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The Montana Legislature's Loss of Faith in the Coal Tax Trust Fund

Back in the early 1970s, when massive strip-mine coal development appeared to threaten eastern Montana, the Montana Legislature sought a way to avoid the boom and bust cycle that had plagued the state's previous mining experience. In order to make sure that there would be something substantial left behind when the coal industry declined, the legislature took two steps. First it levied a whopping 30 percent coal severance tax so that some of the profit associated with coal mining would be available to help meet the state's current and future needs for public services. Coal producers and consumers fought the state on this all the way to the US Supreme Court, but our very high coal severance tax got the legal blessings of the courts. Second, in order to keep the state from riding a fiscal roller coaster as coal mining activity and coal prices, a substantial portion of those coal taxes were to flow into a trust account. The state would be allowed to use only the investment earnings from that trust. That way, even if coal mining or the price of coal declined, the flow of funds from the trust to state government programs would continue in a relatively steady way.

All this made good sense. But the legislature lost its nerve along the way. First it bought into the wishful thinking that came to called supply-side economic were during the Reagan years. The legislature cut the coal severance tax <u>in half</u> on the promise that that would lead to a more than doubling of coal sales, leaving the state better off despite the lower coal tax. Of course, nothing of the sort happened. We cut the coal severance tax in half, coal sales remained the same, and the state simply contributed half of the taxes it had previously received to wealthy coal mine owners who chuckled all the way to the bank. As a consequence, the flow of funds into the coal trust account slowed dramatically.

In the most recent session, the legislature lost its nerve, and vision, again. Rather than respecting the logic of using the trust fund as a reservoir that stabilizes the flow of coal tax money to support state spending on public services, the legislature decided to raid the trust fund itself. Despite a constitutional prohibition against diverting the coal tax funds that flow into the trust fund unless three-quarters of the legislature agree, the legislature voted to divert those funds to current spending on the basis of a simple partisan majority vote. The Montana Supreme Court is now being asked to rule on the constitutionality of this latest ploy to raid the coal tax trust fund.

Alaska provides an interesting example of a state that did not lose its nerve when it came to its mineral tax trust fund. Alaska adopted a trust fund approach to managing the state public revenues flowing from the northslope oil fields that was similar to Montana's approach to coal taxes. Alaska, however, did <u>not</u> lose its nerve when oil prices plummeted in the mid-eighties and then again in the late nineties. It did not cut its tax and royalty rates in a naïve attempt to encourage more oil production. Similarly, it has not allowed the oil-based permanent trust fund to be raided to bail out state government. In fact, Alaska has focused on protecting the real value of the trust fund, reinvesting a good part of the earnings on the trust fund back into the fund. Alaskan's accept that the Permanent Fund should be, at a minimum, "inflation proofed" by not spending that part of the trust fund earnings that are simply tied to inflation. Alaskans are considering going further, reinvesting even more of the earnings so that as the oil in the ground is depleted, the Permanent Fund's asset value grows by the same amount as the oil asset declines in value, thus assuring that Alaska's total assets are not declining.

As a result of this more conservative approach to protecting the long run value of the fund, Alaska's oil Permanent Fund has grown substantially over the years. It now amounts to $23 *billion* dollars and the annual earnings off of the Permanent Fund are greater than the state revenues generated each year by oil production itself. By comparison, Montana's coal trust fund comes to about $600 million dollars.

One big difference between the revenues flowing into Montana's and Alaska's mineral trust funds has nothing to do with our loss of faith in a very rational approach to taxing minerals to build a very real financial asset as the mineral was depleted. The state of Alaska *owned* the oil that was developed on Alaska's northslope. That allowed it to collect substantial royalty payments as well as to tax the oil production and oil transportation businesses. In addition, the flow of oil through the trans-alaskan pipeline has been enormous compared to our coal sales. So Alaska's $23 billion Permanent Fund compared to our $600 million coal tax trust fund is not entirely due to different public policies.

But Alaska did not cut its royalties and taxes in half in the 1980s in a fanciful dream that that would lead to more oil development. It also has not been raiding its Permanent Fund. It limits expenditures from the Fund to a partial use of only the earnings from the fund. That has assured that the fund could grow much more rapidly. Only now are Alaskan's considering using some of the earnings from the fund to support general state spending. But there is no support at all for diverting the flow of oil revenues directly into the state's general fund spending and ending the growth of the Permanent Fund, something a majority of our legislators have been eager to do for a long time.

Alaska, like Montana, set out in the 1990s to make mineral development more sustainable by building a financial asset to replace the mineral asset that was depleted. That was intended to assure that there would be a permanent asset that would support future generations even if coal development declined or ended. That commitment to a more sustainable approach to natural resource development was farsighted at the time. It is a shame that our political leaders have abandoned that long run, future oriented policy for one focused on current spending. That spending may currently be dressed up as investment, but it is really pork barrel of various sorts that is simply a thinly veiled excuse to raid and deplete what we thought was a constitutionally protected legacy for future generations. It is worse than just a loss of faith in a well-designed policy. It is a shortsighted raid on the well-being of future generations.