KENTUCKY CENTER for ECONOMIC POLICY

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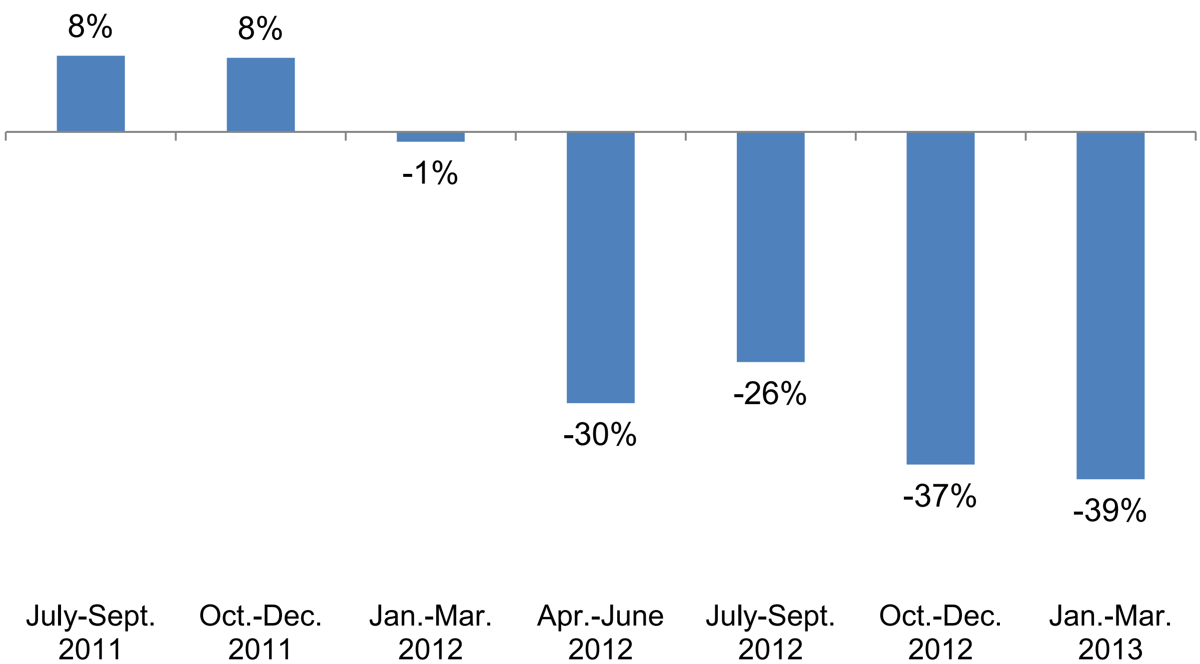
Sharp Decline in Coal Severance Tax Revenue Underscores Need for Economic Plan

By Jason Bailey

New data showing that eastern Kentucky lost 4,000 coal jobs last year should raise alarm among public officials about the longstanding need for an economic transition plan.[1] So should the big drop in eastern Kentucky coal severance tax receipts, which are 33 percent lower over the last 12 months than the previous year.

The coal severance tax is one potential resource for investments that help transition the regional economy. But from April 2012 through March 2013, eastern Kentucky generated only $154 million in coal severance tax revenue compared to $228 million the year before. The steep drop in the region's severance tax revenue began last spring, as the graph below shows.

Percent Change in Eastern Kentucky Coal Severance Tax Revenue from Previous Year



Source: KCEP analysis of data provided by the Kentucky Department of Revenue and the Kentucky Department of Energy Development and Independence.

Declining production is the major force behind lower severance tax receipts. In 2012, 28 percent less coal was mined in eastern Kentucky than in 2011. Several factors are driving this decline. Eastern Kentucky coal is becoming more expensive to mine due to diminishing reserves. Also important is natural gas, which has become a cheaper alternative to coal as a fuel for electric power. Rules dealing with coal's impact on the air and water play a role as well.

When the coal severance tax was established in 1972, public officials should have dedicated most of its revenue to investments that could help transition coalfield economies as coal reserves decline. But for the most part, the coal severance tax hasn't been used for strategies to diversify the economy. A substantial portion of the tax has gone to the state's General Fund and to help coalfield local governments fix roads and pay for basic services. Only in 1992 was a portion dedicated to a fund established for economic development. But use of that fund has been limited to building industrial parks and sites, many of which have sat empty or seen outside businesses come and go after only a few years.

In more recent budgets, the legislature has earmarked dollars that would otherwise go to the economic development fund for a wide variety of local projects and programs—from senior centers to fire trucks, water projects, ball fields and more—all without a broader plan for how those projects add up to a new economic future.

Planning for What's Next

While many of those projects are needed, they won't be enough to transition the economy without accompanying investments in economic diversification. But declining coal severance tax dollars will mean less money and more tough choices for the state and local governments. In the 2013 General Assembly, a bill passed allowing local governments that have experienced a decline of at least 25 percent in their severance tax revenues to shift monies from the economic development fund and local projects to fill the holes in county budgets.[2]

In 2012, we wrote a report calling for the state to create a permanent fund using a small share of coal severance tax dollars, following the lead of other natural resource-dependent states.[3] A permanent fund means a pool of financial resources that can pay dividends and make investments indefinitely through the long period it will take to diversify the economy. Just as important as the fund, we wrote, is the need for a democratic planning body that can create and implement a sound economic transition strategy.

That report anticipated a decline in eastern Kentucky coal severance tax revenue, with a rough estimate of a 63 percent drop by 2020 based in part on federal projections of coal production and prices. Despite falling receipts, the report estimated that dedicating about one-fifth of coal severance tax revenue to a permanent fund could result in a $735 million endowment by 2035 (in 2010 dollars).

This year's trend suggests that the decline may be happening even faster than predicted. And that makes action to create a long-term plan even more important—including the need to examine the severance tax and explore how it should be used. The news also hastens the need to leverage other dollars, including from the federal and state government and from philanthropic sources, to finance the way forward. Every year we delay taking action on a transition plan, the more we lose reinvestment opportunities from the mining activity that remains.

No one knows the future for coal in eastern Kentucky, but it would be foolish to assume that coal will come roaring back. Kentucky Energy and Environment Cabinet Secretary Len Peters recently said he was "convinced that we've seen our last boom-bust cycle for Kentucky coal."[4] It's more important than ever for eastern Kentuckians and public officials to come together around a broad, bold transition plan that includes resources to fund job-creating investments.

The Kentucky Center for Economic Policy is a non-profit, non-partisan initiative that conducts research, analysis and education on important policy issues facing the Commonwealth. Launched in 2011, the Center is a project of the Mountain Association for Community Economic Development (MACED). For more information, please visit KCEP's website at www.kypolicy.org.

[1] Kentucky Department of Energy Development and Independence, "Kentucky Coal Production, 2012," March 18, 2013, http://www.maced.org/files/Kentucky_Coal_Production_Update_2012Q4.pdf.
[2] House Bill 27, 2013 Regular Session of the Kentucky General Assembly, http://www.lrc.ky.gov/record/13RS/HB27.htm.
[3] Jason Bailey, "Promoting Long-Term Investment in Appalachian Kentucky: A Permanent Coal Severance Tax Fund," Mountain Association for Community Economic Development/Kentucky Center for Economic Policy, March 2012, http://www.kypolicy.us/sites/kcep/files/Coal%20Severance%20Tax%20Brief_0.pdf.
[4] Len Peters, "Kentucky's Energy Economics," *Energeia*, Vol., 24 No. 1/2013, http://www.caer.uky.edu/energeia/PDF/vol24_1.pdf#page=5.