TAXPAYERS for COMMON SENSE

ISSUE BRIEF

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Oil & Gas Reform Won't Raise Prices at the Pump

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The federal oil and gas leasing system is antiquated, costs taxpayers billions of dollars a year, and badly needs reform. Thankfully, proposals to reform the management of oil and gas development on federal lands and waters are gaining traction in Congress and have been included in recommendations for the fiscal year (FY) 2022 budget reconciliation process. The better news is that by ensuring a fair return for the oil and gas resources we own, **implementing reforms will increase taxpayer revenues but will NOT impact the price of gasoline at the pump.** Here's why:

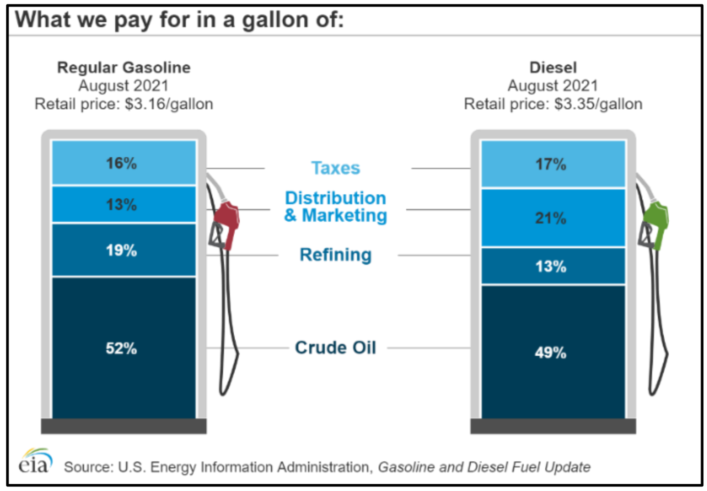
1. Gas prices depend on the global price of oil, consumer demand, and NOT changes in federal leasing policy

The price of gasoline is determined by countless domestic and international factors. However, the terms for leasing federal land and water to produce oil and natural gas – like royalty and rental rates – are not a major factor in the price of gasoline at the pump.

The price of crude oil is a dominant factor in the price of gasoline, but far from the only one (see graphic below). For example, the uptick in the price of gasoline in August 2021 was largely unrelated to crude oil price, according to the U.S. Energy Information Administration (EIA). Instead, the increased price at the pump was due to "high summer driving demand, low gasoline stocks, refinery disruptions from Hurricane Ida, and relatively high ethanol costs."[1 2]

Even when those short-term drivers of gas prices return to baseline levels, the underlying price of crude oil is determined in the global market by forces like Organization of the Petroleum Exporting Countries (OPEC) production agreements, economic activity driving oil demand, geopolitical events in high producing regions, and even the strength of the U.S. dollar, which is used for all oil transactions around the globe.

Total U.S. oil supply does impact global oil prices, but U.S. production remains at near all-time highs. In the second quarter (Q2) of 2011, U.S. drillers produced 5.6 million barrels per day (mmb/d). In Q2 2021, production was double that at 11.3 mmb/d. In fact, the U.S. petroleum trade deficit (the value of petroleum exports less the value of petroleum imports) was the smallest on record in 2020.



In part because of increasing oil production in the U.S. and in OPEC countries – at roughly triple the U.S. rate – EIA projects that both oil commodity prices and U.S. gasolines prices will decline in the short term. Passing much-needed reforms to management of oil and gas development on federal lands and waters would do next to nothing to change those trends.

2. Higher royalty rates will increase taxpayer revenue with little or no effect on oil and gas production

In the FY 2016 Omnibus, Congress directed the Government Accountability Office (GAO) to review studies that modeled the effects of raising federal royalty rates on outcomes like production and federal revenue. GAO reviewed studies by the Congressional Budget Office, the Council of Economic Advisers, and one prepared for the Bureau of Land Management.[3] GAO also interviewed stakeholders such as officials from federal and state agencies, industry groups, and non-governmental organizations.

[1] U.S. EIA, *Short-Term Energy Outlook*, September 2021, pg. 10
[2] Ethanol costs, including the price of corn and the RIN market, affect oil prices because the Renewable Fuels Standard requires refineries to blend biofuels (mostly corn ethanol) into all gasoline; 10% of most U.S. gasoline is ethanol.
[3] GAO-17-540, "Oil, Gas, and Coal Royalties: Raising Federal Rates Could Decrease Production on Federal Lands but Increase Federal Revenue," Jun 20, 2017

Photo credit: Richard Masoner via flickr

One of the studies used 2016 production data to assess the effect of increasing royalty rates to 22.5% – which no one is proposing – and found production could decrease by less than 2%. Similarly, the Congressional Budget Office (CBO) found that any reduction in oil and gas production caused by federal leasing reform would be "negligible" over 10 years, especially in states that already charge a higher royalty rate than the federal government.

Looking specifically at raising the onshore royalty rate to 18.75% – in parity with offshore royalty rates – in its 2016 report,[4] CBO found that compared with parcels owned by other jurisdictions, the profitability of exploring speculative parcels on federal land might drop. But so long as the federal royalty rate remained equal to or below the royalty rates of nearby state and private lands, that any subsequent decrease in production on federal lands would in all likelihood be small.

After interviews with officials from state offices in Colorado and Texas, GAO reported that:

> "the history of increasing royalty rates for oil and gas production on state lands suggests that increasing the federal royalty rate would not have a clear impact on production. In particular, officials from Colorado and Texas said that they have raised their state royalty rates without a significant effect on production on state lands. In February 2016, Colorado increased its royalty rate for oil and gas production from 16.67 percent to 20 percent, and, according to state officials, there had been no slowdown in interest in new leases as of August 2016. In fact, Colorado state officials said they were unsure whether the higher royalty rate played much of a role in companies' decision making. Additionally, Texas officials told us that over 30 years ago, Texas began charging a 25-percent royalty for most oil and gas leases on state lands, and this increase has not had a noticeable impact on production or leasing." (GAO-17-540, p. 21-22)

Reports from the Colorado State Board of Land Commissioners indicate companies bid on the first leases with the increased 20% rate 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, and just 3 of 9 tracts re-offered sold.

As states that increased their royalty rates reported, the royalty rate for a lease plays little role in companies' decisions on where to produce and when. According to CBO, oil and gas companies

[4] CBO, "Options for Increasing Federal Income from Crude Oil and Natural Gas on Federal Lands," April 2016

are primarily influenced by physical factors and market forces. The probability of finding oil or gas, the expected amount, the extraction costs, the current and expected future prices for oil and gas, and the firms' costs of capital all have a large influence on a company's decisions. Factors within a given leasing system, like the royalty rate, have a lesser impact.

The GAO review also found that raising the federal royalty rate could increase net federal revenue between $5 million and $38 million per year.

3. Reforms will have no impact on gas pump prices – by the numbers

The sale of oil produced on federal lands and waters does not dictate the global price of oil. Even if it did, the effect of increasing royalty rates would be imperceptible. Some simple math demonstrates why:

- Increasing the onshore royalty rate – the most consequential reform proposed – would have **no impact on current leases or current production**. Higher rates would only kick in for new leases, which usually take years to develop.
- The vast majority of federal oil and gas is produced on leases that were issued decades ago. Roughly half of onshore oil and gas royalty receipts in 2013 came from leases issued more than 50 years prior. Just 6% of oil and gas royalty payments came from leases issued in the last 10 years. For simplicity, **let's assume 6% of onshore production would be subject to the higher royalty rate in 10 years**.
- Oil production from federal lands made up just 7.6% of total U.S. oil production in 2020. Even ignoring international markets, federal oil sales have a small effect on U.S. supply.
- The cost of crude oil determines just 52% of the price of gasoline.

If…

Congress increases the royalty rate for leases on federal lands from 12.5% to 18.75%,

6% of onshore oil production is subject to the new rate in 10 years,

The entire supply chain is somehow able to pass on the increased royalty cost in the form of a 7.69% price increase,

That price increase affects just 7.6% of all U.S. crude oil used to make gasoline, and

The price of crude oil affects 52% of the price at the pump,

Then…

A gallon of gas costing $3.00 would suddenly cost $3.00055.

That is, even under the impossible scenario in which oil and gas companies could pass on the increased royalty cost to customers a decade after oil and gas reforms are instituted, the resulting increase in the price of gas would be less than 6% of one cent.

4. Oil and gas reforms will decrease liabilities and increase revenues

So, what will the oil and gas reforms do for taxpayers?

Oil and gas leasing reforms like raising royalty and rental rates will raise revenues for taxpayers.

The federal onshore oil and gas royalty rate is 12.5%, well below the offshore rate of 18.75%, and the rates charged on state lands. Had the offshore rate been charged on all oil and gas produced from federal lands, **taxpayers could have received up to $12.35 billion more over the last decade**.

The current rental rates are set at $1.50/acre for the first half of the lease term and $2.00/acre for the second half of the lease term. The rates were set in 1987 and have never been adjusted for inflation since then. Had the rates kept up with inflation, taxpayers would have received roughly $330 million more in rental revenues from FY2011 to FY2020. Like rent, the minimum amount companies can bid at auctions for federal oil and gas leases, set at $2/acre, hasn't been updated since 1987. From FY2011 to FY2020, taxpayers would have received $5 million more had minimum bids been adjusted for inflation. The ambitious infrastructure bill (H.R. 3684) and reconciliation package can benefit from pay-fors like raised rates in the oil and gas leasing system.

Oil and gas bonding and reclamation reform will reduce taxpayer and environmental liabilities and increase industry accountability

Abandoned oil and gas wells pose environmental and public health risks. They can leak methane gas, contaminate surface water and groundwater, fragment habitats, erode soil, and interfere with agricultural land use, etc. It is in the national interest to ensure these wells are properly reclaimed. Strengthening management of idled wells on federal lands can ensure that operators do not let nonproducing wells sit idle and pollute the environment without addressing them for years.

Ensuring that oil and gas companies post bonds sufficiently large to pay for reclamation in case they go bankrupt is the best way to hold the industry accountable and protect taxpayers from paying for industry messes. Current bond minimums were set in the 1950s and 60s, have never been adjusted for inflation, and no longer reflect actual reclamation costs. Adjusted for inflation, today's $10,000 minimum bond for an individual lease was the equivalent of $87,436 in coverage when the minimum was set in 1960. The rate of $25,000 for statewide bonds originally provided the equivalent of $240,531 in coverage in 1954, and the $150,000 nationwide bond minimum provided $1,443,184 in coverage. Raising bond minimums will increase industry accountability and protect taxpayers from more industry liability.

Other reforms like closing the noncompetitive leasing loophole can get taxpayers better and more efficient use of our valuable public lands

Noncompetitive leasing allows companies (and land speculators) to get leases without paying a bid by submitting a noncompetitive offer the day after a competitive auction, for any parcel that didn't sell the day before. Oil and gas companies have disproportionately used the noncompetitive system to avoid paying the $2/acre minimum bid on parcels with more acreage. Over the last 10 years, 2.3 million acres – an area roughly twice the size of Rhode Island – have been leased with no bid. BLM records indicate that lands leased noncompetitively rarely ever entered production. Millions of acres of federal land are currently locked up in nonproducing oil and gas leases. Eliminating the noncompetitive leasing system can lead to more optimal uses like recreation, wildlife viewing, fishing, grazing, timber, etc.

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