

Center On Regional Politics



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President Theobald Urges Regional Leaders to Use Temple Center to Advance Policy Goals

Following are excerpts from remarks by Neil D. Theobald, Temple's new president, welcoming attendees to CORP's inaugural symposium on January 18, 2013.

I am delighted to have this opportunity to welcome all of you to a symposium that combines three important functions that universities can serve: to investigate daunting problems, document impressive achievements, and explore exciting opportunities.

In the aftermath of the Great Recession, we face momentous challenges but also perhaps momentous opportunities to realize a better future. Meeting these challenges will require the courage to change old ways of doing things, the willingness to listen to new ideas, the wisdom to make the best decisions we can, and the resolve to implement those decisions through the adoption and execution of sound public policies, even when the politics of doing so are difficult.

Although the center is headquartered at Temple and supported by the university and by philanthropic grants, it belongs to you, the region's decision makers, policy analysts, advocates, and yes, faculty members not just from Temple but from other universities, who have joined its board of fellows. It is you who will help set its agenda and contribute to its work. Its success will depend not just on the performance of the center's staff and on the continued support of the philanthropic community for its projects but on the use that you as leaders - and particularly the elected officials among you - make of its resources... Temple is committed to expanding economic opportunities and improving the quality of life not just of the students we educate but of the broader community that is our home.



Charles Moschler

Governor Tom Corbett and Temple University President Neil D. Theobald at the Center on Regional Politics symposium, January 18, 2013.

Governor Tom Corbett and Temple President Neil D. Theobald Open CORP's First Symposium

In one of his first public appearances since becoming Temple University's president, **Neil D. Theobald** welcomed more than 100 elected officials and business, labor, civic, and academic leaders to the inaugural symposium held by Temple's Center on Regional Politics on January 18, 2013, at the Penn's Landing Hyatt in Philadelphia.

The symposium's theme, "Building a Stronger Regional Economy: How Pension Funding Challenges and Energy Development Opportunities Will Affect Our Future," reflected directions set by the CORP Executive Committee last spring.

Theobald's remarks were quickly followed by **Governor Tom Corbett**, who noted that the two issues on the symposium's agenda were among the most important facing not just the region but the Commonwealth. He shared his views on both issues and congratulated the center for

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advancing public understanding of the challenges and opportunities they represent.

Alan Greenberger, Philadelphia's deputy mayor for economic development and commerce director, also welcomed attendees on behalf of **Mayor Michael Nutter**, a member of CORP's Executive Committee, who was out of town.

Most of the attendees were members of the center's Board of Fellows. They heard from a wide range of national and regional experts and leaders on pension, finance, energy, and environmental issues. In addition to Governor Corbett, the elected officials on the program included **Congressmen Bob Brady and Pat Meehan, Lieutenant Governor Jim Cawley, Senate Majority Leader Dominic Pileggi, and Montgomery County Commission Chair Josh Shapiro.**

Attendees also received a copy of CORP's first case study entitled *Taking Care of Our Own: How Democrats, Republicans, Business, and Labor Saved Thousands of Jobs and Our Refineries*, authored by Philadelphia Inquirer and Philadelphia Magazine writer Patrick Kerkstra.

PENNSYLVANIA'S STATE AND CITY RETIREE PLANS ARE UNSUSTAINABLE, PEW STUDY SAYS

Pennsylvania's pensions are on an unsustainable course and will run out of money if policy is not changed, according to a presentation by the Pew Center on the States at a January 18 symposium for the Center on Regional Politics (CORP). **Senate Majority Leader Dominic Pileggi**, R-Delaware and Chester, and co-chair with **Mayor Michael Nutter** of the center's Committee on Fiscal Policy and Governance, introduced the symposium's pension session.

Once the Commonwealth pays debt service, pensions, and federal entitlement obligations, there will not be enough money left to pay for remaining programs and services, in the judgment of **Kil Huh**, director of the Pew center's state fiscal research project, and **David Draine**, Pew's leading pension researcher. Pennsylvania's two largest cities – Philadelphia and Pittsburgh – face even greater challenges than the state plans, their data showed.

Policy change could include finding new resources to meet pension and retiree health care costs, cutting spending in other areas, modifying the retirement plans, or some combination of these steps, according to the Pew

team. But Huh and Draine concluded that comprehensive reforms to insure retirement plans were sustainable, affordable, and secure are necessary elements in meeting the funding challenges. (See box on following page.)

Pennsylvania and Philadelphia's Challenges Loom Large in Pew's National Study

Pennsylvania is not alone in facing enormous pension and retiree health care costs. Using the latest comparable data, the 50 states in fiscal 2010 faced a gap of \$1.3 trillion between their assets and obligations for public sector benefits, according to the Pew presentation: \$757 billion for pensions and \$627 billion for health care benefits. On a national basis, the annual recommended contribution for states' pension promises has grown 175 percent since 2000.

By Pew's accounting in 2010, Pennsylvania was one of 34 states without sufficient assets to meet the 80 percent standard commonly used as a measure of adequacy. Although their unfunded liabilities were significantly increased by the Great Recession, many state plans, including Pennsylvania's, were already in trouble due to underfunding by their legislatures before the economic downturn.

Focusing on 2011 data for just Pennsylvania, Pew reported that the combined two plans had only 67.8 percent of the funds needed to meet obligations and were short by a total of \$41 billion. In addition, Pennsylvania's retiree health care plans were underfunded by another \$17 billion, according to Pew's figures for 2010. Taxpayer contributions to Pennsylvania's plans, which were at \$795 million in Fiscal 2011, are projected to reach \$5 billion by Fiscal 2018-19.



Kil Huh of the Pew Center on the States.

Charles Masteller

In a new report using comparable 2010 data for 62 large American cities (the largest city in each state and for all cities above 500,000 in population), Pew reported that Philadelphia, with only 61 percent of the assets needed to meet obligations, was one of the six worst cities at funding pensions. Pittsburgh's funded ratio was even lower, at only 38 percent in the Pew report. Both cities funded ratios have since fallen, with Philadelphia at or just below 50 percent.

Pew Center on the States' Rx for PA's Public Pensions

- * Pennsylvania's pensions are on an unsustainable course and will run out of money if policy is not changed.
- * Once the state pays debt service, pensions, and federal entitlement obligations, there is not enough money left to pay for all remaining programs and services.
- * This funding crisis emerged over a decade as a result of employer contributions that fell short of sustainably funding the system, benefit increases that were not paid for, and expected investment returns that did not materialize.
- * Comprehensive reform is needed to both close the funding gap in a credible way and to offer a new plan going forward that will be sustainable, affordable, and secure and will help recruit and retain the talented public workers Pennsylvania needs.

Source: Pew Center on the States presentation to CORP symposium, January 18, 2013.

RESPONSE TO PEW REFLECTS DIVERSE VIEWS

Responding to Pew's presentation, a panel representing the state's largest public sector employers, largest labor union, and two independent finance and economic experts offered diverse views and remedies to the public pension funding challenges facing the Commonwealth and its school districts and big cities.

Feather Houstoun, former New Jersey state treasurer, SEPTA CFO, and now budget chair of Philadelphia's School Reform Commission, moderated the panel discussion. A member of CORP's executive committee, Houstoun told how she used quiet talks involving "dueling actuaries" representing the government and its unions to set parameters for reaching consensus on steps to improve pensions when she was New Jersey treasurer.

The panel included Charles Zogby, Commonwealth secretary for budget; Rob Dubow, Philadelphia's director

of finance; David Fillman, executive director of AFSCME District Council 13 and a trustee of the State Employees' Retirement System; Timothy Blake, managing director of public finance for Moody's Investor Services; and Dr. Olivia S. Mitchell, professor of business economics and public policy and of the Pension Research Council at the University of Pennsylvania's Wharton School.

Independent Experts: Pennsylvania's Unfunded Liabilities Are Understated

Calling the Pew presentation "absolutely accurate" in its summary of the status of state pension funds as reported by the plans themselves, **Timothy Blake** of Moody's said his bond-rating firm adjusts official data to make them comparable and transparent across many governments.

Among adjustments, accrued liabilities are based on a uniform discount rate tied to a high-grade long-term corporate bond index, which in the case of Pennsylvania's plans would dramatically increase the unfunded liability. Moody's also evaluates assets based on their fair market value and adjusts contributions to reflect a common amortization period. Blake noted that Moody's cited Pennsylvania's unfunded pension liabilities as a factor in downgrading the Commonwealth's bonds late last year.

Similarly, Wharton professor **Olivia S. Mitchell** warned that the unfunded liabilities of most public pension plans are far more grave than either the plan administrators or public officials acknowledge. Were these plans to use the sounder assumptions about the value of their future earnings that many economists believe are appropriate, Mitchell said, the unfunded liabilities of the state's largest plans would almost double. That would mean that the unfunded



Charles Mastoller

Symposium attendees included State Senator Mike Stack (second from left, front row), State Senate Majority Leader Dominic Pileggi (second from right, front row), and Philadelphia City Councilman Bill Green (center, second row).



Charles Mastoller

Labor leader David Fillman, Wharton professor Olivia S. Mitchell, and PA budget secretary Charles Zogby discuss public pension issues.

liability of Pennsylvania’s state and municipal systems would approach \$100 billion rather than \$50 billion. Many economists also argue that plans should be 100 percent funded rather than 80 percent.

Addressing the funding challenge is difficult because pension funding issues are complex and not easily explained in terms that citizens can understand, Mitchell said. She then gave an example of the kind of explanation needed. Even using unfunded pension amounts that the plans acknowledge, which she believes are understated, on average each Philadelphia household is faced with burdens of \$14,000 for municipal plans and \$27,000 for state obligations, or a total \$41,000. Adding Social Security’s unfunded liability of \$78,000 brings total obligations for public retirement programs per Philadelphia household to an average of \$119,000. Acknowledging that her estimates are very rough and that one can quibble about the underlying assumptions, Mitchell observed that they serve to illustrate the real dimensions of funding public retirement programs.

Labor’s View: More Revenue Is Needed

David Fillman, executive director of the state’s largest public sector union representing 65,000 state and local employees, acknowledged that the funding challenges are severe but contended that employees and retirees have made sacrifices and now governments must make up for past underfunding. Further, the average state retiree’s pension is modest and has not been adjusted for inflation in a decade. (See following box for more details.)

Because the Pennsylvania Supreme Court held in the 1980s that the pension benefits are contractual obligations to the employees under the state constitution, there is no legal way to reduce the accrued benefit of current employees,

Fillman said. New, dedicated revenues are needed to address the obligations to public employee pensions. He suggested that the Commonwealth consider eliminating the so-called Delaware tax loophole that allows corporations to escape taxes, re-visiting the Marcellus Shale impact fee tax, and revisiting the on-time payment discount that large retailers use to reduce their sales tax burden.

Fillman also said, however, that as a SERS trustee as well as a union leader, he is concerned about the challenges facing the state system and open to negotiations with the Corbett administration and the legislature to find fair and reasonable ways to shore the system. So far, he said, such negotiations have not commenced.

Labor’s Brief: Workers Have Done Their Share; Governments Must Step Up

- * State and school district contributions were less than needed actuarially in the last 10 years, costing billions of dollars in investment returns.
- * Public employees made their required payments. State employees contribute 6.25% and most school district employees 7.5%.
- * SERS, for the first time since its inception in 1922, has more retirees than active contributors.
- * The average SERS pension is approximately \$24,000 per year.
- * Unlike most states, PA does not provide automatic cost-of-living adjustments (COLAs). Retirees have not received a COLA in the past 10 years.
- * Under 2010 reforms, benefits were drastically reduced for state and school employees hired in 2011 and later. Under the act, new employees’ contributions could increase if investment projections come in below expectation, assuming employers put in their required amounts.

Source: Comments by David Fillman, executive director of District Council 13, AFSCME, at the Center on Regional Politics January 18, 2013, symposium.

State and City Budget Directors: Pension Reform Is Needed to Maintain Public Services

Charles Zogby, budget secretary for Governor Corbett, emphasized that the administration recognized that the benefits promised retirees and earned by current employees to date were obligations that must be paid. Without modifications going forward, however, the huge increases in Commonwealth and school district pension contributions required in the next few years will consume most of the modest growth in projected state revenues, threatening the



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Philadelphia Finance Director Rob Dubow and former New Jersey Treasurer and SEPTA CFO Feather Houstoun on the public pension panel at the CORP symposium.

ability to fund schools, health care, and many other services the public expects.

Agreeing with Pew and other panelists, Zogby said the cause of the pension problems was not just the recession but the failure of previous legislatures and administrations to pay for benefit enhancements they had enacted. Specifically, he was critical of the legislature's decision to raise the multiplier from 2 to 2.5 percent in the pension formula, effectively a 25 percent increase. Although he declined to specify what reforms Governor Corbett would propose in his February 5 budget message, he hinted a defined contribution feature and a reduction of the multiplier for new employees and perhaps even for current employees as of the date of enactment might be among them. (See following box for the governor's budget proposals.)

Rob Dubow, Philadelphia finance director, said underfunding of the pensions was the single largest fiscal problem facing the city government, consuming about 17 percent of the budget, most of which was needed to make up for previous underfunding of the system. Later data than Pew presented put the city's funding ratios at 50 percent or even a bit lower, he said. In a 2009 report, Philadelphia reported that its system had the lowest funding ratio of the nation's 20 largest municipal plans and was in trouble even before the recession reduced the value of its assets.

Dubow noted the city has asked its unions to agree to higher contributions by employees and to accept a hybrid plan for new hires. The hybrid would consist of a less generous defined benefit and an optional defined contribution plan under which the city would match employee contributions.

Governor Corbett's Pension Proposals

In his budget message on February 5, subsequent to CORP's symposium, Governor Corbett proposed the following changes to pensions for members of the Pennsylvania State Employees' Retirement System (SERS) and Public School Employees' Retirement System (PSERS):

1. No proposed changes to current retirees and no reductions to benefits earned by current employees.
2. Reduction in the multiplier used to calculate current employee benefits from 2.5 to 2.0.
3. Change in the years used to calculate employees' final salary from the average of the highest three to an average of the last five years.
4. All new employees placed in a 401(k)-style system with SERS members contributing 6.25 percent of income and SERS members 7.5 percent. The employer contribution would be 4 percent.
5. The proposed reforms would allow for pension debt to be paid off in the same time frame as ACT 120 (2045), but would move all employees to a DC system.

CORP PANEL: HONESTY AND TRUST HELPED SAVE REFINERIES AND JOBS

Honesty about grim corporate finances and trust that bridged Democratic-Republican, city-suburban, and business-labor lines were key to saving thousands of jobs and the Schuylkill and Delaware River refineries, said a panel of leaders who played key roles in the rescue effort.

Panelists included **Congressmen Bob Brady and Pat Meehan**, **Lieutenant Governor Jim Cawley**, corporate executives **Phil Rinaldi** and **Brian MacDonald**, and labor leader **Pat Gillespie**. They were led through a retelling of the story by **Patrick Kerkstra**, author of a CORP case study about the refinery saving effort that was released at the symposium. (Meehan, Cawley, and Gillespie are members of the CORP Board of Fellows.)

A year after Sunoco and Conoco, citing mounting business losses and looming environmental compliance costs, had announced the closing of refineries in Philadelphia, Marcus Hook, and Trainer, all three sites had new owners and brighter futures.

Introducing the panelists in his role as co-chair of CORP's Committee on Energy, Environment, and Land Use, **Montgomery County Commissioner Josh Shapiro** noted many other elected federal, state, and local officials and



Charles Mosoller

Labor leader Pat Gillespie, Congressman Bob Brady, Lt. Governor Jim Cawley, Congressman Pat Meehan, and CEO of Philadelphia Energy Solutions Phil Rinaldi discuss the rescue of the refineries.

business and labor leaders, some in the audience, were involved in the effort. Among those who played important roles: **Governor Corbett, Mayor Nutter, Vice President Joe Biden and Gene Sperling** of the Obama administration, **US Senators Bob Casey and Pat Toomey, Congress members Chaka Fattah and Allyson Schwartz and State Senator Dominic Pileggi** and many other state legislators of both parties, including symposium attendee **State Representative Bill Keller**.

Local officials who helped and were present for the panel discussion included **Delaware County Councilmen John McBlain, and Tom McGarrigle, Chair, Delaware County Commerce Director Pat Killian, and Marcus Hook Mayor Jim Schiliro**.

Shapiro also credited Delta Airlines for boldly entering the energy business with its purchase of the Trainer site, Braskem America for investing in the Marcus Hook facility, and the refinery workers themselves “who marched and cajoled and lobbied their elected leaders to save their way of life.”

The panelists, and Kerkstra’s case study, highlighted the importance of the decision by MacDonald, now CEO of



Portraits by Kellie McGinn

ETP Holdco but then a Sunoco executive, to open the company’s books and reveal the details of efforts to find buyers for the facilities to labor leaders who had signed confidentiality agreements. Speaking from the audience, **Jim Savage**, leader of the **Steelworkers Local 10-1**, credited his members for trusting his decision to control their anger and anxiety and pursue a strategy of constructive pressure, even though he could not share all he knew about corporate finances and behind-the-scenes rescue efforts. Rinaldi, CEO of Philadelphia Energy Solutions, which acquired the Sunoco site in Philadelphia, said the intensity and responsiveness of government leaders in delivering on commitments and the willingness of labor to reach accommodations on work-rule and pension changes helped secure corporate confidence to risk large investments in the future of the facilities.

Several panelists stressed the need to mount cooperative efforts to protect and grow the regional economy “before the deck is on fire,” in the phrase used by Gillespie. Asked what were the key factors turning around what seemed at the outset a hopeless situation, Brady emphasized honesty, trust, and the stubborn refusal to give up. If you can get the right people in the room and everybody wants to achieve the same end, you can get it done, Brady said.

**“A CHANGE OF TECTONIC PROPORTIONS”:
CORP SPEAKER SAYS NEW ENERGY
ECONOMY WILL HELP REGION GROW**

Philip K. Verleger, Jr., a widely respected and quoted expert in energy markets and senior visiting fellow at the Peterson Institute of International Economics, told attendees at CORP’s symposium that the sudden and surprising end of the energy crisis points to new growth in the regional economy. Following are excerpts from his talk.¹

... Clearly, the substitution of renewables for fossil fuels can be justified given the clear and present problem of global warming and the extraordinarily compelling evidence that humans have caused much of the harm. However, many adjustments made in response to the energy crisis that began in 1973 have been a mistake. Forests have been denuded in nations such as the Philippines by those who are desperate for fuel but cannot afford kerosene. Billions of tons of coal have been consumed to produce electricity by utilities wrongly required to abandon oil and gas. Trillions of dollars have been needlessly allocated to projects to produce substitutes for oil and natural gas.

Ten years from now, historians will ask, “What was that all about?” They may also ask, “How could officials support

1. “The End of the Energy Crisis and the Pennsylvania Economy’s Potential for Rebirth,” Philip K. Verleger, Jr.

policies that caused such serious long-term damage for so little short-term gain?"

Historians will be so curious because by 2020 or 2025 the crisis associated with natural gas and petroleum shortages will have ended. Prices for these fuels will have sunk to extremely low levels. Natural gas prices in the United States have already dropped as much as ninety percent from peaks that once approached \$20 per thousand cubic feet (mcf), which is the equivalent of \$120 per barrel for oil, to as low as \$2 per mcf. Crude oil prices are falling as well. Prices peaked at over \$145 per barrel in June 2008. Today, some crudes can be purchased for less than \$50. These prices will decrease further.

Credit for the end of the oil crisis belongs to the scientists and engineers who developed new technologies to tap shale oil and gas reserves. We have known about these reserves for decades. They were not counted, though, in the data published by the Department of Energy or the American Association of Petroleum Geologists because they could not be produced. In other words, technology has made it economically possible to produce large volumes of crude oil and natural gas originally thought unreachable. These are now flowing from the Bakken Shale in North Dakota (oil) and the Marcellus Shale in Pennsylvania (natural gas). They will soon flow from other areas.

Pennsylvania's Advantages Listed

As is often the case, some regions will gain more than others. Pennsylvania has at least three important advantages. First, one of the major sources of low-cost natural gas is the Marcellus Shale, which stretches across the state. Second, unique rail networks built over one hundred years ago provide a way to bring crude from North Dakota and Colorado shale fields to Pennsylvania refineries, as well as to refineries in southern New Jersey and Delaware. Third, eastern Pennsylvania is not exposed to extreme weather, unlike businesses in other coastal states such as Connecticut, Massachusetts, New Jersey, and New York. These circumstances give Pennsylvania a unique opportunity.

The availability of low-cost natural gas to Pennsylvania will reverse a sixty-year trend in regional energy markets that systematically discriminated against the state. Natural gas has been an important fuel for the United States for

more than seventy years. In 1960, Theodore Levitt noted the natural gas industry's emergence after World War II as a competitor to heating oil.² Gas was more convenient, cleaner, and less expensive. Unfortunately, in 1962 the US Supreme Court ruled that natural gas shipped in interstate commerce was subject to federal regulation. Officials at the Federal Power Commission (now the Federal Energy Regulatory Commission) set very low prices. These were based on production costs. Producers quickly stopped shipping new natural gas supplies to interstate markets, choosing instead to sell them in unregulated intrastate markets.³

SOUTHEASTERN PENNSYLVANIA'S COMPETITIVE ADVANTAGES IN THE NEW ENERGY ECONOMY

- * The availability of low-cost natural gas to Pennsylvania, reversing a sixty-year trend in regional energy markets that systematically discriminated against the state.
- * Rail lines that connect Southeastern Pennsylvania with energy producing regions.
- * The existence of several refineries in eastern Pennsylvania and Delaware.
- * The superior protection Pennsylvania refineries enjoy against giant surges associated with superstorms such as Sandy.
- * A fixed-rail mass transit system that, if well maintained, will give the state a competitive advantage over many other regions.

Pennsylvania's competitive position was undercut by these federal regulations. As early as 1973, consumers in the state were paying \$0.77 per mcf while their counterparts in New Orleans paid \$0.35.⁴ Furthermore, incremental gas supplies were available to firms in Texas, Louisiana, and Oklahoma. Such supplies often were not available to new customers in Pennsylvania nor could businesses in the northeast acquire extra volumes if they expanded. In addition, access to low cost gas allowed utilities in states with unregulated supplies to offer lower prices. Buyers in Pittsburgh, for example, paid \$1.69 per one hundred kilowatt hours while those in Texas paid \$1.30.

The energy price advantage in Texas and Louisiana triggered an exodus of manufacturing from the Northeast to the Southwest. In his concise, insightful essay on Philadelphia's economic history, Joseph Gyourko of the University of Pennsylvania describes the movement out of Philadelphia

2. See Theodore Levitt, "Marketing Myopia," *Harvard Business Review* 38, No. 4 (July-August 1960), pp. 45-56.

3. Paul W. MacAvoy, "The Regulation-Induced Shortage of Natural Gas," *Journal of Law and Economics* 14, No. 1 (April 1971) [<http://goo.gl/dp2xf>], pp. 167-199.

4. Foster Associates, *Energy Prices 1960-1973: A Reference Book* (Cambridge, MA: Ballinger, 1974), pp. 198-199.

at the time but misses the impact of lower-cost energy, which clearly contributed to the shift.⁵

The development of natural gas production in the Marcellus Shale will reverse this trend. Prices in Pennsylvania are low today and will likely remain low for the foreseeable future, at least compared to Gulf Coast states. Pennsylvania will enjoy this advantage because there are currently no natural gas export facilities near the Marcellus gas, whereas several plants on the Gulf Coast are being reconfigured for exports. The lack of export facilities in Pennsylvania will effectively trap the gas in the state for five to ten years, giving manufacturers there an advantage. A number of firms have already recognized the change. Shell, for example, has announced it may build an ethylene cracker in Beaver Falls. Its consideration of the project demonstrates the dramatically different circumstances in Pennsylvania. Other manufacturing facilities are expanding and new ones opening to take advantage of low-cost natural gas.

Employment Opportunities Outlined

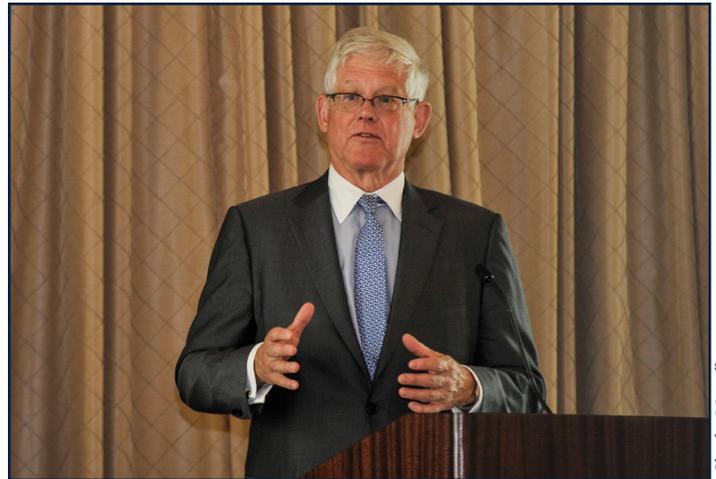
Labor will not be a constraint should firms seize the chance offered by Pennsylvania's access to low-priced gas. Furthermore, industrial development may create training and career opportunities for younger people in Southeastern Pennsylvania.

The energy revolution will offer enormous employment opportunities for those living in Pennsylvania if the state's schools and businesses institute the necessary training programs. I will leave it to the experts on our panel to discuss their view of the strategies needed to help local residents connect to the new jobs in energy and manufacturing.

Historically, exploration for oil required few workers but enormous amounts of capital. The shale revolution is different. It is a manufacturing business. Production from a new well starts at a high level and quickly falls off. This means that firms must keep drilling to hold output constant. Capital requirements are lower but labor requirements much higher. There is a huge opportunity here if Pennsylvania mobilizes its schools as states such as Wyoming have. One can argue that Pennsylvania's good fortune came about due more to serendipity than planning. But then, it is always

better to be lucky than smart. The job now is to make the most of the luck.

The existence of several refineries in eastern Pennsylvania and Delaware provides the second great opportunity for Pennsylvania. There were four major refineries in eastern Pennsylvania and Delaware in 2000. Their combined distillation capacity was nine hundred thousand barrels per day, six percent of the nation's refining capability. If things had gone according to plan, all of this capacity would now be closed. However, again thanks to serendipity and the successful political mobilization described in the Temple case study, it is still open.



Energy expert Philip K. Verleger, Jr.

Instead, as recounted in the Temple case study, Delta Airlines purchased the Trainer refinery and has put it back into operation. PBF, chaired by Tom O'Malley, one of the oil industry's greatest innovators, has kept the Delaware refinery working.

Finally, the Carlyle Group bought Sunoco's Philadelphia facility and kept it open. In a December 22, 2012 article for *The Washington Post*, Mufson (who interviewed the CEO of Sun's refinery twenty-nine years earlier) wrote that Carlyle planned to use low-cost Marcellus natural gas and process crude from North Dakota.⁶ The low-cost gas would reduce operating costs. The North Dakota crude could be obtained at a discount of as much as \$30 per barrel to Nigerian crude. Circumstances had changed. It was serendipity again.

The opportunity is so great that Delta Airlines, which owns the Trainer refinery, proposes to ship crude from North

5. Joseph Gyourko, "Looking Back to Look Forward: Learning from Philadelphia's 350 years of Urban Development," Brookings-Wharton Papers on Urban Development (2005) [<http://goo.gl/ksRDV>], pp. 1-58.

6. Steven Mufson, "Carlyle Group, Sunoco, and Politicians' Joint Venture to Rescue Philadelphia Refinery," *The Washington Post*, December 22, 2012.

Dakota to the reactivated facility and then ship jet fuel back to its Minneapolis hub.⁷ Serendipity indeed.

The oil industry has always been characterized by the existence and exercise of market and political power. It was once said that John D. Rockefeller's Standard Oil "did everything to the Pennsylvania legislature except refine it."⁸ Pennsylvania, ironically, is now playing an important role in breaking monopolies, both those enjoyed for forty years by oil-exporting countries and those enjoyed by Middle America refiners.

Finally, although Pennsylvania's refineries are in river flood plains, they are protected from the giant storm surges associated with superstorms such as Sandy. The human contribution to global warming has been subject to much debate for more than a decade. Whether fossil fuel use has played a part is irrelevant here. Instead, I simply note that meteorologists expect North Atlantic cyclonic activity to increase in coming years.⁹

Refineries in eastern Pennsylvania have a decided advantage if such forecasts prove correct. Superstorm Sandy demonstrated the vulnerability of the petroleum infrastructure in New York Harbor. Coastal infrastructure north to Boston suffers the same exposure. New York is particularly at risk, as Sandy showed, because most of its petroleum refining and distribution facilities lie on the Arthur Kill, the narrow strip of water that separates Staten Island and New Jersey. Two days after Sandy, ninety percent of the New York and New Jersey distribution facilities were disabled. Two weeks later, thirty percent was out of service. As November ended, thirty percent was still out of service. To repeat, one month after Sandy hit, thirty percent of the major petroleum facilities that supply New York were still closed.

New York's exposure to storms can be remedied only by constructing extraordinarily expensive storm gates such as those in Rotterdam or at the mouth of the Thames River. As Crooks and Wright report, experts believe New York Harbor could be protected by putting up barriers at the Verrazano Narrows, the Arthur Kill, and the north end of the East River for a cost of roughly \$20 billion.¹⁰

Given the United States' current budget problems, it seems unlikely that plans to protect New York Harbor will be

fulfilled. Instead, the petroleum infrastructure north of Philadelphia will remain vulnerable.

As a consequence, one should expect a rebirth of petroleum refining in Pennsylvania and Delaware. Facilities there enjoy unique access to crude from Midwest shale production, transportation services based on its extensive rail infrastructure, including the lines built as part of the Pennsylvania Railroad more than 100 years ago, and protection from hurricane-related storm surges. Again, Pennsylvania will benefit not from planning but from serendipity.

Finally, another major legacy of Pennsylvania's railroad past is its fixed-rail mass transit system, which, if well maintained, will give the state a competitive advantage over many other regions.

The oil crisis that has constrained economic activity in the United States, Europe, and Asia for forty years is waning. Entrepreneurs and engineers have cracked the access code for oil and gas trapped in shale. The resource constraints that have bedeviled the world for four decades have been eliminated.

This is a change of tectonic proportions.

This outcome could not have been predicted. It could not have been planned. It now is up to the private sector and governments to make the best of it.

Publications available on the Center on Regional Politics website from the symposium on "Building a Stronger Regional Economy: How Pension Funding Challenges and Energy Development Opportunities Will Affect Our Future":

www.temple.edu/corp

- > Full program with biographies of speakers
- > Pew Center on the States' presentation on Pennsylvania pensions
- > *Taking Care of Our Own: How Democrats, Republicans, Business, and Labor Saved Thousands of Jobs and Our Refineries*, a case study authored by Patrick Kerkstra about the rescue of the Schuylkill and Delaware River refineries
- > "The End of the Energy Crisis and the Pennsylvania Economy's Potential for Rebirth," Philip K. Verleger, Jr.

7. Meghan Gordon, "Delta Expected to Run Bakken Crude at Trainer by April," *Platts Global Alert*, December 12, 2012.

8. The quote is attributed to Henry Demarest Lloyd in Robert H. Weibe's *The Search for Order: 1877-1920* (New York: Hill and Wang, 1967), p. 28.

9. Hiroyuki Murakami and Bin Wang, "Future Changes in North Atlantic Cyclone Tracks," *American Meteorological Society*, May 15, 2010 [<http://goo.gl/JPTkH>].

10. Ed Crooks and Robert Wright, "Climate: Storm Warning," *Financial Times*, November 29, 2012, [<http://goo.gl/dy9n8>].

CORP PANEL SEES OPPORTUNITIES AND CHALLENGES IN NEW ENERGY ECONOMY

Responding to **Philip K. Verleger, Jr.’s** talk, a panel of two corporate executives, a leading environmental advocacy group, a state energy and utility regulator, and the director of Philadelphia’s workforce development agency agreed that the new energy economy holds enormous opportunities for regional growth but said satisfying safety and environmental concerns was key to realizing that promise.

Introducing the panel, **Nick DeBenedictis**, co-chair of CORP’s Energy, Environment, and Land Use Committee and chair and CEO of Aqua America, briefly recounted Pennsylvania’s history as an energy-producing state. “I believe the natural gas industry will become the biggest



Charles Mostoller

Mark Brownstein, chief counsel of the Environmental Defense Fund, Mark Edwards, director of Philly Works, and Sri Iyer, vice president of finance, planning, and strategy for Braskem America react to questions about southeastern Pennsylvania’s future in the new energy economy.

economic driver in Pennsylvania since the heydays of coal and steel,” said DeBenedictis, a former Commonwealth secretary of environmental resources. “Marcellus Shale gas drilling is our second chance to take economic advantage of our rich energy resources and to do it right this time so there is minimal impact to the environment.”

DeBenedictis then introduced **Mike Armstrong**, *Philadelphia Inquirer* business columnist, who moderated a discussion among **Mark Brownstein**, chief counsel for energy programs at the Environmental Defense Fund; **Mark Edwards**, director of Philly Works; **Sri Iyer**, vice president of finance, planning and strategy for Braskem America; **Robert Powelson**, chair of the Pennsylvania Public Utility Commission; and **Philip Rinaldi**, CEO of Philadelphia Energy Solutions. (Edwards and Powelson are members of CORP’s Board of Fellows.)

Brownstein said opportunities for growth could be jeopardized if the public loses confidence in the ability of the Commonwealth’s regulators to protect air and water quality. Agreeing with Verleger’s contention that Marcellus gas extraction is more like a manufacturing process than a traditional mining site, in that it requires constant monitoring of many transient operations, Brownstein contended that state regulators now lack the capacity to monitor thousands of drilling sites, a view that was strongly disputed by PUC Chair Rob Powelson.

Iyer said the proximity to inexpensive energy and superior transportation infrastructure in the Philadelphia region are attractive factors for an industrial company.

Rinaldi expressed confidence in his company’s ability to help the region grow economically. Reinforcing Verleger’s observation that the region’s superb rail network and greater protection from storm surges than northern coastal refineries were major competitive advantages, Rinaldi said that in the aftermath of Sandy, Philadelphia area refineries were supplying 50 percent of fuel needs in the Northeast.



Charles Mostoller

Mike Armstrong, *Philadelphia Inquirer* business columnist, and Robert Powelson, Public Utilities Commission chairman, discuss the impacts of the energy economy on Southeast Pennsylvania.



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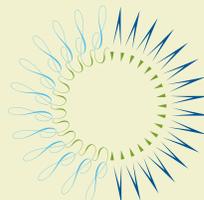
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