

# **Realizing the Promise of an Emerging Resources Superpower**

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## **Realizing the Promise of an Emerging Resources Superpower**

*"We are an emerging energy superpower. We want to sell our energy to people who want to buy our energy. It's that simple."*

*Stephen Harper, February 2012*

### **Executive Summary and Recommendations**

Canadian natural resources diplomacy serves Canada's complex, even at times contradictory, interests as a major resource exporter and resource importer, a country that is both a home to firms with extensive investments in resource-producing countries abroad and a host to their foreign counterparts in Canada.

There is a wide range of entities whose decisions can and do impact Canadian interests and pose challenges to Canadian policy-making and diplomacy. Among the most significant are:

- The US Congress and its ready determination to protect US producer interests, most egregiously with respect to forest products but also potentially as regards all resources that the US itself produces including energy from coal and shale oil and gas.
- The US Administration, while a fairly willing partner on removing impediments to business, is susceptible to the pressures exerted by well-organized and well-financed environmental groups, for example on the Keystone pipeline, and can be myopic in its preoccupations with national security.
- The EU Commission, abetted by savvy activist campaigns, is a major norm setter on environmental and social policy issues, whose rule-making judgments, notably on the impacts of oil sands exploitation on the climate, can have major impacts on consumer-sensitive commerce in Europe, and far beyond in multilateral instances such as the Climate Change negotiations.
- The WTO, as custodian of the General Agreement on Tariffs and Trade, remains the dominant multilateral institution governing international trade and investment despite the stasis of the Doha Round. Actions at the WTO based on the asbestos precedent and the protection of investor rights could have significant impacts on Canada.

- NAFTA, despite its advancing age, remains crucially important but needs updating not least to assure Canada of benefits at least as advantageous as those that Korea and others acquire from the US in bilateral and plurilateral deals.
- The Trans Pacific Forum, which has the potential both to advance Canadian trade and investment interests in Asia and to put at stake Canadian policies, notably on supply management; failure to gain membership could disadvantage Canada across the Asian board, including with respect to resource exports.
- The Comprehensive Economic and Trade agreement with Europe, a Canadian policy goal since the Seventies, which promises substantially enhanced trade and investment benefits, but which will entail greater scrutiny of Canadian environmental and aboriginal policies than we have experienced thus far.
- The UNFCCC, while very unlikely to conclude an agreement in the short term, could do so in the medium term, which could entail binding provisions that would impact a range of Canadian fossil fuels and other resource, agriculture and fiscal policy interests; those who failed to comply or who stood aside from such an agreement could face border measures and other penalties.
- The G20, if it ever went beyond its self-imposed essentially finance and macro-economic mandate could have significant impacts, particularly if it addressed energy security and climate issues.
- The Arctic Council, which under our stewardship could stimulate cooperation and the establishment of ground rules for responsible development and offshore resource exploitation.

There are several non-institutional policy arenas that present significant policy risks to Canada.

- The court of international public opinion, which convenes in many instances around the world, notably.
  - In the US, where coalitions of civil society critical of Canadian policies regarding climate change, pipeline development, environmental protection more generally and the welfare and rights of First Nations, work to hinder oil sands development.
  - In Europe, where decades of Canadian policies from forest clear-cutting, seal hunting and asbestos exports to climate change and oil sands development, have combined to tarnish the Canadian brand in the minds of some of the public, to raise doubts about our bona fides as a

- constructive international citizen, and to jeopardize our access to European markets by imposing tax or other penalties on our exports.
- In Latin America, Africa and Asia where despite their leadership in mining practices, acknowledged expertise, and generally strong overall performance, Canadian mining companies sometimes find themselves in conflicts with local interests and caught up in political imbroglios.
  - In resource-rich, governance-poor developing countries, where interest is growing in greater corporate social responsibility, in financial transparency, and in improved natural resource governance capability.
  - Foreign Investment Protection Agreements (FIPAs), which in addition to protecting Canadian investors abroad, could by their reciprocal nature limit Canadian freedom of action to regulate the exploitation and taxation of Canadian resources, notably by minimizing the procurement of Canadian goods and services and avoiding refining or further processing of resources in Canada.
  - (Chinese) State-Owned Enterprises and Sovereign Wealth Funds, which hold the promise of vast investments, but also the risk of strategic motivations and political control that might be incompatible with Canadian interests and, in subsidized access to funds, harmful to the competitiveness of Canadian private enterprises.

In light of this extraordinary complexity, what should Canada do?

- The central organizing principle of federal policy should be to seek to achieve the long-term optimization rather than short-term maximization of Canadian interests, broadly defined as including economic and social factors, notably the development and preservation of Canada's brand. It is difficult to exaggerate the importance of preserving and enhancing Canada's reputation as a successful, responsible, reliable, law-abiding and competent partner.
- Regarding the US, while acknowledging the unique power of the presidency, we need to continue to prioritize Congressional relations, to work where possible with issue-specific American industrial and state government allies and to ensure that Canada speaks coherently with one voice in Washington.
- Recognizing that the US market, by virtue of its wealth and proximity, will inevitably remain crucially important to Canada, and that, properly managed, the Mexican relationship can enhance Canadian competitiveness, we need to develop NAFTA to enhance our privileged access at a time when the US is opening its own market to Asian economies.
- With 99 per cent of Canada's oil and gas exports going to the U.S. and only 15 per cent of American imports coming from Canada, we are not negotiating with

equivalent leverage. While we obviously need to maintain our standing as a reliable major supplier of all forms of energy to the US, if we are to be a real energy superpower, and even if we are just to protect our interests in the US, we need to develop complementary and alternative markets in Asia and Europe and the infrastructure to get our resources to market. Diversification - a pipeline to the West coast (or East coast or Arctic coast) and facilitation of Liquefied Natural Gas (LNG) projects – is part of the answer.

- Crucial to shielding oil sands exports from international interference will be improvements in the emissions footprint of the sands and marked progress in meeting our climate change commitments.
- In climate change negotiations, to prepare for the unlikely contingency of a deal, Canada should pursue “no regrets” investments in energy, lead on efficiency standards in building and transportation, reduce the carbon footprint of the oil sands and sharpen the legal arguments against border tax adjustments, both in the context of NAFTA and the WTO.
- At the WTO, we need to monitor, and where important and feasible, to intervene in cases that would impose import bans and border tax adjustments that excessively expand the boundaries of environment protection and human health and safety.
- In the G20, we should pick up on the opening created at the Pittsburgh summit to promote energy security and efficiency and cooperation on climate change.
- To realize the benefits of the Global Commerce Strategy, we should do whatever it reasonably takes to conclude the Comprehensive Economic and Trade Agreement with the EU, and seek free trade and investment agreements with the world’s remaining larger economies, notably Japan, Brazil, Turkey and prospectively China, and to conclude the negotiations with Korea and Singapore.
- We should continue to welcome foreign investment but recognize both the significance of Canadian ownership of globally strategic industries (e.g., uranium and potash) and the advantages inherent in resource upgrading and further processing in Canada. We should distinguish between renewable and non-renewable resources ownership and exploitation.
- We should seek to leverage the interest of investors in access to Canada to obtain equivalent access for Canadian investors interested in investing in their countries.
- Our attitude to (Chinese) State Owned Enterprises (SOEs) should be conditioned on their performance, notably as regards market capitalization, transparency, and the impacts on Canadian competitiveness. To the extent that their performance corresponds to that of private foreign investors, they should

be treated in a like manner. To the extent that they operate in ways that pose risks to Canadian industry and local communities, we should impose remedies.

- We should likewise monitor Sovereign Wealth Fund investors to ensure benefits.
- We should seek consultative relations with other major resource players, especially Australia and Norway – to learn how they are advancing their interests in contemporary governance frameworks.
- In the Arctic, we need to lead the Arctic Council in promoting development cooperation and offshore resource exploitation while continuing to cooperate with the other four Arctic littoral states to develop agreed offshore boundaries. We should also establish a leadership position on Arctic environmental protection, both for the inherent benefits it brings and as insulation against damaging criticism that can all too easily materialize, which could ultimately jeopardize our territorial sea claims that are based on environmental stewardship.
- As regards the extractive industries abroad, our goal should be to maintain and enhance Canada's reputation as a leader in responsible practices, which is built on our effective domestic regulation of mining, the generally positive performance of Canadian mining companies, significant contributions to global natural resource governance and our promotion of high CSR standards for the operation of Canadian companies abroad.
- We should promote high standards of performance abroad by Canadian companies, encourage their efforts to operate responsibly and support them when they do.
- In developing countries we should support host country resource management capacity building, especially with respect to environmental protection, labour relations, indigenous interests and rule of law;
- We should lead in multilateral fora on good governance initiatives, making use of the Commonwealth and the Francophonie, where the Prime Minister himself can lead in the promotion of cooperation in capacity-building.
- We should take a coherent whole-of-government approach, including DFAIT, NRCAN, Environment Canada and CIDA as necessary.
- We should also revisit CIDA's development concentration priorities to ensure that we are building enduring relationships with countries in which Canadian industry, including the extractive industry, is engaged and contributing to development and growth.
- With respect to the Persian Gulf oil-producing countries, we should develop relationships that give us insights into their oil and gas policies and promote cooperation on political and economic issues of common interest.

## **I. Introduction**

The Prime Minister has called Canada an emerging energy superpower. The statistics indeed tell an impressive story. Canada ranks third in the world in crude oil reserves, after Saudi Arabia and Venezuela. Canada is the 3rd largest natural gas producer in the world and the third largest exporter, the 6th largest crude oil producer the 6th largest electricity generator, the largest uranium producer and the 5th largest energy producer. Canada is the most significant source for U.S. energy imports, providing the highest foreign volumes of primary energy and electricity.<sup>1</sup>

At the same time, and less well known, Canada is a global mining giant. Canadian financial markets in Toronto and Vancouver are the world's largest source of equity capital for mining companies undertaking exploration and development. Mining and exploration companies based in Canada account for 43 per cent of global exploration expenditures. In 2008, over 75 per cent of the world's exploration and mining companies were headquartered in Canada. These 1293 companies had an interest in some 7809 properties in Canada and in over 100 countries around the world. At about \$79.3 billion in 2007, mining and energy investment is the third-largest component of Canadian direct investment abroad (stocks), generating significant additional exports from Canada. Canadian mining companies have invested over \$60 billion in developing countries, including about \$41 billion in Latin America (including Mexico) and almost \$15 billion in Africa.<sup>2</sup>

It is evident that major Canadian interests are in play. This paper briefly canvasses the bilateral, regional and multilateral landscape and sketches the key entities, frameworks and arrangements that govern investment, development and trade of natural resources, and reviews the major issues and concerns they raise for Canadian diplomacy and foreign policy. Natural resources in this paper include fuels, ores and other ferrous or non-ferrous minerals, fishing and forest products, agricultural raw materials, and water resources; the first two commodities are the principal focus of this research.

Governance frameworks comprise the bilateral, plurilateral and multilateral agreements and arrangements, i.e., the ways and means by which norms and rules are set, decisions are made, performance is monitored and compliance is enforced in the international arena. Rules relate, inter alia, to import and export restrictions, border

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<sup>1</sup> DFAIT website, CAPP website, US Energy Information Administration website.

<sup>2</sup> DFAIT Website and documents

tax adjustments and subsidies, freedom of transit, international commodity agreements, and investment issues such as performance requirements.

Where and how might norms and rules of significance to Canada be set in future? As an important resource producer and investor in major foreign projects, where are our interests in play? How do we reconcile our sometimes contradictory interests in regards to foreign investment here and Canadian investment abroad? What are the possible future developments in international governance mechanisms likely to be most relevant to Canada's optimizing the potential wealth and diplomatic power derived from natural resources? In defending and promoting Canadian interests, which international initiatives and contingencies most bear watching? In the bilateral, regional and multilateral institutional landscape governing resources, what should the Canadian focus of attention be and in which priority arenas should we work to shape the rules of the game? In short, how best do we advance our interests?

The global rules of the game that shape and constrain national policy choices on energy and resource issues have been characterized as an incoherent and inadequate mishmash (Florini and Sovacool, 2011). The WTO is effective in "governing" trade in goods, services and intellectual property – based on the principle of "national treatment"<sup>3</sup> and provides the most sophisticated process for dispute settlement. The WTO, nevertheless, inadequately meets the interests of emerging and poorer economies and the effort to move forward through the Doha Round seems likely to remain dead-locked.

NAFTA is an important framework, but is showing some signs of age and needs to be updated to take account of the threats to Canadian competitiveness in the USA presented potentially by US free trade agreements and the Trans-Pacific Partnership. The TPP negotiations are incomplete, and the nature and scope of the eventual agreement is not yet clear. It is important for what it might become eventually. China

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<sup>3</sup> The principle of giving others the same treatment as one's own nationals. Internal taxes and other internal charges, and laws, **regulations and requirements** affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production. Imported and locally-produced goods should be treated equally — at least after the foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents. This principle of "national treatment" (giving others the same treatment as one's own nationals) is also found in all the three main WTO agreements (Article 3 of [GATT](#), Article 17 of [GATS](#) and Article 3 of [TRIPS](#)).



is not a participant<sup>4</sup>, and Japan and Korea are more prospects than participants. Canada has been accepted around the table, grudgingly in the cases of our usual close allies New Zealand, Australia and the US, as has been Mexico. Were Ottawa to reject the eventual deal, Canada could be disadvantaged not only in terms of market access in Asia, but also as regards the advantages we derive from NAFTA, depending on the concessions regarding its home market that the US might make to others .

The IEA is the premier energy-importers' organization, but excludes most oil producers, as well as several major consumers including China, India, and Russia and some other major emerging economies.

Global governance of the natural environment is characterized by fragmentation, the relative weakness of the UN Environment Program (UNEP) and the often subsidiarity of environmental concerns in difficult economic times and in developing countries generally. There are over 200 international organizations administering multilateral environmental agreements, and the locations of their secretariats are widely dispersed. Beyond UNEP, other relevant institutions attempting to govern natural resources development include the UNFCCC, OPEC, the International Renewable Energy Agency (IRENA), the Renewable Energy & Energy Efficiency Partnership (REEEP) and the Renewable Energy Policy Network for the 21st Century, (REN21), the IAEA, the Nuclear Suppliers Group, the OECD's Nuclear Energy Agency (NEA), the UN's Division for Ocean Affairs and the Law of the Sea, etc. Labour norms and the willingness of both governments and investors to respect them vary significantly.

Environmentalists have long argued that a continuation of existing trends in energy production and use will lead to unacceptable environmental degradation, and that preventive and mitigating actions are necessary and, seen against the costs of inaction, affordable. The interaction of trade and environment rules and norms is one of the most tendentious areas of international economic relations, pitting those who fear that the environment is being sacrificed to development against those who see environmental regulation as disguised trade and investment protectionism.

The issues raised thus far are neither hypothetical nor trivial. The EU's proposed fuel directive would affect exports from Canada's oil sands; similarly provisions for its Emission Trading System that requires airlines using European airports to pay for carbon emissions would affect Canadian airlines. China's restrictions with respect to

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<sup>4</sup> But see <http://www.scoop.co.nz/stories/PO1206/S00116/china-looking-at-joining-trans-pacific-partnership.htm>

“rare earths” exports will have consequences for Canada. While perhaps partly motivated by environmental considerations, as the Chinese claim, it violates WTO principles regarding equitable access to raw materials.

Domestically, the major issues relate to investment and trade in oil sands. Potentially troublesome will be possible future American and other international interest in the development of Arctic petroleum. Beyond that, emerging controversies include competition rules (abuse of dominance), price fixing for strategic commodities, behaviour of sovereign wealth funds and state owned enterprises, and trade restrictions targeting genetically modified organisms. Issues that will have little impact on Canada include the legality of export bans on agricultural products (we are unlikely to want to limit exports to protect access by the domestic market) and, with the exception of their application to oil sands, which could be very important, “green” motivated border tax adjustments. Internationally, the comportment of Canadian mineral exploration and mining firms and their vulnerability to sometimes weak, environmentally lax, corrupt and unpredictable governments is at issue, with implications for their own goals and for Canadian relations with their host countries, notably in the Andes, Central Asia, and Sub-Saharan Africa.

## **II. The Importance of the Canada Brand**

### “A Conversation Overheard at the Bar at Wilfred’s”

Cynic: Canada, as an emerging energy superpower, cannot both prosper and, at the same time, burnish its reputation as a good global citizen. Forget Mr. Nice Guy. Don’t kid yourself, “Nice guys finish last”. International trade and business is hardball, with no room for naïve romanticism or altruism. Sanctimony does not play in the market place. Sure, lip service is paid to transparency, corporate social responsibility and anti-corruption, but the world consists of self –interested and unethical individuals. For example, the vaunted Kimberly process fails to deal effectively with problem cases; blood diamonds are still fuelling violence and human rights abuses. In international affairs, you can be rich or be loved – not both.

Optimist: We can both prosper and burnish our image, indeed we must do both. We can sell our energy, maintain our primacy as a global mining giant, and preserve our standing as a leader in responsible practices and a supporter of host government capacity building. The goal is not to be “loved”; the objective is to succeed. Unless Canadian companies operating abroad are seen as responsible actors, their existence will be nasty, brutish, and short. Corporate social responsibility and anti-corruption

initiatives contribute to Canada's excellent reputation – yes, the Kimberly Process, the Canadian Corporate Social Responsibility Strategy for the Extractive Sector, the Intergovernmental Forum on Mining, and the Africa Mining Vision. Other countries are not ingenuous in investing in polishing their brand. Australia is investing some \$120 million in programs to foster responsible mining governance in developing countries. Norway has its Oil for Development program. Self-interested countries strive to be respected. The point is that maintaining and enhancing Canada's reputation as a global giant, should be a key pillar in Canada's strategic foreign and trade policy on natural resources for selfish reasons. There is no tradeoff. Civil society will make life miserable for "bad apples". Investors and customers will insist that Canadian firms act responsibly.

In this light, how should Canada position itself in the global governance agenda? Our "brand" in the global governance debate should be as a respected and responsible player, particularly in mining. We want the global governance regime to assist Canadian extractive sector companies' ability to manage risk in states with weak governance, and to be a leader in regional and multilateral fora in fostering improved natural resource governance in developing countries that are resource rich. We want to be favourably compared to China, in constructively fostering responsible mining governance in developing countries.

In addition to experience in multilateral fora, perceptions of the Canada brand will be influenced by the impressions of the behaviour of Canadian companies abroad. In the future, more countries will grant concessions to companies with the reputation for responsible operations, given their environmental and social impact. Canada has a good reputation for effective domestic regulation of mining. We should highlight the generally positive performance of Canadian mining companies abroad. We should lead in multilateral fora on good governance initiatives. We should advertise Canada's promotion of high CSR standards for the foreign operations of Canadian firms.

One question is how to assist Canadian extractive sector companies manage risk in states with weak governance. What should the policy stance be in assisting Canadian firms' manage government and community relations? Should we update the 2009 CSR Strategy for the Canadian International Extractive Sector? There will be instances where trade and investment concerns appear to be trumped by issues of human rights and international peace and security. An example is the World Gold Council's "Conflict-Free Gold Standard" intended to ensure that precious metal and mineral supply chains

are not contributing to armed conflict or the abuse of human rights. In the long run, responsible behaviour is likely to be consistent with an improved bottom line.

### **III. The Major Multilateral Governance Frameworks and their Relevance to Canadian Natural Resources Exploitation Interests**

#### **1. The World Trade Organization**

The WTO remains the principal, albeit not the exclusive, institution whose decision-making can substantially affect Canada's interests, including with respect to natural resources. WTO agreements that are directly relevant to cross-border energy and resources trade and investment include the General Agreement on Tariffs and Trade (GATT); the General Agreement on Trade in Services (GATS); the Agreement on Technical Barriers to Trade (TBT); the agreement on Trade Related Investment Measures (TRIMs); the agreement on Subsidies and Countervailing Measures (SCM); and the Agreement on Government Procurement.<sup>5</sup>

Principal WTO issues for Canada, some of which we will oppose and others we will champion, include:

- The interpretation by our trading partners of the General Exceptions in Article XX to permit action inconsistent with obligations, including measures taken to protect human life, to conserve exhaustible natural resources or to take measures essential to the acquisition or distribution of products in short supply.
- Eco labelling or process and production methods which leave no trace in the final product e.g. you cannot tell whether a table has been produced from sustainably managed wood by simply looking at it.<sup>6</sup> Discriminatory treatment of products depending on the source of energy used in the manufacturing process.

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<sup>5</sup> See Yulia Selivanova

The WTO and Energy: WTO Rules and Agreements of Relevance to the Energy Sector  
<http://ictsd.org/downloads/2008/05/the20wto20and20energy.pdf>

<sup>6</sup> "WTO Members agree that countries are within their rights under WTO rules to set criteria for the way products are produced, if the production method leaves a trace in the final product, for example cotton grown using pesticides leaving pesticide residue in the cotton itself".

[http://www.wto.org/english/tratop\\_e/envir\\_e/labelling\\_e.htm](http://www.wto.org/english/tratop_e/envir_e/labelling_e.htm)

- Whether the Agreement on Sanitary and Phytosanitary measures (SPS Agreement) could be employed to ban importation of asbestos as a natural resource product harmful to human life.
- The potential application of a future provision that allows imposition of a charge equivalent to an internal (carbon) tax on imports of any product.
- Whether quantitative restrictions on energy exports to deal with depressed price are allowed under WTO rules and on which basis.
- The absence of a single definition or clear notion of what is meant by energy services, an area in which only limited commitments have been made.
- National treatment as regards internal taxes and charges, laws and regulations, specifically differential taxes as regards imported energy material and products and domestic origin energy material and products.
- Exceptions to GATT's Article XI prohibition of quantitative restrictions, i.e., the provision that allows temporary export prohibitions in order to relieve critical shortages of foodstuffs or products essential to the exporting country.
- Interpretations of Article V of the GATT which provides for freedom of transit for cross-border energy trade, including through fixed infrastructure such as electricity grids or pipelines.
- The undertaking of parties to the GATT under Article XVII of the GATT that ensure that state trading enterprises (STEs) act in a manner consistent with the general principles of non-discrimination.
- The Agreement on Subsidies and Countervailing Measures (SCM Agreement), prohibiting subsidies contingent on the use of domestic products, being applied to natural resources.
- Disciplines on agricultural subsidies in the Agreement on Agriculture, noting that irrigation for agriculture accounts for an estimated 60 per cent of global water consumption<sup>7</sup>.
- Whether the Technical Barriers to Trade Agreement (TBT Agreement) could be interpreted to allow disadvantageous eco labelling.

A potential future issue is whether Canada could maintain domestic prices for natural resource products at levels below world market prices, depressing costs for domestic industrial users for domestic downstream industries such as fertilisers and metals. If dual energy pricing applies to all enterprises and industries throughout the economy, this practice does not meet the specificity requirement for actionable subsidies.

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<sup>7</sup> <http://ga.water.usgs.gov/edu/wuir.html>

Energy-importing states are interested in addressing issues such as pricing practices, natural resource development policies, procurement in the energy sector, and restrictive practices of incumbent energy companies. Some acceding countries have faced demands to fully liberalise their energy services sector, to eliminate export taxes and dual price systems, and even unbundle energy monopolies.

Issues of concern are discrimination and market access of energy products and materials as well as downstream products, the access to market of energy services, transit, and high consumption and excise taxes imposed by importing countries on energy materials and products.

### *The General Agreement on Trade in Services (GATS)*

The GATS contains limited provisions that deal with the conduct of private entities such as monopolies and exclusive service suppliers. In 2000-2001, the United States and Norway proposed to devise a Reference Paper for energy services, modelled on the Reference Paper to the GATS Agreement on Basic Telecommunications Services. Both telecoms and energy (read electricity) can be regarded as highly regulated markets for network services characterised by large incumbent suppliers and regulation.<sup>8</sup> In the event the idea is resurrected, Canada should support it given the potential for electricity exports.

### *The Trade Related Investment Measures (TRIMs) Agreement*

The TRIMs Agreement elaborates on the national treatment obligation and prohibition of quantitative restrictions with respect to investment measures such as local content and foreign exchange-related requirements. It prohibits imposition of investment measures that require companies to buy a certain amount of goods of national origin or condition certain imports on the amount of exports. This provision is helpful to Canadian firms investing abroad. On balance, while certain provincial or municipal governments will object, we will want to maintain this provision.

## **2. The Energy Charter**

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<sup>8</sup> [http://ictsd.org/downloads/2008/05/informal20roundtable\\_trade20in20energy20services201920042007.pdf](http://ictsd.org/downloads/2008/05/informal20roundtable_trade20in20energy20services201920042007.pdf)

The Energy Charter<sup>9</sup> is a treaty negotiated after the end of the Cold War designed to encourage investment and trade, to ensure reliable transit, and to promote efficient energy use in Eurasia. Canada is an observer with China and the US among others. A primary aim was to promote the necessary climate of predictability, a stable interface between the foreign investor and the host government that can attract private sector involvement. The Charter offers binding protection for foreign energy investors against key non-commercial risks, such as discriminatory treatment, direct or indirect expropriation, or breach of individual investment contracts. A second priority was to promote reliable international transit flows (of more significance in Eurasia than in North America). The Charter lost much of its significance when Russia announced it would not ratify.

### **3. Organization of the Petroleum Exporting Countries (OPEC)**

OPEC's mission is "to coordinate and unify the petroleum policies of its Member Countries and ensure the stabilization of oil markets in order to secure an efficient, economic and regular supply of petroleum to consumers, a steady income to producers and a fair return on capital for those investing in the petroleum industry."<sup>10</sup> Inter alia, it recommends oil production targets "ensuring the stabilization of prices in international oil markets with a view to eliminating harmful and unnecessary fluctuations".<sup>11</sup> While OPEC members have an interest in high prices for their non-renewable exports, they recognize that price spikes can dampen international economic activity and in turn reduce the demand for their product

### **4. The International Energy Agency (IEA)**

The IEA, founded in 1974, has as its core mission emergency response to oil supply disruptions. It runs the International Energy Program, a treaty-based commitment to hold oil stocks equivalent of at least 90 days of the prior year's net imports. The treaty also includes an integrated set of emergency response measures for major international oil disruptions, i.e. when supplies are reduced by 7per cent or more to individual member countries or to the IEA member countries as a group. The treaty defines the following emergency response measures: a drawdown of oil stocks,

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<sup>9</sup> <http://www.encharter.org/index.php?id=18>

<sup>10</sup> [http://www.opec.org/opec\\_web/en/about\\_us/23.htm](http://www.opec.org/opec_web/en/about_us/23.htm)

<sup>11</sup> [http://www.opec.org/opec\\_web/static\\_files\\_project/media/downloads/publications/OS.pdf](http://www.opec.org/opec_web/static_files_project/media/downloads/publications/OS.pdf)

demand restraint measures, fuel-switching out of oil, surge oil production and the sharing of available supplies.<sup>12</sup>

The IEA has 28 member countries. It does not include Mexico, or five other OECD members. More important it does not include China, Brazil, India or South Africa. A longer term policy option is to envision an "ideal IEA" with Mexico and the BRICs as members.

## **5. The International Atomic Energy Agency and the Nuclear Suppliers Group**

The IAEA is an independent intergovernmental, science and technology-based organization, in the United Nations family, that serves as the global focal point for nuclear cooperation. It assists its Member States in planning for and using nuclear science and technology for various peaceful purposes, particularly electricity generation and facilitates the transfer of technology to developing member states. It develops and promotes nuclear safety standards and verifies through its inspection system that states comply with their commitments under the Non-Proliferation Treaty and other non-proliferation agreements.

The Nuclear Suppliers Group (NSG) is a group of 46 nuclear supplier countries (including five permanent members of the UN Security Council) which seeks to prevent the proliferation of nuclear weapons. The NSG has been an effective instrument in limiting the illicit procurement of weapons-relevant equipment and materiel, including uranium. Its guidelines are implemented by each participating government in accordance with its own national laws and practices and decisions on export applications are taken at the national level. It has been largely effective, but member states have when it suited them interpreted its strictures selectively, as the Bush administration did in negotiating a strategic partnership with India.

Uranium has properties unlike most commodities. The effectiveness of the IAEA and the NSG is of major importance to Canadian national security and crucial to Canadian uranium and nuclear technology and services exporters. Absent IAEA regulations and NSG imprimatur, the export of nuclear materiel could be subject to embargoes.

## **6. North American Free Trade Agreement (NAFTA)**

The NAFTA chapter on energy and petrochemicals sets out specific rules for these sectors. It eliminates import tariffs and quantitative restrictions, but allows Mexico to maintain a licensing system for petroleum and electricity trade. Minimum and

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<sup>12</sup> <http://www.iea.org/about/ems.asp>



maximum import and export prices are prohibited, while domestic prices are not regulated. The chapter also clarifies that energy regulatory measures – defined as “any measure, by federal or sub federal entities, that directly affects the transportation, transmission or distribution, purchase or sale, of an energy or basic petrochemical good” – are subject to the disciplines on national treatment, import and export restrictions, and export taxes.

Article 605 requires that whatever percentage of Canada's oil production is supplied to the U.S. during good times cannot be curtailed during bad times. For example, if we currently supply 20 per cent of our production to the U.S., then we cannot reduce that percentage over the next 36 months. That applies to all situations including if we are in the midst of a domestic shortage. It has been interpreted to mean that we must sell our resources to the U.S. at the same price as we sell them to Canadians. We cannot apply excise taxes, for example or set minimum price guarantees.

A contingency to prepare for in the intermediate future is the fact that WTO rules and NAFTA disciplines may be applied to natural resources before they are harvested or extracted. In the Softwood Lumber IV case, the Subsidies and Countervailing Measures (SCM) agreement was applied to standing, unfelled trees. The question is whether in future this line of argument will be applied to water to challenge BC's legislation banning large scale transfers of water.

What is the future of NAFTA? It will soon be twenty years old; it operates in a very different world from the one in which it was negotiated. NAFTA was first implemented on January 1, 1994. Its dispute settlement system has been criticized for having been corrupted by delays and procedural abuses. Can we fix it, with or without amending NAFTA? Others have criticized the rules of origin system as ill-conceived and costly, arguing that it should be replaced by a common external tariff or a customs union.. Other suggestions<sup>13</sup> to update NAFTA have included proposals to harmonize regulations among the three countries in a number of sectors- automotive vehicle safety standards and regulations, food inspection and product safety and financial regulation in order to provide more efficient access to capital, to improve the availability and affordability of insurance coverage for cross-border carriers, and to find new ways for cross-border collaboration on investment. Another suggestion was to implement a common regime for more protection of intellectual property rights.

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<sup>13</sup> <http://blog.udlap.mx/wp-content/uploads/2011/10/NAFTA-Advantages-October-2011.pdf>

The prospects for deepening NAFTA will likely have to await the end of the recession and a return of the US economy to sustained strong growth. It is unlikely, in the current perverse economic environment, that there would be American political will to deepen NAFTA, given the vocal opponents who will argue that Canadian competition is unfair on all manner of grounds from perceived lower labour standards to lax environmental regulations. Nor is it obvious that Canadians, let alone Mexicans, would welcome deeper integration into an America dominated by a dysfunctional US government and characterized by growing disparity between the 1% and the 99%. Muddling through and solving problems as and when possible, as per the Perimeter Security and Economic Competitiveness Action Plan, seems the more probable and palatable policy course

## **7. The United Nations Framework Convention on Climate Change (UNFCCC)**

Canada's long term, and perhaps even medium term, prospects for energy exports will in principle be affected by the outcome of the UNFCCC. In the immediate to short term, i.e., in the next three years, however, there is no prospect of an agreement with effective non-compliance penalty provisions. The UNFCCC website claims that *"The United Nations Climate Change Conference, Durban 2011, delivered a breakthrough on the international community's response to climate change. In the second largest meeting of its kind, the negotiations advanced, in a balanced fashion, the implementation of the Convention and the Kyoto Protocol, the Bali Action Plan, and the Cancun Agreements. The outcomes included a decision by Parties to adopt a universal legal agreement on climate change as soon as possible, and no later than 2015. The President of COP17/CMP7 Maite Nkoana-Mashabane said: 'What we have achieved in Durban will play a central role in saving tomorrow, today.'"*<sup>14</sup> This was a face saving, if not delusional, assessment.

The two key elements to any deal is an agreement on binding national emission targets and financial transfers to developing countries for adaptation and mitigation. Neither element can be achieved in the next five years. The current fiscal dilemmas of the European Union and the US simply punctuate the point. China and India try to insist that national targets be allocated on a per capita basis. Negotiating a bargain on progressive convergence over the next several decades is very unlikely to succeed, given the political imperatives to develop in China and India and the gridlock in the US decision making system In the US especially, a deal made in international negotiation

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<sup>14</sup> [http://unfccc.int/meetings/durban\\_nov\\_2011/meeting/6245.php](http://unfccc.int/meetings/durban_nov_2011/meeting/6245.php)

is fraught with perils in ratification, and the interpretation and administration of its implementation.

To prepare for the unlikely contingency of a deal, Canada should pursue “no regrets” investments in energy, lead on efficiency standards in building and transportation, and sharpen the legal arguments against border tax adjustments, both in the context of NAFTA and the WTO.

One relatively improbable scenario for Canada to watch would be an ultimate UNFCCC conclusion that fairness demands national emission targets being based on per capita national consumption. A second would be that the ultimate consumer would be responsible for carbon content of products consumed, no matter where commodities are produced. From a global perspective, responsibility for emissions embodied in a product should rest with the consumer, rather than the producer or transporter of internationally traded goods. In this scenario, national targets should be based on emissions in commodities produced domestically plus emissions due to imports netting out emissions embodied in exports. For example, Americans should be responsible for the emissions due to the manufacture of the products the US imports from China.

In this approach, the *quid pro quo* will be Border Tax Adjustments to account for the carbon content of imported goods, with the final consumer responsible for paying the tax. The carbon content of all goods consumed, whether imported or produced domestically, would be taxed. A fair and efficient carbon tax could be structured as a type of value added tax, with the entire burden on final consumers. Input tax credits provide for reimbursing taxes paid by intermediate suppliers on their inputs. BTAs should be treated as analogous to taxes on intermediate inputs, with offsetting credits for producers and retailers - the final consumer pays the sales tax. Canada should calculate the net impact on our trade and investment of such an unlikely, but logical, scenario.

This scenario is not entirely far-fetched. The European Union is already attempting to extend its Emission Trading System (ETS), requiring all airlines flying to and from the EU to buy carbon permits. Canada is of course joined by other major players (the “coalition of the unwilling”) in fighting this attempt to, in effect, apply emission taxes to the export of Canadian services<sup>15</sup>. But the EU’s fuel quality directive<sup>16</sup> is a different story. Imagine if the fuel quality directive is adopted by other trading partners of

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<sup>15</sup> <http://www.reuters.com/article/2012/07/13/us-airline-carbon-idUSBRE86C0AI20120713>

<sup>16</sup> <http://www.cbc.ca/news/politics/inside-politics-blog/2012/03/sorting-out-the-spat-over-europes-fuel-quality-directive.html>

Canada, surviving a WTO challenge. Instead of being supported by the US, China, India and dozens of other countries, Venezuela and Saudi Arabia will be our allies in opposing discriminatory taxation of tar sands due to their higher emissions. The prospect is the legitimization of discriminatory taxes and restrictions to be imposed on Canadian energy exports and products embodying Canadian energy.

## **8. The Kimberley Process**

The Kimberley Process was created in 2003 by concerned governments, NGOs and business interests to end the phenomenon of conflict diamonds. The Kimberley Process Certification Scheme was introduced by United Nations General Assembly Resolution 55/56 following recommendations by Canadian Ambassador Bob Fowler in his capacity of chairman of the Security Council sub-committee on Angola, specifically on the rebel group UNITA. Thanks to Fowler's groundbreaking work and the Kimberley process, UNITA was unable to sell illegal diamonds, starving its war effort of funds for weapons and hastening the end of the conflict. The process also helped to bring the violence in Sierra Leone to an end. The Kimberley Process, which facilitated cooperation and communication between governments, industry and civil society has been seen as a model for other extractive industries. Ultimately, however the Kimberley Process foundered on the unwillingness of participants to call out the miscreants, notably Zimbabwe. (For fuller treatment of the Kimberley Process, See Ian Smillie, "Assessment of the Kimberley Process in Enhancing Formalization and Certification in the Diamond Industry – Problems and Opportunities, Deutsche Gesellschaft fur Internationale Zusammenarbeit). A Canadian effort that re-established the credibility of the process would serve the interests both of oppressed miners in Africa and of the Canadian diamond extraction industry.

## **9. UN Global Compact and Other International Corporate Social Responsibility Entities.**

According to the UN, the Global Compact is the world's largest corporate citizenship and sustainability initiative. Since 2000, it has grown to number more than 8,000 participants, including over 6000 businesses in 135 countries. The Global Compact's ten principles are derived from:

- The Universal Declaration of Human Rights
- The International Labour Organization's Declaration on Fundamental Principles and Rights at Work

- The Rio Declaration on Environment and Development, and
- The United Nations Convention Against Corruption

The UN Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption.

The government encourages and expects Canadian companies to meet high standards of corporate social responsibility. The Prime Minister acknowledged that Canadian investment in the extractive sector abroad can result in a win-win outcome both for the economy of Canada and those of resource-rich developing countries, but that the extractive sector faces unique challenges in operating in complex situations abroad. Canada's foreign and trade policy in this area is driven in large part, though not exclusively, by the CSR Strategy for the Canadian International Extractive Sector, announced by this government in 2009.

#### **10. The Extractive Industries Transparency Initiative (EITI)**

In brief, EITI compliant countries issue a report that reconciles what companies say that they pay in taxes, royalties and signature bonuses, with what governments say they have received.

EITI has evolved into an international coalition of governments, the World Bank Group, oil, gas and mining companies, industry bodies, investors, and civil society organizations such as Transparency International, Oxfam, and Global Witness. Canada has joined Australia, Belgium, Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, the United Kingdom and the United States to support the EITI. These governments provide political, technical and financial support, both through a World Bank trust fund and at the country level.<sup>17</sup> Several countries, including the United States, have signalled their intent to implement the EITI and are working towards meeting the sign-up indicator requirements.

Broadening the focus of EITI's revenue transparency agenda, EITI++ will cover the entire length and breadth of the resource chain, from extraction, to other stages such as processing, managing revenues, and promoting sustainable and efficient utilization

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<sup>17</sup> [http://eiti.org/files/2012-03-01\\_Fact\\_Sheet.pdf](http://eiti.org/files/2012-03-01_Fact_Sheet.pdf) 14 countries are now EITI Compliant: Azerbaijan, Central African Republic, Ghana, Kyrgyz Republic, Liberia, Mauritania, Mali, Mongolia, Peru, Nigeria, Niger, Norway, Timor-Leste and Yemen. 21 other countries have achieved EITI Candidate status: Afghanistan, Albania, Burkina Faso, Cameroon, Chad, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Gabon, Guatemala, Guinea, Indonesia, Iraq, Kazakhstan, Madagascar, Mozambique, Sierra Leone, Tanzania, Togo, Trinidad and Tobago and Zambia. 29 of these countries have disclosed their payments and revenues in an EITI Report.

of resource wealth. The EITI ++ will seek to support committed governments, notably in Africa, in implementing good policy and practice throughout the whole process of natural resource utilization. The work contemplated by EITI++ would improve the conditions for the private sector to invest in resource rich countries

Canada will not be an implementing country<sup>18</sup>, claiming that that existing regulations and financial disclosure requirements provide the required transparency in taxation, royalties and other natural resource revenues – through budget consultations, adherence to international standards for reporting and disclosure and independent public auditors<sup>19</sup>. Furthermore, “EITI is a tool for development, and because we are not a developing country, there is no reason to comply”.

Industry points to competitive reasons and the complexity of Canadian tax systems for not releasing information. “Interestingly though, the Dodd-Frank legislation in the United States may force some Canadian companies to undertake some EITI-like reporting. In addition, some First Nations communities and mining companies have already entered into transparency agreements following the EITI multi-stakeholder model.”<sup>20</sup>

#### **IV. Bilateral Investment Agreements and their Relevance to Canadian Natural Resources Exploitation Interests**

Canada currently has Foreign Investment Promotion and Protection Agreements (FIPAs) in force with 24 countries and is engaged in active negotiations with 10 others.

The Canada-China FIPA, initiated in 1994, still requires legal review, signature and ratification before it comes into force. It has been characterized as “a high-standard agreement with comprehensive scope and coverage and substantive obligations pertaining to national treatment, most-favoured-nation treatment, minimum standard of treatment, transparency, transfers and expropriation.” (DFAIT Press Release)

The balance of benefits will depend on the detailed rules in the Agreement regarding access to investor-state dispute settlement, the rights of investors to bring direct international arbitration claims, standing, procedural requirements and enforcement. Critics observe that FIPAs give corporations of one country the right to sue the

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<sup>18</sup> Norway, a leader in development policy, is EITI-compliant, the only wealthy nation to be.

<sup>19</sup> <http://www.nrcan.gc.ca/extractive-industries/canadas-role/2286>

<sup>20</sup> <http://www.canadianlawyermag.com/3861/is-the-eiti-a-vehicle-for-corporate-social-responsibility.html>

government of another country for imposing domestic environmental, health and safety, and human rights standards that negatively affect their bottom line – claiming that American firms have used NAFTA Chapter 11 to extract over \$160 million from lawsuits against Canadian public policy. Chinese investors' in tar sands or uranium mines would have the same right to sue for any new rules implemented by Canada to protect the environment, local communities or First Nations peoples from extractive industry practices deemed harmful.

Brazil is considering a measure directed uniquely against China that would ban the Chinese purchase of land in Brazil. China does not permit private ownership of farmland and has cautioned local governments against granting large-scale or long-term leases. China also bans foreign companies from buying mines and oil fields. The current president of the China-Brazil Business Council articulated the broader concern over Chinese state investment: "Sometimes you don't know whether the investments are looking for Brazil as a market or whether they correspond to strategic purposes of the Chinese government." Brazilians are trying to be "smart" about Chinese investments by ensuring that the Chinese will not only buy soybeans from Brazilian producers but also manufacture soy oil in Brazil rather than in China.<sup>21</sup>

## **V. Major Canadian Concerns**

### **Oil Sands**

"The oil sands are of enormous importance to the future prosperity of the country and by their sheer size the security of all Western countries. We need a plan to reduce their vulnerability without sacrificing their vitality."<sup>22</sup>

There are risks that may upset future development of the oil sands. The NAFTA and WTO are the two institutions that are supposed to provide the fairness and stability of a level playing field. The first risk concerns the reliability of the American market. We look to the Americans' self-interest that Alberta's oil will flow freely given its proximity and reliability. But access to the American market may be compromised by carbon-based border duties and legislative constraints masterminded by US competitors and/or environmental lobbies. One issue is pricing –while we ship virtually all our oil to the US (and only 15per cent of their imports are from Canada), a glut at the pricing

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<sup>21</sup> <http://www.cfr.org/china/chinas-global-quest-resources-implications-united-states/p27203>

<sup>22</sup> CIC, "Energy and Environment: A Superpower in Need of Super Powers." *Open Canada: A Global Positioning Strategy for a Networked Age*

point for US crude means Canada receives a price well below world prices.<sup>23</sup> A second issue is the future agenda of American special interests (shale gas, those with energy ties to Middle Eastern countries), oil companies, refiners and the coal industry demanding quotas and punitive countervailing duties.

The goal must be to safeguard the resource from possible carbon-based border duties and American legislative action. The Canadian International Council has noted it would be imprudent to rely on the sense of fair play and strategic rationality of the American political system. [Recall Keynes characterization of the Americans – “They mean us no harm, but their minds are so small, their prospects so restricted, their knowledge so inadequate, their obstinacy so boundless and their legal pedantries so infuriating”.] With 99 per cent of Canada’s oil and gas exports going to the U.S. and only 15 per cent of American imports coming from Canada, we are not negotiating with equivalent leverage. Diversification - a pipeline to the West coast (or East coast or Arctic coast) and facilitation of Liquefied Natural Gas (LNG) projects – is only a partial answer. The priority must be to preserve and secure access to the US market.

The second risk is that the oil sands will be tarred with the climate change brush, that Canada’s perceived relative delinquency on climate change will undermine our industry’s reputation for conducting business responsibly. Greenpeace has said that *“Simply put, when the government was told that the tar sands are creating problems for water quality, climate change and human rights, they chose to go with a public relations campaign backed by some brass-knuckle politics rather than force the oil companies to clean up their act.”*<sup>24</sup> Greenpeace joined with the Climate Action Network Canada (with NRDC, Environmental Defence, Équiterre, and the Sierra Club) to produce a 32 page report damning the development of oil sands.<sup>25</sup> The oil sands will likely be subjected to further well-financed campaigns akin to those that targeted clear-cutting and the baby seal harvesting industry, rendering the importation of Canadian petroleum product controversial and creating advantages for US producers. Canada cannot win a replay of the controversy regarding British Columbia rain forest logging – where Greenpeace attacked companies through retail markets (Scott paper in UK) and traditional customers (Germany) and campaigned to get investors to divest in Canadian forest product companies.<sup>26</sup>

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<sup>23</sup> <http://www.mining.com/2012/02/08/crude-canada-most-expensive-to-extract-sold-cheapest/>

<sup>24</sup> <http://www.greenpeace.org/canada/en/Blog/dirty-diplomacy-what-happens-when-we-let-oil-/blog/39422/>

<sup>25</sup> <http://climateactionnetwork.ca/2012/03/08/dirty-oil-diplomacy/>

<sup>26</sup> <http://www.greenpeace.org/canada/en/campaigns/forests/greatbear/archive/background/history/>



There is some profit but not enough in telling critics they have it all wrong – that technological advances have resulted in a 33 per cent reduction of emissions per barrel since 1990. When the issue is Canada’s growing carbon footprint, intensity improvements are regarded as being beside the point. Actual reductions are what is wanted, and what Canada has promise to achieve, Pro oil sands public relations campaigns while necessary will not themselves be sufficient. . The opposition will be mounted by environmentalists as well as US legislators, “*Coupled with environmental concern around water and land use, northern Alberta’s oil sands have become the bête noir of environmentalists globally. The situation is heightened by the fact that activists view Canada, with its free press, open travel and head start in unconventional energy production, as the perfect place to make a stand against new, more carbon-intensive forms of energy exploitation around the world.*”<sup>27</sup>

A salient case is France’s ban of the importation of asbestos and asbestos-containing products, on the grounds that the ban protected human life and health” and that “no reasonably available alternative measure” existed. Canadian industry claims that asbestos can be handled safely, even in developing countries where the bulk of Canadian asbestos exports are shipped, and that the type of asbestos mined in Quebec -- called chrysotile -- is not as dangerous as other forms of the mineral persuaded few abroad. The public-relations battle (conducted by environmentalists) was devastating for the industry. “According to Jeffrey Mine president Bernard Coulombe admitted in a recent interview with The Canadian Press, “We are so criticized, so misunderstood, so tarnished.”<sup>28</sup> Or perhaps we are better understood than we appreciate.

The WTO Panel and the Appellate Body in this case both rejected Canada’s challenge to France’s import ban, reinforcing the view that the WTO Agreements support members’ ability to protect human health and safety at the level of protection they deem appropriate. This may become a difficult precedent, if evidence continues to accumulate concerning the health and safety risks of advancing climate change.

Last year, an EU energy panel proposed a fuel quality directive. Their green ranking of fuels based on the entire life cycle of emissions would rank Alberta’s heavy oil as the globe’s most polluting – 22 per cent more so than conventional crude because of what’s involved in extracting and refining. A WTO case would hinge on whether the directive singles out oil sands in a discriminatory, arbitrary or unscientific way. The

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<sup>27</sup> CIC, "Energy and Environment: A Superpower in Need of Super Powers," *Open Canada: A Global Positioning Strategy for a Networked Age*

<sup>28</sup> <http://www.ctv.ca/CTVNews/Canada/20120303/quebec-asbestos-mine-uncertain-future-120303/>

EU's commissioner for climate action is on record that the commission has conducted a study on oil sands crude, which shows that the fuel is more polluting than conventional oil, that Greenhouse gas (GHG) emissions are higher than for other feedstocks. While Canada can document big intensity gains<sup>29</sup>, the outcome of any WTO process would be problematic. The onus will be on Canada to demonstrate that that the EU case is unscientific – that on a basis of “emissions per BTU”, Europe’s consumption of more than a million tons of coal per year is more polluting than oil sands product. Our stand on climate change will not make our case for the oil sands easier to make

The more substantial risk is that the decision will not occur in formal institutions, but rather in the court of public opinion<sup>30</sup>.

### **Arctic Petroleum and Mineral Resources**

*It has been observed that "exploration in the Arctic presents new challenges because of the frigid waters and short open season in this environmentally delicate area. Simultaneously, the current ban on drilling off the coasts of both California and British Columbia raises questions about just who should make decisions concerning the exploitation of this natural resource—a commodity that is at present essential to our energy security and to citizens in all parts of our countries."*<sup>31</sup>

Some of the same arguments against the oil sands—notably, the damage done to the environment in their exploitation-- have some salience for Arctic oil and gas exploitation. As Canada made sweeping claims for vast and exclusive jurisdiction in the Beaufort Sea and elsewhere in the 1970’s on environmental grounds, any lax environmental approach to oil and gas would have the unintended consequence of undermining our sovereignty claims, as well as further harming our environmental reputation. Clearly, the standards Canada sets for exploitation must meet the stringent requirements for production in one of the world’s most pristine and

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<sup>29</sup> Technological advances and operational gains have translated into a 33 per cent reduction of emissions for each barrel produced since 1990. But the pace of new production has outrun the gains from existing production. And so the oil sands attract growing fire from U.S. elected officials wanting to block access, British Parliamentarians wanting to block investment and consumer-friendly companies wanting to burnish their environmental credentials.

<sup>30</sup> Kumi Naidoo, head of Greenpeace International, musing about his status at the Davos World Economic Forum, having been eleven times, the first eight as the secretary-general of the Global Call to Action against Poverty. “When I came [to Davos] in that capacity, I never could get a C.E.O. to talk to me .... When I came as Greenpeace, two years ago, I was amazed how keen they were to meet me. A C.E.O. told me, ‘Some of my peers are eager to have you at their table so they won’t be on your menu.’” [http://www.newyorker.com/reporting/2012/03/05/120305fa\\_fact\\_paumgarten?currentPage=5](http://www.newyorker.com/reporting/2012/03/05/120305fa_fact_paumgarten?currentPage=5)

<sup>31</sup> [http://www.wilsoncenter.org/sites/default/files/One%20Issue\\_14\\_Offshore\\_FINAL.pdf](http://www.wilsoncenter.org/sites/default/files/One%20Issue_14_Offshore_FINAL.pdf)

vulnerable environments. Canada's goal should be to establish a leadership position on Arctic environmental protection, both for the inherent benefits it brings and as an insulation against damaging criticism that can all too easily materialize.

As regards resource exploitation in areas claimed by the US and Canada (and possibly others) the recently signed Trans boundary Hydrocarbons Agreement, which resolved the question of what to do with potential oil reserves along the dividing line between Mexico and the United States in the Gulf of Mexico.<sup>32</sup>, provides one possible model. Perhaps a custom tailored dispute settlement process could be agreed. Further, as Canada assumes the chair of the Arctic Council in 2013 for a two year term and is scheduled to be followed in the chair by the US for 2015 and 2016 we should work to develop the effectiveness of the Arctic Council's Sustainable Development Working Group. While the the Arctic Council does not have ambitions to regulate resource exploitation and exports, with appropriate Canadian steering, it could evolve into a useful institution.

## **Water**

Canada has 7 per cent of the world's renewable supply of freshwater. Freshwater exports between Canada and the US currently take place at a small scale, mostly as bottled water. Many states in the US, particularly in the Southwest, may experience future severe water shortages. Environmental lobbies are concerned that with population growth and climate change, greater pressure will be placed on Canada to export water to the US and to other countries that suffer water shortage. A PR campaign in favour of exports t the world's water-deprived is all too easy to envision—"Water Is Life". This may lead to promotion of schemes to export water from Canada to the US and elsewhere on a large scale – like the scheme of a few years ago to dam James Bay to create a freshwater reservoir and reverse the water flow of the 20 rivers that flow into Bay into pipelines to serve the south-western US. There has been similar grand scheme to divert the Yukon, Liard, and Peace rivers.

Although water has been classed as a commodity under the NAFTA, Canada, Mexico and the US released a joint statement in 1993 proclaiming that "NAFTA creates no rights to the natural water resources of the parties to the Agreement". The legal status of this proclamation is unclear. Notwithstanding the undoubted vigorous opposition of environmental groups<sup>33</sup>, the issue will likely re-emerge. In the past, government action

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<sup>32</sup>[http://www.wilsoncenter.org/sites/default/files/March\\_2012\\_Transboundary\\_Oil\\_Agreement\\_0.pdf](http://www.wilsoncenter.org/sites/default/files/March_2012_Transboundary_Oil_Agreement_0.pdf)

<sup>33</sup>[http://canadians.org/water/issues/policy/exports\\_factsheet.html](http://canadians.org/water/issues/policy/exports_factsheet.html)

by BC and Ontario prohibited the issuance of water export permits. It is unclear the extent to which Chapter 11 may apply. Canada should prepare for the contingency that a future US government recants the 1993 proclamation.

## **Chinese Resource Ownership and Control**

The United States, Europe and Japan have joined forces to challenge China's restrictions on exports of rare-earth metals, escalating a trade row over access to some of the most important raw materials used in advanced technologies. In a formal complaint to the World Trade Organization (WTO), the three trade powers accused Beijing of trying to hold down prices for its domestic manufacturers and to pressure international firms to move operations to China. China has said its export curbs aim to both control environmental problems and preserve supplies of an exhaustible natural resource. Refining rare-earth metals requires large amounts of acid, and also produces low-level radioactive waste.<sup>34</sup>

Chinese investment in Canada, particularly by state owned enterprises (SOEs), presents different but perhaps even more significant challenges for Canada. In a February Study for the Canadian Council on Chief Executives, Margaret Cornish notes *"The popular debate reflected in the media suggests widespread, if not clearly articulated, uncertainty about the purpose and operations of SOEs, namely: non-commercial orientation, state subsidization, regulatory compliance, and governance....government ownership implies that SOEs are at least in part directed by the Chinese state in a way that serves the interests of the state and as such may operate to disadvantage local firms and markets. Their operations are taken to be funded by the state, with international acquisitions subsidized by borrowing from state banks at subsidized rates and soft repayment terms thereby enabling them to compete unfairly against global rivals."*<sup>35</sup>

In the "Fact and Fiction of Sino- African Energy Relations", Erica Downs dismisses the notion that national oil companies (NOCs) are mere puppets of the state executing directives of their political masters: *"Where many international analysts see a carefully devised strategy for the acquisition of overseas oil and natural gas assets driven from the 'top down', Chinese analysts see chaos generated from the 'bottom up'. Chinese commentators—with a clear preference for the kind of highly co-ordinated*

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<sup>34</sup> <http://www.reuters.com/article/2012/03/14/china-trade-eu-idUSL4E8EE0DR20120314>

<sup>35</sup> See Behaviour of Chinese SOEs: Implications for Investment and Cooperation in Canada , [http://www.opencanada.org/wp-content/uploads/2012/02/Cornish\\_China\\_SOE\\_2012.pdf](http://www.opencanada.org/wp-content/uploads/2012/02/Cornish_China_SOE_2012.pdf)

*government/company plan for securing energy abroad that their foreign counterparts imagine exists—have complained that the foreign investment of China’s NOCs are like a battle in which ‘each soldier is fighting his own war’.*<sup>36</sup>

Andreas Golthau opines that “*In contrast to popular perceptions, the apparent Chinese “scramble for resources” may in the end mean that China is “taking one for the team” by producing African oil at higher cost and shoring up global supply while at the same time taking a significant international political beating” for its efforts with corrupt African regimes*”.

The question is whether SOEs could be asked to carry out Chinese overseas political goals, provide cover for industrial espionage or undermine local interests in some way responding to direction of the Chinese government. Could SOEs defer exports and thereby reduce legitimate taxes? Cornish concludes “the preponderance of political risk with respect to any asset “in the ground” is borne by the foreign investor—not the host country”. She argues that Canadian laws provide required protections, that “*all Canadian jurisdictions have the wherewithal to enforce vigorously their health and safety, labour, and environmental protection laws. Canadian transfer pricing and administration is in place to address the concern that SOEs might try to export to China at prices at or below the Canadian price. Should an SOE be found to operate in non-commercial ways that disadvantage Canadian market or a Canadian company, Canada has a robust range of policy and legal forms of recourse.*”

The “SOE Guidelines” under the Investment Canada Act (ICA) presume that all SOEs behave differently as a function of their state ownership and presumed non-commercial orientation. The ICA requires that applications for control of Canadian businesses and assets be reviewed to ensure they provide net (cumulative) benefit to Canada, and, if the Minister requests, can be reviewed with respect to national security. But the ICA does not contain a definition of what is considered injurious to national security or specify what factors are to be considered as part of a review. The Canadian Council of Chief Executives just published a report on Chinese investment in Canada proposing a new national security test for foreign takeovers of Canadian companies.<sup>37</sup> The author suggests assessing three threats:

- Would the proposed takeover make Canada dependent on a foreign supplier that might delay, deny or place restrictions upon a provision of goods or services crucial to the economy?
- Would the acquisition transfer technology or expertise that could prove harmful to Canadian interests?

<sup>36</sup> [http://www.chinasecurity.us/index.php?option=com\\_content&view=article&id=106&Itemid=8](http://www.chinasecurity.us/index.php?option=com_content&view=article&id=106&Itemid=8)

<sup>37</sup> <http://www.ceocouncil.ca/news-issues/news-energy-and-the-environment>

- Would the presence of a foreign company in Canada pose a risk of infiltration, surveillance or sabotage?

This suggestion warrants serious consideration.

## **Extractive Industries**

There are several concerns affecting the functioning of Canadian mining firms abroad. Canada has a good reputation for effective domestic regulation of mining, but may be losing ground to Australia as the global centre of mining. Our companies are facing significant competition in bidding for contracts. Australia announced in 2011 some \$120 million in programs to foster responsible mining governance in developing countries. Chinese state-owned enterprises and other emerging market companies are making huge inroads into resource-rich Africa, and they are using strategic diplomacy as well as, in some cases, favourable home-based funding arrangements to pave the way for their companies. Beyond access, Additionally, as mining companies push into ever more remote areas and challenging political climates, the importance of managing political risk grows accordingly. Human rights protection is a crucial issue, as companies are called upon in conflict-affected states to ensure that they are not themselves through their security providers contributing to those conflicts. The need to assist host countries in building their capacities to manage natural resource exploitation follows apace. Further, natural resource governance is increasingly an issue of interest to regional and multilateral organizations, including the Francophonie and the Commonwealth.

## **Forestry**

The issue of the export of raw logs is an excellent example of the dilemmas confronting Canadian natural resources foreign policy. On the one hand, we want to maximize the prices and returns received for the raw natural resource. On the other hand we want to maximize the benefit to Canada from further processing. The current controversy in British Columbia hinges on buyers in China, Japan and South Korea purchasing B.C. logs in record volumes at premium prices that B.C. mills can't afford. The wood is being sold to Asian mills at about double the domestic price. B.C. mills are idle because of a shortage of fibre. Governments must find the "appropriate balance" to maintain both harvesting and processing jobs.<sup>38</sup>

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<sup>38</sup> See for example <http://www.theglobeandmail.com/news/national/british-columbia/bc-politics/minister-costing-logging-jobs-critics-say/article2368563/>

This issue will become much more significant as foreign investment rises. Foreign investors, either state owned enterprises or private sector conglomerates will likely be willing to pay a premium compared to Canadian local suppliers and processors who are not part of an integrated family of companies. In many cases, Canadian interests are best served by processing in Canada. Government room for action (export restrictions, export taxes, government procurement, and performance requirements) will be limited by our investment treaties and multilateral disciplines to which we have agreed.

## **Procurement**

The future political environment in the US will likely produce more “Buy American” clauses, as in the USA’s recent financial stimulus bill. It stipulated that “any public building or public works project funded by the new stimulus package use only iron, steel and other manufactured goods produced in the United States.”<sup>39</sup> “Buy American” goes against the principle of National Treatment. Canada must be prepared for this “whack a mole” phenomenon.

## **VI. The Opportunities and Risks Affecting Natural Resources and Foreign Policy**

### **Where Are Canadian interests with respect to natural resources primarily at stake?**

- The unreconstructed proclivity of the US Congress to protect US producer interests, notably with respect to forest products, is a standing reason for concern. The US Administration is likewise susceptible to electoral season pressures to impede Canadian exports, for example on environmental grounds, damaging to Canadian interests.
- The EU Commission is a major norm setter on environmental and social policy issues, whose judgments can not only affect Canadian interests in Europe but far beyond in multilateral instances such as the Climate change negotiations
- The WTO, as custodian of the General Agreement on Tariffs and Trade, will remain the dominant multilateral institution governing international trade and investment, the stalled Doha Round notwithstanding.
- NAFTA will remain crucially important but will need to be updated to provide guarantees of access and to provide benefits to Canada at least as

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<sup>39</sup> <http://www.canadainternational.gc.ca/sell2usgov-vendreaugouvusa/procurement-marches/ARRA.aspx?lang=eng&view=d>

advantageous as Korea and others acquire from the US in bilateral and plurilateral deals.

- The Trans Pacific Forum has the potential to be the most consequential trade grouping for improving Canadian trade and investment with Asia, and for protecting Canadian interests vis-à-vis the US; conversely, failure to gain membership could disadvantage Canada across the board, including with respect to resource exports
- While little of consequence will happen in the short term, there is a possibility that the UNFCCC will in the medium term reach an agreement affecting fossil fuels, with binding compliance provisions, and entailing border measures and other penalties for those who stand aside.
- The G20, if it emerges from the current difficult financial environment as the “premier economic forum for decisions on the global economy” could have significant beneficial influence, particularly if it addressed energy security and climate issues.
- The Arctic Council could evolve under our stewardship to stimulate responsible resource exploitation.
- In addition to protecting Canadian investors abroad, Foreign Investment Protection Agreements (FIPAs) could limit Canadian freedom of action to regulate the exploitation and taxation of Canadian resources
- The key interest is in the balance of benefits in FIPAs, where protection of our investors abroad is gained in exchange for restrictions on the freedom of action of the Canadian government at home
- Just as we expect foreign entities to respect Canadian laws and norms, we have an interest in encouraging good citizenship on the part of Canadian mineral exploration and mining firms abroad, especially in developing countries, and in supporting their efforts

***Which contingencies most bear watching re possible international initiatives to defend and to promote Canadian interests?***

- Tendencies in the US to increase unilateral action in the Arctic based on inconsistent interests and conflicting claims to jurisdiction over the waters in the Arctic”.
- Coalitions of governments, civil society and American producers forming to boycott oil sands imports.
- A disposition internationally to view the Canadian brand as flawed as a consequence of real and alleged climate change shortcomings and lax



environmental standards, and to seek to deny access or seek to impose tax or other penalties on Canadian goods and investors.

- Actions at the WTO based on the asbestos precedent and clarification of investor rights.
- FIPAs to restrict the freedom of foreign investors to minimize procurement of Canadian goods and services and avoid refining or further processing in Canada.
- Growing interest of partner governments in corporate social responsibility, including the UN's Global Compact, particularly as regards investments in Third World countries

***What should be the Canadian focus of attention on the bilateral, regional and multilateral institutional landscape governing resources? In which priority arenas should we work to shape the rules of the game?***

- Bi/trilateral; we need to modernize NAFTA, partly to preserve privileged access & security of supply at a time when the US is opening its own market to Asian economies through bilateral and plurilateral groupings, especially the TPP
- Regional; we need to promote cooperation in developing and exploiting Arctic resources
- Multilateral; we need to monitor, and where important and feasible, to intervene in WTO cases that would impose import bans and border tax adjustments that expand the boundaries of protecting human health and safety.
- To the extent that the purpose and behaviour of Chinese State Owned Enterprises (SOEs) correspond to those of private foreign investors, they should be treated in a like manner. To the extent that the ways in which they differ pose risks to Canada and local communities, even potentially, conditionality and remedies should be considered.<sup>40</sup>
- By virtue of the enormity of their assets, Sovereign Wealth Fund investors represent both benefits and risks, and their behaviour should be monitored accordingly. Future work should focus on how other major players - US, China, Australia and Norway - are operating in this governance framework to advance their interests and should review Canadian positioning in the various governance frameworks, and provide recommendations on where Canada should be actively promoting and defending its interests, and how.

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<sup>40</sup> Cornish, *ibid*

## ANNEX 1

### **Other International Commodity Organizations**

OPEC raises the question of the future potential of international commodity organizations.

Historically the stated objectives of international commodity agreements were to

- i) prevent or alleviate the serious economic difficulties which may arise when adjustments between production and consumption cannot be effected by normal market forces alone as rapidly as circumstances require;
- ii) prevent or moderate pronounced fluctuations in the price of a primary commodity; and
- iii) maintain and develop the natural resources of the world and protect them from unnecessary exhaustion<sup>41</sup>.

UNCTAD has added the objective of increased export earnings for developing countries, re-allocation of resources, and increased consumption.

Beyond oil, there were international commodity agreements for tropical timber, natural rubber and tin. The only one that remains operational today is the 1983 International Tropical Timber Agreement. The International Tin Agreement was in force between 1955 to 1985, while the International Natural Rubber Agreement operated from 1979 and 1999. Both attempted to stabilize prices using buffer stocks and export controls. Neither succeeded. The issue in commodity agreements is the difficulty distinguishing between stabilizing prices and affecting price trends.

The (thus far inconclusive) Doha negotiations have seemed to allow for intergovernmental commodity agreements of which only producing countries of the concerned commodities are Members. The possibility exists for Canada to take a more active role in international producer agreements respecting commodities we produce.

#### **1. United Nations Convention on the Law of the Sea (UNCLOS)**

UNCLOS outlines many aspects of ocean governance, including: navigational rights, territorial sea limits, economic jurisdictions, the legal status of resources on the seabed beyond the limits of national jurisdiction, passage of ships through narrow straits,

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<sup>41</sup> Havana Charter, Article 57 <http://www.worldtradelaw.net/misc/havana.pdf>

management of living and non-living marine resources, protection of the marine environment, a marine scientific research regime, as well as a binding procedure for settling disputes between nations.

Canada has begun scientific work in the Arctic ocean to establish the maximum extent of its continental shelf, in accordance with UNCLOS which Canada ratified in 2003. The purpose is to confirm Canadian sovereign rights for exploring and exploiting the natural resources of the seabed and subsoil. As regards the Arctic, the particulars, including the scientific basis of the claim of the outer limit of Canada's continental shelf are to be submitted to the Commission on the Limits of the Continental Shelf by the end of 2013. The Arctic Council was established in 1996, serves as a forum for discussion and collaboration. Canadian sovereignty over the land mass of the Canadian north including the islands is unchallenged, with the single small exception of the uninhabited Hans island which is also claimed by Denmark. This singular case could, nevertheless, affect resource rights and should be resolved promptly.

Illegal, unreported and unregulated fisheries have resulted in a worldwide decline of commercially important fish stocks. UNCLOS does not deliver effective management of international fisheries. International fisheries are governed by a patchwork of binding and non-binding instruments with differing geographical and legal reach, and different levels of participation by states. Agreed targets and declarations have not been respected. Existing multilateral instruments do not include important states. Implementation at the regional level is derisory.

The International Fisheries Conservation (IFC) Program within Fisheries and Oceans Canada (DFO) was created to initiate reforms in international fisheries management. According to its DFOs evaluation, "IFC achieves its intended outcomes for the development of international instruments, demonstrating foreign state compliance with international agreements, developing constructive relationships and participating in international commissions".<sup>42</sup> At best, this is a "glass is half-full" assessment. Given the dim prospects for success in this area, it is not worthwhile to invest in increased Canadian efforts beyond the current level.

## **2. Northwest Atlantic Fisheries Organization (NAFO)**

NAFO, an intergovernmental fisheries science and management body, was founded in 1979 as a successor to ICNAF (International Commission of the Northwest Atlantic

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<sup>42</sup> <http://www.dfo-mpo.gc.ca/ae-ve/evaluations/10-11/6b121-eng.htm>

Fisheries. NAFO's overall objective is to contribute through consultation and cooperation to the optimum utilization, rational management and conservation of the fishery resources of the Convention Area. It covers most fishery resources of the Northwest Atlantic except salmon, tunas/marlins, whales, and sedentary species (e.g. shellfish).