Summary

The situation in Ukraine has intensified political and media scrutiny of the United States’ restrictions on the export of crude oil and liquefied natural gas (LNG). With supplies of Russian energy to Ukraine and Europe at risk, an increasing number of politicians and commentators—many of whom have not previously opined on the issue—have called for reform of these longstanding restrictions to counter Russia’s influence in the region. Although some advocates have argued that the Obama Administration has ample discretion to liberalize crude oil or LNG exports, others have proposed congressional legislation to achieve this result.

There are several economic and legal reasons for reforming US energy export policy, but the Ukraine situation has added a geopolitical element to the political debate that was heretofore lacking. Unless the situation escalates, however, there is insufficient political support to loosen the export restrictions.

Analysis

I. BACKGROUND

Restrictions on the Export of Crude Oil From the United States

The United States federal government regulates the export of crude oil primarily pursuant to Section 103 of the Energy Policy and Conservation Act of 1975 (EPCA), which requires the President to "promulgate a rule prohibiting the export of crude oil and natural gas produced in the United States, except that the President may... exempt from such prohibition such crude oil or natural gas exports which he determines to be consistent with the national interest and the purposes of this chapter." This export restriction was implemented through an export licensing system originally authorized by the Export Administration Act of 1979 (EAA) and was implemented under the Export Administration Regulations (EAR) “Short Supply Controls,” which are administered by the Bureau of Industry and Security (BIS) within the US Department of Commerce. The EAA expired on March 30, 1984; however, the export controls in effect under that Act have been maintained pursuant to (i) a declaration of national emergency by the President under the International Emergency Economic Powers Act, found in 50 USC. § 1701; and (ii) annual renewals by executive order.
Part 754 of the EAR specifies several narrow categories of exports that qualify for automatic approvals from BIS, most notably exports of crude oil to Canada “for consumption or use therein.” For all other exports that do not fall into one of these categories, BIS reviews export applications “on a case-by-case basis and... generally will approve such applications if BIS determines that the proposed export is consistent with the national interest and the purposes of the [EPCA].” BIS must deem certain narrowly defined transactions to be in the “national interest” and will reject all others unless the President issues a formal finding that the transaction at issue is in the “national interest.”

The result of this system, as confirmed by monthly export data, is an effective ban on all crude oil exports destined for anywhere other than Canada.

Restrictions on the Export of Natural Gas From the United States

The export of natural gas is primarily governed by the Natural Gas Act of 1938 (the “Act”). The law states that gas exports must be authorized by DOE and that authorization shall be granted unless exportation “will not be consistent with the public interest.” The system provides for automatic licensing for exports to any US FTA partner (i.e., exports destined for FTA partners are deemed to be consistent with the “public interest”). For exports to all other countries, the system creates a rebuttable presumption that a proposed export is in the “public interest.” The term “public interest” is not defined by law, and there are no objective criteria that would bind DOE’s determination of whether the “public interest” standard has been met. Thus, the agency has the discretion to reject an export license based on a subjective determination under the “public interest” standard.

DOE approval of a license to export natural gas to non-FTA countries does not automatically lead to such exports because the gas must be condensed and liquefied at special LNG export terminals, the construction of which is regulated by the Federal Energy Regulatory Commission (FERC) within DOE. Section 3 of the Act grants FERC the “exclusive authority to approve or deny” an LNG export terminal prior to construction (along with siting and expansion). This process has proven difficult and lengthy: FERC has approved only one LNG export terminal—the January 31, 2011 Sabine Pass application was approved on April 16, 2012. Thirteen other LNG export terminal authorization requests remain pending.

II. POLICY CONCERNS WITH THE US ENERGY EXPORT REGIME

An increasing number of critics across the political spectrum are concerned that the regimes governing exports of US oil and gas are inconsistent with international trade law, geopolitical interests of the United States and its allies, and other US economic and trade objectives.

International Trade Law Concerns

The US crude oil and natural gas export systems could be inconsistent with the United States’ legal obligations under the World Trade Organization (WTO) Agreements. These concerns relate to international trade in both upstream and downstream products.

Upstream Issues

Restrictions on crude oil and natural gas raise several concerns under the country’s WTO obligations. The primary issue is that they appear to be inconsistent with the general prohibition on quantitative export (and import) restrictions under Article XI of the WTO General Agreement on Tariffs and Trade (GATT). WTO jurisprudence has established that discretionary export licensing systems, as well as those in which license approvals are delayed for long periods, violate Article XI. The legal standards for exports of both crude oil (the “national interest”) and natural gas (the “public interest”) leave the executive branch with almost unlimited discretion to approve or deny a license to export such products. Many applications for the export of natural gas to non-FTA countries have been delayed for unreasonable periods of up to several years.

The permitting process for LNG export terminals also may be susceptible to challenge as a violation of Article XI, which prohibits “quotas, import or export licenses or other measures” that restrict imports or exports. WTO jurisprudence has interpreted this last category broadly, noting that it is “meant to encompass a ‘broad residual category’ of trade restrictions.” A WTO Panel has found that an analogous measure—Colombia’s express limitation on port access for certain transactions—was an impermissible import restriction under Article XI. The limitation in US law on LNG export terminal construction, as enforced by FERC and demonstrated by the lack of approved facilities, could be deemed to constitute a similar type of restriction (in this case on LNG exports).
In the event of a WTO challenge under Article XI or another WTO provision, the United States could find it difficult to rely on any of the exceptions to WTO rules under GATT Article XX or XXI. Article XX provides ten general exceptions from GATT obligations, but only paragraphs (b) (allowing measures “necessary to protect... health”) and (g) (allowing measures “relating to the conservation of exhaustible natural resources”) appear applicable. A defense of the US crude oil and natural gas export restrictions based on one of these exceptions, however, may prove unsuccessful. Given that environmental or health protection is not a core tenet of the EPCA or the Natural Gas Act, an Article XX(b) defense would likely be tenuous. Moreover, the successful invocation of Article XX(g) requires commensurate “restrictions on domestic production or consumption,” but there are no such restrictions for natural gas or crude oil in the United States.

A GATT Article XXI “national security” defense would also be problematic. This provision permits a WTO Member to take “any action it considers necessary for protection of its essential security interests,” but the only provision that would apply to US energy export restrictions is that governing actions “taken in time of war or other emergency in international relations.” This standard is subjective and Article XXI has never been interpreted in WTO jurisprudence. Although Members are deferential to security concerns, on the merits it would be difficult to maintain an argument that, in this time of American energy abundance, decades-old export restrictions fit within the criteria of Article XXI. Moreover, the United States would probably be hesitant to invoke Article XXI to justify these particular measures out of concern for the precedent it would set.

Downstream Issues

US export restrictions on crude oil and natural gas also raise legal concerns with respect to trade in downstream or energy-intensive goods like refined products, petrochemicals, fertilizer or aluminum. These concerns stem from a heightened risk of (i) trade remedy (anti-dumping or countervailing duty (CVD)) actions against US exports of downstream products in key foreign markets, or (ii) a WTO challenge alleging that the export restrictions constitute “prohibited” export subsidies to these goods. Such actions could lead to remedial duties on downstream exports from the United States, thereby offsetting any alleged competitive advantage that US exporters currently gain from the upstream export restrictions.

First, export restrictions on upstream inputs could be deemed to constitute actionable or even prohibited subsidies under the WTO Agreement on Subsidies and Countervailing Measures (“SCM Agreement”) or national CVD laws. If an export restriction reduces the domestic cost of an industrial input, overall production costs for goods using that input would in turn be reduced. Thus, domestic downstream products made from US crude oil or natural gas could benefit from the upstream export restrictions, thus leading to claims by other WTO Members that the restrictions act as unfair subsidies. If such subsidies provide an incentive for downstream producers “to skew anticipated sales towards exports,” then they could be found to be prohibited “export-contingent” subsidies under Article 3.1(a) of the SCM Agreement.

A WTO Panel has ruled that the export restraint at issue in that dispute did not constitute a subsidy, but this remains a live issue in both WTO dispute settlement and CVD proceedings. Indeed, the United States regularly uses such logic to find that export restrictions constitute countervailable subsidies on downstream products. China is currently challenging this view in a WTO dispute, where it argues that the US Department of Commerce incorrectly deemed export restraints (quotas, taxes and licensing arrangements) to constitute countervailable subsidies. That case remains pending.

Second, the export restrictions could raise concerns for US exporters of downstream products that are targeted in national anti-dumping investigations. In calculating dumping, certain WTO Members, including the European Union, have cited export restrictions as grounds to reject investigated exporters’ home market sales prices and record input costs on the view that export restrictions render these values unusable. Instead, the Members’ investigating authorities have calculated dumping using adjusted values based on “undistorted,” higher international market prices, thereby leading to higher anti-dumping duties on the downstream products under investigation (or duties that would not otherwise exist at all).

If an anti-dumping investigation were initiated against imports of refined products, petrochemicals or other downstream goods from the United States, a national authority following this policy could find that upstream export restrictions on gas or oil render downstream US exporters’ sales and cost records unusable for calculating dumping. Such an approach would likely increase the margin of dumping and lead to higher duties on the subject merchandise than would have been levied using the exporters’ actual records. Although this methodology is controversial (it is the subject of two pending WTO disputes), it will be effective unless WTO rulings disapprove it.
Geopolitical Concerns
The current restrictions on crude oil and natural gas exports also have raised geopolitical concerns, as US allies in Asia and Europe endure high and erratic energy prices and remain dependent on a limited number of regional suppliers. Although the immediate geopolitical impact of systemic reform should not be overstated, there is general agreement that the export of US energy resources would, by providing a new, significant supply source, help stabilize global energy markets in times of global turmoil and provide Asian and European consumers with an alternative to less predictable suppliers, including those in Russia. US exports, in turn, would limit allies’ concerns about the potential impact of their foreign policy decisions on domestic energy availability and prices. The White House has recently noted its own efforts to promote energy exports for these very reasons.

Many experts have argued that the liberalization of US crude oil and natural gas exports also would demonstrate US flexibility to tackle security challenges through diverse measures—beyond, or in conjunction with, more forceful action such as economic sanctions or military action. Given the instability in many energy exporting countries and regions and current US reluctance with respect to expansive foreign commitments, these experts assert that geopolitical benefits of a liberalized US energy export regime are clear.

Other Concerns
Critics of US export restrictions also claim that the restrictions undermine US economic and trade policy. First, by depressing domestic prices and subjecting export approval to nonmarket forces, the restrictions are said to retard domestic energy production and discourage investment in the oil and gas sectors. Artificially low prices prevent producers from achieving a sustainable rate of return on the large up-front costs required to drill and extract oil and gas, and investors lack any assurances under the discretionary licensing systems that domestic prices will not collapse when output increases. Domestic supply gluts in natural gas have caused US producers to divest from the sector, and analysts expect similar problems for crude oil in the near future. These economic concerns led the International Energy Agency to warn that US export restrictions put the entire “American oil boom” at risk.

Moreover, independent reports show that the exportation of oil and gas would not cause a traumatic spike in oil and gas prices for US industrial and individual consumers. According to these reports, US natural gas prices would remain well below prices in other markets, and several economic analyses predict that crude oil export reform would likely lower US gasoline prices—thus answering US lawmakers’ most prevalent liberalization concern. In fact, studies indicate that the primary beneficiaries from the crude oil restrictions are certain US refiners who buy domestic crude at a discount and freely export refined products at global prices. One such study found that, from 2010 to 2013, refiners in the Rocky Mountain and Midwest regions paid between 16 and 21 percent less per barrel for crude oil than those on the East Coast, but wholesale gasoline prices were essentially unchanged.

Second, current policy might undermine several other Obama administration trade priorities. Restricting oil and gas exports is difficult to reconcile with President Obama’s National Export Initiative or his support for other energy exports, particularly renewables. Moreover, the use of export restrictions that benefit domestic downstream industries is inconsistent in principle with longstanding US policy of applying anti-subsidy (countervailing) duties on foreign imports that are found to benefit from export restrictions on upstream inputs. Finally, the US government has long opposed restrictive and opaque export licensing systems in WTO negotiations and dispute settlement. It is difficult to square the current US export restrictions on crude oil and natural gas with these positions.

III. UKRAINE: BRINGING US ENERGY EXPORTS TO THE FORE
The situation in Ukraine has moved US energy export liberalization from a niche issue to the forefront of American political discourse. Before the crisis, a steady-but-small group of public figures advocated reforming the US crude oil and natural gas export regimes. In addition to several advocacy and policy groups, Senators Mary Landrieu (D-LA) and Lisa Murkowski (R-AK), the Chair and Ranking Member, respectively, of the Senate Committee on Energy and Natural Resources, advocated liberalizing the export of both crude oil and LNG. These Senators were joined by Rep. Fred Upton (R-MI), Chair of the House Committee on Energy and Commerce, leading GOP 2016 Presidential contenders Senators Ted Cruz (R-TX) and Rand Paul (R-KY) and a few other lawmakers, but overall congressional support remained limited.
Since the situation arose in Crimea, however, the ranks of reform advocates have blossomed, as has related congressional legislation. Because of Europe's reliance on Russian energy resources, many people now have advocated liberalizing US energy exports as a check on Russia's regional ambitions. Editorials in The New York Times, The Washington Post, and The Wall Street Journal all called on the Administration to liberalize US energy exports. In the course of two days, three bills were introduced in the House and Senate concerning LNG exports. House Majority Leader, John Boehner (R-OH), has championed reform, noting that the Ambassadors of four Central and Eastern European States (Hungary, Poland, Slovakia and the Czech Republic) have asked him and Senate Majority Leader, Harry Reid (D-NV), for the “presence of US natural gas” in the region in order to counter Russia's influence. Another leading contender for the 2016 Republican presidential nomination—Senator Marco Rubio (R-FL)—also has called for crude oil and LNG export reform, as have several Democratic lawmakers.

IV. OBSTACLES TO REFORM REMAIN

Despite the heightened scrutiny of US energy export regimes and the added sense of geopolitical urgency, near-term systemic reform remains unlikely. The Obama Administration has, to date, indicated that it does not intend to alter these longstanding policies because market and infrastructure limitations prevent reform from immediately affecting the Russian government's behavior. Analysts further speculate that the President's resistance to reform also stems from base political concerns: Democrats face a difficult 2014 mid-term election cycle, and reform could upset environmental and other groups that oppose any policies that might increase domestic fossil fuel production. Indeed, prominent environmental groups have just begun a concerted effort to persuade President Obama to oppose LNG export reform, while also noting that their push is "not in response to what's happening in Crimeal." Regardless of the accuracy or strategic value of the President's current position, his role in any reform process—as head of the executive branch and de facto leader of the Democratic Party—makes White House support critical to any such initiatives.

Moreover, significant political opposition to energy export liberalization remains. Aside from the aforementioned environmental groups, certain downstream industries have organized lobbying efforts to oppose export liberalization. Moreover, many US lawmakers remain steadfastly opposed to reform. For example, just a day after Senator John Barrasso (R-WY) introduced an amendment to a bill on aid to Ukraine that called for expediting LNG exports, the amendment was ruled procedurally “out of order” and Foreign Relations Committee Chairman, Robert Menendez (D-NJ), concluded that “this may be a debate for another time.” Other lawmakers, such as Senator Ed Markey (D-MA) also have criticized reformers' position as geopolitically impotent or harmful for US energy consumers. As such, liberalization initiatives still face an uphill climb despite recent geopolitical developments.

V. CONCLUSION

The situation in Ukraine has not altered the policy rationales for reforming US oil and gas export restrictions, but it has provided significant new political momentum for liberalization. Political support for loosening exports is still too diffuse to overcome the Obama Administration's inertia, but if the situation in Ukraine intensifies or spreads to other parts of Eastern Europe, the current political opposition or indifference to reform efforts may disintegrate. The White House could then view the political cost of inaction as higher than that of any possible retribution from domestic political supporters or consuming industry groups in 2014. At that point, congressional Democrats and the President could be forced to accept and embrace energy export reform, regardless of their political, environmental and geopolitical views. Ukraine thus warrants continued monitoring, as it, not actual policy concerns, could dictate the pace of any reforms to US natural gas or crude oil export systems.
1 18 USC. § 6212 (2013).
2 18 USC. § 6212(b)(1). This chapter lists the EPCAs purposes: (1) “to grant specific authority to the President to fulfill obligations of the United States under the international energy program;” (2) “to provide for the creation of a Strategic Petroleum Reserve capable of reducing the impact of severe energy supply interruptions;” (3) “to conserve energy supplies through energy conservation programs, and, where necessary, the regulation of certain energy uses;” (4) “to provide for improved energy efficiency of motor vehicles, major appliances and certain other consumer products;” (5) “to conserve water by improving the water efficiency of certain plumbing products and appliances.” 42 USC. § 6201.
6 15 C.FR. § 754.2(b)(2).
7 15 USC. § 717b(b).
8 15 USC. § 717b(e)(1).
10 15 USC. § 717b(e)(1).
13 Panel Report, India – Quantitative Restrictions, paras. 5.129 (citing and adopting a GATT panel’s decision that “export licensing practices… leading to delays of up to three months… had been non-automatic and constituted restrictions on the exportation of such products inconsistent with Article XI”).
15 Colombia – Ports of Entry, paras. 7274 – 7275. The fact that this case addressed import, rather than export, restrictions would be immaterial to any Panel analysis of LNG export terminals under GATT Article XI.
16 A secondary challenge to the crude oil licensing system could come under the most-favoured nation (MFN) obligation of GATT Article I, which requires a WTO Member to treat all other Members equally in respect of cross-border trade in goods. The presumption of license approval for crude oil exports to Canada might violate the United States’ MFN obligation because exports to all other WTO Members are granted no such preference. The United States could argue that this discrimination is permitted under GATT Article XXIV because Canada is an FTA partner, but its position would be difficult to reconcile with the fact that (i) the North American Free Trade Agreement (NAFTA) does not contain a provision explicitly permitting US crude oil exports to Canada while restricting them to Mexico; and (ii) unlike natural gas, no other US FTA partners are granted preferential access to US crude oil exports. In any event, conformance of a US FTA with GATT Article XXIV would not excuse the presumptive violation of GATT Article XI.
17 GATT, art. XX(b)(iii). The other two security interests relate to “fissileable materials or the materials from which they are derived” and “traffic in arms” and other weapons. GATT, arts. XX(b)(i), XX(b)(ii).
19 Appellate Body Report, EC and certain member States – Large Civil Aircraft, para. 1047.
24 See Carol Davenport and Steven Erlanger, US Hopes Boom in Natural Gas Can Curb Putin, N.Y. TIMES, Mar. 5, 2014 (quoting Carlos Pascual, head of the US State Department Bureau of Energy Resources as stating “that although the prospective American exports would not immediately solve the problems in Europe, ‘it sends a clear signal that the global gas market is changing, that there is the prospect of much greater supply coming from other parts of the world’”).
33 Such groups include industry associations, such as the American Petroleum Institute and National Association of Manufacturers, as well as think-tanks, including the American Enterprise Institute, Brookings Institution, CATO Institute and Council on Foreign Relations.


