Joint Hearing of the Senate Finance and Environmental Resources & Energy Committees to Discuss Proposed Severance Tax
Testimony
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Thank you, Chairmen Eichelberger, Blake, Yaw, Yudichak, and distinguished members of both committees, for inviting me today to discuss the Education Reinvestment Act's key funding mechanism, a severance tax on natural gas.

To begin, I'd like to highlight for the committees two important facts: one, that Pennsylvania is the second largest producer of natural gas in the country, but the only state in the U.S. that is home to abundant natural gas production but doesn't impose a tax on those resources; and two, that our education system is suffering from funding cuts that increased class sizes, shrank teaching staffs and led schools to eliminate programs that would enhance our children's development.

The Pennsylvania Education Reinvestment Act will impose a reasonable tax on natural gas severed in Pennsylvania. The tax will provide revenue for basic education, economic growth and Act 13 Impact Fee replacement.

Governor Wolf's proposal – a tax of 5 percent on the value of the gas and natural gas liquids, plus 4.7 cents per thousand cubic feet of gas extracted – was modelled after the severance tax in West Virginia, a state that has proved a sensible severance tax and a thriving natural gas industry can coexist. Last year the value of natural gas severed in Pennsylvania was nearly $14 billion, up from $5.6 billion in 2011, and there is no reason to believe natural gas companies will not remain strongly profitable.

To facilitate understanding of how the tax will be practically applied, let me first review with you how natural gas is defined and how chemical components and processing impact what is ultimately sought by consumers. What comes out of the ground is gas, and, if it contains enough liquids, it is considered wet gas. The gas from the ground may be processed into dry gas and natural gas liquids. The dry gas is made up mostly of methane and is what is delivered to purchasers through the pipeline system, and this is what's commonly referred to as natural gas. The other gas hydrocarbons such as ethane, butane and propane are heavier and become natural gas liquids. These are the chemicals that manufacturers are interested in because they can be used to make plastics and other materials. Natural gas liquids have many other uses as well. For example, butane is used in cigarette lighters and propane is sold in tanks to power everything from heating systems to gas grills.

The tax will only apply to gas severed from unconventional formations using the technology generally known as hydraulic fracturing, or fracking. And since Pennsylvania exports a significant amount of the natural gas it produces, an estimated 80 percent of the tax will ultimately be paid by non-Pennsylvanians, according to the Independent Fiscal Office.

To determine the 5 percent of value portion of the tax on dry natural gas, producers will use a statewide average market price. On a quarterly basis, the Department of Revenue will publish a weighted average of market prices at major hubs within Pennsylvania. To determine the value portion of the tax on natural gas liquids, producers will report to the department the gross value of natural gas liquids sold.

Reasonable deductions will be allowed for low producing "stripper wells," gas given to leaseholders and gas severed from a storage field. Additionally, producers may not reduce royalty payments to landowners by any portion of the severance tax.

Estimates of volume are modelled using Pennsylvania Department of Environmental Protection well data, as well as federal Energy Information Agency well productivity calculations. The severance tax proposed will take effect January 1, 2016 and volume in 2016 is projected to be approximately 5 trillion cubic feet.

Governor Wolf's proposal sets a price floor of $2.97 per thousand cubic feet to provide certainty that revenue will be available to fund schools and maintain funding to communities impacted by drilling. The administration is closely monitoring conditions in the natural gas market. While we expect that natural gas prices will increase from current levels by 2016, the Governor has made clear his willingness to modify the floor as warranted.

Revenue from the severance tax will preserve funding currently delivered through the Impact Fee established by Act 13 of 2012. The Governor understands the importance these funds have for counties and municipalities across the state and has proposed to continue the distribution as designed within Act 13, and at the highest level to date. This consistent and reliable distribution will allow municipalities addressing the impacts of drilling to plan financial obligations year to year. Policymakers will be able to rely on the fact that a set amount of revenue will be available as they prepare their budgets.

The severance tax will also provide $10 million for additional oil and gas enforcement officers to assist DEP's environmental protection operations monitoring air and water quality.

Additionally, beginning in fiscal year 2016-17, the severance tax would fund debt service payments for the Governor's proposed Economic Growth Bond. These funds will support initiatives that include funding for the Pennsylvania Industrial Development Authority to address current and future business growth needs; the Business in Our Sites financing tool that allows Pennsylvania to compete for business expansions and relocations; and energy and technology investments to ensure a comprehensive energy portfolio.

Most importantly, the Education Reinvestment Act will help enable the commonwealth to invest an additional $2 billion to improve our education system over the next four years and pursue a goal of universal pre-kindergarten education for all Pennsylvania children. Governor Wolf's severance tax is a common sense approach that capitalizes on Pennsylvania's fortune in sitting atop one of the largest natural gas deposits in the world and transforms that abundant resource into better education for our children, another resource on which Pennsylvania's future will depend.

Natural gas has the potential to fuel not only our homes and truck fleets, but also a world-class education system for our children and a manufacturing renaissance for our communities and economy.

I thank the committees for the opportunity to offer this testimony, and I look forward to addressing your questions.