CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Peter R. Orszag, Director

September 9, 2008

Honorable Nick J. Rahall II
Chairman
Committee on Natural Resources
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman,

You asked for information about the budgetary implications of a recent administrative action and potential legislative changes in policies governing the leasing of oil and gas resources on the Outer Continental Shelf (OCS). In particular, now that the President has removed previous restrictions on leasing in areas off the Atlantic and Pacific coasts, you asked how CBO would estimate the budgetary impact of legislative proposals that would authorize the spending of some of the receipts from future leasing or that would impose a permanent restriction on leasing in certain OCS areas. This letter identifies the key factors governing estimates under current law and of potential legislation.

Framework for Estimating OCS Receipts

The federal government leases areas for the potential development of oil and gas resources in the OCS in exchange for certain payments from the companies that obtain those leases. Such payments generally take three forms: A bonus bid payment when a company acquires a lease, an annual rental payment on the leased acreage prior to production, and annual royalties based on the value of any production.

CBO projects the amount of offsetting receipts (a credit against direct spending) from future bonus and rental payments based on information regarding the areas that could be leased under current law over the next 10 years. We also estimate total royalty payments based on the likelihood and extent of resource production in that 10-year period. Production and the resulting payments of royalties typically begin several years after the issuance of a lease because of the time needed to prepare exploration and development plans and bring any discovered oil or gas resources into production.

In most years, royalties generally dominate total federal receipts from OCS leasing. In fiscal year 2007, for example, the federal government collected $6.8 billion in OCS receipts, of which $6.1 billion was derived from royalty payments.[1] The bulk of such royalties were for leases entered into during the 1980s and 1990s.

CBO's baseline projections reflect the statutory terms and conditions governing OCS leasing at the time that we prepare our projections. Under current law, the Minerals Management Service (MMS) at the Department of the Interior (DOI) is authorized to lease areas of the OCS, subject to certain geographic and procedural restrictions. For example, the authorizing statutes for the OCS:

- Require MMS to develop a five-year plan and schedule for lease sales based on various criteria and procedures, including consultation with industry and affected states (43 USC 1344);

- Prohibit leasing in certain areas in the Eastern and Central Gulf of Mexico until 2022 (the Gulf of Mexico Energy Security Act of 2006 [GOMESA], Public Law109-342);

- Allow the President to withdraw lands from the leasing program (43 USC 1341(a)); and

- Subject MMS leasing decisions to review for consistency with state Coastal Zone Management Plans.

Finally, annual appropriation acts for several years, including fiscal year 2008, have included restrictions on the use of funds for various leasing activities. For example, the Consolidated Appropriations Act for 2008 states that none

1. That total excludes additional payments of some royalties "in kind," paid in the form of oil used to help fill the Strategic Petroleum Reserve.

of the money provided by that act may be used by DOI "for the conduct of offshore preleasing, leasing and related activities" in areas off the Atlantic and Pacific coasts and certain portions of the Eastern Gulf of Mexico. Because that provision does not apply to future years, however, CBO's projection of future OCS receipts assumes that the restriction expires at the end of the fiscal year.

Collection and Spending of OCS Receipts Under Current Law

Existing law directs MMS to deposit proceeds from OCS leases in the Treasury as offsetting receipts, subject to certain revenue-sharing provisions. States adjacent to federal waters receive 27 percent of the proceeds from leases issued within an area known as the "8(g)" zone (43 USC 1337(g)), which is generally the first three nautical miles of federal water, except for Texas and Florida, where that zone extends for nine nautical miles.

States bordering federal waters in the Gulf of Mexico are entitled to additional amounts under GOMESA, which awarded such states 50 percent of the proceeds from two designated areas and, starting in 2018, 50 percent of the receipts from leases issued after 2006 in the Central and Western planning areas in the Gulf of Mexico, subject to an aggregate limit of $500 million a year. In addition, the Energy Policy Act of 2005 authorized direct spending of $250 million for each of fiscal years 2007 through 2010 for coastal impact assistance for certain states.

Recent Changes in the Geographic Scope OCS Leasing Activity

The geographic scope of future OCS leasing activity primarily depends on the terms of any Presidential withdrawals and the restrictions in GOMESA. Large portions of the OCS off the Pacific, Atlantic, and Florida coasts were withdrawn by President George H.W. Bush in 1990, and those withdrawals were subsequently expanded and extended by President Clinton through June 30, 2012. CBO's March 2008 baseline did not include any proceeds from areas off the Atlantic and Pacific Coasts because those areas were administratively withdrawn from leasing under current law.

On July 14, 2008, President George W. Bush narrowed the scope of the Presidential withdrawal to include only areas designated as National Marine Sanctuaries. With this change, MMS will be authorized starting in fiscal year 2009 to conduct leasing activities in all areas other than those covered by GOMESA or located within a marine sanctuary, subject to statutory procedural requirements.

Taking into account a wide range of potential leasing results under current law, CBO estimates that OCS receipts will increase by about $2 billion over the 2009-2018 period as a result of the recent administrative action. That estimate is a probability-weighted average of potential results, taking into consideration that leasing in some areas may be inconsistent with coastal zone management plans or may be affected by other legal or policy actions. Such additional leasing on the OCS under current law could yield significantly more or less than $2 billion depending on the resource value of acreage offered by MMS through 2018.

The bulk of the estimated increase in receipts under current law would come from bonuses, and those would be received primarily in the second half of the 10-year period. A small amount of additional rental payments would accrue to the Treasury, with little or no additional royalty payments during the next 10 years.

Because most of the oil and gas resources off the Atlantic coast are well beyond the statutorily defined 8(g) zone, CBO anticipates that the proceeds from those areas resulting from the President's July 14 order would not be shared with states under current law. Some revenue sharing under 8(g) could occur off the Pacific coast, however.

Budgetary Implications of Legislation Regarding OCS Leasing

In your August 7 letter, you inquired about the budgetary impact of legislative provisions that would:

(1) Require the sharing of future lease receipts with affected states (or otherwise provide for the spending some of those receipts), or

(2) Impose permanent restrictions on leasing in certain areas.

Sharing a portion of OCS receipts (that otherwise would be deposited in the Treasury) with states would reduce net collections by the federal government, thereby increasing net direct spending. Imposing a permanent restriction on leasing in certain off-shore areas could reduce receipts (thus, increasing net direct spending), depending on whether the restricted acreage is likely to be leased under current law. Conversely, legislation that increased the OCS acreage that is available for leasing could generate additional offsetting receipts; the net gain to the government would depend on whether any of those additional receipts would be shared with states or spent for some other purpose.

I hope this information is useful to you. If you have further questions on this subject, the CBO staff contact is Kathleen Gramp.

Sincerely,

Peter R. Orszag
Director

cc: Honorable Don Young
Ranking Republican Member

Identical letters sent to the Honorable Peter A. DeFazio and the Honorable George Miller.