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What's behind high gas prices?

Can you spell gouge?

By Hugh Mackenzie

Late in August, I shared an experience with millions of other Canadians—my first ever $60 gas fill-up. It's a good thing I didn't get too excited, though, because just a week later, I had by first ever $70 fill-up. And just to keep the good times rolling, a week later I filled up at $1.39 per litre for my first $80 fill-up.

With headlines in the newspapers every day about oil prices hitting record-high levels, we are being encouraged to think that there's nothing more going on here than high prices for crude oil, and that the oil companies have no choice but to pass these cost increases along. We're supposed to throw up our hands and pay.

It is even suggested by some apologists for the oil industry, who blame the high gas prices on taxes, that the real culprit here is the government.

Of course, when we're asked to accept high crude oil prices as a given, we're supposed to ignore the fact that the gas we're pumping into our tanks doesn't cost one cent more to produce today than it did five years ago, when the pump price was less than 60 cents per litre—a fact that provides the oil industry with a windfall of $1.7 million every day for every dollar the price of crude goes up.

And it turns out, when you look at the facts, that taxes have virtually nothing to do with the price increases we face. Provincial and federal 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 accounts for only 7% of any increase in prices.

But is that really the whole story? Is it just crude oil price increases—helped along a little by the GST—that are responsible for the astronomical prices we're facing today?

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 the current exchange rate of 85 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 (including GST) 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. 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 justify a 7-9 cent-per-litre increase (including GST) at the pumps. Not the $1.04 we see every day in major Canadian cities. Not the $1.09 average for the first full week in September. And certainly not the $1.30 the average price hit around the Labour Day weekend.

A 7.9-cent increase would have matched the crude oil price increase. The 15-cent increase we're now paying is profiteering. And the 40-cent increase we were paying over the 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 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. Crude oil at $68 (U.S.) a barrel translates to 50 cents per litre (Cdn) at the pump. Normal refining and marketing margins add 14 cents per litre. Provincial taxes (Ontario) add 14.7 cents. The federal gasoline tax adds 10 cents per litre, for a total of 88.7 cents per litre. Add 6.3 cents for the GST, and that gives us 95 cents—which is what we should be paying.

The difference doesn't sound like much. About 10 cents. But every penny per litre generates an additional $1.1 million for the industry every day.

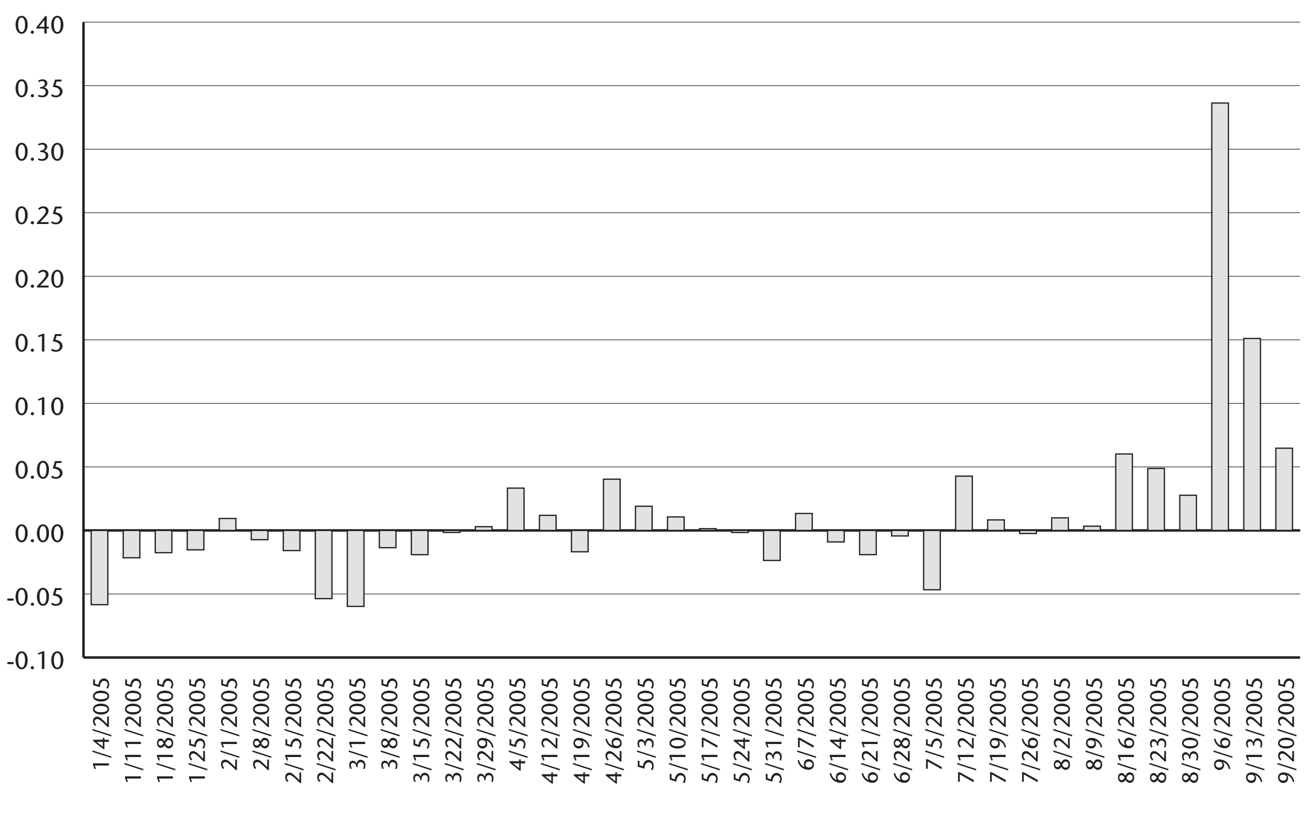
And for that period around Labour Day, when the difference between the price and what would have been justified by crude oil prices was much greater—as much as 45 cents per litre at the peak—the industry was knocking down excess profits at a cool $49.5 million a day. Not a bad payoff from exploiting fear.

Now, to be fair to the industry, it doesn't gouge us all the time. Indeed, there is normally a pretty stable relationship between crude oil prices and prices at the pump. The chart below makes the point. 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 mid-September.

The consistency of the pattern over the past nine months makes the profit grab in August and September all the more obvious.

So let's not beat around the bush. What we've seen over the past month is nothing short of price-gouging: the Canadian oil industry taking advantage of public fear prompted by the devastating hurricanes in the southern United States, taking far more in increased

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



prices than was justified by the increase in raw material costs.

Of course, no one is going to do anything about this. Just as no one is going to do anything about the fact that the industry is making billions from increases in crude oil prices that have nothing to do with its costs of production. Just as no one is going to do anything about the fact that every time the price goes up, the industry makes another windfall profit from their inventories of gasoline and heating oil.

But it's still worth keeping in mind the next time the oil industry protests its innocence in the face of criticism of high gas prices, or the next time the industry or one of its apologists points a finger at taxes as the culprit for high prices.[1]

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

Endnotes

1 Data sources: crude oil prices and exchange rates, Natural Resources Canada; retail gasoline prices, Ontario, Ministry of Energy, Ontario; refining and marketing margins, Fuel Facts (various issues), Canadian Petroleum Products Institute.

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