Statement before the Committee on Banking, Housing, and Urban Affairs

of the

United States Senate

on

Lifting the Crude Oil Export Ban

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The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

Thank you, Mr. Chairman and distinguished members of this committee, for this opportunity to offer my views on lifting the export ban on crude oil. Ending this ban would be an important dimension of:

- A rationalization of U.S. energy policy narrowly;
- A reform of misguided policies from the past as they have evolved in the face of political and bureaucratic objectives shaped by interest group pressures;
- An ongoing effort to inform the public debate on such important related issues as the construction of the Keystone XL pipeline and the prospects for the export of liquefied natural gas;
- A more-general need to increase the importance of economic markets and the overall expansion of free trade as determinants of resource use and as vehicles with which to increase aggregate wealth and individual economic opportunity and wellbeing; and
- A larger defense of individual freedom and competitive capitalism from the cronyism, favoritism, and wasteful subsidies emerging from the politicized allocation of resources that is the inexorable result of a substitution of competition by politics in place of market forces.

The current export ban on crude oil was enacted as part of the 1975 Energy Policy and Conservation Act, and was justified on the basis of two fallacies. First: That the 1973 Arab OPEC oil "embargo" was the cause of the higher oil prices and the gasoline lines and other market disruptions experienced in the early 1970s. Second: That a ban on exports of crude oil would insulate the U.S. economy from the effects of international supply disruptions.

A straightforward economic truth can be stated simply: Abstracting from such minor factors as differential transport costs and the varying characteristics of different types of crude oil, there can be only one price for oil in the world market. A higher price in one region would attract sellers, reducing the price there so as to equalize it with prices everywhere else.

And that is why the 1973 embargo, directed at the U.S., the Netherlands, and some other allies of Israel, had no effect at all. Since there can be only one price in the world oil market, that attempt by Arab OPEC to impose a higher price on those nations did not succeed; market forces resulted in the reallocation of oil so that prices were equal everywhere. Despite conventional wisdom on this issue, the U.S. faced the same higher international prices as everyone else.

The actual source of the worldwide price increase was not the embargo; it was for the most part the production cutback by Arab OPEC. Persian Gulf production fell from an average of about 20.7 million barrels per day in 1973 to about 18.9 million barrels per day by 1975.[1] That represented a decline in world production of about 3.4 percent by 1975.[2] A far less

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[1] See the U.S. Energy Information Administration at http://www.eia.gov/totalenergy/data/monthly/pdf/sec11_5.pdf.

[2] That percent decline might seem small, but given low demand elasticities for crude oil in the short run, it yielded large price increases, from $56.07 in 1973 to $104.19 in 1975, in year 2014 dollars. Source: author computations from data reported by the U.S. Energy Information Administration at

important factor was the weakening of the dollar related to the collapse of the Bretton Woods exchange rate system and the decision by the Nixon administration to close the gold window.

Similarly, the gasoline lines and market disruptions were the result of the price and allocation controls imposed upon the domestic market for crude oil and refined products. They were *not* caused by the embargo: Notice that there was no embargo in 1979, but there was a production cutback in the Persian Gulf as a result of the overthrow of the Shah of Iran, from the 18.9 million barrels per day in 1975 noted above to less than 18 million barrels per day in 1980. But: There was a newly invigorated system of price and allocation controls, and there were once again gasoline lines and market chaos.

This straightforward economic analysis means that the justification for the export ban as a tool with which to insulate the U.S. economy from the effects of supply disruptions and other factors affecting prices was and remains fundamentally flawed. Accordingly: The intellectual and policy justifications for the export ban were bankrupt then and remain so today.

Suppose now that the current export ban were to be removed. With respect to the domestic prices of crude oil, I believe that a repeal of the export ban would increase those prices very modestly, by an approximate amount of $2-3 per barrel. This would be a straightforward supply-and-demand effect reducing the difference between the spot prices for crudes produced domestically and overseas. An obvious example is the price difference between West Texas Intermediate and Brent crudes, about $5.50 per barrel ($48.14 vs $54.62) as of the morning of July 27.[3] That difference is very likely to have been made artificially larger by the export ban.

There is the further matter that an increase in crude exports would have the effect of strengthening the dollar, the magnitude of which is very difficult to estimate among all the many factors influencing the dollar exchange rate. But however difficult to measure, this effect is real, and it would put some downward pressure on the dollar prices of crude oil internationally, thus offsetting to some degree the supply/demand effect that I have just mentioned. And that stronger dollar would increase aggregate wealth in the U.S., which in principle would take the form of a reduction in the overall price of the U.S. basket of goods and services, an effect that again is difficult to measure in isolation.

Given the small price effect of ending the export ban, it is difficult to believe that the narrow employment effects in specific economic sectors would be significant, and it is likely to be the case that those impacts would not be measurable given the normal fluctuations of such employment on an annual basis. But in a larger context, those employment effects would be offset over time by increased employment in other sectors---in particular, import sectors and sectors complementary with them---and by the positive aggregate employment effects of a stronger dollar and the larger economy and increased employment demand resulting from it.

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http://www.eia.gov/totalenergy/data/annual/showtext.cfm?t=ptb0521, and by the Council of Economic Advisers at https://www.whitehouse.gov/sites/default/files/docs/2015_erp_appendix_b.pdf, Table B-3.

[3] See the daily price data reported at http://www.oil-price.net/.

With respect to the U.S. prices of such refined products as gasoline and diesel fuel: Because refined products are not included in the export ban, and thus are traded freely in the international market, it is difficult to see how a repeal of the export ban on crude oil could increase product prices. Instead, ending the export ban actually would put downward pressure on product prices for two reasons.

First: The increase in the international supply of crude oil created by increased U.S. exports would reduce both crude and product prices overseas. Accordingly, product prices in the U.S. would be lower than otherwise would be the case because, again, products are traded more-or-less freely in the world market, creating the one-price outcome.

Second: Both internationally and domestically, the export ban has distorted the allocation of differing types of crude oil among refineries, which are designed in various ways to refine particular crude oil types more efficiently than others. An end to the export ban would improve the alignment of refinery and crude oil characteristics, particularly in the U.S. and particularly over the medium- and longer terms, thus reducing the cost of refining crude oil generally, and therefore of producing refined products. As an aside, this effect clearly would be one of the hidden benefits of the Keystone XL pipeline were it to be constructed.

Let me make two final points in passing. First: The reduction in international crude prices would have salutary effects in terms of reducing foreign exchange earnings by several unsavory regimes, the Iranian and Russian ones in particular. That impact might be modest; but as far as I am concerned, every bit helps, particularly in terms of increasing energy security in Europe.

Second: The defense of free trade is a crucial component of the larger defense of capitalism and freedom, with important implications for such other specific issues as the prospects for the export of liquefied natural gas. The export ban on crude oil was from the very beginning a deeply perverse policy implemented in a futile attempt to mitigate the perverse effects of other government policies. Ending the ban would be an important component of a larger reform agenda for this Congress.

I thank you again, Mr. Chairman and distinguished members of this committee, and I would be very pleased to address any questions that you may have.