LEGISLATIVE BUDGET AND FINANCE COMMITTEE

Report Highlights
Review of the Commonwealth's Growing Greener II Initiative

House Resolution 2009-17 calls on the LB&FC to conduct a review of the Growing Greener II initiative. In 2005, Pennsylvania voters approved a referendum to borrow $625 million for the Growing Greener II program "for the maintenance and protection of the environment, open space and farmland preservation, watershed protection, abandoned mine reclamation, acid mine drainage remediation and other environmental initiatives." Act 2005-45 directs how these funds are to be distributed. We found:

- **The Commonwealth has issued $384.5 million of the $625 million in GGII bonds.** These bonds have interest rates of between 3.45% and 5.50%, with varying maturity dates through 2028-29. The remaining $240.5 million is to be issued by the end of FY 2010-11.
- **Debt service payments are currently about $30 million annually, but this will increase to about $50 million annually once all bonds are issued.** The revenue to make the principal and interest payments on the GGII bonds comes from the Environmental Stewardship Fund (ESF). The primary source of revenue for the ESF is the $4.25/ton solid waste disposal fee, which has ranged from $65-$84 million annually (including interest).
- **In recent years, the ESF has also funded $35-$54 million annually in non-GGII environmental projects. This will soon decrease to about $15 million annually.** Once all the GGII bonds are issued, the amount needed from the ESF for debt service will increase by about $20 million. This will leave much less available in the ESF to be used for future environmental projects.
- **Virtually all of the $625 million in GGII funds have already been spent or committed:**

Growing Greener Bond Fund Allocations and Expenditures
($ in Millions)

	Act 45 Allocations	Actual Expenditures (as of 6/30/09)	Actual Plus Estimated (Through 6/30/2011)
Agr.	$ 80 .0	$ 74.5	$ 80.0
DCED....	50.0	45.0	71.8[a]
DCNR....	217.5	148.9	216.6
DEP.......	230.0	94.5	212.2
PFBC	27.5	10.3	30.1
PGC......	20.0	10.8	17.4
Total....	$625.0	$371.6	$628.0

[a]Includes DEP funds allocated to DCED for Industrial Sites Reuse.

- **Many of the over 1,500 projects funded through GGII are unique, and therefore do not lend themselves to aggregate performance metrics.** But to the extent we were able to quantify outcome measures, we found that as of 6/30/2009 GGII funds had been used to support:
  - *Agriculture*- 316 farmland preservation projects, which preserved 33,713 acres of farmland in perpetuity.
  - *Community and Economic Development*- 66 projects that created 1,500 jobs, improved 41 buildings, leveraged $140.4 million in private dollars, remediated 1 site, and constructed 4 new buildings.
  - *Conservation and Natural Resources*- 441 projects, including improvements in 234 community parks, 132 state park and forest infrastructure projects, and the purchase of 42,357 acres of open spaces.
  - *Environmental Protection*- 685 projects involving abandoned mine reclamation (46), acid mine drainage (16), brownfields (25), drinking/wastewater (104), energy development (72), watershed protection (400), gas and oil well plugging (13), stream improvement and dams (9).
  - *Fish and Boat Commission*- 9 projects, primarily to improve state hatcheries.
  - *Game Commission*- 29 projects for various purposes.
- **Act 45 also created the $90 million County Environmental Initiative Program, which has funded 509 projects.** The report lists the CEIP projects, including 36 farmland preservation, 20 community revitalization, 139 community parks and recreation, 90 drinking water/wastewater, and 198 watershed protection projects initiated by the counties. The CEIP monies are exhausted for most project categories.

Fair Compensation for Pennsylvanians
Understanding the Natural Gas Severance Tax

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Pennsylvania is on cusp of a 21st Century natural gas "gold rush" in the Marcellus Shale, a deep geologic formation that spans West Virginia, Ohio, New York, and most of Pennsylvania. The thickest and most promising portion of the shale formation underlies northeastern Pennsylvania. New drilling techniques and rising natural gas prices have made it economically feasible and potentially highly profitable to exploit the vast gas reserves.

Pennsylvania has been through this before, during the coal mining, oil, and timber booms of the 19th and early 20th Centuries. While the harvesting of natural resources has built great fortunes for some and helped Pennsylvania grow and develop into the state we are today, some of the negative effects, like acid mine drainage and loss of wildlife, continue to linger.

Natural gas extraction poses similar challenges. Some landowners and drilling company shareholders will receive a hefty bounty, but Pennsylvanians could be left with the tab for inevitable environmental damage, water supply issues, road damage, housing and social issues, and changes to the way of life in rural Pennsylvania.

Natural Gas Production Will Create New Costs for State and Local Governments.

The Commonwealth and its municipalities are already facing new costs related to the natural gas industry that will be borne by state and local taxpayers:

- Environmental Monitoring and Protection: The drilling process has great potential to contaminate both surface and groundwater. Water usage and treatment will have to be monitored for many years.
- Infrastructure Costs: Counties and townships will need to build or upgrade roads to handle heavy truck traffic and expand first-responder units to meet the emergency demands of this often dangerous enterprise.
- Demand for Services: Development will attract new workers to the region, many with families and children, creating new demands for schools and other public services.
- Land Reclamation: Disrupted habitats will need to be rehabilitated, developed sites will need to be remediated, and local economies will have to be repositioned after the natural gas and developers are gone.

The gas industry already enjoys special tax preferences.

The Commonwealth's current tax system allows natural gas producers to reap substantial economic benefits without paying their fair share of taxes. Federal tax policies substantially reduce drillers' taxable income – lowering their state income taxes. Many out-of-state drillers take advantage of state tax laws allowing them to pay the personal income tax rate, rather than the higher corporate tax rate.

Oil and gas wells are exempt from paying property taxes in Pennsylvania. As a result, gas companies pay virtually no tax to compensate local governments for their expenditures. This benefit is not afforded to other mining businesses, or residential and commercial taxpayers.

A Severance Tax Can Help Compensate Pennsylvanians for the Loss of this Non-renewable Resource.

Every other major energy-producing state, including Texas, Arkansas, Oklahoma, Alaska, Wyoming, and West Virginia, imposes a tax on natural resource extraction. Pennsylvania is the only mineral-rich state without this tax.

Governor Ed Rendell has proposed a tax on the removal, or "severance," of natural gas from the ground in Pennsylvania. The proposed tax, modeled on neighboring West Virginia's severance tax rate, would take effect July 1, 2010 and is expected to generate $177 million in the first year and grow to $528 million within four years.

A natural gas severance tax will benefit Pennsylvanians:

- It will ensure gas companies contribute to the cost of their activities rather than leaving state and local taxpayers to foot the bill for additional environmental, infrastructure and public safety costs.
- It will compensate Pennsylvanians for removal of this non-renewable resource.
- Finally, it will contribute to the Commonwealth's long-term ability to provide education, senior services, environmental protection, and health care, as well as help reimburse local governments for service costs imposed by drilling activity.

Without the tax, Pennsylvania loses much of the benefit of drilling:

- Federal domestic energy production incentives reduce drillers state income tax payments.
- 70% of drillers in Pennsylvania pay the 3.07% personal income tax rather than the 9.99% corporate net income tax, creating a further windfall.
- Gas producers no longer pay local property taxes on reserves, due to a 2002 court-created loophole. Consequently, other property taxpayers must pick up the tab for industry-related costs in largely rural counties, municipalities, and school districts hosting drilling activity.

Severance taxes are the norm in energy-producing and mineral-rich states:

- Pennsylvania is the only mineral-rich state that doesn't levy any kind of severance tax.
- Thirty-five states levy some kind of severance or extraction tax on the removal of natural resources.
- Twenty-seven states levy a severance tax on the extraction of natural gas. Twenty-three of those states also have corporate income or other corporate taxes.

Natural gas production in the Marcellus Shale will create jobs, but the industry is still small:

- In 2008, the industry directly employed 10,300 people, according to the U.S. Bureau of Labor Statistics, and the state estimates that number will grow to 12,400 by 2016. By comparison, Wal-Mart employed 48,800 people in Pennsylvania as of January 2010.

The severance tax will not make Pennsylvania less competitive:

- Drilling decisions are based on the location of the reserves and the expected price of natural gas – not severance tax rates.
- Almost half of the price of natural gas to consumers is due to transportation and distribution costs. Due to its proximity to the lucrative Northeast market, Pennsylvania has a natural price advantage over competing states.
- Numerous studies have shown that increasing a state's severance tax has little to no effect on production or employment.
- The rate being proposed in Pennsylvania is the same as in neighboring West Virginia, eliminating any possible tax incentive to drill in one state or the other.
- All states with greater natural gas production than Pennsylvania currently have severance taxes or fees on its extraction.

Imposing a severance tax will not increase utility costs for Pennsylvania consumers:

- Pennsylvanians currently import four times more gas than we produce. We already pay tax on the gas we import from Texas, Wyoming, Oklahoma, and New Mexico.
- Most of the gas that will be produced in Pennsylvania over the next 20 years will likely be exported to other Northeastern states.

> *"The industry will probably hate me for saying this, but as far it goes in my world of spreadsheets, the severance tax is not a deal-breaker. I don't believe it will have a huge impact on drilling. It's not that large."*
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> ***— Subash Chandra, oil and gas industry analyst, Jefferies & Co. Inc., The Philadelphia Inquirer, May 2, 2010***

May 11, 2010

For Hearing On HB 334
Indiana, Pa

Sirs,

Pennsylvania Production Service Company does data collection and routine maintenance on a contract basis on 1,995 natural gas wells in Indiana and surrounding counties for many different customers. We have been doing it for a long time. Roughly half the wells are for local producers and half for publicly held companies. When we became aware of this hearing we queried our databases for your benefit.

MCF/DAY	Number	Percentage	MCF/DAY	Number	Percentage
0-5	588	29%	30-40	56	3%
5-10	571	29%	40-50	34	2%
10-20	523	26%	50-60	19	1%
20-30	170	9%	>60	34	2%
				1,995	100%

While I have some other issues with the bill, my main concern is the cost it imposes on the people who don't have to pay the tax. This comes at a time when well owners have been victims of much cost shifting from the gas buyers in recent years, and at time when low gas prices has placed the economic viability of many wells on the edge.
My issues are as follows.

1. The requirement for a meter on each well: The norm is to have enough meters so that you can pay the landowners correctly and investors correctly. Note that 29% of the wells feed less than 5 mcf/d. If a well feeds 4 mcf/d and has an 82.5% working interest it will net $2,442 per year if it is a dry well and requires no major repairs at a $4.50 gas price. The meter requirement would cost $3,500 to $4,500 per well, and add to yearly cost as well. It will eat two years of net income, again assuming there are no major repairs. Many, many wells will be abandoned. I have bought some old wells from customers over the years and would have to spend upward from $312,000 just for meters and installation and I am not a rich oil or gas company. I would pay no tax or even come close to it.

2. Putting a meter on each well will require many more visits to each well site at a cost the low flow wells can not afford. We will leave a much greater environmental footprint. Farmers will not be happy as we are required to use up more of their land. Most roads will have to be improved which also has a significant footprint. Road building is