Coal Tax Credits Aren't Working

Over $700 Million Spent Since 1988 Hasn't Slowed Industry Decline

By Aaron Williams and Michael J. Cassidy

After years of gradual decline, coal mining, which used to be the economic engine of southwest Virginia, is now in a free fall. Southwest Virginia's economy is weaker now than before the recession. Hundreds of millions of dollars in state tax credits handed out since 1988 haven't changed things. Today, too many people are out of work and short on opportunity.

Legislation extending one of Virginia's two coal tax credits and a key component of the other has passed the General Assembly and will be reviewed by the governor. Contrary to what supporters of the subsidies claim, the decision on these tax credits isn't a choice between mining jobs and no jobs, since the credits are a drop in the bucket compared to the decline in key coal prices due to global economic factors. That global trend is out of lawmakers' hands.

In reality, the choice is about whether to extend tax credits that are not achieving their stated goal of promoting employment and prosperity.

After Millions in Credits, Little to Show

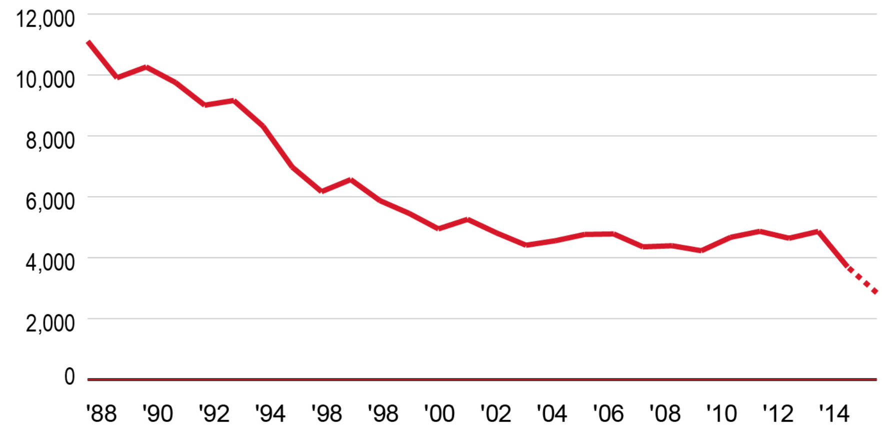
In an attempt to slow the decline of coal mining activity and employment in Virginia, the state gave Virginia coal producers and electricity producers who use Virginia coal $737 million (in 2015 dollars) through tax credits between 1988 and 2014. During that time, annual coal tonnage and employment both declined by 67 percent. Preliminary data show that employment continued to decline another 23 percent to 2,850 in 2015. Meanwhile the amount the state spends on coal tax credits regularly tops $25 million per year.

The credits used to be modest investments. But what started costing the state a little more than $675 in tax credits per job in 1988, after adjusting for inflation, has exploded to an average of more than $9,000 per job, per year between 2010 and 2014.

The decline of Virginia's coal industry is nothing short of tragic. But tax credits for coal utilities and mining companies have done little to change the situation. The state's legislative watchdog, the Joint Legislative Audit and Review Commission said as much in 2012: "changes in coal mining activity appear unaffected by the credits."

Virginia Coal Employment is Plummeting

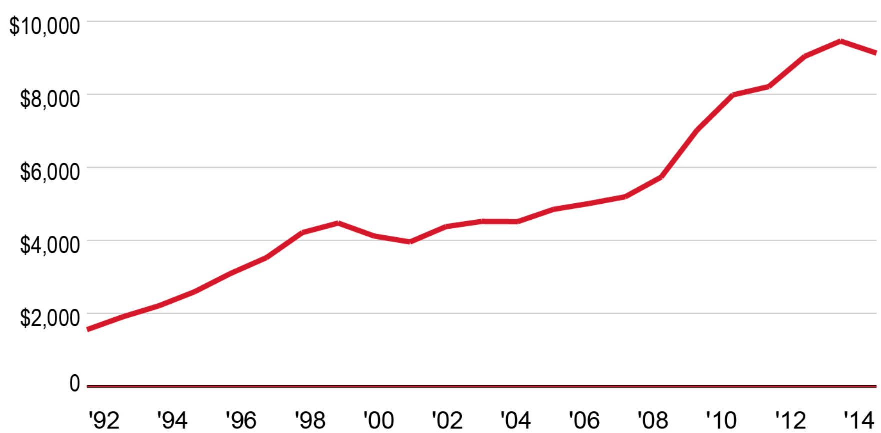
Coal Employment in Virginia



Source: TCI analysis of Virginia Department of Taxation data

Significant Growth of Subsidies

Five Year Rolling Average of Coal Credits Per Employee (2015 Dollars)



Source: TCI analysis of DMME and VATAX data

From Glide to Tumble

A number of factors that Virginia policymakers can't control drive coal production and employment – available coal reserves, production costs, transportation costs, and market prices – "suggesting that the credits could only have limited impact," according to the JLARC report. Compared to these market forces, even hundreds of millions of dollars in state subsidies for coal producers and consumers simply hasn't stemmed the tide.

This is a natural resource problem that can't realistically be solved by public policy. Less than one-third of Virginia's coal reserves remain, and most of the low-hanging fruit has already been plucked. That means the remaining coal reserves are often in remote locations and in deep, thin seams that are expensive to reach and mine. Dwindling coal reserves and high production costs have made it tough for Virginia to compete with other states like Kentucky and West Virginia.

Decreasing demand has also affected coal. The production of natural gas, a competitor of coal, has risen sharply because of the spread of hydraulic fracturing, and the prevalence of renewable energy production has grown. These factors are especially damaging for steam coal used to produce electricity.

Despite these issues, Virginia coal employment showed resiliency through the recession and even grew in the following years because of the demand for the high-quality coal found in Virginia called metallurgical coal or "met" coal. Demand and prices for met coal, which is used for steel production, increased dramatically because of rapid industrialization in China. The demand was so great it has accounted for half of global steel demand in recent years. However, as China and other emerging economies have since slowed, it has devastated Virginia's coal employment.

The Rhodium Group, an international economics and policy research organization, estimates that "between 2011 and 2014, 93 percent of the decline in U.S. coal producer revenue was due to a drop in met [coal] quantities and prices." JLARC pointed out the importance of met coal before prices started plummeting, "when demand and market prices drop for metallurgical coal, Virginia coal mine operators are faced with competing in the steam coal market, where they may not earn a profit and be forced to reduce coal production and employment, despite the availability of tax credits."

And the problem isn't just current production. The diminished long-term outlook for met coal demand in China and other emerging economies has fueled big-name bankruptcies, significant devaluations, and dramatic layoffs that won't reverse any time soon – if ever.

As experience has shown, tax credits that amount to roughly $2 per ton of met coal created in Virginia will be minimal when compared to the precipitous drop in the price of met coal to around $85 per ton from a peak of over $200 per ton.

Southwest Virginia has been hard hit by the decline of coal and needs a hand up, but Virginia's coal tax credits are not the answer. The governor's choice is between what works and what doesn't work – and Virginia's coal tax credits have definitely not worked.

Met Coal Prices Have Collapsed

Export Price Per Short Ton of Metallurgical Coal (2015 Dollars)

Source: TCI analysis of EIA Quarterly Coal Reports

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