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The Deep Ocean Energy Resources Act of 2006: State Control, Increased Supply, and Lower Prices

Ben Lieberman

Congress passed a 1,700-page energy bill last year and has since introduced hundreds of additional energy bills. Unfortunately, most of these measures will not bring down oil and natural gas prices. In contrast, the Deep Ocean Energy Resources Act of 2006 (DOER Act, H.R. 4761), would expand domestic offshore oil and natural gas production and is a strong step towards more affordable and stable energy supplies.

A Short History of Offshore Energy Restrictions

Many of America's offshore areas are off-limits to energy production. Beginning in 1982, Congress restricted more and more of these areas through annual Department of the Interior appropriations. Interior has authority over the Outer Continental Shelf (OCS), which includes most areas more than three miles offshore. Congress chose to deny the agency the funding needed to conduct leasing of new offshore areas to oil and natural gas companies.

By the 1990s, these off-limits areas comprised 85 percent of the OCS—almost everywhere except the central and western Gulf of Mexico—and the congressional moratoria became a standard feature of each year's Interior appropriations bill. A recent effort in the House to exclude natural gas from the moratoria was defeated but garnered over 200 votes. This is the first sign that support for the annual restriction on new drilling is losing strength in the face of high energy prices.

In addition, President George H.W. Bush in 1990 issued a presidential directive restricting new exploration and drilling. As with the congressional moratoria, the presidential directive effectively banned new energy production off the Atlantic and Pacific coasts, parts of offshore Alaska, and the eastern Gulf of Mexico.

At the time, oil and natural gas were only one-third the current price, and so the need for this additional energy was not seen as significant. In 1998, President Clinton extended these restrictions through 2012.

Thus, the central and western Gulf of Mexico is now the only offshore area where drilling is allowed, and that area was dealt a severe blow last year by Hurricanes Katrina and Rita. At the peak of damage, one-quarter of domestic oil and gas production was unavailable. Politics, not geology, is the reason that America has put so many energy eggs into this one hurricane-prone basket. A key lesson from the hurricanes is that if America were to allow offshore drilling (and related refining and pipeline infrastructure) elsewhere, Americans would not only have greater supplies and lower prices overall, but would also be

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214 Massachusetts Avenue, NE
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(202) 546-4400 • heritage.org

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less vulnerable should a natural disaster strike any one particular area.

America stands alone in the world as the only nation that has placed a substantial amount of it domestic oil and natural gas potential off-limits. It is not certain how much energy is in these restricted areas, but preliminary estimates from the Department of the Interior suggest the presence of 19 billion barrels of oil and 84 trillion cubic feet of natural gas.[1] As it is, this equals several years of total American oil and gas consumption (7 billion barrels and 23 trillion cubic feet annually) and is enough additional supply to reduce prices for decades to come. Moreover, such preliminary estimates in poorly explored frontier areas have often proven low by a wide margin. For example, the trans-Alaska pipeline recently transported its 15 billionth barrel of oil to market, more than twice some initial estimates of Alaskan reserves. And drilling in the central and western Gulf has already yielded more energy than initially believed to exist there, and the region is still a long way from running out. Off-shore reserves in now-restricted areas could be far higher than the Department of the Interior's initial estimates.

The DOER Act

The DOER Act would not repeal the current restrictions but would give coastal states that want offshore drilling the power to opt out of the restrictions. The bill makes permanent the moratorium on energy production within 50 miles of the coastline, unless a state legislature explicitly votes to end the restrictions and allow drilling. The requirements are slightly different for drilling between 50 to 100 miles; states could also forbid it but would have to affirmatively pass legislation to that effect. Only beyond 100 miles would states have no authority to stop drilling. In effect, each coastal state could act to either allow or prohibit oil and gas production within 100 miles of its shore. By way of contrast, drilling beyond 20 miles cannot even be seen from the shore.

As an inducement, states that allow coastal energy production would, for the first time, share in the revenues from OCS leases and royalties. These revenues have ranged from $4 to $8 billion in recent years and would increase once new areas are opened up. Companies pay up-front for leasing rights on offshore parcels and then ongoing percentage royalties once energy is being produced. Under the DOER Act, states that allow offshore drilling would eventually receive 75 percent of the royalties out to 12 miles and 50 percent beyond that.

Currently, almost all revenues from OCS drilling go to the federal government. This stands in contrast to the revenue-sharing scheme for drilling on onshore federal lands, which are split evenly between the state and the federal government. The DOER Act would treat offshore revenues more like onshore revenues. As well, a portion of the state and federal proceeds would be allocated for coastal protection and other programs.

Common Criticisms Are Off the Mark

The DOER Act has a great deal of common sense on its side. In these times of high energy prices and political uncertainty in so many oil producing nations, America should make better use of its own substantial energy resources. And allowing each coastal state to decide its own drilling policy is far more equitable than the current one-size-fits-all federal ban on drilling in new areas. Nonetheless, the bill has substantial opposition. Their most frequently repeated criticisms are off the mark:

Myth: Drilling poses great risks of oil spills. The last major offshore oil spill in America occurred off of Santa Barbara in 1969. Critics of offshore drilling still refer to this incident, but much has changed in the interim. Drilling technology has greatly advanced in recent decades, and any new drilling will have to comply with strict safeguards that did not exist then.

According to the National Academy of Sciences, "[I]mproved production technology and safety training of personnel have dramatically reduced both blowouts and daily operational spills."[2] Currently, only 1 percent of oil in North American

1. Department of the Interior Minerals Management Service, "Report to Congress: Comprehensive Inventory of U.S. OCS Oil and Natural Gas Resources," February 2006, p. xii.

2. The National Academies, "Oil In the Sea III," 2002, p. 2.

waters came from offshore oil wells, far less than that attributable to natural seepage from the sea floor.[3] Hurricane Katrina provided another reminder that fears of oil spills are overblown and anachronistic: Despite 170-mile-per-hour winds and massive waves striking many platforms, there was not a single significant offshore oil spill.[4]

Myth: The bill would break the budget resolution. The DOER Act would split between participating states and the federal government offshore revenues that currently go only to the federal government. The Congressional Budget Office's (CBO) initial analysis of the bill concluded that, over the next 10 years, $11 billion in federal revenues would be lost.[5] For this reason, the Bush Administration and others raised concerns that the bill would break the budget resolution and increase the deficit. In response, the sponsors of the bill reduced the revenues going to states, which are now projected by CBO to cost to $3 billion over 10 years.

To be sure, under DOER, a smaller proportion of the current offshore revenues would go to Washington. However, by opening up new areas, the DOER Act will, over time, lead to increased production. Depending on the amount of new energy produced, the federal government may not lose future revenues, and states will certainly gain them.

Notwithstanding the impact on federal offshore revenues, the DOER Act will also result in increased individual and corporate income tax receipts from an expanding oil and gas industry. CBO ignored this revenue. And most important of all are the overall economic benefits of lower oil and natural gas prices. This is particularly true of natural gas because U.S. natural gas prices are higher than those in most of the rest of the world and several natural gas-dependent industries like chemicals and fertilizer production have already been forced overseas.

Myth: Americans won't benefit from new drilling. Critics focus on the very low end of the range of estimated resources in restricted areas and also point out that drilling in non-restricted areas continues unimpeded. But even the low-end estimates—19 billion barrels of oil and 84 trillion cubic feet of natural gas—represent a substantial increase in domestic energy production. In tight oil and gas markets, like those of recent years, even modest additions of supply can make a significant difference in prices.

While true that drilling in the central and western Gulf continues, the persistently high prices of oil and natural gas are strong evidence that current (and expected future) production from these non-restricted areas is limited and unlikely to be enough to provide price relief. Simply put, America must make better use of the oil and gas available to it to impact prices—and that includes drilling in the vast areas currently off limits. This is particularly true given that demand for energy is expected to increase by 1 percent annually in the decades ahead.

Conclusion

America has substantial domestic offshore oil and natural gas reserves that will remain unused under current law, and yet Congress has done nothing so far to reduce energy prices. The DOER Act would allow increases in the supply of domestic oil and gas and thereby improve the prospects for a more affordable energy future.

Ben Lieberman is Senior Policy Analyst in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

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3. Ibid.
4. Press release, U.S. Department of the Interior, "Interior Secretary Gale Norton Reports on Gulf of Mexico Energy Status," October 4, 2005.
5. Congressional Budget Office, "H.R. 4761 Deep Ocean Energy Resources Act of 2006," June 26, 2006.