

# NAFTA: Building North American Energy Security



American Security Project

Fact Sheet

-

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May 2018

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Congressman Donald Beyer is the former United States Ambassador to Switzerland and Liechtenstein, as well as a former Lieutenant Governor and President of the Senate of Virginia.



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Robert B. Crowe is a Partner of Nelson Mullins Riley & Scarborough in its Boston and Washington, DC offices. He is co-chair of the firm's Government Relations practice.



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Lee Cullum, at one time a commentator on the PBS NewsHour and "All Things Considered" on NPR, currently contributes to the Dallas Morning News and hosts "CEO."



### **Nicholas Clark**

Nicholas Clark is the CEO and Executive Director of Alexium International. He is also co-founder and Managing Partner at Viaticus Capital.



### **Admiral William Fallon, USN (Ret.)**

Admiral Fallon has led U.S. and Allied forces and played a leadership role in military and diplomatic matters at the highest levels of the U.S. government.



### **Raj Fernando**

Raj Fernando is CEO and founder of Chopper Trading, a technology based trading firm headquartered in Chicago.



### **Scott Gilbert**

Scott Gilbert is a Partner of Gilbert LLP and Managing Director of Reneo LLC.



### **Vice Admiral Lee Gunn, USN (Ret.)**

Vice Admiral Gunn is the President of the Institute of Public Research at the CNA Corporation, a non-profit corporation in Virginia.



### **The Honorable Chuck Hagel**

Chuck Hagel served as the 24th U.S. Secretary of Defense and served two terms in the United States Senate (1997-2009). Hagel was a senior member of the Senate Foreign Relations; Banking, Housing and Urban Affairs; and Intelligence Committees.



### **Lieutenant General Claudia Kennedy, USA (Ret.)**

Lieutenant General Kennedy was the first woman to achieve the rank of three-star general in the United States Army.



### **The Honorable John F. Kerry**

John Kerry is a distinguished fellow for global affairs at Yale University. In 2013, Kerry was sworn in as the 68th secretary of state of the United States. Kerry served for more than twenty-five years as a U.S. senator from Massachusetts.



### **General Lester L. Lyles, USAF (Ret.)**

General Lyles retired from the United States Air Force after a distinguished 35 year career. He is presently Chairman of USAA, a member of the Defense Science Board, and a member of the President's Intelligence Advisory Board.



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Dennis Mehiel is the Principal Shareholder and Chairman of U.S. Corrugated, Inc.



### **Stuart Piltch**

Stuart Piltch is the Co-Founder and Managing Director of Cambridge Advisory Group, an actuarial and benefits consulting firm based in Philadelphia.



### **Ed Reilly**

Edward Reilly is Global Chief Executive Officer of the Strategic Communications practice of FTI Consulting.



### **LtGen Norman Seip, USAF (Ret.)**

Lieutenant General Norman R. Seip, USAF (Ret) served in the Air Force for 35 years. His last assignment was Commander of 12th Air Force.

## Introduction

Energy security is a key part of a country's national security. The United States must remain able to fuel its economy and power its defense without challenge from hostile actors.

The United States is fortunate to be blessed by abundant energy resources – of all types – that assure energy security today. The United States is even more fortunate to have two allied neighbors who are also blessed by complimentary supplies of energy resources. When these three countries signed the North American Free Trade Agreement (NAFTA) in 1994, they brought their economies together, drawing their fortunes together on energy security as well.

Over the last decade, the energy revolution has changed America's energy outlook. A flood of oil and gas from American shale deposits has rapidly increased production and available reserves within the United States. Similar geology exists across the border with Mexico. Increased investments by Canadian producers have made Canada the third largest exporter of oil in the world.<sup>1</sup>

The Trump Administration has sought to exploit these gains, and foster more expansion of hydrocarbon exploitation, in the name of “*American energy dominance.*”

However, a better term would be “*North American energy security*” – because 24 years of NAFTA have integrated the energy business of the United States, Canada, and Mexico into a single energy economy. Recent policy changes, like the 2015 removal of the U.S. Crude Oil Export Ban in the U.S. and the 2013 liberalization of Mexico's energy sector, have allowed further integration of the North American energy economy.

Because energy commodities like oil and gas are generally traded tariff-free around the world, the value of Free Trade Agreements like NAFTA for energy security are not in duty-free market access, but in the protections that these agreements provide to investors, the incentives they provide to promote cross-border infrastructure like pipelines, and the reduced costs that low tariff rates provide to inputs like steel that are used for infrastructure.

This Fact Sheet will highlight the growing interconnections of the North American energy market and the opportunities that a modernized NAFTA presents to further increase energy security.

*A note on sourcing: unless otherwise referenced, all numbers are taken from the U.S. Energy Information Agency, and are available at [EIA.gov](http://EIA.gov).*

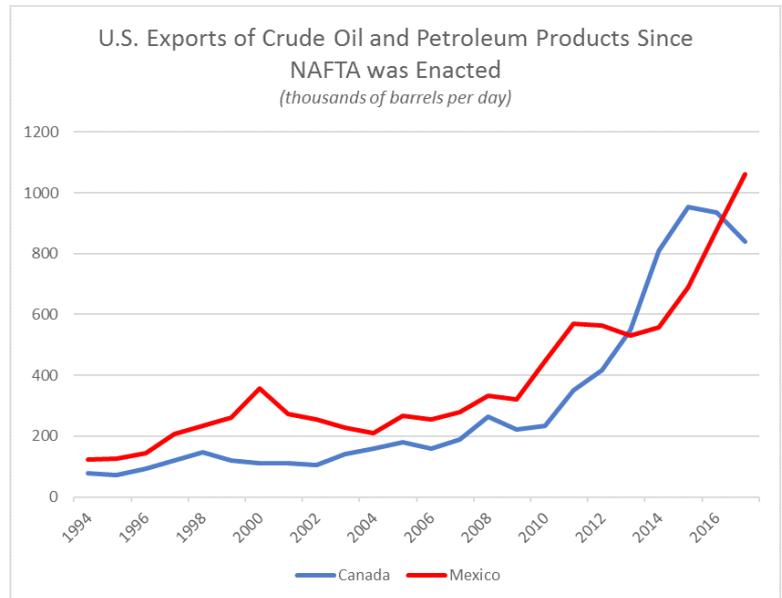
### About the Author

*Andrew Holland is the American Security Project's Director of Studies. He is an expert on energy, climate change, international trade and infrastructure policy, writing widely on each. He holds a Master's Degree in International Strategy and Economics from the University of St. Andrews in Scotland and a Bachelor's Degree in History and Economics from Wake Forest University in North Carolina.*

## Volumes of Trade

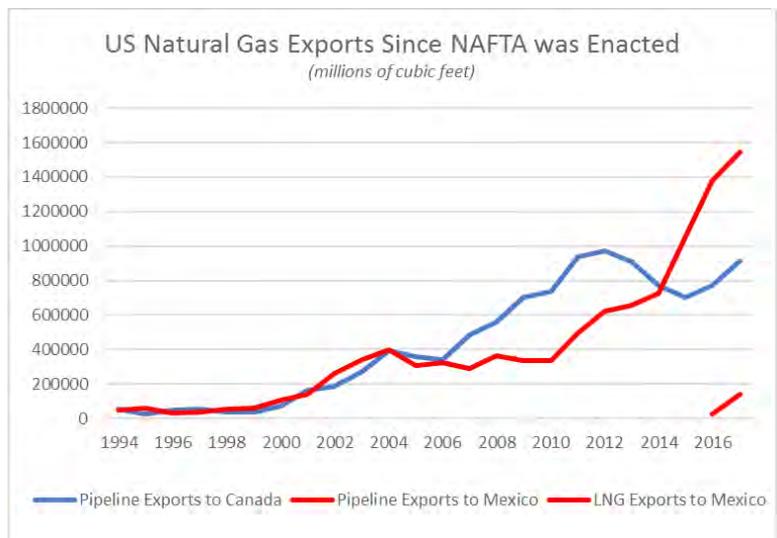
### Oil

- Canada is the largest supplier of crude oil to the U.S., providing 4 million barrels per day in 2017, more than all of OPEC combined.
- Mexico is the third largest supplier of crude oil to the U.S., providing 682 thousand barrels per day in 2017.
- Ironically, Canada is also the largest recipient of U.S. exports of crude oil, receiving 324 thousand barrels per day in 2017 (these are mostly different grades of crude than Canadian crude, and destined for different refineries).
- Mexico and Canada are the top two recipients of U.S. petroleum product exports (refined products like gasoline and diesel fuels or gases like propane or ethane), buying 1.06 million and 516 thousand barrels per day, respectively, in 2017.



### Natural Gas

- Under existing U.S. law, exports of natural gas must apply for and receive a permit from the Secretary of Energy that deems those exports “in the national interest.” By law, all exports to countries with which the U.S. has a Free Trade Agreement, like NAFTA, are deemed to be “in the national interest.”
- Until 2017, the only countries that received significant volumes of U.S. exports of natural gas were Mexico and Canada, the two countries with which the U.S. had pipeline infrastructure. Now, with a growing Liquefied Natural Gas export industry, the U.S. is poised to be one of the leading natural gas exporters in the world.
- Since 2013, Mexico is a growing market for U.S. natural gas exports. In 2017, it was the largest recipient of both pipeline gas, buying 1.5 trillion cubic feet of gas through pipelines and 140 billion cubic feet of gas through LNG tankers.



## Cross-Border Electricity Trade

Electricity trade between NAFTA nations is a small, but growing portion of energy trade.

- The U.S. and Canadian electricity grids are substantially interconnected into one large North American grid, with over 35 electric transmission interconnections.<sup>2</sup>
- Electricity trade between Canada and the U.S. amounted to \$2.44 billion in 2017, the majority of that (\$2.3 billion) as exports of Canadian electricity to the U.S.<sup>3</sup>
- Electricity trade between Mexico and the U.S. was much smaller, but has been growing rapidly since the liberalization of Mexico's energy market in 2014. In January 2017, the U.S. and Mexico signed an agreement to create an increasingly interconnected American and Mexican electricity grid.<sup>4</sup>
- Between 2014 and 2016, the total megawatt hours of electricity traded between Mexico and the U.S. grew from 6.8 million to 11.1 million.

## Renewables

Cross-border electricity trade enables greater access of renewable energy onto each country's electric grids because it enables geographic specialization and diversification that can overcome renewable energy's challenge of variability.

- Quebec's expansive hydropower resources provide an expanding source of clean baseload electricity for both Canada and the American Northeast. Quebec has about 35 gigawatts of installed hydroelectric capacity. Hydro Quebec exports approximately 7 terawatt hours of electricity to New York every year, and reached a deal with Massachusetts in January 2018 to deliver 9.5 terawatt hours to Massachusetts.<sup>5,6</sup>
- Mexico's energy reforms have catalyzed an unprecedented increase in renewable energy investment. 4.5 gigawatts of solar capacity have been allocated by three government auctions since 2013, with more coming.<sup>7</sup>

## Mexico's Energy Reforms: Enabling Cross-Border Investment

In 1938, the government of Mexico nationalized the oil and gas industry, expropriating the assets of foreign oil companies operating in Mexico. Then-President Cárdenas would go on to create Petróleos Mexicanos (PEMEX), as the state-owned oil and gas monopoly. Two decades later, Mexico would also nationalize the electricity industry, creating Comisión Federal de Electricidad (CFE) as the state-owned electricity monopoly. These actions were enshrined in Mexico's constitution.

In 2013, Mexico's current President Enrique Peña Nieto pushed through constitutional amendments that allowed for private investment in oil, gas, and electricity generation. Since then, American investors have participated in auctions for oil and gas leases, electricity transmission investment, and renewable power production. As of May 2017, American oil companies had committed to \$6.5 billion worth of investment in Mexican oil and gas since the reforms went into place.<sup>8</sup>

## NAFTA's Energy Chapter

- NAFTA's "Energy and Basic Petrochemicals" chapter (Chapter 6) generally liberalizes trade in energy commodities, prohibits export taxes or restrictions, and ensures that regulations on energy do not discriminate against foreign investors.<sup>9</sup>
- Under the provisions of Article 605, NAFTA countries are not allowed to restrict exports of energy goods to each other, unless they also restrict domestic consumption. This clause is intended to prevent market manipulation like OPEC countries often do.
- There is an "emergency clause" that allows restrictions on exports for reasons of national security, conservation, supply shortages, or price volatility, but it has never been invoked.
- However, when NAFTA was originally negotiated, Mexico negotiated an exclusion for itself from Chapter Six, because its Constitution prohibited foreign investment in oil and gas, calling them "strategic activities" reserved to the Mexican State.
- There are reports that Mexican negotiators have asked to remove this exclusion, subjecting their energy sector to NAFTA requirements.<sup>10</sup> This would "lock-in" the constitutional reforms against future policy changes from a new government that could want to return to a nationalized energy sector.

## Investor-State Dispute Settlement

- Investor-State Dispute Settlement (ISDS) is intended to create an international arbitration body that protects investors against government.
- NAFTA's Chapter 11 provides investment protections; it was the first trade agreement among developed countries to include ISDS provisions.
- To date there have been 85 ISDS cases filed under NAFTA, 19 of those against the U.S. The U.S. has a perfect record against such cases, having never lost a case, meanwhile American domiciled investors have successfully won hundreds of millions of dollars in damages from the Canadian and Mexican governments.<sup>11</sup>
- ISDS is particularly important to the energy industry because of the scale at which energy companies must invest: each offshore drilling block will require hundreds of millions of dollars in investment.
- The Mexican National Hydrocarbons Commission estimates that oil and gas contracts agreed since the 2013 reform have a combined investment value of \$61 billion.<sup>12</sup> ISDS protects those investments from arbitrary changes in Mexican government policy.

## Conclusion: Modernize NAFTA to Complete North American Energy Security

Although the Trump Administration has expressed deep skepticism of trade deals, saving special scorn for NAFTA, the effects of nearly a quarter century of NAFTA on the North American energy market are clear and significant. Because of the close economic relationship engendered by NAFTA, North American energy security is assured.

On the U.S.'s northern border, NAFTA has fostered a close Canada-U.S. energy relationship. Some parts of Canada's electricity grid are more closely integrated with the American grid than they are with other areas of Canada. The U.S. energy revolution has built an increasingly integrated petroleum market, with oil production on both sides of the border, and a growing market in Canada for U.S. refined products.

In the energy relationship along the U.S.' southern border, the benefits of NAFTA were delayed by two decades until passage of the Mexican energy reforms in 2013. As new electricity and pipeline infrastructure is built crossing the border (whether there is a wall there or not), the two markets will grow closer together. NAFTA, if modernization negotiations are completed before the July 1 elections, could help to ensure the completion of an integrated energy market between Mexico and the U.S. With a robust ISDS process remaining in NAFTA, American investment would be protected from the political risk of upcoming elections.

Because of the North American energy relationship, North America is becoming ever more energy secure. The North American energy grid is becoming cleaner and more resilient thanks to cross-border trade, investment, and regulatory cooperation. NAFTA ensures a growing and secure market for U.S. petroleum exports. Finally, completing NAFTA negotiations will protect American energy investment from political pressure.

## Endnotes

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The American Security Project (ASP) is a nonpartisan organization created to educate the American public and the world about the changing nature of national security in the 21st Century.

Gone are the days when a nation's security could be measured by bombers and battleships. Security in this new era requires harnessing all of America's strengths: the force of our diplomacy; the might of our military; the vigor and competitiveness of our economy; and the power of our ideals.

We believe that America must lead in the pursuit of our common goals and shared security. We must confront international challenges with our partners and with all the tools at our disposal and address emerging problems before they become security crises. And to do this we must forge a bipartisan consensus here at home.

ASP brings together prominent American business leaders, former members of Congress, retired military flag officers, and prominent former government officials. ASP conducts research on a broad range of issues and engages and empowers the American public by taking its findings directly to them via events, traditional & new media, meetings, and publications.

We live in a time when the threats to our security are as complex and diverse as terrorism, nuclear proliferation, climate change, energy challenges, and our economic wellbeing. Partisan bickering and age old solutions simply won't solve our problems. America – and the world - needs an honest dialogue about security that is as robust as it is realistic.

ASP exists to promote that dialogue, to forge that consensus, and to spur constructive action so that America meets the challenges to its security while seizing the opportunities that abound.



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