MARCH 11, 2015

# Position Statement Supporting Senate Bill 712, With Amendments

Given before the Budget and Taxation Committee

## Taxing Natural Gas Extration Helps Pay for Side Effects

Fracking—the extraction of natural gas and other products through the injection of pressurized fluid into rock—appears increasingly likely to come to Maryland, and if it does the state will need additional funds to pay for increased school enrollment, higher costs for road maintenance, and reducing health and environmental harm that could result. The Maryland Center on Economic Policy therefore supports Senate Bill 712, with amendments, to raise the necessary revenue.

With natural gas drilling potentially starting in Maryland as early as 2017, Maryland should follow the example of other states and enact a "severance tax" and a permanent fund to protect communities and invest in the future. The production of natural gas through fracking is a short-term activity and the state must take steps to avoid the boom-and-bust economic cycle that accompanies it.

Severance taxes help the communities most affected by fracking pay for necessary services that come with an increased workforce and the other side effects of fracking. That includes things like road repair and environmental protections, and the increased use of public services like schools, police, and fire protection. A permanent fund fed by severance tax revenue would allow the state to save for when fracking ends and help repair long-term damage to the communities closest to fracking sites. A state severance tax would also reduce federal corporate income taxes paid by the natural gas producers.

If Maryland begins to frack, the state must take the right steps to protect its future. Garrett and Allegany counties, where the Marcellus Shale formation is located, already have local severance taxes of 5.5 percent and 7 percent. Maryland should enact a tax on the state level, without reducing the local severance tax. Neither county's tax is invested for the long-term, and the state will face its own costs. Garrett County's severance tax is distributed among cities, public schools, and the county hospital[1]. All of Allegany's severance tax is deposited into the county's general fund[2]. While these local taxes might mitigate the immediate cost to the counties, they do not fund future costs for

[1] Public Local Laws of Garrett County, Sections 51.01through 51.07., http://www.mde.state.md.us/programs/Land/mining/marcellus/Documents/Meetings/Briefing_Revenue.pdf
[2] Code of Alleghany County, Maryland § 394-10, http://ecode360.com/14700429

1500 Union Avenue, Suite 2500 Baltimore MD 21211 | mdcep@mdeconomy.org | 410-412-9105

repairing the harm fracking may do.

Despite our support of this bill, we do propose two amendments.

First, we ask that the committee amend the proposed tax rate of 2.5 percent to a more effective rate of 10 percent. A lower tax rate won't increase fracking. The incentive to drill comes from the location of the gas deposit and global demand for natural gas, not tax incentives. Maryland should enact a tax rate sufficient to compensate communities that will bear the brunt of fracking and that will increase the state's revenue. Several studies have proven increased severance tax rates do not hurt the bottom line of business in a meaningful way[3]. In fact, a 2010 Pennsylvania State University study found that every $100 million in severance tax imposed on oil and natural gas companies would create a net gain of more than 1,100 jobs, and slightly boost gross state product[4]. Furthermore, any tax holiday for fracking would only reduce the revenue collected, as each fracking well has a relatively short lifespan of just a few years.

Second, we do not support the tax being levied on "the gross fair market value of the natural gas produced." Instead, the severance tax should be based on "the economic value of the gas," which includes the market value and a rate per unit, such as the cubic feet of gas produced.

Taking into consideration the volume of the gas extracted, along with the market value, is common throughout the US because it provides a more effective and accurate way to compensate states.

Taxing only the market value would create a more volatile tax --as the price increases, so would the tax revenue, and vice versa, creating a boom-and-bust cycle. A rate-per-unit tax creates a more sustainable and predictable revenue system, since it is not dependent on the market price of the natural gas.

Natural gas extraction has the short-term potential to add jobs and dollars to Maryland's economy. Maryland needs to take steps to make the economic benefits as sustainable as possible by enacting an effective state severance tax.

**The Maryland Center on Economic Policy respectfully requests that the Senate Budget and Taxation Committee give a favorable report to Senate Bill 712 with the specified amendments.**

[3] Shelby Gerking, et al, Mineral Tax Incentives, Mineral Production and the Wyoming Economy, December 2000.; Gabriel Lozada and Michael Hogue, The Effect of Proposed 2009 Tax Changes on Utah's Oil and Gas Industry, University of Utah, December 18, 2008.; Headwaters Economics, Energy Revenues in the Intermountain West, October 2008, page x

[4] West Virginia Center on Budget & Policy, 2011, http://www.wvpolicy.org/downloads/severance_taxes_and_natural_gas111511.pdf