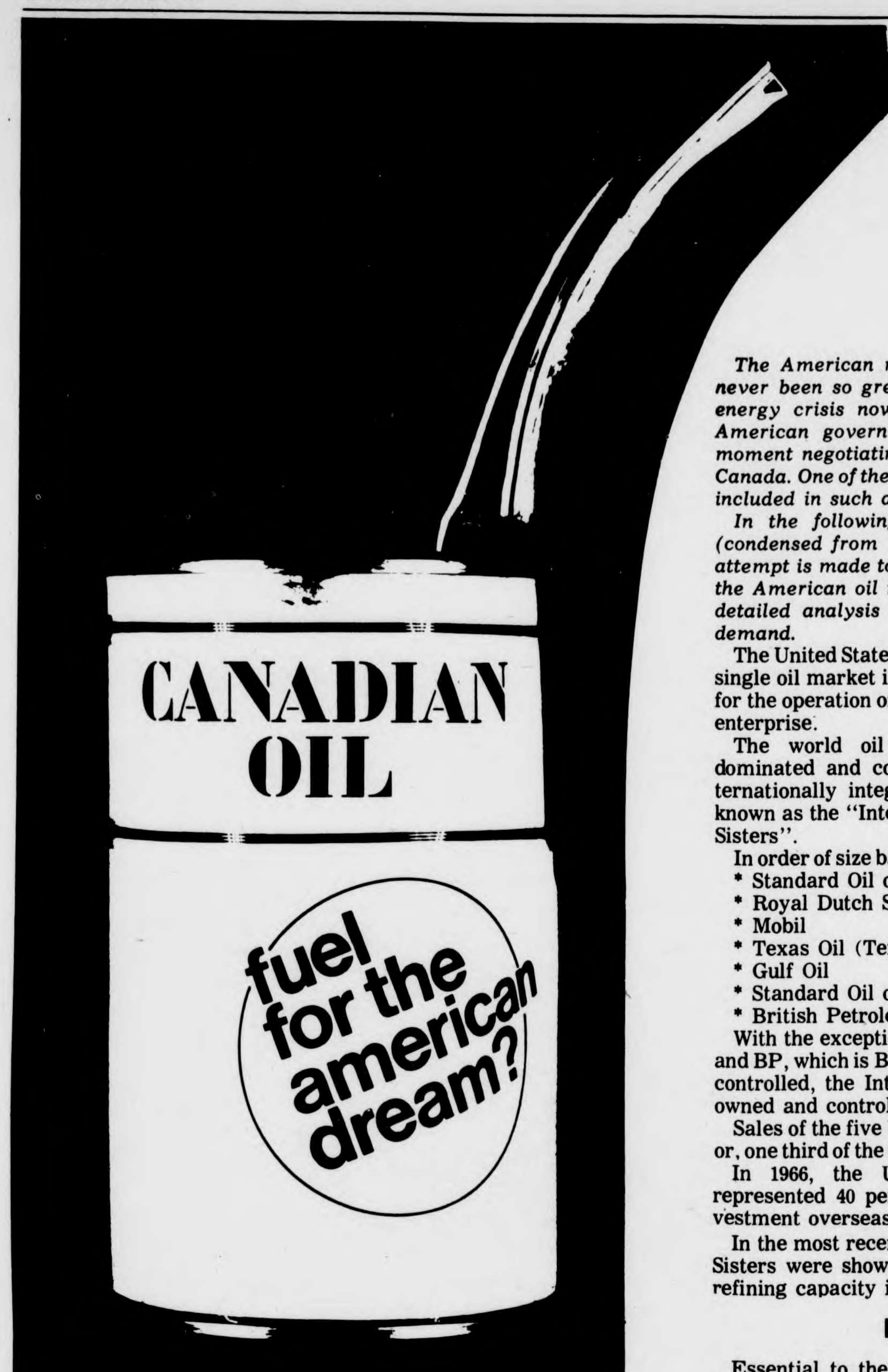
The Canadian petroleum industry

Keeping the wheels of empire well oiled



The American need for Canadian resources has never been so great as it is today. Because of the energy crisis now looming in the United States, American government officials are at this very moment negotiating a continental energy pact with Canada. One of the resources that would, no doubt, be included in such a deal is oil.

In the following article by Gordon Cleveland, (condensed from The Last Post, Vol. 1, No. 3) an attempt is made to shed some light on the nature of the American oil industry in Canada and to give a detailed analysis of why Canadian oil is in such demand.

The United States is the largest and most important single oil market in the world. Oil is the power base for the operation of the vast majority of its industrial enterprise.

The world oil market has historically been dominated and controlled by the seven major internationally integrated oil companies, commonly known as the "International Majors" or "The Seven Sisters".

In order of size based on sales, they are:

* Standard Oil of New Jersey
* Royal Dutch Shell
* Mobil
* Texas Oil (Texaco)
* Gulf Oil
* Standard Oil of California
* British Petroleum (BP)

With the exception of Shell, which is Dutch-owned, and BP, which is British-owned and half government-controlled, the International Majors are US-based, owned and controlled.

Sales of the five US majors in 1967 were $32 billion, or, one third of the Gross National Product of Canada.

In 1966, the US Majors' foreign investment represented 40 per cent of the total US direct investment overseas.

In the most recent major study, in 1960, the Seven Sisters were shown to own over 70 per cent of all refining capacity in the non-Communist world.

Price fixing

Essential to the domination of the International Majors is the maintenance of an artificially high world price structure for petroleum.

The Majors were able to sustain this artificial price-fixing structure because of their high vertical integration — that is, control over the exploration, the exploitation, the transport, the refining, and a large part of the market (gas outlets, for example). In short, vertical monopoly.

World prices, including Canadian, have historically been set to a level required to make US oil production economic. Prices in Venezuela and the Middle East, for example, were set by the US majors at a level high enough to guarantee profits for oil produced out of the "Gulf of Mexico Price Zone", the Texas producing region.

Thus even though companies like Jersey Standard and Gulf Oil in 1959 drew two thirds of their net income from foreign operations, it was important to their profits to keep the Gulf of Mexico prices as high as possible. And since the cost of production in the Middle East is at most one third of producing inside the US, it becomes crucial to the survival of the international cartels to maintain a high price level calibrated to the most expensive production area.

A task force set up last year by the Nixon administration reflected the magnitude of this price distortion. It revealed that if import restrictions into the US were lifted, and the country thrown open to the onslaught of cheap foreign-produced oil, the domestic wellhead price of $3.30 per barrel would decline by 1980 to $1.87 a barrel.

Thus Washington, sensitive to the lobbies of this immensely powerful industrial sector, preserves the position of Texas oil from the competition of a cheaper external market, and delivers staggeringly inflated profits to the companies that explore in foreign countries.

The price-fixing knows no borders and extends directly into Canada. Here is an example of the operation of the price-control system in Canada in the late Fifties:

The price of oil at the wellhead in Western Canada in the late fifties varied between $2.50 and $2.65 a barrel. This price was set through a complicated procedure that assured that the price of Western oil in Central Canada would be the same as the price of oil from the closest major petroleum-producing centre in the US, in this case Illinois. This assured that Canadian oil could not compete effectively with the bulk of American oil, even in Canada's own markets.

This $2.50 to $2.65 a barrel from the West, according to the Borden Commission on Energy of 1959, actually cost only slightly in excess of one dollar (not including taxes) to produce. That is the measure of American control over the continental and world market price.

It might seem logical that one Canadian producer could rebel against these prices and cut his far below the American level, while still retaining a handsome profit over his production costs.

This does not happen because:

a) Sixty-two per cent of the Canadian oil industry is American controlled,

b) It is in the interests of the oil producers to maintain the highest possible price, therefore profit,

c) Any smaller Canadian producer who rebelled could be easily crushed in any price war,

d) no one need worry about his price being undercut because imported oil from the international market is equally controlled.

As long as the companies play the game, they are prosperous and protected. If anyone tries to buck the game, he faces price wars, battles for markets and for supplies.

In this complex price-control system, coupled with the US control of Canadian oil production, already lies a continental energy policy.

But what the US wants extends even beyond this.

Lifting skirts

It's fair to begin to ask why our neighbor, who already sleeps with us when and if he chooses, is suddenly proposing marriage. And why Joe Greene ran to Washington lifting the Liberal Government's skirt.

In the late Fifties and into the Sixties, the international oil market began to quaver. For the first time on any major scale, a world surplus of oil started developing. The patterns of control of the International Majors started becoming undone, and the world oil market started slowly shifting its face.

This increasing world competition stemmed from the rise of 20 to 30 smaller international companies which began breaking up the cosy party of the International Majors.

These became known as the "International Minors".

At the same time, forces of nationalism in oil-producing countries have led to a number of state-controlled firms, state control of share blocks in companies, state regulation of percentages of profits that must remain in countries of exploitation and increases in tariffs.

This together with the gradual increase of the International Minors, started a downward pressure on the international oil prices. With international prices declining, however, US prices have remained steady or gone up, in a domestic market shielded by a high wall of quotas and tariffs.

What has preserved the remarkable profitability of American oil has been the US import policy of 1959, in direct response to the looming crisis in international oil.

This was, simply, the erection of a quota wall around the US, which effectively sealed out the cheaper foreign oil. By thus sealing off the prime market, it was able to stabilize prices and, of course, protect the US oil industry.

This import policy, enshrined in diverse pieces of legislation established under the Eisenhower administration, was achieved largely at the insistence of the independent domestic producers who could be wiped out if their expensive production facilities were thrown into the competition of cheaper world oil. (These independents, with their Texas oil lobbies controlling a large number of Senatorial and Congressional votes, are more important in the US market than the international Majors, since the US Majors control only one third of crude oil reserves in the US, whereas in other countries they control 60 to 70 per cent of the reserves.)

Canada's response

The response of the Canadian government to the same crisis in international oil prices was the establishment of the Borden Commission, which resulted in the national oil policy established in 1961.

In Canada there had also been a battle between the independent petroleum interests and the International Majors, but the Majors were much stronger here than in the US. The bid of the independents for the same kind of security as the US independents in large part failed.

The substance of the 1961 policy was the division of the Canadian market into two parts — all of Canadian oil markets west of the Ottawa Valley were to be served by domestic (Alberta) oil; all markets east were to be served by imported foreign oil. This was a voluntary policy, rather than the mandatory US one, but since at the time it was the policy, the Majors wanted, no one should be surprised that it was effectively followed for some years until material conditions began to change.

This left the independents somewhat out in the cold, since the Western Canadian market is not profitable enough, so a natural corollary of the 1961 policy was that the federal government had to constantly push to get larger markets for Alberta oil in the United States in order to placate the independent Alberta producers. Clearly, the 1961 policy left Canada vulnerable to US whims and wishes, since Washington could, and did, impose quotas on our oil anytime it felt like it.

But this set of policies in the two countries — the oil import policy in the US and the national oil policy in Canada — has begun to show a number of very large cracks. Powerful interest groups and forces in the United States are aligning themselves against the oil producers, in a confrontation between the Northeast and the Southwest.

The quota wall has raised US prices domestically and created such a disparity in petroleum costs between domestic and foreign crude that the heavily industrial US Northeast is beginning to rebel against the prices set by the oil producers of the Southwest.

New England senators and congressmen, representing Northeastern industry, have been pressing for a policy which would allow foreign imports to come in at a controlled rate, thus providing cheaper oil.

The wide-spread lobbying power of the industry — particularly in its home territory, the South — has enabled oilmen to shrug off the liberal gadflies for the last 43 years, since the profitable depletion allowance tax provision was voted in.

New England consumers have focussed their demands on a request to build a refinery at Machiasport, Maine, and are demanding for it an import allocation of 100,000 barrels a day.

The low-cost oil which would come out of such a refinery would be sufficient to undermine northern oil prices. But even worse, in Southern minds, this break in the 11-year-long import quota program would set a precedent very likely to lead eventually to the total destruction of the program itself, and with it the vast protected market which has guaranteed high profits for so many years.

U.S. compromise

The US oil interests would much rather compromise on a continental oil scheme which would bring comparatively high cost Canadian oil into the market.

The main battlefront for the fight between the producers and consumers in the US has been a series of hearings on the petroleum industry held by Michigan senator Philip A. Hart's Antitrust and Monopoly Subcommittee, as well as hearings conducted by a special task force to review US oil policy.

Together these investigations have brought forth a caricature of a monopolistic, profit-grabbing industry that oilmen would rather had not seen light.

Since the same companies that dominate the US market also own the Canadian one, and tactics and policies are virtually indistinguishable, that picture has strong parallels with our own.

As a result, estimated Sen. William Proxmire, in 1968 oil refineries averaged only 11 per cent federal tax on their earnings while other manufacturing firms averaged nearly 41 per cent.

New York Democrat Bertram Podell finished off the picture by releasing figures showing that 13 major oil companies have been paying federal taxes at a rate lower than that of taxpayers earning $4,000 per year. Of the 13 companies, with net incomes ranging as high as $2.3 billion per year, Sinclair and Atlantic Richfield paid no taxes at all; Gulf Oil paid less than one per cent in federal taxes and Standard Oil of New Jersey paid less than 10 per cent of its $2.3 billion net income to the Federal Treasury.

The US oil interests have found themselves desperately looking for an answer, but necessarily one which will not fundamentally shake their privileged position.

Casting their eyes about for some sign of relief, they see it on the northern horizon, just over the 49th parallel — Joe Greene's "invisible border".

There was something pathetic about Joe Greene thumping a nationalist fist before the oil men in Denver warning them that Canada will not stand for this or sit idly by for that. Only Canadians might have really believed what he said, and the hollow posture he assumed, because they would like to believe what he said is possible. But the men he spoke to in Denver must have viewed the performance with amusement.

Choices already made

The fundamental choices were made years ago, when we geared our resource policy to the United States' needs, when we set no national goals on energy exploitation.

Canada's first mass oil export was born of California's energy shortage in the time of the Korean War. The basis of the co-operation was, from the beginning, not economics, but political and military security. The initiative was American, not Canadian.

The United States Petroleum Administration for Defense decided in 1951 that California needed more oil, the west's traditional oil shortage having been aggravated by the war. A safe source of oil was required; for strategic reasons Canada was chosen to be the supplier.

A pipeline from Alberta to California was constructed, and a $65 million tab was picked up mostly by the major American oil companies.

The framework for this first exercise in continental energy planning had been set out in a joint agreement in 1950, which in effect established a sort of economic NATO or NORAD for scarce resources in time of emergency. It gives us a view of what a continental energy policy would be. That agreement declared that the two governments agree to "co-operate in all respects practicable. . .to the end that the economic efforts of the two countries be co-ordinated for the common defense, and that the production and resources of the two countries be used for the best combined results. . ."

Unmarketable commodity

Canadian oil is too expensive to sell abroad — almost three times more expensive than Middle East oil. So we have a commodity that is unmarketable overseas. But we allowed it to be developed and a sector of our economy and country to become dependent on it.

If our American markets are lost, a massive recession will hit the West. Our economy is, then, controlled by the economic vicissitudes and political decisions of a foreign country.

The American offer today is a simple exchange — yield what political control you have over your energy production, provide for our needs, and reap the economic benefits. Don't, and reap the economic consequences.

It is uneconomic for Canada to have become the ninth largest oil producer in the world. Our oil is only marketable in one market, because of the high fixed and controlled prices.

Canadian producers are getting steadily frozen out of the American market because of such developments as Alaska oil finds, and the building of a pipeline to Illinois that speeds Texas oil to the Northeastern US industries.

The Ottawa Valley line has already begun to crumble, and the big Ontario market has begun to fall to foreign oil. Golden Eagle (Canada) Ltd., Petrofina (Canada) Ltd., Newfoundland Refining Co. Ltd., Gulf Oil (Canada) Ltd. all announced refinery building programs, signalling an impending influx of foreign oil.

Dry up Canada

In the short run, the US can dry up the Canadian oil industry without suffering any setbacks. But in the longer run, we will be a crucial supplementary source of supply. The long-run thirst that will develop in the US explains Washington's pushing for the continental policy. The short run security of the US market is the club with which it can clout us into that continental scheme.

And these are the choices we have allowed ourselves to be faced with:

* agree to a continental energy scheme and pay the political price of taking a giant step towards further economic and political domination by the United States,
* face the fact that our oil is uneconomic and get out of the oil business, causing a massive recession in the West,
* or make the decision we refused to make over ten years ago (under pressure from the US Majors) and build the Alberta to Montreal pipeline.

The last choice may end up being the least of three evils, but it's no easy way out.

Gordon Cleveland was formerly with the Department of Industry, Trade and Commerce.

'It is not important

who gets the dividends,

Wall Street or Bay Street'

Joe Greene,
minister of energy, mines
and resources