

STATE OF COLORADO

OFFICE OF STATE PLANNING AND BUDGETING

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Bill Ritter, Jr.
Governor
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Director

MEMORANDUM

TO: Title Setting Review Board

FROM: Todd Saliman, Director

DATE: May 5, 2008

SUBJECT: Fiscal Analysis for Proposed Ballot Initiative #71

Ballot Initiative #71 would amend the existing severance tax statutes to raise the top marginal severance tax bracket to 8.5 percent. As the initiative raises the rate of an existing tax, the Governor's Office of State Planning and Budgeting (OSPB) is tasked with calculating the annual amount of the tax increase as specified by TABOR in the following format: "Shall state taxes be increased \$_____ annually...?"

The OSPB has several concerns regarding proposed Ballot Initiative #71. They are outlined below. These concerns relate solely to estimating the fiscal impact of the initiative. It is important to note that the revenue received from this tax increase could vary greatly from the fiscal estimate if passed. In an effort to create a reasonable fiscal estimate, the OSPB consulted with the Department of Local Affairs and Legislative Council Staff economists on the assumptions inherent to this analysis.

- **Severance taxes are extremely volatile.** Energy prices are determined by global supply and demand and are highly sensitive to unforeseeable economic and geopolitical events. The production decisions of firms in Colorado depend on several variables apart from output price, such as interest rates, technological ability and the political climate around drilling in areas of environmental significance. Colorado is a marginal state with respect to energy production, and as such it experiences all of the booms and busts of the industry in an aggravated manner.
- **The fiscal impact of this initiative is not observable *ex post*.** The total value of all transportation, manufacturing and processing deductions is not tracked by the Department of Revenue due to the layout of the severance tax form and limitations of the antiquated tax accounting software system. Therefore, it will not be possible to identify how much of the presumed gain in tax revenue is due to the increased rate and how much results from changes in those deductions or from changes in price or production volume. Therefore, there is no basis for calculating the net revenue gain for TABOR compliance purposes.

Fiscal Analysis

Prices for Colorado's natural gas and oil are a weighted approximation, derived at the point-of-sale at hubs located in surrounding states where Colorado natural gas and oil is priced. These weighted prices are tracked by the Colorado Oil and Gas Conservation Commission and are accessible from their website (<http://oil-gas.state.co.us/>). Colorado is distant from markets, leading to generally lower prices and a "basis differential" from national market gas prices. Ultimately, the basis differential, combined with national market behavior in response to supply and storage capacity, all act to create an extremely dynamic price environment.

Due to the structure of the severance tax in Colorado, forecasting any particular component of the tax is difficult. Although the Title Board requires a single number for its title setting purposes, it is important to stress that the actual fiscal impact of this initiative falls within a range of possibilities. Based on the available data and our understanding of the ballot language, OSPB believes that the fiscal impact of this initiative will be between **\$293.3 million** and **\$332.9 million** above the current law OSPB severance tax forecast for FY 2009-10. It is then the recommendation of OSPB that the Title Board adopt the **\$332.9 million** figure for its title setting purposes.

The OSPB incorporated the component analysis used by the Department of Local Affairs in order to make projections regarding the value of production of oil and gas in FY 2009/10 as the basis for this estimate, incorporating estimates of gross production value, exemptions for small wells, and deductions for transportation, manufacturing and processing costs to indirectly estimate the fiscal impact of the proposed tax change.