western values project

A Voice for the Majority in the American West

THE OIL EXPORT BAN AND THE TAXPAYER:

Low royalty rate ensures Americans lose

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Introduction

Americans First, Energy Company Profits Second

In the brewing debate regarding the future of our nation's crude oil export ban, a critical question has been strikingly absent. If the U.S. starts allowing companies to export resources overseas—the oil drilled from American soil—what would the American public get in return? Put another way, would Americans get a fair return from the increased drilling that would likely occur if the export ban was lifted? After all, revenue from the oil and gas boom in America could pay for important public services, reduce taxes, improve schools and build critical infrastructure. Yet Americans' cut of that remains among the lowest in the world.

By repealing the export ban without first ensuring a fair return for the American taxpayer, we risk letting multinational oil companies sell our resources on the world market, while American taxpayers get taken to the cleaners.

Time and time again, the U.S. Government Accountability Office (GAO) has pointed out that America has one of the lowest rates of return for oil and gas resources drilled on public lands of any country in the world.[1] Even as states struggle with reduced budgets, veterans see their pensions reduced and senior citizens watch their retirements evaporate, oil companies continue to enjoy a wide array of tax breaks.

Yet Americans receive a paltry return because the royalty rate for extracting oil and gas resources from public lands is 12.5 percent, the same as it's been for nearly a century. And it's far less than the rate set by most other oil producing countries.[2] Increasing our take to better reflect the value of those resources in the marketplace is a popular idea. In fact it has been prioritized in federal budgets over the past few years.[3] Unfortunately, there has been no follow-through. Now is the time.

Improving taxpayer returns would help realize the goals a majority of Westerners support, including economic stability, fiscal responsibility and national security. Those values are reflected at the national level where polling following the recent State of the Union address suggests that strengthening the nation's economy and national security remain priorities.

Doing Business on America's Public Lands: It's a Steal

Many valuable national assets are concentrated in the West, including our national parks, prime hunting and fishing opportunities and untapped energy reserves. As an agency within the Department of the Interior (DOI), the Bureau of Land Management (BLM) has a multiple-use mandate, which requires striking a balance between protection and development of its vast acreage.[4]

Public lands are supposed to be managed on behalf of all American citizens. Oil and gas companies now lease roughly 37.8 million acres of federal public lands from the BLM.[5] In the first five months of Fiscal Year (FY) 2013, over 650,000 additional acres have been leased.[6] And there are now 92,000 wells capable of producing oil and gas from public lands—more than ever before.[7]

For the right to develop oil and gas resources on federal lands and in federal waters, companies make payments to the government. Those include bonus bids, rents, royalties and taxes. For onshore leases, revenues collected on oil and gas development are split with the states in which the leases are located[8] (51 percent goes into the U.S. Treasury and 49 percent goes to states).[9] For both onshore and offshore oil and gas development, DOI is required to ensure that American citizens receive "fair market value" for those resources.[10]

However, DOI is not making good on its "fair return" mandate and as a consequence all Americans are losing out. This is best explained in the President's FY 2014 budget, which estimated that common-sense royalty reform—raising onshore royalty rates to ensure that Americans are getting "fair market value"—would generate $2.5 billion in net revenue for the U.S. Treasury over a decade.[11] An additional $400 million to $600 million to Western states' coffers annually.[12]

Royalties and Fair Return 101

Compared to the cut that governments in other oil and gas producing countries get for extracted oil and gas, the U.S. is among the lowest—in the world.[13] The "government take" for oil and gas resources extracted from federal land is a percentage of how much total revenue is generated from the extraction of those resources.[14] That "take" is split between the federal government (51 percent) and the state (49 percent) in which the lease was developed and is used for public expenditures or fiscal responsibility.[15]

Those takes amount to one of the federal government's largest, non-tax sources of revenue. They also provide a significant influx of cash to state economies.[16] In FY 2012, for example, oil and gas companies received over $66 billion from the sale of oil and gas produced from federal lands and waters, and paid nearly $10 billion to the federal government for developing those resources.[17] The biggest piece of that pie—about $8.5 billion—came from *royalties*.[18] Of that total, over $2.5 billion amounted to royalties from onshore leases.[19]

Drilling down further, the take for five Western states (Wyoming, New Mexico, Colorado, Montana and Utah) was about $1.1 billion.[20] That sounds like a lot, but for Montana, that meant a relatively modest $18.8 million dollar paycheck.[21]

All Royalties are not Created Equal

The federal government's current royalty rate for onshore oil and gas development, set in 1920, is just **12.5 percent**. That rate—established the same year that prohibition went into effect and women were guaranteed the right to vote—is long past its prime.

Federal royalty rates have lagged for both onshore and offshore leases, in part, because DOI has not done a comprehensive evaluation of the oil and gas fiscal system in decades. As a result, DOI has no finger on the pulse of the global oil and gas market and, essentially, no way of knowing whether or not American taxpayers are getting a fair return for the extraction of their oil and gas resources.[22]

That revelation led to two hikes in royalty rates for offshore leases; first to **16.67 percent** then to **18.75 percent**.[23] That makes offshore leases more on par with global averages (although still low), but onshore federal royalty rates continue to languish. Instead of boosting state and national economies, those billions of dollars in potential revenue continue to contribute to industries' already well padded bottom-line.

States, apparently wiser to the value of their natural resources, have raised their royalty rates over the past several years. Among major oil and gas producing states in the American West, royalty rates more closely mirror the federal offshore royalty rate. Their rates range from 16.67 to18.75 percent, which is from 33 to 50 percent higher than the going federal rate. Texas, where the state royalty rate is even higher at 25 percent, has suffered no mutiny from private oil and gas developers.[24]

These commonsense rates stand to benefit American taxpayers, especially those in Western states. In 2012 alone, even a minimal bump in royalty rate percentages would have meant between $400 million to $600 million in additional revenue for states in the Rocky Mountain West.[25] It's time for the DOI, entrusted with American taxpayers' non-renewable resources, to lift the nation's oil and gas reserves out of the bargain basement.

The royalty rate fix

Federal onshore royalty rates don't measure up to those for resource development on state-owned land.[26]

Texas: 25%

Federal offshore royalty rate: 18.75%

New Mexico: 16.67%-18.75%

North Dakota: 16.67%-18.75%

Wyoming: 16.67%

Utah: 16.67%

Montana: 16.67%

Colorado: 16.67%

Federal onshore royalty rate: 12.5%

How much did taxpayers lose out on?[27]

If the onshore royalty had been 16.67… 18.75 in FY 2012:

In Wyoming: 161.2 million ... $241.6 million

In New Mexico: $155.5 million…$233.1 million

U.S Treasury: $117 million…$175 million

In Utah: $43.9 million…$65.8 million

In Colorado: $36.6 million…$54.9 million

In Montana: $5.8 million…$8.7 million

Lifting the Export Ban

Whether or not the crude oil export ban should be lifted is shaping up to be one of the biggest energy debates this year. It's a complicated discussion, which juggles national priorities and global dynamics. At the end of the day, lifting the ban has a number of serious potential consequences on its own, but even before those arguments are made, it's important to ensure that America's fiscal energy house is in order.

For nearly a century, royalty rates for onshore oil and gas development have been a steal for private industry. While oil and gas production booms, an antiquated policy shortchanges American taxpayers. If the crude oil export ban comes to an end while extraction on public lands increases, Americans' losses will intensify. Instead of flowing into federal and state coffers, to the benefit of all taxpayers, those earnings from shared resources will continue to get banked by private industry and ultimately boost prosperity and energy security in foreign nations.

Crude Awakening

The global crude oil market was highly volatile in the 1970s. In 1973, in protest of the U.S.' Middle East politics, Arab members of OPEC cut production and stopped oil shipments to the U.S.[28] The immediate scarcity of the resource threw developed and developing nations alike into chaos. Despite the great need for domestic energy sources, U.S.-based oil companies began exporting crude oil to nations paying much more than the industry was allowed to charge at home.

In fear of "profiteering" and in an attempt to keep valuable resources at home to promote domestic energy independence, the federal government intervened. The Emergency Petroleum Allocation Act of 1973 implemented price controls, which seriously curtailed crude oil exports. The total ban on those exports, which had been put into place by the Commerce Department, was followed up by the 1975 Energy Policy and Conservation Act, which extended oil price controls into 1979.[29] The initiative was a bipartisan one with broad support from a Republican president and a Democratic majority in both chambers.[30] Exports of refined goods such as gasoline and diesel fuel were, and continue to be, permitted.

The Global Oil Market and the Export Ban

The world oil market is a complex arena in which both governments and private companies move oil from producers to consumers. Government-owned national oil companies (NOCs) control most of the proven oil reserves (85 percent in 2010) and current production (58 percent in 2010). International oil companies (IOCs), often well-known stockholder corporations, own and produce the remainder of the oil.[31]

In 2011, the world's top three NOCs by share of world production were Saudi Aramco (12 percent), National Iranian Oil Company (5 percent) and the China National Petroleum Corp (4 percent). The U.S. has no national oil company; the largest three U.S.-based international oil companies (ExxonMobil, Chevron and ConocoPhillips) are accountable to their shareholders. The top three IOCs by share of 2011 world production were Exxon Mobil (3 percent), BP (3 percent), and Royal Dutch Shell (2 percent).[32]

The factors that drive crude oil prices are many and fluctuating, including physical market factors and those related to trading and financial markets. Supply is a critical piece.[33]

For Americans, perhaps an even more critical question is refining capacity. The "light" crude, which is now in abundance from the Bakken formation of North Dakota, for example, cannot be effectively refined in the U.S. This is helping to keep oil and gas prices in many parts of the country low, as our domestic supply of crude oil increases while it waits to be refined and used domestically.

That limited refinery infrastructure and the export ban together keep down the price of crude oil in the U.S. If the ban was lifted, it's likely Americans would pay more at the pump. By opening up the export market, that crude oil would not be refined here nor used here. It would be sold on the world market, refined elsewhere and used elsewhere. It would also be drilled and sold at the current low royalty rate, adding insult to injury.[34]

If the export ban was history, estimates suggest that international companies would dump 500,000 barrels of U.S. crude oil into the global market by 2017.[35] This additional supply would be produced from both federal and non-federal areas, and those produced from federal lands would be subject to the low 12.5 percent royalty rate, low rental rate and every barrel would be subject to the tax breaks enjoyed by companies drilling on both federal and non-federal lands.

In order to keep oil prices high, Organization of the Petroleum Exporting Countries (OPEC) nations (which produce about 40

Not measuring up

When the royalty rate in the U.S. goes head-to-head with those in other countries, it comes up short. Here's how America compares to other countries:[57]

Canada: (up to 45 percent)

New Zealand: (up to 20 percent)

Ecuador: (18.5 percent)

Venezuela (up to 33.3 percent)

Colombia (up to 25 percent)

Nigeria, Algeria and Russia onshore (up to 20 percent)

The U.S. royalty rate is the same as it is in Pakistan.[58]

percent of the world's crude oil) may respond by cutting back on their own production. What happens then? According to the U.S. Energy Information Administration: "Cuts in OPEC production targets tend to lead to price increases."

Battle of the Ban

Arguments for ending the crude oil export ban pretend to defend the interests of average Americans. Alaska's Senator Lisa Murkowski (who represents the only state which is allowed to export crude oil) says the ban disrupts supply and discourages U.S. production.[36] It's an odd assertion at a time when U.S. crude oil output is surging and is on track to hit its highest level since 1972 within the next two years.[37] Furthermore, the limited refining capacity in the U.S. means that this oil, instead of staying in the ground until our refining infrastructure is updated, would be shipped out of the country, refined elsewhere and used elsewhere, with no potential gain for American energy security.

In some ways, the U.S. is in the same position it was in when the oil embargo hit. Energy issues are at the top of the national agenda and, while U.S. imports have declined over the past several years, they still rely on high-risk imports.[38] Despite an overall drop in U.S. consumption of crude oil in the past few years, undesirable imports have spiked. Imports from Persian Gulf states increased 30 percent from 2009 to 2012, and made up 25 percent of the total in 2012. Imports from OPEC countries were 47 percent of the total. Imports from Iraq, Kuwait, Saudi Arabia, Colombia, Libya and Egypt are all on the rise.[39]

The natural gas factor

Shoulder to shoulder with the crude oil export ban question is whether or not industry should be shipping natural gas abroad. The boom in shale resources has flooded the market with relatively cheap natural gas leading to analysis of what effect exporting those resources would have on energy prices at home. The EIA concluded, "Increased natural gas exports lead to increased natural gas prices. Larger export levels lead to larger domestic price increases…"[44]

Last month, frigid weather across the country demanded record amounts of natural gas, since about half of all American homes heat with it. On the 'Top 10' list of all-time demand days for natural gas, January 2014 had seven of them. A 10 percent colder-than-forecast winter can boost energy bills by 25 percent.[45] A lack of supply due to international exports could push the price tag for average Americans even higher.

Economists agree that the recent boom in oil production does not insulate the U.S. from foreign supply disruptions. Crude prices spike amid political upheaval and natural disasters. As long as one barrel of oil is imported, price and supply vulnerability does not entirely dissolve.[40]

In a recent letter to President Obama, Sen. Robert Menendez, D-N.J. expressed deep concern over easing the ban and how it could impact the bottom line for American families. "Allowing for expanded crude exports would serve only to enhance the profits of Big Oil and could force U.S. consumers to pay even more at the pump," he said.[41] Menendez argues that exports could boost domestic crude prices, narrowing the price gap between U.S. and global oil.[42] "Why would we want to export oil and raise American oil prices to match the world's oil price?" Menendez asked.

Graeme Burnett, senior vice president of Delta Air Lines Inc. agrees. At a Senate Energy and Natural Resources Committee hearing on January 30, 2014, he testified that ending restrictions would raise fuel costs.[43]

Why Royalties are Critical to the Export Ban Debate

The export ban and federal oil and gas royalty rates intersect on public lands. Between FY 2007 and FY 2012, the contribution to total U.S. crude oil production from resources extracted from federal lands ranged from 25 percent to 37 percent.[46] In 2012, private industry withdrew 331,000 barrels of oil per day from federal onshore leases.[47] By lifting the export ban, another 500,000 barrels would be sent out of the country, an estimated 125,000 to 185,000 of which would have come from federal lands.

According to a Congressional Research Service report published in 2013, "Crude oil production on federal lands is likely to continue to make a significant contribution to the U.S energy supply picture and could remain consistently higher than previous decades… ."[48]

It's a critical time to close the gap on resource giveaways and get taxpayers their fair share. DOI increased offshore royalty rates in 2007 as a partial response to improved exploration and production technology.[49] The very same scenario is now playing out onshore, as advances in fracking and horizontal drilling technologies over the past several years have resulted in a sharp rise in domestic oil and gas supplies. Domestic crude oil output, in particular, is surging beyond expectations. According to EIA, total crude oil production averaged 7.5 million barrels per day (bbl/d) in 2013 (an increase of one million bbl/d from the previous year). It's expected to continue in that vein, topping out at 9.3 million bbl/d in 2015, which would mark the highest annual production level since 1972.[50]

If the export ban was lifted, a significant contribution to the U.S. energy supply picture could be shipped overseas, resulting in yet another loss for American taxpayers. This potential scenario makes it imperative to put the horse back in front of the cart, and resolve the debate over raising royalty rates before the export ban is discussed. Americans need to be ensured a fair share for the development of their oil and gas resources before considering sending those resources elsewhere.

CONCLUSION

Every two years the GAO puts out its list of programs at "high risk of fraud, waste, abuse and mismanagement." In 2011, that's exactly where DOI's management of federal oil and gas resources landed.

In its 2013 update of the "high-risk" list, GAO found that while DOI had made some progress, one critical issue that remains unresolved is "ensuring that the public is getting an appropriate share of oil and gas revenues."[51]

The GAO has repeatedly said that the "U.S. is a desirable place to invest in oil and gas development and production."[52] Compared to many other countries, especially large oil and gas producers like Nigeria and Venezuela, the U.S. has a very stable government. Since that is unlikely to change in the short-term, raising royalty rates for onshore oil and gas development is the rational move toward collecting revenue currently being left on the table. Until those rates are raised from the level set in the early 20th-century, those oil and gas resources will continue to be the government's greatest giveaway.

DOI has been considering increasing the onshore royalty rate since 2009.[53] In 2011, then-Interior Secretary Ken Salazar said a boost to onshore royalty rates was past due. The department estimated that an increase in the onshore royalty rate to 18.75 percent could increase revenue collection by hundreds of millions of dollars in the short term.[54] Various Interior secretaries have championed the idea. Current Interior Secretary Sally Jewell has said the interests of taxpayers must be represented in the sale of federal fossil fuels.[55]

But DOI continues to drag its feet. According to a GAO report released late last year, Interior needs, “to revise BLM’s regulations to provide for flexibility to the bureau to make changes to onshore royalty rates, similar to that which is already available for offshore leases, to enhance Interior’s ability to make timely adjustments to the terms for federal onshore leases.”[56]

The prospect of an end to the crude oil export ban should intensify action on royalty rates. If the ban is lifted without first enacting a common-sense rise in royalty rates, the economic, political and social losses to American taxpayers will only be magnified. It’s time to get to work for Westerners. Our economy and quality of life depend on it.

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