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The Liberalization of Canada's Oil and Gas Markets by R.G. Skinner

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The Liberalization of Canada's Oil and Gas Markets

By Robert G. Skinner♦

Abstract

Today, Canada is the world's fourth and fifth largest producer of crude oil and natural gas respectively. Its oil and gas markets and trade are among the most liberalized in the world. But this has not always been the case. From 1961 to 1985 oil markets were fettered by government interventions. First, in the late fifties to secure market access for major discoveries in Alberta, then in the early seventies to protect consumers from rapid oil price increases. With U.S. restrictions on imports in 1958, the Canadian government sought to increase the domestic market for shut in capacity. Through the National Oil Policy, it imposed a voluntary two-price system in Canada—higher U.S.-linked prices west of the Quebec-Ontario border and lower world prices to the east. In 1973 with rising international prices, dwindling domestic production, and rising demand coupled with federal/provincial tensions over sharing resource rents, and notably the rise of separatism in Quebec, the Canadian government froze the price of domestic crude. At first, administering the price amounted to compensating importers of higher-priced oil, taxing exports, and providing the import price equivalent for a new synthetic oil plant. After the Iranian revolution's impact on oil prices, the federal government announced the National Energy Program, a comprehensive pricing and taxation regime for oil and gas. The ensuing negotiations with producing provinces resulted in a program of pricing for different classes of petroleum, which began to unravel with the fall in world oil prices starting in the early eighties. Deregulation was inevitable. This paper focuses on the administration of a multi-price system, issues of leakage and unintended outcomes, and its eventual liberalization in 1985. Many lessons can be drawn from this experience. Firstly, managing a two-price system with price caps might be manageable with rising prices: It becomes fraught with falling prices. Secondly, both consumers and producers become accustomed to subsidies—some the result of loopholes in the artificial price architecture —and naturally resist deregulation. And therefore, thirdly, once started, administered pricing systems can last a long time before the political climate makes deregulation feasible.

Introduction

In the face of rising inflation recently, many governments are reacting with a combination of monetary and fiscal policies to ease the impact on families and businesses. Proposed and enacted interventions include price caps, reduction in fuel taxes, consumer subsidies such as utility bill rebates, and windfall profit taxes. We have been here before. As historian Margaret Macmillan reminds us, "*While history does not repeat itself precisely*" it certainly does rhyme.[1]

Rising inflation through the late sixties prompted U.S. President Richard Nixon to enact comprehensive wage and price controls in 1971.[2] After a 'white paper' and a commission of

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[1] Margaret MacMillan 2013, *The Rhyme of History: Lessons of the Great War*, Brookings Institute, http://csweb.brookings.edu/content/research/essays/2013/rhyme-of-history.html

[2] https://www.aier.org/article/nixonomics-in-retrospect-devaluation-and-wage-price-controls-august-15-1971/

inquiry, and a federal election partly fought on the need for wage and price controls, Canada eventually followed suit with its Anti-Inflation Act of 1975.

For Canadians, living in a vast and cold country, the price of fuels to heat their homes and to move about has always been a major preoccupation. For government, Canadian firm's competitiveness with their American counterparts, and thus the price industry pays for its inputs, especially energy, has informed Canadian economic policy since the 1880s.[3] After the 40% rise in oil prices from 1970, on September 4th, 1973, Canada's Prime Minister, Pierre Trudeau requested the domestic oil industry to not pass on the increase to consumers until he could consult with provincial premiers on the appropriate response. This marked an historic development in oil price intervention in Canada. It took eleven years to the day before a government was elected that promised deregulation of energy markets.

The embargo by the Organization of Arab Petroleum Exporting Countries (OAPEC) against supporters of Israel in the Yom Kippur War in October 1973 is often blamed for the oil price crisis. It merely reinforced many other factors at play[4], not the least of which was surging oil demand[5] and uncertainty of supply, since OPEC had nationalized and controlled 60 percent of world production outside the USSR. Earlier in the year, the pricing agreements between OPEC member governments and international oil industry operators came under strain owing to the fall in the U.S. dollar attributed to the cost of the Vietnam War. The weakened dollar with rising inflation reduced the buying power of producing governments wanting more revenue from their oil. The shift of the power over pricing from industry to OPEC would provide Canada's politicians with an easy rationale for intervention in the Canadian oil market: that Canadians need not accept prices set by a cartel when Canada produces much of its own oil and (then) at lower costs.

The US oil price controls that distinguished imported from 'old' domestic oil had perverse outcomes, sent the wrong signals to both producers and consumers, and spawned a whole new industry of paper traders that negated the regulated price difference. The federal government frantically tried to counter these antics through revised regulations, rulemaking and guidelines, to no avail. Much has been written about this era and of the distortions and the consequences of price controls.[6] The Canadian government, following some of the U.S. actions, and wanting to ensure its industries would not be subjected to higher input costs than their American competition, believed it could avoid many of the administrative mistakes of their neighbour. But the consequences were similar in terms of perverse price signals, economic and administrative costs, and above all political tensions between producing provinces and the federal government. An enduring lesson from both attempts to hold back the tides of market forces was that the only thing exceeding the ease of intervention was its durability. Even as their administration becomes more complicated, the embedded subsidies, some of which were

[3] The first Prime Minister, John A. MacDonald, established the National Policy in 1878—a system of tariffs on foreign imported goods, and low or no tariffs on imported raw materials, to shield Canadian manufacturers from American competition. See https://www.thecanadianencyclopedia.ca/en/article/national-policy

[4] Kilian, Lutz. 2008. Exogenous Oil Supply Shocks: How Big Are They and How Much Do They Matter for the U.S. Economy? *Review of Economics and Statistics* 90(2): 216-40

[5] Free world oil demand rose from almost 19 million barrels per day in 1960 to more than 44 million barrels per day in 1972; Yergin, D. 1991, *The Prize: The Epic Quest for Oil, Money & Power*, Simon & Schuster, 909 p, p. 567

[6] Kalt, Joseph. 1981. *The Economics and Politics of Oil Price Regulation*. Cambridge, MA: MIT Press; Bradley, Robert L., Jr. 1996, *Oil, Gas and Government: The US Experience*, 2 vols. Lanham, MD: Rowman & Littlefield; Murphy, Robert P., 2018 Removing the 1970s Crude Oil Price Controls: Lessons for Free-Market Reform, *The Journal of Private Enterprise* Vol 33 (1) p 63-78

unintended by policy makers, nourish dependencies that become politically difficult to remove. Deregulation eventually becomes unavoidable as the international market evolves in a direction opposite to the assumption underpinning regulation, and the domestic political and economic climate changes.

This paper reviews the long arc of fettered oil markets in Canada, starting in the late fifties in response to U.S. oil import quotas, followed in 1961 with the *National Oil Policy* when intervention relied on the industry's voluntary cooperation. Its effect was to subsidize producers at the expense of some consumers. This was followed by an about-face in 1973 when crude oil price controls were imposed under statute to subsidize all consumers at the expense of producers. The most aggressive and politically disruptive energy policy intervention took place under the *National Energy Program* of 1980 (NEP). As such, it has been the subject of a large volume of analysis, comment, and opprobrium, especially in the producing regions.

A principal and invaluable resource for this review is the *Canadian Energy Chronology* by Toombs, 1998, a record of federal energy policies, announcements and programs from 1945 through 1995.[7] As a former official of the federal energy department, Toombs described events, quite properly avoiding political analysis and comment. However, many journalists and academic researchers have analyzed, reviewed, and critiqued Canada's energy policies and their impact on the political economy of energy in Canada.[8] For an academic examination of the turbulent period in energy policy leading to the NEP, the reader is referred especially to Doern and Toner 1985.[9] The roles of 'interests' and personalities are frequently addressed in historical analyses of Canadian energy policy.[10] They were central to oil and gas price regulation and in turn to energy policy in general—indeed, the major and dramatic increases in the world oil price was the propellant that drove Canada's energy policy in the seventies and early eighties, especially the battle for rents and the consequential fiscal responses, at both the federal and provincial levels. For a critical examination of the players behind the development of the NEP by a leading Canadian political and economic journalist, Foster's *The Sorcerer's Apprentices* provides valuable insights.[11]

Given this author's direct involvement with the administration of Canada's oil and gas pricing system post 1981 through deregulation in 1985, this paper focusses on an aspect not normally covered in any detail by academic reviews, namely, the administrative processes and challenges in regulating oil and gas markets, and eventual market liberalization. The author has drawn on unclassified, unpublished reports he and colleagues prepared in 1984 and 1985 related to deregulation of oil prices and the history of oil price administration in Canada from

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[7] Toombs, Ralph. 1998, *Canadian Energy Chronology*, 431 p, https://docs2.cer-rec.gc.ca/ll-eng/llisapi.dll/fetch/2000/90464/90552/548311/956726/2392873/3781642/3890553/3934773/C06898-25_Appendix_K_gid_297918_-_A7G4T1.pdf?nodeid=3934227&vernum=-2. Chronology references are indicated hereafter, for example, as Toombs, ibid p. 1984-3, referring to the third page for 1984. Subject entries in the margins of the Chronology are also frequently provided.

[8] See for example, Helliwell, John F. 1979, Canadian Energy Policy, *Annual Review of Energy*, 4:175-229, and McRae, Robert N. 1985, A Survey of Canadian Energy Policy: 1974-1983, *The Energy Journal*, Vol. 6, No. 4, pp. 49-64.

[9] Doern, Bruce and Toner, Glen, 1985 *The Politics of Energy: The Development and Implementation of the NEP*, Methuen Publications, 523 p

[10] Berry, Glyn R., 1974, The Oil Lobby and the Energy Crisis, *Canadian Public Administration* 17 pp 600-35. For an in-depth treatment of the subject of the influence of interests in the context of Canada – USA energy relations, see Nemeth, Tammy L., 2007 *Canada-U.S. Oil and Gas Relations, 1958-1974*, PhD dissertation University of British Columbia.

[11] Foster, Peter, 1982, *The Sorcerer's Apprentices – Canada's Super-Bureaucrats and the Energy Mess*, Collins Publishers, 1982

1973 to 1985.[12] References are necessarily made to the broader political and economic context but only to the extent they influenced adjustments to the system of price administration.

The build up of oil price regulation was controversial, prolonged and complicated, while deregulation by comparison, once decided and agreed with the provinces, was mostly non-controversial, quick and simple. Natural gas price regulation and deregulation is not addressed to the same extent as for oil. However, given the gas sector's different structure and contract-based market, it has long been subject to some regulation, while gas price deregulation was more protracted than was the case for oil. The paper points to some of the lessons from the Canadian experience for today's policy makers as they design policies to contain energy price increases as anti-inflation measures.

Fettered Oil Markets in Canada—First to Help Producers

Canada's 'mineral' oil industry began in mid-nineteenth century in New Brunswick but especially in southwestern Ontario across the Canada – USA border from the oil plays in the State of Pennsylvania.[13] Under Canada's constitution, natural resources within provincial boundaries come under provincial jurisdiction. Each province has its own oil and gas statutes and regulatory agencies.[14] Today Canada is blessed with a massive and diverse endowment of natural resources; it is the world's fourth and fifth largest producer of oil and gas respectively, and the sixth largest producer of primary energy in general.[15]

However, geology's gifts have not been democratically distributed across Canada. Notably for hydrocarbons, most reserves are in the relatively unpopulated western provinces, whereas most of the country's population (consumers) are in central Canada. This acute hydrocarbon and demographic geographic asymmetry has been a crucial determinant for energy policy choices by the federal government. But policy has not always been for the benefit of consumers[16], as McDougall noted, *"the fuel producing provinces have all benefited at one time or another at the expense of at least part of central Canada, although the federal government has consistently balked at imposing the larger burden on (central Canadian taxpayers) ...necessary to bring about a nationwide market for Canadian fuels"*.[17]

Security of supply as a top priority in energy policy waxes and wanes with the world oil price. From the early nineties until the Russian invasion of Ukraine in 2022, climate change has been the principal motivator for policies affecting Canada's energy sector. Climate policy is energy policy. Achieving federal provincial consensus on a unified climate policy bedevils federal

[12] "Crude Oil Pricing Options", September, 1984 and "Oil Price Regulation in Canada: 1973 to 1985", on file with the author.

[13] History of the Petroleum Industry in Canada, https://en.wikipedia.org/wiki/History_of_the_petroleum_industry_in_Canada

[14] For an overview of Oil and Gas Regulation in Canada, see for example, https://iclg.com/practice-areas/oil-and-gas-laws-and-regulations/canada#:~:text=Pursuant%20to%20the%20Canadian%20Energy,export%20oil%20and%20gas%20production.

[15] https://www.nrcan.gc.ca/sites/nrcan/files/energy/energy_fact/2021-2022/PDF/2021_Energy-factbook_december23_EN_accessible.pdf

[16] The coal industry in Nova Scotia and New Brunswick were subsidized for many years, first in 1870 with duties on competing imports of U.S. coal to Ontario, and transportation subsidies, then in the fifties to the nineties with various subsidies to keep mines operating. McDougall, John N. 1982, *Fuels and the National Policy*, Butterworth & Co. (Canada) Ltd, 199 pp. The western Canada coal industry was subsidized in the seventies to enable tidewater access. RT 1969-1, Subventions on coal exports – western Canada

[17] McDougall, *ibid*, p. 159

policy makers to this day. At the root of the challenge is the acute diversity of resource endowment of the provinces—some blessed with hydroelectricity, others 'cursed' with fossil fuels. Geology, demographics, the Constitutionally-based provincial ownership of resources and explicit recognition of the rights of indigenous peoples, mean that agreement on anything resembling a national energy policy or strategy—or its proxy policy, climate change—especially affecting oil has been historically fraught and will likely remain so.[18]

The National Oil Policy: 1961 to 1973

Following discovery in 1947 of a major light crude oil play in Alberta, Canada's oil production capacity increased from 21 kb/d to over 900 kb/d by 1959. The global market was awash with output from major discoveries in the Middle East, Venezuela and, in the late fifties, significantly in terms of the history of international oil prices, Libya (see below).[19] This surge of oil on the market pleased governments of most consuming governments. The government of the United States, however, had its own producers to deal with.[20] For years, they objected to cheap foreign oil coming into 'their' market and lobbied Washington for action. After much pressure, President Eisenhower eventually relented and approved the *Mandatory Oil Import Quota* Program (MOIP) of 1959.[21]

Canadian exports to the U.S. were at first exempted under MOIP but limited to no higher than the import level in 1955 and predicated on Canada not building a pipeline to Montreal.[22] However, over the next decade, Washington altered its position at times including Canadian exports in the mandatory quota, then calling for more oil when U.S. supply seemed at risk (such as during the 1956-1957 and 1967 Suez Crises[23,24]), then threatening to decrease Canadian allowances (under the Kennedy administration) to finally giving up altogether applying MOIP to imports of Canadian oil.[25,26]

At the time MOIP was imposed two thirds of Canada's capacity was shut in. With access to the U.S. market reduced, something had to be done to increase access to the domestic market. The Alberta government had long urged federal action to extend the interprovincial pipeline system from western Ontario to the Montreal refining complex, but the downstream industry, owned by the international oil companies' Canadian affiliates, insisted this would not be

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[18] Skinner, Robert. 2017, *A NATIONAL ENERGY STRATEGY: The Holy Grail of Canadian Public Policy*, https://www.ucalgary.ca/science/redevelop/files/redevelop/ecc-18-150-anniv-pub-18-03-05.pdf

[19] Yergin, D., 1991, p. 529

[20] Idem, p. 535-540

[21] As Yergin recorded, ibid p. 538, Eisenhower's unhappiness with this intervention was expressed at a Cabinet meeting when he criticized the "*tendencies of special interests in the United States to press almost irresistibly for special programs like this (that were) in conflict with the basic requirement of the United States to promote increased trade in the world*". The U.S. finessed GATT rules by invoking national security.

[22] Nemeth, T. 2007 pp. 137-155

[23] Toombs, ibid p. 1973-2; Nemeth, T. 2007 Table 2 p. 130

[24] Yergin, D. 1991, p. 493

[25] Toombs, ibid p. 1965-1 Overland exemption for Canada in the U.S. Mandatory Oil Import Program: For other references in Toombs tracing the MOIP's varying treatment of imports of Canadian crude oil, see p. 1959-2, p. 1963-1 US restricts Canadian imports within quota, p. 1965-1, exemption resumed, p. 1966-6 re restraint if new pipeline loop to Chicago market, p. 1967-3, 4, p. 1969-2, p. 1970-1, Canada—U.S. energy relations, p. 1970-2 US Presidential Proclamation (restricting Canadian oil imports)

[26] For an in-depth analysis of this period, in particular the importance of the relationships between successive Prime Ministers and U.S. Presidents, see Nemeth, 2007 ibid p. 121-132

economic.[27] Besides, it would "*jeopardize (Canada's) hard-won exemption*" to the MOIQ[28], which in the end was the most compelling reason why the government demurred, for the time being at least, on supporting a pipeline to Montreal.[29]

In February 1961, the federal minister responsible for energy matters, announced in the House of Commons the *National Oil Policy* (NOP).[30] The policy had two principal elements—volume and price. Regarding volume, it aimed to achieve target levels of oil production, specifically 800 kb/d in 1963, a level based on what would theoretically happen had there been pipeline access to Montreal. The production target and subsequently increased targets including exports ensured that refiners west of the Ottawa Valley would be dependent on Canadian oil. The NOP was relatively non-controversial. The west got an expanded market protected from imports; Ontario's refining and petrochemical market would be expanded, and Quebec got lower prices.[31] But sustaining the price difference would not be easy.

Under the NOP, consumers east of the Ottawa Valley Line[32] (Figure 1) paid prices based on the price of imported crude, which was lower than the price west of the Line, the latter pegged to the price of U.S. domestic crude at Chicago, which was 60 percent higher than the world

[27] The issue of pipeline access to Montreal existed since the fifties and, in part triggered by the disruption of world supply during the 1956-57 Suez Crisis, prompted the federal government to establish the Royal Commission on Energy in 1957 Toombs, p. 1956-2, Suez Canal Crisis. The Royal Commission held hearings on the subject, with strenuous arguments from the producing provinces for access to Montreal refineries, and as it turned out more convincing arguments from the foreign-owned integrated oil companies that a pipeline would not be economic. Toombs, ibid p. 1959-3-5; See *Royal Commission on Energy* – Second Report at https://publications.gc.ca/site/eng/472650/publication.html. After the 1973 OPEC crisis, a pipeline to Montreal was compelled by the federal government as an emergency project for reasons of energy security, and was completed in 1976, with a portion of its tolls subsidized. It would be reversed in 1998 to take advantage of low-priced offshore crude and then reversed back to its original west-to-east mode in 2015.

[28] Nemeth, T. 2007, p. 143

[29] Ibid, p. 158

[30] Toombs, p. 1961-1, p. 1968-4

[31] Doern and Toner, ibid, p. 133.

[32] The Ottawa River demarcates the boundary between the provinces of Quebec and Ontario from the northern tip of Lake Timiskaming nearly 1,300 kms southeast to Montreal where it flows into the St Lawrence River.

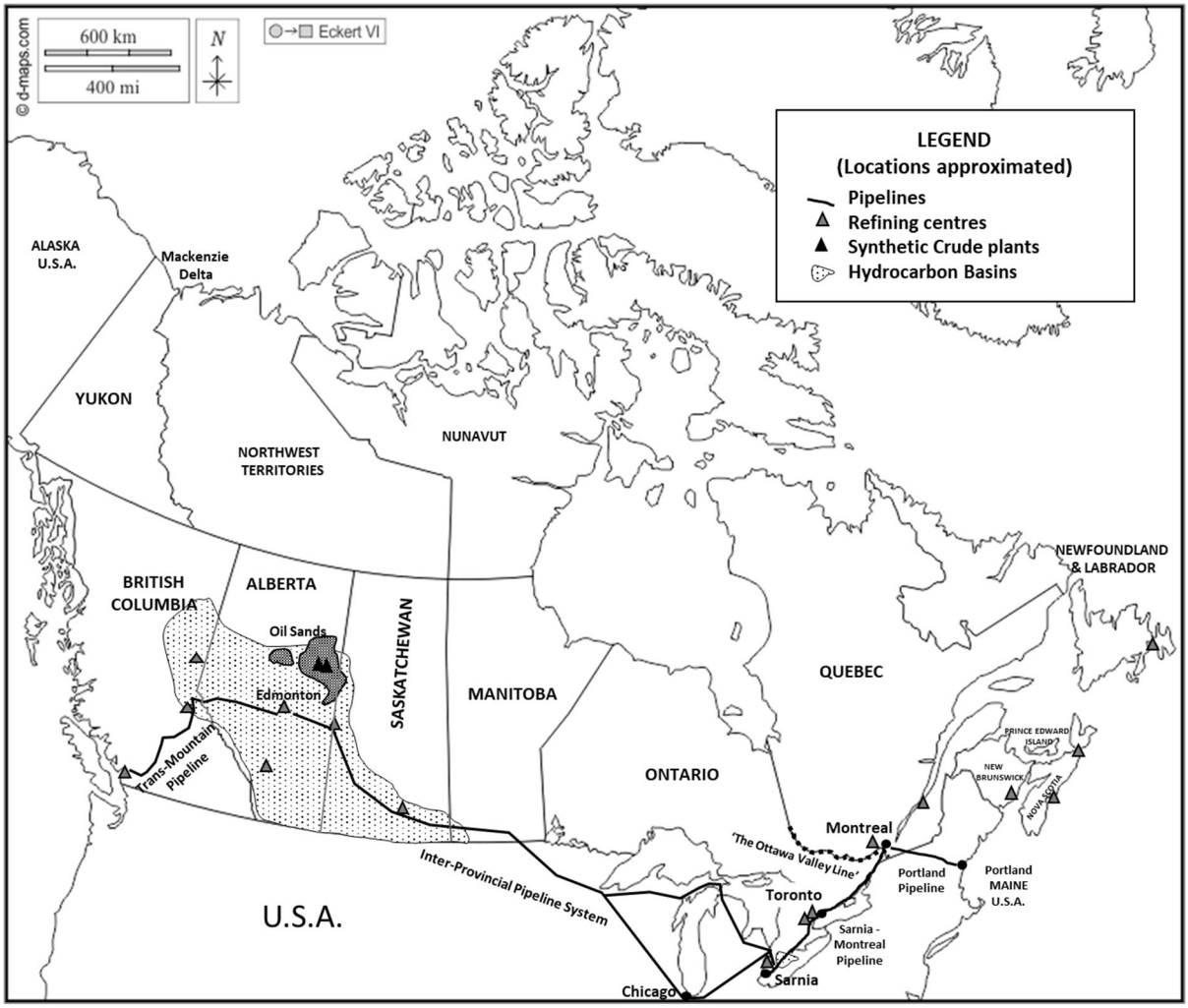

Figure 1. Location map. Hydrocarbon producing basins and infrastructure in existence in the seventies, referred to in the text. Refinery centres (1 or more refineries). Locations are approximated.

price in 1961.[33] Compliance with the NOP by refiners east of the Line was voluntary at first. But the price difference became irresistible to independent marketers east of the Line. They began trucking product into eastern Ontario. Also, many of the refineries in the east had been expanded with government assistance (under regional development programs), and the resulting capacity far exceeded the regional market.

In 1968 the NOP was reviewed, and the NEB imposed licensing requirements on imports and prohibited the movement of product out of the eastern region.[34] Both Canada and U.S. were reviewing their oil policies; the leakage across the Ottawa Valley Line and the high oil price in Ontario concerned Ottawa.[35] Canada-U.S. energy relations were deteriorating on several fronts, but the MOIP and NOP were central irritants—the latter to the U.S. because of products from foreign oil imported by eastern Canada exported into the northeastern U.S. markets.[36] During

[33] From Statistics Canada data in Nemeth, T. 2007, p. 337, but this significant difference in crude price did not mean consumers in Quebec and east paid dramatically lower prices for products such as gasoline, since the provinces imposed relatively heavy provincial fuel taxes. Nemeth, ibid (at footnote p. 292).
[34] Doern, Bruce and Toner, Glen, 1985, p. 170-171
[35] Toombs, ibid, p. 1968-4), Review of the NOP required, p. 1969 1-2, NEB report on NOP; p. 1969-3, Oil policy review in Canada
[36] Toombs, ibid, p. 1970-6 Tension in Canada—U.S. energy relations; also, RT 1970-8

the sixties, Middle East oil production had increased dramatically as host governments, still unable to have much influence against the oil majors regarding price, chased revenues by approving increased output. Not surprisingly, global demand skyrocketed. In 1970, with the Suez Canal still closed from the Six Day War of 1967, the pipeline from Saudi Arabia to the Mediterranean shut down, oil supply to the European market was tight. After the coup d'état in Libya, the new regime under Muammar al-Qaddafi, extracted a significant change in the revenue split with Occidental Petroleum. The price increase, and those from subsequent agreements in early 1971 with Gulf members of OPEC, marked a pivotal moment in the international oil market.[37] Pricing power had shifted from industry to the governments of OPEC.

At the same time, a continental approach to energy was politically attractive.[38] To encourage the Canadian producing industry, Joe Greene, Canada's energy minister in 1971, relying on advice from his industry-dominated National Advisory Committee on Petroleum (NACOP)[39] remained upbeat about Canada's resources. In April he stated that the U.S. restriction[40] on Canadian oil imports was a mistake, that Canada had ample resources to meet future requirements. In June the Minister told an industry gathering that "*At 1970 rates of production, Canada had 923 years of oil and 392 years of natural gas in the ground."*[41] But by the end of the year, it became apparent that actual reserves (as opposed to resources) were not so great after all. The NEB reduced or denied several gas export applications.[42]

In Ottawa, the energy ministry (EMR) sought Cabinet authority to prepare an energy policy study.[43] It was eventually released in June of 1973, as *An Energy Policy for Canada*, as a basis for consultations with the provinces and Canadians.[44] As for domestic crude prices, noting the recent increases in foreign oil prices, the department's view was ambivalent.

> "As a result of the proximity and the established trade pattern between Canada and the United States, it is likely that Canadian crude prices will continue to reflect crude price movements in the United States *unless some government mechanism is developed to insulate Canadian prices from U.S. price influences* (italics added). (The policy's analysis assumed that) for the first time in many years North American crude and product prices will reflect international price developments…an important assumption (because)…if Canadian prices are held down the resources available are reduced and, at the same time, a greater domestic demand than projected may develop."[45]

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[37] Yergin, ibid pp. 577-585
[38] Doern and Toner, ibid, p. 133
[39] Toombs, ibid, p. 1969-7 NACOP established
[40] Under both the Kennedy and Nixon presidencies, the U.S. threatened to rescind Canada's 'pass' under the MOIP. Nixon announced in spring of 1970 that "*the volume of Canadian oil imported in the U.S. was to be formally limited*", but the MOIP was essentially dead. Nemeth, T. p. 269
[41] Honourable Joe Greene, 1971, "*Speech to the Petroleum Society of the Canadian Institute of Mining and Metallurgy*", Banff, Alberta, June 1, 1971. This often-quoted statement inferring a no-holds-barred policy on exports stands in contrast to his statement just eleven days earlier expressing a cautious position on making long term commitments on resource exports. See Toombs ibid, p. 1971-3 re Continental energy policy
[42] Toombs, ibid, p. 1971-5, NEB denies gas export applications
[43] Toombs, ibid, p. 1970-20, Proposal for an energy policy study
[44] Toombs, ibid p. 1973-3, "An Energy Policy for Canada"
[45] Information Canada, 1973, *AN ENERGY POLICY FOR CANADA*—Phase 1, Volume I Analysis, p. 66-67

While officials noted the option of applying some mechanism to control Canadian prices, they clearly understood the importance of the price signal for addressing the declining base of oil reserves. Ambivalence would vaporize a few weeks later.

The U.S. Administration was chasing its ever-increasing demand estimates with increments to Canada's quota. By the end of 1972, it gave up altogether on the MOIP for Canadian oil and would take all that Canada could supply.[46] The U.S. concern had quickly shifted from protecting its producers to ensuring security of supply, and therefore its bilateral oil policy interest with respect to its northern neighbour changed to pressing for a continental energy policy. Suddenly in 1973, the picture changed dramatically: industry was advising the National Energy Board that Canada's oil was running out. In fact, it looked more like the country had just ten years' supply.[47] Political sentiment switched to nationalism.

In a very short period, Canada went from assuming its oil reserves were sufficient to meet both domestic needs and growing export demand for the foreseeable future, to imposing export controls. The control of the volume of Canadian oil crossing into the U.S. flipped from Washington to Ottawa. Such was the primitive art of economic forecasting and especially the limited understanding by politicians of the arcane and nascent discipline of estimating and distinguishing petroleum reserves from resources. It also reflects the significant deterioration in the transparency between the upstream and downstream of the international industry that accompanied the nationalization in OPEC members and the shift in control of the global market. Canada's oil pricing policy was about to pivot in favour of consumers.

1973—Consumers' Turn for Protection

The political context for energy policy and market intervention is obviously critical. When reacting to dramatic increases in oil prices, Canadian political leaders tend to make the simple calculus that consumers' votes vastly outnumber those of producers.[48] This demographic/geographic reality certainly informed Prime Minister Pierre Trudeau's decision over the long holiday weekend on September 4th, 1973, to call for a freeze on domestic crude oil prices and impose an oil export tax. The Prime Minister could hardly simply switch the NOP's two-price system and have Quebec consumers pay a higher price than Ontario consumers. Especially since Ottawa had not approved a pipeline to Montreal to now provide Quebec with lower priced Canadian oil. The government had rejected windfall profit taxes not wanting to add to the complexity of the tax system.[49] In December, the PM announced in Parliament the end of the NOP's two-price system, the launch of a single price net of transportation, that the Interprovincial pipeline would be extended to Montreal and the creation of a publicly owned oil company.[50]

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[46] Toombs, ibid p. 1973-1-2 For the sequence of activities, announcements and policy reviews and the rapid reversal of policies on oil, see Toombs, ibid p. 1970 to 1973

[47] Foster, Peter, 1982, *The Sorcerer's Apprentices*, p. 257

[48] This is not always the case for all commodities. For example, the federal government is steadfast in its support of supply management for dairy, poultry and eggs through quotas and import controls. There are fewer than 16,000 farms that gain the benefit of this policy, while nearly forty million consumers pay more than they otherwise would in the absence of supply management.

[49] Doern and Toner, 1985 p. 172. For a review of the history of the complex and ever-changing oil and gas taxation in Canada, see Helliwell, John, MacGregor, Mary, McRae, Robert and Plourde, Andrew, 1988, Oil and Gas Taxation, Osgoode Hall Law Journal, Vol 26, No. 3

[50] Toombs, ibid p. 1973-9

The decision to freeze the domestic oil price and its unilateral nature are considered a major conjuncture in Canadian energy politics. It was the first time the federal government exercised its constitutional authority over energy pricing in interprovincial trade and commerce.[51] Previously oil prices were set by industry and under the NOP the higher price west of the Ottawa Valley was a product of industry's voluntary compliance to not jeopardize Canada's access to the U.S. market under the MOIP.

When he asked industry to not pass on to consumers the increase in the oil price, Pierre Trudeau led a minority government in the House of Commons with the balance of power held by the (more) socialist, anti-corporatist New Democratic Party (NDP).[52] The main consuming provinces, Ontario and Quebec, had strong, left leaning ('Red') majority Progressive Conservative and (left) Liberal governments respectively. The latter government, elected a few weeks after the price freeze, saw the separatist Parti Quebecois significantly increase its share of the popular vote.[53] Trudeau, a Quebecer, faced pressure from both these premiers[54] to keep the price freeze in place, which he confirmed in December would be held until the end of winter. In January 1974, the *Oil Export Tax Act* was passed as well as the *Energy Supplies Emergency Act*[55], to provide the authority to preserve energy supplies in the event of emergency caused by shortages.[56] At a First Ministers' meeting Trudeau gave in to the Ontario and Quebec premiers and agreed to extend the price freeze until March, when First Ministers agreed to a price increase from $2.70/bbl to $6.50/bbl[57], which would be the largest single relative increase over the period of regulation to 1985.

Trudeau's minority government fell with a budget it expected the opposition would not support.[58] Trudeau was restored to power with a majority in an early July election. Inflation (running at 11%) was a central issue along with rising corporate profits and unemployment.[59] The government eventually announced its Anti-Inflation Program in October 1975; compliance with the program's guidelines became a condition of eligibility for petroleum import compensation.[60]

Over the months following the freeze of prices in the fall of 1973, which was assumed would be short term, the government implemented the oil import compensation program. At first,

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[51] Doern, B. and Toner, G. 1985, p. 172

[52] History does rhyme. In March of 2022, Pierre Trudeau's son, Justin Trudeau, the current Prime Minister, heading a minority Liberal government is supported by the NDP in a Supply and Confidence Agreement to keep the Liberals in power until June of 2025. https://pm.gc.ca/en/news/news-releases/2022/03/22/delivering-canadians-now

[53] https://en.wikipedia.org/wiki/1973_Quebec_general_election

[54] Ontario politicians argued that having paid prices higher than world prices during the NOP justified paying less than world price after the OPEC crisis. McDougall, J. 1982 p. 140.

[55] *Energy Supplies Emergency Act*, https://laws-lois.justice.gc.ca/eng/acts/E-9/FullText.html

[56] There are many parallels with legislative actions in the U.S. However, if the underlying goal for Canada was to protect the competitive position of its industry versus American industry, in the U.S. the goal of its *Emergency Petroleum Allocation Act* was to "*preserve the competitive viability of independent refiners, small refiners, nonbranded independent marketers, and branded independent marketers*". See Bradley, R. 1996, p. 1626

[57] All dollars in this paper are in Canadian nominal dollars unless otherwise indicated.

[58] The fall 1973 Quebec election saw the rise of the separatist *Parti Québécois*; Pierre Trudeau, a Quebecer, had to be generous to the province under its Liberal leadership and no better way than to continue the freeze on oil prices.

[59] Jon H. Pammett, Lawrence LeDuc, Jane Jenson, and Harold D. Clarke, 1977 The Perception and Impact of Issues in the 1974 Federal Election *Canadian Journal of Political Science* Vol. 10, No. 1 pp. 93-126

[60] Between 1974 and December 1978, price controls went from 'voluntary' (until December 1974), then mandatory under the oil import compensation program, then mandatory under the federal anti-inflation Program. Toombs, ibid p. 1978-17, Post Anti-Inflation Program oil price administration.

officials in EMR administered the import compensation payments. The government changed the oil export tax to an export charge and promulgated oil import compensation regulations, then a year later, November 1, 1974, transferred administration to the Energy Supplies Allocation Board (ESAB) under the *Energy Supplies Emergency Act*. In the beginning, funding and legislative authority came by way of supply bills as Appropriation Acts.[61] In July 1975, the *Petroleum Administration Act* (PAA) was passed to replace the *Energy Supplies Emergency Act.* The PAA enabled administration of the system of prices, charges, and compensation.[62] It provided authority to impose a charge on crude and product exports, provide for compensation for certain petroleum costs and to regulate the prices of Canadian crude and natural gas in interprovincial trade. A subsequent amendment to the Act established the means to compensate purchasers of synthetic crude deemed to be imported oil and to set the Syncrude Levy to pay for it, with the levy proceeds paid into a Petroleum Compensation Revolving Fund. Prior to this change, levy revenues and export taxes were paid into the government's Consolidated Revenue Fund and compensation payments were a line-item vote in the national accounts.

The government's focus on energy self-sufficiency at this time saw numerous decisions. The Syncrude project, under construction in the oil sands, would receive the international price. Ottawa also agreed with Alberta and Ontario to share in Syncrude's equity.[63] It acceded to Quebec's demand that its refiners not pay more than Ontario's for Canadian oil, so Ottawa agreed to cover the resulting deficiency in the tolls on the new Sarnia to Montreal Pipeline.[64] As in the U.S., the department of energy launched an energy conservation program, which with a set of off-oil programs would become major activities for the department.

Determining the 'Reference' International Price

The bureaucracy had to craft a system to administer a two-price oil market in which some refiners paid the lower domestic price of crude oil while importing refiners paid the higher, fluctuating international price, and were compensated for the price difference. Defining and agreeing with producing provinces what in precise terms would be the 'international' or import price would become an enduring preoccupation for the price administrators through to eventual deregulation.[65] It was critical to ensure that the importers were kept whole relative to their domestic crude-reliant competitors, by being compensated for the total cost difference. Also, the government faced the challenge of how to pay for the program's cost. The export tax on crude exports, equal to the difference between the domestic and international price, was an obvious first step, but imports soon exceeded exports so other sources of revenue would be

[61] *Appropriation Acts* (Supply Bills) https://www.canada.ca/en/treasury-board-secretariat/services/planned-government-spending/appropriation-acts.html

[62] Toombs, ibid p. 1974-4, *Petroleum Administration Act*; in July 1982, as part of a suite of bills to enact the National Energy Program's Energy Security legislation, the PAA was replaced by the *Energy Administration Act*.

[63] Syncrude started production in 1978. However, another synthetic crude plant owned by Sun Oil of the U.S., the Great Canadian Oil Sands Company (subsequently named Suncor), producing since 1969, had not received world price; by agreement with the Minister, it would do so in exchange for commitment to expand the plant's production by thirteen thousand barrels per day. Once it did, compensation for Suncor was removed, but eventually reinstated.

[64] Toombs, ibid p. 1974-7, Quebec position on oil and gas prices. To keep transport costs equal, the Deficiency Agreement covered the fixed and variable costs shortfall per calendar year from disallowed costs by the NEB and to equalize transport costs, together totalling 18 cents per barrel; see Toombs, ibid p. 1977-5 IPL 18 cent subsidy. In its first year it cost $16 million. A Montreal Crude Use Program commenced under which refiners to be eligible for import compensation would have to use crude from the pipeline.

[65] In the seventies, this was not a significant issue for the producing provinces. It became more so once it was agreed that certain classes of oil would receive the international price, adjusted for quality and transportation.

needed. In mid 1975, an Excise Tax of ten cents a gallon was imposed on gasoline for non-commercial use.

For the first eighteen months of the import compensation program, importers were compensated on a cargo-specific basis relative to prices on November 30, 1973, of comparable quality domestic crudes. This basically froze international price relationships relative to that date, and importers became indifferent to the actual price difference. Cabinet decided in July 1975 that compensation would be determined on a flat rate basis. The rate was based on the difference between the theoretical average cost of three equally weighted foreign crudes from Nigeria, Iran and Venezuela and the cost of equivalent quality Canadian crude oil at Toronto (the furthest east that Canadian crude could go at the time). The rates were set in U.S. dollars before the beginning of the month to which they would apply. A currency adjustment was determined as a separate component of compensation to ensure refiners importing at different times during the month would be compensated for currency exchange costs.

In March 1976, the rates were changed to rolling two months, then a year later, rolling three months based on the three-foreign crude slate over the prior month's loadings. After the NEP, when the international price started to weaken, the methodology was criticized for not being sufficiently responsive to changing crude oil sourcing, and to spot market prices and imports. Thereafter, compensation rates were determined after the fact, based on actual loadings for the month for which they applied. After the 1981 agreement with Alberta on energy pricing and taxation, which provided for international prices for various classes of new oil, the system would change several times again. As discussed below, near the end of price administration when domestic crude quality differentials were seriously out of line with market differentials, compensation was based on a set of fifty-two traded crudes on the world market.

Besides providing for an equal price of crude oil (net of transportation) for all Canadians, an important principle of the blended price system was that refiners, dependent on imported crude would not be disadvantaged relative to their domestic competitors who refined only lower-priced domestic crude. This necessitated prompt payment of import compensation, which would challenge most governments' financial processes and oversight requirements[66] Once all the proof of volumes, quality, and delivery[67] were confirmed, a government of Canada cheque co-signed by officials with delegated authority under the EAA, was deposited in the recipient's bank account in Ottawa before the end of banking the same day.[68]

Paying the Cost of Compensation

Through the 1974 to 1976 period a major fiscal battle ensued with the producing provinces when the federal government disallowed royalty deductions from federal corporate income tax. The provinces responded by increasing royalties on price increases which cut the federal take in half, to 6%. While adjustments were made to the federal tax system, in part to provide greater

[66] Staff from the Auditor General's office were stationed in the branch of the Energy department responsible for administering the program as part of the AG's continuing review of the Oil Import Compensation Program. See for example Auditor General of Canada, 1983 audit for the 1982/83 fiscal year. https://publications.gc.ca/collections/collection_2015/bvg-oag/FA1-1-1983-eng.pdf, Sections 17.116 to 17.125

[67] For the Montreal refiners, who received crude via the pipeline from Portland, Maine, USA, the USA port was deemed a port of entry for purposes of the import compensation program.

[68] Documentation had to be received before 10:00 AM to receive payment before 3:00 PM the same day.

incentive for industry to increase exploration, the increasing federal-provincial fiscal asymmetry continued to widen and would become a crisis for Ottawa.

While battling with the producing provinces over oil and gas prices and economic rent, Ottawa was in intense discussions with U.S. authorities on several bilateral energy issues. Canada's 1970 decision to suspend further approvals of natural gas exports and in 1976 to phase out oil exports by the early eighties was a major irritant for the U.S. and considered a pivotal event in the bilateral energy relationship.[69] Both countries were focussed on energy self-sufficiency, and therefore anxious to move oil and natural gas south from major discoveries in the Mackenzie Delta and the North Slope of Alaska. After Canada's sudden reversal on approving more hydrocarbon exports to the U.S., Washington was understandably nervous about a transit gas pipeline across the territory of its perfidious neighbour.[70]

Internationally this was a period of peak anxiety over energy security. OPEC was able to act in a coherent organized manner. However, the consuming countries within the Organization of Economic Cooperation and Development (OECD), appeared to be in organizational disarray, unable to act in a unified way.[71] North America (U.S. and Canada) had imposed crude oil price controls, while some European OECD countries such as Sweden, Italy, the United Kingdom, and the Netherlands (along with the U.S., a specific target of the OAPEC oil embargo) reacted to the price increase variously with rationing[72] and price caps on certain products. West Germany, with ample product stocks, decided to rely on market forces, principally higher prices to induce consumers to reduce demand. The government did however impose a temporary ban on Sunday driving.[73]

To deal with the oil price crisis, OECD member countries created a new institutional mechanism was needed. The International Energy Agency (IEA) was created in 1974 to ensure security of oil supply. Three years later the agency's member countries would approve a set of *Principles for Energy Policy*, which included a limp nudge on pricing: "*Pricing energy in domestic markets at levels which encourage conservation and stimulate supply*".[74] This gave sufficient air cover for price control policies in the U.S. and Canada.

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[69] Nemeth, T. 2007, ibid p. 4; Toombs, ibid p. 1976-14 Canada-U.S. energy relations

[70] A *Transit Pipeline Treaty* was signed in January, 1977, providing for the non-inference for transit pipelines carrying oil and natural gas destined for one country across the territory of the other (https://www.treaty-accord.gc.ca/text-texte.aspx?id=101884). The treaty has been recently resurrected by Canada to counter the wishes of the Governor of Michigan to rescind a long-existing permit for a transit oil pipeline through the State to Canada. https://www.cbc.ca/news/business/judge-sides-with-enbridge-1.6555265

[71] For a description of the OECD's institutional arrangements for economic coordination to address crises, see Scott, Richard, *The History of the International Energy Agency: The First Twenty Years, Volume I: Origins and Structures of the IEA*, OECDE/IEA 1994, pp. 33-38

[72] In the case of the United Kingdom, rationing of petrol, reduced supply to power stations, speed limit reductions and voluntary restrictions on domestic heating. *The National Archives*. For a description of thehttps://www.nationalarchives.gov.uk/cabinetpapers/themes/global-oil-shortage.htm#:~:text=At%20the%20end%20of%201973,27%20per%20cent%20in%201975.

[73] https://www.nytimes.com/1974/01/24/archives/west-germans-at-a-price-a-void-oil-crisis-a-surprise-in-statistics.html

[74] Scott, Richard, 1995, *The History of the International Energy Agency*, *The First Twenty Years, Volume* II: *Major Polices and Actions*, pp. 171, 381-394, IEA/OECD. The Energy Minister of Canada chaired the ministerial meeting that approved the principles. The Canadian delegation would have ensured their Minister would not be caste advocating policy for pricing on the international stage that was inconsistent with the Canadian policy at the time.

With what seemed to be a lull[75] in the world oil price, in early 1977, with encouragement from the IEA[76], in its *Energy Strategy for Canada: Policies for Self-Reliance*, Ottawa committed to institute "*appropriate energy pricing…to move the domestic price of oil towards international levels*".[77] The following year after meetings with First Ministers, the government and Alberta agreed to four, one dollar per barrel increases every six months starting July 1, 1977. The following November, they agreed to continue the increases until the end of June 1980 (but forgo an increase on January 1, 1979) all subject to not exceeding the Chicago oil price.[78] However, again, the context changed. The doubling of the world price following the Iranian revolution together with domestic politics compounded challenges for Canada's administered oil pricing system.

Its term running out, in March 1979 the Liberal government had to call an election, which it lost to a minority Conservative government led by a relatively inexperienced Joe Clark from Alberta.[79] The new government was handed a major deficit, about to balloon with a rapid increase in the oil compensation bill as the gap between the world and domestic oil prices gap increased from $3 to $10/bbl.[80] The compensation cost was soon augmented by a deteriorating CAD/US dollar exchange rate. At above parity—US $1.03—in the summer of 1976, with the ensuing political uncertainty following the election of a separatist government in Quebec in November, weakening non-energy commodity prices, and rising cost and wage pressures undermining competitiveness, the Canadian dollar started a protracted sell-off. Two years later it had fallen to US$0.84.[81] The exchange rate became a crucial factor for the petroleum compensation revolving fund.[82]

The oil revenue split among Industry, producing Provinces and Ottawa in 1979 was 45:45:10 respectively. The new Conservative government needed to adjust the revenue lever for import compensation so in its first budget in December 1979 announced an increase of 18 cents/gallon

[75] Oil prices had actually declined five percent in real terms between 1974 and 1979, prior to the Iranian revolution. Doern and Toner, p. 102

[76] International Energy Agency, 1977, *Energy Policies and Programmes of IEA Member Countries*, P 69-73. However, the secretariat noted "*room to move on prices is limited by the rate of progress towards world levels in the U.S. It might be in Canada's best interests to continue the process of increasing her oil and gas prices across the board to world levels whatever happens in the U.S.…and not to be inhibited by a possible delay in the U.S.*"

[77] *An Energy Strategy for Canada: Policies for Self-Reliance*, https://ftp.maps.canada.ca/pub/nrcan_rncan/publications/STPublications_PublicationsST/328/328789/gid_328789.pdf

[78] Toombs, ibid p. 1977-7 The June 1977 Canada-Alberta oil pricing arrangement

[79] https://www.cbc.ca/archives/when-joe-clark-became-prime-minister-at-age-39-1.4673437. For a description of the changing political context over this short period of two elections, see https://canadaehx.com/2021/09/09/the-elections-1979-1980/

[80] When the election campaign was launched in March, West Texas Intermediate was around US$15.85. By election day May 22, it was over $19. When the government fell on its budged the price had risen to $32.50 headed for $39.50 the following April. Prices from US Department of Energy, Energy Information Administration statistics

[81] James Powel, 2005 *A History of the Canadian Dollar*, Bank of Canada, p 75-76 https://www.bankofcanada.ca/wp-content/uploads/2010/07/dollar_book.pdf After the May 20 1980 Referendum on separation and announcement of the National Energy Policy the following October, the exchange rate continued to decline, reaching US$0.6913 in February 1986 as the Mulroney government cancelled the NEP's programs. See Chart 6, p 84 in Powel, 2005.

[82] Later in the oil pricing and compensation program (1984), with more oil receiving the international price (see below), every 1 cent decline in the Canadian dollar raised compensation costs by $140 million on an annual basis.

to the excise tax on gasoline.[83] Two days later, the Liberals and NDP voted against it, and the Clark government fell.[84]

Campaigning on 'leadership' (to address Quebec separatism) along with other promises to get the economy right, including a nationalistic and pro-consumer energy policy, the Liberals under Pierre Trudeau were returned to power with a majority.[85] In April of 1979, President Jimmy Carter announced phased decontrol starting in June 1979, to be completed by September 30, 1981. But Canada would go for an even heavier system of price controls.

The National Energy Program: The Blended Oil Price system

In the fall of 1979, the weighted average international price had increased to US$32.55 while the regulated wellhead price of oil in Canada was CAD$16.75 ($19.57 at Toronto) versus CAD$38.85, the cost of imports at Montreal.[86] Ottawa's annual bill for the difference ($19.28), around $3.3 billion, underpinned the fiscal imbalance between the producing provinces and Ottawa. It was unsustainable. Assuming prices would continue to rise, if the government was going to continue its policy to keep the domestic price lower than the world price, drastic steps would be needed.

Negotiations on oil pricing between Alberta and Ottawa through the summer of 1980 failed to reach agreement. Alberta would accept a price linked to world prices (rising to 85% of the Chicago price), while Ottawa wanted to implement its proposed blended price, which would reflect what it considered to be Canadian production costs and producers' cash needs.

In late October 1980, the government announced the *National Energy Program* (NEP). It was effectively a federal budget—designed to bolster security of supply, increase Canadian ownership of the petroleum sector, and establish what it viewed as a fair splitting of oil and gas rent. The NEP was the federal government's most aggressive and comprehensive intervention in Canada's energy sector in the nation's history. It left a legacy of political tensions between Ottawa and the western provinces that continues to this day.[87]

The NEP was predicated in part on the government's conviction that to meet its responsibility for managing the national economy, as a resource-rich country, it should not have to accept prices set by an international oil cartel.[88] To underscore how the government was aligned with its allies, it quoted excerpts[89] from the G7 Summit Communique of June 1980 in Venice, which was dominated by the price and supply of energy and the implications for inflation. However,

[83] While this does not seem much in 2023, it was nearly a 20 percent increase in the price of gasoline at the time.
[84] https://www.nytimes.com/1979/12/31/archives/canada-budget-is-election-issue-conservatives-austere-policy-to-be.html
[85] https://www.thecanadianencyclopedia.ca/en/article/elections-of-1979-and-1980-feature
[86] Energy, Mines and Resources (EMR), 1980 *The National Energy Program*, https://publications.gc.ca/collections/collection_2016/rncan-nrcan/M23-12-80-4-eng.pdf p 4-5
[87] https://www.alberta.ca/alberta-sovereignty-within-a-united-canada-act.aspx; https://policyoptions.irpp.org/magazines/november-2019/the-trudeaus-and-western-alienation/ In 2023, as Ottawa pushes its policies to address climate change, it has triggered strong opposition in Alberta and Saskatchewan, for example to the federal idea of a Just Transition. See for example, https://www.theglobeandmail.com/politics/article-alberta-just-transition-plan/
[88] In his preface to the NEP, Minister Marc Lalonde stressed that Canada already produces for energy than it consumes and is "*less vulnerable than most other nations to the caprice of an international oil cartel and are better able than most to break that bond*".
[89] EMR 1980 ibid Box, p. 6,

the NEP did not quote the Summit's consensus on pricing, "*To this end, maximum reliance should be placed on the price mechanism, and domestic prices for oil should take into account representative world prices*".[90] This left enough wiggle room for Ottawa: The government would certainly rely on *a* price mechanism and *take into account* world prices—just not entirely. A key component of the NEP was a "*made in Canada oil price*". The Blended Price system was launched.

The NEP's set of taxes on domestic oil, natural gas and gas liquids infuriated the producing provinces and industry. The federal government would now receive one third of oil and gas rent, which would allow it to fund all the programs in the NEP.

The NEP's announcement caused a major crisis with Alberta and Saskatchewan, the main producing provinces. Immediately Alberta enacted legislation allowing the province to withhold oil destined for central Canada, which it did starting March 1, 1981.[91] This in turn required Ottawa to impose an additional levy, the Special Compensation Charge (SCC at $1.15/bbl) to cover the cost of compensating extra imported oil. The NEP also instituted a Canadian Ownership Special Charge (COSC) to raise funds to pay for the Canadianization of the industry.[92]

After two cuts of 60 kb/d each, and negotiations with the Alberta government, an agreement was reached on September 1: *Canada/Alberta Memorandum of Agreement on Energy Pricing and Taxation* (MOA), known as the September Agreement. With a significant adjustment in the NEP's pricing and adjustments to the NEP's tax elements, producers and governments would receive greater shares of the rent and consumers less by paying more sooner.[93] Regarding pricing, the MOA provided for the price of old conventional oil to increase much faster than the rate envisioned in the NEP, subject to a ceiling of 75% of the "*actual international price*".[94] A key pricing element, conventional oil discovered after December 31st, 1981, synthetic oil, and oil on Canada Lands[95] would receive the New Oil Reference Price (NORP[96]). The schedule of NORP wellhead prices foresaw $45.92 starting January 1, 1982,

[90] http://www.g7.utoronto.ca/summit/1980venice/communique/index.html

[91] Alberta threatened to cut oil supply to central Canada by 60 kb/d every three months until a satisfactory agreement could be reached with Ottawa. A further cut of 60 kb/d was made June 1. See Toombs, ibid pp. 1981 5-6, Alberta oil cut-back leads to Special Compensation Charge

[92] The COSC on oil and gas consumed in Canada was paid into the Canadian Ownership Account, which by 1983 accumulated over $964 million, of which nearly $900 million was paid to Petro Canada to buy Petrofina. Created in 1975, the national oil company also acquired Atlantic Richfield Canada Ltd and Pacific Petroleum Ltd. With the pressure on the Canadian dollar, the Bank of Canada discouraged foreign borrowing so a domestic source of funding was needed for Petro Canada's acquisitions, which consumers would pay through the COSC.

[93] John F. Helliwell and Robert N. McCrae 1982 Resolving the Energy Conflict: From the National Energy Program to the Energy Agreements, *Canadian Public Policy / Analyse de Politiques* Vol. 8, No. 1, pp. 14-23

[94] The NEP, ibid, p 26-27, set increments of $1/bbl every 6 months until January 1, 1984, when the price would increase $2.25 every 6 months, then in 1986, $3.50 every 6 months. The MOA, TABLE 1, p 2, the price would increase $2.50 on October 1, $2.25 January 1 and July 1, 1982, and thereafter $4.00 every 6 months beginning January 1, 1983. Whereas the NEP scheduled the domestic price to reach $38.75 on July 1, 1986, the MOA set the price of $$41.75 on July 1, 1984.

[95] Canada Lands are those territories under federal jurisdiction, such as the north and offshore regions that are subject to the Canada Oil and Gas Land Regulations.

[96] The NORP would not exceed 100% of the quality-adjusted price of imported crude oil laid down in Montreal. Schedules A and B of the MOA set out how the conventional old oil price (COOP) and NORP and their respective quality differentials per degree API and per 0.1% sulphur in Alberta's 9 X 9 pricing matrix for purposes of collecting and marketing its royalty in kind. The quality differentials for COOP and NORP would increase with increases in the import price, determined based on the average price and quality of crude delivered over the

rising to $77.48 July 1986. The parties agreed to assume that international prices would continue to rise. At any rate, they believed the MOA provided industry certainty out to 1986.

The Blended Oil Price system partly as envisaged in the NEP would provide all Canadian consumers with a single price adjusted for transportation. It would incentivize new oil discoveries and more oil sands production, while giving Canadian oil consuming industries a competitive advantage over their international competitors. The Blended Price shifted the entire cost burden for the price subsidy properly from taxpayers to oil consumers. It would be sufficient to send an appropriate signal to consumers to reduce demand, supplemented by generous off-oil grants through the Canada Oil Substitution Program.[97] It was agreed that the Blended Price would never exceed 85% of the lower of the international price or the average price of oil in the United States. However, determining the U.S. price would be a challenge: President Reagan had fast-forwarded U.S. price decontrol.[98]

The MOA provided for a schedule of increases in the Alberta border price for natural gas subject to never exceeding 65% of the equivalent oil price at Toronto, and for revenues from gas exports to the U.S. to flow back to Alberta. Alberta also agreed to make payments to the federal government to facilitate the expansion of gas markets east of Alberta.

As shown graphically in Figure 2, the Blended Price was the sum of the regulated domestic wellhead price (COOP) and a new levy, the Petroleum Compensation Charge (PCC). The PCC paid for the incremental cost (above COOP) of imported oil, world price for synthetic crude and other classes of 'new' oil. The PCC incorporated the existing Syncrude Levy. The Special Compensation Charge to cover extra imports to make up for the Alberta cuts was also absorbed by the PCC once the incremental imports owing to Alberta's cuts were landed and compensated. On top of the Blended Price shown in Figure 2, consumers also paid the Canadian Ownership Special Charge (COSC).[99]

previous three months at Montreal. Federal administrators of NORP applied the quality matrix to compensation for other provinces' new oil.

[97] The Canada Oil Substitution Program (COSP) included taxable grants to homeowners to convert from oil heating to natural gas, propane, renewables, electricity and coal. It accompanied the Canada Home Insulation Program (CHIP), which offered a maximum $500 grant to upgrade home insulation. For an evaluation of the program after three years, concluding that the COSP grant was not the main stimulant for homeowners to convert of oil, see https://www.aceee.org/files/proceedings/1984/data/papers/SS84_Panel10_Paper_01.pdf In the Auditor General's Report of 1983, the department was criticized for not carrying out sufficient evaluation of the CHIP program.

[98] Eight months earlier, on January 28, 1981, President Ronald Reagan, by Executive Order 12.287 decontrolled U.S. prices, with immediate effect, bringing forward President Carter's scheduled decontrol by eight months. Canada would continue with its increasingly complex—but not nearly as complex as the U.S. system—for another four years.

[99] The COSC was introduced May 1, 1981, at $1.15/bbl on petroleum products and $0.15/mcf of natural gas. It was paid into a separate revolving fund and by the state-owned oil company, Petro Canada, to acquire foreign-owned oil assets in Canada, principally PetroFina.

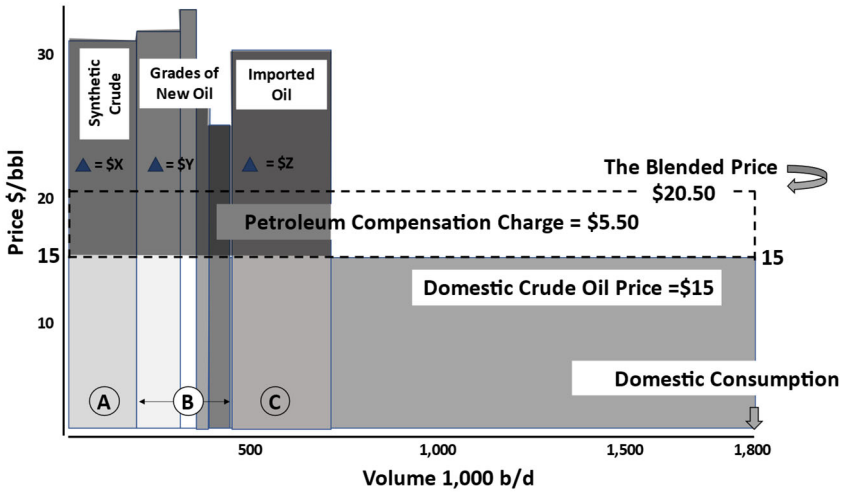

Figure 2. The Blended Price Concept. The PCC is imposed on all domestic consumption = 1,800 kbd. Its level is set to generate sufficient revenue to cover the sum of the price differences (▲) versus the domestic crude price times the volumes (A, B, C) of the different classes of compensated oil (Synthetic, New, Imports): Thus, A*$X + B*$Y + C*$Z = Total Consumption*$PCC. Graphically, the sum of the dark shaded areas—compensated oil classes—equals the area within the dashed line. (Numbers and scale only indicative)

Thus, the PCC acted as the 'blender'. The pricing system was administered and financed through the Petroleum Compensation Account (PCA) pursuant to the *Energy Administration Act*[100], which replaced the *Petroleum Administration Act*. PCC revenue[101] was to match compensation expenditures and, as agreed with Alberta in the MOA, the PCA would not become a source of revenue for the federal government over the life of the agreement to December 31, 1986. The Account would be kept in balance annually on an accrual basis. In other words, administrators would set the PCC (with Ministerial approval) to generate revenues to cover projected expenditures. However, for purposes of the public accounts for the fiscal year, what mattered was whether PCC revenues could meet all actual cash expenditures. When not, pending an increase in the PCC, supplementary funds were sought through Parliamentary appropriations.

The economic backdrop through the 'energy battle' with Alberta in 1981 was stark: the worst recession since the 1930s, triggered by tight monetary policy[102] to confront rampant inflation, as oil demand fell. Internationally, non-OPEC production continued to increase. International oil prices began to wobble. In March 1982 the spot price dropped below posted or Official Selling Prices for the first time since 1973. This proved to be a critical turning point for Canada's administered oil and gas pricing system as unintended consequences surfaced as reality failed to match assumptions.

With the drop in Canadian oil demand, production increasing owing to NORP, and exports constrained by policy, Alberta confronted major shut-in production that grew to more than 400

[100] See Petroleum Compensation Accounting, PART VII, Division I, Section 86 of the Act. https://laws-lois.justice.gc.ca/eng/acts/E-6/page-1.html#docCont

[101] The Act provided for the account to receive export charge revenues, the PCC plus a Parliamentary appropriation of five hundred million dollars and any other amount as appropriated by Parliament for purposes of compensation.

[102] The Bank of Canada Overnight Rate reached 19.38% in August 1981, with the Prime Rate at 22.75%. In Alberta, these rates together with the job losses associated with the NEP's effects on the oil industry, led to a high rate of mortgage foreclosures.

kb/d. The federal government responded with an action program[103] that included easing off on oil export restrictions by licensing more heavy oil exports, and restricting importers to contract volumes rather than spot-priced cargoes.[104] The government also approved the *Domestic Transfer Compensation Program*[105] to subsidize the cost of shipping Canadian oil by tankers and barges from Montreal to the (then) five east coast refineries.

The National Energy Program: Update 1982

Producers' increasing cashflow concerns compelled governments to respond further. Alberta launched its promised royalty changes worth $5 billion to industry. In May 1982 Ottawa issued the *National Energy Program: Update* providing for another $2 billion in benefits to industry.[106] Some concessions had already been made to producers, for example, NORP for heavy oil from in-fill wells and from all experimental heavy oil projects.[107] Besides easing the NEP's tax and fiscal regime, the Update provided NORP for old EOR projects, low productivity wells and notably a Special Old Oil Price (SOOP) for oil from wells drilled after 1973 (affecting some 200 kb/d).[108] The SOOP was set at 75% of NORP and was expected to pinch away with the scheduled increases of the COOP towards the world price, which occurred the following summer—earlier than expected.[109]

As Lester Thorow observed of economic policy, "*The mathematical sophistication intensifies as an understanding of the real world diminishes*".[110] The administered oil pricing system's complexity continued to increase as the assumption of an ever-rising oil price failed to materialize and Ottawa responded with policy and program adjustments. The compensated price differential in the Blended Price system was about to sharply decrease. The world price was going in one direction, while Canada's planning was headed in the opposite. First, OPEC agreed to reduce the price of the Saudi marker crude from US$34.00 to US$29.00. As agreed in the MOA, the domestic price was set to increase by bi-annual $4/bbl increments starting January 1, 1983. All else equal, this would shrink outflows from the PCA and put it in strong surplus status, which normally would have called for a drop in the PCC. However, the Canadian dollar was plummeting, which increased compensation outflows. To have rising prices for domestic oil while international oil prices were falling was politically untenable. Also, anticipating the increase, domestic producers would stockpile oil, exacerbating the shut-in

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[103] Toombs, ibid p. 1982-8, Oil markets action program

[104] This disallowance of lower priced spot cargoes was a major departure from a key principle of the import compensation program, which used a flat rate of import compensation, signalling importers to purchase cargoes below the flat rate. The approach had been to set the compensation rate in advance based on past cargoes but current posted prices, to setting the rate after the fact based on prices paid for actual cargoes.

[105] The Domestic Transfer Compensation Program was not announced in the Update announced in May 1982. It was proposed by an east coast refiner and was launched on July 1 of 1982. It proved to be an effective innovation within the compensation program saving nearly $3.00 for every $1.00 spent subsidizing the oil movements by ship and barge to the Atlantic refineries.

[106] Energy Mines and Resources (EMR) (1982) *The National Energy Program: Update 1982* https://publications.gc.ca/collections/collection_2016/rncan-nrcan/M23-12-1982-4-eng.pdf

[107] Experimental heavy oil projects at the time were testing Cyclic Steam Stimulation, or 'Huff & Puff" technology primarily in the oil sands formations. The province's royalty rate for experimental projects was set at 5%.

[108] New (post-Dec 1, 1981) EOR projects were granted NORP for the incremental output owing to tertiary recovery stimulation (i.e., not from waterflood) in the MOA. These subsequent, new NORP categories commenced on January 1 the following year (1983) out of concern for the impact on the Petroleum Compensation Account.

[109] While acknowledging the uncertainties surrounding oil prices, the government erred on the side of caution for the Update and assumed the lull in prices was temporary. EMR 1982 ibid p. 12

[110] Thurow, L. 1983, *Dangerous Currents: The State of Economics*, New York Random House

problem. Changes in the PCC flowed through to pump prices on the day of announcement; to encourage the draw down of stocks and to allow time for the crude to move to Toronto, crude price changes took effect 60 days later. So, the PCC was cut on January 1 (gasoline prices dropped) and the domestic price increase flowed through in March when import prices would decrease. However, the compensation rate was based on prices of imports over the three previous months, so would not reflect the falling world prices and not fully for another 4 to 6 months.[111] Moreover, the 75% ceiling for COOP would be at risk. Lowering COOP was out of the question. The pressure for price decontrol was mounting.

The governments returned to the negotiating table and an *Amending Agreement* was struck on June 30, 1983.[112] They agreed to freeze wellhead prices at their current level, grant NORP for all SOOP oil (discovered between 1974 and 1981) and all infill wells. Also, as agreed previously, natural gas prices would not exceed 65% of the price of oil (BTU basis at Toronto). The $4/bbl increase in COOP scheduled for July 1 was cancelled. In effect, future price changes would wait on what happened to international prices.

An important administrative cost issue with NORP concerned the growing distortions in the quality differentials based on the quality of the average imported crude price calculated at Montreal. The differentials in the Alberta government's 9 X 9 Sulfur/Gravity grid were equal—for example, the difference was the same between the 38° API and 37° API price block as between the 11° API and 10 API° blocks.[113] The likelihood that differentials might need to be adjusted had been recognized in the 1981 MOA, but Alberta was not inclined to agree to adjust them. The governments committed in the *Amending Agreement* to address this problem and after months of negotiations changes were eventually agreed to and implemented effective January 1, 1984.[114] Prices would be based on current posted prices (no 4-to-6-month delay) of 52 traded crudes from 17 different countries, compared with under the previous methodology, which used as few as three crudes from two countries. Had the change not been made, it would have conferred a 'bonus' on producers exceeding $175 million.[115]

Not all consumers of course felt the system benefited them. The petrochemical industry in Ontario and Quebec, based on oil-derived feedstock, was increasingly uncompetitive as their foreign competitors enjoyed decreasing feedstock costs with the falling oil price. The government rejected the industry's request for reductions in their oil and gas feedstock prices. Pressure for deregulation increased from producer associations and think tanks, while consuming provinces complained about the impact of rising oil prices on their economies.[116] Another federal election was in the offing.

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[111] In the negotiations of the MOA, Alberta insisted that only actual imports at Montreal could be used to determine the import price, thus the sample of foreign crudes was significantly reduced.

[112] Toombs, ibid p. 1983-16, Amendment of the Sept. 1, 1981, federal/Alberta agreement to provide for price changes.

[113] The MOA set out a reference crude, 38°API and 0.5% sulphur. The differentials for NORP oil were set at 22 cents per API degree and 16.5 cents per 0.1% sulfur/bbl and would adjust from month to month depending on any change in the NORP price for the Canadian reference crude delivered at Montreal.

[114] The change should have taken place much earlier. But urged by producers, who were enjoying a significant windfall relative to the world price, especially for heavy grades of crude, the producing provinces dragged their feet, delaying the change by six months.

[115] Toombs, ibid p. 1984-1 Revised NORP System

[116] Toombs, ibid p. 1984-24

Deregulation Promised

On September 4th, 1984, eleven years to the day after Pierre Trudeau froze the domestic oil price, a Progressive Conservative government under Brian Mulroney was elected, committed to getting the government's fiscal house in order, and redefining the role of government in the economy, especially major liberalization of the economy including deregulation of oil and gas markets. A few weeks later, the new Energy Minister formally announced the government's intention to deregulate oil and gas, while committing (somewhat inconsistently with the spirit of a free market) that Canadians would never pay more for natural gas than their immediate U.S. neighbours. The Minister, Pat Carney, previously the Opposition's parliamentary energy critic, had been actively working with a set of task forces headed by leaders in the oil and gas industry to advise on the elements of a new energy policy.[117] While the Minister enjoyed much acclaim for deregulation and removing the NEP's taxes and subsidy programs, she was pushing at an open door. Given the course of world oil prices and the accumulation of distortions and the bulging deficit in the PCA, deregulation would have been the obvious and overdue course of action for any government. As an important business council put it, "*The time (had) come to rethink the whole strategy*".[118] But the government could not dismantle the NEP right away—it had to negotiate with the producing provinces and consult with the consuming provinces, especially Ontario and Quebec.

As world prices weakened[119], the compensated gap between the price of old oil and reference import oil in Canada's price system decreased, which should have reduced the payout of compensation. But the increased volumes of compensated classes of crude increased dramatically with the Amending Agreement in particular. Worst of all, the Canadian dollar had weakened sharply.[120] The Blended Price architecture was falling apart. For example, the average NORP compensation was $10-$12/bbl greater than the compensation for an imported barrel of similar quality. By January 1985, for light, sweet crude, the blended price at Montreal was about $39/bbl; the export price in the west was $34; the COOP was $30; and the NORP was $40, while the market price was about $35.[121]

In the new government's first Economic Statement in early November of 1984, the finance minister made specific reference to the deficit in the Petroleum Compensation Account, growing by more than $140 million per month.[122] To at least reduce the rate of increase in the PCA's deficit, he announced an increase in the PCC by the maximum amount that would ensure the blended price did not exceed the world price. The oil-based petrochemical industry along with "*farmers, fishermen, loggers and mine operators*" would not be burdened with the PCC

[117] Nemeth, Tammy 1998, Pat Carney and the Dismantling of the NEP, *Past Imperfect*, Vol 7, pp 88-123 https://journals.library.ualberta.ca/pi/index.php/pi/article/view/1399/944

[118] The Business Council on National Issues, 1984, THE FEDERAL DEFICIT; SOME OPTIONS FOR EXPENDITURE REDUCTION, Discussion Paper, https://thebusinesscouncil.ca/app/uploads/2021/02/SEPT_19_84_ENG_Paper_The_Federal_Deficit.pdf

[119] After Britain and Norway reduced their prices by $1.35 and $1.50 respectively, Nigeria cut its price by $2.00. OPEC solidarity was under threat. https://www.washingtonpost.com/archive/politics/1984/10/19/nigeria-lowers-oil-price-by-2/a9e76147-f699-4ede-968d-bc6b5562d68f/

[120] J. Powel 2005 ibid p 77; the dollar was 80 cents at the beginning of 1984 and 74.9 cents in mid-July (RT 1884-37)

[121] Toombs, ibid p. 1985-1. NOTE: The Chronology contains a typo; the blended price at Montreal was $39, not "$29".

[122] Economic Statement, Hon. Michael Wilson, Minister of Finance, 96 Commons Debates, November 8, 1984, HANSARD https://www.poltext.org/sites/poltext.org/files/discoursV2/DB/Canada/CAN_DB_1984_33_1.pdf p 101-102

increase. This would necessitate one last acronym under the pricing system, the Petroleum Levy Offset Program (PLOP).

The first few months of 1985 saw the elimination of many of the subsidies and programs under the NEP. With *The Western Accord*[123] initialed by Energy Ministers of B.C., Alberta and Saskatchewan and Canada, oil price decontrol was set for June 1st and natural gas pricing for November 1st. The charges and levies (COSC, PCC), and oil price compensation programs came to an end.

The day of deregulation was largely unremarkable. There was a trivial drop in gasoline prices owing to removal of the Canadian Ownership Special Charge. Producers and consumers were free to buy and sell to whomever without obtaining government approvals. Oil companies began posting prices, the Alberta Petroleum Marketing Commission continued to sell the government's royalty share of crude, but private marketers and aggregators emerged offering an alternative service to market small and medium-sized producers' production. But the PCA was left with a $1.5 billion deficit.[124] Ironically, while the Trudeau government had agreed with Alberta in September 1981 that the PCA would never be used to accumulate revenue, it turned out to be the opposite when it came time for the Mulroney government to deregulate. The account's deficit had to be added to the overall federal deficit.[125]

Over the period between 1974 and end of 1984, the gross cash shortfall on domestic crude production relative to international prices exceeded $50 billion.[126] The net fiscal transfers from Alberta attributable to policy interventions in both oil and gas pricing over the period from 1972 to 1985 totalled $69.8 billion (in 1984$).[127] Then, to add insult to injury, in 1986 with the dramatic drop in world oil prices[128], producer cash-flow fell by some $5 billion. Drilling, previously mostly oil-directed given the attractive NORP supplements, fell by half from the record high of 12,560 to 6,450 wells. Over 25,000 jobs were lost in Alberta.

Some Lessons from Canada's Administered Oil Pricing System

From the perspectives of jurists, public administrators, economists and political scientists, deregulation holds far fewer lessons than the machinations of the regulatory regime itself over its twelve-year life. The fact that it lasted that long is itself an important lesson. An academic analysis of the *Western Accord* in 1986 after the significant collapse of world oil prices

[123] Toombs, ibid, p. 1985-11, The Western Accord. See also John Helliwell, Mary MacGregor, Robert McRae and Andre Plourde, 1986, The Western Accord and Lower World Oil Prices, *Canadian Public Policy,* Vol. 12, No. 2

[124] In theory the PCA should have been kept in balance on an accrual basis. When projected disbursements would significantly exceed projected revenues, officials would recommend to the Minister an increase in the PCC. But this faced considerable technical and political difficulties. Forecasting the international price, the exchange rate, the actual price, quality and volumes of imported cargoes, volumes of domestic crude transferred to eastern refineries, the success of drilling new wells, their quality, start-up and productivity and significant fluctuations in output from the two upset-prone synthetic oil projects were just some of the technical challenges. The major political challenge related to the PCC's immediate flow-through to pump prices for consumers. Ministers quickly acceded to any opportunity to announce PCC reductions (few) as they would show at the gasoline pumps the same day. But when a PCC increase was seriously needed in early 1984, the Minister at the time did not want to be associated with a pump price increase because he aspired to run for the leadership of his party.

[125] Toombs, ibid p. 1985-16 Deregulation of the Canadian oil market

[126] Crude Oil Pricing Options, 1984, On file with the author

[127] Mansell, Robert and Schlenker, Ronald, 1995, The Provincial Distribution of Federal Fiscal Balances, *Canadian Business Economics*, Winter 1995, p. 5

[128] In the four months from December 1985 to March 31, 1986, the posted price for light crude at Edmonton fell by 60%. Industry cut investment accordingly. Toombs, ibid, p. 1986-3

projected that its impact would have macroeconomic benefits.[129] But deregulation of domestic oil prices alone would have a relatively small impact since the rise in COOP would be largely offset by the drop in the overpriced NORP oil (which kept the PCC higher than it should have been). The removal of the NEP's taxes, especially the PGRT would have the greatest positive economic impact.[130]

Getting approval today for the same-day payment of import compensation in any large government bureaucracy, would pose major challenges, although today's electronic banking technology would certainly obviate officials running to the banks with paper cheques.

While there were many changes in how import compensation was determined over the life of the program, the change to a flat rate below the average import price was an innovation designed to encourage refiners to try to purchase crude at prices below this average. It was changed several times before eventual deregulation. Getting it right from the outset, is virtually impossible as it would require perfect market knowledge on the part of government officials.[131]

Gasoline prices as in many countries tend to be a very sensitive political issue in Canada. "*Next to the weather, and perhaps taxes, few topics generate greater public comment than the prices of gasoline*".[132] An enduring belief of many Canadians is that a conspiracy exists among fuel companies to fix the price of gasoline. This suspicion has been the focus of several inquiries in Canada over the last half century, the first in 1966, in British Columbia. Others include Nova Scotia in 1968, Ontario in 1976, Alberta in 1978, and Quebec in 1985.[133] More recently, with the continued volatility in international crude prices, an inquiry by the B.C. Utilities Commission in British Columbia examined the gasoline price differences in the lower mainland.[134] But the longest inquiry into competition in Canada's Petroleum Industry was that of federal competition authorities, launched in 1973 by the Director of the Competition Bureau and referred to the Restrictive Trade Practices Commission in 1981. Among the Director's assertions was that the Oil Import Compensation program contributed to higher prices, but the Commission found that this was "*not supported by the evidence*".[135] Administrators of regulated oil price programs should expect and welcome public review of any suspicions of collusion and critical examinations of their administrative practices. Especially since the public might expect however unreasonably that an administered pricing system should eliminate price volatility.

Alberta was by far the largest oil producing province, however four other provinces had oil production subject to COOP, but also with 'new oil' that qualified for the NORP and SOOP supplements. They included British Columbia, Saskatchewan, Manitoba, and Ontario. Each had their own oil and gas resource statutes and associated regulatory regimes. Differences existed between provinces, for example the definitions of a new pool, pool boundary or infill

[129] John F. Helliwell, Mary E. MacGregor, Robert N. McRae and Andre Plourde, 1986 The Western Accord and Lower World Oil Prices, in *Canadian Public Policy*, XII:2:341-355

[130] For analyses of the economic impact of the National Energy Program and subsequent amendments, see Watkins, G. C. 1981, "Mr. Lalonde and the Price Mechanism: Or Never the Twain Shall Meet.", In Watkins and Walker, eds., *Reaction: The National Energy Program*, Vancouver, British Columbia: The Fraser Institute.

[131] The members of the Energy Supplies Allocation Board established under the Energy Supplies Emergency Act, included persons with industry experience, and necessarily were broadly knowledgeable of the industry.

[132] Restrictive Trade Practices Commission (RTPC), 1968, *Competition in the Canadian Petroleum Industry, Introduction, Conclusions and Recommendation*s, p. 3.

[133] Toombs, ibid p.1978-18 Oil Price Inquiries - provincial

[134] https://www.bcuc.com/OurWork/ViewProceeding?applicationid=681

[135] RTPC, 1968 Vol. 2 p. 187

well. These differences were mostly ignored in the interests of administrative efficiency. So, if a well was spudded at a date acceptable under the respective provincial regulations, it would qualify to receive the supplements. Payment was managed through the respective provincial government administrations rather than directly from the federal government to individual producers. In a federal system like Canada's, flexibility and simplicity in market interventions, while a challenge, was essential.

Leakage and Perverse Outcomes

In the 1980/81 fiscal year, the Petroleum Compensation Program expenditures were $4.390 billion, second only to expenditures that fiscal year for pensions and social security.[136] Given the magnitude of the program and its complexity, leakage might be expected. For example, claims might be made for payments found after audit to have not qualified, or there might be unrecoverable funds (overdue remittances of PCC levies) owing to bankruptcies or financial distress, and oil products leaving the country without repayment of compensation. The program experienced all of these and more. The administrators of the PCA had a duty to seek recovery of such funds and for most cases, did so. Reference has been made above to the overpayments of NORP supplements owing to the rigidity in quality differentials.[137] A few other examples follow.

Air Transport Carriers

The first significant leakage occurred related to transportation fuels, both marine and especially aviation fuel. There was never much incentive for individual Americans to cross the border to purchase fuel because the load of federal and provincial taxes and charges on Canadian gasoline ensured its price was higher than in the U.S.[138] However, commercial vehicles in particular aircraft and ships posed a problem.

Canadian air carriers destined for European cities paid a lower price for fuel than did carriers from nearby US airports flying to the same European destinations. Mirabel airport, a major new international airport in Quebec north of Montreal became a major stopover for inter-continental flights. Foreign Airlines originating flights in the USA flying to Europe found the Mirabel price of 13 cents/litre versus the international spot price of 58 cents/litre too good to ignore.[139] But recovering compensation was not as simple as hoped. A Transportation Fuel Compensation Charge was set under the EAA. Some Canadian carriers refused to pay it; the US government charged that it contravened bilateral agreements and rules of the International Air Transport Association. It was withdrawn and replaced by a NEB-determined 'just and reasonable' price and the difference recovered through income tax on fuel sales revenue. That too was successfully challenged in the courts. Eventually, the leakage from all means of transport exiting Canada was essentially ignored—with deregulation it became moot.

[136] Budget Papers, Canada Department of Finance, June 28, 1982, p 14-15 https://www.budget.canada.ca/pdfarch/1982-pap-eng.pdf

[137] There was no attempt to recover the NORP overpayments owing to the distortions in the differentials.

[138] Spector, Charles P., 1984, Government Regulation of the Petroleum Sector, Table III-1, p 217 https://www.usherbrooke.ca/droit/fileadmin/sites/droit/documents/RDUS/volume_15/1/Vol_15_1_-_Spector.pdf

[139] Oil Price Regulation in Canada: 1973 to 1985, 1985 unpublished report, On file with the author.

Legal Contests and Bankruptcies

Other cases involving refiners and a petrochemical firm facing bankruptcy, as well as contested recovery of compensation were noted by the Auditor General in his report of 1983.[140] Sarnia, in western Ontario has hosted a long-standing refining and petrochemical industry. "*The prosperity of Sarnia was founded on the artificially high oil prices on world markets as the result of the OPEC cartel and artificially low prices in Canada because of government policy*."[141] Petrosar was a joint venture launched in 1973 that relied on oil-based feedstock for its petrochemical operations. When the difference between the blended price and international prices pinched away, its competitive advantage disappeared. As with another firm facing bankruptcy[142], presumably with agreement from its other creditors, its officers ensured remittance of the PCC arrears.

Unintended Outcomes and Policy Conflicts

After long opposing extension of the interprovincial pipeline to Montreal, the government approved its construction as an emergency in 1973, and subsequently agreed to pay the toll shortfall to meet Quebec's demand that its refiners pay no more for Canadian crude than Ontario refiners. The deficiency payments were covered in the compensation program. But there were knock-on effects for the Portland Pipeline system from Portland, Maine to Montreal. Its throughput declined so its tolls had to increase. This increased the cost of imports and therefore the import compensation rate. But other refiners in the east did not incur this extra cost so were receiving more than their actual costs. Adjustments were made to ensure only the Montreal refiners received the extra compensation.

The Sarnia-to-Montreal pipeline, Line 9 in today's Enbridge Pipelines system[143], started up in 1976, peaked at around 310 kb/d in 1979, then steadily declined with declining demand for petroleum products and therefore closure of four Montreal refineries between 1982 and 1985.[144] With deregulation, and termination of the marine transport subsidy, eastern refiners increased imports as they were cheaper than oil from Alberta. This in turn led to a shut-in of crude in Alberta.[145] Throughput on Line 9 had dropped to around 100 kb/d in 1987. By 1991 it fell to 31 kb/d, so the Minister requested the NEB to assess the need for the pipeline. The Board replied that Canadian crude was not competitive in Montreal and that there were no compelling energy security reasons to keep it in a west-east mode.[146] Deactivated in 1991, it was reactivated the following year, but then reversed in 1998 so western Ontario refiners could access low-priced offshore crude. It was reversed back to its original west-to-east mode in 2015. The mixture of federally mandated construction despite feeble economics, subsidized

[140] Auditor General of Canada, 1983 paragraphs 17.122-17.124.
[141] https://www.sarniahistoricalsociety.com/story/history-of-the-chemical-industry-in-lambton-county/
[142] Turbo Resources, an Alberta company deeply in debt to pay for an acquisition and a new refinery north of Calgary.
[143] The Interprovincial Pipeline system, shown schematically in Figure 1, started operation in 1950. It is now known as Enbridge. See https://www.enbridge.com/about-us/our-history
[144] Closure of the last Montreal refinery, owned by Gulf Canada Ltd, became a political issue for the Mulroney government, which asked Gulf to keep it operating for a period. In the end, after generating a lot of political and media attention, it was acquired by Ultramar to expand its market in Quebec but finally foisted off onto the Quebec government.
https://news.google.com/newspapers?nid=1946&dat=19860627&id=1kkwAAAAIBAJ&sjid=R6gFAAAAIBAJ&pg=1497,3193669&hl=en
[145] Toombs, ibid p. 1985-21, surplus domestic oil capacity
[146] Ibid p. 1991-4, Sarnia-Montreal Pipeline future; p. 1991-8

tolls[147] ($150 million from 1976 to 1990), mandated off take as a condition of import compensation, aggressive off-oil subsidies under the NEP, and its Quebec location destined this pipeline to be a subject of constant political attention.

Pricing Policies Impacts on Canadianization

One of the pillars of the NEP was increased Canadianization of the oil and gas industry. However, the benefits of lower prices for the consuming domestic industrial and manufacturing sector were in many respects passed on to their foreign (mostly U.S.) owners. The Canadianization programs (grants to Canadian-owned companies) stimulated their exploration efforts, thus many were early recipients of NORP supplements. And given the relatively low cost of wells in the heavy oil fields, they benefitted from the distortions in quality differentials. When these disappeared with deregulation and the drop in world oil prices, these NORP-dependent firms faced serious financial problems. Two years after deregulation, followed by the oil price crash in 1986, in response to industry pleading, in repudiation of all the principles of its free market policies, the federal government implemented the Canadian Exploration and Development Incentive Program (CEDIP).[148] It directed grants up to ten million dollars per year to small and medium-sized companies along with the possibility of flowing through eligible expenses to tax-paying shareholders to claim as income tax deductions. As with all addictions, kicking the subsidy habit was difficult for Canada's oil and gas producers—and for politicians to stop handing them out.

Other Policy Conflicts

The NEP's objective of security of supply conflicted with the pricing/taxation and Canadianization objectives; these translated into fewer wells by the major oil companies' Canadian affiliates and resulted in a smaller and less-capitalized industry, notwithstanding incentive grants for Canadian-owned firms. The lower consumer prices meant demand would not be decreased as quickly as would occur with world prices. Canada's energy efficiency indicators did not compare well with other countries.[149] So, to stimulate the demand response, the major increase in rent (which reduced producers' capital) from the NEP enabled Ottawa to fund the multitude of off-oil programs. As once summarized for the effect of price controls in the U.S., "*they stimulated demand, depressed supply, and gave OPEC the chance to do it again*".[150]

In 1980, following the international fashion at the time to bolster security of supply, Canada signed a State-to-State oil purchasing agreement with Mexico.[151] Canadian importers had to take their pro-rated share of the supply (50kb/d) as a condition to receive import compensation. However, when Mexico subsequently increased the heavy crude component of the deal, Canadian importers took significant losses on the crude. Their capacity to process heavy crude was already at a maximum for domestic heavy crude—induced by the distortions in NORP

[147] The Deficiency Agreement with IPL allowed for a subsidy of tolls comprising two components; firstly, to ensure Montreal refiners paid the same transport costs as Ontario refiners for Canadian crude; secondly, to cover certain construction costs not allowed by the regulator to be included in tolls, about $7-$10 million per year.
[148] Toombs, ibid p. 1987-3, Canadian Exploration and Development Program (CEDIP)
[149] Toombs, ibid p. 1987-1 Energy Ministers' Conference
[150] Vietor, Richard, 1984, *Energy Policy in America since 1945*, Cambridge, UK, Cambridge University Press, in Bradley, R. 1996, p. 532
[151] Toombs, ibid p. 1980-6

differentials. Also, the government's off oil subsidies were rapidly reducing their local heavy fuel oil markets.

Some general lessons include:

- Market players quickly develop workarounds or engage in special pleading to get on the upside of the effects of intervention. The examples of the aviation and petrochemical industries illustrate the diversity of players and their businesses, in particular how their relationship to international markets motivates behavior with respect to subsidies and loopholes in a regulated pricing system.

- The domestic political context is paramount in policy shifts and reversals. The best example of this was at the outset in 1973 when, confronted by the Premiers of Ontario and Quebec and especially the rise of separatism in the latter, the Prime Minister extended the price freeze on crude oil. Agreements on future pricing are inevitably undone by external forces. In 1977, the agreement to move up to world prices, was undermined by the price surge after the Iranian revolution. Then later, the caps on price relationships such as the Blended Price 85 percent of Chicago prices, COOP 75 percent of NORP, SOOP 75 percent of NORP, and natural gas 65 percent of oil at Toronto (see below), were generally ignored when breached. All these ceilings were predicated on an ever-rising world oil price. While attractive in theory, in a falling market they were unimplementable in practice. As Warren Buffet observed of investors, *"Only when the tide goes out do you discover who's been swimming naked".*[152]

- As with any subsidy program, dependencies become intrenched and eventually perceived by the recipients as entitlements, whether for consumers (mostly) or producers (of high-cost oil). Come 1985, not all oil producers supported full deregulation of oil prices. Some small producers, whose production was all eligible for NORP supplements, wanted to keep some aspects of the two-price system, especially for heavy oil.[153]

- The principal and obvious lesson from this experience is that regulation of oil prices should be avoided. Secondly, if regulation is undertaken, eventual deregulation should be comprehensive, not drawn out and not attempt to shelter some sector or part of the value chain, thereby creating moral hazard. The decisions by the

[152] https://www.brainyquote.com/quotes/warren_buffett_383933

[153] In 1985 a few months before the deregulation of oil prices, in a letter to the finance minister, the Chairman of the Canadian Petroleum Association commended the government's intent to deregulate oil prices but urged retention of NORP for heavy oil. The distortions in the NORP pricing system had conferred a significant bonus for new heavy crude. It was also self-reinforcing. The more heavy crude produced, the lower the price in the export market. Also, given its viscosity, the more heavy crude in the pipelines, the slower the through-put, compounding the shut-in issue; because heavy oil wells could not be pro-rated for technical reasons, the shut- in fell disproportionately on the much higher value light crude wells. After deregulation, and as world oil prices declined, the Senate Committee on Energy and Natural Resources held hearings on the oil market. They heard industry lamenting the low prices and recommended financial assistance for small producers, floor prices for nonconventional oil, and consider an administered price if producers do not receive lower prices than those in the Chicago market. Toombs, ibid, p. 1986-7, Senate Committee report on Oil Marketing.

Mulroney government to provide PLOP to the petrochemical industry and certain primary producers and the CEDIP incentive grants to producers are examples.[154]

Natural Gas Deregulation

The deregulation of natural gas prices, markets and trade began effective October 31, 1985, and after a transition year of frozen price, full deregulation would occur. The liberalization of the gas market included direct sales at prices and terms freely negotiated between producers and buyers, competitive marketing programs by distributors to meet the competition, regional export floor prices rather than a single Toronto price, and removal of volume restrictions on short term exports.[155] In many senses, gas deregulation was more complicated than oil market deregulation, more so owing to take or pay obligations of the main gas trunkline owner and other contractual elements with distribution companies (LDCs) and their customers in central Canada. Also, unlike for oil for which demand was falling, demand for natural gas was increasing for the growing surplus both in Canada and importantly south of the border. This export element was and continued to be an obsession with politicians and certain consumer sectors. Above all, in stark contrast with oil, the 'border price relationship' promised by the Minister obligated a continuous monitoring and reporting process by the energy department and the export regulator.

Prior to 1975, the price of gas in interprovincial trade was negotiated between producers and TransCanada Pipelines (TCPL)[156], the monopoly buyer and (main trunkline) transporter of gas east of Alberta. Prices and TCPL tolls, regulated by the National Energy Board, were passed on to the LDCs, whose tolls were regulated by their respective host provinces. In 1975, the federal and Alberta governments agreed to link gas prices to crude oil prices. Export prices were set by the federal government. After the NEP in 1980 and subsequent MOA of September 1981, the federal government agreed to keep the price of Alberta gas in Eastern Canada at 65 percent of the price of crude oil. However, as international oil prices declined through 1983, this price relationship became difficult to maintain, notwithstanding commitment to reduce taxes and charges on natural gas to try to keep the 65 percent relationship.[157]

With full natural gas deregulation, barriers to entry were greatly reduced on the consumer side. Direct sales from producers to marketers, aggregators and even to individual industrial gas consumers were possible. Individual households were no longer obligated to purchase their gas supply from their LDC. By the fall of 1986 some 400 billion cubic feet or 35% of the market in eastern Canada was served by renegotiated prices.[158] A very active spot market for one-month sales had quickly developed. The Chairman of the NEB reported that not all market players had been affected equally: producers lost ground, consumers benefitted enormously, asset values declined, new business opportunities were created, and the transmission sector had

[154] After S1.25 billion dollars in incentive payments, 5% directed to small and medium sized firms, and given positive prospects for the industry, CEDIP was terminated in the government's budget of April 28, 1989. Toombs, ibid p. 1989-3, p. 1989-6 CEDIP benefits to small producers. See ibid p. 1989-10 re its termination.
[155] Toombs, ibid p. 1985-33, Terms of the Natural Gas Agreement
[156] Now named TC Energy, it owns and operates the major gas trunk line from Alberta into Quebec, as well as major export lines into the U.S. See https://www.tcenergy.com/operations/maps/
[157] For a legal analysis and review of Natural gas deregulation at the time, see Allan McLarty and David A. Holgate, Natural Gas Deregulation: Review and Perspective, in *ALBERTA LAW REVIEW*, Vol. XXVI, No. 1, pp 1-34.
[158] Doug G. Stoneman, 1987, The Impact of Canadian Gas Deregulation—a Producer's Perspective, *Energy Exploration & Exploitation* Vol 5, No. 1, SPECIAL ISSUE: International Oil and Gas Markets Conference, pp 58-64

grown rapidly.[159] After a decade, virtually all industrial consumers were meeting their gas needs through direct purchases.[160] LDCs were required by their provincial regulators to provide transport service. Ontario buyers today are served by over two dozen direct marketers licensed by the Ontario Energy Board.

Several issues that producers[161] considered inconsistent with a free market remained unresolved for several years, The federal energy minister's political commitment—namely, that export prices at the dozen export points would never be less than prices in the adjoining domestic market—became difficult to fulfill.[162] In 1986 the rigid price test was dropped in favour of price monitoring to ensure that U.S. purchasers would not be favoured on a sustained basis.[163]

Also, the long-standing 25-year surplus test for the National Energy Board's approval of natural gas export licenses was clearly inconsistent with a liberalized market. LDCs in Ontario wanted the test retained. But there was nothing stopping them from engaging in contractual arrangements with producers to secure their long-term supply. After a set of hearings, the NEB established new procedures based on a reserves to production (R/P) ratio and a twenty-year forecast of productive capacity, along with reviews of projected demand, estimated exports and other factors. The R/P test became impractical. To be consistent with deregulation, in July 1987 the NEB (CER)[164] established a Market-Based Procedure (MBP). For export license applications, the CER does not refer specifically to the MBP; rather, it "*ensures that the quantity of gas and natural gas liquids exported does not exceed the surplus remaining after Canadian requirements have been met*". According to the CER, over five hundred natural gas producers achieved an all-time high of nearly 18 Bcf/d in November 2022; nearly half is exported to the U.S. and of domestic consumption, 30 percent is used to produce bitumen from the oil sands.[165]

Free Trade Agreements

Given the often-testy history of bilateral oil and gas relations with the United States, it is not surprising that the most sensitive and slowest-to-change piece of liberalization related to Canada – USA trade. Exports of oil and especially gas from Canada have always been subject

[159] Toombs, ibid p.1992-6 Report on natural gas deregulation
[160] National Energy Board, 1986 Natural Gas Market Assessment, Canadian Natural Gas: Ten Years After Deregulation. This report provides an instructive ten-year status report, regarding the rapid evolution of the Canadian natural gas market, the industry and trade as well as the many changes in regulation, royalties, industry cost reductions and other efficiencies engendered within the free market environment. By 1995, nearly 60 percent of natural gas in Canada was Direct sales versus 'System' gas sales from LDCs.
[161] Stoneman, 1987 *Ibid* p. 63
[162] Minister Carney came from British Columbia. She may have adopted the border price idea from the "105 percent" clause in export contracts from B.C. in the seventies, requiring that export prices must be 105 percent of domestic prices to comparable customers. See Helliwell, J. 1979 p. 188 Nemeth, 1998 (ibid p. 107) described how in discussions on deregulating crude oil prices, Ontario officials sought assurance "*that natural gas would not be sold to Americans at a cheaper rate than that paid by Canadians so Ontario industry would remain competitive with the American Competition*".
[163] Toombs, ibid pp. 1986-10-11, Gas export price test replaced by price monitoring and Natural gas deregulation process. For several years the Department issued biannual Natural Gas Monitoring Reports that covered this sensitive issue.
[164] The NEB became the Canada Energy Regulator (CER) in 2019.
[165] See Canada Energy Regulator's *Market Snapsho*t at cer-rec.gc.ca

to some form of government oversight and approval.[166] The US always had strong views on oil exports from Canada—from limiting them in the sixties to wanting as much as possible in the seventies, hopefully within some continentalist framework.

The U.S. did not allow the export of oil until 2015.[167,168] Embittered by Canada's limiting new export licenses in the seventies, the negotiators of the 1989 bilateral Canada USA Free Trade Agreement[169] believed they had reinforced liberalization of hydrocarbon markets, notably through the proportionality Article 904a. The Article stipulated that if a party introduces a reduction of export volumes, the volume of remaining exports must be in proportion to exports over the previous thirty-six months.[170] This restriction was maintained in the 1994 trilateral North American Free Trade Agreement (NAFTA Article 605)[171] but did not apply to Mexico. The clause was eliminated for the 2018 trilateral Canada USA Mexico (CUSMA) free trade agreement, which Canada views as "*reaffirming Canada's sovereignty over its energy resources*".[172] Perhaps a more convincing interpretation consistent with the history of invariably lop-sided Canada – U.S. energy relations, is that post NAFTA, the U.S. had become a major exporter of hydrocarbons—significantly for the bilateral relationship, natural gas to Ontario and less so to Quebec. The strategic importance that the U.S. has always attached to energy security would never countenance relinquishing its right to limit or terminate exports for any reason to any country, even to Canada.

Conclusion

By the end of the twentieth century, Canadian oil and gas markets were perhaps the most liberalized in the world. Energy markets and pricing had largely moved off the policy agenda for Canada, replaced by climate change. This shifted the government's focus on energy matters to the multilateral level.

From limiting exports of oil to the U.S. in 1958, then relying on the Quebec and Maritime refining industry to voluntarily refrain from selling lower-priced product west of the Ottawa Valley, to requesting the industry in 1973 to not pass on the increases in world oil prices, then imposing an increasingly arcane and mandatory Made-in-Canada Blended Oil Price system, paradoxically as a resource trading nation, successive Canadian governments over twenty five years tried to resist the forces of open and free markets. The costs to the economy and to

[166] With the discovery of natural gas in Alberta in the forties, several pipeline proposals were put to governments. The federal government's Transport Commission recognized Alberta's authority to approve removals from the province. The Alberta legislature passed the *Gas Export Act* in 1951 to allow the removal of gas from Alberta to provide power for a major smelter in Butte, Montana. See https://www.canlii.org/en/ab/laws/astat/sa-1951-c-36/latest/sa-1951-c-36.html

[167] U.S. Crude Oil Export Policy: Background and Considerations, Congressional Research Services, March 26, 2014, https://www.energy.senate.gov/services/files/DFE108C9-CEF6-43D0-9F01-DC16E6DED6B4

[168] As recently as summer 2022 summer, legislators in Washington urged the President to limit exporting crude oil. https://www.resources.org/common-resources/considering-another-export-ban-on-us-crude-oil-what-would-happen-to-gasoline-prices/

[169] https://www.international.gc.ca/trade-commerce/assets/pdfs/agreements-accords/cusfta-e.pdf

[170] The U.S. had a restriction on the export of Alaskan crude under section 7(d) of the *Export Administration Act of 1979* but agreed in Article 902.5 – 3 to exempt Canada up to a maximum of 50 kb/d of Alaskan crude provided it was exported to Canada from the lower 48 states. This trivial volume stood in stark contrast to the U.S. having access to all the oil that Canada could export, subject to the proportionality clause.

[171] https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/fta-ale/06.aspx?lang=eng

[172] https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/cusma-aceum/energy-energie.aspx?lang=eng

national unity have been firmly lodged in the political psyche of the country. For Alberta, the net fiscal transfers to the province during the NOP (1961 to 1972) were $1.8 billion. The higher prices paid in Ontario, often referred to by Ontario's politicians to justify paying less than world prices after 1973, pales in comparison to the $69.8 billion in net transfers from Alberta during this latter period, to mid 1985.[173] The lessons from Canada's experience with regulated energy prices may not be transferable wholly and precisely to other countries, but the cliché of subsidy dependency, as if its reconfirmation is needed, is clear: Once subsidy of an essential consumable, or of its production, is commenced, it is very difficult to terminate.

[173] Mansell R. and Schlenker, R. 1995, ibid, p. 5 Fiscal transfers with respect to the oil and gas pricing interventions from 1961 to mid-1985 are treated as implicit, as opposed to explicit, taxes and subsidies.