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Chair

Mr. James Rajotte

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● (1300)

[*English*]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): Members, I am calling the afternoon meeting to order.

Pursuant to Standing Order 108(2), we are continuing this subcommittee's study on oil and gas and other energy prices. We had a very interesting morning session. We should have a very interesting afternoon session as well.

We have two guests appearing in person, and one witness is appearing by video conference and one by teleconference.

First of all, in person, from Carleton University, we have Ellen Russell, professor at the School of Public Policy and Administration. We also have Mr. Eric Sprott, the CEO and portfolio manager of Sprott Asset Management. Welcome to the committee.

Thirdly, by video conference, we have, from PFC Energy, Mr. Roger Diwan, partner and financial analyst.

Mr. Diwan, can you hear me?

Mr. Roger Diwan (Partner and Financial Advisor, PFC Energy): Yes, I can hear you very well. Thank you.

The Chair: Thank you.

And by teleconference, from Masters Capital Management, we have Mr. Michael Masters, the president.

Mr. Masters, can you hear me? This is the chair of the committee, James Rajotte.

Mr. Michael Masters (President, Masters Capital Management): Yes, I can hear you, James. Thank you.

The Chair: Thank you very much for that.

We have allocated about five minutes for each of you for an opening statement, and then we will have the rest of the two hours allocated to members for their questions and comments.

I think we will start with Ms. Russell, and then we'll continue with Mr. Sprott, Mr. Diwan, and then Mr. Masters.

Ms. Russell, you have five minutes for an opening statement.

Dr. Ellen Russell (Professor, School of Public Policy and Administration, Carleton University): Thanks very much. It's good to see you all.

I'm going to address the question of whether the price of oil is justified by underlying economic fundamentals. So do garden-variety demand and supply factors explain the high price of oil, or is something else going on that is distorting these fundamentals? Are there perhaps speculative pressures that are buffeting the price of oil away from fundamentals?

There are many angles one could take on this issue. I can't speak to all of them; my expertise doesn't extend to all of them. I am going to look at the role of financial deregulation in promoting speculation.

Recently there have been a lot of funds out there, including money that has fled other problems in the financial markets in the wake of the sub-prime meltdown. The money is coming from institutional investors, sovereign wealth funds, pension funds, and index funds. I sense that Michael Masters might address some of this. My angle on this is going to be the following question: if this money enters commodity markets, thanks in part to regulatory changes, do these institutional investors that enter commodity markets exacerbate speculative pressures?

Historically, speculation in commodity markets has been a big worry to regulators in commodity markets. In the United States, for example, in the wake of the Great Depression there was concern that price manipulation in commodity markets had run up the prices at one point and then contributed to this disastrous stagnation and downfall in commodity prices later. To prevent that kind of abuse from occurring in the future, laws were put in place in 1936, and subsequent regulations attempted to prohibit or at least deter speculation in commodity markets.

Typically, these kinds of regulations were intended to put speed bumps in place that basically limited the influence of speculation. Examples of these speed bumps included position limits—a limitation on the size of any one investor's holdings in an individual commodity, and limits on positions for market participants that were in the market for non-commercial purposes, entities that were not buying or selling commodities for underlying economic purposes. These sorts of regulations don't eliminate speculation. In fact, nobody thinks it's really possible to completely eliminate speculation, nor is it desirable. But speed bumps of this sort make it more difficult for speculators to overwhelm commodity markets.

Fast forward to the 1990s. As financial deregulation gathered momentum, many of those speed bumps were relaxed. One of the deregulatory milestones was the Commodity Futures Modernization Act of 2000 in the United States. It put oil in a so-called exempt category outside the regulatory regulations normally imposed by the Commodity Futures Trading Commission, the body set up to basically put these speed bumps in place in the first place. Thanks to this deregulation, two types of energy derivative markets were thereby exempt. One involved transactions between two counter-parties that weren't executed within a trading facility, and the other involved trades done electronically.

The idea that you could set up an electronic trading facility that could function without those speed bumps became known as the Enron loophole, so called because presumably Enron lobbied to have it put in place to facilitate its Enron online electronic energy market. The Enron loophole meant that limits on the size of positions that speculators could hold did not apply, so it in effect evaded the regulatory speed bumps that were supposed to deter speculation. In my opinion, the Enron loophole and other such manoeuvres to get around regulatory speed bumps have had an impact on oil markets. It's hard to quantify that impact. I can only rely at this moment on the IMF May 2008 regional economic outlook, which said it's hard to explain current oil prices in terms of fundamentals alone:

> Producers and many analysts say it is speculative activity that is pushing up oil prices now. Producers in particular argue that fundamentals would give an oil price of about $80 per barrel, with the rest being the result of speculative activity .

So why should you care if speculative activity is at least in part elevating the price of oil? There are a number of reasons, and I'm sure you've discussed many, but consider this one. When the price of oil climbs, investment in oil-related sectors is stimulated. Investment projects that would not be viable if oil was at $80 a barrel become viable when oil is $100 or more per barrel.

● (1305)

Now, if the price of oil is determined by underlying economic fundamentals, then any free market economist would claim that additional investment in oil is justified. But if the price of oil is being pushed up by speculative pressures beyond what the underlying fundamentals would dictate, then investment in Canada in the oil sector may be distorted by speculation in oil.

This is one of the grave problems about speculative bubbles. In the dot-com bubble, for example, lots of investment in Internet-related projects went forward, and when that bubble burst it was subsequently revealed that investment was really wrong-headed. Ditto for the latest sub-prime bubble.

If speculation is playing as large a role in the price of oil as the IMF report I just quoted would indicate, it is possible that in Canada we are experiencing a grave misallocation of investment. It is possible that we're over-investing in oil and under-investing in other sectors. If we are experiencing that kind of unjustified distortion of investment because the price of oil is not a reliable price signal, then this could have a negative legacy far into the future. It would indeed be tragic if we let our manufacturing sector and others be hammered and our oil sector overblown, only to realize that we have been guided by price signals that have been distorted.

Thanks very much.

The Chair: Thank you, Ms. Russell.

We'll go to Mr. Sprott, please.

Mr. Eric Sprott (Chief Executive Officer and Portfolio Manager, Sprott Asset Management): Thank you very much. I look forward to the opportunity of presenting our views to the committee. We have a presentation that I think each of you has, and I will briefly go to that.

We have two views on this topic. One is that we think that fundamentally the price of oil is going up because of the Hubbert peak oil thesis, which I will discuss. Two, we certainly have a view about who is involved in the commodity markets, because my job every day is to be a student of those markets. We are involved to some extent in some of the markets, and I'd be happy to speak to that.

There is a reason I want to talk about Hubbert's theory. In 1956, M. King Hubbert predicted that in 1970 peak oil production would occur in the United States in the lower 48 states. In 1970, peak oil occurred in the United States and has gone down ever since. Those same theorists who I follow—I'm not a geologist or chemist or have any intimate knowledge with the oil and gas business other than being an investor in it—have predicted that we will hit peak oil in this decade. In fact, in the data points that we have, if you go to the third page, you can see that conventional crude oil production—not non-conventional such as tar sands, methanol, and biofuels, but conventional production—has peaked out in 2005.

On page 4, we've shown the level of discoveries by decade. It's very easy to see that we do not find much oil these days. In fact, I think the commonly accepted number is that for every six barrels we consume, we find one today. So anybody who has any level of math knows we're going to run out. There's absolutely no doubt about it.

We've also put in another chart, on page 5, that basically shows that if you take the known reserves of oil in the ground and their grades, most of them are heavier grades now. We've been producing light grades, which produce more transportation fuels. Now we have in the reserves a higher grade. To produce the same fuels as we have today, we have to go from 85 million barrels a day to 100.5 million barrels to get the same light fuels.

So the message I'm trying to deliver here is that the world is in a real state of declining production in conventional oil. Frankly, I'm not surprised for one second that the price of oil goes up constantly. I'll also talk about speculators in the market.

We've given some examples. The example of Canadian conventional oil is on page 6. Most people would be surprised to look at that number and see that it has been going down since 1971. That's conventional crude oil production. We've had a little blip up here recently, undoubtedly with Newfoundland coming into play.

If you look at the next few slides, we show North Sea oil production, Norwegian oil production, and the Cantarell field in Mexico, which is a famous example. In 2004 it produced 2.4 million barrels. As of the month of July, it was at 971,000 barrels. It has lost a million and a half barrels in four years. Perhaps you might have a sense of how difficult it is to create 1.4 million barrels when I put to you that to produce 100,000 barrels in the tar sands it takes 10 years and $10 billion. This field has gone down 1.4 million barrels in four years. We also show a few other fields there, and 60 of the 98 producing countries in the world have peaked.

So I am of the belief that we are going to have an oil shortage. That oil shortage causes all commodities in the energy area to rise, as we've seen uranium skyrocket, coal has recently skyrocketed, and natural gas has gone to 15%.

Is there speculation in the energy markets? Absolutely. We have our own “made in Canada” examples of it. Amaranth lost a large amount of money, being in long gas contracts, and essentially had to wind up their fund. We had an example of a major Canadian bank announcing that they had lost $680 million in natural gas derivatives. If you lose $680 million, how much did you have invested? You're a chartered bank. Are you speculating, or is this some logical thing?

● (1310)

I'm a student of the gold market. I see major banks get involved in the gold markets ad nauseam, negatively or positively affecting the price. I think the speculators are very much involved in the commodity markets. We have a nickname. We call it the New York Comedy Market—it's a bit of a joke sometimes to see the volatility in those markets.

That concludes my preliminary comments. Thank you.

The Chair: Thank you, Mr. Sprott.

Mr. Diwan.

Mr. Roger Diwan: Good afternoon. Thank you for giving me this opportunity.

What I want to talk about is price formation in the oil market and how we got from $20 to $140 and back down to $120.

What's important to know is that the oil market, between 1985 and 2003, had a very large “spare capacity”, unused capacity. We had over-invested in the seventies when oil prices went up and demand suddenly declined. During those 20 years, OPEC had to shut down a large amount of production. That spare capacity, between 1985 and 2003, shrunk a little bit every year but kept oil prices at a very low level, between $18 and $20. At these prices, we have under-invested in the industry for something like 20 years.

Think about it. It meant that for every new barrel of demand we had, we didn't need to go and find oil or produce oil. We just needed some of the producers to turn on the tap. If you look at how we met the rising demand during those 20 years, over 60% came from opening the tap. That didn't cost a lot of money.

In 2003, 2004, and 2005 there were two shocks, a supply shock and a demand shock, which basically wiped out the spare capacity. The supply shock happened in 2003 when there was the Venezuelan strike, the situation in Nigeria, and then the Iraq war. We removed a lot of barrels from the market at a time when the world was starting to witness a demand shock, not only from China but also from certain places in the Middle East and in the United States. In 2004 we had incredible demand in the United States. These two shocks at the same time have removed all the spare capacity, and without spare capacity, oil markets work in a very different way.

Think about it. Before that, if you were an investor or speculator, you weren't really willing to play on that market, because any decision by OPEC could increase or decrease production by a very large amount and completely change the price structure. So there was a political risk, an OPEC risk, which for a lot of financial players was unacceptable.

As spare capacity wilted, we saw the emergence of the supply narrative. According to this narrative, we don't have enough oil, peak oil is here, and demand is rising.

I have my own slightly different opinion on that, but this narrative is very powerful among financial players, much less so among the industry players. Oil companies don't get that worked up about peak oil, but the narrative is important because it tells you that we're entering an era of scarcity, so this is the time to invest and put money into oil. That movement and that supply narrative, in a way, has created another phenomenon, which is the key to understanding oil prices. It's what I call the financialization of oil markets.

Before 2003 or 2004, oil markets were small commodity markets with few players, some of them very large, who were able to move a lot of barrels in arbitrage. In 2003 you had something like 50 financial institutions on the NYMEX. Today there are over 400 financial institutions trading on the NYMEX. So when you removed that spare capacity and added into the mix the supply narrative, that scarcity element, you brought into the market a lot of players. Many of them didn't know much about the commodity but saw one price trajectory, which seemed to them a good way to make money and to put money into play.

The financialization of the oil market is important because, between 2005 and 2008, the key oil price indicators became something other than supply and demand. I'm a fundamentalist. I've been doing this for 15 years. I know how to look at supply and demand and forecast oil prices. It worked very well until 2002. But between 2003 and 2005, the key indicator for forecasting the movement of oil prices became the amount of money coming into the exchange. It was purely the amount of money coming into the exchange, and later on, between 2006 and 2007, it was largely the position of the non-commercials, the net lengths of the non-commercials. So these specific speculators—and I have a lot of trouble with that term, for I would call them investors—were directing the magnitude and the shape and the trajectory of oil prices.

● (1315)

That's very important. Suddenly it's not the physical players but the financial players who are directing, just because of their weight and their size, the direction of oil prices.

As that market matured, in a way, and these players became a lot more savvy, suddenly we started to see other phenomena appearing, and what happened in the last 12 months is actually very intriguing. As all these financial players come into the market, suddenly they're making arbitrage: they're not only putting money in oil, but they're deciding, if they're putting money into oil, to take it from somewhere else. They're making portfolio arbitrage across all the asset classes. This is what I call it. Oil becomes an asset class per se. Suddenly they're deciding one day to invest in the dollar; the next day the dollar is going down, so they're investing in oil, or they're investing in the Canadian dollar, or whatever. They're making this arbitrage among their portfolio assets. That obviously has brought in more money, because new players have come in who are largely university endowments and pension funds—what are called more passive money, in general.

This arbitrage has somehow linked oil prices with other fundamentals, with what I call the “macro macro-fundamentals”. Suddenly oil prices in the last 12 months.... If you want really to understand what happened to oil prices, you need to correlate oil prices with the U.S. dollar and U.S. interest rates. The mortgage crisis in the United States, which has had an impact on loosening interest rates and weakening the dollar, had a tremendous impact on oil prices. You have a very good correlation there.

And actually we see it happening in the reverse now: as the dollar is strengthening, oil is weakening. In that sense, oil has become a financial asset, where the fundamentals matter. After all, we have under-invested for a long time. The physical supply and demand balances until now have been fairly tight. I think they're probably reversing a little bit in the next year and a half, because oil prices have started to destroy demand, but what you had in a way is macro-fundamentals and oil fundamentals having become, both together, the key driver of the oil prices.

I'll stop it here. I'll take questions later.

● (1320)

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

We'll now go to Mr. Masters.

Mr. Michael Masters: Thank you.

I appreciate the opportunity to speak with you today about a recent and never-before-seen phenomenon in the commodities futures markets. Historically, these markets have had two types of participants: one, physical hedgers, who are the actual producers and consumers of tangible, real-world commodities; and two, speculators, who trade commodities futures to try to make a profit.

The commodities futures markets were started by physical hedgers and exist to serve them, and traditional speculators are allowed to participate because they provide liquidity by actively buying and selling. However, in the last five years, large institutional investors have adopted the misguided belief that commodity futures are an asset class in which they can make a passive, broadly diversified, long-term investment in the form of commodity indices. I call this new and more damaging breed of speculator “index speculators”. They have been encouraged by Wall Street to think of an allocation to the S&P Goldman Sachs Commodity Index or the Dow Jones-AIG Commodity Index, which are the two leading indexes of commodity futures, in the same way as they think about the S&P 500 stock index. The problem is that commodity futures markets are not capital markets, and when deep-pocketed investors try to make passive, long-term investment in commodity indices, it causes great damage to the commodities futures markets and to the economy as a whole.

Institutional investors have poured hundreds of billions of dollars into the commodity futures markets, and assets tied to the commodity index investments have ballooned from $13 billion in 2003 to approximately $317 billion as of July 1, 2008.

As chart one in my written testimony shows, this has driven up prices for essential food and energy commodities by an average of more than 200% in the last five and a half years. In fact, the total open interest of the 25 largest and most important commodities upon which the indices are based was $183 billion in 2004. From the beginning of 2004 to today, index speculators have poured $173 billion into these 25 commodities. This is a very significant amount of money flowing into what amounts to a very small market.

As chart two in my written submitted testimony shows, this has caused futures prices to rise dramatically as the commodities futures markets were forced to expand in order to absorb this enormous new influx of capital. Index speculators have bought more commodity futures contracts in the last five years than both physical hedgers and traditional speculators combined. They are now the single most dominant force in the commodities futures markets today.

In 1998, physical hedgers on average outnumbered speculators by a greater than 3:1 ratio, according to the CFTC. Today speculators in general outnumber physical hedgers by more than a 2:1 ratio. This is a colossal shift in the balance of power. Physical hedgers' positions have grown more than 90% in the last 10 years, while speculators' positions have grown more than 1,300% in the same timeframe.

The worst thing about index speculator buying is that it has really nothing to do with true supply and demand fundamentals. As an example, when a $10 billion pension fund investment committee decides to put $500 million, or 5% of its portfolio, into the S&P GSCI commodity futures index, then the $200 million that consequently flows into WTI crude oil futures has absolutely nothing to do with the supply and demand for crude oil in the marketplace. More damaging still, because index speculators enter the commodity futures markets with a fixed amount of dollars to invest, they care little what price they pay per barrel as long as they can put all their money to work. They buy as many barrels as they can, at whatever price they have to pay, until all their money is fully invested.

As a result, the prices for commodities are pushed much higher and are amplified more than supply and demand dictate. This means that the price discovery function of the commodity futures markets is greatly damaged. In fact, because futures prices are the benchmark by which commodity prices are set in the real world, this raises the real-world prices for food and energy. So not only are the misguided actions of index speculators distorting the commodity futures markets, but they're hurting the worldwide economy because every participant in the spot market is forced to pay more for food and energy.

● (1325)

The U.S. government must take action to re-establish reasonable and rigid limits on speculation and to prohibit the damaging practice of index speculation. The world's economies cannot be held hostage by the investment whims of Wall Street.

This concludes my testimony.

The Chair: Thank you very much, Mr. Masters. We appreciate that.

Now we'll go into questions from members.

Mr. Masters, there are 12 members of the committee, so we'll ask each member of the committee to identify themselves as they ask questions, especially for you and Mr. Diwan on video conference.

For the first round, we have six minutes for each member; for the second and third rounds, we have five minutes for each member. It's a very limited time for questions and answers, so we ask that you be as brief as possible in your responses. If a question is asked of one witness and someone else would like to answer, please indicate that to me.

We'll start the six minutes with Mr. Dan McTeague, the vice-chair.

Hon. Dan McTeague (Pickering—Scarborough East, Lib.): Thank you, Mr. Chair.

Mr. Diwan, Mr. Masters, Ms. Russell, and Mr. Sprott, thank you for being here today.

I just want to say that your testimony here is absolutely important. Several months ago when we were looking at the issue of why prices were instantaneously rising without real explanation, certainly not from the industry, it was refreshing to hear your comments to the U. S. subcommittee. It's too bad we weren't able to do this earlier, but this is a committee that works by consensus. I'm glad that the amendment I made to get this on the record is indeed bearing fruit today.

We've just heard from representatives of the downstream of the oil industry who suggested that in fact supply and demand are very much in order as it relates to pricing. Of course I don't believe that, and I'm refreshed by the comments you have just made.

I'm wondering if, Mr. Diwan or Mr. Master, and perhaps you, Ms. Russell, you can explain to us the dimension to which Canadian pension funds, sovereign funds, index investors, and institutional investors, as you've called them, may be involved in taking advantage of the loopholes created by the commission on futures trading in the United States.

Mr. Michael Masters: I believe the Ontario teachers' fund is one of the participants in commodity futures indexation replication strategies. Beyond that, I am not aware of any others. It is a reasonably popular asset class now for many pension funds across the United States. And I imagine there are other participants in Canada other than the Ontario teachers' pension fund.

● (1330)

Hon. Dan McTeague: Mr. Diwan.

Mr. Roger Diwan: I'm not particularly well aware of the Canadian market; I work mostly here in the United States. But I imagine that hedge funds and pension funds have replicated what American, European, Asian, and Middle Eastern pension funds have done. Unless there is a legal reason in Canada not to be able to do that, I imagine they have done what their counterparts have done.

Hon. Dan McTeague: Yes. I just noticed the Intercontinenta-lExchange has one of its offices here in Winnipeg, Manitoba.

Ms. Russell.

Dr. Ellen Russell: Well, I think that when one group of institutional investors, say in the United States, is able to do something, it creates pressure for everyone to do likewise. So even where there might be some regulatory restrictions in place, they will scramble to try to find their way to do what the other folks that are in the same ball club do. There's a lot of pressure there for them to do likewise.

Hon. Dan McTeague: Let me ask all of you if this is correct.

I'm noticing that the Department of Energy has just released its figures, saying that demand in the United States, which represents half of the world's transportation demand on fuels, has now dropped to levels we haven't seen since 1998 in terms of crude, gasoline, and jet fuel.

I find it rather interesting—I'm looking at Bloomberg as we speak—that gasoline prices are heading up 7.7¢ to 8¢ a gallon tonight; crude is up $2 a barrel. Is this an example of the sickness and the dysfunctionality of this market, which has eluded Canadian officials up until now, Mr. Diwan?

Mr. Roger Diwan: Well, yes and no. I mean, there are short-term events. There is a very big storm in the Caribbean coming toward Louisiana, and you have a long holiday here—Monday is closed—so the market is preparing for a potential big disruption. You have to be careful about these small movements.

I want to comment a little on the gasoline, because that's important. If you look at supply and demand in gasoline in the United States, it has really loosened, and the suspicion is that gasoline is fairly oversold now. You are producing more gasoline than you need or you're importing a lot less, and you've seen it in the gasoline prices. The gasoline prices are low in the United States. What's high is the crude portion of the price, not the gasoline portion. Refiners are not doing well. They're not losing money, but they're not really making money. They have very low margins, so we have to be careful when talking about gasoline prices. Yes, the price that consumers are paying is high because the crude portion of it is high, not because the gasoline portion of it is high.

Hon. Dan McTeague: Mr. Diwan, if I were to tell you that Canadian refiners are charging 30¢ a gallon more than NYMEX RBOB unleaded gas, would you say that's a fairly profitable proposition for Canadian refiners?

Mr. Roger Diwan: Yes, it's certainly profitable.

Hon. Dan McTeague: Thank you.

Mr. Chair, how much time do I have?

The Chair: Mr. Sprott, did you want to comment?

Mr. Eric Sprott: I have a comment on both questions.

I do have some answers about Canadian participation. I've already mentioned that Amaranth was involved in the natural gas market to a very large extent. I've mentioned that a major Canadian bank was involved in natural gas derivatives to a very major extent. If one bank is, maybe lots of banks are. Sometimes they're long, sometimes they're short, and I think that's one of the things this committee should be aware of, because every time there's a futures transaction there's a buyer and a seller.

Hon. Dan McTeague: On that point, Mr. Sprott, perhaps I could ask Mr. Masters the following question: the level of institutional investors that you've referred to who are entering the futures commodities markets, is it greater than and outstrips the demand of the Chinas, the Brazils, and the Indias who are usually used as an excuse to drive these prices up?

Mr. Michael Masters: I think right now you have demand that's certainly equivalent to China's, based on the data that we've seen.

One other point that I'd make really quickly, going to Mr. Sprott's point that there's a buyer for every seller, is that it's correct, there absolutely is a buyer and a seller. Our really important point—and this is how markets allocate around the world—is at what price? There's been a buyer or seller for every transaction in history, so clearly that's not the only issue with regard to price movement. It's a question of the demand at a certain price.

So as far as I'm concerned, I think there are very positive supply and demand fundamentals that have contributed somewhat to the increased price of crude oil and other commodities. But just as important, I think, what is lesser known is the amplification, as Mr. Diwan has said, or the financialization of commodities that has taken place. And I think that's had a very, very significant effect on price—as well as the typical supply and demand fundamentals that people quote .

● (1335)

The Chair: Thank you.

Thank you, Mr. McTeague.

We'll now go to our second member, *Monsieur Bouchard*.

[*Translation*]

Mr. Robert Bouchard (Chicoutimi—Le Fjord, BQ): Thank you, Mr. Chair.

Thank you for coming to testify this afternoon.

I am the member for the constituency of Chicoutimi—Le Fjord in the Saguenay—Lac-Saint-Jean region. We get a tax rebate. The Quebec government levies a tax of about 15 cents per litre. In my region, the tax is 10 cents per litre. Until 2003, we were never able to see this reduction because the fluctuations in the price of oil meant that the price was the same in Saguenay—Lac-Saint-Jean as it was everywhere else. However, a movement started in our region called the coalition on gas prices. Companies were boycotted in turn with the result that the 5-cent reduction can now be seen. In other words, there is a difference of 5 cents per litre in the price of gas in Saguenay—Lac-Saint-Jean and the price in Montreal or in Quebec City.

Here is how we explain that difference. When people put pressure on a company, things start to happen. The pressure in our region gave us back the 5 cents per litre reduction granted to outlying areas to recognize transportation costs. When consumers put pressure on a company and object to price increases, it has an effect.

So, do you see it the same way?

[*English*]

The Chair: Who would like this?

Mr. Eric Sprott: Maybe I'll try to answer the question about Chicoutimi.

As I reflected when coming down here, in my life I was the CEO of a company called Canadian Turbo, which was in the business of refining oil and had 300 gasoline stations in western Canada. I thought it was the worst business in the world. I still think it's the worst business in the world. I noticed that Conoco today announced it's getting out of the business and is selling 900 stations in the United States.

I have not been a great believer in integrated oil companies making much money at the pump. We know they make lots of money, but I think, quite frankly, they make it upstream.

I can't answer the specifics of whether a group raising concerns about a thing will have any natural impact. I don't think the margins in the refining business are particularly high. I know they're very low in the U.S. right now.

The Chair: Mr. Diwan.

Mr. Roger Diwan: I agree. I think the refining business has been terrible for the last 25 years, except for the last three or four years. You had excess capacity, and the problem in the refining business is that once you build it, it's there forever. It doesn't waste...as you do for the upstream. So oil companies have little interest in the downstream, with tight margins. However, in certain regions you have positions of monopoly and certain companies do benefit much more than others, depending on their regional implementation and how much competition exists. So you have big regional price differences. It depends a lot on concentration and the distribution networks.

I don't know the situation in Chicoutimi, but in the U.S. you can see that different markets have different fundamentals, with different prices. In California, we pay a dollar more than does the rest of the country. In the midwest, some regions are difficult to access by pipeline, so some of the local refiners make a lot more money.

We need to make sure—and that's the role of the regulators—that we have a level of competition, that we have access to the logistics and are able to monitor prices to compare them to the main prices, or the exchange prices, to see if there are big differentials and whether or not certain companies are really pushing the envelope a little bit.

● (1340)

The Chair: Ms. Russell, did you want to respond?

Dr. Ellen Russell: Yes, I'd like to speak to that question.

I don't know about this particular example in your riding, but what I think is interesting as an illustration is that it would appear, from your story, that people got together and started questioning whether the price was reasonable and whether they could do anything about it. They said, this price perhaps doesn't arrive as a force of nature; there may be some room to question it.

That may be the case in terms of the price at the pump, but for me, the larger question is the many steps before that fuel hits the pumps. There are questions to be asked. As a group, we could ask questions to see if we think these various steps along the way are being conducted appropriately.

[*Translation*]

The Chair: Mr. Bouchard, you can ask a quick question.

Mr. Robert Bouchard: In Canada, does the Competition Bureau have the necessary power to check if there is real competition at all levels, whether crude oil producers, refiners or retailers, so that gas prices are fair?

[*English*]

The Chair: Who would like to take that one?

Mr. Sprott.

Mr. Eric Sprott: I'm no authority on the Competition Bureau. I hope you don't think I'm sticking my head in the sand, but I've been around almost as long as all of you people, and I keep hearing about reviews of gasoline pricing in committees in the U.S. and in Canada year after year. Every time the price goes up, some committee reviews it, and every time there seems to be no evidence. Now, why there's no evidence, I don't know.

I think it's been overdone. As Mr. Diwan and I have both said, people in the refining business or the marketing business make very little money. It's not a great business to be in, unfortunately. I think it's something we chase all the time. But I always go back to saying we have a fundamental, major problem in this country and in the world. The biggest problem in the world is the declining sources of energy, and the International Energy Agency is going to go there. You will see that in November they're going to come out with a whole new study of world supply and they're going to change your assumptions. It's a very big issue.

The Chair: Thank you.

Merci, monsieur Bouchard.

We'll go to Bruce Stanton, please.

Mr. Bruce Stanton (Simcoe North, CPC): Thank you, Mr. Chair.

Welcome to our panellists here today. This is a very important topic that is certainly on the minds of many people in our home constituencies and right across the country.

Ms. Russell, it's good to see you again. I want to direct my first question to you.

In preparation for today's meeting, we read fairly extensively from the report of the interagency task force, a U.S.-based organization, as I understand it, that looked at this issue of speculation over the last five years and the degree to which it's in fact causing oil prices to increase and at what the cause and effect circumstances are.

In their interim report, which just came out at the end of July, they indicate that they really can't see any evidence of that; that when they employ what's called the Granger causality test to that transaction, it would in fact indicate that the price of oil comes after the fact, not the other way. In other words, the positions that are taken by the so-called speculators or investors are taken after price changes. One might conclude from this that the price changes are affected by supply and demand factors and that the investment positions that are taken follow.

This seemed to be fairly consistent through the course of their conclusions—and I will point out that thus far It is an interim report.

Do you have any comment on that? Certainly what you discussed earlier painted a different picture.

● (1345)

Dr. Ellen Russell: Yes, we get to play the game of whose study is the right study.

Mr. Bruce Stanton: To be honest, that's what we end up doing.

Dr. Ellen Russell: That's the game you're all playing, right ?

Mr. Bruce Stanton: Exactly.

Dr. Ellen Russell: It's not a fun game to play, because they're highly technical, and to excavate the technical methodology to figure out whether you think a study was done the right way with the right data, or whether something has changed since the.... It is laborious, to say nothing of the other adjectives in this process, to try to figure out whether you believe these studies or not. It defies reason, to me, that all of this money can be coming into the market with no effect, that this is all after the fact—you know, moving around and not doing something to the underlying price of the thing that's being examined. I think probably you could line a bunch of studies up on one side and a bunch of studies on the other and debate their technical merits for a long time, and ultimately you'd come to your own position on it.

My position is that there is some impact. It's not an all-or-nothing thing, it's not just speculation, it's not just these underlying fundamentals; it's a blend.

The Chair: Mr. Masters, did you want to comment?

Mr. Michael Masters: Yes. I was going to say that the CFTC has had a lot of issues concerning this. There has been a lot of criticism of the agency.

During my testimony in May, one of the senators, Carl Levin, called the CFTC a sort of "see no evil, hear no evil" kind of agency, in the sense that they tend not to see what's going on sometimes. There are some questions about staffing, and so forth. I have nothing against the CFTC, but I find it interesting that until testimony in May from me and others, the CFTC denied that they needed to do a study or anything else.

The Republican administration has had views on this that have been one way, and because the CFTC chairman and the treasury and so forth—that working committee—all derive from the same administration, it's clear to me that it's unlikely that they would—

Mr. Bruce Stanton: Are you saying it's because of political bias?

Mr. Michael Masters: Yes. Recently a CFTC vice-chairman, Bart Chilton, said that he felt the study may have reflected a foregone conclusion. More important, in the last few weeks the CFTC themselves reclassified one very large trader, Vitol Corporation. I believe it was in *The Washington Post*. They had classified them as commercial and then reclassified them as a—

Mr. Bruce Stanton: Mr. Masters, I don't want to cut you off, but I only have six minutes. I have one little follow-up question along the same lines, if you don't mind, which I will direct to Ms. Russell.

In our context, we're faced with the same issue. You have contradictory reports on this phenomenon, if I can call it that. From a public policy point of view, it's in our interest to do what we can to make sure we have prices for oil that are reflective of supply and demand. If we assume that there are some issues, what is one to do, Ms. Russell, to bring some effective public policy to bear on them?

● (1350)

The Chair: Ms. Russell, and then Mr. Sprott.

Dr. Ellen Russell: I've used your time. Why don't you go?

Mr. Eric Sprott: Mr. Stanton, it is my belief that the commodity markets are not well regulated. I would not believe that report. We have seen so many examples. All of us have seen them. We saw Amaranth. We saw the SemGroup recently blow up and lose $3 billion. How much did you have invested to lose $3 billion? Maybe you had $12 billion. All the regulators who say they are regulating things, particularly in the U.S., are not regulating. People say they're regulating the banking business. They have no idea what's happening in the banking business. The derivatives market is totally out of control. There are six hundred trillion derivatives out there that have nothing to do with the commodity market.

But the one thing I want to say about the commodity market is that it's a paper market. It's paper. Anyone with a lot of paper, a bank or hedge fund, can trade paper, but do you know what? They don't take delivery of the oil. You have a real oil market and a paper market. They're two different things.

The Chair: Thank you.

Ms. Nash.

Ms. Peggy Nash (Parkdale—High Park, NDP): Thank you.

Welcome to the witnesses this afternoon.

Ms. Russell, I'd like to start with you. I hear you saying that there may be factors like supply and demand involved in the prices, but the deregulation of the market, specifically the Enron loophole, has led to dramatically greater speculation investment that wouldn't otherwise be there. We can all think of the dot-com investment and the sub-prime mortgages, which hurt a lot of average people, made a few people rich, and then created real havoc in the aftermath. You talked about how it drives up prices. You said it was a misallocation of investment that could leave a legacy far into the future.

Can you tell us what such a misallocation of investment could mean for Canada? What should we be trying to do to prevent that misallocation?

Dr. Ellen Russell: When the price of oil is relatively high, this encourages investment. Investment in oil is a long-term proposition. You can't suddenly reverse investment made in enhancing the supply of oil. These are big, lumpy investments that will extend far into the future. In response to the 1970s oil difficulties, there was a lot of investment made to increase supply, which ended up casting a shadow over the market for some time to come.

The issue I'm flagging for you is that we might be overheating investment in oil in response to these price signals, which have been partly inflated by speculation. Once we've committed to those investment decisions, we're going to have to build facilities intended to serve the market far into the future—this is oil that doesn't come today, it's oil that will come in the future—and perhaps that's not justified with the underlying economic fundamentals. So when you consider the landscape of the economy in general, it's a concern to be putting all of this emphasis on the oil sector, to the detriment of other sectors that might merit investment if this price signal mechanism weren't so distorted.

Ms. Peggy Nash: Just to pursue that, the main industry committee did a study of the impact of the dollar on the manufacturing sector, and certainly we heard concern there from manufacturers and anybody who exports or is particularly price-sensitive, I would argue —tourism as well, the cultural sector. Is there similar concern about the high price of oil, especially if it is an artificially high price, that it could permanently damage key sectors of the Canadian economy, like tourism, like manufacturing, that may afterwards have difficulty recovering? Are we putting too many of our eggs in one basket?

● (1355)

Dr. Ellen Russell: Certainly the concern is that these are decisions that have repercussions far into the future. So if, for example, you over-invested in oil today, let's say, and under-invested in manufacturing, and you did that for as long as an oil bubble lasts —I don't know how long that is—then once you've misallocated that investment, you can't reverse it instantly. So a manufacturing plant that gets closed today because it's a casualty of this difficulty doesn't just open up the minute the price signals return to something like fundamentals. That may be gone. That window of opportunity is closed, because it's shuttered by the—

Ms. Peggy Nash: Mr. Masters, are we facing an oil bubble?

Mr. Michael Masters: I don't know if I'd call it a bubble or not. I think you have definitely seen the amplification of price, of a fundamental supply and demand situation, by investors. Now there's debate over what that amplification is.

My view of the world is that $170 billion going into anything is going to have pretty significant distortions on the price, especially when the markets are much smaller than the typical capital markets that capital market investors usually invest in. So I think it's had a fairly significant impact on the price, and if that's the case, then it does call into question the level of investment that's appropriate. To a certain extent, what you may be getting is more investment than you would otherwise get today, front-end loading it. The problem with that is that what you don't want to see for true energy security is that investment to suddenly go away if prices come down significantly, because they shouldn't have been up as much as they were. That's the issue with bubbles.

You go back to the housing market; you go back to the Internet situation. A lot of supply that was planned to come on ended up not coming on, and so the demand that was anticipated in fact didn't actually materialize, but the plans and the financing and so forth that were anticipated came into being and they were left sort of holding the bag, if you will.

The Chair: Ms. Nash, Mr. Sprott wanted to comment as well.

And I think, Mr. Diwan, you wanted to comment? Okay.

Mr. Sprott.

Mr. Eric Sprott: I'd like to make two points.

As you realize, I believe we have an oil problem in the world. It's because of something called depletion. When you start production, a well automatically depletes because the pressure depletes. Your production goes down. You're on a treadmill here, where you have to spend a lot of money just to keep production up. I would venture to say that the industry in the world spends 15% more a year and it gets nothing for it. There's no extra production. So we have a problem.

Exxon, I believe—and I wish I knew the exact number—spent something like $50 million a day and the reserves went down last year. It is not easy to find oil; it's not easy to find gas. Everything gets more expensive all the time. So that's the point I'd make.

The Chair: Just briefly, Mr. Diwan.

Mr. Roger Diwan: I want to make the same point.

We have a tremendous increase in oil prices, but we haven't seen supply increasing. So we are not in a situation right now where we are misallocating in a big way. What high prices have done is reduce demand, and it's painful for consumers. But from the point of view of public policy in the United States in particular, it's probably a good thing.

But the fact is that the increase in prices has not given us more supply, for a number of reasons. One is that we don't have the capabilities in the service sector to increase production; the second is that we are not finding any more very large new provinces. We're finding some of them: Brazil is an interesting one; the deep water off the Gulf of Mexico is a good one; Canada, the oil sands, is a good one. But what you see is a big depletion across the world. So what you have here is that as new fields are coming online, they're just not replacing the declining older large fields, and supply is not rising.

The Chair: Thank you.

Thank you, Ms. Nash.

We'll go to Mr. Alghabra, please.

● (1400)

Mr. Omar Alghabra (Mississauga—Erindale, Lib.): Thank you, Mr. Chair.

Mr. Diwan, I want to follow up on that point because initially, in your earlier testimony, you said that you were not necessarily accepting the narrative of the oil industry that there is a shortage of reserves or oil production, but now you have just said that they're having a hard time finding oil.

So could you reconcile that, please, for me?

Mr. Roger Diwan: Yes, it's fairly simply.

The world is divided in two, if you want. You have what I would call the OPEC and non-OPEC countries. Inside the non-OPEC countries is where production has really not been increasing over the last five years—or you had an increase in Russia and a decline pretty much everywhere else. When you think about the non-OPEC world, basically the countries outside the cartel, they represent something less than 15% of global reserves—and that includes Russia. All the rest of the reserves are in areas that are not open to investment and/or exploration by the international oil companies.

So if you take 100% of the reserves in the world, if you want, 77% reside in countries or among companies that do not allow third-party access. The exception to the rule is places such as the United States, Canada, Australia, and Great Britain. The rule is that it's not open. It's in Saudi Arabia, it's in Iran, it's in Iraq, it's in Mexico, etc., where you do not have access.

So in the portion of the world that is open—and really, the truly open commercial oil represents only 6% of world reserves, that is, in the U.S., Canada, Australia, and Great Britain—yes, you are reaching levels where you're producing a lot and it's very difficult to replenish your reserves and continue producing at these levels. In the rest of the world, where we do not have access, the problem doesn't seem to be oil under the ground or the reserves of molecules, but access and the capacity for production.

And if you take all of these countries together, which represent something like 35 to 40 million barrels per day of production, there's only one country that's really investing, and that's Saudi Arabia. The rest are not.

Mr. Omar Alghabra: Thank you, Mr. Diwan.

There appears to be a very powerful scientifically based narrative that speculators are over-speculating or increasing the price of oil not based on fundamentals. One would think that in an informed, intelligent market there would be a correction soon if one were worried about one's investments, but we also know that there are a lot of emotional factors and peer pressure and wanting to participate in the money-making now, taking risks and hoping that it will last until you pull your money out.

From our perspective, what can a government do? We know that in the U.S. now there is a movement that is rightly asking the government why they didn't act to protect against the sub-prime crisis. What can we do, as legislators, as a government, to ensure that we manage this crisis before it occurs?

The Chair: We'll go back to Mr. Diwan.

Mr. Roger Diwan: I'll go back to what Mrs. Russell said, that we removed the speed bumps; we removed the speed bumps in the United States. And the question is—and there has been a lot of discussion on this in the United States, where Mr. Masters and I have been quite involved—how do you put back the speed bumps to make sure that you basically look at these markets and understand what is going on? There is a movement here, and the CFTC has to look a lot more into the data and reclassify them, and I think in September we're going to see a much larger reclassification of the data to better understand the dynamic of these markets. They're complicated. But at the same time, I think it's also a political battle, as you have certain lobbies; and the financial industry, which has not been doing particularly well, doesn't want to see that loophole closed, because it's the only place where they're making money right now.

So you have different interests at play in the United States, and at the end of the day, it's a U.S. issue of how you put back the speed bumps and make sure you regulate your markets.

The Chair: Okay, we'll go to Mr. Sprott.

Mr. Eric Sprott: I want to reiterate that there are paper markets and there are real markets, and the commodity exchanges are a paper market.

● (1405)

Mr. Roger Diwan: It's the same thing.

Mr. Eric Sprott: There's rarely delivery of a commodity. So money forces can make prices do what they want them to do, and very often the physical market follows that price, because that price is the one quoted in the paper every day. But there rarely is a trade in commodities.

I would point out—and most people wouldn't be aware of this—that the latest example of a company having a problem in the commodity market is a company called SemGroup. It would seem, from information in the public domain, they were short oil. They were short oil and got caught offside.

Remember, there are both buyers and sellers here. Each side can be offside. No one has made the point that the shorters are more significant than the others, and I think Mr. Diwan actually made a very salient point that you missed. He said the best public policy is to have the price go up so that people stop using oil.

Mr. Omar Alghabra: Mr. Sprott, you just said that the market is not really regulated, and we saw what deregulation caused the sub-prime market in the United States. So are you suggesting that we should just let the market work its way through this?

Mr. Eric Sprott: No. I think the commodity markets might be very poorly regulated. That's the paper market. Then there's there real world where oil is produced, consumed, and purchased.

Mr. Omar Alghabra: So you're suggesting we should regulate the paper market.

Mr. Eric Sprott: Yes, and I already called it the comedy exchange. I think there are too many institutions that force the price around.

The Chair: Thank you.

I'll go to Mr. Carrie, please.

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

There seem to be a lot of different opinions on this, and I wonder if we could get a comment.

I have a quote here from Mr. Manzoni, the CEO of Talisman Energy. He said that the oil market is in a structural fix, with supply growth lagging demand rather than speculative activity fuelling the high prices. While speculation and currency fluctuations are issues, they aren't driving the long-term oil price. He stated, “It's going to stay structurally high for a year or two, certainly not at $140 a barrel...but at $90 plus”.

I wonder if you could comment on that quote, Mr. Diwan, and then maybe Mr. Masters could comment.

Mr. Roger Diwan: Sure. As I said in my opening statement, there is a supply and demand issue. You have fundamental issues and you've had two shocks. Think about the last 12 months, when oil prices moved from $70 to $150 and back to $110. Obviously fundamentals haven't changed that much in the last 12 months for supply and demand. They have changed, but not that dramatically. They haven't doubled. We haven't seen such a big difference in what we thought the market would be this year when we were thinking about it last year.

Obviously you have massive amplifications of movement due to money coming in and out of the oil market. Mr. Manzoni is right in a sense, but that doesn't tell me if the price should be $70, $90, $110, or $130. Nobody knows what that price should be; we know that it's amplified. I know only one price I can tell you about, which is basically the marginal cost of producing an extra barrel of oil from a green field. It's probably around $80 or $90 right now, because the dollar is declining. So we know that the marginal price in the long term, if you start a new investment today, is around $80 or $90. That's the only thing I know. I don't know exactly where supply and demand should put my oil prices, because the indicators are all over the place.

The Chair: Mr. Sprott.

Mr. Eric Sprott: I think what Mr. Diwan has said is incredibly important, certainly for us as Canadians. We know what the tar sands cost to produce. It's not $80; it's very expensive. We're not going to get any further production of the tar sands with $80 oil. Nothing will go forward. That tells us what it costs to produce a marginal barrel of oil. To think that even a conventional barrel might cost $80, what would an unconventional barrel cost? It's not easy to find and produce oil.

The Chair: Mr. Masters, do you want to comment?

Mr. Michael Masters: There's no question that the price is, and has been, well above the marginal cost of production for most of the year. When we look at index flows of money into the commodity futures markets, it's very interesting. They have really gone up all year, until peaking around July 1. Subsequent to that time we have seen significant index flows out of commodities, and the price has come down fairly significantly. So we really feel that whether that spread above the marginal cost of production is $10 or $50, a lot of it is dictated by the amplification mechanism of financial investors. That has been our point from the get-go: how much of that do we need to tolerate?

If oil producers don't believe the price should be $130, because they know from their contacts that it's been artificially amplified through speculation, then they're not necessarily going to explore as we would prefer them to.

● (1410)

The Chair: Mr. Carrie has one more question.

Mr. Colin Carrie: I wanted to touch briefly on the peak oil theory too. Mr. Diwan talked about how much oil is out there, because we really don't know. There's a gentleman, whose name is Nansen Saleri, who is a former Aramco executive, I guess, working with the Saudi oil company. He was saying that the globe has consumed only 1 trillion out of a grand total of 12 trillion to 16 trillion barrels of oil. He, along with Exxon Mobil and the U.S. energy department, all argue that the high prices are propelling companies to innovate and invest more, and as a result, supply will rebound and prices will fall from current levels.

Do you believe this is true? Mr. Diwan, do you want to start?

The Chair: Mr. Diwan.

Mr. Roger Diwan: Yes. The amount of oil in the ground changes at different prices. It means that what's important is that if you have $600 oil you'll have a lot more oil. If you have $20 oil you'll have a lot less oil. It costs money to produce oil, and as the prices increase you have access to deeper, smaller, more complicated reservoirs. So it's an economic commodity. There's no price, there's no physical limit that we're reaching, and that's my problem with peak oil.

At different prices you discover more oil. Think about it. When oil companies book reserves, they book reserves at different prices.

I know Mr. Saleri, and he knows what he's talking about. He's been managing the reservoirs for Saudi Aramco, so....

The Chair: Thank you, Mr. Carrie.

We'll go to Monsieur Vincent.

[*Translation*]

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

I welcome you all.

Ms. Russell, you said that a lot of speculation raises the price of crude oil. How could we reduce this speculation in order to have fair prices? That question is for everyone.

[*English*]

Dr. Ellen Russell: We are in a bit of a fix in the sense that you, as elected officials in Canada, have very little to say about regulatory policies taking place in the United States, which are so influential in this. So I would encourage you to encourage the Government of Canada to make it known that this speculation in oil prices is having consequences that you don't like and that you would like to see more regulatory moves made south of the border to inhibit speculation.

That's also a tall order for things that people around the table have been saying already. There are lots of interests who are profiting from this and who do not want to see speed bumps reimplemented.

If you're not optimistic that you can get some of these measures made, then we are faced with a decision. I mean, do we wish the volatility in the international price of oil to be causing these difficulties in Canada? If not, then we would have to take much more interventionist measures to try to protect ourselves from some of these excesses.

[*Translation*]

Mr. Robert Vincent: Mr. Sprott, you talked about the paper market and the real market. If speculation were reduced, would it be possible that the people remaining in the real market would form an oligopoly?

[*English*]

Mr. Eric Sprott: Thank you for the question.

As I've said, I believe there's a paper market and a real market. I think that the real market is a truer market.

It's interesting. I think someone mentioned that the price of oil was up $2 today and they didn't know why. The reason is that we are in so fine a balance between supply and demand, we are right there. For example, when I worry about oil, I worry about the supply going down. I haven't even talked about demand going up. We know demand is going up. I'm telling you that supply is going down. It will go down in the future. That's my expectation here.

I really could care less about the commodity markets, quite frankly. People do make money by speculating these markets, and they shouldn't. It is costing people. It costs companies, on one hand, sometimes if the shorts are winning, and it costs the consumer, on the other hand, if the longs are winning. People dupe big institutions to participate in those markets, and I'd love to see it not happen. But I think that in the long run the really big issue is that you have to deal with supply and demand for oil, and we have nothing but problems to look forward to in that area.

● (1415)

The Chair: Monsieur Vincent, Mr. Diwan wants to respond.

Mr. Roger Diwan: Quickly, I want to answer Mr. Sprott on this notion that there is a physical price and a paper price. No, there is only one price; there is a paper price. The physical price is basically a derivative of the paper price. The price discovery mechanism is on the exchanges; it is not any more into the physical market. The physical players only take the indication from the paper market and apply a price differential if the quality or the location is different.

So we don't have these two markets and one is good and one is bad. There is one market. They are all together. The problem is that traditionally the physical players were a large player in the market but now they are a very small player. They represent probably less than 5% or 10% of the overall market. So in a way, that horse left the barn a long time ago, and the question of how you bring it back is very complicated.

The question of how you influence Washington is very simple. I live in Washington. You hire a lobbyist. That's the only way for Canadians if you want to have an impact on this regulation—you do as everybody else does.

[*Translation*]

The Chair: Mr. Vincent, you can ask a final question.

Mr. Robert Vincent: My colleague mentioned the Competition Bureau.

Mr. Diwan, you said that the profit margin for refiners was more or less the same. But the profit margin was 28 cents in 2007 and 14 cents in 2006. Now it is back to a normal level of 9 cents.

If a refiner decides to fix the margin at 28 cents, why would other refiners fix theirs at the same amount? Does competition not mean that everyone moves down in price rather than that everyone moves up? If the Competition Bureau had more power, it could help.

My question goes to you, Mr. Sprott, since you were also in the refining business.

[*English*]

The Chair: Mr. Diwan.

Mr. Roger Diwan: Well, you had more competition in refining. And as I said, in the last 20 years you only had three good years of refining margin, which was the last three years. And this year it is pretty bad.

The reason is very simple. Supply and demand do work on refining in the sense that as the refining margin increased, and they increased because the product balance was very tight—the diesel and the gasoline, not the crude—suddenly we added refining capacity. And we're adding a lot of refining capacity right now in China and in India and the Middle East and in the United States, while demand has been decreasing. So the refining balance, if you want, for gasoline in particular has really gone quite negative and the refining margins have decreased. And I think they will be low for some time, going forward.

Really, the bite out of the price is coming from the crude, not from the refining. It's really the crude price that is driving the gasoline price at the pump and not the strong fundamental for product.

The Chair: Thank you.

Mr. Sprott, just a very brief comment.

Mr. Eric Sprott: I would say that obviously you have the power to do whatever you want in the country. You create the Competition Bureau; you can enforce it or not, if you want to. All the data is available. The data on refining and marketing is as simple as A, B, C, right? You pay *x*; the price at the pump is this; the tax is that. Surely to goodness we can figure out whether we're being gouged or not. And it's well within the government's power to do that. So I'd just say, if you want to do it again, just bring it on.

The Chair: Thank you, Monsieur Vincent.

We'll go to Mr. Van Kesteren.

Mr. Dave Van Kesteren (Chatham-Kent—Essex, CPC): Thank you, Mr. Chair.

And thank you, witnesses, for appearing before us again. This has certainly been an interesting day, and I think we all have a lot to ponder.

I want to reflect and I want to just carry on with the question that I think was asked by Mr. Stanton. We were talking about putting into effect what I believe our analyst called the Granger causality tests. Do we have statistical evidence? Have we used that to determine whether or not this correlation actually exists between spot price and futures in crude? Have we applied that test to this?

● (1420)

Mr. Roger Diwan: Oh yes.

Mr. Dave Van Kesteren: Go ahead and answer, Mr. Diwan, and then maybe Mr. Sprott can answer.

Mr. Roger Diwan: Yes, this is what we do. We constantly look at what's happening in the oil market. This is my profession.

And it's very clear that it's a future market driving the spot market. And if you look at oil prices—and we try constantly to understand how they are created, because this is what we try to forecast—if you look at the last 12 months, the only serious correlation you have here as to why oil prices have moved from $70 to $140 and back down, the only serious correlation that works, is the value of the dollar. As the dollar declined, oil prices went up, and as the dollar strengthened, oil prices went down. And the correlation is in the high 90% range. It's a very strong correlation. It's not supply and demand in the last 12 months; it's the supply and demand of dollars.

Mr. Dave Van Kesteren: Mr. Sprott, do you agree?

Mr. Eric Sprott: I'm not familiar with the causality equation, if you will, and I'm not going to say it's just the U.S. dollar. I think it's many things. For example, with tropical storm Gustav coming into the gulf, the dollar, I think, was down today, but the price of oil was up two bucks. So it didn't work today.

Hon. Dan McTeague: Now the dollar is back up.

Mr. Eric Sprott: Yes, but it won't be up 2%, and it depends on whether you're using the U.S. dollar or the Canadian dollar and what you are comparing it with.

Mr. Dave Van Kesteren: Mr. Sprott, you're convinced that we've hit our peak and are on a downward slide and that therefore the price of oil is being driven up. But you also stated that the term $80 was best defined as a greenfield. I take a greenfield as one where you just drill and get some oil, rather than than drilling into the sea bed—seven miles down, I understand. If that is true, wouldn't it stand to reason, since most of our new exploration is coming from areas such as the gulf coast, that this would be the cause of our high prices?

I want to ask this one to Mr. Diwan first. Then we'll go—

Mr. Roger Diwan: The term “greenfield” means basically a brand new field. It doesn't have to be onshore; it could be offshore. And clearly the high cost, the $80 cost, is for a deep offshore field, not an onshore field.

Mr. Dave Van Kesteren: What would it cost to drill down seven miles in the Gulf of Mexico? Does anybody know?

Mr. Roger Diwan: It's around $70 to $80.

Mr. Dave Van Kesteren: According to the IMF—I'm reading this from the *World Economic Outlook*—

> there is little evidence that the increasing investor interest in oil and other commodities as an asset class has affected price trends for oil and other commodities, although purely financial factors, including shifts in market sentiment, may have short-term price effects.

Could you comment very quickly? I'll start with Mr. Sprott, and then continue with Mr. Diwan.

Mr. Eric Sprott: I would totally agree with that. Obviously in the short term the paper markets have a view and move the price around based on some data point. In the long run they can't win the day, because supply and demand will win the day in the long run.

But yes, definitely in the short run, and the sentiment can last for six or eight weeks at a time.

Mr. Dave Van Kesteren: Mr. Diwan?

Mr. Roger Diwan: Yes, but it has actually been lasting longer, because just the size of these players has overtaken the market.

I take you back to what Mr. Masters said earlier. These indexes have a tremendous impact, because you're investing in all commodities, so you see everything else going up at the same time.

Mr. Dave Van Kesteren: I asked this question earlier too, and I want to ask Mr. Sprott this. Doesn't a higher price at the well encourage new development, and won't that somewhat correct the problem? Aren't there two things at play here—that, first of all; and secondly, doesn't a higher price encourage us to look for new sources? Are we moving in the right direction when we...?

Mr. Eric Sprott: Well, yes, higher prices cause people to expend more trying to find more oil. Yes, they do. Unfortunately, the cost of anything real today.... If you want anything real, such as a piece of steel or copper—whatever, real—we've had exponential inflation in real things, so the cost of finding these things has gone up almost exponentially. The cost probably rises 15% a year, and you haven't even drilled any more wells, because there has been a lot of inflation. Much as we all like to say there is no inflation, there is incredible inflation in real things.

So it's not easy, necessarily, to say that at 80 bucks or 100 bucks we should find lots of oil. I'm shocked myself that, as I think Mr. Diwan said, it costs 80 bucks in a greenfield site today. A year ago the price was $70. Today we're saying it costs 80 bucks to find something. Well, we know what part of the problem is; it's inflation. Things just get more expensive all the time. These developments are not inexpensive.

So that would be my answer to the question.

● (1425)

The Chair: Thank you.

Mr. Diwan, do you want to make a final comment on that?

Mr. Roger Diwan: Yes.

I think it's only part of the problem. I think—you're right—you have cost inflation and it costs a lot of money to discover oil. But the primary issue is access. You do not have access to the most prolific basins in the world. They are closed. Oil companies are not allowed to explore in—I can give you the list of the countries—Mexico, Russia, Saudi Arabia, Iran, Iraq, Kuwait, UAE, etc. So you do not have access to the most prolific basins. The money is going to a very few places that are open, but you don't have the most prolific basins. And it's because the money is all going into a few places that inflation is increasing on the cost side.

The Chair: Thank you.

Thank you, Mr. Van Kesteren.

Ms. Nash.

Ms. Peggy Nash: On the issue of the dollar, Mr. Diwan, if I understood you correctly, you were saying that the price of oil went up and that the dollar went down. Here our dollar was going up, and it seemed to be pushing us more into a commodity-driven economy as opposed to a value-added economy, which is very troubling to many of us.

Mr. Sprott, you made the point about yes to high prices, because there is a limited supply in the market. Oil is a non-renewable resource. These high prices are going into private pockets and it is skewing production. You end up with incredibly inefficient production such as the tar sands. If there are going to be higher prices, it would be better to invest some of that money in more sustainable alternatives. This is a comment on that. I think it might benefit the greatest number of people.

I want to get back, Ms. Russell, to your point about speed bumps. A few people have referred to speed bumps along the road of paper speculation. I'd like to know what power we have in Canada to take action on apparently damaging speculation. What are our abilities under NAFTA to control prices? What are our abilities internationally? Do we have the power to introduce those speed bumps here in Canada, or are we at the mercy of other countries when it comes to regulatory control of investment in the important commodities we rely on?

Dr. Ellen Russell: To the extent that we regulate our own domestic financial markets, we have the capacity to put in whatever speed bumps we might like. The difficulty is that the financial market players in Canada will ask why they should do business in Canada if they can go elsewhere and not face that same speed bump. They will pressure the government not to put in such speed bumps, and it will become difficult to do so.

If we can't persuade other countries that it's in our collective interest to put in these speed bumps in our various domestic markets, we have a problem. We're in effect saying that we can't control the speculative excesses. Then we're forced to adopt a more interventionist approach to try to handle the fallout from speculation.

Ms. Peggy Nash: To all of you, what public policy do you recommend that this committee should advise, given the issues we've been talking about here this afternoon? If there's time, I'd like to hear from each of you.

● (1430)

The Chair: Mr. Masters.

Mr. Michael Masters: I was just going to mention that while it may seem that some of this is out of your hands, as some of it has to do with the legislative actions of other countries, one weapon that has proven effective, in my opinion, is moral suasion. I think that when politicians make the point poignantly and appropriately that we're having issues of speculation that are amplifying the effects on markets, people hearing this message tend to act. I imagine that if many people knew what the Ontario teachers' fund was doing, there would be some hard questions about whether that activity, even if it was only partially driving up the prices for food and energy for folks in Canada, was appropriate.

The Chair: Thank you.

Mr. Diwan.

Mr. Roger Diwan: It's really a collective action issue. You can regulate the Ontario teachers if you want, but it's not going to actually help the Ontario teachers' pensions, so you're hurting the pensioner here.

The problem is really collection action, because in the U.S. we're saying exactly the same thing: we shouldn't regulate these markets because the British are not regulating them. Canada is saying it's not their problem because of the Americans. There is a forum for this, and it's called the G8. Canada and other countries should put on the agenda how to re-regulate the commodity market, because it's a collective action. You need the United States, Canada, and the Russians to sit down and agree what to do. There is a forum for it. You need leadership. If you're fortunate and reasonable, some countries will accept that leadership.

The Chair: Thank you.

We'll go to Mr. Sprott.

Mr. Eric Sprott: Well, there's nothing you can do. You cannot do anything about the price of oil in the world. We're a small part of world oil. Forget it, it's not going to happen in Canada.

I find it incredibly ironic that we are the one country in the world that benefits the most per capita from the price of oil being where it is. We only have 35 million people and we're going to be producing 3.5 million barrels. This is a bonanza for this country, and everyone participates, whether it's the provinces or the federal government through taxation, the business of discovering oil and doing tar sands plans, or whatever. This is an incredible bonanza for this country. It's not a problem.

I realize that it's a problem for the individual consumer because the gasoline price goes up, but the gasoline price goes up anyway. If the government wants to subsidize gasoline prices, as many other countries do, go right ahead, but that will create massive inefficiencies in terms of consumption.

It's a world problem that we have. Yes, we could go to sustainable energy. That would be the one thing you could do to solve the world's problem. We don't have a problem; the world has a problem.

The Chair: Thank you.

Ms. Russell, just very briefly, please.

Dr. Ellen Russell: In terms of learning from speculative bubbles in the past.... When bubbles are inflating, it is always argued that you can't do anything to defy that sort of market, that you can't stand in the way of that sort of tsunami of activity. And then after it bursts, everyone wrings their hands and says, why didn't the people who were in charge of this do something about it?

So what you're faced with is having to take what might not be a popular position right now—well, among some it might be—and to say that we see further than the momentary frenzy of market activity, and to try to do something that's sustainable for the long term rather than just respond to the vicissitudes of price today.

The Chair: Thank you.

We'll go to Mr. Eyking, please.

Hon. Mark Eyking (Sydney—Victoria, Lib.): Thank you, Mr. Chair.

It's been quite a day. We had quite an eye-opener here on how we produce oil in the world and how we pay for it.

My question is to Mr. Sprott.

In your summary here, you have two-thirds of the countries that produce oil on a decline. You repeat it yourself many times that it's a given; there's going to be less oil. It was also alluded to that the Asian demand is not going to curtail any time soon. So wouldn't it be a viable course for any individual or country that relies a lot on oil to start reducing it?

My question is, wouldn't a responsible government show leadership and implement some disincentives for using oil, and also reward the users for alternative sources of energy?

● (1435)

Mr. Eric Sprott: That's exactly what I was suggesting here recently in response to Ms. Nash's question. Yes, there are other sustainable options that obviously every government in the world should look at. It's not as critical to Canada as to almost every other country, quite frankly. But yes, I would encourage.... I'm not a big fan of biofuels, but solar or geothermal or other sustainable methodology is exactly what we should be supporting today. But you're really solving the world's problem, because fortunately I don't really think we have a problem as a country today.

Hon. Mark Eyking: But we could show leadership for many of these western countries.

Mr. Eric Sprott: Absolutely.

Hon. Mark Eyking: And there are countries like Denmark and other European countries that have already showed that leadership.

Mr. Eric Sprott: Absolutely. There are many countries that realize the problem—particularly countries who've never had hardly any oil production. They sense the problem more than anybody. We probably don't sense it as much because we've always had our own supply of oil and we're oversupplied with oil.

But there is a big problem out there, and yes, anything the government could do to create other sources of energy—as long as they weren't consuming more energy to produce than the output—then yes, we should do that.

Hon. Mark Eyking: Similar to the green shift, then. The green shift would help that.

An hon. member: Carbon taxes.

Mr. Eric Sprott: Oh, I see, yes.

But, you know, there's one thing I would suggest. For example, the U.K. government came out and said they were going to put a tax on oil companies, and all I could say was, “Please.” It's just less money.... And they have a serious problem in the U.K. now; their production is plunging like crazy. Okay, you're going to tax people or tax the oil companies more. Well, then they're going to have less to spend on—

Hon. Mark Eyking: On production.

Are there any other comments from the other witnesses on that? It's a given that there's going to be less production in the world and that if we use a lot of energy we're really going to look at finding alternative sources of energy. Is that a given?

Mr. Roger Diwan: Yes.

Hon. Mark Eyking: Dan, do you have anything?

Hon. Dan McTeague: Yes, very briefly.

The Chair: Two minutes.

Hon. Dan McTeague: Thank you, Mr. Chair. And thank you, Mr. Eyking.

I have a very short question for now. You've all pointed out about the paper market. My concern is what happens when you have investor demand outstripping consumer demand.

Can any of you give us a real reason why futures commodities markets in the past have prevented non-commercial players from playing? What were the real reasons for saying we should not have speculators in this particular market? We understand the dynamics of how it will hurt, but I'd like to hear from any one of you as to why these prohibitions were put in place.

Ms. Russell, I can begin with you, if you wish.

Dr. Ellen Russell: Sure. I know the story in the States the best. Back in the thirties, there was concern.... Certain individuals were seen to have taken positions in wheat and things like that, which was suspected of driving the price out of whack. It's not just that the price went high; it's the volatility, that they can push it up and push it down.

When they pushed it down, the wheat farmers were angry and so on. That created demands for limits to entities that don't have a commercial reason for being in that market; i.e., they're not growing the wheat or using the wheat to make other products, so they should have limits in terms of how much they can participate in the market. It doesn't eliminate speculation, but it does keep it in reasonable bounds.

Hon. Dan McTeague: Mr. Diwan or Mr. Masters.

Mr. Roger Diwan: There's still position limit, by the way.

The problem, as Mr. Masters has identified very well, is that you can go on the market and have a position limit, but if you can go through the back door, if you will, and take an index fund, you don't have a position limit. We have opened a loophole for companies. We closed the door, but we left the window open. We've been arguing for some time that they should close the window too. We opened the window in regard to the changes in the regulations in 2000, which has allowed a lot of these players to burst the position limits that the regulators have set. That's a real issue.

Also, we should remember there's a reason that the non-commercial are in the market. They create liquidity. I remember the oil market in the early and mid-nineties. There was a very small liquid market, where you had very large commercial players who actually used cargoes and their physical positions to manipulate prices. We often had manipulation on the brand price, what we used to call the “brand squeeze”, etc. The commercial has rote liquidity, and liquid markets are good. The question is whether they are too good sometimes.

● (1440)

The Chair: Thank you.

Mr. Masters, briefly.

Mr. Michael Masters: I think the difference is that you want sufficient speculation but you don't want unlimited speculation. You need sufficient speculation to grease the wheels to allow for the liquidity that Roger was talking about, but you don't need too much speculation because you then destroy the price discovery process. And if you destroy the price discovery process, there is no reason for a futures market.

The Chair: Thank you.

We'll go to Monsieur Arthur, please.

[*Translation*]

Mr. André Arthur (Portneuf—Jacques-Cartier, Ind.): Thank you.

What an absolutely fascinating day! We have learned a great deal and we have defined concepts because of our guests who have been excellent teachers and wonderful coaches.

What we have just heard about speculators could be very effective. There is something morally repugnant about the idea that speculators can fix the prices of essential commodities. We would not permit speculators to control or influence the price of vaccines or antibiotics. Things like that appall us.

But Mr. Sprott hit us over the head with a concept a few moments ago when he told us that Canada is richer because of current oil prices which are kept up by speculation on international markets. I now realize that there are two sides to the story. You can look at things from the point of view of the consumer, who will always say that things cost too much, or from the point of view of the producer, who will say that they do not cost enough.

If we believe that Canada can become an energy giant, we must include oil, but also electricity. In Quebec, there is a deeply held view that electricity must be as cheap as possible so that the people get the maximum benefit. As a result, there is less and less to export because we waste more and more.

If we tell ourselves that oil is always too expensive, it also means that the provinces of Canada that have oil will take in less and less revenue because the price is not allowed to rise. The collective wealth will be affected, with fatal results.

[*English*]

Madame Russell, you told us that those regulations against those scalpers have been made easier for them. Could you estimate what would be the price of oil if those regulations had not been modified?

Dr. Ellen Russell: I read a quote that I think said $80 to $90.

Mr. André Arthur: Okay. Would the oil sands be in operation at that price?

Dr. Ellen Russell: No.

Mr. André Arthur: No.

Thank you, Chair.

[*Translation*]

The Chair: Is that all?

M. André Arthur: That is all.

[*English*]

The Chair: Back to Mr. McTeague, please.

Hon. Dan McTeague: Mr. Sprott, I have a couple of questions.

You've raised some very interesting points here. I notice on page 11 of your presentation that you say 60 of 98 producing countries have peaked. I note here that it doesn't include Saudi Arabia. I think it's a fairly significant omission. I know that you will know that is not possible, given that they don't provide information.

I wonder if you have any comments for this committee about the fact that Canada doesn't either. In fact, Canada provides it sporadically, every month or every year.

This market functions on a day-by-day basis. I know you know that, because you're in the business of working and placing money for clients. How is it that you can make the statement you've made about Canada being a great place, having all this kind of oil, when you have no idea how much oil we have on any given day?

Mr. Eric Sprott: How much we have or how much we produce?

Hon. Dan McTeague: How much we produce, how much we have, how much we have in storage, how much we have in inventory, on a given day or on a—

Mr. Eric Sprott: I don't know each day, but I'm pretty certain that we know exactly what the country produces every month, and the data is available.

Hon. Dan McTeague: Yes, but the data would be irrelevant if trades are taking place on a daily basis. In fact, as we speak, there are probably trades taking place right now, over the counter, in Winnipeg, in London, around the world. I find it a little fascinating that you've made a declaration, which I think is important, that Canada does in fact have plenty of oil and we should be celebrating this.

Tell me, what celebration is there for Canadian consumers when the price of oil rises and the Canadian dollar doesn't rise correspondingly, as it did two years ago? We've seen it stall.

● (1445)

Mr. Eric Sprott: There is no doubt that the consumer, if the price goes up—and personally I think the price is just fine—on a world-wide analysis, then everyone suffers. Everyone who is a consumer suffers. If you want to ask me if, as a country, we benefit, yes, I think we benefit more than almost anybody. I really do. The government revenues go up, the provincial revenues go up. It's a huge source of revenue.

I'm only trying to give you my.... There are both losers and winners in any price going up.

Hon. Dan McTeague: I've just heard the peak used before, and I've heard the arguments about supply and the availability around the world, and about more difficult places in order to get new supply. And I've heard that we can't poke in the hole and have conventional oil coming out, and that we have all sorts of alternatives.

But it was interesting that the testimony by the American oil industry, when it came before Congress, was pretty straightforward about where they thought the price ought to be. In their wildest dreams, I doubt they could have imagined $147, let alone $117 or $118 a barrel.

What I think we're trying to get at around here is whether or not you believe that beyond the issue of scarcity, the market has already factored that into the $90 a barrel as opposed to the $115 or $117. And that difference of 27¢ or 28¢ a litre for every consumer out there is having a devastating impact on the bottom line of the country, not to mention government revenues when they add GST to the increased price of gasoline, which netted the government $1.7 billion this year alone on gas and diesel.

Mr. Eric Sprott: Right. Well, let's just imagine that it does cost $80—and I mean cost $80. Now, the federal government has to get something, the provincial government has to get something—there are taxes and royalties. So what are you going to sell it for if it actually cost you $80 to produce it, if it really did? And I'm not saying for sure.... I think the tar sands oil costs $80. But there are all sorts of levels of taxation. When you're finally finished with it all, what does it really cost to have it refined and delivered to the gas pumps?

Hon. Dan McTeague: Maybe I could put this question. Do all of you here believe that we spend too much time, as representatives and perhaps in the media, looking at crude as opposed to looking at the cost, day in and day out, of the market?

I think Jane Savage, from the Canadian Independent Petroleum Marketers Association, pointed out that we're not spending enough time talking about the other market—that is, unleaded gasoline.

I know, Ms. Russell, you had a point to make there, and I don't want to interrupt you on that. But are we missing the point here in terms of overemphasis on one particular commodity while other commodity prices seem to be going through the roof?

Dr. Ellen Russell: May I answer the previous question?

Hon. Dan McTeague: Yes, sure.

Dr. Ellen Russell: I think you spoke to a question about distribution. Who wins and who loses is not just a question of adding up big numbers and seeing which is the biggest. Canadians are divided into all kinds of different groups, including consumers and people who work at workplaces that are affected by the cost of oil, and all kinds of economic activities that are affected by the level of the dollar, which is in turn affected by the price of oil. All these tertiary effects and effects that spin on out affect people in different ways, so we can't be cavalier by saying that Canadians win or lose, without doing a lot of work to see that there are some people who are winning and some people who are losing, and they're not always the same people.

The Chair: Is there anyone else who wants to speak?

Mr. Sprott.

Mr. Eric Sprott: I would love to answer one of Mr. McTeague's other questions: what we can do about it.

All that went through my mind was the Glass-Steagall Act. The Glass-Steagall Act came out in the 1930s, because the banks and the brokers used to work together and then they realized, boy, we can't work together any more because this is going to kill people. That got canned about eight years ago, and now we have the same situation, where the banks and the brokers work together and we end up with A, B, C. We end up with this piece of paper that's worth nothing. We don't learn by our mistakes.

That is the answer to your question, in my mind.

Hon. Dan McTeague: Mr. Sprott, you pointed out that these are paper deliveries, and I'm just wondering again, are we talking about physical inventory? When you're actually buying a crude future, are you not buying with a deliberate date on which you have to lift or take that delivery within 23 days?

I'm concerned about seeing guys from the banks and the pension funds—the Ontario Teachers' Pension Plan—driving around with barrels of crude in the back of their BMWs. And this is the sort of parity we have. But the reality is that for many, this is a serious market. It deals with supply, it deals with product, and yes, it's done with a paper transaction, but sooner or later someone is going to have to buy that product down the road.

And if Mr. Masters and Mr. Diwan are correct, as long as you have a larger presence of people from the financial industry looking for a way to hedge their bets and to make up where they've lost in places like sub-prime, are you not going to wind up with an eternal self-fulfilling prophesy of higher prices that will continue to undermine the economy and deny other industries the ability to invest in new technology?

● (1450)

The Chair: Mr. Sprott.

Mr. Eric Sprott: It's complicated.

First of all, 99.9% of all contracts are never delivered. They're settled off, so there is no delivery taking place. That's why there is a paper market and there is a real market.

And at different times there can be different forces in the paper market. I've already pointed out that some guys.... There is a belief that the price went to $147 because a guy was covering a short and he got nailed. That's what is in the common lexicon these days, that this same group got caught short and bid the price out.

But to your point, we shouldn't be talking about the price of crude oil. I think you people are really talking about the price of gasoline, and that's a whole different thing.

The Chair: Thank you.

Thank you, Mr. McTeague.

I'm going to take the final spot here, as the chair.

We start with the price of gasoline, but the primary determinant of the price of gasoline is the price of crude. It's interesting. Last year the focus was all on the wholesale margins, but the wholesale margins have dropped quite dramatically over the last year; the focus seems to be much more on the price of crude.

Mr. Sprott, you very eloquently described the decline of world conventional crude oil production. You've also described how a lot of the crude oil reserves we have now, like the oil sands, are actually much harder to get at. We have a decrease of supply for the conventional side and a challenge in supply in terms of the oil sands and other reserves. Even those reserves we're discovering in Venezuela are similar to the oil sands in terms of getting it out of the ground, separating it from other natural resources, and then refining it. It costs much more in terms of refining.

We also have an increase in demand. We have some figures on countries like China, going back to 1980. They were consuming about two million barrels a day and now they're above seven million barrels a day. Clearly there's a demand and supply issue. How can we, as legislators, have any idea how much is due to the natural intersection of supply and demand and how much is due to speculation?

It is a funny word, right? Mr. Diwan said we shouldn't say “speculators”, we should say “investors”.

But how much is due to the natural intersection of conventional supplies going down and demand going up, and how much is due to the entrance of what we could call “newer investors” since, say, the 2000 period? Can anyone here accurately predict it? It went up to $137 and came down to about $117. Should it be at $100? Should it be $98? Should it be at $70?

Mr. Eric Sprott: I'd love to take a shot at that.

Under the peak oil thesis, which is not my thesis but a thesis of petrophysicists who study these things, if you go out 20 years, they would suggest we'll be producing 65 million barrels in the world, not 85 million barrels.

Well, where do we all think the price is going to be? It's not going to be at $120 a barrel. I mean, it's a major thing to think about. If you believe in the peak oil thesis, we haven't even begun to see the problems. That's not just problems with the price of oil, but the whole of living. You don't have fuel products now; how do you get to work?

I suggest that people study it. We have this choice. Do you believe in the theory or don't you? If you believe in the theory, we have a big problem coming our way. I've been a believer in the theory for a number of years, and every day that the price of oil goes up I'm the least surprised guy in the world.

The Chair: Mr. Diwan, do you want to comment?

Mr. Roger Diwan: Sure.

We had $140 dollar oil, and demand in the United States was down 800,000 barrels per day for the first six months of the year. People react. Obviously it creates pain, but you also get more efficient.

The notion that we are using 85 million barrels per day efficiently in the world is a joke. I live in the United States. I'm not American, but I look at how people live here, and the waste is tremendous. Why do we need cars that weigh five tonnes and you can put twelve people in them when you commute to work by yourself? You can be more efficient. There's plenty of creativity. High prices will destroy oil prices. This is what we're seeing. Clearly we can be more efficient. After all, when you use your car, in general you're using only 15% of the gasoline to move the car; the rest is for the heating, cooling, CDs, DVDs, and everything else you have in your car. So technology can improve a lot, but you need price signals. These extreme prices have pushed signals, and they are forcing new technologies, which is a good thing.

On your question regarding whether we know what the real price should be, if I knew, I would be a rich man today. I would advise all my clients, and they would make a lot of money. It's a million-piece puzzle. You can't remove one piece and ask what happened. Everything shifts. It's a very dynamic market.

● (1455)

The Chair: With respect to my final question, Mr. Diwan, you mentioned earlier that this is a discussion that should happen at the G8. I want to get Mr. Masters in on this as well.

The article in *The Washington Post* that our colleague Dan McTeague passed out talks about regulations being changed in terms of commodity exchanges. Also, they're allowing trading of energy commodities on private electronic platforms. Are those two specific items that the G8, or Canada and the U.S., have to look at? Are there other things specifically that the U.S., Canada, and other countries in the G8 have to look at?

Mr. Roger Diwan: There's the whole notion of commodity regulation, but you're right, it's these two exchanges. Who do you allow, how do you put position limits, how do you track and classify the money? How many investors do you want, and how much speculation do you want? These questions are important, and right now we have basically deregulated the market. We have weakened our ability to understand these markets because we have fewer people watching them. We have less data. It's very muddled. We don't have good data to give you straight responses here. We're always blaming OPEC for not giving us data and we don't know what's happening, but here we're in the most sophisticated market and we don't get data. The data released every week is a joke.

So it's a G8 issue. The United States needs to take a leadership role, and so far they have refused. That's something that needs to be brought up.

The Chair: Thank you.

Mr. Masters, do you want to complete this briefly?

Mr. Michael Masters: I agree with Roger. Along with that is having strong position limits reinstated. This is something that worked well for 70 years in the United States. There are no unperceived consequences. You have strong position limits on excessive speculation. That allows the market to work more in balance with some speculation and some folks in there who are producers and consumers of crude. They make a better market. They make better price discovery. So any solution needs to have position limits involved.

The Chair: I want to thank all of you for coming in today. I want to thank Ms. Russell and Mr. Sprott for being with us here in studio, as they say.

Mr. Diwan, thank you for being here via video conference from New York.

Mr. Master, I understand you're in the U.S. Virgin Islands. Thank you for being with us by teleconference.

We appreciate your testimony today. If you have anything further for the committee on this topic, please feel free to submit it. As for your presentations that have not been translated, we will translate them for members.

Members, thank you for being here and for your good questions.

The meeting is now adjourned.

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