THE WALL STREET JOURNAL.
WSJ.com

Kasich's Tax Swap

A creative Ohio plan to trade levies on income and energy.

The U.S. fracking boom is leading an economic transformation, at least in the states with the wisdom to manage it well—c.f., gas-rich North Dakota's unemployment rate of 2.9% versus gas-rich New York's 8.9%. Less noticed is that it can also improve the tax climate, as evidenced by Governor John Kasich's plan to convert Ohio's energy wealth into a tax cut.

The Buckeye State currently imposes a relatively low 20-cent severance tax on oil and three cents for gas. For a barrel of oil, this double dime levy amounts to two-tenths of 1%, an artifact of the era when its resources weren't economically or technologically recoverable. But hydraulic fracturing for natural gas and especially crude is now surging in the Appalachian foothills on the eastern side of the state. Think Youngstown.

Severance taxes are routine in energy states like Texas and Alaska, and they also commonly apply to other nonreplaceable resources like timber and coal. Mr. Kasich wants to modernize the tax structure now that Ohio is becoming an energy producer, but without enlarging government. Annual proceeds would go into a fund devoted to lowering all personal income tax rates dollar for dollar.

The proposal would raise the severance tax to about 2.7% of the market value of oil or gas, depending on the type of well. As the industry matures and production peaks, the tax would on present price trends raise between $459 million and $547 million each year, equivalent to a 5% across-the-board tax cut for each of Ohio's nine brackets.

Yes, nine brackets. Mr. Kasich's plan is welcome relief for a state with some 3,300 taxing jurisdictions, including some library boards and parks departments. This system led to a combined state-local tax burden that for most of the 2000s was among the country's highest, according to the Tax Foundation. Ohio has dropped into the top third after Mr. Kasich's first-year tax reforms, and his tax swap would reduce it further.

The energy levy shouldn't stifle development. A study by Ernst & Young for the Ohio Business Roundtable compared the proposed severance levy to those in seven competing states, including North Dakota, Pennsylvania, Texas and West Virginia. It found Ohio's tax would be 16% lower than the average for wells producing dry gas, 40% for oil. Including all energy taxes, Ohio would be 40% and 48% lower than the average, respectively.

The plan is controversial in Ohio's Republican-controlled legislature and among some Tea Partiers, and as with any tax increase the danger is that some future government will renege, pocket the revenue and return to raising income taxes. But the energy levy is sure to increase if production booms, and the Kasich formula ensures the money isn't spent on new programs. Meantime, lower rates on income and capital investment are a net plus for economic growth.

Another virtue of the Kasich plan is to increase public confidence in energy exploration by giving voters a stake in, and a direct share of, its economic benefits. Political opposition to fracking has led some states to squander this incredible natural gift. Attn: Andrew Cuomo. Mr. Kasich may have hit on a strategy to help prevent the New York Governor's model of nonexploration from going national.

Printed in *The Wall Street Journal*, page 9

A version of this article appeared July 25, 2012, on page A14 in the U.S. edition of The Wall Street Journal, with the headline: Kasich's Tax Swap.