OCTOBER 18, 2024

WEEKLY ECONOMIC COMMENTARY

IN THIS ISSUE:

- **Tough Choices For Energy Policy**
- **The Middle East, And Oil**
- **The Role of Regulation**

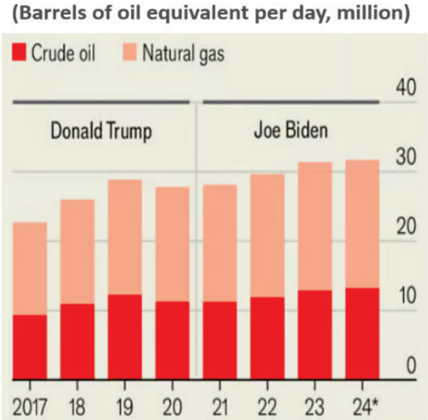
The former U.S. first lady Eleanor Roosevelt once said: “It takes as much energy to wish as it does to plan.” American politicians would do well to devote their energies to planning a sound long-term energy strategy, as opposed to wishing the issues would go away.

The U.S. is the largest oil producer in the world and the second largest source of global greenhouse gas emissions. U.S. oil and gas output hit a record high last year. Fossil fuels remain the country’s dominant source of electricity, accounting for more than half of total generation this year. Job growth related to U.S. fossil fuel production far outpaced that for renewable energy in 2023.

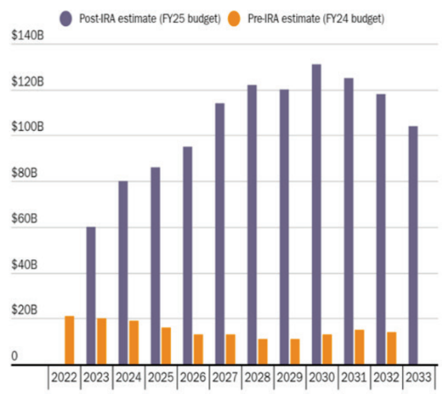
In the 2020 election, Joe Biden positioned climate as a major crisis. When elected, he followed through with several steps. The most notable of these was the Inflation Reduction Act of 2022, which included hundreds of millions of dollars in clean-energy tax credits and measures to encourage the sale of electric vehicles (EVs).

In this year’s contest, former President Trump and Vice President Harris share the twin goals of lowering energy costs and boosting jobs in the sector. But the two of them have completely different takes on the energy transition and climate risks.

U.S. Fossil Fuel Production
(Barrels of oil equivalent per day, million)



Total Annual Cost of Energy Tax Credits
Before and After IRA



Sources: The Economist, CATO, CRFB

Harris seeks to build on the Biden administration’s policies, favoring an expansion of renewable energy. Her policies will include consumer incentives for purchase of domestically-produced EVs and investments in charging stations, along with clean-energy tax credits. However, she has retracted her past support for the progressive Green New Deal proposal and a fracking ban.

On the other side, a Trump presidency would de-emphasize programs to manage climate change. He plans remove restrictions on new fossil fuel exploration to increase supply

Global Economic Research
50 South La Salle Street
Chicago, Illinois 60603
northerntrust.com

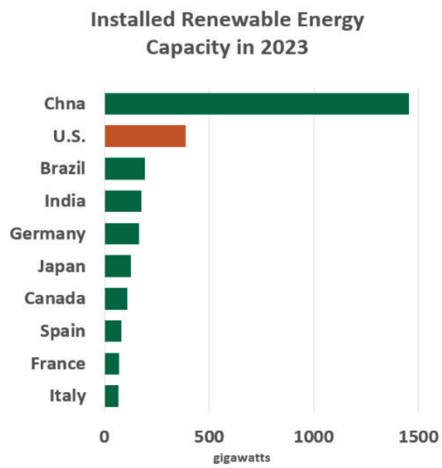
Carl R. Tannenbaum
Chief Economist
312-557-8820
ct92@ntrs.com

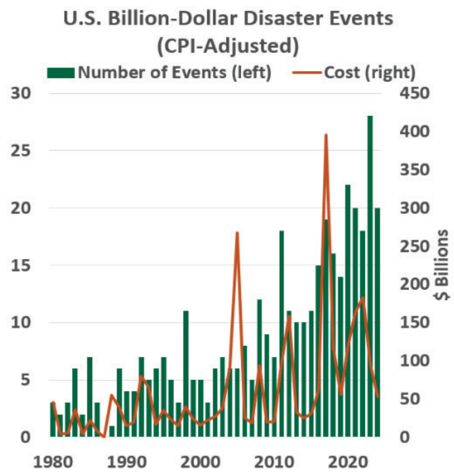
Ryan James Boyle
Chief U.S. Economist
312-444-3843
rjb13@ntrs.com

Vaibhav Tandon
Chief International Economist
630-276-2498
vt141@ntrs.com

and lower energy costs. During his four years in office, Trump rolled back more than 125 environmental protection rules. He intends to repeal all of the conservational regulations put in place by the current administration. Trump could also cut tax credits for electric vehicles.

The former president pulled America out of the Paris climate accord during his tenure. He promises to not only withdraw from the agreement again, but also from the United Nations convention on climate change. The realignment could render global climate goals out of reach.





Sources: Statista, NOAA

The costs from climate change are rising.

The consequences of climate change are growing. 2023 was the warmest year on record in the U.S. The country witnessed 28 extreme weather events, causing $95 billion in damage and displacing 2.5 million Americans. Warmer sea temperatures added to the strength and persistence of Hurricanes Helene and Milton this year. Insurers took a large hit, losing money on homeowners' coverage in 18 states across the nation.

The economic consequences are only going to compound with time. Disruptions related to climate change will lead to higher inflation and lower growth. According to the Office of Management and Budget, uncontrolled climate change could cost the U.S. economy up to $2 trillion annually, with additional expenditures of $128 billion per year to cover factors like disaster risks and insurance. Food inflation alone could rise by as much as 3 percentage points a year.

The First Lady from Hyde Park was a staunch environmentalist who highlighted the importance of respecting nature. In the current day, the ecology and the economy are inextricably linked. Policy must seek to preserve both for future generations.

Crude Considerations

Jimmy Carter turned 100 years old earlier this month, the first former U.S. President to reach that age. Carter's humanitarian work over the past four decades is notable; some suggest he has been a bigger success since leaving office than he was when he held office.

That characterization is a bit unfair, as President Carter was the victim of circumstances that were beyond his control. Two oil price shocks during the 1970s damaged the competitiveness of U.S. heavy industry, raised inflation and interest rates to intolerable levels and diminished America's confidence.

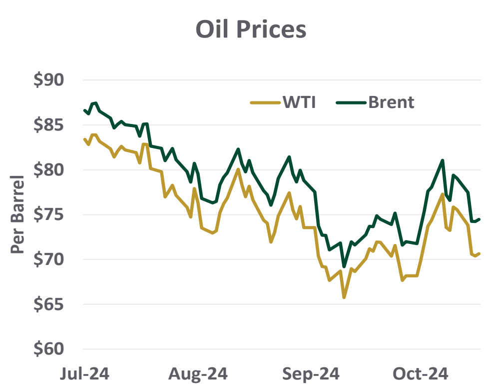
Inflation is once again a central economic issue in the 2024 election. But energy prices have not been a leading concern until very recently, when the conflict in the Middle East escalated. Oil prices had been falling for much of the year, but war has introduced a risk premium. Uncertainty in the market for this essential commodity is likely to be with us for some time.

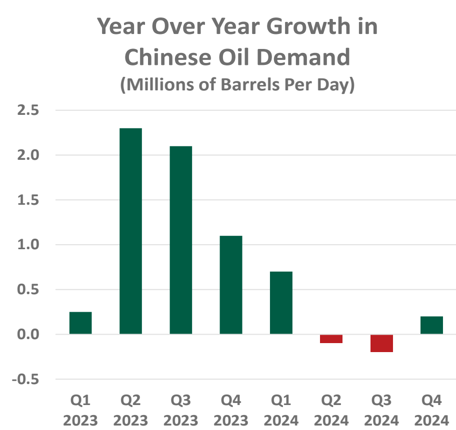
Post-pandemic inflation was already ascending when Russia invaded Ukraine in 2022. Sanctions against Russia altered global supply dynamics and led crude prices well over $100 per barrel. Sensing the political consequences of rapid increases in the price level, the Biden administration authorized releases from the strategic petroleum reserve (SPR) and opted not to aggressively enforce sanctions against Iran's oil shipments.

The Middle East conflict has oil markets on edge.

Iran has increased its daily oil output from less than 2 million barrels per day in 2020 to more 3 million today. 1.5 million of that is exported, with China a top client. The earnings from that activity are critical to Iran and a target for Israel, one reason why some analysts suggest that the Islamic Republic has little appetite for a regional war that could curb its output. As a deterrent, the Biden Administration recently banned additional entities from involvement in Iranian oil exports.

Should the war expand, Iran would be in a position to block shipments through the Strait of Hormuz, through which 30% of global oil exports travel. Attacks on critical energy infrastructure could be conducted by Israel or by Iran's proxies. Under that scenario, crude prices could jump to $150 per barrel or more.





Sources: Bloomberg, IEA

Fundamentals, however, are placing downward pressure on oil prices. One central factor is reduced demand from major manufacturing countries. Early last year, China took initial steps to stimulate its sluggish economy; among them were incentives and instructions for heavy state-owned industries to raise production. This resulted in an increased appetite for fuel.

It also resulted in increased inventories of goods that were difficult to sell, either domestically or internationally. The supply glut added to deflation risks, prompting Chinese officials to turn to other avenues to improve growth.

A second governor on oil markets this year has been U.S. output, which is at a record level. The discovery of new reserves and technology have contributed to this achievement. While the current administration has prioritized the development of alternative fuels, it has declined to implement measures that would limit traditional energy sources. This is due in part to a desire to keep prices low, and to rebuild reserves. Some modest additions have been made to the SPR, but it remains more than 40% lower than it was in 2020.

As the United States considers the environmental and geopolitical consequences of energy, it finds itself struggling to balance competing objectives. We want cheap energy, we want clean energy and we want it to come from reliable places. Resolving this “trilemma” will require policies that promote production and manage utilization across sources, supported by investments in technology and infrastructure.

America has been on a 50 year search for an effective energy policy.

That was the challenge that faced Jimmy Carter nearly fifty years ago, and it remains a challenge today. Then, as now, the Middle East is in some tumult, with Iran at the center. Then, as now, America was trying to achieve better balance in its sourcing of energy. Perhaps the next administration will have the kind of success in setting energy strategy that has eluded its predecessors.

There Ought To Be A Law

I was born during Ronald Reagan’s first Presidential term. I have only lived under the received wisdom that the nine most terrifying words are, “I'm from the government, and I'm here to help.” And yet, I can’t say I have ever lived under small government.

Regulations are the guardrails of our society and economy. A large and complex system will need institutions of similar sophistication to ensure good operation. The coin is two-sided: Businesses benefit from order, but decry the cost of compliance. Building codes add to construction costs, but guard against disaster. Vehicle safety regulations are frustrating for automakers, but life-saving for their customers. And the list goes on.

Predictably, the state of regulation has been a hot political topic during the U.S. election campaign. The U.S. federal regulatory apparatus is large and can be perceived as unwieldy. Spates of deregulation did lower the federal civil employment level by nearly 20% in the course of the 1990s, but it has only grown since. And the difficult questions our leaders are facing could make the case for bigger government.

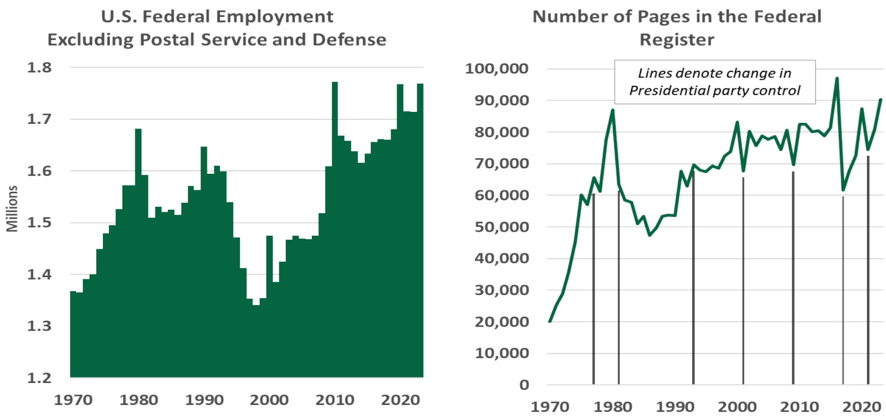
Technology regulation is in the forefront. After a breakout run of growth, the tech sector is facing antitrust investigations across the markets for internet search, advertising and app distribution; global requirements around data privacy have also grown. Their market power can be defended as a free-market outcome of network economies, but their commanding positions could be stifling innovation and costing consumers. Questions of tech firms’ power are a point of bipartisan alignment, with scrutiny to persist under any election outcome.

Meanwhile, the newest technology, artificial intelligence (AI), is the subject of substantial regulatory attention. Though still in its formative stages, AI’s pioneers have warned of its potential to confuse and disrupt in unintended ways. Congress has not advanced federal AI legislation, leaving a patchwork of state rules. The United Nations has released a “Governing AI for Humanity” initiative to attempt a globally-cohesive approach to AI regulation, but the effort will be slow. Neither presidential candidate has made AI a focal point of the campaign, but its growing importance cannot be ignored.

Housing is also a focus of the presidential platforms. The Harris campaign has proposed incentives to support more development and down-payment assistance for first-time homebuyers; Trump advocates releasing federal land for development. But whatever these proposals’ merits, the residential market is complicated by layers of local control. Efforts to expand development will be frustrated by municipal, county and state laws governing land uses, lot sizes, occupancy, stormwater runoff, tree preservation and a host of other restrictions. National policies to support construction may conflict with local regulations to protect current property owners.

Under either party's control, we expect the regulatory state to continue its growth. Presidents are elected to enact their agenda, whether by advocating for legislative changes or through executive orders. Using the number of pages in the Federal Register as a proxy for the extent of regulation, all modern party-changing presidencies have been marked by a sudden drop as old policies are repealed, and a rise as the new leader's polices are enacted.

Regulation is easy to criticize but often necessary.



Sources: Bureau of Labor Statistics, Office of the Federal Register, Haver Analytics

Former President Trump promises to deregulate, most vocally in the energy and education sectors, but his trade agenda is by no means *laissez-faire*. Vice President Harris would leave most Biden policies unchanged, with some marginal new regulation around housing and emissions.

Regulation can be strengthened or weakened at the discretion of the appointed leaders of federal agencies. However, either winner may be frustrated by a new convention that limits agencies' ability to act. The Supreme Court changed precedent this year by rejecting the doctrine of "Chevron deference," which granted administrative regulators wide discretion to act as they deemed necessary. Now, enforceable regulations are meant to come only by act of Congress. At the legislature's current pace of output, the prospects for new laws are diminished.

The push for a smaller state did not start with Reagan. As early as 1837, Henry David Thoreau wrote, "The best government is that which governs least." Whatever the government's size, portions of the populace will call for both more and less regulation. Whatever the election outcome, we will likely get more rules to live by.

northerntrust.com

@NT_CTannenbaum