

Intelligence MEMOS



As NAFTA renegotiations proceed through the summer and fall C.D. Howe Institute Intelligence Memos will be looking at what to expect and provide analysis on the latest developments at the table. This post is part of that series.

From: Peter Tertzakian
To: NAFTA Negotiators/ Concerned Canadians
Date: September 22, 2017
Re: **OIL UNDER THE NAFTA MICROSCOPE**

As NAFTA talks resume this weekend in Ottawa, oil is visible under negotiators' microscopes.

Last year, the bilateral trade of energy (including natural gas, oil and power) between the US and Canada was about \$55 billion (all figures US), with oil comprising 80 percent of the total. Oil's dollar amount dwarfs other industries, but negotiators may need to view the commodity using a different lens.

The US has long been Canada's biggest oil customer, and since 2014, it's grown to become Canada's biggest supplier too. As a result of this exchange, the growth in the trade deficit (from the US perspective) has somewhat slowed. That's notable for negotiations. Of more interest is that both countries have pushed out a large portion of their "foreign" oil suppliers.

The upshot of NAFTA may be less about trade and more about mutual energy security. For decades, a geopolitical premium was layered onto price; the threat of disruption of delivery from places like the Middle East or Africa was an uncertainty that warranted a bonus for safe delivery. For much of the early 2010s, the market layered on a premium of about \$10 a barrel.

Things began changing about six years ago when the US started producing more of its own oil. Concurrently, Canada was ramping up its oil sands production. So, Americans began buying more western Canadian oil, and Eastern Canada began buying more US oil. This swap began happening at the expense of foreign suppliers.

In short, Canada and the US are bilaterally trading more oil than ever, more intertwined than ever, more collectively secure than ever. Since 2011, sales to the US have grown by a million barrels a day, while Canada's oil imports from the US have grown from almost nothing to averaging 300,000 barrels a day in 2016. At today's prices, Americans buy about \$45 billion a year of Canadian oil, and Canadians now buy about \$5 billion.

Almost 55 percent of Canada's oil imports now come from our southern neighbour. Consequently, for the first time in 70 years the US and Canada are meaningfully reducing their dependence on overseas oil. The US has dropped its dependency by 36 percent since 2010. That's one of the reasons why rebels attacking oil facilities or military actions garner no more than a yawn in the markets these days.

Excess global inventories remain another major factor in price weakness. It provides market comfort that a serious outage in a far corner of the world can be offset by drawing from storage tanks. The qualitative value of an increasingly oil-secure continent is tacitly present in traders' psyche.

Which brings us back to NAFTA, in the context of a world that remains hostage to unforeseen geopolitical events and the vagaries of OPEC action. The relative dollar value of the North American oil trade can easily be calculated, but the question is whether negotiators' microscopes will see the value of energy security.

In conclusion: Not messing with NAFTA's success will ensure that the well-established oil trade market that exists between Canada and the US is left unscathed.

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