Proposed Drilling Fee Fails to Address Pressing State Needs

While fee dollars are highly targeted to drilling communities, most state tax revenue comes from non-Marcellus counties yet still benefits Marcellus counties

PENNSYLVANIA Budget and Policy Center

412 N. Third Street, Harrisburg, PA 17101 • www.pennbpc.org • June 27, 2011

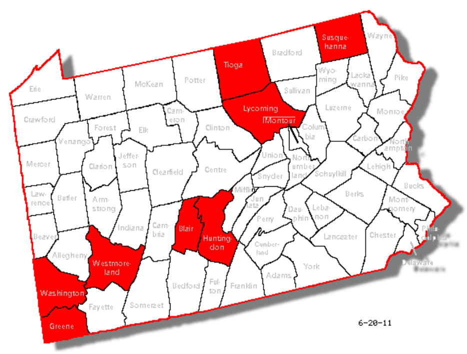
The Pennsylvania General Assembly is weighing various proposals to impose an impact fee on natural gas drilling in the Marcellus Shale.

Pennsylvania is the only significant gas-producing state without a drilling tax or fee on natural gas. Virtually every other gas-producing state in the nation has a production-based extraction tax or fee, and many collect property taxes on oil and gas reserves, a practice Pennsylvania stopped in 2002 after a successful lawsuit by the gas industry.

Governor Tom Corbett and legislative leaders have taken a firm position, insisting that no drilling tax revenue go to offset planned budget cuts for public schools, health care, services for the vulnerable, or public universities.[1]

This position is out of sync with most Pennsylvanians. A Quinnipiac poll released in June finds that 69% of voters would support a new tax on drilling companies to balance the state budget.[2]

Eight Counties Would Receive Bulk of Drilling Fee Funds



Pennsylvania Budget and Policy Center calculations

It is unusual for gas-producing states to prohibit drilling tax revenue from contributing to General Fund services like education or health care. Most states treat this revenue as they do general tax revenue, while also allocating a portion to local governments and/or environmental programs.

Only two of 13 gas-producing states allocate no funds from drilling taxes/fees to general state services.[3] Three states, including Texas, provide no revenue from gas drilling taxes to local governments at all. Instead, local governments — including school districts — recover incurred costs through local property taxes on reserves and equipment, as they do with most industries.

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[1] "Corbett opens up to Marcellus fees," The Associated Press, March 24, 2011, http://www.pittsburghlive.com/x/pittsburghtrib/news/state/s_728891.html; "Corbett attaches conditions to possible gas-drilling fee," EnviroPolitics Blog, June 1, 2011, http://enviropoliticsblog.blogspot.com/2011/06/corbett-attaches-conditions-to-possible.html.

[2] Quinnipiac University Polling Institute, "June 14, 2011 - Big Gender Gap Keeps Pennsylvania Gov's Approval Low, Quinnipiac University Poll Finds; Voters Support Natural Gas Drilling 2-1," http://www.quinnipiac.edu/x1327.xml?ReleaseID=1610v.

[3] See Shared Costs, Shared Responsibility, State Distribution of Severance Tax Revenue, at: http://pennbpc.org/sites/pennbpc.org/files/How%20States%20Distribute%20Severance%20Tax%20Revenues.pdf

It is also unprecedented for state taxes collected primarily from one part of the state to be spent only in that same part of the state. For example, Pennsylvania's Gaming revenues are collected from just a few parts of the state and the Bank Shares Tax is collected primarily from businesses in the Philadelphia and Pittsburgh metro areas. In both cases, the revenue is distributed statewide. More broadly, non-Marcellus regions provide most of the state's current tax revenue even though substantial portions of those taxes are used in the Marcellus region.

For three significant parts of the state budget on which data are available — school funding, Medicaid, and water and sewer infrastructure funding — the Marcellus region of the state benefits as much or in some cases much more than parts of that state that contribute more tax revenue. With the proposed Marcellus drilling fees, however, the 10 counties that contribute 61% of current state taxes would receive 0.1% of funds dedicated for local impact. (Some funds from the proposed drilling fees would go to grant programs that serve the state as a whole. There is no readily available data that make it possible to estimate the geographical distribution of funds from these grant programs.)

As of June 27, Pennsylvania has lost an estimated $192 million in potential drilling tax revenue since October 2009 due to inaction on the part of the General Assembly.[4] That revenue could have been used to reduce the impact of proposed cuts to Medical Assistance, public schools, colleges and human services. Moving forward, the General Assembly should adopt a responsible drilling tax that supports core state services and benefits all Pennsylvania residents.

Impact Fee Proposals Depart from the Traditional Distribution of Tax Revenue

The Legislature is considering several competing Marcellus Shale plans. Only one, Rep. Greg Vitali's House Bill 33, would specifically allocate funds for general state services.[5] Several set aside a portion of funds for "statewide impacts," but those are largely allocated to environmental programs. Four other proposals would reserve 35% to 60% of their funds for local governments, with the Scarnati proposal at the top of this range (60%). *See Appendix for details*.

Top 10 Counties in Tax Collections from Current State Taxes and Estimated Local Share of Drilling Fee

County	Taxes[1]	Est. Local Share of Drilling Fee (2012)
Allegheny	$ 1,735,830,000	$73,000
Montgomery	$ 1,627,593,000	$0
Philadelphia	$ 1,284,238,000	$0
Bucks	$ 975,686,000	$0
Chester	$ 878,613,000	$0
Delaware	$ 821,926,000	$0
Lancaster	$ 647,798,000	$0
Berks	$ 506,241,000	$0
York	$ 481,269,000	$0
Lehigh	$ 468,701,000	$0
Total	$ 9,427,896,000	$0
Share of total	**61%**	**0.1%**

Sources. Pennsylvania Department of Revenue and PBPC calculations

This highly proscribed distribution of drilling fee revenue is a departure from standard practice for state taxes. Income, sales and corporate taxes are collected from across the state, pooled in the state's General Fund and largely redistributed across the state to local institutions, school districts and local governments. While the services may be delivered locally, they meet a shared state objective,

[4] See PBPC Drilling Fee Tracker: http://pennbpc.org/severance-tax-ticker

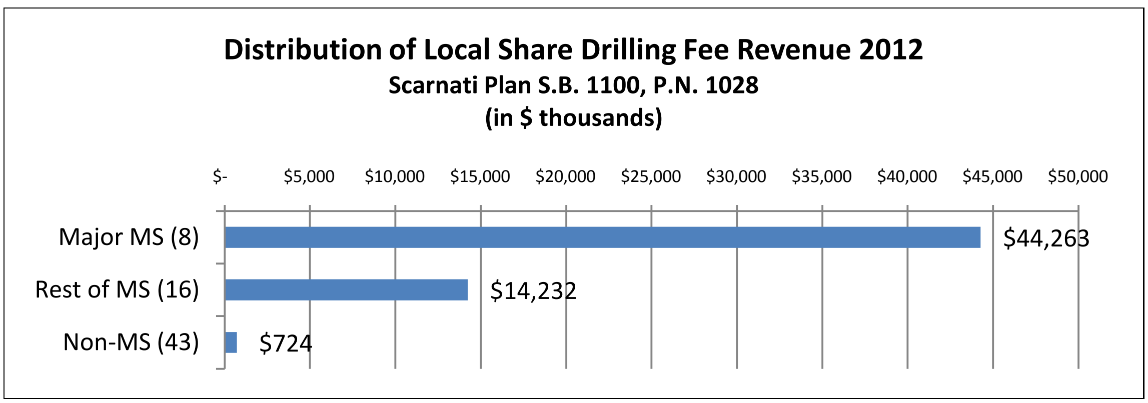
[5] Rep. Kate Harper's bill HB 1406 would allocate revenue specifically to education and higher education, which are General Fund expenditures.

such as transportation for people with disabilities or educating children. They are made available across the Commonwealth and contribute to the overall benefit of the state's residents and to its overall economy.

Gaming tax revenue is a good example of a tax that is generated locally but distributed statewide. Ten licensed gaming facilities have generated a total of $1.25 billion in taxes so far in 2010-11.[6] Only $91 million, or 7.3%, of taxes collected from slot machine stay in the host communities, while the vast majority — more than $776 million this year[7] — is distributed to school districts statewide for property tax reductions.[8] Roughly 88% of the revenue from table games ($64 million so far in 2010-11) goes directly into the state General Fund.

Impact Fee Benefits a Small Share of Drilling Communities

Most fee proposals give the lion's share of revenue to local governments in drilling counties. The most generous of those, Senator Scarnati's proposal (SB 1100, PN 1238), allocates 60% of fee revenue to counties with active shale gas production. Based on current production, 75% of funds would go to just eight of the 23 drilling counties (those with more than 100 active wells). In 2012, these eight counties would receive $44.3 million; 16 other counties with fewer wells (10-99) would split $14.2 million; and eight of the state's remaining 43 counties would receive less than $1 million in total.[9]



Source. Pennsylvania Budget and Policy Center calculations.

Most Tax Revenue in the State Comes From Non-Marcellus Counties

Marcellus Shale drilling activity is concentrated in 24 of 67 Pennsylvania counties (hereafter, "Marcellus counties"),[10] and these counties account for 16% of the state's total population.[11] Over 10.5 million, or 84%, of Pennsylvanians reside in non-Marcellus Shale drilling counties.

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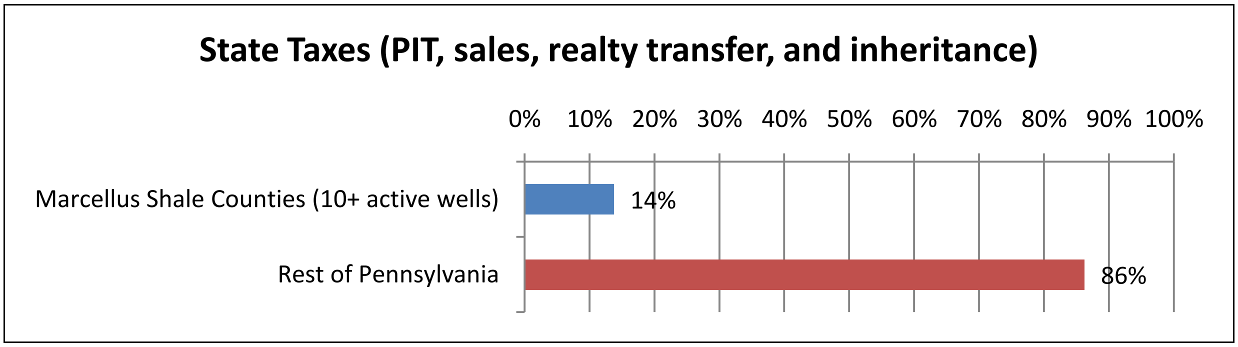
[6] Pennsylvania Gaming Control Board, "Slot Machine Gaming Revenues," June 19, 2011, http://www.pgcb.state.pa.us/files/revenue/Gaming_Revenue_Weekly_20110619.pdf.
[7] Pennsylvania Office of the Budget, "Budget Secretary Certifies $776.2 Million for Statewide Property Tax Relief," April 15, 2011, http://www.portal.state.pa.us/portal/server.pt?open=18&objID=1060301&mode=2.
[8] Philadelphia uses state-distributed gaming revenue to reduce its wage tax.
[9] To receive an allocation of the Scarnati fee's local share, a county must have producing wells. As of April 2011, eight counties had between one and nine Marcellus Shale wells.
[10] Counties with 10 or more active Marcellus Shale wells, as of April 2011, account for 98.8% of all producing shale wells in Pennsylvania.
[11] The counties with 10 or more Marcellus Shale wells, as of April 2011, include: Armstrong (53 wells), Bradford (617), Butler (69), Centre (55), Clearfield (87), Clinton (56), Columbia (17), Elk (22), Fayette (92), Greene (202), Huntingdon (104), Indiana (25), Jefferson (13), Lycoming (177),

The 43 non-Marcellus counties have been the state's economic engines. They have a total of 4.6 million of the state's jobs (86%) and 84% of all establishments. These counties accounted for 89% of all wages earned in Pennsylvania in 2009.[12] They also accounted for 86% of state tax revenue collections.[13]

The top 10 counties (which include Allegheny, Montgomery, Philadelphia, Bucks and Delaware) contribute 61% of the $15.4 billion in tax collections on which county-level collections are readily available.



Sources. Pennsylvania Budget and Policy Center calculations using data reported by the Pennsylvania Department of Revenue.

Many Increased Service Needs That Result From Drilling Are Financed Through General Fund Programs

The crux of the argument for restricting drilling fee revenues to drilling areas and a very restricted set of programs is that the impacts are primarily local. Clearly, there are major localized environmental and infrastructural costs that result from drilling activity, such as local road reconstruction, surveying, deed search and recording, and specialized emergency response.

However, some of the local impacts — byproducts primarily of economic and population growth — will place increased demand on General Fund programs. These local impacts include growth in public school enrollments, increase in demand on state-funded criminal justice services including probation, parole and correctional facilities, increased expenditures on state roads carrying supplies for drilling operations, increased demand for environmental regulation and enforcement. If these increased costs are not matched by increases in General Fund revenues, then the demands of the Marcellus region will reduce funds available in the rest of the state, leading to even more severe cuts outside the shale region.

In addition, some Marcellus Shale impacts are not local and will impose costs on state programs financed through General Funds. One example, discussed below, is the threat of drilling to the watersheds of the state's rivers.

McKean (32), Potter (51), Somerset (17), Sullivan (36), Susquehanna (211), Tioga (456), Washington (367), Wayne (62), Westmoreland (127), and Wyoming (40).

[12]Annual figures for employees, establishments, and wages as reported by the U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages. http://data.bls.gov/cgi-bin/dsrv?en.

[13] This analysis includes sales, realty transfer, and inheritance taxes for 2009-10 and personal income tax revenue for tax year 2008. Corporate income and other state tax data are not available on a county-by-county basis.

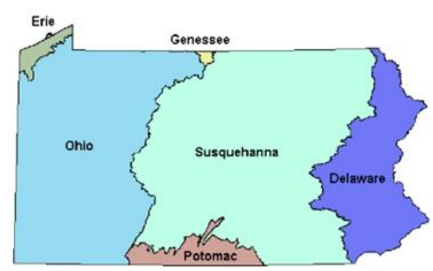
Plans Fail to Pay for Environmental Enforcement

One of the clearest problems with the prohibition on drilling revenue for the General Fund is that no money would be allocated to the Pennsylvania Department of Environmental Protection for general efforts to protect the state's water, air, and land – or to supplement gas permit revenue that currently funds regulation of the gas drilling industry. From 2007-08 to the budget proposed by Governor Corbett in 2011-12, total state funding for the Department of Environmental Protection (DEP) has declined by $97 million, or 19%.[14] The drilling fee does nothing to stem this decline at a time when demands on DEP resources are increasing due to drilling activity.

Non-Shale Counties Will Face Water Impacts

Most of the current bills define impacted communities as counties with active wells, but the bulk of the drilling activity is taking place within the Commonwealth's three primary watersheds (of the Ohio, Susquehanna, and Delaware rivers) and has the potential to affect the drinking water, farmland, and recreational use of waterways for residents in non-Marcellus counties.

Pennsylvania Watersheds

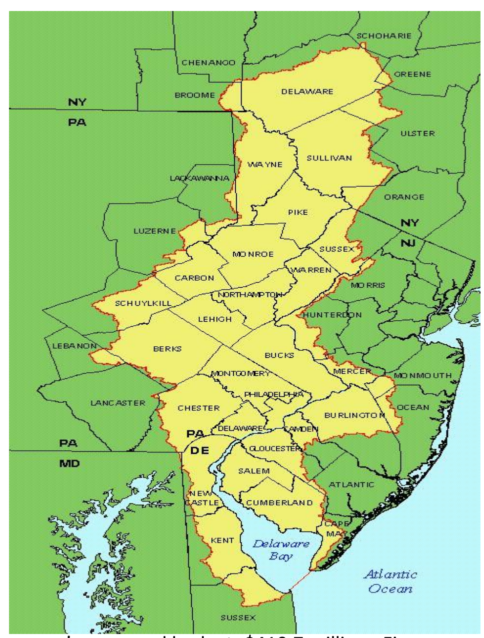


Source. Pennsylvania Association of Conservation Districts

Thirty-nine of the 43 non-Marcellus counties lie mostly or completely in watersheds that have substantial drilling activity:

- Delaware River Basin: Berks, Bucks, Carbon, Chester, Delaware, Lehigh, Monroe, Montgomery, Northampton, Philadelphia and Pike.
- Susquehanna River Basin: Adams, Bedford, Blair, Cambria, Cameron, Cumberland, Dauphin, Juniata, Lebanon, Lackawanna, Lancaster, Luzerne, Mifflin, Northumberland, Perry, Schuylkill, Snyder, Union, York.
- Ohio River Basin: Allegheny, Beaver, Clarion, Crawford, Forest, Lawrence, Mercer, Venango and Warren.

Delaware River Watershed



Senator Scarnati's proposal would distribute 40% of fee revenue to environmental and other statewide impacts, but the bulk of these funds ($31.5 million in 2012) would be distributed through grants from the Commonwealth Finance Authority. These grants could be used to fund a wide range of environmental programs, including acid mine cleanup,

[14] Total state funds (all sources except federal) in 2007-08: $507.3 million. In 2011-12 Governor's proposed budget: $410.7 million. Figures compiled from 2009-10 and 2011-12 Governor's Executive Budgets.

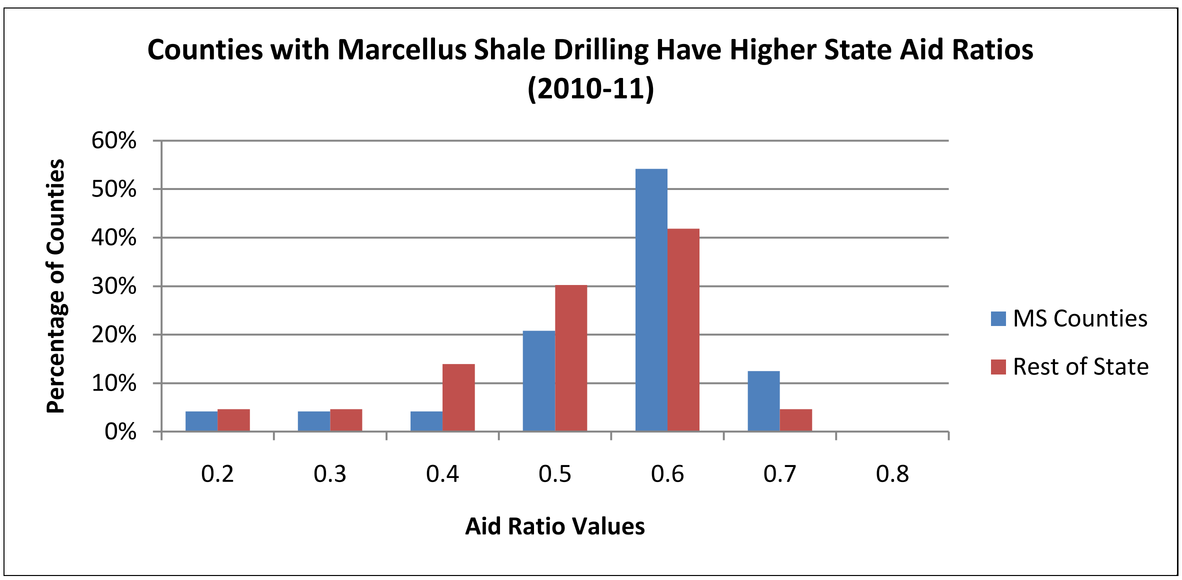
watershed protection, water and sewer plant improvements, flood control, parks, recreation, and forest conservation. However, the basic operation of state programs that protect the environment and conserve the state's natural resources would not receive any state funds.

Marcellus Shale Residents Heavy Users of State Services

None of the leading Marcellus tax plans contribute any revenue to the state's two largest expenditures, Medical Assistance and public education, although Marcellus regions are as likely and, in some cases more likely, to avail themselves of those services.

The Marcellus region has a greater share of school districts with high state aid ratios. Two-thirds of school districts in the region have state aid ratios of 60% or more, compared to just 45% of districts in non-Marcellus counties. This means that state taxpayers contribute a greater share of the educational costs of these students than do local taxpayers, and a greater share than to students enrolled in non-Marcellus school districts.

Additionally, Marcellus Shale residents are almost as likely to enroll in Medical Assistance as their counterparts in non-Shale counties. In June 2011, 17.3% of residents in Marcellus counties received Medical Assistance, compared to 18.5% of non-Marcellus residents.



Sources. Pennsylvania Budget and Policy Center calculations using Pennsylvania Department of Education aid ratio data.

School districts across the Commonwealth are cutting services or raising local property taxes to make up for what will be close to a billion in state funding cuts. Under most proposed drilling plans, local taxpayers will be forced to pay more for their own schools, while continuing to subsidize school districts in the gas-rich region.

The water and sewer programs administered by the Commonwealth Finance Agency also disproportionately favor the Marcellus Shale region to the disadvantage of other parts of the state.[15] The counties in the Marcellus Shale regions receive between 1.8 and 3.9 times as much funding per capita from the state's H2O PA water and sewer program, for example, whereas the state's biggest economic engine, the five counties in Southeastern Pennsylvania, receive only one-quarter of the state per capita average ($11 vs. $41 per capita average) from this program. Thus, most Marcellus counties receive more than seven times as much water and sewer funding per capita as Southeastern Pennsylvania. A similar pattern holds for other regions, including the Lehigh Valley and the Berks/Lancaster region.

The distribution of water and sewer program funds is particularly important to the Marcellus fee debate. Senator Scarnati's bill would allocate a large share of "statewide impact" funds to water and sewer grants administered by the Commonwealth Finance Agency. If CFA uses existing program guidelines, counties outside the Marcellus area will continue to be shortchanged.

Conclusion

Most tax and fee plans in the Legislature mark a significant departure from the manner in which the Commonwealth currently collects and distributes tax revenue. The vast majority of revenue from both individual and business activity comes from non-Marcellus counties and is distributed statewide to support shared priorities, including schools, child abuse prevention and senior services, in drilling and non-drilling communities. A natural gas fee should likewise provide some benefit to all state residents.

The public is squarely behind a drilling tax and supports the idea that drilling tax revenue should help balance the state budget and fund environmental initiatives. The conversation in Harrisburg, which virtually forbids the use of this revenue to pay the Commonwealth's bills, is a far cry from the public's understanding or expectations around a potential gas drilling fee.

The General Assembly should adopt a natural gas tax plan that takes a balanced approach, helping local governments address drilling-related impacts, supporting conservation and environmental enforcement initiatives across the Commonwealth, and contributing to core state services that benefit all Pennsylvania residents.

[15] See the analysis of Pennsylvania water and sewer funding online at www.keystoneresearch.org/sites/pennbpc.org/files/KRC-Targeting-PA-Water-and-Sewer-Funds.pdf

Appendix 1.

Summary of select Marcellus fee plans.

Plan	Effective Tax Rate[16]	2012 Revenue[17]	Distribution
Rep. Vitali (HB 33)	5.9%	$405 million	32% General Fund 33% Local Governments $33% Environment 1.3% LIHEAP(heating assistance)
Rep. Quinn (HB 1700)	5.0%	$238 million	50% Local Governments 32% Environment 20% State Roads/Bridges
Rep. George (HB 833)	6.8%	$568 million	35% Local Governments 25% Environment 20% Wastewater treatment 16% Roads and bridges (MS area)
Sen. Scarnati (SB 1100)	3.1%	$106 million	60% Local Governments 32% Environment 4% State Roads/Bridges
Senate Democratic Amendment to Scarnati Plan[18]	*5.0%*[19]	*$230 million*[20]	*55% Local Governments* *45% Environment*

[16] Pennsylvania Budget and Policy Center calculations of effective tax/fee rate over the life of a well using well size (3.8 BCF) and price ($4.28 per MCF) assumptions used to forecast Scarnati Fee proceeds by the Senate Republican Caucus.

[17] Pennsylvania Budget and Policy Center calculations of calendar year 2012 revenues, using Scarnati fee methodology (well size, price, and number of wells drilled).

[18] Details of this proposal were not available at the time of writing. These characteristics of the proposal were based on a description from the Pennsylvania Senate Democratic Caucus website (accessed June 24, 2011): http://www.pasenate.com/?p=4372.

[19] No details were available regarding how this calculation was made.

[20] The Democratic Caucus estimated 2011-12 revenue at $200 million and 2012-13 revenue at $260 million. As this table contains calendar year figures, the 2011-12 and 2012-13 figures were averaged to get $230 million in calendar year 2012.