Toward a North American Energy Strategy

New drilling technology and supportive market prices have opened vast reserves of oil and natural gas resources to extraction in North America. Canadian oil sands development is now operating at scale, the shale gas and tight oil revolutions are upon us in the United States, and major institutional energy reforms in Mexico are under way that could enable substantial new investment in the Mexican oil and gas sector.

The three countries have much to gain from these developments. The exploitation of these resources and the potential for enhanced cross-border energy trade will make the energy-intensive economic sectors more competitive, improve energy security, dampen short-term energy price volatility, and stimulate continent-wide economic growth.

How this boom will impact the environment is an unresolved question. On one hand, extraction and use of these reserves could increase North American carbon dioxide (CO_2) emissions far beyond the limits espoused by each country. Then again, to the extent that natural gas substitutes for coal in electricity generation (and fugitive methane emissions are low) and electric vehicles powered by relatively clean electricity substitute for gasoline and diesel, CO_2 emissions over the next two decades could be far less than expected 10 years ago.

How the environment is managed will depend on the degree of continent-wide energy policy collaboration and planning. A united North American energy strategy—perhaps in the form of an Energy North American Free Trade Agreement (E-NAFTA)—could help to ensure that each nation reaps the economic benefits from development of these reserves while maintaining and enhancing commitments to protect the environment.

The Benefits of an Integrated Strategy

Politically, the current focus in North America is the development of the oil and gas reserves and the substantial increase in cross-border trade in these commodities. The Keystone XL pipeline and potential changes in the crude export law to permit Canada to re-export US crude are two prominent examples. But Mexican energy reforms permitting direct foreign investment in the Mexican oil and gas sector, which has been capital starved for decades, could be a huge boon to North American energy independence and security as well as cross-border energy trade.

Moreover, harmonized regulatory policies and reduced barriers to electricity trade could enable expanded US imports of hydroelectric power from Canada. Similarly, low-cost power from Texas could flow across the border to Mexico, and renewable resources along the Baja, Mexico–California border could bring more carbon-free electricity into the Southwest. Clearly, there are gains from trade to be had by a more tightly integrated continental energy strategy.

A Role for Governments

While private energy and capital markets throughout North America will drive the development of expanded continental energy and trade, there is a substantive role to be played by the governments. Coordinated policies can effectively foster economic

growth, technological development, and environmental protection, while meeting the political needs of each country. A formal North American energy strategy would serve to shape a shared vision of the areas where government policy can effectively be deployed to coordinate infrastructure development and project financing; reduce trade, investment, and technology barriers; and develop harmonized approaches to reduce continent-wide CO_2 emissions.

The idea of integrating North American energy is not new. Following on the heels of NAFTA entering into force, a large two-year study by the University of Texas in 1996 examined the goal of facilitating the free flow of cross-border trade in natural gas and electricity. Unfortunately, while NAFTA has served to increase cross-border trade in general, little progress toward true energy market integration has been made over the past 15 years.

Given the recent developments in the continent-wide oil and gas markets and regulatory structures, and the pledges and policies by all three countries to limit greenhouse gas emissions, the time is right to revisit the energy integration issue. However, the task of integration has become both more difficult and beneficial than it was in the 1990s.

The difficulty comes in part from the environmental overlay of climate policy—in particular how the continent-wide goal to reduce CO_2 emissions from the combustion of fossil fuels clashes with the desire to exploit newfound fossil fuel wealth for the purposes of economic growth. The benefits come from the greater opportunities for economic growth through investment in fields and infrastructure, as well as the tax revenues and reduced energy costs awaiting with such development.

As mentioned above, one approach to the advancement of such a continent-wide

energy strategy would be to consider the negotiation of an energy-specific NAFTA. Such an international agreement would facilitate the coordination of cross-border energy trade infrastructure (pipelines, railroads, shipping, and electricity transmission) and harmonize energy regulatory structures so energy markets could be effectively integrated continent-wide—a crucial concern. Other aims would be to reduce barriers to energy trade, and enhance continent-wide exchange of best practice related to sustainable energy extraction technologies, renewable energy technologies, and regulatory structures.

The negotiation of an E-NAFTA will raise domestic political and economic issues in each of the three countries as well as significant cross-border concerns. But many of these issues are already in play—look no further than the debates over Keystone XL and the US oil export ban. These developments are being addressed in a one-off, stove-pipe fashion, where policy consistency, effectiveness, and economic efficiency are attained only by chance. While challenging, a coordinated consideration of these issues—whether bilateral or, better still, trilateral, and whether within a NAFTA framework or not—has much to recommend. ● —Raymond J. Kopp and Alan J. Krupnick