House of Commons
CANADA

Standing Committee on Industry, Science and Technology

INDU • NUMBER 070 • 1st SESSION • 39th PARLIAMENT

EVIDENCE

Monday, June 18, 2007

Chair

Mr. James Rajotte

Also available on the Parliament of Canada Web Site at the following address:

http://www.parl.gc.ca

Standing Committee on Industry, Science and Technology

Monday, June 18, 2007

● (1535)

[*English*]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): Order, please.

This is the 70th meeting of the Standing Committee on Industry, Science and Technology. We are continuing our study on gas prices and refinery margins.

Today we have two witnesses from the Canadian Petroleum Products Institute, Mr. Dane Baily and Mr. Tony Macerollo. Who will be doing the presentation? Mr. Macerollo? Okay.

You have up to 10 minutes, and then we'll go into questions from members.

Mr. Tony Macerollo (Vice-President, Public and Government Relations, Canadian Petroleum Products Institute): Thank you.

Mr. Chair, members of Parliament, and Canadians who have access to this hearing, on behalf of the members of the Canadian Petroleum Products Institute, thank you for inviting me to better understand your preoccupations with our industry.

I'll keep my comments brief so as to answer as many questions as possible.

As some of you may know, the CPPI is a national association of major Canadian companies involved in the refining, distribution, and/or marketing of petroleum products for transportation, home energy, and industrial uses. Collectively we operate 16 refineries, representing over 80% of the refining capacity in Canada, and we supply over 7,000 branded retail outlets with transportation fuels across Canada. Our members include Chevron, Husky, Imperial Oil, North Atlantic Refining, Shell Canada, Suncor Energy Products, Ultramar, NOVA Chemicals, and Bitumar Inc. Our members operate refineries in British Columbia, Alberta, Ontario, Quebec, Nova Scotia, and Newfoundland and Labrador. Arco Products Corp. and the Parkland Income Fund are marketers in western Canada.

We recognize that our industry is under the spotlight. For most Canadians we are the indispensable enabler of the drive to work and school, the transportation of paramedic and fire services, home heating fuel, and right now, even the Sunday or Saturday cutting of grass. We provide quality products, proven performance, and our complex facilities operate safely and reliably. We make our products affordable by keeping our costs down. We are also the ones, I will say, who face the consumer reaction head-on, with price signs larger than I am tall.

Affordability of our products is one of the key questions that face consumers, consumer advocates, social activists, environmentalists, scientists, engineers, and economists as well as people like you, the public policy decision-makers. We understand your interest in gas prices and refinery margins, and I hope to provide you with a reasonably straightforward answer today.

The first chart in the presentation that has been provided to you sets out the movements in gas prices in four major urban centres compared to the New York harbour wholesale price for gasoline. This says fairly straightforwardly that we operate in a commodity-based market where we are, in effect, the price taker, not the price maker.

The Chair: I'm sorry. Mr. Van Kesteren, on a point of order.

Mr. Dave Van Kesteren (Chatham-Kent—Essex, CPC): Could we get that presentation he is talking about?

The Chair: Do members not have this presentation?

Hon. Dan McTeague (Pickering—Scarborough East, Lib.): I should have it, but I don't have it now.

Mr. Dave Van Kesteren: I did not see it. Mr. Shipley doesn't have it, and Mr. Arthur doesn't have it.

The Chair: I have a bilingual copy here, French and English.

Everyone now has a copy? Okay.

I apologize for that.

Mr. Dave Van Kesteren: No problem.

Mr. Tony Macerollo: I'll turn to the first graph, which marks 2007 wholesale gasoline prices. In this particular case, we've tracked the price movements, from January through to June, at New York harbour, Montreal, Toronto, Calgary, and Vancouver. What you can see, or at least what this graph attempts to underscore, is that we operate in a North American market for gasoline products. We are very much the price taker, not the price maker, in this situation.

There's an additional phenomenon associated with speculation that I'd like to comment on a bit. To quote Natural Resources Canada:

> News of the recent declines in stock levels, combined with the earlier than usual up-tick in gasoline demand, has market analysts speculating about possible gasoline shortages this summer. This has sent speculators and traders scurrying to the market to secure contracts for summer delivery. This trader activity has driven up wholesale prices of gasoline across North America and, subsequently, prices at the pump. Prices are likely to remain high until inventory levels begin to build or analysts are comfortable that there will be enough gasoline to meet summer demand.

That comes from Natural Resources Canada's 2007 "Petroleum Product Market Outlook", available on their website.

This isn't something we do; rather, this is the reality of commodity trading.

In terms of refinery margins, the second chart presents the movement in margins. It is volatile, there's no question about that. And there is no question that the margins are averaging upward.

In public policy terms, this Parliament and previous Parliaments have mandated fuel policies whose financial impact in terms of fiscal expenditures has been about the magnitude of a high-speed rail corridor between Montreal and Toronto and in a much shorter period of time. Just as an example, in mandating a low-sulphur fuel requirement for gasoline and diesel, CPPI members have invested approximately $5 billion in expenditures to reconfigure this manufacturing process.

We worked in collaboration with government officials to achieve this policy, and we managed to achieve this goal while protecting Canada's competitive advantage in the production and distribution of fuels for Canadians. I'll emphasize this, because it's a lot of money: the investment is $5 billion of private sector money in a private sector-operated and competition-driven modern infrastructure. We will continue to make similar investments as a full partner with you as we take on new challenges with climate change and clean air.

For a few moments, consider the business environment in which the institute's members operate. Our principal input is crude oil, a commodity determined by a global pricing system, sourced from multiple areas in the world. There are taxes from something as complicated—and expensive, I might add—as the CRA definition of the amount of gasoline used to denature ethanol to the GST collected on the final tally. In the former, our members independently bear the cost of administering a public policy decision, and it's not that easy.

The third component is our refinery margins, which is the differential between crude input costs and the price at which fuel is sold, essentially a commodity market on top of a commodity market, which is the crude oil market, based on thousands of transactions all over the world, by the hour, involving futures and derivatives and so on. It is a margin, which is not to be confused with profit. For at least one CPPI company, it ranged from zero in December of 2006 to 10.7¢ when I wrote this brief.

Finally, there is the marketing, those services for which consumers are attracted beyond price—groceries, motor services, the location, etc.

Nevertheless, the fact remains that over the last 10 years, after-tax profits have averaged approximately 1.5¢ per litre. That is reflected in the chart entitled "Downstream Petroleum Financial Performance".

The Canadian fuel infrastructure is alive and best serves consumers in a fully competitive marketplace. Nevertheless, a confusing policy environment is not conducive to investment decision-making. Removing the tax exemption on renewable fuel mixes should be revisited. It increases the cost of fuel vis-à-vis the United States.

With respect to clean air, the underlying assumption in the latest data provided by Environment Canada suggests that we will need to supplant future consumption with imports. With fixed caps on these criteria air contaminants, it is not going to be possible to grow to meet demand, even though our members possess the technologies that are available right now to produce the cleanest fuel possible. We are being asked to exceed performance requirements of our principal competitors in the U.S.

● (1540)

In respect of GHGs, the uncertainties over the pricing of carbon dioxide credits beyond the short term continue to be a challenge. What we know is that an 18% reduction target by 2010 for all large industrial emission sources, along with a 2% per year escalation thereafter will create a large domestic demand for these credits. This, coupled with the diminishing access to compliance options over time, will impose large costs on our sector, which will not have to be borne by the United States.

In implementing the renewable fuel policies—and I stress policies because we have more than one in this country—major costs have already been incurred to respond to each jurisdiction.

As for price fluctuations, I'll be honest: who doesn't hate them? They're hard to follow, and they're hard to understand, but as frustrating as they can be, they are evidence of the biggest savings over time for consumers. In fact—and other witnesses have referred to this—studies in Nova Scotia suggest that while price regulation causes few movements in price, consumers in Nova Scotia end up paying more than their counterparts in the rest of the country do.

I will plead with you to not ask us to do what we can't. This is a global commodity market where the rule of supply and demand prevails. Successive studies by, among others, the Competition Bureau and the Conference Board of Canada have concluded that Canadians benefit economically even though it can be a frustrating retail experience at any given point in time.

Historically, Canadians have had the second lowest gas prices in the western world. Whether that is good or bad in public policy terms is for you to decide, but our business is to provide Canadians with the lowest-cost fuel at the highest quality and safety, and our industry has an excellent track record of doing exactly that.

There is heightened interest in what we do and how we do it, and the CPPI welcomes that, because though our product may be a commodity, its safety, cleanliness, and low cost are functions of the incredible minds and integrity of the people who work for our members. As is the case with using different light bulbs and energy-efficient furnaces, there are more things that can be done to make consumption more efficient. To that end, CPPI has endorsed the driving tips of the Canadian Automobile Association, and just as an example, yes, tire pressures actually do matter.

On that note, I'm open to questions.

Thank you.

● (1545)

The Chair: Thank you very much, Mr. Macerollo.

I just want to ask a question about your presentation. Would you happen to have a copy, perhaps e-mailable, in colour? Some of the graphs—for instance, the one showing 2007 wholesale gasoline prices—are hard to follow—

Mr. Tony Macerollo: In the black and white.

The Chair: Yes. If you could, I would appreciate that. We'd get that to all the members.

Mr. Tony Macerollo: I'll send that this afternoon.

The Chair: Okay, thank you.

We'll start with questions.

Mr. McTeague, you have six minutes.

Hon. Dan McTeague: Mr. Baily, Mr. Macerollo, it's good to see you here. It's good to see that some of us have changed hats and some of us haven't.

Two out of three ain't bad, Dane.

Mr. Macerollo, thank you for the presentation. I was interested in what the chair asked for with respect to the graph, because, of course, he knew I was going to ask questions on the differentials between the New York harbour cargo rate and the price. I'm going to find out in about 35 minutes what we'll be paying tomorrow. My sense is that it has always gone anywhere from 2¢ to 7¢ a litre, depending on the circumstance.

Given that we don't have similar gasoline to Buffalo's and Toronto's, and the gasoline sold in Plattsburgh, New York, which is another comparative model that you use, is not the same as the gasoline produced in Montreal, how do you justify, on almost any given day, a wholesale price for gasoline charged to your own members by your refiners, whom you represent, that is higher than wholesale prices at the refinery gate, generally in the United States?

Mr. Macerollo or Mr. Baily.

Mr. Tony Macerollo: The first comment I'll make and underscore was made by Ms. Savage from the independents the other day. She said that in fact, while the administrative treatment of the product on either side of the border is different, the product is not actually essentially that different. It's the administrative requirements that cause the difficulties in moving product across the border, but the product specs actually are not that different at all.

In terms of why there would be a price differential between what is sold wholesale here and what is sold wholesale in the States, that is a function of what the market is going to bear.

Hon. Dan McTeague: Mr. Macerollo, your members control virtually 100% of the product in many of my markets, including Toronto. You control the price, the members you represent control the price, and in Toronto those prices are identical at the wholesale level.

Do you then believe either that you have no competition at the wholesale level in places like Toronto or that in fact there is control of the price? I'm not suggesting collusion, because I think it's a bit of a tawdry comment, and I think you and I would agree on that. You worked for the Minister of Industry when a number of suggestions were made to try to restore competition to the wholesale level.

Mr. Tony Macerollo: We don't control, as I said to you earlier, Mr. McTeague. The market is North American. It's not uniquely Canadian. The price movements are going to follow very closely what happens at the New York Mercantile Exchange. There are going to be variations from market to market. There are going to be incremental costs that may be associated with transportation and otherwise. They do track each other, and there is a strong correlation. That's what happens, with the exception of western Canada, throughout all of North America.

Hon. Dan McTeague: I agree with you, Mr. Macerollo, in terms of where this price is going and that we do follow New York harbour as the benchmark, as we do with crude. But the analogy you're giving with gasoline is that it's always 2¢ to 7¢ a litre higher in Canada. We can't trade the product either side of the border. Substitution would only be a penny or two. How is it possible then to make a contention, as you've just done, that it's acceptable and that we don't control that price differential? It seems to me that if Canadians are producing gasoline, the market would bear, say, 68¢ a litre today, not 72¢ in my region or in places like Montreal.

Mr. Baily, you may want to jump in on this as well.

Mr. Dane Baily (Vice-President, Business and Communications, Canadian Petroleum Products Institute): First of all, there are a couple of pennies in transportation costs. The short-term reality is that the product doesn't flow instantaneously across the border, but if there is a long-term differential, because the products are essentially the same, and if there's an opportunity for a U.S. refiner or a U.S. wholesaler to move product in the Canadian market and make a couple of pennies more, they will do that, at the debit of the U.S. market.

So the product can move across the border. It doesn't move day to day, and that's why, when you take single days or points in time, it can be really misleading. I can pick numbers to say that—you know, I remember one day, I think in 2005, when the gasoline price was lower than crude oil. If our industry had the control that is often ascribed to us, why would we give this stuff away? The markets fundamentally set the price, and we go with that.

When you look in detail, you sometimes ask what happened to Vancouver pricing and how come it distanced—Well, the Vancouver market is a little bit distinct from New York. They tend to follow, but there are special conditions. You can see special conditions happen out west. When the western refining circuit out of Edmonton, which supplies basically Victoria to Thunder Bay, gets very tight, you'll see the wholesale prices rise in that market, and they do that to attract imports. As the wholesale price goes up, what you do is set up a condition to attract imports. If you're short on supply, that's exactly what you want to do. That's how the market balances those situations.

● (1550)

Hon. Dan McTeague: Mr. Baily, I'll get back to the other point in a second, but let me go right to the question of supply.

We in Ontario have been badly affected. Our chairman's area has also been poorly affected. In many respects, during the wintertime in Ontario we were landlocked. We don't just have a price concern, which is being raised to members of Parliament and obviously to your industry and to independents; we have a supply problem. I'm wondering what steps your industry is prepared to take to restore that before it loses what confidence is left in our ability to...as you said, Mr. Macerollo, I think reliability has been put in very serious question.

The second and final comment, to either one of you, is this. The independents have suggested that you provide inventory every week or so to Natural Resources Canada, as many of your parent companies do in the United States. Would this be acceptable to you?

Thank you, Mr. Chair. That's it for me.

The Chair: Mr. Macerollo.

Mr. Tony Macerollo: The first question, as I understand it, is what members are attempting to do to ensure that there is reliable access to quality product in Canada. I will say to you that they're doing everything they can to make the investments that are necessary to ensure that their operations are running at full capacity, because it's in their business interests to do so.

As for whether or not you are going to see major expansion of refining capacity, be it in a region like Ontario or in other parts of Canada, those will be individual business decisions, where the planners are going to go forward and compete with capital from other parts in their organization to see whether or not they can make a business case to do that expansion.

You will have to remind me what the second question was.

Hon. Dan McTeague: The independents had suggested providing inventory levels so that we can anticipate supply problems rather than have the shocks we had this summer.

Mr. Tony Macerollo: Well, let's step back. At a principled level, in terms of a petroleum monitoring agency, the CPPI does actually support that concept. In the case identified by Ms. Savage a couple of days ago, where you can advertise inventory slowdowns in advance, my economics training tells me that when that kind of information gets posted, you're going to see a more immediate response by way of price reactions. For instance, in the United States right now, when the energy information agency reports on inventory levels in the U.S., there's an immediate price response. In fact, it's not too different from how the Bank of Canada announces an interest rate and then what the banks do subsequently.

The Chair: Thank you, Mr. McTeague.

We'll go to Madame Brunelle.

[*Translation*]

Ms. Paule Brunelle (Trois-Rivières, BQ): Welcome, gentlemen, and thank you for being here today.

In your presentation, you correctly indicate that prices fluctuate. What consumers find really difficult is that prices jump in time for the Christmas and summer holidays. We are trying to understand what is behind that.

I believe that you represent the major oil companies in Canada. Imperial Oil, Petro-Canada, Husky Oil, EnCana, Suncor and Shell, who are the people that you represent, I imagine, racked up record profits of some $12 billion in 2006. That was an increase of 25% over 2005 and 70% over 2004.

My first question is a simple one. How can you tell us in your presentation that your companies are in a really difficult situation when you have been making record profits?

[*English*]

Mr. Tony Macerollo: I don't want to give you the impression that our companies are facing tough times. I do want to impress upon you that a number of public policy decisions are placing strains on the refining sector in this country. And let's make a distinction between upstream and downstream. We represent the downstream. That's when the oil arrives at the refinery, to the point where it goes to the retail station.

That has not been a profitable business for a very long time. If you look at historical data, it was the losing end of the business for quite a while. So I come back to you that at one point, a profit of 5¢ a litre.... Admittedly, that's a lot of litres, but $5 million is also a lot of money to do desulphurization, which doesn't get you either an extra cent or an extra litre of gasoline. They're both good purposes. The pollution requirement to lower sulphur is an excellent public policy decision, and we implemented it, but it does cost money.

As for the price fluctuations, Madame, there's no question that in the summer months there is an increase in demand for motor gasoline. There are only so many refineries in Canada and the United States. There is only so much product that can come in from Europe to increase the supply that is available. In the absence of more supply flexibility, you're going to see price movements.

This is not something we control. It's something our members do a pretty good job at, which pays off in dividends to the shareholders. But the refining sector—and I do underline in particular refining as opposed to the entire spectrum of activities—has not been a particularly profitable industry. It's only been that in the last couple of years.

● (1555)

[*Translation*]

Ms. Paule Brunelle: Is it not at the refining stage that you are making enormous profits? In May of last year, a barrel of oil cost $73 and a litre of gas was selling at $1.06 in Quebec. In May of this year, oil was $61 a barrel and gasoline $1.15 a litre. That is a big gap. The difference is certainly the margin that you take at the refining stage. Is it because there are fewer refineries?

We have been told that a reasonable margin should be between 4¢ and 7¢ a litre. In March and April 2007, the refining margin was over 15¢ a litre. Even if you say in your presentation that $5 billion has been invested in modernizing infrastructure, that there is competition, and so on, I find it hard to explain to people in my riding, to average families, why your margins are so high. Is it not because you control the number of refineries in Canada?

[*English*]

Mr. Tony Macerollo: The first thing I would point out to you is that margin does not equal profit. When you see a refinery margin, whether it be 10¢ or 20¢, that is just a simple calculation of the difference between the wholesale price and the crude inputs.

What I'm telling you is that our profits are averaging about 1.5¢ a litre. The margin may be high, but at a given point in time, the margin also may very well be low. As it shows on the graph there, it is actually very volatile. But at the end of the day, I think what is most important, from people's point of view, in the context of what is a reasonable profit is really the question of the 1.5¢ a litre, not the volatility in the margin.

Do you want to add something, Dane?

[*Translation*]

Mr. Dane Baily: I just want to mention the example of sulphur reduction in gasoline and diesel. We have invested $5 billion across the country in the whole refining network, which added 1¢ a litre to the cost of gasoline production, 2¢ a litre to distillate fuel and 3¢ to heating oil. Those are additional costs that are absorbed. The margin has to cover those kinds of costs.

Since the early 1990s or the beginning of this decade, the refining margin has been high enough that refiners are starting to think about investing to increase production capacity. During the 1980s and 1990s, the return on investment was at an acceptably low level, which led to the closure of many refineries in the early 1980s. You no doubt experienced that situation in Montreal.

● (1600)

Ms. Paule Brunelle: France imposed a cap on gasoline prices. Is that something that could be done here by the provinces? We know that this is under provincial jurisdiction.

Mr. Dane Baily: A number of provinces have regulated prices, and many studies have been carried out on this issue. The latest one, which was done by Gardner Pinfold in Nova Scotia, shows that maintaining price stability has cost the public and drivers in those provinces 1¢ a litre, which adds up to around $10 million. Our customers, who are also voters, show us every day that price is very important to them. They are prepared to go across the street to save two tenths of a cent per litre.

In my opinion, if we ask people if they want prices to be regulated, they will all say yes, because they expect that prices will go down. But that is not what happens.

[*English*]

The Chair: Thank you.

We'll go now to Mr. Carrie.

Mr. Colin Carrie (Oshawa, CPC): Thank you very much, Mr. Chair.

I want to thank both of the witnesses today, because I think you have clarified refining margin versus profit.

Some of the other witnesses we had, as Madame Brunelle was saying, said a 4¢ to 6¢ refining margin should be appropriate, and we're seeing those margins increase. I'm curious about your opinion on the trend. We see in Canada that all parties, all governments, are saying we need cleaner emissions, that we need to blend different biofuels and come up with newer technologies. And because this is a North American market, with differences between Canada and the States, we had another issue about new refineries in Canada.

How would you say the regulatory framework in Canada versus the United States plays into effect where companies make decisions on where to put refineries? Is there a big difference?

Mr. Tony Macerollo: Under ordinary circumstances I would suggest actually that the Canadian marketplace is a more stable, friendly marketplace, from a pro-competition point of view, but there have been some bizarre things happening.

There has not been a refinery built in North America—period—for many, many years. It's not just a Canadian phenomenon that it's difficult to attract capital to invest in these kinds of things. Even with the existence of refinery subsidies—those in the United States to build refineries—people are not taking up those offers.

One of your questions the other day was on tax policy. There are, in fact, incentives south of the border. We're not asking for that. As has been shown south of the border, they don't necessarily work.

In the example of renewable fuels, the federal government alone provides a 51¢ per gallon subsidy on ethanol-blended gasoline. In the last budget, the government announced that it is eliminating the equivalent of our blend or subsidy as of April 1 of next year and replacing that with a subsidy that goes directly to the producer, further widening the competitive disparity between those in Canada and our U.S. counterparts.

Those are just some of the examples. Provincial governments have done the same thing as well. There's a lot of tax policy that circles around our product, but on balance, when you look at it worldwide, the North American marketplace is, generally speaking, the lowest-tax fuel environment.

Mr. Colin Carrie: Thank you very much.

During the last hearing, Ms. Savage from the CIPMA, the Canadian Independent Petroleum Marketers Association, stated that differences in specs between Canada and the U.S., for example, with respect to the sulphur levels, have inhibited imports of gasoline into Canada.

To what extent is this a problem? If it is, what measures could the government take to rectify it?

Mr. Tony Macerollo: I was here for Ms. Savage's testimony, and what I understood her to say was that the specs themselves.... For example, sulphur is uniform. In fact, one of the truly Canadian success stories is that the implementation of the desulphurization plan was done in a way that we could stay competitive with our American counterparts who have also embarked on desulphurization.

The problem lies largely in, I would say, marginal spec differences that could easily be taken care of, so anything that can be done to open the border, so to speak, between Canada and the U.S. regarding specifications without compromising the public policy priorities in our regulations would be most welcome.

I'm not sure how difficult it would be. It would probably be quite tedious—sort of like NAFTA and rules of origin—but it would be well worth it.

● (1605)

Mr. Dane Baily: I could add something on that.

We have an unwritten understanding with Environment Canada to harmonize our fuel specifications with those of the U.S. We had a slight difference with the sulphur. We went a little bit faster because between the two U.S. dates we had an interim measure, which threw off our availability to bring imports in from anywhere in the States. Generally, it's an agreed-upon principle, and it's supported by NRCan, knowing that the more open the border is, the more transparent the prices are going to be, and the more competitive the market will be for the Canadian citizens. We've been pushing for that, and it's a very important part of our understanding with Environment Canada.

Mr. Colin Carrie: I'm from Oshawa, and I had a few complaints from constituents as far as shortages of certain blends go, like premium or medium blend. Why does that happen? In your opinion, does it really happen, and is it a problem? What are your members doing to prevent that, especially over the summer months coming up?

Mr. Tony Macerollo: The medium-grade blend in Ontario right now is problematic. That is a function of the Government of Ontario's specifications on renewable fuels.

As Ms. Savage explained, you cannot take regular, unleaded gasoline that has ethanol in it and mix it at the pump with high grade to get medium grade, because the chemistry just doesn't work. It's not a product that would be useful in the marketplace. It has to do with reed vapour pressure.

He's the engineer and I'm the economist. Perhaps he wants to explain what we mean.

The point is that it's not a desirable product. That is probably going to manifest itself at least in the short term as all fuel suppliers are moving up to the renewable fuel mandate set by the Government of Ontario, which came into effect only this year.

Mr. Colin Carrie: Is this something I'm going to tell my constituents to just get used to, that we're going to end up without it?

Mr. Dane Baily: We could conceivably see a disappearance of the middle grade. I don't know the exact sales of it, but it's a fairly low premium. As the prices go up, it's amazing how people are buying more and more of the regular grades. Some of the car manufacturers say that you should use premium, when technology-wise, if you do the research, it's more of a marketing ploy—because it is a premium car, it must need premium gas—as opposed to engineering saying that the combustion ratio is high enough that you actually need premium gas.

We want to see you do your homework.

The Chair: Thank you, Mr. Carrie.

That's quite interesting, Mr. Baily. The automakers will be asking to appear next.

Now we have Mr. Byrne, please, for five minutes.

Hon. Gerry Byrne (Humber—St. Barbe—Baie Verte, Lib.): Tony, would you be able to describe the cross-border trade in gasoline between Canada and the U.S. for wholesale gasoline as opposed to crude? Are Canadian refiners supplying 100% of the Canadian wholesale gasoline supplies for Canada, or is there a swap between us?

Mr. Tony Macerollo: On an annualized basis we are net exporters. I'll get you the latest data from Statistics Canada. It works out to about 10% of the product that we make being exported.

Hon. Gerry Byrne: Here's a question for you.

Why were we so knocked by Katrina? Why is it that external forces from outside Canadian borders seem to wreak such havoc on Canadian retail gas prices? It's a real mystery to me and to my constituents as to why, if we are actual net exporters of wholesale gasoline products, either slumps or destruction of refining capacity outside our own borders impacts us so directly.

● (1610)

Mr. Tony Macerollo: It is because the border, simply put, is only useful in this industry for the calculation of Statistics Canada data. The reality is that it's a North American market for the product. In some respects you could also make the argument that not only do we take the prices, but Canadian consumers are competing with American consumers for the same product that, generally speaking, can move anywhere in North America.

It is frustrating. I realize that.

Hon. Gerry Byrne: It is frustrating, because it has the appearance of refiners actually taking advantage of very difficult circumstances in other parts of the world and applying that difficult circumstance in a speculative price increase for Canadian consumers here in Canada.

Just to use Katrina as an example, if we are net exporters of gasoline products, we're really not impacted, but they've appeared to say, let's take advantage of Katrina because the U.S. is basically prepared to buy more gasoline; the price is very inelastic, they need to buy it, so let's take advantage of that, and let's jack up domestic Canadian prices so that we can just take advantage of all that.

Mr. Tony Macerollo: If you tried to set a price that was substantially different from that which you experience south of the border, it would manifest itself in another fashion. It could be a supply shortage, because product moves to the highest price, and in this case, whether it's gasoline or corn, it's a commodity, and the supply is going to go to the highest price. Therefore, it's the events south of the border that would have acted to shorten supply, that would have caused a supply increase, that would cause supply to move to that area.

Hon. Gerry Byrne: You raised the point that there's been no new capital...well, you didn't say there has been no capital investment; there have been no new refineries in North America for a significantly long period of time. This is almost a public utility that is operating on a pretty decent margin. It seems like an attractive investment opportunity for the oil and gas industry in particular—and I'm talking about primary producers—to actually take some of their own money and put it into refining capacity. In fact, as you know, the purchaser of Come By Chance in Newfoundland is a primary producer.

Why isn't that happening more and more? Why isn't there more vertical integration between the cash of the primary producer and the processing sector?

Mr. Tony Macerollo: Because the refining operation is—

There are a number of factors here. First of all, we are a very regulated industry. When governments, in both Canada and the United States, make pronouncements about conservation and energy efficiency—i.e., that we have to cut down on our consumption—they're sending messages into the marketplace that this is not a lucrative area to invest in. Government policy is trying to actually bring demand down.

Even though that hasn't worked, if I may be blunt—because it hasn't worked. Demand, very robust demand, continues in the Canadian marketplace. That coupled with environmental regulations, coupled with the whole series of planning involved to put together a refinery over a ten-year period, does not jibe with, as I mentioned in my brief, an inconclusive policy environment. We depend very much on government policy, and predictable government policy, to make those decisions.

The Chair: Last question.

Hon. Gerry Byrne: How is consumption affected by price? It doesn't seem to me to be a very elastic sort of relationship. It seems pretty inelastic. When the price was $1.48 at home, we were still finding a fair bit of gas—

The Chair: Mr. Baily.

Mr. Dane Baily: It's very elastic but it's not very responsive. When we had the price shocks in the seventies, it took until about 1981 for the demand to drop. It dropped about 20% to 30% in the early eighties, but the price shock started in 1973 and 1977.

So it will happen, but it takes time. That's basically because we don't all trade our cars in and buy something more efficient or reinsulate our houses or stuff like that.

In a very short period of time, in Katrina and Rita, the high prices actually did their job. They pushed demand down very significantly for a few months until the refineries could balance out and we could get additional imports from Europe.

● (1615)

The Chair: Thank you.

Thank you, Mr. Byrne.

We'll go to Mr. Shipley, please.

Mr. Bev Shipley (Lambton—Kent—Middlesex, CPC): Thank you very much for coming today.

I was just making a little analogy here, listening to my colleague from Oshawa, with his concern about blended fuels, that actually, under the Ontario mandate, should the Ontario premier go out, it would likely be good for his constituents. I think that's just a little understanding, I might add.

Hon. Dan McTeague: Are you looking at me?

Mr. Bev Shipley: No, no.

You talk about profit here. I'm looking at the part above this chart in your presentation where you say, “Nevertheless, the fact remains, that over the last ten years, after tax profits have averaged about 1.5¢ per litre.” You also talk about going from zero in December up to 10.7¢ as of late. So there's great variation in what has happened.

When I look below the chart, I see the earnings per litre, which I'm taking to be the profit. It's almost on a vertical climb, whereas the ROCE price is staying around 17%, 17.5%, 16.9%, and then it was 14.3%.

Can you help explain that to me? How many litres are we talking about in terms of the profit?

Mr. Dane Baily: In Canada, about 100 billion litres of petroleum products are sold. So the 2.5¢ a litre says that the downstream industry, the refiners marketers, made about $2.5 billion last year. Just to put that in context, the capital spending over the last seven or eight years has been about 130% of earnings.

As you're seeing in the chart, the return on capital employed is dropping off. For the last few years there have been huge capital investments for these environmental projects and for expansion increases. The number of refineries is very misleading. We've closed three refineries since the year 2000, which cost about 100,000 barrels a day of capacity, but the total capacity in Canada is up 100,000. So there's a net change of 200,000 barrels a day of additional capacity, not with a new refinery but by expanding existing refineries.

The same thing happened in the States. Over the last ten years they've increased their capacity by 10%, which is almost the same value as the entire Canadian refining industry.

Mr. Bev Shipley: One thing we heard the other day is that part of the problem at the refineries is around the pipelines to get it to them. There's limited capacity. I mean, there is all kinds of product, I think, but it's at the refining end where it's been limited.

You say that a number have closed down, but I'm wondering, have they just decided to close because of the profit margin or because the plants were inefficient?

Mr. Dane Baily: The major closure was Petro-Canada in Oakville. It's no secret that that refinery was not an attractive investment to put in the expenses required to desulphurize the gasoline. It was a smaller refinery and it just wasn't worthwhile.

There are three big refinery projects right now that are being talked about. Shell has one in southwestern Ontario; we're talking about 300,000 barrels a day. The total Canadian capacity is two million, so this is a huge chunk. Irving has another one, and Irving is primarily an export refinery. They supply all their local demands, but they export quality products to California—very specific gasoline blends required for California. It is a very sophisticated refiner, and that would double their capacity, another 300,000 barrels a day. Then there is another refining complex being discussed in Newfoundland. Those are huge investments.

You really have to put it into the context of the risks refiners are facing. One of the risks, certainly, is the demand, as Tony mentioned. If in the transportation segment Canada were to hit its Kyoto targets, the demand would have to drop by 30%. So it takes a fair bit of intestinal fortitude to spend $4 billion or $5 billion with the chance that your demand might go down by 30%. Those are the planning decisions that these major corporations have to look at before investing in that segment.

When you look at the upstream, over 80% of the profits of the integrated companies last year came from the upstream business. On average it's about 75%; last year it was 80%, and it's driven by the crude price.

● (1620)

The Chair: I'm sorry, we're over time, Mr. Shipley.

We'll go now to Monsieur Vincent.

[*Translation*]

Mr. Robert Vincent (Shefford, BQ): Thank you, Mr. Chairman.

You say that it costs $5 billion to build a new refinery and that even if the government invested money or provided subsidies, the industry would not want the refinery. Is there a particular reason for that?

[*English*]

Mr. Tony Macerollo: Mr. Vincent, it's very simple. The proponents to build a refinery have to go to their financing sources and say, “This is why it is worth your investment”. What you've seen up until at least recently is that the people who have the capital to give are looking at it and saying, “No, I can put that money elsewhere and make a better return”.

[*Translation*]

Mr. Robert Vincent: In any case, until there is a new refinery, the margin stays as high as possible. The fact that there are no new players to increase the number of refineries and create a surplus is a lot more profitable for you. As long as there is a shortage of supply, the price can be kept high and blamed on demand. That is the best explanation that you can give us today. With new refineries, there would be a surplus, and gasoline would simply cost less.

[*English*]

Mr. Tony Macerollo: Conversely, you could do what many of our members have already done, and I'll remind you that even though some refineries have closed, existing refineries have expanded. The advantage of expanding an existing refinery rather than building a new one, among other things, is—You have to deal with the community around you. Not everybody wants a refinery in their backyard.

What I will tell you is that there has been expansion of refineries. We have increased our production of product. I'm not sure we need necessarily to determine the type of expansion that is required to get more supply, but what I can tell you is that the investment climate has to be good in order for that money to come.

[*Translation*]

Mr. Robert Vincent: You have told us that a refinery would cost $5 billion, but from what I understand, it is not a question of money. ExxonMobil recorded an impressive net profit of $9.3 billion in the first quarter of this year. So that is not where a lack of money will be felt. But we understand that its sales went down by 2% because of the price of oil. Last year, oil was $73 a barrel, compared with $61 this year.

Even so, profit margins have been much higher. They made $39 billion last year and will make much more this year. But where is this profit coming from? According to the magazine *Les Affaires*, these people are making much more money because of the refining margins. Crude oil prices have declined, but the companies have increased the refining price.

The situation is even clearer in Canada. As my colleague mentioned, Petro-Canada recorded a net profit of $590 million in the first quarter, compared with $206 million last year in the same period. Not only did first-quarter profits double, but oil companies investing in the development of the oil sands can deduct 100% of their investment beginning in the first year.

Moreover, in a recent study that it prepared, the Canadian Association of Petroleum Producers provided estimates for the next three years on the impact that the tax breaks would have on oil companies. They amount to $5.1 billion in 2005; $4.5 billion in 2006; $3.2 billion in 2007 and $2.3 billion in 2008.

With that in mind, I do not think that building a refinery for $5 billion is a question of money. That is not a problem for the oil companies. Since the beginning, you have said that you own 16 refineries and refine 80% of the products on the Canadian market. If there are too few refineries, a new one should be built. In any case, the government will help you and give you tax breaks. Who will benefit?

● (1625)

The Chair: Please ask your question.

Mr. Robert Vincent: Consumers will benefit.

[*English*]

Mr. Tony Macerollo: It's very simple.

Through you, Mr. Chair, to Mr. Vincent, I'll say two things.

First of all, the government's plans for criteria air contaminants—air pollution—in effect, prevent us from growing in Canada. If those numbers do not change, we cannot grow. However, we have been working with officials on this, and we're confident that something is going to break.

I'll make a deal with you. I will bring members of my industry to come and see you if you are interested in having a refinery built in your riding.

The Chair: Thank you.

I assume that goes for all the members of the committee.

Mr. Tony Macerollo: That's for all the members.

The Chair: We'll go to Mr. Van Kesteren, please.

Mr. Dave Van Kesteren: Mr. Chair, I didn't think I was going to be—

Hon. Dan McTeague: He wants to own one.

Mr. Dave Van Kesteren: Yes.

Thank you for coming. This has been fascinating.

What I'm hearing is that economics 101 works in your industry as in any other industry.

Tell me, do we import any refined fuel? You say we're a net exporter, but do we import any?

Mr. Tony Macerollo: Yes, we do. I can get you the exact number if you like. Our balance is such that we're net exporters.

Mr. Dave Van Kesteren: Is a two-year write-off for capital expenditures going to help, say, for the proposed refineries in Sarnia? You mentioned two in the east as well. Will that make a difference?

Mr. Dane Baily: Absolutely.

Mr. Dave Van Kesteren: So that makes a difference?

Mr. Dane Baily: In the integrated companies you're competing for funds versus investments in the tar sands or gas wells or oil wells. If they can get 100% write-off—The average return on capital employed in the upstream is about 30% plus. It depends on the company. If they're investing in that business at 35%, they can invest in the refining at 17%. There isn't enough money to do everything. There aren't enough people—there are lots of other issues—and skilled labour to do everything, so you have to pick your winners.

Mr. Dave Van Kesteren: Okay. So good government policies will, in effect, bring down the price. If we have less regulation—and we're not talking about regulation where it is necessary, but the regulations at the—

Sorry, Tony, it looked like you wanted to jump in.

Mr. Tony Macerollo: We're at a crossroads in this country, and it's an important crossroads. We have a public that is demanding action on the environment, action on climate change, low gasoline prices, and other things as well. There is going to come a point in time where all of these requirements are not reconcilable, and it's going to be a tough transition for all of us—members of the CPPI, the Canadian public, and public policy makers. We are at that crossroads. There is no doubt about it. Our hope is that as we chart down this path, we will base our decisions on science and economic impact as well as our contribution to the rest of the world.

● (1630)

Mr. Dave Van Kesteren: In essence, if we decrease our demand, then we can actually see some reduction in prices. That is just softening the prices. As I said, it's all economics 101.

Mr. Tony Macerollo: It's all relative. Again, I would underscore the fact that we're a North American marketplace, not just a uniquely Canadian marketplace. So if demand skyrockets in the United States while it comes down in Canada, Canadians will be spending less on fuel, but that will not necessarily manifest itself in price movement.

Mr. Dave Van Kesteren: There's a federal political party that's arguing in their platform that the Government of Canada should impose a $500 million surtax on the profits of oil companies as a measure to curb their profits. Can you explain to this committee what impact a surtax like that would have on member companies and consumers at the moment?

Mr. Tony Macerollo: I'm not sure that tax plan was targeted to the refining industry, but as a general rule, corporate taxes.... If they're not competitive with comparable jurisdictions, they will see a loss of economic activity within their own jurisdictions in favour of somebody else, especially in the context of a commodity that is used virtually all around the world.

Mr. Dave Van Kesteren: So we would drive the oil companies outside Canadian borders and we would just wind up buying from different sources?

Mr. Tony Macerollo: If they have comparable investment choices, yes.

Mr. Dane Baily: And that is what happened in the U.S. refining industry.

The Chair: You have time for one more question.

Mr. Dave Van Kesteren: I wonder if you could explain something quickly. You say we're being asked to exceed the performance requirements of our principal competitors—the United States—at significant cost. In respect of the GHGs—I don't know if I'm going to have time for this—I just need some clarification on that part of your briefing. You don't have a page number, but it follows a graph.

Mr. Tony Macerollo: Is that the chart in respect of GHGs?

Mr. Dave Van Kesteren: Yes. I just need a little clarification on that. I don't quite understand it.

Mr. Tony Macerollo: There were some key points to this. I could go on for 30 minutes too, but I'll keep it to 30 seconds.

First of all, the pricing of compliance costs requires certainty for business planning. If you don't know what the price is, you don't know how to input that into your business model.

Secondly, the diminishing access to offsets assumes a certain amount of technological innovation, which, again, is uncertain. We don't know that some of the stuff that everybody is hoping is going to work is going to work. What we do know, at least in those two examples, is that our U.S. competitors simply don't face this issue right now. They may, in which case the field may level, but we don't know that, and uncertainty is the worst thing you can do to a business.

The Chair: Okay, thank you.

We'll go to Mr. McTeague.

Hon. Dan McTeague: Thank you.

Mr. Baily, I have a question for you.

The crack spread today between crude and refined gasoline in the United States is 17.5¢ a litre, as of about 3 o'clock our time. I'm going with $226.43 for U.S. gas and I'm going with $69.09 for crude. I think it's WTI, but there's probably a blend of Brent and others in that, which we are using out here.

The wholesale price established by your members—$423—would give me, nine minutes ago, 68.8¢ for Ottawa, which is down two-tenths of a cent from Friday and, the same thing, down two-tenths of a cent in Toronto, 68.7¢. Montreal remains unchanged at 67.9¢.

I'm wondering how much competition is required for your member industries to come to the identical wholesale price posted for tomorrow morning's gasoline, which will mean here in Ottawa gasoline will sell for $1.053 cents per litre and in Toronto for $1.043. How do you do that in one hour? How do you come to the identical wholesale price, which will be posted tomorrow at your stations? Unless, of course, given the fact that I say this, you'll do it to spite me, and they won't be.

Mr. Tony Macerollo: We can't do that.

Hon. Dan McTeague: But tomorrow morning—I will wager that on any other day you don't appear here, I can predict the price pretty much in eastern Canada to one-tenth of a cent per litre.

Mr. Taylor from the Competition Bureau thought he'd be cute and say he knows the discount prices, but that doesn't stop Canadian Tire or Esso from posting the price that is exactly what it's going to be. The three factors that you quite rightly pointed out will be your wholesale price, your taxes, and your retail margins—5¢ in Toronto and 6¢ up here. Thankfully, they have a margin.

My question is this. If you are making a 17.5¢ crack spread, I know that no refinery in this country, regardless of the kind of oil they're putting in, is going to make more than 5¢. That would be a handsome return. So you're making at least 12¢ a litre on the crack spread alone, and you're now making another 4.7¢ a litre tomorrow morning, assuming 40 billion litres are sold every year and you can keep this up for a couple of years. That's a couple of billion bucks out of the bottom line for consumers, which I don't have a problem with as long as you're reinvesting it.

How do you do that? How do you manage to get an identical wholesale price by every city right across this country, and why doesn't the Competition Bureau rule that offside? Perhaps it's a rhetorical question.

● (1635)

Mr. Dane Baily: You'd probably have to ask the Competition Bureau that.

The Competition Bureau has on many occasions said that parallelism in pricing is not an indication of a lack of competition. It's the same as asking, why can you go around to all the retail sites and find they are the same? The same thing applies. Canadian consumers demand competitive pricing. We as consumers are extremely price sensitive; we look for value. So when we're shopping for gas, if somebody is two-tenths of a cent cheaper, we'll cross the street. You can't afford, as a retailer, to lose 30% of your volume—we did some surveys on that—for two-tenths of a cent, plus all the traffic that generates money for your convenience stores, your car washes, and your doughnut shops.

Hon. Dan McTeague: I understand that. You can sell oodles of potato chips and have no margin, which was the contention of Mr. Macerollo's predecessor some years ago.

My interest here is that the consumer doesn't know the price yet. You've already established the wholesale price for tomorrow, which sets in motion...given the extent to which you control not only the retail sector but also the refinery sector. Mr. Macerollo began by listing all the companies that both of you represent. That, to me, sounds like 95% of all the gasoline coming into this country, or better.

How is it possible? The consumer has no impact on that price. The consumer doesn't even know this. In fact, our government refuses to publish these prices beforehand. But that will be the price at the pump tomorrow, regardless of what the consumer, driving over six lanes of highway, if I've heard the explanations from the Competition Bureau before.... These are prices that you've already predetermined. How do you do it? And more importantly, how is it that it's always identical, region to region?

Mr. Baily.

Mr. Dane Baily: The pump prices are not uniform in terms of the market. You can drive around Ottawa and find all kinds of different prices. So I have trouble understanding the question.

If you're talking about the rack prices, I think most of the companies follow a very similar methodology. They look at what has happened to the wholesale prices, at least in eastern Canada and in New York. What's my supply demand? If everything is normal, then I'll follow the normal market. I've seen cases where one company happens to be in distress and they move their rack prices higher again to push demand away. As Tony said, supply flows to a higher price and demand flows to the lowest price. That's how the markets balance themselves.

Hon. Dan McTeague: Anybody who knows this, Mr. Baily, would have to say that if you have a wholesale price that's set to one-tenth of a cent and it's identical, and it remains that for the whole day, that, above all, would lead to a number of conclusions that you may want to consider. But the one that is escapable is that someone has an awful lot of control to be able to set that price, such that the pump price, at least wholesale, will be what it's going to be tomorrow morning. I guarantee that the numbers I've cited here on record will be the price tomorrow morning.

Now, if I know that, why doesn't the government know that? Mr. Macerollo, why would you not share information as to the inventory, if this is done in the United States? If it's good enough for Americans, why shouldn't it be good enough for Canadians?

Mr. Tony Macerollo: Again, Mr. McTeague, as I said before, in the context of the establishment of a petroleum monitoring agency, which, by definition, would have to collect these kinds of data, we support the concept.

The Chair: Thank you.

We'll go to Mr. Arthur.

Mr. André Arthur (Portneuf—Jacques-Cartier, Ind.): Good afternoon, sir.

If your clients or people you represent had to make a choice between refining and selling retail, what would they choose?

Mr. Tony Macerollo: Between refining and retail? You'd have to ask each one of them, because each one of them has different strategies. Some emphasize retail and others don't.

Mr. André Arthur: So some would choose one and some would maybe choose the other, and then we would have a real market.

Mr. Dane Baily: If it were ten years ago, most of the companies might have said retail.

● (1640)

Mr. André Arthur: But refining is kind of nice these days.

Mr. Dane Baily: Nowadays it's very nice, but back then it wasn't nice at all. Like everything else, things change. If you're talking about separating retail and wholesale, they tried that in the States several times, and in fact all of the states that have laws that you can't be a refiner and a marketer don't have any refineries. I don't know if that's cause or effect, but it doesn't really have any bearing on it.

From a competition law standpoint, you have to sell to people who compete with each other as long as they have similar volumes and they're in the same business. It's illegal to sell at a different price. If one of our members has an independent service station, and even one of the service stations that may be an independent but flying their flag, they would have to sell at the same price.

Mr. André Arthur: So what is good for communications today is not good for gasoline.

Mr. Dane Baily: I'm less familiar with telecom.

Mr. Tony Macerollo: You're referring to the issue of structural separation, and that has been a hotly debated context across a number of industry sectors for which there's no definitive answer. We don't have complete structural separation in the telecommunications sector either.

Mr. André Arthur: We are short on supplies, and the price tends to go up after refining.

Mr. Tony Macerollo: When demand is going up and supply is not going up as fast, that's right.

Mr. André Arthur: The price between gasoline in Canada and diesel fuel in Canada is a little bit higher when it gets out of the refining process than it is in the States.

Mr. Tony Macerollo: Not always.

Mr. André Arthur: These days.

Mr. Tony Macerollo: Well, no. For example, we did this with CBC TV in Vancouver not even a month ago, and we found that the actual pre-tax price in Vancouver was lower than it was in Blaine, Washington, and consistently so.

Mr. André Arthur: If we look at volumes, they depend on production, they depend on demand. The more people ask for gasoline, the more will be refined, we hope one day. And there's also thermodynamics.

I am a cross-border driver. I drive heavy equipment, I drive cars.... It is common knowledge among most Quebec drivers, be they bus drivers, truck drivers, or snow birds, that you can go seven to nine kilometres farther on a gallon of American gas than on a gallon of Canadian gas. Most people attribute that to the difference in additives. Some additives are illegal in Canada, like molybdenum, and some additives are legal in the States only. This difference is stretching the mileage and therefore reducing the demand accordingly. Is this true?

Mr. Tony Macerollo: I'm the economist.

Mr. Dane Baily: The engineer will have to deal with that.

Mr. André Arthur: I go farther on a gallon of American gas than on a gallon of Canadian gas. Why?

Mr. Dane Baily: I find it a bit of a stretch. It would be very tough to simulate. You would have to be driving the same roads with the same wind conditions...the same everything. It would likely be very different. There is a possibility that U.S. gas may be a little heavier and have slightly more energy, and that would be due to the climate. All of our gasolines...you talk about winter gas and summer gas. Winter gas is more volatile. It has more butane in it and it evaporates. But I wouldn't—

Mr. André Arthur: Talk about the stretch. The same gas refined in Quebec City by Ultramar sold on the U.S. side according to U.S. standards will get you farther than the same gas bought in Quebec according to Canadian standards. Why?

Mr. Tony Macerollo: Just on that, sir, the best I can do for you right now—You've given us a comparable example. I will contact Ultramar right after this hearing and we will furnish you with the data.

Mr. André Arthur: You look surprised.

Mr. Tony Macerollo: There are a lot of ideas out there about what you can do with gasoline, about what's true, about how it works in each individual car. The only thing I can say is that it's the quantitative studies, the thorough studies, the testing done under identical weather and road conditions, that are really the only—

● (1645)

Mr. André Arthur: I'm talking about the same road on the same day.

Mr. Tony Macerollo: What day was it, sir?

Mr. André Arthur: We went from Quebec to Montreal on a tank of diesel gas bought in Quebec. We came back at night, on the same road, with a tankful of gas bought in New York and stretched it 10%, easy. Why?

Mr. Tony Macerollo: I don't know the answer to that question—if in fact it's even true—but we'll get you that information.

Mr. Dane Baily: Most of the consumption is due to wind resistance. You'd have to know what the wind conditions were.

I ride a bicycle, and let me tell you, when you're going with the wind, it's a breeze. When you're going against the wind, it's no fun at all. Your engine is—

The Chair: Okay, thank you, Mr. Baily.

Merci, Monsieur Arthur.

Monsieur Vincent.

[*Translation*]

Mr. Robert Vincent: Thank you.

It all ties in together. People think that since gasoline has gone past the $1 a litre mark, you can keep the price at over $1. Even if there is a drop in the price of crude, you just have to increase the refining margin and keep prices stable.

Is that the way you work?

[*English*]

Mr. Tony Macerollo: I'm sorry, I didn't catch all of that, sir.

[*Translation*]

Mr. Robert Vincent: No problem.

Gas prices have reached $1 a litre; that was the psychological barrier for everyone, the line that must not be crossed. Now that the price has gone past $1, you can play with it, and we see prices of $1.06, $1.09, $1.15. So every time the price of a barrel of oil goes down, the refining margin goes up, and the price remains stable.

Is that how price stability is maintained?

[*English*]

Mr. Tony Macerollo: No, that is not how it's done. And I'm going to impute that you're referring to the study done by the Canadian Centre for Policy Alternatives, who talked about a psychological barrier. We reject that study. We reject the methodology outright. It is, to be perfectly blunt, an extremely left-leaning excuse for price regulation and for which there is no justification whatsoever.

The reality of the matter is that Canadians are some of the most price-sensitive consumers of gasoline in the world. They'll make a U-turn on 0.1¢ a litre. It is in the interest of suppliers to keep their costs down, because they cannot control the wholesale price.

So there is no psychological barrier, sir. This is not, for us at least, a manipulation of psychological activities. At the end of the day, though, I remind you that these products are sold, for all intents and purposes, worldwide, and used by motorists worldwide. As long as demand is going up at a pace that is in excess of the rate of increase in supply—in this case, the North American market—you're going to see the price go up.

I wish it were more complicated, because then I might have a different job and make more money on it, but it's just not as complicated as you're implying.

[*Translation*]

Mr. Robert Vincent: I have two final questions to ask you.

If you want to buy a car, you visit various dealerships, hoping to get a better price. Why is there no competition for the company retailers or convenient store owners that sell gas? In New Brunswick, Irving refines oil for everyone. In Halifax, Esso does the same thing. In Quebec City, it is Ultramar. Why is the price the same for everyone?

We are all looking for the same thing. Where is the competition? The companies are not competing amongst themselves like car dealerships do, with the same vehicle being sold at different prices depending on the dealership. Why is that the case?

My second question is this. Based on your experience, can you tell us when the next increase in gas prices will take place?

● (1650)

[*English*]

Mr. Tony Macerollo: I fully expect that over the course of the day there have been many price increases and decreases, depending on where you are in the country.

I've been in this job since November, and I just recently discovered that, for example, in British Columbia the price that you see outside is not necessarily the price that you actually pay when you arrive at the gas station. It's a different marketing reality in Vancouver from what it is in Montreal and in Toronto.

The fact of the matter is that there is an element to this that is local market dynamics, where the number of gas stations on a given corner in fact does matter. Those are decisions taken by individual business people in the context of everything they're selling when you drive into that gas station.

[*Translation*]

Mr. Robert Vincent: Do you believe there will be an increase of 3¢, 4¢, or 5¢ on Friday, just before the holiday weekend in Quebec? No?

[*English*]

Mr. Tony Macerollo: It may or may not, but what I would suggest is that Mr. McTeague has developed some mechanisms to determine where prices go. I think the other important indicator that I've learned is that if you actually take a look at the data releases by the energy information agency in the United States shortly after the announcements come out on inventory levels, you see price movements fluctuate after that.

[*Translation*]

Mr. Robert Vincent: We base ourselves more on when the long weekends and holidays are in order to figure out whether gas prices will be going up.

Mr. Dane Baily: The Conference Board of Canada carried out a study a few years ago. In fact, this is the only statistical analysis that has been carried out regarding increases. There was actually no correlation found between long weekends and higher gas prices. They found that there was no link.

Mr. Robert Vincent: In any case...

Mr. C. Dane Baily: As consumers, we are much more sensitive to gas prices. We travel a lot, so it is natural to think that prices tend to be higher before long weekends. But statistically, it is not true.

Mr. Robert Vincent: Two weeks before the long weekend in May, people said that gas prices were going to go up. They were right. The Friday before the three-day weekend, the gas price went up by 7%. What a coincidence! The following weekend, the price was back down to where it was before. I do not understand.

[*English*]

The Chair: Mr. Vincent, thank you.

Mr. Tony Macerollo: I think we've answered the question. That may very well happen in some communities, but the only way you can get a comprehensive understanding of this is to do a proper study. You can do a study that looks at a local market, and it might verify your assumptions, but the Conference Board clearly in their national study did not correlate the two together on a nationwide basis.

[*Translation*]

Mr. Dane Baily: There is also the fact that two thirds of service stations have their prices set by the station manager. One third of the retailers are managed by the refiners. The largest has 7% of the service stations. It is impossible to push prices up with only 7% of the market. But it is easy to push prices down: if even a single station decides to drop its prices, the market will follow.

[*English*]

The Chair: Okay.

[*Translation*]

Mr. Dane Baily: All the...

[*English*]

The Chair: Thank you.

I don't have any other members on my list.

I did want to ask a few questions of the witnesses. First of all, thank you for coming in today.

When Natural Resources Canada were here they gave us the Canada average pump price components, and I think it's important to keep coming back to this. The 2006 average retail price was 97.7¢ per litre, crude oil was 45.8¢, the federal and provincial taxes portion was 32.7¢, refining margin 14.1¢, and marketing 5.1¢.

Their explanation on crude oil is that Canada produces 3% of the crude oil and we are therefore a price taker and we therefore cannot influence that portion of the final price of gasoline. Federal and provincial governments can choose to increase or decrease taxes, according to how they best see fit. The marketing margin, we are told, is 5.1¢ per litre, so it's fairly small. It's a very competitive market, especially at the local level.

So the hearings have really focused on the refining margin, which according to the 2006 average is 14.1¢. A big question there is of the margin, what is cost and what is profit? I thought I heard you say here today, Mr. Macerollo, that the profit was 1.5¢ per litre. I don't know if that was for 2006, but that's saying that the cost of refining is 12.6¢.

Am I correct in separating the cost and the profit within the refining margin?

● (1655)

Mr. Dane Baily: That's an average over the last 10 years, the 1.5¢ a litre.

The Chair: The 1.5¢ a litre is an average over the last 10 years.

Mr. Dane Baily: In 2006 it was about 2.5¢ a litre after-tax profit for the downstream. That's not an absolute calculation; it's an extrapolation using Imperial Oil, Petro-Canada, Shell, and Suncor. They are the only ones that produce that data publicly. They represent about 70% of the refining capacity in Canada, so it's a reasonable proxy for what is represented by the Canadian market.

The Chair: The rest—at least for the companies that are willing to share that information—is all cost of refining.

Mr. Dane Baily: I think it was about 2.1¢ a litre the year before. I actually have the numbers.

The Chair: Can you provide all that information to us in terms of which companies are willing to share that?

Mr. Tony Macerollo: Based on those that are willing to share it, yes.

Mr. Dane Baily: Those are all annual report data from those four companies.

The Chair: Another chart we have here shows that the marketing margin is relatively stable over time, but the refining margin in fact is incredibly volatile. It goes through massive swings, up and down. What is the explanation for the volatility in the refining margin?

Mr. Dane Baily: I'll dispute the point a little bit. In terms of the marketing margin, those are probably monthly averages. On a monthly average they don't change. On a daily, hourly basis, the marketing margin in Ottawa can go up and down 12¢ a litre.

The Chair: This chart is monthly. But the refiner operating margin is much more volatile on a monthly basis.

Mr. Dane Baily: Yes.

Mr. Tony Macerollo: Sure, because that would also reflect volatility in crude oil. That would also be affected by things like speculation in the marketplace after the energy information agency reports their data on inventories. I'm not sure what the frequency is, but it's at least once a month.

Mr. Dane Baily: You can pick Katrina, you can pick the power outage we had in 2003—you can see some of those peaks very clearly.

The Chair: Yes. Especially recently, this year, 2007, the main question I got in my office from people who were phoning in was.... Look, if you take crude oil as the primary...that is the main cost of the retail price, according to NRCan. People watched the price of crude oil, and the price of crude oil in fact was going down, but the price of gasoline was not following, at least closely.

What's your answer to people who phone us and say, look, the cost of crude is going down, but the price of gasoline is still going up, and therefore the refining margin is increasing and that's where the companies are making more profit than they should be—whatever that expression means? What's your answer to that question?

Mr. Tony Macerollo: I have two pieces of advice.

Certainly, as one who for many years took calls on the subject on behalf of a member of Parliament, I told them to call the Canadian Petroleum Products Institute.

In the absence of that, if you want to get into a detailed explanation, the crude oil market is a commodity market and the gasoline market is a commodity market on top of a commodity market. Operating at 100%, there's a maximum amount you can make. You may have all the crude oil in the world, but if you don't have—The facilities can only produce so much in a given day. If at any given point in time demand is outstripping the ability of the refineries to produce that kind of supply in the marketplace, you're going to see upward pricing pressures.

It's a North American market. Canadian consumers are competing with American consumers for the same product, and American consumers will pay more, quite frankly.

● (1700)

The Chair: Thank you.

I'd love to keep asking questions, but I see that my time is up.

That seems to be where the questions are in terms of the refining margins. Any information your organization or your members could provide on that would be very helpful.

I want to thank you for appearing before us today. Again, if you do have any further notes you'd like to pass along, please pass them through me or the clerk, and I will ensure that all committee members get them.

Mr. Tony Macerollo: Thank you, Mr. Chairman.

The Chair: Members, we will suspend for a couple of minutes. We will go in camera to do the counterfeiting and piracy report.

Thank you.

[*Proceedings continue in camera*]

Published under the authority of the Speaker of the House of Commons

Publié en conformité de l'autorité du Président de la Chambre des communes

Also available on the Parliament of Canada Web Site at the following address:
Aussi disponible sur le site Web du Parlement du Canada à l’adresse suivante :
http://www.parl.gc.ca
