SENATE TAXATION
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Mr. Chairman, Members of the Committee:

For the record, my name is Molly Severtson, and I'm here today representing The Policy Institute, a nonprofit organization here in Helena. Our mission is to promote public policy based on economic justice, fair taxation, corporate accountability and environmental responsibility. I rise today in support of Senate Bill 408.

I'd like to start by offering you a brief history of oil and gas taxation in Montana to provide you with a backdrop for the rest of my testimony.

The first oil and gas tax "holiday" was granted in Montana in 1979. In 1981, the legislature increased the state's severance tax on oil from 2.65 to 5 percent for 1982-83 and to 6 percent thereafter. Montana's severance tax on oil had not been increased in 1962, and the '82 increase was proposed to offset a reduction in vehicle license taxes.

From 1987 to 1995, many bills were passed that reduced the effective tax rate for various types of drilling and many of these included triggers, meaning that when the price of oil and gas rose, the incentive was reduced or eliminated.

In 1999, under the banners of "simplification" and "incentive," the Montana Legislature enacted a number of changes that did two basic things: 1) Reduced the basic production tax rate and 2) Revised the terms of the "holiday" periods for taxation of oil and gas production. The changes made in 1999 were the biggest and most influential made over the decades, and I would submit to you that they were some of the worst tax changes made in 30 years in Montana in terms of the enormous reductions in revenue they caused. The Department of Revenue estimates a loss of more than $500 million to the state from 2003-2007 as a result of the changes made in 1999.

Let's recall for a moment the rationale behind the various reductions given in 1999. That year, oil was selling for about $20/barrel and the argument went that the incentives were needed to spur production, thus creating jobs and promoting economic growth. Now, indeed oil production in Montana has increased since the mid-90s, but this relationship isn't necessarily causal. One must consider other factors that occurred during that time period as well.

- The first: discovery of reserves, including the Elm Coulee Field, in Richland County, which began producing in 2000 and by 2005, had doubled Montana's total oil output, meaning that this one new field was producing more oil in Montana than all other fields in the state combined.
- The second: technology. Drilling methods and equipment evolved markedly during the 1990s. The use of horizontal drilling, though not new to oil extraction, increased rapidly as technology advanced, oil prices rose, and the geology of the Elm Coulee field proved highly suitable for the horizontal approach.
- The third: rising prices. From 1998 to 2008, oil prices generally rose steadily to a 2007 average price of $66/barrel and to a June 2008 high of $147/barrel. As of last week, oil was again trading at more than $100/barrel.

The predominance of these factors – and others – over tax rates on drilling decisions is backed up by two recent academic studies that I would like to bring your attention to today.

One was published in 2000 by the University of Wyoming and the other was released in 2008 by Headwater Economics.

The Wyoming study asks the following question: "To what extent do taxes, tax incentives, and environmental regulations alter employment and other economic activity in Wyoming as compared with what would occur in their absence?" The finding: changes in oil and gas drilling and production attributable to lower tax rates are relatively small, but for the state coffers, "the overall story is one of a substantial loss in revenue."

The study goes on to ask the question, "Why is the response of oil and gas output so small when production taxes are changed or tax incentives are applied?" The study lists four reasons.

1. "A reduction in production taxes (or an increase in tax incentives) offers no direct stimulus for exploration.
2. Production taxes and tax incentives are deductible against federal corporate income tax liabilities, so that when production tax rates fall, federal corporate income tax liabilities rise
3. A reduction in production tax rates by, say, 2 percentage points has only a small impact on the net-of-tax price received by operators
4. Fourth, and most importantly, production of (as contrasted with exploration for) oil and gas is driven mainly by reserves, not by prices, production tax rates, or production tax incentives. This, the study says, is a basic fact of geology and petroleum engineering."

The Headwaters study compared the approaches taken by Montana and Wyoming in the late 1990s and in the year 2000. In 1999, Montana lowered its basic tax rates and enacted the holiday rates and Wyoming lowered its severance tax rate by two percent. But in 2000, Wyoming repealed the tax break it enacted in 1999 and in subsequent years made other changes that elevated its effective tax rate to 15.9 percent, the highest of the states profiled in the report. This is how the Headwaters study characterized the results of the two approaches:

"Both states have experienced a surge in natural gas drilling and an increase in commodity prices since 2000. Wyoming added over $10 billion in production value and Montana about $2 billion between 2000 and 2006. New drilling continues in Wyoming at a faster pace than in Montana, and Wyoming's energy economy is significant. There is little evidence in the overall figures to suggest that firms fled Wyoming's higher tax climate and moved to Montana."

Of course, the results and methods of these studies can and should be scrutinized by opponents of this bill, but will the other side produce any empirical, un-biased evidence that tax rates do come into play in a significant way in drilling decisions, over and above location of reserves and market price and accessibility of resources and labor availability? I don't think they will.

But let's say for a moment that these holidays were needed to aid the oil and gas industry in Montana during troubled times. That was certainly the rationale behind granting them. Where then, is the reciprocity from the industry now that prices are high? Over the years, these policies have resulted in more than half a billion dollars in lost revenue to our state without any proof that they've significantly affected drilling decisions. In the early days of the "holidays," as I've noted, there were triggers in effect, so that when prices rose, rates returned to normal. But in 1999, that element of fairness disappeared, so now the holidays just continue despite what happens with prices.

Mr. Chairman, Members of the Committee, it's a matter of fairness. For decades the Montana Legislature has continually decreased the effective tax rate on oil and gas production, ostensibly to aid the industry in times of trouble, but where is the reciprocity for the state when prices are high? It's here in Senate Bill 408 and I urge you to support it.

Thank you,

Molly Severtson
Executive Director