Conservation Economics Institute

Comments on BLM's Advanced Notice of Proposed Oil and Gas Rulemaking

Pete Morton, Ph.D. [1,2]
Joe Kerkvliet, Ph.D.
Evan Hjerpe, Ph.D.

Executive Summary

The Bureau of Land Management (BLM) recently sought public comments on regulations guiding oil and gas development on public lands. Specifically, the BLM is considering updating the following economic instruments as they relate to onshore federal leasing for oil and gas production: royalty rates, annual rental payments, minimum acceptable bids, bonding requirements, and civil penalty assessments. This rulemaking (BLM-2015-0002-0016) has broad economic implications and could add much needed economic improvements to federal oil and gas development. As such, the Conservation Economics Institute (CEI) (conservationecon.org) has provided the BLM with numerous regulatory suggestions for capturing and offsetting costs of oil and gas development. We strongly believe that the regulatory structure of the BLM's oil and gas program needs to be updated to be more responsible for protecting the environment and taxpayers. We therefore heartily applaud and support the BLM's rule making process and encourage them to make full use of the public comments solicited.

This document summarizes our economics research and comments submitted to the BLM in June, 2015. We first illustrate why the BLM's current economic policy tools covering oil and gas development are not working. We provide suggestions for improving these tools and suggest four broad economic analyses that would help quantify how much oil and gas revenue is needed to be invested by the BLM to achieve an environmentally and fiscally responsible program. In 2016 we will be publishing a book on redefining responsible oil and gas that incorporates our comments. In the meantime, as part of our public service work, we are providing our comments for the public to use (conservationecon.org/#!og/kl7ht). If you would like the full comments, please contact us.

<u>BLM's Current Economic Instruments are Inadequate for Covering the Costs of Oil and Gas</u>
The BLM has goals of developing and implementing an environmentally and fiscally responsible oil and gas program. To achieve these goals, the BLM must invest a higher rate of oil and gas receipts into programs used to offset environmental costs and improve fiscal management. Unfortunately, the BLM's current implementation of economic instruments is inadequate for achieving these goals and must be updated for several reasons. One – royalty rates need to increase in order to internalize the negative externalities (non-market costs) from oil and gas production. Two – a greater percentage of oil and gas revenue must be captured in order to invest in better management tools and applied science to manage risk. Three –BLM and state agencies need to allocate a higher percentage of royalties to staffing and administration for responsible oil and gas development.

The BLM is required by law to fully consider the social and environmental costs of oil and gas exploration, production, and remediation. Economists refer to the hidden non-market costs that spillover into communities and our environment from oil and gas production as "negative externalities". The polluter pays principle (PPP) is a

[1] Primary Contact is Pete Morton, Ph.D. pete@conservationecon.org
[2] Senior Economist, Conservation Economics Institute, Professor Applied Economics, Oregon State University, Executive Director, Conservation Economics Institute.

basic economic concept for internalizing negative externalities into oil and gas production and consumption decisions. Economic instruments like royalty rates, assurance bonding, fines and penalties are examples of the tools available for implementing PPP. We recommend the BLM quantify the social and environmental costs including carbon and methane pollution, associated with the BLM's oil and gas program to provide guidance on upward adjustments to royalty rates and bonding amounts.

BLM's current economic policy concerning oil and gas development is not only insufficient at offsetting environmental costs, it is also does not allocate enough revenue needed to increase the tools, information, and applied science available to the BLM, local communities, and partner agencies in order to implement the highest level of environmentally responsible oil and gas development. The BLM proposed rule must recognize the need for capturing a higher percentage of revenues from royalty rates, in order to invest in applied research to generate critical information for managing risk, making informed decisions and accomplishing the stated goals. The lack of past investment in data collection, monitoring, and applied science has weakened the BLM's ability to accomplish its stated goal of environmentally and fiscally responsible oil and gas development. Likewise, an environmentally responsible oil and gas program requires sufficient funding for baseline data collection and monitoring; adaptive management based on applied scientific information, and trained biologists, ecologists and environmental protection staff to implement. Based on numerous investigations we know that the BLM does not have the information, staffing or budget to actually implement environmentally responsible oil and gas development.

BLM Must Invest in Tools and Better Information to Accomplish Agency Goals

We agree with the BLM on the need for more tools and recommend four macro-level tools. The information generated from investing in these four macro-level tools is critical for developing a solid economic rationale for the proposed rulemaking and for successfully implementing environmentally responsible oil and gas development on public land. Without quantifying the total costs of oil and gas production, the BLM has no idea how much oil and gas revenue is needed to be reinvested into administering a responsible oil and gas program.

1) Programmatic Environmental Impact Statement (PEIS)

The direct, indirect and cumulative effects of the decade long domestic drilling boom must be examined through a comprehensive PEIS, much as the agencies have proceeded with other large-scale energy development initiatives. We strongly recommend that the Obama Administration immediately complete a PEIS for the BLM's oil and gas program. Having an up-to-date Programmatic EIS is a prerequisite for implementing environmentally responsible oil and gas.

2) Benefit-Cost Analysis using a Total Economic Valuation Framework

A Total Economic Value (TEV) perspective has been used to evaluate the benefits of wilderness, roadless areas, and clean groundwater and is appropriate for evaluating and internalizing the negative externalities from oil and gas development. When the BLM ignores negative externalities and relies exclusively on measures of value based on the market prices of oil and gas, its economic analyses are incomplete. To correct this error, we recommend that the BLM complete a benefit cost analysis and fully assess the non-market costs associated with its oil and gas program by using a Total Economic Valuation Framework for the analysis. Strategically, the BLM already has provided guidance to consider nonmarket environmental values in a benefit cost analysis. And conducting a benefit cost analysis is mandated by the Obama Administration's Executive Order 13563.[3]

3) Budget Analysis

Historical evidence indicates significant budget shortfalls have prevented the BLM from fully implementing and keeping the promises and environmental commitments made in past management plans. In order to address this problem, we recommend the BLM estimate the fully funded budgets necessary for successfully implementing responsible oil and gas development and comparing them with historic budgets. Comparing fully funded budgets with historic budgets provides an estimate of the additional revenue that must be captured in order to implement an environmentally responsible oil and gas program. The revenue estimates can be used to help derive, along with estimates of externalities, the necessary increases in royalty rates and bonding amounts.

[3] Executive Order 13563, "Improving Regulations and Regulatory Review," 76 Federal Register 3821, January 21, 2011

4) Net Fiscal Impact Statement.

A Net Fiscal Impact Statement (NFIS) involves collecting and analyzing data on the fiscal costs and revenue from a program. Revenue from the oil and gas program is compared to the cost of administering the program. While the BLM has a goal of fiscal responsibility, we are not aware of the Federal government ever completing a NFIS for domestic oil and gas development. Conventional wisdom assumes the fiscal impacts are positive because of the millions in revenue reported. But the revenue reports are only gross revenues. Generating oil and gas revenues is not a cost free endeavor.

What has been missing from the economic conversation and fiscal calculus are the costs to taxpayers associated with collecting the gross revenue (i.e. administration, proper oversight, frequent inspections, increased road maintenance costs, etc.). We recommend the BLM prepare a detailed NFIS in order to evaluate the fiscal responsibility of its oil and gas program. Requiring a NFIS of the BLM oil and gas program is entirely consistent Colorado bill HB 1057 – recently endorsed by the oil and gas industry and signed into law by Governor Hickenlooper – which requires fiscal impact statements of citizen initiatives calling for a moratorium on fracking.

Additional Recommendations

- Increase royalty rates to 25% to implement an implicit carbon-methane pollution tax and to provide revenue to fund an oil and gas program that achieves a high level of environmental responsibility.

- Eliminate state-wide and nation-wide bonding and instead implement site specific bonding with bond amounts equal to the estimated reclamation costs of each site.

- Estimate the volume of oil and gas underneath public land that can be extracted economically over a wide range of prices.

- Explore the advantages of establishing minimum bids for a lease based on estimates of the economically recoverable oil and gas involved in that lease.

- Eliminate below cost lease sales.

- Eliminate lease sales where the public costs are greater than the public good.

- Utilize sealed bidding at lease auctions. Sealed bidding is efficient for establishing fair market value and lessening gaming of the system – reducing the frequency of non-competitive lease sales.

- Implement a user fee to compensate future generations for their inability to use the fossil fuels consumed. The revenue from a user fee should be invested in an “untouchable” fund. Earnings from the fund would go to future generations.

- Abandon proposals to adjust royalty rates on a sliding scale based on changes in the oil and gas market. Adjusting royalty rates downward will cause agency budgets to fluctuate - leading to cuts in environmental programs when prices drop.

Closing Thoughts

The BLM must focus on land stewardship and investing sufficient revenue to implement responsible oil and gas development on Federal public land. Currently, the BLM is not allocating enough oil and gas revenue to cover environmental and social costs of production. This represents a large taxpayer-funded subsidy to oil and gas producers. The BLM must consider the total economic values and damages associated with its leasing of federal lands for oil and gas production. For example, storing tons of carbon and methane in the ground would produce annual benefits measured in the millions of dollars. This is just one of the many non-market social and environmental benefits generated annually by removing land from oil and gas leasing that must be accounted for in BLM decision-making and economic analysis.