House of Commons

Standing Committee on International Trade

Priorities of Canadian Stakeholders Having an Interest in Bilateral and Trilateral Trade in North America, Between Canada, United States and Mexico

Opening Remarks of the Canadian Association of Petroleum Producers

May 16, 2017

Thank you Mr. Chair and Honourable Members of the Committee for the opportunity to appear before you today. My name is Nick Schultz and I am Vice President of Pipeline Regulation and General Counsel to CAPP -- the Canadian Association of Petroleum Producers.

CAPP represents producers large and small that explore for and develop Canada's oil and natural gas. Our members produce about 80% of Canada's oil and natural gas. The upstream petroleum industry, even with budgets severely reduced from a few years ago, remains the largest private investor in Canada and among the largest sources of export revenue. (2016 estimated capital expenditures of $37 Billion and net export revenues of $40 Billion)

Access to export markets for Canadian oil and natural gas is vital for our industry and the Canadian economy.

Gilbert Winham, Professor Emeritus, Dalhousie University, in his 1992 book *The Evolution of International Trade Agreements*, reminds us that, in free markets, enterprise and trade have flourished and, when markets are constrained by intense regulation, enterprise and trade languish.

The maintenance of frameworks that support the operation of free markets and enable a globally competitive Canadian industry is a fundamental premise of free trade and it is the cornerstone of my Association's position on free trade.

Thirty years ago, in 1987, Canada and the United States were negotiating a free trade agreement. The negotiations were difficult. They were controversial. Most important, the negotiations were successful.

Those negotiations were successful for many reasons not the least of which is the simple fact that Canada and the United States are substantially free market economies with a common acceptance of the primacy of competition and with economies that already had in 1987 many interconnections and interdependencies.

On energy, by 1987, both Canada and the U.S. had adopted similar policies that relied on market forces to drive the energy economy. Both countries continue to operate on the basis of market-based energy policies.

The Canada/U.S. Free Trade Agreement came into effect January 1, 1989. It eliminated non-tariff barriers to energy trade, including those related to tax policies, and set the stage for elimination of tariffs and customs processing fees.

In 1994 the free trade area was expanded to include Mexico and NAFTA superceded the earlier Canada/U.S. agreement.

The creation of a North American free trade zone has been and continues to be beneficial to all three countries: Canada, the U.S., and Mexico.

The expectation of mutual benefit that drives nations to enter into trade agreements has been a reality for North America.

In the decades since, our economies have become even more interconnected and integrated. The logic of a North American free trade zone is even more compelling now than it was three decades ago.

The energy pie has grown. All of us in the free trade area have shared in that growth. Supply and demand have increased. Technology has made vast resources of oil and natural gas economic at prices that are affordable for consumers.

Canadian oil exports in 2016 were over 3,000,000 barrels per day compared to less than 700,000 in 1987. Natural gas exports are 8 billion cubic feet per day compared to less than 3 in 1987.

Billion upon billions have been invested in the upstream industry in North America and in related midstream and downstream infrastructure. Pipelines have indeed been built and expanded across the entire free trade area and more will be built.

The economically recoverable natural gas resource in Canada is five times what it was thirty years ago (more than 1000 Tcf compared to about 200 Tcf 30 years ago). Canada is now recognized to have the third largest oil reserves in the world (after Venezuela and Saudi Arabia).

U.S. oil production is back to 1970 levels and has made large in-roads into eastern Canada displacing offshore oil supply to eastern Canadian refineries. With the boom in shale gas production, U.S. natural gas has displaced Canadian natural gas in traditional eastern U.S. markets as well as in eastern Canadian markets. In 1987 U.S. exports of oil and natural gas to Canada were nil to negligible.

Canadian producers are exposed to intense competition but are competing and will continue to compete at every opportunity but we need policy frameworks that recognize the competitive forces affecting investment flows and the relative ability to compete.

We have a technologically vibrant and innovative industry that is one of the largest, direct and indirect, employers in the country, including of indigenous peoples, and is regulated to standards that are among the highest in the world.

Businesses wherever they are located within the free trade area – Canada, the US, or Mexico – are looking at a North American energy market when they make investments and conduct business.

There is always room for improvement: to build on the agreement that we now have and to enhance.

The starting point is to recognize the shared fundamental value of free markets and competition and focus on sustaining the free market structures that we know lead to positive outcomes.

The goal is to maintain the fully reciprocal market access provided for energy goods between Canada and the U.S., as well as the opportunity to further liberalize trade that Mexico enjoys, under NAFTA. With that goal in mind, one can seek to improve competitive opportunities for energy goods within the free trade area.

In the process, we should do no harm to the deep trade relations that have developed and long term investments that have been and are being made on the basis of secure access to the North American market that is both the legacy and promise of NAFTA.

National treatment and redress for individual investors that are aggrieved by state action are key elements of the security provided to businesses under NAFTA.

In that regard, it is significant that it is not the business community in any of Canada, the U.S., or Mexico that is asking for NAFTA to be renegotiated - certainly not the oil and natural gas industry. My Association, CAPP, is very much aligned with our U.S. and Mexican counterparts on the importance of NAFTA and maintaining the benefits of interconnectedness and integration.

In terms of areas of improvement, the trade in oil and natural gas between Canada and the U.S. has evolved in a very efficient and liquid way. Commodities are traded many times before there is a physical delivery. Electronic platforms facilitate this trade with sellers and buyers blind to each other to keep everyone honest.

In a competitive market, price drives supply and demand. Liquidity is vital in ensuring the efficient transmission of the price signal. Efficient, liquid markets also give consumers increased confidence that the energy they receive comes with a fair market price.

Unfortunately, the rules of origin developed under NAFTA are difficult to apply in the context of a highly liquid commodity market place with electronic bulletin board trading, multiple trades, and commingling of goods in pipeline transport. The result is that all too often sellers do not provide the certificates of origin required to obtain access to the U.S. free of duty and customs fees. The result is that much Canadian oil and natural gas is not receiving the tariff preference promised in NAFTA and is instead paying duties and fees to U.S. Customs due to technical rules of verification.

Currently it is estimated that $20 - $30 Million in duties and fees are being paid to U.S. Customs. The promise of tariff elimination is not a reality for too much Canadian oil and natural gas.

We of course share the objective of ensuring no country in the free trade area becomes a back door for goods from countries outside the free trade area. We do, however, believe that finding a solution to the rules of origin problem must be part of any renegotiation of NAFTA.

Compatibility of environmental and tax policies, and related cost implications for industry, are also an increasing concern. The U.S. is our major export market for oil and our only market for natural gas. There are presently strong indicators of divergence on environmental policies and continued discussion of unwelcome potentially trade distorting tax policies.

As a consequence, there is much uncertainty as to the degree to which the U.S. and Canada may diverge on key policies that impact trade and the extent to which industry in Canada may be disadvantaged competitively relative to a company operating in the U.S. The uncertainty is already impacting investment and that is simply because significant divergence drives investment out of Canada.

Finally, the uncertainty created by the renegotiation of NAFTA is impacting investment decisions throughout the free trade area – Canada, the U.S. and Mexico – and we would very much wish the renegotiation, as with any trade agreement negotiation, to be conducted with diplomacy, efficiency, expedition, with success for all concerned.

Thank you for your kind attention.