COUNCIL on FOREIGN RELATIONS

Renewing America

POLICY INNOVATION MEMORANDUM NO. 34

Date: July 8, 2013

From: Blake Clayton

Re: The Case for Allowing U.S. Crude Oil Exports

Federal lawmakers should overturn the ban on exporting crude oil produced in the United States. As recently as half a decade ago, oil companies had no interest in exporting U.S. crude oil, but that has changed. Oil production has grown more in the United States over the past five years than anywhere else in the world, even as domestic oil consumption has declined. With these changes has come a widening gap among the types of oil that U.S. fields produce, the types that U.S. refiners need, the products that U.S. consumers want, and the infrastructure in place to transport the oil. Allowing companies to export U.S. crude oil as the market dictates would help solve this mismatch. Under federal law, however, it is illegal for companies to export crude oil in all but a few circumstances. Over the past year, the Department of Commerce granted licenses to several oil companies to export a small amount of U.S. crude oil. But these opaque, ad hoc exceptions are insufficient. Removing all proscriptions on crude oil exports, except in extraordinary circumstances, will strengthen the U.S. economy and promote the efficient development of the country's energy sector.

THE ISSUE

When Congress in the 1970s made it illegal to export domestically produced crude oil without a license, the goal of the legislation was to conserve domestic oil reserves and discourage foreign imports. In reality, the export ban did not help accomplish either of these objectives. It has now become more of a hindrance than a help. The opaqueness of the export approval process discourages would-be exporters from applying for licenses. Companies see a lack of legal clarity and fear inconsistent regulation. They are hesitant to incur negative publicity on Capitol Hill when they doubt they will be granted approval.

Two important elements of the U.S. oil export equation have changed in the past few years. First, exporting U.S. crude oil has become economically attractive to the energy industry. Crude oil exports have grown from next to nothing in 2007 to around one hundred thousand barrels per day in March 2013, all of which went to Canada. Second, the United States has become one of the world's largest gross exporters of refined oil products, such as gasoline and diesel. Unlike crude oil, which is unprocessed, oil that has been refined can be exported freely under U.S. law. Roughly three million barrels per day of refined oil products were exported in December 2012, a major increase from prior decades. Until 2011, the United States had not been a consistent net exporter of oil products since 1949.

Restrictions on crude oil exports are already beginning to undermine the efficiency of the U.S. oil economy. Much of the country's rapidly growing production of light crude oil, including lease condensates (i.e., ultra-light oil), comes from either areas where refiners are not interested in or able to process it, given that many U.S. refineries are configured to run lower-quality crude oil, or in parts of the country with inadequate transportation infrastructure. With few viable domestic buyers, producers are forced to choose between leaving oil in the ground and pumping it at depressed prices. These artificially low prices slow additional U.S. crude oil production. New refineries and pipelines currently under construction will help remedy some of these market distortions over time, but a simpler, more cost-effective solution would include allowing U.S. crude to be exported. Doing so will not raise gasoline prices. Prices at the pump will continue to be determined by the global market, regardless of whether the United States exports crude oil. Were the ban overturned today, crude exports would immediately rise by several billion dollars a year, according to industry executives, likely surpassing five hundred thousand barrels per day by 2017.

U.S. LAW GOVERNING CRUDE OIL EXPORTS

The primary laws prohibiting crude exports are the Mineral Leasing Act of 1920, the Energy Policy and Conservation Act of 1975, and the Export Administration Act of 1979. The so-called short supply controls in the Export Administration Regulations (EAR) of the Bureau of Industry and Security (BIS), an agency of the Department of Commerce, spell out these restrictions.

A few obscure types of crude oil automatically qualify for export licenses under EAR. These types include crude oil produced in Alaska's Cook Inlet or exported to Canada, as long as it is consumed there; and small amounts of heavy (or viscous) crude oil produced in California. Other niche cases do not require licenses. Crude oil transported via the Trans-Alaska Pipeline System or produced overseas and stored in the U.S. Strategic Petroleum Reserve may be exported.

Some U.S. crude oil can be exported with a presidential finding. This includes crude oil of U.S. origin transported on federal right-of-way pipelines, crude oil produced from the outer continental shelf, and crude oil produced from naval petroleum reserves that were once set apart for use by the military but that are now almost entirely commercialized.

In nearly all other cases, U.S. crude oil can only be exported if the BIS finds that proposed exports are "consistent with the national interest and the purposes of the Energy Policy and Conservation Act." The agency has the right to accept or reject applications for an export license according to its own unarticulated definition of the "national interest." The only specific case the EAR mentions as meeting these strict criteria is when the exported crude is exchanged for more or better refined oil imports, under a contract that can be terminated if U.S. oil supplies are "interrupted or seriously threatened," and could not have "reasonably [been] marketed" in the United States.

A BETTER APPROACH

A better approach would be to allow companies to freely export oil as the market dictates, eliminating the requirement that companies obtain a license for each crude oil export transaction. The only exception to this policy should be when the president determines there is a national emergency. To make this change, Congress should repeal EAR's short-supply controls that apply to crude oil exports.

BENEFITS VERSUS COSTS

Exporting energy is good for the economy. Crude oil exports could generate upward of $15 billion a year in revenue by 2017 at today's prices, according to industry estimates. Those gains would be partially offset by displacing some refined product exports, however. Today's export restrictions run the risk of dampening U.S. crude oil production over time by forcing down prices at the wellhead in some parts of the country. Letting drillers reap extra profits from selling crude oil overseas, if the market dictates, would provide greater incentives for drilling, stimulating new supply. It would also encourage investment in oil and gas production in the United States rather than abroad. In oil-producing regions, more workers would be hired for oil exploration and production, as well as for local service industries. Greater policy certainty regarding exports would also catalyze the expansion of U.S. energy infrastructure.

As it stands, the primary beneficiaries of the export ban are a few fortunate oil refineries in the central United States—not U.S. consumers—that are able to buy crude oil at depressed prices before selling it at prevailing market rates. Current law arbitrarily works to the benefit of these companies. In several years, a wider range of refineries will benefit from the ban as pipeline capacity constraints are alleviated and more light oil flows to the U.S. Gulf Coast. These pipelines will help reduce the discount that some producers face in the domestic market, but they would be more effective at bringing domestic oil prices in line with global ones if U.S. crude oil could be freely exported and other restraints on shipping were removed.

Allowing crude oil exports will not affect U.S. energy security. Proponents of the export ban might argue that it increases national security by slowing the depletion of U.S. oil fields. Yet the ban also slows production growth, increasing the country's reliance on imported energy. Insofar as oil self-sufficiency would be economically and militarily useful in a time of crisis, removing the ban would increase U.S. security by catalyzing oil production. Were an international emergency to arise, exports could be temporarily suspended, providing extra oil for domestic needs, though such extreme measures would likely hurt U.S. trade relationships.

Liberalizing the crude oil export regime would advance U.S. foreign policy. It would demonstrate Washington's commitment to free and fair trade, even in a politically sensitive sector, bolstering its negotiating position on other trade issues. It would also avoid putting Washington at odds with allies that would like to source their oil from the United States. If the United States were to become a major crude exporter, its leverage as an oil trade partner would grow significantly.

To the extent that exports mean greater domestic production of tight oil from hydraulic fracturing, or "fracking," allowing exports could bring environmental risks such as water contamination and local pollution. These risks, however, are manageable through prudent regulation. Continuing to ban crude oil exports is not an effective means of preventing harm to the environment. Environmental regulators will need to manage the risks of oil production regardless of whether the United States exports more crude oil.

CONCLUSION

Without compelling reasons for continuing to restrict crude exports, and given the potential benefits, Congress should liberalize the crude oil export regime. Republicans and Democrats alike, including President Obama, express support for boosting U.S. exports in general. Crude oil should be no exception. Some observers might object to exports on the grounds that U.S. oil production could fall short of today's optimistic forecasts or that exports will cause gasoline prices to rise. These should not be major concerns. U.S. crude exports are self-limiting: if the supply gains expected do not materialize, the market will induce producers to keep the oil at home rather than to send it abroad. Though the companies that benefit from today's export restrictions might oppose any change in the status quo, the broader gains available to the United States from allowing crude exports make it the far better choice.

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The Renewing America initiative is supported in part by a generous grant from the Bernard and Irene Schwartz Foundation.

This Policy Innovation Memorandum is made possible in part through the generous support of the Alfred P. Sloan Foundation. The Sloan Foundation takes no institutional positions on policy issues. All views expressed herein are solely the responsibility of the author.

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