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Making the Most from Fracking: The Benefits of a State Severance Tax

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, the state, and invest in the future. A moratorium on extraction from the Marcellus Shale is coming to an end, potentially allowing energy companies to begin natural gas production, or “fracking,” in that geological formation.

Natural gas is a short-term product and the state must take steps to avoid the boom-and-bust economic cycle that accompanies it. Maryland should look to other states with natural gas production for examples on tax policy, and most of them levy a severance tax on the removal of such non-renewable resources. Severance taxes help the communities most impacted by fracking pay for necessary services that come with an increased workforce and the effects of fracking. That includes things like road repair and environmental protections, and the increased use of public services like schools and police and fire protection. A severance tax also is a source of revenue that can be used for long-term investments that boost a state’s economy. A permanent fund fed by severance tax revenue would allow the state to reap the economic benefits of fracking beyond production time and repair long-run damage to the communities closest to fracking sites. As an added benefit, a state severance tax would 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.

County Severance Taxes

Maryland’s Garrett and Allegany counties, where the Marcellus Shale is located, have local severance taxes of 5.5 percent and 7 percent. Maryland could still enact a state tax, without necessarily reducing the local severance tax. Additionally, neither county’s tax is invested for long-run economic gain. Garrett County’s severance tax is distributed among city officials, 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 mitigate the harm the counties are currently experiencing, they do not fund future harm reduction interventions.

Low Tax Rates & Tax Incentives Won’t Increase Drilling

Tax incentives and lower tax rates won’t increase fracking. The incentive to drill comes from the location of

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[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

the gas deposit, so Maryland should not attempt to lower its tax rate or provide unnecessary incentives for fracking. Instead, Maryland should enact a tax rate that will 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 Penn State 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]. Incentives like a tax holiday (offering a lower tax for a period of time) would not promote industry; instead it would weaken the revenues collected from the producers.

Minimizing the Boom-Bust Cycle

The state needs to follow other energy-producing states and enact a natural gas severance tax based on the economic value of the gas, including its market value and a rate per unit, such as the cubic feet of gas produced. Taxing only the market value would create a more volatile tax --as the price increases, so would the tax revenue, and vice versa. Additionally, 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.

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[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