

ENERGY SUPERPOWER OR SECOND-RATE SUPPLIER?

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The world is not going to wait for Canada to get its energy act together.

Le monde ne se croisera pas les bras en attendant que le Canada mette de l'ordre dans ses politiques énergétiques.

Canadians have been treated to an endless stream of politicians declaring our newly discovered energy “superpower” status. In 2006, Prime Minister Stephen Harper boldly claimed that Canada was an emerging energy superpower at the G8 meeting in London and would later repeat the statement on several international trips. Former Alberta Premier Ed Stelmach referred to our potential as a clean energy superpower in a 2009 letter to the Prime Minister. Two years later, Canada’s energy ministers reached an agreement in Kananaskis “that would unite the country on its quest to become a global energy superpower.” And since taking office, Premier Alison Redford has called for a Canadian energy strategy, focusing on ensuring Canada becomes an energy superpower.

It’s been almost seven years after the term “energy superpower” was coined, and the path to achieving this lofty goal is beset with challenges. The Enbridge Northern Gateway, announced in 2001, has seen its regulatory application process reignite the debate about Canada’s role as an exporter of raw materials instead of an upgraded product. It has also set the tone of a national debate about the ethics of resource development that has little consideration of the rapidly changing international market.

Similarly, though in Canada TransCanada’s Keystone XL received National Energy Board approval in 2010, it has since been mired in the US in a regulatory maze of state-level regulators. It now awaits a presidential permit to build the cross-border pipeline from Hardisty, Alberta, to Steele City, Nebraska. New west-to-east proposals such as the reversal of Enbridge’s line 9, between Sarnia and Westover in Ontario, also face hearings.

Sir Arthur Lewis said, “Market prices are a more powerful incentive than ministerial speeches, and indeed while we

debate the merits of these projects, the markets we aspire to secure have been changing rapidly.” This holds true for Canada, as the challenges facing our natural resources sector increase and the window of opportunity closes.

The foremost challenge is the decline in demand from Canada’s main energy consumer, the United States. According to the US Energy Information Association (EIA), over the 2011-14 period, US crude oil and other liquids demand is expected to shrink more than 0.1 percent per year. At the same time, US production is expected to increase, which will reduce the growth of the US’s import of crude oil by close to 0.5 percent per year. Natural gas imports are expected to decline by 1.9 percent per year. In short, the US energy pie is not growing, and Canada’s slice of the pie is likely to shrink over the next three decades.

In the short to medium term, a glut of light oil from tight oil plays in places like North Dakota have depressed prices for Canadian producers. Pipeline constraints in the US Midwest have created a gap between the North American oil price (West Texas Intermediate, or WTI) and the offshore world price (Brent); the latter is used to price 65 percent of the world’s oil. In 2012, the EIA calculated that this differential averaged almost US\$18 per barrel, while the differential between the world and Canadian prices (Western Canadian Select or WCS) was around \$39, costing billions in lost revenue for Canadian producers and significantly less in taxes, leases, and royalties for governments.

The pipeline constraints are further aggravated by the fact that in the US Midwest the refining capacity for processing Alberta heavy oil is diminishing and will continue to do so unless sophisticated and relatively expensive upgrading units called cokers are constructed. Midwestern refiners prefer to process light crude over the heavy Alberta oil. Keystone XL is critical to Canada’s oil industry because the US Gulf Coast is home to 30 percent of the world’s coking capacity, a lucrative opportunity.

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Extraction: Asian markets are not waiting for Canada to get its act together.

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While the United States poses a challenge for Canadian energy, Asia presents a major opportunity, especially as it is a large potential market for liquefied natural gas (LNG) exports. Currently, Japan is the world's biggest importer of LNG and will require up to 10 million tonnes to offset the losses from the Fukushima Daiichi disaster, which led to the shutdown of one-fifth of Japan's nuclear power generation. The *Economist* estimated in July 2012 that Canada could export up to 30 million tonnes per annum (TPA) by 2020, and with Asia expected to require an additional 168 million TPA of LNG between now and 2025, this seems like a perfect match.

But Asian markets are not quietly waiting for Canadian natural gas to get tidewater access. The world's top exporters of LNG include Qatar (which has more than double the annual output of the next largest exporter), as well as Malaysia, Indonesia and Australia — all of which have easier geographic access and an aggressive approach to

securing markets. The Russian Federation's annual production of natural gas, including LNG, accounts for 20 percent of world production, and it has proximity as well as familiarity with the markets. Negotiations between China and Russia over the provision of LNG to the Chinese market by Gazprom are ongoing.

Asia is frequently suggested as a potential buyer of Canadian oil, but much of this interest rests on the demand forecasts rather than the nuts and bolts of getting the oil to customers. While the potential for accessing Brent prices for oil exists, and Asia could soon account for 60 percent of the world's oil trade, the market is not as free or as open to newcomers as we might assume. Asian state-controlled oil companies impose restrictions on the resale of their crude and bypass traders to sell directly to refineries.

There is an urgent need for a national consensus on energy extraction, but also one that moves beyond energy

to include resource development projects across Canada. Those include the Ring of Fire in Ontario, Quebec's Plan Nord, British Columbia LNG development and offshore opportunities in the Flemish Pass/North Central Ridge region of Newfoundland and Labrador. Our energy industry is vital to our economy and represents about 7 percent of GDP and 23 percent of exports, as well as employing 260,000 people. The industry contributes taxes and royalties to governments and is a crucial part of the economy, providing competitively priced fuel for transportation and power for business operations. Canada ranks fifth in global energy production and is poised to increase this advantageous position, if a consensus can be reached on the urgency of accessing international markets.

Creating a national resource development framework must be based on a market-oriented approach that avoids the costly inefficiencies of subsidies and monopolistic extraction practices favoured by some of

our trading partners. The framework must also respect the division of powers and responsibilities for energy development between the provinces and territories and the federal government. Reaching a national consensus will have practical benefits, such as enhancing the regulatory system and securing agreement on energy transportation infrastructure. It could enable greater sharing of energy-system information, best business practices and new technologies to maximize the country's resource potential and also improve its environmental performance.

The current debate goes deeper than just resource development and looks at Canada's identity. No other natural resource endowment has caused as much national debate as the oil sands. There is no weekly Question Period duel between parliamentarians on the wisdom of developing Ontario's Ring of Fire, nor is there national angst about Quebec's Plan Nord mining development or squabbling over the wisdom of expanding hydroelectricity projects in Labrador. Only the oil sands cause otherwise sensible politicians to refer to them as the tar sands (a pejorative term in Alberta), a source of dirty oil and the reason for the diminishing Canadian manufacturing sector.

The environmental impact of the oil sands is often touted as the greatest threat to the climate. Let's put this in perspective. Oil sands extraction and upgrading produced 48 megatonnes of carbon dioxide equivalent greenhouse gas (GHG) emissions in 2010, accounting for 7 percent of Canada's emissions. That is less than one-tenth of 1 percent of global greenhouse gas emissions.

In comparison, the American coal industry produces 2 billion tonnes of GHG emissions, and this amount is set to grow by one-third by 2025. Alberta levies a carbon tax on its large industrial emitters, including oil sands producers. In a well-to-wheels comparison, extracting oil from the Alberta oil sands is 5 to 15 percent higher in GHG emissions than the average crude

oil produced in the United States. In addition, 80 percent of the oil sands are accessible by in-situ methods that minimize the environmental impact by reducing the land disturbance to 10 to 15 percent of a similar-sized mining operation. The Alberta oil sands also produce no tailings ponds — the toxic cocktail left over from older operations.

Are there environmental challenges? Undoubtedly. After decades of mining, 715 km² of oil sands mineable area has been disturbed by industrial activity. The original projects did produce large tailings ponds and will be looked at for permanent remediation. However, more than 104 hectares of land has been reclaimed as certified by the Government of Alberta, albeit not to its previous state, as no large industrial project can be reclaimed to the point of returning the land to its exact original state. Alberta oil companies understand the need to deliver on world-class environmental performance, and in March 2012 they struck the Canada's Oil Sands Innovation Alliance to accelerate the pace of improving environmental performance.

We do not need more rhetoric on the environmental apocalypse, nor do we need more unabashed grandstanding on behalf of industry. We need a frank debate about what is, and what is not, in the best interests of Canada. We need to take advantage of irreversible economic trends, while being one of the most responsible extractors of natural resources. We need an end to the debate on whether or not we should provide adequate infrastructure to move western oil. Energy superpowers do not bicker internally over the wisdom of development, but ask for reasonable and credible measures to maximize the value of their product and enable responsible development.

Far from being an energy or natural resource superpower, at this time we are at best a second-rate supplier that is unable to resolve deep-seated division about our economic future. The political class has resorted to squabbling about benefits and revenues, high-value currency and "Dutch disease."

There is a prevailing view across the country that our energy is a harbinger of great calamity — we are a one-trick pony, we're a "staple" economy, unstable, dependent, a single-resource producer. But this argument has been countered by influential thought leaders such as Bank of Canada Governor Mark Carney. In a September 2012 speech in Calgary, he stated that high commodity prices were unambiguously good for Canada and, rather than debate their utility, we should focus on minimizing the pain and maximizing the benefits of our resource economy.

As Madelaine Drohan mentions in a 2012 report entitled "The 9 Habits of Highly Effective Resource Economies: Lessons for Canada," we need to decide where resource development fits within the broader context of our national interests. We have national interests that need to be articulated both domestically and to international investors. To achieve the status of resource superpower we need to resolve the national debate on the virtues of resource extraction and accept our role in the world. Former industry minister, now vice-chairman of the CIBC Jim Prentice accurately sums it up: "There's no shame hewing wood and drawing water as long as you are the best in the world at it."

Sir Arthur Lewis was right. The business community has already reached a consensus that resource development is in our national interests. There is little that can be done to retrieve the time and opportunity already forfeited to our competitors. We must move beyond our petty political bickering to establish a national consensus on resource development and become more than just an energy player, but a true resource superpower.

We need to achieve a national consensus on resource extraction, to green-light projects that increase market access and to continue to build on international trade deals to maximize our market share before our international competitors do. To continue on our current path is to do a disservice to the opportunity we have been granted. ■