Testimony of Benjamin Fishman

Representing

the Institute for Policy Integrity

at New York University School of Law

Before

Secretary of the Interior, Ken Salazar

and

Acting Director, Minerals Management Service, Walter D. Cruickshank

on

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in

Atlantic City, New Jersey

Thank you for the opportunity to testify today. My name is Benjamin Fishman and I am here today representing the Institute for Policy Integrity at New York University School of Law. The Institute is dedicated to improving the quality of government decisionmaking by expanding the use of unbiased and balanced cost-benefit analysis. Our comments today focus on the Draft Proposed Program released by the Minerals Management Service in January.

The MMS plan may cost Americans over $600 billion in lost wealth. In the plan, MMS has violated basic economic principles by failing to value the option to wait to auction drilling leases. Using estimates in the MMS report, the result may be well over $600 billion in lost option value for the American public.

MMS is required by statute to consider the economic value of nonrenewable resources when constructing its plan to auction drilling rights offshore. In its analysis, it uses the "net present value" formula for estimating the economic value of offshore drilling. However, economists have recognized for decades that this model does not apply to *irreversible* decisions under conditions of *uncertainty*—exactly the kind of decision faced by

MMS when considering extracting oil and gas at widely fluctuating prices. The result is a bias in favor of drilling too much, too soon.

There are numerous models that have been developed by financial economists to account for price uncertainty. These models are based on the valuation of "options." Just as an executive may receive the option to buy stock as part of a compensation package, the United States holds the option to lease drilling rights offshore. Those executives often wait to cash in their options, and in many cases it makes sense for MMS to wait until an optimal price threshold to auction leasing rights. By leasing too much too fast, MMS is selling the leases too cheaply and wasting hundreds billions of dollars in option values.

By failing to account for the potential value of waiting to lease drilling rights, the MMS plan essentially values all of the drilling options held by the American public at zero. This is clearly inaccurate—those options could be worth hundreds of billions of dollars. By placing a zero-value on these options MMS is extremely biased in favor of leasing too much too soon. By destroying the option value it holds, MMS allows oil companies to access resources at an inefficiently rapid pace, causing significant losses for the American public .

Given its statutory mandate to consider the economic consequences of its leasing program, MMS is under a duty to ensure that it accounts for all economic value, including options value. By failing to give due consideration to the value of the option to wait, MMS severely underestimates the wealth held by the American public in natural resources, and ends up destroying that wealth through short-sighted policy based on outdated economic models.