

Testimony of Michael Wood, Research Director of the Pennsylvania Budget and Policy Center before the House Marcellus Shale Drilling Tax Policy Committee meeting, February 23, 2011

Good morning Representatives. Thank you for the opportunity to speak to you about the importance of a well-crafted shale drilling tax and why, more than ever, we need one in Pennsylvania.

My name is Michael Wood. I am the Research Director of the Pennsylvania Budget and Policy Center, based in Harrisburg. The Pennsylvania Budget and Policy Center was formed in 2006 to provide independent and credible analysis of tax and budget issues, with a focus on revenue adequacy and the impact of budgetary decisions on working families.

Learning from Our Past, Preparing for Our Future



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Pennsylvania has had a long history of resource booms and busts. From oil, to timber, to coal, and now natural gas, Pennsylvania has seen industries come in to harvest the resources, then leave. These industries have helped some Pennsylvanians become very wealthy and created prosperous communities. When the resources were gone, all Pennsylvanians had to chip in to repair the damage. This time, we can learn from our past and enact a severance tax to help repay the citizens for this non-renewable resource.

Pennsylvania is the Largest Producer of Natural Gas to Not Levy a Severance Tax or Fee

Natural Gas Wellhead Value and Marketed Production (Million Cubic Ft.) and Severance Tax Rates

State	2009	2009 Rank	2009 % of U.S. Production	Current (2010-11) Tax Rate
Texas	6,818,973	1	31.6%	7.5%*
Wyoming	2,335,328	2	10.8%	6%
Oklahoma	1,857,777	3	8.6%	7.095%*
Louisiana	1,548,607	4	7.2%	8.67% - 9.5%*
Colorado	1,499,070	5	6.9%	2% or 5%, based on income
New Mexico	1,383,004	6	6.4%	\$0.164 per MCF (~4%)
Arkansas	679,952	7	3.1%	5%*
Utah	444,162	8	2.1%	3.2% on first \$1.50 per MCF, 5.2% on rest
Alaska	397,077	9	1.8%	25% - 50% of net income
Kansas	354,440	10	1.6%	4.33% (after property tax credit)
California	276,575	11	1.3%	\$0.01063 per MCF conservation assessment
Pennsylvania	273,869	12	1.3%	None
West Virginia	264,436	13	1.2%	5% + \$0.047 per MCF
Alabama	236,029	14	1.1%	2% production tax and 4%-8% privilege tax
Michigan	153,736	15	0.7%	5.29%
18 Other States	652,204		3.0%	All but VA and NY impose a state or local severance tax
U.S. TOTAL	21,604,158			

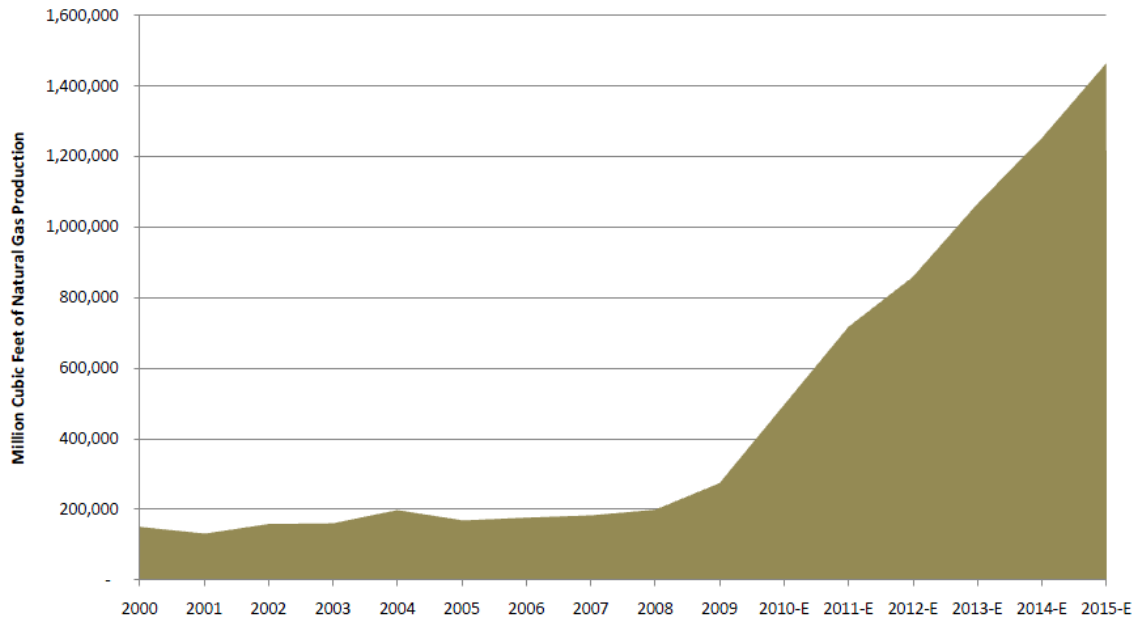
Notes: States with * offer initially lower tax rates for horizontal or high cost drilling.

Sources: U.S. Energy Information Administration, various state revenue department websites.

In 2009, Pennsylvania produced 274 billion cubic feet of natural gas, representing 1.3% of the nation's supply. Pennsylvania currently ranks 12th out of 33 states that produce natural gas. The 2009 figures show a sizable increase in Pennsylvania production, and movement up the rankings from 15th in 2008. Still, some states produce much more. In 2009, #2 Wyoming produced ten times more gas than Pennsylvania, and #1 Texas extracted 25 times more gas.

This slide also shows that severance taxes are extremely common in the natural gas business. Of the top 15 natural gas producing states, Pennsylvania stands alone in not taxing its extraction. Of the 33 states that report any commercial natural gas extraction, only three – including Pennsylvania – fail to levy a drilling tax. At least 35 states levy some type of severance tax – on oil, gas, coal, or even things like timber and fish.

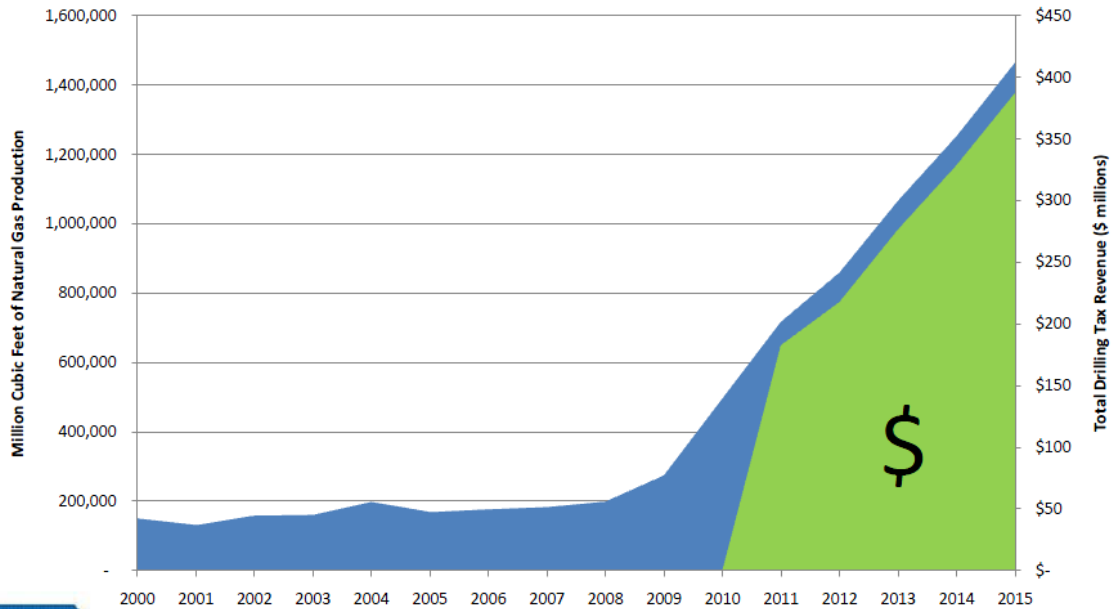
Natural Gas Production Forecasted to Grow Rapidly



Sources: U.S. Energy Information Administration, House Democratic Appropriations Committee (Global Insight)

The rate of gas production in Pennsylvania is expected to accelerate in the next few years. Estimates have production rising from 279 billion cubic feet of natural gas in 2009 to over 1.5 trillion cubic feet of gas by 2016.

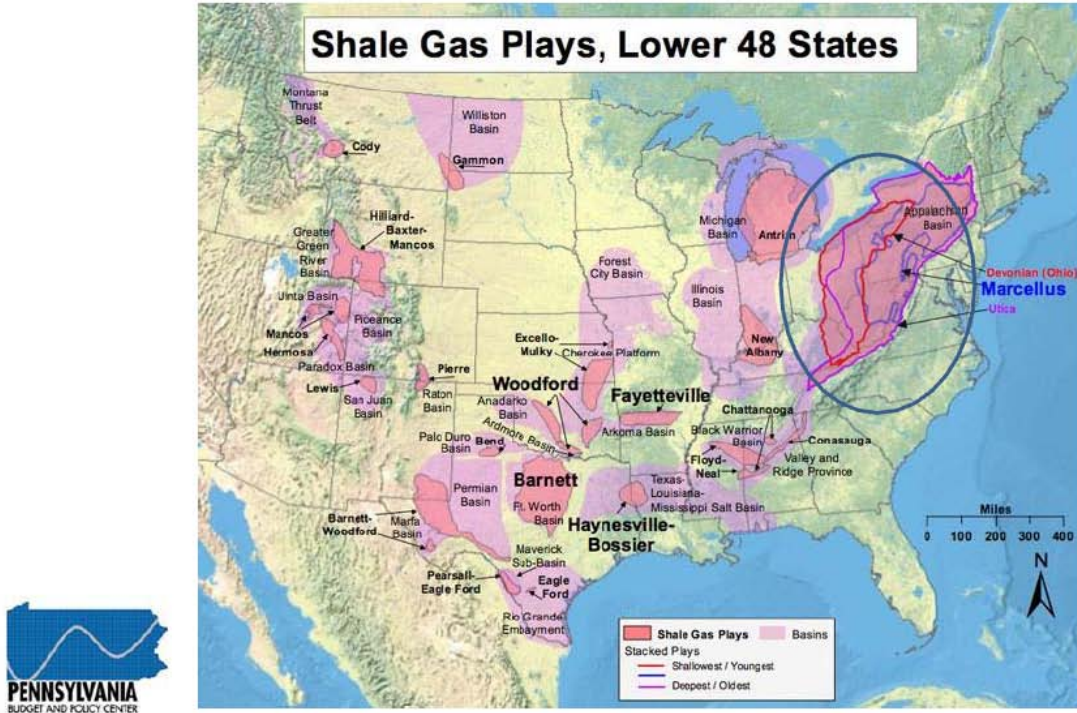
So Would the Drilling Tax



Sources: U.S. Energy Information Administration, House Democratic Appropriations Committee (Global Insight), Pennsylvania Budget and Policy Center calculations.

If enacted, so would the drilling tax. By 2015, the tax as proposed in House Bill 33 could generate close to \$400 million in annual revenue.

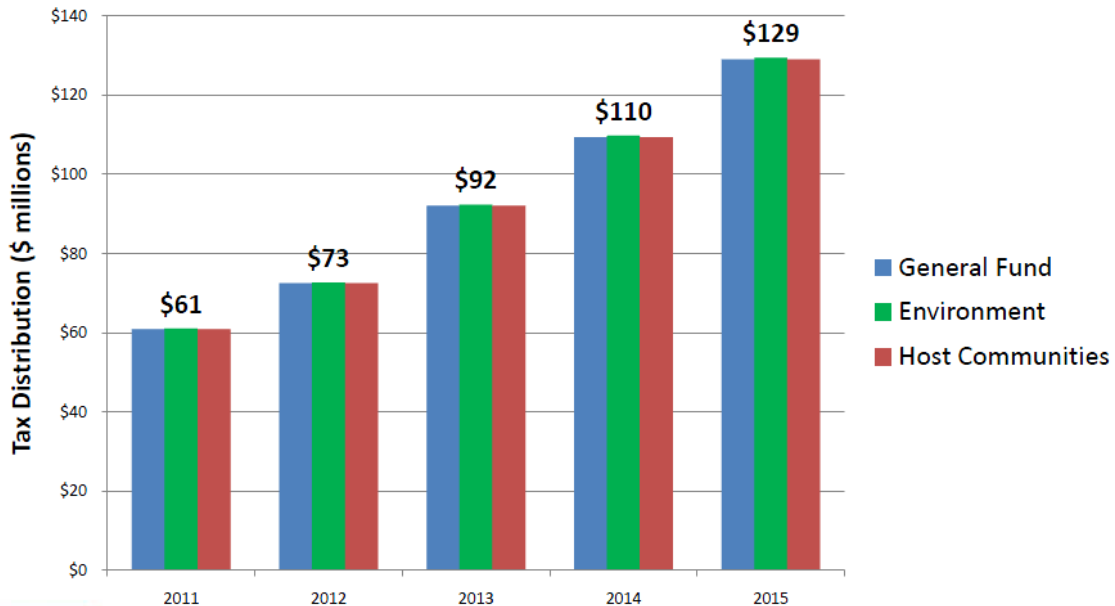
Marcellus may be Only the First Wave of Natural Gas Development



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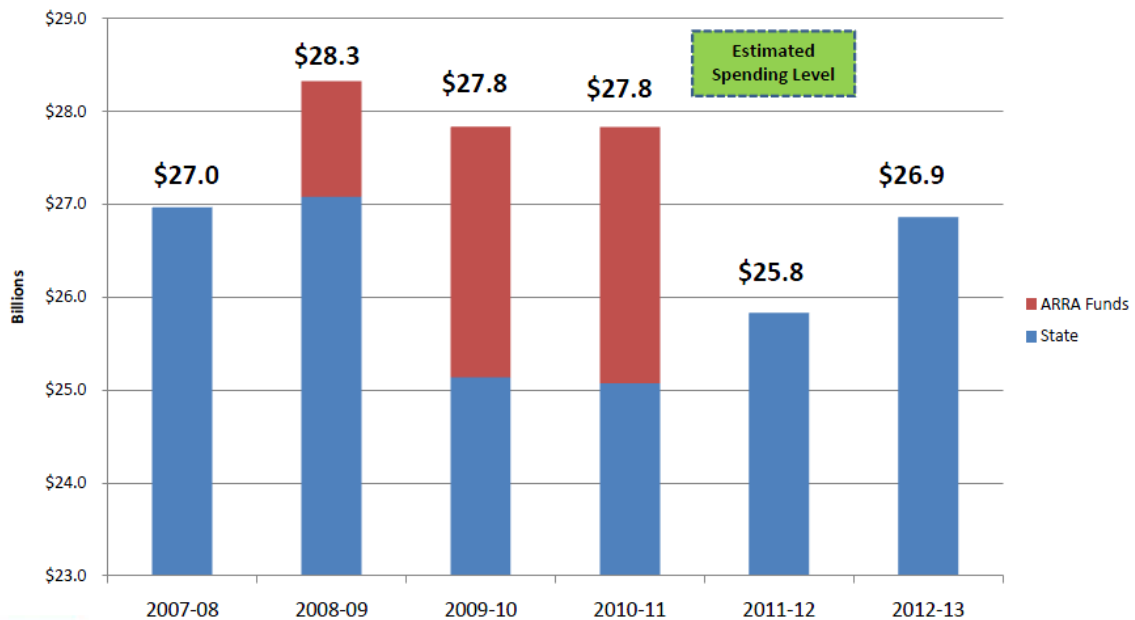
The extraction of gas from the Marcellus Shale could be only the first of several waves of shale gas development in Pennsylvania. The Devonian and Utica Shales both may have commercial potential and are quite reachable with today's technology. Drilling could be going on here for a long time.

Drilling Tax Repays Pennsylvania in Three Ways



House Bill 33 provides revenue for the three major areas that are affected by gas drilling: local communities, the environment, and the state, as a whole. County and municipal governments in host communities would receive a third of the tax to help offset infrastructure damage, increased emergency responder costs, as well as other social costs from drilling activities. Funding earmarked for environmental uses, largely through the Environmental Stewardship Fund, would help limit and remediate damage to wild spaces. Finally, the state's General Fund would receive about a third of tax proceeds. This would help the state government provide health care, education, public safety, and environmental protection services – for all Pennsylvanians. By 2015, each of these three areas could receive \$129 million in funding from the drilling tax.

Pennsylvania Faces Multi-Billion Dollar Shortfall in 2011-12



Sources: Pennsylvania Office of the Budget, Pennsylvania Budget and Policy Center revenue estimates.

The funding could not come at a more critical time. Due to the Great Recession and the phasing-out of federal assistance this year, Pennsylvania is facing a \$4 billion shortfall going into 2011-12. While some of this gap will be filled through program and service cuts, new revenue is needed to avoid even deeper, more damaging cuts – to schools, hospitals, and services for the elderly and disabled. While the drilling tax cannot solve the problem by itself, it can certainly help.

Let's Stop Giving Away the Store

“We also find no evidence to suggest that the dramatically different effective tax rates in the Intermountain West have led to more or less investment from state to state.”

- Headwaters Economics, *Energy Revenues in the Intermountain West*, October 2008, p. 26.

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Other Drilling Tax materials can be found at
www.pennbpc.org/severance-tax

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In closing, I would like to address concerns some have made about the setting an excessive tax rate and driving away business. Headwaters Economics, a Montana firm that studies energy and land use policies in the West, looked at the wide array of tax rates levied by states on oil and gas production. As the quote here indicates, they could find no evidence that higher or lower tax rates led to more or less production in a given state.

Levying a tax rate on par with neighboring West Virginia, as House Bill 33 does, will not force drillers to look elsewhere for natural gas. With or without a severance tax, Pennsylvania will be a very attractive place to drill.

Without a drilling tax, though, Pennsylvania will be giving away this one-time resource. Without the revenue from the tax, as part of the regulatory framework, we all will be left foot the bill for repairing the social and environmental damage that the extraction business brings. Pennsylvania has seen this far too often.

We welcome responsible drilling and the economic benefits it may bring. This drilling tax proposal helps make responsible drilling truly possible.