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SYMPOSIUM

Multinational Corporations and the Energy Crisis

Foreign Governmental Control of Multinational Corporations Marketing in the United States

American Tax Credits and Foreign Taxes and Royalties

Expropriation, Threats of Expropriation and Developmental Policy

PANEL DISCUSSION: AMERICAN TAX CREDITS AND FOREIGN TAXES AND ROYALTIES*

Jon E. Bischel
Stanford G. Ross
Leslie Cookenboo
Pierre F. de Ravel d'Esclapon

PROF. BISCHEL: Do either of you wish to make any introductory remarks with respect to the panel discussion?

MR. COOKENBOO: I would like to say a word about some numbers. A figure of six percent was quoted on tax burden percentages. That is a number which causes a lot of oil tax people to sit up in their seats. The six percent reflects U.S. income tax divided by worldwide income; some years it is six percent, others it is eight percent. We think it should be either U.S. tax divided by U.S. income, or worldwide tax divided by worldwide income. We have a survey of the 18 largest American companies which shows that on U.S. tax divided by U.S. income, the rate is about 23 percent, which I think compares with an average rate of something like 37-40 percent for all American industry. That varies from year to year too. It is not 48 percent, by the way, because the statutory rate is not paid by people in businesses other than the oil business. I do not know what would happen if you did a survey of the whole industry. It might not be that high.

Now worldwide, you include both foreign and domestic taxes divided by foreign and domestic income. Worldwide taxes divided by worldwide income was 55 percent in 1972. I hate to think how high it is now.

One other point on section 482. The U.S. income tax is computed on the basis of fair market value, not on the basis of posted prices; that applies to all businesses. We do feel that section 482 does bear heavily on us because we are under an obligation to demonstrate to the Internal Revenue Service that the prices that our affiliates pay to their foreign

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brethren are, in effect, fair market prices. These are the prices we use for determining U.S. income tax liability. We spend many man-hours working on the problem of a fair market price and so does the Internal Revenue Service. I am not sure what General Motors' problems are; perhaps ours are more complex because of the highly integrated nature of the oil industry. We have to try to decide what a fair open market value is between willing arms-length buyers and sellers in an industry where a large part of the transfer is within companies. Then we have this posted market price thing; but there have been some rather vigorous long-term revenue proceedings on this matter. So we think that our affiliate transfer prices reflect market price.

MR. D'ESCLAPON: I think I have a question for Mr. Cookenboo regarding the House Ways and Means Committee's proposal, however flexible it may be at this point in time. When you drew your box there with the oil-related income and the non-oil-related income,[1] one point I think you made was that it removes the shelter effect of the foreign tax credit against the unused non-oil-related income. Wouldn't you say that since some of your non-oil-related activities are in low tax countries and some in high tax countries, there should be some possibility to use some of the tax credits generated by some of your operations in high tax countries to shelter the income from some other operations in low tax countries?

MR. COOKENBOO: I am not sure I understand your question. But looking at the non-oil model, there may be some high taxes and some low taxes. Within that, you could still average; but you cannot transfer an unused credit from an oil operation on balance to a non-oil operation. There is still the averaging in the non-oil operation. However, some say most of those tend to be loss operations anyway when a company tries to diversify into a business that it does not know anything about.

PROF. BISCHEL: Mr. Ross, let me get back to you. You indicated that the U.S. effective rate for the taxation of oil companies is something in the neighborhood of six percent plus and then you stated that there were essentially no taxes paid on foreign source income but there are foreign taxes paid.

MR. ROSS: Yes, but no U.S. taxes.

PROF. BISCHEL: I take it that is in line with your concept of tax neutrality.

MR. ROSS: No, not necessarily.

PROF. BISCHEL: Could you elaborate on it?

MR. ROSS: I do not think there is any quarrel between us, Mr. Cookenboo. It is just that on the foreign source income the effective rate is pretty close to zero, however you compute it.

1. *See* Cookenboo, *supra* at 223.

MR. COOKENBOO: There is no quarrel between us that U.S. companies do not pay too much U.S. tax on their foreign operations.

That is true, although there may be some companies that do. Tax rates on foreign oil producing operations are much higher than U.S. tax rates, and foreign refining and marketing are concentrated in the five or six largest countries around the world just like other industries. Those tax rates are not significantly different from the U.S. rates. One may be 55 percent and one may be 45 percent. Now, I am sure that would be true for most any company.

MR. ROSS: Yes, I think that is right for most any oil company.

MR. COOKENBOO: What about General Motors or those people?

MR. ROSS: No, their effective rates tend to be such that there would be some residual U.S. tax.

MR. COOKENBOO: Does their average effective foreign tax rate, that is taxes paid to foreign countries divided by their foreign taxable income, tend to be somewhat below the U.S. rate?

MR. ROSS: Yes.

MR. COOKENBOO: That certainly is not the case in the oil industry. There are always exceptions.

MR. ROSS: I find it a little distressing that the international oil companies are largely in the forefront of taxation of foreign income reform. I would have preferred to have had general reform of taxation of foreign income, say as a part of the trade bill last year, which would have set neutral U.S. tax principles across the board. Unfortunately, the multinationals, including oil companies (but certainly a lot of others as well) succeeded in having that postponed until the general tax reform, and so the oil company situation is coming up in a context where our general scheme for taxing foreign income has not, at least in my opinion, been set right.

What I consider to be a neutral system for the United States would be to eliminate deferral, to provide a full foreign tax credit as long as there is a per-country or an overall credit, one or the other, but not giving the taxpayer the choice of the better, which he has now. Personally I would be happy with either one as a neutral tax principle. There are strong arguments for the overall and there are strong arguments for the per-country credit. We have switched from one to the other many times in our history and if this were a tax session we might usefully debate the relative merits of per-country or overall credits for quite a while. Whichever one we arrived at, I would not allow foreign losses to offset domestic income. I would hold them in suspense to offset foreign income when it is earned. I would eliminate such extravagances as Western Hemisphere Trade Corporation provisions. After 30 years in the Code, nobody yet knows who benefits from the provisions, or why.

With this sort of an overall program the question would be "what

is special about the oil companies?" At that point I would be pushed to a difficult judgment. The oil companies and the government have acted for nearly a quarter of a century on the premise that what they paid to the Middle Eastern countries were income taxes. We are going to change that; we ought to change it for the future. I find it hard to look at the taxes that are being paid now and to consider them to be technically regarded as an income tax. Now, there are many ways to cure this situation. One way is with a series of limitations which are designed to say that we are not going to judge whether or not it is an income tax, but that we *are* going to quarantine those payments so that whether they are taxes or royalties, they cannot give you any benefit against other income. That is the quarantine theory. I am looking for words that I know will be familiar to an international law audience. Another way would be to say that they will not be allowed to offset tax on any other kinds of income. Another way would be the Treasury way, which Mr. Patrick would have articulated for you if he had not been required to stay in Washington. That is, the Treasury would use a mathematical formula to convert anything above 48 percent from a credit into a royalty.

The essential question is what to do with the excess credits. Under present law, there are activities that are not taxed internationally, like shipping. Oil companies can run so-called captive tanker fleets and use oil tax credits to offset tax on earnings from those activities and to avoid tax on them. What would happen if full taxes had to be paid on income earned from shipping operations? And if the result is less interest in shipping operations, how much less, and would it matter to the country? These are the issues that have to be considered. While I regard the foreign tax credit as part of a neutral system, it is just one part of it.

MR. COOKENBOO: I think that we could agree that you cannot just look at the fact that Company *X* pays no foreign tax and conclude that there is something wrong. Suppose Company *X* operated only in Ruratania and Ruratania's tax rate is 48 percent. Assume, also, that Ruratania's tax code is an exact duplicate of the U.S. Internal Revenue Code. That is the only foreign operation that Company *X* has. Then, it is not going to pay any U.S. income tax on foreign operations. Now that does not mean that the tax system is bad and there are inequities in it. That is just the way it is. Now there are some people who think that any U.S. company should pay some minimal taxes to the United States because they should help to defray the costs of operation of the government. That is a side issue. The fact that a company does not pay any U.S. tax on its foreign operations is not per se evidence that the tax laws need to be changed.

Now Mr. Ross' questions are the ones that we need to ask. Given the basic principle of the foreign tax credit to try to avoid international

double taxation, we still have within the law certain problems. He raised one on shipping. I think maybe I can give you an answer on shipping. Last fall I found that our people were evaluating a tanker program on the assumption that we would not have to pay U.S. income taxes on our international shipping. These are tankers that go anywhere in the world, unlike U.S. flag tankers, which we use within the United States, and unlike French flag tankers. (The French have some kind of requirement that part of their oil must be imported in French ships.) The business under consideration was a real international tanker business. Now, I suggested that there is lots of talk in Washington—pressure in Washington—to change various laws like Mr. Ross' suggestion of eliminating so-called deferral which might subject our U.S. tanker fleet to taxation in the United States. I suggested that perhaps we ought to run a sensitivity on the economics. The man in the logistics department said it would be a waste of time. If we have to pay a U.S. tax, we cannot compete. If we have to pay U.S. taxes we are out of the international shipping business. That is because our major foreign-owned competitors do not have to pay taxes. We would end up chartering. But, is it, or can it be in the national interest not to have a U.S.-controlled international tanker fleet? On such specific questions apart from the basic principle of the foreign tax credit, the issue should be addressed in this way: how do they affect the U.S. national interest?

MR. ROSS: I think that if you assume that answer, then our government has to say to itself, who are these principal competitors? Are their home countries happy to be giving the people who run shipping from their countries tax exemptions? Should shipping at an international level be a tax-exempt type of business? Should we encourage that type of international tax system where only people who are exempt will be involved in shipping or should we get together with the United Kingdom, the Netherlands, Greece, wherever there are people who know about shipping, and decide that maybe we ought to have a multilateral convention that imposes some level of taxation on this international activity? I think that is a legitimate question to think about.

MR. COOKENBOO: Now that is the legitimate and, indeed, the only way to solve the problem without damaging the competitive ability of the American shipper, because a unilateral action by the United States will not affect the tax laws of the other countries.

MR. ROSS: There are people who would say that if Americans who undertake business activities do not want to pay some U.S. tax, we do not care if those activities are undertaken by American companies. Let somebody else run the shipping industry. Why is it important that Americans have a big stake in international shipping? I do not subscribe to it, but there are those who do. They would say unless business profits are taxed at a fair rate we do not want Americans to engage in

them. The way you would get them not to engage, assuming Mr. Cookenboo is correct, is simply to apply a tax on their operations. Then they would not engage in the business.

MR. D'ESCLAPON: On this question of international shipping, the determination was made by the Administration when they pushed for and got the Merchant Marine Act of 1970 (with the capital construction fund provisions) because it was found, as I recall, that less than five percent of the U.S. cargo was transported on U.S. bottoms and that 75 percent of the U.S. flag merchant vessels engaged in foreign trade were over 20 years old. For national security reasons as well as for a host of commercial reasons, it was found not to be acceptable and thus the argument of "barn burning" does not seem to have much favor with the Administration.

MR. ROSS: I would caution you on one thing. I think one of the big problems in this area is that we talk about Washington, the U.S. Government, the Administration, and we must remember that there are a lot of different institutions in Washington and in the Government. The Administration often does not speak with one voice. I think one of the things the Church Committee has shown is how, even within the same department, there are differences. They have just recently released some documents on the Iranian consortium showing that at the same time a case was being brought under the antitrust laws to break up a cartel arrangement, there were others who were trying to foster another cartel arrangement. Our Government has many people with many different views and I think one of the problems is that we are now in a very difficult era where we do not really know what our national interest is vis-a-vis many multinational corporations. We do not want to acknowledge that there is good and bad and that it has to be sorted out very carefully and patiently. Everybody is looking around for the white hats and the black hats and simple solutions, and there just are not any. These things are part of the fabric of our national and international relations and I guess we need more debates and symposia to figure out what it really is we want.

PROF. BISCHEL: Mr. Ross, would you perhaps care to categorize the oil companies here as perhaps having the black hat put on them and being unduly discriminated against with respect to having their foreign tax credit and their own deferral changed when, for instance, ITT and other large U.S. multinational corporations are not being subjected to that same sort of scrutiny?

MR. ROSS: I would not go that far. In the context of an energy crisis and interest in energy taxation generally, domestic as well as foreign, it is legitimate to take up the oil tax rules. The biggest part of what the Ways and Means Committee can do concerns domestic oil operations, not foreign. When they are talking about windfall profits taxes and

repeal of percentage depletion, it is the domestic side that they are critical of, because I would say that when all is said and done the amount of increased taxes that are likely to come out of the foreign side is probably quite minor relative to what could happen domestically. So, I think it is legitimate, as part of your national focus on these companies, to consider the oil tax rules.

MR. COOKENBOO: On the question of the relative importance—as the bill stands, the dollars and cents effects on us are the same order of magnitude, both foreign and domestic.

MR. ROSS: Is that right?

MR. COOKENBOO: Yes, particularly if we went to the Administration's 48 percent limit on the foreign tax credit instead of 52.8 percent in the Ways and Means Bill. Then, I presume the foreign effect might actually be a little larger. But these are both very serious matters.

PROF. BISCHEL: It is my understanding, however, and in talking recently with Mr. Patrick, that ending the deferral per se would not add a substantial amount of revenue because of the overall tax credit limitation. It would add some additional revenue from foreign sources, not an enormous amount, particularly when you consider currency restrictions and other sorts of problems with respect to taxation.

MR. ROSS: It depends on what you mean by elimination of deferral. I tend to think the conclusion you state is probably right but the question is how you eliminate it and what the provisions are that go with it. If that were the only change, I would guess that the oil companies would be glad to take it, that elimination of deferral would not have a major impact for them because they have very high effective rates of foreign tax. Somebody read a quotation before about passions. It appears to be the passion of multinational corporations headquartered in the United States to maintain deferral. If they would once acknowledge that they are Americans from a tax standpoint and allow deferral to be eliminated you might get more rationality into the whole scheme than we have now. I would say that even if elimination of deferral raised no revenue, which is not likely, it would still be a beneficial change because it would assure the taxpaying public that there is nothing peculiar about foreign operations. Income would be reported on a current basis just as with operations in upstate New York. However, the companies have not seen the benefits to them from elimination of deferral.

MR. COOKENBOO: Well, my company does not happen to be on the per-country basis, so I am speaking second-hand here. I am pretty sure that the elimination of deferral, that being the only change, would have a very severe economic impact on many oil companies. Combine it with what you have in the Ways and Means bill and you would have a very severe economic impact on all of us.

MR. ROSS: How would it have an impact if that was the only change?

MR. COOKENBOO: For a company on the overall basis that has surplus tax credits, an elimination of deferral would be a matter of no consequence.

MR. ROSS: That is exactly my point.

MR. COOKENBOO: But for one on the per-country basis, which has operations in low tax countries or low tax industries, it could have a very substantial effect.

MR. ROSS: The per-country is in ill repute with the oil companies for obvious reasons. People incurring losses in Ruratania and subsidizing that by not paying tax on income earned in New York is no longer something which anybody really thinks is going to stay in the law. The Administration has come out against it twice now, both last April and recently in February. The Kennedy Administration went after it in 1963. The Ways and Means Committee went after it in the House version of the 1969 Act. I think its life is about done.

MR. COOKENBOO: You are stipulating a case where you are doing other things besides eliminating the deferral. If you eliminate the per-country and put everyone on the overall, then a company that has surplus tax credits, I suppose, would not be affected.

MR. ROSS: What is so wrong with eliminating deferral, eliminating foreign losses against U.S. income, and providing for only an overall limitation?

MR. COOKENBOO: I should really have a tax lawyer to speak on this because it does not have much economic content one way or the other. I do know some tax lawyers who do not call it deferral; they call the elimination of it acceleration. They say what you really are doing is accelerating the tax on income earned by foreign incorporated subsidiaries of U.S. corporations. The present law is like taxation of subsidiaries in the United States. I am no lawyer and I do not want to press that one way or the other.

On the foreign loss deduction, I believe the Administration proposal, insofar as it relates to oil exploration, is that the losses would continue to be deductible but that the intangible development cost deduction would be recaptured by the Treasury in the event of a successful discovery. There is a national interest reason, in my view, for continuation of the loss deduction; and that is diversification of international supply. If the United States succeeds in "Project Independence"—and I think that we all hope that it will, so we will not have to worry about more Arab oil embargoes or, if not political embargoes, at least the quadrupling prices within a year—then you might say, "Why do we care about diversifying world petroleum supplies?" The world economic system, the world monetary system, the economies of France,

Germany and Japan and other large trading partners would still be subject to the same sort of political and economic pressures that they are subject to today. Those political and economic pressures could have decided reverberations on the United States. American foreign policy could be affected by a threat to do something to the international monetary system. Diversification of supply is a valid national goal; and deduction of foreign exploration losses from U.S. income, at least in the views of some oil companies, is a device to assist them in doing that. The Administration proposal, as I understand it, would recapture the loss deductions that were on productive properties.

MR. D'ESCLAPON: I would like to ask a question about the competitive advantages you mentioned being possibly eliminated by the Ways and Means Committee proposals. You mentioned the French and Dutch tax exemption system on foreign source income. If I recall correctly there is a corrollary: "If they do not tax the foreign income they also do not allow the losses to be taken into account." Of course, not every oil operation is profitable from the start. I would like to ask the question: Do the foreign countries like France, or the Netherlands, have a depreciation allowance and an intangible cost allowance the same way as the United States has?

MR. COOKENBOO: Doesn't France require that it be spent on exploration within five years? Various countries have various things. The U.S. package at the moment has percentage depletion and we can expense intangible development costs. That is, for example, when you drill an oil well, the contractor's fee for punching the hole in the ground is an intangible cost. The equipment at the top of the well, the meters or the pump, is tangible. We can expense the intangibles currently. We now have either the overall or the per-country limitation method for the foreign expenses. You can deduct an overall foreign loss from U.S. income if you happen to be on the overall basis and have the misfortune to have an overall foreign loss. You can deduct it country by country if you are on the per-country basis. That is the U.S. package. In France, they do not tax foreign source income to my knowledge; but domestically they have a depletion allowance which has a plowback criterion within it. You are entitled to depletion at 27.5 percent. Germans, I think, are encouraging their companies to go abroad. They have a loan for exploration purposes which is not repayable in the event of failure. It is repayable after six years in the event of success. In the United Kingdom, I think, you can expense the tangibles but not the intangibles. That is just the opposite of the United States. The Japanese have a whole package of benefits including tax free loans and that sort of thing. All of our major competitors have one kind of benefit or another.

CHART I[2]

Summary Statement of Tax Treatment and Other Incentives for Foreign Petroleum
Operations by Companies Domiciled In:

(1) *France* *Does not tax.*
Other Incentives:
None for private companies. (Government finances wholly-owned government company and owns substantial interest in large private company.)

(2) *Japan* *Taxes on overall basis with credit.*
Other Incentives:
Exploration loans of up to 50% not repayable in the event of failure; government guarantees of bank loans for exploration and development; percentage depletion at 15% with reinvestment requirement; expensing of dry holes.

(3) *Netherlands* *Does not tax.*
Other Incentives:
Allows deduction of foreign losses from domestic income.

(4) *United Kingdom* *Taxes on per-country basis with credit.*
Other Incentives:
Expensing of all pre-discovery costs; expensing of plant and machinery expenditures; rapid depreciation of other post-discovery expenditures. Allows a form of averaging of foreign losses and profits similar to U.S. overall method. Allows deduction of a net foreign loss. (Government owns substantial interest in large private company.)

(5) *West Germany* *Taxes on per-country basis with credit.*
Other Incentives:
Outside the Common Market, exploration loans up to 75%, not repayable in the event of failure —50% of a loan may not be repayable in the event of discovery; expensing of all exploration costs; rapid depreciation of tangibles and intangibles. Allows deduction of a net foreign loss.

2. Testimony of W. L. Henry, Executive Vice President, Gulf Oil Corporation, before the U.S. House Committee on Ways and Means, Feb., 1974. (Reprinted in AMERICAN PETROLEUM INSTITUTE "ENERGY PROFITS, SUPPLY, AND TAXATION" 38 (1974).)

(6) *United States* *Taxes on per-country or the overall basis with credit.*

Other Incentives:

Percentage depletion; expensing of dry holes and intangibles on producing wells (but no deduction of pre-discovery costs other than dry holes, until properties are abandoned). Allows deduction of a net foreign loss.

Everybody is interested in diversifying supplies. Everyone has his own package. I will say that as far as international exploration is concerned the two most favorable are the German and the Japanese. It is understandable because they are two highly industrialized countries which, especially in the case of Japan, find themselves very dependent on one area of the world for energy. They are making every effort by government assistance, either in the tax code or through direct government subsidy or loan, to encourage their nationals to go abroad.

MR. D'ESCLAPON: Do you find on a worldwide basis that there is a tendency among oil producing countries to shift somewhat from the income tax basis to oil royalties like the Venezuelan system in which part of your royalties are to be paid in oil?

MR. COOKENBOO: Perhaps Mr. Finlay can help me here because he was a long-term Exxon international lawyer. I believe in all of our cases, if the country is so inclined, it can take its royalty oil in kind. You will remember that recently Kuwait and Abu Dhabi have held auctions for oil and if the prices were not to their satisfaction, some of them did not sell. The reason the prices were not to their satisfaction was that this was royalty oil and we are obligated to buy royalty oil from them at the posted price which would be $11.65 per barrel for light Arabian and Persian Gulf oil. If they were to get a bid less than $11.65, it was better to let us take it. I think they have the right to take the oil in kind in many cases. Now that certainly is true in the United States. If you are a landowner, you can take your royalty oil in kind. The Government does take some of its oil in kind. In California, for example, for a good many years they have been taking federal royalty oil or state royalty oil as a source of oil for independent refineries. So, I think they could take it if they wanted.

PROF. BISCHEL: Let me ask Mr. Cookenboo what would happen if the oil companies were denied part of the current foreign tax credit if they are on the overall basis. Literally, how would it affect their competitive position, for instance in Europe or the Far East, if they are operating in that area? In a sense, are American taxpayers perhaps subsidizing the European oil consumers by allowing this extra amount of foreign tax credit? Would the tax be passed on? Would the production tax, for

instance, from Saudi Arabia be passed on to consumers or would it be eaten by their companies?

MR. COOKENBOO: A U.S. tax increase on U.S. operations abroad, a unilateral thing, could not be passed on because it would not apply to foreign competitors.

PROF. BISCHEL: So you are saying that in order to remain competitive abroad you would not be able to raise prices?

MR. COOKENBOO: I presume there are some tax "changes" that they could make in the rules that would not lead to any increase in taxes. Obviously those are not going to have any effect. But if there are substantive changes that do lead to increases in taxes, if it is a U.S. tax increase on a U.S. company—or a German tax increase on a German company—and that is unilateral (not accomplished by an international tax treaty), then companies domiciled in the country increasing tax unilaterally are going to suffer. That is sort of like passing on percentage depletion in a free market. People say why in the world didn't the oil industry get rid of percentage depletion because it would affect all oil companies operating in the United States and the price would go up to take care of it? If in fact the price is set by the world market, you cannot pass on a tax increase levied unilaterally; that is a basic principle of international economics. If the price of *X* is determined internationally, producers of *X* in Country *A* have a unilateral tax increase. They either absorb it or they go out of business. There is no way that they can pass it on because the price is determined in the world market. People will go elsewhere if producers in *A* try to charge more. That sort of situation is faced when there is a unilateral tax increase on companies domiciled in one country.

PROF. BISCHEL: Approximately what percentage of the world market do the U.S. multinational oil companies control?

MR. COOKENBOO: I am sorry but I cannot answer the question with any precision. It will vary substantially depending on whether you are talking about production or refining or marketing or that sort of thing. I would say that in refining and marketing, all American oil companies together account for about one-third of the world market excluding North American and the centrally planned economies.

PROF. BISCHEL: What about production?

MR. COOKENBOO: That depends on the current status of the participation negotiations in the Persian Gulf. That situation is in such a state of flux that we cannot compute a number that is very meaningful. I would say about one-half of production in the same area.

PROF. BISCHEL: Are there any questions from the audience?

MR. FINLAY: I do not think nearly enough attention for a mixed audience like this has been given to the proposition that all taxation should be geared to the public purposes that are designed to be served.

You mentioned, for example, tankers. It is a perennial preoccupation of the maritime unions in the United States to try to get legislation through Congress to force American companies out of the foreign flag tanker business under the naive assumption that if that legislation is passed the American companies will have more American flag tankers. That is simply not a fact. An American flag tanker is so costly due to high American construction costs and high crew costs that it is simply not competitive except in the protected intracoastal trade. The same thing applies on these foreign oil companies. If a taxation rate is imposed on American oil companies it makes them non-competitive with the British, the Dutch, the German and the French oil companies. They will simply lose the market. Now the biggest single contribution to the American balance of payments is the earnings of the American oil companies on their business abroad. On domestic taxation you have to consider the total package. In return on investment over the period of years the oil companies have been approximately equal or a little below manufacturing in general, and that means that depletion allowance is really geared into the price structure and gets back to the public or the government one way or the other. Just the other day there was an offshore lease sale in the Gulf of Mexico with bonus payments of a billion six hundred odd million dollars. On December 20, 1973, there was a lease sale of bonus payments of a billion five hundred million dollars. Now those payments, in effect, are a payment in advance for the benefits of the depletion allowance and other tax benefits. The total production from the Gulf of Mexico since the first offshore leases has not, as I understand it, repaid the investment already made by the oil industry. Is that correct, Mr. Cookenboo?

MR. COOKENBOO: It was correct a couple of years ago. With the tremendous bonus payments that have been made on these last two lease sales, I would feel sure it is correct again today, if it was not in between. If you include bonus payments for the last two or three years for future production, I am sure that is true.

MR. FINLAY: Now, by the same token on the depletion allowance, when the 5.5 percent depletion was made in 1967, that was roughly equivalent to a five percent reduction in the sales price of the oil. The production today with this tremendous shortage is less than it was at the time of the depletion allowance. I believe it is less than it was a year ago and the combination of the reduction and the depletion allowance puts us in a ridiculously low federal ceiling on the price of natural gas sold in interstate commerce. The average rate today, even with recent liberalizations, is only about $.22 or $.23 per thousand cubic feet which is equivalent to about $1.20 or $1.25 per barrel of crude oil. This has resulted in a decline in the incentive to look for oil in this country. You must look at the total picture and the public purpose that is to be

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served. It would be a terrible mistake for anyone in the audience to try to make a judgment on the basis just of a technical discussion of tax provisions.

MR. ROSS: Let me just illustrate the complexity of this problem. If you assume that what he said is correct, then we have, in effect, for many years encouraged a lower price for gasoline in the country, which as an economist you will have to agree has encouraged more driving in larger cars, less conservation measures, and less concern for ecology. Has it been right for this country to encourage all this additional resource use by providing gasoline at below market price to the American public? Has that been a good thing for this country over the past quarter century? I do not know the answers to these questions, but you must ask all those kinds of questions to know what you want to do.

MR. COOKENBOO: I do not want to get off into a discussion of the economics of domestic percentage depletion allowance, but let me say that as an economist I would not subscribe to the idea that the depletion allowance has inevitably cheapened petroleum relative to a neutral tax system, evaluated on the basis of what kind of resource allocation we would have in the absence of the corporate income tax. The corporate income tax clearly discriminates against capital intensive industries, and percentage depletion can be looked on as a counter-discriminatory device to offset a discrimination which is inherent in the tax law.

MR. ROSS: I do not necessarily ascribe to the assumption either. I was just taking Mr. Finlay's assumption and showing you how to take it one more level which is, I think, something that we all had better do.

PROF. BISCHEL: Let me take it one more level than that and point out that the Treasury Department estimates that if percentage depletion were removed, it would generate about $2 billion per year or more in revenue which would be about $.02 per gallon of gasoline.

MR. ROSS: Well, they are not sure that there will not be readjustments. All those revenue estimates are based on certain assumptions, and if habits change, which they might well do, I think that even with the embargo off, the price of gasoline may stay high even if there is adequate supply. People may change their habits; they may buy smaller cars or do other things over a prolonged period of time. There may be an immediate impact holding things the way they are in terms of consumption.

PROF. BISCHEL: I think it is true that percentage depletion obviously is directly or indirectly a subsidy to the consumer.

MR. COOKENBOO: I cannot agree with that.

MR. ROSS: I am not sure I agree with that either. It may be a subsidy of the company or a little bit to each or it may have all kinds of impacts.

PROF. BISCHEL: Even if the cost were totally passed forward to the consumer, the increase in the cost of gasoline would be sufficient from

what is evident today to deter or conserve our energy if you are talking of a couple of cents a gallon. That is not a very large figure, is it?

MR. ROSS: That depends on how many gallons you use. It might be for a lot of people.

PROF. BISCHEL: If you are talking about the difference between $.48 to $.50 per gallon.

MR. ROSS: I think it is a question of mental attitude too. There was a lot of overreaction to the embargo but at the same time, people really began to consider whether they really wanted a small or large car, whether they liked carpools, riding to work and talking with three or four other people. One thing that happens out of this is that for quite non-economic or non-tax reasons people are made conscious of things, and their perceptions and habits change, and I think sometimes that is good.

MR. GRIFFIN: It seems to me that in much of this rather technical analysis of the individual tax provisions, in much of the discussion, especially by Mr. Cookenboo and Mr. Finlay, the focus has been on the competitive positions of the oil companies as a whole and what would happen to American oil companies if certain changes were made in American tax law that were not made in Germany, Greece, etc. I would just like to observe as a lone dissenter (and get the panel's opinion on all of the evidence that has come out, both in the Church Hearings and in earlier hearings, on the fact that there is no competition between the major oil companies) that there is an oil cartel in fact fostered by the U.S. Government. If you accept that point of view then all these arguments about the fact that if we raise the American tax laws we will be at the mercy of the foreign oil companies suddenly goes out the window, because that is not the way the system works at all. Oil industry people will always quote you figures that there are so many thousand producers, so many thousand refiners, and so many thousand independents. The point is: how many sizeable multinational oil companies are there that have anything more than about two percent of the market? The answer gets to be 18, 20, 25 or something like that. I would just like to get your reaction to all of the evidence that some of Senator Church's committee has been bringing in. Is it really competition?

MR. COOKENBOO: I do not think that you can demonstrate that there is a high degree of concentration in the oil industry internationally except in the producing stage—where there is a high degree of concentration of *country*, not company, control of the market. There is no question that if you look at the tanker stage of the business or any other stage for that matter—and this has been evaluated by other people who are neutral—there is not a high degree of concentration in the oil industry. It is a competitive industry.

MR. FINLAY: I do not think there is the slightest doubt about that. Just consider the percentage figures. Sixty percent of the market can

keep 40 percent from setting a price level at a point where the other 60 percent cannot greatly increase their supply. Right at the present time it happens to be even with the lifting of the embargo, there is just about a balance between crude production and global demand. When you do not have a surplus supply situation, you have a seller's market, but up until very recent months, it has been a buyer's market. It has been totally impossible for the larger companies to dominate the market internationally, just as it is totally impossible for them to do it in this country, where you have 140 or 150 separate companies in the refining business, about 5,000 companies in the producing business and 20,000 to 40,000 people in the distribution business.

PROF. FRIED: It would seem, historically, that percentage depletion and the intangible drilling costs deduction were incentives for domestic exploration of oil. I would question whether these incentives should apply to foreign source income as well as foreign development?

MR. COOKENBOO: Historically there has been no distinction.

PROF. FRIED: The original laws were passed when foreign development and foreign exploration of oil was either nil or minimal.

MR. ROSS: That is probably true.

MR. COOKENBOO: Percentage depletion is simply a statutory replacement of its antecedent, "discovery value," which goes back to the very origins of the income tax laws; and there was an international oil industry at that time, just as well as there is now. The basic issue of this question is: do you want American companies to continue to compete in the international business? We have our package of incentives or tax treatment, and the other countries have their own; but if you change ours, then you are going to make our companies somewhat less competitive. It depends on what kind of changes you make. If you do want American companies to continue to compete, changing the package is undoubtedly going to affect their ability to do that.

MR. ROSS: Let me see if I can elucidate the issue a little. I think it is fair to say that the application abroad of the intangible deduction and percentage depletion did not draw substantial public attention when they were first put in the law. I think what Mr. Cookenboo is doing now and what the companies are doing now is saying there is a different rationale for this allowance domestically than on foreign production. Domestically, the rationale is in the area of incentive, or if he does not want to call it incentive, he will say "helpful to a capital intensive industry." He will say something which is designed to justify it in terms of encouraging or keeping up the level of domestic discovery. On the foreign side, the rationale that they are using is different. It is that to really be competitive in the foreign oil field you have to be nearly tax exempt on it. If you put a little tax on it, we can probably absorb it; if you put a lot of tax on it, the Dutch, French and British will take it

away. I think many people are aware that this is the rationale in the foreign tax field. The underlying issue which is being focused on is: what difference does it make that it is a Delaware company pulling it out of Saudi Arabia? Would it matter one iota to our national security, our national health, welfare or anything else if the Japanese were pulling it out of Saudi Arabia? We can obviously put a sufficient tax on to prohibit a Delaware company from extracting oil from Saudi Arabia. The question is, do we want to? There is a middle ground though; could you pay some taxes and still do that kind of business? The companies' position rhetorically and in their public posture is that the status quo is what we need. I am not so sure that they are not prepared to pay some kind of so-called minimum tax to their home country and pretty much have the status quo. But, basically there is a different rationale for domestic than for foreign.

MR. HAIGHT: There has been reference to the oil industry being a capital intensive industry, but the question is: how much tax should be taken out of the individual industry? Doesn't that question turn on what we want the industry to do? Do we want more oil produced by the industry worldwide? If we do, we have to allow the industry the means to get the capital. Recently the Chase Bank made a a survey of the next 15 years capital requirement of the industry. I do not remember the figures, but they are very big indeed and there is a big gap between what the industry can generate itself out of profits remaining after taxes and dividends, and what it will be required to spend. If the tax bite is increased, it seems to me that the industry will have that much less to use, and we will just have that much less oil. Maybe we do not need that. Politically, in this country everybody is screaming for oil and it does not seem to me to make any sense at all to hobble the industry today because the amount of capital that it will require over the next 15 years bankers say just is not available.

MR. D'ESCLAPON: With respect to the capital needs of the oil companies, aren't there some oil companies that are government-owned and perhaps have easier access to capital sources? And what impact does that have on their competitive strength?

MR. COOKENBOO: There are some that are government-owned and some partly government-owned and subsidized. The Italian company, for example, ENI, is government-owned and theoretically it is supposed to make a profit; but I believe it does receive an annual contribution from the government. I believe the French government company is also subsidized. Then there are other forms of government assistance to privately owned companies, which comes to the same thing.

MR. FINLAY: To give you an order of magnitude, Mr. Cookenboo's company announced that they are going to spend $4 billion in capital expenditures in the year 1974 and $16 billion over a four year period. Now that is a single company, and if you assume that they have an eight

or nine percent market share, multiply it by 11 or 12 times $16 billion over a four year period and that gives you something in the magnitude of $150 to $160 billion over four years.

MR. COOKENBOO: In terms of 1974 prices, the U.S. industry needs to spend something like $25 billion a year from now to 1985 in order to achieve about 83 to 85 percent self-sufficiency. That does not include things like electric transmission; it includes refining, pipelines, and production. Historically, we have spent perhaps $8 billion per year.

MR. ROSS: I think this gets back to Mr. Griffin's question. What is the structure of the industry? What should it be? Could it be structured in a way which would meet the needs in a more efficient manner? Is this the only way it can be done? Is this the best way? Are there no improvements that can be made, no new efficiencies that can be found? I think that these are the questions, and they are broader than antitrust policy. They go to a whole consideration of a major segment of the economy.

MR. D'ESCLAPON: Mr. Ross, part of the question also relates to a comment that you made earlier in your presentation about the need for a multilateral approach to the problem. Perhaps a consequence of that would be increasing the degree of partnership of producing countries, especially where the capital needs are concerned. A great deal of the capital that is required now is to be found in the Middle East thanks to the increased boost in prices and thus, if you need that much money it is well worth looking at that as a source of capital.

MR. ROSS: Suppose the American companies did not come in and provide the capital to drill up Saudi Arabia, and Saudi Arabians had to take their own money and invest their own capital into the development of their resources. From a political standpoint, would we, as a country that imports from them, get better treatment as a consumer if they ran the entire economic risk of it themselves?

MR. HAIGHT: You can look at Mexico as an example of a country that has taken over its industry and operates it itself. The government does it; you find that the industry is not very efficiently run. The Mexicans are quite happy to have this industry for themselves and run it themselves, but that would not indicate that the government ownership and management of an industry such as this would be of great benefit to other countries. It may be that Saudi Arabia and the other Arab countries would be very good at managing their own industries and contributing to the world what the oil companies in the past have contributed. But the political picture in the Middle East does not indicate all that amount of cooperation and stability. It seems to me a very hazardous prospect to think of the oil industry being in the hands of a half-dozen or dozen Middle East governments that will quarrel among themselves as to who is going to do what. Perhaps all will decide they will sit on their bag of gold like bacteria in Wagner's Ring, and just not let anybody have any. Or, they may decide to let the Europeans have

it and not the Americans, or the Asians or the Africans and they will build up Africa as a great economic power.

MR. COOKENBOO: That is why I think that diversification of international supply is clearly a valid policy for this country even if we succeed in making ourselves independent, because there is still a potential economic power bloc which can affect us indirectly.

MR. ROSS: I think that one thing the discussion has shown is that you ultimately come back to political questions, that even things as technical as a three-tier limitation system really involve making political decisions which you disguise as technical tax questions. You could put in a four-tier limitation system or a six-tier system with lots of language but ultimately the question is what is it designed to do and ultimately it gets back to the question of what our national interest is in the world. Are the companies that control such a large part of Middle Eastern oil production furthering our interest by doing this and is this why we provide them with a tax package that gives them tax exemptions?

PROF. BISCHEL: We are running out of time. Maybe I could ask each of the panelists to give a one minute summation if they wish.

MR. COOKENBOO: I believe I have had my say.

MR. ROSS: I just want to congratulate Professor Goldie and the program. I think it is a very timely program and I think this kind of inquiry is important because I think too much has just been taken for granted about this whole area.

PROF. BISCHEL: I would like to concur on just what Mr. Ross said. Thank you gentlemen.