

“Fuel Change”

Presentation to the Industry Committee hearings on Gasoline Prices in Canada

Kory Teneycke, Executive Director

Canadian Renewable Fuels Association

September 22, 2005

Ladies and gentlemen,

A significant part of the solution to today’s high gas prices lies within our grasp. It is a renewable fuel called ethanol and it is made from homegrown commodities like corn, wheat, and even straw.

Ethanol-blended gasoline can be used in every car on the road today and can be easily integrated into our existing fuel infrastructure. Used in large enough quantities it has the potential to diversify our national fuel supply and add to our stretched refining capacity. It would broaden our supply of gasoline and help temper the shocking price spikes we are experiencing today.

Ethanol can achieve these goals, but it will require leadership from you as Parliamentarians. It will require you to fuel change across the country.

Breaking the Crude Monopoly

While several witnesses today have testified that intense competition exists within the petroleum industry, there is a virtual monopoly on the raw material used to make our fuel – crude oil.

As you all know, crude oil is a finite, non-renewable resource. You extract it, you burn it and it is gone. While we are not in imminent danger of running out of oil, but we are having to go to more remote and more dangerous places to access the world's remaining petroleum reserves – further increasing the cost of crude.

Prices are driven even higher by increased demand for petroleum around the world – especially in rapidly expanding markets like China and India.

The result has been a new floor for crude oil prices. I will leave the speculation on where that floor will be to others, but suffice to say the days of \$18/barrel crude are unlikely to be seen again.

In contrast, ethanol is made from renewable agricultural commodities – not crude oil. In this way ethanol adds competition into the fuel market at the most basic level.

Today ethanol production costs are lower than crude oil.

In the past, critics of ethanol have pointed out the cost of producing ethanol is higher than the cost of producing petroleum based fuels. While this was true at \$18/barrel, it is NOT true at today's oil prices.

At \$41/barrel the average variable cost of producing a barrel of ethanol is the equal to the average wholesale cost of producing a barrel gasoline. At the 2005 average crude oil price of \$54/barrel, ethanol becomes significantly cheaper to produce than crude.

While production costs for petroleum have been rising, the production costs for ethanol have declined slightly. Unlike crude, ethanol production costs are driven by agricultural commodity and natural gas prices – making them far more stable.

So the potential of ethanol as a viable fuel source is real. It is both economically and technically feasible. If Canada were to embrace a national fuel strategy to expand the use of ethanol, we would break the crude monopoly.

Shortage of Refineries Increases Gasoline Prices

Another major factor contributing to increased fuel prices is declining refining capacity.

The Canadian refining capacity is 18% lower today than it was in 1980. Instead of running our refineries at 86%, as we did 25 years ago, we are now running them at 97%.

This is not just a Canadian problem. The United States has a similar shortage of refining capacity. Over the past 20 years, domestic refining capacity declined by 9%, while domestic gasoline demand increased by 20%.

While capacity has been dropping the margin charged by refiners has been going steadily up. The average margin has doubled over the past decade to over 10 cents/litre. As our ability to increase the supply of gasoline is reduced the premium that refiners can charge is increased.

This loss of elasticity in our ability to refine gasoline has also increased our vulnerability to price spikes caused by disruptions at refineries. As hurricanes Katrina and Rita have shown, even a short disruption at refineries thousands of kilometers away can cause a 20-cent/litre price spike in our market.

So where is the strategy for increasing refining capacity? Which petroleum companies in North America are building new refineries? In the United States, no new refineries are being built and the provisions designed to encourage the building were dropped from the Energy Bill. Things are no better on our side of the border. Not only is Canada not building any new refineries, the Oakville refinery was shut down last December.

Ethanol Increases our Refining Capacity

Ethanol can help address this shortage by increasing refining capacity and providing much-needed competition to those refining crude oil. It can do this because ethanol is

added after the gasoline has passed through the refinery. By blending 10% ethanol you can “extend” a gasoline refinery’s capacity by a similar volume.

Increasing the supply of refined fuel in a market has a positive effect on price (regardless if that fuel is ethanol or gasoline). Provided the petroleum industry doesn’t shut down additional refineries, expanding ethanol production will also increase elasticity in the fuel market by reducing pressure on our existing refineries.

As many in the oil industry have pointed out, the environmental barriers associated with building a new petroleum refinery are significant. We are all familiar with NOT IN MY BACKYARD. These barriers do not exist to the same extent for ethanol refineries, because ethanol production uses a biological process (fermentation), not a chemical one.

If Canada were to blend 10% ethanol in all gasoline across the country the new demand would spur the construction of an entire new series of ethanol plants. These plants would be the equivalent of building a new, 200,000 bbl/day petroleum refinery.

We need a federal strategy

So if ethanol has the ability to break the crude monopoly in Canada, and expand our refining capacity, why has it not happened? Well, it is not in the financial interest of the petroleum industry. They are not interested in adding water to their wine by blending a competing product into their fuel.

Canada currently consumes 40 billion litres of fuel a year and yet a paltry 300 million litres, not even 1%, of that is ethanol. We must do better.

A number of provinces have taken steps to increase renewable fuel use. Ontario is implementing a renewable fuel standard requiring 5% ethanol be blended in gasoline by 2007. Similar requirements are being implemented in Saskatchewan and Manitoba. The federal government has just completed the Ethanol Expansion Program, providing \$118 million in grants to increase Canadian ethanol production. Estimated production of ethanol in Canada is expected to grow to 1.4 billion litres by 2007-2008.

This is inadequate compared to the 15 billion litres of ethanol produced in the United States today or the 28 billion litres/year required under the recently passed Energy Bill. Similar fuel standards are being implemented around the world – China, India, Japan, Brazil and the EU to name only a handful. The ethanol industry is experiencing explosive growth around the world – and Canada should not be an exception.

The Canadian Renewable Fuels Association believes the time has come for a national renewable fuels standard requiring 10% ethanol content in gasoline by 2010. It is a realistic and achievable goal. It would diversify our energy supply, add to our refining capacity and help moderate price.

Thank you for your time and I hope you will help “fuel change” for Canada.