USING SEVERANCE[1] TAXES, SUBSIDIES AND TAX CREDITS TO PROMOTE HIGH VALUE ADDED COMMODITY PROCESSING IN-STATE.

Dr. F. George McDuffee
gmcduffee@mcduffee-associates.us

Narrative:

When the Constitution of the United States was adopted in 1789, taxes and levies on the goods and services between the states were quite rationally prohibited.

> ...
> Article I, Section 7
> *No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing it's inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Controul [sic] of the Congress.*
> ...

Most unfortunately, very significant changes have occurred in the following 226 years in the patterns of trade and economic organization, for example the extraordinary reductions of transportation costs, national branding of consumer items, continually increasing globalization/internationalization and the meteoric rise of transnational corporations.

This has had the easily foreseeable, and highly pernicious effect, of transforming what were states with vibrant, autonomous, and largely stand-alone economies, into what are now operationally colonies, in that their products are largely exported in the raw or minimally processed form, high value added operations/processing are performed externally, increasingly in other countries as well as other states, and then re-imported at much higher prices. This has several very adverse effects on the state economy (nationally there are many more such as the immense Current Accounts Balance of Trade deficit). Three are:

1. Much “high value added” employment with high wages yielding high taxes was lost to the state, resulting in the exodus of our best, brightest and most motivated young, many into the burgeoning and grossly excessive urban areas, but many relocating out of state entirely, taking their education, skills, training and initiative with them.

2. Local property tax revenues were lost when in-state production/processing facilities were abandoned or relocated.

3. The organizational memory, methodology, expertise, as well as the skills and training, to engage in “high value added” operations, which frequently required generations to acquire and perfect is being rapidly being eroded.

1 http://en.wikipedia.org/wiki/Severance_tax

An analysis of the total problem with a complete solution is far beyond the reasonable limits of a short proposal (and may even be impossible at this point), however if the discussion is limited to a single commodity (natural gas), analysis and suggestion of few ameliorative, if not corrective, action items is realizable.

- ➔ Natural gas production from conventional wells in Kansas has been steeply falling for over a decade, from 735,031 MMCF [million cubic feet] from 16,572 wells in 1996 to 311,974 MMCF from 25,213 wells in 2011[2], indicating rapid depletion of conventional gas deposits. This is a non-renewable resource.

- ➔ It appears Kansas is blessed with large gas bearing shale deposits[3], and the new directional drilling techniques are enabling economic recover of this gas. Unfortunately, Most of this gas will be exported at low raw commodity prices, to provide cheap fuel and feed stock for out-of-state and foreign consumption, with little compensation for the depletion of this non-renewable resource, or the creation of additional in-state high value added operations/employment.

A Few Suggested Action Items:

1 Imposition of a very high "severance" tax for the depletion of this non-renewable resource. This tax should be high enough to price most natural gas produced in Kansas out of interstate domestic and international markets. It should be adjusted, so that in conjunction with the following items, neither a in-state surplus nor shortage of natural gas develops. Production quotas may be required to not only stabilize prices, but maximize long term recover of this increasingly valuable resource.

2 The state of Kansas provides significant subsidies, tax credits, etc. from the severance tax, to in-state GTL [gas to liquid] and ethylene conversion operations that they can afford to pay the higher prices for the necessary in-state produced natural/shale gas feed stock.

3 The state of Kansas provides subsidies, tax credits, etc. as necessary to in-state users of the synthetic petroleum, and ethylene, as feed stocks such as in-state petrochemical plants and polyethylene producers such that their products are priced very competitively in the interstate and international markets, thus promoting increased in-state high value added production, with the objective of moving as far up the "value added" chain as possible.

4 The surplus from the severance tax should be accumulated in a legacy fund against the time when the shale gas is also depleted.

2 http://www.kgs.ku.edu/PRS/petro/state.html
3 http://skyways.lib.ks.us/ksleg/KLRD/Publications/Energy_Resources/Jan_mtg/Carr_Newell_Select_Committee_on_Energy_010606_handouts.pdf

5 Analysis should be made of investing some of the severance tax money in the legacy fund in a longer term and more comprehensive energy solution such as a state LFTR [Liquid Fluoride Thorium Reactor] project[4].

6 The anticipated cries of outrage from the international consumers, commodity speculators, and transnational energy companies on the implementation by our policy makers of the new and novel priority "*the well-being of the state and the needs of its' citizens comes before your profits*" should be completely and serenely disregarded.

4 http://www.mcduffee-associates.us/DROP%20BOX/LFTR01.pdf