



Assessing States' Fiscal Responses to Negative Energy Shocks

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Background

Fossil-fuel production generates government revenue that supports essential public services in many U.S. states. As the global economy seeks to transition away from fossil fuels, states that have long relied on these revenues to sustain low tax rates and robust public spending will face significant fiscal challenges. This policy brief summarizes research examining fiscal responses to declining fossil-fuel revenues in U.S. states through three complementary approaches.

First, we documented how state governments have historically responded to negative fossil-fuel shocks, providing insight into likely fiscal responses to future revenue declines. Second, we conducted a survey experiment to examine public preferences for alternative policy responses. Third, using Wyoming as a case study, we assessed the feasibility of several tax policy options for addressing budget shortfalls resulting from projected declines in fossil-fuel revenues.

Cutting Taxes During Energy Booms Raises Fiscal Risks

To better understand how U.S. state governments respond to negative fossil-fuel shocks, we adopted a retrospective approach, examining two historical episodes of declining oil prices: the early 1980s and the mid-2010s. Our empirical framework is flexible enough to capture short-, medium-, and long-term effects of sudden drops in fossil-fuel revenue. During both the 1970s and 2000s, fossil-fuel booms prompted the governments of fossil-fuel-rich states to cut taxes—such as the top marginal income rate—while also increasing overall spending.

We also identified a notable asymmetry between booms and busts: during energy downturns, states reduce spending but typically maintain the artificially low tax rates established during prior booms. The policy implications of these findings are twofold. First, **public officials should be cautious when implementing tax cuts**—or even eliminating taxes—during future booms, as such changes tend to be “sticky” and can create substantial budget shortfalls once the boom subsides.

Second, unless public attitudes shift, future declines in fossil-fuel revenue are likely to be managed through cuts to state spending, and **both policymakers and citizens should be prepared for the impacts of reductions in public services**. Both implications underscore distinct but related effects of saving fossil-fuel revenue: saving limits the potential scale of (sticky) tax cuts in the short term while also cushioning against fiscal shortfalls that can occur as revenues decline after a boom.

People's Preferences for Future Fiscal Responses

The second part of this project evaluated people's preferences for, and reactions to, different fiscal responses to negative energy shocks. Identifying such preferences using real-world observational data is challenging because fiscal responses to energy shocks do not occur in a vacuum. Rather, they are context specific and potentially correlated with a host of other factors that also influence people's preferences and behaviors. We therefore designed and implemented an online survey experiment to evaluate people's stated preferences for—and willingness to leave their state in order to avoid—various policy responses to declining fossil-fuel revenue. The survey was designed in Qualtrics and administered online via Prolific (an online platform for recruiting research participants, widely used by social scientists to run surveys and experiments). Our sample includes roughly 3,000 residents from oil-rich U.S. states, spanning a wide range of ages, education levels, incomes, and political ideologies. A number of

insights emerged from this work:

- In response to declining fossil-fuel revenues, respondents tend to prefer tax increases applied to high income individuals over reductions in state health and education expenditures.
- Respondents—especially politically conservative ones—report a greater willingness to relocate in response to higher personal tax liability than to reductions in education or health spending.
- There is some—albeit weak—evidence that conservatives are more opposed to the implementation of a new tax compared to a marginal increase in an existing one.
- Respondents in fossil-fuel-rich states respond similarly to fiscal policy changes regardless of whether they are framed as responses to declining fossil-fuel revenue or not.

Modest Tax Policy Changes Could Provide a Meaningful Fiscal Cushion in Wyoming

The third part of our study used Wyoming as a case study to assess the viability of various tax changes to account for predicted future declines

in fossil-fuel revenue. We used Regional Economic Modeling Inc. (REMI) to simulate five different tax scenarios and forecast the impacts on Wyoming's budget and the general state economy. The five scenarios included simulations for (1) the status quo, along with scenarios that included changes to (2) personal income tax, (3) sales tax, (4) property tax, and (5) corporate profit tax.

The simulations show that modest tax increases (e.g., a one percentage point increase in the sales tax) have the potential to backfill Wyoming's revenue lost from an assumed 20% decline in the production of fossil fuels by 2040. The simulations also show that income and sales taxes are generally more effective in raising revenue than corporate and residential property tax increases. The results of the simulations can be accessed from our online budget tool, which is available here:

<https://www.uwyo.edu/cbea/fiscal-budget/index.html>

[Read the companion policy brief](#) exploring economic diversification options for Wyoming.

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About the Resilient Energy Economies Initiative

The REE Initiative was established in 2024 to develop strategies that support the economies of fossil fuel-dependent communities across the United States as the energy system transforms. In addition to supporting action-oriented research to find what works, REE has built a community of scholars, policymakers, and economic development practitioners from the local, state, tribal, and federal levels to share knowledge and build relationships across the nation's energy communities.

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