

Free Energy Trade: Time to Lift the Oil Export Ban



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Introduction

In July 2014, the United States passed Saudi Arabia and Russia to become the world's biggest oil producer for the first time since 1970. This dramatic turn of events marked the end of an era in U.S. energy policy—an era that began in the 1970s with two oil embargoes, soaring gas prices, and growing dependence on imported oil, especially from the Middle East.

For better or worse—and some environmentalists think it's definitely for worse—America unexpectedly finds itself richly endowed with fossil fuels again. The question now is how can we take advantage of this new energy abundance without accelerating global warming?

The answer, in PPI's view, lies in a balanced national energy strategy that promotes both economic growth and a healthy environment. Such a strategy would capitalize on the domestic shale oil and gas boom while also enabling America to meet its international commitments to reduce greenhouse gas emissions. There are two ways to square that circle. One is to boost public investment in energy-related research and development. The other is to price carbon accurately, which will spur more investment in efficiency, clean tech innovation, and renewable and nuclear energy.

This approach steers a pragmatic course between “drill baby drill” conservatives, who ignore or deny the overwhelming scientific evidence for climate change, and extreme environmentalists who imagine that Americans will go along with their demands to keep the nation's shale bounty “in the ground.”

A progressive energy policy embraces twin realities: global warming is a serious threat, and fossil fuels will remain an important part of the U.S. and global energy mix for decades to come. Carbon taxes or cap and trade systems, together with robust energy innovation, can ensure that the United States does its part to curb climate change as we develop America's shale resources to meet domestic and global energy demand and to create more good jobs at home.

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Repeal makes sense on three grounds. First, the shale boom has shattered the rationale for restricting U.S. energy exports. This reality shifts the burden of proof to those who want to continue suspending the normal rules of free trade when it comes to oil and gas.

Second, increased U.S. oil production and exports will create jobs, lower domestic oil prices, and reduce America's trade deficit. Moreover, as former Treasury Secretary Larry Summers noted in a recent speech, "there is no environmental argument for a policy that distinguishes between oil produced in the United States for domestic consumption and oil produced in the United States for foreign consumption."¹

Third, U.S. energy exports could yield geopolitical dividends as well. America's return to global markets would weaken the ability of oil-rich states to manipulate the price of gasoline. And it could dilute the economic leverage of unfriendly petro-powers like Russia and Iran.

In fact, we are already witnessing the effects of expanding domestic crude oil production on global markets. West Texas Intermediate (WTI) prices have historically tracked closely to Brent (light sweet crude oil from Europe's North Sea that serves as a benchmark price for international crude oil contracts) and sometimes at a slight premium, yet since 2010 WTI has been selling at a discount. As of November 2014, WTI December contracts have sold at \$75.08 per-barrel—almost three dollars below the international price.

The growth in U.S. production, the response of other producers including OPEC, and weak global demand, including in Europe has led to a precipitous decline in Brent crude oil prices (June contracts were priced at \$114.92), which are the most important determinant of U.S. gasoline prices. As a result, Americans are seeing these lower crude oil prices reflected at the pump where regular gasoline is averaging \$2.82 per gallon nationally. In other words, by expanding overall crude oil supply, a flood of U.S. oil on world markets would put downward pressure on crude oil prices everywhere.

At first glance, it might appear that exporting U.S.-produced crude oil would lead to higher prices at home. This is not the case, however, because the price of oil is set globally. According to a recent GAO report, U.S. gasoline prices "tend to follow international crude oil prices, rather than domestic crude oil prices."²

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Economists are moving up their forecasts for further decreases in Brent crude prices, suggesting that the impending glut of oil on global markets will lead to \$70 per-barrel by the end of 2016.³ Many factors are contributing to this drastic increase in crude oil supply, including reluctance by major Arab producers to respond with cutbacks in production, weakened global demand, the recent return to production of Libya, increased production in Iraq and Iran, and falling U.S. demand for imports as our domestic crude oil production surges. Monthly domestic crude oil production has increased from an average of about five million barrels per day (bpd) in 2008 to over nine million bpd this year, a more than 80 percent increase.⁴

These profound market changes bring implications that were not foreseen in years past when analysts, the public and policymakers operated under the old assumptions of finite and dwindling U.S. reserves and ever-escalating foreign oil imports. They call into question old policy assumptions and laws, especially the nearly 40-year-old ban on U.S. crude oil exports.

PPI urges the incoming 115th Congress to give priority to lifting the ban on crude oil exports. If Congress fails to act, President Obama should exercise his authority to ease export restrictions on grounds of national interest. Besides the strong potential for spurring job creation, wage and productivity increases, a stronger dollar, and a lower current account deficit, lifting the oil ban would provide our allies a better trade partner in one of the world's most valuable commodities.

The Legacy of the Energy Crisis

During the heyday of the 1970s “energy crisis,” Congress passed the Energy Policy and Conservation Act of 1975 (EPCA), which gave the President broad authority to restrict or permit exports of crude oil, natural gas, petroleum products, petrochemical feedstock, and coal. It also authorized the Strategic Petroleum Reserve to hedge against the prospect of future oil embargoes. These and other policies over the last four decades (including Nixon-era price controls on domestic crude oil) aimed chiefly at assuring stable energy supplies and protecting consumers from sharp price spikes. However, these policies, by dampening incentives for domestic production, led to both rising oil imports and higher gas prices.

In 1981, Congress lifted export restrictions on petroleum product exports (gasoline, petro-chemical feedstocks and condensates). Today only EPCA's ban on crude oil exports remains largely in place. Exceptions with special permitting include U.S. exports to Canada, and crude oil from Alaska's North Slope, which was mostly exported to Asia (until about 2001). The volume of legal exports of course is tiny compared to what would happen if the restrictions were completely lifted on crude oil.

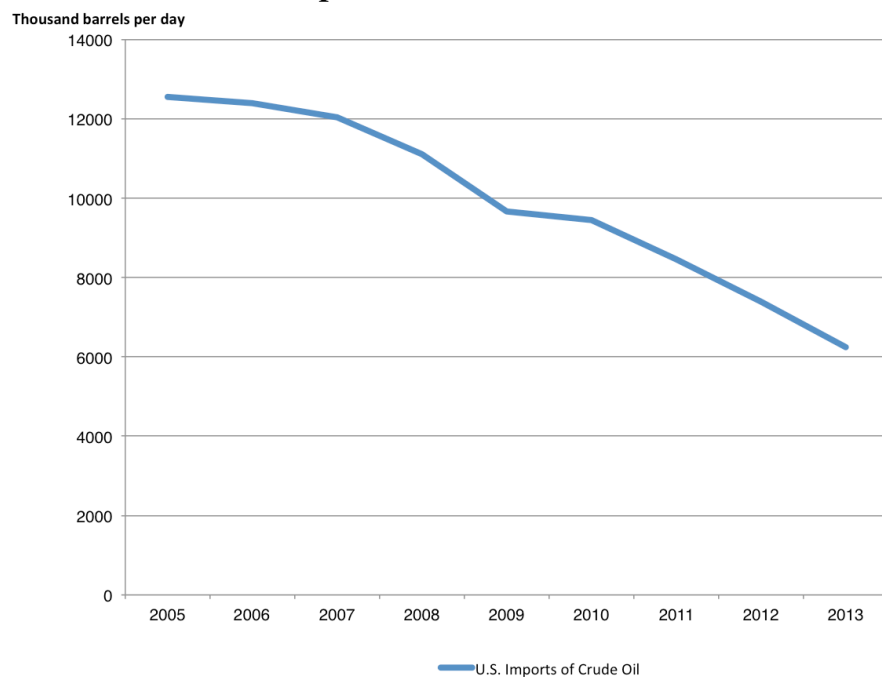
The United States would reap major economic benefits from removing outdated restrictions on free trade in oil. Besides lowering domestic fuel prices, several studies project if restrictions are lifted it would stimulate domestic production by

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as much as an additional 1.3 million barrels per day by 2019.⁵ According to a review of relevant studies by the General Accounting Office (GAO), removing export restrictions would boost investment in crude oil production and employment.⁶ This growth would spread across the economy, increasing government revenues \$1.4 trillion between 2016 and 2030.⁷

There would be trade benefits as well. In fact, as shown in Figure 1, expanded crude production in the United States has already cut America’s oil import substantially. Crude oil imports have steadily declined since 2008, reducing wealth transfers from the United States to other countries and keeping several billion dollars home for investment. One study GAO reviewed estimated that removing crude oil export restrictions would improve the U.S. trade balance by \$72 to \$101 billion per year over the next 15-years.⁸ Also promising from a trade standpoint is the fact that U.S. “light and tight” oil (LTO) fetches higher prices on world markets than heavier, sour crude oil, which requires more refining.

FIGURE 1: U.S. Net Imports of Crude Oil and Petroleum Products



Source: U.S. Energy Information Administration.

The U.S. Refinery Opportunity [and Risk]

U.S. refineries are the most complex in the world, with more hydrocracking, cat cracking and coking capacity relative to basic crude distillation than anywhere else, including Europe, Asia, or the global average.

Even though U.S. refineries have been able to handle some of the new light crude, they are reaching their limit and are unable to refine enough to match growing production levels. If refineries were to take in more LTO, they would lose revenue,

because they would have to sacrifice capacity normally used to refine heavy crude. In fact, many refineries have spent billions of dollars retooling their plants to handle an influx of Canadian “tar sand” oil via the controversial Keystone XL pipeline.

Because refining lighter U.S. crude is less lucrative, many U.S. refineries demand steep discounts—as high as 20%—on the price of LTO. This of course undercuts oil producers’ ability to cover the costs of drilling new wells. The problem is compounded by inadequate pipeline transport capacity from North Dakota to the Gulf Coast and East Coast refineries. For example, this has caused a backup at the prices. The backup has moved from Cushing this year to the U.S. Gulf Coast.

Lifting the export ban would allow U.S. LTO producers to sell their crude internationally at the highest possible and undiscounted prices. Lifting the ban could raise the price on currently discounted crudes for U.S. refiners, but they would maintain their competitive advantage due to lower shipping costs to obtain crude vs. those who import. Given the expected decline in U.S. oil demand there isn’t a need for new refining capacity in the U.S., and developing countries are building their own refineries to handle their growing demand and desire to import crude and not products; these simpler refineries are well suited to process the generally higher-priced LTO, while complex U.S. refineries are well suited to process relatively lower cost and heavier feedstock.

Shale Boom Reshapes Geopolitical Landscape

Surging U.S. oil production is reshaping the world’s geopolitical landscape, adding to America’s arsenal of “soft” power while undercutting the economic leverage of traditional petro-states. For example, plunging oil prices, sparked in part by increased U.S. production, mean plunging revenues for the petro-centric governments of Russia, Iran, and Venezuela. That reality, in turn, gives international sanctions on Iran and Russia more bite.

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Forecasters predict that Russia’s economy will contract by 1.7 percent next year after essentially zero growth in 2014. Inflation is on the rise, and the value of the ruble is falling. And, as *The Telegraph* recently reported “oil below \$70 is already playing havoc with budgets across the global petro-nexus. The fiscal break-even cost is \$161 for Venezuela, \$160 for Yemen, \$132 for Algeria, \$131 for Iran, \$126 for Nigeria, and \$125 for Bahrain.”⁹

The drop in global crude oil prices, caused in part by the increase in U.S. crude oil supplies, is a boon for U.S. consumers. According to *The Washington Post*, “Every day, Americans are saving \$630 million on gasoline compared with what they paid at June prices, and they would get a \$230 billion windfall if prices were to stay this low for a year.”¹⁰ This additional money will flow back into the economy giving an income boost to lower- and middle-income families, who bear a disproportionate burden when there are higher gasoline prices, and inflated prices on other goods due to higher prices at the pump. And internationally, it weakens the

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ability of unfriendly states like Russia, Iran, and Venezuela to use their vast oil and gas reserves to wield their influence.

Conclusion

It is time for Washington to update policies that are the legacy of a bygone “energy crisis” symbolized by Jimmy Carter’s cardigan sweater. That crisis was characterized by falling U.S. oil production, rising imports, the advent of OPEC as a global price-fixing cartel and politically motivated oil embargoes. None of these conditions hold true today. Thanks to breakthroughs in exploration and drilling technology, the United States finds itself once again abundantly supplied with oil & natural gas. This of course raises a new set of issues and reminds us that the main energy-related crisis of the 21st century is climate change.

With a new and balanced set of energy policies, the United States can do its part to capture the benefits of the shale boom without forgoing climate change mitigation. Instead of clinging to 1970s-vintage policies, U.S. leaders should put their trust in energy innovation, as well as restore free trade principals for crude oil exports.

Endnotes

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