NEW MEXICO VOICES FOR CHILDREN

POLICY BRIEF

November 2019
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Ensuring a Fair Share

Modernizing Federal Oil and Gas Revenue Policies

The Problem

We'd all love to be paying the same prices for food, housing, and other commodities that were being charged in 1920. But inflation, changes in technology, and other factors have driven prices up. Fortunately, the same influences have driven up our incomes and wages. And corporate profits have soared, too. But some things haven't changed – like what oil and natural gas producers pay for our natural resources. They are getting the deal of the century.

The oil and natural gas lying beneath our public lands belongs to us all. That's why we require oil and gas companies to pay rents and royalties for what they extract. New Mexico uses this revenue to fund schools, hospitals, and other public infrastructure.

Unfortunately, New Mexico's school children are not getting their fair share of oil and gas revenues. That's because the rental and royalty rates for drilling on federal lands are beyond outdated – some have not been revised in over a century. Over time, our state has lost out on billions of dollars that could have been used for teacher raises, school materials, and supporting student success in the classroom.

To add to this problem, companies are not required to put up enough money – called bonds – to cover clean-up costs in case of bankruptcy. But the bonding rates currently required are inadequate and have not been updated since the 1950s and '60s. When companies go bankrupt, a well becomes "orphaned" and the responsibility for the high cost to plug the well and restore and remediate the land around it falls instead on working New Mexicans. Orphaned wells that are not plugged can pollute the air, ground, and water.

By the Numbers

32% of our state's general fund is supported by oil and gas.

48% of oil and gas payments went towards New Mexico schools (2017-18).[1]

53% of oil production in New Mexico takes place on federal lands.

63% of natural gas production in New Mexico takes place on federal lands.[2]

New Mexico is now the **2nd** largest oil-producing state.

How it Works

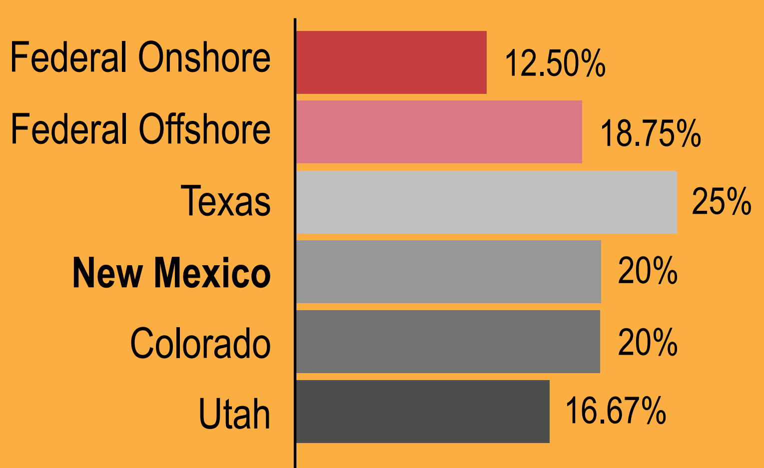
Oil and gas production can take place on federal, state, tribal, or private land. On federal land, New Mexicans are supposed to receive "fair market value for the use of the public lands and their resources," including use for oil and gas production.[3]

New Mexico determines how much is charged for oil and gas production on state public lands. But when it comes to oil and gas production on federal public lands, the rates are set by the Bureau of Land Management (BLM) within the Department of the Interior. The revenue that's collected through royalties, rental payments, and minimum lease bids is then split roughly 50/50 with the state.

The BLM's rates for these three forms of payment, however, are severely outdated, as are federal bonding rates. The royalty rate has not been updated in over a century, and the rental rate and minimum lease bids have not been updated in decades. Meanwhile, oil and gas production has grown tremendously in New Mexico while the cost of capping and cleaning up an orphaned well has increased. This is particularly problematic for New Mexico because the state has the highest share in the nation of oil and natural gas production on federal lands, so we are losing out the most from the BLM's outdated policies.

The result of these policies is that the federal royalty rate is lower than New Mexico's rates on state land, as well as the rates charged by surrounding states. That's because many western states have strengthened their own fiscal policies to give a fair deal to their residents. In New Mexico, the royalty rate for production on state lands is as high as 20%.The BLM rate is just 12.5% for production on federal lands – even lower than the federal offshore rate.

Federal and State Royalty Rates



What the Federal Rates Cover

Royalties – a share of the production value of the oil or gas extracted: **12.5%** (onshore rate)

*Last updated: **1920***

Rentals – the annual, per-acre fee paid for leasing the land for production: **$1.50/acre** for first 5 years, **$2.00/acre** for next 5 years

*Last updated: **1987***

Minimum Lease Bids – minimum acceptable bid to lease federal land for oil and gas extraction: **$2.00/acre**

*Last updated: **1987***

Bonds – funding required to be set aside to cover clean-up costs in case of bankruptcy. Rates are: **$10,000/individual** lease, **$25,000/statewide** lease, **$150,000/all nationwide** leases

*Last updated: **1951** (statewide, nationwide leases), **1960** (individual lease)*

Impact on Revenue and Production

Oil production from federal leases in New Mexico has boomed with a cumulative total of 554 billion barrels sold between fiscal year 2009 (FY09) and FY18, making New Mexico the largest producer of oil from federal lands. Over the same time frame, 8 trillion cubic feet of natural gas was produced from federal lands in New Mexico – more than from any other state except Wyoming.

While this production has resulted in substantial revenue for the state, New Mexico has lost out on billions of dollars of additional revenue due to BLM's outdated rates. If the prevailing federal offshore rate of 18.75% had been imposed between FY09 and FY18, for example, New Mexico would have received $2.5 billion more in revenue. That's funding that could have been used in our classrooms and put toward critical community investments. Similarly, if rental rates had been annually adjusted for inflation, New Mexico could have benefited from an additional $9-$10 million.[4]

Updating the rates is smart policy, and there is no evidence to suggest that doing so would significantly impact oil and gas production. In fact, independent analyses by the Government Accountability Office and the Congressional Budget Office have both determined that revised rates could increase revenues up to $90 million per year, while having a minimal impact on production. Officials in Colorado and Texas have said that raising the royalty rates for oil and gas production on state lands did not have a significant effect on production. This is despite the fact that Colorado increased its rate most recently from 16.67% to 20%.[5]

When production levels do fluctuate, it's usually because there are a number of physical and technical factors, as well as broader market forces that influence whether companies decide to produce oil and gas, and not the prevailing royalty and rental rates. Global oil and gas prices are the largest influencer of production levels. Other factors include the likelihood of finding oil or gas at a certain location, how much is available if it is found, the estimated extraction costs, and the cost of capital.[6]

The Solution

As the BLM resumes leasing federal lands for oil and gas production, it's urgent that the agency update its rates. Our children are paying the price for the BLM's inaction, and New Mexicans should get a fair return for the natural resources that belong to ALL of us.

Recommendations

- Increase current minimums:
    1. Royalty rates from 12.5% to 20%
    2. Rental rates from $1.50-$2.00/acre to $3.00-$5.00/acre
    3. Lease bids from $2.00/acre to $10.00/acre
    4. Bonding rates from $10,000/individual lease, $25,000/statewide, $150,000 nationwide to $150,000/individual and $500,000 statewide, while eliminating nationwide bonds
- Adjust periodically to ensure that we are receiving our fair share as mandated under federal law.

1 *State and Local Revenue Impacts of the Oil and Gas Industry*, New Mexico Tax Research Institute, January 2019
2 *New Mexico: A Comparative Analysis*, report, Moss Adams, 2019
3 43 U.S.C. § 1701(a)(9)
4 "New Mexico's Boom that Cost Billions: How Federal Oil & Gas Policies Fail Taxpayers," fact sheet, Taxpayers for Common Sense, 2019
5 *Oil, Gas, and Coal Royalties: Raising Federal Fates Could Decrease Production on Federal Lands but Increase Federal Revenue*, report, U.S. Government Accountability Office, June 2017
6 *Options for Increasing Federal Income from Crude Oil and Natural Gas on Federal Lands*, report, Congressional Budget Office, April 2016

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