



ENERGY, ECONOMIC GROWTH, AND U.S. NATIONAL SECURITY

The Case for an Open Trade and Investment Regime

David F. Gordon, Divya P. Reddy, Elizabeth Rosenberg,
Neil Bhatiya, and Edoardo Saravalle

About the Authors



DAVID F. GORDON is an Adjunct Senior Fellow in the Energy, Economics, and Security Program at the Center for a New American Security (CNAS). Dr. Gordon is also an adjunct professor in the School of Foreign Service at Georgetown University. Formerly, Dr. Gordon served as Director

of Policy Planning for Secretary of State Condoleezza Rice, after a distinguished career in intelligence culminating in his leadership of the National Intelligence Council. After leaving government service, Dr. Gordon became the Chairman and Head of Research at Eurasia Group, a global political risk advisory firm, where he is currently Senior Advisor.



DIVYA P. REDDY is the head of the Global Energy & Natural Resources practice at the Eurasia Group focusing on global gas markets, North American energy policy, climate change and alternative energy, and metals and mining. Previously, she was a Research Associate at the Council

on Foreign Relations and an Analyst at Bear Stearns & Co. covering oil, gas, coal, precious metals, and energy technology.



ELIZABETH ROSENBERG is a Senior Fellow and Director of the Energy, Economics, and Security Program at CNAS. Previously, she served as a Senior Advisor at the Department of the Treasury on international illicit finance issues, and as an energy policy correspondent at Argus

Media analyzing U.S. energy policy, regulation, and trading, as well as OPEC production policy.



NEIL BHATIYA is the Research Associate for the Energy, Economics, and Security Program at CNAS. His work focuses on the geopolitics of energy, climate change, and tools of economic statecraft. Prior to joining CNAS, he was the Climate and Diplomacy Fellow at the Center for

Climate and Security. He was previously a Fellow at the Century Foundation.



EDOARDO SARAVALLE is a Researcher in the Energy, Economics, and Security Program at CNAS, where his work focuses on the geopolitics of energy and the use of sanctions and economic statecraft. Previously, he worked as an investment banker at Moelis & Company covering oil,

gas, and energy services.

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Introduction

It has been nearly two years since Congress lifted the ban on the export of crude oil from the United States. A Center for a New American Security (CNAS) report on the national security implications of the ban argued that opening up the export market for oil, which had been closed since the Organization of the Petroleum Exporting Countries (OPEC) oil embargo of the mid-1970s, would help make U.S. energy producers nimbler and the U.S. economy more resilient, while at the same time strengthening America's influence and leverage around the world.¹

At the core of this report was the argument that an open U.S. energy market would strengthen global energy resilience, improve the U.S. trade balance, and ensure the continued primacy of the U.S. dollar, while avoiding putting upward pressure on U.S. gasoline prices. At the same time, it would promote more open energy markets globally, which is positive for both the U.S. economy and U.S. national security interests. By increasing the proportion of global energy supplies from politically stable regions, U.S. exporters would support U.S. allies both in this hemisphere and in Europe and East Asia, while weakening the leverage of the OPEC cartel and thus making the market less vulnerable to price spikes. Finally, the report argued that opening

up exports would enable the United States to sustain its technological advantage in unconventional energy production, a further source of leverage (and admiration) around the world.

In December 2015, Congress and the Barack Obama administration reached an agreement on legislation to lift the crude ban and extend tax credits for renewable energy. At about the same time, U.S. policy leaders also began to loosen the regulatory regime around natural gas exports. As a result of these actions, the U.S. role in international energy markets grew substantially, especially in 2017.

When President Donald Trump hosted “Energy Week” in early July 2017, his main theme was that the United States was poised to enter a new world of energy dominance. According to Energy Secretary Rick Perry, “An energy-dominant America means self-reliant. It means a secure nation, free from the geopolitical turmoil of other nations who seek to use energy as an economic weapon. An energy-dominant America will export to markets around the world, increasing our global leadership and our influence.”²

The “energy dominance” slogan suggests a more zero-sum relationship than is accurate or desirable – global energy players are fundamentally interconnected, and our energy market partner countries do not want to be dominated by the United States. The



Early in his term, President Trump promised to ramp up oil and gas production in the United States and embark on a policy of “energy dominance.” (Kevin Dietsch-Pool/Getty Images)

U.S. political debate around energy still features arguments for restricting exports and naïve calls for “energy independence.” However, the growing perception of the United States as an energy market “maker” rather than a “taker” speaks to how rapidly and profoundly global energy markets are evolving, and to the central U.S. role as a major producer and exporter in that revolution. Two years after the CNAS report on lifting the crude export ban was published, and its core recommendation adopted, almost all of the impacts discussed in the report are happening in the real world.

Two years ago, an outdated regulatory framework stood in the way of the United States reaping the benefits of an open energy trade and investment regime. Those constraints are, for the most part, no longer a factor. However, while the trajectory of energy policy seemed to be moving toward reducing some of the last vestiges of regulation of U.S. energy markets, like the Jones Act mandating that only U.S.-flag ships can transport goods between U.S. ports, the dynamic is now different.



In December 2015, President Obama lifted the 40-year-old ban on the export of crude oil. (Mark Wilson/Getty Images)

Today, a rising populist backlash against the international system finds its expression in trade protectionism and a distrust of multilateralism. These themes appeal to voters who remember a time of U.S. industrial dominance that they believe has been eroded by globalization and the willingness of elites in Washington to sign trade deals that hurt U.S. competitiveness. While these sentiments do not focus specifically on energy markets, they may erode the political and economic arrangements that support them. They may also be here for an extended period; there are few signs that the economic and global migratory forces that set them in motion will change anytime soon.

In the United States, there has been an erosion of popular support, on both the right and the left, for open trade and commercial flows, as well as for U.S. leadership in the international institutions that underpin these activities. This now threatens the actual and potential benefits to the United States – in both economic and national security terms – that have begun to accumulate since the dramatic shift in U.S. energy policies in the final years of the Obama administration. In this context, it is more important than ever to explain why open energy markets are beneficial to the United States. That is the purpose of this report. But beyond this analysis and its policy recommendations to the administration, it is absolutely critical that energy firms invest more in conservation, community engagement, and trust-building with the people affected by their activities. Without this, no amount of regulatory support will afford these firms the “social license to operate” or relieve them of massive litigation activities that challenge their operating capacity.

This report assesses why, in the context of expanding U.S. energy production and exports, open U.S. markets are good for the U.S. economy and the broader global economy and, at the same time, support U.S. national security interests. The report then makes a series of policy recommendations – largely on what traps the Trump administration needs to avoid – to ensure that “energy dominance” does not veer down the path of a new version of damaging energy protectionism. The report also presents ideas for how companies may be able to restore broader public confidence in the responsible operation of the U.S. fossil fuel industry.

The Recent Rise of Populism in the United States

The years since the 2008 financial crisis have seen the reemergence of populism across advanced economies. The populist phenomenon has arisen in response to globalization, the technological revolution that has accelerated it, public indebtedness, and concerns about immigration.³ Contemporary populism takes both left-wing and right-wing forms. In Europe, for example, the share of parliamentary seats held by left-wing populist parties increased fivefold since the 1960s, reaching 11.5 percent, while for right-wing populist parties it doubled, reaching 13.7 percent.⁴ In the United States, it is right-wing populism that has found the most success with the election of Trump. While populists on opposing sides of the partisan divide have disagreements on key issues – especially immigration – they have both challenged some key long-standing assumptions that have dominated U.S. policy. Nowhere is this more apparent than on trade issues, where the right-wing populist embrace of protectionism and tariffs mirrors similar left-wing positions.⁵

The populist wave in the United States culminating in the 2016 election marks a tipping point in attitudes toward major institutions. According to current research on public trust, confidence in institutions in general has steadily declined in the United States since the 1970s, with a marked drop since 2010. In the early 1970s, only 18

percent of Americans expressed “hardly any” confidence in Congress; by 2010–2012, that number had increased to 46 percent. At the turn of the century, surveys of U.S. 12th graders found that 54 percent of them thought corporations were doing a “good” or “very good” job. By 2010–2012, that number dropped to 33 percent. Researchers found that the decline was consistent among different age groups and correlated with shifting macroeconomic conditions.⁶ Rising income inequality and poverty were strongly correlated with lack of faith in large institutions, including nongovernmental organizations (NGOs), businesses, media, and government. In 2017, the most trusted among these – NGOs – were trusted by only 53 percent of the population while the least trusted – government – found support among only 41 percent of the global population.⁷ In other surveys, trust in government currently sits at 20 percent.⁸ Within the government, the military is by far the most trusted institution.

In the economic realm, there is growing distrust in the fundamentals of globalization: trade and cross-border commercial movement. In a 2017 poll, only 35 percent of Republicans, for example, thought that free trade had helped their finances, compared to 44 percent in 2006.⁹ There also is a growing discrepancy between the public and experts on economic issues. For example, while 49 percent of the U.S. public thought U.S. involvement in the global economy was mostly negative because it



NAFTA countries, represented by U.S. Secretary of Commerce Wilbur Ross and Mexican Minister of Economy Ildefonso Guajardo Villarreal, pictured above, are renegotiating the treaty following President Trump's promise of a better deal. (Justin Sullivan/Getty Images)

lowered wages and cost jobs, only 2 percent of surveyed international relations scholars agreed.¹⁰ On more concrete issues, opinions have also evolved. For example, Republican support for the North American Free Trade Agreement (NAFTA), the free trade agreement among Mexico, Canada, and the United States, fell to 22 percent in 2017 compared with 40 percent in 2004.¹¹

The current wave of U.S. populism also focuses on foreign policy and U.S. intervention globally.¹² Here, too, broad popular doubts about the U.S. role in the world, and especially participation in international institutions, have grown. Today, 69 percent of Americans still tend to believe that the country “should not think so much in international terms but concentrate more on our own national problems,” and a plurality (41 percent) believe the United States is doing too much to help solve world problems.¹³

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These broad policy preferences find expression in many current administration statements and initiatives. President Trump and his principal trade advisors have repeatedly articulated their skepticism of free trade and globalization. Trump set the tone early in his administration in ordering U.S. withdrawal from the Trans-Pacific Partnership (TPP), a trade agreement that the Obama administration had spearheaded bringing together 12 economies in Asia, North America, and South America. Trump wrote, “It is the policy of my Administration to represent the American people and their financial well-being in all negotiations [sic], particularly the American worker, and to create fair and economically beneficial trade deals that serve their interests.”¹⁴ Secretary of Commerce Wilbur Ross has argued that other countries engage in unfair trade practices and criticized the World Trade Organization’s (WTO) characterization of the increase in U.S. trade enforcement cases as protectionism rather than attempts to ensure a “level” playing field.¹⁵

But it is not clear how much the populist rhetoric of the administration will find expression in policy, given that some of Trump’s economic advisors and most of his national security team lean toward more traditional views. During his first months in office, in addition to the TPP, the president also withdrew the United States from the Paris Agreement on global climate change,

specifically citing economic arguments rather than climate-specific objections.¹⁶ But the president shifted away from his threat to impose across-the-board tariffs on Chinese imports, and he is now focusing on the widely shared view that China engages in many forms of intellectual property theft. On NAFTA, Trump shifted from scrapping the agreement to renegotiating it, albeit seeking to erode some of the agreement’s multilateralist elements, especially on dispute resolution.¹⁷

While Trump has generally strongly supported the energy industry, particularly fossil fuel development, the populist outlook the administration espouses in terms of trade, multilateralism, and U.S. provision of public goods could have negative effects on the U.S. energy sector. Industry observers are concerned that changes to NAFTA could make the substantial U.S.-Mexico energy trade more cumbersome and expensive, and therefore more limited. There is also the risk that U.S. efforts to restrict Chinese investments in key high-tech sectors, due to intellectual property concerns, could chill investment in energy infrastructure. Potential steel or aluminum tariffs, or restrictions on trade with China, may have negative effects on the energy industry, raising costs for equipment and materials.

Moreover, the environmental movement is increasingly targeting big energy companies, as it seeks to limit fossil fuel development and expansion of the energy infrastructure. Permits for liquefied natural gas (LNG) export terminals are regularly challenged in the courts by environmental groups. Only recently, in August 2017, a federal court struck down a challenge by the Sierra Club



One of President Donald Trump’s first actions in his administration was signing an executive order withdrawing the United States from the Trans-Pacific Partnership. (Ron Sachs/Getty Images)

claiming that the Department of Energy (DOE) did not consider indirect environmental impacts of increased LNG exports when approving the Freeport LNG export terminal.¹⁸ And “keep it in the ground” movements that partly stem from hostility to big energy companies have gained more momentum amid a perceived backtracking on environmental protection by the Trump administration, in coordination with the fossil fuel industry. In fact, many environmental groups that vowed to fight the administration’s environmental agenda reported a bump in membership and funding following Trump’s election.¹⁹

The development of shale resources in the United States has fundamentally reshaped the concept of energy security.

The hostility toward energy production and export activities, and traditional energy companies, may have serious implications, and there is no indication that this, or economic populism more broadly, will soon recede. In fact, there is recent precedent for political and trade disputes spilling over into the energy sector. The 2010-2015 rare earth mineral dispute between Japan and China points to the deeply disruptive role disputes over trade can play in energy security. China was able to inflict a heavy economic cost on Japan, temporarily cutting off its supply of raw materials for high-technology electronics including in hybrid cars and energy saving appliances, in pursuit of purely political aims.²⁰ The United States and India also aggressively pursued grievances against each other’s solar energy policies in the WTO.²¹ Such disputes are more likely to arise in a context in which governments are becoming more skeptical about free trade and open markets.

Why Open U.S. Markets in Energy are Good for the Economy

The United States’ abundant energy resources represent a substantial economic opportunity for the nation, but maximizing that opportunity is contingent on maintaining open markets for energy. The development of shale resources in the United States has fundamentally reshaped the concept of energy security. Concerns about imminent global peak energy supply have receded, and U.S.-specific concerns about dwindling supply and the increased need for imports have passed as well. BP’s annual Statistical Review estimated that U.S. proved reserves of oil surged from 29.4 billion barrels at the end

of 2006 to 48 billion by the end of 2016, while production grew from 6.8 million barrels per day (bpd) to 12.4 million bpd over the same time frame. Meanwhile, proved reserves of natural gas grew from 6 trillion cubic meters in 2006 to 8.7 trillion by 2016, and production rose from 524 billion cubic meters to 749.2 billion.²² As such, measures to reserve domestic resources for domestic consumption are outdated in America’s energy reality today. Quite the contrary: The United States has an opportunity to stimulate further energy production and associated economic activity by tapping overseas demand opportunities.

While the crude oil export ban was in place, the differential between West Texas Intermediate crude and the global Brent benchmark price grew to as much as \$23 in February 2013.²³ As a result, U.S. producers were unable to capture higher margins from exports.²⁴ The lifting of the ban allowed U.S. producers to earn higher prices, thereby stimulating more production, to the benefit of the domestic market. Moreover, for crude oil, free trade allows the United States to sell its premium-priced light, sweet crude from domestic shale production while importing cheaper heavy, sour crude, which U.S. refineries are better equipped to process. Any restriction on crude exports would force U.S. refineries to take more U.S. shale output, for which they are not optimally configured.

Not only do export opportunities stimulate economic activity through better earnings for companies, more upstream activity, and associated services and job creation, but expanding the global supply of oil also helps



Lifting the crude oil export ban allowed U.S. producers, like the Permian Basin producer pictured above, to receive higher prices, stimulating further production. (Spencer Platt/Getty Images)

to lower global prices of crude, which in turn reduces prices for U.S. consumers at the pump. Notwithstanding variances in crude quality reflected in various global benchmarks, oil is fundamentally a fungible commodity. Therefore, the main driver of U.S. gasoline prices will continue to be the global price of crude, even though the United States has dramatically grown its own crude production. More global supply translates into more optionality and lower prices, which benefits U.S. consumers and the American economy (not to mention global consumers and the global economy).

Oil markets and prices have in recent decades been bound by OPEC's moves. As a cartel, OPEC has coordinated to set global supply in a way that establishes

growth in U.S. shale production has fundamentally undermined the ability of OPEC to manage oil markets. Most importantly, the quick-startup nature of U.S. shale production has upended the basic tenet of OPEC's cartel leverage, namely that oil supply is relatively price-inelastic. The recent cycle of OPEC production cuts, which commenced last November, has failed to materially stimulate a notable price resurgence, in large part due to the mitigating impact of increased U.S. shale production, as well as extensive available inventories. As U.S. production and exports grow further, both U.S. and global energy consumers will be far less beholden to cartel behavior and the distorting impacts it has on energy prices.

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a price point that maximizes its own revenues. Global consumers, including those in the United States, have historically been price-takers with minimal clout to shift that paradigm. The shale revolution and the emergence of the United States as a major supplier have shaken up these dynamics in an unprecedented way. Though U.S. exports are still fairly modest compared with those of other major oil producers, such as Saudi Arabia, the

Natural gas is a slightly different story. The U.S. market has traditionally been insulated from dynamics on the global stage, as pricing and supply have been relatively localized matters. But with far more global trade, a convergence of U.S. natural gas prices with global prices might introduce more volatility to prices at home. There is nevertheless widespread recognition that the U.S. resource base is vast enough to accommodate



Worries about gas import dependency a decade ago have now given way to discussion of how to maximize U.S. exports. Pictured above, an LNG tanker docks in Boston. (Kelly Turner/U.S. Coast Guard via Getty Images)

both growing domestic needs and exports.²⁵ In fact, absent exports, a sizable share of the domestic natural gas resource could very well remain shut in because its abundance keeps prices so low, and, therefore, it would not be available for domestic end users anyway. Considering this, the economic benefits of investment, job creation, and revenues from natural gas exports still outweigh what would probably be a manageable risk of increased price volatility from exposure to global market trends. For example, the United States exported \$3.76 billion worth of natural gas to Mexico alone last year,²⁶ narrowing a \$55.6 billion trade deficit.²⁷ U.S. LNG exports are still in their early days, but the economic boom once all six terminals currently under construction are operational will also be substantial.²⁸

There is widespread recognition that the U.S. resource base [of natural gas] is vast enough to accommodate both growing domestic needs and exports.

Lastly, open borders on energy extend beyond the flow of physical commodities. The United States needs large volumes of investment, including in infrastructure, to fully take advantage of its energy wealth. Particularly following the investment slowdown in the energy sector on the heels of the oil price collapse in 2014, domestic lending has slowed.²⁹ At the same time, global consumers of energy, from Europe to the Middle East to Asia, remain very interested in importing U.S. oil and gas. Capital injections from abroad have the potential to rejuvenate the investment pipeline for LNG export projects in particular, many of which are fully permitted but in search of customers and financing. To expand crude export opportunities, upgrades to ports on the U.S. Gulf Coast are required to handle very large crude carriers.³⁰ Moreover, rising oil and gas production and exports will require expansions to the U.S. pipeline system.³¹ All these projects will create jobs and revenues, and foreign investment can help them come to fruition.

Not only has the boom in U.S. oil and gas production and exports supported strong economic benefits in the oil and gas sector itself, it will continue to bear fruit across a host of sectors as low energy prices create new opportunities for growth, especially in energy-intensive manufacturing. Continuation of this trend will be supported – not hindered – by open borders, which

will provide demand signals for increased U.S. shale production as well as allow for importation of energy when the price is more favorable.

Beyond oil and gas, trade has also led to dramatic declines in the cost of renewable energy installations. In particular, an oversupply of solar photovoltaic (PV) components in China prompted a collapse in costs worldwide, including in imports from the United States.³² Though competition has driven some U.S. manufacturers out of business, cheap imports have led to a surge of investment and job creation in the U.S. solar sector. The Solar Energy Industries Association estimates that the sector now employs around 260,000 people at over 9,000 companies.³³ However, the industry expects that new solar installations could be decimated by the U.S. International Trade Commission's ruling in favor of two companies that petitioned the panel to impose tariffs on imported solar components.



Although Chinese overproduction of solar panels has driven some producers out of business, cheap imports have also led to growth of investment and job creation in the U.S. solar sector. (Kevin Frayer/Getty Images)

Why Open Global Energy Markets Support U.S. National Security

The U.S. policy of restricting energy trade grew out of disruptions caused to the U.S. economy from the Arab OPEC oil boycotts of the 1970s. The United States' move differed from those of other oil-importing states, who either never put in place such a restrictive policy regime or dismantled the regimes over time. In the United States, it was only when domestic demand limitations threatened to limit the growth prospects of both shale-based oil and natural gas production that both the executive and legislative branches moved to ease restrictions on exports.

The authors of this report support efforts by the Trump administration to shift more speedily and comprehensively in the direction of easing export restrictions. But, just as the arguments for how open energy markets are good for the U.S. economy go well beyond the direct impact of exports, the national security arguments for open global energy markets go beyond U.S. exports. In this regard, it is unfortunate that President Trump has articulated his energy policy in terms of U.S. "dominance," which plays well to a domestic audience. But America's energy partners around the world are excited by a larger U.S. energy role, because they seek to liberate themselves from energy dominance, be that dominance in the form of an OPEC cartel which has sought to raise oil prices above their market-driven levels; or Russia and Iran, which have used (in the case of Russia) or seek to use (in the case of Iran) the limited energy options of their neighbors as a means to secure their political subservience. Asia-Pacific countries, which have long faced energy price differentials institutionalized in both OPEC pricing and a gas market that has been too shallow to create a spot market with hedging opportunities, certainly welcome this new role for the United States.

The return of the United States as a major global energy producer and exporter creates significant opportunities for Washington to use its leverage to open global energy markets more generally. At the same time, it is providing greater resilience to those markets, which adds to the security of supply. This has already led to concrete national security benefits for the United States. The use of multilateral oil sanctions against Iran, which is what most observers believe was key to bringing Tehran to the negotiating table on the future of its nuclear program, was viable and sustainable because U.S. unconventional oil production alleviated fears that sanctions would lead to an oil price spike.³⁴ That same supply resiliency

provided by the U.S. shale revolution has also prevented the dramatic uptick in political tension and instability in the Middle East from being transmitted to the rest of the world in the form of higher oil prices, as has been the case for the prior half-century. Open markets are more resilient markets, and greater resilience undermines would-be regional hegemony who seek to use energy as a coercive tool against the United States and its allies by limiting their ability to control access to their energy resources.

Open U.S. energy markets also deepen foreign interdependence with the United States and create interests in continued U.S. economic strength. Here, the biggest opportunity lies with China. In the first dozen years of this century, global commodity markets – especially energy markets – were destabilized by China's push for rapid urbanization and growth at all costs, leading oil prices to soar to over \$100 per barrel. While China drove higher prices, it was also hurt by them. But in the last five years, increased U.S. oil and gas production – and more recently exports – have rebalanced global markets. In May, the Trump administration clarified its support for China receiving LNG shipments from the United States and for U.S. suppliers to enter into long-term contracts with China.³⁵ While President Obama's agreement with Chinese President Xi Jinping on climate change highlighted increased natural gas usage in China as a transitional strategy away from coal, the Chinese were uncertain whether domestic politics would make the United States a reliable natural gas partner. U.S. relations with China will continue to be fraught on many issues. But maximizing U.S. energy ties with China will promote greater stability in the relationship by strengthening the economies of both countries, and at the same time will aid global efforts to limit climate change.

Finally, a substantial U.S. role in global energy markets reinforces the credibility of U.S. power and will reassure U.S. allies. The Trump administration is correct that the reemergence of the United States as a global energy superpower directly supports and broadens other elements of national power, especially given the continuing influence of the narrative about U.S. decline. Overwhelmingly, U.S. allies around the world have an interest in a resilient global energy market in which a greater proportion of energy comes from stable geographies. They also have an interest in a regulatory environment that is conducive to the investments needed to sustain confidence around supplies. It is these themes – rather than the invocation of U.S. "dominance" – that will maximize the benefits of the United States' new energy capabilities to its national security.

Policy Recommendations

There are a variety of measures that the current administration should take to maintain and strengthen the economic and security benefits to the United States of open global trade and investment in energy. President Trump should continue to build on the advantageous U.S. role as a major global energy trading power. This will help ensure that a robust U.S. energy system will continue to create both stable low-cost energy and well-paying jobs, and will expand many of the security benefits it delivers. Encouraging international energy trade can enhance U.S. international economic influence more broadly.

To be sure, action along the lines proposed may be seen as unwelcome by certain constituencies who had supported the president and who make up the populist branch of his political base. Given this expected pushback, effective public communication of these points can help to inform public opinion and assuage economic populist sentiments in the United States. Several recommendations for preserving and strengthening open U.S. markets for energy follow.

Support “Gas Globalization” by Routinizing U.S. Gas Exports

The gas market is on its way to becoming more globalized as LNG supplies from more diverse places such as the United States and Australia come on stream and new markets open up for demand. That said, market conditions will be challenging for several years due to oversupply and uncertainties over market rebalancing. Most analysts, however, expect that the market will tighten at some point in the next decade (with greatest consensus around a mid-decade tightening). Under these conditions, only the most competitive projects will advance, and a key element of competitiveness will be the regulatory regime.

Under the U.S. Natural Gas Act of 1938, the DOE is required to authorize LNG export projects to non-free trade agreement (FTA) countries if they are consistent with the public interest. The U.S. licensing process for LNG exports has been streamlined considerably from when the Obama administration worried that exports would drive up domestic prices.

Since 2014, the DOE has been operating under this more streamlined approach to LNG export approvals, requiring projects to first seek environmental approval from the Federal Energy Regulatory Commission before applying for a DOE license, thereby eliminating the need for two DOE reviews, and ensuring that only serious projects are reviewed by the DOE.

Nonetheless, there is still unease, which may in fact be mounting given the current administration’s tough stance on international trade, on the part of customers and financiers abroad that the approval process can be subject to political intervention. Legislating to further streamline LNG licensing would be beneficial, either by doing away with the DOE approval process entirely (crude oil, petroleum products, and coal are not subject to similar reviews) or by amending the Natural Gas Act to grant automatic DOE approval to non-FTA countries, akin to the licensing process to export gas to FTA countries. At the very least, passing bipartisan legislation, such as that currently under consideration in the Senate, to codify the length of the review would be a modest step in the right direction.³⁶

The United States will be better served employing a subtler approach to helping Europe diversify its gas resources.

Beyond LNG export licensing, the United States can further support LNG exports by using the Overseas Private Investment Corporation (OPIC) to support LNG import terminals in key importing markets, where import infrastructure is lacking. This would be especially beneficial for Central and Eastern Europe, which currently has an outsized dependency on Russia for gas supply. By helping these countries diversify away from Russian gas, the United States can check Russia’s geopolitical ambitions in the region.

At the same time, the United States will be better served employing a subtler approach to helping Europe diversify its gas resources. In this regard, recent U.S. sanctions legislation targeting pipelines from Russia, such as Nord Stream 2, should be considered very carefully before any attempt to implement the measures. The legislation has had the unintended effect of casting a cloud over the intentions of U.S. LNG exports in places like Germany and Austria, with a recent poll showing Germans view Russia as a far more reliable gas supplier than the United States.³⁷ The globalization and deepening of gas markets, in creating more options for European consumers, will by itself limit the leverage that the Russians have over European choices.

Use the Current Renegotiation of NAFTA to Promote Greater North American Energy Integration

When NAFTA was originally negotiated in the 1990s,

it did not include ambitious goals for the energy sector because Mexico was still committed to largely excluding foreign investment in the energy and power sectors of its economy.³⁸ But in 2013, President Enrique Peña Nieto was able to persuade the Mexican Congress to substantially liberalize the energy sector and open it up for foreign investment. As a result, energy ties between the United States and Mexico are increasing,³⁹ though they are still not as significant as ties between the United States and Canada, which is the largest crude oil supplier to the United States as well as a net exporter of electricity to the United States.⁴⁰

The energy chapters in the proposed new NAFTA agreement have the potential to provide substantial benefits to all three countries by developing an explicit regional strategy to strengthen the continent's energy infrastructure, expand energy exports, support Mexico's historic reforms, improve safety, and encourage harmonized policies to promote energy conservation and reduce carbon emissions.⁴¹ The good news is that it appears that the political winds are enhancing the feasibility of just such an outcome. In the United States, President Trump has backed away from his earlier punitive approach to Mexico,⁴² and has acted speedily to approve the Keystone XL pipeline, a major priority for Canada.⁴³ House Speaker Paul Ryan's agreement to stop pushing for a border adjustment tax on imports as part of the tax rewrite will take off the NAFTA agenda a potentially very disputatious topic.⁴⁴ In Mexico, Peña Nieto will be looking to extend NAFTA benefits as a major legacy of his government, while the leading candidate to be his successor, the left-wing populist Andrés Manuel López Obrador, looks like he will support extending NAFTA into the energy sector as part of a strategy to increase his legitimacy with the business community.⁴⁵ Finally, Canadian Prime Minister Justin Trudeau will look to NAFTA, and to greater energy integration generally with the United States, to restore the confidence of global energy investors in the face of the collapse of several recent deals.

Democrats in the U.S. Congress may be tempted to oppose the new NAFTA agreement, especially if the partisan divide in Congress remains as tense as it is today, and the president continues to refuse to reach across the aisle for support. But Democrats in the Senate voted overwhelmingly to confirm Trump's chief trade negotiator, Robert Lighthizer, and responded favorably to the latter's presentation of the administration's NAFTA negotiating framework. If that is what he delivers, NAFTA should not be treated as a partisan issue.

Do Not Invoke "Section 232" – The National Security-Based Rationale – for Trade Actions against Steel and Aluminum Imports

In April, Secretary of Commerce Ross announced that his department was launching investigations of the steel and aluminum industries under the Section 232 authority of the Trade Expansion Act of 1962, which allows the president to restrict certain imports if they compromise U.S. national security.⁴⁶ Ross originally said the results would be released by the end of June, but the administration has until the end of the year to report back on its findings.

President Trump, in meetings with U.S. steel executives, has emphasized that foreign competitors have taken advantage of lax trade laws and have flooded the U.S. market, leading to widespread job losses.⁴⁷ If he is right, the remedy is trade action under the anti-dumping guidelines of U.S. law and the WTO. To approve a Section 232 action, there is no need to find that imports are being unfairly subsidized.

The problem with Section 232 is that, unlike the case for dumping, there are virtually no guidelines in either U.S. or international trade law governing its use. While the law was put into place during the John F. Kennedy administration, it has resulted in presidential actions only five times since, because administrations of both parties knew that taking major action under Section 232 threatened to open up a Pandora's box of tit-for-tat trade actions not linked to the behaviors of foreign companies and governments.⁴⁸ This would be particularly true if a precedent was created in the commodities sector for



Requirements for the steel used in pipelines to be domestically sourced and potential 232 actions can help revive the industry in the United States, but also risk driving up project costs and spurring regulatory pushback. (Rick Gershon/Getty Images)

metals whose overwhelming use is for commercial, not national security, purposes. More than 95 percent of U.S. steel consumption and 99 percent of U.S. aluminum consumption is commercial.⁴⁹

Trade actions in steel or aluminum may very well be justified. But the rationale and remedies for such action should be found in the well-grounded anti-dumping sphere.

Hopefully, the administration is wielding the Section 232 threat to exert leverage on trading partners to reach agreements with the United States. The danger for global energy markets and U.S. national interests is clear; at a time when the U.S. private sector is succeeding in creating a more open and resilient energy market with the United States as a key player, it does not need the U.S. government to be promoting actions that would provide foreign governments and companies a rationale to impose restrictions of their own under a category that can be invoked without demonstrating any unfair practice. Trade actions in steel or aluminum may very well be justified. But the rationale and remedies for such action should be found in the well-grounded anti-dumping sphere.

Avoid a Border Adjustment Tax as Part of Comprehensive Tax Reform

As part of a plan to overhaul the tax system, the U.S. House of Representatives leadership has floated the idea of a border adjustment tax (BAT) that would do away with import cost deductions for companies as well as eliminate taxes on export revenues. Stated simply, the BAT would tax imports and promote tax-free exports. Recently, it appears as if the House leadership is moving away from its support for BAT. That is positive, as BAT would significantly distort energy markets, increase energy costs for U.S. consumers, and, as with possible Section 232 use, set a precedent that would invite tit-for-tat retaliation by other nations.

The BAT would impact different parts of the energy value chain unevenly. The BAT would benefit U.S. domestic drillers. Its effect on the refining sector would vary. The BAT would make imported crude more expensive for U.S. refiners (though expected fluctuations in currency could mitigate this impact).⁵⁰ However, it would help refined product exporters, particularly those

on the U.S. Gulf Coast with better access to attractive domestic crudes.⁵¹ Studies have also suggested that a BAT would drive up the price of domestic crude and drive down the global price of crude, which is priced in U.S. dollars, as the BAT leads to dollar appreciation.⁵² Though the growth in shale production has reduced U.S. demand for imported crude oil, imports are still a sizable piece of the U.S. energy picture. In 2016, the United States still imported around 7.9 million bpd of crude, relative to total consumption of petroleum products of 19.6 million bpd.⁵³

Ultimately, refiners would likely pass on the higher input costs to their customers – i.e., U.S. motorists. Internal studies conducted by the American Petroleum Institute and the American Fuel and Petrochemical Manufacturers, whose members are divided on the topic, assessed that a BAT would drive up gasoline prices domestically by at least 20 cents per gallon.⁵⁴ Higher gasoline prices could, in turn, take a bite of the U.S. economic recovery by straining consumer spending. Moreover, in a context of rising populist pressures, a policy that penalizes U.S. consumers to fund a corporate income tax reduction not only could be economically damaging, but also would prove to be political folly. Beyond the impact on consumers, businesses would be hurt by the BAT's impact on energy prices. Energy-intensive manufacturers could see the competitive advantage granted to them by the shale revolution partly eroded.

Regardless of the specific impacts on individual energy subsectors, it is clear that a border adjustment tax could create price disruptions that hurt the average American consumer the most. As a result, Congress and the administration should resist its inclusion in tax reform efforts.

Clarify the National Security-Based Restrictions that Will Guide CFIUS Decisions on Chinese Investments in the U.S. Energy Sector

Both the United States and the European Union are moving to broaden existing restrictions on Chinese firms entering their respective high-technology sectors. The U.S. Senate is mulling significant changes to legislation governing national security reviews of foreign investment in the United States. The revamp of the investment review process is primarily directed at China's use of massive state-backed funds, intellectual property licensing deals, and other creative technology transfer mechanisms designed to bypass investment reviews. Right now, it is not clear how any such restrictions might affect Chinese investment in the U.S. energy sector.

In recent months, nearly all key U.S. national security officials have endorsed reform of the Committee on Foreign Investment in the United States (CFIUS). This includes Director of National Intelligence Daniel Coats, National Security Agency chief Michael Rogers, CIA Director Mike Pompeo, Joint Chiefs Chairman Joseph Dunford, and Secretary of Defense James Mattis.⁵⁵ A report earlier this year by outside experts recommended changes to CFIUS in the wake of a wave of Chinese investment in Silicon Valley, particularly in foundational technologies for future innovation – artificial intelligence, autonomous vehicles, augmented/virtual reality, robotics, and blockchain technology.⁵⁶ The administration's trade and economic officials have grown more supportive after having expressed initial skepticism about changing the legislation.

U.S. Treasury Secretary Steven Mnuchin has several times expressed his interest in restarting the talks around a U.S.-China Bilateral Investment Treaty (BIT).⁵⁷ It may very well be the case that, given likely continued trade tensions, there is more room for progress on the investment side. Chinese firms are eager to invest in the U.S. energy sector but are worried about the prospects of a negative recommendation coming out of the CFIUS process. It is not clear that the pending legislative changes to CFIUS will provide more clarity for such firms. The BIT negotiations will likely be the place

where such clarity can be provided. While there are likely to be particular technical areas in energy where Chinese investment might create national security risks, there should not be any kind of blanket restriction or negative assumption in the CFIUS process about Chinese investment in expanding U.S. energy infrastructure and capability.

Companies Should Do Their Part on Community Outreach and Support for Open Markets

Part of the rise of populism in the United States and globally can be attributed to a perception that large corporations and the government are working to promote their own self-interest, while the welfare of average citizens has been sacrificed to that of vested interests. Activism motivated by such beliefs is distinct from grassroots organizing to protest the environmental and social impacts to communities from hydrocarbon drilling. The latter is a manifestation of a long-standing tradition of activism on health, safety, and environmental grounds, rather than a form of economic populism. The rise of shale oil and gas production, which brings drilling closer to homes, communities, and local water supplies, has fueled this activism.

The citizen activist backlash against “big energy” largely stems from an assumption that oil, gas, and coal companies are willing to sideline environmental protections and community interests in the name of increasing production and sales. It may be linked, or coincide, with economic populism in the United States in that both movements feature diminished trust in, or indeed demonization of, large energy-producing firms and their activities. In any case, the remedy for more constructive engagement between energy firms and local communities, and for unencumbered, responsible energy production, is the same. Companies must take a more prominent role in engaging with local communities, hear their concerns, and attempt to address them.

Governments can help address economic populism and local organizing around environmental and community concerns through smart environmental regulations, but the buck ultimately stops with companies. Not only will companies be better able to engage with citizens by avoiding automatic fights against any and all environmental regulations on principle, but



While the Trump administration has engaged with China, it has also launched investigations into its trade practices. Pictured here, Secretary of State Rex Tillerson meets Chinese President Xi Jinping. (Joe Raedle/Getty Images)



Much of President Trump's electoral success in industry-heavy regions like Cedar Rapids, Iowa, where he held a rally in June 2017 (pictured above), was built on promises to revive U.S. manufacturing. (Scott Olson/Getty Images)

they can also further improve on efforts to establish relationships, environmental stewardship, and community support in the areas in which they operate.

In addition to conducting outreach, industry should also recognize that open borders are ultimately better for them than distortionary trade restrictions, and therefore should speak with a common voice in their advocacy efforts to the government. Manufacturers should be wary of gas export curbs, which can harm America's reputation as a reliable supplier and spur similar arguments to keep domestic prices artificially low for other products, including manufactured goods. Cherry-picking which products warrant trade restrictions and which do not can result in a slippery slope of distorting policy measures based on which industries lobby more aggressively and effectively. In a similar vein, though a border adjustment tax might benefit export-oriented U.S. companies, those same companies could find themselves on the receiving end of retaliatory measures in importing countries and the victim of other damaging distortionary trade policies at home. The private sector should accept that open borders are generally best for business and should promote policies supportive of that premise with a unified and unanimous voice.

Conclusion

The rapid political and economic changes that have occurred since the onset of the global financial crisis a decade ago have precipitated a resurgence in economic populism, a development which in the United States culminated in the election of Donald Trump as president in 2016. Having ridden a wave of distrust of globalization to office, Trump is now seeking to find a balance between his popular mandate and the hard realities of global economic interdependence, as well as the fact that open trade and investment policies have promoted U.S. national interests and security abroad.

Nowhere is this clearer than in the energy sector, where the policy trend has been to sharply reduce protectionist regulations and the result has been the rapid growth of the United States as a major exporter and shaper of markets, with positive impacts both in domestic economic and national security spheres. Global energy markets are evolving in a way that, for the most part, is very favorable to the United States. The administration should follow an approach of "do no harm" to these positive trends and pursue policies to reinforce them. At the same time, both government and the energy industry need to do more to engage the backlash against "big energy," which threatens new constraints on maximizing the economic and security benefits of U.S. energy resources.

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