TAXPAYERS for COMMON SENSE

O & G REPORT

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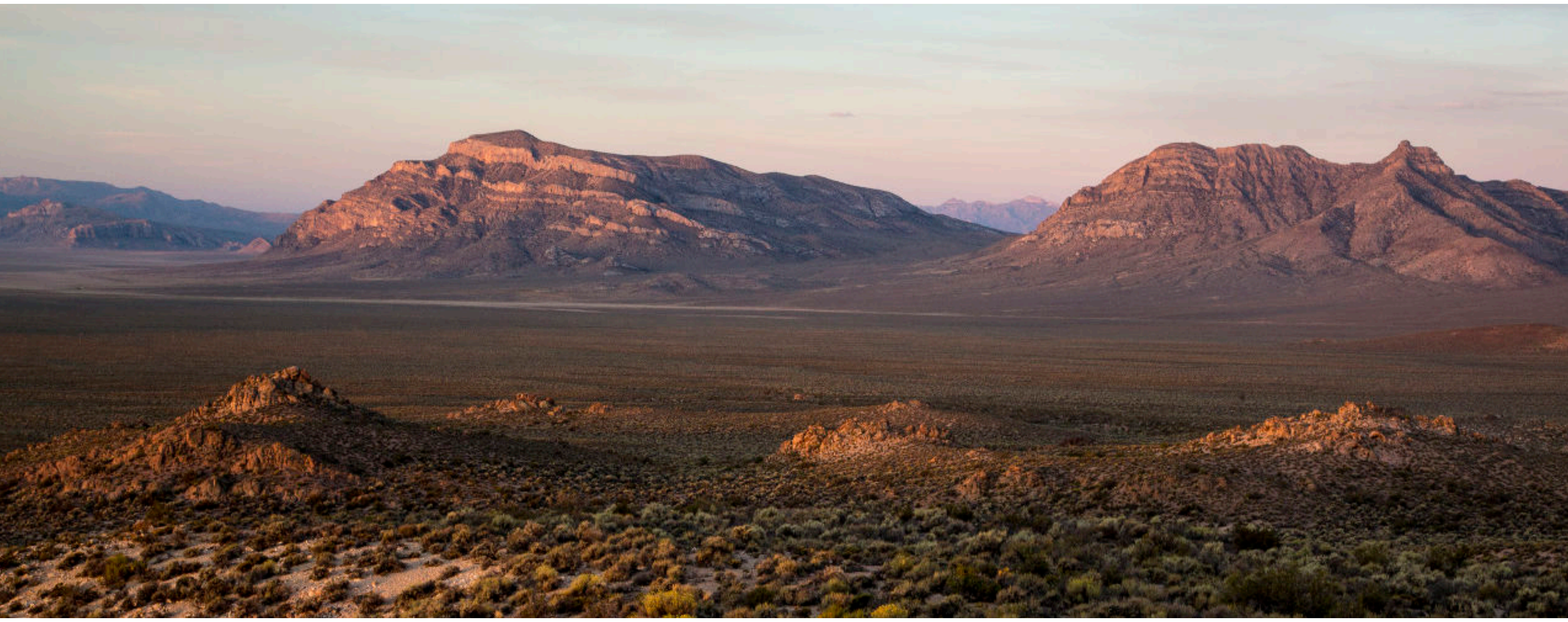
Royally Losing: Higher Royalties on State and Offshore Oil and Gas Production Reap Billions More than Drilling on Federal Lands



The federal government lost up to $12.4 billion in revenue from oil and gas drilling on federal lands from 2010 through 2019, because it continues to apply a grossly outdated royalty rate set in 1920. Bringing the onshore federal royalty into the modern era, in line with rates for state and offshore production, will stem the losses and generate billions more dollars for federal and state coffers in the coming decades.

Federal lands throughout the Western United States contain vast deposits of valuable oil and gas resources. The U.S. government holds millions of acres of these lands in trust for federal taxpayers, the true landowners.

The Mineral Leasing Act of 1920 (MLA), 30 U.S.C. §181 et seq., established the process for leasing, managing, and developing publicly owned lands for oil and gas exploration and development. Since the 1970s, this process and much of the U.S. mineral estate has been administered by the Bureau of Land Management (BLM), an agency within the Department of the Interior (DOI). In exchange for the right to drill on federal lands, the BLM requires lessees to pay a bid at auction (usually)[1], annual rent per acre of land leased, and a royalty on the value of extracted resources.

[1] The BLM allows oil and gas companies to avoid bidding for parcels of federal land at auction and acquire leases noncompetitively as soon as the day after a parcel is offered in a lease sale. This process is a relic of the leasing system in place prior to 1987. More than 2.7 million acres have been leased noncompetitively over the last decade.

Taxpayers lost up to $12.4 billion in revenue 2010-2019 due to an outdated royalty rate of 12.5 percent

One hundred years ago, the MLA established the royalty rate charged for the removal and sale of oil and gas from federal lands at 12.5 percent of the resources' market value. This is still the royalty rate charged on federal lands, even as other landowners with significant oil and gas deposits, including Texas, Wyoming, New Mexico, Colorado, and Utah have increased their royalty rates over the intervening decades numerous times (see chart on next page).

The rate has even changed for federal waters while remaining stagnant on federal lands. Between 2006 and 2008, the Bush Administration increased the royalty rates for offshore drilling in federal waters to 18.75 percent. According to TCS analysis of DOI data, if the onshore royalty rate had been set at 18.75 percent, in parity with offshore oil and gas, onshore production could have generated up to $12.4 billion in additional royalty revenue from 2010 to 2019.[i] This would have also provided a boon to western states, as half of royalty revenues collected by the federal government are returned to the state where the development takes place.[2]

Royalties Rate Should Have Parity

There is little evidence of industry's claims that increasing the federal onshore royalty rate would drive developers away and reduce overall revenues. Oil and gas production occurs where fossil fuel reserves are located—be that state, private, or federal land. Further there is no evidence state production dropped in response to higher royalty rates adopted for leases on state lands.[3]

[2] The Office of Natural Resource Revenue (ONRR), another sub-agency of DOI, is responsible for the collection and disbursement of royalty revenues from oil and gas produced on federal lands. Under current law, 49% of all revenues collected from resource development in the Lower 48 are returned to the state of production.
[3] In interviews conducted by the Government Accountability Office, officials from both Colorado and Texas stated that raising their state royalty rates did not have a significant effect on production. (GAO-17-540)

The independent Congressional Budget Office notes that:

> "Such an increase in the royalty rate [to 18.75 percent] would also reduce the profitability of exploring speculative parcels compared with parcels owned by other jurisdictions, so CBO expects that some exploration would shift away from federal lands. But the subsequent decrease in production on federal lands would in all likelihood be small or negligible, particularly if the federal royalty rate remained equal to or below the royalty rates that apply to nearby state and private lands."
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> Moreover, "because the higher rate would apply only to new leases and the affected parcels would not go into production immediately, the effect on federal income would be small initially but increase over time as the number of producing parcels subject to the new rate grew."[ii]

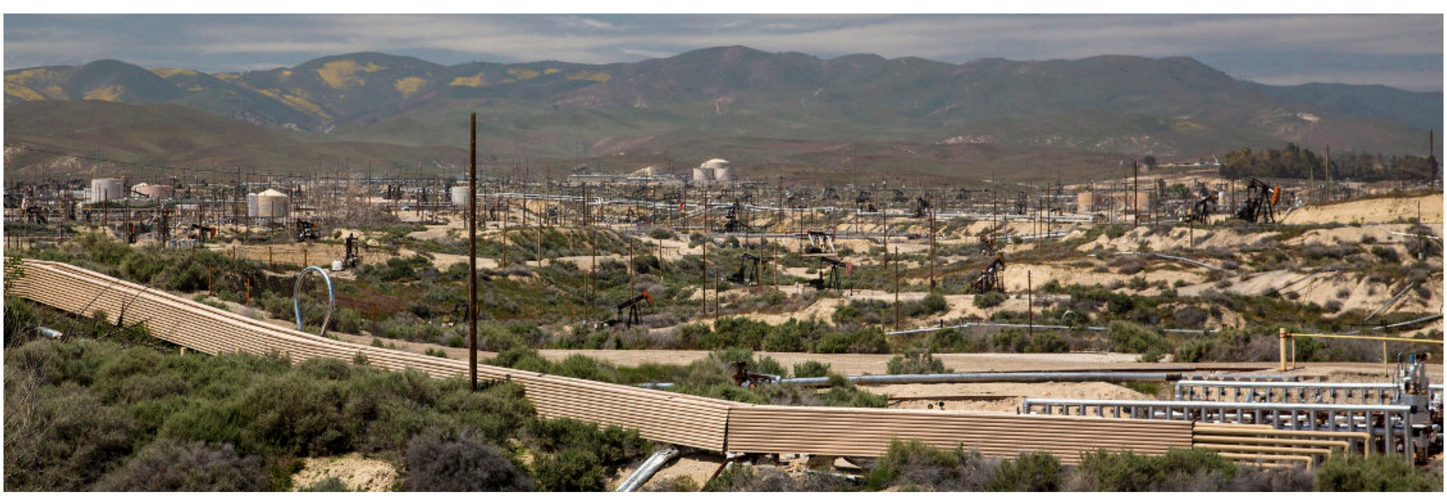
Leasing Jurisdiction	Oil & Gas Royalty Rate[4]
California	Negotiated lease-by-lease, but generally no less than 16.67 percent[iii]
Colorado	20 percent[iv]
Montana	16.67 percent[v]
New Mexico	18.75-20 percent[vi]
North Dakota	16.67 or 18.75 percent depending on the county[vii]
Oklahoma	18.75 percent[viii]
Texas	20-25 percent[ix]
Utah	16.67 percent[x]
Wyoming	16.67 percent[xi]
Private Lands	Generally, 12.5-25 percent[xii]
Federal Lands	12.5 percent, sometimes less[xiii]

By continuing to retain the outdated royalty rate of 12.5 percent, the BLM has deprived federal and state taxpayers of tens of billions of dollars over the course of decades. Increasing the oil and gas royalty and reforming the royalty collection system is paramount if taxpayers are to receive a fair return for these valuable resources.

Time for Much-Needed Change

Low royalties on oil and natural gas produced on federal lands have deprived the federal treasury of billions of dollars. Congress has the power to reform oil and gas royalty collection policies that the BLM has been unable or unwilling to do on its own.

On the 100th anniversary of the MLA, we call on policymakers to stand up for taxpayers and bring the federal oil and gas system into the modern era by increasing the royalty rate from 12.5 to 18.75 percent, in line with the rate currently charged for offshore production.



[4] The prevailing rate state land management agencies have for new oil and gas leases. Rates for legacy leases on state lands may differ.

ENDNOTES

[i] Estimate calculated from actual royalties collected from oil, gas, and natural gas liquids (NGL) production from federal, onshore leases reported by the Office of Natural Resources Revenue. The estimate captures additional potential royalty revenues had an 18.75% rate been in place for all BLM-managed leases using the sales value of resources net of transportation and processing deductions. The figure reflects a maximum, recognizing the potential for some, though likely minimal, deterred federal production under the alternative scenario of an 18.75% rate set decades ago. It also does not attempt to forecast increases in revenue from legislation setting an 18.75% rate prospectively.
[ii] Congressional Budget Office, "Options for Increasing Federal Income From Crude Oil and Natural Gas on Federal Lands," April 2018. **https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51421-oil_and_gas_options-OneCol-3.pdf**
[iii] Ca. Pub. Res. Code § 6827
[iv] Government Accountability Office, "Raising Federal Rates Could Decrease Production on Federal Lands but Increase Federal Revenue," June 2017. **https://www.gao.gov/assets/gao-17-540.pdf**; Some parcels not sold with the 20% rate are offered in subsequent sales with an 18.75% rate. **Recent reports** from the Colorado State Board of Land Commissioners indicate companies have been bidding on leases with 20% rates rather than wait for them to be re-offered with an 18.75% rate: 91 of the 102 tracts offered between August 2017 and May 2018 were sold on first offer; just 3 of 9 tracts re-offered sold.
[v] Ibid
[vi] Ibid; The New Mexico State Land Office offered all parcels for lease with a 18.75 or 20% royalty rate in the last two years. In prior years, some parcels were leased with a 12.5-16.67% rate.
[vii] Ibid
[viii] Congressional Budget Office, "Options for Increasing Federal Income From Crude Oil and Natural Gas on Federal Lands," April 2018. **https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51421-oil_and_gas_options-OneCol-3.pdf**
[ix] Ibid
[x] Government Accountability Office, "Raising Federal Rates Could Decrease Production on Federal Lands but Increase Federal Revenue," June 2017. **https://www.gao.gov/assets/gao-17-540.pdf**; For some leases, the royalty is set at 12.5 percent if approved by the Director of the Utah Trust Lands Administration.
[xi] Ibid; For parcels offered but unsold in a previous sale, the rate is set at 12.5 percent.
[xii] Ibid
[xiii] 30 USC §226

PHOTO CREDITS

p. 1 Basin and Range National Monument, Nevada. Source: BLM
p. 2 Pump jack on Federal Land in Wyoming. Source: BLM.
p. 3 Federal Oil and Gas Production in California. Source: BLM.
p. 4 Oil Rig in Montana. © Lindsey, via Flickr.