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INFORMED BUDGETEER

OIL AND GAS LEASING ON THE OCS

The spike in energy prices over the last 2½ years has reenergized a debate in Congress about U.S. production of oil and gas and the role of exploration in federal waters offshore on the Outer Continental Shelf (OCS). The Deep Ocean Energy Resources Act (H.R. 4761) passed the House of Representatives on June 29, 2006, by a vote of 232 to 187. One month later, on August 1, 2006, the Senate passed its own version, the Gulf of Mexico Energy Security Act (S. 3711), by a vote of 71 to 25.

Currently, the two houses remain stymied in pre-conference discussions. The Senate maintains that its bill represents a delicate compromise and that changing it in conference would spawn a filibuster. The House holds that it needs a more comprehensive bill, more like its own version, because the Senate bill does not do enough to open new areas to leasing.

Since the 1980s, oil and gas leasing has not been allowed on most of the OCS. Since 1982, Congress has enacted in the annual appropriation bill that funds the Department of Interior (including the Minerals Management Service (MMS) which conducts the OCS leasing program) provisions prohibiting MMS from conducting leasing activity on various areas of the OCS (aka leasing moratoria). As a result, since the early 1980s, new leasing activity has occurred only in the Gulf of Mexico (but not near Florida) and parts of Alaska. Additionally, a presidential executive order in 1998 prohibits offshore leasing in areas covered by the annual legislative moratoria until 2012.

New OCS Areas Opened to Leasing. The Senate OCS bill focuses narrowly on the Gulf of Mexico region. Under S. 3711, the MMS would offer to lease an area that is already eligible to be leased (i.e. not prohibited by moratoria) but only part of which is included in MMS' most recent draft lease plan covering 2007 - 2012. This area is referred to as Lease 181 because that was the lease sale held there in 2001. In addition, the Senate bill would direct the MMS to conduct a lease sale in the area south of the 181 area (hence the designation "Lease 181 South"), which is currently prohibited from leasing by moratoria.

The House OCS bill would amend the leasing moratoria that currently applies to most of the OCS: for areas within 50 miles of the shore, leasing would continue to be prohibited unless a state requests that area to be opened; for areas between 50 and 100 miles of the shore, leasing would be allowed, and a state would have to petition to have an area withdrawn; for areas more than 100 miles from the shore, the leasing moratoria would no longer apply.

While much of the debate surrounding this legislation focuses on which offshore areas to open to leasing, another significant issue exists: whether federal receipts from OCS leasing should be shared with coastal states and how much that would cost the U.S. Treasury. Under current law, all receipts generated from oil and gas leasing (i.e. rents, royalties and bonus bids) on the OCS beyond state waters belong to the federal taxpayers. Both S. 3711 and H.R. 4761 would shift significant shares of OCS receipts from the Treasury to coastal states.

Revenue Sharing Schemes Affect Budget. Both bills would increase OCS receipts over the next 10 years. (OCS receipts are classified as offsetting receipts on the spending side of the budget (aka negative direct/mandatory spending), because they result from a voluntary business relationship the federal government has with the private sector. This is why they are not revenues or taxes - because OCS receipts are not involuntary payments compelled by the federal government's sovereign power.) But CBO's 10-year cost estimates (see table below), however, mask losses that would occur to the Treasury over the long term.

Senate Bill. Beginning in 2007, S. 3711 would direct the MMS to begin leasing in the expanded area of the Gulf that, under current law, is not expected to be leased. The bill, however, would redirect half of the receipts from these new leases away from the Treasury. Under the bill, 37.5 percent of the receipts would go to the coastal states where OCS production currently occurs in the Gulf of Mexico: Alabama, Louisiana, Mississippi, and Texas. Another 12.5 percent of receipts would go out as new mandatory spending from the Land and Water Conservation Fund (LWCF).

Beginning in 2017 (which, not coincidentally, is outside of the window for enforcing most budget points of order), however, the budgetary hit to the Treasury and the federal taxpayers would expand. Receipts from leases in the new areas as well as receipts from leases in areas already part of MMS' existing lease plan would be diverted, at the same rate of 37.5 percent to the Gulf states and 12.5 percent to LWCF. Instead of receiving 100 percent of all OCS receipts, as would be done under current law, the Treasury would only see 50 percent.

S. 3711 also includes a spending cap to control the total amount of receipts being diverted to the states and LWCF and to limit the losses to the Treasury. Beginning in 2016, annual outlays cannot exceed $500 million, which in turn keeps total outlays in any 10-year period under $5 billion (abiding by the Senate's long-term spending point of order).

Comparison of Budgetary Impacts of S. 3711 and H.R. 4761

By Fiscal Year, In Billions of Dollars
Changes in Federal Outlays

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-2011	2007-2016
S. 3711 - Major Provisions												
Receipts from Leasing New OCS Areas	0	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.3	-0.4	-0.5	-1.6
Payments of OCS Receipts to States and from LWCF	0	0.1	0.1	*	0.1	0.1	*	0.1	0.1	0.1	0.3	0.7
S. 3711 Total Changes	**0**	**-0.1**	**0.1**	**-0.1**	*****	*****	**-0.1**	**-0.1**	**-0.2**	**-0.2**	**-0.2**	**-0.9**
H.R. 4761 - Major Provisions												
Receipts from Leasing New OCS Areas	-0.2	*	-0.2	-0.5	-0.3	-0.3	-0.5	-0.6	-0.7	-0.8	-1.2	-4.0
Payments of OCS Receipts to States	0.5	0.7	1.1	1.0	1.5	1.7	2.0	2.7	3.2	3.6	4.8	18.0
Fee to Adjust for Past Royalty Relief	0.0	-1.0	-1.0	-1.1	-1.4	-1.3	-1.4	-1.9	-2.1	-1.9	-4.6	-13.0
Repeal of Existing OCS Receipt Sharing Programs	-0.3	-0.3	-0.3	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-1.4	-2.0
H.R. 4761 Total Changes	**-0.1**	**-0.6**	**-0.4**	**-0.9**	**-0.4**	**0.1**	**0.1**	**0.1**	**0.4**	**0.7**	**-2.3**	**-0.9**

Source: Congressional Budget Office (CBO)

Notes:

1.) Minus (-) sign means decrease in outlays and decrease in deficit; plus (+) sign means increase in outlays and increase in deficit.

2.) For more detailed information, go to http://www.cbo.gov/ftpdocs/74xx/doc7423/s3711Ltr.pdf and http://www.cbo.gov/ftpdocs/73xx/doc7350/hr4761amen.pdf for complete CBO cost estimates of S. 3711 and H.R. 4761, respectively.

3.) * means between -$50 million and $50 million.

House Bill. In contrast, H.R. 4761 would immediately provide states with a share of OCS receipts from all existing and new leases throughout the OCS, not just the Gulf of Mexico. The House plan includes both phased-in receipt sharing as well as immediate sharing, depending on the location and timing of the lease. H.R. 4761 would not redirect any receipts to LWCF.

The House bill, unlike the Senate bill, includes new fees to address the issue of royalty relief and the lack of price thresholds that would suspend such relief in certain existing leases. While these fees are estimated to bring $13 billion to the Treasury over the next 10 years, this savings would not offset the $18 billion in receipts the Treasury would lose and pay to coastal states as a result of the House bill.

Finally, H.R. 4761 does not include a cap on new spending to states. As a result, beyond the 10-year budget window, the picture only gets worse, with the federal government losing out on an even greater amount of OCS receipts. While CBO has not prepared an estimate for years after 2016, in the last year of the budget window, $3.6 billion would be paid to coastal states.

HIGHER ENERGY PRICES AND THE ECONOMY

While the global economy has experienced a dramatic rise in energy prices over the past few years, this increase has not – contrary to many expectations – resulted in significant problems for the overall U.S. economy. In aggregate, the effects on the nation's economic output (gross domestic product – GDP), employment, and inflation have thus far been surprisingly moderate.

These conclusions, as well as some observations about why the U.S. has not suffered sudden inflation and recession like it did during the oil crises of the 1970s, are provided by the Congressional Budget Office (CBO) in its July 2006 paper entitled "The Economic Effects of Recent Increases in Energy Prices" (http://www.cbo.gov/ftpdocs/74xx/doc7420/07-21-Energy%20DIST.pdf).

Energy Price Run-up Has Effects … Since late 2003, the price of crude oil has doubled, and retail gasoline prices have risen by 87 percent. While the price of crude oil has fallen from its recent high of $77 a barrel, the consensus forecast does not expect the price to fall significantly. Worldwide demand for crude oil continues to grow, while today's worldwide supply is close to its limits for what can be pumped out of the ground in the short term.

CBO estimates that GDP in 2006 is probably about 1 percent lower than it would have been if energy prices had not risen over the past 2½ years. In 2005, the consumer price index was about 3 percent, with more than 1 percent of that attributable to the rise in energy prices. Excluding energy prices, however, consumer price inflation appears to only have been slightly higher than it would have been otherwise, so even if energy prices remain at current levels, the inflation rate will likely fall back to 2 percent by the end of 2007.

Household income and spending have experienced the direct impact from the recent increase in energy prices. The growth of real hourly compensation slowed, while the average household's annual spending on energy goods and services increased by almost 45 percent or about $1,600 between 2003 and mid-2006. Instead of spending less to help compensate for the greater share of their paycheck needed for energy-related commodities, households have been saving less.

Corporations have been less affected by the increase in energy prices. Preliminary data indicate that corporations' total economic profits (relative to GDP) rose to a 40-year high at the beginning of 2006. Energy-consuming businesses appear to have maintained profit growth by passing most of the higher energy costs on to their customers and by keeping labor costs from rising with inflation.

Over the long term, CBO predicts a slightly lower level of economic output than what would have occurred without the energy price increase. The evidence suggests, however, that higher energy prices do not permanently reduce productivity; they simply cause temporary productivity losses while firms reallocate resources to adjust (though those temporary losses are not made up in subsequent years). Increased energy prices will not permanently increase the inflation rate, since the Federal Reserve's monetary policy decisions have much more of an effect on the rate of inflation. Finally, the U.S. standard of living will remain lower to a greater extent than will GDP. Why? GDP does not take into account how much of their production U.S. residents have to trade for imports, while standard of living does. Since the United States imports a substantial share of the energy it consumes, the standard of living measure remains lower to account for this fact.

But Today's Impacts Are Not As Bad As The Past Because … In contrast to the oil crises in the 1970s when the U.S. economy slowed dramatically, today's economy continues to hum even with the weight of higher energy prices. CBO offers three "levels" of possible, interrelated explanations.

First, U.S. consumers and businesses have more confidence in the economy, and they continue to spend and invest. Today, households are more willing and able to maintain spending, fueled in part by the increase in housing wealth and the ability to borrow. In addition, business investment has soared over the past 2 ½ years as a result of high demand for goods and services caused by low capital stock levels in 2003. Consumers and businesses also possess confidence in the Federal Reserve and its ability to control inflation and fight recession.

Second, monetary policy responses have evolved. Inflation was already high before both of the oil price increases in the 1970s. When the oil price shocks hit in 1973 and 1979, the Federal Reserve acted quickly to rein in additional inflation. CBO suggests the Federal Reserve's abrupt tightening is the primary reason for the subsequent recessions. Learning from these experiences and realizing that a one-time increase in inflation can quickly spiral into a higher inflation rate for some period of time, the Federal Reserve is now more likely to adjust interest rates incrementally in order to keep inflation low.

Third, the 21st Century U.S. economy is more resilient than the economy of the 1970s for several reasons. In the 1970s, many U.S. industries were regulated by the government. Since then, much of that regulation has been removed, which leaves these industries more agile. Additionally, today's companies are more responsive to changes in relative prices because of the growth of international trade and information technology and the new environment of global competition. Companies must adapt, or else they will no longer be in business. Energy markets have also changed, in order to help petroleum sellers and buyers manage uncertainty. Finally, developments in financial markets and institutions have occurred. Recent financial innovations provide businesses an alternative to bank lending and give individuals greater access to credit. Between these innovations and the decrease in financial regulation, the financial system has become more resilient, spread the risk of default more widely and efficiently, and created an economy that is better prepared to adjust to energy price increases.