



Energy Dominance Is Within Trump's Grasp

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In this latest installment of a series of five articles on the global impact of North American shale, the authors offer an interim readout of the Trump administration's effect on the shale revolution's growth trajectory. Overall, the authors see a net-neutral domestic policy effect—at best—and, in broader but commercially very relevant atmospherics, even slightly negative. An earlier segment of the series described the shale industry's technological and financial resilience; another surveyed global liquefied natural gas (LNG) demand, especially in Asia.

As we outline below, macro-level missteps in trade policy can easily crimp investment and stifle export gains which pro-industry oil-and-gas policies aim to foster. While the Trump White House has won acclaim (or vilification) as a fossil fuel champion, the permissive regulations liberating shale development count as an Obama era legacy. Indeed, the previous administration's lifting of the U.S. oil-export ban, and its expediting of LNG export licenses, played a major policy role in America's ongoing energy renaissance. Yet above all, it's the market fundamentals, not the regulatory arena, which have set the pace of shale in recent years.

Given a normal interplay of scarcity and productivity, export prospects for United States sourced hydrocarbons seem bright. So do those for increasing extraction of natural gas and oil from shale deposits. Shale enthusiasts have good reason to expect a perpetuation of today's demand situation, one in which "tight" North American supply continues to ramp up to meet burgeoning non-OECD country demand, especially in China and India. This view portends continuing cap-ex for pipelines, liquefaction terminals, and for the additional LNG tankers carrying an increasingly "commodified" product, the ownership of which changes hands multiple times during the voyage.

In this scenario, extrapolating from recent trading trends, and casting them forward unchanged into the near future, makes sense. But what impact might the current administration's isolationist/nationalist trade policies have on these trends, which offer some prospect of rectifying "imbalances" in America's global and bilateral merchandise accounts?

The administration's destructive approach to global trading norms (and to regional trading blocs like NAFTA) has a malign effect on U.S. energy export commerce. The largest importing countries, China in particular, are tempted to use state-directed procurement of natural gas and oil for extra leverage in their broader disagreements with the United States. The abrupt twists and turns in political/security relations directly influence producers' and traders' risk calculations. Against this backdrop, the net-positive effect on North American gas extraction from, say, a generous easing of the regulatory and tax burden can be quickly overshadowed by uncertainty and negative sentiment.

Trump Inherited a Policy Environment Already Friendly to Oil And Gas

The current incumbent of the White House ran his election campaign on a pro-fossil fuel platform. The oil-and-gas industry naturally has responded very positively, before and after the 2016 election. Already encouraged by the Obama era's loosening of drilling strictures, the oil-and-gas industries have cheered on Trump's promises of more regulatory rollbacks, including even more tax incentives and new federal areas to open to drilling leases. Beyond these specific inducements, U.S. energy policy now features as an instrument and weapon in the Trump administration's National Security Strategy. The administration's recent energy policy event, entitled "Unleashing American Energy," took the same approach.

Far from a radical departure from a predecessor's actions, the current administration's policies rest upon and embellish the Obama era's industry-friendly policies. Both Trump loyalists and doctrinaire environmentalists (the latter keen to vilify Trump and the fracturing of shale), resist accepting that the immediate past president adopted a pro-industry policy.

Specifically, the Obama White House rolled out the following initiatives during that administration's second term:

- Ended a ban on U.S. oil exports which dated to the oil-shortage crises of the 1970s
- Provided a process for expedited approval of LNG export terminals
- Auctioned thousands of acres of public land for oil-and-gas drilling
- Opened 119 million acres to offshore drilling leases in the Gulf of Mexico
- Allowed drilling in the Arctic Ocean
- Chose to do little to limit offshore oil-and-gas activity following BP's Deepwater Horizon disaster.

- Chose drilling rules that avoided pre-empting the regulatory role of U.S. state governments for non-federal lands.

Apart from specific, very industry-friendly moves like these, the Obama administration also championed a mix of commercially and environmentally friendly policies. For example, Obama's Clean Power Plan (CPP) promptly received a thumbs-down from the new White House incumbent, despite broad support from natural gas producers for the plan. No surprise here: The CPP required coal plants to increase their operating capital to enable conformity with new green guidelines, something clearly at variance with the new administration's lifeline to coal.

Another Obama era inducement for the shale industry appeared in various EPA air pollution regulatory initiatives, all of which favor cleaner burning natural gas. These rules now face roll back by the new administration, keen on extending the lifespan of coal-fired power generating and skeptical of climate change forecasts. This has hit manufacturers hard; consider General Electric's combined cycle generating turbines (CCGT), tailor-made for natural gas. This doesn't seem to mesh well with Trump's pro-domestic manufacturing stance.

In truth, the Shale Revolution's full potential only became apparent during the Obama years, especially after 2014 when, the positive federal-policy mix simply rode the wave as the price of oil rose to \$100/barrel and above. Strong global-demand growth intersected with supply disruptions in Algeria, Libya, Syria and Venezuela to create a strong investment climate—one which brightened further as technical advances in seismic imaging, lateral drilling, and hydraulic fracturing enabled ever higher on-site production.

Trump's Domestic Energy Policy Action Items

Riding on this industry-favorable legacy, the Trump administration from the onset of 2017 initiated a rollback of seventy environmental regulations. These measures include, as mentioned above, the scrapping of the CPP, and eliminating rules for reducing the release of methane from fracking operations. Trump has also prompted a review of the so-called CAFE standards, yet a diminution of these would likely have a negligible effect: Irrespective of the political and regulatory mood swing since 2016, the American consumer still shows a preference for more fuel-efficient cars and for increasingly stringent state and local vehicle standards.

The current administration is also contemplating rescinding current Bureau of Land Management (BLM) drilling rules applicable to both federal lands and the outer continental shelf. New rules aim to permit more leasing of federal lands for oil-and-gas prospecting. An expedited review of the Dakota XL pipeline is also imminent.

From an environmental perspective, the oil-and-gas industry undoubtedly will benefit from faster licensing approvals and less costly regulatory requirements. Yet it's worth remembering that the entire sector only spends an estimated two percent of revenue to comply with environmental guidelines on average (the "dirtier" the power source, the more capital required). With state and local authorities setting most of these regulations, federal rollbacks will have limited impact in most circumstances.

Trump's Tax Cut and Jobs Act (TCJA), often characterized as a handout to the oil-and-gas industry, is at best a modest boost to fossil fuel companies. The Tax Cut and Jobs Act on aggregate reduces the tax burden on the industry by lowering rates, but some operators will actually end up paying more in taxes than they did before 2017 due to the elimination/limitation of certain tax breaks. Rystad Energy estimates the TCJA will enable over \$5 billion annually in new cash flow per year for oil and gas players, equivalent to just a \$3 increase in the oil price.

Blowback and Indirect Consequences

Trump's stance favoring fossil fuels has therefore enmeshed with his predecessor's encouragement of domestic hydrocarbons. Yet these trend lines may collide with the current president's foreign policy or, more correctly, his variable foreign policies. These pose the most significant, long-term consequences for the production and sale of U.S. shale energy.

The prospects for NAFTA figure among the most fraught of these investment climate concerns. For the energy industry, writ large, the continent provides much more than an enlarged marketplace or a "force multiplier" for business. Joining Canadian and Mexican potential to shale exploration and production (E&P) will provide new economies of scale and new locations for LNG terminals aimed at Asian markets. Uncertainty about Trump's feuding with both our northern and southern neighbors will give investors pause. Decisions to simplify permitting procedures for U.S.-Canada pipelines could be checkmated by investor hesitation, reminding us again of the old adage that "capital is a coward."

Trump's restrictions on trade, particularly steel and aluminum tariffs, seem inconsistent with the same man's push for "American Energy Dominance." Energy companies rely on imported steel as a critical input for drilling equipment, pipelines, liquefied natural gas terminals and refineries. No surprise then that prominent oil-and-gas industry executives have lambasted the administration's 25 percent tariff on steel, and its ten percent tariff on aluminum, as "job killing" moves. An Association of Oil Pipelines study last year showed that a 25 percent increase in pipeline costs can increase the budget for a typical E&P project by \$76 million.

The tariff weapon is a double-edged sword with China, the fastest growing market for U.S. hydrocarbon exports. Beijing threatens to impose a 25 percent import duty on all American energy products in retaliation for new U.S. steel (and other) tariffs levied against it. This will hammer U.S. crude oil exports, twenty percent of which reached China last year. The pre-tariff war expectation of \$6.7 billion from American LNG sales to China by the end of this year, must be radically revised. Then consider the cloud now hanging over investment in midstream and downstream infrastructure.

In addition, American coal miners—particularly those extracting bituminous coal from West Virginia—may face a rapid reversal of last year's 100 percent growth in coal exports to Asia. It would take little effort for China to replace the 3.2 million short tons of U.S. coal with product from other countries, while the impact for certain American producers would be catastrophic.

Iran provides another example of how the impact of foreign-policy decisions on American energy security can trump favorable domestic conditions. Withdrawing from the Six Power Iran nuclear deal, and the imposition of new sanctions, will raise oil prices. Iran's oil production will shrink from the current production of two million barrels per day, but by how much will hinge on international sanctions compliance. Goldman Sachs projects a global price increase of between \$3.50 and \$7 per barrel. By those estimations, Washington's Iran policy may be twice as consequential as the TCJA. American motorists, some of whom vote, will feel the sting very quickly.

Notwithstanding the current administration's wanting to buttress an already favorable pro-shale investment environment, gravely unsettled trade politics have created chaotic investment conditions. The consequences pose a countervailing danger to the pro-shale regulatory and policy edifice. Though guilty of multiple errors elsewhere, the Obama presidency has left behind a legacy landscape propitious for the oil-and-gas sector.

If this unexpected president aims to consolidate the "energy dominance" he now senses within America's grasp, he could begin by accepting the pro-industry policy achievements achieved by previous administrations [i.e., those of George W. Bush and Barack Obama]. He might also re-evaluate the blowback effect of his foreign- and trade-policy decisions—which will impede or even undermine the astonishing progress of U.S. shale operations.

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