The Great Pennsylvania Severance Tax Pickle

This column is presented weekly by the Public Education sub-committee of the Clinton County Natural Gas Task Force in an effort to provide accurate, up-to-date information on activities surrounding the Marcellus Shale formation and the natural gas exploration industry.

One of the most divisive issues facing Pennsylvanians this year is whether natural gas production should be taxed.

Some Pennsylvania legislators, commentators, and citizen groups believe that revenue from a tax would represent just payment for public infrastructure, goods, and services that the gas industry will use as natural gas resources are developed in the Commonwealth.

Others believe that a tax would amount to no more than legal plunder of an emerging Pennsylvania industry that is using its precious capital to build gas production capability from which all Pennsylvanians will benefit. In this view, a tax on natural gas production would add high costs to the gas industry that could destroy opportunities for jobs, income, and prosperity in Pennsylvania.

The type of tax on natural gas that is under consideration in Pennsylvania is called a severance tax, which is a tax levied on the extraction of nonrenewable natural resources—such as crude oil, coal, timber, and natural gas—from land or water bottoms within the territorial boundaries of a state. Pennsylvania is the only major natural gas producing state that does not tax natural gas severance.

The stakes are high surrounding the decision to tax natural gas production. First, natural gas is plentiful and offers significant economic potential in Pennsylvania.

The Marcellus Shale geological formation lies beneath about 60% of Pennsylvania's total land mass. The formation might contain more than 500 trillion cubic feet of natural gas, approximately 10% of which might be recoverable. The amount of recoverable natural gas in Pennsylvania is estimated to have wellhead value of approximately $1 trillion.

A research study authored by Timothy Considine (formerly Penn State, now University of Wyoming), Robert Watson (Penn State, retired), and Seth Blumsack (Penn State) and released through the Department of Energy and Mineral Engineering in Penn State's College of Earth and Mineral Sciences asserted that spending planned in 2011 by Marcellus Shale gas producers could generate nearly $1 billion in state and local tax revenues and more than 100,000 jobs.

Second, a severance tax could produce revenue for the Commonwealth. Current projections show it is needed.

Pennsylvania is in a deep fiscal crisis. The state might run a budget deficit this year in excess of $5 billion. The $400 million originally anticipated from the tolling

of I–80 cannot be collected now. Courts have ruled that $800 million spent by the Commonwealth from a special fund to alleviate exorbitant medical malpractice premiums must be paid back. Stimulus funds for Pennsylvania from the American Recovery and Reinvestment Act of 2009 are likely to decline by $2.5 billion. The solvency of government employee pension funds is in jeopardy, with costs expected to rise by $800 million. Highways and bridges are crumbling and badly in need of repair. The state owes the federal government $3 billion in unemployment compensation payments. And, so the list of budget problems grows.

Not much serious interest is evident for raising tax revenues during the current recession to cover these shortfalls, nor do backbones seem to be stiff enough to implement plans for reducing expenses. Jack Wagner, Pennsylvania Auditor General, stated, “It appears to me and to most others we have grown excessively beyond our means.”

In his 2010-2011 Executive Budget proposal, Governor Edward Rendell recommended a tax rate of 5 percent of the market value of the natural gas extracted at the wellhead plus 4.7 cents for every 1,000 cubic feet of gas severed. An exemption was proposed for wells that produce less than 60,000 cubic feet of gas per day. Four–year projections of severance tax revenue included in the Governor’s budget summed to $1.45 billion.

The final state budget for 2010–2011 did not include a severance tax on natural gas. However, after the budget was enacted, the Pennsylvania Fiscal Code was amended to require the leadership of the Pennsylvania General Assembly to authorize a severance tax on natural gas extraction by October 1, 2010, with implementation no later than January 1, 2011.

Since the Governor offered his tax proposal, legislators have proposed a variety of competing severance tax plans. The most recent plan by House Democrats calls for a tax of 39 cents for every thousand cubic feet of gas extracted. Senate Republicans want 1.5 percent of the wellhead value of gas extracted for the first 5 years, and, then, 5 percent after. On October 12, Governor Rendell proposed a tax of 3 percent of the wellhead value of gas extracted during the first year of well production, up to 5 percent by the fifth year, and 5 percent after.

As of today (October 17), the General Assembly has not enacted a severance tax on natural gas production. Governor Rendell said in a press conference on October 12 that he believed a tax would be enacted into law before the end of the legislative session if the industry and Senate Republicans had the will to support it. However, the Pittsburgh Post–Gazette reported that Jane Orie, Republican state Senator from McCandless, said, when asked whether the severance tax proposal was dead, that: "To me, it sounds like it. They say negotiations are continuing. Everybody is saying good-bye to each other. No one is saying 'I'll see you next week.' "

Public opinion is unclear about the desirability of enacting a severance tax. For example, a March poll conducted by Franklin & Marshall College indicated that only

35 percent of Pennsylvanians favored raising taxes from natural gas production. Nearly one–half were opposed. In contrast, an August poll conducted for the Rendell administration found that three out of every four voters in both Pittsburgh and Philadelphia wanted the Pennsylvania General Assembly to pass a severance tax. Support was even stronger in rural areas, where 84% responding to the poll supported a tax. Three out of every four Republicans polled supported a severance tax, while 79% of Democrats wanted the tax passed. However, adding to the uncertainty about public opinion about a severance tax are results from a July Harris Interactive poll that found 31 percent of respondents supporting higher taxes on the oil and gas industry, with 61 percent opposed.

Terry Madonna, director of Franklin & Marshall's Center for Politics and Public Affairs, told The Philadelphia Inquirer that he does not detect much public commotion about taxing natural gas production. "I think it is not exactly something the residents of the state know much about or are very much concerned about, despite the fact it's a huge policy and political issue in the state," he said.

Even research on the potential impact of the severance tax has produced mixed findings. Concluded in the Considine/Watson/Blumsack study is that revenues gained from a severance tax could be offset by losses in sales and income tax receipts resulting from lower drilling activity and natural gas production as producers shift their capital spending to other gas fields outside Pennsylvania. Our own study (see http://PA-SevTax.notlong.com) concluded that every $100 million of severance tax collected in Pennsylvania would make only a small dent in employment, business activity, and personal income in the state.

No one seems to know how the issue will ultimately play out, but, if there is a solid, politically acceptable plan for enacting a severance tax, implementing a plan is likely to be delayed until after the November election.

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