OPINION

Why the U.S. Needs to Lift the Ban on Oil Exports

Surprisingly, this will mean lower gas prices at the pump, and a greater supply of crude in an unstable world.

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The U.S. has, with minor exceptions, banned the export of crude oil since the early 1970s. For most of the following decades this did not matter, as U.S. appetite for imported oil seemed insatiable. But it matters now, and it will matter more in the years ahead. While it may seem paradoxical, exporting U.S. crude will increase, not reduce, domestic oil supplies and lower, not raise, domestic gasoline prices.

Moreover, the crises in Iraq and Ukraine, and the disruptions in Libya and other countries, demonstrate the importance of growing, reliable U.S. oil production—and the urgency of lifting the ban in order to support that growth.

There were two reasons for the original export ban. First, because of fear of inflation and panic about supplies in the 1970s, price controls were slapped on crude oil and refined products. But if cheaper price-controlled oil could be shipped to higher-priced world markets, it would undermine the price-control system. The second reason was to prevent the newly-flowing oil from Alaska's North Slope being sent to Japan instead of the U.S. West Coast.

Yet oil price controls were abolished in January 1981, and the ban on exporting gasoline and other petroleum products was lifted a few months later. President Clinton excepted Alaskan crude from the oil-export ban in 1996, although the volumes have never amounted to much.

With domestic production declining and the U.S. importing so much oil—60% of total consumption as late as 2005—there was no reason to re-examine the export ban. Domestic oil production has since dramatically surged—by 3.3 million barrels a day since 2008, a 66% increase. The International Energy Agency projects that the U.S. will in a few years overtake Russia and Saudi Arabia as the world's top producer.

Yet the U.S. still imports about 30% of its oil. So why allow exports? The reason is that the new crude being produced—so called tight oil, or "light oil" recovered by hydraulic fracturing and horizontal drilling—is a poor match for refineries in the Midwest and along the Gulf Coast.

Refineries have spent more than $100 billion in recent decades reconfiguring their equipment to process heavy, lower-quality imported oil from Canada, Mexico and Venezuela, as well as the new supplies coming from the Gulf of Mexico. They have been able so far to absorb the new light crude but are reaching their limit even as tight production keeps growing. If these reconfigured refineries run more light
instead of heavy crude oil, they lose output capacity—and revenue—due to a mismatch of the light oil with their equipment. To make up for the lost revenue, refineries won't buy the light oil except at a discount, which could run as high as 20%. At that price, oil producers can't cover the cost of some of the new wells, and cash flows would decline. This means less drilling and lower crude production.

Specialized new refineries can be built to handle light oil, but that can take years. Meanwhile, in a warning sign, discounts for light oil began to approach 20% late last year when key refining capacity on the Gulf Coast was offline for normal seasonal maintenance.

Allowing exports would enable light-oil producers to get world market prices, and their revenues would flow back into higher investment in U.S. production. Meanwhile, refineries would continue to import heavier crude. The net volume of U.S. crude imports would be about the same, but the country would gain major economic benefits.

We estimate that removing the export ban, combined with continuing innovation in production technologies, would lead to as much as 2.3 million barrels per day of additional production over the next 15 years, and new investment approaching $1 trillion. That increase would support an average of 860,000 more jobs over the same period and generate nearly $3 trillion of additional government revenues.

Yet what about gasoline? How can U.S. crude oil receiving higher prices on world markets lead to lower prices at the pump?

The answer is the difference between the gasoline and crude oil markets. U.S. gasoline is part of a freely traded global market. The U.S. both exports gasoline from the Gulf Coast and imports it on the East Coast because it costs less to import surplus gasoline from Europe than ship it by tanker from Texas. U.S. gasoline prices are set by global gasoline prices, not domestic crude oil prices.

The additional domestic oil production that results from allowing exports means more oil on world markets—and lower prices. That means lower global gasoline prices and, because the U.S. gasoline market is part of that global market, lower prices for American motorists. We estimate this would reduce the price by as much as 12 cents a gallon, saving U.S. motorists $420 billion over 15 years.

Although the rationale for the U.S. export ban disappeared decades ago, it didn't much matter for a long time. Now it does. Ending the ban would enable the U.S. to benefit significantly more from its oil-production renaissance. As Iraq, Ukraine and Libya are making so clear, the sooner the better.

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