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Political Perspectives on State and Local Taxation of Natural Resources

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POLITICAL PERSPECTIVES ON STATE AND LOCAL TAXATION OF NATURAL RESOURCES*

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It is in the political realm that the issues of federalism raised by state and local taxation of natural resources have captured the popular imagination. Political rhetoric from the Northeast and Midwest invokes images of "blue-eyed Arabs" in the energy-rich states exploiting their advantages of location to exact tribute from shivering energy consumers in New York and Chicago. Political oratory from resource-producing regions responds with visions of scarred landscapes, abandoned mining towns, and irretrievable resource losses for which taxes are but small recompense. And forebodings of a second War Between the States over state taxation of natural resources preoccupy the news media.

It is in the political realm as well that these conflicts will have to be resolved, if they are to be resolved at all. Whatever possibility may once have existed for disposing of them through the judicial process has been foreclosed by the Supreme Court's decision in *Commonwealth Edison Co. v. Montana*,[1] which permanently removed them from its docket. The Court instead consigned their resolution to the political process "by state legislatures in the first instance and, if necessary, by Congress, when particular state taxes

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[1] 453 U.S. 609 (1981). In *Commonwealth Edison*, the Court upheld Montana's 30% severance tax on coal produced in the state over objections that the levy violated the commerce and supremacy clauses. *Id.* at 614. For a discussion of the case, see Hellerstein, *Constitutional Limitations on State Tax Exportation*, 1982 AM. B. FOUND. RESEARCH J. 1, 45-59; McGrath & Hellerstein, *Reflections on Commonwealth Edison Co. v. Montana*, 43 MONT. L. REV. 165 (1982).

are thought to be contrary to federal interests."[2]

This article investigates the questions that have dominated the political debate over state and local taxation of natural resources in the federal system. It seeks to identify areas of consensus, clarify points of disagreement, and examine proposals that could provide a basis for reconciling the competing concerns. Part I briefly considers the issues as they arise within the framework of the individual state. Part II addresses interstate and interregional conflict. Part III turns to the dialogue over the role, if any, that the federal government should play in mediating the disputes.

I. Intrastate Politics

With all the attention that has been directed to the specter of interstate economic warfare over natural resource taxation, it is easy to forget that the state legislation underlying the controversy is itself the product of fierce political battles waged in individual states. This section examines the intrastate struggles over natural resource taxation in three illustrative cases.

The widespread impression that resource-rich states are political monoliths acting without internal opposition to maximize their resource tax revenue is tempered, if not belied, by the facts. As the Governor of North Dakota described the political controversy over his commitment to a substantial coal severance tax:

> We have been opposed by the energy industry; we have been admonished by special interest groups in our own state who express concern that if the severance tax goes too high energy development will be stymied and North Dakota will lose great economic opportunities; we have been cajoled by our own energy consumers who worry that their industries, businesses and residences will have to absorb the cost of the severance tax through higher utility bills.[3]

The history of North Dakota's coal severance tax legislation reflects these pressures. In 1973, the legislature, with strong industry support, enacted a five cents per ton coal severance tax to become

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[2] *Commonwealth Edison*, 453 U.S. at 628.

[3] Link, *Political Constraint and North Dakota's Coal Severance Tax*, 31 Nat'l Tax J. 263, 263 (1978).

effective in July 1975.[4] The Governor vetoed the bill on the ground that it was "unrealistically low"[5] and because of the postponement of the levy's effective date. In 1975, the Governor proposed instead a 33⅓% coal severance tax.[6] The legislature enacted a compromise bill of fifty cents per ton, with a one cent per ton increase for every three point rise in the wholesale price index.[7] The base rate was increased to sixty-five cents in 1977 and to eighty-five cents in 1979, where it stands today,[8] still far below the value-based rate that the Governor proposed in 1975.

In Minnesota, political and economic pressures in the state combined to limit the power of the legislature to tax some of its natural resources. The demands of two world wars had depleted the supply of iron ore from Minnesota's Mesabi range, and in the 1940's the iron mining industry undertook a world-wide search for alternative sources of supply.[9] Although Minnesota's iron ore industry still provided 83% of the nation's requirements in 1950, this percentage had fallen to 42% by 1960.[10] Moreover, the quality of Minnesota's iron ore (that is, its natural iron ore content) was lower than that of competing foreign ores.

In addition to its iron ore, however, Minnesota possessed vast reserves of taconite, rock that contains iron-bearing particles but is not merchantable as iron ore in its natural state and requires extensive processing to make it merchantable.[11] Although development of Minnesota's taconite resources had become economically feasible, the state's historical pattern of heavy mineral taxation was perceived as an obstacle to further development of its taconite industry. In 1961, a proposed constitutional amendment designed to create a healthier tax climate in the state by limiting taxes on taconite was introduced into the Minnesota Legislature. The liberal majority defeated the amendment.[12]

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[4] *Id.* at 264.

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] N.D. CENT. CODE § 57-61-01 (1983).

[9] Weaton, *The History of Minnesota Mining as Influenced by Taxation*, in SYMPOSIUM ON MINE TAXATION 7-26 (1969).

[10] *Id.; see also* Hamilton, *Taxes and Taconite: Iron Ore Tax Legislation in the Lake Superior Region*, 7 NAT'L TAX J. 342 (1954).

[11] MINN. STAT. ANN. § 298.23 (West 1972).

[12] Weaton, *supra* note 9, at 7-27.

The proposal for a taconite amendment soon became a major political issue in Minnesota. Conservatives argued that it was necessary to attract the taconite industry to the state. Liberals replied that such a restraint on the state's tax power would be selling its "birthright to its natural heritage."[13] In 1963, a conservative legislature adopted a proposed taconite amendment, and the following question was put to the voters of the state: "Shall the constitution of the State of Minnesota be amended by . . . prohibiting the amendment, modification, or repeal for a period of 25 years of [l]aws . . . relating to the taxation of taconite and semitaconite, and the facilities for mining, production, and beneficiation thereof . . .?"[14] The liberal elements in the state represented by the Democratic Farm Labor Party initially opposed the amendment until Senator Hubert Humphrey induced the Party to change its stand.[15] With both liberal and conservative backing, the amendment passed with a more than 80% majority.[16] Within twenty-four hours after the amendment's approval, the United States Steel Corporation and the Hanna Mining Company announced that new taconite plants would be under construction within two weeks.[17] Taconite has since become Minnesota's commercially most significant mineral. In 1981, Minnesota produced 49.4 million tons of taconite yielding $12.7 million in occupation taxes; it produced a mere 1.7 million tons of iron ore yielding $1.2 million in occupation taxes.[18]

In Georgia, political opposition has successfully prevented the enactment of any production tax on the state's $800 million mineral industry.[19] In 1976, the State House of Representatives passed a bill imposing a one dollar per ton severance tax on coal, but mining interests defeated the bill in the State Senate.[20] A legislative

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[13] *Id.* at 7-28.

[14] *Id.* at 7-29; see MINN. CONST. art. X, § 6 for the text of the amendment.

[15] Weaton, *supra* note 9, at 7-28.

[16] *Id.*

[17] *Id.*

[18] MINERALS TAX DIV., MINN. DEP'T OF REVENUE, MINNESOTA MINING TAX GUIDE 11 (1982). During the recession-plagued year of 1982, these figures declined by approximately 50%; Minnesota produced 23.4 million tons of taconite yielding $6.2 million in occupation taxes and a mere 789,000 tons of iron ore yielding $719,000 in occupation taxes. MINERALS TAX DIV., MINN. DEP'T OF REVENUE, MINNESOTA MINING TAX GUIDE 20 (1983).

[19] Atlanta J., Nov. 21, 1983, at 1A, col. 3; *id.* at 6A, col. 1.

[20] Atlanta Const., Oct. 4, 1983, at 1A, col. 3.

study subcommittee in 1983 held hearings on a proposal to place a severance tax on the substantial nonrenewable mineral resources in the state.[21] The state produces 90% of the United States' kaolin, a white clay used in paper coating, automobile tires, paint, and the stomach medication Kaopectate.[22] At the hearings, officials of the $500 million kaolin industry opposed the severance tax, maintaining that they already paid sufficient state property, corporate, and sales taxes and that a severance tax would severely reduce their profitability. They stated that kaolin is not a glamorous mineral like oil and gold, is not essential to any product, and faces competition from less expensive minerals.[23] It was not industry opposition, however, that killed the proposal before a bill was even drafted. The committee cancelled its last scheduled hearing after the Governor, who was elected on a pledge not to raise taxes, told committee members he would veto any tax increase.[24] Thus, Georgia remains one of the few states with substantial mineral resources that has no production tax.

The specific issues at stake, the varying configuration of political forces involved, and the different economic circumstances of particular states make generalizations about the intrastate politics of natural resource taxation hazardous. One point is clear, however. The political opposition to natural resource taxes in most states is more than token, and stories similar to those recounted about North Dakota, Minnesota, and Georgia could be told about other states. In 1983, for example, increased oil production taxes were proposed in twenty states and were defeated in well over half of them.[25]

II. The Politics of Interstate Jealousy

Despite substantial internal political opposition, many resource-rich states in recent years have increased the scope and level of their taxes on natural resources. This part examines the interstate conflicts that these taxes have generated.

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[21] Atlanta J., Nov. 21, 1983, at 1A, col. 3.

[22] *Id.* at 6A, col. 2; *id.*, Oct. 2, 1983, at 1A, col. 2.

[23] Atlanta Const., Nov. 22, 1983, at 12A, col. 2.

[24] Telephone interview with Representative Bill Dover, Chairman of the House Ways and Means Subcommittee on Mineral Taxation (Sept. 26, 1984).

[25] Highway Users Fed'n, 1983 Legislative Action 3 (1983).

A. *The Scope of the Problem*

The public debate over the regional issues raised by state taxation of natural resources has been directed largely at production taxes. To be sure, concern has been expressed over efforts of some resource-consuming states to single out the energy industry in their income[26] and gross receipts[27] taxes. But the issues of interstate conflict that they raise have not been a subject of intense national scrutiny, even though they have caught the eye of the organized bar. Property taxes, despite the unique features of their application to natural resources, have likewise been ignored in the political dialogue, perhaps because they are perceived as inherently local or perhaps because the issues of interstate conflict they raise are poorly understood. The ensuing discussion is, therefore, addressed primarily to production taxes.

B. *Shared Assumptions*

Although the acrimonious exchanges between representatives of producing and consuming states might lead one to wonder whether they share any common ground, there are several fundamental principles that command universal support. First, no one questions the right of producing states to single out natural resources for special taxes. The diversity of the individual states' tax structures has been characteristic of the American tax system from the beginning, and it is taken for granted that it will remain that way. Second, no one questions the right of the producing states to recover the reasonable costs that the extractive industries impose on the state. These include not only the costs of schools, roads, and hospitals, but also the environmental and social costs that natural resource development may impose on the state. Finally, no one questions that those who benefit from natural resource extraction should bear the burden of the costs it generates, even if those beneficiaries are not residents of the taxing state.

C. *Sources of Conflict*

The list of shared assumptions is short, especially by comparison

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[26] *See, e.g.*, Adams, *State "Oil-Only" Taxation: New Dangers in an Energy-Troubled Society*, 31 OIL & GAS TAX. Q. 413 (1982).

[27] Bloss, *Gross Receipts Taxes: Toward Parity in State Energy Industry Taxation*, 32 AM. U.L. REV. 873 (1983).

to the list of issues that divide the producing and consuming states. For purposes of exposition, it will be useful to distinguish between disagreements over premises and disagreements over facts.

1. Conflicts Over Premises.

a. Should a natural resource production tax be limited to the reasonable costs imposed by production activities on the state? Perhaps the most fundamental theoretical issue separating consuming and producing states is whether a natural resource production tax should be limited to the reasonable costs imposed on the state by production activities. Although the Supreme Court in *Commonwealth Edison* resolved the issue in favor of the producing states as a matter of constitutional law,[28] it did nothing to solve the political question. In contending that resource production taxes are "excessive,"[29] "exploitative,"[30] and "exorbitant,"[31] consuming states' spokesmen implicitly or explicitly rely on the proposition that some level of taxation would not inspire such epithets. Invariably this level is one that reflects a "fair return"[32] or one reasonably related to the "needs"[33] of the producing state, a standard defined in terms of the costs attributable to natural resource development. As the Mayor of Minneapolis put it in congressional testimony on coal severance taxes: "Our basic belief is that the levels of the severance tax are in excess of what is required to deal with the local impact of coal mining."[34] Indeed,

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[28] *See supra* note 1.

[29] *See, e.g., Coal Severance Taxes, 1980: Hearings on H.R. 6625, H.R. 6654, and H.R. 7163 Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce*, 96th Cong., 2nd Sess. 19 (1980) (statement of Donald W. Riegle, Jr., U.S. Senator from Michigan) [hereinafter cited as *1980 House Coal Severance Tax Hearings*].

[30] *See, e.g., id.* at 12 (statement of Samuel L. Devine, U.S. Representative from Ohio).

[31] *See, e.g., Coal Severance Tax Limitations, 1982: Hearings on H.R. 1313 Before the Subcomm. on Fossil and Synthetic Fuels of the House Comm. on Energy and Commerce*, 97th Cong., 1st & 2nd Sess. 19 (1982) (statement of Sam Gibbons, U.S. Representative from Florida) [hereinafter cited as *1981-82 House Coal Severance Tax Hearings*].

[32] *See, e.g., 1980 House Coal Severance Tax Hearings, supra* note 29, at 25 (statement of James L. Oberstar, U.S. Representative from Minnesota).

[33] *See, e.g., Fiscal Disparities, Part 2, The Commerce Clause and the Severance Tax, 1982: Hearings Before the Subcomm. on Intergovernmental Relations of the Senate Comm. on Governmental Affairs*, 97th Cong., 1st Sess. 17 (1982) (statement of William P. Rogers, Attorney, Rogers & Wells) [hereinafter cited as *1982 Senate Fiscal Disparities Hearings*].

[34] *Coal Severance Tax, 1980: Hearing on S. 2695 Before the Senate Comm. on Energy*

spokesmen from consuming states consistently point to the allocation of production tax revenues to trust funds earmarked for future generations as irrefutable evidence that the production tax exceeds any justifiable norm.

Producing states' spokesmen reject this premise. In response to the Mayor of Minneapolis, the Governor of Montana replied: "I don't subscribe . . . to the arguments of Mayor Fraser that the only revenues we should derive from our severance tax is just to take care of the damage done to the State . . . . Every State that imposes a severance tax also gets money for general support of government."[35] Producing state representatives claim that they are entitled to impose production taxes with the same freedom that they impose other taxes and that they may use the revenues not only for the general support of government but also for future generations who will populate the state when the resource is gone.

If framed as a general question of the appropriate limitations on state taxation in the federal system, the producing states have the better of the argument. One would be hard-pressed to find in the broad assumptions of economic and political unity underlying the federal system any commitment to the benefit principle[36] as a restraint on state tax power. This conclusion is reinforced when one recognizes the importance to the states' autonomy of the ability to fashion their tax structures to accommodate individual circumstances. As Alexander Hamilton, writing in *The Federalist*, declared: "[T]he individual States should possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants . . . . I affirm that (with the sole exception of duties on imports and exports) they would . . . retain that authority in the most absolute and unqualified sense."[37]

But one need not frame the question so generally. One might ask specifically whether there is something distinguishable about special taxes on natural resources that might warrant the application of the benefit principle as a restraint on such taxes even though, as a general policy, one would not impose a like restraint on broad-

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and Natural Resources, 96th Cong., 2nd Sess. 173 (statement of Donald M. Fraser, Mayor of Minneapolis) [hereinafter cited as *1980 Senate Coal Severance Tax Hearings*].

[35] *Id.* at 235 (statement of Thomas L. Judge, Governor of Montana).

[36] The benefit principle is the principle that taxes should reflect the benefits the taxpayer receives in public services.

[37] THE FEDERALIST No. 32, at 241 (A. Hamilton) (B. Wright ed. 1961).

based property, income, and sales taxes or on special excises levied on such items as motor fuel, alcohol, and tobacco. An answer to that question depends on the answer to a series of other questions, which are considered below.

b. Natural resources and the natural heritage theory: whose birthright? An early predicate for the imposition of production taxes in addition to the general ad valorem property tax on natural resources was the notion that natural resources constituted part of the state's natural heritage.[38] This was said to justify the state's exaction of a special levy on behalf of the states' citizens whose collective birthright these resources were thought to represent. Although this theory has been discredited on its own terms,[39] it has not lost its force in the political arena. In the context of interstate conflict over state taxation of natural resources in our federal system, however, it is by no means clear which way the natural heritage theory cuts.

In most nations, the sovereign retains underground mineral rights with private parties owning only the surface rights associated with mineral lands.[40] In the United States, by contrast, private ownership of the surface typically carries with it a correlative claim to any minerals lying beneath the surface.[41] Nevertheless, except for the area of the original thirteen colonies, Texas, and Hawaii, the federal government once owned all of the land within its present borders.[42] Although it has given away much of the public domain to private owners and, to a lesser extent, the states, the federal government still retains title to about one-third of the nation's land area, and it owns an additional sixty million acres of reserved mineral interests in the Western states.[43] Furthermore, the federal government has a controlling interest in the natural resources of the outer continental shelf,[44] an area of approximately

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[38] *See* W. HELLERSTEIN, STATE AND LOCAL TAXATION OF NATURAL RESOURCES IN THE FEDERAL SYSTEM chapter 2 (forthcoming from Section on Taxation, American Bar Association, 1985).

[39] *Id.*

[40] Ashworth, *Continuity and Change in the U.S. Decision-Making Process in Raw Materials*, in 1 NATURAL RESOURCES IN U.S.-CANADIAN RELATIONS 70 (E. Beigie & A. Hero eds. 1980).

[41] *Id.*

[42] G. COGGINS & C. WILKINSON, FEDERAL PUBLIC LAND AND RESOURCES LAW 1 (1981).

[43] *Id.* at 2.

[44] United States v. California, 332 U.S. 19 (1947).

860,000 miles extending from three miles offshore seaward to the edge of the geographic shelf.[45] The states, by contrast, with the exception of those noted above, own only those lands (and mineral rights) that have been granted to them by the federal government or acquired by them independently.[46]

All this has some rather interesting implications for the relationship of the natural heritage theory to state natural resource taxation. To the extent that the state is taxing resources that are owned by the federal government and leased to private enterprise, the natural heritage theory supports a *national* rather than a state claim to collective ownership of the resource. This point has not been lost on spokesmen from resource-poor states who claim that producing states' taxing schemes are attempting to appropriate for their own citizens a resource that belongs to the entire nation. Thus, with respect to federally-owned minerals, the natural heritage theory lays the foundation for an externally-imposed limit on state natural resource taxation, perhaps related to the governmental costs attributable to resource development. The counterargument of producing-state spokesmen that these minerals have been leased to private interests and therefore no longer carry a federal label does not undermine this position. After all, the natural heritage theory is only an inchoate claim to a collective popular interest in natural resources that is rooted in notions of sovereignty over such resources.[47] In this context, that sovereignty plainly must be regarded as more federal than state. Indeed, if the federal government had not leased its interest to private parties, the state would have been in no position to tax it in the first place.

With respect to privately-owned mineral lands acquired in fee from the federal government, the implications of the natural heritage theory are less clear. Although the birthright was initially a national one, the state might assert that, once property within its borders is owned privately, it possesses all the attributes of sovereignty with respect to such property, including the representative one of claiming the people's collective birthright. These assertions of sovereign interests are somewhat attenuated, however, and may be accepted more readily as assertions of traditional police power

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[45] G. COGGINS & C. WILKINSON, *supra* note 42, at 2.

[46] *Id.* at 45-56.

[47] G. ELIAN, THE PRINCIPLE OF SOVEREIGNTY OVER NATURAL RESOURCES 1-26 (1979).

over property within the state's jurisdiction.

With respect to privately-owned lands in the original thirteen states, Texas, and Hawaii, the state would be in a position similar to the federal government, except to the extent that private parties had directly succeeded to ownership interests of foreign sovereigns. Even with respect to those interests, however, the state might claim it succeeded to the sovereign claims of the foreign power to its natural resources, but here it might encounter a conflicting assertion of sovereignty by the federal government.[48] And if one wanted to pursue the natural heritage theory to its logical conclusion, one would have to acknowledge the claims of the Indian tribes, a point that is more than academic.[49]

In sum, if the natural heritage theory proves anything, it proves that there is some basis for limiting state production taxes in the West where the nation can assert a common claim to hundreds of square miles of resource-rich lands that lie in federal ownership. On the other hand, the theory has uncertain implications for privately-owned lands originally acquired from the federal government, and it has some peculiar and complex implications for the original thirteen states, Texas, and Hawaii.

c. *State natural resource taxes in the federal system: what are the criteria of interstate equity in state tax policy?* Most political questions raised by state natural resource taxation would fit comfortably under this rubric, and it was chosen in part for that reason. Literally hundreds of questions, many of them related or overlapping, have arisen in the course of efforts to define interstate equity in state natural resource taxation. These questions have been debated in congressional hearings, in conferences of state officials, and in the national news media. This section attempts to distill these debates without stripping them entirely of their color.

A common charge emanating from states without significant resource endowments is that the resource-rich states are "profiteering"[50] from their happy circumstances with a "beggar-thy-neigh-

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[48] *Cf.* United States v. Maine, 420 U.S. 515 (1975) (United States has sovereign rights over the offshore seabed underlying the Atlantic Ocean to the exclusion of the 13 Atlantic coastal states).

[49] *See Symposium on Indian Law*, 62 OR. L. REV. 3 (1983).

[50] *1980 House Coal Severance Tax Hearings*, *supra* note 29, at 255 (statement of Thomas A. Tauke, U.S. Representative from Iowa).

bor"[51] policy inconsistent with the tenets of political and economic unity on which the federal system was founded. Many of these assertions are merely a restatement, without more, of the proposition considered above,[52] namely, that citizens of resource-poor states may be asked to pay their fair share of the costs of producing the resources they consume but they ought not be charged billions of dollars over a period of years to support general governmental programs for citizens in other states. Some of the contentions go further, however, and attempt to provide a substantive rationale for limiting the producing states' tax power.

An initial argument is that resource-rich states should not be permitted to exploit unreasonably the advantages that accrue to them solely by virtue of their geologic good fortune. The argument has historical support if one is willing to analogize between different types of locational advantages. As James Madison explained in his preface to the debates of the Constitutional Convention of 1787, which detailed various sources of dissatisfaction with the Articles of Confederation:

> The other source of dissatisfaction was the peculiar situation of some of the States, which having no convenient ports for foreign commerce, were subject to be taxed by their neighbors, thro whose ports, their commerce was carryed on. New Jersey, placed between Phila. & N. York, was likened to a Cask tapped at both ends: and N. Carolina between Virga. & S. Carolina to a patient bleeding at both Arms. The Articles of Confederation provided no remedy for the complaint: which produced a strong protest on the part of N. Jersey; and never ceased to be a source of dissatisfaction & discord, until the new Constitution, superseded the old.[53]

More than twenty years ago, the Editors of the *Harvard Law Review* seized on the analogy, likening a severance tax to "a tollgate lying athwart a trade route . . . [that] conditions access to natural resources."[54] Northeastern and Midwestern political representa-

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[51] *Id.* at 277 (statement of Irwin M. Stelzer, President, National Economic Research Associates).

[52] *See supra* text accompanying notes 29-34.

[53] Madison, *Preface to Debates in the Convention of 1787*, in 3 THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 542 (M. Farrand ed. 1966).

[54] *Development in the Law—Federal Limitations on State Taxation of Interstate Busi-*

tives continue to sound that theme today in suggesting that excessive taxes on natural resources violate first principles of federalism.

In response, producing-state spokesmen echo the Supreme Court's conclusion that the Constitution does not "giv[e] residents of one State a right of access at 'reasonable' prices to resources located in another State."[55] They contend that "[i]t would be very bad politics . . . to grant the residents of one State, or one part of the country, the right to control the terms and conditions of resource development and depletion in their sister States."[56] They observe that the Framers adopted the import-export clause and the related duty of tonnage prohibition—the only explicit limitations on state tax power in the Constitution[57]—to deal with the problem raised by Madison. And they claim that vague considerations of federalism do not warrant extending that principle to other special advantages the states may enjoy. Moreover, they point out that the argument may prove too much. If the economic and political assumptions underlying federalism impose a benefit-related restraint on the states' power to tax activities associated with fortuitous locational advantages, it would cut a broad swath across state and local tax structures when one includes in the calculus such advantages as access to transportation, water, sunlight, and perhaps even skilled labor.

Retaliation, according to advocates from consumer states, is another likely consequence of unbridled natural resource taxation and one that in their view demonstrates the irreconcilability of such unrestrained tax power with the values underlying the federal system. The Northeast-Midwest Institute, the research arm of a congressional coalition representing that region, has warned of "a strong possibility that a dangerously divisive [severance] tax warfare will break out, with each state striving to tax a precious commodity just to preserve its competitive position."[58] An Iowa congressman reported that "there is talk of a severance tax on corn,

ness, 75 HARV. L. REV. 953, 970 (1962).

[55] Commonwealth Edison Co. v. Montana, 453 U.S. 609, 619 (1981).

[56] *1982 Senate Fiscal Disparities Hearings*, *supra* note 33, at 81 (statement of Malcolm Wallop, U.S. Senator from Wyoming).

[57] *See* U.S. CONST. art. I, § 9, cl. 5-6.

[58] T. COCHRAN & J. PRESTIDGE, THE UNITED AMERICAN EMIRATES: STATE REVENUES FROM NON-RENEWABLE ENERGY RESOURCES 16 (1981).

soybeans, and other grains."[59] And Governor Brendan Byrne of New Jersey is said to have suggested in jest that "the Northeast can place a severance tax on Ivy League educations."[60]

However acute may be the theoretical dangers of the "economic civil war"[61] conjured up by such speculation, they are more a function of wishful thinking than of practical political concern. If Iowa were to impose a severance tax on corn, it would have no appreciable effect on the price of corn which farmers from Kansas and Nebraska would presumably continue to supply at the market price. The result would be an effective reduction in the income of Iowa farmers and, ultimately, of the value of corn land in Iowa. The enactment of a corn severance tax by Iowa would therefore be the legislative equivalent of shooting oneself in the foot. Similar consequences would ensue from Detroit's imposition of a "severance" tax on automobiles. This is not to suggest, however, that if permitted to tax without restraint (other than that imposed by the Constitution) consuming states might not identify some levies with which they can effectively retaliate against their sister producing states. Indeed, one can argue that they already do.[62]

In addition to arguments resting on the premise that the preservation of the Union depends on restraining "rapacious"[63] resource-rich states from acting in their narrow self-interest, a more positive strain of argument stresses the collective self-interest of the nation. It relies on the premise well expressed by Justice Benjamin Cardozo that our "political philosophy . . . was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division."[64] Even assuming that producing states have a legitimate concern in providing for future generations, the question, from the standpoint of interstate equity, becomes

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[59] *1981-82 House Coal Severance Tax Hearings, supra* note 31, at 14 (statement of Thomas J. Tauke, U.S. Representative from Iowa); *see* Note, *Severance Taxes and Soil Depletion: Is Grain a Natural Resource Amenable to Severance Taxation?*, 31 DRAKE L. REV. 621 (1981-82).

[60] *1981-82 House Coal Severance Tax Hearings, supra* note 31, at 22 (statement of Sam Gibbons, U.S. Representative from Florida).

[61] *Id.* at 14 (statement of Anthony T. Moffett, U.S. Representative from Connecticut).

[62] *See supra* pp. 39-41.

[63] *1981-82 House Coal Severance Tax Hearings, supra* note 31, at 21 (statement of Sam Gibbons, U.S. Representative from Florida).

[64] Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 523 (1935).

whether "the present generation of people in Michigan and Illinois and Minnesota and Texas . . . [should] provide a trust fund for future generations of Montanans."[65] More generally, the question is whether the federal system can or should tolerate the massive shifts of wealth from one region to another that such tax policies will induce.[66]

Finally, the issue of exhaustibility, which has been a central theme in the historical development of natural resource production taxes, retains its significance in contemporary interstate conflicts over such taxation. Defenders of producing states' severance tax policies constantly remind us that their resources are a "one time harvest,"[67] which, when mined, will be lost forever. They vow not to repeat the mistakes of the past,[68] when "the state was exploited by mining interests who removed enormous amounts of wealth from the state, leaving little but the ruins of the Copper Kings' Mansion, and a shrunken boom town."[69] They also point to Appalachia for contemporary illustrations of the failure to provide adequately for the departure of the natural resource industry.

Although advocates for consuming-state interests are not wholly unsympathetic to these considerations, they counter that the producing states ignore the benefits of economic development that will accrue to the states from exploitation of their resources. As Congressman Philip Sharp of Indiana stated:

> We understand the costs. We understand the reclamation problems, the development costs, but we also know that enormous wealth comes with that. There are new incomes that pay income taxes. There is new value to land that pays automatically without the government having to make the tough political decisions of raising the tax rates. It is not as if it is a one-way proposition and the only way it can be corrected is by taxing the coal shipped out of State.[70]

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[65] *1980 House Coal Severance Tax Hearings, supra* note 29, at 94 (statement of William P. Rogers, Attorney, Rogers & Wells).

[66] *See infra* text accompanying notes 96-119.

[67] Link, *supra* note 3, at 264.

[68] *1980 House Coal Severance Tax Hearings, supra* note 29, at 374 (statement of Dorothy Bradley, National Committeewoman, Montana Democratic Party).

[69] *Id.*

[70] *Id.* at 247 (statement of Philip R. Sharp, U.S. Representative from Indiana).

Moreover, some spokesmen for the industrial regions have questioned the very concept of a trust fund to tide the state through future bad times when its economic base may have lost its lustre:

> Should Detroit have established a trust fund, *in advance*, to mitigate the boom-town effects of unemployment and urban blight that are accompanying the failing automobile industry . . .? The answer of course is "no." A "contingency fund" in advance of unknown environmental or social impact costs suggests that we don't have adequate mechanisms at the national level to deal with these contingencies when they arise.[71]

2. *Conflicts Over Facts.*

a. *What are the costs reasonably attributable to natural resource production in the state?* Few questions stir more bitter controversy than those bearing on the scope and magnitude of the costs imposed on producing states by natural resource development. Consuming-state spokesmen, armed with economic studies, contend that such costs amount to only a small fraction of the enormous tax revenues that the producing states collect from natural resource production. Even while protesting the relevance of the inquiry, producing-state representatives fiercely dissent from these assessments. Without rehearsing every point and counterpoint in this dialogue, the following discussion seeks to identify the principal issues that divide the contending parties over what constitutes a fair estimate of the costs that natural resource development imposes on a state.

First, there is the pedestrian but often critical question of assigning a dollar figure to costs that everyone agrees should be included in the analysis. An economic consulting firm hired by the plaintiffs in *Commonwealth Edison* attempted to measure in dollars the local impact costs of coal mining in Montana. It concluded that these impact costs amounted to two cents per ton—a "fact" that was said to demonstrate the excessiveness of Montana's tax which in some cases was 100 times the amount of such costs.[72] A state senator from Montana did the arithmetic differently: "Based

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[71] *Id.* at 290 (statement of Irwin M. Stelzer, President, National Economic Research Associates).

[72] *1980 Senate Coal Severance Tax Hearing*, *supra* note 34, at 417, 420 (statement of Sally Hunt Streiter, Vice-President, National Economic Research Associates).

on five years of actual experience in Montana and figures used by the Congressional Budget Office . . . I have compiled the actual costs of the limited impacts [the economic consulting firm] attempted to measure. They understated the impacts by a factor of 53 to 1."[73]

Second, there is the question of what effects one would measure in assessing the costs that natural resource production imposes on a state. In criticizing the study that the *Commonwealth Edison* plaintiffs ordered, the Montana Senator contended that it did not even "include any impacts for mine mouth generating systems, conversion facilities, synthetic fuel plants, construction work on both plants and mines, and roads."[74] A spokeswoman for the consulting firm disagreed,[75] but who is right is not the point. It is rather that in any debate over the measurement of impact costs, disputes will invariably arise over which costs should be embraced within the determination and perhaps over whether they have been accounted for at all.

Third, the claim is often made that producing states cannot justify production taxes to compensate them for the environmental damages allegedly caused by natural resource development because producers are already required by federal and state law to minimize environmental impacts and ultimately to restore the land to its original condition. As one witness testified before Congress:

> To open and operate a mine in Montana, thirty environmental laws must be complied with, and mining plans must be submitted and approved before mining begins . . . . If any damage to the environment is suspected, mining plans are rejected. State mine inspectors, all environmental scientists, visit the mines every two weeks; federal inspectors come quarterly. Mines are required to install weather stations with air monitoring devices, stream gauging stations, and observation wells to monitor water quality. The soil is tested repeatedly by the U.S. Forest Service. If it appears that mines will threaten existing wells, plans are disapproved. If a well on someone's property is destroyed, the mining company is re-

[73] *Id.* at 329 (statement of Thomas E. Towe, Montana State Senator).

[74] *Id.*

[75] *Id.* at 433-35 (statement of Sally Hunt Streiter, Vice-President, National Economic Research Associates).

> quired to dig another. Mine operations must reclaim the land mined within two years after completion of mining activities. In 1979, reported reclamation costs averaged $5,000 per acre . . . . Two federal taxes levied on coal production provide funds that are funnelled back to states to offset potential deleterious effects of mineral production. The Surface Mining Control and Reclamation Act of 1977 levies a 35 cent tax on each ton of strip-mined coal and 50 percent of this money is returned to the state from which it originated for the purpose of reclaiming strip-mined land. An additional 20 percent of fees may become available to states under the Rural Abandoned Mine Program.[76]

As the witness succinctly concluded: "It appears that all of the *known* potential environmental damages that may occur as a result of strip mining have been subjected to a regulatory climate that has left 'no stone unreturned.' "[77]

The predictable rejoinder from defenders of the producing states' tax policies is that the *unknown* and presently *unknowable* environmental damages of mineral extraction are potentially of greater magnitude than those we can currently identify. It is responsible fiscal policy, they maintain, to provide for these eventualities now before the source of revenues to deal with the problems has been exhausted. "[N]o one really knows the true cost of development," declared Governor Ted Schwinden of Montana. "No one can calculate the impact of soil loss, of erosion, of loss of habitat for wildlife."[78]

The point is not limited to environmental costs. "No one can put a real price tag on the social costs that are associated with the development of the Powder River Basin, and the other mineral fields in the West. It is the same with the boom town atmosphere and increases in crime and domestic problems."[79] The countercharge is that "the tears shed by some legislators, for boom towns, are croco-

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[76] *1980 House Coal Severance Tax Hearings, supra* note 29, at 286-88 (statement of Irwin M. Stelzer, President, National Economic Research Associates).

[77] *Id.* at 288.

[78] *1981-82 House Coal Severance Tax Hearings, supra* note 31, at 47 (statement of Ted Schwinden, Governor of Montana).

[79] *Id.*

dile tears"[80] because most of the revenues from state production taxes go into the state's general fund. Western state spokesmen insist, however, that the states through their general funds will inevitably bear the brunt of the massive burden of "human reclamation"[81] that will be thrust upon them when the mines are depleted. And, like Wyoming's Senator Wallop, they ask: "Who makes the judgment that it exceeds legitimate social costs? Have you been to Wyoming and seen those social costs?"[82] Furthermore, if production taxes are objectionable both because they *are* earmarked for the needs of future generations and because they *are not* earmarked for the local impact needs, the freedom of producing states to shape their own fiscal policy would be narrow indeed.

b. To what extent are state production taxes exported to nonresident consumers? The battle lines for the political debate over state tax exportation have been drawn in familiar fashion. Consuming-state advocates routinely assume that natural resource production taxes are borne by the ultimate consumers of those resources. The complaint of Senator Bumpers of Arkansas, an energy-importing state, is typical: "All across the country, States are moving to enact new taxes on energy production . . . [and] to stick consumers in other States with the bill."[83] Proponents of producing states' interests, while not seriously denying that their jurisdictions export their taxes, point out that tax exporting is a universal phenomenon in the federal system and that producing states are not the worst offenders. "I find it fascinating," observed Senator Alan Simpson of Wyoming, relying on figures prepared by the Department of Commerce, "that those states which have been the most successful . . . in exporting their tax burden to nonresidents are composed of those states [Illinois, Michigan, and Wisconsin] which rely chiefly on coal from [the] states of Wyoming and Montana."[84] It is also observed that the issue is so mired in economic

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[80] Gulley, *Severance Taxes and Market Failures*, 22 NAT. RESOURCES J. 597, 614 (1982).

[81] *1980 House Coal Severance Tax Hearings*, *supra* note 29, at 201 (statement of Malcolm Wallop, U.S. Senator from Wyoming).

[82] *1980 Senate Coal Severance Tax Hearings*, *supra* note 34, at 175 (statement of Malcolm Wallop, U.S. Senator from Wyoming).

[83] *1982 Senate Fiscal Disparities Hearings*, *supra* note 33, at 213 (statement of Dale Bumpers, U.S. Senator from Arkansas).

[84] *1980 House Coal Severance Tax Hearings*, *supra* note 29, at 171 (statement of Alan K. Simpson, U.S. Senator from Wyoming).

and factual complexities that it offers no guidance for sound interstate fiscal policy.

In the end, both sides are right in their allegations regarding the nature of state tax exportation in the federal system. The resource-rich states *do* export their tax burdens through production taxes, but other states do the same thing through other taxes. The issue *is* complex, although perhaps less complex than it appears when one considers institutional arrangements, such as long-term contracts with pass-through clauses and federal regulatory schemes, that place the burden of production taxes squarely on energy consumers. The real issue, of course, is not tax exportation, but "excessive" tax exportation.

c. *How significant is the producing states' tax burden on nonresident consumers?* Although the significance of the producing states' tax burden on consumers in other states is more an issue of characterization than of fact, the extensive and heated interchanges between spokesmen for consuming and producing states over this question may conveniently be considered at this juncture. Even if the producing states' severance taxes are exported, the question is sometimes raised whether the amounts involved are of sufficient proportion to warrant attention. So many other factors of greater individual and collective significance dictate the final price of the consumer product that production taxes, it is suggested, are not worth our time, at least as compared to the other factors.

Transportation costs, for example, commonly dwarf production taxes as a percentage of the price of the delivered coal, oil, or gas to the energy consumer. In 1981, Montana's 30% severance tax on coal amounted to about $2.30 per ton compared to rail rates of more than $20.00 per ton to Illinois and Texas, $17.50 to Iowa, and nearly $12 to Wisconsin.[85] Such taxes generally amounted to from 2% to 3% of a consumer's utility bill, which translates into a few pennies a day, often substantially less than the sales tax imposed by the consumer's own state on his purchases of electricity.[86] The

[85] *1981-82 House Coal Severance Tax Hearings, supra* note 31, at 54 (statement of Ted Schwinden, Governor of Montana); *id.* at 100-01 (statement of John Melcher, U.S. Senator from Montana).

[86] *1981-82 House Coal Severance Tax Hearings, supra* note 31, at 100-03 (statement of John Melcher, U.S. Senator from Montana).

Congressional Research Service of the Library of Congress prepared a study that showed the impact of severance taxes on oil, gas, and coal on the cost of various products to the consumer.[87] Employing March 1981 data and utilizing the highest severance tax rates then prevailing for the resources in question (Louisiana's 12½% rate for oil, Alaska's 10% rate for natural gas, and Montana's 30% rate for coal), it found the following:[88]

End product	Price at point of taxation	Amount of severance tax	End-use cost	Percentage of end-use cost as tax
Oil-fired powerplant (electric)	$38.00/bbl	$4.75/bbl	$ .84/kw	11.8%
Home-heating oil	$38.00/bbl	$4.75/bbl	$1.30/gal	12.0%
Gasoline	$38.00/bbl	$4.75/bbl	$1.35/gal	8.1%
Residential Gas	$ 1.60/mcf	$0.16/mcf	$4.10/mcf	4.0%
Coal-fired powerplant (electricity)	$12.00/ton (F.O.B. MT; 9300btu.lb)	$2.64/ton	$ .046/kw	3.5%
Gas-fired (electricity)	$ 1.60/mcf	$0.16/mcf	$ .058/kw	3.2%

As a result, one partisan observer concluded that "[t]he severance tax is peanuts, absolute peanuts."[89] What increases the cost of the resource to the consumer "are items like mining costs, revegetation, reclamation, Federal taxes, labor contracts, labor pensions, freight rates, black lung payments, [and] return on investment."[90]

Politicians from consuming states prefer to focus on their constituents' aggregate severance tax bills, which can scarcely be characterized as de minimis. The Mayor of Minneapolis complained that consumers in his city paid $1.246 million in 1980 "in tribute

[87] L. Parker, Energy: Limiting State Coal Severance Taxes, Issue Brief No. IB80060, at 6 (Congressional Research Service, Library of Congress, June 24, 1980).

[88] *Id.* The chart uses the following abbreviations: "bbl" stands for barrel, "mcf" stands for thousand cubic feet, and "F.O.B. MT" stands for Free on Board Montana.

[89] *1980 House Coal Severance Tax Hearings, supra* note 29, at 168 (statement of Alan K. Simpson, U.S. Senator from Wyoming).

[90] *Id.*

to the State of Montana."[91] The Co-Chairman of the Northeast-Midwest Congressional Coalition's task force on energy taxation warned of massive shifts of wealth from the energy-consuming to the energy-producing regions, with projected energy-tax revenues in the hundreds of billions of dollars, much of it derived from the pockets of energy consumers.[92] And energy consumers deny that they ignore the non-tax contributions to the increase of energy prices: "I would say to my friend," declared Senator Lloyd Bentsen of Texas, whose oil-rich state is nonetheless a major consumer of Western coal, "I have been just as diligently fighting . . . [the railroads]. They have done a job of raising the rates to an exorbitant level and we passed legislation here to put a limitation on that."[93]

The issue of "excessive" tax exportation anticipates the question addressed below.[94] Should natural resource tax exportation be viewed as a discrete "problem" demanding a national solution or as an endemic feature of our federal system whose fabric would be destroyed by serious efforts to curb it?

III. The Federal Role in Limiting State and Local Taxation of Natural Resources

The interstate conflicts over state and local taxation of natural resources have stimulated pleas for a federal solution to the problem. Legislation has been introduced in Congress to impose a ceiling on state severance tax rates and to limit state severance taxes to costs imposed upon the state by natural resource production. Broader proposals have been advanced for a national severance tax and for a revision of revenue-sharing formulas to counterbalance the "fiscal disparities"[95] emerging from the shift in tax and economic wealth from resource-poor to resource-rich jurisdictions. These proposals have encountered predictable hostility from

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[91] *1982 Senate Fiscal Disparities Hearings, supra* note 33, at 273 (statement of Donald M. Fraser, Mayor of Minneapolis).

[92] *1981-82 House Coal Severance Tax Hearings, supra* note 31, at 170-71 (statement of Howard E. Wolpe, U.S. Representative from Michigan).

[93] *1980 Senate Coal Severance Tax Hearings, supra* note 34, at 12 (statement of Lloyd Bentsen, U.S. Senator from Texas).

[94] *See infra* text accompanying notes 96-119 & 146-51.

[95] The term "fiscal disparities" has become a code word for the issues associated with the differentials in wealth and tax capacity of states and regions, particularly those arising from access to natural resources and natural resource revenues.

spokesmen for states well-endowed with natural resources. They accuse their proponents of disrespecting state sovereignty, creating a dangerous legislative precedent, and waging a "war on the West."[96]

This section reviews the considerations supporting and counseling against federal intervention in this area and explores the merits of the various forms of intervention that have been proposed. The fundamental positions that the contending parties have staked out on these issues have been shaped in large part by their perspectives on the interstate conflicts examined in the preceding section, positions that will not be retraced here. The discussion will focus instead on whether and how the federal government should limit state and local taxation of natural resources.

A. *The Advisability of Federal Intervention*

The case for a federal solution to the problems raised by state and local taxation of natural resources rests on the grounds that they are significant in magnitude, national in character, and incapable of resolution by other means. The magnitude of the problem is reflected in the numbers associated with state natural resource taxation. State severance taxes, which amounted in 1973 to $850 million or 1.3% of state tax collections,[97] had increased nearly tenfold by 1983 to $7.4 billion or 4.3% of state tax collections.[98] The United States Treasury Department estimated that tax and royalty revenues accruing to states from oil-price decontrol alone could be as great as $128 billion from 1979 through 1990.[99] And the United States Advisory Commission on Intergovernmental Relations found that natural resource revenues were contributing to increasing disparities in the states' fiscal capacities which in 1980 ranged from a low of $817 per capita in Mississippi to a high of $6,161 per capita in oil-rich Alaska.[100]

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[96] *1980 House Coal Severance Tax Hearings*, *supra* note 29, at 36 (statement of Ron Marlenee, U.S. Representative from Montana).

[97] BUREAU OF CENSUS, U.S. DEP'T OF COMMERCE, GOVERNMENT FINANCES 73, No. 1, STATE GOVERNMENT TAX COLLECTIONS IN 1973, at 5, 7 (1974).

[98] *See* BUREAU OF CENSUS, U.S. DEP'T OF COMMERCE, GOVERNMENT FINANCES 83, No. 1, STATE GOVERNMENT TAX COLLECTIONS IN 1983, at 5 (1984).

[99] Cuciti, Galper & Lucke, *State Energy Revenues*, in FISCAL FEDERALISM AND THE TAXATION OF NATURAL RESOURCES 13 (C. McLure & P. Mieszkowski eds. 1983).

[100] U.S. Advisory Comm'n on Intergovernmental Relations, State Taxation of Energy Re-

The problems spawned by state and local taxation of natural resources are also national in scope. The bulk of the revenue derives from oil, gas, and coal, and the states' tax policies therefore implicate national energy policy. Indeed, the alleged "windfalls"[101] that the states are now reaping from taxes on increased energy resource values are attributable in part to federal energy policy. For example, federal oil price decontrol created a dramatic increase in domestic oil prices, and Congress increased the demand for coal by requiring certain industrial and utility consumers to use it.[102] It is only just, the argument continues, that the federal government limit the extent to which a few states are permitted to benefit from the federal government's own regulatory policies at the expense of their sister states.

The national character of the problem is reinforced by the location of a substantial portion of the nation's natural resources under federal lands and their reservation by the federal government. Wholly apart from technical questions of title to the resources at the moment they are severed and taxed, there is a federal interest in the revenues generated by these "national resources"[103] that may justify federal restraints on the states' power to tax them.

The political and economic Balkanization caused by state taxation of natural resources is a further matter of national concern. If the nation faces "economic warfare among the States"[104] over state and local natural resource taxation, it is certainly within the federal government's purview to prevent it. Indeed, one can argue that the federal government would be reneging upon its essential responsibility by failing to try. Moreover, the fiscal disparities attributable to the differential access to natural resource tax revenues raise additional questions of national dimension.

Finally, proponents of federal action insist that there is no other avenue of relief from the problem. The judicial door was tightly shut by *Commonwealth Edison.* Despite the difference of opinion

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sources 4-7 (Jan. 1983) (preliminary review copy).

[101] *1980 House Coal Severance Tax Hearings, supra* note 29, at 23 (statement of Bruce F. Vento, U.S. Representative from Minnesota).

[102] *See* Power Plant and Industrial Fuel Use Act, 42 U.S.C. § 8301(a)(1) (1982).

[103] *1980 House Coal Severance Tax Hearings, supra* note 29, at 21 (statement of Bruce F. Vento, U.S. Representative from Minnesota).

[104] *1980 Senate Coal Severance Tax Hearings, supra* note 34, at 41 (statement of David Durenberger, U.S. Senator from Minnesota).

over the extent of intrastate political restraints,[105] the trend toward increased state revenues from natural resources is unmistakable, a fact that spokesmen from energy-poor states ascribe to "[t]axation without representation."[106] Only at the federal level, they contend, are the interests of all concerned parties adequately represented. As for economic constraints on state natural resource taxation, advocates of federal legislation point to the market dominance of the producing states, long-term contracts, and regulatory mechanisms that jointly and severally deprive the market of its restraining force.

There is nevertheless a case against federal intervention in this domain. First, it is vigorously asserted that a federal limitation on state severance taxes would violate basic principles of state sovereignty and thereby upset the settled relationship between state and national power in the federal system. Although some regard invocations of state sovereignty as empty rhetoric, it is no mere shibboleth in many states, especially in the South and the West where the federal presence is often viewed with a jaundiced eye. Nor does anyone deny that the states' taxing power is critical to their independent existence in the federal system. One cannot wade through the volumes of testimony directed to this question without appreciating the sensitivity of the issue and the intensity of feeling surrounding it in states whose taxing authority is imperiled by federal legislation. The prediction that its passage will make the Sagebrush Rebellion[107] "look like a garden party"[108] is no idle threat.

Opponents of federal legislation also point to the dangerous precedent it would set.

> [I]f Congress is able to restrict the amount of taxation which the mining States are able to levy . . . then why should not

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[105] *See supra* text accompanying notes 3-25.

[106] *1980 House Coal Severance Tax Hearings, supra* note 29, at 14 (statement of Samuel L. Devine, U.S. Representative from Ohio).

[107] The Sagebrush Rebellion is a political movement with widespread support in the Western states that seeks to force the transfer of federally-owned public lands to the states in which the lands lie. *See* Mollison & Eddy, *The Sagebrush Rebellion: A Simplistic Response to the Complex Problems of Federal Land Management*, 19 HARV. J. ON LEGIS. 97 (1982).

[108] *1980 House Coal Severance Tax Hearings, supra* note 29, at 36 (statement of Ron Marlenee, U.S. Representative from Montana).

> Congress also act under its commerce powers to restrict the level of State taxation in the farm belt States, in the manufacturing States, the timbering regions of America, and any other State which sustains within its borders a regional or national center of production?[109]

Moreover, it is suggested that there is no equitable basis for limiting such restrictions to natural resources. If Congress is concerned about excessive state tax exportation based on locational advantages, why not impose similar restrictions upon Florida's taxation of the tourist industry, Washington's taxation of stevedoring, and, perhaps, New York's taxation of stock transfers?

Opponents of federal restrictions on state natural resource taxation further assert that such a restraint is mischievous on its own terms, even assuming one were not concerned about its implications for state autonomy. They argue that the proposed legislation is an ill-conceived effort of the energy-poor states to reverse the market verdict against them through the political process.[110] They claim that imposing artificial restrictions on the energy-rich states' tax power or, worse yet, redistributing their revenues to the decaying cities in the industrial heartland is to impede the adjustments that the nation must make in confronting the economic realities of the late twentieth century. They observe that the South and the West have long consumed the products of the Northeast and the Midwest, contributing to the once flourishing economies and ample tax bases of those regions. And they resent what they perceive to be the efforts of those regions to change the rules of the game now that resource-rich states are having their economic day in the sun.

Finally, opponents of congressional legislation limiting state natural resource taxes express doubts about the constitutionality of the legislation. Their reservations are usually based on the Supreme Court's opinion in *National League of Cities v. Usery*,[111] which held that Congress lacked the power under the commerce clause to prescribe minimum wages and maximum hours for state employees pursuant to the Fair Labor Standards Act. The Court's

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[109] *Id.* at 18 (statement of Alan K. Simpson, U.S. Senator from Wyoming).

[110] Leman, *Comparing Canadian and U.S. Regional Energy Conflicts: Contents and Lessons*, in REGIONAL ISSUES IN ENERGY DEVELOPMENT 19 (C. Leman ed. 1981).

[111] 426 U.S. 833 (1976).

opinion was rooted in the constitutional policy, which is reflected in the tenth amendment,[112] that "there are limits upon the power of Congress to override state sovereignty, even when exercising its plenary powers . . . to regulate commerce."[113] The Court concluded that in attempting to exercise its commerce power to prescribe minimum wages and maximum hours for the states in their sovereign capacities, Congress had "sought to wield its power in a fashion that would impair the States' 'ability to function effectively in a federal system,' "[114] and that Congress may not exercise its commerce power "so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made."[115]

It might be maintained that the states' ability to employ severance taxes to finance their integral governmental functions is essential to their separate existence and that any interference with such taxing power would impermissibly trench on state sovereignty under *National League of Cities*. After the Court's decision in *Commonwealth Edison*, however, it is difficult to credit such a contention at least if Congress did not absolutely prohibit the levies. In *Commonwealth Edison*, the Court indicated that Congress possesses the power to limit state severance taxes without hinting that *National League of Cities* constitutes a roadblock to federal legislation. In declaring that the appropriate level of state taxes may be established "if necessary, by Congress, when particular state taxes are thought to be contrary to federal interests,"[116] the Court explicitly noted that "[t]he controversy over the Montana tax has not escaped the attention of the Congress"[117] and referred to legislation introduced in Congress "to limit the rate of state severance taxes."[118] Serious questions have been raised, however, whether Congress possesses the power under the commerce clause to impose an absolute ban on state severance taxes.[119]

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[112] The Tenth Amendment provides: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. CONST. amend. X.

[113] 426 U.S. at 842.

[114] *Id.* at 852.

[115] *Id.* at 855.

[116] Commonwealth Edison Co. v. Montana, 453 U.S. 609, 628 (1981).

[117] *Id.* at 628 n.18.

[118] *Id.*

[119] Browde & DuMars, *State Taxation of Natural Resource Extraction and the Com-*

B. *Proposed Federal Legislative Responses to State and Local Taxation of Natural Resources*

1. Limiting State Severance Tax Rates. The most widely supported form of federal intervention into the controversy over state and local natural resource taxation is a specific percentage limitation on state severance tax rates. A number of bills have been introduced into Congress embodying a percentage limitation.[120] Indeed, a bill limiting coal severance taxes to 12.5% of the coal's value was approved by the House Subcommittee on Energy and Power in 1980,[121] but was trapped in the backlog of legislative business that preceded the presidential election of 1980 and never went to the House floor for a vote.[122]

If one is persuaded by the wisdom of a federal legislative solution to the problems raised by state and local natural resource taxation, a limitation on the rate of such taxation has several appealing features. The most prominent is its simplicity. A ceiling on tax rates requires little explanation and can be judicially enforced without difficulty so long as the definition of value to which the ceiling applies is clear and is pegged to readily accessible data. Another virtue of a rate limitation is its relative lack of intrusiveness into state fiscal affairs, at least by comparison to other proposals. While the state's tax power is restricted, no additional federal apparatus need be created to administer the restriction. Finally, by placing the ceiling at an appropriate level, one can lessen, if not satisfy, objections based on a state's right to recover the costs imposed on it by natural resource development.

The principle of a fixed rate limitation is usually subjected to

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merce Clause: Federalism's Modern Frontier, 60 OR. L. REV. 7, 54-56 (1981). For other scholarly discussions of the power of Congress to enact legislation restricting state severance taxes, see *1982 Senate Fiscal Disparities Hearings*, *supra* note 33, at 19 (testimony of Walter Hellerstein, Professor of Law, University of Georgia); Note, *Western Coal Severance Taxes and Congress: A Question of State Sovereignty*, 61 OR. L. REV. 589 (1982); Note, *The Constitutionality of a Federal Ceiling on State Severance Taxes*, 23 SANTA CLARA L. REV. 867 (1983); *cf.* Parnell, *Constitutional Considerations of Federal Control over the Sovereign Taxing Authority of the States*, 28 CATH. U.L. REV. 227 (1979) (discussing the power of Congress to limit state taxation of income derived from interstate commerce).

[120] *See e.g.*, S. 178, 97th Cong., 2d Sess. (1981); H.R. 1313, 97th Cong., 1st Sess. (1981).

[121] H.R. 6625, 96th Cong., 2d Sess. (1980); *see* HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, LIMITATION ON COAL SEVERANCE TAXES, H.R. REP. No. 1527, 96th Cong., 2d Sess. (1980) [hereinafter cited as H.R. REP. No. 1527].

[122] *See* Cuciti, Galper & Lucke, *supra* note 99, at 15.

two criticisms. First, as is often the case with simple solutions, such solutions are also arbitrary. The choice of a single rate to approximate a state's legitimate claims, however defined, to its natural resource tax base cannot account for the variations in the nature and extent of the costs imposed by different kinds of natural resource production. The costs of schools, roads, and hospitals, of environmental impacts, and of social services will vary dramatically depending on whether they stem from the extraction of oil from the fields of east Texas, the gathering of gas in the Louisiana wetlands, the production of coal from the underground mines in West Virginia, or the strip-mining of coal on the plains of eastern Montana.

Second, the use of a percentage limitation keyed to the value of production arguably bears unfairly on states with relatively low-value resources. For example, coal from Eastern and Midwestern states has been priced three times higher than Western coal because of higher energy content or lower transportation costs.[123] Eastern and Midwestern coal-producing states can therefore raise substantially greater revenues under a fixed ceiling than can their Western counterparts. Yet it is hard to see why the former should be permitted greater taxing power than the latter.

Moreover, in terms of the burden of the production tax on the ultimate consumer, which is a central concern of many legislators favoring federal legislation, the implications of an across-the-board rate limitation are unsettling. As the table reproduced above demonstrates,[124] a 12.5% severance tax on oil valued at $38 per barrel will comprise about 12% of the cost to the consumer of electricity generated by an oil-fired powerplant or of the cost of home heating oil. A 30% coal severance tax,[125] on the other hand, will comprise a mere 3.5% of the cost to the consumer of electricity generated by a coal-fired powerplant. Yet a flat 15% limitation on the rate of production taxes based on the value of production at the well head or mine mouth would leave the oil severance taxes undisturbed while

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[123] *See* H.R. Rep. No. 1527, *supra* note 121, at 34 (dissenting views of Timothy E. Wirth, U.S. Representative from Colorado).

[124] *See supra* p. 51.

[125] The nominal rate of 30% employed in the Montana coal severance tax was adjusted for the credits for other taxes as permitted by the Montana statute. *1980 Senate Coal Severance Tax Hearings*, *supra* note 34, at 513 (issue brief of Larry Parker, Congressional Research Service, Library of Congress).

cutting the coal severance tax in half.[126] Such an outcome is hard to square with a concern for the ultimate resource consumer, let alone with notions of interstate equity.

The proposed legislation embracing a severance tax rate limitation that has actually been introduced into Congress raises still further questions. Most of the bills, including the one endorsed by the House Subcommittee on Energy and Power, have taken the form of an amendment to the Powerplant and Industrial Fuel Use Act of 1978.[127] The Act was a centerpiece of President Carter's National Energy Plan to achieve energy independence. As President Carter described that plan: "Coal, the nation's most abundant fossil energy resource, should be used in place of oil and gas wherever economically and environmentally feasible. Programs that increase the use of coal as a substitute for oil will receive the highest priority."[128] In implementing this policy, the Act, among other things, called for the conversion of existing electric utility powerplants and major fuel-burning installations to switch from oil to coal and for the construction of new plants to utilize coal as the primary energy source. The severance tax limitation to be appended to the Act placed a 12.5% limit on coal destined for interstate commerce.[129]

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[126] To the extent that the effective rate of the tax was less than 30% of the tax, see *supra* note 125, the reduction affected by the 15% limitation would be less.

[127] 42 U.S.C. §§ 8301-8484 (1982).

[128] *See* H.R. REP. No. 1527, *supra* note 121, at 3.

[129] H.R. 6625, 96th Cong., 2d Sess. (1980). The proposed bill stated:

> (a) LIMITATION.—Notwithstanding any other provision of State or Federal law, with respect to any coal which is destined for shipment in interstate commerce for use in any powerplant or major fuel-burning installation, the sum of all severance taxes or fees, in respect to any fiscal year, levied upon or collected from any taxpayer, by a State or any political subdivision thereof on such coal or on any improvements or other rights, property, or assets produced, owned or utilized in connection with the production of such coal shall not exceed a total of 12-½ percent of the value of such coal produced during such fiscal year at the time it has been extracted and prepared for transportation free on board the production site, exclusive of all State and local taxes and fees.
>
> (b) SEVERANCE TAXES OR FEES DEFINED.—For purposes of subsection (a), "severance taxes or fees" includes any tax or fee, by whatever name called, levied, or collected upon coal or upon any improvements or other rights, property, or assets produced, owned or utilitized in connection with the production of coal except for income, sales, property, or other similar taxes or fees of general application which are not disproportionately imposed thereon.

Id.

Three House bills were introduced that were identical to H.R. 6625. *See* H.R. 1313, 97th

Federal legislation directed at a particular resource violates the concept of evenhandedness in restricting the states' power to tax natural resources. Still it may be justified by the fact that it is rooted in a specific federal policy to encourage the use of that resource. The determination whether evenhandedness toward the states, on the one hand, or the effectuation of specific energy policies, on the other, should be the overriding objective in designing federal legislation limiting state and local natural resource taxation is, of course, a value judgment about which reasonable people will differ.

Two additional considerations ought to give us serious pause before adopting a limit on severance tax rates. First, in light of the general recognition that any federal limitation on state tax power should be viewed as a matter of the greatest delicacy, we should view with more than the usual caution any legislation that singles out the taxes or resources of a few jurisdictions that may lack the political muster to resist it. One wonders, for example, whether spokesmen from Texas who so avidly supported a limitation on coal severance taxes[130] would have been as enthusiastic in their support of a limitation that included oil and gas.[131] And, if they

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Cong., 1st Sess. (1981); H.R. 7163, 96th Cong., 2d Sess. (1980); H.R. 6654, 96th Cong., 2d Sess. (1980). Two Senate bills were limited to "coal produced on Indian lands or lands owned by the Federal Government" but were otherwise identical to H.R. 6625. *See* S. 1778, 97th Cong., 1st Sess. (1981); S. 2695, 96th Cong., 2d Sess. (1980). Senate bill 1778 proposed a broader limitation in the following terms:

> [N]otwithstanding any other provision of law, with respect to coal, oil, natural gas, oil shale, or other energy resources mined or produced from Indian lands or lands owned by the United States, the sum of all taxes or fees levied or collected by a State or within a State on such energy resources or on any improvements or other rights, property, or assets produced, owned, or utilized in connection with the production of such energy resources, shall not exceed a total of 12-½ per centum of the value of such resources at the time they have been extracted and prepared for transportation free on board the production site, exclusive of all State and local taxes and fees, unless such taxes or fees collected within that State are fairly related to services (1) provided by said State or its local authorities in connection with the production of such resources and (2) for which royalties under section 35 of the Mineral Leasing Act of 1920 do not provide adequate compensation.

S. 1178, 96th Cong., 1st Sess. (1979).

[130] *See, e.g., 1981-82 House Coal Severance Tax Hearings, supra* note 31, at 172-78 (statement of J.J. Pickle, U.S. Representative from Texas); *1980 Senate Coal Severance Tax Hearings, supra* note 34, at 6-8 (statement of Lloyd Bentsen, U.S. Senator from Texas); *1980 House Coal Severance Tax Hearings, supra* note 29, at 85-91 (statement of Mark W. White, Texas Attorney General).

[131] In fairness to Senator Bentsen, *see supra* note 130, it should be pointed out that he

would not have been, can we confidently assume that the difference is attributable to their commitment to a national policy to encourage use of coal rather than to the traditional political objective of looking out for one's own? Second, if there is to be a significant incursion on the states' power to tax natural resources, perhaps we should be reluctant to predicate it on something as uncertain as national energy policy. With the weakening of OPEC, increased conservation efforts, and the impact of oil price decontrol, the national energy picture looked quite different in late 1984 than it did in 1980 and 1981 when efforts to impose restraints on state coal severance taxes may have reached their high water mark. Indeed, the National Energy Policy Plan sent to Congress in the fall of 1983 reflected a softening of the commitment to energy self-sufficiency, a de-emphasis of fossil fuels as the sole source of domestic energy, and a reliance on a more " 'balanced' mix of resources, including solar, wind and hydroelectric energy and other renewable sources of power."[132] If excessive state taxation of natural resources is a threat to the federal system, a limitation upon it should be rooted in firmer soil than the shifting sands of national energy policy.

2. *Limiting State Severance Taxes to Costs Incurred by the State Attributable to Natural Resource Production.* The fundamental position that state taxes on natural resource production are excessive in relation to the costs that such activities impose upon the state is reflected in the proposed Severance Tax Equity Act introduced into Congress in 1982 and 1983 by Senator Alan Dixon and Representative Henry Hyde of Illinois.[133] The proposed legislation is more broadly based than the bill to limit coal severance tax rates, as the Act applies to oil, gas, and coal. It also comports more comfortably with the underlying rationale for such legislation, as it eschews arbitrary percentage limitations and instead limits state severance taxes to the "costs incurred by the State (and any political subdivision thereof) . . . which are directly attributable to the production within the State of crude oil, natural

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introduced Senate Bill 1778, which included oil, gas, and other energy resources within the scope of the rate limitation. See *supra* note 129 for provisions in his bill.

[132] Wall St. J., Oct. 5, 1983, at 2, cols. 3-4.

[133] S. 463, 98th Cong., 1st Sess. (1983); H.R. 2690, 98th Cong., 1st Sess. (1983); S. 2890, 97th Cong., 2d Sess. (1982).

gas, or coal, as the case may be."[134]

At the same time, however, the proposed legislation is considerably more complex than the virtually self-executing percentage limitation. It would establish elaborate federal enforcement machinery, authorizing the United States Attorney General or an aggrieved taxpayer to bring suit in federal court against any state violating the statute. It would generally place the burden of proof upon the plaintiff to prove that the aggregate revenue from the state severance tax exceeded the costs incurred by the state that are directly attributable to natural resource production. In the event, however, that a state's severance tax exceeds either its "adjusted 1978 State tax rate for such State for such fiscal year"[135] or the "adjusted 1978 national average tax rate for such fiscal year,"[136] terms defined with the labyrinthine detail we have come to expect from drafters of federal tax provisions, the burden of proof shifts to the defendant state.

In short, the legislation proposed by Senator Dixon and Representative Hyde appears to offer gains from the standpoint of both interstate equity and consistency with legislative purpose by comparison to the simple rate limitation considered above.[137] These gains must be weighed against the manifest losses it would entail, again by comparison to the simple rate limitation, in ease of understanding and implementation. Nor should one underestimate the increase in federal-state friction that might be occasioned by permitting taxpayers ready access to federal court to challenge state taxes, a practice contrary to general congressional policy in this area.[138]

3. A National Severance Tax. When we move beyond the con-

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[134] S. 463, 98th Cong., 1st Sess. § 3(a) (1983). Hearings on Senate Bill 463 were held in 1984. *Hearing on S. 463, The Severance Tax Equity Act of 1982, Before the Subcomm. on Energy and Agricultural Taxation of the Senate Comm. on Finance*, 98th Cong., 2d Sess. (1984).

[135] *See* S. 463, 98th Cong., 1st Sess. § 3(b)(3)(B)(i) (1983).

[136] *Id.* § 3(b)(3)(B)(ii).

[137] *See supra* text accompanying notes 120-32.

[138] The Judicial Code of the United States provides that "[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." 28 U.S.C. § 1341 (1982). As the Supreme Court has observed, "the statute has its roots in equity practice, in principles of federalism, and in recognition of the imperative need of a State to administer its own fiscal operations." Tully v. Griffin, 429 U.S. 68, 73 (1976).

cept of a federal restraint on state production taxes to the broader proposals advanced for dealing with fiscal disparities that are due to state natural resource tax revenues, we confront a vast array of legislative possibilities. Most of these have retained their character as casual suggestions. One exception is the proposal for a national severance tax levied either in conjunction with a limitation on state severance taxes or as a replacement for them. Revenues from the federal tax would be earmarked for distribution in a manner more consonant with its proponents' views of national priorities than are revenues from existing natural resources taxes. For example, legislators from the Northeast-Midwest Congressional Coalition introduced a bill in Congress in 1982 proposing a federal severance tax on crude oil as well as a limitation on state severance taxes based on the "adjusted 1978 State tax rate"[139] or the "adjusted 1978 national average tax rate."[140] A portion of the revenues was to be allocated to the states under a complicated scheme designed to assure that a goodly portion of the funds made their way to the then beleaguered economies of the Northeast and Midwest.

Columbia Law School Professor Lewis Kaden has suggested that:

> Congress might consider replacing state severance taxes and royalties with a national levy on energy extracted from the mines, with the revenues shared nationally on a basis of a formula designed to serve the goals of fiscal balance, payment for impact costs, energy independence and rehabilitation of public infrastructure in the consuming regions.[141]

Mere statement of such an agenda for legislative consideration is sufficient to demonstrate why more suggestions of this kind have been advanced informally rather than articulated as legislative proposals.

The concept of a national severance tax is not solely a child of the energy crisis. The idea was actually put forward in 1969 before energy independence had become a national priority. Ironically in

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[139] H.R. 6330, 97th Cong., 2d Sess. § 301(1) (1982).

[140] *Id.* § 301(2).

[141] *1982 Senate Fiscal Disparities Hearings*, *supra* note 33, at 69 (statement of Lewis B. Kaden, Professor of Law, Columbia University).

light of recent history, it was offered by Senator Lee Metcalf from Montana to encourage states like his own to impose reasonable taxes upon their natural resources.[142] Senate Bill 910 sought to impose a 5% federal severance tax on the gross income from mining, with amounts paid as state severance taxes available as credits against the federal tax.[143] As Senator Metcalf explained his proposal on the Senate floor, many resource-rich states had failed to impose reasonable severance taxes upon mineral producers because a "State acting alone runs the risk of placing some mining companies operating within the State at a competitive disadvantage relative to companies operating where there are no severance taxes . . . . Interstate competition, in other words, acts to keep severance taxes low."[144] The purpose of the bill was therefore to encourage state legislatures to enact severance taxes at the minimum rate of 5%, which they could do without fear of offending local industry. Local producers would credit the tax against their federal severance tax liability. A similar scheme has existed for years in the state death tax field, which has encouraged states to impose death taxes up to the maximum federal credit allowable.[145] This proposal suggests a broader point than its particular merits: In considering both the wisdom and direction of federal legislation in this area, it is worth recalling that just fifteen years ago the issue was whether there should be a floor, not a ceiling, on state severance taxes.

4. Fiscal Disparities and Federal Revenue Sharing Formulas. Although it does not involve taxation as such, one final matter merits brief attention here because it relates to the problem of fiscal disparities created by state natural resource revenues. This is the matter of the formulas that are employed by the federal government to allocate general revenue sharing and other federal funds among the states. The general question, whose scope extends far beyond the narrow issue addressed here, is whether these formulas fairly reflect the fiscal capacities of the states to which the funds are allocated. For our purposes, the particular question is whether these formulas adequately account for the massive influx

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[142] Jones, *The Struggle for Equitable Taxation of Mines—The New Mexico Example*, 16 ROCKY MTN. MIN. L. INST. 463, 479 (1971).

[143] S. 910, 91st Cong., 1st Sess., 115 CONG. REC. 2583 (1969).

[144] 115 CONG. REC. 2583 (1969) (statement of Sen. Metcalf).

[145] J. HELLERSTEIN & W. HELLERSTEIN, STATE AND LOCAL TAXATION 819-20 (4th ed. 1978).

of natural resource revenues enjoyed by a number of states.[146]

Federal grants to state and local governments amounted to about $95 billion in fiscal year 1980.[147] Many grants are made pursuant to programs that recognize the differences among jurisdictions in their ability to finance public services and are designed in part to equalize their post-grant fiscal condition. In allocating federal revenues among states and localities, the formulas in many cases therefore consider the fiscal capacity (or the lack thereof) of the recipient state or locality. Fiscal capacity has always been measured by personal income in the federal grant programs that rely on such capacity as a guide to allocation of funds.[148] Another factor that has been employed for this purpose, most notably in allocating the $4 to $5 billion of general revenue sharing funds, is the state's general "tax effort," defined as "total [s]tate and local tax collections divided by the state's personal income."[149]

The critical issues raised by these allocation factors in light of some states' access to substantial natural resource revenues are not difficult to appreciate. Under most circumstances, per capita income is an acceptable measure of a state's revenue-generating ability because tax yields tend to depend on the income of residents in the taxing state. Hence a formula that equates fiscal capacity with personal income and that distributes federal funds in an inverse relationship to its capacity would appear unobjectionable. As Robert Rafuse of the United States Treasury Department has observed, however:

> [T]he link between the availability of natural resources and the income of a State or locality is tenuous at best. The exploitation of such resources generates a potential source of revenues, but the demand for energy production depends largely upon national rather than State markets. This is one of the reasons it has been argued that the measure of fiscal capacity in the Revenue Sharing formula is imperfect. That is,

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[146] *See Fiscal Disparities, Part 1, Federal Allocation Formulas 1981: Hearings Before the Subcomm. on Intergovernmental Affairs of the Senate Comm. on Governmental Affairs*, 97th Cong., 1st Sess. (1981) [hereinafter cited as *1981 Senate Fiscal Disparities Hearings*].

[147] U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, TAX CAPACITY OF THE FIFTY STATES 3 (1982).

[148] *Id.*

[149] *1981 Senate Fiscal Disparities Hearings*, *supra* note 146, at 94 (statement of Robert W. Rafuse, Jr., Deputy Assistant Secretary, U.S. Department of the Treasury).

> it does not allow for the potential yield of severance taxes in the minority of States that are exceptionally endowed with natural resources, whose exploitation creates an unusually lucrative base for taxation.[150]

Natural resource revenues have an even more dramatic—some would say perverse—impact on federal revenue allocation formulas that take account of tax effort in the equation. Tax effort, which reflects the ratio of tax collections to per capita income, is assumed to be a proxy for the tax burden borne by residents of a particular state. The higher a state's tax effort (and the implied tax burden on state residents), the greater is that state's share of federal funds.[151] When natural resource production tax revenues increase the ratio of state tax collections to per capita income, additional federal revenues are allocated to that state because of the assumption that state revenues reflect the residents' own tax effort. Natural resource taxes, however, are often exported to residents of other states. To the extent that they are exported, the tax effort factor has the bizarre effect of allocating revenues to some states on the basis of the tax effort of residents of other states. Of course, the same point can be made concerning any tax that is exported, but the phenomenon appears to be particularly widespread in the context of natural resource taxation.

Identifying the problems associated with the impact of natural resource revenues on federal revenue allocation formulas is easier than identifying the solutions. If per capita income and tax effort were abandoned as allocation factors, the question is what would replace them. The United States Advisory Commission on Intergovernmental Relations has developed an alternative measure of fiscal capacity, denominated the "representative tax system."[152]

> The representative tax system defines the tax capacity of a State and its local governments as the amount of revenue they could raise (relative to other State-local governments) if all 50 state-local systems applied *identical tax rates* (national averages) to their respective tax bases. Fiscal capacity is thus viewed as an attribute of government derived from the eco-

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[150] *Id.* at 95.
[151] *Id.* at 94.
[152] U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *supra* note 147, at 11-12.

> nomic strength inherent within a State's jurisdictional boundaries. The system is "representative" in the sense that potential revenues are determined by applying a uniform taxing system in a State which represents a cross section of State and local government tax practice currently affecting most citizens.[153]

Even the Commission, which has advocated implementation of the representative tax system for years, recognizes that its adoption presents serious technical and political problems. As the Commission's Assistant Director John Shannon has stated: "The replacement of the traditional per capita income measure with the tax capacity estimates is bound to be highly controversial because it would create a new set of winners and losers."[154]

There is no end in sight to the national debate over whether Congress should modify the traditional formulas for allocating the billions of dollars in federal revenues that are distributed to state and local governments. The possibility that it may do so, however, should alert us to the opportunity for reducing the fiscal disparities created by the states' power to tax natural resources without tampering with that power in restrictive federal legislation.

Conclusion

Even if interstate conflicts raised by state and local natural resource taxation are not amenable to judicial solution, as the Supreme Court has assured us that they are not, we should nonetheless be extremely cautious in pursuing a legislative solution to these problems. Any such solution is likely to produce consequences that were neither contemplated nor desired. State and local tax systems are sufficiently protean in nature that the attempt to curtail one perceived abuse may create similar abuses in different form. For example, states might respond to a federal restriction on their production taxes with increased property taxes on their resources. Yet, federal legislation that sought to limit all state and local taxes on natural resources in accord with some federally-defined norms of fiscal balance would represent an unprecedented

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[153] D. Halstead, Tax Wealth in Fifty States 4 (1978).

[154] *1981 Senate Fiscal Disparities Hearings*, *supra* note 146, at 61 (statement of John Shannon, Assistant Director, U.S. Advisory Comm'n on Intergovernmental Relations).

restraint upon the freedom to shape their own fiscal policies that states and localities have traditionally enjoyed in our federal system. There are, moreover, less intrusive means at the federal government's disposal, such as the modification of existing revenue-sharing formulas, to achieve some of the ends usually invoked to justify direct federal limitations on state power to tax natural resources.