The Case for Curbing Oklahoma's Oil and Gas Tax Breaks

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Oklahoma's economy relies heavily on oil and gas. The energy sector accounts for nearly ten percent of the gross state economic product and employs almost five percent of the state's nonfarm labor force. Although the Oklahoma economy has diversified to some extent since the oil bust of the 1980s, the state's prosperity remains closely tied to the fortunes of the energy sector.

Oklahoma state government also depends on energy production. In 2010, the $744 million in taxes Oklahoma collected from oil and gas producers amounted to more than ten percent of all tax collections. Taxes on oil and gas are the state's third largest source of revenue, behind only the personal income tax and the sales tax.

But Oklahoma taxes on energy do more than collect revenues. The tax code includes costly subsidies and breaks for certain firms – and the case for maintaining the breaks is very weak.

Tax Breaks for a Flourishing Industry

Understanding how oil and gas companies benefit from tax breaks requires a look at the details. On the face of it, Oklahoma assesses a seven percent gross production tax on oil and gas extraction, except when prices fall below a certain floor. But the tax rules include rebates and credits for specific production methods, including horizontal drilling and deep-well drilling.

- Companies that claim all the breaks can greatly lower their tax rates – to just one percent on production from horizontally-drilled wells, and to four percent for deep wells.

- These generous tax breaks can be claimed for four years after wells first come into production, regardless of the market price of the oil and gas produced.

Originally, these breaks supported new and risky drilling methods. But now the techniques are routine. Ninety percent of the rigs operating today in Oklahoma use horizontal drilling.

Tax breaks drain resources Oklahoma needs to fund its schools, roads and bridges, public safety officers and health care system. Rebates and credits to the industry cost the state $645 million over the last three years, and most of the money went into the pockets of producers routinely using horizontal wells. Without legislative action to change course, the cost of these credits will continue to grow exponentially in coming years.

Curbing Tax Loopholes Won't Harm Oklahoma's Economy

Tax breaks are not a good way to encourage oil and gas production, and careful research shows that curtailing these breaks would not harm Oklahoma's energy sector.

- **State tax preferences do not significantly influence investment decisions.** In a survey of Oklahoma oil and gas companies, state tax incentives were ranked as the least important factor affecting drilling decisions. Estimates of reserves, drilling costs, and commodity prices are more important.

- **Oil and gas tax make little difference in the profitability of drilling.** Even though drilling costs are high, horizontal and deep wells have considerably higher production rates and greater reserves than do vertical wells. The profits are there regardless of tax breaks.

- **Companies won't leave if the tax breaks go away.** With or without tax subsidies, Oklahoma will remain an attractive location to drill due to our ample reserves, existing levels of production, skilled workforce, and established infrastructure.

What the Legislature Should Do

The recent economic downturn has made it more difficult for Oklahoma to meet growing public needs – and of course tax cuts and the continuation of outmoded tax breaks just makes things worse. Support for most vital public services has been cut or held flat each of the past four years, even as the population grows. More children need schooling, our transportation infrastructure is decaying, and federal help is harder to come by.

In this situation, why does it make sense to preserve tax breaks for standard oil and gas production methods? The tax breaks take a bigger and bigger bite out of state revenues, and they have lost whatever economic justification they once had.

Today, Oklahoma's economic growth and job creation would get a bigger boost if special loopholes were closed and all energy producers could make profits and pay taxes on a level playing field. Everyone in Oklahoma also stands to gain if the state uses uniform taxes to raise the revenues needed to help all families, communities, and businesses prosper. In a time of scare resources, it is counterproductive for Oklahoma to make special-interest tax breaks a higher priority than support for roads, schools, and health care.

Legislators need not vote for tax increases. All they need to do is let inefficient tax preferences expire. Currently, the exemptions for horizontal and deep well drilling are due to expire July 1, 2015, and the other special breaks for some energy producers have a sunset date of July 1, 2014.

If exemptions are left in place until the sunset dates, the legislature can take several interim steps to save money and level the playing field. Subsidies could be authorized only when oil and gas prices fall below a reasonable floor. Legislators could also cap annual breaks and tax all drilling methods at the same rate.

The bottom line is straightforward: Oklahoma no longer needs to give our flourishing oil and gas industries tax breaks that have lost their original economic justification. Oklahoma businesses and workers can continue to enjoy the profits and jobs the energy sector creates – and at the same time the state can use fair and efficient taxes to support transportation, education, and health care, the building blocks of future economic prosperity for all.

Read more in David Blatt, "Unnecessary and Unaffordable: The Case for Curbing Oklahoma's Oil and Gas Tax Breaks," Oklahoma Policy Institute, November 2012.