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# U.S. Energy Election Winners 2020

## Impact of new administration.

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### Morningstar Commodities Research

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### Data Sources for This Publication

EIA

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### Close Call

At the time of writing, the outcome of the 2020 U.S. presidential election is undecided but appears to be leaning toward a victory for Democrat Joe Biden. The Senate looks to remain under Republican control, making for a divided congress. The Trump administration's energy agenda has rolled back environmental regulation and protected fossil fuel industries like coal. These domestic initiatives had some beneficial impact on oil and gas, but the expansion of shale output in the past decade focused U.S. energy development on international markets. A new administration's international relations and trade policies will therefore have the most impact on the domestic industry. Growth in clean energy and renewables is already affecting the U.S. energy market, despite attempts by the Trump administration to frustrate the trend. A Biden administration is likely to run with the tide and accelerate clean energy developments. This analysis highlights how current trends in the U.S. hydrocarbon industry could be affected by a new administration.

### Immediate

If Biden wins the election, we don't expect a new administration to act impulsively on energy. Any legislative agenda would be constrained by the Senate remaining under Republican control. Headline actions to look out for include new administration appointees to the Department of Energy and the Environmental Protection Agency increasing scrutiny for infrastructure permits and protecting federal lands. An agenda to combat climate change could lead to direct legislation to tax carbon emissions and indirect targets being assumed by the United States rejoining the Paris Agreement. Investment incentives will favor renewable technologies and projects over hydrocarbons. Specific pipeline permits such as Keystone XL can be overturned, but there are limited circumstances (for example, border crossings) where infrastructure decisions lie in federal hands.

### Long Term

Administrations direct policy but don't control long-term industry trends. A good example is the Trump administration's effort to stem the decline of the coal industry. That policy failed because coal can't compete with cheaper and cleaner-burning natural gas. Given that decisions to retire and replace generating assets were already made and given the 40- to 50-year horizon of investments, the writing is on the wall for coal-fired generation. No coal plant was saved by the administration, and coal-fired power plant retirements weren't canceled or postponed.

### **Green Energy**

Today's long-term energy trend is for clean solutions and renewable sources. A new administration may slow that trend or speed it up but can't reverse it. Given the choice and equal price and convenience, consumers desire clean vehicles like electric autos. Although the success of Tesla's stock price isn't reflected by market share, it does reflect the direction investors believe the market is headed. Investor sentiment has turned away from fossil fuel companies, including drilling and production, during the Trump administration. The hydrocarbon industry faces these headwinds regardless of who heads the government. In the end, the Trump administration's efforts to defend oil and gas development haven't affected the trend away from fossil fuels or the growth of renewables. A Biden administration's green energy agenda would work with the long-term trend. Arguably, government investment is better spent on new and cleaner alternative sources of energy than preserving legacy plants. Clearly, renewable energy has significant growth prospects for investors and jobs.

### **Fracking**

The impact of an anti-fracking or anti-oil and gas agenda from a Biden administration would be slow to take effect and limited to areas where the federal government has oversight. The government controls federal lands, including offshore waters, but not state or private land. A national fracking ban isn't possible, so restrictions would be limited to federal land. Any fracking limitations aren't likely to suspend or negate existing leases; they would only affect new lease sales. If this happens, it will limit drilling in shale basins, most particularly in the New Mexico Delaware Basin, which is part of the Permian and largely on federal land. Such a ban on new drilling lease sales would certainly frustrate exploration and production companies with expansion plans, but they have many alternatives to choose from in the Permian or other U.S. shale basins. If Permian output is stunted, crude and natural gas prices will increase, encouraging more drilling elsewhere and increasing producer returns.

A clear shortcoming of shale development is boom and bust cycles caused by too much growth followed by a price collapse. Arguably, drilling restraint through government policy helps to even out boom and bust. A 2014 state-imposed fracking ban in New York prevented development of the natural gas shale industry in a region that forms part of the Appalachian Basin. While this restricted investment and growth in the Empire State, it probably cemented development in Pennsylvania and Ohio by placing a geographic boundary on the boom and providing a market for natural gas production from those states.

### **Renewable Fuels**

U.S. refiners have long endured political intervention in the form of renewable fuel standards set by the 2007 Energy Independence and Security Act, mandating blending increasing volumes of biofuels into gasoline and diesel. These mandates led refiners to surrender 10% gasoline and 5% diesel market shares to renewable fuels that primarily benefit domestic farm interests and have been the subject of intense political lobbying by successive administrations. On this issue, Republican politicians support a clean energy initiative because it favors agricultural communities despite hurting the refining industry. In the Trump administration, support for farmers on clean fuel was ultimately deemed more important than support for refiners despite efforts to prevaricate (see our August note [Ethanol Mandates Split Republican Interests](#)). A Democratic administration will favor agricultural interests as well as clean

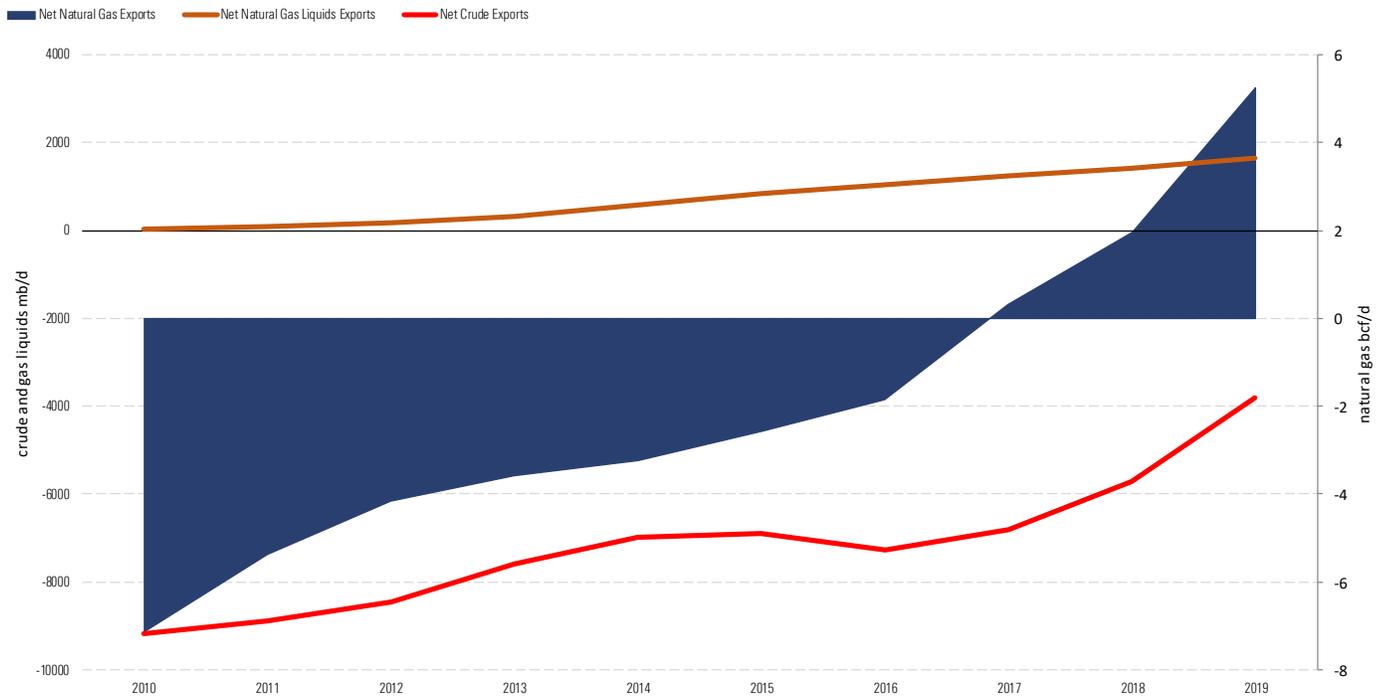
energy, reducing any ambiguity around the renewable fuels issue. Policies such as preference for renewable fuels as well as subsidy of electric vehicles and battery development threaten refiners' market share of transport fuels.

### **Feedstock Discounts**

U.S. refiners benefited from lower feedstock costs in the shale era due to transport congestion. As crude production increased and infrastructure took time to build out, stranded crude was discounted, allowing domestic refiners to increase margins. A federal ban on crude exports increased the volume of stranded crude until it was repealed in December 2015. If new administration policies reduce shale output, then transport congestion will be reduced, ending discounts for stranded crude. This also affects Western Canadian crude imported into the Midwest, which has earned hefty discounts because of pipeline congestion. Lower crude output frees up pipeline distribution space and raises crude prices. Government policies to limit infrastructure, such as cancelling the Keystone XL pipeline permit that opens incremental capacity between Western Canada and the U.S., have the opposite effect. By increasing congestion, reducing prices, and encouraging Midwest refiners to process greater volumes, canceling Keystone could increase Canadian crude volumes processed in the U.S.

### **Hydrocarbon Exports**

During the shale era, the U.S. reduced dependence on imported hydrocarbons. By 2019, it was a net exporter of 1.6 million barrels/day of natural gas liquids and 5.3 billion cubic feet/day of natural gas according to Energy Information Administration annual data (Exhibit 1). Although the U.S. remains a net importer of crude, mainly from Canada and the Mideast, the country exported an average 3.0 mmb/d of light shale crude in 2019. Aside from imports of heavier crude, domestic production of natural gas and gas liquids more than met the nation's needs, meaning any surplus output is destined to export markets. That means any growth in U.S. production is driven by export markets. Growth in output is therefore ultimately determined by worldwide supply/demand balance. If the rest of the world needs U.S. production, prices increase to encourage output; if the international market is saturated, prices fall and discourage producers.

**Exhibit 1** U.S. Net Hydrocarbon Exports 2010-19

Source: EIA, Morningstar.

**Trade and Sanctions**

This supply/demand principle should determine incremental output, but the U.S. doesn't compete for market share on a level playing field. Trade and sanctions policies have an outside impact on international sales. The January 2020 U.S.-China phase 1 trade agreement is an example. The agreement set dollar quotas for Chinese imports of U.S. energy products that encourage China to buy from the U.S. regardless of economics. Such agreements support American producers but are vulnerable to renegotiation and disputes between the parties, affecting their adherence to the quotas (see our February note [Hollow Energy Promises in China Deal](#)). U.S. energy exports have also been supported in the shale era by OPEC and OPEC+ production agreements limiting members' output. These agreements don't involve the U.S. but indirectly benefit exporters by ceding market share to competitors. More directly, U.S. sanctions policies toward Iran and Venezuela blocked crude exports from those countries and increased market share available to U.S. exporters. A recent example in the opposite direction is that of utility Engie ending negotiations on a long-term purchase agreement for liquefied natural gas from NextDecade's Rio Grande, Texas, liquefaction plant after pressure from the French government over the facility's carbon footprint. In this case, the Trump administration's lax regulation of emissions hampered domestic industry. A Biden administration would benefit energy exports by alignment with trade partners on climate change, but likely harm crude exports by lifting sanctions on Iran. A Biden administration is likely to be more deliberative in trade negotiations with China, potentially leading to longer-term, reliable purchase agreements.

**Recovery**

U.S. crude production and refining are currently suffering their worst decline since the start of the shale era a decade ago. A new administration can help the economic recovery required to revive demand by resolving the coronavirus crisis. But the crisis hastened trends reducing consumption of fossil fuels for transport. Investors have also lost faith in the fossil fuel agenda and are looking for energy companies to diversify into renewable energy. A new administration's focus on policies that encourage this energy transition can be beneficial if accepted by the industry. But demand for U.S. fossil fuels is ultimately driven by international needs that push up prices and encourage extraction. We expect a Biden administration to conduct more-reliable trade and sanctions policies that encourage investment and long-term commitments in overseas markets. ■■■

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