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The Keystone Debacle

Was Obama's decision to delay the Canadian oil pipeline shrewd politics? Maybe not.

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The U.S. decision to allow the Keystone XL pipeline to go forward should have been easy.

The pipeline would mean at least 20,000 new construction jobs. It would provide lower cost and reliable shipping opportunities for surging North Dakota oil production. Shipping petroleum from Canada's oil sands to the Gulf of Mexico means refiners there would gain a ready replacement for declining supplies of Mexican and Venezuelan crude. Most importantly, it would reinforce expectations that massive and long-term North American infrastructure investments could proceed free of political risk.

And yet the Obama administration's decision to delay the project, despite already extensive and positive environmental review, puts all this in jeopardy.

Both Canada and the United States benefit from highly integrated energy and investment flows. Keystone XL's owner, TransCanada, has already spent more than $2 billion for steel and related facilities. All previous cross-border pipeline requests have been granted, and the U.S. imports over 2.5 million barrels per day of Canadian crude oil and petroleum products. U.S. refiners also ship large volumes of petroleum products to Eastern Canada, taking advantage of geographic transportation efficiencies.

Under the North American Free Trade Agreement (Nafta), no permits are required for shipment of Canadian crude to U.S. destinations by either rail, ocean tanker, or even incremental volumes through existing cross-border pipelines. The creation of a stable investment regime was central to the treaty, and U.S. negotiators successfully argued against reluctant Canadian negotiators that U.S. companies be given full national treatment when investing in Canada.

For Canadians, it was unthinkable that a U.S. president would pull the plug after extensive reviews and 57 project-specific requirements exceeding all U.S. pipeline safety standards, including satellite-linked, computerized leak-detection systems and puncture-resistant steel pipe. Even one of TransCanada's competitors, Enbridge, which ships Canadian crude through existing cross-border pipelines, supported the Keystone permit: Any interruption in the historic bilateral energy trade relationship was a more serious threat to its business than crude shipments by competitors.

The decision to delay the project is such a shift in expectations on the future of U.S.-Canadian energy trade that perhaps the only surprising outcome is that Prime Minister Stephen Harper has not recalled his ambassador. He did announce that shipping the crude to Asia will now receive the highest priority.

A decision to proceed with the pipeline would have sent a strong signal to the world petroleum market (including OPEC) that North America is putting into place a long-term and sustained strategy for expanding domestic oil supplies. True, the administration has stated that it is not denying the cross-border permit, but merely addressing the concerns of Nebraska Republicans who seek an alternative route. Nevertheless, the heavy pressure exerted on the administration by its environmentalist followers was obvious and very public. And in the best of circumstances, federal environmental review of a new route may take over a year.

We are in the early stages of sustained and large increases in domestic crude oil output from the same hydraulic fracturing technology that brought us the shale gas revolution. New crude supplies, combined with the current surge in natural gas production, offer the promise of a renaissance in long-moribund petrochemical processing and petroleum refining industries. The capital now sitting on the sidelines is ready to come off the bench and fund profitable projects. But it will not be deployed if there's a political risk that cannot be contained.

Should we then at least give Mr. Obama credit for a shrewd political strategy? The decision to punt on the project may indeed energize the president's environmental base for the November 2012 presidential election. But that's not the only political effect it could have.

Consider the crucial swing state of Ohio. The Buckeye State's vast Utica oil shale deposit, which now has well over one million acres under lease to companies such as Chesapeake, Hess and Devon, is likely to see some positive results in crude oil production over the next 12 months. On the eve of the presidential election, we may very well be in the early stages of an Ohio oil boom and the promise of coming prosperity.

Which candidate can make the promise that this opportunity will not be brought to a halt by the vast array of job-killing federal agencies? The one who visibly shut down the Keystone XL pipeline and remains engaged in promoting federal initiatives to curtail domestic oil and gas production, or his Republican opponent?

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