John Kasich's History of Errors on the Severance Tax
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One would think that after being rebuffed several times by the Ohio General Assembly, Governor John Kasich would admit defeat and end his zealous bid to raise the severance tax. Even more puzzling, one would think given his history of enormous errors on the Utica Shale formation revenue projections, he would have quietly moved on to other tax-shifting pursuits. The severance tax vividly illustrates why Governor Kasich has seen both success and failure in politics; namely, his utter stubbornness on issues.

That stubbornness positively enabled him to propose alternative federal budgets year-after-year that ultimately helped pave the way for a balanced budget when Republicans took control of the U.S. House of Representatives in 1994. His stubbornness also helped to define him as a know-it-all whose legendary lack of listening skills alienates potential allies and undermines his likability. His renewed push for a higher severance tax illustrates both aspects, as it is an effort to "do what he thinks is right" and a direct attack on the character (energy industry patsies) and wisdom (I'm right and they're just wrong) of Republicans in the Ohio General Assembly.

Roughly five years ago, the "Kasich Administration estimate[d] that shale drilling…would generate $23.1 billion by 2016." With his severance tax hike, that revenue would result in "an income-tax cut worth $500 million annually by 2017." How did Governor Kasich's estimates pan out? They weren't remotely close to the actual results.

In Quarter 3 of 2016, the Ohio Department of Natural Resources stated that 1,464 wells produced 3,954,095 barrels of oil and 360,681,356 Mcf of natural gas. Those figures represent a -34% decline in oil and 46% increase in natural gas from one year earlier. Using those figures to estimate a year's worth of production, Ohio's 1,464 wells would have produced 15,816,380 barrels of oil and 1,442,725,424 Mcf of natural gas in 2016.

The Governor and his team made several big mistakes in their 2012 original assumptions. First, Governor Kasich based 95.8% of his model on the Utica Shale being an oil play instead of a natural gas play. As is patently clear from the production figures, Ohio has very little oil and an abundance of natural gas. That single fact eviscerated his model, as it depended upon oil being sold at $90.00 per barrel. Oil sold on average at $38.00 per barrel in 2016, so even Ohio's small oil deposits would only produce 15,817,056 barrels of oil generating $0.6 billion in sales for energy companies – not the nearly $19 billion per year contained in his original model.

Next, as a natural gas play, two forces weakened revenue results. With the proliferation of hydraulic fracturing and horizontal drilling, the energy industry has found enormous natural gas deposits across America and all over the world. In conjunction with warmer winters and tepid economic growth over the last few years, the need for natural gas to heat homes and power the private sector has been weak. This double hit from high supply and low demand drove the prices to historic lows. At just $1.37 per MMbtu (the 2016 average for the Dominion Transmission Index), Ohio's 1,442,725,424 Mcf generated an estimated $2 billion (at 1 Mcf = 1.032 MMbtu) in energy industry sales.

When combined with oil revenues, the energy industry generated roughly $2.6 billion in 2016 sales in Ohio, which is nearly 90% less than Governor Kasich's 2012 estimate of $23.1 billion. This huge discrepancy highlights additional errors related to substantially lower activity in Ohio than expected. He estimated that after four years Ohio would have 4,138 producing wells, with each generating over 89,000 barrels of oil in their first year of production. As noted above, Ohio only has 1,464 active wells, or 65% fewer wells than expected, and those wells are generating a small amount of oil.

Finally, together, all of these errors significantly shrink the severance tax funds that could have been collected for a personal income tax cut from Governor Kasich's 2012 estimate of nearly $500 million by 2017 by over 90 percent.

So, how did Governor Kasich react to all of these errors, with actual revenue only coming in at 10% of his original estimate? Did he have the humility to admit his original proposal was based on very flawed assumptions? Unfortunately, rather than taking the "to err is human" approach and apologizing to the Ohio General Assembly members and the energy companies that he and his team routinely disparaged, he has stubbornly proposed a new tax that is over four times higher than his original proposal.

Ironically, even though Governor Kasich states that the existing severance tax the energy industry already pays is insufficient or "a joke," it generated roughly the same amount of tax revenue in 2016 as his original proposal would have generated had it been adopted. This outcome is due to the numerous errors made by Governor Kasich in his original proposal. With that being the case, one has to wonder if he would have returned to the Ohio General Assembly after securing his initial proposal to increase the severance tax a second time to obtain the tax revenues he seeks as part of his high spending, tax shifting budgets.

Thankfully, the Ohio General Assembly has stood its ground against Governor Kasich over the last four years. With just twenty-one drilling rigs currently working in Ohio, the odds of ever attaining Governor Kasich's original estimate of production are slim and none. As with his pursuit of lower personal income taxes to make Ohio more competitive with other states, Governor Kasich should end his pursuit of a higher severance tax, as our current severance tax rate makes Ohio very competitive with other states, especially Pennsylvania. Higher taxes would chase Ohio's energy industry activity across the border where equal or better oil and natural gas deposits exist. Tax rates really do matter.

The Ohio General Assembly should once again reject Governor Kasich's proposed severance tax hike.

For more information, see the short videos we released on the issue in 2015: Reagan's Wisdom, Drilling for Dollars, and Pennsylvania Versus Ohio.