CANADA AND THE NEW AMERICAN EMPIRE

CBC newsworld

ENERGY

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Subject

Modern industrial societies rely on crude oil and natural gas to fuel economic prosperity and sustain a quality of life their citizens have come to expect.

In addition to being one of the primary energy sources for heating and cooling systems and motor fuels, oil and gas also provide the polymers and other petroleum by-products that are used to produce everything from plastics and fertilizers to clothing, food and pharmaceuticals.

Since the petroleum industry emerged about 150 years ago, it has developed on the basis of international trade. Companies explore the world in search of resources and then deliver oil, gas or their by-products to wherever there is demand.

And in the international energy world, Canada is a big player.

Exploration and production of oil and gas in Canada is a $75-billion-a-year industry and Canadian companies produce more than one million barrels of oil a day in Africa, Asia, the Middle East and other parts of the world.

Canada is the world’s third largest natural gas producer and the ninth largest producer of crude oil. It is one of few countries in the world with the ability to significantly expand its petroleum production in the next decade to meet rising global demand.

Free and open trade in oil and gas across all of our borders represents a major economic opportunity for Canada. With the world’s largest energy consumer right next door, there is a ready-made market for our products.

Canadian oil and gas help underpin the competitiveness of the North American economy and cross-border energy trade with the United States is a critical component of Canada’s overall economic health.

Our industry is encouraged that energy issues - Canada-U.S. energy trade in particular - has become of interest for governments in Canada as well as public policy forums like this one.

This attention is well warranted. We are in one of the most unsettled eras for the energy sector since the Middle East oil embargoes of the 1970s and early 1980s. There is wide concern about the volatility of oil and gas prices, seemingly relentless growth energy demand, particularly in Asia, and the high cost of finding and developing new supplies amid declining productivity from convention low-cost basins. There is also the challenge of meeting ever-more stringent environmental requirements.

Canada's petroleum resources are immense -- our 175 billion barrels of oil sands reserves is second only to oil-soaked Saudi Arabia -- but the challenges to develop them are as big as the opportunities. It's also worth noting that 10 years ago as there was no oil produced offshore Newfoundland and Labrador but today it accounts for one-third of Canadian oil production.

There is intense global competition for the investment dollars required to find, develop and produce petroleum resources. If Canada is to enjoy the financial and social benefits from developing reliable, affordable and environmentally sound sources of energy for domestic and export markets then conditions for investment must be optimized in this country.

Background

The pre-conference materials noted that the Canada-U.S. energy relationship could be characterized as a piece of unfinished business due to the absence of an institutional framework or a common understanding of objectives.

The petroleum industry supports the development of a comprehensive long-term energy vision that builds on successes of the past - such as NAFTA - to integrate research and development, energy, environment, and economic policies in order to increase energy supply while protecting the environment.

The last major public debates in Canada over energy policy, especially exports of oil and natural gas, occurred around the Free Trade Agreement (FTA) in 1988 and in 1992 when Mexico joined to create the North American Free Trade Agreement (NAFTA).

Within those frameworks and institutions, energy trade has grown dramatically in North America.

Trade is one of the most ancient of human practices and it has always been subject to the push and pull of government policy over its relative value versus other issues of national importance.

When protectionism has been intense throughout history, trade has languished and entire nations have suffered. As protectionism receded and trade flourished, nations prospered. The Great Depression that followed a breakdown in the international trading system in the 1930s is an example of this scenario.

Today, Canada and the United States are the world's two biggest trading partners and an example of the mutual benefits of a successful trading relationship. This is especially true in the energy sector. In contrast to other bilateral concerns, energy trade between Canada and the U.S. has been relatively free of stress. The primary reason is NAFTA and, in particular, free trade in energy with the United States.

Canada is now the number one foreign supplier of energy to the United States.

About half of Canada's oil and gas production is sold to American markets – accounting for 17 per cent of U.S. gas imports and nine per cent of its total supply of oil and refined petroleum products. Canadian oil and gas exports to the U.S. were worth $47 billion in 2003.

It has not always been such smooth sailing.

In the 1960s, Canada wanted more access to U.S. markets but the Americans restricted oil imports in favor of their still-growing domestic production. By 1970, U.S. crude oil production had peaked and went into decline. Within three years, an Arab oil embargo would trigger a global energy crisis and Ottawa responded by imposing export taxes on Canadian crude.

The lower domestic oil price and restrictions on access to foreign markets set in motion a sharp drop in Canadian oil production. Within one decade, Canada went from being a net exporter of oil to being a net importer.

After steep declines in investment, governments in Canada and the U.S. shifted away from the interventionist policies in the 1980s. Since then, Canada has seen oil and gas production triple. The numbers tell the story.

Natural Gas

- In 1985, Canada produced six billion cubic feet of gas a day (Bcf/d). By 2003 it had increased to 18 Bcf/d. Canada has an estimated 363 trillion cubic feet (Tcf) of remaining gas resource potential. Unconventional resources, such as natural gas from coal (NGC), have an estimated 167 Tcf of untapped resources.

Crude Oil

- In 1985, Canada pumped 1.6 million barrels of oil a day (b/d). By 2003, it increased to 2.5 million b/d. Total production, including Atlantic Canada, is projected to increase to 3.6 million b/d by 2015, when, three out of every four barrels of oil produced in Canada will come from oil sands. In addition to the oil sands, Canada has five billion barrels of conventional reserves.

It is worth noting that since the shift in economic policies in the mid-1980s, Canada and the United States have experienced some of the longest periods of economic growth in their history.

Key Issues

Energy trade between Canada and the United States is one of the most successful bilateral economic relationships in the world. It provides Canada with jobs and investments from coast to coast to coast and gives North America a secure supply of energy in a world rife with geopolitical uncertainties.

Canada needs more oil and gas to supply a growing domestic market and take advantage of export opportunities. With 30 million people, Canada is too small to justify the huge capital investment required for oil sands, frontier and offshore projects. Our vast resources will only be developed if there is access to foreign markets. Geographic proximity means   that the U.S. will likely remain the number one foreign buyer of Canadian oil and gas exports.

However, petroleum is a global commodity and crude oil from offshore Newfoundland and Labrador can easily move to European refineries. One suggestion to accommodate oil sands growth, meanwhile, is to build a pipeline to the British Columbia coast in order to open up access to the Pacific Basin including fast-growing Asian markets.

The Canadian energy sector clearly has the potential to grow on a world-class scale but it must remain economically competitive. Governments and industry must work together to improve fiscal regimes, reduce regulatory overlap, support new technologies and meet the skill shortages in trades and professions.

Global energy demand continues to surge and put supply systems around the world under pressure. One estimate has put the price tag to overhaul the global energy and electricity infrastructure - oil refineries, pipelines, nuclear plants, power grids - as high as $10 trillion US over the next 30 years.

Investment spending in Canada’s oil sands alone is projected to exceed $30 billion in the next decade.

Flash points

There are two primary flash points in the Canada-U.S. energy trade.

Recent high gasoline prices have prompted suggestions that Canadian oil and gas should be kept here to meet our needs. As noted above, this is not a realistic solution. It would ultimately lead to higher consumer prices in this country due the relatively small size of the Canadian market.

There have also been attempts to link American access to Canadian petroleum resources with the resolution of other trade issues such as the mad cow crisis or the long-running softwood lumber dispute.

Attempts to use oil and gas (or autos or steel) to apply pressure in another dispute simply create more issues than it resolves. Canada and the United States have the world's biggest two-way trading relationship and a tit-for-tat trade war creates the potential for never-ending retaliatory actions. Restricting energy exports would have serious consequences for Canada's economy.

Instead, the success of oil and gas trade between Canada and the U.S. should be seen as a model for other sectors follow.

The mega-projects that are so critical to Canadian energy supply face intense competition for capital funding. While oil and gas investment is likely continue at historic high levels going forward in Canada the International Energy Agency has warned that private and foreign capital considering high-risk and high-cost investments is very sensitive to the nature and stability of government policies.

If Canada's fiscal policies and regulatory processes are clear, efficient and effective then the many other attractive features will make this country a destination of choice for energy investment.

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Recommendations

Given the economic and social benefits that Canadians enjoy from development of their petroleum resources for both the domestic and foreign markets, CAPP would offer the following suggestions for action.

Successful development of our petroleum resources will require co-operation between industry and government to resolve issues in a number of critical areas. In addition to ensuring there is timely and reasonable access to resources, the petroleum industry requires more effort to ensure:.

- **Global Competitiveness**
  - Recognize increasing cost pressures on the industry.
  - Build on success of NAFTA and deregulation.
  - Adopt a North American approach to research, innovation and labor.

- **Secure and Efficient Access to Markets**
  - Continue to support market-based energy development.
  - Resolve infrastructure shortfalls in areas like refineries and pipelines that limit supply growth.
  - Resist linking oil and gas exports to other trade issues.

While not everyone embraces free trade - in energy or other areas - there is great support to develop the infrastructure across the continent in order to better deliver the both energy and economic benefits of our resources to society.

A recent poll by research firm Ipsos-Reid found an overwhelming majority of Canadians and Americans want a common set of rules created to standardize how energy resources are developed, transported and sold throughout North America.

The bottom line is that if industry and governments can work together in an efficient and environmentally sustainable manner, then Canadians will enjoy the benefits of playing a critical role in the global petroleum supply system -- both now and long into the future.