

Royalty-in-Kind: A Costly Complication

Under intense pressure from the oil and natural gas industry, the Minerals Management Service (MMS)¹ started the Royalty-in-Kind (RIK) program in the late 1990's. The program allows companies to pay royalties owed to the federal government in oil or natural gas rather than cash, and the federal government in turn sells this oil or natural gas on the market. By turning the federal government into a natural resource marketer, the RIK program has become a bureaucratic nightmare, creating vast opportunities for fraud and taxpayer waste.

Royalty in Kind is not Cost-Effective

- RIK programs are only cost-effective when governments have easy access to pipelines for transportation and experience in selling resources on the market. But MMS fails to meet these standards, which lead the Government Accountability Office (GAO) to conclude that RIK programs “*would not be feasible for the federal government.*”²
- A follow-up GAO report found that MMS's methods of calculating the benefits of its Royalty-in-Kind program failed to account for all costs and uncertainties. For example, MMS does not bother to use available third-party data to verify industry-reported numbers for natural gas production.³
- Big Oil has also pushed for the constant expansion of the RIK system, even lobbying for legislation that would mandate all royalty payments to be made in kind. This would cost taxpayers as much as \$367 million annually.⁴
- Far from saving taxpayers money, RIK programs require additional administrative expenses as the government must transport and market the oil or natural gas. In studies, RIK programs had an extra \$1.7 million in annual operating and \$13 million in marketing costs.⁵
- **The MMS itself has admitted that in 2006, it sold 64% of all the oil it collected in kind for less than it would have received had it collected the royalties in cash.**⁶



Photo from Federal Deposit Insurance Corp.

Ripe for Abuse

- Claiming that RIK programs were profitable, the MMS continued to expand the program, despite warnings from the GAO that officials were using sloppy accounting practices: “*MMS has not systematically assessed and documented the overall administrative cost and revenue impacts of many RIK sales.*”⁷
- In an investigation of MMS officials who manage the Royalty-in-Kind program, the Department of Interior Inspector General found that from 2002-2006 about a third of the entire program staff had “socialized with, and had received a wide array of gifts from, oil and gas companies with whom the employees were conducting official business.” Moreover, the Department's Inspector General found that the royalty-in-kind program lacked “acceptance of government ethical standards.”⁸

Congress must end further expansion of the royalty-in-Kind program until the program has a thorough evaluation and has been proven to save taxpayer money. Otherwise, Congress risks expanding a broken system and opening up even more opportunities for waste.

September 2008

For more information visit www.taxpayer.net or contact Autumn Hanna at 546-8500

¹ MMS is a bureau of the Department of the Interior that manages oil, natural gas, and other mineral leases on offshore and onshore federal and Indian lands.

² Government Accountability Office, "Federal Oil Valuation: Efforts to Revise Regulations and an Analysis of Royalties in Kind," August 1998, GAO/RCED-98-242.

³ GAO: "Mineral Revenues: Data management problems and reliance on self-reported data for compliance efforts put MMS royalty collections at risk", March 2008.

⁴ Government Accountability Office, "Federal Oil Valuation: Efforts to Revise Regulations and an Analysis of Royalties in Kind," August 1998, GAO/RCED-98-242.

⁵ GAO: "Cost and Revenue Information Needed to Compare Different Approaches for Collecting Federal Oil and Gas Royalties", April 2004.

⁶ GAO: "Mineral Revenues: Data management problems and reliance on self-reported data for compliance efforts put MMS royalty collections at risk", March 2008.

⁷ GAO: "Cost and Revenue Information Needed to Compare Different Approaches for Collecting Federal Oil and Gas Royalties", April 2004.

⁸ Office of the Inspector General of the Department of the Interior, "Investigative Report of MMS Oil Marking Group", August 2008.