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Federal Mineral Royalty Disbursements to States and the Effects of Sequestration

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Introduction

Federal mineral royalty revenues are often overlooked, but they represent a substantial portion of some states' revenues. Certain minerals, such as coal, oil, and gas, are available for extraction and production via a contractual agreement between a private producer and the federal government known as a mineral lease.[1] These leases grant rights to firms for a certain period of time and outline payments to be made by producers to the federal government.[2] Some of these payment revenues are then distributed back to the state in which the mineral production took place.

One of these payments is a royalty, which is calculated based on the amount of mineral production on the leased land. The term "royalty" is a historical artifact—it literally means "a payment to the crown."[3] Today, the royalties are payments to a landowner (in this case, the federal government) for the right to extract minerals from the land. Payments are calculated as a percentage of revenue.[4] In fiscal year 2012, 36 states received federal mineral royalty disbursements totaling $2.1 billion.

In March, the Office of Natural Resources Revenue announced that, due to sequestration, $110 million in royalty revenue payments to states would be withheld.[5] Some state officials contend that royalty payments

[1] A mineral lease can be onshore, in which production takes place on land, or offshore, in which production takes place at sea. For more information on the boundary for offshore oil and gas production, *see* U.S. Energy Information Administration, *Frequently Asked Questions*, http://www.eia.gov/tools/faqs/faq.cfm?id=42&t=6.

[2] U.S. Government Accountability Office, *Mineral Resources: Mineral Volume, Value, and Revenue*, Memo accompanying a report to the Subcommittee on National Parks, Forests, and Public Lands (Nov. 15, 2012), http://www.washingtonpost.com/r/2010-2019/WashingtonPost/2012/12/11/National-Politics/Graphics/GAO-Report-on-Mineral-Extraction-on-Federal-Lands.pdf.

[3] *Oil and Natural Gas Leasing*, in ENCYCLOPEDIA OF ENERGY, http://www.credoreference.com/entry/estenergy/oil_and_natural_gas_leasing [hereinafter *Oil and Natural Gas Leasing*].

[4] According to the American Petroleum Institute, the Mineral Land Leasing Act dictates that for onshore leases, the "royalty share" is "one-eighth of the value of production." For offshore production, the leasing rate as of 2008 was 18.75 percent. *See* American Petroleum Institute, *Oil and Gas Development on Public Lands are an Important Revenue Source for Government*, http://www.api.org/policy-and-issues/policy-items/exploration/oil_and_natural_gas_development_on_public_lands.

[5] *Western senators seek to restore minerals payments*, CASPER STAR TRIBUNE, May 7, 2013, http://trib.com/news/state-and-regional/western-senators-seek-to-restore-minerals-payments/article_0acadb3b-ccff-55d7-aece-d9f0ce51f895.html.

are the legal property of the states and have explored legal recourse to the federal government's actions. The Department of the Interior, however, asserts that they are not exempt from sequestration.[6]

Historical Development of Mineral Production in the United States

In the latter portion of the eighteenth century, many existing states had claims to lands in the West. The Land Ordinance of 1785 and the Northwest Ordinances of 1785 and 1787 ceded the western land claims of the early eastern states to the federal government, allowing the land to be sold. This enabled westward expansion, federal revenue generation, and paved the way for the creation of future states.[7] By 1821, seven states had emerged from public lands in the West, with ownership of portions of the land within their borders retained by the federal government.[8]

The push for development continued into the nineteenth century by means of the General Mining Law of 1872, under which the federal government granted permanent and exclusive mining rights with no royalty obligations. As time went on, some called for stronger oversight of the extraction process and questioned whether extraction was the best land use.[9] Further, critics questioned why firms were not required to forego a portion of profits to the owner of the land (the federal government).

These concerns led to the enactment of the Mineral Leasing Act of 1920, authorizing the Department of the Interior to lease federal lands "for the production of oil and gas and other hard minerals."[10] It limited the lands on which mineral production could occur and required royalty payments to be made by the leaseholder.[11]

Federally Owned Public Lands Across the U.S.

Today, the federal government owns approximately 28 percent of land within the United States.[12] Figure 1 shows the total land area within each state owned by the U.S. government.[13] Nevada has the largest portion of total area owned by the federal government (81.1 percent), followed by Utah (66.5 percent), Alaska (61.8 percent), Idaho (61.7 percent), and Oregon (53.0 percent).

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[6] *Id.*

[7] George W. Geib, *The Land Ordinance of 1785: A Bicentennial Review*, 81 INDIANA MAGAZINE OF HISTORY, March 1985, at 1-13; William Toth, *Northwest Ordinances of 1785 and 1787*, ENCYCLOPEDIA OF NORTH AMERICAN INDIAN WARS, 1607-1890: A POLITICAL, SOCIAL, AND MILITARY HISTORY (Spencer C. Tucker ed., 2011).

[8] Paul W. Gates, *Whose Public Lands?*, *in* HISTORY OF PUBLIC LAND LAW DEVELOPMENT 1, 1 (1969).

[9] *Energy Development on Public Land in the United States*, ENCYCLOPEDIA OF ENERGY (Oxford: Elsevier Science & Technology, 2004) [hereinafter *Energy Development on Public Land*].

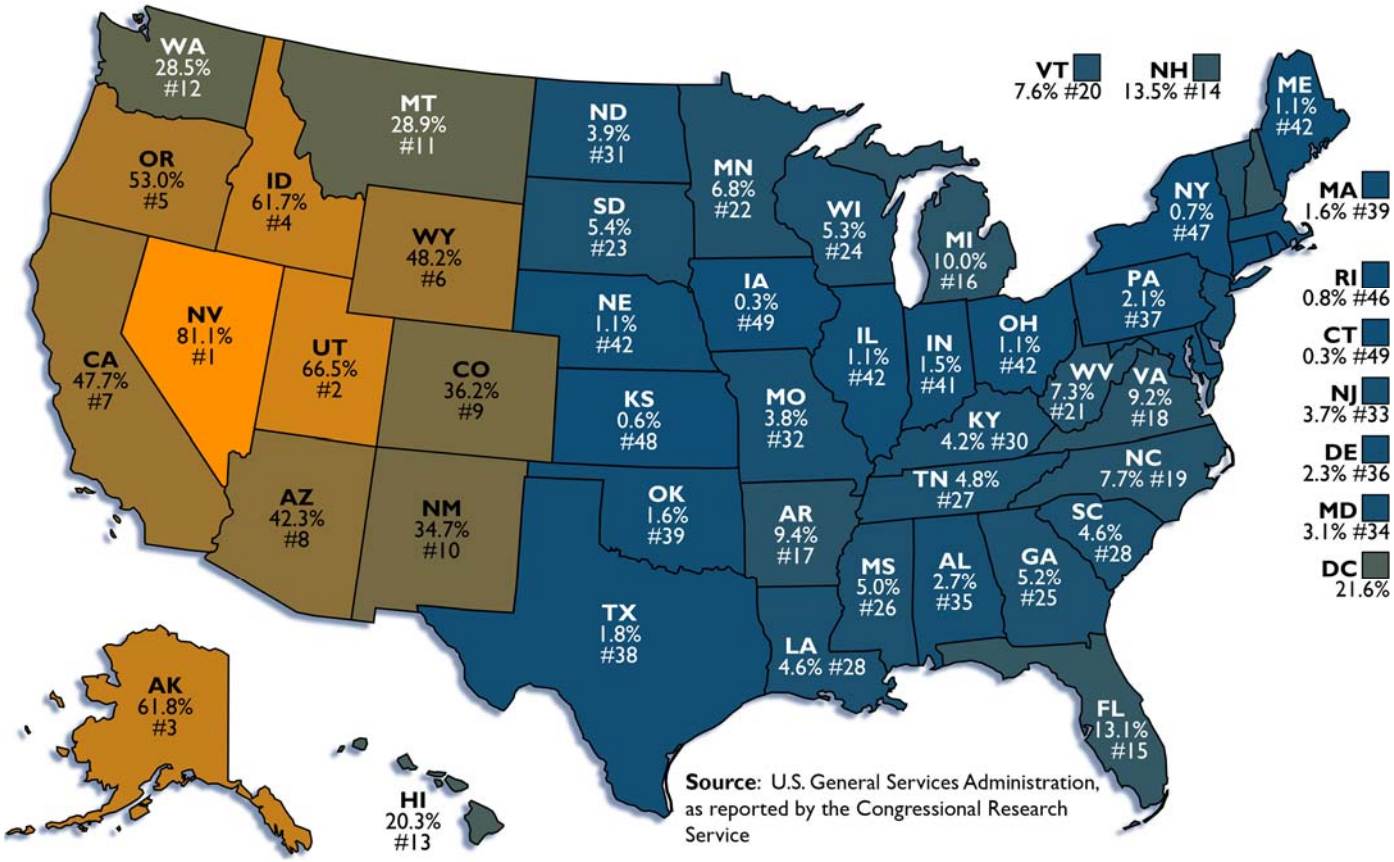
[10] *Oil and Natural Gas Leasing*, *supra* note 3.

[11] *Energy Development on Public Land, supra* note 9.

[12] Ross W. Gote, Carol Hardy Vincent, Laura A. Hanson, & Marc R. Rosenblum, *Federal Land Ownership: Overview and Data*, Congressional Research Service Report for Congress, Feb. 8, 2012, http://www.fas.org/sgp/crs/misc/R42346.pdf [hereinafter *Federal Land Ownership Overview*].

[13] *Id.*

Figure 1: Federally Owned Land by State, 2010



State Payments Justified by State Provision of Services and Costs Imposed on Adjacent Communities

Who should benefit monetarily as a result of mineral production on federally-owned land within the states? Though the federal government legally owns lands on which production takes place, opponents of federal mineral leasing argue that "not all costs of…leasing operations are internalized by the lessees."[14] That is, "external costs are borne disproportionately by those citizens living near the projects"[15] because states must furnish services such as infrastructure and emergency production from which lease-holders benefit.

Rather than divest land from federal to state ownership, the government has opted to compensate states that contain federal lands on which production occurs via the disbursement of a portion of royalty revenues to affected states.

[14] *Oil and Natural Gas Leasing*, *supra* note 3.
[15] *Oil and Natural Gas Leasing*, *supra* note 3.

Disbursement of Federal Mineral Royalty Income

Mineral royalties collected by the federal government are disbursed to a variety of funds. Fifty percent of onshore lease revenue goes to the state in which the lease is located (except in the case of Alaska, where 90 percent of the royalties go back to the state), 40 percent is disbursed to the national Reclamation Fund[16] (except in the case of Alaska, where no Reclamation Fund disbursement takes place), and the remaining 10 percent goes to the U.S. Treasury.[17] In the case of offshore leases, 27 percent of all payments go to the state in which lease is located, $150 million is deposited to the Historic Preservation Fund each year, and the remaining money goes to the U.S. Treasury.[18]

Table 1 provides an overview of the recipients of federal mineral royalty disbursements in 2012.[19] The U.S. Treasury derives the most benefit, keeping nearly 55 percent of total royalty revenues. State governments receive 17.5 percent of total payments.

Table 1: Destination of Federal Mineral Royalty Revenue Disbursements
FY 2012

Fund	Amount	Share of Total
American Indian Tribes & Allottees	$717,556,925	5.9%
Historic Preservation Fund	$150,000,000	1.2%
Land & Water Conservation Fund	$897,141,113	7.4%
Reclamation Fund	$1,646,314,405	13.5%
State Share: Offshore	$36,972,094	0.3%
State Share: Onshore	$2,088,316,005	17.2%
U.S. Treasury	$6,615,350,730	54.4%
Total	**$12,151,651,272**	**100.0%**

Source: U.S. Office of Natural Resources Revenue, Tax Foundation calculations

In the 2012 fiscal year, 36 states received federal mineral royalty disbursements, totaling $2.1 billion. Wyoming received the most revenue, at $995.2 million—nearly 47 percent of total disbursements. Rounding out the top five in most royalty funding were New Mexico (23.0 percent of total), Utah (7.7 percent), Colorado (7.4 percent), and California (5.3 percent). Table 2 outlines federal mineral royalty disbursements by state. Disbursements include both onshore and offshore mineral leases.

Effects of Sequestration on Royalty Disbursements to States

In March, the Office of Natural Resources Revenue announced that royalty payments to states were subject to sequestration cuts and that 5 percent ($110 million) would be withheld. Wyoming will see the largest funding decrease at $53 million.[20] Fortunately, Wyoming has a positive budget balance (upwards of $1.6

[16] The Reclamation Fund is used to fund water resources management projects in the U.S.
[17] *Oil and Natural Gas Leasing*, *supra* note 3.
[18] *Id.*
[19] Office of Natural Resources Revenues, *Disbursements: FY 2012 through FY2012*. Detailed raw data can be downloaded here at http://statistics.onrr.gov/ReportTool.aspx.
[20] Trevor Brown, *Lawmakers to fight for mineral funds*, WYOMING TRIBUNE EAGLE, Apr. 4, 2013, http://www.wyomingnews.com/articles/2013/04/04/news/19local_04-04-13.txt.

Table 2: Federal Mineral Royalty Disbursements (Onshore + Offshore) by State
FY 2012

State	Amount	Share of Total	Rank
Alabama	$7,949,539	0.4%	12
Alaska	$16,570,897	0.8%	9
Arizona	$14,171	0.0%	31
Arkansas	$2,067,326	0.1%	17
California	$111,618,105	5.3%	5
Colorado	$157,819,385	7.4%	4
Florida	$542,318	0.0%	20
Idaho	$4,606,160	0.2%	14
Illinois	$263,732	0.0%	25
Indiana	$4,417	0.0%	34
Kansas	$1,330,807	0.1%	19
Kentucky	$485,939	0.0%	21
Louisiana	$26,780,579	1.3%	8
Massachusetts	$23,835	0.0%	30
Michigan	$330,884	0.0%	23
Minnesota	$11,502	0.0%	33
Mississippi	$2,812,239	0.1%	16
Missouri	$3,061,606	0.1%	15
Montana	$47,257,456	2.2%	7
Nebraska	$27,550	0.0%	29
Nevada	$11,785,383	0.6%	10
New Mexico	$488,155,684	23.0%	2
North Carolina	$158	0.0%	36
North Dakota	$64,501,004	3.0%	6
Ohio	$284,145	0.0%	24
Oklahoma	$5,372,191	0.3%	13
Oregon	$416,628	0.0%	22
Pennsylvania	$67,081	0.0%	27
South Carolina	$1,391	0.0%	35
South Dakota	$1,907,122	0.1%	18
Texas	$9,152,281	0.4%	11
Utah	$164,602,984	7.7%	3
Virginia	$45,215	0.0%	28
Washington	$13,583	0.0%	32
West Virginia	$235,294	0.0%	26
Wyoming	$995,169,510	46.8%	1
Total:	**$2,125,288,098**	**100.0%**	**N/A**

Source: U.S. Office of Natural Resources Revenue, Tax Foundation calculations

Table 3: Federal Mineral Royalty Payment Reductions by State,
FY 2013

State	Amount
Alabama	$217,731
Alaska	$603,381
Arizona	$759
Arkansas	$98,739
California	$5,500,974
Colorado	$8,417,896
Florida	$28,853
Idaho	$245,792
Illinois	$10,717
Indiana	$187
Kansas	$70,871
Kentucky	$20,547
Louisiana	$347,677
Michigan	$16,763
Minnesota	$487
Mississippi	$110,102
Missouri	$129,602
Montana	$2,520,706
Nebraska	$1,470
Nevada	$630,685
New Mexico	$26,038,169
North Carolina	$7
North Dakota	$3,222,598
Ohio	$11,798
Oklahoma	$283,862
Oregon	$22,335
Pennsylvania	$2,741
South Carolina	$59
South Dakota	$101,724
Texas	$324,742
Utah	$8,780,195
Virginia	$1,877
Washington	$728
West Virginia	$9,626
Wyoming	$53,082,211
Total:	**$110,856,609**

Source: U.S. Office of Natural Resource Revenue

billion in its rainy day fund, in addition to other accounts).[21] Other states, however, may find it difficult to weather this payment reduction.[22] Table 3 shows the amount of royalty payment reductions by state.

While some policymakers in Wyoming have contended that royalty payments are the "legal property of the states,"[23] Wyoming Governor Matt Mead (R) announced recently that he did not believe the state would be able to pursue legal means to reinstate funding.[24]

Conclusion

The existing federal mineral royalty system is a result of the way in which lands in the U.S. were historically developed. Royalties collected by the federal government from mineral production on public lands is disbursed to a variety of areas, one of which serves as compensation to states for the costs accrued from production. The federal sequester cut a portion of these disbursements to states. Since federal aid to states can be uncertain, it is wise for states to ensure they are able to provide adequate backing funding in the form of savings or surplus funds in the event that federal funding is reduced.

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[21] Ben Neary, *Interior Department cuts mineral payments to 35 states*, GREAT FALLS TRIBUNE, Mar. 28, 2013, http://www.greatfallstribune.com/viewart/20130328/NEWS01/303280013/Interior-Department-cuts-mineral-payments-35-states.
[22] Joseph Henchman, *Trend #8: Insufficient Rainy Day Funds*, TAX FOUNDATION FISCAL FACT NO. 306 (June 5, 2012), http://taxfoundation.org/article/trend-8-insufficient-rainy-day-funds.
[23] *See* Brown, *supra* note 20.
[24] Trevor Brown, *Mead: State unlikely to sue over federal mineral funds*, WYOMING TRIBUNE EAGLE, Apr. 6, 2013, http://www.wyomingnews.com/articles/2013/04/06/news/20local_04-06-13.txt.