Coal Transition in Montrose County, Colorado

Economic and Policy Context

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Summary

After a long history of coal production and energy generation, Montrose County is witnessing the sunset of coal-related industrial activity—possibly in as few as four years. These industrial changes have implications for the local economy, particularly for local government revenue, that demand a response from local and state leaders. In this paper, we assess Colorado's fiscal policies related to replacing coal revenue and the ability for the state and local governments to fund transition-related planning. We find that Colorado's existing coal fiscal policies weaken the ability of local governments to plan for and work toward transition. Anemic state taxes on coal production, limitations on local government's fiscal autonomy, and cuts to state assistance—particularly for school districts in rural communities—exacerbate dependence on existing revenue sources and leave communities without dedicated transition funds. We also discuss solutions that focus on allowing resource-dependent communities to build wealth over time and invest in community capacity.

Fiscal Policy Barriers to Transition

- State restrictions on local government property tax assessments and levies make it difficult to replace coal revenue after mine or plant closures.
- State restrictions on expenditures and savings limit the autonomy of resource-dependent communities to manage volatile and uncertain revenue sources.
- School finance policy fails to insulate school districts from budget cuts caused by industrial closures.

Recommendations for Wealth Retention and Capacity Building

- Increase state assistance for transition-related planning and investments, including direct distributions to stabilize local revenue, grants for specific transition investments, and state assistance negotiating with utilities and federal partners.
- Reform local government finance rules to allow greater flexibility and autonomy to manage volatile natural resources revenue and budget for long-term transition strategies.
- Create a new permanent fund or endowment for coal-dependent communities.
- Focus on transition strategies that support and grow local institutions to enhance community capacity.

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About Headwaters Economics

Headwaters Economics is an independent, nonprofit research group that works to improve community development and land management decisions. https://headwaterseconomics.org/.

Introduction

Rural communities are highly exposed to risks and uncertainty associated with structural changes in the United States economy. First, economic growth in high-wage service sectors is concentrating in cities and not occurring in most rural and isolated communities.[1] Meanwhile, sectors that have traditionally supported rural communities, such as manufacturing and natural resource sectors, have experienced significant productivity gains leading to fewer jobs and stagnant wages.[2] Montrose County, Colorado is spilt between these diverging trajectories of rural communities. The City of Montrose is capturing jobs related to the resort and recreation economy of Telluride and the Black Canyon of the Gunnison National Park.[3] Montrose is also connected to major U.S. cities via the Montrose airport, providing opportunities to diversify.[4] Comparatively, the "West End" of Montrose County is remote and not competing as well for high-wage service jobs that are driving the U.S. economy forward. At the same time, the West End is disproportionately affected by transitions in energy sectors away from coal and restructuring in other goods-producing sectors—particularly associated with labor-saving technology.

The most effective policies and programs that help isolated communities overcome economic challenges are those that enable places to build wealth over time and strengthen community capacity. Building wealth occurs when fiscal policies allow local governments to retain wealth from resource extraction through permanent savings. This implies and necessitates local fiscal autonomy to manage volatile revenue that allows for investments in assets that will continue to generate wealth after the resource endowment is exhausted or markets and politics move away from extraction. For rural and vulnerable communities, these investments should focus on sustaining and expanding community capacity. This includes supporting local institutions that share information, network and connect different community stakeholders, coordinate and prioritize activities, and facilitate constructive dialogue and action. Capacity is closely linked to social resilience and increases a community's ability to respond to shocks, such as the loss of a major employer or a natural disaster.

In this paper, we review the economic context that shapes the likely impacts of and solutions to a transition away from coal in Montrose County, Colorado. First, we discuss existing policies that restrict local government's ability to replace lost revenue when coal mines and coal-fired power plants close. Then we examine policies for wealth-retention and capacity-building in rural places. The purpose is to help decision makers at the local and state level in Colorado better understand the fiscal policy barriers and identify opportunities for reform that would benefit Montrose County's transition from coal. A companion report analyzes current revenue generated by coal activities for local governments in the county, including the county government, local schools, and other special districts.

We begin by describing current economic drivers and trends in Colorado that provide context for Montrose County's economic challenges and opportunities. Next, we assess current fiscal policies related to coal and economic development. Policies that exacerbate dependence on coal revenue are considered barriers to transition. Recommended policies aim to retain resource wealth and invest in community capacity and transition strategies.

Context: Coal Fiscal Policy and Economic Development

Colorado's economy is growing, adding jobs, income, and population at a rate faster than the United States average. Since 2000, the state has grown by 30 percent, with more than half of population growth from people moving to the state.[5]

However, Colorado's growth is not evenly distributed across the state. Colorado's metropolitan counties have seen an increase in nearly 400,000 more jobs in 2016 since the onset of the 2008 Great Recession. In contrast, the state's rural counties struggled to recover from the impacts of the global financial crisis. In 2016, rural counties had about 2,000 fewer jobs compared to pre-Great Recession levels.[6]

Most of Colorado's new jobs and income are in services. Since 2001, jobs in non-services-related industries, such as construction and manufacturing, have declined by two percent. Services-related sectors added 29 percent more jobs over the same period. The most important of these new jobs are high-wage services in innovation sectors including software, internet, research, and technology. These jobs occur across all economic sectors, including health care, energy, professional and technical services, manufacturing, and finance.

Innovation jobs are most often located in cities that have clusters of creative companies and workers, and access to markets and finance.[7] By comparison, rural areas, particularly those relatively isolated from metropolitan areas, are not competing as well for these jobs. Rural areas also are most acutely affected by declines in non-service-related activities that are largely the result of productivity gains and restructuring in traditional sectors. Agriculture, mining, manufacturing, and timber require fewer workers, and wages have been largely stagnant for several decades.

These trends change the relative contributions of natural resources to rural areas. Natural resource development, including coal mining and coal-fired power generation, can still lift rural communities during booms in commodity and energy prices, but managing these resources in ways that lead to long-term prosperity remains challenging. Policies focused on retaining jobs by reducing taxes and regulations can lead to dependence on coal. Dependence on coal can result in slower growth and persistent poverty—a resource curse.[8]

Alternatively, policies that retain and replace resource wealth with investments in assets that will continue to create wealth over time can lead to a virtuous cycle of growth. For example, the Colorado Office of Economic Development and International Trade reports that the kinds of investments associated with greater resiliency include quality of life, industry diversity, education, health care, and transportation access.[9]

Recent research recommends that communities evaluate existing fiscal policies and make necessary changes to reduce dependence on annual coal revenue and re-allocate these revenues to support economic transition strategies.[10]

A companion report assesses local government's dependence on coal revenue in Montrose County, Colorado. It finds that the West End School District and several special districts also in the West End of the county (for example, the Nucla-Naturita Fire District) are most dependent on coal revenue. The Montrose County government is somewhat insulated from the loss of coal revenue due to growth in the City of Montrose and the "East End" of the county.

Fiscal Policy Barriers to Transition

This analysis of fiscal policy draws on previous work examining dimensions of rural economic development, including a recent review of transition planning efforts in communities where coal-fired power plants are closing.[11] The plan review applied four assessment criteria, including fiscal policy, to assess the current state of transition planning and identify solutions for vulnerable communities. The review found that no community in the U.S. West had access to a dedicated transition fund at the time plant closure was announced. All transition funding and resources had to be negotiated with utilities or secured through grants and assistance from state and federal sources. Communities often were surprised by closure announcements and lacked capacity to address transition challenges.

The paper recommended that communities develop and implement a transition revenue and investment (TRI) strategy that begins with an assessment of current fiscal dependence on coal revenue and then identifies strategies to address lost revenue and to link revenue to strategic transition and economic development goals. Headwaters Economics subsequently hosted a Solutions Forum that brought together government officials, policy experts, and academics to identify the most promising solutions to revenue replacement and transition investments.

In this paper, we use the TRI strategy framework to assess the current policy barriers specific to Montrose County, Colorado. Policies that exacerbate dependence on continued revenue and limit the ability of local governments to replace revenue and fund transition strategies are considered barriers to transition. Some policy barriers are common to all types of local governments while others are specific to school districts, which have a separate set of funding sources and laws. The rest of this section describes specific policy barriers to transition in Colorado.

State School Funding Policy

The West End School District in Montrose County was among the entities most dependent on coal revenue in 2017. In theory, school districts are insulated from the effects of declining local revenue because of the state equalization law and state aid. But declining state aid that disproportionately affects vulnerable districts undermines the effectiveness of school equalization policy for the West End schools.

Amendment 23 passed in 2000 requires schools to fund a base budget annually calculated on a per-student basis and adjusted using factors that include enrollment, local cost of living, and the student population eligible for free school lunches. These factors can increase funding above the base amount for districts that are relatively poor or where cost of living is relatively high. The factors are intended to allocate funding in ways that reduce inequality across districts.

The base budget (as adjusted by the factors listed above) is drawn first from local sources of revenue, primarily property taxes. The difference between the base budget and local revenue is made up with state aid. Beginning in 2010, the state legislature cut state funding to schools. The funding cuts affect the funding made available to school districts based on the adjustment factors. These cuts called the “Budget Stabilization Factor” disproportionately affect districts that are more dependent on state aid and where the factors are most important in determining school budgets, e.g., relatively poor school districts.

The impact of losing coal property taxes will increase the West End school’s dependence on state aid because local sources of revenue will decline. Also, Montrose County is likely to experience an increase in the number of students eligible for free and reduced-cost lunches. If this also occurs in the West End schools, the district will not only be more reliant on state aid, but also more exposed to budget cuts that affect the portion of the budget determined by the factors.

The budgets cuts will phase in over several years after the mine closes because the property valuation formula is calculated on an average basis over a period of three years. Delta County’s experience, where two coal mines have recently closed, suggests that the school population will “unwind” over several years as families try to remain either with unemployment assistance or by commuting to work and staying in the community. Some of these families ultimately leave and the school population declines for several years after the initial shut-down and out-migration. While the slow unwinding will be hard on the schools, it does provide the district time to plan for the impacts of declining enrollment and budgets.

Gallagher and TABOR

The Gallagher Amendment and the Taxpayer Bill of Rights (TABOR) will interact to reduce revenue capacity for the county government, the West End School District, and special districts, including the Nucla-Naturita Fire District.

The Gallagher Amendment requires that residential property make up no more than 45 percent of total assessed value of property statewide. If residential property values rise disproportionately faster than commercial and industrial property values, the assessment rate on residential property must fall to remain within the 45 percent ratio. To maintain the same level of property tax revenue, local governments would have to increase the tax rate or the mill levy. Montrose County has not "de-Bruced," or voted to get out from under TABOR's restrictions, so it would have to ask voters to raise the tax rate which may be difficult in the wake of plant and mine closures.

The county government is not as dependent on coal revenue, however, and has experienced increases in taxable value over the last few years due to growth on the east side of the county. This growth will insulate the county against the loss of property values in the West End of the county. The Gallagher Amendment is forcing down residential assessment rates statewide, which may have a larger impact on property tax revenue in the county.

The West End schools have de-Bruced, meaning the district could increase tax rates to adjust for the decline in property valuation after the Nucla plant closes. However, the loss of industrial property value, the reduced residential assessment rate, and the economic hardship associated with lost mining and utility jobs would make adopting higher levies difficult.

The Nucla-Naturita Fire District may be the most exposed to the limitations imposed by TABOR and Gallagher. It is the most dependent on local property taxes and has fewer options to replace revenue without increasing tax rates.

Limits on Local Government Savings Authority

Local governments in Colorado are prohibited from directly establishing rainy day or permanent savings funds. Counties can carry fund balances in capital improvements funds, but these funds must be obligated by a capital improvements plan, limiting their usefulness for funding transition planning and implementation strategies focused on traditional economic development strategies (workforce training, entrepreneurial support, and small business assistance). Some counties, such as Garfield County, have found ways to build up savings from federal royalty distributions by establishing special revenue funds independent from the county government. Coal-dependent counties may be able to create similar funds. However, state budget restrictions on dedicated rainy day and permanent funds limit local autonomy and flexibility to set aside unobligated funds for transition after mines and plants close.

State Severance Tax Policy

Colorado has a low severance tax effective rate of 1.3 percent when compared to 9.5 percent in Wyoming and 11.1 percent in Montana. Colorado does return a larger share of state severance revenue to local governments (more than half) compared to these same coal-producing states. However, the relatively low tax rate means the state has fewer resources to invest in savings, transition planning, and implementation strategies.

In addition, Colorado's Department of Local Affairs (DOLA) direct distributions and grants are allocated to counties using annual royalty and severance tax collections. Once these revenues end, local governments in counties that no longer generate new revenue will no longer receive direct distributions. Colorado needs to create new distribution policies that directly address transition needs and opportunities.

Fiscal Policy Solutions for Transition

Due to state policy constraints on local governments, replacing revenue lost after coal activities end hinges on state policy reforms. In some cases, local governments can pursue planning efforts to increase resilience and expand local fiscal autonomy by finding workarounds and flexibility within state limitations. This section describes several possible solutions that would increase the ability to local governments to build wealth over time from coal or from other natural resources sectors.

Increase State Coal Severance Tax Revenue

Increasing the state severance tax, even by one or two percent, and obligating the revenue to transition activities would generate new and dedicated funding for coal-dependent communities facing economic transition. Severance taxes are designed to compensate counties for the extraction of non-renewable resources from the state. Severance tax rates and spending policies should account for transition and ensure that communities are able to invest in assets and capacity that will continue to generate wealth after coal activities end.

Create Specific Exemptions from TABOR and Gallagher for Coal-Dependent Communities

Local governments dependent on revenue from coal and other natural resource development are more exposed to revenue volatility and long-term decline when resource activities slow or end. TABOR and Gallagher could be reformed to allow for exemptions specifically associated with volatile and time-limited natural resource revenue. This would allow local governments to retain revenue during commodity price and resource extraction booms and use these revenues for specific transition planning and investment purposes. This may include making long-term investments in economic diversification, infrastructure, and community institutions that build capacity while plants and mines are open or setting revenue aside in unobligated rainy day and permanent funds.

Create Opportunities for Long-Term Savings

The state should establish new permanent trust funds and/or rainy-day funds that local government would access as savings vehicles (e.g., a state-managed mutual fund for eligible local governments). Local governments that invest in the state funds would be the sole beneficiaries of their investments and distributions would be used to fund transition activities in those communities.

Establishing savings vehicles at the state level would utilize existing fund management capacity of state investment boards and guard against local governments raiding the principal of permanent funds. States could also identify specific revenue available for investment (e.g., coal and resource-related revenue) and require local governments to develop transition plans that would guide how distributions could be used.

De-Bruce and Establish Coal Revenue Funds

Even without state policy reform, local governments can work around state budget limitations by de-Brucing and establishing specific revenue funds to retain revenue for transition purposes. For example, Garfield County, Colorado established a federal royalty fund to save windfall natural gas royalties during a recent boom. The royalty fund provides a buffer for budgets during downturns in natural gas prices and production declines.

Identify Strategic Transition Investments

Increasing community resilience before and after mines and plants close requires specific investments in institutional capacity, workforce, and local businesses and entrepreneurs. For example, DOLA suggests investments in quality of life, industry diversity, education, health care, and transportation access. Local governments should develop a transition plan that identifies strategic investments specific to the community's context and goals and use coal revenue specifically to implement these strategies.

Stronger State Support for Transition

The devolution of governance to the local level has left coal-dependent communities largely on their own in negotiating with utilities and regulatory agencies, often in different states to have their transition goals and needs heard. This can lead to power dynamics where communities do not have access to information, funding, or political capital. These deficits can include basic information related to closure timing, process, and where and how to intervene. Solutions to information and capacity gaps can include support from the state government, regional organizations, community foundations, and the nonprofit community, including direct intervention in negotiations with utilities, to secure funding from private, public, and federal sources, and by facilitating and supporting networks of stakeholders, peer communities, and local leaders.

For example, the state of Montana aggressively negotiated on behalf of Rosebud County and the city of Colstrip when the utility owners set a closure date in 2022. The state legislature introduced legislation that would have obligated the utility to fund transition impacts, the attorney general attempted to intervene in utility rate cases in Washington State, and other pressure was brought to bear. In addition, NGO parties to the settlement agreement, including Western Energy, actively negotiated for transition funds. The cumulative pressure resulted in Puget Sound Energy offering a $10 million transition fund to be obligated by the community, and other utility owners may follow suit.

Colorado's governor's office, attorney general, state legislature, and federal delegation could become a stronger ally to coal-dependent communities and secure private, public, and federal funding for transition.

End Notes

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