Testimony

before

U.S. House of Representatives Committee on Foreign Affairs
Subcommittee on the Western Hemisphere

Hearing on Rising Oil Prices and Dependence on Hostile Regimes: The Urgent Case for Canadian Oil

March 31, 2011
2 pm
Rayburn House Office Building
Washington, DC

Submitted by:

Lucian Pugliaresi
President, Energy Policy Research Foundation, Inc (EPRINC)
Washington, D.C.
www.eprinc.org

Chairman Mack, Ranking Member Engel, and members of the subcommittee on the Western Hemisphere, on behalf of myself and EPRINC we welcome this opportunity to testify on this important topic to American energy security. The Energy Policy Research Foundation, Inc. (EPRINC) is a not-for-profit organization that studies energy economics, specializing in petroleum and downstream product markets. EPRINC has been researching and publishing reports on all aspects of the petroleum industry since 1944. Our reports are posted online and made available free of charge. We are known internationally for our objective analysis on energy issues. We recently published a research report on the Keystone XL pipeline and the value of Canadian oil sands to the United States.

My testimony today will explain the economic and energy security benefits of additional supplies of Canadian oil sands imports from Canada to the U.S. Immediate approval of TransCanada's Keystone Expansion pipeline is of increasing importance given the declining production in Venezuela and Mexico, extensive volatility in the Middle East, rising oil prices, and growing constraints in efficiently moving crude oil to major refining centers in the mid-continent and on the Gulf Coast.

The United States and Canada maintain ties in security, border cooperation, trade, and investment. The signing of NAFTA (North American Free Trade Agreement) in 1994 only strengthened the economic ties between the two nations, resulting in a near six percent increase in trade each year since the treaty signing and a two-way merchandise trade growth of 265 percent. U.S. companies have made substantial investments in Canadian mining and smelting industries, petroleum, chemicals, machinery, transport equipment, manufacturing, and finance. Additionally, Canada is the number one supplier of oil to the Unites States and provides 90 percent of U.S. natural gas imports (15 percent of U.S. consumption), significant volumes of uranium, and almost all imported electricity. Any increase in petroleum imports from Canada is inherently stable and contributes directly to U.S. energy security also making important and substantial contributions to sustainable employment growth in the United States. The North American energy market is highly integrated.

The pipeline extension would permit the shipment of an additional 509,000 b/d (barrels per day) of Canadian oil to U.S. refining centers. Most of the expanded import volume would be in the form of blended bitumen which is similar to heavy crude oil. Because of production declines in Mexico and Venezuela, U.S. refiners are receiving reduced shipments of heavy crudes. Higher volumes of heavy crudes from Canada offer considerable potential to improve operating margins for U.S. refiners, many of whom long ago made expensive upgrades in complex facilities that favor heavy oil. Additionally, TransCanada is expanding Keystone XL's capability by offering Bakken oil producers, located in North Dakota and Montana, a chance to link into the pipeline and send their crude to Gulf Coast refineries for the first time. By increasing transport efficiency and allowing Bakken producers to tap into new Gulf Coast refinery markets, the Keystone XL project will have the added benefit of improving wellhead values for oil production from the Bakken formation. EPRINC estimates that the Keystone expansion would provide net economic benefits from improved efficiencies in both the transportation and processing of crude oil of as much as $600 million annually, in addition to an immediate boost in construction employment.

Critics of Canadian oil sands production have recommended that the U.S. restrict Canadian imports and seek to replace these imports with alternative fuels and conservation. This strategy is a false choice--alternative fuels can reduce net imports of crude oil and petroleum products, but these alternatives (biofuels, electric vehicles, natural gas vehicles, new auto fuel standards) offer limited opportunity to substantially lower oil imports in the near to medium term. Denying oil sand supplies to US refiners will not prohibit the production of Canadian oil sands. Eventually bitumen would flow to alternative markets, displacing crude supplies which would eventually find their way to the U.S.

Additional imports of Canadian oil sands will provide substantial and long-term operating efficiencies for the U.S. refining sector, an industry characterized by declining margins and growing competition from foreign refining centers in recent years. Many U.S. refineries are complex and designed for processing heavy crudes to produce the transportation fuels needed for the U.S. economy.

A major factor driving historic investment in heavy processing capacity was the expectation that heavy crude oil supplies would remain abundant and that the price differential between heavier and lighter crudes would continue to justify the large domestic investments in complex refining capacity. Mexico and Venezuela have historically been two of the largest suppliers of heavy crude oil to the U.S. Yet each country has experienced drastic production declines over the past few years, removing significant volumes of expected heavy crude oil from the market, and creating at least one important driver of the tightened spread.

We asked Turner Mason and Company, a highly respected petroleum and refining consulting firm out of Dallas, to give us their perspective on this issue as well. Turner Mason estimates that total Canadian crude production will increase by over 400,000 thousand barrels/day (or 17%) in the next five years and by almost 1.1 million barrels/day (or 42%) in the next 10 years. This increase alone represents almost 50% of our expected Venezuelan crude imports in five years and 100% in the next 10 years. In addition, Turner Mason's assessment of economically recoverable unconventional oil shows Canada exceeding the reserves of Saudi Arabia.

The surge in Canadian imports does not mean we would not import Venezuelan crude oil, as it will remain well matched to U.S. refining configurations. But Canadian imports will certainly reduce Venezuelan leverage over the U.S. refining sector. In anticipation of the increase in Canadian production, U.S. refineries will continue to invest billions of dollars to convert their refineries away from the lighter crude types produced in areas such as Libya, Algeria, UAE, and Nigeria to the type of crude that is produced in Canada.

This leads me to my final and most important point. In world oil markets prices are determined by not only what is happening now but also the expectations buyers and sellers have about future production. We are often told that quickly moving forward on Keystone, opening up Alaska, permitting drilling in arctic waters, expanding oil and gas leasing in new provinces, and even deepwater drilling in the Gulf of Mexico will bring new supplies into the market too far into the future to help us with the current crisis – or that the supplies will be too small to make a difference. Putting aside that we say this every time there is a crisis in world oil markets, this is a much too simplified view of the oil market. If we open up more North American resources for development, we may very well shift long-term expectations on domestic supply and receive the benefits of lower prices even before the supplies come to market. We may even get some pleasant surprises such as we recently experienced with the shale gas revolution. I will leave you with a statistic worth thinking about, if we can alter the long-term price of crude oil by $20/bb, over any base forecast price (say $80/bbl instead of $100/bbl), the present value savings in our import bill alone would be $1 trillion and it would easily be twice that for the national economy. This means jobs, return on capital, corporate and personal income taxes, and government revenues from bonus bids and royalties would grow substantially.

This concludes my testimony and I look forward to your questions.