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Trump, Energy and Trade: A New U.S. Administration and New Directions

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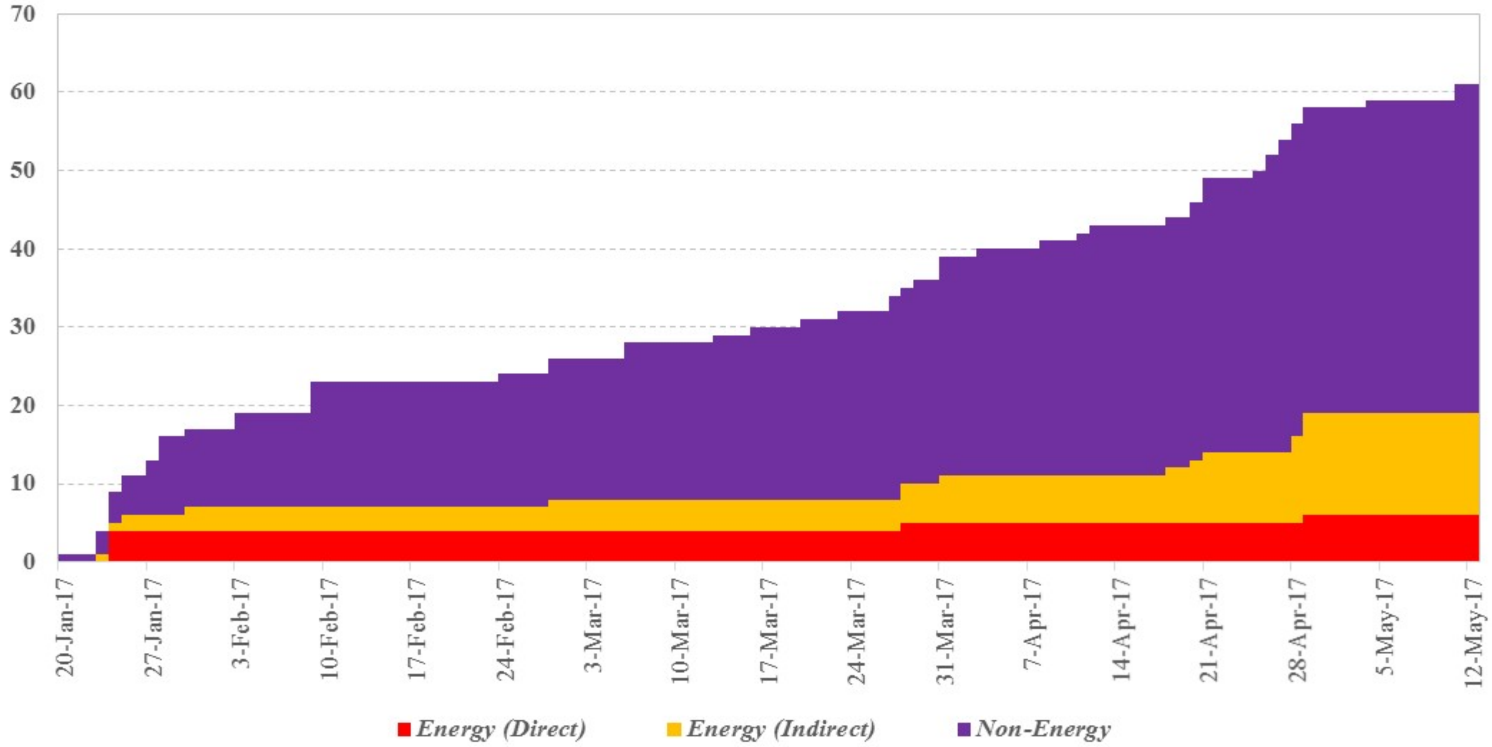
A Timeline of Change

- The Administration has been very active since inauguration – authoring a significant number of executive orders (36) and presidential memoranda (25) – with some implications for energy markets and participants.
    - o 6 are energy-specific while 13 are broader but with energy implications.



A Timeline of Change (cont.)

	Date	Type and #	Order/Memoranda
Direct	24-Jan-17	EO2	Expediting Environmental Reviews and Approvals for High Priority Infrastructure Projects
	24-Jan-17	PM4	Regarding Construction of American Pipelines
	24-Jan-17	PM5	Regarding Construction of the Dakota Access Pipeline
	24-Jan-17	PM6	Regarding Construction of the Keystone XL Pipeline
	28-Mar-17	EO19	Promoting Energy Independence and Economic Growth
	28-Apr-17	EO31	Implementing an America-First Offshore Energy Strategy
Indirect	23-Jan-17	PM3	Regarding Withdrawal of the United States from the Trans-Pacific Partnership Negotiations and Agreement
	24-Jan-17	PM7	Reducing Regulatory Burdens for Domestic Manufacturing
	30-Jan-17	EO7	Reducing Regulation and Controlling Regulatory Costs
	28-Feb-17	EO14	Restoring the Rule of Law, Federalism, and Economic Growth by Reviewing the "Waters of the United States" Rule
	27-Mar-17	PM16	The White House Office of American Innovation
	31-Mar-17	EO21	Establishing Enhanced Collection and Enforcement of Antidumping and Countervailing Duties and Violations of Trade and Customs Laws
	18-Apr-17	EO24	Buy American and Hire American
	20-Apr-17	PM21	Steel Imports and Threats to National Security
	21-Apr-17	EO25	Identifying and Reducing Tax Regulatory Burdens
	27-Apr-17	PM25	Aluminum Imports and Threats to National Security under the Trade Expansion Act of 1962
	28-Apr-17	EO30	Establishment of the American Technology Council
	29-Apr-17	EO32	Addressing Trade Agreement Violations and Abuses
	29-Apr-17	EO33	Establishment of Office of Trade and Manufacturing Policy

Trade Policy

- Mercantilism: the theory that trade generates wealth and is stimulated by the accumulation of trade surpluses (profitable trade balances), which a government should encourage through protectionist policies. When corporations, politicians, and special interests demand control over imports through higher-duties to protect local jobs and industries, they are resorting to mercantilism.
- Examples of mercantilist agenda?
  - Renegotiation of NAFTA (North American Free Trade Agreement)
  - Destination-based tax (incl. Border Tax Adjustment (BAT))
  - Withdrawal from Trans-Pacific Partnership (TPP)
  - Bilateral trade negotiations

Trade Policy (cont.)

- NAFTA
  - Significant constituency that supported Trump wants action on NAFTA.
  - No movement yet, but any renegotiation, much less abandonment, would impact energy market participants significantly.
- BAT
  - Some overly simplistic research has been done to convey dramatic impacts on energy markets. These works tend to:
    - ignore the issue of tax incidence,
    - make unrealistic assumptions about the relative elasticities of supply and demand for crude oil and petroleum products,
    - ignore heterogeneity in crudes, i.e. – heavy crude is not light crude, and
    - no attention to broader macro drivers, hence catering to special interest motivation.
- TPP
  - 5000+ page document that was abandoned.
  - The alternative will apparently be selected bilateral agreements.

More on the BAT

- What is it?
  - A mechanism to generate forgone revenue associated with a corporate tax cut. The GOP plan suggests a 20% tax rate in imported goods.
  - Everything sold in the U.S., domestic or imported, gets taxed (including intermediate goods – parts and materials that are imported – are also taxed), but revenue from exports is not taxed. So, companies would be taxed based on point of sale. In principle, it would encourage domestic production because offshoring is no longer as attractive. It would also encourage exports as it would provide domestic manufacturers an advantage in foreign markets because they won't pay income tax on foreign sales.
  - The BAT is comparable to a value-added tax (VAT), which is where businesses pay sales tax on the value added as goods are produced along the supply chain. Lots of nations already use a VAT, particularly in Europe, rather than rely on income taxes like the U.S.

Implications of a BAT

- What does it mean for energy markets and trade?
  - o The jury is out, but many analyses suggest a hike in gasoline prices domestically, a rise in WTI, and an advantage to US coal, oil and gas exports.
- For oil markets, to determine the impact of the BAT it is important to recognize that the US has already eliminated its imports of light crudes (thanks to shale). It still imports heavy and medium crudes.
  - o So, attempting to focus any analysis on WTI can be misleading.
  - o The implications of a BAT for crude oil prices in the U.S. and abroad, as well as petroleum product prices, as will be determined by
    - substitution opportunities for foreign heavy and medium oil producers,
    - substitution opportunities for domestic refiners, and
    - the barrel at the margin for petroleum product sales.
- For natural gas markets, exports will look much more profitable relative to domestic use. But…
  - o The impact on domestic price will depend on the elasticity of domestic supply, and elasticity of domestic and foreign demand.

NAFTA Renegotiated?

- Commerce Secretary Ross has promised NAFTA is at the top of his list for review, even as ongoing sugar trade discussions with Mexico continue…
- Nobody really knows what a renegotiation could mean, and the implications would be much broader than just energy. But…
- If NAFTA remains intact, cross-border energy export infrastructure will continue to be "rubber stamped".
- NAFTA would also have bearing for the BAT with regard to crude oil prices because it could have implications for Canadian and Mexican heavy crude oils to the Gulf Coast versus other crudes.
- It could also affect joint development opportunities in the Gulf of Mexico by altering the competitive landscape for US Gulf Coast-sourced services and equipment, particularly if abandonment of NAFTA carries stricter local content requirements for Mexican GoM developments.
  - So, leaving NAFTA in place could avoid repercussions that would compromise export capabilities, which presents an anti-mercantilist irony, at least for energy.

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All of this fits into a changing global energy scene…

So, what does it all mean for globalization?

- Mercantilist trade policy will present barriers to trade by raising costs.
- This could be exacerbated if trade wars emerge.
- The implications for renewables in the US is potentially significant.
- Some review has been done of shifts in trade policies in other countries (see TaxFoundation.org, for example), and the predicted dire consequences do not seem to be realized. However, the dramatic shifts in trade and tax policy suggested for the US have no real analog. So, the analysis is needed.
- This said, it is important not to engineer dramatic outcomes. Rather, a measured approach that considers relative elasticities and appropriate incidence of various measures is needed. Moreover, the inter-relation between different measures needs to be considered, for example, when considering the independent and co-dependent impacts of shift in NAFTA and the adoption of a BAT.
- In then end, any shift in US trade policy will impact energy markets, and will likely induce a reshuffling of trade flows. But, the long run implications are likely to mediated by overall global fungibility.

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