

## IMO Compliance and the Trump Factor: Rising Distillate Prices in an Election Year Would Increase Risk of a US Delay/Withdrawal

Conventional wisdom assumes that looming regulation from the International Maritime Organization (IMO) to limit sulfur content for fuel used in international seas to 0.5% beginning in 2020 (IMO2020) will require diesel cracks and prices to spike starting late next year (some experts see distillate cracks doubling - from projections of roughly \$10 in 2019 to nearly \$25 in 2020 in Asia - and [IEA sees distillate prices rising 20%](#)). We agree that some increase in cracks/prices is needed to incentivize currently unprepared shipping and refining industries to install scrubbers and produce low sulfur product. However, a critical factor remains largely overlooked: If IMO2020 is seen to cause US distillate (home heating oil, road diesel, jet fuel) prices to rise in the winter of an election year, President Trump could well decide to end US participation in the IMO entirely or insist on a delay of the regulations. Color:

### **As a rule, policies that increase retail fuel prices can attract bipartisan opposition in Washington**

At this point, two things seem certain about IMO2020: (1) shippers aren't scrubbing nearly enough ships (less than [250](#) out of the ~60,000-ship merchant fleet had installed scrubbers as of end-2017, while both [cost](#) and [time](#) will limit sufficient scrubber installations before 2020); and (2) IMO officials are showing no flexibility on the January 2020 start date and are looking to tighten compliance by moving point of obligation to ports.

Equally clear but less appreciated is that IMO has not yet appeared on the White House's radar screen. That is likely to change as implementation approaches, especially if expected distillate price increases slam consumers in the winter of 2019-2020. Few things attract the attention of (and terrify) elected US officials more than rising pump prices. Case in point: when RINs spiked to \$1.40 in 2013, threatening to push already high gasoline pump prices higher, it galvanized a bipartisan push in Congress to reform the Renewable Fuel Standard. Only EPA's assurance that it could administratively alter the program to provide some relief at the pump quelled the push for legislation. Looking ahead, any US political backlash to IMO2020 hinges on the size of a distillate price spike and the base price level. The higher the latter, the greater the risk the former will attract notice and controversy among important constituencies such as farming, trucking, and heating oil-using voters in swing states like Pennsylvania.

### **The political order of battle in Washington over IMO2020**

Most of the key constituencies in any political battle over IMO2020 are currently either unaware of the issue or unwilling to engage. We identify them and outline their expected positions below:



US Distillate Consumption by Sector		
Sector	Distillate Demand (2016, mb/d)	Share of Total US Distillate Consumption
Motor Vehicles & Trucking	2.63	66.2%
Residential & Commercial	0.37	9.3%
Industrial	0.33	8.4%
Farms	0.23	5.7%
Railroads	0.23	5.7%
Marine Bunkering	0.15	3.7%
Other	0.04	1.0%
<b>Total</b>	<b>4.0</b>	<b>100%</b>

Source: EIA, Rapidan Energy Group

Likely US Proponents of IMO2020		
Group	Color	Voices to Watch
Complex US Gulf refiners	The typical US refinery has relatively superior coking capacity and is generally " <a href="#">very, very well positioned</a> " to comply with the rule.	American Fuel and Petrochemical Manufacturers
US shipping groups	IMO2020 primarily hurts international shippers, as the majority of US shipping takes place within US Emission Control Areas (ECAs) which have been under a strict sulfur cap (0.1%) since 2015 and will be unaffected by the new regulations.	American Maritime Partnership
US shale oil producers	Augmented demand for sweet crude will be a boon for US oil producers.	Independent Petroleum Association of America, American Petroleum Institute
Environmental groups	These groups would attempt to lobby sympathetic legislators and grassroots groups to take action if the US attempts to weaken IMO participation.	Sierra Club, Environmental Defense Fund



Likely US Opponents of IMO2020		
Group	Color	Voices to Watch
Farmers	Rising diesel prices will increase farming costs and farm-to-market transport costs, both of which will pass through to consumers. Farming production accounts for nearly 6% of domestic diesel consumption.	American Farm Bureau Federation
Trucking	Diesel is the second largest cost <a href="#">for the trucking industry</a> after labor, accounting for 20% of operating costs. Truck use for business purposes consumes approximately 64% of American diesel. Any goods shipped by truck will see a cost increase for consumers.	American Trucking Association
Northeast heating oil states	Heating oil costs would rise in Pennsylvania, New York, and New England, which together consume the bulk of the country's heating oil (see chart below).	Upstate New York Energy Association, Oilheat America, National Oilheat Research Alliance
Railroads	The industry as a whole accounted for 5.7% of domestic diesel consumption in 2016. Fuel costs totaled 14.3% of <a href="#">Union Pacific's</a> operating expenses in 2017. Any goods shipped by rail will see a cost increase for consumers.	BNSF, CSX, Union Pacific, Association of American Railroads

Distillate Consumption for Home Heating in Key Swing States				
State	Number of Electoral Votes	Trump Margin of Victory in 2016	Distillate Demand for Home Heating (kb/d)	Share of Total US Distillate Demand for Home Heating
Pennsylvania	20	1.2%	41.2	11.7%
Maine	4	-2.7%	18.1	5.1%
New Hampshire	4	-0.4%	11.6	3.3%
Ohio	18	8.6%	9.3	2.6%
Virginia	13	-4.9%	8.6	2.4%
Florida	29	1.2%	6.7	1.9%
North Carolina	15	3.8%	6.7	1.9%
Michigan	16	0.3%	4.4	1.3%
Wisconsin	10	1.0%	4.0	1.1%
<b>Total</b>	<b>129</b>	<b>-</b>	<b>110.7</b>	<b>31.4%</b>

Source: EIA, Rapidan Energy Group

### **If Trump's constituency is threatened, he may walk (à la Paris)**

If IMO2020 ignites a political firestorm, Trump will likely announce his intent to exit the IMO, invoke the treaty-mandated one-year waiting period before formal exit, and then attempt to negotiate a delay or weakening of the rule as the price for continued US participation - much like the strategy the administration has employed in exiting the Paris Climate Accord. This strategy - announcing a sweeping policy change as an opening offer in continued negotiations - has become a hallmark of the Trump Administration.

The law on whether Trump can withdraw the US from the IMO without congressional consent is far from clear, as the Supreme Court has generally declined to clearly define presidential vs. congressional authority over treaty removal, finding it to be a political question rather than a legal one. As the IMO treaty was both ratified by the Senate and cemented into US law by subsequent legislation, a unilateral decision to withdraw would certainly test the limits of the President's authority; that said, while Congress may not actively approve, there may not be much active opposition either. Democrats, particularly in the Northeast, will likely be hesitant to commit to a climate change policy if it means their constituents may have trouble affording adequate heat in the winter or will see an increase in the price of food and any good shipped by road, rail, or sea. Oil-state Republicans will be likewise hesitant to side with oil producers and refiners in the face of rising fuel prices. As with the RFS crisis of 2013 noted above, rising fuel prices can lead to bipartisan action.