A Fair Return for the American People:
Increasing Oil and Gas Royalties from Federal Lands

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Introduction

For decades, revenues from minerals extracted from federal lands—minerals owned by the American people—have been among the most important non-tax sources of funding for the U.S. government.[1] These revenues have been substantial even though it is widely believed that the federal government shortchanges the public by charging too little for what they sell and collecting even less than they charge. The federal government is charged with returning to the American people fair market value for the sale of these minerals and is found, too often, to have failed to do so.

There are many parts to the federal mineral revenue story—some quite colorful and notorious. In 1922, Secretary of the Interior Albert Fall accepted bribes to award below value, no bid leases to friends for the production of oil at Teapot Dome in Wyoming and two locations in California. Fall distinguished himself by becoming the first sitting Cabinet official to go to jail. In 1980, Charles B. Thomas, an inspector for the U.S. Geological Survey, stopped a tanker truck coming off the Wind River Reservation with stolen oil that bypassed royalty meters. The discovery triggered investigations revealing years or even decades of oil theft from federal and Indian lands—with major losses never fully recovered for the public or tribes. In 2008, Interior Inspector General Earl Devaney issued three reports detailing a "culture of ethical failure" and a culture of "substance abuse and promiscuity" that permeated the oil and gas royalty-in-kind program. He reported on how oil company employees traded gifts, graft, sex, and drugs with Interior staff for sweetheart "royalty-in-kind" oil and gas deals that cost the American public millions of dollars in lost royalties. Interior Secretary Salazar canceled the royalty-in-kind program and reorganized the entire Minerals Management Service out of existence, but no one was criminally prosecuted to the chagrin of the Inspector General.

Scandals are bright, shiny objects that attract momentary attention. Yet, after the headlines and drama of these sensational episodes fade, the thought and consideration given by officials, the press and the public to federal revenues from natural resources also wanes. That failure to pay attention allows a deeper, more consequential scandal—one that has gone on for every minute of every day for decades—to continue with no corrective action taken. That deeper scandal is the failure of the Department of the Interior (Interior) to collect royalties on natural resources produced from federal lands at rates that return fair market value to the American people. In the nearly hundred years Interior has managed federal minerals, it has not

[1] In recent years, federal mineral revenues have been temporarily eclipsed by interest revenues from bonds purchased by the Federal Reserve in the course of its quantitative easing policy designed to pull the economy out of the Great Recession.

changed even once the standard 12.5% royalty that it charges for oil and gas extracted onshore from federal lands. Meanwhile, royalties charged by other owners have increased, including those collected by states for oil and gas from state-owned lands and even by the federal government for offshore deposits. Texas, for example, charges and receives 25% and has done so for thirty years, with 18.75% increasingly a mid-level rate among the largest producing states.

Royalty rates are not a complicated matter. They are simply the price that owners, in this case governments on behalf of their citizens, charge for oil and gas produced. The royalty rate is the same as a homeowner offering to sell a home for a certain price. The federal government, in effect, offers to sell a home for $200,000. In contrast, based on current relative royalty rates, most states close the deal for the identical house between $267,000 to $320,000. Louisiana sells the house for $374,000—and Texas gets $400,000 and has for a long-time.

The question might be asked, "Even if states charge higher prices for oil and gas, are they selling less and reducing production, jobs and economic activity in their states?" The answer is basically no. Economic studies find that even near the highest rates charged by states production would decline by 2% or less—too small to detract from the revenue gains from higher royalty rates. Further, Texas with its highest royalties in the nation remains the largest oil and gas producing state in the nation, with a new boom in production emerging in the Permian Basin within that state.

States are diligent in reviewing and adjusting their royalty rates to ensure their citizens receive a fair return on state minerals. Collectively, they test the marketplace for oil and gas by raising rates and seeing if they secure as much or more production. The states' diligence stands in contrast to Interior's failure to ever test in a hundred years the marketplace for higher rates for onshore oil and gas. Interior has not even established, as the U.S. Government Accountability Office (GAO) has urged it do so, a regular process for continuously reviewing and adjusting the royalty rates for federal oil and gas, which is often produced from the same fields as state oil and gas.

In terms of the practical uses of royalty revenues, achieving a fair return from oil and gas is important to managing the effects of the boom and bust cycles of resource extraction, especially on local communities in rural areas. Those states and communities share in the revenues from federal lands. Shortfalls in royalty collections hamper efforts in those communities to protect public health and safety, repair environmental damage, and diversify their economies for long-term resiliency. Finally, unjustified or improper deficits in federal mineral revenue collections contribute to a combination of reduced public services, higher taxes or increased federal debt.

The failure of Interior to collect royalties at a full and fair market value rate is the real scandal. The best evidence is that at the very least the federal government is giving away to oil and gas companies a third of the royalties that ought to be paid to the American people for onshore production. That is happening every moment of every day for every barrel of oil and

cubic foot of natural gas that flows off of federal lands. It is an enormous breach of trust with the American people. For that reason, this report will focus on royalties for onshore oil and gas and the process needed to ensure those royalties are fully and properly collected.

The federal government does deserve credit for increasing federal royalty for offshore production during the Bush Administration. In 2007, royalty rates for deep water oil and gas were increased from 12.5% to 16.67% (to match the existing rate for shallow water production). In 2008, the royalty rate for new offshore leases at all depths was increased to 18.75% where it remains today. The fact that Interior increased offshore royalty rates but has left onshore rates unchanged further highlights Interior's lack of diligence in securing for the public a fair return from onshore oil and gas.

Over the past decade or more, public agencies and non-profit groups have issued several reports evaluating the royalty rate for onshore federal oil and gas. On balance, these studies make a compelling case that Interior should increase the royalty rate for onshore oil and gas above the 12.5% rate and can do so with minimal impact on oil and gas production. The prior studies supporting increases in royalty rates remain fundamentally sound. Beyond updating information to reflect more recent developments, this report does not undertake a new analysis of royalty rates. Instead, it primarily seeks to summarize and refocus attention on the prior findings. In addition, the royalty rate issue will be placed in the context of related issues of determining the proper value of extracted minerals to which the rates are applied. More importantly, in light of continued inaction by Interior in adjusting rates or adequately evaluating potential changes, this report will recommend steps other public officials, agencies and non-profit organizations can undertake to encourage public knowledge and oversight of public mineral revenue issues.

Summary of Findings and Recommendations

This report makes the following findings:

1. States, whose lands are generally held in trust for their public schools, and the federal government have a responsibility to achieve a fair market value return for their citizens on oil and gas produced from their public lands.
2. State governments, collectively, test the market price—the royalty rate—for oil and gas by increasing rates and observing the response in terms of leases secured and oil and gas produced. Thus, state royalty rates reasonably reflect the fair market level for royalties. The federal government has not similarly tested the market price for onshore oil and gas production in over a century, reflecting a lack of diligence in meeting its responsibilities to the public. The untested federal rates are below market value as compared to the market-tested state rates.
3. Federal oversight of natural resource revenue policies and practices is episodic (often prompted by recurring scandals) and fails to regularly engage the broader public. The federal government should establish new mechanisms and procedures to give increased

and continuing attention to these policies and practices with greater opportunities for public participation in the process.

Consistent with the findings above, this report recommends the following actions:

1. As an initial step toward achieving a fair return for the American people, Interior should increase standard royalty rates for new leases for onshore oil production to 18.75% matching both its current offshore royalty rates and the middle range of state royalty rates for onshore oil and gas production. Further changes in the level and structure of federal royalty rates should be considered through the new royalty evaluation process described under items 3, 4, and 5 below. If Interior fails to increase the rate to 18.75%, Congress should adopt that rate by law as the minimum level for new oil and gas leases and mandate Interior to periodically evaluate and report to Congress on potential increases above this minimum.
2. To protect the integrity of natural revenues and prevent royalty payments from being undermined by gaps and loopholes in reporting oil and gas values, Interior should take additional and continuing measures to ensure that oil and gas producers report the full amount and value of their production.
3. Interior should establish, as the GAO has recommended, a continuous process to "evaluate the oil and gas fiscal system as a whole."[2] and review policies through these measures:
   a. Establishing an "Office of Natural Resource Revenue Analysis" to conduct regular and transparent studies of leasing and bid practices, royalty and rental rates, resource measurement practices, valuation policies and methods, and other natural resource revenue topics. The charter and organization of the office should be instituted in a manner the supports the objectivity, independence, and transparency of its work and public participation in its studies and operations.
   b. Reevaluating the level and structure of its natural resource revenue policies as a whole on a periodic schedule. The process should include incorporating lessons learned from state experiences, with specific attention to keeping federal rates at least consistent with the middle range of state rates. The process should also provide opportunities for active public participation in proposed changes prior to formal adoption.
4. Congress should strengthen its oversight of natural resource revenue policy and practices by establishing a Joint Committee on Natural Resource Revenue to conduct studies of natural resource revenue laws, policies and administration. The structure, duties and operations of this new joint committee would be modeled after the Joint Committee on Taxation, with members drawn from the U.S. Senate Energy and Natural Resources Committee and the U.S. House Natural Resources Committee. The joint committee's powers should extend to examining confidential records of returns, disputed cases and other matters necessary to evaluate the effectiveness of Interior's policies and practices.
5. To fulfill the public's right to know what they are being paid for the minerals they own and further strengthen oversight through well-informed public engagement in natural resource

[2] U.S. General Accountability Office, "Oil and Gas Royalties: The Federal System for Collecting Oil and Gas Revenues Needs Comprehensive Reassessment," GAO-08-691, p. 16.

revenue policies, Congress should re-enact transparency laws that require reporting, by lease, of revenues paid, production levels, and mineral values on public lands.

6. As improvements occur in the transparency of federal natural resource revenue systems, state governments should improve the transparency and availability of state natural resource revenue information in a comparable manner.
7. In addition to advocating for substantive improvements in federal royalty policy and administration, non-profit conservation, environmental and public lands management organizations should support increased transparency of natural resource revenue data and evaluate the need for and feasibility of establishing a Natural Resource Policy Center to conduct regular and systematic research on federal and state natural resource revenue policies and administration.

Increasing Royalty Rates for Onshore Oil and Gas Production

From 2007 through 2017, the GAO issued a series of reports focusing on the level and structure of federal oil and gas royalty rates. In its 2008 report, it found that the "inflexibility of royalty rates to change oil and gas prices has cost the federal government billions of dollars in foregone revenues."[3] In the course of its reports, the GAO also noted various comparisons between federal rates and those charged by states and foreign governments.[4] It generally concluded that the federal rates were among the lowest collected. Those comparisons, while not receiving widespread attention, may have had an impact on the increases in offshore federal royalty rates in 2007 and 2008.

The table below compares the royalty rates in major oil and gas producing states.[5] The term "top" royalty rates is used because in some states, slightly lower rates are charged on lower quality, "speculative" deposits. Those deposits are not representative of the primary sources of production in the United States, so the top rates are the most relevant ones for policy purposes. To underscore the regular attention states give to their rates, in the last few years Colorado increased its rate from 16.67% to 20%, and New Mexico increased its top rate from 18.75% to 20%. The following are the current onshore rates in major producing states as compared to the federal onshore rate.

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[3] *Id.*, p. 16.

[4] For another state/federal royalty rate comparison, see also: Center for Western Priorities, "A Fair Share: The Case for Updating Oil and Gas Royalties on Our Public Lands," Update, June 18, 2015. Colorado and New Mexico increased their rates since that report was issued.

[5] The practices of two other major, long-term production states, Alaska and California should be noted. California does not appear to have onshore production of oil or gas on state lands because of the limited extent of those lands. Thus, there is not a relevant state royalty rate. Alaska charges a 12.5% royalty for production from its state lands, but it also levies a higher and more extensive structure of state taxes on oil and gas production. Alaska's royalties and taxes combined result in a higher governmental share of revenues than what occurs for the federal onshore rate. Thus, listing Alaska's royalty rate alone would constitute a misleading "apples and oranges" comparison with the other states.

Federal Onshore Royalty Rates Lag Behind State Rates Rates Applicable to New Leases	
Jurisdiction	**Top Rate**
Texas	25%
Louisiana	23.4%
Colorado	20%
New Mexico	20%
North Dakota	18.75%
Montana	16.67%
Utah	16.67%
Wyoming	16.67%
Federal Onshore	12.5%

States exercise a higher-level of diligence than the federal government does regarding royalties from mineral production on their state lands. Fifteen states, predominantly located in the West, retain state lands.[6] Except for Texas, whose public lands derive from its unique history, these state lands were granted at statehood by the federal government for the support of public schools. It is the author's experience that issues regarding earnings from state lands attract greater public interest in these states as compared to the earnings from federal lands. That level of public attention may be attributable, in part, to the direct connection between the revenues from state lands and the budgets of local schools throughout a state.[7] In contrast, federal royalties take a circuitous route through Washington, with about half the revenue returning to the states to be distributed in a variety of ways, not all of which are visible to the public. In addition, state officials and legislators are simply more accessible to the citizens of these fifteen states than federal officials whose responsibilities extend to the entire nation. For these reasons, mineral royalties on state lands get more attention in states than do the same issues for federal lands. That translates into a level of regular and systematic diligence by state officials in managing revenues from state lands that is regrettably absent at the federal level.

States deserve substantial credit for doing a better job than the federal government in securing a return for their citizens from oil and gas produced on public lands. States have tested the market for their oil and gas resources by increasing rates and observing the results. In general, the states discover that higher rates do not reduce production. The GAO has reported this conclusion from state experiences:

> Officials from two state offices we interviewed said that the history of increasing royalty rates for oil and gas production on state lands suggests that increasing the federal

[6] Souder, Jon and Fairfax, Sally, "The State Trust Lands," The Thoreau Institute. Initially, thirty states owned federal lands, but half of these sold their lands and presumably hold the proceeds in trust for their public schools.

[7] A vivid example of the "state lands for schools" connection is displayed on the website of the Texas General Land Office. See, in particular, the pages associated with "Education" and "Energy" tabs on that site: http://www.glo.texas.gov/glo-education/index.html and http://www.glo.texas.gov/energy/index.html.

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.[8]

Beyond serving their citizens well, state royalty rates provide actual marketplace information on attainable royalty rates. That information is a reasonable guide to setting minimum federal royalty rates.

Proposals to increase royalty rates raise objections from the oil and gas industry that such changes would reduce production. However, there is little evidence to support that viewpoint. In 2017, the GAO reviewed studies on the impact that increasing federal onshore oil and gas royalty rates would have on revenues and production.[9] It noted that a Congressional Budget Office study found that an 18.75% federal onshore rate would raise revenues on federal lands as new leases were granted and placed in production but would likely have only a negligible effect on production. The CBO estimated that, after subtracting payments to states, federal revenue would increase by $200 million in the first 10 years as new production phased in, and more in the subsequent decade.[10] Because states receive nearly half of the federal royalties, the CBO estimate means that total royalty payments would be expected to increase by approximately $400 million over the first decade after the change. A second study by Enegis, LLC, modeled 3 increases in federal royalty rates to 16.67%, 18.75%, and 22.5%. The study found only a small impact on production, ranging from a 0% to a 1.8% decline in oil production across the three scenarios over 25 years, and a 0% to less than a 1.0% decline in natural gas production over the same period. With little or no impact on production, the three scenarios would produce between $125 million and $939 million in additional revenue over 25 years.[11] Raising the federal royalty rates to match the middle-range of state rates will produce revenue with negligible impact on production, jobs and economic activity. An increase of federal royalty rates to 18.75% would represent a modest step forward.

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[8] U.S. General Accountability Office, "Oil, Gas, and Coal Royalties: Raising Federal Rates Could Decrease Production on Federal Lands but Increase Federal Revenue," GAO-17-540, June 2017, pp 21-22.
[9] *Id., pp. 16-23.*
[10] *Id.,* pp. 16 and 22. Recent increases in estimates of future production would appear to make the CBO estimates conservative. New estimates using more current data would be in order.
[11] *Id.,* pp. 16-17 and 22-23.

Similar conclusions arise from a recent major study of the impact of state severance taxes on revenues and oil production.[12] The study modeled four dramatically different severance tax regimes ranging from 0% to 12%, 25%, and 25% with a drilling subsidy. Their overall conclusion was as follows:

> A key result . . . is that oil production is closely linked to the size of the reserve base and is relatively insensitive to changes in oil prices. This outcome, which is broadly consistent with experience in the U.S. oil industry over the past 50 years, leads to the conclusion that severance tax has little effect on production levels and serves mainly to redirect rents earned in the oil industry to the public sector. Thus, increases in severance taxes or a reduction to subsidies provided to the oil and gas industry may lead to rent taxation and therefore have only marginal effects on the drilling and production of oil . . . [13]

What Chakravorty, et. al. found was that even with very high severance taxes of 25% added to the typical public land royalty payments, production of oil is not significantly reduced. The reverse was also true: lower taxes or subsidies for drilling did not produce material increases in production. This outcome also supports a more important conclusion that current royalties are failing to return to their owners what they are owed: the full and fair value of the unproduced resource. In this study, even the highest severance taxes are simply returning a remaining portion of the intrinsic value of the unproduced resource to the public.[14] That is because even the highest taxes added to royalties do not significantly affect production. Producers still receive sufficient after-tax income to cover their costs of production including normal profits, which is the maximum they should receive.

No portion of the value of the unproduced oil and gas should go into excess profits of oil and gas producers over and above their production costs and a normal profit. That is because producers do nothing to create the wealth embodied in the raw, unproduced oil and gas. The multiple studies showing that higher royalty or tax rates can increase revenues without reducing production prove that the current low rates allow oil and gas producers to capture wealth they did not create. The result is that producers unjustly secure excess profits that ultimately benefit the largest shareholders of oil and gas companies and executives whose compensation is tied to stock options.

Current federal royalties are too low to return fair value to the American people who are the owners of this resource. Raising royalties will reclaim wealth that is now improperly gained by oil and gas companies. Higher royalties will not affect production, but will reduce the

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[12] Chakravorty, Ujjayant, et. al. "State Tax Policy and Oil Production: The Role of the Severance Tax and Credits for Drilling Expenses," in Gilbert E. Metcalf, ed., *U.S. Energy Tax Policy*, Cambridge University Press, pp. 305-337.

[13] *Id.,* p. 306.

[14] This sentence and the preceding one translate into less technical terms the quote in the Chakravorty study concerning severance taxes redirecting "rent" from the oil industry to the public. "Economic rent" is supposed to be paid to the original owners for the value of the unproduced oil and gas and not to the oil industry. Thus, the redirection is proper and justified.

excess profits of oil and gas companies and the resulting inflated, unearned income of their major shareholders and top executives. This effect on wealthy shareholders and top executives explains the intensity of corporate lobbying against increases severance taxes and royalties. However, oil and gas lobbying claims that increases in royalties or taxes will decrease production, jobs, and economic activity are not valid. Policies setting royalties below market levels simply subsidize shareholders and executive pay at the expense of the public.

The recent dramatic increase in oil and gas production in the United States also supports the conclusion that the size and nature of a resource deposit and the ability based on current technology to tap that deposit are the real factors that determine output. From 2008 through 2018, crude oil production in the United States essentially doubled. Production has now matched the previous peak in 1970 and is expected to reach even higher, record levels in 2019 and 2020. Indeed, the U.S. is expected to become the world's largest oil producing nation. Natural gas has also boomed. The increased production is largely attributable to fracking technology increasing oil and gas production in both old and new deposits. In particular, fracking led to the development of oil from the Bakken Formation primarily in North Dakota and also Montana. Fracking is also producing huge increases from the redevelopment of the Permian Basin in Texas and New Mexico. All these states charge higher royalties than the federal government, with Texas the highest at twice the federal rate and New Mexico not far behind. The lesson from the history of U.S. oil and gas production is clear. Geology and technology determine the amount of production, not royalty or tax rates.

Interior, by leaving in place for a century a 12.5% royalty rate, has failed the American people and has facilitated the transfer of enormous wealth that belongs to the public to wealthy shareholders and top executives of oil and gas companies. That failure needs to end. The median rate of state royalties in the table above is 19.375%. Increasing the federal onshore rate to 18.75% to match the federal offshore rate would be a conservative first step for Interior to begin doing justice for the American people and the states and communities responsible for responding to and managing the effects of oil and gas production. The rate would apply to new leases issued after the rate change. After this initial rate change, further increases in royalty levels should be thoroughly analyzed and considered with a firm goal of fully guaranteeing that the public is paid the fair market value for unproduced oil and gas.

If Interior fails to increase the rate to 18.75%, Congress should establish by law that rate as the minimum royalty for new oil and gas leases on federal lands. Further, that law should mandate Interior to periodically evaluate and report on Congress on possible increases in rates above this minimum.

There are other proposals for changing royalties such as sliding rate scales in relation to oil and gas prices, the quality or location of the resources, or the timeliness of production undertaken. Consideration of additional rate increases beyond 18.75% and these more sophisticated ideas should occur after the federal policy-making process regarding natural resources revenues is strengthened through improved analysis, oversight, transparency, and

public participation in decision-making as recommended later in this report. The time is long since past when Interior should be left with developing royalty policy on its own.

However, before moving on to a discussion of revitalizing and opening up the natural resource policy process, this report will briefly note the need to restore the integrity of the oil and gas royalty base—the quantity and value of the resource to which royalty rates are applied. No amount of royalty rate increases or restructuring can make up for understatements in the amount and value of oil and gas produced.

Restoring the Accuracy and Integrity of the Federal Royalty Base

Royalty payments, especially if rates are increased, can be undermined by gaps, loopholes, and weaknesses in determining the amount and value of oil and gas produced. There are at least three areas of chronic problems that need to be solved if the public is to receive a fair return. Each could be the subject of a report on their own. They will be summarized here simply to note additional issues that need urgent and effective attention. These issues include (a) problems with measurement of oil and gas production, (b) understatement of the value of natural gas through non-arm's length sales and the bundling of deductible and non-deductible costs, and (c) the waste of methane gas through leaks and flaring and the failure to collect royalties on such gas.

The GAO has long identified Interior's management of oil and gas as one of the governmental programs it monitors as a "high risk" of abuse or failure. One of the continuing reasons the GAO classifies the program as a high risk is because it is concerned about deficiencies in Interior's methods of ensuring accuracy in the measurement of natural gas produced for royalty purposes. While the GAO cites some progress made by Interior, that progress is still not sufficient to fully resolve these problems.[15]

In 2007, the Bush Administration's Royalty Policy Committee took note of long-standing issues that non-arm's length sales of natural gas (and also coal) and the bundling of deductible and non-deductible costs created difficulties in valuing natural gas for royalty purposes.[16] These problems include circumstances where companies, by selling gas at below market prices to their captive affiliates, can undervalue the gas in calculating royalties. They also include cases where costs for items that are deductible and non-deductible are bundled together, creating situations where deductions from value can be overstated. Either circumstance results in shortchanging the public.

The Bush committee recommended that Interior remedy these problems by proposing new rules by the end of FY 2008—just nine months after the recommendations were made.

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[15] U.S. General Accountability Office, "High-Risk Series: Progress on Many High-Risk Areas, While Substantial Efforts Needed on Others," February 2017. See p. 141 on deficiencies in the accuracy of measuring natural gas produced.
[16] Subcommittee on Royalty Management, "Report to the Royalty Policy Committee: Mineral Collection from Federal and Indian Lands and the Outer Continental Shelf," U.S. Department of the Interior, December 17, 2007, p. 72-73.

Instead it took nine years for Interior to adopt new rules that tightened up the royalty rules to prevent this loss of revenue by the public. Those rules took effect on January 1, 2017, but were suspended by the Trump Administration in late February 2017 and repealed a few months later. So, these problems of properly accounting for the value of natural gas for royalty purposes continue today.

Perhaps the costliest gap in the oil and gas royalty base occurs with the waste of methane that is flared and vented or leaked in the course of producing oil and gas. Producers not only waste this valuable resource but also fail to pay royalties on it—even though it is part of the minerals extracted. This problem is further aggravated by the fact that methane is a potent greenhouse gas. Interior adopted new rules in 2016 to reduce methane waste and improve the payment of royalties. However, the Trump Administration delayed those rules and then replaced them with weaker standards in 2018. The 2018 rule is estimated to cost the public up to $80 million in lost royalty revenue over ten years.[17]

This and other problems that erode the royalty base and shortchange the public have generally persisted for a long time. As in the case of royalty rates, Interior has not been diligent in correcting these problems. Further, the shield of secrecy surrounding royalty valuation has hampered the ability of Congress and the public to hold Interior accountable for failing to seek or implement solutions that ensure the accuracy and integrity of the federal royalty base. Indeed, the secrecy prevents the public from knowing the extent of revenues it is losing to gaps, loopholes and weaknesses in the royalty system. The secrecy and lack of oversight needs to end.

Achieving Effective Public Oversight of Natural Resource Revenue Policies

The GAO in its reports on federal oil and gas also struck a recurring theme that Interior does not adequately and regularly evaluate the oil and gas fiscal system. It stated,

> Interior does not routinely evaluate the federal oil and gas fiscal system as a whole, monitor what other governments or resource owners worldwide are receiving for their energy resources, or evaluate and compare the attractiveness of the United States for oil and gas investment with that of other oil and gas regions. As a result, Interior cannot assess whether or not there is a proper balance between the attractiveness of federal lands and waters for oil and gas investment and a reasonable assurance that the public is getting an appropriate share of revenues from this investment.[18]

Interior might note in response that at various times it has convened advisory committees on royalty policy including in the Bush Administration and again in the current one. The Bush-era committee was thoroughly focused on details and produced over 100

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[17] Taxpayers for Common Sense, "Issue Brief: Methane Waste on Federal Lands," at https://www.taxpayer.net/article/methane-waste-on-federal-lands .

[18] GAO-08-691*, Supra* at note 3, p. 20.

recommendations, mostly quite valuable as individual pieces. However, the committee's recommendations may have been a case of "missing the forest for the trees." It did not produce the kind of overall assessment of the level and structure of royalty policies that the GAO seems to be recommending.

The Trump Administration's Royalty Policy Committee is still operating. It is subject to criticism of being overbalanced in representing oil, gas and coal producers. Interior's formation of this committee is even subject to an ongoing court challenge. The committee, with little or no expert analysis, recommended reducing the 18.75% offshore royalty rate. That recommendation was then quickly rejected by then-Secretary of the Interior, Ryan Zinke. A final evaluation of this committee is premature until it completes its work. However, there are few signs that it will satisfy the GAO specification as an overall assessment of the oil and gas fiscal system.

The use of advisory committees is episodic and uneven instead of being a process that is continuous and consistent in the scope of analysis, with expertise and knowledge accumulating and improving as it proceeds over time. Further, the administrative staff of Interior typically staffs the episodic reviews through committees. That both interrupts the regular operation of the mineral management function, but also carries the risk of unconscious bias in favor of existing practice.

Thus, it would be better to develop a specific unit in Interior—an Office of Natural Resource Analysis—with the charge of developing a framework for evaluating natural resource revenue policies at three levels: as a whole in its entirety, in its major components and in specific details as needed. At the mid-level of analysis, the office would conduct regular and transparent studies of leasing and bid practices, royalty and rental rates, resource measurement practices, valuation policies and methods, and other natural resource revenue topics. On an established schedule, the office would also conduct a higher-level periodic assessment of the fiscal system as a whole, including the structure and level of royalties as compared to states and other governments. Again, as stated previously, narrow and detailed issues would be examined as they arise. Regardless of the stage or level of analysis, the office would ideally incorporate lessons learned from state experiences, with attention to keeping federal rates at least consistent with the middle range of state rates.

Part of a framework of evaluating natural resource policies will involve the development of consistent series of data and analytical tools that would be continuous but also improved over time. The objective would be to systematically accumulate and improve a body of knowledge and expertise on natural resource revenue policy. That would replace the current process that appears to jump from one episode or policy crisis to another using different tools and information at different times in a disorganized manner.

This office would be charged with working with the public in as open a manner as possible using advisory committees, public workshops and listening sessions and other methods of participation as appropriate. Standards and procedures need to be established to support

the independence and objectivity of this office and insulate it from criticism as being subject to undue influence of any kind. The transparency recommendations below would reinforce these efforts.

Congress also needs to strengthen its oversight of Interior's natural resource revenue policies. It should build its own independent capacity to evaluate these policies. It should establish a Joint Committee on Natural Resource Revenue to conduct studies of natural resource revenue laws, policies and administration. The structure, duties and operations of this new joint committee would be modeled after those of the Joint Committee on Taxation. The membership of the joint committee would be bipartisan and drawn from the U.S. Senate Energy and Natural Resources Committee and the U.S. House Natural Resources Committee. The joint committee's powers should extend to examining confidential records of returns, disputed cases and other matters necessary to evaluate the effectiveness of Interior's policies and practices.

Congress should also require an annual report on the natural resource revenue system from Interior. That report would be subject to public hearings by the respective House and Senate Committees. Whether Congress goes further and uses its increased capacity to delve more deeply into revenue issues cannot be guaranteed. However, the process would be improved if Congress would empower the public to engage more effectively in natural resource revenue issues.

Congress should serve the public by providing for greater transparency in royalty information. The American people who own the minerals on federal land are not informed of the amount of royalties they are paid on federal leases or the production amounts and values on which those royalties are based. By keeping this information secret, the public is effectively disenfranchised in the natural resource revenue process. In response to an international movement, the Extractive Industries Transparency Initiative, other nations are providing enhanced royalty and tax information to their citizens. As of today, U.S. citizens can discover how much U.S.-based companies have paid to the government of Nigeria in various taxes and royalties on a project level basis. However, U.S. citizens cannot have access to the same information about the same company payments to the U.S. or state governments on a project or lease basis. That is a disgrace that should be rectified.

Congress actually enacted a law—the bipartisan Cardin-Lugar provisions in the Dodd-Frank Act—requiring disclosure of royalty and lease payments on a detailed basis. It charged the Securities and Exchange Commission (SEC) with developing technical rules to implement that law. The SEC did so, largely only repeating the law itself and adding an administrative reporting process. However, as one the first actions by Congress in 2017, with the support of the new Administration, those largely ministerial rules were overridden by Congress. The law is still on the books, but the disapproval action under the Congressional Review Act now makes it virtually impossible for the SEC to implement it. The Trump Administration then followed this action with a formal removal of the U.S. from the Extractive Industries Transparency Initiative.

Congress should reverse this action and enact new legislation requiring reporting of governmental payments for resource extraction and production amounts and values on a lease-level basis. The public has a right to know what is being paid for the minerals they own and why. Without that information, the public is prevented from effectively participating in natural resource revenue decisions. The policy field is inevitably tilted in favor of oil and gas and other extraction companies to the detriment of the public interest.

Organizations interested in natural resource revenue policy should support this and other transparency measures on a priority basis. States should join in adopting their own improved transparency measures. The result would be to empower the public as the vital means to ensuring accountability by Interior for collecting the full and fair amount of royalties and other revenues for the American people.

Conclusion

For a hundred years, the federal government has shortchanged the American people, Indian tribes, and resource-dependent states and communities by failing to charge royalties at a rate that returns to the public full and fair value for the oil and gas deposits they own. Interior has neglected to evaluate and adjust royalty rates on a regular basis, even though they have an example set for them by state governments on how to do so.

Congress has provided insufficient and uneven oversight to federal minerals management. Worse yet, the federal government has kept secret from the American people information about what they are paid in revenues on each lease and the values and production used to calculate those revenues. The failure of Congress to conduct effective oversight and to provide the public with information necessary for effective participation in federal mineral policy discussions has contributed to the ongoing negligence that plagues the management of federal minerals.

Oil and gas production is rising to record levels in the United States, which means that if royalty rates are left the same, the public will lose even more of the revenue to which it is entitled. Past estimates of increased revenue from raising federal royalty rates are now likely too conservative. Rising production makes it all the more urgent that the federal government increase its rates to a level comparable to state rates.

Beyond that initial increase, the federal government needs to engage in a systematic process of evaluating and adjusting federal mineral revenue policies on regular, diligent and determined basis. Most importantly, Congress needs to welcome the American people into the discussion of federal mineral policies and empower the public to participate through transparent information on the operation and outcomes of current policies. All of this and more are necessary to achieve fiscal justice, accountability and transparency for the American people with respect to the minerals that they own.

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