

# Oil, the State and NAFTA Is Canadian Oil Up for Grabs?

Aaron Roth\*



Andrew Winning/Reuters

Oil is the lifeblood of any modern state, and Canada is no exception. It is limited in quantity and, once taken, can never be put back. The same, of course, is true of other fossil fuels such as natural gas and coal. However, the fuels that drive most industrial economies today are gasoline or diesel. Coal usage is minimal at best; and, while natural gas can be used as fuel for heating and cooking, as well as the making of certain products in its dry form, modern society is dependent on and, in some cases, built around, the extraction and production of oil.<sup>1</sup>

As oil is such an important resource and source of wealth, great conflicts

have arisen over controlling it. In the Canadian case, Westerners, particularly Albertans, still brood over the National Energy Program (NEP) 15 years after it ended, and they continue to guard crude like a mother protecting her child. Oil has made the province of Alberta, in particular, rich, and as a result has made other Canadian provinces envious.

## BACKGROUND

In the Canadian federation the division of powers is clearly set out in Sections 91 and 92 of the original Constitution Act of 1867. Section 91 gave the federal government certain powers, and

Section 92 gave the provincial governments another set. While these powers were designated solely for the jurisdiction they are included under, of course some practical overlaps occur (for example, the creation of criminal law is a federal jurisdiction, but its enforcement is provincial).

However, four areas of concurrent or shared jurisdiction are explicitly spelled out in the Constitution.<sup>2</sup> The one we are concerned with in this article is Section 92A: Non-Renewable Natural Resources, Forestry Resources and Electrical Energy. Essentially, what this says is that the provinces own and can make decisions as to the exploration and extraction of natural resources, including oil. Additionally, according to Section

\* Ph.D student at the University of Alberta.

92A(4), the provinces can collect monies from resource developers and extractors by any mode or system they deem fit. This is the only jurisdiction of the Constitution in which provinces can raise monies by any mode or system of taxation.

Federal jurisdictional concurrency comes into this section with regard to exports. Essentially Canada's parliament can make laws about the inter-provincial trade of natural resources. In addition, under Section 91(2) the federal government is responsible for "The Regulation of Trade and Commerce."<sup>3</sup> This includes, as we will see, the export of resources, including oil. In short, the provinces own and extract the resource and, if it is to be exported, the federal government is responsible.

Despite this jurisdictional division, there have been agreements between provinces and extra-Canadian territories about the trade of products. These trade agreements are worked out either through special relationships or multi-sectoral partnerships, trans-boundary partnerships, or economic memoranda of understanding.<sup>4</sup> In these relationships, agreements on trade, joint regulation or joint concerns over specific fields are dealt with. Provinces like Alberta have now established trade agreements through economic memoranda of understanding on items such as agricultural and food products with Kangwon, South Korea for example, although it is admitted that "trade between Alberta and Kangwon is still limited and indirect."<sup>5</sup> Due to the "unofficial" nature of these agreements, they are not enforceable by law but are mutual understandings, the political equivalent of a handshake.

It is the economic memoranda of understanding that we will be discuss-

ing, particularly the possibility of direct provincial "unofficial" trading arrangements with the United States about oil, thereby skirting the federal government's constitutional role in establishing formal trading arrangements. This raises some additional questions we will be looking at, for instance: How would these types of relations strain federal-provincial relations? And to what degree can or will NAFTA have an effect on either prohibiting or expanding these types of informal agreements? The hypothesis that we will

Oil has made the province  
of Alberta rich and,  
as a result,  
has made other Canadian  
provinces envious.

explore in this article is that in the coming years, "unofficial" agreements of the type suggested above on oil trading and exports may become a reality. This would result in the increasing exclusion of the federal government from its role in the export of oil. Further, in this case, NAFTA may hinder the federal government, not help it. As a result, relations between the provinces and Ottawa may be strained.

Only one province—Alberta—will be looked at in this article because Alberta is by far Canada's largest oil producer.

#### THE EXISTING PROCESS

The existing process for extraction of and exporting oil is, as mentioned, a

responsibility shared by both levels of government. On a provincial level, the Alberta Energy and Utilities Board (EUB) is responsible for issuing permits to companies who wish to extract oil. It is important to know that much of Alberta's reserves are located on government land.<sup>6</sup> According to an official I spoke to at the Department of International and Intergovernmental Relations (IIR), in such cases, in order to drill on government land for resources, a company must sign an agreement with the province for land lease. To obtain the lease however, the extractor must participate in an auction of the land rights. This process creates a free market option for lease and in some cases the sale of the land.<sup>7</sup>

At this point the operator (company) must make an application to the EUB for drilling or the establishment of an energy project.<sup>8</sup> Once the application has all the "i's dotted and the t's crossed," the board approves or denies the company permission to extract the resource.<sup>9</sup> If conflicts arise with area residents or other land owners, the EUB holds a hearing and makes a decision.<sup>10</sup>

Essentially, once a permit is granted or denied, the process ends. According to the EUB official, from their point of view as soon as the oil leaves the ground they have no restrictions.<sup>11</sup> Transportation within the province can go one of two ways: "pipelines within the provinces are regulated by provincial authorities...Transport of crude oil by truck where no gathering pipelines exist is subject to provincial [transportation] legislation."<sup>12</sup> In essence once it is out of the ground, with the exception of pipeline and road safety of transport trucks, the province's involvement is at an end. If the oil is

destined outside the province, inter-provincial trade agreements apply. However, if the oil is destined outside the country, the National Energy Board (NEB) steps in.

Before we address NEB involvement in exports, there is one vital area of provincial jurisdiction left to discuss: that is, of course, how the province collects the oil royalties from the company. Royalties from oil companies are given “in kind” to the province. Officials from both the IIR and the Department of Energy proper stated that the province receives a percentage of the profits from oil sold.<sup>13</sup> Marketers determine the amounts of oil sold, by pipelines for example, and then the province receives a portion of the profits thereof.<sup>14</sup>

As mentioned, the export of oil—or any other resource for that matter—comes under the jurisdiction of the federal government. The Federal Department of Natural Resources has the mandate in this case, exercised through the National Energy Board.

In discussions with a member of the National Energy board, the process was described quite clearly. In essence, an operator would apply for not just an export license or permit but also an import license or permit from the NEB.<sup>15</sup> The application would then be analyzed by the NEB and sent to the full board or a 2-member panel for consideration.<sup>16</sup> In evaluating the application, one of the main tests for determining if oil can be exported is that of “sufficient surplus.” Essentially this test involves the condition that there be sufficient surplus oil to meet Canadian needs. If the NEB conditions are met then a permit or license can be issued (although licenses require a hearing before they are granted).

#### CHALLENGES TO FEDERAL GOVERNMENT INTERVENTION

Several reasons exist—some more likely than others—for the provinces or perhaps even extra-Canadian sources to wish to leave the federal government out of the oil export equation. One simplistic, and perhaps insignificant, reason was mentioned above. The provinces, especially oil-rich Alberta, see the resources as theirs. Indeed, it can be truthfully said that they are theirs. The experience of the

The export of oil  
—or any other resource for  
that matter— comes under  
the jurisdiction of the federal  
government.

National Energy Program (NEP) in the early 1980’s left a bitter taste in Albertans’ mouths with regard to the federal government’s role in energy policy. According to Archer et al., “[t]he NEP was designed to control the increase in oil prices; to provide greater oil tax revenues for the federal government; to Canadianize ownership of the oil industry; and to shift exploration from provincial lands to ‘Canada Lands’ in the North and offshore.”<sup>17</sup>

The analogy of the parent-child relationship between the province, its people and the oil resources of Alberta may have been exaggerated, but not by much. It may perhaps be better analogized by a person’s relationship with his or her bank account. The reaction to the prime minister’s summer 2001 comments was evidence enough

that this sentiment has not died out. The suggestion was made the day after a federal caucus meeting in Edmonton that Alberta’s neighbors were jealous of the province’s wealth, and that perhaps Alberta should “share.” Albertans’ response was spectacular: a hue and cry rang throughout the province that a second NEP was on the way. At the time I was an assistant in the Leader of the Official Opposition of Alberta’s office in Lethbridge, and it will not be easy to forget that the phone rang off the hook with concerns from Albertans railing against the prime minister for even daring to speculate where our oil revenues should be going. The point is that Albertans generally guard their oil and the revenues from it very jealously and want no intrusion by the federal government in the area.

The second reason the provinces might wish to sell directly to the United States without intervention by the federal government has two parts. The first deals with the United States’ increasing need for oil to fuel its gargantuan industrial and societal needs. Any businessperson will tell you that if there is a market demand to be filled, you can make money by filling it. If the United States has a thirst for “black gold,” those who can fulfill the desire can also get rich. Since Alberta’s oil revenues are a percentage of the profits of the oil sold, it seems logical to this writer that the more oil sold means more profits for the provincial coffers, and thus the province itself has a vested interest in satisfying the demand. This may be a rather crude model (no pun intended), perhaps simplistic in the sense that it is also logical to conserve and save oil reserves over the long term; however to some

politicians and companies, this may be a potential avenue to explore. Indeed, Duquette argues that “the provinces invariably favor maximum resource extraction in the shortest possible time and on the largest possible scale, without particular concern for the nationality of the interests to whom these resources are conceded.”<sup>18</sup> In that event, federal control over oil exports may become a nuisance.

Thirdly, some scholars have speculated that NAFTA could assist the provinces and companies in the export of oil to the United States. Robert McRae argues that the federal government could be constrained in terms of its role. “The North American Free Trade Agreement... makes it difficult for the federal government to regulate the Canadian energy industry under nationalistic principles, such as forcing Canadian energy prices to be lower than those in the United States, and/or to withhold supplies from the US market.”<sup>19</sup> Further, the IEA’s document states that NAFTA “ensure[s] that that energy trade will be based on market principles and subject to fewer trade restrictions.”<sup>20</sup> It could be inferred that NAFTA is possibly a tool to be used against federal government intervention in oil exports.

Finally, Gilles Paquet discusses the increasing powerlessness of states, their institutions and their increasing inability to deal with the demands of “sub-national” groups. He argues that what he calls the “Gulliver Effect” is weakening these institutions. “The joint impact of information dominance, accelerated change, and of a more distributed governance has made the socio-economy both more volatile and more malleable. But it has also put immense strain on the ‘national insti-

tutions.’”<sup>21</sup> Further he states that, “The nation state, when confronted with the global adjustment processes and the demands of sub-national groups, is not unlike Gulliver: unable to deal effectively either with the dwarfs of Lilliput or the giants of Brobdingnag.”<sup>22</sup>

The long and the short of it is that “globalization” and “glocalization” are affecting institutions’ ability to work in the arenas they were intended to. Decentralization is the order of the day, as is the clearing of traditional barriers to the outside world. Now, of

NAFTA makes it difficult  
for the federal government  
to regulate the Canadian  
energy industry under  
nationalistic principles.

course, Paquet is speaking here with regard to the evolution of the information age, but his statements could have the ring of applicability to other areas, including federal government institutions involved in trade.

#### FINDINGS

Despite all the challenges Canada’s federal government faces when it comes to regulating international oil trade, it must be concluded that the hypothesis of this article is essentially disproved. As we shall see, the likelihood of the provinces going it alone in the international community in terms of oil exports and skirting federal authority to issue licenses or permits for these exports is very minimal, indeed, prac-

tically non-existent.

One of the questions asked directly to an official at the Department of International and Intergovernmental Relations dealt with the possibility of using economic memoranda of understanding (MOUs) in a manner suggested in the hypothesis. The answer was simply that it is theoretically possible that such an agreement could be signed, however the possibility is extremely remote.<sup>23</sup> In her opinion, the province was primarily concerned with the extraction of the resources.<sup>24</sup> Further, the only real role for MOUs in the field being discussed would be in the form of research efforts with individual provinces or states, and how, for example, the resources could be extracted more easily and efficiently.<sup>25</sup>

The response when the same question was asked of the member of the National Energy Board was abundantly clear: the provinces have no authority to work out agreements with other countries without the federal government.<sup>26</sup> Leaving constitutionality aside, the National Energy Board Act further clarifies the answer. It states that “except as otherwise authorized by or under the regulations, no person shall export or import any oil or gas except under and in accordance with a license issued.”<sup>27</sup> By act of parliament, the NEB is the authority that grants permits for the export and import of oil and gas. Indeed, a company which acted under a hypothetical MOU agreement between the Province of Alberta and a foreign territory would face several barriers to its success.

The first is of course a deterrent which comes with any law. According to the National Energy Board Act, anyone found guilty of contravening the export and import division of the act

can be fined, imprisoned, or both.<sup>28</sup> Secondly, and more surprisingly, in the case of pipelines especially, my discussions with the member of the National Energy Board showed that two other deterrents can arise for failure to possess NEB approval for oil exports to the U.S. The first is that marketers in the United States can halt construction or the flow of oil in pipelines from Canada into the United States without NEB permits or licenses. Secondly, a company exporting oil without NEB approval can be sued by its competitors for unfair trading practices.<sup>29</sup> As we can see, enforcement and deterrent measures are in place. However one of the main questions and points in the hypothesis was that NAFTA could change the scope and ability of the federal powers, and perhaps even prevent provincial powers from operating effectively.

While it is the case, as mentioned by McRae, that governments cannot impose non-market price levels for oil or withhold exports just because they feel like it, NAFTA still allows the federal government to perform its role. According to the member of the National Energy Board interviewed, NAFTA does not impose restraints on the NEB. NAFTA's only effect is that the board can never refuse an export license, unless there is an order by the governor general in council showing that the "surplus for Canadian's needs" test has not been met, or that the granting of such a license would not be in the public interest.<sup>30</sup> In support of this answer, the text of NAFTA itself states that "The Parties confirm their full respect for their Constitutions."<sup>31</sup> In Canada's case, this means that the federal government's constitutional and legal role in issuing permits and licenses for oil exports is not annulled.

With respect to NAFTA curtailing

the Alberta provincial government's role as owner and regulator of oil extraction, what is good for the goose is good for the gander. In other words, the provinces' constitutional role is also intact. Officials from the Alberta Energy and Utilities Board stated that NAFTA has had no real effect on the rules and regulations of oil extraction.<sup>32</sup> As officials from the Department of International and Intergovernmental Affairs stated, NAFTA focuses on exports, not on extraction. There are, of course, obligations about treatment

Because it focuses  
on exports, NAFTA has had  
no real effect on the rules  
and regulations of  
oil extraction.

of companies involved in the oil business in Alberta; however that is the extent of NAFTA's influence over the province's control of resources.<sup>33</sup>

#### CONCLUSIONS

According to the member of the National Energy Board interviewed, since its founding in 1952, the NEB has never had to deal with a province trying to skirt the federal jurisdiction over oil exports abroad.<sup>34</sup> Indeed, after speaking with officials at the Departments of Energy, International and Governmental Affairs and the EUB, I have concluded that there is currently no desire to try. NAFTA has maintained the federal government's role in authorizing oil exports, however it has also reduced its

power to pursue nationalistic endeavors or withhold oil exports. The NEB must now demonstrate that an export license should not be granted because it will leave Canada in a shortfall position in terms of its oil needs.

What does this all say about Canadian federalism? Federalism, as Ronald Watts states, involves "combining strong constituent units and a strong general government, each possessing powers delegated to it by the people through a constitution."<sup>35</sup> In essence it involves autonomous control over certain aspects of society. Natural resource ownership and export abroad provide an example of the two levels sharing autonomy over a jurisdiction in a clear cut fashion that allows each to exercise its rights without friction (by and large). Indeed, agreements such as NAFTA may actually enhance the federal principle in some respects, at least where oil is concerned. The provinces cannot willfully step on federal toes by facilitating the export of oil without federal approval. Neither can the federal government impose price restrictions on oil which would affect companies and the province as a secondary beneficiary of oil development. It might be fair to say that while the federal government remains a part of NAFTA, National Energy Program 2 will never occur. A balance has been achieved; both levels seem content or at least accepting of the powers they have, something rarely seen or achieved in the larger scope of Canadian federalism.

#### NOTES

<sup>1</sup> "Fossil Fuels," *Microsoft Encarta Encyclopedia* (Microsoft Corporation, 1993-1999).

<sup>2</sup> Douglas Brown, David Cameron, Peter Meekison and Ronald Watts, "Federalism in Canada: Structures and Practices," (paper presented to the colloquium "The Road to

- Federalism in Mexico," San Juan del Río, Mexico, June 1996), p. 9.
- <sup>3</sup> Ibid., p. 404.
- <sup>4</sup> [http://www.iir.gov.ab.ca/iir/inter\\_rel/pages/twinning.htm](http://www.iir.gov.ab.ca/iir/inter_rel/pages/twinning.htm) Alberta Department of International and Intergovernmental Relations.
- <sup>5</sup> Ibid.
- <sup>6</sup> Author's discussion with officials at the Department of International and Intergovernmental Relations, Government of Alberta (November 16, 2001).
- <sup>7</sup> Ibid.
- <sup>8</sup> Author's discussion with officials at the Alberta Energy and Utilities Board (November 16, 2001).
- <sup>9</sup> Ibid.
- <sup>10</sup> Ibid.
- <sup>11</sup> Ibid.
- <sup>12</sup> International Energy Agency, *The Role of IEA Governments in Energy: 1996 Update* (Paris: OECD/IEA, 1996), p. 100.
- <sup>13</sup> Author's discussion with officials at the Department of International and Intergovernmental Relations and Department of Energy (November 16, 2001).
- <sup>14</sup> Author's discussion with officials at the Department of Energy (November 16, 2001).
- <sup>15</sup> Author's discussion with a member of the National Energy Board (November 19, 2001).
- <sup>16</sup> Ibid.
- <sup>17</sup> Keith Archer, Roger Gibbins, Rainer Knopff, Leslie A. Pal, *Parameters of Power: Canada's Political Institutions* (Scarborough: Nelson Canada, 1995), p. 120.
- <sup>18</sup> Michel Duquette, "Domestic and International Factors Affecting Energy Trade," Stephen J. Randall and Herman Konrad, *NAFTA in Transition* (Calgary: University of Calgary Press, 1995), p. 297.
- <sup>19</sup> Robert McRae, "The Emergence of North American Energy Trade Without Barriers," Stephen J. Randall and Herman Konrad, op. cit., p. 91.
- <sup>20</sup> International Energy Agency, *The Role of IEA Governments in Energy: 1996 Update* (Paris: OECD/IEA, 1996), p. 98.
- <sup>21</sup> Gilles Paquet, "Institutional Evolution in an Information Age," Thomas Courchene, *Technology, Information, and Public Policy* (Kingston: John Deutsch Institute for the Study of Economic Policy, 1995), p. 207.
- <sup>22</sup> Ibid.
- <sup>23</sup> Ibid.
- <sup>24</sup> Ibid.
- <sup>25</sup> Ibid.
- <sup>26</sup> Discussion with a Member at the National Energy Board (November 19, 2001)
- <sup>27</sup> The National Energy Board Act, Part VI. Exports and Imports, Division I, Oil and Gas, 116, <http://www.neb-one.gc.ca/pubs/nebactp6.htm>
- <sup>28</sup> The National Energy Board Act, Part VI. Exports and Imports, Division iv Offenses, Punishment and Enforcement, 121, <http://www.neb-one.gc.ca/pubs/nebactp6.htm>
- <sup>29</sup> Author's discussion with a member of the National Energy Board (November 19, 2001).
- <sup>30</sup> Ibid.
- <sup>31</sup> North American Free Trade Agreement, Chapter 6, Energy and Basic Petrochemicals, Article 601.01, <http://www.dfait-maeci.gc.ca/nafta-alena/chap6-e.asp>
- <sup>32</sup> Author's discussion with officials at the Alberta Energy and Utilities Board (November 16, 2001).
- <sup>33</sup> Author's discussion with officials at the Department of International and Intergovernmental Relations (November 16, 2001).
- <sup>34</sup> Author's discussion with a member of the National Energy Board (November 19, 2001).
- <sup>35</sup> Ronald Watts, *Comparing Federal Systems*