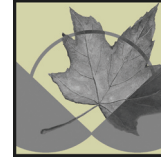


# BEHIND THE NUMBERS

economic facts, figures and analysis



CCPA

CANADIAN CENTRE  
for POLICY ALTERNATIVES  
CENTRE CANADIEN  
de POLITIQUES ALTERNATIVES

Volume 8, Number 3 • May 2007

## Gas price gouge: The sequel

*By Hugh Mackenzie*

Gasoline prices are on the rise again, the latest in a series of spikes that have pushed prices far above levels that would have been described as outrageous just a few years ago. Every time one of these jumps takes place, the self-appointed analysts point to “events” to “explain” the increase.

The explanations range from the obvious—increases in crude oil prices—to the plausible—the oil refinery fire in Ontario this past winter—to the patently ridiculous—the oil refinery problems in Oklahoma to which the increases in May 2007 are being attributed.

What links all of these explanations—with the exception of the prices of imported crude oil—is that they have nothing whatsoever to do with the cost of producing gasoline in Canada. What these explanations have in common is that they represent signals to the oil industry that the price that the market will bear has gone up.

Over the years, Canadians have become used to the oil industry’s finely-tuned price-gouging strategies: price jumps just at the beginning of every summer long weekend; the softer prices in mid-week in the winter; and, in some markets, fluctuating prices during the day; high prices during morning and afternoon commute times, when people don’t have time for price shopping, lower at night, when many customers have the option of cruising around for a gas price bargain.

But these strategies moved up a notch in August of 2005 when the U.S. Gulf Coast hurricanes provided the mother of all opportunities to push retail prices up. Millions of Canadians shared an unprecedented experience: their first-ever \$60 gas fill-up. A week later the fill-up hit \$70, and a week after that, at \$1.40 per litre, it took \$80 to fill the tank.

That sharp rise at the pumps later subsided, but the point was made, and the precedent set as the psychological barrier of \$1.00 per litre for regular gasoline was broken. The precedent of Hurricane Katrina served the industry well when Esso’s Sarnia refinery went down in February 2007, ushering in a long run of elevated gasoline prices. And prices that would have been off the charts just a couple of years ago are the new normal.

Canadians are rightfully skeptical about the gas price increase stories peddled by the industry and its apologists. The stories are too obviously tailored to fit the circumstances. When the “explanation” is linked to events thousands of miles away in the United States, we are told that Canadian wholesale gas prices are set by U.S. prices. When the “explanation” is closer to home, as it was in the Sarnia story, those prices are determined by domestic market conditions, not those in the U.S.

---

It is evident that these aren't "explanations" at all, that they are after-the-fact rationalizations for the price-gouging opportunities seized by the oil industry, or noise introduced into the discussion to distract attention from what is really going on.

As an example of the latter, consider the claim by some apologists for the industry that the real culprits here are the governments that put hefty taxes on gasoline. It turns out, when you look at the facts, that taxes have virtually nothing to do with the price increases. Federal and provincial gasoline taxes are all flat amounts per litre: they don't go up when crude prices go up. The federal GST does apply, but that now accounts for only 6% of any increase in prices.

So as far as explanations are concerned, we're back with crude oil prices which, the industry correctly notes, are set in world markets. Of course that's convenient for the oil industry, because it obscures the fact that rising world crude oil prices produce massive profit windfalls for the companies that produce the crude oil that ends up in our tanks as gasoline. That's because most of the crude oil that ends up in our tanks today doesn't cost one cent more to produce today than it did in 2001 when the pump price was less than 60 cents a litre. And the windfall for Canadian producers amounts to \$1.7 million every day for every dollar the price of crude goes up.

Even without doing the math, there seems to be more at play here than just crude oil prices. Crude oil prices sometimes work as an explanation, except when prices continue to go up or stay the same.

So what is going on here? Answering that question is a bit complicated, because there are so many moving parts. Gasoline is priced in Canadian cents per litre; crude oil is priced in U.S. dollars per barrel. So we have to translate between barrels and litres, as well as between Canadian dollars and U.S. dollars, to get the answer.

At current exchange rates in the range of 85 to 90 U.S. cents to the Canadian dollar, a one dollar (U.S.) increase in the price of a barrel of crude oil translates to an increase of 4/5ths of one cent (Cdn) per litre at the pump. Or to look at it from the other end of the telescope, a one cent (Cdn) per-litre increase at the pumps (including the GST) translates to a crude oil price increase of \$1.25 (U.S.) per barrel.

Now we're getting pretty close to the answer. To go back to the summer of 2005, between the middle of June and the middle of September, crude oil prices increased by \$10 U.S. per barrel. Average Canadian gasoline prices increased from just under 90 cents to more than a dollar. In one week in early September, the average price in Canada came within a whisker of \$1.30 per litre. Using our rule of thumb, the \$10 increase in crude oil prices would have justified a 7.9 cent per-litre increase (including GST at the then-applicable 7% rate) at the pumps, or about 97 cents per litre. *Not* the \$1.04 average in major Canadian cities in the second half of September 2005. *Not* the \$1.09 average for the first full week in September, 2005. And certainly not the \$1.30 the average price hit around the 2005 Labour Day weekend.

A 7.9 cent increase would have matched the crude oil price increase. The 15-cent increase we ended up paying was profiteering. And the 40-cent increase we were paying over the 2005 Labour Day weekend was just plain gouging.

In fact, Canadians already know what \$100-a-barrel oil is like: we were paying a price equivalent to \$110 a barrel oil on the 2005 Labour Day weekend.

What should the price be? What would it be if we weren't being gouged by the oil industry? Let's figure it out. In early May 2007, crude oil was priced at about \$64 a barrel, and the exchange rate was \$1.10 to the U.S. dollar. That translates to a crude oil cost of just under 45 cents Cdn per litre at the pump.

Of course, that's not the only cost. The price at the pump includes the cost of refining the crude oil into gasoline, distributing it to the retail network, and selling it to the public at the pumps. These costs—including an allowance for normal profit—vary from region to region in Canada, but would typically total in the range of 14 to 15 cents per litre in normal markets.<sup>1</sup>

Taxes also vary from province to province, and in some cases from city to city within provinces. In Ontario, provincial taxes add 14.7 cents per litre. In Alberta, the tax is 9 cents per litre. In Vancouver, there is a provincial tax of 14.5 cents per litre and a city tax of 6.5 cents per litre. The federal gasoline tax adds 10 cents per litre.

So, to use Ontario as an example, we estimate the price we should be paying for gasoline as follows:

**Gasoline price breakdown,  
May 2007 Ontario**

	<b>Cents/litre</b>
Crude oil costs	44.6
Refining and marketing	14.0
Federal tax	10.0
Provincial tax	14.7
Total before GST	83.3
GST at 6%	5.0
<b>TOTAL Normal Price</b>	<b>88.3</b>

*(at price for sweet crude oil of \$U.S. 64 per barrel and an exchange rate of \$1.10 Canadian dollars to the U.S. dollar)*

Compared with prices in the \$1.05-to-\$1.10 range in southern Ontario at the beginning of May 2007, that's an excess profit to the gasoline industry of 16 to 21 cents per litre.<sup>2</sup>

That difference doesn't sound like much. But every penny per litre generates an additional \$1 million for

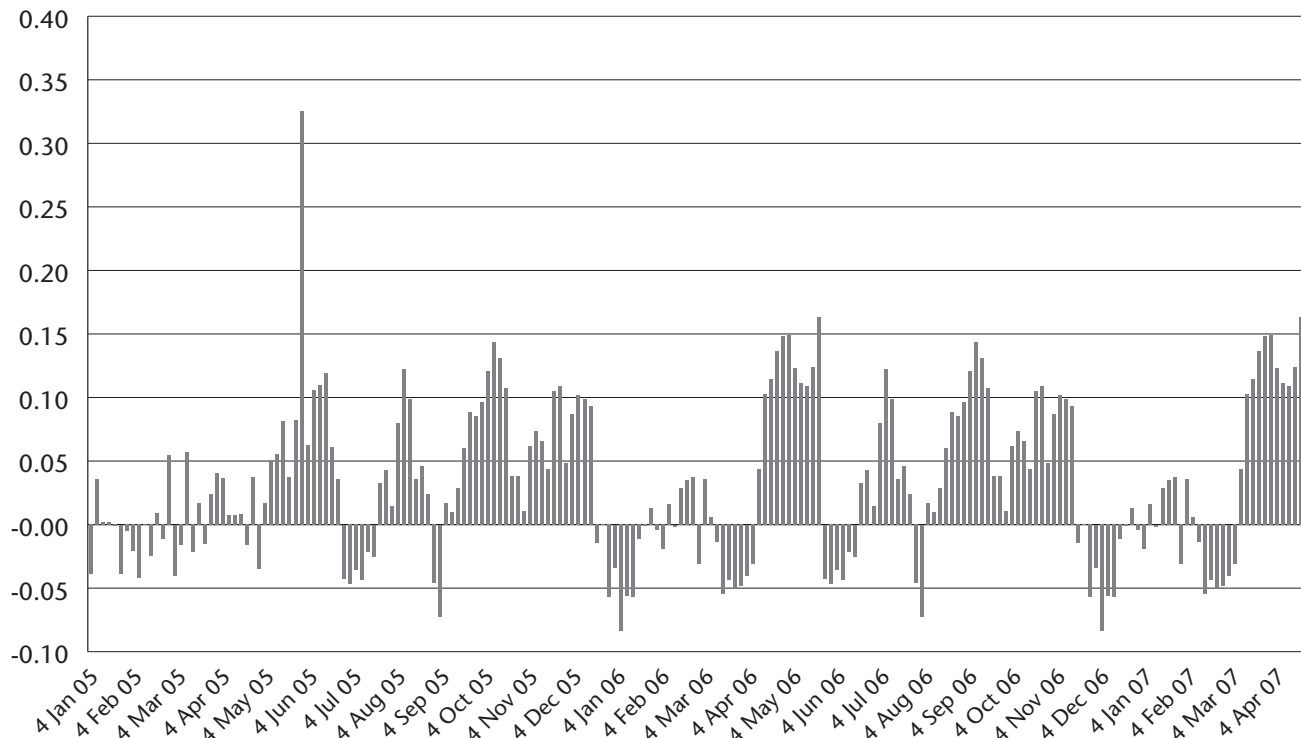
the industry every day from gasoline sales alone. At the beginning of May, the excess profit amounts to \$16 to \$21 million per day, just for gasoline.

For that period around Labour Day 2005, when the difference between the price and what would have been justified by crude oil prices was much greater—as much as 45 cents per litre at the peak—the industry was knocking down excess profit at a cool \$45 million a day. Not a bad payoff from exploiting fear.

Now, to be fair to the industry, it doesn't gouge us all the time. Indeed, before the big jump in prices in August and September 2005, there was a relatively consistent relationship between costs—including taxes and normal profit margins—and prices at the pump. Once the \$1.00 per litre price barrier was broken, however, the industry's pricing structure clearly changed.

The chart below illustrates the trends. It shows the portion of the price of gasoline in Ontario in cents per litre that could not be explained by crude costs, normal refining and marketing margins and taxes, from January 2005 to early May 2007.

**Retail gasoline price in Ontario not explained by crude oil, refining, marketing and taxes  
January 2005 to May 2007**



The first seven months of 2005 show the pricing pattern that one would expect in an industry in which demand and supply fluctuate and in which retail “price wars” are common. On average, pump prices matched costs—including normal profit margins for retailing and refining—with prices exceeding costs in some periods and falling short of costs in others. After the August-September 2005 price spike, however, a different pattern emerged, with prices consistently exceeding the levels that would be justified on the basis of costs and normal margins.

The tricky question is: how do you know when you’re being gouged? You *could* do the math, but that would be frustrating, depressing, and ultimately a waste of time. To help Canadians fight their way through the numbers, the Canadian Centre for Policy Alternatives has come up with an online gasoline price gouge meter.

You just type in the retail price you are paying and select the closest city from the list of cities on the site.

The meter does all the calculations and gives you an estimate of how much you are being gouged today. It even tells you if you’re lucky enough to be paying *less* than the normal price.

You can find the site in two ways: from the Canadian Centre for Policy Alternatives’ web site at [www.policyalternatives.ca](http://www.policyalternatives.ca) or [www.gasgouge.ca](http://www.gasgouge.ca).

*(Hugh Mackenzie is an independent economic consultant and a CCPA Research Associate.)*

### Notes

1. These estimates of normal margins are based on the actual reported refining and marketing margins reported by the Canadian Petroleum Products Institute for the first 6 months of 2005. The specific city-by-city estimates use the period from June 15 to July 15 2005 as the normal market reference point.

2. Results for major cities in Canada are summarized in the table below.

### Normal prices, by city, May 2007

Crude price \$U.S. 64/barrel; \$1 U.S. = \$1.11 Cdn

City	Crude cost	Normal refining/ marketing	Taxes with normal margins	Total normal price	Actual price 8 May 2007	Not explained by normal price
Halifax	0.446	0.158	0.375	<b>0.980</b>	1.174	0.194
Saint John	0.446	0.161	0.364	<b>0.972</b>	1.118	0.146
St. John’s	0.446	0.169	0.388	<b>1.004</b>	1.167	0.163
Charlottetown	0.446	0.142	0.355	<b>0.944</b>	1.129	0.185
Montreal	0.446	0.139	0.382	<b>0.967</b>	1.103	0.136
Québec	0.446	0.160	0.368	<b>0.974</b>	1.164	0.190
Sherbrooke	0.446	0.147	0.366	<b>0.959</b>	1.144	0.185
Chicoutimi	0.446	0.176	0.370	<b>0.992</b>	1.144	0.152
Toronto	0.446	0.128	0.296	<b>0.871</b>	1.022	0.151
Ottawa	0.446	0.150	0.298	<b>0.894</b>	1.035	0.141
Sudbury	0.446	0.121	0.296	<b>0.863</b>	1.078	0.215
London	0.446	0.136	0.297	<b>0.879</b>	1.029	0.150
Winnipeg	0.446	0.158	0.264	<b>0.868</b>	1.077	0.209
Regina	0.446	0.173	0.302	<b>0.921</b>	1.139	0.218
Lethbridge	0.446	0.170	0.238	<b>0.855</b>	1.047	0.192
Edmonton	0.446	0.158	0.238	<b>0.842</b>	1.024	0.182
Kamloops	0.446	0.171	0.297	<b>0.914</b>	1.124	0.210
Prince George	0.446	0.191	0.298	<b>0.935</b>	1.139	0.204
Victoria	0.446	0.200	0.325	<b>0.971</b>	1.225	0.254
Vancouver	0.446	0.155	0.359	<b>0.961</b>	1.233	0.272

*“Normal” is defined as actual refining and marketing margins in June/July 2005*