Insight

Crude Oil Exports: Where's the Debate?

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The next big debate in oil policy is whether to overturn a four decade-old ban on the export of domestically produced crude oil. Thanks to the shale revolution, oil production and trade has changed substantially over the last seven years. Despite headwinds from the federal government, between December 2008 and December 2014, oil production increased 81 percent in the U.S. This drove down net petroleum imports 58 percent over the period, helped reduce the U.S. trade deficit by $97 billion between 2011 and 2013, and boosted oil and gas employment nearly 60 percent in the last 10 years despite sluggish growth in the larger economy.

With such massive changes, government officials and industry are reopening a decades-old conversation about how federal policy should interact with the domestic oil market. This primer offers a brief explanation of the export ban, clarifies its impacts on oil producers and consumers, and explains how overturning the ban would benefit the U.S. and change international oil markets.

What is the law?

The Arab Oil Embargo was a major shock to the U.S. economy and accentuated the insecurity of an energy system highly dependent on fuel imports. In the wake of this crisis, Congress passed the Energy Policy and Conservation Act (EPCA) of 1975 as part of a strategy to promote future energy security. One component was a general ban on the export of crude oil.

Specific restrictions on the export of oil are described by the short supply controls in the Bureau of Industry and Security (BIS) Export Administration Regulations. Generally, a license is required for the export of crude oil to all destinations; that license may not be granted unless BIS determines that the proposed export is "consistent with the national interests and the purposes of the Energy Policy and Conservation Act." BIS provides no clear definition of "national interests."

The president may grant exceptions to the export ban. Presidents Regan, Bush, and Clinton each weakened the restrictions, and exports are now permitted to Canada, from Alaska's Cook Inlet and North Slope, from certain oil sources in California, and select other circumstances. The details of each exception are included in the short supply controls.

The general ban applies to crude oil defined as "a mixture of hydrocarbons that existed in liquid phase in underground reservoirs and remains liquid at atmospheric pressure after passing through surface separating facilities and which has not been processed through a crude oil distillation tower." This permits the export of refined products like fuel oil, propane, and gasoline. The U.S. is a net exporter in this category, shipping 3.9 million barrels per day of petroleum products to trade partners around the world.

Incidentally, the current oil boom has increased very light oil production. To improve the safety of transporting this oil, it is passed on-site through distillation towers that remove the most volatile components. Though this oil is not processed into distinct products, a strict interpretation of the BIS definition also accepts this oil for export.

What does the law do?

Effectively, the export ban eliminates the international trade of any domestically produced oil except in a small number of specific circumstances. The export ban does not apply to petroleum products, so once the petroleum is refined at a domestic facility, it enters the global market. This is where the trouble starts.

Congress enacted the export ban in an attempt to insulate the U.S. economy from damaging market shocks. The ban served two purposes: the implementation of price controls to diminish the threat of foreign shocks and the creation of a domestic “reserve” of oil. Neither purpose was well served by the ban. U.S. oil production peaked in 1970, and increased imports were needed to meet the country’s energy needs.

Further, because the ban is restricted to the export of crude oil and does not apply to petroleum products more generally, it severs the domestic crude producer market from the global oil consumer market. The result is that domestic oil producers have an artificially small number of customers while consumers purchase all products – gasoline, diesel, propane, and more – from the global market. That’s why domestic oil prices started falling well below international oil prices in the fall of 2010, but gasoline prices didn’t start dropping until the fall of 2014.

More threatening, export restrictions diminish the incentive for oil and gas exploration and development when domestic prices fall. Today, experts expect that oil production will decline in the three largest tight oil reserves because of low prices. In the absence of the crude oil export ban, oil producers would face a more forgiving pricing market without impacting consumer prices.

Do markets care?

The U.S. produced more than 9 million barrels per day in December 2014, amounting to about 10 percent of global supply. If the U.S. lifts the export ban, domestic crude would flood the global market, which, combined with flagging global oil demand, would push down global oil prices. Even very small changes in the price of crude oil internationally could drop gasoline prices 1.5 to 13 cents per gallon.

In turn, oil prices may see a slight increase of $2 to $8 per barrel. This increase would bolster development of extraction technologies, short-term oil exploration and production, job creation in oil fields, and long-term domestic supply security.

Definitively, the domestic market would benefit from lifting the crude oil export ban. More broadly, international trading partners and the U.S. diplomatic profile stand to gain from lifting the oil export ban thanks to larger demand and supply trends.

Demand for oil in the U.S. is relatively stable, dampening incentives for the oil extraction innovations that will keep the fuel supply abundant and affordable into the future. To maintain its profile as the largest combined oil and gas producer worldwide, the U.S. needs to leverage demand growth from international trading partners emerging from a strong economic recession.

Contending with the largest oil producers is a strategic advantage for the United States and our allies. Large and growing North American oil supplies threaten the hegemony of OPEC and Russia, which have historically used energy security as a weapon against our allies and an excuse to eschew international diplomatic responsibilities. High and sustained U.S. oil production and exports can weaken Europe and Japan's trade dependency on Russia and the Middle East, providing more flexibility in setting international policy. At the same time, the U.S. can become a crucial oil supply hub, expanding our influence in growing demand centers in China and India.

Conclusion

The oil export ban is an outdated policy that provides no benefit to the American consumer. The ban restricts markets for domestic oil producers, keeping domestic prices artificially low, international prices artificially high, and inhibiting investment in advanced oil development technologies. Repealing the ban would drop consumer prices for gasoline, improve our long-term energy security, bolster our trade and diplomatic profile on the international stage, and enable the U.S. to reap the full benefits of its abundant resources.