Justice at the Coal-face

The dynamics of poverty and property in the Appalachian Mountains

W. Carrington Heath

TRAVELLERS passing through the Appalachian region are struck by the paradox of widespread poverty in a part of the United States that has been generously bestowed with the bounties of nature. The explanation for the deprivation, explains Carrington Heath, is to be found in the way governments raise public revenue.

For generations, the absentee owners of the natural resources were able to avoid making a contribution to the cultural development of the communities that was proportionate to the value that they extracted. So villages and towns languished behind the general development of the US: the people who contributed their labour to the mines and in the forests have been among the poorest in America.

Opposition to a balance distribution of the income from natural resources could not succeed without the cooperation of political forces that condoned the impoverishment. In this case study, the author shows that the economic interests of the corporate owners of the natural resources came before the popular will of local communities. Anti-democratic obstacles to the popular demand for fiscal reform surfaced when elected representatives of local communities sought reforms through the political process over the past two decades.

The persistence of those who insisted on reform has begun to pay.

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THE KENTUCKY mountaineer appears much too old to be the father of boys not yet in their teens. He had been a coal miner for most of his adult life but lost his job three years ago when the coal company began using machines to dig coal in a process known as strip mining. He had served his country in Vietnam. On this day, in the winter of 1974, he stands before the judge in an eastern Kentucky courthouse, charged with failing to send his children to school.

"I agree with everything that's been said. My children ain't been going'to school and nobody wants them to go any more than I do. We live no more'n a mile away from the schoolhouse door and that ain't the problem. I just don't have the money for the kind of clothes they need for school. If you want to fine me I ain't got a penny to pay it with and I'll have to lay it out in jail. If puttin' me in jail will somehow help my boys any, then go ahead and do it, and I'll be glad of it. And if you could work something out to where I can buy my kids some clothes to wear, I'll be much obliged to you as long as I live."

The man's financial predicament is not uncommon among former mine workers. Coal mining is far and away the most important industry in the economy of eastern Kentucky, and it is virtually the only source of employment for a large number of workers with little education and no special job skills outside of mining. The lack of industrial diversity means that jobs are few and far between for those who cannot find work in the mines. An out-of-work miner is – well, out of work.

It is ten years later, 1984. The young schoolteacher, tired but pretty, is the paragon of dedication and hard work. She typically puts in 65 hours a week during the school year, including bus duty, PTA and consultations with parents. She is bright, well trained, energetic – and she is one of the least effective teachers in the country. Of the 435 U.S. Congressional districts, her district, Kentucky's fifth, has just been rated 435th in educational attainment.[1] A fundamental problem, she feels, is insufficient funding, and the numbers would seem to bear her out. In average expenditures per student for 1984, Kentucky ranked a lowly 42nd in the nation.[2]

"Educational improvement is desperately needed, but the money just isn't available. We're out there all the time, scraping and scratching for pocket change to buy some pretty basic classroom materials. Bake sales, square dances, food booths, almanac sales, auctions, roadblocks, rummage sales – we do what we can. But that's only so much. Only so little, I ought to say."

The mountaineer and the teacher reside in a state that possesses enormous natural resources. Millions of dollars worth of raw materials have been carted away from Kentucky to the factories of the world – timber, coal, gravel, clays, oil, gas – and prodigious resources remain untouched, particularly unmined minerals and fuels. The economic history of Kentucky proves one point beyond cavil: the blessing of natural bounty need not give rise to general economic prosperity. The common citizens of Kentucky would rank near the bottom of America's income scale: 41st in personal income in 1974, 41st in 1984, and 42nd in 1990.[3] The land is rich – so why are the people poor?

This essay explores the paradox of poverty amidst natural bounty in the generally impoverished Appalachian region of the United States. It identifies the political forces that have condoned – indeed perpetrated – that paradox, and it bears testimony to the persistence of those who have insisted on reform.

Much that is said about Kentucky could be said about the Appalachian region in general – that the level of personal income is low, that decent housing is scarce, educational funding inadequate, public services inadequate or nonexistent. We have chosen to focus this study rather more narrowly by what might be called the Gould Principal Research: Stephen Jay Gould, the renowned biologist at Harvard University, maintains that one should approach the study of history "not by a direct assault upon the center, but by an end run through the details of a truly wondrous case study," adding that he knows "no better tactic than the illustration of exciting principles by well-chosen particulars." What follows is a case study that illustrates important (and timeless) principles in the art and science of political economy.

Our investigation starts with the night of April 3, 1977. That was when the rain began.

Strip mining & land tenure

IT WAS CLOUDY and mild in the mountains of eastern Kentucky that evening. The rain began shortly after dark. At first it fell lightly on ground saturated from the snowmelt of an especially harsh winter. The rain grew heavier, and it lasted through the night.

By daybreak, most of the thousands of creeks feeding out of the hollows and coves had become roaring torrents in full flash flood. The tributaries of the Cumberland, Big Sandy and Licking Rivers rose with awesome speed. In Harlan, at the headwaters of the Cumberland, the water came up ten feet in less than three hours. The Tug and Levisa forks of the Big Sandy boiled out of their banks. Prestonsburg was flooded, as was Pikeville and other smaller towns.

In a period of 72 hours some 15 inches of rain fell on eastern Kentucky. Harlan, Prestonsburg, Whitesburg, Pikeville, Williamsburg, Elkhorn City, Martin, Inez – all were devastated by the floods. Four people died; hundreds were left homeless; $175 million worth of property was destroyed.

Local residents suspected that strip mining had contributed significantly to this unprecedented havoc. Orville Blankenship, a resident of Camp Creek, put it this way:

> My dad's 85 years old, and if his father were alive, he'd be 125 and they've lived in this hollow all their lives. There's never been anything like this in this hollow for 225 years ... The strip mines are about 2 miles on up past us ... They don't care, just that lump of coal.[4]

Seven houses were washed out of Camp Creek. Two women we carried downstream inside their house. The water rose so fast during the early morning hours that people were trapped. Becky Simpson, who lived near Cranks Creek in Harlan County, was blocked in her home by rising water. She managed to escape but describes life on Cranks Creek in the wake of the floods:

> Folks can't raise a garden and they can't farm anymore because clay mud has washed over the soil ... By the time all the refuse gets to the bottom, it's raining rocks, trees, cars, houses ... [People are] afraid of a quick flood, afraid we'll be asleep and drown ... Before the strip mines came, you could sleep the sweetest sleep that ever was, but now I can't sleep at night for fear of rain.[5]

The use of land is determined by the ownership of land. Whether or not there is harmony between the use of land and the lives of the residents on that land is also largely determined by the ownership of the land. In eastern Kentucky, people were not living in harmony with the land for a simple reason: they did not own it. An official for the Soil Conservation Service of U.S.D.A. stated the problem succinctly:

> A private owner will use something, take care of it, and keep it. But a large corporation doesn't have the same feelings. Nearly all of these corporations are absentee, and their purposes are exploiting the land. When the coal is gone, there won't be much left.[6]

The Appalachian Alliance, a coalition of citizens began to study land ownership in the late 1970s. Before long it became obvious that land ownership was not just one of the several problems facing the region but "the seminal problem from which all the region's problems flowed", in the words of John Gaventa, one of the early leaders of the Appalachian research effort.[7]

In 1981 the Alliance presented its findings to the Appalachian Regional Center.[8] Their documentation of land ownership and taxation in county after county established a pervasive pattern of imbalance that seemed unquestionably to add up to inequity. A handful of corporations were absentee landlords, controlled enormous portions of the region's land and minerals and yet paid a pittance in local taxes. The study used a sample of 80 Appalachian counties. It revealed landholders, including corporations with headquarters out-of-state, who numbered less than one percent of the population; that of the 13 million acres of surface land sampled, 72% were absentee-owned; that 80% of the mineral rights were absentee-owned.[9]

The Appalachian study included a close and detailed examination of ownership and taxation in 12 eastern Kentucky counties. (Known as the Kentucky Land Study, it was one of seven Volumes comprising the larger Appalachian study.) Its findings revealed that the patterns of land ownership in eastern Kentucky are similar to those of the region as a whole:[10]

- A high percentage of surface land was owned by out-of state individuals and corporations: 58% of the surface land in Harlan County (48% by absentee corporations); 48% in Bell; 46% in Breathitt; 26% in Floyd; 57% in Martin; 57% in Knott and 39% of the surface land in Laurel was held by absentee owners.
- Absentee ownership accounted for a large portion of eastern Kentucky's mineral reserves as well: 29% in Knox County and a whopping 81% of the mineral reserves in Perry. In Martin County, one absentee corporation owned 81,333 mineral acres, equivalent to 55% of the county's surface acres. Total absentee ownership of mineral rights was equivalent to 91% of the county's surface acres. Mineral acres in the hands of absentee owners equaled 34% of the surface acres in Floyd County.
- The ten largest owners in the 12 counties were all corporations, owned 736,921 acres of land and mineral rights, representing about one-third of all the land and mineral rights documented.

It is widely agreed that absentee ownership in the coal counties of eastern Kentucky has contributed much to the tolerance of environmental degradation. In addition, the concentration of land in the hands of relatively few owners, both local and absentee, has contributed significantly to two other socio-economic maladies: a shortage of decent housing; and glaring inequality in the distribution of wealth.

In the coalfield counties, large blocks of land have been tightly held by their owners for possible future exploitation of energy resources with one result being a shortage of land for housing construction. In an earlier time, the corporate landholders were also principal housing providers in the form of "coal camps". When the coal industry declined in the 1950s and 1960s, much of that housing was torn down or allowed to deteriorate to substandard levels. The industry rebounded in the 1970s, but the housing units were not replaced. In a number of the counties of Kentucky and West Virginia, there were actually fewer housing units in 1970 than in 1950, and this decline was not related to population shrinkage.[11] The housing situation continued to deteriorate through the decade of the '70s.

Kentucky counties by the end of the 1970s

PERHAPS the most demoralizing feature of the pattern of land ownership in Kentucky and ultimately the most destructive sociologically, was an extremely unequal distribution of personal wealth. Scholars may disagree as to whether or not an unequal distribution of land ownership generally leads to an unequal distribution of personal income and wealth. But no serious student of Kentucky's economic history would deny that *here* the two are correlated. The relationship is a fact, a reality in the historical existence of Kentucky's mountain folk.

Dorothy Mills, a community outreach worker employed by Christian Family Services, an interdenominational agency sponsored by the Harlan Ministerial Association, described Harlan as "a real study in classes". She explains:

> Private individuals and corporations own the land; as a matter of fact, they own everything around. Land is their resource ... The town folks are well off and many of them live in big houses. A small group of folks, the "pillars of the community", have lots of money, and they control what happens ...The hill folks are destitute; they have no money and are frequently out of work. An unbelievable number of folks have nothing but food stamps ...In Harlan, one is either very wealthy, very poor or working poor; there is no real middle- class. Harlan is like a feudal system.[12]

The pattern of land ownership is fundamental to the paradox of poverty amidst wealth in Kentucky. Few scholars have understood the implications of land ownership as deeply as did the 19th century political economist Henry George, and few have written so eloquently about them. The following is from George's monumental work, *Progress and Poverty*, written in 1879:

> The ownership of land is the great fundamental fact that ultimately determines the social, the political, and consequently the intellectual and moral condition of a people. And it must be so. For land is the habitation of man, the storehouse upon which he must draw for all his needs, the material to which his labour must be applied for the supply of all his desires; for even the products of the sea cannot be taken, the light of the sun enjoyed, or any of the forces of nature utilized, without the use of land ... Everywhere, in all times, among all people, the possession of land is the base of fortunes, the source of power.[13]

What justice demands, according to George, are not the redistribution of land but the imposition of a tax on land. This tax would be on the economic rent of land:

> No owner of land need be dispossessed, and no restriction need be placed upon the amount of land any one could hold. For, rent being taken by the state in taxes, land, no matter in whose name it stood, or in what parcels it was held, would really be common property, and every member of the community would participate in the advantages of its ownership.[14]

In fact, as Henry George might have predicted, the political issue in Kentucky has never really been land ownership *per se*. The issue was fair taxation. The people of eastern Kentucky wanted taxation that would bear equitably on all citizens. At the very least, they wanted tax systems which would *not* give land owners, especially absentee mineral owners, tax breaks that are denied to other property owners.

Tax policy in Kentucky had become manifestly inequitable by the time of the studies cited above. The Appalachian Land Ownership Study revealed that over 75 per cent of the mineral owners in the survey paid under 25 cents per acre in property taxes in 1979. Eighty-six percent paid less than one dollar per acre. A review of taxes paid on combined mineral and surface acreage holdings revealed that the top ten land/mineral owners paid an average of only $0.21 per acre in property taxes.[15] Pocahontas-Kentucky, the largest mineral owner in the sample, held 81,333 acres of mineral rights valued at nearly $8 million. Its tax bill on this property was a pittance: $76.00 in mineral property taxes, about the sum that would be paid by the owner of a very modest $14,000 house in Martin County. It also owned some 47,000 surface acres, for which it paid roughly $21,000 in property taxes. Pocahontas' combined tax bill was hardly enough to buy one school bus at 1980 prices.[16] In the major coal counties surveyed, the average tax per ton on known coal reserves was only $0.0002 – or 1/50th of a cent.[17] The potential revenue to any particular county was therefore such a paltry amount that tax bills were seldom even prepared by the county tax assessors.

Prior to 1976, coal in the ground in Kentucky was "officially" treated the same as other forms of real property for tax purposes. It was assessed by the local property valuation administrators (PVAs) and subject to the various tax rates applicable to other real property in the several counties. Unfortunately, most PVAs had neither the expertise, money or staff to assess unmined coal in an adequate and equitable manner. As a result, coal reserves were often simply left out of consideration in valuing property.

The legislature might have addressed the problems of under-funding and inadequate staffing of PVAs, but it chose, instead, to take a path dictated by political expediency. In 1976, the legislature passed a bill that reclassified unmined coal in the tax codes, making it subject to *state* taxation *only*. The job of assessing coal values then fell on the state of Kentucky's Department of Revenue, but the legislature failed to fund the Department's assessment effort adequately. Only four field persons were hired to assess all coal reserves statewide – in America's Number One coal-producing state! Not surprisingly, the new policy failed to raise significant additional revenues. Only about $600,000 was collected in each of the first two years.[18]

In fact, it appears that the politicians never intended to collect any significant new revenue from unmined coal. In 1978, they followed the reclassification of 1976 with a new tax rate on assessed coal reserves: one tenth of a cent per one hundred dollars worth. To put this tax rate in perspective, consider that a company that owned coal reserves valued at $8 million would pay only $80.00 in taxes. Kentucky was estimated to be forfeiting between $50 million and $80 million every year by refusing to tax unmined mineral property in the same manner as other real property.[19]

Kentucky Revenue Cabinet (KRC) officials would later admit that the legislative purpose of the new tax rate was to effect a *de facto* exemption for the politically powerful coal owners. Section 171 of the Kentucky Constitution requires that taxes "shall be uniform on all property of the same class." Creating a *de facto* exemption for coal thus involved a two-stage procedure, first reclassifying coal separately from other real property, then enacting the rate of $0.001 per hundred dollars. Did these actions add up to a legitimate tax-avoidance concession by the state for the purpose of promoting industrial development, as the KRC would surely argue? Or did they amount to unconstitutional tax evasion for purely political purposes? Several persons took the latter view – all the way to the Kentucky Supreme Court. But let us not get ahead of the story.

The reluctance to tax mineral lands was undoubtedly a factor in the public financial problems which severely handicapped the educational system. By the late 1970s, there were huge disparities among Kentucky's counties in the amount of revenue per pupil raised from local property taxes. The difference was most dramatic between Kentucky's mineral producing counties and its urban counties. Jefferson County (which includes Louisville) raised $1,076 per student in 1981.[20] For the top ten coal producing counties, the 1981 average was a paltry $121 per student.[21] Kentucky's Power Equalization Program requires the counties, which do collect relatively more in property taxes, to subsidize those that do not. Still, the total amount of revenue available for educational expenditures from local taxes had long been woefully inadequate, and the unwillingness of the coal counties to tax unmined mineral reserves contributed greatly to that inadequacy of public revenues. The under-funding of education, in turn, has contributed to lower achievement test scores, minimally-trained instructors, lower expenditures for books and classroom supplies and a shortage of advanced courses in mathematics.

Science and foreign languages

THE APPALACHIAN Land Study provided hard-numbers documentation of the inequitable patterns of land ownership and taxation, and the connections to weaknesses in education and other essential services. Not since Michael Harrington's *The Other America* moved liberal forces in the Kennedy-Johnson Administration to launch its "War on Poverty", has a report on American rural life had such an impact. Inspired by the Land Study, a number of citizen groups began pushing for a tax reform in Appalachia.

In Martin County, Kentucky, a citizens group, calling itself Concerned Citizens of Martin County (CCMC), launched an awareness campaign. Its first main objective was to alert its neighbours that the big absentee corporations were not doing their fair share to support community services. In November, 1980, the CCMC held a tax workshop to discuss taxation issues with representatives of state and local agencies. One of the discussants was Martin County Property Valuation Administrator, Betty Muncy. "My job is to make a list of all property in Martin County and make sure that the properties are assessed at fair cash value", she declared in her opening remarks.[22] Muncy went on to stress that land must be assessed at the value which a willing buyer of land would pay a willing seller, i.e., at the land's sale price. "If we don't look at sales and evaluate accordingly, we don't meet the rations set up by the Department of Revenue...We're required by law to do it this way. There's just no way around it."[23]

PVA Muncy proved to be a woman of her word. After looking at sales figures for the Pocahontas-Kentucky Corporation, which, in 1981, owned one-third of the surface land and more than half of the mineral rights in Martin County, Muncy quadrupled Pocahontas' tax assessment. Pocahontas immediately appealed to the local Board of Assessment Appeals, but the Board backed Muncy's figures. Pocahontas then turned to the Kentucky Board of Appeals.

The CCMC was formally allowed to enter the appeal as a third party, the other party (besides Pocahontas) being Martin County. Shortly before the Board was to hear the case, Board member, Bruce Montgomery, announced that Pocahontas and Martin County had proposed a joint order in which Pocahontas was willing to drop the appeal and pay $83,000 plus interest and back taxes. The CCMC balked. It felt the settlement should be higher and wanted to see the records; instead of quietly acquiescing in the agreement, the CCMC filed for a full hearing.

When the Board met, it issued an order accepting the Pocahontas-Martin County agreement. According to the Board, the CCMC had failed to appeal the assessment within the required time. It was a bitter loss for the CMCC – and for Martin County, where community services remained woefully inadequate: no hospital, no sewage system, bad roads and school facilities in dire need of repair.

Another citizens group, the Clover Fork Organization to Protect the Environment (COPE), had been pushing for a more equitable tax structure in its county. Members of COPE, CCMC and other persons interested in land taxation issues met in Berea. The main issue discussed was the property tax on unmined minerals. Recognizing the need for coordinated action at the state level, the newly formed coalition turned to Joe Childers, a bright young attorney for the Appalachian Research and Defense Fund. A graduate of the University of Kentucky Law School, Childers had coordinated the Kentucky Land Study and was well aware of the need for tax reform.

Childers enthusiastically built a statewide network of persons who shared an interest in taxation issues. Findings from the Land study were circulated, along with news stories and magazine accounts of related issues. Calls were made to potential supporters. A grassroots network took shape, but soon it was time to establish a more formal coalition of citizens.

On August 17, 1980, 26 persons representing 12 counties gathered in Hazard for the organizational meeting of the Kentucky Fair Tax Coalition, or KFTC. Gladys Maynard, formerly chairperson of the CMCC, was elected chairperson of the new group, and Jerry Hardt, a reporter for the *Salyersville Independent*, agreed to serve as secretary-treasurer. A collection was taken up and the KFTC had its first funds: $38.

The group adopted a statement of purpose, which reflected their conviction that inequitable tax policy lay at the heart of the region's economic problems:

> The Kentucky Fair Tax coalition is a coalition of community-based organizations and interested individuals promoting more effective and efficient community services, through a fair and equitable taxation system, throughout the state of Kentucky, with particular interest in the coal counties.[24]

The KFTC intended to effect some sort of tax reform. A new General Assembly legislative session would begin in January, and the KFTC was determined to offer a concrete plan of action. Its leaders drafted a proposal for legislation concerning taxation of mineral land, calling for the property taxation on unmined minerals, excluding oil and gas,[25] to be at the same rate as all other real property. The value of minerals in the ground would be assessed by the state in a uniform manner and then state, county, school and any special tax levies applied.

Technically, an unmined minerals tax already existed; it just was not being assessed or collected. The bill proposed by the KFTC would increase the rate of taxation and give a positive mandate to the KRC, working with local PVAs, to develop an accurate and uniform assessment of mineral properties throughout the state. Furthermore, the bill would recognize the authority of local units of government, including school districts, to tax unmined minerals in a manner similar to the taxation of other real property in their respective jurisdictions. Finally, the bill would lay down stringent reporting requirements for mineral owners.

On February 18, 1982, Representatives Clayton Little and Majority

Caucus Chair, William Donnermeyer, introduced House Bill 549, the minerals tax bill drafted by KFTC. Mailings went out the same day to potential supporters, and follow-up calls were made over the ensuing days and weeks. The response to HB549 was generally quite positive. The United Mine Workers endorsed the bill, as did the Kentucky School Boards Association, the Catholic Committee of Appalachia, Barbourville/Knox County Jaycees, Cumberland Rotary Club, Appalachian Science in the Public Interest and numerous other organizations.[26]

Opposition to the bill came not from citizens groups at the grassroots level, but from the board rooms and public relations organs of the major coal corporations. An editorial in the February issue of *The Kentucky Coal Journal*, a principal forum for the interests of the major coal owners, stated that the legislators were "being giggled by a number of sapheads to inflict on this industry an assortment of tax increases that would replace federal budget cuts in other service, enlarge the bureaucracy and enhance the comfort of all Kentuckians from the cradle to the grave." As expected, the coal companies lobbied against the bill; it remained to be seen just how effective that lobbying would be.

Objections to the tax plan

FEW PROPOSALS in the history of Kentucky politics have been as controversial as the unmined minerals tax proposal, despite the fact that it was straightforward, economically sound and eminently fair. Perhaps the best way to see the strengths, as well as the weaknesses, of the unmined minerals tax is to review the objections that were raised against it in the general debate that followed the introduction of HB549.

Objection 1: *It is impossible to know how much mineral is in the ground or to accurately assess its value.*

There were serious problems in accurately assessing the value of coal reserves. Assessment of coal in place involves superimposing coal maps developed by the Kentucky Geological Survey over property ownership maps being developed by the KRC. In 1982, ownership maps were lacking for eleven coal counties and were obsolete for many others. Geological mapping was more complete, although some of the maps were probably seriously obsolete. An inadequate staff of geologists, engineers and other specialists at state offices meant that high accuracy in assessment of coal reserves was several years away.

The use of coal maps to establish "zones" of a certain valuation per acre was suggested as a tolerably efficient stopgap method; in fact, such a system had been used in Kentucky in 1976-77. However, the Kentucky Supreme Court, in *Dolan, et.al. v. Land, et.al.* (1983), rejected a similar "zone" system for valuing farmlands based on soil maps. The court essentially said that *each parcel* must be valued according to its unique characteristics. In all likelihood, a zone system for valuing mineral reserves would be challenged on the basis of *Dolan*, so this idea never found much support.

Despite similar difficulties in assessing value of unmined minerals, several other states were collecting such property taxes in 1982. Pennsylvania, Tennessee and West Virginia in the eastern U.S., as well as 16 western states, had unmined minerals taxes of one description or another. All were raising significant revenues for schools and other community services. Kentucky's neighbour, West Virginia, had been raising $10-12 million each year for nearly a decade[27], despite assessments that were unrealistically conservative.[28]

No one argued that the accurate assessment of unmined minerals would be an easy task in 1982. Nonetheless, the experience of other states demonstrated that it could be done with tolerable, which is not to say perfect, accuracy. (Today the task can be done much more accurately for a number of reasons.[29])

Objection 2: *The unmined minerals tax would merely be passed on by the minerals owners and paid by the consumer in higher energy costs.*

To have an impact on energy costs, the Kentucky tax would have to be passed along in the price of coal sold for energy production. The price of Kentucky coal cannot be significantly raised, however, because of competition from other energy resources — not only coal from other states but also natural gas and oil. In the terminology of economics, the demand for Kentucky coal is too "elastic" to allow any significant part of the tax to be shifted forward to the utilities companies, let alone to consumers.

Economist A.M. Church, who specializes in the taxation of nonrenewable resources, estimated that the unmined minerals tax would be borne almost entirely by the owners of coal reserves. Church predicted that only a small portion of the burden – less than 1% – would be paid by consumers.[30] Since approximately 80% of the coal produced in Kentucky is consumed in out-of-state power plants,[31] the portion of the tax that might, in fact, be shifted to consumers would be shifted almost entirely to electricity users outside of Kentucky.

Objection 3: *The small, independent coal producers, who are strictly speaking lessees, not owners, would be forced to bear the burden of the tax.*

The owners of land – including the big corporations – frequently *lease* mining rights to small, independent coal producing companies; faced with paying the new tax, landowners would merely raise the price of such leases, thus shifting the tax burden to the small independents or would include clauses in the leases to force the lessee to pay the tax. However, such contract arrangements seemed unlikely in light of a 1950 court case, *Head v. Little*. In this case, the Kentucky Supreme Court held that a coal producing company, or lessee, was responsible for property taxes on coal *only after it is mined*, when title vests in the lessee.

The court attached no importance to a provision in the lease which purported to pass "all taxes…charges for revenues…and all levies" on to the lessee.[32] Since producers' leases typically convey no ownership interest in the unmined coal to the lessee, the owner of the coal usually remains solely liable for property taxes on the unmined reserve. In light of *Head*, it seems unlikely that owners would be successful in shifting the unmined minerals tax to the small, potentially vulnerable lessee through legal arrangements. As for shifting the tax through the pricing of the lease, the same arguments that were noted above, about elasticity of demand for Kentucky coal and competition from other fuel sources, pertained to this situation as well.

Objection 4: *Small mineral owners cannot afford to pay the property tax on unmined minerals and will, thus, be forced to sell their minerals.*

The KFTC proposal contained a provision that would allow those who owned surface rights and minerals *but anticipated no financial gain from their interest in those minerals*, to be taxed at the original rate of one-tenth of one cent per $100 of mineral value.[33] To discourage owners who *did* intend to develop their interests from seeking temporary shelter under this provision, the bill included a rollback clause which provided that any non-extractable interest that is converted to an extractable interest would be liable for previously deferred taxes based on the applicable rates for the current year and the preceding five years.

Objection 5: *Kentucky already has a coal severance tax. Why not just raise this tax? It would serve the same purpose and would avoid "double taxation" of the coal industry.*

An unmined minerals tax and a severance tax are two different kinds of taxes. The economic and ethical arguments for them are quite different from each other.

The severance tax recognizes the fact that mineral reserves are nonrenewable. Once mined, this form of wealth, this asset, is gone forever. The state, as the representative of "society", shares in the permanent loss of this wealth; it is both economically necessary and ethically appropriate that the state (or "society") should also share in whatever resources – alternative capital assets or just plain money – have been received in exchange for the mineral wealth; hence the severance tax.

The tax on unmined mineral wealth, on the other hand, is merely a traditional property tax similar in economic and ethical respects to other property taxes; it is imposed because the wealth exists, is present in the community and *not* because it is leaving the community forever. Property taxes are viewed by different scholars in different ways. Some analysts consider them to be excises on particular forms of capital, which may be "regressive" in effect and raise ethical questions about the "ability to pay" of taxpayers. Other scholars see them as user fees for local services, which approximate to "proportionality" and thus to ethical equity since the biggest property owners are *ordinarily* the biggest users of local government services (although such might not be the case in Eastern Kentucky, where so many owners are absentee corporations). Whatever the scholarly analysis, however, property taxes, including those on unmined mineral reserves, are public fees on *existing and continuing* wealth, not fees on the *disappearance* or severance of wealth.

It is important to bear in mind that the severance tax is placed on the *producer*, rather than the owner as such. In the case of coal, producers are often local operators who also pay state income taxes and other local taxes such as sales tax. The owners, from whom they lease, in particular the large absentee owners may pay little or nothing to local governments. The charge that the unmined minerals tax would amount to "double taxation" simply could not apply to many absentee owners of coal reserves since they are *not* paying the first level of taxes. In any case, the imposition of both unmined minerals taxation and coal severance taxation would not constitute "double taxation" any more than would, say, property taxation of rental housing and income taxes on rental earnings.

Objection 6: *The unmined minerals tax would make Kentucky coal uncompetitive and discourage coal production in the state.*

This was one of the main findings in a patently self-serving "study" conducted by the Kentucky Unmined Minerals Tax Advisory Commission, a coal industry lobbying group in 1983.

To calculate the ultimate net impact of an unmined minerals tax, one must consider that this tax would reduce the income on which federal taxes are levied. The federal corporate income tax rate was 49% in 1982. Thus, the effect of the unmined minerals tax would be to increase the corporation's total tax expense by only about one-half of the unmined minerals tax – and, in effect, to shift tax revenues away from the federal government to Kentucky.

A study commissioned by the KFTC looked at 16 of the largest coal owners and attempted to estimate the "worst possible effects" the unmined minerals tax could have on them. The study made assumptions that would maximize the impact of the tax: high coal recovery rates, a 50 cent per ton value placed on unmined coal (instead of the widely-accepted 13 cent value), and use of corporate financial statements from 1982, an especially poor year for the coal market. This study projected unmined minerals tax charges of $11.9 million (for the 16 companies) based on four and a half billion tons of coal reserves.[34] This sum works out to less than $0.003 per year per ton of coal reserves – about five cents per ton on unmined coal over 20 tax years.

Obviously, coal production cannot be "discouraged" in Kentucky by the producers "picking up and moving" in quite the same sense that owners in other industries can; in the case of minerals, the property necessarily stays behind. Owners who are unhappy over the unmined minerals tax could, of course, sell their interests in one state and buy reserves in some other state. By doing so, they might reduce the market value of the reserves they leave behind. However, it seems unlikely that coal owners would find any other state more attractive than Kentucky, at least in the eastern U.S., since its property taxes in general are lower than in other eastern states. If the coal industry ever abandons Kentucky, which is highly unlikely, it will not be because of an unmined minerals tax but because cleaner industrial coal from the western United States somehow becomes less expensive than the high-sulfur coal of the eastern states, including Kentucky.

It is, indeed, possible that an unmined minerals tax could have a slight effect on coal production in Kentucky, but the effect would be to *encourage* production, not discourage it. Because mineral owners pay virtually no tax on their considerable property, they can afford to leave it idle for speculative purposes. They face no financial pressure either to produce coal or to sell their reserves to someone who will produce; and they can hold out until they feel the price is "right". If mineral holdings were fairly assessed and properly taxed, however, mineral owners would have a powerful incentive to use their resources, to lease their tracts to local operators to earn income with which to pay the tax. The incentive for increased extraction rates is illustrated in Table 1.[35]

Table 1 Property Tax on the Resource Remaining in Situ

(The dollar value of the unmined resource is shown in parentheses and the expected tax bill for each year is shown under it; the present value of those tax bills is calculated at a 10% discount or interest rate.)

Year	Three-Year Extraction		Two-Year Extraction	
	5% Property Tax on Resource in Situ	Present Value of Property Tax	5% Property Tax on Resource in Situ	Present Value of Property Tax
0	(15,000) 750.00	$750.00	(15,000)	$750.00
1	(10,000) 375.00	$454.55	(7,500)	$340.91
2	(5,000)	$206.60	–	–
TOTAL		**$1,411.15**		**$1,090.91**

This table illustrates that the mineral owner realizes a net reduction of more than 20% in the present value of the total tax paid when minerals are extracted in two years instead of three. Such rates of tax saving over a period of years and applied to substantial mineral holdings could constitute a considerable incentive for an increased rate of extraction.

The severance tax would partially offset such an incentive for increased extraction. The severance tax is a tax on *production*. While the property tax makes current extraction relatively more profitable than future extraction, the severance tax makes future extraction relatively less costly (in present value terms) than current extraction. Thus, the two are offsetting. Given that the severance tax already exists, however, the imposition of the unmined minerals tax would tend to increase extraction rates somewhat.

A property tax on unmined minerals might affect production in another way: it could reduce the quantity of mineral reserves deemed economically recoverable in any given tract of land. This would be the result if the market price of the minerals were to fall as a result of higher extraction rates. As mining continues in a given tract, cost per ton eventually increases; i.e., additional mineral extraction becomes increasingly expensive. Therefore, if the market price falls, the "cut-off" point occurs sooner, and less total extraction occurs.

One other tax impact deserves mention. A tax on unmined minerals is, in effect, a tax on exploration; it reduces the potential reward to be gained from finding new deposits. Thus, it is a deterrent to the discovery of new reserves. However, most of Kentucky has already been extensively mapped out for minerals, especially coal. The deterrent effect of an unmined minerals tax would probably not be significant.

In summary, an unmined minerals tax would tend to increase the rate of mineral extraction but might reduce the ultimate *total* amount extracted, *ceteris paribus*. Needless to say, *ceteris* are rarely *paribus*. More importantly, these effects are not likely to be nearly as large as other influences at work determining the competitiveness and production levels of Kentucky coal.

Objection 7: *The unmined minerals tax would not raise enough revenue to significantly enhance the state budget.*

This was another conclusion of the Unmined Minerals Tax Advisory Commission, the landowners' interest group. However, the Appalachian Center at the University of Kentucky conducted a study in 1982 to estimate the yield from an unmined minerals tax on coal.[36] They used the following formula:

$$Y = C \times R \times P \times T$$

Where:

Y = the estimated yield of the tax in dollars
C = estimated coal reserves (KGS)
R = rate of actual recovery of estimated reserves (several alternative rates were used as shown below)
P = estimated fair cash value of coal in the ground per ton
T = property tax rate for taxing jurisdiction

The researchers estimated tax yields of between $49 million and $79 million annually for the state budget *alone*. Reserves were estimated to be 89.6 billion tons. The current (1982) price of $0.50 per ton of coal was used, along with a tax rate of 22.1 cents per $100 valuation. Table 2 identifies yield estimates for different recovery rates:

Thus, the University study did indicate that these taxes would not be a major source of revenue for *state* government – probably not much more than 5% of total state tax revenues.

Table 2:

Recovery Rate (%)	Yield (millions of dollars)
50	$49.5
60	$59.4
70	$69.3
80	$79.2

For counties and local school districts, however, the yield would be significant. Using the conservative 50% recovery rate, the Appalachian Center study concluded that coal counties would average a 101% increase in total annual operating revenues with the tax. This would represent a mean increase in operating revenue *per capita* from $61.19 to $122.65. School revenues for all counties would increase an estimated $42,109,065 annually.[37]

These estimates were based on known reserves in 1982. New reserves are "discovered" as geological survey data are improved. In the very long run, of course, mineral reserves would be depleted and tax yields would inevitably fall. An interesting possibility for providing a *permanent* source of income for each county would be to use some tax revenue to establish an investment fund. Alberta, Canada, provides an example. Its Alberta Heritage Savings Trust Fund was started in 1976 as a repository for 30% of the revenues from taxes on Alberta's non-renewable resources. The Trust Fund was estimated to be worth about $10 billion in 1980.[38] As one Trust official put it, the purpose of the fund is "the ensurance of future generations of Albertans. Look at it this way: when our petroleum is gone, we have to have something to fall back on"[39]. Used in this way, a property tax on unmined minerals could provide long-term financial resources to counties that are now dependent on sales of coal, a non-renewable resource.

Objection 8: *An unmined minerals tax would be inequitable and unfair.*

Those who oppose the tax on equity grounds have made three basic points. The first point plays (yet again) on the theme of inaccurate assessment. If the tax is to be equitable, two tracts of minerals of equal value should be liable for the same tax assessment. The possibility of assessment errors means that there might be inequitable differences. A second source of possible inequity is that two tracts of equal value, although assessed uniformly and accurately within the state, may lie in different tax jurisdictions (i.e., counties) and may, thus, be liable for different tax levies, depending on the amount of revenue needed by the local taxing district. The third usual objection on equity grounds is that such a tax is not based on ability to pay. Smaller owners would pay the same rate as larger owners in the same district, and for this reason, some critics of the bill have (incorrectly) labeled the minerals tax "regressive".

In a study for the Appalachian Center, Ms Virginia Wilson makes the point that these arguments against the unmined minerals tax on equity grounds are the same as those offered against the property tax in general. "Given that the state and local governments have decided to use property taxes", she writes, "the question becomes whether there is any equity justification for *not* taxing mineral rights in the same manner in which other forms of real property are taxed".[40]

Locke's labour theory of ownership

PERHAPS THE MORAL CASE for an unmined minerals tax is even stronger than Ms Wilson's analysis suggests. A compelling moral justification for a tax on unmined minerals is found in Locke's *labour theory of ownership*. According to this theory, not to be confused with Marx's discredited labour theory of *value*, private property is ultimately justified by the right to one's own person and, as an extension thereof, to the fruits of one's labour. Since unmined minerals are not created by human effort but represent what might be called "a fund of opportunity intended by God for the use of all"[41], the argument for private ownership cannot apply to it. Thus, unmined minerals are in a category apart from other property, an important point not recognized in Wilson's defense of the unmined minerals tax.

One of the implications of the labour theory of ownership is that no one may justly monopolize land, including, of course, minerals as well as surface property, without fully indemnifying those who are thereby deprived of an equal opportunity for the use of it. A tax on unmined minerals could justly be appropriated by the public as an indemnity to them and applied to public services that would otherwise have to be supported by taxes on earned income and other forms of property. This is the ethical basis for Henry George's land tax[42], and it remains one of the strongest ethical justifications for the tax on unmined minerals.

The arguments against the tax on unmined mineral reserves, which have been classified here into eight "objections" can be combined and permuted in many different ways. Nearly all possible permutations and combinations were offered during the debates over HB549 after it was introduced into the Kentucky legislature in 1982. Some of these objections are obviously stronger than others, but none of them seems very persuasive, and most of them are quickly and easily dismissed by straightforward economic analysis. When set in the balance against the one overwhelming argument *for* additional taxation – the extraordinary poverty of eastern Kentucky and the scandalous paucity of publicly financed social services – these objections seem weak indeed. Nonetheless, the legislature gave them a very serious and earnest hearing, sensing perhaps that HB549 would be the occasion for a great historic confrontation between Kentucky's richest and most powerful industry, the coal companies and its poorest citizens, the residents of the eastern counties.

How HB549 was sentenced to death

THE HOUSE Appropriations and Revenue Committee heard HB549 on March 19. Joe Childers and Rep. Little testified in favor of the bill and submitted written testimony from numerous other supporters. Impressed by the widespread popular support for the bill, Appropriations and Revenue passed the bill by a vote of 11 to 1, and thus gave KFTC its first important victory. But KFTC was also about to receive its first and hardest defeat, a lesson in the complex workings of Kentucky politics.

As was routine, the unmined minerals tax bill now went to the House Rules Committee. The function of the Rules Committee is to screen bills, to make sure they meet certain technical and stylistic criteria before they go to the House floor for full discussion and vote. The Rules Committee also determines the routing of a bill, sending it either to the House floor directly or to any one of a number of other committees. The Rules Committee is supposed to concern itself with the substance of a proposed bill only in terms of this routing – but its disposition of HB549 indicates that it may have been very much concerned with its substance.

Rather than send HB549 directly to the House floor where it might have passed fairly easily, the Rules Committee elected to send the bill next to the Agriculture and Small Business Committee, several of whose members had expressed reservations against an unmined minerals tax.

This disposition was clearly intended to reduce the chances that HB549 would ever be brought before the full House for a vote. As expected, the A&SB Committee allowed the measure to expire for the 1982 legislative session.

The individuals most responsible for killing HB549 were Bobby Richardson, Speaker of the House, and David Thomason, Speaker Pro Tem of the House. Richardson seemed to waffle before finally coming down against the bill. Just days before the Rules Committee decision, Richardson had sent a letter to KFTC President, Gladys Maynard, predicting passage of the bill and implying his support. As it turned out, Richardson had no intention of supporting the legislation. The letter was apparently a mere ploy to keep KFTC at bay until the Rules Committee met.

Both Richardson and Thomason had close ties to the coal industry. As a lawyer in private practice, Richardson had represented the St. Joe's Minerals Corporation, a company with vast coal interest in Kentucky. Thomason, also a lawyer, had done work for Consolidation Coal Co., as well as numerous oil and gas firms, many of which owned coal interests and were leery of the proposed legislation. Both Richardson and Thomason would eventually leave their governmental positions to work as full-time professional lobbyists for the coal industry.

Word spread quickly that HB549 had been effectively sentenced to death by the leadership of the House. On March 23, just four days after the assignment of the bill to the Agriculture and Small Business Committee, some 50 supporters of the bill rallied in the Capitol rotunda. They marched into the office of Speaker Richardson and demanded a meeting with him. After waiting several hours, the marchers were granted fifteen minutes. The Speaker informed them that he had not personally voted to transfer the bill to Agriculture and Small Business but that he did "support" the action and opposed the unmined minerals tax.

At least 21 groups publicly endorsed HB549 and thousands of letters of support reached Frankfort between February 18 and March 30, the end of the legislative session. Clearly the "little people" were in favor of the unmined minerals tax. The wealthy coal owners were not, however, and in the end, which was what mattered most to those in a position to decide the fate of HB549.

A switch in strategy

REFLECTING on the failed campaign for the bill, Gladys Maynard remarked that "We believe we have witnessed a failure of the democratic process in Frankfort. In fact, it insulted me that Richardson would make a decision for all other representatives and not let it come to the floor for an open debate and vote...We don't believe this is what the majority of our representatives want or believe is right, nor do we believe that it is representative of the views of the majority of Kentuckians."[43]

Supporters of the unmined minerals tax tried to revive their bill. Representative Little attached the measure to a general property tax bill (HB534) already posted for action on the House floor, but Speaker Richardson refused to allow a vote on the amended bill, and so it died.

In 1984, a bill that was essentially the same was introduced by Donnermeyer and Little as House Bill 92. Again, the House leadership killed the measure. This time round, the bill got no further than the House Appropriations and Revenue Committee, which tabled it on a 13-6 vote. Several members of the Committee, who might have voted in favor of the bill, did not do so because they were disturbed by a recent lawsuit filed by KFTC. The political temperature was rising!

In this suit, *Nowak v. Foster*, KFTC attorneys Childers and Ira Burnim, charged that it was unconstitutional for unmined minerals to be taxed at the rate of one-tenth of one cent per $100 of market value, so far below the rate on other forms of property. This rate amounted to a tax exemption, they argued, and the Kentucky Constitution does not give the state legislature the power to grant such an exemption. The suit also charged that unmined minerals were being systematically under-assessed, thus, reinforcing the *de facto* exemption. While the suit pursued its way through the courts, the legislature considered HB92, the 1984 reincarnation of 1982's HB549.

This time around, as in 1982, Richardson and Thomason led the political maneuvering against the bill. Thomason protested that proponents of the unmined minerals tax had attempted to bypass the General Assembly by undertaking their lawsuit. "I don't think it's a coincidence", Thomason told reporters, "that process of service was begun on the property valuation administrators (who are the defendants in the suit) just yesterday ... [The legislature] can't submit to these heavy-handed tactics".[44] Steve Jones, a lobbyist for the Western Coal Association, agreed: "I think the members of the committee did the responsible thing. The issue has been put before the federal court, and the General Assembly had to wait to let the court decide. It was the choice of those who filed the suit to let the court decide."[45]

These charges were countered by Joe Childers in a piece that ran on the editorial page of the Lexington *Herald Leader*:

> [I]t's hard to see how filing a suit asking that an existing law is enforced makes it impossible for the legislature to consider a new law. And it is even harder to see how the suit puts legislators under such unbearable pressure.
>
> Of course, members of the legislature have a rather selective sense of when they are being inappropriately pressured.

> Few of them cried foul when the National Rifle Association flooded them with mail in support of a bill that would keep cities from regulating firearms …
>
> Few of them protested when bankers threw an obscenely lavish reception to woo votes in favor of multicounty banking …
>
> Few of them have found it improper that Jay McCoy, who has close ties to the Western Kentucky Coal Association, is also an unpaid aid to House Speaker Bobby Richardson, or that the association's lobbyists appear to have taken up residence in Richardson's office this session.[46]

Publicly, Childers and the KFTC were not about to fold their hands, but privately did they admit to having played the wrong card? Perhaps the filing of *Nowak v. Foster* did signal a change of strategy. A miscalculation, then, or a new game plan? When asked if the KFTC had misread the political situation, Joe Childers was adamant: "Not at all. Look, the legislature was not about to pass an unmined minerals tax bill. The lawsuit may have given some of the legislators an easy out, but it didn't change the outcome one bit. We intended to get a court order to force the state to assess unmined coal."[47]

The KFTC had, indeed, embarked upon a new strategy. Henceforward, the fight for tax justice would be waged primarily in the courts. And there it would be won, eventually.

Turning to the courts for tax justice

THERE WERE ORIGINALLY two counts in the suit filed by KFTC attorneys. Count I alleged that the PVAs had systematically under-assessed taxable property owned by coal, gas and oil interests. As a result, these interests had paid less than their fair share of *ad valorem* taxes. The discrepancy between tax obligations fairly assessed and taxes actually paid constituted a violation of the Fourteenth Amendment to the U.S. Constitution, which guarantees "equal protection" for all citizens under the law.

The original Count II alleged that the tax rate of $0.001 per hundred constituted an exemption, which the legislature was not empowered by the Kentucky State Constitution to grant; this second count was, however, voluntarily dismissed by the plaintiffs and subsequently became part of another suit.

Thus, only the first count, which dealt with assessment, was brought before the court. The defendants sought to dismiss it on two bases: the Tax Injunction Act and the comity doctrine. The Tax Injunction Act provides that a Federal district court shall not enjoin, suspend or restrain the collection of any tax under state law where an efficient remedy may be reached in a state court. The comity doctrine provides that courts shall not enjoin state officers from collecting taxes unless an injunction is necessary to protect the rights of the citizen whose property is being taxed. The defendants argued that these two points of law, taken together, divested the U.S. District Court for the Western District of Kentucky of jurisdiction to grant injunctive or declarative relief, and the action must, therefore, be dismissed.

The plaintiffs argued that their action sought to *enhance*, not inhibit, the collection of taxes in Kentucky, and so the Act and the comity doctrine did not bar their suit. The district court agreed. The defendants appealed, and eventually, in January 1988, the Court of Appeals sided with the defendants. Citing the Tax Injunction Act, the Court of Appeals ruled essentially that the issue of state tax assessment could not be brought into Federal court.

Thus, of the two issues originally raised in *Nowak v. Foster*, the assessment issue proved finally to be a loser, and the "exemption rate" issued had been voluntarily dismissed. The latter issue was, however, raised in another 1984 case, *Yount v. Gillis*. Attorney Joseph Leary representing William Yount in this class action suit, naming as defendants Gary Gillis, Secretary of the KRC and the Kentucky Coal Association. Mr. Leary was a semi-retired elderly gentleman whom Joe Childers describes as "eccentric, sometimes incoherent, but brilliant". He questioned the constitutionality of the statute by which the Legislature in 1976 had established a separate classification for coal reserves apart from all other real property. Leary argued that this action was unconstitutional under Section 171 of the Kentucky Constitution, the pertinent part of which states:

> The General Assembly shall provide by law an annual tax, which, with other resources, shall be sufficient to defray the estimated expenses of the Commonwealth for each fiscal year. Taxes shall be levied and collected for public purposes only and shall be uniform upon all property of the same class subject to taxation within the territorial limits of the authority levying the tax; and all taxes shall be levied and collected by general laws.

Attorneys for the KRC countered with the argument that the 1891 Constitution was "outmoded", that "[t]he politics and issues of Kentucky in 1890 are as foreign to this generation as the intrigues of ancient Rome.[48]" In particular, they maintained that the stated purpose for and definition of taxation in Section 171 failed to take into account the present need to use taxation to promote economic development. Hence, they argued, the judiciary should aid and abet the General Assembly in structuring tax policy free from constitutional restraints.

Yount v. Gillis was first tried in Kentucky's Franklin Circuit Court, where Leary prevailed. The defendants then turned to the Kentucky Court of Appeals. Childers and Burnim were involved in the appeal representing Allison Moore, who had also challenged the constitutionality of the $0.001 tax rate on the grounds that it bestowed, on unmined coal, an unconstitutional de facto exemption from property taxation. While *Nowak v. Foster* was a federal suit, *Moore* had been filed in state court and related to the Kentucky Constitution. The Moore suit was now consolidated with the original Yount case in what was to become commonly known as *Moore v. Gillis*, the case heard by the Kentucky Court of Appeals.

In March 1987, the appellate court upheld the trial court's opinion. The classification of coal was deemed arbitrary and, therefore, unconstitutional under Section 171, and the $0.001 tax rate was, in fact, an unconstitutional exemption. The defendants then took their case to the Kentucky Supreme Court.

March 3, 1988, was an historic day for the KFTC and the state: the Kentucky Supreme Court affirmed the decision of the Court of Appeals. Specifically, the Supreme Court ruled that the *classification* issue was "the threshold issue on discretionary review"[49], and it elected not to consider whether the $0.001 tax *rate* was unconstitutional. The decision reads, in part:

> [T]he critical point in this case remains that the constitutionality of the one mil tax ($0.001) on unmined coal does not turn on whether the General Assembly perceived that this tax treatment served a public purpose, but on whether the tax classification was constitutionally permissible within the limiting language of Section 171.

The opinion continues:

> Under Section 171 the stated purpose for taxation is to raise revenue ...
>
> Making tax distinctions for purposes of promoting some perceived state economic advantage rather than for purposes related to raising revenue is permissible in taxes other than property taxes because other kinds of taxes do not involve the same constitutional restrictions...But the tax scheme for state property taxes expressed in the 1891 Constitution...was exactly the opposite, i.e., taxation is permitted for the limited purpose of raising revenue and shall not be subject to manipulation to promote any taxpayers or group of (taxpayers') economic advantage.

The justices of the Supreme Court were well aware of the broad public debate over mineral taxation. They felt strongly enough about some of the issues involved to mention them in the Court's opinion – and in fairly scathing language!

Problems in property valuation techniques

SINCE THE 1988 Kentucky Supreme court decision in *Gillis v. Yount*, unmined coal has been classified, assessed and taxed in the same manner as other real property. In the beginning, unmined coal was assessed by local property value assessors (PVAs). But a lawsuit filed by KFTC shortly after the decision in *Gillis v. Yount* challenged the assessment by local PVAs, and the Franklin Circuit Court entered a temporary injunction which directed the KRC to commence centralized assessment of all unmined minerals, including unmined coal. Then in 1994 the General Assembly officially placed the responsibility of valuing and assessing unmined minerals with the KRC.

The KRC has experienced considerable difficulty in implementing appropriate valuation methods for unmined minerals, and unmined coal in particular. Among the issues raised are how to value coal that cannot be practically mined, how to value coal that must be that left in the ground to prevent the mine from caving in, and how to make a valid distinction between property that is being actively mined and property that is not. These kinds of issues inhere in the taxation of unmined minerals, and can probably never be resolved to the complete satisfaction of everyone. Given that perfection is impossible in practice, we must accept a measure of uncertainty, even error, as inevitable.

But the inability to attain perfect accuracy does not remove the obligation to approach it as closely as possible. Whether or not the KRC has even tried to assess and tax unmined coal accurately is a serious question, especially in light of a study completed in 1999 by the Mountain Association for Community Economic Development (MACED)[50]. This study, entitled *An Examination of Coal Resources and Revenues for Letcher County*, was conducted by attorney Joe Childers, along with researchers Don Harker and Shepard W. McAninch. They showed that companies in Letcher County, Kentucky, are taxed on less than half of the value of their unmined coal reserves. The same, the authors argue, is likely true of all coal producing counties.

The KRC uses a variation of the "income approach" in valuing unmined minerals. This approach is theoretically valid in general, but it may yield inaccurate valuations in specific applications due to bad data or false assumptions. According to the MACED study, the KRC valuations are wrong for both reasons.

Here, in a nutshell, is how the assessments are calculated by the KRC. First, each coal owner is required to report to the KRC the number of acres of coal expected to be mined over various time periods: within the next year (producing); within the following six years (permitted active); and additional acres to be mined over the next 15 years (permitted inactive). All other coal acres reported by the owners as mineable are placed into the "idle" category. The KRC then determines the number of tons assigned to each category, based on the acres reported and the reported thickness of the seam being valued. Each ton is valued on the basis of reported and assigned royalty rates. In Letcher County, the KRC's assessed values for 1997 averaged $2.06 per ton for producing; $1.13 for permitted active; $0.61 for permitted inactive; and $0.15 per ton for idle. The KRC determines the total assessment by multiplying the calculated number of tons for each category by its value per ton. Finally, it applies a discount rate (17.5%) to future earnings in order to arrive at their present values.

The KRC procedure is fraught with problems, according to the MACED report. To begin with, the KRC relies upon self-reporting by the coal owners, who have an obvious incentive to minimize their tax liability. The result is a significant underestimate of coal reserves and royalty values, and subsequent loss of tax revenue. Perhaps more significantly, the discount rate applied to future income is unreasonably high at 17.5%. As a matter of simple mathematics, merely adjusting the discount rate a few percentage points can make a huge difference in discounted present values. A lower discount rate would increase present values, hence tax revenues, generated from unmined coal in the "permitted active" and "permitted inactive" categories.

Discount rates are based on current interest rates plus a risk premium. Given that the interest rate on "riskless" US Treasury issues is less than 7%, the high discount rate of 17.5% would be justified only if the future of coal mining in Letcher County were extremely uncertain, which it is not. A more reasonable discount rate, according to MACED, would be about 12.5%.

The following charts show comparisons of Letcher County coal reserves by three agencies: the KRC, MACED and a Pennsylvania consulting firm, Resource Technologies Corporation (RTC). The first chart reveals the under-reporting of taxable coal reserves. Both MACED and RTC rely upon geological maps and recent trends in coal production to arrive at estimates of coal reserves; the KRC, on the other hand, relies upon self-reporting by coal owners.

Besides the Volume of taxable reserves, another factor in the calculation of future value is the time frame over which the calculation is made. The longer the time frame, i.e., the greater the number of years into the future the analysis extends, the greater the present value. Here again, MACED and RTC base their estimates on objective data from geological maps and historical trends in coal production.

Figure 3 shows the "bottom line," as they say in the corporate boardrooms. When all things are considered – a proper discount rate, accurate estimates of coal reserves, an appropriate time frame for analysis – the KRC's annual coal assessments fall far short of what should be collected, according to both MACED and RTC estimates.

Figure 1 Taxable Coal in the Ground (million tons)

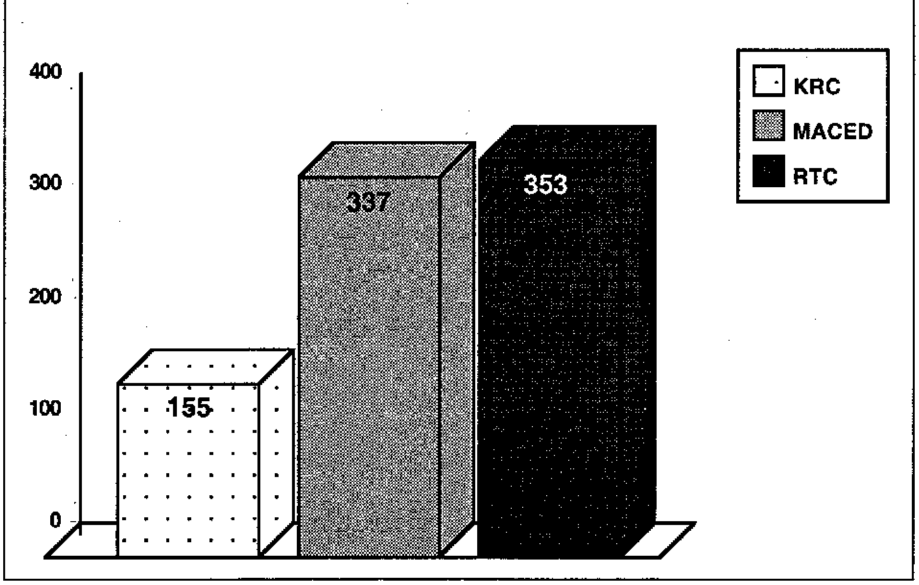


Figure 2 Years of Mining Remaining

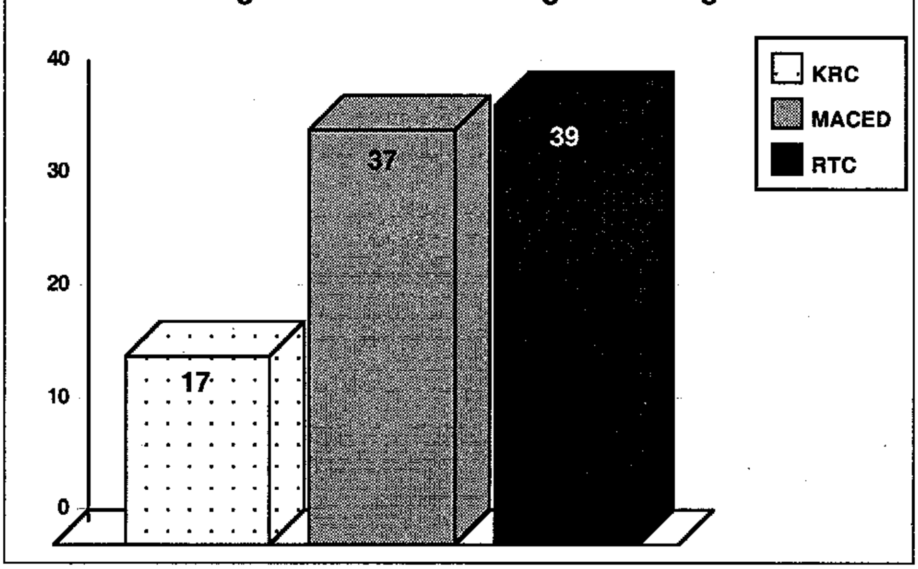
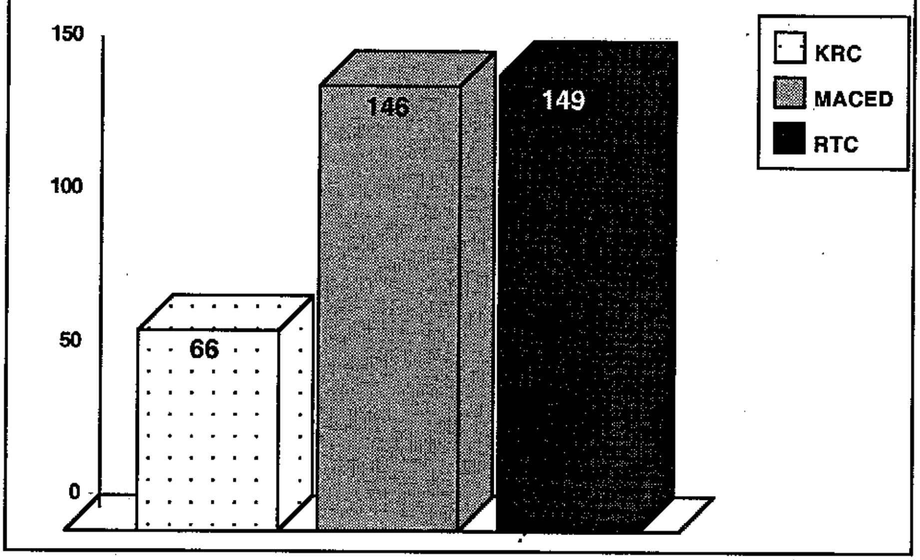


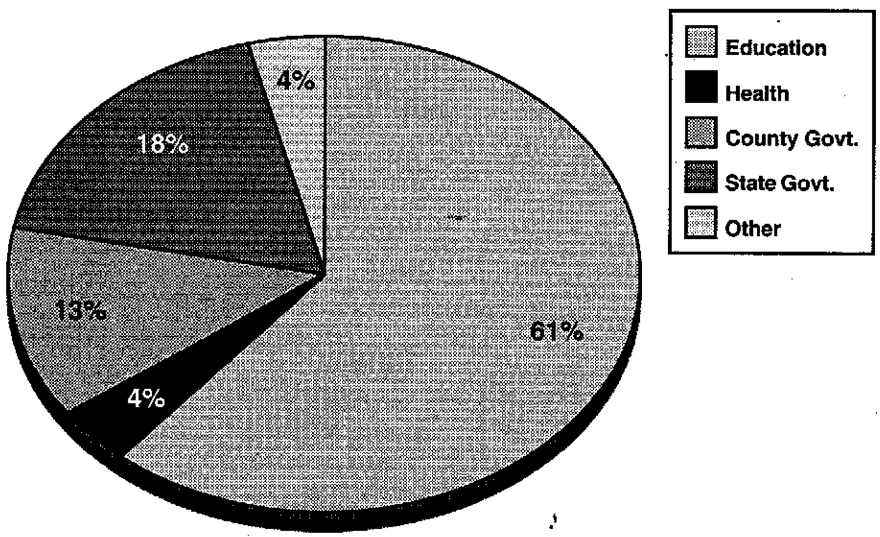
Figure 3 Unmined Coal Assessments – Year 1



Problems identified by the MACED study suggest that the unmined coal assessment program for all of Kentucky needs to be re-examined. These problems do not suggest, however, that the program be discontinued, or that unmined coal should be exempt from taxation. (Repeal of the *ad valorem* tax on unmined minerals would require a Constitutional amendment which would allow the General Assembly to exempt unmined minerals from taxation – an unlikely action, at least in the foreseeable future.) Improvements to the program would significantly enhance the flow of revenue to education and other worthy purposes. And some improvements may be imminent: findings in the MACED study have helped in lawsuits brought by county officials to recover revenue from coal companies. One such case is awaiting a decision by the Kentucky Supreme Court.

An important step in addressing the shortfalls identified in the MACED report would be to make mineral tax assessment information available under the Kentucky Open Records Act. At present, such data are not considered public information, and detailed statewide figures are virtually impossible to obtain. But general estimates provided by the KRC put state assessments at about $2 million annually, and local collections at just over $9 million annually. Clearly, the unmined coal tax generates a significant amount of revenue each year for a variety of programs, most of which support education directly or indirectly. Figure 4 shows the allocations of unmined coal tax dollars collected in Letcher County, which is fairly representative of all coal producing counties in Kentucky today.

Figure 4 Allocation of Revenues



Ideology, pragmatism & ethics in public finance

HENRY GEORGE advocated a tax on land in the name of justice, since such a tax could insure that land ownership serves the benefit of the community. The ownership of land is "the great fundamental fact that ultimately determines the social, the political and, consequently, the intellectual and moral condition of a people"; George believed that appropriate taxes on land would insure that the people's condition reaches the highest possible level. In eastern Kentucky, prior to the events discussed in this essay, there was certainly an inadequate system of land taxation; and equally certainly, the people's condition left a lot to be desired. Henry George would not have been surprised.

Later and more pragmatic writers on taxation, however, might have been surprised. In modern times, the argument for taxing land has been a "practical" one. For example, in his classic text on *The Public Finances* in 1960, Nobel laureate James M. Buchanan remarks that "ideological bases" for the taxation of property – such as those associated with Henry George and *Progress and Poverty*

> no longer exert major influence ... immobile property, including land, tends to be subjected to higher effective rates of property taxation for much more practical reasons. Immobile property can be taxed more easily; the tax is far more difficult to evade and less intergovernmental competition for tax sources can take place.

Surely coal in the ground qualifies as an immobile property, but the pragmatic considerations that Buchanan lists as important, were no more influential in Kentucky than the ethical considerations suggested by Henry George. Neither justice nor efficiency was able to make Kentucky politicians levy a reasonable tax on mineral reserves; it took an aroused citizenry, together with the courts, to do the job.

References

1 From a KFTC report on education in Kentucky, 1983. Here "educational attainment" refers to the percentage of the population who goes on to earn a college degree.
2 *Statistical Abstract of the United States*, 1984.
3 *Statistical Abstract of the United States.*
4 *From Landownership Patterns and Their Impacts on Appalachian Communities: A Survey of Eighty Counties*, a study prepared by the Appalachian Land Ownership Task Force and submitted to the Appalachian Regional Commission in February, 1981. This quotation is from Vol. III, the Kentucky State Report, p.138.
5 *Ibid.*
6 *Ibid.*
7 From his lecture at the Henry George School in San Francisco, Nov. 1983.
8 The study consisted of seven volumes – a regional overview (Vol. I) and one Volume for each of the six states studied: Alabama (Volume II), Kentucky (Vol. III), North Carolina (Vol. IV), Tennessee (Vol. V), Virginia (Vol. VI) and West Virginia (Vol. VII). Each state Volume consists of a state summary, in-depth case studies and statistical profiles of land patterns. Major funding for the study came from the Appalachian Regional Commission. The project was administered by the Center for Appalachian Studies, Appalachian State University, with research coordinated from the Highlander Research and Education Center, New Market, Tennessee, and by teams of researchers in each state. In 1983 a summary of the study was published by the *Appalachia? Land Ownership and Its Impact.*
9 *Who Owns Appalachia? Landownership and Its Impact*, Appalachian Landownership Task Force, University of Kentucky Press, 1983, pp.14-15.
10 These figures are from the original report of the Appalachian Land Ownership Task Force, Landownership Patterns, Vol. III, *op.cit*
11 *Ibid.*
12 *Ibid.*
13 Henry George, *Progress and Poverty* (abridged version), New York: Robert Schalkenbach Foundation, 1970, p.115.
14 *Ibid.*
15 *Struggling for Tax Justice in the Mountains*, Kentucky Fair Tax Coalition, Lovely, Kentucky, 1982, p.13.
16 *Ibid.*, p.17.
17 *Ibid.*, p.13.
18 *Ibid.*, p.9.
19 Virginia Wilson, "An Economic Analysis of a Proposed Property Tax on Unmined Minerals in Kentucky", University of Kentucky Appalachian Center, 1982, p.16.
20 From a Kentucky Fair Tax Coalition report on education in Kentucky, 1982.
21 *Ibid.*
22 *Struggling for Tax Justice in the Mountains*, *op.cit.*, p.17.
23 *Ibid.*

24 *Ibid.*, p.3.
25 Oil and gas would be excluded because of the special difficulties in determining the quantities in the ground. The proposal does not exclude oil and gas from any current taxes levied by the KRC.
26 *Struggling for Tax Justice*, *op.cit.*, p.7.
27 The Lexington Courier Journal, December 24, 1983.
28 In arriving at valuations, the West Virginia tax department first determined the average royalty rate for each county by looking at recent transactions in the county (or a neighbouring county). It then valued each seam of coal taking into account the seam thickness and the BTU content. So far so good. But then the department applied the value per ton of coal in the *least valuable* seam to all the other seams on a given parcel of land. As an example, suppose there are two seams of coal on a particular parcel of land. One seam is one foot thick and has a BTU rating of 11,000, while the second is four feet thick and has a BTU rating of 13,000. Of course, the second seam is more valuable than the first, say $3 as compared with $0.50, respectively. The $0.50 per ton figure would be multiplied by the number of tons estimated to be recoverable in the *second* seam, in effect costing tax payers $2.50 of tax revenue per ton of recoverable coal in the second seam.
29 Geological mapping of Kentucky mineral reserves has come a long way since 1980, especially with regard to coal. Other sources of data on reserves (e.g., mining permit applications, core drillings and similar sources) are more accessible today because of the more extensive use of computers to record such data. Of course, the best geological information on mineral reserves would come from company maps and records of their own holdings, for the companies themselves know better than anyone the quantity and quality of their reserves. It would be naïve, perhaps, to expect enthusiastic cooperation from them. The best data on the economic or true "market value" of mineral properties would be obtained from sales of mineral properties, which the KRC could more easily monitor today than in the past, again due largely to better and more accessible data sources. In recent years, computer science has made tremendous progress in solving the technical problems of superimposing economic and geological data. With the development of G.I.S. (Geographic Information Systems) computer technology, it is now possible to build up "layers" of data with unprecedented speed and accuracy. The result is a complex "profile" of an area (e.g., the coalfields of Appalachia) in several or many "dimensions".
30 His findings are summarized in Virginia Williams, "An Economic Analysis of a Proposed Tax on Unmined Minerals in Kentucky", op.cit., p.9.
31 *Ibid.*, p.13.
32 *Head v. Little*, Kentucky, 226 S.W. 2nd 322, 1950.
33 "Taxing Unmined Minerals in Kentucky: Questions and Answers", Kentucky Fair Tax Coalition, 1983, p.6.
34 "A Study of the Effects of an Unmined Minerals Tax on Selected Financial Indices of Sixteen Companies", Kentucky Fair Tax Coalition, 1984, p.x.
35 V. Wilson, "An Economic Analysis ... ", op.cit., p.7.
36 *Ibid.*, pp.13-17.
37 *Ibid.*, p.17.
38 *Ibid.*
39 *Ibid.*
40 *Ibid.*, p.5.
41 From Robert V. Andelson's essay on Henry George and the philosophical basis for

a tax on land. R.V. Andelson, "Ryan and His Domestication of Natural Law", in *Critics of Henry George: A Centenary Appraisal of Their Strictures on Progress and Poverty*, R.V. Andelson (editor), London: Associated University Presses, 1979, p.342.

42 See R.V. Andelson, "Ryan ...", op.cit., especially pp.340-41.

43 *Ibid.*, p.6.

44 Louisville *Courier Journal*, March 7, 1984.

45 *Ibid.*

46 Lexington *Herald Leader*, March 8, 1984.

47 Mr. Childers was interviewed by Carrington Heath in February 1991.

48 Quoted in the Kentucky Supreme Court Opinion, 748 S.W.2d 357; 1988.

49 *Ibid.*

50 "An Examination of Coal Resources and Revenues for Letcher County," a study prepared by Joe Childers, Don Harker and Shepard W. McAninch, in *Investing Kentucky's Future*, the Mountain Association for Community Economic Development, 1999. For a copy of the full report, visit MACED's website, http://www.maced.org/LTstudy/. All data and charts presented in this essay are from this report.