Frontiers

April 2017

Energy independence sure sounds like a winner.

Who could argue with the prospect of a strong, independent domestic oil and gas industry that produces all the energy our country needs?

After all, conventional wisdom says achieving energy independence would allow the US to avoid the geopolitical turmoil that roils markets and threatens supply; reduce our reliance on other governments (including some that are unstable or otherwise problematic); and add lots of high-paying, blue-collar jobs. Since the advent of the domestic shale revolution, pundits and politicians alike have been calling for the US to declare its independence from foreign energy, ramp up domestic production and put a halt to imports. The idea has support from both the right and the left (for different reasons, obviously). And the notion of energy independence certainly gained momentum during the recent presidential election. It was, in fact, a key element in the Trump administration's platform and in the America First Energy Plan, released 20 January 2017. With the right mix of increased efficiency and higher output, American energy independence is definitely doable. But is that the right path?

What independence really means

The longer answer is that once you dig a little deeper into what energy independence will require and the different definitions of what energy independence could look like, there are a host of unintended consequences.

Some of the potential unintended consequences of energy independence

Having influence around the world isn't a bad thing. It is true that importing crude oil ties the US to countries around the globe. But being a major buyer of crude also gives the US strength and influence, because those governments need our business. Retreating from the global crude market will shrink our influence in geopolitical hot spots such as the Middle East and Africa, where we will still want – and need – a presence. Energy independence would also require domestic companies to rethink plans to export liquefied natural gas (LNG) to Europe, foregoing the opportunity to strengthen ties to key allies there while giving us leverage with Russia, Europe's primary natural gas supplier. Most importantly, it's not the 1970s any longer. Canada and Mexico – obviously important trading partners – are two of our biggest crude oil suppliers, accounting for more than 20% of our imports. The Persian Gulf states supply just 13% of our crude; we import almost as much from Africa.







Frontiers

In other words, the idea that we are beholden to the Middle East for our energy needs no longer holds true. If anything, the growth of domestic shale has lifted many of the prior restraints we had in the region and given us the freedom to act independently without the need to actually be independent. In the event of a geopolitical situation that shuts down production in the Persian Gulf, US producers could quickly and easily fill the supply gap – and keep it filled for as long as necessary. And our other crude suppliers could step in to help as well.

Achieving and maintaining energy independence will be expensive. While it is true that the US has enough supply, thanks to shale, domestic tight oil has a fundamentally higher price point than the marginal barrel of production from markets in the Middle East and elsewhere. That price differentiation will likely continue for the foreseeable future.

Thus, maintaining higher-cost production to remain energy independent is an inefficient use of capital. Oil and gas companies will spend a lot of money unnecessarily; the investing community will be forced to forego better opportunities for capital to ensure that production continues to meet demand.

But the biggest loser would be the American consumer, who will subsidize this higher-cost production – and not just with more expensive gasoline. Because the cost of crude is embedded so deeply in our economy – think shipping costs, farming, petrochemicals, etc. – higher energy prices impact all our economic measures and create a drag on the economy as a whole.

A better goal: stronger interdependence

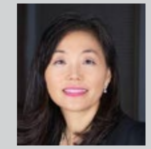
On the surface, energy independence appears to be an admirable goal, one that would create numerous benefits for the US and strengthen both our geopolitical position and our economy. But a better strategic approach is one that supports energy security via energy interdependence, where US capacity and capabilities are used for the greatest economic good and domestic production is supported by trusted relationships with foreign suppliers.

Crude oil and natural gas are commodities that are easily transportable, and they need to find the most efficient and cost-effective markets. Congress recognized these principles by lifting 40-year restrictions on export of crude oil in 2015 and the Department of Energy in recent years has approved several LNG export projects. And in the event of a major supply disruption or natural disaster – such as a hurricane that destroys offshore production or refining capacity – we need agreements and mechanisms in place with our allies and trading partners to help us continue to meet demand. Closing off those avenues of support is dangerous.

With a proper policy framework in place, one that encourages domestic production and supports open and competitive markets, the US can maximize the economic benefit of its abundant resources while remaining a significant participant in global energy markets. Energy interdependence is the most sensible approach for the future.

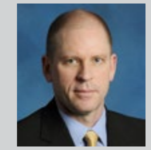
About Frontiers: In order to not just survive, but thrive, oil and gas companies and their executives must look around every corner, into the distance, to forecast the industry's next frontier. There are many weak signals that if they gain velocity could have major implications on the industry. But, what happens when companies are too busy managing the current environment, especially in today's lower-for-longer landscape, to focus on the horizon? And how can companies prepare for those weak signals with an eye on the present and toward the future? Please follow along as we analyze different energy futures and weak signals impacting the industry regularly through our Frontiers series. If you are interested in receiving future Frontiers editions please contact **usenergy@ey.com.**

Contributors



Deborah Byers
+1 713 750 8138
deborah.byers@ey.com

John Hartung
+1 713 751 2114
john.hartung@parthenon.ey.com



Vance Scott
+1 312 879 2185
vance.scott@ey.com

EYG no. 01506-174Gbl
1702-2205577
ED None