



Creating a Severance Tax Permanent Fund in the Mountain State

Presentation to the Joint Commission on Economic Development

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WEST VIRGINIA CENTER ON BUDGET AND POLICY

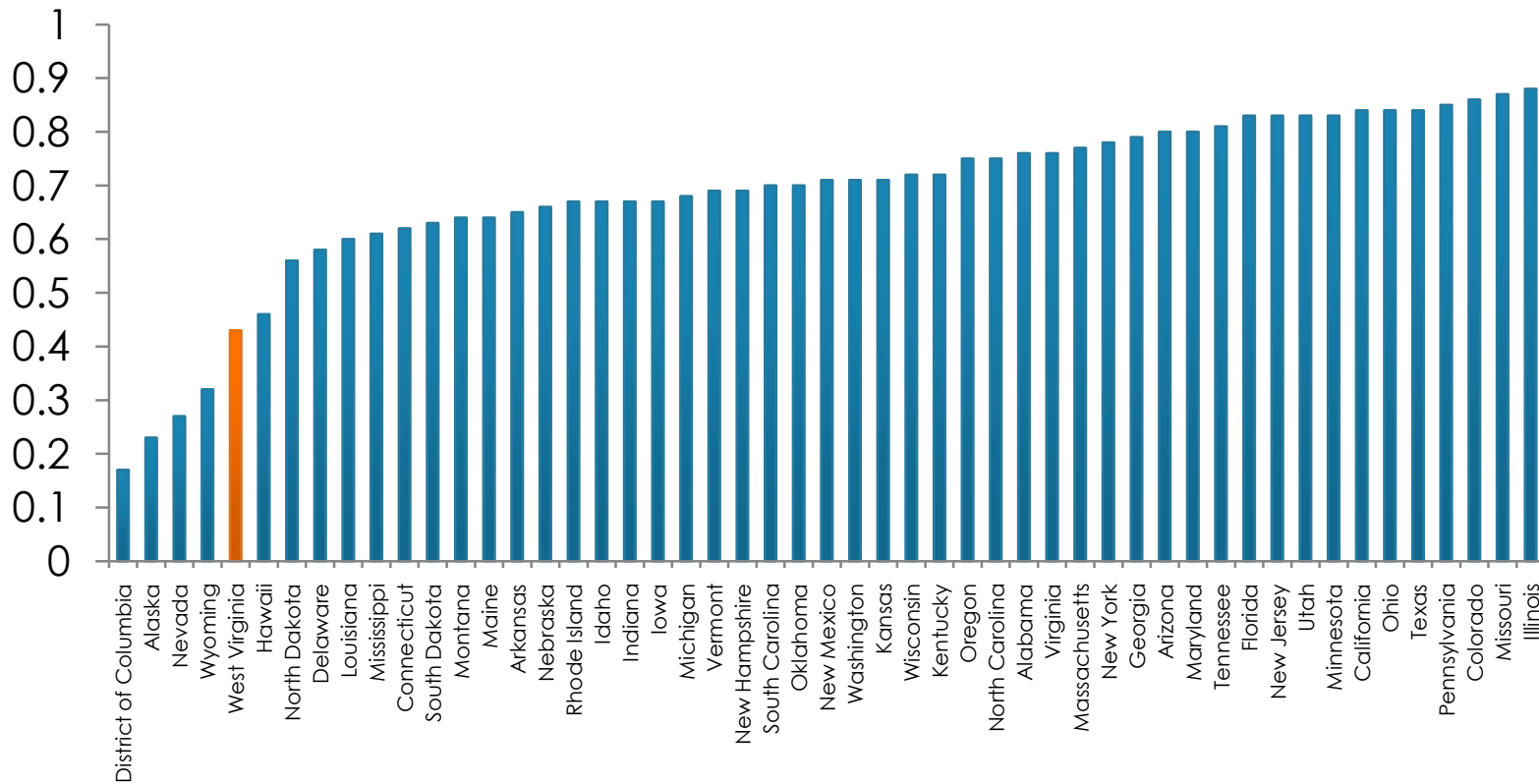
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Overview

- What underlying factors in WV suggest a need for a permanent fund?
- What is a severance tax permanent fund?
- Why do states create permanent funds?
- How do states use their permanent funds?
- Creating a West Virginia severance tax permanent trust fund

Economic Diversity, 2009

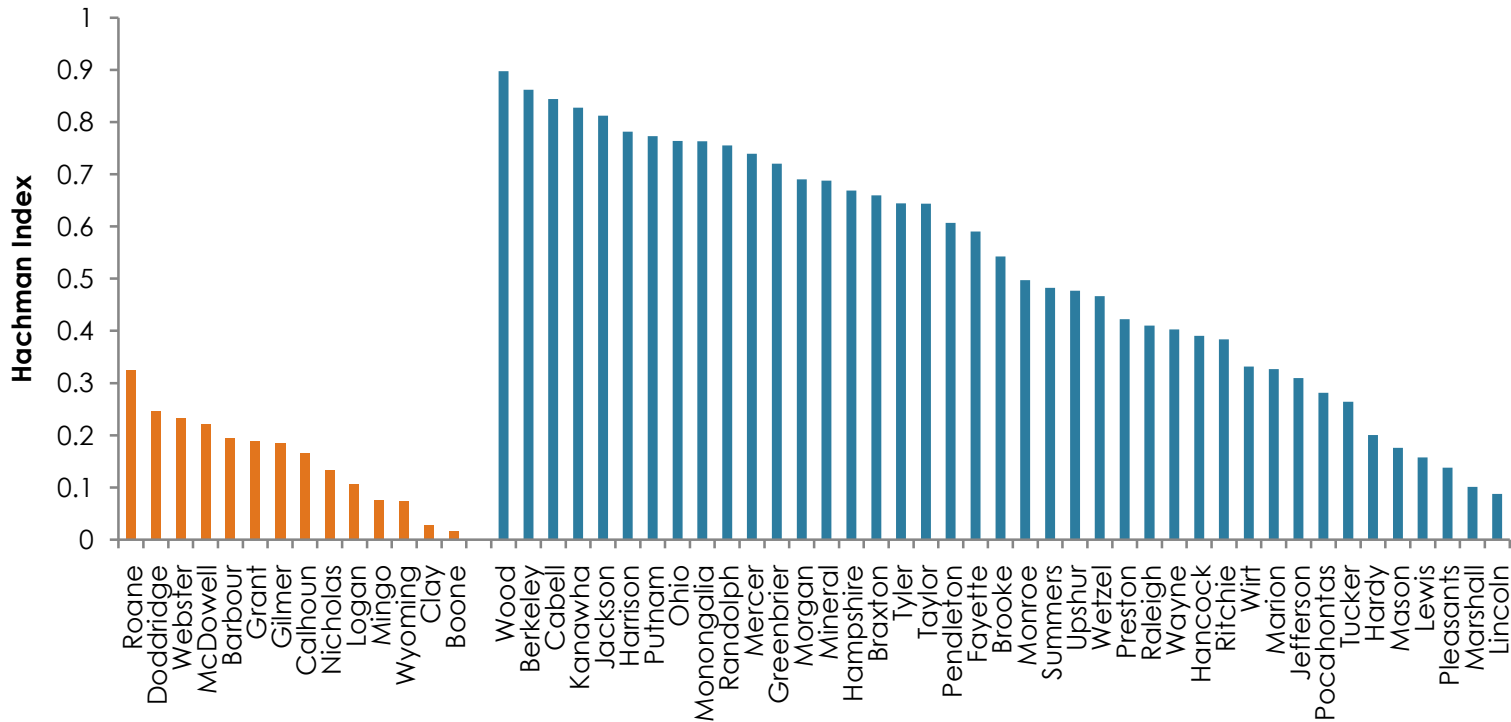
(Hachman Index: 1 = U.S. Employment Mix)



Source: WV CBP analysis of U.S. Bureau of Labor Statistics data

Economic Diversity in WV

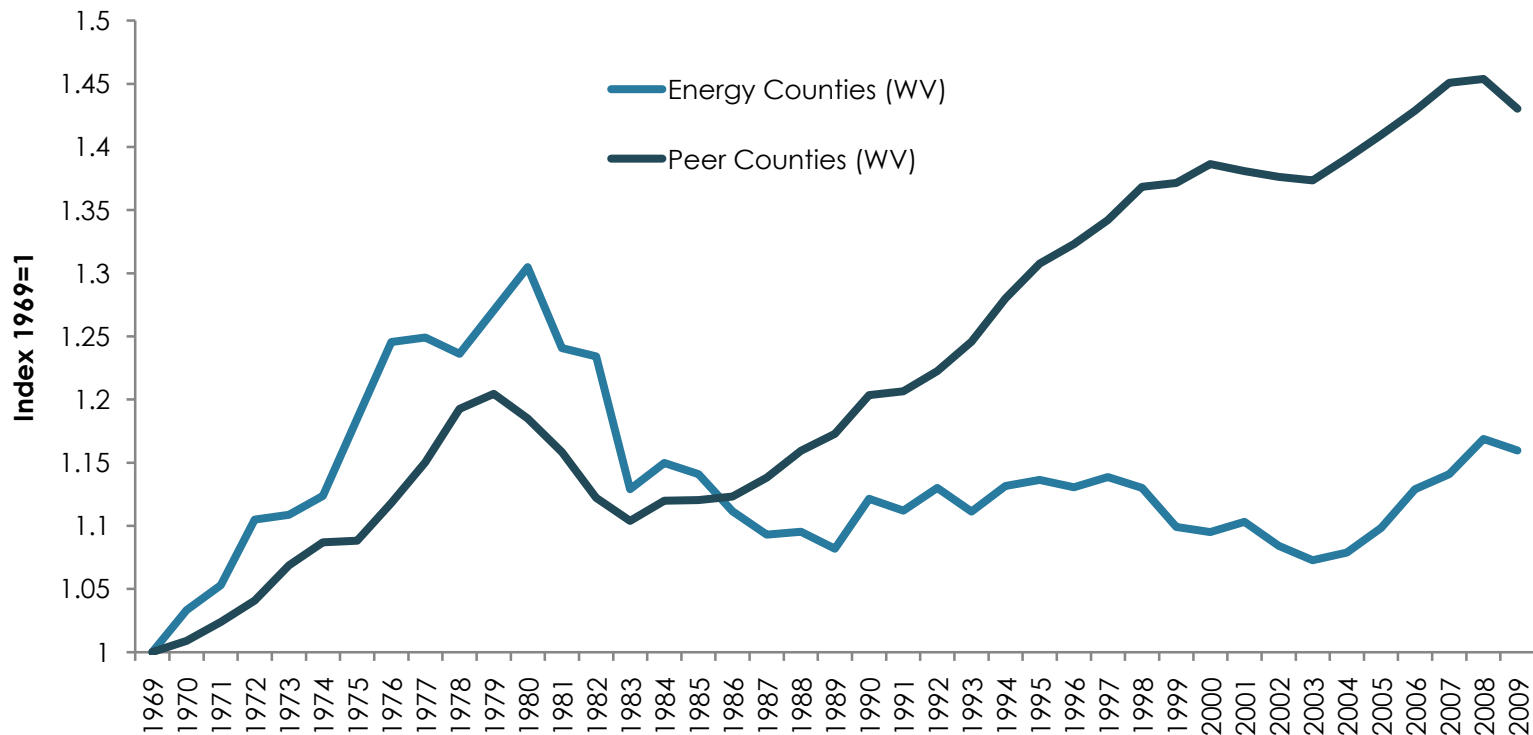
Energy vs. Peer Counties



Source: WVCBP analysis of U.S. Bureau of Economic Analysis data.

Note: Energy counties are defined as counties with an annual average (1969-2009) of at least 14 percent of private employment in mining.

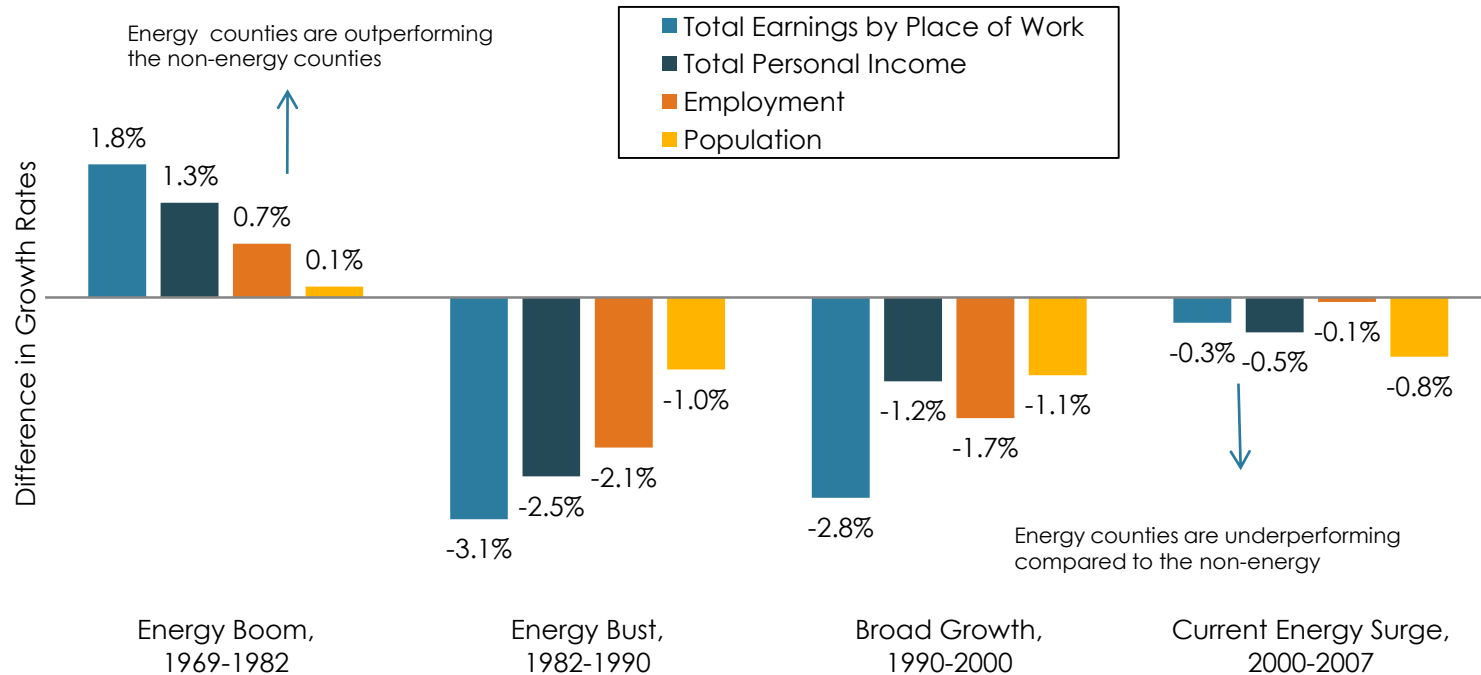
Employment Growth in WV Energy vs. Peer Counties



Source: WVCBP analysis of U.S. Bureau of Economic Analysis data.

Energy Booms & Busts in West Virginia

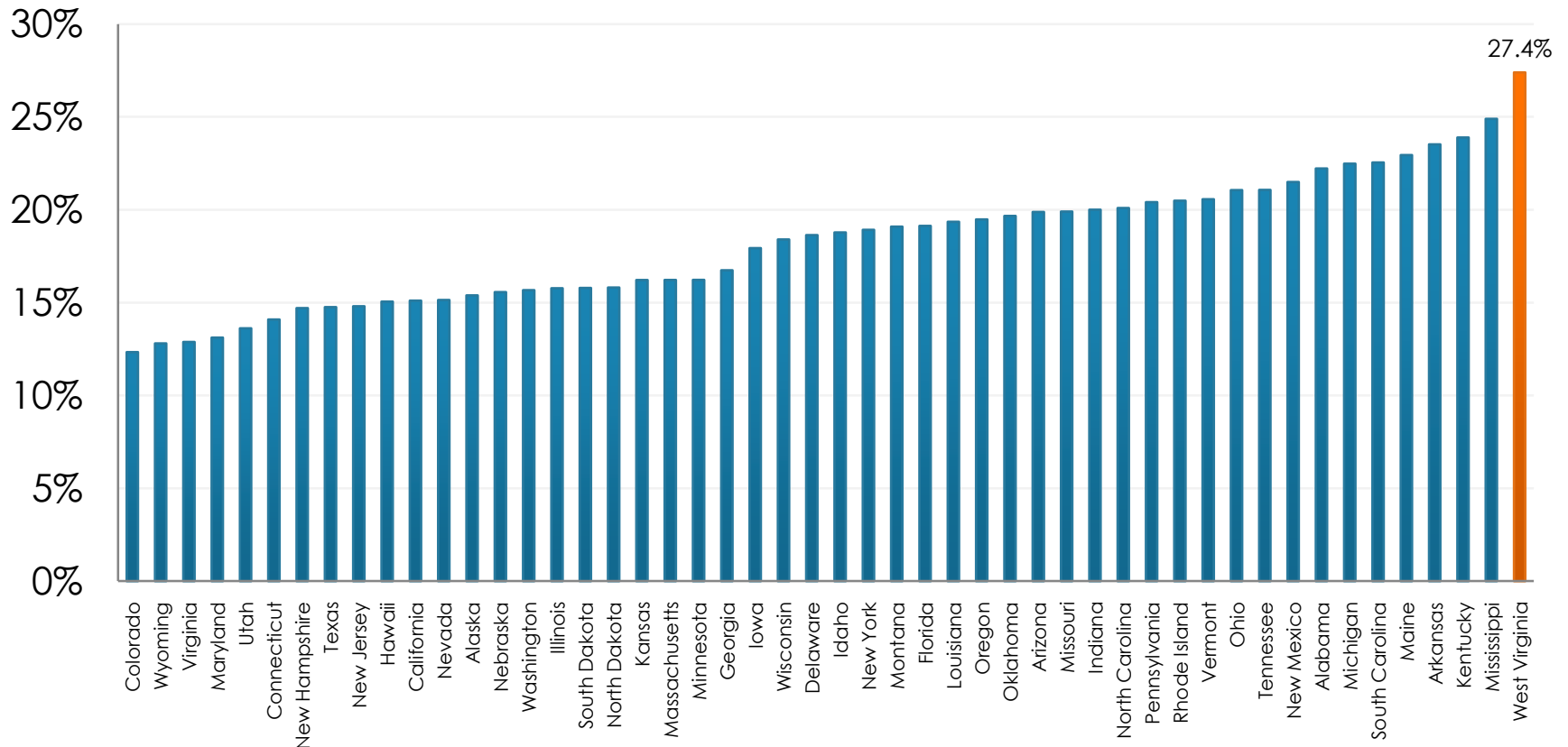
Annual Rates of Growth of Key Economic Indicators, Shown as the Difference in Growth Rates Between Energy-focused Counties and their Peers in the West Virginia



Source: WVCBP analysis of U.S. Bureau of Economic Analysis

WV Leads Nation in Transfer Payments

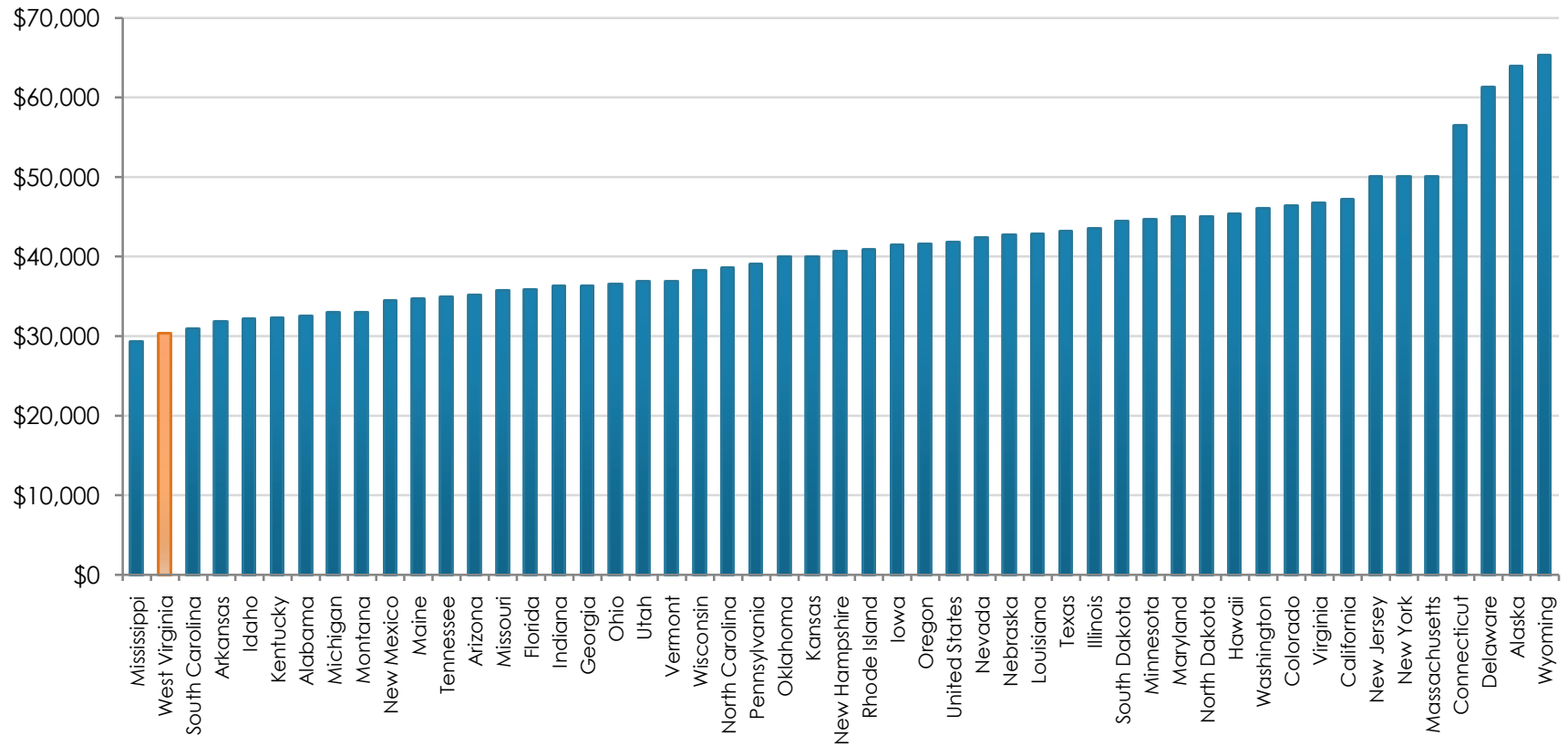
(as a share of state personal income)



Source: U.S. Bureau of Economic Analysis, Table SA035, 2009

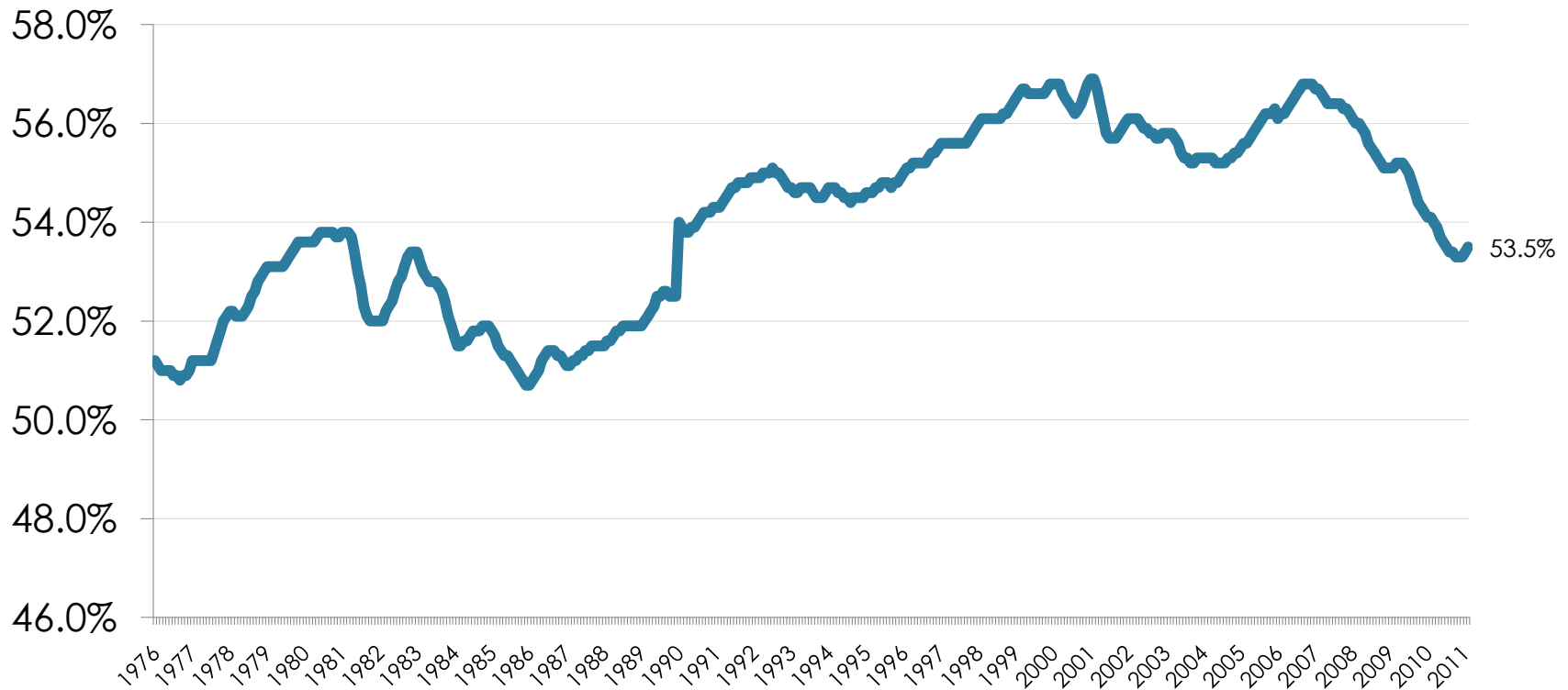
Low Economic Output

(Real State GDP Per Person, 2009)



West Virginia's Labor Force Participation Rate: 20 Year Low

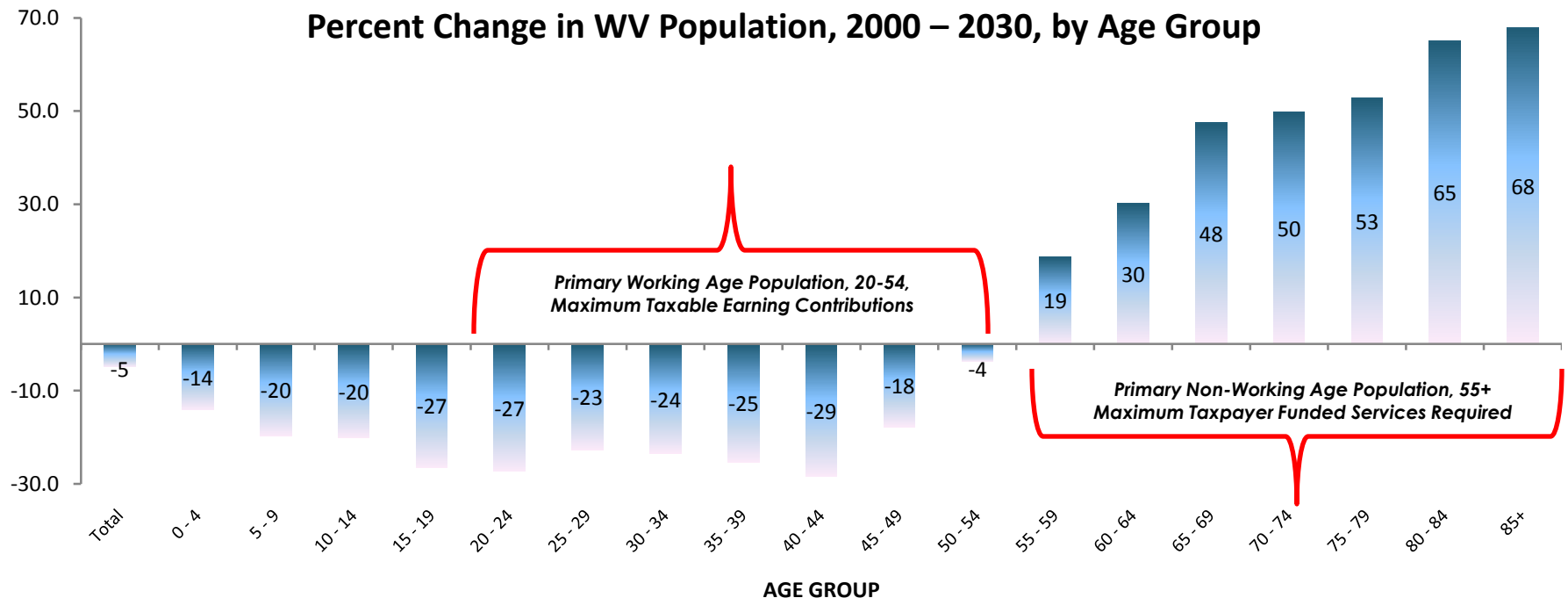
(Jan 1976-Feb 2011)



Source: U.S. Bureau of Labor Statistics, Local Area Unemployment Statistics

West Virginia Population is aging

By 2030, **25%** of population will be 65 or older compared to **17%** in 2010. This will require **more** state services in the future at the same time that the tax base **shrinks**.



Definition of Permanent Severance Tax Trust Funds

States have created permanent funds to:

- Convert depleting natural resources into a source of sustainable wealth for communities today and into the future.
- Even out the fluctuations of the boom-bust natural resource – based economy.
- Diversify and expand local economies.

Existing funds include:

- Alaska Permanent Fund (1976)
- Montana Coal Severance Tax Trust Fund (1976)
- New Mexico Severance Tax Permanent Fund (1973)
- North Dakota Coal Development Trust Fund (1979), Permanent Oil Tax Trust Fund (1997) Legacy Fund (2010)
- Utah Permanent Trust Fund (2008)
- Wyoming Permanent Mineral Trust Fund (1974)
- Navajo Nation (est. 1985)

Source of funds – Size of funds

State	Source of fund's principal	Current fund size
Alaska	Mineral leases & royalties, federal mineral revenue sharing payments, & legislative appropriations	\$40.3 billion (2.28.11)
Montana	Remainders of revenues from coal severance tax after principal & interest payments on coal severance tax bonds	\$817.9 million (6.30.10)
New Mexico	Remainders (about 12.5%) of revenues from severance and oil & gas severance taxes after principal & interest payments on severance tax bonds	\$3.4 billion (6.30.10)

Source of funds – Size of funds

State	Source of fund's principal	Current fund size
North Dakota	<ul style="list-style-type: none"> • Permanent Oil Tax Trust: Revenues from oil & gas taxes which exceed \$71 million in a biennium • Coal Development Trust Fund: 30% of coal severance tax • Legacy Fund: 30% of all oil related revenues beginning 7.1.2011. 	\$475 million (FY09-11) \$61.1 million (3.31.09) \$619 million (FY11-13)
Utah	Revenues in excess of \$71 million from oil & gas tax; revenues in excess of \$27.6 million from coal mining	N/A
Wyoming	2.5% severance tax on gas, oil, and coal	\$4.5 billion (8.30.10)
Navajo Nation	12% of all revenues projected annually from coal, oil, gas, timber leases and taxes	\$1 billion (2011)

Income Withdrawn from Fund

Investment earnings/income are withdrawn according to various guidelines:

- 5-year average of interest earnings (Alaska)
- Percentage (4.7-5.0%) of annual 5-year average of market value in general fund (Wyoming and New Mexico)
- All interest earned by fund withdrawn annually (North Dakota and Utah)

Why do states create permanent funds?

Most frequent uses:

- General fund expenditures (NM, WY, ND)
- Education (NM, ND)
- Infrastructure projects (NM, MT)
- Reinvested in fund corpus for growth and inflation-proofing (several)

Other uses:

- Investment in Lignite Research, Development & Marketing Program (ND Coal Development Trust Fund)
- Permanent fund dividend program (AK)

Sustainable uses:

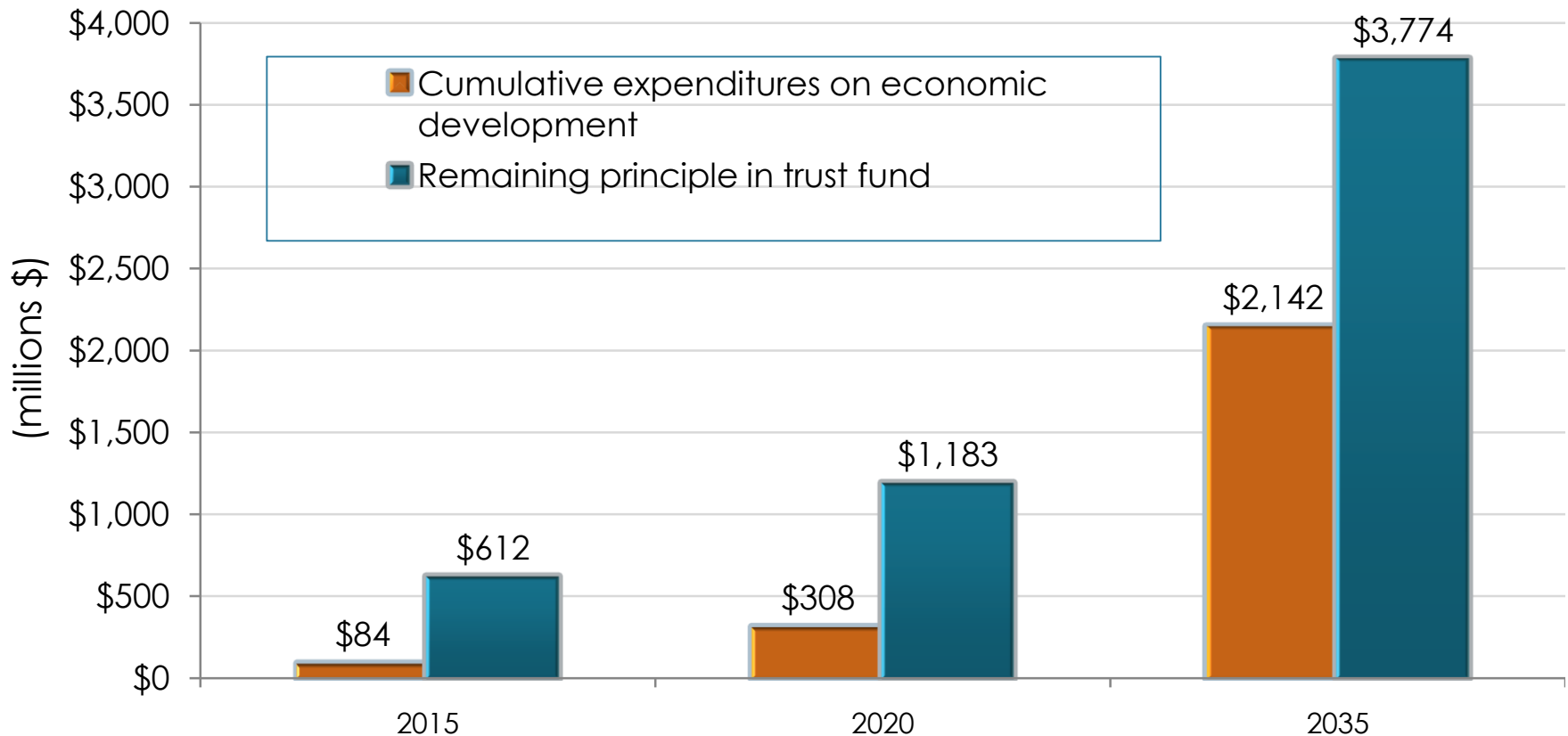
- Economic development grants & loans including funds targeted to mining communities (MT, NM, UT)
- Remediation of impacts of mining (ND)

PROPOSAL

A West Virginia Severance Tax Permanent Fund

- A modest 1 percent severance tax on coal, oil, and gas (estimated revenue of \$100 million in 2011)
- Five percent of investment earnings are withdrawn when earnings exceed five percent.
- A set percentage of investment earnings from fund go to energy producing counties.

Potential Growth of Fund

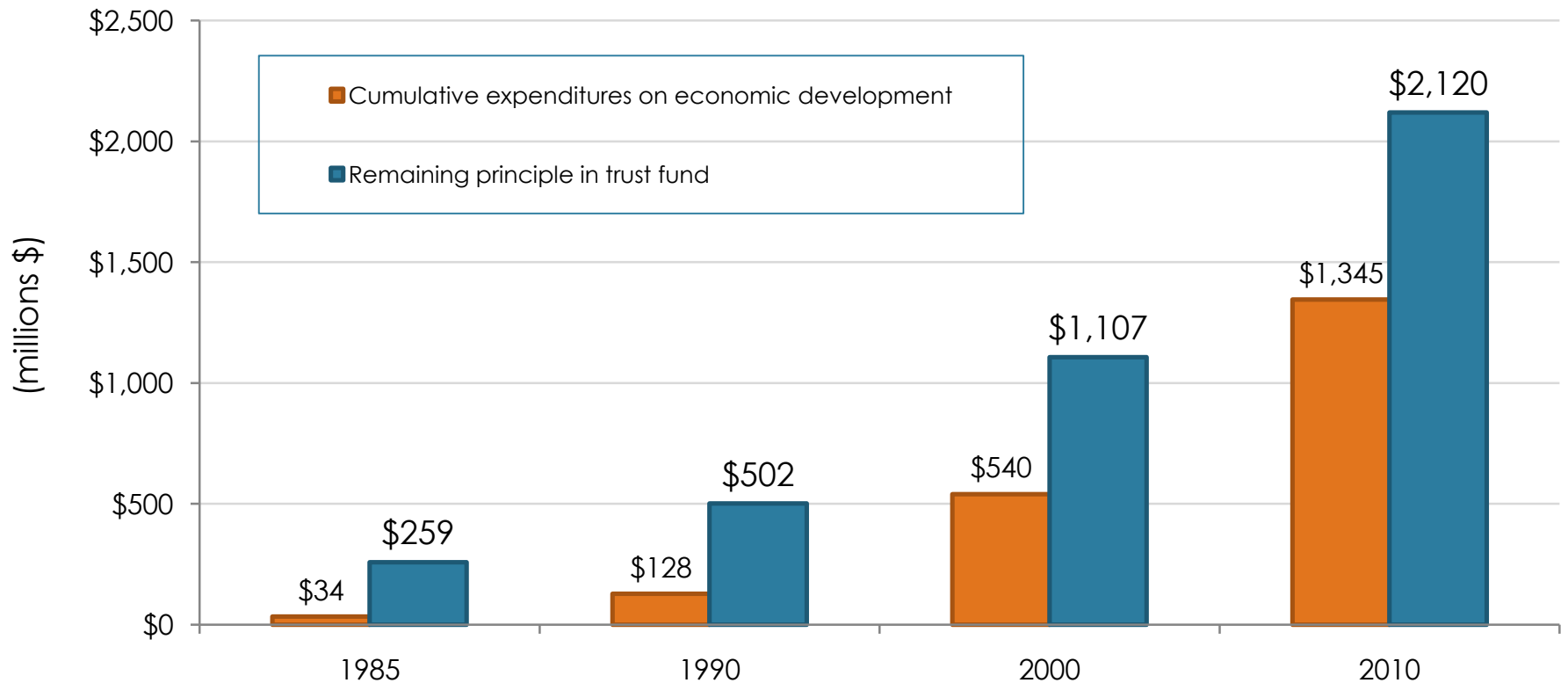


Source: Downstream Strategies

Note: Assumes a 7.5% investment return. Projections of coal, oil, and natural gas production and price based on U.S. Energy Information Administration data.

What if WV implemented a Permanent Fund in 1980?

1% Severance Tax on Coal



Advantages of a Severance Tax Permanent Fund

- Turns non-renewable resources into sustainable wealth for a low-income state.
- Protect against booms and busts of energy economy.
- Helps address externalities of natural resource industries (e.g. remediation).
- Addresses historical land and mineral ownership patterns.
- Highly exportable tax (e.g. 87% of coal produced in WV is exported) with little effect on employment, production, and business location decisions.
- Builds assets toward the state's unfunded pension and long-term liabilities (West Virginia ranked 4th highest in the nation, according to Moody's Investors Service) and improves the state's credit rating.

Advantages of a Severance Tax Permanent Fund

- Potential uses of fund earnings/interest
 - Workforce development (e.g. job training)
 - Early childhood development
 - Expand infrastructure (broadband, roads, sewers, bridges, etc)
 - Remediation and clean energy programs
 - Drawing down federal money
 - Grants and loans