New Mexico: A COMPARATIVE ANALYSIS

The Oil & Gas Industry’s Fiscal Contribution to State Governments
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## NEW MEXICO

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## STATE-TO-STATE COMPARISONS

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Overview

The level of support that oil and gas production operations provide to their respective states has long been a topic of discussion, particularly in New Mexico. In turn, legislative and governmental initiatives implement policy responses to these discussions.

A central question is whether a particular state’s revenue claim on the total production value is lax or if it creates a competitive disadvantage when compared with neighboring states. However, finding comparable policy-related data between states is a struggle.

To that end, the New Mexico Tax Research Institute retained Moss Adams to analyze the contributions made by oil and natural gas producers to state and local government revenue. The analysis compares revenue contributions for the largest western onshore producing states in the context of the burdens placed on the productive value of each state’s resources.

The research provided here is intended as a resource when assessing state and local government revenue policies, with a particular focus on the obligations paid by the oil and natural gas producers in each of the states analyzed. In the course of our research, we developed an appreciation for the difficulties of collecting and compiling revenue-related information in each state as well as the complexities of various revenue policies. To say it in simplistic terms, all severance taxes aren’t created equally.

Moss Adams surveyed a number of similar research efforts performed in these same producing states. The complexities of fees, taxes, and royalties that oil and natural gas producers contribute in each state make these prior comparative efforts extremely difficult and potentially inconclusive. Acknowledging our significant appreciation for the contributions provided by these previous efforts, it’s our hope to try and build on these prior accomplishments.

We’re incredibly thankful to the many individuals who assisted and shared their knowledge while compiling this large volume of data and information. We couldn’t have accomplished this task without your assistance.

Any comments or feedback would be greatly appreciated as we continue to update and revise our analyses.
SUMMARY OF FINDINGS

Comparing government revenue streams from oil and natural gas production activities among the producing states included in this study resulted in two very significant conclusions when considering the industry’s fiscal contribution to New Mexico.

DIRECT ROYALTY AND TAX CONTRIBUTIONS

Land income—primarily oil and gas royalties—sets New Mexico apart from the cohort of states analyzed.

Although revenue contributed by taxation of oil and gas production in New Mexico is in the upper tier of the surveyed states, the direct contributions from royalties on New Mexico production sets New Mexico apart from the other states analyzed.

New Mexico taxes oil and gas production at rates that provide revenue contributions consistent with the highest percentage share of production values earned by the industry in the eight other states investigated. If tax policy impacts the industry’s investment and production decisions, then changes to how the industry is taxed in New Mexico could impact the competitive market position of the state’s producers (in relation to other states in the study area).

STRUCTURE OF GOVERNMENT REVENUE

Second, the royalty revenue earned by New Mexico in the form of land income is an attribute that’s a significant structural component of government revenue, defined by existing federal and state lease terms and subject to market value dynamics. New Mexico and Wyoming are roughly comparable in these land income attributes of its oil and gas revenue streams.

Royalty Investments in Permanent Funds

There’s a third fiscal component resulting from the investments of oil and natural gas revenue: royalty revenue investments in permanent funds. This provides New Mexico’s government with large, stable revenue stream additions in the form of investment income from the historic management of oil and gas resources.

The states that receive significant, direct benefits of oil and gas market value royalties also realize the additional benefit of creating predictable investment income streams to help stabilize their respective governments’ budgeting tasks.
FISCAL CONTRIBUTION TO GOVERNMENT

Significant revenue contributions are provided to numerous local and state government entities in the development and production of the oil and natural gas resources in the western states.

Governments’ fiscal resources are substantially impacted by the operations of these economic enterprises, affecting both public services and resources available to citizens living in those communities. Conversely, the policies of producing states, with respect to the revenue obligations placed on the industry, can significantly impact the development climate for a state’s oil and natural gas resources.

It’s frequently expressed that these revenue contributions should be adjusted—either increased or decreased. In this analysis, we don’t offer opinions about the sufficiency of the revenue contribution in support of state governments. Instead, the goal is to provide a valid comparison of the economic contribution to their respective primary jurisdictions. This information could then be used to help assess policies and their potential competitive impacts between producing states associated with these production-related revenue obligations.

In producing states, economic activities that provide revenue to governments start with property or lease acquisition costs and field services, including landmen, roustabouts, drilling rigs, truckers, and consulting geologists or engineers.
PRODUCTION VALUE CHAIN

The cost of developing operating properties is significant, but the production-related activities produce the bulk of collected revenue in the form of taxes and royalties. The production value chain is generally completed with gathering and other operating field services, such as water hauling, trucking liquid products, and treating oil and gas to the point when produced oil may be marketed and natural gas is conditioned to enter interstate market pipelines. The economic value chain for oil and gas production is illustrated in the following diagram.

FIGURE 1: Value Chain for Oil and Natural Gas Production

A producer’s total production value is burdened by a variety of obligations to government, but also must provide sufficient revenue for the costs of development and operations as well as pay other private interest owners in those production activities. The production-related activities that potentially generate government revenue are broken out with brackets in the above diagram.
METHODOLOGY

The analysis is limited to onshore oil and natural gas production. It’s also important to note that what may appear similar frequently isn’t—a severance tax in one state isn’t similarly defined or administered as a severance tax in another state, for example. Our approach seeks to reduce this confusion.

ANALYSIS PROCESS

• Aggregates the revenue received by state and local governments
• Compares that fiscal revenue to the total production value that occurred in each of the producing states (those included in the study are listed in the next section)
• Characterizes revenue contributions to government in context of costs and private royalty obligations and the distribution of federal mineral lease royalties from oil and gas production in each of those states

BENEFITS

• Provides a valid comparative basis between states with vastly different levels of oil and gas resource production
• Compares oil and gas revenue burdens in widely divergent production areas by looking at government revenue received as a percentage of total production value

SCOPE

Although this analysis focuses on New Mexico, the comparisons also include government revenue from production in the states marked in the following map.

STUDY AREA
Government revenue data

This was sourced from the revenue agencies in each state and involved multiple agencies in most of the states. Revenue data was collected with respect to fees, bonuses, royalties, sales and gross receipts taxes, production taxes, and taxation of field services through production area processing activities.

Oil and natural gas production

Production is identified by county in each state, along with the estimated production value in each of these geographic areas. Market value was compiled from a variety of posted or published price data.

Production data

This is tied to monthly reported oil and natural gas volumes reported by the US Energy Information Administration (EIA). This data is supplemented, when available, with additional detail related to production at the county level from federal, state, tribal, private, and state trust lands. Maps 1 and 2 (pages 18 and 19) present an overview of the locations and volumes of oil and natural gas production in the study area.

Abbreviated terms

The industry sometimes uses specific, nonstandard abbreviations.

<table>
<thead>
<tr>
<th>NATURAL GAS</th>
<th>OIL</th>
</tr>
</thead>
<tbody>
<tr>
<td>cf</td>
<td>bbl</td>
</tr>
<tr>
<td>Mcf</td>
<td>Mbbl</td>
</tr>
<tr>
<td>MMcf</td>
<td>MMbbl</td>
</tr>
</tbody>
</table>

Production value

In our analysis, we obtained discreet pricing data for nearly 50 locations throughout the study area where pricing information is reported either as a posted price or published index price for monthly transaction volumes. For individual production areas, such as the Texas Permian Basin, we developed composite prices reflecting availability of multiple price series for both oil and gas. Maps 3 and 4 (pages 22 and 23) report calculated production value by aggregated pricing pools, which is used in the analysis.

Valuation of the natural gas production

This is impacted by the recovered natural gas liquids (NGLs) entrained in the wellhead gas stream. The recovery of NGLs generally occurs in the production area and will result in a volumetric reduction of 5%–15% between the wellhead and in the marketed production of residue gas. Since about 2015, NGLs have been valued at up to an approximate 30%–50% net premium over the wellhead value of the unprocessed gas. We applied that premium to the reported recoveries of NGLs.

LIMITATIONS

Governmental revenue from oil and natural gas production is frequently dedicated to specific public purposes or funds. We’ve attempted to identify all revenue flowing to state and local governments, but aren’t able, within the current scope of this investigation, to reflect on how the revenue is specifically distributed.

To illustrate, some revenue is dedicated to permanent trust funds, such as New Mexico Trust Land royalties, while other revenue flows directly to a state’s general expenditure accounts—federal mineral lease revenue is distributed directly to New Mexico’s General Fund, for example. Although revenue distribution is interesting and important, this investigation focused on the total contributions of the oil and gas industry to government revenue.

1 For all states, except Texas, revenue data is provided on a fiscal year July through June basis. For Texas, the fiscal year data is for September through August. The analytical method employed isn’t compromised by different fiscal year definitions. For each state, we rely on fiscal year revenue and month production data. Results are compared on a fiscal year basis, ignoring the two-month shift between Texas and the other states without significant consequence to the validity of the analysis.

2 Obtained principally from each producing state at a monthly county level and calibrated to match reported monthly statewide EIA data.

3 Price data was obtained from Bloomberg terminal tickers, which is available to Moss Adams through subscription. As such, we’re unable to publish monthly price data tables for each individual series.

4 EIA provides data as to the Btu composition of the gas reported as entering each processing facility within our study area (US Energy Information Administration, EIA-757 Processing Capacity, https://www.eia.gov/naturalgas/ngqs/#?report=RP8&year1=2014&year2=2014&company=Name [to be updated October 2018]). This data allows estimates of the net uplift obtained in each producing area that’s provided by the recovery of NGLs because the Btu content of the gas stream correlates with the entrained liquids available for recovery.
New Mexico

SUMMARY OF FINDINGS

New Mexico has the greatest percentage share of total oil and natural gas production value directly contributed to government revenue when compared with the rest of the states in this analysis. This result occurs because:

• New Mexico taxes oil and natural gas production at rates comparable to the highest rates of taxation compared with the other eight states.

• New Mexico realizes a larger share of total oil and gas production value through its royalty earnings, a product of a larger share of total production originating from public oil and gas leases, whether state or federal.

• Historic decisions to invest a large portion of New Mexico’s annual oil and natural gas revenue in permanent funds created a significant annual income from these investments. This income stream augments current year revenue contributions from oil and gas production.

Robust policy considerations are also offered by the structure of New Mexico government’s large share of revenue streams from the industry’s oil and natural gas production activities.

Compared with New Mexico, no other state in the study area:

• Receives as large a share of tax, land income, and investment returns of the industry’s total production value

• Experiences the same level of exposure to the dynamic market value of the produced petroleum commodities

• Enjoys the same degree of insulating stability to state revenue from permanent fund income management
**PRODUCTION PROFILE**

**STATE**

**3rd Largest Oil-Producing State**
behind only Texas and North Dakota

**9th Largest Natural Gas Producer**
in the United States

**REGION**

Primary oil- and gas-producing regions:

- **San Juan Basin**
in the northwest corner of the state

- **Permian Basin**
in the southeast corner of the state

**COUNTY**

- **Lea County**
largest oil-producing county

- **Eddy County**
largest natural gas-producing county

Although traditionally thought of as an oil-producing region, the rise of associated gas has driven Eddy County, the state’s second largest oil producer, to be the largest natural gas-producing county. It surpassed San Juan County in fiscal year 2018.

*These stats were accurate at the time of publication in January 2019.*

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6 Energy Information Administration, US Department of Energy, “Natural Gas Marketed Production” (ng_prod_sum_a_epi00_vgm_mmcf_m.xls) and “Crude Oil Production” (pet_crdd_crpdn_adc_mbbl_m.xls), accessed at http://www.eia.gov.
Since 2010, New Mexico’s oil production has increased exponentially. Associated gas production in the traditionally oil-producing Permian has even reversed the decade-long decline in natural gas production.

Historically, New Mexico’s production value was derived primarily from natural gas. Advances in production technologies have led to an oil production boom, combined with the long, steady decline in natural gas prices, which tipped the production value balance in favor of crude oil around 2010. In fiscal year 2018 (July 2017–June 2018 production months), oil accounted for over 75% of total production value in New Mexico.
PRODUCTION BY LAND TYPE

A significant proportion of production takes place on public lands, both state trust lands and federal mineral leases. As compared with most of the other states in the study, New Mexico derives a large share of its oil and gas-related government revenue from this land income.

The following chart depicts the distribution of production volumes for natural gas and oil in fiscal year 2018.

FIGURE 4: Production by Land Type
New Mexico, FY2018

This finding is significant because only one other state—Wyoming—approaches a similar share of production that provides royalty income directly to government entities. Royalty earnings are categorized in our analysis as land income, which also includes fees, rent, and bonus payments received by the state.
FIGURE 5A: Natural Gas Production Volume by County
New Mexico, FY2017 (MMcf)

FIGURE 5B: Oil Production Volume by County
New Mexico, FY2017 (MMbbl)
GOVERNMENT REVENUE

The New Mexico oil and gas industry has a significant role in revenue contributions to New Mexico’s government. The state government’s primary sources of revenue from oil and gas production comes in the form of taxes, land income, and, to a lesser degree, investment income.

Aggregating government revenue from oil and gas production activities and comparing that revenue as a percentage of the production value is a valid measure of the contributions made by the industry in support of government. Importantly, it’s also a valid basis for comparing different producing states with significant structural differences in their revenue collection programs.

FUNDS AND INVESTMENT INCOME

The revenue contributed to the New Mexico government provides for approximately one-third of the state’s total General Fund revenue expended annually. In total General Fund revenue terms, tax-related revenue is approximately equal to land income.

Permanent Funds

• **Land Grant Permanent Fund.** New Mexico dedicates its state trust land income to this fund, which was valued at $18 billion as of September 30, 2018. Investment income from investments distributed approximately $638.1 million in fiscal year 2018 to public beneficiary institutions.

• **Severance Tax Permanent Fund.** A portion of the severance tax collections are invested in this fund, which was valued at $5.3 billion. It generated an additional $200.4 million in investment income to the state in fiscal year 2018.6

No other state in our study area, with the exception of Texas, has established permanent funds and related investment earnings of this magnitude. However, these funds are a significantly smaller share of the Texas total government revenue stream than is found in New Mexico.

Notably, some of these revenue streams are related to the dynamic value of production, which fluctuates with market prices, while other streams are tied to fixed fees or one-time payments, such as bonuses.

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GOVERNMENT REVENUE CATEGORIES

The following table lists types of revenue that make up the larger revenue categories, which span taxes, land income, and investment income. The specific types of revenue—production and income taxes, for example—are further disaggregated to the individual revenue programs, such as oil and gas severance tax and oil and gas rentals.

### TABLE 1: Government Revenue Sources by Category and Type

New Mexico

<table>
<thead>
<tr>
<th>Category</th>
<th>Type</th>
<th>Name</th>
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<tbody>
<tr>
<td>Taxes</td>
<td>Individual income taxes</td>
<td>Personal income tax</td>
</tr>
<tr>
<td></td>
<td>Processing taxes*</td>
<td>Natural gas processors tax</td>
</tr>
<tr>
<td></td>
<td>Production taxes*</td>
<td>Emergency school tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Oil and gas conservation tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Oil and gas severance tax</td>
</tr>
<tr>
<td></td>
<td>Property taxes*</td>
<td>Ad valorem production equipment tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ad valorem production tax</td>
</tr>
<tr>
<td></td>
<td>Sales and use taxes</td>
<td>Gross receipts and compensating tax</td>
</tr>
<tr>
<td>Land income</td>
<td>State Land Office*</td>
<td>Oil and gas bonus</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Oil and gas rentals</td>
</tr>
<tr>
<td></td>
<td></td>
<td>State oil and gas royalties</td>
</tr>
<tr>
<td></td>
<td>Office of Natural Resources*</td>
<td>Federal mineral leasing</td>
</tr>
<tr>
<td>Investment income*</td>
<td>Land Grant Permanent Fund distributions</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Severance Tax Permanent Fund distributions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SLO oil and gas interest</td>
</tr>
</tbody>
</table>

*Available directly from state-published sources and don’t require estimation.*

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7 Corporate income taxes aren’t included in this analysis. The diversity of many corporate operations, extending beyond the production-related activities, which are the focus of this report, can’t be disentangled to identify corporate tax revenue related to production-related activities in any particular state. In addition, the breadth of economic activities of these corporate enterprises allow many deductions, net operating loss carryforwards, and other complexities that preclude a discrete statement of corporate income tax paid in relationship to just the oil and gas production activities.
STATE GOVERNMENT REVENUE

In the 2016–2017 fiscal year, New Mexico collected $3 billion in revenue from activities related to oil and natural gas production. This data is summarized in the following graph.

FIGURE 6: Government Revenue by Category
New Mexico, FY2015–2018 ($Billion)

It’s important to recognize that the state government revenue data included in this analysis reflects both state and local government revenue collections as well as a state’s share of the federal royalty income. The industry makes these revenue contributions to government but is also obligated to pay private royalties and lease operating expenses from the total production value. As a result, this analysis isn’t what’s known as a total burdens analysis. Instead, it reflects only the industry’s revenue contribution to state and local governments.
PRODUCTION VALUE

Stating these government revenue contributions as a percentage of total estimated annual production value serves to reflect the comparative contributions from year to year—and for that matter, from state to state. As can be seen in the following graph, the percentage of the total New Mexico production value providing revenue to government has fluctuated in recent years. This is simply the product of the dynamic production value, primarily related to increased oil production in the southeast part of the state.

FIGURE 7: Revenue as Percentage of Estimated Production Value
New Mexico, FY2015–2017

In the preceding diagram, note that investment income isn’t received from current year production value. For comparative purposes, the magnitude of investment income can be scaled in relationship to the total value of production in a state. While this investment income is current year income, it’s derived from investment of prior-period production revenue by the subject state.

It’s also important to recognize that the production value not contributed to government revenue has other economic significance.

Throughout the study area, the two largest shares of the remainder value are used to pay private royalties and cover lease operating expenses. Myriad other costs that don’t fall under the government revenue category also come out of the value of production.

8 Production value differs widely throughout the nine states in our study area. Moss Adams relies on Bloomberg, which reports transaction survey pricing for 14 oil market locations and 33 transaction locations related to natural gas prices throughout our study area. These are monthly prices, and allows our valuation to be applied to monthly volumes by county and to reflect significant regional price differentials in the calculation of the total production value.

9 The calculation of the state share of federal royalties is derived simply from the 48%–52% split between state and federal interest. Of course, specific lease operating expense is both location specific and dependent on operations that are impacted by market conditions.
The substance of this analysis is summarized as a comparison of the contributions of the oil and gas producers to state revenue—and then looking at the percentage contributions between the producing states. We’ve chosen for comparison the large western onshore oil and gas-producing states. Of particular interest is assessing how revenue differs between states as a proportion of production value.

Presenting this comparison as a proportion of production value equalizes the scale between states. For example, if revenue in only discussed in dollar terms, Texas dwarfs every other state, with about 10 times the production and five times the revenue of New Mexico.

This section will introduce the study area and set the context for the comparisons.
MAP 1: Natural Gas Production Volume
Study Area, FY2017 (MMcf)
MAP 3: Natural Gas Production Value
Study Area, FY2017 ($Billion)
SUMMARY OF FINDINGS

Employing the same methods for calculating the governments’ revenue as a percentage of the total production value, the following compares fiscal year 2017 results for the study area states.

FIGURE 8: Government Revenue as Percentage of Estimated Production Value
Study Area, FY2017

In the preceding diagram, note that investment income isn’t received from current year production value. For comparative purposes (between states), the magnitude of investment income can be scaled in relationship to the total value of production in a state. While this investment income is current year income, it’s derived from investment of prior-period production revenue by the subject state.
Two observations are most apparent in comparing New Mexico to the other states in our study area.

First, the New Mexico structure of taxes on oil and natural gas production activities is third highest as it relates to the total production value.

**FIGURE 8A: Tax Revenue as Percentage of Estimated Production Value**

<table>
<thead>
<tr>
<th>State</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Montana</td>
<td>12.8%</td>
</tr>
<tr>
<td>Texas</td>
<td>12.8%</td>
</tr>
<tr>
<td>New Mexico</td>
<td>11.5%</td>
</tr>
<tr>
<td>North Dakota</td>
<td>10.5%</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>10.1%</td>
</tr>
<tr>
<td>Wyoming</td>
<td>9.9%</td>
</tr>
<tr>
<td>Kansas</td>
<td>9.6%</td>
</tr>
<tr>
<td>Colorado</td>
<td>9.3%</td>
</tr>
<tr>
<td>Utah</td>
<td>6.2%</td>
</tr>
</tbody>
</table>

Second, Figure 8B shows that New Mexico’s royalty revenue (generated from both state trust land and federal leases) is first when compared with other states. The bulk of this income is in state trust land royalties and federal lease royalties, which contributes revenue to government that’s more than 9% of the total value of oil and gas production in the state. Wyoming obtains revenue at more than 5% of the value of statewide oil and gas production, but no other state reaches revenue contributions amounting to 5% of production value.¹⁰

**FIGURE 8B: Land Revenue as Percentage of Estimated Production Value**

<table>
<thead>
<tr>
<th>State</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Mexico</td>
<td>9.2%</td>
</tr>
<tr>
<td>Wyoming</td>
<td>5.4%</td>
</tr>
<tr>
<td>Utah</td>
<td>3.7%</td>
</tr>
<tr>
<td>Texas</td>
<td>2.0%</td>
</tr>
<tr>
<td>Montana</td>
<td>1.8%</td>
</tr>
<tr>
<td>North Dakota</td>
<td>1.8%</td>
</tr>
<tr>
<td>Colorado</td>
<td>1.4%</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>0.7%</td>
</tr>
<tr>
<td>Kansas</td>
<td>0.1%</td>
</tr>
</tbody>
</table>

¹⁰ New Mexico’s federal royalty revenue is distributed for current year budget requirements, while state trust land revenue is deposited in the state’s Land Grant Permanent Fund and then invested to provide investment income.
PRODUCTION PROFILE

Having established that the percentage of production value is an appropriate basis for the state-to-state comparisons, this analytical requirement is clearly illustrated by comparing the volumes of oil and natural gas productions in each of the study area states.

FIGURE 9: Production Volume
Study Area, FY2017

The graphics illustrate why it’s essential to use revenue contributions as a percent of value. Texas production volumes obscure everything else if it isn’t scaled relative to the other states. Policy issues remain the same in each of the states when it comes to oil and natural gas revenue, but the scale of the impacts are simply different.

Charting the production value provides further support for the scaling method employed for the state-to-state comparative analysis. The following graph reflects the total oil and natural gas production value for 2017 in each of the states included in this report’s study area.

FIGURE 10: Estimated Production Value
Study Area, FY2017 ($Billion)
GOVERNMENT REVENUE

Comparing the oil and gas-related government revenue between the states shows the clearest perspective on the differences in revenue policies in the jurisdictions analyzed for fiscal year 2017.

REVENUE FROM OIL AND GAS PRODUCTION

FIGURE 11: Government Revenue by Category
Study Area, FY2017 ($Billion)

- Texas earned over $12 billion.
- New Mexico received about $3 billion.
- No other state received even $2 billion in revenue from its oil- and natural gas-related resources, although North Dakota comes within rounding error of $2 billion at $1.99 billion.
REVENUE CATEGORIES AS A PERCENTAGE OF TOTAL CATEGORY REVENUE

Whereas New Mexico, Wyoming, Utah have relatively large shares of reported revenue from land income—primarily state and federal royalty income—the other producing states in are substantially more dependent on income from taxation of the produced resources. New Mexico oil and gas-related revenue is the most evenly balanced between the three major categories. This observation has significant tax policy implications.

FIGURE 12: Distribution of Revenue
Study Area, FY2017 (%)
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