TAXPAYERS for COMMON SENSE

ISSUE BRIEF

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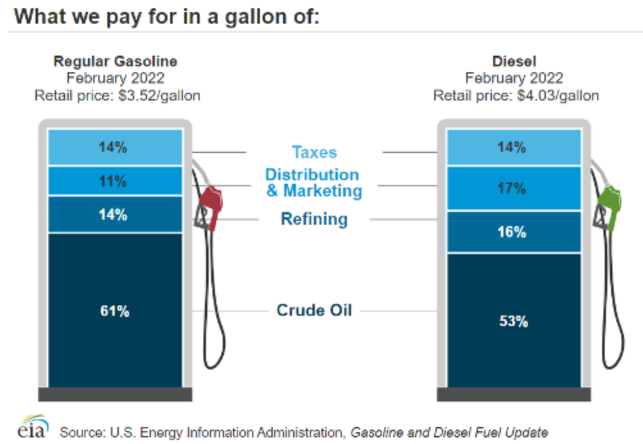
# Understanding Gas Prices & Why We Need Federal Oil and Gas Reform

With prices at the pump reaching peaks not seen in more than a decade, many Americans are feeling the pinch, and elected representatives are eager to take action to help. Public policy changes can shape markets in the long-term, but the price of gas is determined by the balance of supply and demand, even more than most products we buy. In fact, the federal government has few options to affect gas prices that would not jeopardize the foundation of our market-driven economy and create problems down the road.

In contrast, **the oil and gas industry's production decisions directly affect oil supply and the price of gas**. Despite high prices, U.S. oil production has remained essentially flat since November 2021. Executives of many oil and gas companies have said they are intentionally not increasing production out of pressure from their investors or that they cannot increase production because of limited access to federal lands. But companies are choosing to limit production and keep the price of oil high so they can have more capital to return to their shareholders, while advocating for more support from taxpayers.

- In 2021, the **top 6 multinational oil and gas companies** reported **$90.4 billion in profits**.
- In 2021, the **top 20 U.S. oil and gas drillers** reported combined **profits of $73.6 billion**, led by Exxon Mobil with $23 billion and Chevron with $15.6 billion.
- In a recent Federal Reserve Bank of Dallas survey, **3 out of 5 oil executives said they were restraining growth** because of investor pressure.
- In the last six months, the top U.S. drillers announced their intent to funnel recent gains to investors through stock buybacks and special dividends. Exxon Mobil and Chevron will spend up to **$10 billion each on stock buybacks in 2022**. Devon Energy, EOG Resources, and Pioneer Natural Resources announced special cash dividends **worth up $4.2 billion combined.**
- Oil and gas interests were **sitting on 11,600 non-producing leases** covering **9.6 million acres of federal land** at the end of 2021, and **8,800 unused but approved permits to drill** at the end of February 2022.
- Federal **subsidies to the oil and gas industry cost taxpayers more than $5 billion every year**, including $1.7 billion from outdated policies for leasing federal land. Ending those subsidies would bring in significant revenue to taxpayers without raising gas prices.

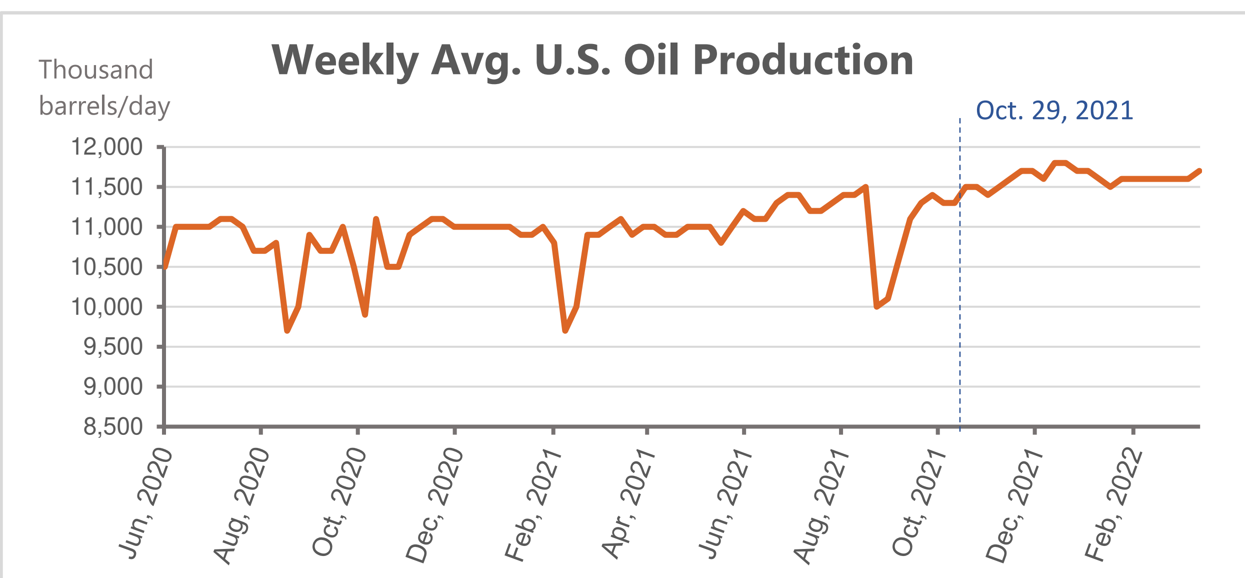
## Gas prices – the basics




The price of gasoline is determined by countless domestic and international factors. The most dominant of these is the price of crude oil, which is determined in the global market by forces like economic activity driving oil demand, Organization of the Petroleum Exporting Countries (OPEC) production agreements, geopolitical events in high producing regions, and even the [strength of the U.S. dollar](), which is used for all oil transactions around the globe.

In 2021, crude oil benchmark prices began climbing as demand from economies around the world recovering from COVID-19 shocks increased. Meanwhile, low oil inventories limited how much of that demand could be immediately met. In early 2022, crude oil spot prices rose further as buyers began to shift away from Russian oil markets. For example, the United States, the U.K. and other countries announced bans or limits on the amount of Russian oil that could be imported. This increased the demand for non-Russian oil at a time when inventories were still low, pushing prices up.

Increasing the supply of non-Russian oil would minimally help lower the price of oil and gas at the pump. U.S. producers contribute a little over one-fifth of all non-Russian oil, but they've demonstrated little urgency to increase production despite high prices for their product. In late October 2021, the world benchmark price for oil reached $80/barrel for the first time since October 2014. That's more than what companies say they need to turn a profit from drilling a new well. But since late October 2021, weekly average oil production has only increased 2.6% (see chart). If companies operating in the US decided to increase production, it would marginally help drive down the prices of oil and gasoline. **There's no barrier to oil companies expanding production; they simply are choosing not to so they can reward their investors.**



## Oil and gas companies protect investors, not taxpayers

Since the beginning of 2022, industry analysts and executives from oil and gas companies like Pioneer Natural Resources, PDC Energy, and Occidental Petroleum have all acknowledged the industry is intentionally restraining their investment in new production.

Some hesitancy may reflect lessons learned from past boom and bust cycles, but oil prices are far above what companies say they need to drill a well profitably ($50-$70/barrel). In a recent Federal Reserve Bank of Dallas survey, nearly a third of oil company executives said no price would be high enough to get them back into “growth mode.” In the same survey, 3 out of 5 executives said they were restraining growth because of investor pressure.

That pressure seems to be working. Instead of immediately investing more in new wells, many oil and gas companies are using their huge profits in recent months to boost their stock price or share more of it with investors through special dividends.

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In 2021, the top 20 U.S. oil and gas drillers reported combined profits of $73.6 billion. That’s roughly triple what the same companies reported for 2019. When reporting their results for Q3 and Q4 2021, many companies announced new programs to distribute their windfall revenue from high prices to their investors. Exxon Mobil and Chevron corporations announced their intent to spend up to $10 billion each buying up their own common stock to boost its value to shareholders. Devon Energy, EOG Resources, and Pioneer Natural Resources announced they would distribute Q3 and Q4 earnings through special cash dividends worth up $4.2 billion combined. The boards of those three companies also authorized stock buyback programs worth $10.6 billion.

Other companies chose to simply increase their regular dividends. No matter the method, oil and gas companies are demonstrating their intent to funnel recent gains back to investors rather than help consumers at the pump.

## Taxpayers are losing to outdated leasing policies

Despite companies raking in profits and intentionally not producing more oil in the short-term to alleviate price hikes, oil and gas industry lobbyists are claiming drillers need more federal subsidies and handouts. They are pushing for more access to federal land while opposing royalty reform and other updates to the federal leasing system. Reform, they claim, will make matters worse. But that's not true. Ensuring a fair return for the oil and gas resources we own and implementing **long overdue reforms will increase taxpayer revenues but will NOT impact the price of gasoline at the pump or production levels.**

The federal oil and gas leasing system has not been updated in decades and costs taxpayers billions of dollars every year. **With high gas prices, it is even more important proposals to reform the management of oil and gas development on federal lands and waters move forward to protect taxpayers.**

The royalty rate for onshore federal oil and gas leases is 12.5%. Since 1920 when it was set, all the big oil and gas states have raised the royalty rate for leases on their state lands to 16.67%, 18.75%, 20% or even 25% in the case of Texas. Because royalties are collected as a percentage of the *sales value* of the resource extracted, as prices increase, the difference between what federal taxpayers receive and what they *should* receive under a higher royalty rate grows.

Had an 18.75% royalty been collected on all oil and gas produced from federal lands over the last decade, **taxpayers could have received up to $13 billion more.** It's time to raise rates, and there's no reason not to.

### *Higher royalty rates will have little or no effect on oil and gas production*

The Congressional Budget Office (CBO) found that any reduction in oil and gas production caused by federal leasing reform would be "negligible" over 10 years, especially in states that already charge a higher royalty rate than the federal government.

As states that increased their royalty rates reported, the royalty rate for a lease plays little role in companies' decisions on where to produce and when. According to CBO, oil and gas companies are primarily influenced by physical factors and market forces. The probability of finding oil or gas, the expected amount, the extraction costs, the current and expected future prices for oil and gas, and the firms' costs of capital all have a large influence on a company's decisions. Factors within a given leasing system, like the royalty rate, have a lesser impact.

A GAO review found that raising the federal royalty rate on new leases could increase net federal revenue between $5 million and $38 million per year.

### *Other oil and gas reforms will decrease liabilities and increase revenues*

- Taxpayers would have received roughly $330 million more from FY2011 to FY2020 if the rental rate for federal leases had been adjusted for inflation.
- Similarly, if the minimum bid at federal oil and gas lease auctions had been updated since 1987, taxpayers would have received $5 million more from FY2011 to FY2020.

- Too often, taxpayers are left to clean up abandoned oil and gas wells that pose environmental and public health risks. Ensuring that oil and gas companies post bonds sufficiently large to pay for reclamation in case they go bankrupt is the best way to hold the industry accountable and protect taxpayers from paying for industry messes.
- Noncompetitive leasing allows companies (and land speculators) to get leases without paying a bid. Oil and gas companies use the noncompetitive system to avoid paying the $2/acre minimum bid on parcels with more acreage. Over the last 10 years, 1.8 million acres – an area nearly twice the size of Rhode Island – have been leased with no bid.

## Conclusion

The global price of oil and consumer demand determine the price of gasoline. Companies are raking in billions of profits while prices are high and making decisions that further squeeze consumers at the pump and reward investors. All while taxpayers continue to lose from a grossly outdated federal system that subsidizes oil and gas companies from leasing and drilling through production and well cleanup. Increasing royalty and rental rates to get taxpayers a fair return for the resources we own will not impact the price at the pump. As oil profits soar, it's time for taxpayers to get a fair return from our resources, now more valuable than ever.

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