“We’re As Vulnerable to Oil Shocks As We’ve Ever Been”

Description

Jeff Rubin is the former chief economist of CIBC World Markets and author of two bestselling books, *The End of Growth* and *Why Your World Is About to Get a Whole Lot Smaller*. He’s also a regular contributor to *The Globe and Mail* and *The Huffington Post*. You can follow Jeff’s latest musings on his blog here.

In part 3 of my interview, I ask Jeff about how the oil sands industry is addressing transportation issues. Below is the transcript of our conversation; it has been lightly edited for clarity.

Robert Baillieul: Earlier this month, billionaire oilman Harold Hamm told the *National Review* that TransCanada’s (TSX: TRP, NYSE: TRP) Keystone XL pipeline was no longer critical. Steve Williams, Chief Executive at Suncor (TSX: SU, NYSE: SU), recently echoed similar sentiments. Is there any truth to that?

Jeff Rubin: Yeah, well it’s no longer critical because they’re loading oil on rail cars like never before. Last week over 13,000 rail cars were loaded with oil in the United States.

And the fact is — and I’m certain that this is an unintended consequence — but environmentalist victories to lay or stop new pipelines construction — whether it be Keystone XL, whether it be **Enbridge’s** (TSX: ENB, NYSE: ENB) Northern Gateway, or **Kinder Morgan’s** Trans Mountain — has led to the unintended consequence of putting oil on rail cars and we have gone from bad to worse as a means of moving oil.

You know it’s only a matter of time. If you read the front page of *The Globe,* Hunter Harrison, the CEO of **Canadian Pacific Railway** (TSX: CP, NYSE: CP), calls it as it is. It’s only a matter of time before we have another rail disaster. And that’s not a statement of corporate negligence or corporate malfeasance. That’s a statement of the laws of probability at work. There’s probably not much that Stephen Harper and I would agree on when it comes to energy and carbon policy, but I certainly don’t disagree when he says that moving oil by rail is the much more costly and more environmentally hazardous way of doing things.

Now what the environmental movement wanted to do by stopping pipeline construction is keep oil in the ground. What has happened is oil is being moved onto rail cars and that's an issue we're going to have to face. Because the next derailment might not happen in rural Quebec. The next major derailment or disaster might happen outside of Chicago or outside Toronto.

And I think we're going to look again at this issue and I think we're going to find that the Achilles' heel of our newfound energy independence is that we don't really have the infrastructure to move all this oil.

Baillieul: There was crude train derailment outside of Calgary last week; literally a spark away from a major disaster.

Rubin: We've gone from less than 100,000 barrels per day to over 1.25 million barrels per day being moved on rail in the last couple of years. If we're going to continue to see production increases in the Bakken at 875 [thousand barrels per day], three-quarters of that stuff gets floated on rail. In fact it was oil from the Bakken that exploded in Lac-Megantic.

If we start going up to 1.5 or 2 million barrels per day, it's inevitable that we're going to see another train disaster because as we look at the track record, the chance of disasters is much greater with rail than pipeline. That's not to say I don't have issues with pipelines, I'm just saying we've gone from bad to worse.

It's like what I write in my book, *Zero Sum World,* on the unintended consequences like how an environmental victory saving some Apple Cider in Nebraska, all of a sudden has the industry's gun sights set on the Great Barrier rainforests. If Enbridge tries to get to Kitimat, a victory on one front leads to a defeat on another. Stopping pipeline is certainly honorable from an environmental standpoint. Putting over a million barrels on rail is certainly a hollow victory.

Baillieul: With all of these pipelines being built to transport oil to the Gulf, could we see another discount for North American crude emerge? Can these refineries actually handle all of the crude coming their way?

Rubin: They can beef up. Irving is planning to beef up its throughput in Saint John and there's record shipments coming into refiners in California from places like the Bakken.

But understand why it's so vital for the oil industry to get to the coast. It doesn't really matter which coast they get to be it the Pacific, or the Gulf coast, the Atlantic coast, or who knows or maybe in time the Arctic coast. It's because when you get to a coast you can put oil on a tanker and that gets world oil prices. It gets Brent.

At one point there was so much oil coming out of the Alberta oil sands with nowhere to go and getting deadheaded in the U.S. Midwest, that Western Canadian Select which is the benchmark price for Alberta producers, was trading at a 45% discount to Brent. That was about the time that Suncor announced that it was to abandon its plans for the heavy oil upgrader Voyageur. And that was around the time that we were seeing the Canadian energy sector be the S&P 500 energy sector because it was hard for the Canadian energy sector to attract capital and it was getting such a huge price discount from Brent.

Now thanks to loading oil on rail, and I just talked about during an interview with Blue Sky on CBC radio, about building new rail terminals in Saskatchewan to haul oil. Thanks to this huge increase in oil transport by rail, those price spreads have narrowed and West Texas, which is the benchmark U.S. price, is trading within $2 to $3 of Brent.

And all that shows that for all of the increases in North American energy independence, we're as vulnerable to oil shocks as we've ever been. So it's not like all of the production from the Bakken or the oil sands has buffered us from any oil shocks. Instead, once we're connected to world oil prices, our prices are as high as theirs. Which is great news for the folks at Suncor. Not such great news for Canadian motorists, of course, because Canadians have not been paying the world oil prices. Their feedstock price has been significantly lower, and Americans' as well, though not as much as the Canadian price.

Coming up next
In part 4 of my interview with Jeff, we discuss the importance of TransCanada's Energy East pipeline to the Canadian energy industry.

Motley Fool Canada's top 2 stock ideas
Our senior investment analyst will unveil his top two stock ideas for new money now on Oct. 1. And YOU can be one of the select few investors to find out first — just click here to reserve your invitation.

Disclosure: Robert Baillieul has no positions in any of the stocks mentioned in this article. The Motley Fool owns shares of Kinder Morgan.

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Date
2025/07/07
Date Created
2013/09/25
Author
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