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**Testimony before the House Committee on Foreign Affairs
The Geopolitical Potential of the U.S. Energy Boom**

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Chairman Royce, Ranking Member Engel, and distinguished members of the Committee, thank you for the opportunity to testify today on the geopolitical potential of the U.S. energy boom.

Remarkable recent increases in U.S. oil and gas production have had substantial positive economic effects. They are changing the way Americans use and trade energy and the way we think about the strategic value of energy resources. For decades this nation considered energy a scarce resource and framed investment in energy infrastructure and energy policy around the expectation of dependence on imported energy. But the application of sophisticated, unconventional energy extraction technologies over the last several years has ushered in an era of relative energy abundance and turned the tide on energy import dependence. The United States is the top global natural gas producer and will be the largest oil producer, surpassing Saudi Arabia, by next year, according to the International Energy Agency (IEA).

Prolific U.S. oil and gas resources have important geopolitical significance. They also have striking benefits for U.S. industrial manufacturing competitiveness and the trade deficit, which reached its lowest level in four years last year. Expanding U.S. energy supplies means that a larger portion of global oil supply comes from reliable sources. This supports well-supplied international markets and can erode the cartel pricing ability of some global energy producers. The broad innovation and economic gains associated with the energy boom reduce U.S. indebtedness, including to countries sometimes hostile to U.S. interests, and allow the United States new capacity and flexibility to advance foreign policy interests.

To fully realize the geopolitical potential of the U.S. energy boom, however, national leaders must revise paradigms and policy that restrict energy exports. A new national energy policy should encourage production and embrace a more nimble and permissive regime for liquefied natural gas (LNG) and crude exports to enhance energy and national security.

Global Energy Trade is in the U.S. Interest

Shunning energy exports with the assumption that only domestic energy supplies can make us safer and more prosperous fundamentally misunderstands how energy markets work. With abundant new domestic energy supplies, it is no surprise that we hear enthusiastic calls in the United States for “energy independence” or self-sufficiency. It would be easy to assume that we should try to replace oil imports from some unstable, dangerous and hostile overseas producers with only stable, abundant, domestic energy supplies. Particularly because natural gas and crude oil are relatively cheap in some U.S. regions due to infrastructure bottlenecks and export restrictions, they seem particularly attractive compared to supplies purchased from abroad. The reality is more complex. The interconnectedness of global energy

markets and the economic and geopolitical benefits of active international trade in energy means that the United States should support unencumbered energy exports.

The United States will continue to require oil supplies from overseas for the foreseeable future. Irrespective of the amount of domestic oil production, it will remain impossible to render the U.S. economy (and American consumers) immune from global oil market disruptions or shocks. The price of oil is set in the global market and all oil consumers are subject to the same price movements, even if those are spurred by events far beyond their borders. The United States will become the largest crude producer next year, and will be self-sufficient in natural gas by 2017, according to the U.S. Energy Information Administration (EIA). But it would be counterproductive to hoard energy at home and withdraw from trade and strategic relationships with energy players abroad. Even while we reap economic benefits from exporting value-added refined petroleum products, as well as natural gas liquids, we miss out on additional economic and valuable geopolitical opportunities by restricting crude and moving very slowly to permit natural gas exports.

Increasing international trade in energy, including U.S. exports, is compatible with enhancing energy security. In the case of oil, U.S. policymakers should promote energy security and insulate the U.S. economy from oil market price spikes by focusing primarily on *using* less, rather than focusing primarily on *importing* less, oil. Strong policy to increase energy efficiency and alternatives, including natural gas, can help achieve this goal. Using less oil in the transport sector is a particular challenge as petroleum products account for 97 percent of fuels. Vehicle fuel economy standards are an important step in the right direction. They have delivered significant energy savings, doubling since the 1970s, and are set to increase by more than 50 percent by 2040, according to the EIA.

Another important energy security strategy is maintaining sufficient strategic oil and refined product stocks in the United States to help soften the impact of market shocks. This should be paired with strong international coordinating mechanisms to manage global strategic stock releases during times of supply disruption.

New Energy Statecraft

The United States should develop and use new tools of energy statecraft to serve foreign and security policy interests drawing on its tremendous experience in exploiting new energy technology and resources. They can be used separately or in tandem with trade or visa restrictions, targeted financial measures or development assistance. But together, they form a suite of economic measures that can create diplomatic leverage and, ideally, deter aggressive confrontation. In a period of budget austerity, policymakers cannot afford to overlook creative economic options or collaboration with international allies to advance national security priorities. Additionally, economic statecraft may help to avoid relying on the military for safeguarding oil trade.

The tools of energy statecraft are energy policy, trade and technical assistance measures that can punish adversaries and support allies. In large part, their utility relies on well-supplied markets and, in some cases, on an ability to export energy. Tough sanctions that brought Iran to the negotiating table are an

example of energy statecraft. They were made possible to a large extent by prolific, new domestic oil supplies on the market. Another energy statecraft tool, LNG export, is made feasible because of the flood of natural gas in the United States. LNG export will generate political goodwill abroad and revenue at home. Energy statecraft tools also include diplomacy and foreign assistance to promote energy development and market reform abroad. They are deployed, for example, by U.S. government programs to help foreign governments develop shale resources.

Another energy statecraft tool is sales or swaps of oil from the Strategic Petroleum Reserve (SPR). With more domestic oil production and decreasing oil imports, the United States will rely less on the SPR to replace disrupted supply. Therefore, it has increasing flexibility to use this stockpile to influence the market for other, possibly geopolitical, reasons. However the constitution, location and criteria for use of the SPR should be reassessed to ensure that this stockpile maintains its strategic value. It should include more medium or heavy grades of crude, to balance the increasing share of light crudes produced domestically. The location of stockpiles should also be diversified away from the Gulf Coast. If more refined product is held on the East Coast, it would more quickly and easily serve major market centers during a supply disruption.

Crude Exports

Permitting the export of U.S. crude, currently subject to near-total restriction, would strengthen the U.S. economy and convey geopolitical benefits. By trading its crude overseas the United States would expand the portion of reliable U.S. energy supplies in the market. Specifically, lifting crude export restrictions would ease U.S. supply bottlenecks and market dislocations, and signal drillers to continue production growth. This would raise some crude prices in the United States to come in-line with global benchmark pricing. However it is unlikely that this would broadly increase retail gasoline prices for consumers. They could even drop marginally, between three to seven cents per gallon, according to experts at Resources for the Future.

Current refinery capacity, even with planned upgrades, looks unlikely to be able to accommodate the large volumes of light crude in the midcontinent as they continue to expand this year and beyond. Permitted exports to Canada or swaps with Mexico will eventually be maxed out. Without the crude export relief valve, oil companies will pull back on what will be increasingly uneconomic production. Industry estimates of when this point will arrive vary, though they place this point in the near future. Analysts at IHS and Barclays believe it will occur in 2015, for example.

Restricting crude exports while permitting and encouraging the export of other energy exports is arbitrary and does not insulate consumers from price spikes. Refined products and natural gas liquids, as well as energy technology and services, are much more easily exported than crude. They generate important revenue and competitiveness advantages for the U.S. economy. However, elevating the export of these over the export of crude lacks a strategic basis. It may also have negative geopolitical consequences for the United States. For example, foregoing crude exports means foregoing an opportunity to expand the global oil market share of a stable producer. Significantly, such an enlarged market share could enhance oil market stability and erode the cartel pricing control of OPEC.



Foregoing crude exports may also reduce policy leverage over Iran. If international nuclear talks with Iran fail, U.S. policy leaders may want to implement tough new oil sanctions on Iran. Congressional proposals to this effect seek the removal of Iran's remaining roughly 1 million barrels per day of oil exports from the market to starve the regime. However, this threat is only credible if sufficient, affordable alternative oil supplies are available so that the international community will participate in sanctions. The United States would help to ensure that these alternatives are available by encouraging its crude production and exports. This will mean that the United States more robustly supplies international markets, rather than relying on other countries, mostly OPEC members, to do so.

U.S. LNG Exports

For the recipients of future planned U.S. LNG exports, these new supplies represent an economic and strategic benefit. The United States is a stable producer and would ship LNG, in most cases, along trade routes that involve few maritime choke points or hot spots. In markets abroad, U.S. LNG will bring greater supplier diversity, more competitive pricing arrangements and less politicized contract terms. For the United States, selling LNG will slightly increase domestic natural gas prices, though they will still be lower than those in Asia and Europe. Also, the United States will retain a competitive environment for gas-intensive manufacturing. According to NERA Economic Consulting, "there is no support for the concern that LNG exports...will obstruct a chemicals or manufacturing renaissance in the United States."

Despite the likely gas price increase associated with LNG exports, the effect LNG exports will have on domestic revenue and in strengthening U.S. strategic and economic ties with key allies and partners make them well worthwhile. Refraining from selling LNG abroad in order to support domestic gas-intensive manufacturing industries or halt gas production would undermine foreign relations and the scope of U.S. leadership abroad. It would also cause the United States to lose out economically to Canada and other countries that proceed to sell LNG overseas.

For Northeast and East Asia, where a substantial portion of planned U.S. LNG exports are likely to flow, LNG trade would constitute an important economic plank of the U.S. rebalance to Asia. According to expert analysis from the Institute of Energy Economics, Japan, the amount of U.S. LNG currently under contract with Japanese buyers at the six U.S. LNG export projects with Department of Energy (DOE) permits could equal almost 18 percent of Japanese LNG imports last year.

U.S. LNG cargoes may flow to Europe as well, diversifying the regional gas supply base and diminishing Europe's dependence on Russian gas imports and political influence. The mere potential for U.S. supplies to move to Europe creates the market expectation that Europe can diminish its 30 percent reliance on Russian gas. In the face of anticipated European gas supply diversity, as well as increased pricing transparency, Russia has already conceded to cheaper contract terms with European purchasers. In the recent past, LNG cargoes that would have landed in the U.S. market, were it not saturated with gas, instead landed in Europe. This additional LNG supply diversified suppliers, increased price competition and helped force Gazprom to cut some European gas prices.



The DOE should hasten the diversification of European gas and more competitive pricing in that market by accelerating consideration of the 25 LNG permit applications in the queue. It should also give special “national interest” consideration to LNG export projects that could supply Europe, a possibility that Energy Secretary Ernest Moniz recently acknowledged. The LNG export market will probably only support the construction of a few of the proposed U.S. LNG projects. But with all options on the table, market participants would maximize U.S. gas production and the potential benefits to global gas consumers, including those in Europe.

Even if U.S. LNG does not ultimately flow directly to Europe, it will displace LNG cargoes from Africa, the Middle East or Australia that would have moved elsewhere, likely to Asia. Europe can purchase those displaced cargoes, a step that will help diversify European gas supply and chip away at Russia’s European gas pricing power. It may also erode Russia’s gas pricing power in Asia, because that market too will have more suppliers, including the United States, vying for market share.

Promoting European Energy Security

In the case of Ukraine’s need for gas and its vulnerability to politicized Russian supply arrangements, the prospect of U.S. LNG exports offers no immediate relief. The first U.S. LNG export facility will not ship cargoes abroad until late next year, and those cargoes will likely flow primarily to Asia where gas prices are highest. Even if U.S. LNG cargoes could go to Europe now, Ukraine has no LNG receiving terminal and Turkey will not allow LNG tankers to transit the Bosphorus in order to access Ukraine’s coast. However signaling that the U.S. plans to permit and export more LNG in the future would provide a marginal immediate benefit to Europe in the form of a signal of European gas diversity to come. This would be an indication to Russia that it will have to concede to more competitive pricing to maintain market share.

Aside from permitting the export of LNG, there are other strategies the United States can employ to help Europe develop and diversify its energy supplies, whittle down Russian gas price control, and create more transatlantic energy leverage. The U.S. government can help Europe access its indigenous shale gas resources by working with the U.S. private sector to support technology transfer. Also, U.S. officials can provide technical assistance and engage diplomatically with counterparts to help European countries develop the necessary legal, regulatory and tax structures for companies to produce shale gas. In fact, such U.S. government technical assistance and diplomatic engagement with Asian countries could help them meet gas demand locally and eventually free up global LNG for the European market.

U.S. officials can also support European energy diversity with diplomatic engagement to encourage market and gas pricing reform. Additionally, they can work with lending institutions and counterpart governments to help facilitate public or development bank financing for pipeline projects or expensive LNG import projects that some European countries struggle to lock in. Encouraging energy efficiency and alternative fuels, and urging the removal of oil or gas energy subsidies that distort market forces, are other useful efforts U.S. officials can promote in Central and Eastern Europe. They are already assisting with some of this critical work, but they should make a larger, sustained commitment to these efforts. This



work will not offer a quick fix for Ukraine or Europe, but with additional and sustained U.S. efforts this could begin to cause a very meaningful, permanent economic impact over time.

In the immediate future, further sanctions against Russia present an opportunity to show opposition to Russia's provocative and aggressive actions in Crimea. Sanctions also serve as a serious warning to international investors in Russia—particularly in lucrative economic sectors, such as energy—about the risks and possible punishment of economic engagement with an aggressor. However, as policymakers consider additional sanctions, and possible Russian countermeasures, they must be aware of the broader ramifications of broadly targeting the Russian energy sector or state energy companies. Russia is the third largest global oil producer and the second largest gas producer. In 2012, 79 percent of its oil exports and 76 percent of its gas exports went to neighbors in Europe, according to the EIA. Sanctioning Russian energy companies would have significant global oil market impacts that would be felt in economies still recovering from the financial crisis. It would also require the participation of our allies in Europe, who would most immediately suffer economic pain, making this option an extraordinarily hard sell and perhaps too painful to enforce.

Conclusion

The rapid expansion in U.S. unconventional energy production offers both foreign policy benefits and economic growth and competitiveness benefits. It raises concerns about exporting jobs or economic benefits, should the United States embrace a more permissive energy export policy. It also raises concerns about the environmental and community effects of the energy boom and further growth in unconventional energy globally. A careful consideration of all of these issues is appropriate and necessary for American leaders to balance competing interest and to implement smart energy exports policy to realize the potential economic, security and geopolitical benefits of the U.S. energy boom.

Biography

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Elizabeth Rosenberg is a Senior Fellow and Director of the Energy, Environment and Security Program at the Center for a New American Security.

From May 2009 through September 2013, Ms. Rosenberg served as a Senior Advisor at the U.S. Department of the Treasury, to the Assistant Secretary for Terrorist Financing and Financial Crimes, and then to the Under Secretary for Terrorism and Financial Intelligence. In these senior roles she helped to develop and implement financial and energy sanctions. Key initiatives she helped to oversee include the tightening of global sanctions on Iran, the launching of new, comprehensive sanctions against Libya and Syria and modification of Burma sanctions in step with normalization of diplomatic relations. She also helped to formulate anti-money laundering and counter-terrorist financing policy and oversee financial regulatory enforcement activities.

From 2005 to 2009 Ms. Rosenberg was an energy policy correspondent at Argus Media in Washington D.C., analyzing U.S and Middle Eastern energy policy, regulation and trading. She spoke and published extensively on OPEC, strategic reserves, energy sanctions and national security policy, oil and natural gas investment and production, and renewable fuels.

Ms. Rosenberg studied energy subsidy reform and Arabic during a 2004-2005 fellowship in Cairo, Egypt. She was an editor of the Arab Studies Journal from 2002-2005 and researched and wrote on Middle Eastern politics at the Council on Foreign Relations in 2003. She received an MA in Near Eastern Studies from New York University in 2004 and a BA in Politics and Religion from Oberlin College in 2000.