

POLICY BRIEF **03.06.19**

NOPEC's Extraterritorial Overreach Would Harm Core U.S. Economic and Energy Interests

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The Sherman Antitrust Act of 1890 provided a powerful lever for the U.S. government to break up John D. Rockefeller's Standard Oil Trust. Now, more than a century later, enterprising members of Congress seek to amend the Sherman Act to "make oil-producing and exporting cartels illegal" under U.S. law and allow suits against the Organization of Petroleum Exporting Countries (OPEC).¹

This legislation—the No Oil Producing and Exporting Cartels Act, or NOPEC—draws on congressional animosity toward OPEC dating from the 1973 Arab oil embargo that helped quadruple oil prices.² It is also likely rooted in an increasing wave of anti-Saudi sentiment on Capitol Hill. Politicians and pundits of all stripes have labeled the cartel an "enemy of the free market" and a "club of adversaries" that colludes to undermine economies of the developed world.³ Rhetoric aside, supporters of NOPEC should consider the potentially momentous consequences that will likely arise if the bill becomes law.

NOPEC would not involve garden-variety trust busting, but rather, legal action against instrumentalities of powerful sovereign countries for which control over oil production is an existential economic priority and in some cases, underpins the survival of ruling families.

If such a bill were passed and signed, it could weaken Washington's ability to effectively project extraterritorial

legal power, much of which rests on the implicit threat of coercive action rather than the actual implementation of sanctions.⁴ Judgments obtained under NOPEC's broad antitrust mandate could prove unenforceable in practice, perhaps undermining unrelated extraterritorial sanctions imposed by the United States—for instance, against Russia or Syria.

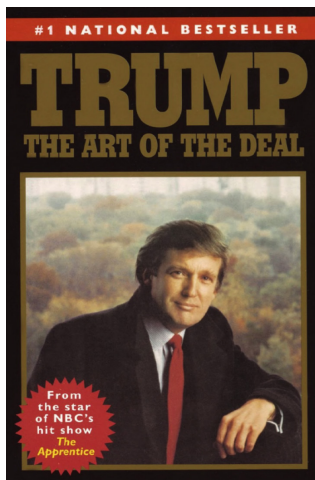
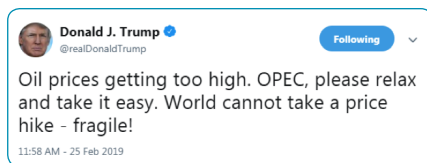
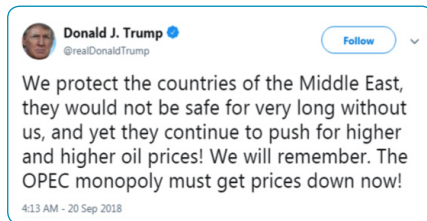
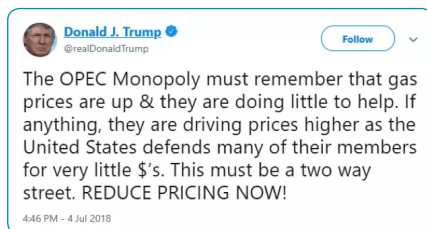
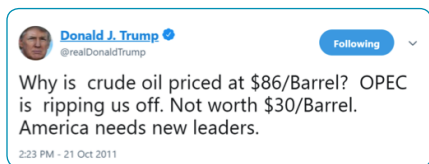
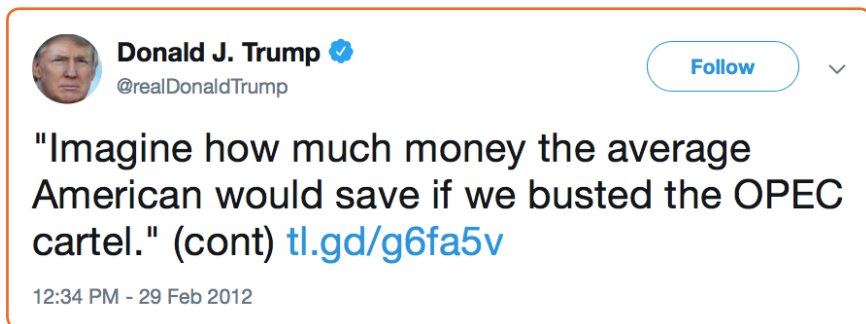
Enforcement of NOPEC could cause a host of further problems. It could increase oil price volatility while potentially depressing oil prices and bringing negative effects for U.S. oil producers, now the No. 1 source of global supply and an important driver of U.S. economic growth. It may, in addition, deter foreign investors and government entities from purchasing or even maintaining assets in the United States. In more extreme cases, this could include avoiding dollar transactions and the American financial system. OPEC countries that faced adverse judgments in NOPEC antitrust cases might also retaliate against U.S. firms, which hold substantial assets in Saudi Arabia, Angola, and other OPEC member states.

Longer term, NOPEC could even jeopardize political stability in other producer states, and by depressing the price of oil, stimulate additional demand that would undermine various climate and environment initiatives.



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FIGURE 1 — PRESIDENT TRUMP'S 32 YEARS OF ANTI-OPEC RHETORIC



“There was just one problem: OPEC.”

From “The Art of the Deal,” 1987

THE NOPEC LEGISLATION

The idea of NOPEC legislation is not new, with the first such measure sponsored nearly 20 years ago.⁵ But the contemporary situation appears to be different, first and foremost because the White House is occupied by a president whose documented 32-year history of anti-OPEC pronouncements suggest he might actually sign a NOPEC bill that passes the House and Senate (Figure 1). At the same time, Congress appears motivated by the murder of a U.S.-based Saudi journalist by officials in King Salman’s regime, and by the humanitarian catastrophe created by the Saudi-led war in Yemen. The risk of passage is not as remote as the NOPEC campaign’s long history might suggest. In 2007, the House of Representatives passed a NOPEC bill by a margin of 345–72 and the Senate passed it by a vote of 70–23, but the bill ultimately was not signed into law after President George W. Bush threatened to veto it.⁶

ANTI-OPEC RHETORIC AMID SHIFTING OIL MARKET REALITIES

OPEC declares that its function is not the maximization of profits or price of oil. Rather, it aims to “ensure the stabilization of oil markets in order to secure an efficient, economic, and regular supply of petroleum to consumers, a steady income to producers, and a fair return on capital for those investing in the petroleum industry.”⁷

Stability-focused strategic goals arose from the serious damage OPEC incurred by politicizing price management in the 1970s. Those acts—foremost among them the 1973 embargo—set the stage for macroeconomic disturbances that reduced global oil demand and stimulated the growth of alternative supplies from locations such as the North Sea; together, they reduced OPEC’s market share. In response, OPEC—and Saudi Arabia in particular—adopted pragmatic longer-term strategies aimed at price stability. Among these were the OPEC production increases in the early 2000s that served to offset production losses from geopolitical events in Iraq and Venezuela and to maintain oil prices in a range acceptable to consumers.⁸

SOURCES Google, Twitter, and various media outlets

Despite its adoption of more market-friendly goals, OPEC is justifiably defined as a cartel. That is because the benefits it provides its members are achieved by constraining oil production—and by the less understood practice of restraining production capacity in Saudi Arabia, Kuwait, and other Gulf producers through underinvestment in the world's lowest-cost oil reserves.⁹ The combined effect of these two measures is to preserve oil prices at levels higher than unconstrained production and cost-efficient investment would warrant.

OPEC cartel activities would almost certainly lie within the reach of a NOPEC-enhanced Sherman Act. Recent antitrust enforcement guidelines published by the U.S. Department of Justice and Federal Trade Commission note that federal antitrust laws “apply to foreign conduct that has a substantial and intended effect in the United States.”¹⁰ Even commerce that does not involve directly importing goods into the U.S. can still be subject to the Sherman Act if the conduct in question “has a direct, substantial, and reasonably foreseeable effect on commerce within the United States.”¹¹

Put simply, a hypothetical OPEC decision five years from today that influences oil pricing in a U.S. marketplace that imports no OPEC oil could still place the cartel in Justice Department crosshairs under the proposed NOPEC legislation because the price of oil in the U.S. is directly affected by prices in the global market.

From the perspective of an OPEC member state, the timing of the latest incarnation of NOPEC must feel strange because unlike previous times of strong support for the idea, the U.S. now enjoys relative oil abundance and the global oil price environment is muted compared to 2007 and 2008. Past support for NOPEC grew from concerns about American consumers being “taxed” by OPEC decisions at a time when the U.S. appeared to be on a trajectory of ever-increasing oil import dependence. Now, however, congressional empowerment to undertake coercive energy diplomacy arises not from scarcity, but from the same domestic oil abundance that is constraining OPEC's own strategic decision-making.

Of the 10 introductions of specific NOPEC legislation in the House and Senate, eight occurred between 2000 and 2012. With the exception of a brief, V-shaped oil price crash in late 2008 and early 2009, this roughly decade-long span featured generally rising oil prices and declining-to-stagnant domestic crude oil output (Figure 2). Yet NOPEC's most recent introduction in February 2019 comes with oil prices at less than half their 2008 peak levels and U.S. domestic crude output at roughly 12 million barrels per day, more than twice its year-end 2010 level.

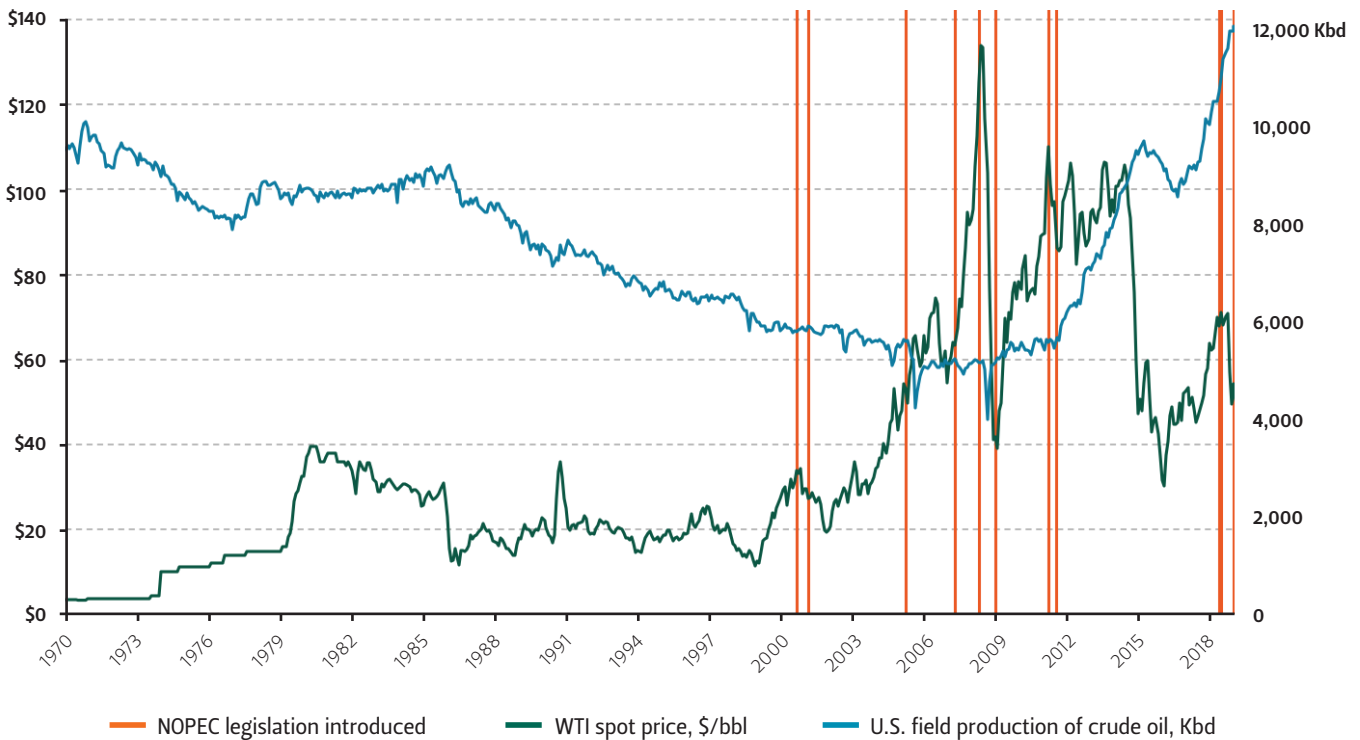
RISKS OF NOPEC TO KEY U.S. ECONOMIC AND DIPLOMATIC INTERESTS

Just because a concept has a viable legal foundation does not make it a strategically advisable course of action. By passing a NOPEC bill and signing it into law, the U.S. political establishment would at a minimum inject new systemic risks that could deter OPEC countries from investing in U.S. assets; in other instances, it would place the U.S. in a position where it appeared to be selectively imposing its domestic law on foreign entities for narrow geopolitical or economic ends. Even if such a campaign yielded some success, the longer term effects on U.S. diplomatic and economic influence could be dire. Extraterritorial legal and economic actions are akin to antibiotics in the sense that when used sparingly and appropriately, they bring great benefits. But when used improperly and inconsistently, they yield resistant microbes that leave future doctors with fewer treatment options.

The perception—at least in Washington—of “success” in prior coercive economic diplomacy campaigns has arguably been distorted by the fact that actions against small economies such as Iran damaged the target country sufficiently that Washington could declare “victory,” but avoided imposing costs high enough to alienate key U.S. allies.¹² If a NOPEC bill became law and Washington moved to enforce it, things would be drastically different.

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FIGURE 2 — INTRODUCTION OF NOPEC LEGISLATION VS. U.S. DOMESTIC OIL OUTPUT AND BRENT CRUDE SPOT PRICES



SOURCES U.S. Energy Information Administration, Library of Congress, and authors' analysis

OPEC Is Not Standard Oil

Today's OPEC is also quite different from the 1910 incarnation of Standard Oil, whose monopolistic control of oil prices spurred antitrust legislation at the turn of the 20th century. As the U.S. Supreme Court put it, Standard Oil "had obtained a complete mastery over the oil industry, controlling 90 percent of the business of producing, shipping, refining, and selling petroleum and its products, and thus was able to fix the price of crude and refined petroleum, and to restrain and monopolize all interstate commerce in those products."¹³

OPEC, in contrast, provides less than half of global supply, primarily via government-owned-and-controlled national oil companies. OPEC also works within a globalized market where new developments such as North American unconventional oil can blindside it, and where refining and transportation of products occur mostly beyond the cartel's control.

Perhaps more pointedly, Standard Oil's early 20th century operations were heavily U.S.-centric and thus lay squarely under the jurisdiction of U.S. law. OPEC oil producers are entirely distinct. They are fundamentally foreign entities and, rather than operating in opposition to government desires as Standard Oil did, are the very instruments by which Saudi Arabia, Kuwait, Iran, and other OPEC members attempt to achieve key national policy objectives.

Consumers of OPEC oil would have compelling reasons to revolt against a U.S. action to hobble the cartel. OPEC oil accounts for 40 percent of the total global supply, and an even larger proportion of the oil that is globally traded. G-20 industrial powers are key customers, including multiple U.S. treaty allies such as Japan and South Korea. Forty million barrels of oil per day trading at a conservative price of \$60 per barrel represents nearly \$2.5 billion in daily trade

and more than \$900 billion in annual revenue. The latter figure was exceeded by the annual GDP of only 16 countries in 2017, according to the World Bank. It is a massive economic flow to risk disrupting through extraterritorial legal action.

OPEC oil producers would have even greater incentives than consumers to resist U.S. NOPEC enforcement and develop workarounds. Enforcement would unilaterally extend a domestic U.S. law into the heart of major oil exporters' sovereign economic and foreign policy decision-making. A NOPEC enforcement action would likely be "priority number one" for a target government but only one of many competing priorities for the U.S. government. The resulting asymmetry between the interests of the U.S. in enforcing NOPEC and major OPEC countries' potentially existential degree of interest in resisting those enforcement efforts would set the stage for confrontation.

This could take the U.S. relationship with those countries, as well as broader regional and global economic and diplomatic alignments, down unpredictable and potentially unpleasant paths. At some point, the U.S. could be forced to either escalate its enforcement attempts—potentially to the point of turning longstanding relationships hostile—or accept the failure of enforcement and the diminishment of U.S. extraterritorial legal power.

Damage to U.S. extraterritorial legal and diplomatic influence could have broad, negative impacts. The current sanctions regime against Iran, which some European countries are already working to bypass, could be weakened further. Major oil exporters and importers would have much stronger incentives to move away from dollar pricing of crude oil, since dollar transactions offer a jurisdictional "hook" that can expose them to punitive U.S. actions.

China and Russia have nibbled at the margins of non-dollar oil pricing, but as things stand now, yuan and ruble pricing of crude oil is effectively just "dollar conversion" pricing, with oil exporters rapidly converting alternative currencies received as payment for oil shipments back into dollars for actual use. However,

concerted U.S. legal action against OPEC could stimulate broader use of alternative currencies, perhaps to the point that pricing crude oil in a currency other than the U.S. dollar becomes feasible. Losing the lead pricing role in a multi-trillion dollar global commodity market would be a major blow to U.S. global financial preeminence.

Passage of the NOPEC bill would also expose all OPEC member states to the possibility of future legal action that threatens their U.S. asset holdings. This new risk layer would likely be highly politicized. OPEC members that happen to be U.S. allies would presumably be given waivers. Sanctions might be pursued against member countries with more problematic U.S. relationships, such as Iran and Venezuela. If the law covered "OPEC+" collusion, Russia might also be targeted. Adding such legal uncertainties would likely discourage oil exporters' investments in U.S. assets, a major blow given that key OPEC states including Saudi Arabia, Kuwait, and the UAE have cycled systemically important volumes of petrodollars back into various U.S. asset holdings over the past several decades.

Official data show that as of December 2018, Saudi Arabia, the UAE, Kuwait, and Iraq hold a combined total of nearly \$305 billion in U.S. Treasury securities.¹⁴ Stock market, real estate, and industrial asset holdings such as Aramco's Motiva refinery are also substantial and all of these assets could potentially be liquidated or confiscated to satisfy a judgment if the Justice Department prevailed in a NOPEC antitrust suit against any of these countries. If OPEC holders of U.S. assets begin to systemically divest or just more deeply diversify their holdings in response to NOPEC-driven legal risks, downward price pressure from upfront sales and loss of future buyer demand could prove damaging for U.S. asset markets.

Furthermore, disrupting OPEC market stabilization operations through antitrust enforcement actions based on NOPEC would likely injure both U.S. consumers and U.S. oil producers. Right now, American producers can "free ride" on OPEC's efforts to raise prices, enjoying an increase in revenues without the burden of production cuts faced

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by the cartel's member states. Further harm would flow from the increasing volatility of an OPEC-free oil market. Oil price swings could become even more severe and higher price volatility would disrupt key producers' capital investment cycle. Greater oil price volatility and the risk of lower prices would also adversely impact the U.S. industrial economy, where the shale value chain accounts for as much as \$1.3 trillion in total economic impact (equal to 6.5 percent of U.S. 2018 GDP) while supporting more than 10 million jobs.¹⁵ Finally, if NOPEC led to structurally lower global oil prices, greater oil consumption could undermine emissions reduction goals.

CONCLUSION

If passed, the NOPEC legislation could impose significant economic harm while damaging the long-term power and legitimacy of U.S. international law enforcement initiatives. International oil trade is far too vital for the global community to accept its subjugation to unilateral U.S. extraterritorial legislation. To boot, OPEC member states, for which the oil trade is vitally important, will have deep incentives to find ways of bypassing potential U.S. enforcement actions. Market-based solutions, intelligent energy diplomacy, and technical innovation offer much more practical and effective policy instruments for pursuing U.S. energy and oil security.

ENDNOTES

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