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WVCBP: Fund from severance tax could raise more than \$5 billion by 2035

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The West Virginia Center on Budget and Policy just released a report concluding its model of an "Economic Diversification Trust Fund" could create \$2 billion in cumulative funding with \$3.7 billion of remaining principal by 2035.

Had the report been in place since 1980, the report states, the fund would already have assets of nearly \$2 billion due to interest from investments. The report suggests raising the severance tax on gas and coal by 1 percent and creating a permanent trust fund.

"The purpose of these funds are to take nonrenewable resources and make them into a source of sustainable wealth into the future," said Ted Boettner, executive director of the West Virginia Center on Budget and Policy.

The trust fund, the authors of the report write, could be used to fund infrastructure projects, boost educational opportunities and fund economic development projects. The report points out that according to the authors' examination of U.S. Bureau of Economic Analysis data, West Virginia is the fourth least economically diverse state in the nation.

"With coal production declining in West Virginia, we see that local and state economies cannot rely indefinitely on finite natural resources for jobs and tax revenues," said Rory McIlmoil, co-author of the study and Downstream Strategies project manager.

Boettner said the move is conservative financially and makes sense for ensuring future West Virginia generations are not left without assets.

"The purpose of this fund would be to set some of that severance tax money aside, sort of like a rainy day fund," Boettner said.

How the fund would work

The fund as described by the WVCBP would invested in a permanent fund, a fund that is protected constitutionally or requires three-quarters of the Legislature to withdraw from the principal. Earnings from the funds, all or in portion, could be redirected to the state's general fund, redistributed to citizens, held for future use or redistributed in a number of ways.

"What we want to do is provide a base of infrastructure, higher education, workforce training, transition assistance ... We need to plan for the future for that. If we can use the money to help sustain economic development in those areas, that would be beneficial to all of us."

Building a permanent fund, the WVCBP said, would also likely increase the bond rating of the state. Moody's Investors Service raised Alaska's obligation bond rating significantly when the state created its Permanent Fund Earnings Reserve.

A portion of severance tax leases, leases or bonus payments would be directed into the fund.

The report uses a rate of return of 7.5 percent, "the rate used by many states to determine the present value of public pension funds."

Critics of increasing the severance tax often point to decreased business activity in the state due to the increase, but Boettner said most literature suggests the severance tax plays very little role in the location of extractive industry.

"As we've shown in a previous report, back in December, the severance tax doesn't cause a big distortion on production employment," Boettner said.

Senate President Jeff Kessler, D-Marshall, has proposed a similar type of fund, but one that would not increase the severance tax. Kessler's proposal is to instead use data from before the Marcellus shale drilling boom as a baseline, with additional revenues going into a permanent trust fund. Boettner said Kessler's idea was a "good start."

"I think it would be less effective, but it would be a good start," Boettner said. "Anything over the status quo is better."

According to a WVCBP analysis, the "West Virginia Future Fund" proposed by Kessler would contain just under \$1.5 billion, less than half of the projected \$3.8 billion forecasted from a one percent

increase in the severance tax. This increase is despite higher project withdrawals from the fund.

In Wyoming, the Consumer Price Index is used to calculate how much of the annual earnings are placed back into the fund to ensure the fund continues to benefit the state in the future.

West Virginia's economic challenges

One problem in the Mountain State is that its economy is largely tied to fluctuations of energy markets. Much of the state's economic success is tied to coal and natural gas prices.

"We have a real lack of economic diversity," Boettner said. "Moody's Investors has pointed out a weakness in our state's economy because we are so dependent on natural resource drilling. That's not always a bad thing, but it's a non-renewable resource that depletes over time."

Only Wyoming, Alaska and Nevada have lower employment diversity, as measured by the Hachman Index. Alaska and Wyoming are also energy-focused states while Nevada's prime industry is tourism.

One of West Virginia's biggest challenges, the report says, is transitioning from an industry-based economy to a knowledge-based economy.

The New Economy Index ranked West Virginia second worst for "making the transition to the New Economy."

"A number of West Virginia-based organizations ... are working to attract new sustainable industries to the state," the report states. "However, a comprehensive vision of economic diversity remains elusive, as do the public policy and resources needed to support it."

Other barriers to economic growth in the state include low rates of advanced education attainment, a low labor force participation rate and a limited fiscal capacity.

"We have, in West Virginia, a low revenue capacity, low per capita income, low GDP per workforce, we have a very low amount of people who make over \$200,000 per year, so we have a very small tax base," Boettner said. "At the same time that we have a very small tax base, we have a population that needs a lot of services such as Medicaid and things like that."

According to a study by the Brookings Tax Policy Center and New England Public Policy Center, West Virginia has the third lowest fiscal capacity in the nation. With the aging population, the difficulties are likely to continue, Boettner said.

Deteriorating infrastructure is another challenge to the state's economic health, the report states. West Virginia's infrastructure investments have been on the decline and the list of critical infrastructure in need of replacement and repair has grown.

"The severance tax fund isn't going to be the end-all bullet to all of those problems, but it could go a long way toward addressing some of those problems," Boettner said.

Other states

"A lot of the forward-looking states out West did this in the '70s when we had an energy boom," Boettner said. "Just think about in West Virginia if we had a little tax on coal from the beginning. West Virginia would like Shangri-La."

Had a 1 percent increase been in place for just coal since the '80s, Boettner said, the fund would have close to \$2 billion in it today. The fund, he said, could have been used for projects for increasing the state's economic viability.

Every state handles its mineral trust funds separately, and the report examines a number of the similarities and differences among the states.

"New Mexico puts most of their permanent fund into public schools," Boettner said. "Wyoming puts almost all of theirs in the general revenue. I think for West Virginia, we have to think a little differently than some of these other states. We have a real sense that we don't want to repeat the past like we did with coal."

Montana bases its fund on coal, Alaska on oil, and Wyoming and New Mexico collect for their funds on the sale of oil, natural gas and coal.

Montana's Treasure State Endowment Fund and Regional Water System Fund are used to administer grants for major sewer, water and bridge projects. North Dakota uses some of the Coal Development Trust Fund for school construction. New Mexico sells bonds for capital projects based on its permanent fund.

A popular and well-known program in Alaska returns dividends from the funds to qualifying Alaskan citizens. In Montana, another program called the Big Sky Economic Development Fund writes grants to "high poverty" counties.

Political will

One of the challenges in passing such a measure, Boettner said, is overcoming industry interest

groups.

"When you think about our children and the future of this state, it makes sense," Boettner said. "Political courage is hard to come by, but I think there are some people who would like to see this, but if you have industry folks not behind it and they're running ads against you and all this, you're not going to be able to do it if it's about money."

Boettner said his organization looks at things from a "best-policy" perspective and not from a political perspective.

"We need a race to the top," Boettner said. "We need to quit engaging in a race to the bottom in economic development."

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