

## OIL PRICE PLUNGE

### MINDS ON

Canada is the 5th largest producer of natural gas, crude oil and energy in the world. In fact, the petroleum sector employs 550 000 Canadians (either directly or indirectly) and accounts for \$18 billion in revenue for Canada's federal and provincial governments.



How would a drastic drop in the price of oil mean affect people relying on this sector of the economy?

### SETTING THE STAGE

Nobody saw this one coming. After reaching a high of \$107 a barrel in the summer of 2014, oil prices plunged more than 50 per cent, closing at just under \$50 a barrel by early 2015. And as the price plummeted, nervous energy sector workers looked on in shock, wondering what the future had in store for them. The free fall in the price of oil became the business story of 2014.

### Too much oil

It is naïve to think that oil prices could either remain stable or even keep going up. History has been very clear: oil is a commodity and responds to the business cycle like any other commodity. Supply and demand will either drive the price of oil up or down depending on how much crude is available. In the fall of 2014, it became very clear that there was a glut of oil on the market and the price of crude spiralled downward.

### Definition – Glut

An excessive quantity, surplus or oversupply.

### Why the glut?

One of the contributing factors to the emergence of the oil glut has to do with countries like Canada and the United States finding ways to enter the oil game. Canada has managed to tap into the huge supply of oil sands crude in Alberta and exploit oil reserves off the coast of Newfoundland. In the United States, hydraulic fracturing (fracking) and horizontal drilling have allowed our neighbour to the south to extract their own oil and become major oil producers. Thus, the era of importing oil has been replaced by an era of extraction and self-sufficiency. Similar enterprises have emerged around the world, creating an oil glut as too many sellers appeal to too few buyers.

Another factor is the push towards sustainable energy. Cars and trucks have become more fuel efficient. Many nations are replacing coal power with more environmentally friendly alternatives, with some investing heavily in wind and solar power. This has created less need for crude as we move to a greener approach to energy consumption — a prospect that will continue to grow as we head deeper into the 21<sup>st</sup> century.

## Losers

The oil glut has created an energy market with very low crude prices. This stands to have a negative effect on the Canadian oil industry. Oil sands extraction in particular is costly, with the breakeven point hovering around \$60 a barrel (the price of oil was under \$50 a barrel on January 6, 2015). A sustained dip below the breakeven point will mean job losses and shutdowns in Alberta and, to a lesser extent, Saskatchewan. Meanwhile, offshore drillers in Newfoundland and Labrador will also have to buckle in for a bumpy ride if prices don't go up. Just to be on the safe side, many oil sector companies have already put projects on hold and some subsidiary businesses have started to lay off employees.

## Winners

The manufacturing and service-based economies of Ontario, Quebec and British Columbia stand to gain the most from low crude prices. Some financial analysts believe that these provinces may even outpace Alberta in terms of economic growth in 2015.

Other winners include anyone who has to put fuel into their vehicle. According to Statistics Canada, Canadians pump 41 billion litres of gas into their cars and trucks every year. A price drop of 20 cents a litre frees up \$8 billion for consumers to spend. The question is: will they spend that money? With the per capita debt load of Canadians at record levels, will consumers be more inclined to bring what they owe under control rather than buy more goods and services?

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## To consider

1. Why was the falling price of oil the business story of 2014?
2. What factors contributed to the emergence of an oil glut?
3. a) Who stands to suffer the most if oil prices remain low?  
b) Who stands to gain the most if oil prices remain low?

## VIDEO REVIEW

### Pre-viewing

In March 2014, Maclean’s magazine published an article that many considered laughable. With oil prices seemingly stable at around \$100 a barrel, reporter Jason Kirby wrote about Vancouver-based financial analyst Bob Hoye’s prediction that oil prices could go into a free-fall in the not too distant future. Hoye’s reasoning: demand for crude had peaked and the market was flooded with cheap oil. According to Hoye, the only place for oil prices to go was down.

1. Why would many people consider Hoye’s position to be laughable?

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2. What is the strength of Hoye’s reasoning? Why did it appear that he was probably right on the money with his prediction?

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### While viewing

1. Who benefits when oil prices are low?

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2. Who suffers when oil prices are low?

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3. Why does Alberta need the price of oil to rebound to a higher level?

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4. Who is OPEC and what did it do to drive the price of oil down?

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5. How important is oil in terms of Canada’s overall economic growth?

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6. How did Canada manage to turn the oil sands into a profitable economic initiative?

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7. Which provinces benefited from the oil boom that started after 2000? Which provinces stumbled?

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8. How high does the price of a barrel of oil need to be for energy companies to make money?

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9. What are the likely consequences if oil slips below \$60 per barrel?

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10. Why is it dangerous to rely too much on one commodity — in Canada’s case oil — moving deeper into the 21st century?

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11. a) How low do analysts at Morgan Stanley think oil prices could go in 2015?

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b) What two factors could force the price of oil down?

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12. How is Precision Drilling changing its short-term plans based on the low cost of oil?

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13. a) How much tax revenue do economists at TD estimate governments have lost since the price of oil started dropping?

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b) How many jobs does this kind of reduction represent? \_\_\_\_\_

14. What is the flipside of lower energy costs?

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15. What is the relationship between a weaker dollar and falling oil prices?

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16. Besides Canada, which other countries are feeling the pressure from plunging oil prices?

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17. Why haven't the Saudis taken steps to help improve the price of oil?

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18. Who are cheap oil producers targeting by keeping the price of oil low?

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### Post-viewing

In an effort to manage Alberta's coffers when times are tough in the oil industry, the provincial government set up the Alberta Heritage Fund using energy-related revenue. The fund currently has a little over \$17 billion waiting to be used, if and when it is needed.

Norway also has a fund that has been built by using revenue generated from its nation's oil reserves. That fund currently has over \$900 billion available for the people of Norway to access if needed.

Alberta has a population of just over 4 million. Norway has a population of just over 5 million.

In light of this information, consider the perspective of energy analyst Michael Lynch who, upon reflecting on falling oil prices, said, "I keep telling people, it's not boom and boom, it's boom and bust. People complain about short-termism in the private sector, but short-term thinking is also in government. Prices go up and people think this is how it's going to stay, that they can keep spending money the way they had. But the good times don't always last." (Maclean's, November 3, 2014)

How are the positions of Alberta and Norway reflected in the Lynch quote?

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## CLIMATE CHANGE AND THE FUTURE OF OIL

### Lima's ambitious climate goal

In late 2015, the United Nations will hold its annual climate change conference in Paris, France. This event promises to be very contentious as UN member states attempt to come up with a legally binding, universal agreement on climate change with the need to dramatically curtail carbon emissions at the top of the agenda. The 2014 conference in Lima, Peru, was designed to set appropriate goals for the negotiating parties to work toward in Paris. One of those goals includes an ambitious attempt to get the nations of the world to agree to long-term zero-emissions standards by 2050. In the bargaining group's view, developed nations would see their emissions peak in 2015 and then steadily decline to the point of carbon neutrality by 2050. The overall goal is to achieve negative carbon emissions by 2100 (The Guardian, December 8, 2014). This goal is consistent with what the scientific community has been recommending for the last 20 years.

### Canada: Not up to the challenge

UN Secretary General Ban Ki-moon is concerned that Canada will not be up to this challenge. He points out that Canada is already well behind its self-imposed goal of reducing greenhouse gas emissions by 17 per cent from 2005 levels by 2020

(as of 2012, Canada had reduced emissions by 5 per cent). Ban Ki-moon says that, as a developed nation, Canada needs to take a lead in providing visionary solutions to the climate change problem.

### Will Canada make excuses in Paris?

Going into the Paris climate change conference, many critics are concerned that Canada will find a way to avoid a legally binding climate deal. With the Canadian economy relying heavily on the energy sector, critics worry that Canada will choose economics over the environment. To justify this concern, some point to the fact that the government of Canada and the oil industry celebrate the fact that we have 150 years' worth of bitumen crude in the Alberta oil sands — even though the planet desperately needs to move away from fossil fuels immediately!

In fact, a study published in the science journal *Nature* warns that burning all of the oil sands crude would have catastrophic consequences for the planet. Climate scientists warn that 2050 represents a point of no return in terms of getting global warming under control (2014 was the hottest year on record), with carbon neutrality being a must by 2100. Our future as a planet hinges on our ability to stop burning fossil fuels.

### Definition – Carbon neutrality

Achieving ecological balance between activities that emit climate pollution and processes that reduce the impact of that pollution to zero (or close to zero). This means phasing out fossil fuel emissions while phasing in energy efficiency, renewable energy and other measures to bring down emissions.

Source: Yamin, Farhana (May 23, 2014). What is 'carbon neutrality' – and how can we achieve it by 2050? Retrieved from: [theelders.org/article/what-carbon-neutrality-and-how-can-we-achieve-it-2050](http://theelders.org/article/what-carbon-neutrality-and-how-can-we-achieve-it-2050)

### To Consider

1. What was the ambitious goal set in Lima? What do scientists think of this approach to addressing climate change?
2. Why does Ban Ki-moon think that Canada might not be up to the climate change challenge?
3. What do some critics fear will happen when Canada attends the climate change conference in Paris?

## Critical Thinking

Some people fear that governments around the world are putting short-term economic gain ahead of long-term environmental sustainability. In other words, governments are more concerned with money than the planet. This perspective is not new.

Read the two passages below and answer the questions that follow:

**1** At a planting of a Tree of Peace in Philadelphia in 1986, Mohawk Chief Jake Swamp shared a creation myth with those in attendance:

In the beginning, Creator made people and gave them everything they needed. Creator only wanted one thing in return: Always remember and appreciate the gifts of Mother Earth.

What followed was a prolonged period of ignorance, crime, war, and injustice.

To help put the world back on track, Creator sent a Peacemaker to teach people how to honour Mother Earth, to turn away from violence, and to embrace justice for the sake of those who are living and the seven generations of people to come.

Source: Paraphrased from Yarrow, David (September 1987). *The Great Law of Peace – New World Roots of American Democracy*. Retrieved from [kahonwes.com/iroquois/document1.html](http://kahonwes.com/iroquois/document1.html).

- a) What message does this myth provide for people today?
- b) While Canadians celebrate low gas prices at the pumps, some would say that, as good stewards of the planet, we are called to take care of the entire ecosystem — not just satisfy our immediate material needs. What would Mother Earth have to say about the current state of affairs in Canada in terms of energy consumption and climate change?

**2** In 1790, Edmund Burke wrote that society “...is a partnership in all science, a partnership in all art, a partnership in every virtue and in all perfection. As the ends of such a partnership cannot be obtained in many generations, it becomes a partnership not only between those who are living, but between those who are living, those who are dead, and those who are to be born.”

Source: Burke, Edmund (1909-14). *Reflections on the French Revolution*. Harvard Classics.

- a) On the one hand, Canada has enough oil sands bitumen crude to last the next 150 years. On the other hand, climate scientists say the planet needs to achieve net zero carbon emissions by 2050. Are these opposing realities a reflection of society breaking its partnership with “those who are living, those who are dead, and those who are to be born”? Explain.
- b) In light of Burke’s statement, how can we build a partnership that looks out for the future of all Canadians?