



# Budget Facts 2009

from the COMMONWEALTH FOUNDATION

July 2009

## Natural Gas Severance Tax

*Pennsylvania faces a \$3 billion tax revenue shortfall in the state's General Fund Budget. Competing proposals from Gov. Ed Rendell and the Republican-led Senate differ on raising taxes and reducing/reprioritizing spending. This is the fifth in a series of fact sheets on the state budget.*

### WHAT IS THE MARCELLUS SHALE FORMATION?

- The Marcellus Shale formation is thick and difficult to drill using normal, low-cost drilling methods.
  - ⇒ The development of cost-effective horizontal drilling in the Barnett Shale formation in Texas has spurred development in the comparable Marcellus Shale region.
  - ⇒ More than two-thirds of Pennsylvania contains accessible natural gas.
  - ⇒ Conservative estimates place the amount of recoverable natural gas in the entire formation (not just Pennsylvania) at **50 trillion cubic feet**. More recent estimates place recoverable gas at **392 trillion cubic feet**.

### GOVERNOR RENDELL'S PROPOSED TAX

- Governor Rendell has proposed a tax of **5%** of on the value of natural gas extracted, plus **\$.047 per thousand cubic feet** of extracted gas.
- The governor modeled his proposal after West Virginia's severance tax, which originally sent drilling companies to Pennsylvania. New York, which is closer to destination markets, has no severance tax.

### HOW MUCH WILL GOVERNOR RENDELL'S PROPOSED SEVERANCE TAX COST PENNSYLVANIANS?

- Pennsylvania's natural gas reserves, while large and close to destination markets, only remain attractive investments if costs are carefully controlled and expenses minimized.
  - ⇒ The market price of natural gas has fallen to **one-third of its 2008 high**, which as reduced the incentive to invest in drilling at this time.
- Pennsylvania's average gas well earns profit averaging 15 percent of investment. **Governor Rendell's proposal will tax each well by one-third of its average cash flow.**
  - ⇒ Seneca Resources Corporation already **left Pennsylvania due to higher-than-expected costs**. Seneca was the seventh largest drilling company (by market share) in the state, **reducing Pennsylvania's lease revenue by \$31 million**.

- 
- Through increasingly stringent environmental regulations and the desire for a more tax revenues, Governor Rendell has undermined Pennsylvania's budding natural gas industry.
    - ⇒ Drilling companies are relocation to other states, like Louisiana, where drilling in the Haynesville Shale did not begin until 2008, **long after many companies began investing in Pennsylvania's Marcellus Shale.**
    - ⇒ The increased investment from natural gas production in Louisiana has created **\$3.9 billion** in household earnings, **\$3.2 billion** in lease and royalty payments to landowners, **32,742 jobs**, and increased state and local tax revenue by greater than **\$153 million** – all in one year, largely insulating Louisiana from the economic recession.

#### WHAT ARE THE ALTERNATIVES TO RENDELL'S PROPOSED TAX?

- Oklahoma applies a severance tax of 7 percent on natural gas extraction, but exempts all horizontally-drilled wells until payback (when the company recovers its multi-million dollar per well head investment).
  - ⇒ Texas reduces its 7.5 percent severance tax for high-cost gas wells drilled in the Barnett Shale formation by 80 percent.
  - ⇒ A moratorium on any sort of severance tax, like Oklahoma and Texas implemented, will allow the natural gas industry to emerge, **bringing jobs, revenue, and economic development to Pennsylvania.**
- Governor Rendell's budget expects to collect **\$107 million** in the upcoming fiscal year from the proposed severance tax and **\$632 million by 2013-14.**
  - ⇒ Pennsylvania is unique among natural gas states in that much of the recoverable gas is located beneath public land. In 2008, the state opened up 74,000 acres of state forests for drilling, receiving **\$190 million in leasing fees.**
- In the long-term, Pennsylvania can gain more revenue from **lease payments and royalties** through opening up additional state-owned lands to lease to natural gas drilling than from pushing out the industry through excessive taxation, before it has a chance to properly develop.
  - ⇒ Leasing additional state lands would foster additional new jobs and industries in Pennsylvania.
  - ⇒ Allowing the industry to develop with reasonable and competitive tax rates will provide long-term growth and benefits to Pennsylvania's economy.

###

*For more information on the State Budget, visit [CommonwealthFoundation.org](http://CommonwealthFoundation.org).*