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U.S. Energy Security: Enhancing Partnerships with Mexico and Canada

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Hearing on U.S. Energy Security: Enhancing Partnerships with Mexico and Canada

Chairman Salmon, Ranking Member Sires, members of the subcommittee, thank you for inviting me to speak with you about the potential for U.S. partnerships with Canada and Mexico to help the United States effectively pursue its energy-related goals, and particularly to discuss the Keystone XL pipeline and the U.S.-Mexico Transboundary Hydrocarbons Agreement.

American energy is changing more rapidly than at any time in perhaps forty years. Oil and gas production are both surging. U.S. oil use has fallen strongly, and renewable energy deployment continues to set records. These trends are being reinforced by developments in Canada and Mexico. The United States has a historic opportunity to capitalize on all of these changes, provided that it makes the right policy choices.

In doing so, U.S. strategy needs to treat broad-based economic growth, national security and international relationships, and the environment and climate change, with similar care. Doing this will require creating new opportunities for energy production across the board while implementing smart protections for the local environment. But it will also require limiting or penalizing actions, including excessive oil consumption and greenhouse gas emissions, that create intolerable damage on any of these fronts.

The Keystone XL Pipeline

Those who have raised concerns about the climate and other environmental impacts of the Keystone XL pipeline are right to be strongly concerned about global climate change and environmental protection. The administration has been prudent in taking time to ensure that local environmental protections along the pipeline route are sound. Still, the world is currently on track to exceed every potentially safe climate threshold. Strong actions are necessary if current trends are to be changed and ultimately reversed.

Yet blocking the Keystone XL pipeline would do little to rein in climate change. The pipeline would carry about 800,000 barrels a day of diluted bitumen from Alberta to the Gulf Coast. In an extreme case – if it proves impossible to build alternative pipelines or other transport routes, and if other producers do not compensate for a Keystone denial by boosting their own oil production – then this would add slightly less than 0.5 percent to global carbon dioxide emissions from energy use. The real-world impact would be lower.

Any project in isolation, of course, has limited climate impacts, which makes this a poor reason alone to give the pipeline the go-ahead. More important for Keystone XL is that the costs that would result from blocking the pipeline would likely exceed the accompanying climate benefits.

In an earlier study of the energy security and climate change impacts of Canadian oil sands production, I identified six areas in which analysts have claimed that oil might affect U.S. national security.[1] I concluded that many of these have been exaggerated, particularly in the context of the Canadian oil sands. Buying more U.S. oil from Canada, for example, would not starve petrodictators elsewhere of cash; they would sell their oil to other customers. Moreover, buying more oil from Canada is not necessary to protect the United Statse against hostile producers: oil-fueled dictators are not capable of cutting off U.S. oil supplies, since the United States can draw oil from global markets and its Strategic Petroleum Reserve (SPR) in the face of any cutoff attempt. Finally, buying more oil from Canada would do relatively little to shield the United States from the impacts of the most destructive oil price spikes. During times of severe turmoil in global oil markets, the price of Canadian oil generally rises just as much as the price of Middle Eastern oil does; that inflicts the same pain on U.S. consumers and similar (though slightly less) damage on the U.S. economy.

But greater Canadian oil production does create real benefits for the United States. To the extent that Canadian oil production facilitated by the Keystone XL pipeline increases total world supplies, that drives down the cost of oil for all U.S. consumers. The impact is likely to be very small – a few dollars a barrel at most and likely much less – but, spread across the U.S. economy, it adds up: a one dollar a barrel decrease in world oil prices saves the United States more than two billion dollars each year. If, at the other extreme, additional Canadian oil production were fully offset by production cuts elsewhere in the world, the price of oil would remain unchanged. In that case, though, climate damages associated with the pipeline would also be largely mitigated, falling as much as tenfold from the high-end estimate. In all cases, expanded Canadian oil sands production would create commercial opportunities for U.S. firms that supply oil sands producers.

[1] See, in particular, Michael Levi "The Canadian Oil Sands: Energy Security vs. Climate Change", Council Special Report No. 47. Council on Foreign Relations, May 2009.

The Keystone XL pipeline decision introduces several additional factors to the equation. Approving the pipeline would, as many have noted, create several thousand temporary jobs. This should not be dismissed but should also not be exaggerated: the Keystone XL pipeline would not be a large job creator.[2] (This does not include indirect jobs that would created in the United States if the Keystone XL pipeline facilitated additional oil sands development.) Pipeline opponents are right to highlight that there are opportunities for job creation in clean energy as well. But this need not be an either-or decision: the fate of clean energy will not be meaningfully altered by the Keystone XL decision.

Rejecting the Keystone XL pipeline would also be a clear negative for U.S.-Canada relations. To be certain, there is considerable controversy within Canada over oil sands expansion. But even among Canadians who are skeptical of the oil sands, many would chafe at what they would see as heavy-handed U.S. intervention.

Denying a permit for the Keystone XL pipeline would not be the unmitigated disaster that some claim – and allowing the pipeline to proceed would not be the climate catastrophe that many have asserted. Ultimately, though, allowing the pipeline to proceed would likely produce benefits that outweigh the associated costs.

<u>U.S.-Mexico Transboundary Hydrocarbons Agreement</u>

The United States benefits economically from expanded Mexican oil production in the same way that it gains from greater Canadian oil output. U.S. national security also gains from greater Mexican petroleum production and from improved efficiency in the Mexican oil and gas industry. Mexico still relies heavily on the industry for a large part of its government revenues, and a healthy Mexican government is one better able to deal with crime, economic growth, and other social challenges that spill over to the United States.

The U.S.-Mexico Transboundary Hydrocarbons Agreement, signed in February 2012 and ratified by Mexico in April 2012, would help encourage progress in that direction. The agreement itself is of limited direct consequence. It would allow development of offshore fields that straddle the U.S.-Mexico maritime boundary, but the Mexican government and industry have made clear that most development of these fields would likely occur even without the Agreement. More important, the Agreement would boost opportunities for U.S.-Mexico cooperation on environmental supervision of offshore drilling activities and on emergency response, reducing the odds of an oil spill and helping mitigate the consequences of any that might occur.

The agreement also comes at a critical time for reform in the Mexican oil industry. The Mexican oil industry has long been largely closed to outside capital. The result has been insufficient investment and technology adoption to sustain (let alone boost) supplies. The new Mexican President, Enrique Peña Nieto, has made constitutional reform that would create new opportunities for foreign investment a priority. U.S. failure to move forward with the already-concluded Transboundary Hydrocarbons Agreement could only sour the environment in which these constitutional changes will be debated. More consequentially, if opening of Mexico's petroleum sector creates new investment opportunities, a U.S. government with a positive record of credible petroleum-related dealmaking will be one that will be more capable of advocating U.S. interests. This could be valuable as new opportunities, not only in offshore development but also in shale gas and tight oil, emerge. The current focus on hydrocarbon reform in Mexico also means that extended U.S. inaction on

[2] For more detail, see Michael Levi, "Five Myths About the Keystone XL Pipeline", *Washington Post*, January 18, 2012.

the Transboundary Hydrocarbons Agreement will be noticed, with potentially negative consequences for the broader bilateral relationship.

<u>Cooperation Beyond Oil Development</u>

The United States has important opportunities to cooperate on energy with Canada and Mexico in ways that go beyond the issues at the focus of this hearing. Areas that Congress could investigate include:

- Shale Gas. Mexico and Canada both have large potential shale gas resources. Mexico would benefit from greater openness to international investment and hence technology. It would also gain from cooperation on gaining a better geological understanding of its resource deposits. Both countries would also benefit from cooperation with the United States in understanding the (still evolving) U.S. experience with managing environmental and community impacts of shale gas development. Congress should provide support for State Department efforts to work with other countries on shale gas and encourage Mexico to participate more actively.
- Clean Energy Markets. Bigger markets for clean energy technologies increase the incentives for innovators and boost opportunities for U.S. exporters. North America already enjoys a highly liberal market for trade in goods and services of all kinds. Some have suggested restricting access to the U.S. clean energy market in conjunction with U.S. government policies to support growth in that market. This would be a mistake that could ultimately hurt U.S. competitiveness and climate goals. Congress should instead look for ways to boost other countries' demand for U.S. clean energy technologies.
- Emissions Standards. Canada is matching the ambitious fuel economy standards adopted by the EPA in 2012; Mexico is attempting to do the same. As the United States pursues additional regulatory measures to reduce greenhouse gas emissions, Congress should encourage the administration to work with Canada and Mexico to seek commensurate measures in those countries. This would boost the net benefits resulting from new U.S. regulations for the economy and the environment.

<u>Confronting Energy Insecurity and Climate Change</u>

Those who are skeptical of oil development in general and the Keystone XL pipeline in particular are right to warn that the United States must confront its broader climate change and energy security problems. The United States ultimately needs to reduce its exposure to volatile oil markets through measures like stronger fuel economy standards for cars and trucks and support for next-generation automobile technologies. It also needs to curb its greenhouse gas emissions, ideally through a market-based policy enacted by Congress, but if that is not possible, through careful regulation under the Clean Air Act. I strongly urge Congress to move forward on these fronts, or to allow the administration to do so through prudent regulation. Strong action here, together with progress on oil and gas production at home and in cooperation with U.S. friends and allies, would be a win for the economy, security, and the environment.