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US State and Local Oil and Gas Revenues: Sources and Uses

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Key Points

- US state and local governments collect revenue from oil and gas production through a variety of sources, ranging from a low of 1 percent of production value to a high of nearly 40 percent.
- Severance taxes make up the largest source of oil and gas revenues for state and local governments, followed by state oil and gas leases, local property taxes, and federal leases.
- Revenue allocation varies substantially across states. On average, most revenue goes to state expenditures and education. Smaller shares flow to local governments and long-term trust funds.
- Some policy designs, such as those that allocate a large share of revenue to current operational expenditures, can generate windfalls in periods of high prices or production and create budgetary challenges when prices or production decline.

Background

Oil and gas production has grown substantially in the United States over the past decade, with major implications for state and local governments in regions where production occurs. Although the US federal government levies taxes and imposes certain regulations on the oil and gas industry, the bulk of fiscal and regulatory policy is designed and implemented at the state level. However, as policymakers consider how to tailor their fiscal policies to best meet the needs of residents, businesses, and multiple levels of government, there exists limited analysis that allows stakeholders to compare policies among states.

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Methods and Data

This brief quantifies revenues raised by state and local governments directly from oil and gas production. Because of methodological issues and limited data, we do not include corporate income taxes or estimate indirect revenues such as sales taxes or income taxes.

The major direct revenues for local and state governments associated with oil and gas production are (1) state taxes levied on the value or volume of oil and gas produced (often referred to as “severance” taxes); (2) local property taxes levied on the value of oil and gas property; (3) oil and gas lease revenues from state lands; and (4) oil and gas lease revenues from federal lands. To make clear comparisons among states, we examine revenues in a single year, fiscal year 2013 (FY13), and show the amount of revenues generated as a percentage of the total value of oil and gas produced during that period. To calculate oil and gas revenue flows to each level of government, we rely on government data along with estimates based on statutes.

We focus on the top 16 oil- and gas-producing states: Alaska, Arkansas, California, Colorado, Kansas, Louisiana, Montana, North Dakota, New Mexico, Ohio, Oklahoma, Pennsylvania, Texas, Utah, West Virginia, and Wyoming. During FY13, these states respectively produced 99 percent and 97 percent of US onshore oil and natural gas.

Results

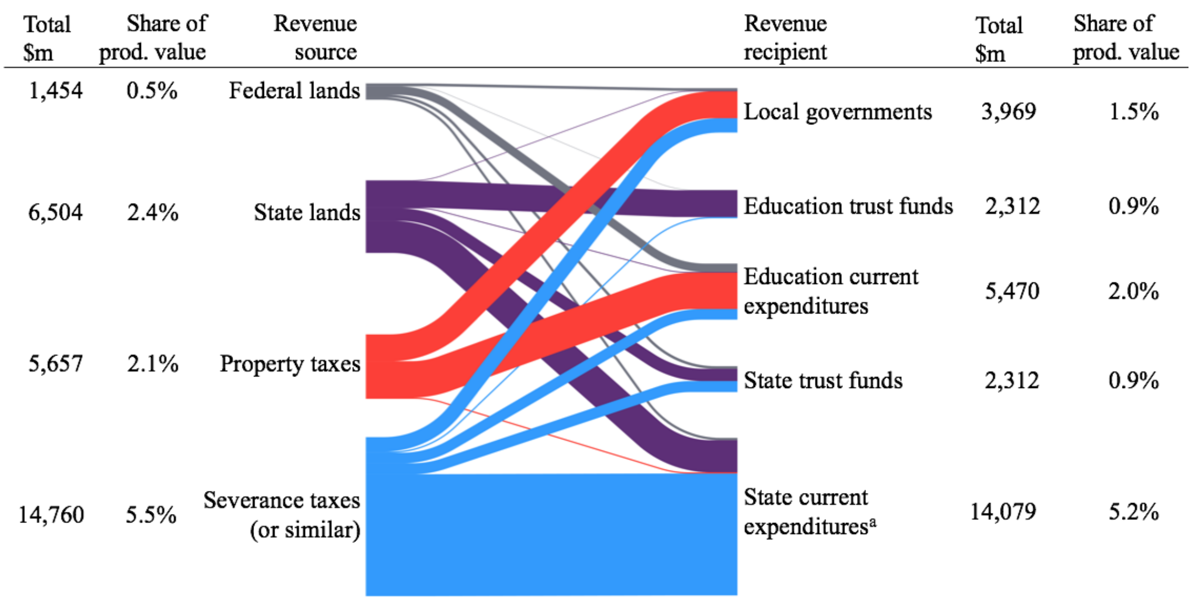
State and local governments collected roughly 10 percent of production value in FY13 through the mechanisms we examine here. Revenues from the largest source, severance taxes and similar mechanisms, primarily flow to state current expenditures. Revenues from oil and gas leases on state lands are mostly shared between state current expenditures and education trust funds, whereas revenues from federal leases tend to flow toward education and current expenditures. Local property taxes primarily support education current expenditures (i.e., school districts) and local governments (e.g., counties) (Figure 1).

State and local government revenues range from a low of about 1 percent to a high of nearly 40 percent of production value. At the high end, Alaska collected nearly 40 percent of production value in FY13, led by a production tax (21.6 percent) and revenue from state leases (14.8 percent). While all revenue sources directly tied to oil and gas prices tend to be unpredictable, Alaska’s production tax design is particularly prone to volatility. The tax applies to operators’ net profits, meaning that an operator with $0 (or less) in net profits will pay $0 in taxes (in most states, operators pay a tax based on the value or volume of production, regardless of profits). Alaska also offers tax credits for certain exploration and production activities. As a result of recent declines in industry profits coupled with these tax credits, the state’s FY15 production tax collections totaled negative $264 million.

Severance taxes are particularly prominent in Alaska, North Dakota, Montana, New Mexico, and Wyoming. State leases make large contributions in Alaska, New Mexico, and Louisiana. Local property taxes in some states (notably California, Colorado, Kansas, Oklahoma, and Wyoming) were the largest single revenue sources in FY13. Three states—Montana, North

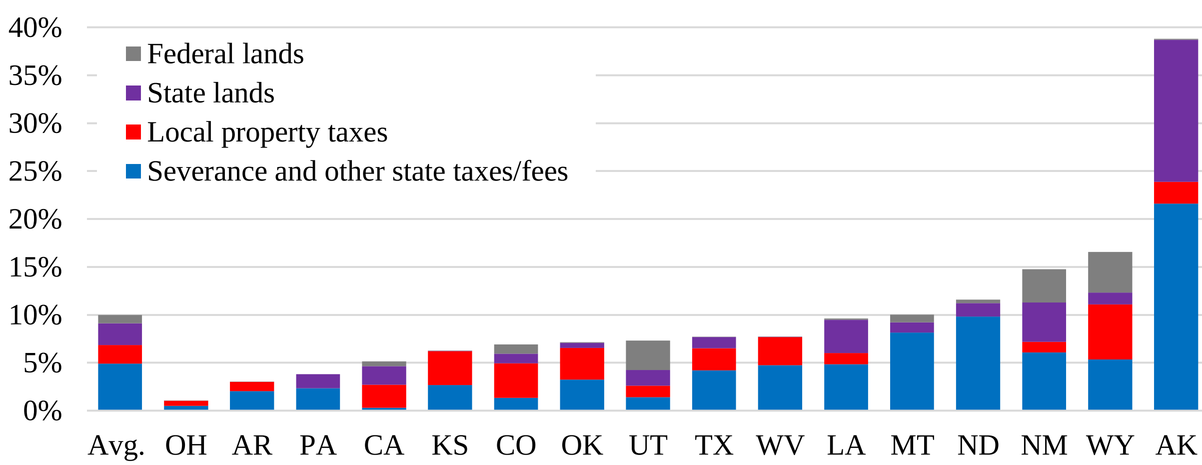
Dakota, and Pennsylvania—do not allow local governments to tax oil and gas production property; they instead allocate a substantial portion of state-collected oil and gas revenues to local governments. Federal leases provide major revenues in Utah, Wyoming, and New Mexico, where the federal government respectively maintains 65, 48, and 35 percent of total land area (Figure 2).

FIGURE 1. OIL AND GAS REVENUE FLOWS IN FY 2013



[a] A portion of these funds is allocated according to a state budgetary process that includes allocations to education and local government current expenditures.

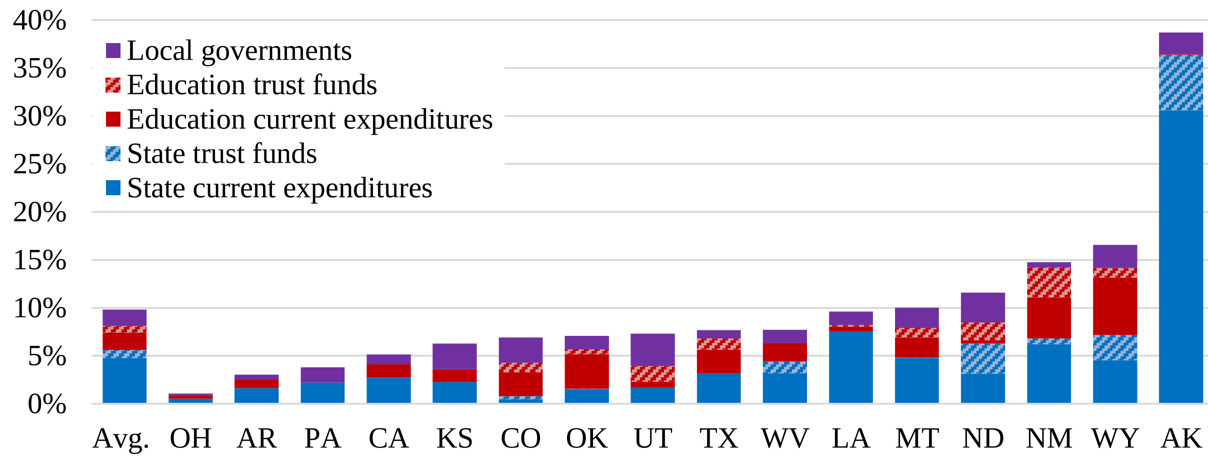
FIGURE 2. SOURCES OF GOVERNMENT REVENUES AS A SHARE OF OIL AND GAS PRODUCTION VALUE IN FY 2013



Note: The average is a simple (unweighted) mean.

Revenues from the four sources discussed above flow to a variety of state and local government entities according to state-specific policies. Making comparisons among these allocations can be complex, and we group the revenue flows into five major destinations: (1) state current expenditures, i.e., funds that flow into state general funds or directly to state agencies to support operational expenses; (2) state trust funds, i.e., savings funds that endow future state government operations or, in the case of Alaska, annual disbursements to residents; (3) education current expenditures, i.e., funds that are collected by or flow to school districts, units of higher education, or other educational institutions; (4) education trust funds, i.e., savings funds that endow future educational operations; and (5) local governments, i.e., funds that are collected by or flow to local governments, including counties, municipalities, and others. Figure 3 summarizes these uses of revenue among the 16 states.

FIGURE 3. USES OF GOVERNMENT REVENUES AS A SHARE OF OIL AND GAS PRODUCTION VALUE IN FY 2013



Notes: In most states, a portion of the revenue flowing to state current expenditures goes through an annual budget process, where funds may flow to education current expenditures and local governments. The average is a simple (unweighted) average. For North Dakota, the local governments category includes flows of state severance taxes to tribal governments.

As Figure 3 shows, oil and gas revenues are put to different uses in each state. On average, 4.8 percent of production value supported state government current expenditures, with an additional 0.9 percent flowing into trust funds that support future state operations. Education current expenditures received on average 1.8 percent, with an additional 0.7 percent flowing into trust funds to support future education expenses. Counties, municipalities, and other local governments shared 2.1 percent of production value.

Education current expenditures receive the second-largest share of revenue on average. In Oklahoma and Wyoming, educational institutions are the largest recipient of oil and gas revenues. In several states (notably Colorado, New Mexico, Texas, and Utah), a substantial share of oil and gas revenues flows to education through long-term trust funds that support local school districts or higher education.

One approach to managing potentially volatile oil and gas revenue streams is to use state trust funds that can provide a fiscal cushion during periods of low production or prices. Alaska, North Dakota, and Wyoming respectively allocated 5.8, 3.2, and 2.6 percent of production value to these mechanisms in FY13. However, sustained downturns in prices coupled with certain tax policy designs have the potential to drain these funds quickly.

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