statutes, I believe, it is only available for emergency purposes.

But certainly that is one way of addressing the political instability problem. Although the current statute doesn't suggest it, it could be a way of dealing with the volatility problem. Oil does tend to be more volatile than other commodities, so it does have a certain status, I believe.

Chairman HOUGHTON. So, that has been drawn down, quite substantially. And so, to build that up and to use the reserves as a place where independents could sell their production.

Would that take them through 1 year or 6 months or 3 months? What is it?

Mr. HAKES. Well, the current inventory is a little bit over 560 million barrels, and there was a small draw during the Persian Gulf war which was replaced, and then there was a small draw during 1996 which has not been replaced but is currently planned to be replaced.

That would replace U.S. imports for a period of 60 to 70 days perhaps. But, in one sense, that doesn't sound like a lot, but in international commodities markets sometimes differences in that amount can make a big difference. The capacity of the Strategic Petroleum Reserve is somewhat higher than that, so there is still some room physically for the reserve to accept more oil than it has now.

Chairman HOUGHTON. OK. It doesn't seem like it is going to help very much. It will help on a very, very small basis. Maybe 1 or 2 or 3 months, but not long.

Yes, sir?

Mr. FLIAKOS. Well, there are all kinds of patchwork solutions that one can find to solving the problem. I think fundamentally, however, what we need is a higher price of oil. We have to get the price of oil higher. And I think that the way to do this—and the question involves politics, and it was pointed out very correctly that the buildup of Iraqi oil has been a major factor in creating the inventory glut. With Iraq it is politics. There was a war. There was an embargo. There was——

Chairman HOUGHTON. So, you are suggesting a higher price, and that means a higher tax, is that right?

Mr. FLIAKOS. Well, not necessarily. I think that the way to do it is so that the tax system can be a vehicle, but I think that the way to do it is through more cooperation at the international level.

I recall in 1986, when the price of oil collapsed, then-Vice President Bush went to Saudi Arabia and discussed the serious implications of low oil prices, not only for this country but for the world at large.

I think that it is a much more broad issue than just tax or the Strategic Petroleum Reserves.

Chairman HOUGHTON. Well, unless there are any other questions, I thank the panel for being here.

Thanks very much, and your testimony will be put on the record.

Mr. WATKINS. Mr. Chairman, may I make a point?

Chairman HOUGHTON. Go right ahead.

Mr. WATKINS. You alluded to it again, and I think that we need to repeat it. This administration does have a policy, they may not want to admit it, but—my friend, Jim McDermott left to go vote awhile ago, but—Iraq was only producing about 500,000 barrels of oil a day. In 1 year, they have come to 2.5 million barrels of oil a day. At a time when we have been in conflict and bombing Iraq, we have allowed them to continue to turn the spigots on, and our policy is for the people of that country to have unrest and overthrow Sadaam Hussein. They are not going to be if we are allowing the produce and bringing all the money in the world from the sale of oil.

And the policy is the death of our domestic oil economy and really putting lives in danger also. I don't understand this. It is a crazy, crazy policy.

Chairman HOUGHTON. Your solution would be to go to the United Nations and ask them to crank down the production of Iraqi oil.

Thanks very much, gentlemen.

Now, we have another panel. Julia Short, member of the National Association of Royalty Owners from Norman, Oklahoma; Bill Waller, vice president of business development of Somerset Oil and Gas Co. in Buffalo, New York, and Indiana, Pennsylvania; Mitchell Solich, president and chief operating officer, Chandler and Associates, Denver, Colorado, and president of the Chandler Development Co.; Don Macpherson, president of the Macpherson Oil Co., and president of the Independent Petroleum Association in Bakersfield, California; Michael Cantrell, president of the Oklahoma Basic Economy Corp. in Ada, Oklahoma; and John Bell, owner of the DBA Reata Resources in Kermit, Texas. And I was hoping that Mr. Stenholm would be here to introduce the next witness, and that would be—but I'll do it on his behalf—Glenn Picquet, executive vice president of C.E. Jacobs Company in Albany, Texas, on behalf of the North Texas Oil & Gas Association, Panhandle Producers, Royalty Association, and a variety of other producers and owners.

If Mr. Stenholm comes in and would like to make a comment, we would like to have him. Also, it was Mr. Thomas who—OK, good.

All right. Ladies and gentlemen, thank you very much for being here.

Ms. Short, would you begin the testimony.

**STATEMENT OF JULIA A. SHORT, MEMBER, NATIONAL ASSOCIATION OF ROYALTY OWNERS, NORMAN, OKLAHOMA**

Ms. SHORT. Thank you.

My name is Julia Short. I am 71 years old and live in Norman, Oklahoma. I am retired and live on Social Security payments of $427 a month supplemented by royalty income from some small, older oil wells in Oklahoma. My Social Security is also small because most of the jobs that I had in my working years were short term and paid minimum wage.

In 1997 my total royalty income was a little over $8,600. In 1998 it dropped to around $5,300. That is a 40-percent drop in 1 year for someone already living near the so-called poverty level.

There are approximately 200,000 other Oklahomans in the same boat who depend on investments or assets in oil and gas mineral royalties. With 4.5 million royalty owners nationally scattered across every State in the Union, although their incomes may come from 1 of the 20 or 30 producing States.

I am here to talk to you about what is happening in my life and in the lives of hundreds of thousands of Americans like me because of the current oil collapse.

First, there is nothing royal about oil and gas royalties. Please don't confuse royalty owners with the British use of the term. American royalties are tied directly to the land from which our mineral assets are drawn, and we exchange the rights to produce oil from that land for a small share of the revenues when oil is sold. Since the bulk of Oklahoma royalty owners are either retired or rapidly approaching that state of economical dispair, oil royalty income is badly needed for the economic base of our entire State.

Royalty income has sustained countless families, small farms, and ranches in rural towns for decades. Royalty dollars circulate many times through a local economy by way of the grocer, the pharmacist, the feed store, the doctor, small shops, and those who provide the services to the elderly. When those dollars disappear, whole communities can be financially devastated. Family farms are sold to giant agriculture corporations. The elderly and infirm lose their self-sufficiency and become dependent on public welfare for survival.

I was born October 27, 1927, in Duncan, Oklahoma, the great-great granddaughter of pioneers who settled near Velma in what was then the Chickasaw Nation. My grandfather, Sid Jones, was primarily a rancher who worked land in various sections of Stevens County, Oklahoma.

In order to provide a secure future for his family, my grandfather began to save, acquire, and trade land. He learned to hang onto the mineral interests when he sold surface acreage. This was a customary hedge against the often devastating brutality of drought, floods, the dust bowl, and other harsh realities facing farmers and ranchers in the southwest.

When he died in 1958, he owned small percentages of minerals in over 30 tracts. When I say small, I mean fractions as low as 0.0003360 percent. Of course, some were larger, but he was still not what you would call a wealthy man by any standard.

At his death, mineral interests, which when and if producing are called royalty interests, were divided among several family members: A son and daughter, my mother, my sister and I and my cousins. None of us most certainly became rich—but the extra income was welcome and needed to survive.

In the sixties, my monthly royalty checks rarely totaled more than $300. At that time, like most women of my generation, I was a stay-at-home mother and housewife, and the royalty income was used to help feed, clothe, and educate three children.

By 1970 oil prices and production had dropped and reduced that income to an alarming $90 a month. But when things turned around a few years later, it was a godsend. By then I was single and supporting myself. My father had died and I was left with the care of my 80-year-old mother.

Because of our royalties, she spent her last years with dignity and good medical care. And I was able to devote myself to her needs. When she died in 1991, I had reached retirement age myself, and my share of the remainder of the family nest egg—so carefully gathered by my grandfather and nurtured by family management—has been, until this year, my financial salvation.

I live modestly. I still drive my mother's 20-year-old car and felt almost even until my medical bills began rising and my royalty income started dropping. I have had to ask for financial help from others, and it is distressing and humiliating. My health is poor. I can't get a job at my age, and I would like to keep my pride and some measure of independence.

What really scares me is that, even if oil prices rise again, it may be too late for me if some or most of those oil wells that I have an interest in are plugged and abandoned. Very few new wells are being drilled. It has been well over 1 year since I have been ap-

proached for a lease on my few remaining undeveloped tracts. Right now, I have very few hopes for my future.

If I am to survive, our domestic oil industry must survive. I know that there is no magic cure for the many problems facing small, struggling independent producers and many large entities who are shutting in all the wells and not drilling new ones, but there is surely something that you in Congress can do. Like all of my friends, family, and neighbors throughout the State, I am very confused. Why does the Federal Government continue to aid, subsidize, and enrich foreign countries hostile to our way of life with spoils for devastating our own small, elderly royalty owners and independent producers?

Thank you.

[The prepared statement follows:]

**Statement of Julia A. Short, Member, National Association of Royalty Owners, Norman, Oklahoma**

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Right now I have very few hopes for the future.

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Like all of my friends, family and neighbors throughout the state, I'm very confused. Why does the federal government continue to aid, subsidize and enrich foreign countries hostile to our way of life with spoils from devastating our own small, elderly royalty owners and independent producers?

Thank you.

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Chairman HOUGHTON. Thank you very much, Ms. Short.

Gentleman, we have a bit of a time problem, here, and so, if you could rather than reading just summarize your statements, I would certainly appreciate that, and your full statement will be put in the record.

Mr. Waller.

**STATEMENT OF BILL WALLER, VICE PRESIDENT, BUSINESS DEVELOPMENT, SOMERSET OIL AND GAS COMPANY, INC., INDIANA, PENNSYLVANIA**

Mr. WALLER. Thank you, Mr. Chairman. Congressman, I will be quick with my comments since you have a timeframe here.

My name is Bill Waller. I am vice president of Business Development for Somerset Oil and Gas Co. which is an independent oil and gas company headquartered in Indiana, Pennsylvania, operating in excess of 1,000 wells primarily in the Appalachian basin. I am originally from Oklahoma, and I married someone from Pennsylvania, so I have feelings from both areas of the country here.

Chairman HOUGHTON. No relation in New York?

Mr. WALLER. Pardon me?

Chairman HOUGHTON. No relation in New York? Just a few miles there with homes—[Laughter.]

Mr. WALLER. Today's hearing is intended to examine the current state of the petroleum industry and to present possible options to address these problems. I must say, at the outset, that I have

never seen the domestic petroleum industry facing a more complicated and potentially devastating set of problems that it now does.

The industry now has faced a low-price crisis for the past year. But today's problems are very different and far more threatening than the ones that began early on. A year ago the price crisis was started by a combination of effects: The collapse of the Asian economies, warmer than normal winters in the Northern Hemisphere, and ultimately a market share fight between Venezuela and Saudi Arabia.

The events created a surplus of oil in the international market and prices fell. The production most at risk was marginal oil wells in the United States, wells that produce about 20 percent of America's domestic production, an amount equivalent to our imports from Saudi Arabia.

Now, we have experienced more than 15 months of low oil prices, historically, low prices that threaten the very heart of United States production. If we look at domestic oil production as divided into three general areas, as was mentioned earlier: The lower 48 States, offshore, and Alaska. The onshore lower 48 States account for about 60 percent of the total of domestic oil production. Now, the Energy Information Agency recently released a report that over 60 percent of this onshore lower 48 State production comes from independents, a percentage that has increased by 10 percent over the past 10 years. It reflects an irreversible trend. Major oil companies, as you can see in the paper everyday, they are leaving the onshore lower 48 States. Because independents are so vulnerable to the price shocks, at current prices, most, if not all, of this production is at risk of loss.

This hearing was convened to address what can be done to address the crisis, that question keeps coming up. Clearly, there are two options: raising prices and cutting costs.

To raise prices, the United States must recognize the need to participate in decisions in the world-oil market. Make no mistake about it, the world-oil market is not as free-market as the administration frequently suggests. Rather, it is defined by the political interests of oil-producing nations. Failure of the United States to participate in this arena will result in increased reliance on foreign oil. No mistake.

In 1995 the Clinton administration concluded that our current oil level represented a threat to our—our import level represented a threat to national security. But it concluded that the threat could be met by diversifying import sources. And that was a flawed strategy. Diversity is not necessarily security.

Today we import twice as much oil, on a percentage basis, from the OPEC countries that embargoed us in the early seventies. If we build our energy lifeline on foreign, particularly Middle Eastern oil, we are placing our economic future in the hands of rogue nations like Iraq. In fact, recent analysis by the Independent Petroleum Association of America suggests that Iraq now controls world oil price. A year ago, Iraq exported 700,000 barrels a day. In January 1999, it exported 2.5 million barrels a day. By March you will have another 500,000 barrels of capacity online.

Iraq was the only OPEC country to boost its oil level in 1998. As other OPEC countries have reduced production to stabilize oil prices, Iraq has become the swing producer of world oil, and the swig producer, as we know, in any industry, can set the price.

This analysis argues that the current U.N. sanctions, that their program has failed on two counts.

First, it has failed in its primary mission to provide humanitarian aid to the Iraqi people.

Second, it has handed Sadaam Hussein the victory that he lost in the gulf war.

If it is accurate, we oil producers can only wonder why our President, our State Department, and our Congress and other leaders are doing nothing. If we really want a world where our economic future is defined on Sadaam Hussein, is this what we really want?

But if the United States intends to sit idly by as Sadaam keeps oil prices at levels that punishes enemies and rips the underpinnings from our domestic production, then we must look at the other side of the equation.

Now, can Congress act to reduce domestic production costs? The answer is, yes.

One are where it could act is the creation of low-interest loan programs or loan-guarantee programs patterned on disaster-relief programs.

The second area is squarely within the jurisdiction of this Subcommittee, and that is revisions to the Federal tax structure. The oil industry has identified nine areas where tax restructuring could reduce production costs and get cash back into the hands of domestic producers. And I want to focus on three of these, and I will do so quickly and highlight the others.

First, Congress could pass Congressman Watkins' marginal wells tax credit legislation, H.R. 53. This legislation would create a counter-cyclical tax credit program that would phase in as oil and natural gas prices fall. It is a concept identified in the National Petroleum Council's 1994 marginal wells report. However, to help in today's situation, there are several key elements in the bill that must be included. It must apply to both regular and alternative minimum taxes, and it must include a 10-year carryback provision, and, regardless of when it is enacted, it must apply for all of 1999.

Second, the net income limitations suspension on the use of percentage depletion that was incorporated into the taxpayer relief bill expires at the end of 1999. It must be made permanent or further extended. Without this provision, the net income limitation requires percentage depletion to be calculated on a property-by-property basis. It prohibits percentage depletion to the extent that it exceeds a net income from a particular property.

Now, the typical independent producer can have numerous—a small producer can have numerous oil and gas properties and many of which could be marginal, marginal properties with high-operating costs and low-production yields. During periods of low prices, the producer may not have net income from a particular property, especially from these marginal properties. When domestic production is most susceptible to being plugged and abandoned, the net income limitations discourages producers from investing income to marginal and maintain those marginal wells.

Third, as many small producers are trying to find ways to keep their production operation, they are frustrated by other constraints on the use of percentage depletion that are tying up their resources and could be eliminated. In particular, current law limits the use of percentage depletion to 65 percent of net taxable income. Percentage depletion deductions in excess of this amount can be carried over to future years. But, in certain circumstances, it will be unavailable as income falls. Now this problem can be rectified by eliminating the 65-percent limitation and allowing an annual selection——

Chairman HOUGHTON. Mr. Waller, how long will this testimony go on because the red light has been on for quite awhile.

Mr. WALLER. Let me just go on down and touch on the other matters.

Chairman HOUGHTON. All right, thank you.

Mr. WALLER. There are six other matters: Modifying the current oil and mineral tax and allowing the expenses of geological and geophysical and compelling that we capitalize that expense: allowing the expensing of delay rentals as have been done in prior years by the IRS actions; expanding the definition of enhanceable recovery techniques and updating the current limitation and providing for a net operating loss carryback. Legislation has been introduced by Congressman Thomas of this Committee for that. And enact a inactive well-recovery program, and Congressman Thornbury has introduced legislation for that.

This package of changes would address the bottomline issues and would address the critical resources that we need to have available. The domestic oil wells in the United States, that is truly America's true strategic petroleum reserve.

Thank you for the time.

[The prepared statement follows:]

**Statement of Bill Waller, Vice President, Business Development, Somerset Oil and Gas Company, Inc., Indiana, Pennsylvania**

Thank you, Mr. Chairman. My name is Bill Waller. I am vice president of business development of Somerset Oil and Gas Company, Inc., an independent exploration and production company headquartered in Indiana, Pennsylvania and operating in excess of 1,000 wells primarily in the Appalachian Basin.

Today's hearing is intended to examine the current state of the petroleum industry and to present possible options to address its problems. I must say at the outset that I have never seen the domestic petroleum industry facing a more complicated and potentially devastating set of problems than it now does. The industry has faced a low oil price crisis for the past year, but today's problems are very different and far more threatening than the ones that began early on.

A year ago, the price crisis was started by a combination of effects—the collapse of Asian economies, a warmer than normal winter in the northern hemisphere, and ultimately a market share fight between Venezuela and Saudi Arabia. The events created a surplus of oil in the international market and prices fell. The production most at risk was marginal oil wells in the United States—wells that produce about 20 percent of America's domestic production, an amount equivalent to our oil imports from Saudi Arabia.

Now, we have experienced more than 15 months of low oil prices—historically low prices that threaten the very heart of U.S. oil production. If we look at domestic oil production, it is divided into three general areas—onshore lower 48 states, offshore, and Alaska. The onshore lower 48 states account for about 60 percent of total domestic oil production. The Energy Information Agency has released a recent report that over 60 percent of this onshore lower 48 production comes from independents, a percentage that has increased by ten percent over the past ten years. It reflects an irreversible trend. Major oil companies are leaving the onshore lower 48

states. Because independents are the most vulnerable to price shocks—at current prices, most—if not all—of this production is at risk of loss.

This hearing is convened to address what can be done to address this crisis. Clearly, there are two options—raising prices and cutting costs. To raise prices the United States must recognize the need to participate in decisions in the world oil market. Make no mistake about it; the world oil market is not a free market as the Administration frequently suggests. Rather, it is defined by the political interests of oil producing nations. Failure of the United States to participate in this arena will result in increased reliance on foreign oil.

In 1995 the Clinton Administration concluded that our current import level represented a threat to national security, but it concluded that the threat could be met by diversifying import sources. It is a flawed strategy. Diversity is not security. Today, we import twice as much oil on a percentage basis from the OPEC countries that embargoed us in 1973. If we build our energy lifeline on foreign, particularly Middle Eastern oil, we are placing our economic future in the hands of rogue nations like Iraq.

In fact, recent analyses by the Independent Petroleum Association of America suggests that Iraq now controls world oil prices. A year ago, Iraq exported about 700,000 barrels/day. In January 1999, it exported about 2.5 million barrels/day. By March it will have another 500,000 barrels/day of capacity on line. Iraq was the only OPEC country to boost its oil revenue in 1998. As other OPEC countries have reduced production to stabilize oil prices, Iraq has become the swing producer of world oil. The swing producer sets the price.

This analysis argues that the current UN sanctions program has failed on two counts. First, it has failed in its primary mission to provide humanitarian aid to the Iraqi people. Second, it has handed Saddam Hussein the victory he lost in the Gulf War. If it is accurate, we oil producers can only wonder why our President, our State Department, our Congress and other leaders are doing nothing. Do we really want a world where our economic future is defined by Saddam Hussein?

But if the United States intends to sit idly by as Saddam keeps oil prices at levels that punish his enemies and rips the underpinnings from our domestic production, then we must look at the other side of the equation. Can Congress act to reduce domestic production costs? The answer is yes.

One area where it could act is the creation of low interest loan programs or loan guarantee programs patterned on disaster relief programs. The second area is squarely within the jurisdiction of this committee—revisions to the federal tax structure. The oil industry has identified nine areas where tax restructuring could reduce production costs and get cash into the hands of domestic producers. I want to focus on three of these and highlight the others.

First, Congress could pass Congressman Wes Watkins' marginal wells tax credit legislation—HR 53. This legislation would create a countercyclical tax credit program that would phase in as oil and natural gas prices fall. It is a concept identified in the National Petroleum Council's 1994 Marginal Wells report. However, to help in today's situation, there are several key elements of the bill that must be included. It must apply to both regular and alternative minimum taxes. It must include a ten-year carryback provision. And, regardless of when it is enacted, it must be applied for all of 1999.

Second, the net income limitation suspension on the use of percentage depletion that was incorporated in the Taxpayer Relief Act of 1997 expires at the end of 1999. It must be made permanent or further extended. Without this provision, the net income limitation requires percentage depletion to be calculated on a property-by-property basis. It prohibits percentage depletion to the extent it exceeds the net income from a particular property. The typical independent producer can have numerous oil and gas properties, and many of which could be marginal properties with high operating costs and low production yields. During periods of low prices, the producer may not have net income from a particular property, especially from marginal properties. When domestic production is most susceptible to being plugged and abandoned, the net income limitation discourages producers from investing income to maintain marginal wells.

Third, as many small producers are trying to find ways to keep their production in operation, they are frustrated by other constraints on the use of percentage depletion that are tying up their resources and could be eliminated. In particular, current law limits the use of percentage depletion to 65 percent of net taxable income. Percentage depletion deductions in excess of this amount can be carried over to future years, but in current circumstances will be unavailable as incomes fall. This problem can be rectified by eliminating the 65 percent limitation and allowing an annual selection of the percentage limitation to be made by the taxpayer. Secondly, to free these resources for today's needs, the carried over percentage depletion deductions

should be allowed to be carried back for ten years under the revised conditions. These changes would assist producers in keeping existing operations going.

Let me touch on six other tax changes that would greatly aid domestic oil producers:

1. Modifying the current alternative minimum taxable income calculation to phase out critical preference items during times of low oil prices.
2. Allowing the expensing of geological and geophysical costs instead of compelling them to be capitalized.
3. Allowing the expensing of delay rental payments as they have been done prior to a September 1997 IRS action
4. Expanding the definition of Enhance Oil Recovery techniques to update the current list that was written in 1979.
5. Provide for a net operating loss carryback for oil and gas production as has been proposed for farmers and the steel industry. Legislation has been introduced in the House by Congressman Thomas of this committee—HR 423.
6. Enact an inactive well recovery program. Congressman Thornberry has introduced legislation—HR 497.

This package of changes could address many bottom line issues for U.S. producers. They are not the only actions that need to be taken, but if taken they can help keep critical resources available—domestic oil wells that are America's true strategic petroleum reserve.

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Chairman HOUGHTON. Thank you very much, Mr. Waller.

We do have this time problem, so if you would keep your eye on that red light, I would certainly appreciate it.

Now, I would like to introduce William Thomas, the Congressman from California, who would like to make a statement and also introduce Mr. Macpherson.

Mr. THOMAS. Thank you, Mr. Chairman. I apologize that I haven't been with you. This obviously is of great concern to me.

I want to thank you for putting my statement in the record, and, for the record, the reason that I am interested is that my district, a portion of California, produces more oil than the entire State of Oklahoma. If Kern County were a State, we would be behind Alaska, Texas, and Louisiana. So, we have an interest in what happens in the oil patch.

I also have an interest in making sure that what we ask for during this hopeful temporary time is not a complete read, write, and swallow, of the Tax Code, notwithstanding a list of wishes that may be wanted. My understanding is that Treasury testified that even the very modest bill that my colleague is sponsoring, and I am cosponsoring, on a tax credit phaseout, and my even more modest bill of simply allowing for the current downturn to be spread over a greater number of years where there may have been a profit by someone, simply are not useful in today's market. I find it ironic when last year the 5-year carryback was used for agriculture in terms of getting them over a difficult time, a freeze and a disaster, that this afternoon our colleague from Pennsylvania and the Chairman and others will be joining the Trade Subcommittee, of which I am a Member, looking at the possibility of the carryback concept being used for steel in a critical time. And for the Treasury to say that there simply would be no use available for either the carryback or the tax credit, is, to me, a rather amazing statement to make.

When I introduce Don—Don Macpherson, Jr., is one of those individuals who allows me to make the statement that we produce more oil than the State of Oklahoma because we obviously have

major international oil concerns. But just as the west is concerned about the mom and pops on the royalty end, and it is real income to them, and if they don't, they don't have an income—for us, it is mom and pop extended to a certain extent.

The particular kind of oil that we have, which is heavy oil, high sulfur, which requires secondary and tertiary recovery, means that if we ever shut a well in, you walk away from that actual resource because you cannot get it back given the investment necessary, and the potential and the substrata that gets you to produce it again.

What I am looking for is an ability to create a modest change in the Tax Code that gets us through this period. Not a complete rewrite because, frankly, a complete rewrite is not in the cards.

What amazed me—and I will underscore this—was that I have been informed that the Treasury said that something as simple as a 5-year carryback, in terms of losses, or a $3 credit phasing out between $14 and $17 a barrel, is something that would not be of any use to you folk, and therefore it is not necessary to talk about this kind of a change.

What I hope you will do, in response to my question, is to give your testimony, but for the record, make sure that you answer the question that I ask you because I am not going to be able to stay. And that is do you think H.R. 53 or H.R. 423, the $3 tax credit or the 5-year carryback, is useful tax legislation for you now? And that is the question that I would like you to answer.

And with that, Mr. Chairman, I want to thank you very much. Don, it is good to see you here. That is snow outside in case you didn't know what it was. And that is a joke, because in Bakersfield, less than 1 month ago, we had 8 inches of snow. That was the first time that it ever happened, I think, and most of us hope that it is the last time that it happens. We are used to visiting it, not to living in it.

Don, good to see you.

Mr. WATKINS. Will the gentleman yield?

Mr. THOMAS. Certainly.

Mr. WATKINS. I would like for the record to show that his in-laws are from Oklahoma and those people who probably are working to get it out of the ground are from Oklahoma that are out in Kern County.

Mr. THOMAS. Tell the gentleman that not only does my district produce more oil than Oklahoma, I think that I have more Okies than you do in my district. [Laughter.]

Mr. WATKINS. We will take this controversy out to the corridors.

Mr. THOMAS. I am very sensitive whence our folk came.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you very much.

All right. Mr. Macpherson.

## STATEMENT OF DON MACPHERSON, JR., PRESIDENT, MACPHERSON OIL COMPANY; AND PRESIDENT, CALIFORNIA INDEPENDENT PETROLEUM ASSOCIATION, BAKERSFIELD, CALIFORNIA

Mr. MACPHERSON. Thank you.

My name is Don Macpherson, Jr. I am president of the Macpherson Oil Co. and president of the California Independent Petro-

leum Association, known as CIPA. And, notwithstanding what you heard earlier today about taxpayers, I can tell you that I have paid taxes over the last 5 years.

I would like to thank you for the opportunity to speak today. I would also like to start by thanking Congressman Thomas, who is a distinguished Member of this Subcommittee, for his leadership on oil and gas issues.

Macpherson Oil Co. operates 39 oil and gas leases producing approximately 900 barrels of oil per day. These leases are mainly located in Congressman Thomas's district in Kern County, California. Macpherson Oil also has some production in Alabama. Macpherson Oil Co. develops these leases that it operates by extensive thermal steam recovery, water flooding and high-volume lift operation techniques.

CIPA is a statewide trade association representing 500 independent producers, service, and supply companies operating in California.

The first step to finding a solution is to let the people know that there is a problem. And I can assure you that, from California's producers' perspective, there is a big problem. Last week I presided over a rally at the State capital in Sacramento, California, to raise awareness of the serious crisis facing the California oil and gas producers. We heard from union members, small oil and gas producers whose wells are shut in, a bipartisan delegation of State senators and assemblymen, and from oil workers about just how bad the low oil price crisis really is.

The message is that our industry really is important and vital to the freedom of all Californians and the one that powers the economic engine of California and the United States. We cannot afford to lose it.

The current low oil price crisis puts about 75,000 direct and indirect California jobs at risk. If Congress does not act soon, California independents will be out of business. A 25-year low crude oil price caused by a glut of foreign oil and a reduced demand worldwide has put California producers on the endangered species list.

Adjusted for inflation, California oil prices haven't been this low since the Great Depression. California and other U.S. producers will soon be extinct unless we get some help.

When California's other commodity producers, such as the agricultural farmers, milk producers, hog farmers, and others faced natural or economic disaster, the State and Federal Government stepped in for help. Our industry, the oil and gas producing industry, is in trouble, and we need help now.

California is the fourth largest producer behind Alaska, Texas, and Louisiana. And, as Congressman Thomas states, Kern County alone produces more oil than all of Oklahoma. California's production is usually the first to feel the effects of the price downturn because of the low gravity, poor quality, heavy oil that makes up about two-thirds of the State's production. The average price for California's benchmark Kern River crude oil has been hovering in the $7 per barrel range for several months and has been under $10 a barrel for over 1 year. At current prices, oil producers receive less than 15 cents a gallon. You can't buy water for 15 cents a gallon.

The economic contribution for the exploration and producing sector of California's oil and gas industry economy is about $10 billion a year. In 1997 the industry provided approximately $1.3 billion in direct payroll, and an estimated $2.3 billion in total statewide employment wages. In 1997 the industry paid about $400 million in State and local taxes and fees. None of these figures included royalties paid to the State and Federal Government and to individuals which are in the hundreds of millions of dollars.

California producers supply about half of what Californians consume. The rest comes from Alaska and foreign suppliers including Iraq, Venezuela, Mexico, and Saudi Arabia. When domestic producers are gone, who will make up the shortfall? You can bet that South America and Mideast producers will fill the void with high-price crude oil that will turn into high-price gasoline for U.S. drivers. Without domestic oil and gas producers, California and other Americans will be held hostage to foreign producers.

One of the untold stories of this impact is what low crude oil prices are petroleum service sector. A recent study conducted by the California Independent Petroleum Association shows that just amongst its members, capitals budget spending, money that supports the maintenance and production levels, has decreased by over $100 million during the last year. What this means is that this money won't go to support jobs and families for those companies and workers for independent producers.

Congress needs to act decisively to help producers in the petroleum sector in California and the rest of the United States. Without the help of Senators and Representatives in Washington, DC, jobs, taxes and production will drop sharply. The freedom of all Californians will be significantly impaired.

But it doesn't have to be this way. Several Members of Congress have introduced or cosponsored legislation that would help independent producers to get back on their feet. H.R. 423, authored by Congressman Thomas, will allow domestic oil producers to reduce their taxes by a carryback of net operating losses for 5 years from their regular and alternative minimum taxes during the past 5 years. If enacted, producers would use this legislation to increase cash flow for current operations and maintenance on production on wells that would otherwise be abandoned.

This legislation would also allow independent producers the ability to recover cash from earlier profitable years to be used in the current operations when cash flow may be negative. This bill would be effective for all years after December 31, 1997.

H.R. 53, authored by Congressman Wes Watkins, would give producers a marginal tax credit for low-volume, high-cost oil and gas wells. This legislation is vital to the oil and gas producers with marginal economic production. This bill would allow an independent producer to obtain a $3 credit from the first for each 3 barrels of qualified production that may be carried back 10 years. The credit is phased out as the price of oil is increased. Similar rules would apply to natural gas producers.

I urge Members of this Subcommittee to support these two pieces of legislation and the myriad other legislation that are being proposed to provide disaster relief to the U.S. oil and gas industry. Oil is not a partisan issue. Oil is not an environmental issue. Oil is a

job issue. Oil is an economic issue. Oil is a family issue, and oil is a freedom issue.

Producers are looking for a hand up, not a handout. We want to do business on a free and fair market. Right now, we have neither.

Thank you for your time and opportunity to address you today.

[The prepared statement follows. An attachment entitled "Review of the Economic Significance of California's Oil and Gas Industry" is being retained in the Committee files.]

**Statement of Don Macpherson, Jr., President, Macpherson Oil Company; and President, California Independent Petroleum Association, Bakersfield, California**

My name is Don Macpherson, Jr. I am the President of Macpherson Oil Company and President of the California Independent Petroleum Association (CIPA). Thank you for the opportunity to speak to you today.

I would like to start out by thanking my Congressman, Bill Thomas who is a distinguished member of this Committee, for his leadership on oil and gas issues.

Macpherson Oil Company operates 39 oil and gas leases, producing approximately 900 barrels of oil per day. These leases are mainly located in Congressman Thomas' district in Kern County California. Macpherson Oil also has some production in Alabama. Macpherson Oil company developed the leases its operates using expensive thermal steam recovery, water flooding and high volume lift operating techniques.

CIPA is a statewide trade association representing approximately 500 independent producers, service and supply companies operating in California.

The first step in finding a solution is letting people know there's a problem. I can assure you that from California producers' perspective—there is a big problem.

Last week I presided over a rally at the state capitol in Sacramento, California to raise awareness of the serious crisis facing California's oil and natural gas producers. We heard from union members, small oil and gas producers whose wells were shut-in, a bi-partisan delegation of State Senators and Assemblyman and from oilfield workers about just how bad the low price crisis really is.

The message today is that our industry is important and vital to the freedom of all Californians and one that powers the economic engine of California and the United States. We can't afford to lose it!

The current low oil price crisis puts about 75,000 direct and indirect California jobs at risk. If Congress doesn't act soon California independents will be out of business.

A 25-year low in crude oil prices caused by a glut of foreign oil and reduced demand worldwide has put California producers on the endangered species list. Adjusted for inflation, California oil prices haven't been this low since the Great Depression. California and other US producers will soon be extinct unless we get some help.

When California's other commodity producers—agricultural farmers, milk producers, hog farmers and others face natural or economic disaster the state and federal government steps in to help. Our industry—the oil and gas producing industry—is in trouble. We need help now.

California is the fourth largest producer of oil behind Alaska, Texas and Louisiana. Kern County alone—which is in Congressman Thomas' district—produces more oil than in all of Oklahoma!

California production is usually the first to feel the effects of a price downturn because of the low gravity, poor quality "heavy" crude oil that makes up about two thirds of the state's production. The average price for the California benchmark Kern River crude oil has been hovering in the $7 per barrel range for several months and has been under $10 per barrel for over a year! At current prices producers receive less than 15 cents a gallon. You can't buy bottled water at that price!

The economic contribution of the exploration and production sector of the California oil and gas industry to the economy is about 10 BILLION dollars. In 1997 the industry provided approximately $1.3 BILLION in direct annual payroll, and an estimated $2.3 BILLION in total statewide employment wages. In 1997 the industry paid about $400 million dollars in state and local taxes and fees.

None of these figures include royalties paid to the state and federal government and to individuals in the hundreds of millions of dollars.

California producers supply about half of what Californian's consume. The rest comes from Alaska and foreign suppliers including Iraq, Venezuela, Mexico, and Saudia Arabia.

When domestic producers are gone who will make up the shortfall? You can bet that South American and Middle East producers will fill the void with high priced crude oil that will be turned into high priced gasoline for US drivers. Without domestic oil and gas producers, Californians and other Americans will be held hostage to foreign producers.

One of the untold stories is the impact that low crude oil prices have on the petroleum service sector. One recent study conducted by the California Independent Petroleum Association shows that just among its members capital budget spending—money that supports the maintenance of production levels—has decreased over $100 million dollars during the last year. What that means is that this money won't go to support the jobs and families of those companies that work for independent producers.

Congress needs to act decisively to help producers and the petroleum service sector in California and in the rest of the U.S.

Without the help of Senators and Representatives in Washington, D.C., jobs, taxes and production will drop sharply. The freedom of all Americans will be significantly impaired. But it doesn't have to be that way.

Several members of Congress have introduced or co-sponsored legislation that will help independent producers get back on their feet.

HR 423 authored by Congressman Thomas will allow domestic oil and gas producers to reduce their taxes by carrying back net operating losses for five years from their regular and alternative minimum taxes during the past five years. If enacted, producers will use this legislation to increase cash flow for current operations and maintain production on wells that would otherwise be abandoned.

This legislation would allow an independent producer the ability to recover cash from earlier, profitable years to be used in current operations when current cash flow may be negative. This bill would be effective for all years after December 31, 1997.

HR 53 authored by Congressman Wes Watkins would give producers a marginal well tax credit for low volume, high cost oil and gas wells. This legislation is vital to oil and gas producers with marginally economic production.

This bill would allow an independent producer to obtain a $3.00 credit from the first three barrels of qualifying production that may be carried back 10 years. The credit is phased out as the price of the oil increases. Similar rules would apply to natural gas producers.

I urge members of this Committee to support these two pieces of legislation and the myriad other legislation that is being proposed to provide disaster relief to the U.S. oil and natural gas production industry.

Oil is not a partisan issue. Oil is not an environmental issue. Oil is a jobs issue. Oil is an economic issue. Oil is a family issue. Oil is a freedom issue.

Producers are looking for a hand up, not a hand out. We want to do business in a free and a fair market. Right now, we have neither.

Thank you for your time and the opportunity to address you today.

I have submitted a copy of the study "Review of the Economic Significance of California's Oil and Gas Industry" for your information along with my written testimony to document the economic importance of the California oil and gas industry.

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Mr. WATKINS [presiding]. Thank you very much for those—asking in the question again that Mr. Thomas' H.R. 53, the marginal well tax credit, or the income averaging, would be a great help. Is that correct? I don't know what you said—it would be very vital.

Mr. MACPHERSON. Yes, the answer is that those two bills—his bill and your bill would both help the industry. The answer is absolutely that it would help.

Mr. WATKINS. I would like to yield at this time to Mr. McInnis who would like to introduce the gentleman from his home State of Colorado to give his testimony, and let me say that we will have your entire testimony that will be part of the record, and if you would just summarize it.

Mr. MCINNIS. Thank you, Mr. Chairman.

Mr. Chairman, I would like to introduce Mitchell Solich. Mr. Solich is a longtime friend of mine, and we go back a long ways.

He, in fact, has become my in-State expert on oil matters, and briefed me, a person who is not in the oil business, through some of the complicated tax credits and some of the complications in your industry. So, he came to Washington, DC, at his own expense and on his own time, and I appreciate it very much, and it is a great honor for me to have him here and look on the Nation's Capitol.

Mitch, I appreciate the points that you have to make because we are here to try and figure it out. Obviously, it is a catastrophe for us, and we, in our particular district, as you know Mr. Speaker, my district has 22 million acres of Federal land. My district, geographically, is larger than the State of Florida.

And I have a gentleman like Mr. Babbitt, and some others, like Earth First and the national Sierra Club who want to ban all Federal lands from exploration. So, that is another difficulty that we have up in my area.

Thank you for letting me introduce the witness, and I ask that he be allowed to proceed.

Mr. WATKINS. Thank you, Mr. McInnis.

Let me say again that your testimony will be a part of the record, and if you could please summarize your remarks.

**STATEMENT OF MITCHELL SOLICH, PRESIDENT AND CHIEF OPERATING OFFICER, CHANDLER & ASSOCIATES, LLC; AND PRESIDENT, CHANDLER COMPANY, DENVER, COLORADO**

Mr. SOLICH. Yes, sir, thank you.

Mr. Chairman, my name is Mitch Solich. I am president of the Chandler Co. which is an independent domestic producer of oil and natural gas. We have been in continuous operation in Denver over the last 44 years.

You, Congressman Wes Watkins, and Congressman Scott McInnis, along with the other Members of the Subcommittee, are to be commended for holding this hearing.

If Congress and the administration do not act quickly, small, independent oil and gas producers will not survive. The melt down in world oil prices is the cause of this crisis, but the effects of the price collapse have been exacerbated by discriminatory government policies, both tax and land access.

The price collapse began in 1997. It continued unabated through 1998, and the carnage is expected to continue into 1999. Oil prices, adjusted for inflation, are as low as they were in the thirties. Now these oil prices are not part of a normal cycle, but are a catastrophic anomaly that has forced many domestic producers out of business and has extinguished tens of thousands of jobs and cost the Federal Government billions of dollars in lost taxes, rents, and royalties.

Now, you have heard from others today about the gruesome statistics about the condition of the industry. Let me just add that in my own State of Colorado, companies have lost between 25 percent and 65 percent of their net revenues. To put it into perspective, I wonder how the panelists from Treasury today would deal with a 25- to 65-percent loss in revenues.

We have lost highly skilled, technical people as well. We are not going to be able to get these people back or to replace them and

this fact is jeopardizing the basic infrastructure of our company and companies like us.

While most other countries encourage energy development, the United States, with discriminatory tax provisions and excessive restrictions on access to Federal lands, seriously and needlessly restricts the exploration and production of oil and natural gas in this country.

The most important step that Congress can take now is to change these policies. The marginal well production credit, introduced by Congressman Watkins, is important to slow the shutting in of marginal wells. Marginal wells are those producing less than 15 barrels a day. And while that may not sound like much, I should note that between 20 and 25 percent of total domestic production comes from these marginal wells.

Relief from the alternative minimum tax, or AMT, is also critically important. The AMT actually increases taxes on companies that are struggling financially in periods of falling prices. In order to alleviate the AMT's effect, the industry proposes phasing in changes to the AMT preference and adjustment as the price of oil drops.

Alleviating the restrictions on percentage depletion to permit producers to take advantage of depletion allowances that they have carried over is the third step that Congress could take.

Three other tax provisions are: Inactive well recovery incentives, the expensing of geological and geophysical costs, and the expensing of delay rental.

All of these tax improvements will help, but they will fall far short of their potential to sustain domestic oil and gas production unless Congress also acts to solve the other problems: unnecessary and arbitrary restrictions on access to Federal land.

In my written statement I describe some of the government action that adds up to an overall government policy that is hostile to domestic oil and gas production. Hostile tax policies, coupled with hostile access policies, is a prescription for increasing dependence upon foreign oil.

The changes that I have discussed would not only rescue this country's independent producer of oil and natural gas, but would also slow a growing dependence on foreign oil.

Thank you, again, for holding these hearings. I hope that they will bring about the action needed to help our independent producers to deal with the difficult conditions.

I would be happy to answer any questions you may have.

[The prepared statement follows:]

**Statement of Mitchell Solich, President and Chief Operating Officer, Chandler & Associates, LLC; and President, Chandler Company, Denver, Colorado**

Mr. Chairman, I am Mitch Solich, President of The Chandler Company, an independent, domestic producer of oil and natural gas.

You, Mr. Chairman, and Congressmen Wes Watkins and Scott McInnis, along with the other members of this committee are to be commended for holding these hearings on the perilous state of the U.S. oil and gas industry. For, unless the Congress and the Administration act quickly, a vital national asset—independent oil and gas producers—may soon disappear.

The catastrophic collapse in world oil prices is the immediate cause of the industry's distress. But the effects of that price collapse have been magnified by discrimi-

natory tax and access policies imposed by the federal government. Congress can help by changing those policies.

The collapse in world prices began in 1997 and has continued virtually unabated throughout all of 1998 and on into 1999. Oil prices, adjusted for inflation, have fallen to levels not seen since the Great Depression, tangible proof that despite more than a century of production, world oil supplies—relative to demand—have become more abundant than ever.

But, that greater abundance on the world stage has also meant accelerating dependence on foreign oil here in the United States. Historically low prices have forced many domestic producers out of business, extinguished tens of thousands of jobs and cost the federal government billions of dollars in lost taxes, rents and royalties. Loss of government revenues has been especially severe in energy-producing states.

- Since oil prices began falling in 1997, U.S. independents have been forced to shut in more than 136,000 oil wells and 57,000 natural gas wells.
- Daily onshore production outside of Alaska dropped nearly a quarter of a million barrels from 1997 to 1998.
- Overall, last month (January) U.S. crude oil production fell to the lowest level in more than 50 years, according to the American Petroleum Institute (API).
- The shutting-in of wells has already eliminated 24,000 jobs and threatens another 17,000 during the first half of 1999, according to the Independent Petroleum Association of America (IPAA).
- In January alone, 11,500 jobs were lost in the domestic oil and natural gas production industry—the largest single-month drop since 1986—ccording to API.
- Exploration and development has all but ceased. Utilization of U.S. oil rigs has dropped by nearly two-thirds from 361 in December 1997 to 125 in January 1999, the lowest oil rig count since Baker Hughes began keeping separate records for oil and gas in 1987.
- In my own state of Colorado, companies have literally lost between 25 and 65% of their net revenues overnight because of the collapse in prices. With fewer dollars to invest, drilling and project activity has been curtailed in most areas, and we can expect additional cutbacks and job losses. The job cuts mean further loss of highly skilled people in technical disciplines -a condition which has been ongoing and is only exacerbated by the current price meltdown. As technical people leave the industry, there is a real risk that these disciplines that are a necessary part of our industry's infrastructure are being lost and that we will be unable to recruit new expertise.

The current conditions also affect federal and state government revenues.

- The President's budget shows a decrease of $1.4 billion between 1998 and 1999 in rents and royalties from the OCS, and a decline of $80 million from previous 1999 estimates of onshore rents and royalties.
- Oklahoma's gross production tax collections for 1998 were down more than half.
- In Texas, oil severance tax revenues fell nearly $95 million during the first eight months of 1998, a reduction of more than a third.
- Last month (January), according to API, domestic oil producers received an average of about $9 a barrel at the well-head, the lowest inflation-adjusted prices since the Great Depression more than a half century ago.

But the history of the last 50 years also shows that low prices and a world supply "glut" are the exception, not the norm. A quarter century ago, millions of Americans were stuck in long gasoline lines, triggered by the Arab oil embargo. World oil prices tripled in a few years, sparking widespread concern of a permanent "energy crisis." Many feared that we were rapidly using up the oil and natural gas left to us by nature—a resource barrier that neither domestic price decontrol nor human ingenuity could overcome. Growing demand for a depleting, finite resource stimulated predictions that world oil prices would reach, or even exceed, $100 by the year 2000.

Instead, however, soon after remaining price controls were ended in 1981, domestic producers quickly proved that, with a favorable economic climate and supportive public policies, solutions could be found to the "energy crisis." Producers ended the supposedly "irreversible," decade-long decline in U.S. oil production within months. Annual domestic production began increasing by 1982. Around the world, so much new resources were found and developed that today—despite growing demand—proved reserves represent nearly a half century of supply (at current rates of consumption).

But while most other countries encourage energy development, flawed public policies—especially discriminatory tax provisions and excessive restrictions on access to federal lands—are once again seriously and needlessly restricting the exploration and production of oil and natural gas in this country. The most important step that Congress can take now to help independent producers is to change these policies.

The Marginal Well Production Tax Credit, introduced by Congressman Wes Watkins, is an important step that the Congress can take to help independent producers and also slow the shutting-in of marginal wells because of historically low prices for oil and natural gas. The bill provides a $3 a barrel tax credit for the first 3 barrels of daily production from an existing oil well and a 50 cent per thousand cubic feet (Mcf) tax credit for the first 18 thousand cubic feet of daily natural gas production from a marginal well. The credits would phase in and out as oil and natural gas prices fall and rise between specified levels. The credits would be allowed against both the regular income tax and the AMT.

Relief from the heavy impact of the Alternative Minimum Tax (AMT) is also high on the list of steps needed. The AMT was enacted to make sure that companies reporting large financial income also paid at least the prescribed minimum tax. It was not intended to increase taxes on companies that are already struggling financially or exacerbate the financial impact of falling commodity prices. Yet, that is how the AMT actually impacts the independent petroleum producers of today who face historically low market prices for the products they sell—forcing them to curtail their operations and consider closing higher-cost wells—but who also have numerous preference items under the AMT.

In order to alleviate the impact of the AMT, the industry proposes that certain changes—such as eliminating specified preferences—would begin to phase in when the annual average price of oil falls below $23.50 a barrel and would be fully phased in when the price falls below $18.50.

Alleviating the restrictions on using percentage depletion by independent producers would be a third step the Congress could take to help the industry pull itself out of its current depression. For independent producers and royalty owners, current tax law limits the allowance for percentage depletion to 65 percent of a taxpayer's taxable income for the year. Percentage depletion in excess of this 65 percent limit may be carried over to future years until it is fully utilized. In past years, many independent producers spent much of their income to develop their properties, reducing their taxable incomes and thereby limiting the use they could make of percentage depletion. These producers accumulated deductions for use in later years. Now, after the collapse of world oil prices, independent producers are struggling to make any income at all and, so, cannot use their carried over deductions. And, even those independent producers that can use their deductions currently may find that the AMT restricts their use of percentage depletion, unreasonably constraining their cash flow. Under the proposal:

—By annual election, the 65 percent taxable income limitation would be reduced or eliminated for current and future tax years.

- Carried over percentage depletion could be carried back for ten years subject to the same annual election on the taxable income limitation. And,
- The suspension of the 100% Net Income From The Property Limitation would be extended.

Three other important steps that Congress can take to help the industry and slow the decline in domestic production include inactive well recovery incentives and the expensing of geological and geophysical costs (G&G) and delay rentals.

Improving tax incentives for oil and natural gas independents will fall far short of their potential to help sustain domestic petroleum production, unless Congress also acts to reduce restrictions on access to federal lands. These lands contain a disproportionate share of the nation's best prospects for new petroleum discoveries that are needed to replace fields now in decline.

These restrictions have proliferated over the past decade and a half.

- Onshore, since 1983, access to mineral reserves on federal lands in the western United States has declined by more than 60 percent.
- In 1983, over 114 million acres were under lease compared to 32.5 million acres today.
- Known domestic crude oil reserves have dropped about a fifth during that period—from 29 billion to 23 billion barrels.

The reduced access is due to a variety of actions that add up to an overall government policy grown hostile to domestic petroleum production, even though growing supplies of petroleum are a prerequisite for continued U.S. economic growth.

- The discretionary and arbitrary exercise by the BLM and the Forest Service of their authority to close lands to access.
- The arbitrary interpretation and application of key statutes by these two agencies—including NEPA, FLMPA, the Endangered Species Act and the Clean Air Act.
- The inability of the two agencies to coordinate their land management programs.

Growing consumer demand for petroleum—coupled with growing hostility by public policies to domestic production—is a prescription for increasing dependence on

foreign oil. At the time of the Arab embargo, more than a quarter century ago, Americans depended upon imports for a third of their supplies. Now, we depend on foreign oil to meet more than half—about 55 percent—of the oil we use each day. According to the latest ("reference") projection by the U.S. Department of Energy, we will be depending on imports for 70 percent of our oil by 2020. And we will depend upon the socially and politically unstable Persian Gulf for much of that 70 percent.

The changes I have discussed would not only help this country's independent producers of oil and natural gas, but would also slow our growing dependence on foreign oil.

Again, I want to thank Chairman Houghton, Congressmen Watkins, McInnis, and the other members of this committee for holding these hearings. I hope they will help bring about the actions needed to help our independent producers deal with these difficult conditions.

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Mr. WATKINS. Thank you very much for your comments.

I yield to Mr. McInnis to see if you have any quick questions of your constituent there.

Mr. MCINNIS. Thank you, Mr. Chairman.

Mr. Chairman, I will reserve my questions. I know we are trying to give all the witnesses an opportunity to talk. We are coming to an end, so I will reserve my option to ask questions after we conclude.

Mr. WATKINS. I appreciate that. I didn't know exactly what your timing was.

I would now like to turn to my State of Oklahoma longtime friend. And let me say to Mrs. Short that I want to thank you very much for your perspective as a mineral oil royalty owner to bring a different phase of this problem. And a lot of people are out there on the land. Many of them have farms and are suffering on that angle along with others who have been depending on some type of assistance. It is really very few dollars per month. And we appreciate that enlightenment for a lot of Members here.

But, my good friend from Ada, Oklahoma, Mike Cantrell, who has been past president of OIPA and who personally, I've heard him talk for many years about the oil patch and the meaning of it—in a very patriotic way—about how important that it is, but also has been sharing insight in what it is doing and the obstructionist coming about in the oil patch today.

My friend, Mike Cantrell. Your entire statement will be made a part of the record, and if you would summarize it and give it from the heart, we would appreciate it.

## STATEMENT OF S. MICHAEL CANTRELL, PRESIDENT/OWNER, OKLAHOMA BASIC ECONOMY CORPORATION, ADA, OKLAHOMA

Mr. CANTRELL. Yes, I will certainly summarize, Congressman. We certainly appreciate you and your other colleagues for holding these hearings.

I am Mike Cantrell. I am a small independent oil producer from Ada, Oklahoma. I have 85 wells that I operate within 30 miles of my home in Ada, Oklahoma. I employ 10 people. We have laid off two people. The rest of us have made a pact with each other that we are going to stick this thing out as long as it takes.

Some of my crews are out today. They make the wells in the mornings, and they build fences in the afternoon. And that is the

sort of family atmosphere that we have at my company to try to get by this.

This is a depression in the oil and gas industry. This is not analogous to anything that we have had in the past in this industry. We have had these up-and-down cycles before, but this is by far the most severe. We have lost 6,000 Oklahoma jobs. We have about 150,000 people in Oklahoma either directly or indirectly employed through the oil industry, and we are in danger of losing at least half of that in a relatively short time. This is a death spiral that we are in in the oil business in Oklahoma.

While oil prices in 1985, and the prices then hit $12 a barrel for 3 months, they have hit under $11 a barrel for 1 year or 15 months this time. The last 3 months have been below $10 a barrel in Oklahoma. That is an exponential death spiral to our economy in Oklahoma. We have $1 billion a year that we are losing in Oklahoma because of this crisis, and it is going to escalate, and when it includes natural gas—when natural gas gets hit along with it, that number will double. And most experts believe that is going to happen in a relatively short time.

I would limit my comments. We all have to point out how really devastating this is. We are at a crossroads in America today. We have not had an energy policy ever except for cheap energy. It is the siren song, cheap energy. It reminds me of the Thomas Payne "Sunshine Patriot" poem in the Revolutionary War. As long as the sun shines today, we don't worry about tomorrow. And that is the energy policy that we have had in this country and have now.

We are at a crossroads. We have got to decide right now, this is the critical time, if we are going to have a viable, U.S. domestic petroleum industry. And that is for you to decide.

I don't ask for help for independent oil and gas producers. I heard an elderly woman say onetime, "You all just take care of the sick and the blind and the lame, and the rest of us will get by OK." Well, I think that this is to take care of the least of our citizens. In the long run, the American public is not the winner with these cheap energy prices today. If you believe that they are, if you believe that it is fine to get rid of this domestic industry and we will rely totally on foreign imports from unfriendly governments, then we don't have any business talking to you here. We'll just go find something else to do. We'll be OK. Now, those people that we employ are going to have to get retrained, and the people who depend on services and the income and the revenue that this industry generates in America, that is painful, that is dislocating.

But, primarily, what you ought to focus on is, is America's natural resource base worth preserving? Yes or no.

Our preeminent geologist in Oklahoma, Dr. Charles Mankin at the Oklahoma geological survey, maintains that there are 18 billion barrels left to be produced in Oklahoma, in the ground. We just celebrated our 100 anniversary of oil production in Oklahoma last year.

We have produced 17 billion barrels so far. So, we have got tremendous natural resources left in this country, that is probably, in our opinion, viable for America for the future.

But if you walk away from them, and we are at the point now where the strategies of the countries that are dumping oil on

America today and their international oil company partners—it is a very good strategy. They dump oil on our marketplace. They take out the high cost of production. And then what is left? They take us out of the marketplace if you all allow that to happen, and then they can get whatever they want for the price of their product. I don't think that is in the best interests either strategically or economically for the average American citizen.

What could you do? We disagree with the Treasury official who says there is no any evidence of dumping. A number of us are right now in the process of filing a Federal Trade Commission action against Venezuela and Canada and possibly others for dumping oil on America for the express purpose of taking us out of the marketplace. And that is an action that we are pursuing.

There is no free market for oil. And the best thing you all can do for us and for America and for the energy reserves of this country is to determine the true cost of the imported oil. Whether as a defense cost or whether it is environmental. We have a $4 environmental fee on American oil today. It is $4 a barrel to produce our oil, environmental costs, an artificial burden that other countries of the world don't have. Perhaps Congressman Stenholm is correct that we should have a compensating environmental assessment fee on foreign oil.

Only by effecting the price are you going to materially save the resource base of America. Now, I have to say, Congressman, that the Treasury official testified that 75 percent of the corporations don't pay taxes now that are in our industry. It makes me want to go back home and fire my accountant, because I sure pay them, and I don't know anybody that hasn't. And I think that your comment was appropriate that most individuals, most independents who are not incorporated are certainly paying taxes.

So, the tax provisions and credits that you all are working toward would be very helpful.

But the main thing, I think is—I think what we are going to find when we look into the subsidization or the producing oil below cost and foreign countries that are dumping on our shores, we are going to find out, regrettably, that those companies are being subsidized, but they are being subsidized by the United States of America. Mexico just got a sweetheart finance deal to restructure their oil industry with nonrecourse loans from America. Venezuela has an act in front of Congress that would give their subsidiaries a United States tax-free treatment on dividends. And we have to compete with people who don't pay taxes.

The defense cost involved with keeping the shipping lanes open. The Saudi Arabian concessions that are made with Treasury so that they can manipulate currency transactions and not feel the pain of low oil, is subsidizing our competition. That is not in the best interests of America.

Thank you very much.

[The prepared statement follows:]

**Statement of S. Michael Cantrell, President/Owner, Oklahoma Basic Economy Corporation, Ada, Oklahoma**

Thank you for the opportunity to share with this committee just one man's view of the devastation that is taking place in the domestic independent oil industry and the ramifications to our nation of this oil price crisis.

I am a native Oklahoman and third-generation "oilie." I am a small independent oil producer from Ada, Oklahoma. I employ 10 people. We operate 85 oil wells, all of them located within 30 miles of my home.

THE OIL CRISIS IS REAL

The business environment for my company is the worst it's been since the Great Depression. Without boring the committee with a series of statistics, please allow me to provide the following back-drop for my testimony:

- Oklahoma's oilfields are among the most mature in the world. Oklahoma has about 85,000 producing oil wells, which pump a total of about 200,000 barrels a day. That means the average well in our state produces about 2 1/2 barrels of oil a day.
- Average costs to produce an Oklahoma barrel of oil is about $13. In other words, at the prices paid for Oklahoma oil since November, Oklahoma producers, like me, have been losing an average of $4/barrel or close to a million dollars a day. No business—no industry—can survive for long in that sort of cash-flow crunch.
- At the beginning of last year, there were 45,000 Oklahomans directly employed in the oil and natural gas industry. There were probably twice that many employed indirectly because of oil and gas exploration and production. Our state oil and gas organization, the Oklahoma Independent Petroleum Association, estimates about 6,000 of those Oklahoma jobs are already gone ... and the rate of layoffs in the Oklahoma oilpatch is escalating at a rate of about 1,500 per month. That means 50 bread-winners a day are being forced to find new work, be re-educated or re-trained or relocate. Just in Oklahoma.
- Oklahoma's preeminent geologist, Dr. Charles Mankin, estimates there are still 18 billion barrels of oil under the ground in Oklahoma. We just celebrated the centennial of our industry in Oklahoma. In 100 years, we've produced 17 billion barrels. But the remaining one-half of the energy resource—the wealth, the tax base, etc.—may not be produced if the access to the oil reservoir, the wellbores, are plugged and abandoned prematurely because these marginal wells are too costly to continue to operate at a loss over the near-term.

THE OIL CRISIS HAS A FACE

Oklahomans are a proud people. Many of us stayed through the horrible oil crash of the mid '80s. This crisis is deeper and has gone on longer than the "bust" of '86. Pumpers, welders, roughnecks, oilfield supply houses, pipe yards, secretaries, accountants, landmen, and company owners. Nobody in the oil industry is spared. But the Oil Crisis doesn't just impact one segment, albeit a major segment, of the Oklahoma economy. It impacts all of us. Hundreds of small "oil towns" across Oklahoma are facing an economic double-whammy as the two staples of our rural culture and economy—oil and agriculture—struggle to survive.

The decline in the value of oil just in the past two years, is the equivalent to the loss of a billion-dollar-a-year industry in Oklahoma. It effects the grocer, the pharmacist, the convenience store owner, teachers and other government service providers. The decline in oil-related tax collections is estimated at $10 million a month to the state treasury, perhaps as much as four percent of the overall state budget. This means less money for schools, roads, services

THE OIL CRISIS "WINNERS"

There are identifiable winners in this oil crisis. No, I won't start by talking about American consumers, because—even though all of us benefit in the short run from lower prices for energy products—these savings won't last.

The winners are the foreign countries, and their oil company partners, who are systematically decimating the U.S. oil producing sector. Every time a U.S. oil well is plugged prematurely, the Oil Barons of the New Millennium, come one step closer to complete control of one of the staples of our existence and one of the foundation pins of our nation's freedom.

The former head of the Venezuelan oil regime announced 15 months ago: " Lower prices will result in some marginal production being shut in and force some high-cost producers, particularly in the U.S., out of business." In the winter of '97, with my oil selling for $18/barrel, that comment flew right past me. Today, it slaps me in the face.

I believe it is Venezuela's goal to displace 1–2 million barrels of U.S. production over the next 3–5 years. I believe they are joined in this global struggle for market share by Iraq, Iran, Canada, Mexico, Saudi Arabia, Norway and other countries. I believe their plan is working. I know some of my friends, neighbors and former col-

leagues in the oil business are already victims. I understand my company could be a fatality in the not-to-distant future.

What I don't understand is why the U.S. Government is compelled to aid and abet this foreign seizure of control of the global energy marketplace. Some will say it is not prudent for Congress or the Administration to interject itself into the "free market." Frankly, I have come to scoff even at the term.

When U.S. taxpayers subsidize the world's largest oil companies because our government allows these major companies to call the royalties they pay to foreign governments taxes ... which allows these companies to avoid paying taxes to our government. When U.S. oil producers pay upwards of $4/barrel in environmental/regulatory costs that producers in other parts of the world don't face. When U.S. taxpayers provide "free-of-charge" protection, via the U.S. Armed Forces, to tankers in shipping lanes around the globe. There is no free market for oil. There is no level-playing field for U.S. oilfield workers.

WHAT CAN CONGRESS DO TO ADDRESS THE OIL CRISIS?

I would offer the following:

- The appropriate Congressional committees and/or federal agencies should begin immediately an investigation to identify the true cost of imported oil.
  —Differences in tax treatment of foreign oil production
  —Differences in regulatory/environmental requirements for foreign oil production
  —Factoring in military costs.
- The appropriate Congressional committees and/or federal agencies should begin immediately an investigation into the substantial harm caused to U.S. oilfield workers by the overt and systematic taking of oil markets by foreign-controlled interests.
- Congress or the Administration should impose a graduated tariff (tied to world oil prices) on imported oil and petroleum products.
- Congress should enact major tax changes specifically aimed at preserving marginal oil wells, including the redefinition for tax credit purposes of enhanced recovery to include both new and existing hydro-injection projects.
- Congress should provide small independent oil and natural gas producers an exemption from anti-trust statutes for the purpose of forming cooperatives to aggregate production and improve the prospects for these small market players a more reasonable opportunity to compete against the conglomerates being formed by mergers of the majors and many larger independent producers.

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Mr. WATKINS. Thank you, Mike, very, very much, and I always gain something from your comments, and I appreciate it very, very much here this morning. And I know you will have lots of time to talk. I know you are part of the record, and I appreciate your mentioning how important these tax provisions are.

At this time, the gentleman from Colorado, do you wish to comment?

Mr. MCINNIS. Thank you, Mr. Chairman. If I might, Mr. Chairman, just make a couple of comments about this testimony.

Now, first of all, I should reflect to you that in my particular family we have a fairly large-size cattle operation. We are not producers on that property. The only thing that saved the ranch this year was low fuel prices. I do want to point out that there has been benefit throughout society, your taxpayer dollars. The government has saved hundreds and hundreds of millions of dollars as a result of these low prices.

I have kind of a fundamental disagreement with some of your testimony based on price. I don't think the way we look at this is by affecting price by doing some kind of governmental intervention that increases the price of the cost of fuel because it has a ripple effect throughout society.

Where I think we have to approach it, which you also touch in your comments, and I wholeheartedly agree with you on, is the cost

basis. And that percentage of the cost basis to you as a producer that is forced on you by the government with unfair and discriminatory taxes and nonenforcement of the dumping that is going out there.

I agree very strongly with most of your statement, but I do want to say to you that there are some positive benefits, and I think we shouldn't look at the gross price of the cost for fuel. But we need to look at how the government is hitting you on the net, not gross, but on net, what comes out of it.

I appreciate your comments. And, Mr. Solich, you state it very well, the discriminatory actions within your statement. That's where we have to target because we are being unfair. The government's being unfair to your industry in this taxing policy.

Thank you, Mr. Chairman.

Mr. WATKINS. The gentleman from Texas, you have a guest here that's on the panel who's going to present his testimony, would you like to make the introduction?

Mr. BONILLA. Thank you, Chairman. And before I introduce my constituent, John Bell from Kermit, Texas, I do want to comment very briefly on Mr. Cantrell's testimony. I leaned over to Mr. Watkins during your testimony, Mr. Cantrell, and said you hit the nail right on the head. I just appreciate that all of you are here from different parts of the country to tell the truth about the threat to national security, and about the dumping problem that we have that we should be dealing with, especially with a rogue nation like Iraq. With one hand we're bombing them, on the other hand we're allowing them to dump oil on the high seas. Not only is it a bad policy, it's domestically threatening our national security domestically.

I just appreciate you all coming here, but I want to tell you, very frankly, that I found out in my short time here in Washington that truth and substance often is not enough to push your case forward. But we're not going to give up. We're going to keep talking about it, and with your help, maybe we will prevail in the end and finally talking about the long-term downside of allowing these things to occur that threatens our country long term.

And as Mr. Cantrell pointed out, when you think the sun is shining today and you see it out there, it doesn't mean it is going to be shining tomorrow. You have to have a vision about what these low prices are doing to us long term. I appreciate you pointing that out.

At this time I would like to introduce, and I appreciate the Subcommittee allowing me to be here today to introduce John Bell, who's done more than any other Texan, in my view, to tell the story, not only here in Washington but around our State. I know you were the man behind the wonderful big show of support for the producers in the Permian Basin in Austin in mid-January. I appreciate all you do, Mr. Bell.

At this time, we'd be pleased to hear your testimony.

Mr. WATKINS. Mr. Bell, your complete testimony will be made part of the record. And you can summarize. Let us know your answer to the question, will H.R. 53 and also H.R. 423 be a benefit to the industry, despite what the Treasury Department said?

## STATEMENT OF JOHN D. BELL, DBA REATA RESOURCES, KERMIT, TEXAS

Mr. BELL. I appreciate that, and I will, rather than follow my agenda—you have that testimony—and I will just tell you briefly that I'm a small producer. I'm one of the smallest producers probably in the business. I have nine wells and make about 20 barrels a day. I primarily provide for my family by working as a drilling and workover consultant and supervisor. I purchased a few wells in order to try to provide a college education for my children, and I had hoped at some point in time to be able to retire selling those properties.

I have six children. The oldest is in college now. I have a son who is a senior and a daughter who is here today behind me, who is a junior. So I'm going to have lots of kids in college right away, and that's going to be a real challenge.

I appreciate Representative Bonilla asking me to come here today. I have to confess that when they first called and asked if I could come, I told them I flat couldn't afford to with oil prices at today's level I could not do it.

Some of my friends in Kermit, Texas, and Laura has a friend back there with her named Shana Smith. And Shana's father has been very supportive of me in doing this effort. And so, Ricky Smith got some other producers together to be able to provide a way for me to come, providing the airline tickets. I want you to understand that we're not J.R. Ewing, this isn't Dallas, and we're in a world of hurt.

I don't know much about politics, but I do know about the pain our people are suffering and enduring in the oil business. To tell you that the economy of west Texas and the other producing areas across America, and of the world, are in a severe state of depression—tens of thousands of workers are being laid off. It just so happens that in our area, a large, large percentage of those are of Hispanic descent. We have been able to gather the support of LULAC as a help to us because we are trying to save jobs.

This is a job issue; this is a school issue; this is a community issue. In our community, in particular, we stand the risk of losing our hospital. We are going to lose a substantial proportion of income for education for our high schools, for our schools there. We have some schools in Texas that may wind up being closed if we can't get some other source of help. Our district, in particular, is 89 percent dependent on mineral values to provide an education for our children.

I want to give you a little background here to make oil prices relative. Some people seem to think cheap oil is good for America. And I think low energy prices, while they may have a benefit to America, I want to tell you that there is a serious problem with energy that is too cheap to preserve itself.

Back in the early seventies, my father acquired some leases down in Kermit, Texas, of which I have since purchased some of those leases and continue to produce them. We were receiving anywhere from $2.85 a barrel up to $3.25 a barrel prior to the Arab oil embargo of 1973. I don't know if you guys have figured out why the Arab embargo took place. But it took place because oil was too cheap.

And I bought a new pickup. I was 19 years old. I bought a new pickup in the fall of 1971. That pickup cost me $3,600. If I go buy that new pickup today, it costs me seven to eight times that much money. If you take and figure that you had an average price of $3 a barrel, that translates to $21 a barrel to keep up with pre-1973 embargo prices, pre-1973 prices, in order to do that today. I received a check last month or in December for $7.75. That's equivalent in 1971 to about $1.15 a barrel. We can't produce it for that, and there is not anybody else in the world who can.

As long as we're subsidizing foreign oil, as long as we are providing for the common defense of the Persian Gulf oil, we have a problem. Persian Gulf oil ought to pay for its own stinking defense. The point is that worldwide production will decline below market demand in a few years, but this will not come until after the destruction of the domestic oil industry.

You are witnessing our industry being damaged now. If oil corrections are not made soon, U.S. production will continue to fall to historic lows. I started out by trying to let producers take care of this problem, and I suggested the 10-day shut-in. Ten days isn't very long, and I thought that might be able to work. But I got warned if I did that and I continued that effort—and I sent a couple of thousand letters around the world. I got a nice thank you letter from OPEC, but they didn't shut-in. I got warned, if I did that and pursued that area, I could be violating antitrust issues. And I just thought, boy, if John Bell from Kermit, Texas, violates antitrust issues, how in the world can we merge major oil companies? Just doesn't make a lot of sense.

So what we need is, we need some help; we need some assistance here because we can't protect ourselves. That's really the bottomline. This morning there was a question asked over here that said, we come when prices are low, that we come in here and talk. I don't remember. I know I certainly hadn't been here before. I can tell you that our industry has provided a lot for this country, and we need some help. I realize there are some serious problems. I ask that you would give some help.

Yes, we need the tax help you have discussed, but it is going to take more than that. And we would ask you to limit Iraq's ability to export oil into our country, and we would ask that you cause for those companies that are importing Iraqi oil to stop that. As long as they are trying to shoot our pilots down, we don't think that ought to be going on.

[The prepared statement and attachments follow:]

**Statement of John D. Bell, dba REATA Resources, Kermit, Texas**

CRISIS IN THE OIL PATCH—IS IT GOOD FOR AMERICA?

Low oil prices are stealing the jobs, savings and future from those of us who produce and work in the oil industry. I've been repeatedly told that "low oil prices are good for the American economy" but I ask, "Are the American people willing to close our children's schools and shut down our hospitals?" Low oil prices have already stolen tens of thousands of our jobs. My family's future including my children's education and our family's savings for retirement are being taken from us while I'm being told "Low oil prices are good for America." I refute that statement. Doesn't America remember the 1973 Arab Oil Embargo?" Are you willing to trade today's low oil prices for the security of America's defense and future? How are you as our elected representatives going to explain the gas lines of tomorrow?

Today's extremely low oil prices are not good for America's long term economy or the world's economy. Let's look at low oil prices from a world view. This price war is devastating the economies of countries around the world. The situation in Russia is horrid. Russia and some of the countries of the former Soviet Union earn most of their foreign income from the sale of oil. I estimate that a $10.00 per barrel drop in the price of oil is costing these FSU countries about $2 billion per month. In a recent US New and World report article, the situation in Russia has been compared to pre World War II Germany prior to Hitler. Yelstin is very sick and Russia is ripe for revolution. Today Russia is more dangerous than pre WW II Germany due to Intercontinental Ballistic Missiles. How long are you going to allow low oil prices to punish the people of Russia?

While America's economy is booming, the Russian economy is being destroyed. Why must the Russian people starve to death while Americans drives around in large sport utility vehicles? If Americans can afford SUV's, they can afford to pay a reasonable price for the gasoline to fuel them. How selfish are the American people? Oil is Russia's largest export commodity. Oil is how they have earned most of their foreign income. Low oil prices are not only damaging the Russian economy but also the economies of Mexico, Venezuela, Indonesia, Malaysia, Nigeria, Kuwait, Saudi Arabia, the United Arab Emirates, Norway, and many other nations. Mr. Chairman and Honorable Representatives, the world needs your help. Please listen.

The United States government recently approved an emergency funding bill which uses our tax dollars to provide billions of dollars as "loans" to the IMF. The IMF (International Monetary Fund) is providing "loans" to help stabilize the economies of these and other countries who are suffering from deflation. Much of this money is being stolen by dishonest politicians and never reaches the people for whom it was intended. Increased oil prices would provide jobs which would allow these countries to take care of their own needs rather than receiving government to government welfare in the form of "loans." Wake up America! Low oil prices are causing terrible and painful repercussions to much of the world and we are paying for the cost of low oil prices in the form of "loans."

As we endure the oil price collapse of 1998 and 1999, we need to ask ourselves why is this occurring. Some have suggested that it is a result of the economic depression which occurred in the Pacific Rim Countries. While that may have played a minor role, we need to look deeper to find the real answers. OPEC countries are fighting an oil price war. This is a battle over market share! Why are OPEC countries allowing this price war to continue while it hurts their own economies? It is to their advantage to eliminate the competition. OPEC could make the necessary production cuts needed to balance supply and demand and to stabilize oil prices now, but if they do they will continue to face world wide competition. If John D. Rockefeller were doing this, the trust busters world be attacking him instead of allowing his former oil companies to merge.

How long will the price war last? What are the battle strategies? We need to find out what is happening and who is involved. How does the rush for the majors to merge fit in to the current scenario? In Austin, I requested that Governor Bush order the Texas Attorney General to investigate the cause of the recent price drop in order to see if the oil market is being manipulated. Now we ask you to initiate an investigation into the situation in order to answer these questions. This is not a difficult request. We have a right to know why our businesses and our lives are being destroyed!

Who is winning and who is losing? The obvious losers are the people who drill, service, and produce oil wells. This affects not only oil field workers but also their families and their communities. Schools in West Texas and other oil producing regions of the country are being financially devastated by this war. Enclosed is a document from Carol Rylander, our Texas State Comptroller, which shows how low oil prices are hurting Texas schools. Many schools are facing the probability of losing millions of dollars which will financially devastate their ability to educate our children. This may force some school districts in Texas to close next year. Entire communities and counties are being severely damaged by this oil price war. Ward and Winkler Counties in West Texas are facing severe cuts. This will not just threaten senior citizens centers and recreational centers but in all probably will force the closure of their hospitals. My neighbors in Kermit and West Texas face dire consequences. We need serious help in order to deal with low oil prices.

Low oil prices are not just hurting people in Texas and the Permian Basin but also those who live in the oil producing areas of New Mexico, Louisiana, Mississippi, Oklahoma, Kansas, Colorado, Wyoming, Montana, North Dakota, Utah, California, and Alaska. Northeastern states such as Michigan, Pennsylvania, Ohio, and upstate New York will be affected as well. The publisher of the Rocky Mountain Oil Journal, Mr. Cody Huseby of Bismarck, North Dakota, stated that not a single drilling rig

is operating up there for the first time since oil was discovered in North Dakota in the early 1950s.

Who is benefitting from low gasoline and fuel prices? The airlines, transportation, and the driving public seem to be reaping the benefits of low prices. Yes, there are many areas of the country and even the world that are currently reaping the reward of low energy prices but I question "How long can low prices last?" Are today's benefits worth the long term costs? In order to answer some of these questions, we need to understand what is happening. Due to the drop in oil prices, drilling for oil has slowed in the US to the lowest level since rig counts started being reported in 1949. Thousands of oil workers have been laid off in the United States, Russia, and around the world. Oil production is dropping sharply especially in the United States and other so called high cost producing areas of the world.

Who are the world's high cost producers? Some have suggested that the high cost oil producers are US independents. I maintain that Persian Gulf oil is more expensive than US oil. The United States government is currently subsidizing foreign oil production from the Persian Gulf by providing the military build up there. A recent IPAA letter to Congress stated "US taxpayers are paying about $50 billion per year to maintain a strong military contingent in the Gulf." This does not include the additional billions which we spent to pay for the bombing cost of Desert Fox and the continuing daily effort in Iraq. Why should American taxpayers pay these costs? Why shouldn't Persian Gulf oil pay the cost for its own defense? The real cost to the American taxpayer for oil imported from the countries in the Persian Gulf includes the cost of maintaining stability in the region. How much are we really paying for Persian Gulf oil? This cost can be calculated by dividing $50 billion by 2.5 million barrels per day multiplied by one year. (In 1998 US imports averaged less than 2.5 million barrels of oil per day from the Persian Gulf.) Therefore, Persian Gulf oil cost US tax payers about $54.00 per barrel plus the purchase price. The total cost is about $65.00 per barrel. By comparison the United States produces about 6.2 million barrels per day and it is worth only $23 billion per year at the current price of $10.00 per barrel. Even at $20.00 per barrel it is still worth less than $50 billion.

During the oil boom of the 1970's and early 1980's US oil producers were penalized for excessive profits. About $77 billion were taken out of the US oil industry in the name of windfall profits. Now when the oil industry is facing a serious crisis due to low prices and severe losses, very little relief is being offered to help us. The unfairness of the situation is frustrating. Foreign oil is subsidized while domestic producers are taxed and penalized out of existence.

In 1986 the Reagan administration, in their efforts to destroy the former Soviet Union and win the cold war, encouraged Saudi Arabia to lower the price of oil by increasing oil production. The leaders of both the US and Saudi Arabia felt their countries could benefit from lower oil prices and increased market share. As I consider what occurred, I suppose maybe the sacrifice of the US oil business was justified in order to win the cold war. I feel that if an industry is going to be sacrificed there should be some type of compensation. Why have we not been compensated? Is a similar agenda being played out today? If so, who is the enemy now?

Saudi Arabia is considering the option of inviting the major oil companies back into their country. Is Saudi Arabia trying to stabilize the market or increase their market share? Who are they trying to drive out of the market place? US Independents? Russia? Mexico? It is obvious that they intend to increase their production in order to gain a larger market share if they are willing to share part of their income with the major oil companies. Have you considered what will happen if the Saudis increase their production and continue to flood the market? Major disruptions will continue to drive other producers out of business. Why should Saudi Arabia be allowed to increase their market share? Are they declaring an economic war on other producers such as US independents, Russia, Mexico, and even their neighboring OPEC producers? If so, is the US military ready to defend Saudi Arabia from other oil producers of the world?

Even more frightening is the UN decision which allows Iraq to increase their market share while they shoot missiles at our American pilots. It is obvious that Saddam Hussein is not using Iraq's oil money to provide for the Iraqi people. We request that Iraqi oil imports be severely restricted as long as Iraq threatens the region's security. We should deny Saddam Hussein the money to build missiles and weapons of mass destruction. Please demand that American oil companies, such as Exxon and Chevron, stop buying oil from Iraq while they are at war.

Low crude oil prices are a contributing factor in the world wide deflationary crisis. Oil prices must be viewed in relation to other industries. For example, the oil and gas industry is a large consumer of steel products. A new oil well requires about the same amount of steel required to manufacture 40 to 50 cars. Low oil prices have

reduced the number of wells being drilled in the US to the lowest level since the late 1940s. Because fewer wells are being drilled, the volume of steel needed to manufacture rigs, tanks, casing, tubing, drill pipe, and pipelines has been dramatically reduced. Due to low oil prices and weak economies abroad, foreign steel manufacturers can't find enough buyers so they increased their steel imports into the US. This resulted in an over supply of steel in the US which caused steel prices to drop. US steel companies have ask Congress and the President to restrict steel imports. If you agree to limit steel imports, we expect you to restrict oil imports! If much of the steel industry's problems stem from a drop in oil prices, don't independent oil producers deserve the same protection as steel manufacturers?

Are today's extremely low oil prices really good for America? We must consider the short and long term benefits and costs. As consumers becomes dependent on cheap oil, the available supply drops. The situation is like a drug addict. The more we become addicted to cheap oil, the more we risk supply disruption. We cannot find and produce enough oil to meet the world's needs at current prices. The current posted price of oil is below $10.00 per barrel while the price for paper oil (NYMEX futures contracts) is about $12.00 per barrel. There will not be enough $10.00 to $12.00 oil available to supply the world's needs for very long. Oil needs to exceed $18.00 per barrel in order for producers to have the incentive to explore for and drill and the additional reserves needed to stabilize production. If you do nothing and wait a few years for the situation correct itself, you are risking a return to supply disruptions similar to the 1970's. The market is out of balance by less than 5%. When oil supplies are reduced below demand, a price spike will occur. The domestic industry is being permanently damaged and it will take years to reverse the decline rate. Is America better off when oil supplies exceed demand or when supplies are short?

The low price of oil will correct itself over a period of time at a very high cost to consumers. This correction will probably occur after much of the US oil industry is bankrupt and destroyed. To find and produce large volumes of oil requires major investments of money and time. The longer the price is low, the higher the price spike will be on the other end. It is a natural consequence. During the early 1970s the low price of oil resulted in a shortage. This resulted in a huge price spike, economic chaos, and inflation which took years to correct. If oil prices remain too low for too long we will repeat the same experience. If corrective actions aren't implemented soon, I predict the price of oil may exceed $50.00 per barrel in a few years.

A serious supply disruption could take place as early as January 1, 2000. Much of the world's oil loading and pipeline capacity is located in third world countries. Most of these facilities are controlled by computers or computer components which may experience Y2K problems. Have you considered what will happen if 25% to 50% of the world's oil supply is disrupted for 30 days? We have less than a 30 day supply on hand now. It won't take very long for oil shortages to occur and oil prices to spike. It will take 5 to 10 years to revive the US industry because our workers are leaving and our equipment is being stacked. Serious corrective action should be taken now.

I recognize that this committee is primarily interested in tax matters. In that regard, the most meaningful tax relief measures which would help the industry are a Marginal Well Tax Credit as proposed by Senator Hutchison, an increase the depletion allowance to the original 27½% level, changes in the Alternative Minimum Tax to eliminate intangible drilling costs as a preference item, and allowing geologic and geophysical costs to be expensed in the current year. Most important of all, a program should be developed to allow the industry to recoup a substantial portion of the $77 billion in Windfall Profits Taxes which it paid between 1980–1986, now that we are making little or no money. That is nothing more than basic fairness. While these tax breaks are not going to fix our problems or save our jobs nor save our schools or hospitals, our communities will benefit from some tax changes. The troubled independent oil industry is similar to a seriously hurt accident victim. First aid is required but a few Band-Aids will not save our industry nor our communities. The surgery of cutting off Iraqi oil is required. We request that you restrict imports temporally until US production and prices are stabilized and a responsible National Energy Policy is in place.

The current US National Energy Policy is inadequate. A responsible energy policy should be implemented to help level out the price spikes on both ends. Prices that are either too high or too low hurt America's and the world's economies. The longer you wait and the more addicted America becomes to cheap oil, the more our economy will be disrupted by the correction which will inevitably occur. Chairman Houghton, and Honorable Representatives, I implore you to take action immediately. For the sake of America's future, please restrict imports now.

## News Release from Texas Comptroller Carole Keeton Rylander

For Immediate Release:
Tuesday, February 2, 1999
Contact: Keith Elkins—512–473–4070

COMPTROLLER SUPPORTS EMERGENCY LEGISLATION TO AID OIL AND GAS INDUSTRY

(AUSTIN)—According to an analysis issued by the Comptroller of Public Accounts today, a decline in oil prices could have a devastating impact on some local school districts.

"While some consumers may welcome lower prices at the gas pumps," Comptroller Carole Keeton Rylander said today, "the trickle down effect on some local property values could have a serious financial impact for some Texas school districts."

In some areas of the state, where oil and gas reserves comprise more than 20 percent of the school's value or where oil and gas are valued at more than $250 million, it is estimated total school district losses for the next year will be approximately $150 to $160 million.

The Comptroller's analysis estimates at least 30 districts will sustain losses of more than a million dollars for fiscal year 2000, ranging from a high of $8.3 million in the Iraan-Sheffield school district located in Pecos to $1.07 million in the Post school district in Garza.

"The financial shortages facing some school districts as a result of the crisis in the oil and gas industry are staggering," Rylander said. "Without emergency assistance Texas homeowners may see their property tax rates climb even higher."

An analysis of declining oil prices on individual school districts can be found on the Comptroller's Window on State Government Internet site at http://www.window.state.tx.us.

## Potential Oil and Gas Property Tax Levy Losses To Texas School Districts

The Comptroller's Office surveyed the appraisal districts or their contract appraisal firms that appraise oil and gas reserves for property tax purposes. These appraisers are currently working on appraised values as of January 1, 1999. Their appraisals will not be complete until about July 25, 1999, after they have been through a local appeals process and are certified to each taxing unit. The appraisers' consensus is that oil properties will decline in value from January 1, 1998 to January 1, 1999 by about 40% and that gas properties will decline by about 15%. This decline in value is caused primarily by oil and gas price declines.

The Comptroller's Office asked for more specific information from the appraisers for school districts where oil and gas reserves comprise more than 20% of the school's total value or where oil and gas are valued at more than $250 million as of January 1, 1998. These value losses were translated into property tax levy losses. The losses will affect school districts in FY 2000 and will affect the state (through the school funding formula) in FY 2001. The total statewide FY 2000 school district loss will be approximately $150–160 million. This is a very rough estimate based on our informal survey of preliminary figures from local appraisers. 1998 tax rates and 1998 local values for oil and gas properties were reported to us by school districts.

Below is a listing of FY 2000 school district oil and gas property tax levy loss estimates sorted from highest to lowest loss. These estimates may vary from the actual levy losses that occur after the local appraisal process is complete.

| School District | County Appraisal District | Levy Loss |
|---|---|---|
| IRAAN–SHEFFIELD | Pecos | $8,332,800 |
| ANDREWS | Andrews | 7,468,380 |
| ECTOR COUNTY | Ector | 6,438,346 |
| SEMINOLE | Gaines | 5,486,371 |
| DENVER CITY | Yoakum | 5,250,000 |
| CRANE | Crane | 3,905,638 |
| MIDLAND | Midland | 3,624,481 |
| CARTHAGE | Panola | 3,233,200 |

| School District | County Appraisal District | Levy Loss |
|---|---|---|
| SUNDOWN | Hockley | 3,094,789 |
| LEVELLAND | Hockley | 2,792,254 |
| PINE TREE | Gregg | 2,448,679 |
| FT STOCKTON | Pecos | 2,398,770 |
| JAYTON–GIRARD | Kent | 2,333,697 |
| CROCKETT CO | Crockett | 1,933,014 |
| ZAPATA | Zapata | 1,918,152 |
| PLAINS | Yoakum | 1,875,000 |
| MONAHANS–WICKETT–P | Ward | 1,651,418 |
| REAGAN | Reagan | 1,596,000 |
| MCCAMEY | Upton | 1,580,250 |
| WHITEFACE–BLEDSOE | Cochran | 1,533,445 |
| GLASSCOCK | Glasscock | 1,461,129 |
| UNITED | Webb | 1,355,525 |
| RANKIN | Upton | 1,309,000 |
| BORDEN COUNTY | Borden | 1,305,000 |
| EDINBURG | Hidalgo | 1,197,232 |
| WINK–LOVING | Winkler | 1,170,000 |
| CONROE | Montgomery | 1,145,670 |
| CLEAR CREEK | Galveston | 1,116,226 |
| WEBB CONS | Webb | 1,107,173 |
| POST | Garza | 1,074,930 |
| KERMIT | Winkler | 939,000 |
| REFUGIO | Refugio | 852,183 |
| STERLING CITY | Sterling | 830,363 |
| SNYDER | Scurry | 825,000 |
| LOOP | Gaines | 816,204 |
| WHITE OAK | Gregg | 802,329 |
| WEST RUSK | Rusk | 799,494 |
| GUTHRIE | King | 777,537 |
| DUMAS | Moore | 763,095 |
| PECOS–BARSTOW–TOYA | Reeves | 757,979 |
| CANADIAN | Hemphill | 747,004 |
| BROOKS | Brooks | 746,462 |
| BROWNFIELD | Terry | 742,371 |
| DAWSON | Dawson | 737,639 |
| FORSAN | Howard | 734,082 |
| IRION COUNTY | Irion | 729,682 |
| BRECKENRIDGE | Stephens | 707,865 |
| BECKVILLE | Panola | 689,108 |
| CALDWELL | Burleson | 684,600 |
| LA GRANGE | Fayette | 680,278 |
| LA JOYA | Hidalgo | 664,266 |
| SONORA | Sutton | 662,400 |
| HAWKINS | Wood | 637,500 |
| LA POYNOR | Henderson | 632,450 |
| MIAMI | Roberts | 626,503 |

Mr. WATKINS. Thank you, Mr. Bell, very impressive testimony and one I know we all take to heart.

Let me ask my good friend from Texas, Congressman Charlie Stenholm, to introduce his guest and make his remarks. We'll enter the official remarks as part of the testimony and summarize it.

We have a vote I think that's been called, but we'll have time to make sure we get his testimony in, Charlie.

Mr. STENHOLM. Thank you, Mr. Chairman. I will be brief, and I thank you and Mr. Coyne again for holding this hearing. Bringing folks like Glenn Picquet to the House Ways and Means Committee helps put a real face on a very real problem which has ramifica-

tions for the entire country to a degree far greater than what has been expressed thus far. I hope this hearing will begin to fill the record and paint the picture which our oil patch is experiencing much more fully.

With all due respect to my colleagues, Glen Picquet is the only VIP that we will hear from today. I know there are different views on that, but he's the only voter in the 17th District that we will hear from today. I just want to make that comment, and recognize Glenn's tremendous leadership within the district and the efforts he has made to reach out to others regarding this issue. We have heard about the effects of low oil prices on funding for our schools, and mentioned the effect of low prices on hospitals. Obviously, the effects of hard times on producers have a significant impact on all areas of our economy.

To find a solution to this crisis, you have got to get other folks involved. Glenn has been very active in reaching out to build a coalition of folks to bring this issue to the forefront. He comes this morning to testify on behalf of his company, C.E. Jacobs Company, in Albany, also the West Central Texas Oil & Gas Association, the North Texas Oil & Gas Association, the Panhandle Producers & Royalty Owners Association, the Permian Basin Petroleum Association, and the Texas Independent Producers & Royalty Owners Association.

Glenn, I thank you and the other witnesses for taking the time to be here. Your participation helps put a real face on a very real problem.

**STATEMENT OF GLENN PICQUET, EXECUTIVE VICE PRESIDENT, C.E. JACOBS COMPANY, ALBANY, TEXAS; ON BEHALF OF NORTH TEXAS OIL & GAS ASSOCIATION, PANHANDLE PRODUCERS & ROYALTY OWNERS ASSOCIATION, PERMIAN BASIN PETROLEUM ASSOCIATION, WEST CENTRAL TEXAS OIL & GAS ASSOCIATIONS, AND TEXAS INDEPENDENT PRODUCERS & ROYALTY OWNERS ASSOCIATION**

Mr. PICQUET. Thank you, Congressman. I do appreciate the invitation, the opportunity to testify. As Congressman Stenholm noted, I do represent, together on these five associations, more than 5,000 individuals and companies, primarily based in Texas, that explore for and produce crude oil and natural gas. These are small companies with less than 100 employees. Most have less than 10 employees. I also have with me these petitions, this stack of petitions here, signed by more than 12,000 individuals asking the Congress to take action to preserve the domestic oil and gas industry.

I'm going to spare you the reading of my prepared statement, as requested by the Chairman. That statement does discuss the problems the crisis has created, and it also spells out some possible solutions.

But I do want to tell you how this crisis has affected my company and our employees. This is about Americans, American workers, American jobs. It's about small, and in many cases, family-owned, second- and third-generation American oil producers competing with foreign governments. There are a large number of hardworking, regular folks whose jobs are in danger of being lost be-

cause of the unchecked flow of cheap crude oil into this country at unprecedented levels.

This is not a fair situation. Foreign governments have elected to flood the market, driving down the price of our product, forcing layoffs of oil field workers, and causing the premature closing of thousands of wells. This is a tragic loss of investment and reserves, and it is creating a dangerous threat to our national security.

My company, C.E. Jacobs Company, has been a successful independent producer since shortly after World War II. We have maintained a staff of between 15 and 20 employees during that time, typically drilling between 10 and 20 wells per year. We survived the extreme drop in oil prices in 1986 and have managed to stay in business during the past 13 years despite the low prices and the heavy tax load and high cost of environmental protection that have been added to the cost of doing business.

In 1997 we did have to reduce staff. And we have been unable to drill any new wells to offset our production decline for the past couple of years. And we have been hanging on with hopes that crude oil prices will return to a level where we can actually make a profit and have a positive return on our investment again.

But with a further drop in crude oil prices during 1998, we find ourselves in uncharted territory, and frankly, we are scared. The most painful part of this crisis involves our employees. They have had only a couple of salary increases in the past 13 years, while they have seen their benefits packages slowly eroding. We are now faced with either reducing benefits further or reducing staff again.

Let me tell you about some of the people that used to work for us that are no longer with us. We've lost a lot of talent. In 1997 we closed our geological office in Abilene, terminating a relationship with our chief geologist, Bill Burton, who was responsible for the success of our wildcat drilling program for four decades. We could no longer afford the overhead associated with his office, nor could we come up with the capital to finance his drilling programs.

Also released from employment at that time was his protege, a young, promising geologist, Paul Zimmerman. We also lost our production foreman, who decided to take a chance by purchasing his own lease and operating it himself. I promise he wishes he was back with us today. Then last year, our best heavy-equipment operator, Steven Williamson, decided that the oil patch probably would not be around long enough to provide him with a job until normal retirement age, which is about 25 years from now, so he went to work for a new cast-iron foundry nearby.

Then our chief financial officer, Ken Thompson, left to take a job leading the business division of Region 14 Education Service Center in Abilene, "because education will always be there."

Even with these losses of employees, we found that by this past Christmas our operating company was still not profitable, so effective January 1, 1999, we terminated two contract pumpers, not because of a lack of ability or anything they had done wrong, but because we simply could not afford to keep them on the payroll with crude oil prices so low and with so many wells shut in due to being unprofitable.

Now, this is not a scenario that is unique to my company. We look around us and we see this story repeated over and over. Good,

experienced oil field employees are leaving the industry and not being replaced. American jobs are being lost at an unprecedented rate because of the actions of foreign governments that export oil.

Therefore, on behalf of the 5,000 members of the combined associations that I represent and the more than 12,000 petition signers that are displayed here today, I urge you and the Congress to take action to save the domestic oil and gas industry.

That concludes my remarks, with the exception that I do want to comment on Congressman Thomas' question: Yes, we definitely can benefit from the proposed legislation, proposed tax changes. And I also do want to reiterate what some of my colleagues have said, that the Treasury Department spokesman was definitely wrong. We independent producers do pay a lot taxes, and we have paid a lot of taxes.

OK, that concludes my remarks.

Thank you.

[The prepared statement follows:]

**Statement of Glenn Picquet, Executive Vice President, C.E. Jacobs Company, Albany, Texas; on Behalf of North Texas Oil & Gas Association, Panhandle Producers & Royalty Owners Association, Permian Basin Petroleum Association, West Central Texas Oil & Gas Associations, and Texas Independent Producers & Royalty Owners Association**

Thank you Chairman Houghton for allowing me to make this statement on behalf of the North Texas Oil and Gas Association, the Panhandle Producers & Royalty Owners Association, the Permian Basin Petroleum Association, the West Central Texas Oil and Gas Association, and the Texas Independent Producers & Royalty Owners Association. Together we represent more than 5,000 individuals and companies that are primarily based in Texas that explore for and produce crude oil and natural gas. They are generally small companies with a majority having less than 100 employees, and most have less than 10 employees.

The decline in crude oil prices in 1998 has had a devastating impact on independents. A December 1998 report of the Interstate Oil and Gas Compact Commission (IOGCC), which is composed of the Governors of the oil and gas producing states from across the nation, notes that the U.S. oil and gas industry is particularly susceptible to long periods of low crude oil prices. This is true largely because about three-fourths of the nation's oil wells are marginally economic. About 436,000 of the nation's 573,000 oil wells produce less than 10 barrels per day. On average, these low-volume "stripper" oil wells produce 2.2 barrels per day. At these quantities, low crude oil prices may not cover production costs. During periods of low prices, wells are idled, produced only sporadically to meet minimum lease requirements, or plugged and abandoned. Marginal wells provide about 25 percent of the domestic crude oil production, excluding Alaska and federal offshore.

Higher volume wells are impacted, too.

As revenue for domestic producers falls, there are usually cutbacks in exploration and production expenditures; corresponding reductions in taxes for state, federal, and local economies; decreased revenue for royalty owners; job cuts in the energy industry and supporting services; and an increase in imports.

A dramatic illustration of vulnerability of U.S. oil wells comes from the fact that the average oil production per well in the U.S. is 11 barrels per day. Compare that to the average production per well in Saudi Arabia is 5,773 barrels per day per well.

Companies' ability to raise capital for drilling and completion programs has also been affected. While low oil prices made tapping debt and equity markets trying for much of the year, recent turmoil in global markets now appears to be shutting down capital markets entirely for most (energy) firms. Energy concerns raised just $7.7 billion in capital markets during the third quarter, the lowest total since the third quarter of 1996. Independent companies, pinched by lower stock prices and reduced cash flow, also are finding it more difficult to obtain loans.

As a natural consequence, rig counts are down significantly. Since its high in 1981 of 4,500, the total number of rotary rigs running in the United States—including oil, gas, directional, horizontal, vertical and miscellaneous—decreased to an all-time low of 558 in January 1999.

Current revenue figures on the impact of lower production, prices and royalty payments on the federal government are not available. However, the August auction of leases in the Gulf of Mexico reflects an industry slowdown.

Bids dropped sharply for the latest auction of offshore petroleum leases in the western Gulf of Mexico, mostly near the coast of Texas. The Minerals Management Service reports 486 bids were received in its most recent sale for 402 tracts in the western Gulf. That's far off the record, 1,224 bids taken on 804 tracts for the western Gulf sale in August 1997. High bids for that sale totaled $616.2 million, according to IOGCC.

Several states rely on taxes and royalty income for their general fund and for school funding. A decrease in production results in lower revenues for states from severance taxes, conservation taxes and ad valorem taxes. A decrease in production from leases on public lands also impacts states by reducing royalty payments, which are often used to fund public education.

The IOGCC stated that in the first six months of 1998, an estimated 48,702 wells have been idled or shut in, according to a recent survey of 23 states. If these wells were plugged and abandoned, it would represent a 142 percent increase over the number of wells (20,087) plugged and abandoned in 1997.

In Texas, oil severance tax revenues have fallen $94.9 million in the first eight months. This represents a reduction of 34 percent. About 2,800 jobs have been lost and 1,087 oil wells idled or shut in.

The IOGCC report states that a group of large independents posted a combined loss of $854.4 million in the first half of 1998, compared with a profit of $2.02 million for the first six months of 1997. Revenues for this group fell 12.2 percent. Despite an increase in revenue, a group of 30 small independents posted a collective loss of $68.5 million for the first half of 1998, compared with a profit of $47.2 million in 1997.

For major, integrated companies, earnings from domestic oil and gas production declined 50 percent, according to the Energy Information Administration.

In the past 15 years, the domestic production industry has changed dramatically. In 1981, nearly 1.9 million people were employed in the oil and gas industry. By 1996, the total employment was 1.4 million. Forecasts indicate continued employment losses.

States have estimated that nearly 11,000 jobs in the oil and gas exploration and production sector have been lost this year.

The list of companies that have cut employees is extensive. The Independent Petroleum Association of America estimates that 24,415 jobs have been lost since the price decline began in November 1997. Based a survey of independents, IPAA estimates that if oil prices remain at $14 or lower for another six months, and additional 17,279 jobs will be lost.

In general, the domestic oil and gas industry is heavily dependent on smaller independent operators, as opposed to large, integrated companies. Many of the major oil companies are concentrating their expenditures abroad. Independent oil and gas operators accounted for drilling 85 percent of the domestic wells, producing 45 percent of the crude oil and 60 percent of domestic gas.

In addition to layoffs, the reduction in earnings has cut back exploration and production budgets across the board. For the third quarter of 1998, completions of oil wells, natural gas wells and dry holes declined by 18 percent, compared with the same period last year. In the third quarter, oil well completions declined 25 percent to 2,361. Also for the quarter, completions of exploratory wells were down 20 percent and development-well completions dropped 17 percent, IOGCC said.

The United States continues to rely heavily on petroleum as its major energy source. Petroleum demand is projected to grow at 1.2 percent per year through 2020 with 70 percent of the total used for transportation fuel, including gasoline, diesel and aviation fuel according to the Energy Information Administration's 1999 annual energy outlook. With domestic demand increasing and domestic supply decreasing, the U.S. relies heavily on imported oil and this trend is expected to continue. Many within government believe that this could create a national security problem.

In December 1994, the Department of Commerce found that *"...the reduction in exploration, dwindling reserves, falling production, and the relatively high cost of U.S. production all point toward a contraction of the U.S. petroleum industry and increasing imports from OPEC sources. Growing import dependence, in turn, increases* U.S. vulnerability to a supply disruption because non-OPEC sources lack surge production capacity; and there are at present no substitutes for oil-based transportation fuels. Given the above factors, the Department finds that petroleum imports threaten to impair the national security."

President Bill Clinton stated in February 1995 that *"I am today concurring with the Department of Commerce's finding that the nation's growing reliance on imports*

*of crude oil and refined petroleum products threaten the nation's security because they increase U.S. vulnerability to oil supply interruptions. I also concur with the Department's recommendation that the Administration continue its present efforts to improve U.S. energy security, rather than to adopt a specific import adjustment mechanism*. (Emphasis added)" The situation is worse in 1999 than in 1995.

According to a poll taken by the Sustainable Energy Coalition, more than four out of five registered voters believe that the United States is still vulnerable to an energy crisis that could be caused by foreign nations shutting off oil supplies to this country. "The poll...shows that an overwhelming majority of Americans believe that rising oil imports are a threat to our economic, environmental and national security," said Bill Richardson, U.S. Secretary of Energy.

The IOGCC report concludes that every key indicator of the health of the domestic oil and gas industry—earnings, employment, production, rig counts, rig rates and seismic activity—is down. "If crude oil prices remain at continued low levels, there will likely be further contraction in the industry, a negative effect on economies of the states and nation due to a loss of tax revenues and jobs, the further loss of skilled labor, and increasing imports of crude oil," the report stated.

Additionally, exploration for and production of natural gas is projected to be impacted as overall earnings reductions result in lower capital expenditures in industry.

In conclusion, we believe that the U.S. Congress and the Clinton Administration should enacted a national energy policy that stresses trade fairness and that the domestic oil and gas industry is a viable aspect of the country's national and economic security. We believe that a new American consensus must be forged to reduce our nation's growing dependence on imported oil; to stabilize U.S. crude oil and natural gas production; to ensure reliability of oil and natural gas supplies; to protect our national and economic security; and to save jobs of Americans. We know that the status quo has not worked. Now is the time for bold and aggressive action!

Therefore, we suggest the following solutions:

• Market stability—The Congress and President must recognized that domestic oil and gas producers—publicly and privately held companies—must compete today in a global economy against foreign governments that control their petroleum production. As stated earlier, U.S. producers are at a competitive disadvantage against foreign governments when our average production is 11 barrels per day per well and when Saudi Arabia produces 5,773 barrels per day per well. Additionally, foreign governments do not have to pay the many taxes imposed on U.S. oil production (income, state severance, property taxes, state franchise taxes and sales taxes) and comply with a myriad of costly regulations.

Venezuela and Saudi Arabia have been fighting to increase their market share in the U.S. Sheikh Ahmed Zaki Yamani, former oil minister to Saudi Arabia, told and audience at Southern Methodist University in December 1998 that upstream cash squeeze is beginning to make serious inroad into drill rates and could affect actual production on non-OPEC areas sooner than expected. "After all, if OPEC is to gain market share, as it hopes to do, it must do so from their higher-cost producers elsewhere," Yamani said. By driving down prices, OPEC can drive out high-cost U.S. production and replace it with their own. We believe that the U.S. government should recognize that this will be detrimental to U.S. producers *and* consumers in the long term. Many independent oil and gas producers have suspected improprieties by foreign oil exporters and other investors, that could benefit from crude price futures fluctuation. The number of crude oil futures contracts traded far exceeds worldwide crude oil production. Foreign oil producers can influence the crude oil markets by increasing or decreasing their production having a dramatic effect on the world crude oil price. As a result, they have the ability to directly influence their commodity price and the futures price. They are in an unique position of being able to determine the direction of the crude oil future price. In our opinion this ability has serious anti-trust and restraint of trade implications. Therefore, we urge the Congress to investigate these allegations of improper trade practices within domestic U.S. markets by foreign oil producers.

We also encourage the Congress and the President to implement market stabilizing mechanism that would include a fee placed upon each barrel of oil and refined product that enters the U.S. by tanker or vessel. The American Petroleum Institute reports that from 1980 to 1994 there were 58,159,000 gallons of petroleum products spilled from tankers, barges, freighters and other vessels compared to only 823,000 gallons from offshore facilities. We believe that foreign oil and products should pay for environmental remediation as does domestic production. In Texas alone, producers have funded its own environmental plugging and cleanup fund that has totaled more than $45 million from 1984 to 1996. Foreign oil should pay its fair share.

• Federal tax relief—Many oil and gas producing states have recognized that as long as oil and natural gas wells continue to produce they are an asset to the state, providing jobs and tax revenues. The IOGCC has produced a report, *Investments in Energy Security: State Incentives to Maximize Oil and Gas Recovery,* that catalogues incentives in 17 states that have a combined economic impact of more than $16 billion each year. For each dollar invested in incentives, state and some local tax streams receive an average of $2.27 in return. In the process, high-paying jobs are created inside and outside the industry and resources are recovered that otherwise would be lost. We encourage the Congress to enact a tax package that would provide similar results. These provisions—a marginal well tax credit, an inactive well provision, immediate expensing of geological and geophysical costs and delay rentals, hydro and horizontal drilling classified as tertiary recovery projects and a tax credit for new drilling—were included in a comprehensive bill introduced in the last session of Congress by U.S. Senator Kay Bailey Hutchison (R–Tx), S.B. 1929. I understand that a similar bill will be introduced shortly by Senator Hutchison in the 106th Congress, and we encourage the Congress to pass it quickly.

• Other legislative solutions—(1) Independent oil and natural gas producers need an exemption from anti-trust laws to form cooperatives to sell our crude oil and natural gas. The mergers within the major oil companies are creating fewer and fewer outlets for products. Competition is dwindling in the oil patch. If independents are to have a strong bargaining position, they must be able to form cooperatives to market their only source of revenue—the sale of oil and/or natural gas.

(2) The federal government should purchase crude oil from domestic oil producers to resume filling the Strategic Petroleum Reserve (SPR) while prices are low. The Congress should allocate funds in its budget for this expenditure.

(3) Enact royalty-in-kind legislation that allows the federal government to take its oil in-kind when it does not want the operator of its leases to sell the oil. Also, the Congress should enact a law that allow for producers to defer royalty payments to the federal government when prices drop below $15 per barrel, and reduce federal royalty on marginal leases (those producing 15 barrels per day per well or less).

• Environmental laws and regulations—The petroleum industry spent $8.2 billion in environmental expenditures in 1996, which is about one-fourth of the net income of the top 200 oil and natural gas companies, according to the *Petroleum Industry Environmental Performance Sixth Annual Report* by the American Petroleum Institute. This is more than the Environmental Protection Agency's entire budget and comes to $83 per U.S. household. Obviously, environmental regulations have become a big cost of doing business for domestic oil and gas producers. Since the 1970s the federal government has passed 10 laws that impact the petroleum industry. And, this does not take into consideration the many regulations that must accompany these laws, and the laws and regulations implemented by states. We believe that laws and regulations should take into consideration the cost of compliance and the benefits derived from society. If the cost are exorbitant and the benefits small, then Congress should reject or strike these laws from the books.

A few key areas that Congress should focus on to bring back some common sense to environmental laws and regulations for oil and gas are:

(1) Congress must ensure that the EPA does not expand the Toxic Release Inventory program to include exploration and production wastes. TRI reporting would provide virtually no environmental or community "right to know" value because of the remoteness of most exploration and production facilities. In addition, the episodic nature of events within the industry would make year-to-year comparisons of TRI data meaningless. Expansion would created a huge new paperwork burden for independent oil and gas producers, and would cost industry more than $200 million in first year compliance costs and more than $100 million each subsequent year, according to the American Petroleum Institute.

(2) Congress should reject EPA's effort to remove oil and gas production's exemption from Subtitle C hazardous waste requirements under the Resource Conservation Recovery Act, and let state continue adopting regulations that are pertinent to their area.

(3) Compliance with procedures dictated in EPA's Spill Prevention, Control, and Countermeasure Plans (SPCC) are confusing and costly with little benefit to the protection of surface waters. Tank batteries near "navigable" water must have costly studies completed, then constructed with dikes or berms around them, and detailed paperwork must be completed on the continuous inspection and upkeep of the facilities. The definition of "navigable" water is so broad that it applies to dry creek beds in arid West Texas. It should be redefined close to Webster's definition: "deep enough and wide enough to afford passage to ships."

SPCC plans have expense built into them that is not necessary for the oil industry when dealing with oil and gas leases. For example, there is no need to require a

registered engineer to approve the plan, and to recertify if a material Change is made in a lease facility. Spills that do not involve contamination of fresh water needs to be addressed as a separate issue, because crude oil is a naturally occurring organic compound that can be reduced and cleaned up by naturally occurring bacteria. Many wells are prematurely plugged because the rule requires mechanical integrity tests instead of allowing wells to be monitored at the surface.

Regulations concerning hazardous chemicals should be different for oil and gas leases in remote areas. Annual filings concerning crude oil in storage in remote areas is not necessary.

(4) Current Department of Transportation rules require "certain person" that transport or "offers" for transport crude oil in quantities of more than 83⅓ barrels to register under its Hazardous Materials Registration Program (HMRP) and pay a $300 registration fee. We believe that legislation should be passed to clarify that crude oil operators that sell their oil at the lease not be require to register under HMRP.

Mr. Chairman, the members, officers and directors of NTOGA, PPROA, PBPA, WeCTOGA and TIPRO encourage you and other members of Congress to look favorably upon these proposals. We seek only what is fair. We ask that you consider the fairness of competition between foreign governments and small independent producers. We ask that you consider what is fair in the tax code when small independents must pay many taxes and yet foreign oil pays little if any. We ask that you consider the fairness of the mountains of environmental laws and regulations that small companies must comply with just as major oil companies.

Mr. Chairman, the members of these associations are not asking for a hand out; all we seek is a helping hand up!

Thank you for allowing us the opportunity to submit these comments.

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Mr. WATKINS. Thank you very, very much.

We are going to have to go and cast a vote, so we'll take about a 5-minute recess. I figure maybe some of you may need a rest stop, also a bathroom stop. We will return, and I'm looking forward to having a discussion back and forth on some of the solutions, what we think might be our high priorities, and some of the things we can get done. So we will return in about 5 minutes.

[Recess.]

Mr. WATKINS. Before we bring the hearing back to order, I wish my Congressman and good colleague, Bill Thomas from California, were here. I would just like to say to him that they may produce more oil, but we got more people here, we must have more people hurting, to say the least. I think we are all hurting in the oil patch.

Congressman Lucas and I are here. We want to have some discussion. And I'd like to ask my colleague from Oklahoma, Frank Lucas, whom I appreciate very much because he's one who is willing to get up early and stay late to try to find solutions.

Now, I'd just like to recognize the fact that the Department of Energy must not have any priority on trying to solve the problem. That is the only conclusion I can reach or they would have had someone here. And that's a real shame and a crime, an indictment, I think, against their not having concern.

I just don't understand it, personally. But I know many of us from Oklahoma discussed the fact that the energy industry is paying the price of having, in some respects, a strong economy because as long as the prices are going down, inflation is sure not going to be going up.

Mr. Lucas, any questions?

Mr. LUCAS. Yes, Mr. Chairman. Thank you for the opportunity. I think, if I could for just a moment, I'd like to turn to Mr. Cantrell. We both, I think, had our blood pressure go up a notch

or two at different times in the Treasury gentleman's comments. Could you touch on for just a moment, from your perspective as an active participant in the business, the comment that 75 percent of the folks who are in the energy industry business don't pay any taxes.

Maybe I misunderstood him. Could you expand on that for just a moment?

Mr. CANTRELL. That is really totally foreign, Congressman, to my experience. With independent oil and gas producers, why would we be pushing the marginal oil tax credit of Congressman Watkins, why would we be in favor of that if it didn't do us any good. I agree that most of us aren't going to pay taxes in the calendar year 1998 cause we have lost so much money. We're not going to pay taxes that year.

But over the last 5 years we have paid an enormous amount of taxes. And I don't know, I'd like to further investigate where that comes from. I know that as far as the multinational companies are concerned, it doesn't surprise me they don't pay taxes because they get to deduct as their royalty payments to foreign governments like Saudi Arabia in the form of foreign tax credits, which go right against their United States tax bill. So it's no surprise they don't pay income taxes perhaps.

But as far as independent oil and gas producers, that's a shocking statement. I just don't believe it to be true. Or why would our folks continue to ask for tax incentives?

Mr. LUCAS. I absolutely agree with you on the question. Now, for the panel as a whole, another point that I found very difficult to digest. When I characterized some of the things going on in the international oil market, either as dumping or predatory practices, we got what I understood to be a response that no, that was not correct.

From your observations, and I'm addressing this to the panel as a whole, whoever would care to, how else can you describe what's going on out there in the international market other than dumping or predatory practices as far as shoving so much petroleum out there to exterminate the competition, being U.S. producers. Inevitably then to lead to a situation with fewer producers, ultimately higher prices. Isn't that dumping with the goal of wiping out your competition? Is that predatory practices? Anyone on the panel who would care to comment?

Mr. MACPHERSON. I'll just comment by saying that it's no secret that OPEC has an objective to increase market share, and we are their target. Our market is what they are after. They are after our industry, and they are picking up that market. And that's been open discussion around the world. So there's no secret about that. We are the target. And if you compare our costs of producing oil with all the environmental costs associated with it, with the costs of foreign countries that do not have those costs, I think there is a real unlevel playingfield.

Mr. LUCAS. If I could, Mr. Chairman, I think I would like to enter into the record a newspaper story from the Daily Oklahoman in Oklahoma City this morning referring to wheat prices and the Iraqis, and they quote in there a wire service report that an Iraqi government newspaper, the name of which I'll not pretend to pro-

nounce, "said Tuesday that the Iraqis won't buy anything in the future from the United States, Britain, Japan, or Switzerland." They further quote the executive director of the Oklahoma Wheat Commission, and I paraphrase, that the Iraqis were the United States seventh largest wheat customers last year.

I find it very ironic that these folks in this free-trade world that we supposedly live in, while at the same time they are shoving out 2 million barrels a day extra crude oil, are withdrawing from participation in buying anything from us.

And that looks like an absolute—well, it stands for itself.

[The information follows:]

**Article from Daily Oklahoman on Wheat Prices Fall; Iraq Shuns Imports by Bryan Painter**

Many in the Oklahoma wheat industry watched low prices go lower Wednesday.

The Kansas City March futures for hard red winter wheat dropped 8¼ cents to $2.75¼.

Several elevators in Oklahoma reported a cash price of $2.20 per bushel Wednesday, according to The Associated Press.

Mike Cassidy at Cassidy Grain Co. in Frederick said the cash price was $2.89 per bushel Jan. 8 and $2.64 per bushel Feb. 5.

By Wednesday that price had dropped to $2.28 per bushel, Cassidy said.

"Last harvest most producers in my area entered the nine-month government loan program, which expires March 31," he said. "So, I think the lower prices are a result of an anticipation of loan redemptions hitting the market in the next 60 days."

In other wheat-related news, a wire service has reported that the United States has possibly lost a major wheat export sales customer.

An Iraqi government newspaper—al-Ittehad—said Tuesday that Iraq won't buy anything in the future from the United States or Britain.

Last year, Iraq was the United States' seventh-largest wheat customer, said Mark Hodges, executive director of the Oklahoma Wheat Commission.

"But the important fact for Oklahomans is that they bought 100 percent hard red winter wheat," Hodges said. "So they were fourth in hard red winter wheat purchases."

A year ago, Iraq had purchased more than 700,000 metric tons of wheat. As of Feb. 11, it had purchased slightly more than 250,000 metric tons.

"Obviously, this is a disappointment," said Nelson Denlinger, of trade group U.S. Wheat Associates in Washington, in a telephone interview with Dow Jones Newswires. "Iraq likes our hard red winter wheat, and they've been very good customers over the years—before and after the Gulf War. We were lucky to sell them well over 1 million metric tons in the last two years

despite the military situation, and we hope this isn't permanent."

Onukaba A. Oja, an information officer for the U.N. program in Baghdad, said Wednesday the United Nations has no authority over Iraq's buying decisions.

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Mr. WATKINS. Your point is well taken, my colleague from Oklahoma. That article goes further to say they buy hard, red winter wheat, which we produce. They are the fourth largest buyers of hard red winter wheat. So they are turning, definitely their backs there, at the same time, not only killing our farmers, they are also killing the independent producers. And I appreciate your point that you made there.

We are honored also to have a colleague from the State of Washington that's joined us, a leader in the Congress in many respects, in a lot of different areas. I'm delighted that Congresswoman Jennifer Dunn has joined us. Would you like to ask some questions or comments?

Ms. DUNN. Thank you very much, Mr. Chairman. And I'm sorry, I apologize for coming in late. We had some required activities that

we had to do, having to do with tax relief. And I hope some of it will help you in ways different from what we are talking about here, but possibly in the long run.

I do want to express to you my appreciation for what your colleagues help us to understand. Wes Watkins, Frank Lucas, Sam Johnson, all the people who represent you and your industry in the Congress, have been very helpful in explaining to us the criticality of the situation in the oil patch.

I want to take this from a point of view, though, of what we can do on a taxwriting Subcommittee. And I guess what I would ask you first is, in your opinion, do you think that tax incentives are the best way to address the consequences of what you are going through now, the low oil prices, or do you think we also ought to be paying attention to regulatory changes or to other types of changes?

And anybody may answer, please.

Mr. SOLICH. I believe your question is a cogent question. We are focused on tax right now because we are in front of this Subcommittee. The regulatory burden on independent producers has grown increasingly. In fact, the environment between independent producers and the regulatory agencies has grown more acrimonious and adversarial over the last several years.

Those agencies—for instance, our company is in Colorado. We have been headquartered in Denver for 44 years and have operated on Federal lands extensively. Those operations have grown more and more costly, burdensome, extraordinary time delays. I think the answer to your question is, we need to move forward on both fronts.

And I think there is a significant disconnect in perception. The perception that low oil prices now are good because they help the economy, and one of the panelists today quoted it as a siren song. I think that's right. The problem is when the demand for domestic crude increases, the industry's ability to respond to that is going to be substantially weakened. We can't turn on and off like a light switch.

The lead time from ground zero to getting an oil well or a gas well producing may be as long as 5 years or more. To the extent the industry's infrastructure is damaged or the burdens placed on us in accessing Federal lands, lengthen that time delay, and that is going to result in substantially higher prices in the long run and damage to the economy.

Mr. CANTRELL. Could I also respond, too? Tax incentives would be a tremendous help, but I would be less than honest with you today if we didn't run up the red flag that that is not going to be enough to save the basic infrastructure of oil and gas in this country. Some way, we have got to come to grips with the country of the true cost of imported oil. The subsidization of other countries producing oil, the cost of defense associated with that oil. Last time I looked, my production on the South Canadian River isn't guarded by any Coast Guard trawlers or battleships. We don't have any cost associated with that for defense for our oil, and yet we do pay $4 a barrel more for environmental costs than any other country in the world.

So somewhere or another, if you want to save the domestic infrastructure, pay me now, pay me later. If you want to save the domestic infrastructure for the long-term benefit of all consumers, and all Americans, then you are going to have to address the price. We're not going to be a viable, domestic industry as long as foreign governments can flood the market, dump oil on our industry, take us out of business—and that is oil that will never come back.

Our mature oil fields, once you abandon those and once you shut them down, you are not going to get them back. And they are not going to be profitable to drill for again. Oklahoma oil wells average 2.5 barrels a day a well. We're just not going to go back and get those again. And they make up a tremendous strategic petroleum reserve all put together. But once they are gone, they are gone. And that is a fundamental decision you all need to make.

Mr. BELL. I'd like to address that just 1 second. I feel like it's, we have been in a train wreck, and as the ambulances start showing up, we've got to have some first aid to get us to the point we need to get to. So we need the tax basis or a start in their help in applying some first aid, maybe getting an ambulance to the hospital. But the real surgery that we need is, I think we need to surgically cut off Iraq. As long as they are continuing to shoot at our pilots and to try to intervene in world commodities and, I think, they are dumping oil, I don't see how it is any other way.

This is a battle over market share. This is not, in reality, it's not a fair line battle. It's a battle over market share. Saudi Arabia and Venezuela—and the Saudis, I don't guess I blame them, but I understand they are in a battle of market share between Venezuela and Iran, and they have been cheating for years. And Iraq dumps an additional 2 million barrels a day on the market. What we are dealing with is something that is just atrocious.

The gentleman that had referred to earlier that we didn't pay taxes—we had $77 billion taken out of this industry in the name of windfall-profits tax when things were good for us. And now, when we are getting kicked and while we are down, we need some help. We need—maybe just send us our $77 billion back and we'll figure out if we can make that work. Somewhere here, we've got to balance that. But we are for restricting imports, and specifically we need to shoot out—Iraq ought to be a pretty easy target. I think we are shooting at them every day. We need to shoot a volley that way.

Mr. PICQUET. Could I just add in response to that? On the marginal well tax credit, I believe that is one of the more important things put forward for the little operators, the really small operators, because that will undoubtedly extend the economic life of these wells and keep these jobs in place for the longest period of time. And 25 percent of our domestic production does come from marginal wells. And every well will be marginal at some point in its life. So I think that would be a huge help for small independents.

Mr. WATKINS. Good point. I appreciate Congresswoman Dunn being here. She had a very viable and sincere question about taxes. I think you have answered it. I want to mention to Jennifer that other places in this body could help us. With Iraq right now, in 1 year, they have increased their production from 500,000 barrels to

2.5 million barrels a day. That's over 2 million. And that's why we are lobbing bombs over there, and we have had, with the United Nations Security Council, allowing them to produce food for oil, and they have gone to the black market, and no one is doing anything about it. They are literally flooding with 2 million.

Now Venezuela has been up to 500,000 barrels more per day than what they have said under their quotas. Other Arab countries are over production. All this glut, dumping if you please, dumping on. At the same time, the Asia market has gone down. The steel industry's affecting that, and there's suits coming on that. So, when you—there are other places if they would cinch it up and try to help, could help us just within the policies that they are supposed to be following.

They are violating the policies that we have set, and we do nothing. The administration does nothing on this phase of it.

And I see my friend from Texas, Charlie Stenholm, has made it back.

But I want to say to Mr. Picquet there, I didn't overlook those 12,000 names that you had up on the side. I'm always looking for ways that we can try to signal to the people up here, get their attention. As Congresswoman Dunn indicated, people want in some cases the help in work, getting to understand. And it may be something that we may not want to overlook out across this country.

I think it needs to be put in a way of national security and national problems we have internationally now with some of these countries. So we may want to follow up on that a little later.

My good friend from Abilene.

Mr. STENHOLM. I have a question for the panel: In the earlier panel, Mr. Lubick wasn't very encouraging in his remarks on the tax proposals, based on his opinion regarding whether the tax proposals would be adequate or necessary. Mr. Picquet, you indicated that the tax proposals certainly would be of help to you. I believe you spoke for most of the industry that there are some positive things to be derived from additional considerations in the Tax Code. But the Secretary also said we need to be looking at other ways to deal with the problem, and that's price.

I have sensed in all of my conversations with the independent oil industry that the problem is price. It's the same discussion that we are having two floors up this morning in the Agriculture Committee. We've got the same problem with agriculture. It's price.

And it's the same entities that are causing our problem. It's governments of the rest of the world. It is not a free enterprise relationship that we have between producers in other countries and producers in this country. It is governments, and national and international policy. And I just wondered if anyone had observations—what we've always used to do, traditionally, until the 1995–96 farm bill took away the general philosophy for this country for food has been that we should set a minimum price, not a profitable price, but a price in which, if the worst happened because of weather or production in other countries or policy, that you would not have what we are now beginning to see.

Any comments that any of you would care to make regarding that kind of an approach in which we look at guaranteed floor price? I believe it might be justified because it is in our national

interest. Any comment any of you would like to make on that? If not, you can just think about it and proceed on, but——

Mr. SOLICH. Congressman, I think the issue is perhaps only partly price. I think the issue may be net income as a consequence of both price and cost. The observation was made earlier today that when prices are down, we all come here and we sort of whine to Congress, please help us. I think all of us were sort of stunned by that statement. What we are asking for today is for Congress to let us keep a larger portion of what already belongs to us. And that's our income. That's why we are addressing the tax measures.

I think it's unknown yet to what extent the tax measures we are talking about will solve the current crisis. But those measures, whatever they are right now, one of the panelists described them as the ambulance on the scene of an accident, and I think that is exactly right. So those measures will be helpful.

Insofar as a minimum price, speaking from my own perspective, I think that I question whether that is even achievable in the dynamic that we are in. Question whether—I'm not dead sure that is a good thing. I just don't know. We believe in a free market economy, but I think it has been pointed out that we are not in a level playingfield, and perhaps another alternate solution to the problem is cause others with whom we are competing on the foreign field to bear the same kinds of costs that we are bearing. And then price almost becomes a relative thing if they are bearing the same kinds of costs.

Mr. STENHOLM. You are obviously entirely correct. Cost as well as price, therefore, the environmental regulations cost that we impose upon you is a cost. And anything that we can do that will alleviate unnecessary cost while still having the protection of our land, water, and air is obviously something we can do. I know it would be a big help to the independent producers that drill on and around my farm, in west Texas.

Mr. CANTRELL. Well, I think, speaking on behalf of Oklahoma, in our board meeting last week at our petroleum association, it's down to the point where we can say all day long that you all aren't going to do something. But our responsibility to our members and to the families that make their living in this business is to tell the truth. We can't hesitate to tell the truth. And the truth is, unless you do something about the price, there is going to be a devastating effect on the infrastructure of oil and gas in America.

We can talk all day long about what's possible politically, but that's not our role; that's your role. You are the ones to tell us you can or cannot do something politically. What we have to do is tell you, I think, and our jobs as Americans that are in this industry is to tell you the truth. And the truth is, without affecting this low price, without some way of taking into consideration other countries' practices and other countries' subsidization by our own government, defense costs, environmental costs. In Venezuela, for example, they dump salt water from half their production. They don't have environmental regulation.

But we're not advocating you do away with environmental regulation. I don't know how much of that $4 a barrel I'd be willing to give up, as a small producer. We are committed in Oklahoma to protecting the environment. We have got a voluntary where we are,

the industry, has been spending $2 million a year cleaning up past damage sites in Oklahoma. We are committed to being good environmental stewards. We don't want to give that protection up. But we think foreign governments that don't have those same safeguards on the environment should through an environmental assessment or some kind of a measure, be made to have a level playingfield.

But we are just kidding ourselves if we think we are going to solve this problem and save this infrastructure without something that affects price.

Mr. BELL. May I address that just a second? This morning, when Ms. Short made her statement from the royalty owners' perspective, these tax things, again, we need first aid. We need that ambulance to get us to the market, but without cutting off some production from areas that are dumping it on our market, it's not going to help Ms. Short; it's not going to help the schools in Kermit, Texas, or all over west Texas. Denver City is at risk of losing their entire school system. It's not going to help those people. It's not going to save the hospital in Kermit if we don't do something about price.

It does come down, there has to be a way to address the price issue. I don't think we can set that price. I don't know what that floor price would be. I'd love to see one. I think that when you do, there could be some complicating factors, but as long as, by my calculations, the oil that comes out of the Persian Gulf is costing about $54 a barrel to defend it, to get it out of there. For the amount that we import in the United States is less than 2.5 million barrels a day.

IPAA recently had a letter come out that said the cost of keeping our ships in the Persian Gulf is about $50 billion a year. That didn't include firing one missile or shooting anything down in Desert Fox. That's additional that we add to that. At $50 billion a year, 2.5 billion barrels a day is about $54 a barrel. Then we pay them another $11 a barrel once we get it here. So we are paying $65 a barrel for that oil.

I just don't see that, if Persian Gulf oil was paying for their own defense, the price would come up and we'd be able to make a living.

Mr. WATKINS. They have been very gracious letting us be over about 15 minutes. I promised them we would be out of here by 15 after. Any other questions or comments? I'm going to say, I understand they've got to get this cleaned up for the next meeting concerning dumping on steel. So that is what they have got to do.

I'm in room 1401, and I'll spend the rest of the noon hour meeting with any of you from Oklahoma or anywhere else that want to come up there. So I wanted to share that with you.

Ms. Short.

Ms. SHORT. I have two things on my mind. One of them is national security. If we do not have enough oil here, then if we are ever engulfed by a number of other countries, we may not be able to fight our way out. The reason we were able to participate in both World War I and World War II, and be on the winning side, was because we had the petroleum. You know those German tanks stopped out in the desert because they didn't have any fuel.

Mr. WATKINS. That's a very good point.

Ms. SHORT. So this problem goes much further than the economic resources which we have or do not have.

Mr. WATKINS. I want to thank my colleagues. Any last moment comment or question either one of you would make? I want to thank them for being here. But also, I want to say how thankful I am you are here helping us get this story out.

Let me ask the staff, how long do they have to get some testimony in? Ten days? There may be some additional testimony that you might want to make part of this record. Since you've been here, you probably have a greater feel for some of the comments and some of the questions and comments that were raised by the administration and others that you may totally disagree with. And I think good information would help us and the staff.

I want to thank the staff very, very much for their cooperation and help. They have done this. We put together this hearing a lot quicker than what we thought we would be able to, and it was because the staff wanted to work and put in a lot longer hours to try to get ready for it.

Again, thank you so much for coming, and we will do everything we possibly can within our power to move this thing as rapidly as we can, and hopefully, we will get either H.R. 53 or some kind of legislation that will help us move forward—knowing full well that some of you have said you have paid taxes, and maybe we can utilize that factor to help us get through this crisis we are in.

Thank you very much. And we stand adjourned.

[Whereupon, at 12:16 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

**Statement of American Petroleum Institute**

This statement is submitted by the American Petroleum Institute (API) for the record of the February 25, 1999 Ways and Means Subcommittee on Oversight hearing on current law incentives for domestic production of oil and gas, and the status of the industry in light of current economic conditions. API represents over 400 companies involved in all aspects of the oil and gas industry, including exploration, production, transportation, refining, and marketing.

The domestic oil and gas industry is suffering through its worst times in recent memory. The collapse of world oil prices that began in late 1997 continued and worsened through 1998, and analysts predict the conditions that led to the price collapse will not improve in the foreseeable future.

BACKGROUND

By the end of 1998, U.S. wellhead crude oil prices had fallen to their lowest inflation-adjusted levels since the Great Depression. These record-low prices reflected a world-wide petroleum market in which, even with production cutbacks initiated by OPEC members and other major producing countries, world crude supplies were still more than ample in relation to flagging growth in world demand. One major cause of that slower demand growth was the economic difficulties in Asia which, during the 1990's, had accounted for well over half of the growth in world demand. At year-end, 1998, the average U.S. wellhead price was less than $8 per barrel, barely half the $15.06 average for the same month one year earlier. For the year, the annual average wellhead price was an estimated $10.85 per barrel, down by more than a third from $17.24 in 1997.

Domestic oil exploration and development activity suffered dramatically from the lower oil prices. The total number of operating rigs in the U.S. fell to 647 in December, down by over 35 percent from one year earlier. The toll was especially large on drilling directed at oil. According to the Baker-Hughes Company's survey, there were only 155 rigs searching for oil in the U.S. in December, down nearly 60 percent from a year ago and the lowest since separate records for oil rigs began in 1987. In January of 1999, the number dropped to 125 rigs. As recently as the mid-1990s, there typically had been 300 to 400 oil-directed rigs operating in the U.S. Rigs drill-

ing for natural gas averaged 491 in December, down 24 percent from a year earlier. Similarly, data from API's *Quarterly Completion Report* show a drop in oil well completions of nearly 50 percent for the fourth quarter, with natural gas drilling declining about 13 percent. Further, oil and gas companies' current upstream spending plans for 1999 for the U.S. have been cut by 20 percent, according to a recent survey conducted by Salomon Smith Barney.

Historically, the full impact of lower crude oil prices has often taken several years to play out. However, already, significant effects are being witnessed in U.S. production, particularly for higher-cost and lower-volume wells. In December, lower 48 production fell nearly 4 percent, a size of decline not typically seen in over four years. For 1998 as a whole, domestic crude oil production fell roughly 3 percent.

State governments have reported a sharp increase in the number of wells shut down during 1998. The Interstate Oil and Gas Compact Commission found that over 48,700 oil and gas wells in 23 states had been idled as of mid-year. If these wells were permanently abandoned, this would be nearly two-and-a half times the typical rate of abandonment in recent years.

Industry employment has also suffered. Bureau of Labor Statistics data show that from October 1998 to February 1999 the oil and gas extraction industry, including field service companies, lost 26,000 jobs. That 4 month loss was 6,000 more jobs than were lost during the entire year from October 1997 to October 1998. The most recent decline reduced the number of upstream jobs in the U.S. to about 291,000—60 percent less than the peak in early 1982 of 754,000 jobs.

The long-term impact on domestic production remains to be seen. Historically, another sharp, sustained drop in crude oil prices occurred in 1986. In that year, the average U.S. wellhead price fell by nearly 50 percent from the previous year and continued at lower levels in subsequent years. Lower 48 crude oil production, which in the early 1980s had been flat to increasing, began a sharp decline. From 1985 to 1990, nearly 22 percent of the lower 48's crude oil production had been lost, in addition to Alaska's decline. Hundreds of nonmajor oil and gas producers went out of business.

Conversely, a review of the last 50 years shows that world oversupply and attendant low prices are the exception, not the norm. Following the Arab oil embargo of 1973, world oil prices tripled over the next several years and soon after remaining price controls were ended in 1981, domestic producers ended a supposedly "irreversible" 10 year decline in U.S. oil production within months. By 1982 annual domestic production was again on the increase. The risk this time is that if the current conditions persist, they could cause permanent damage to the U.S. oil industry's producing and service sectors and that when conditions turn around, the basic infrastructure of the domestic oil and gas industry will be so depleted it will no longer be able to respond. Our domestic petroleum reserves only have value if we maintain the expertise and risk capital to bring those resources to market. Especially in a period of low oil prices, we must preserve at risk marginal production and stimulate development of new resources.

## TAX INCENTIVE PROPOSALS

Several modest tax incentive proposals would assist in that effort.

### *Alternative Minimum Tax Relief*

At this time of financial crisis for the oil and gas industry, the Alternative Minimum Tax (AMT) has the perverse effect of exacerbating the financial impact of low commodity prices. AMT was enacted to ensure that companies reporting large financial income also paid at least the prescribed minimum tax. It was not intended to increase taxes on companies that are already struggling financially.

To alleviate the impact of the AMT on the oil and gas industry during times of low prices, API proposes the following changes. These changes would begin to phase in in equal increments when the annual average price of oil falls below $l7.00, and would be fully phased in when the annual average price falls below $14.00 (average prices adjusted for inflation).

- Eliminating the preferences for intangible drilling costs (IDCs) and depletion;
- Eliminating the impact of IDCs, depletion, and depreciation (on oil and gas assets) as adjustments in the AMT computation; and
- Permitting the Enhanced Oil Recovery (EOR) credit and the Section 29 credit to reduce the AMT.

These changes would only be applicable in a year in which the annual average price of oil is below $17.00. Because the industry needs immediate relief, the proposed effective date is for taxable years beginning after 1998.

*Marginal Well Production Tax Credit*

API supports H.R. 53 introduced by Congressman Wes Watkins (R–OK) and others to provide a $3 a barrel tax credit for the first three barrels of daily production from an existing marginal oil well and a $0.50 per Mcf tax credit for the first 18 Mcf of daily natural gas production from a marginal well. Designed to be phased in and out as oil and gas prices fall and rise, the credit amounts ($3 and 50 cents) are reduced by an amount which bears the same ratio to such amount as the excess of the applicable reference price over $14 ($1.56 for qualified natural gas) bears to $3.00 ($0.33 for natural gas), (dollar amounts adjusted for inflation). "Marginal oil wells" are those producing less than 15 barrels per day or producing heavy oil. "Marginal gas wells" are those producing less than 90 Mcf per day. The credit is allowed against both regular tax and AMT.

*Expensing Geological and Geophysical Costs*

Oil and gas exploration costs include costs incurred for geologists, surveys, and certain drilling activities. The function of G&G costs is to locate and identify the property with the potential to produce commercial quantities of oil and/or gas. Oil and gas companies incur huge up front capital expenditures, including G&G expenses, in their search for new oil. Current tax law requires that G&G costs which result in the acquisition and development of an oil and gas property be capitalized, suspended, and then amortized over a period of years in the form of cost depletion *after* production begins. In this period of historically low oil prices, availability of capital is the crucial issue for continuing operation, and forcing companies to capitalize G&G costs only exacerbates the economic burden imposed by the significant upfront cash outlays. Congress should protect oil and gas exploration companies against this economic hardship by passing legislation that provides that successful G&G costs may be deducted currently.

*Expensing Delay Rentals*

The typical oil and gas exploration company does not normally purchase the land on which it intends to search for minerals but will lease the land and agree to pay royalties as the minerals, if any, are produced. A typical lease expires in a year unless exploration has begun or the lessee pays the lessor a fee for the privilege of deferring development of the property. This payment is called a delay rental. It is not a payment for oil and gas to be produced; rather, it is paid for additional time in which to explore or develop the leased property.

Under Treasury regulations and case law, the lessee has the option to expense or capitalize delay rentals. Current deductibility of delay rentals has been allowed for more than forty years. But the IRS has recently begun taking the position that delay rentals must be capitalized rather than deducted currently. This position ignores forty years of history and long-established regulations.

Oil and gas exploration companies cannot afford to develop new property in this economic environment. In order to retain leases which will not be developed at this time, the companies must pay delay rentals. Forcing them to capitalize these costs exacerbates the economic burden of paying delay rentals. Congress should assist the industry by passing legislation that restates the long-standing rule that delay rentals may be deducted currently.

*Expansion of Enhanced Oil Recovery Credit*

The enhanced oil recovery credit (IRC Section 43) was enacted in 1990 to provide incentives to domestic oil producers to invest in methods of capturing what otherwise might be unrecoverable oil reserves. Section 43 generally provides a 15% tax credit for costs attributable to qualified enhanced oil recovery projects. In enacting the credit, the Congress identified certain recovery methods (listed in the 1979 Department of Energy regulations) as qualifying methods. Since that time, additional tertiary methods have been developed that could significantly increase domestic recovery of oil. The list of qualifying methods under Section 43 should be expanded to include horizontal drilling and waterflooding.

## "FIRST DO NO HARM"—ADMINISTRATION'S BUDGET PROPOSALS

In addition to the positive steps suggested above, Congress could go far to help by ensuring that no additional harm is done to an industry that is already reeling from the current conditions. It is especially troubling that at this time the Administration has come forward with proposals that would increase taxes on the oil and gas industry by as much as $6 billion over the next five years.

*Rules Relating to Foreign Oil and Gas Extraction Income*

As part of its revenue raisers in the fy 2000 budget, the Administration has again proposed to deny the foreign tax credit with respect to all amounts paid or accrued to any foreign country by a dual-capacity taxpayer if the country does not impose a generally applicable income tax. As distinguished from the rule in the U.S. and some Canadian provinces, mineral rights in other countries vest in the foreign sovereign, which then grants exploitation rights in various forms. This can be done either directly, or through a state owned enterprise (e.g., a license or a production sharing contract). Because the taxing sovereign is also the grantor of mineral rights, the high tax rates imposed on oil and gas profits have often been questioned as representing, in part, payment for the grant of "a specific economic benefit" from mineral exploitation rights. Thus, the dual nature of these payments to the sovereign have resulted in such taxpayers being referred to as "dual capacity taxpayers."

The proposal also would convert the special foreign tax credit limitation rules of current law section 907 into a new foreign tax credit basket within section 904 for foreign oil and gas income. This proposal, aimed directly at the foreign source income of U.S. petroleum companies, seriously threatens the ability of those companies to remain competitive on a global scale, and API strongly opposes the proposal.

Because the U.S. taxes the worldwide income of U.S. citizens and residents, including U.S. corporations, the foreign tax credit (FTC) is designed to allow a dollar for dollar offset against U.S. income taxes for taxes paid to foreign taxing jurisdictions. The FTC is intended to offset only U.S. tax on foreign source income. Thus, an overall limitation is imposed on currently usable FTCs. In addition, Congress and the Treasury have imposed special additional limitations on the use of foreign tax credits attributable to foreign oil and gas operations. For example, each year the amount of taxes on foreign oil and gas extraction income (FOGEI) may not exceed 35% (the U.S. corporate tax rate) of such income. Any excess may be carried over like excess FTCs under the overall limitation.

The Administration's concerns with the tax versus royalty distinction were resolved by Congress and the Treasury long ago with the special tax credit limitation on FOGEI enacted in 1975 and the Splitting Regulations of 1983. These were then later reinforced in the 1986 Act by the fragmentation of foreign source income into a host of categories or baskets. The earlier resolution of the tax versus royalty dilemma recognized that: (1) if payments to a foreign sovereign meet the criteria of an income tax, they should not be denied complete creditability against U.S. income tax on the underlying income; and (2) creditability of the perceived excessive tax payment is better controlled by reference to the U.S. tax burden, rather than being dependent on the foreign sovereign's fiscal choices.

The unfairness of the provision becomes patently obvious if one considers the situation where a U.S. based oil company and a U.S. based company other than an oil company are subject to an income tax in a country without a generally applicable income tax. Under the Administration's proposal, only the U.S. oil company would receive no foreign tax credit, while the other taxpayer would be entitled to the full tax credit for the very same tax.

If U.S. oil and gas concerns wish to stay in business, they must look overseas to replace their diminishing reserves, since the opportunity for domestic reserve replacement has been severely restricted by both federal and state government policy. Adoption of the Administration's proposal would increase tax on foreign oil and gas income, and would severely disadvantage U.S. oil companies in their competition with foreign oil and gas concerns in the global oil and gas exploration, production, refining and marketing arena, where the home countries of their foreign competition do not tax foreign oil and gas income. Congress has wisely rejected this proposal in the past, and it should do so again.

*Superfund Taxes*

The Administration would reinstate the Superfund excise taxes on petroleum and certain chemicals as well as the Corporate Environmental Tax through October 1, 2009. API strongly opposes imposition of any Superfund taxes without comprehensive reform of the Superfund program and the tax system supporting the Fund. It is widely recognized that Superfund is a broken program that requires major substantive and procedural changes. A restructured and improved Superfund program can and should be funded through general revenues.

Superfund sites are a broad societal problem. Revenues raised to remediate these sites should be broadly based rather than unfairly burden a few specific industries. EPA has found wastes from all types of businesses at most hazardous waste sites. The entire economy benefited in the pre-1980 era from the lower cost of handling waste. To place responsibility for the additional costs resulting from retroactive

Superfund cleanup standards on the shoulders of a very few industries when previous economic benefits were widely shared is patently unfair.

The petroleum industry is estimated to be responsible for less than 10 percent of the contamination at Superfund sites but has historically paid over 50 percent of the Superfund taxes. This inequity should be rectified. Congress should substantially reform the program and fund the program through general revenues or other broad-base funding sources.

*Oil Spill Excise Tax*

The Administration proposes reinstating the five cents per barrel excise tax on domestic and imported crude oil dedicated to the Oil Spill Liability Trust fund through October 1, 2009, and increasing the trust fund limitation (the "cap") from $1 billion to $5 billion. API strongly opposes the proposal.

Collection of the Oil Spill Excise Tax was suspended for several months during 1994 because the Fund had exceeded its cap of $1 billion. It was subsequently allowed to expire December 31, 1994, because Congress perceived there was no need for additional taxes. Since that time, the balance in the Fund has remained above $1 billion, despite the fact that no additional tax has been collected. Clearly, the legislated purposes for the Fund have been accomplished without any need for additional revenues.

## Statement of Friends of the Earth and U.S. Public Interest Research Group

### INTRODUCTION:

Mr. Chairman and Members of the Committee, we respectfully submit these written comments for the record. Friends of the Earth and U.S. Public Interest Research Group represent environmentalists, consumers and citizens that are concerned with an efficiently run federal government. Among our groups staff, there are several experts who have spent years studying and tracking tax breaks and other government subsidies available to oil and gas industries.

Based on our research and study, we now strongly urge you to oppose any tax breaks for the oil and gas industry. Tax breaks would be unfair to U.S. taxpayers and harmful to the environment. The oil and gas industry already enjoys billions of dollars in federal subsidies, and it seems that no matter what the challenge faced, the industry always suggests the same solution—more tax breaks.

### TAXPAYER ARGUMENT:

Several tax breaks already exist which amount to a simple production subsidy for the oil and gas industry. These special subsidies benefit certain oil and gas producers to the disadvantage of other energy competitors. For some companies all profits may be due to government tax subsidies. These subsidies distort the market by attracting investment that could be used more productively elsewhere in the economy. Many of these subsidies encourage the draining of scarce domestic energy resources and in combination with other subsidies for the oil and gas industry, often exceed 100 percent of the actual value of the energy produced.

In general, subsidies promote oil and gas production and energy waste rather than efficiency or conservation. Increased profits for polluters are not the best use of taxpayers' money, especially when the tax breaks encourage overproduction of scarce resources at the expense of cleaner alternatives.

### ENVIRONMENTAL ARGUMENT:

Oil and gas tax policy has focused on production while doing little to increase energy efficiency throughout the oil and gas system, or conservation of petroleum in the transportation sector. Tax breaks for the oil and gas industry not only drain the treasury but also taxes the environment. Subsidies encourage producers to prematurely tap marginally economic oil and gas fields, resulting in the exhaustion of energy reserves and the destruction of environmentally sensitive areas such as estuaries, bays, and wetlands. Certain subsidies encourage production practices that force oil and sometimes chemical injectants into surrounding surface and groundwater. This can lead to contamination of drinking water, soil, crops, and wetlands. In addition, the oil and gas industry enjoys special exemptions under our environmental laws including Superfund, the Clean Air and Clean Water Acts, the Safe Drinking Water Act, and the Emergency Planning and Community Right-To-Know Act.

THE INDUSTRY SOLUTION:

Do you remember the gas pump crisis of 1996? Gasoline was running about $1.35 per gallon and newspaper headlines declared a crisis. Some political leaders fell over themselves to save the U.S. economy. Former Senator Bob Dole, then candidate for President proposed to slash the federal gasoline tax.

Fast-forward two years to the present day. Oil prices are at historic lows. The world market is flooded with petroleum. Gasoline is cheaper than it has been forever. Americans are driving more, paying less, and buying bigger vehicles. Consumers love it.

But it's crisis time again for the U.S. oil industry. They are screaming for help and holding demonstrations at state capitols in California, Oklahoma, Texas, and South Dakota. And once again politicians are rushing to the rescue. Their solution? Tax cuts.

If prices are too high or too low, the solution is always the same: tax cuts. And why not? It's a strategy that has worked for the oil industry. The tax code is riddled with special exemptions and loopholes for the oil industry. All told, tax subsidies for the oil and gas industry cost about $2 billion each year.

Who pays this $2 billion a year? The other American taxpayers. What do we get for this investment? Not much.

Certainly not cheap gas. Oil and gas prices rise and fall completely independently of these tax policies. In fact, prices are mostly set by world markets in which U.S. oil production is only a modest player. The U.S. influences oil and gas prices more through our consumption than through our production.

Do we get independence from a foreign energy supply? No. U.S. dependence on foreign oil has consistently grown over the last 15 years and shows no sign of slowing. America currently imports 53 percent of our oil for consumption. U.S. oil producers are a weak medicine against our addiction to foreign oil. In reality, our nation has decided not to reduce our reliance. Instead, our government has invested heavily to guarantee the supply with a heavy, costly military presence in the Middle East and the Persian Gulf.

Do we get a cleaner environment for our taxes? Not hardly. U.S. production and transport of oil is arguably cleaner than a lot of foreign production and transport. But it's still a dirty business. Ten years ago this March, the Exxon's *Valdez* spilled 11 million gallons of oil into Prince William Sound. That made headlines for months. But hidden from the headlines are ugly facts about oil pollution and the thousands of small oil spills that routinely threaten wildlife and water supplies. Every year, about 16,000 spills are reported in the U.S. Most of these are small, but the oil industry spills, dumps, or wastes 20 times the Exxon *Valdez* oil spill on the ground and in the waters of America every year. But the solutions—tax breaks for the oil and gas industry—don't fit the problems.

Yes, we need to reduce our use of foreign oil. But the solution is not to create a domestic oil industry more dependent on taxpayer hand-outs. It hasn't worked and it won't. Ultimately, we can only reduce our nation's dependence on oil through increased energy efficiency and use of cleaner, home-grown sources of energy like wind and solar power.

So if what we need is to clean up oil pollution, encourage efficiency and cleaner energy sources giving more tax breaks to a wasteful and dirty industry is not the solution. Reducing existing tax breaks and directing the money to cleaner energy is a solution and tying environmental performance to existing tax benefits is a solution.

THE ENVIRONMENTAL SOLUTION:

We understand that Congress is under pressure to provide more tax breaks for an already highly subsidized industry. Record-low oil prices are cutting into the profits of small oil business in the U.S., and suffering businesses are seeking a government bail out.

Small oil business in the U.S. already receive huge subsidies like the percentage depletion allowance that cost taxpayers billions and end up harming the environment. The percentage depletion allowance allows oil producers to deduct a flat percentage of their gross income, sales or revenue. In some cases, up to 100 percent of a company's total net income can be deducted. That means this subsidy often exceeds the actual value of the energy produced.

While we are sympathetic to the plight of small business and their workers, Congress must not react with misguided policy responses. What Congress should really be considering is cutting subsidies like the percentage depletion allowance. Neither taxpayers nor the environment can afford more government subsidies for such environmentally harmful activities.

*Green Scissors 1999,* a joint report by Friends of the Earth, U.S. Public Interest Research Group, and Taxpayers for Common Sense, identifies more than $573 million federal government subsidies to the oil and gas industry over five years.

The 1998 Friends of the Earth report, *Cool It,* (available on the World Wide Web at: www.foe.org) identified the percentage depletion allowance for the oil and gas industry as one of the eight largest carbon subsidies and a major contributor to global warming. The report recommends shifting government subsidies to alternative energy sources that will help deal with global warming, or to fund programs that help workers and their families deal with its impacts.

[Friends of the Earth, *Cool It* report, is being retained in the Committee files.]

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**Statement of Gas Processors Association, Tulsa, Oklahoma**

The members of the Gas Processors Association ("GPA") commend Chairman Houghton and the Members of the Subcommittee for convening this hearing to address issues of critical importance to members of the oil & gas industry. GPA is an incorporated, non-profit trade association made up of approximately 140 corporate members, all of whom are engaged in the processing of natural gas into a merchantable pipeline gas, or in the manufacture, transportation, or further processing of liquid products from natural gas. The active membership as a group account for approximately 90% of all natural gas liquids produced in the United States. The active membership also includes a number of Canadian and international companies that produce natural gas liquids on a global scale.

The stated purpose of this hearing is to focus on how current law affects the domestic production of oil and gas, to assess the current status of the industry in light of current economic conditions and to evaluate possible policy options. GPA would like to bring to the Subcommittee's attention an significant problem faced by members of the gas processing industry pertaining to the interpretation of current law by the Internal Revenue Service.

The IRS, both on audits and in litigation, has taken the position that natural gas gathering lines are depreciable over a 15-year cost recovery period rather than the 7-year period that the Gas Processors Association believes is contemplated under the Modified Accelerated Cost Recovery System ("MACRS"). Courts have reached conflicting decisions on this issue, and the continued uncertainty that has resulted not only renders business planning difficult, but threatens to impose substantial costs on the gas processing industry in audits and litigation fees.

The useful life for determining the depreciation deductions for specific assets is determined by reference to the asset guideline class which describes the property. Asset class 13.2 clearly includes: "assets used by petroleum and natural gas producers for drilling wells and production of petroleum and natural gas, *including gathering pipelines and related production facilities*." (Emphasis added). Not only are gathering lines specifically referenced in asset class 13.2, but gathering lines are clearly integral to the extraction and production process rather than transportation. Natural gas must be carried from the wellhead to a central processing facility for processing "before" it can be transported via trunk lines to an end user such as a distribution facility. The interpretation advanced by the IRS demonstrates a fundamental misunderstanding of the role of natural gas gathering lines in the natural gas extraction and production process. The Federal Energy Regulatory Commission ("FERC") has recognized this clear distinction; gas processors' gathering lines are exempt from FERC jurisdiction because they are classified as gas gathering equipment that is part of the production facility not pipeline transportation under FERC rules. Assets within asset class 13.2 are subject to a 7-year cost recovery period.

Since 1995, GPA has worked to secure administrative clarification of the proper treatment of natural gas gathering lines for purposes of depreciation both through appropriate inquiries from Members of Congress and through direct meetings with officials from the Department of Treasury. In 1998, Representative Sam Johnson introduced legislation (H.R. 3913) to clarify that natural gas gathering lines are subject to 7-year depreciation under current law. Although this legislation was not enacted during the last Congress, Representative Johnson, joined by original cosponsors Representatives Jim McCrery and Wes Watkins, has once again introduced this important bill (H.R. 674) to continue to seek legislative clarification of the appropriate treatment of these assets.

As an individual company's gathering system represents a significant investment and often consists of many thousands of miles of gathering lines, continued uncer-

tainty surrounding the proper depreciation of these assets is causing great hardship for members of the gas processing industry. As the Subcommittee considers issues affecting the oil and gas industry, GPA and its members would urge your consideration of this important issue and ask that you consider including support for legislation to clarify the proper treatment of natural gas gathering lines in any recommendations that the Subcommittee might make to the full committee on Ways and Means. Thank you for your continued concern and commitment to addressing issues important to our industry.

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**Statement of Hon. Bill Graves, Governor, State of Kansas; on Behalf of Interstate Oil and Gas Compact Commission, Oklahoma City, Oklahoma**

Chairman Houghton and members of the subcommittee, thank you for the opportunity to submit testimony on two issues that are vital to the future of our country.

My testimony represents the views of the governors of 30 member states that comprise the Interstate Oil and Gas Compact Commission (IOGCC). IOGCC states account for nearly all of the oil and natural gas produced onshore in the United States. The IOGCC's mission is two-fold: to conserve our nation's oil and gas resources and to protect human health and the environment.

You have heard from many in the oil and gas industry regarding the effects of low oil prices on domestic operations. Domestic oil and natural gas producers and those who benefit indirectly from petroleum production are facing a battle for the industry's survival. This battle has a direct impact on IOGCC states and on the nation.

Specific incentive legislation is the key to effectively assisting this critical domestic industry. I urge the Congress to support H.R. 53, a timely piece of legislation introduced by Congressman Wes Watkins of this subcommittee, that provides a 10-year "carryback" and a 20-year "carry-over" of unused tax credits for producers of marginally economic wells. This legislation will enable a producer of marginal oil or marginal gas to recalculate past tax benefits, resulting in an immediate refund for some producers. H.R. 497 is another piece of legislation designed to provide tax relief for domestic oil and gas producers. These and other measures are necessary for domestic producers to survive. Successful incentive programs already in place at the state level are documented in two IOGCC publications attached to this testimony, *Investments in Energy Security: State Incentives to Maximize Oil and Gas Recovery* and its newly released update, the 1999 Supplemental Edition. State legislatures are daily passing additional aid measures.

While domestic producers struggle to combat the low price crisis, consumers continue to reap benefits from the low cost of refined products. With gasoline, fuel and heating oil, jet fuel and diesel prices hovering at record low levels, individual consumers, energy-intensive industries and the federal government have pocketed billions in savings.

These savings lining the pockets of consumers—including the federal government—may feel good now but beware of future consequences. Hidden costs to the states and nation reach far beyond the oil and gas industry. I have attached to my testimony the IOGCC publication, *A Battle for Survival?: The Real Story Behind Low Oil Prices,* which is a timely presentation of the widespread effects of prolonged low oil prices.

As an organization, the IOGCC today speaks for the following important constituencies.

First, our citizens. Several million of them benefit from royalty income. Many have seen their checks cut in half. How is this income used? A survey has shown that the No. 1 use of royalty income is for the education of children and other family members.

Hundreds of thousands more citizens hold jobs as a result of the production of oil and gas. They are faced with the prospects of layoffs or pay cuts. Many who leave these jobs have vowed to not return to the industry. They see the actions the federal government has taken to protect other domestic industries from foreign competition and privately ask where government stands on the future of the petroleum industry.

Many of these affected citizens also live in rural communities that are built upon the production of natural resources. Their state-funded services are financed at least in part by tax revenues from oil and gas production.

Second, small business owners. These are the small companies that you rarely hear about, who may employ a dozen people. Their product may be the production of oil and gas, or it may be goods and services required to support these efforts. Gov. Frank Keating of Oklahoma said it this way: "Each lease generates revenue that

results in the operator purchasing materials and services, employing people, paying royalties, paying taxes, mostly in the community where the production occurs. Thus, petroleum production is a significant contributor to the economic health of rural Oklahoma." Then, he concludes with this: "Each lease should be viewed as a small business in the area where the production occurs. The loss of a lease is just as significant as the loss of any local business." It is important to be aware of the thousands of small businesses affected by low oil prices. They are vital contributors to the national and state economies, and to lose their productivity and jobs has a significant ripple effect through many communities. They also represent a part of the industry infrastructure in danger of being further eroded.

Third, we speak as stewards for a non-renewable natural resource that is being abandoned even as we need it the most. Without question, the United States is losing a segment of a critical domestic industry—production from low-volume, barely economic oil wells. Taken singularly, each well is of little significance. The average marginal well produces about two barrels of oil per day. But collectively, they comprise an important hedge against increasing reliance on imports, provide tens of thousands of jobs, millions of dollars in payments to landowners, royalty owners and government, and are a cornerstone industry for hundreds of rural Americans.

In the first six months of 1998, an estimated 48,702 wells were idled or shut in, according to a recent IOGCC survey of 23 states. Assuming these idled wells were eventually plugged and abandoned, this figure represents a 142 percent increase over the number of wells (20,087) plugged and abandoned in 1997.

For the first six months of 1998, oil production was down in 19 of the 23 oil-producing states. The combination of falling production and lower oil prices has lowered revenue collections. In Wyoming, for example, the impact was estimated near $100 million for the first six months of 1998. Severance taxes were down $17.2 million, ad valorem taxes fell by $57.1 million, and the effect of 900 lost jobs totaled $25.5 million. Eight percent—or 1,200—of the wells in the state were idled or shut in.

In Louisiana, production declined by 8.2 million barrels for the first six months. An estimated 1,375 wells were idled or shut in. State officials estimate that the treasury loses or gains about $20 million of direct revenue for each $1 change in oil prices. With prices falling from $17.24 per barrel average for 1997 to $12.45 in 1998, the direct loss of revenue exceeded $95.8 million. Indirect revenue, such as sales tax and income tax, would increase the impact to between $119 million and $191.6 million.

In Texas, oil severance tax revenues fell $94.9 million in the first eight months. This represents a reduction of 34 percent. About 2,800 jobs were lost and 1,087 oil wells idled or shut in.

In Ohio, about 8,700 wells were idled or shut in, 500 jobs were lost, and oil production dropped 15 percent. The state suffered $128,900 in lost severance taxes.

Illustrating the impact of recent price drops, Oklahoma's October gross production tax collections for oil were 74.1 percent lower than estimated. Collections were $2 million, $3.8 million below estimates. For the year, state gross production tax collections were down 57 percent. The state estimates that between 25 and 35 percent of the state's 80,000-plus wells have been idled or shut in. Between 2,000 and 5,000 jobs have been lost. Most state agencies have been asked to cut spending by 3.6 percent as a result of drastically decreased severance tax collections.

Kentucky estimates an impact of $2 million on the state budget, due principally to a decrease in gross production taxes related to lower oil prices. In Nebraska, state severance taxes declined by 29 percent, a reduction of $300,000 projected for the year.

Even in the state with no stripper well production—Alaska—the economy has been seriously affected. For each $1 per barrel decline in price, the state loses $100 million in revenue per year.

As low prices continue to shut down marginal production from the United States, each barrel lost will be replaced by imported oil. The implications on national security and the trade deficit are serious.

We agree with the findings of the U.S. Department of Commerce four years ago that found: *"Growing import dependence, in turn, increases U.S. vulnerability to a supply disruption because non-OPEC sources lack surge production capacity; and there are at present no substitutes for oil-based transportation fuels. Given the above factors, the Department finds that petroleum imports threaten to impair the national security."*

We are far more dependent on oil imports today than at any other time in history. I conclude with a call for action. Do not dismiss the cries of domestic oil and gas producers. View the current industry conditions from a new perspective, through the eyes of our citizens, small business owners, conservationists and those concerned

about the energy future of our next generation—all of whom are looking to you for help.

Thank you, Mr. Chairman and subcommittee members, for the opportunity to be heard on this issue. We look forward to assisting you with further information you may require and working with you to address the country's energy concerns.

[Attachments are being retained in the Committee files.]

**Statement of Hon. Edward T. Schafer, Governor, State of North Dakota; on Behalf of Interstate Oil and Gas Compact Commission**

Mr. Chairman and members of the subcommittee, I am pleased to present comments on behalf of the Interstate Oil and Gas Compact Commission (IOGCC) regarding the current oil price crisis and how it is threatening a vital domestic industry.

The 30 member states that comprise the IOGCC have been among the first to sound the alarm as the fall in oil prices cut deeply into state budgets and thousands of our citizens were laid off from high quality jobs. The IOGCC was the first organization that I'm aware of to document the extent of the crisis in its publication *A Battle for Survival?: The Real Story Behind Low Oil Prices.*

Low oil prices are hurting the economies of many states. For instance, in North Dakota we do not have a single well being drilled right now—for the first time since 1950. Not only is oilfield employment thus affected, but the impact also resonates in each rural North Dakota community with an oil presence.

The case has been clearly made for the serious nature of this crisis and the need for immediate action. The question remains, however, about how best to react to preserve what is left of a withering industry. As you consider these options, I encourage you to mirror steps taken to protect a comparatively tiny industry—broom corn broom manufacturers—from foreign competition.

On Thanksgiving Day, 1996, President Bill Clinton issued a memo to the secretaries of Treasury, Commerce, Agriculture, and Labor under section 203 of the Trade Act of 1974. The President reported that the United State International Trade Commission found "...that imports of broom corn brooms are being imported into the United States in such increased quantities as to be a substantial cause of serious injury to the domestic industry..."

The "serious injury" documented was a loss of 49 jobs (yes, that is the total), from 1991 to 1995. By contrast, the domestic oil industry lost that many jobs yesterday—and more. We have documented the tremendous job loss in the IOGCC publication, *A Battle for Survival?: The Real Story Behind Low Oil Prices," which IOGCC chairman and Kansas Gov. Bill Graves has submitted to this subcommittee.*

To assist the broom corn broom industry, the President further directed the secretaries of Agriculture, Commerce and Labor to "...develop and present, within 90 days, a program of measures designed to enable our domestic industry producing broom corn brooms to adjust to import competition."

The President proclaimed tariff relief for a period of three years to provide time for the domestic industry to implement adjustments to foreign competition. "In short, this action provided the domestic industry with substantial temporary relief from increased import competition, while also assuring our trading partners significant continued duty-free access to the United States market."

"I also note the substantial resources identified by the Departments of Agriculture and Commerce that can provide loans, grants, technical and in-kind assistance to the domestic industry as it implements its adjustment plan," the President said. He directed the departments "...to give priority consideration to adjustment assistance requests, with the intent of providing the maximum appropriate assistance available."

As for the few employees of the domestic broom corn broom industry (a total of 382 people in 1995), the President noted that "The Trade Adjustment Assistance (TAA) program of the Department of Labor has already provided support for employees of broom corn broom manufacturers that have been laid off due to import competition. This assistance remains available, and I instruct the Secretary of Labor to give priority consideration to processing such TAA requests."

The point I am making is that there can be concerted efforts to assist a struggling industry that is threatened by imports. I know of no industry more critical to the national security than energy. In 1994, the Commerce Department found that "Growing import dependence, in turn, *increases* U.S. vulnerability to a supply disruption because non-OPEC sources lack surge production capacity; and there are at

present no substitutes for oil-based transportation fuels. Given the above factors, the Department finds that petroleum imports threaten to impair the national security."

We are far more dependent on oil imports today than at any other time in history. This critical domestic industry deserves some of the "priority consideration" which the President requested of various Departments to assist the broom corn broom industry.

In its determination of the severity of the broom corn broom industry's problems, the International Trade Commission found that industry "as a whole operated at a loss in 1994 and 1995." The Assistant Secretary for Tax Policy from the U.S. Department of Treasury who testified before this committee said essentially the same about the oil industry when he told the committee more than two-thirds of the domestic oil companies paid no income taxes in 1997. These companies are also, obviously, operating at a loss and deserve some consideration.

I urge you to consider comprehensive steps to preserve the industry infrastructure for the sake of our national security and on behalf of the thousands of small businesses caught in the crunch of low oil prices.

In conclusion, I seek your support for efforts to conserve a non-renewable natural resource that is being abandoned even as we need it the most. Without question, the United States is losing a segment of a critical domestic industry—production from low-volume, barely economic oil wells. As low prices continue to shut down marginal production from the United States, each barrel lost will be replaced by imported oil, further escalating our dependence on imports.

This is a domestic industry which deserves at least the same assistance which has been given to the domestic broom corn broom industry. The problems of the domestic oil industry are less easily whisked away because it is such a vital part of the United States' economy.

Thank you, Mr. Chairman and subcommittee members, for the opportunity to be heard on this issue. We look forward to assisting you with further information you may require and working with you to address the country's energy concerns.