Extension of Customs Jurisdiction Over the Canadian Continental Shelf

A Background Paper
Issued by
The Honourable Paul Cosgrove
Minister of State (Finance)

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OBJECT

The purpose of this paper is to examine the considerations involved in extending Canadian customs (and excise) jurisdiction to activities associated with the exploration, development and production of resources beyond existing Canadian waters(1) to the outer limits of the Canadian continental shelf. This paper:

— examines the customs and excise treatment currently accorded installations (e.g. drilling rigs, production platforms and man-made islands) and support vessels and other goods (e.g. machinery, drill pipe and consumables) used on or in connection with those installations both within and beyond Canadian waters;

— outlines various proposals considered by the government in recent years for changes in that treatment;

— outlines representations the government has received about the lack of customs protection in offshore areas;

— examines the customs treatment the United States accords to similar installations and goods beyond its territorial waters; and

— outlines the impact of various options available to the government.

(1) "Canadian waters" is defined in the *Customs Act* as "... all waters in the territorial sea of Canada and all internal waters of Canada ..." The "territorial sea of Canada" as defined in the *Territorial Sea and Fishing Zones Act* includes those waters extending 12 nautical miles from shore.

BACKGROUND

Canadian Legislation

Canadian customs legislation, including the provisions for customs duties, anti-dumping duties and countervailing duties, does not apply to installations, or to goods used on or in connection with such installations, when they are located beyond Canadian waters. This means that Canadian manufacturers of drill ships, rigs and platforms used in the exploration or exploitation of oil or natural gas on the continental shelf more than 12 miles from shore have no protection under Canadian customs law. The same situation holds true for vessels used in support of these installations (provided they are not also used within the 12-mile limit for "coasting" purposes within the meaning of the *Canada Shipping Act*), as well as to all goods used on the installations (e.g., machinery, drill pipe and consumables such as food, petroleum-based fuels, office supplies and equipment, cigarettes and liquor). Furthermore, goods shipped from Canada to locations outside the 12-mile limit are considered to be exported so Canadian suppliers of these goods may claim drawback of any duty paid on articles imported to produce them.

Foreign goods are normally not supplied direct to offshore installations but are assembled and shipped from the nearest coastal facilities. Under the *Customs Act* these goods, when for use beyond the 12-mile limit, can be stored in bonded warehouses in Canada and are not considered to be imported or subject to the provisions of the *Customs Tariff* or other customs legislation.

Goods used in connection with the exploration or exploitation of oil or natural gas on land or on the continental shelf within the 12-mile limit are subject to the provisions of the *Customs Tariff*. In 1964 the Tariff was amended to give effect to recommendations made by the Tariff Board (Reference No. 130) on the dutiable status of equipment used by the oil and gas industry. Under the tariff regime implemented as a result of the Board's proposals, machinery and apparatus for use in exploratory or developmental work in connection with oil or gas wells, if "of a class or kind made in Canada", are dutiable at 10 per cent Most-Favoured-Nation (M.F.N.) Tariff or 5 per cent British Preferential (B.P.) and General Preferential (G.P.) Tariffs. (The 10 per cent rate is being reduced to 9.2 per cent by January 1, 1987 as a result of the Tokyo Round of multilateral trade negotiations.) Generally speaking, these goods are free of duty under all tariffs when "of a class or kind not made in Canada".

The tariff schedule based on the Tariff Board's proposals was implemented at a time when offshore drilling activity was not an issue and was intended to cover only land-based machinery and apparatus. If customs jurisdiction were extended to the offshore drilling areas, however, the tariff classification of floating equipment would become an important consideration and there is a possibility that it would be classified under the tariff items relating to land-based oil and gas equipment rather than under the provisions covering ships at 25 per cent MFN. Most vessels used in support of drilling operations are dutiable at 25 per cent under the provisions of the Canada Shipping Act when imported for Canadian registry. The floating equipment and the support vessels are able to enter Canada on a temporary basis (for up to one year) in cases where no suitable Canadian equipment or vessels are available, with payment of 1/120th of the total duty for each month of operation in Canadian waters.

Drill pipe is accorded duty-free entry while well casings are dutiable at 9.5 per cent M.F.N. or 5 per cent B.P. or G.P. (The M.F.N. rate is being reduced to 6.8 per cent as a result of the Tokyo Round.) Even though some of the duty-free equipment is now made in Canada and is, in fact, being exported, duty-free imports account for over 75 per cent of all imports of equipment, including drill pipe and well casings, but not floating equipment or support vessels, used by the oil and gas sector. Most of the tariff items in this sector are currently being examined by the Tariff Board in its review of the "made/not made" items in the *Customs Tariff* (Reference No. 157).

Under the current excise regime a 5 per cent sales tax is applied on construction materials and a 9 per cent tax is applied on other goods, unless exempted by the *Excise Tax Act*. (The taxable status of tobacco, beer and liquor, however, is regulated by the *Excise Act*.) Schedule III of the *Excise Tax Act* provides exemptions for a broad range of transportation and production equipment and equipment for use in the exploration and development of natural resources. This means that virtually all capital goods used for exploration and exploitation activities are tax exempt. In regard to artificial islands, tax would apply on materials used in their construction and the buildings on them; the drill rigs on the islands would be tax exempt. Taxable goods include motor fuels, food service equipment, office equipment and supplies, furniture, bedding and household supplies.

Changes Proposed to Date in Canadian Legislation

An inquiry into the Coasting Trade and Related Marine Activities (i.e. the Darling Report), which was completed in 1970, recommended that the coasting trade of Canada be reserved for Canadian registered vessels; that the definition of "coasting trade" be broadened to include the carriage of goods and passengers between points in Canada and installations engaged in exploration and exploitation activities on the continental shelf beyond Canadian waters; that exploration and exploitation activities themselves, both within and beyond Canadian waters, be reserved for Canadian registered vessels; and that the *Customs Act* be amended so that goods carried to the installations beyond the 12-mile limit from points outside Canada would be deemed to be imported and as such subject to the customs laws.

In response to the Darling Report, a draft Maritime Code was considered by Parliament in 1976 as Bill C-61. It was decided to separate the provisions of the bill relating to the coasting trade from those relating to such things as navigation, loading and storage of cargo, crew arrangements, and the registry and licensing of vessels. The coasting trade provisions were not acted on; the other provisions were passed by Parliament but have not yet been proclaimed as law.

In 1977, a White Paper entitled "The Coastal Trade Act, A Position Paper Dealing with the Policy Implications of a Proposed Bill on the Coasting Trade of Canada" was made public by the Minister of Transport. The draft Coasting Trade Bill included in the White Paper defined the coasting trade of Canada as including the movement of goods from a place in Canada to installations beyond Canadian waters or between such installations (no matter where located) when those installations are used in the exploration or exploitation of natural resources in accordance with a permit or licence issued by a legislature of Canada. The coasting trade was also defined to include the exploration for or exploitation of natural resources in Canadian waters. Adoption of these provisions would mean that installations in Canadian waters and vessels used to transport goods from the Canadian coast to installations or between them, no matter where located, would become subject to the same rate of duty as vessels engaged in the coasting trade as currently defined, i.e. 25 per cent. Furthermore, the draft bill provided that goods delivered from a foreign port to installations on the continental shelf beyond Canadian waters would be considered to be imported into Canada. The effect of this provision would be to make all foreign goods used on offshore installations subject to the *Customs Tariff* and other customs provisions.

One of the objectives of the National Energy Program (NEP) is to improve the opportunities for Canadians to participate in the industrial activity resulting from the anticipated large investments in oil and gas exploration, development and transport on Canada lands.[2] Extension of customs jurisdiction would complement this objective.

The Ministry of Transport, in consultation with Canadian industry and the provinces, has again reviewed Canada's coasting trade policy. As a result of that review, the government has proposed a number of changes in the coasting trade policy, one of which is that all commercial marine activities, other than fishing, in connection with any work on the continental shelf which has been approved by the government, would be reserved to Canadian ships. Foreign ships would be granted temporary licences when no suitable Canadian ships were available.

(2) "Canada lands" as defined in the *Canada Oil and Gas Act* includes "those submarine areas, not within a province, adjacent to the coast of Canada and extending throughout the natural prolongation of the land territory of Canada to the outer edge of the continental margin or to a distance of 200 nautical miles from the baselines from which the breadth of the territorial sea of Canada is measured, whichever is the greater".

FACTORS

Representations from Canadian Industry

Canadian producers of steel and wire rope are concerned that Canadian customs laws do not apply to these products when used on drill ships, rigs and platforms beyond the 12-mile limit. Concern has also been expressed that the duty on steel products imported and subsequently exported for use on those installations is recoverable under the export drawback regulations.

The Canadian Shipbuilding and Ship Repairing Association has on several occasions requested increased tariff protection on all vessels, including floating equipment, used in exploring for oil and natural gas offshore.

United States Legislation

United States customs jurisdiction, like Canada's, extends offshore as far as its territorial waters (12 nautical miles from shore). However, the U.S. has extended its customs jurisdiction to encompass structures attached temporarily or permanently to the seabed of its continental shelf beyond its territorial waters for resource related activities. The legislative basis for this extension is the *Outer Continental Shelf Lands Act* of 1953, as amended, which states in part:

> "The Constitution and laws and civil and political jurisdiction of the United States are extended to the subsoil and seabed of the Outer Continental Shelf and to all artificial islands and all installations and other devices permanently or temporarily attached to the seabed, which may be erected thereon for the purpose of exploring for, developing, or producing a resource therefrom, or any such installation or other device (other than a ship or vessel) for the purpose of transporting such resources, to the same extent as if the Outer Continental Shelf were an area of exclusive Federal jurisdiction located within a state."

Pursuant to this legislation, foreign-built installations when attached to the continental shelf of the U.S. beyond its territorial waters are considered to be imported and thus subject to the U.S. Tariff and other U.S. legislation. Furthermore, foreign goods used on those installations face the same import regime as if they were imported into the continental U.S.

The U.S. also has legislation, the *Jones Act*, which prohibits the "coastal" movement of goods by ships which are not built in the U.S. Since the customs, navigation and coastal laws of the U.S. apply to structures attached to the continental shelf, the movement of goods from the mainland to the offshore installations, or between installations, is considered to be a coastal movement and subject to the *Jones Act*. The effect is, therefore, to reserve such movements to U.S.-built vessels.

International Laws and Practices

The right of a coastal state to exercise its sovereign rights over resource related activities on the continental shelf beyond its territorial waters is clearly established in state practice, codified in international law and confirmed by international jurisprudence. The 1958 Continental Shelf Convention, which Canada ratified in 1970, provides that:

(a) a coastal state exercises sovereign rights over the continental shelf for the purpose of exploring and exploiting its natural resources;

(b) these rights are exclusive in the sense that if the coastal state does not explore the continental shelf or exploit its natural resources, no one may undertake these activities, or make a claim to the continental shelf, without the express consent of the coastal state;

(c) the term continental shelf refers to the seabed and subsoil of the submarine areas adjacent to the coast but outside the territorial sea, to a depth of 200 metres or, beyond that limit, to where the depth of the superjacent waters admits of the exploitation of the natural resources in the said areas; and

(d) a coastal state is entitled to construct and maintain or operate on the continental shelf installations and other devices necessary for exploration and exploitation of its natural resources.

Although the Convention does not specifically address the question of customs jurisdiction over activities associated with the exploration and exploitation of the continental shelf, the "sovereign rights" exercised by a coastal state can be taken to embrace such jurisdiction.

The United Nations Convention on the Law of the Sea (LOS) reaffirms the principles in the 1958 Convention and should clarify any ambiguities regarding the definition of and the internationally agreed extent of coastal state powers over activities on or related to the continental shelf beyond territorial waters. The 1958 Convention covers primarily non-living (i.e., mineral) resources while the LOS covers both living and non-living resources. The LOS provides that within a coastal state's "exclusive economic zone" it would have jurisdiction over exploring, exploiting, conserving and managing the natural resources, whether living or non-living, to a maximum of 200 nautical miles from shore. The LOS also provides that a coastal state would have jurisdiction over non-living resources on the continental shelf when the shelf extends beyond the "exclusive economic zone".

The General Agreement on Tariffs and Trade (GATT) applies to the customs territories of its contracting parties. For Canada, this means that the GATT applies to activites in Canadian waters. If Canadian customs jurisdiction were to be extended beyond its present limit, our obligations under the GATT would also apply to the expanded territory.

There is nothing under international law or in the GATT which would preclude Canada from extending its customs jurisdiction to resource related activity on the Canadian continental shelf. In fact, international law and state practice recognize that a coastal state has the right to extend its customs jurisdiction to its continental shelf.

Other Factors

At present, there is little substantive law in place to regulate private relations (for example, in the areas of tortious conduct or of contract) between parties engaged in activities on the continental shelf beyond Canadian waters. While Canada has enacted legislation concerning certain matters (such as the *Territorial Sea and Fishing Zones Act*, the *Canada Oil and Gas Act*, the *Oil and Gas Production and Conservation Act* and the *Arctic Waters Pollution Act*), there is no general application of Canadian law (such as the *Customs Act*, the *Immigration Act*, the *Narcotics Control Act*, the *Food and Drugs Act* and the *Canada Labour Code*). The concept of introducing legislation which would extend or confirm the application of the laws of Canada to all activities, civil or criminal, in relation to the exploration and exploitation of the continental shelf beyond Canadian waters is under review. This paper, however, addresses only one aspect of this question, namely extension of federal customs (and excise) legislation to the outer limits of the continental shelf.

With the wide disparity between Canadian interest rates and those of some of our trading partners, and the practice of some exporting countries to offer concessional financing on export sales, there is concern that the economics of sourcing major capital goods used in exploration and exploitation activity is being influenced, unfairly, towards offshore sourcing rather than Canadian suppliers. It is estimated that foreign export financing of vessels results in price disadvantages of up to 20 per cent for Canadian shipbuilders. (This is in addition to a 10-30 per cent cost disadvantage already borne by Canadian shipbuilders vis-à-vis foreign shipyards.) Extension of customs jurisdiction would improve the competitive position of Canadian suppliers through the application of normal duties on foreign sourced equipment and the possibility of applying anti-dumping or countervailing duties in cases where Canadian manufacturers were being injured by concessional financing.

An interdepartmental task force headed by the Department of Industry, Trade and Commerce recently examined the Canadian shipbuilding industry and, in particular, the programs of assistance to the industry. A paper on shipbuilding assistance measures is being issued in conjunction with this paper. As part of a package of alternatives to the continuation of the Shipbuilding Industry Assistance Program (SIAP) 9 per cent production subsidy, that paper suggests the extension of customs jurisdiction to the outer limits of the continental shelf, combined with adjustments to overcome potential problems with duty rates on floating drilling and production equipment.

SCOPE OF JURISDICTION EXTENSION

Canadian customs (and excise) jurisdiction could be extended by amending the *Territorial Sea and Fishing Zones Act* so as to define Canadian waters as extending to the outer limits of the continental shelf (or of "Canada lands" as defined in the *Canada Oil and Gas Act*). Adoption of this alternative would, however, essentially mean that all the laws of Canada would apply to any and all activites which take place in the expanded territory. This is not considered to be a viable option because it goes beyond the extension of sovereign rights agreed to in the 1958 Continental Shelf Convention and in the LOS. It would mean, for example, that the movement of vessels through the extended Canadian waters would be considered to be movements through Canadian territory, subject to regulation in accordance with Canadian law, rather than through international waters; this would not be acceptable to other nations.

Another possible option would be to extend customs jurisdiction on a selective basis — to ships, steel, wire rope and capital goods affected by foreign concessional financing on which representations have been received from industry. A variation would be to make technical amendments to existing customs legislation to remove certain tariff benefits now available to those who engage in resource related activities beyond the 12-mile limit. For example, the drawback regulations could be amended to deny duty refunds on imported goods subsequently exported for use offshore and/or the bonded warehousing provisions in the *Customs Act* could be amended to preclude their use for goods destined for offshore installations. This half-way approach, however, would only address representations the government has received from industry and as such would raise serious problems of equity.

Another approach to extending customs jurisdiction would be to cover only installations (including man-made islands) attached to the continental shelf and to goods (including vessels such as supply ships, work boats and dredges) used on or in connection with such installations when engaged in resource related activities. This approach, which would not affect other marine activities such as fishing in the waters above the shelf, would provide an important assist to efforts to develop a strong Canadian industrial base for supplying drilling equipment, vessels and other goods used on the continental shelf and would fill a vacuum in Canadian law through enhancing Canada's control over its continental shelf consistent with its rights under international law.

ECONOMIC CONSIDERATIONS

In considering the economic impact of extending customs jurisdiction it is necessary to look at its effect on costs of production and its implications both for the level of oil and gas exploration activity on the continental shelf and on the sourcing of Canadian goods. It should be borne in mind that the pace of exploration activity, and thus the volume of goods required for such activity, remains uncertain over the next decade. Much will depend on the degree of exploratory success and associated costs and profitability.

Assuming that Canadian manufacturers would price up to the level of the tariff, extending the current customs regime would result in an increase in the cost of those goods, equal to the level of the tariff, whether they were imported or Canadian sourced. Under current NEP policy, on average, about 50 per cent of this increase in cost would be eligible for Petroleum Incentive Program (PIP) grants. Exploration companies might be able to recoup up to an additional 23 per cent of the cost through tax savings. The following table illustrates the net cost of spending $1 on exploration activity for a company which can take maximum advantage of income tax deductions. Actual net cost will depend, of course, on the tax position of individual companies, their level of Canadian ownership and the tax treatment of the costs they incur.

Explorer After-tax(1) and After-grant Cost of $1 Spent on Canada Lands

Year(2)	Less than 50% Canadian ownership	50% to 60-64% Canadian ownership(3)	61-65% to 66-74% Canadian ownership(3)	67-75% to 100% Canadian ownership(3)
1982	.27	.20	.13	.08
1983	.33	.24	.15	.09
1984	.37	.25	.17	.10
1985 & beyond	.41	.27	.19	.11

(1) Assumes maximum advantage can be taken of deductions for tax purposes; includes corporate surtax for 1982 and 1983, and income tax rate as for Canada lands.
(2) Reflects phase-in of PIP grants and phase-out of the depletion allowance.
(3) Levels of Canadian ownership required for different levels of incentive payments being phased-up during period 1983-1986.

Assuming that exploration companies would qualify for PIP grants and tax savings equal, on average, to about 73 per cent of their costs; that installations and vessels valued at $6 billion before the application of tariffs will be required in the 1982-1992 period; that about $4 billion in other goods will be used during the same period (about 40 per cent of which would be imported, with 75 per cent of those imports free of duty); and that the floating equipment would be classified under the tariff items covering land-based equipment at 10 per cent, it is estimated that extension of the current tariff regime would increase the gross cost of capital equipment and related goods used by exploration companies by about $1.4 billion and the net cost by about $378 million over the 10-year period. These cost increases would, of course, have an impact on the overall cost of exploration activity. It is estimated that they could result in an increase of up to 6.5 per cent in the cost of exploration. If the duty on the floating equipment was set at 20 per cent to eliminate the potential tariff anomaly, as proposed in the paper on shipbuilding assistance measures, the cost of offshore exploration activity would increase by half as much again.

These cost increases would be due primarily to the impact of a duty on installations and related vessels which account for up to 70 per cent of total exploration costs. Since these installations and vessels are usually leased, the duty costs would be reflected in increases in "day rates". On a semi-submersible drill rig valued at about $120 million, a 10 per cent duty would likely increase the day rate by about $4,500 to $6,500. (Day rates include not only capital and interest costs, but also operating costs such as fuel and salaries.) If a foreign rig were used on a temporary basis with payment of 1/120th of the total duty for each month of operation, duty payments would likely increase day rates by about one-half the amount noted above. Such rigs, however, could only be used if no suitable Canadian rig was available. Until recently, there had been a shortage of rigs resulting in significant increases in day rates. This increase in day rates did not seem to have an adverse effect on the level of exploration activity on the continental shelf. This would seem to support a conclusion that the increased costs associated with extension of customs jurisdiction would have only a minimal impact on the level of exploration activity beyond the 12-mile limit. However, such factors as international oil prices, interest rates and worldwide supply and demand for offshore drilling rigs make it difficult to forecast the exact impact customs jurisdiction extension would have on offshore exploration activity.

The effect of customs jurisdiction extension on decisions about where to source goods used in oil and gas exploration and production on the continental shelf is also difficult to predict because so many other factors affect such decisions. These include the availability of unutilized capacity in Canadian and foreign shipyards, exchange rates and levels of government support provided in Canada and abroad. It has been estimated that $6 billion of installations and vessels will be required for exploration for oil and gas on the continental shelf beyond the 12-mile limit in the 1982-1992 period. Assuming that there would be no major increases in Canadian shipbuilding capacity and that floating drilling equipment would be classified under the tariff items covering land-based equipment at a 10 per cent rate of duty, it might be possible for Canadian suppliers to obtain about $3 billion of new business between now and 1992, if customs jurisdiction were extended immediately. This estimate also assumes continuation of the SIAP 9 per cent production subsidy; if this subsidy were cancelled and the tariff rate on installations were set at 20 per cent to eliminate the potential tariff anomaly, as suggested in the paper on shipbuilding assistance measures, the effect, of course, would be to influence sourcing decisions more towards Canadian suppliers than would be the case with the 10 per cent rate, since the 9 per cent subsidy is paid only on construction cost whereas the tariff would apply on the full value of foreign-built rigs.

It is estimated that about $4 billion of other goods will be used beyond the 12-mile limit in the 1982-1992 period. These include drill bits, drill pipe and casing. About 40 per cent of these goods would be imported and 75 per cent of those imports would enter duty-free because they are of a "class or kind not made in Canada". While there would likely be some increase in Canadian sourcing of the dutiable goods, the exact extent of import substitution cannot be pinpointed. As well as the duty factor, in cases where foreign goods were being offered at dumped or subsidized prices, the possible application of the *Anti-dumping Act* and the countervailing provisions of the *Customs Tariff* would also make Canadian sourcing more attractive.

"GRANDFATHER RIGHTS" CONSIDERATIONS

Extension of customs jurisdiction raises special problems with respect to the effective date of any enactment because, unlike other tariff changes which affect only future imports, the extension of jurisdiction could affect goods and installations already in place if no action is taken to relieve them from the payment of any new duties, i.e. to provide them with "grandfather rights". Also, the major capital equipment used in the offshore is generally very expensive and ordered long in advance of delivery. Any move to extend grandfather rights to these goods, however, would have to take account of the effect of such action on Canadian manufacturers of similar goods.

The normal practice with respect to tariff changes is to have them come into effect on the day following the tabling in Parliament of a Notice of Ways and Means Motion. No exemption is normally permitted for goods in transit or on order on that date. This practice poses no hardship for importers in cases involving a tariff reduction, which is the normal situation, but could pose a problem in the case of a tariff increase.

In the present case, there would seem to be no question but that equipment and other goods currently in place on the Canadian continental shelf beyond the 12-mile limit should be exempt from duties, although separate rules might be needed for leased goods. The area of concern, therefore, relates to whether grandfather rights should be extended to

(1) goods that will be brought onto the shelf between now and the effective date of legislation extending customs jurisdiction;

(2) goods that are now on order but will not be imported until after the effective date; and

(3) goods imported after the effective date which were ordered after the publication of this paper.

In the case of goods brought onto the continental shelf between now and the effective date of legislation extending customs jurisdiction, it would be consistent with normal practice to exempt them from duties. An exemption for goods ordered before publication of this paper but imported after the effective date (primarily major pieces of capital equipment such as drill rigs or supply vessels) would be consistent with the practice now followed for certain tariff increases effected by means other than legislative amendments. (For example, under the Machinery Program, in certain circumstances goods on order continue to receive the benefits of duty remission even when imported after the date on which such goods are considered to be available from Canadian production.) However, to exempt goods not yet ordered and imported after the effective date would not only be inconsistent with normal practice but would defeat one of the major objectives of the new policy, namely to begin immediately to influence the purchasing decisions of developers.

Because of the mobility of much of the offshore oil and gas exploration equipment and the prevalence of short-term leasing and chartering arrangements, it would seem desirable to consider special rules for foreign-owned leased equipment which is on the continental shelf when jurisdiction extension is effective or which is now on order. Such goods may enter and leave the expanded jurisdiction several times during their useful life and it would not seem reasonable that they be accorded duty relief in perpetuity, simply by virtue of their being present in the expanded customs territory at the time the new policy becomes effective or on order at the present time. Therefore, in the case of leases entered into before publication of this paper and leased goods on site on the date of the legislative change, it would appear reasonable that exemption from duties should be provided only for a limited period. Thereafter, the leased goods would be subject to duty so as to give Canadian suppliers an enhanced opportunity to compete. Duty exemption for goods imported after the effective date of the legislation under leases not yet entered into would, as noted above, be inconsistent with normal practice and defeat one of the objectives of the policy.

The details of a possible grandfather rights regime based on the above principles are set out graphically in the chart.

RECAPITULATION

In the context of proposals to revise the policy relating to the Canadian coasting trade, the government has given consideration on several occasions during the last decade to extending customs jurisdiction beyond the current 12-mile limit to the outer limits of the continental shelf. Extending jurisdiction would fill a vacuum in Canadian law; it would deal with concerns about lack of customs protection expressed by Canadian industry; it would complement the objective of the NEP to improve the opportunity for Canadians to participate in the industrial benefits of oil and gas exploration and development on Canada lands; and it would address, at least in part, concerns that foreign concessional financing is resulting in Canadian firms losing contracts for capital equipment.

From an economic perspective, the imposition of a duty on goods used on the continental shelf beyond the current 12-mile limit would have little impact on the level of offshore exploration activity. On the other hand, it would have a significant positive impact on the level of Canadian sourcing of offshore installations, vessels and other goods.

Extension of customs jurisdiction to offshore resource exploration and exploitation would enhance Canada's control over its continental shelf consistent with its rights under international law. Furthermore, it would parallel action taken by our major trading partner with respect to resource related activity on its continental shelf.

With respect to grandfather rights, it is reasonable that duty exemptions be granted to equipment and other goods in place on the continental shelf at the time any policy change becomes effective and to goods ordered before the policy announcement but imported after the effective date. This approach would be consistent with current tariff policy and practice. However, separate rules would apply to leased goods. Grandfather rights for goods ordered after the announcement and imported after legislation becomes effective would defeat one of the major objectives of the new policy. In the case of leases or charters entered into before the announcement and leased goods on site on the effective date of legislation, grandfather rights should be provided only for a limited period of time.

POSSIBLE GRANDFATHER RIGHTS REGIME