

Import Taxes on Mexican Crude Oil

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In 2016, the United States imported approximately 588 thousand barrels per day (m/d) of Mexican crude oil [valued at approximately \\$7.6 billion](#). Recently, the Trump administration raised the [possibility of imposing of a 20% tax](#), or fee, on imports from Mexico, presumably including imports of crude oil, to provide funding for the construction of a wall along the U.S.-Mexican border. If imposed, a tax on crude oil imports from Mexico could have important implications for the North American oil market. The relative prices of crude oil in the region could be affected enough to create market inefficiencies and change the incentives for related investment, production, and consumption. This Insight does not attempt to analyze a broader 20% border adjustment tax levied on imports from all destinations, nor does it address possible World Trade Organization issues related to this tax proposal.

Crude Oil Trade Relationships

The United States is the largest consumer, producer, and importer of crude oil in North America. The Energy Information Administration (EIA) reports that the United States consumed [approximately 19.5 million barrels per day](#) (mmb/d) of petroleum products derived from crude oil and other liquids in 2016, while producing approximately [8.9 mmb/d](#) of crude oil and importing about [7.7 mmb/d](#) of crude oil. Canada supplied 39% of U.S. total oil imports, while Mexico supplied about 9%. Over the last decade, imports from Canada have generally increased, while Mexican imports have decreased, reflecting the oil production trends in each country. In addition, the United States exported about 306,000 barrels per day of oil to Canada in 2016, while not exporting any crude oil to Mexico.

North American Oil Trade Patterns

While the prices of specific grades of crude oil are determined in the world market, discounts or premiums on the world price are determined regionally. Both Canada and Mexico produce and export similar—and competing—grades of heavy crude oil. This implies that the prices of crude oil from these countries should be similar, other things being equal. However, in the North American market, there have been significant price differences largely due to differences in transportation availability and costs. For example, [Bloomberg](#) reported that on January 27, 2016, the price of Canadian Select crude oil in the United States was \$39.21 per barrel while the price of Mexican Maya was \$45.67 per barrel, a

difference of \$6.46, or 16%.

Crude oil from Western Canada—Canada's primary production area—must be shipped by pipeline and/or rail to reach U.S. refineries, while Mexican crude oil arrives at U.S. Gulf Coast refineries by ocean-going tankers. Exact cost differentials between these transportation modes depend on distance and other factors, but general estimates suggest that pipeline transport costs about \$5 per barrel while tanker transport costs about \$2 per barrel. Assuming these estimates are applicable, much of the cost difference between Mexican Maya and Canadian Select crude oil delivered to U.S. refiners is attributable to transportation.

If a 20% import tax were applied to Mexican crude oil, it could increase the price of Mexican crude oil by up to 20% from the perspective of U.S. refiners. As a result, oil price and quantity adjustments across the North American market would likely occur. The pre-tax price of Mexican crude oil could be lowered by the amount of the tax, yielding Mexican oil producers 20% lower revenues for the same volumes. If this adjustment took place, the burden of the tax would be borne by Mexico as reduced income from oil sales, but relative quantities sold to the United States would remain the same. If Mexican producers refused to accept lower returns from their oil, they could sell oil originally intended for the U.S. market to another country that does not impose a tax, which would result in a Mexican exit from the U.S. oil market.

If Mexico exited the U.S. crude oil market totally, or partially, Canadian producers could increase sales to the United States, depending on the ability of Canadian oil producers to ramp up production to meet the added demand. Canada might also expect to see a rise in the price of Canadian oil exported to the United States, likely by a small amount, reflecting the increase in demand. If the border tax were viewed as permanent, and Canada's existing production capability was determined to be inadequate to meet expanded U.S. demand, increased investment in production capability could be expected, or U.S. refiners could source crude oil from other countries.

A related factor to a 20% oil import tax on Mexican crude oil is the recent issuance by President Trump of an [executive memorandum](#) inviting the developer of the cross-border Keystone XL pipeline—which did not receive a Presidential Permit by the Obama Administration—to reapply for the permit. The developer has accepted the invitation [and reapplied](#). Construction of this pipeline would increase the capability of Canadian oil producers to export to the United States. If Mexican supplies were reduced due to the tax, there would be a ready demand at U.S. Gulf Coast refineries for more Canadian crude oil. In that respect, the Mexico tax proposal could increase demand for the Keystone XL pipeline's transportation capacity, improving its economics, although [uncertainty remains](#) about the project's viability in a period of persistently low crude oil prices.

Conclusion

The proposed 20% tax on Mexican oil imports is unlikely to have a major effect on the U.S. oil market, at least in terms of consumer prices, but it may have a noticeable effect on oil trade between the United States, Canada, and Mexico. If Mexico continues to export oil to the United States and accepts lower net prices, the U.S. Treasury will gain tax revenue and the Mexican treasury will lose oil revenue. If Mexico is able to find other customers for its oil in the world market which allows it to avoid either partially, or totally, the effect of the tax, U.S. tax revenue from the tax will be reduced and Mexican oil revenues will be sustained.