PRB 06-33E

IN BRIEF

Parliamentary Information and Research Service
Library of Parliament

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16 November 2006

Canadian Oil Exports to the United States Under NAFTA

INTRODUCTION

There is a widespread belief that the North American Free Trade Agreement (NAFTA) requires Canada to sell a fixed percentage of its total oil production to the United States. It has been suggested that, under NAFTA, Canada can do nothing to curtail oil exports to the United States, even in the event of energy shortages at home. This paper examines that claim.

WHAT DOES NAFTA SAY ABOUT ENERGY EXPORTS?

Canada's trade in energy products with the United States and Mexico is governed by the rules found in Chapter 6 of NAFTA, "Energy and Basic Petrochemicals." The scope of NAFTA Chapter 6 is such that it includes virtually all forms of energy, ranging from uranium to fossil fuels to electricity. Only a handful of energy products, none of them significant, are exempt.

There are four specific clauses within NAFTA Chapter 6 that directly or indirectly affect Canada's ability to restrict exports:

- Article 603(2) prohibits the use of minimum or maximum export-price requirements in cases where restrictions on the volume of exports are prohibited.

- Article 604 explicitly prohibits NAFTA members from imposing any export tax or duty on the sale of energy or petrochemical products, unless the same tax is placed on *all* NAFTA members, including the exporting party.

- Article 605 outlines the conditions under which Canada can restrict energy exports. It can do so only if *all* of the following conditions apply:
  - exports as a percentage of total Canadian supply do not fall;
  - Canada cannot charge a higher price to the United States or Mexico by means of taxes, licence fees, minimum prices or any other regulation; and
  - any restriction cannot result from a disruption of normal supply channels.

- Article 607 outlines four specific national security-related scenarios under which energy exports could be restricted:
  - to fulfil a defence contract or supply a military establishment;
  - to respond to a situation of armed conflict;
  - to implement policies related to the non-proliferation of nuclear weapons; and
  - to respond to threats of disruption in the supply of nuclear materials for defence purposes.

These four clauses apply only to Canada and the United States. Mexico reserves the right to control its own energy industries in most cases and is explicitly exempt from the provisions of Articles 605 and 607.

INTERPRETING THE ENERGY PROVISIONS IN NAFTA

From the Canadian perspective, NAFTA Chapter 6 prohibits government intervention in the normal operation of North American energy markets, whether in the form of price discrimination (e.g., the imposition of export taxes), or the direct disruption of supply channels.

Article 605 of NAFTA has been interpreted by some to mean that Canada is required to sell a certain percentage of its energy output to the United States, even in the face of a severe domestic shortage. Moreover, they argue that NAFTA prevents this percentage from falling over time.

Neither of these statements is true. Canadian producers are free to sell as much oil as they wish to whomever they wish, including, for example, overseas customers. As a result, the share of total output exported to the United States can rise or fall according to the normal forces of supply and demand.

The only condition that NAFTA imposes on Canadian energy products is that all buyers in North America must have equal rights to buy those products.

Article 605 does stipulate that energy exports to the United States as a percentage of total output cannot fall. However, this does not refer to the day-to-day operation of the Canadian energy sector. It is valid *only* as a limitation on the extent to which the Canadian government can interfere in energy markets.

NAFTA prohibits the Canadian government from imposing (under normal conditions) any restriction that *causes* U.S. imports of Canadian energy to fall. In essence, therefore, NAFTA does prevent the Canadian government from imposing a policy like the National Energy Program in the 1980s.

WHAT IF THERE WERE OIL SHORTAGES IN PARTS OF CANADA?

It is occasionally suggested that the energy provisions in NAFTA could result in Canada exporting a significant share of its oil production to the United States, even as some parts of Canada suffer shortages. For a number of reasons, this is not a legitimate concern.

As mentioned above, NAFTA requires that all oil produced in Canada be available to all consumers in North America. Since it would not be economically logical for oil producers to charge higher prices to Canadian consumers, this fact alone ensures that NAFTA could not create shortages in Canada because Canada was obliged to export to the United States.

Moreover, oil is bought and sold in global markets. In this way, oil is no different from any other commodity. Nickel producers, for example, sell at prices determined by global supply and demand. Minor differences aside, consumers buy at comparable prices, regardless of whether they live across the street or around the world.

Alberta energy consumers, therefore, have little to no advantage over other Canadian consumers in terms of access to oil supplies. Indeed, under current market conditions, it is advantageous for Eastern Canadian refineries and other users to import oil from countries such as Venezuela and Norway. If, for whatever reason, those supplies were not available, those consumers would simply buy from other sources at prevailing (global) prices.

The important point to ensuring oil supply to all parts of Canada is sufficient infrastructure. If shipping terminals and pipelines (with sufficient capacity) exist, then consumers across Canada will have access to world oil supplies (including those in Western Canada) at world oil prices. The only way a local shortage could exist, then, would be because there was a global shortage.

NAFTA ensures that Canadian and U.S. consumers have equal access to oil produced in either country. In no way does it give U.S. consumers preferential access.

CONCLUSION

Contrary to some claims, NAFTA does not commit Canada to exporting a certain share of its energy supply to the United States regardless of Canadian needs. Canadian producers sell without restriction on the open market.

The only significant limitation NAFTA places on Canada is that it prevents the Canadian government from implementing policies that interfere with the normal functioning of energy markets in North America. Provided they have the demand and can pay the price, Canadian consumers could conceivably buy 100% of all energy produced in the country without violating NAFTA.