GSI Global Subsidies Initiative

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Subsidies or Incentives? Norway's support for upstream oil and gas Seminar Summary

February 2012

Presentations

Leiv Lunde, director of the Fridtjof Nansen Institute and moderator of the seminar, introduced the session by expressing how important the issue of energy subsidies is, though admitting that it is not without its controversies. He noted the wide international and national support for the issue of energy subsidies, particularly since the G-20 had made their phase-out commitment in 2009. Most people agree on the importance of transparency, research and policy analysis, but there are serious complexities, particularly with regard to producer subsidies. Lunde recommended that the International Energy Agency and the Organisation for Economic Co-operation and Development be encouraged to fulfil their mandates in this respect. Western countries must assess their subsidies, which are largely to producers, if they are to have leverage over developing countries to end their consumer subsidies.

Peter Wooders, senior economist of the International Institute for Sustainable Development's (IISD) Global Subsidies Initiative (GSI), set the scene for why the study *Fossil Fuels – At What Cost? Government support for upstream oil and gas activities in Norway* had been undertaken and what we know about producer subsidies and their impacts more generally. The Norway study is the third in GSI's Fossil Fuels – At What Cost? series of detailed studies on producer subsidies, with the fourth (Russia) to be released on February 21, 2012 in Moscow. Wooders stated that we know very little about producer subsidies or their impacts. The other studies, all concerned with upstream oil and gas, identified various subsidies, ranging from US$1.8 billion to over US$10 billion per year. The studies were not principally designed to provide comparisons between countries, and Norway was chosen for a number of reasons, including: transparency; Norway's membership in the Friends of Fossil Fuel Subsidy Reform group and leadership in other sustainable development debates; and Norway's good reputation as a trusted partner in the Gulf and around the world. The choice to study Norway's subsidies does not imply in any way that Norway is a poor performer. Wooders noted that the World Trade Organization (WTO) provided a robust and workable definition of subsidies and that the GSI studies had shown that the "Define" and "Measure" stages are achievable. The last stage—"Evaluate"—is more problematic and should be the focus of work going forward in Norway, with analysis undertaken at the level of individual policies and measures and accounting for all policy aims (energy security, depletion policy, climate change, etc).

Frian Aarsnes, principal at Econ Pöyry and lead author of the Norway study, explained that his organization were fully behind the results of the study, noting that the work had been scoped by GSI and that the subsidy definition was also provided by GSI. Aarsnes noted the semantics that subsidies and incentives are both preferential treatment. He appreciated that GSI had been open and honest about the rationale and aims of the study. His presentation opened

with explaining that the study had worked through 30+ potential subsidies, analyzing 17 in detail and focusing on nine that could be considered subsidies or potential subsidies. Using 2010 data (which is not necessarily representative of other years), these nine subsidies amounted to NOK25.5 billion (US$4 billion). They did not characterize any subsidies as "good" or "bad," but they did conduct impact analyses for the three that could have a material impact on the oil and gas industry: the Snøhvit LNG project, exploration refunds and fast depreciation rules. The first two of these were already a focus of public debate, though the third has not been to date. Aarsnes disputed the view of Kjetil Lund (State Secretary of the Ministry of Finance) that Norway's cash-flow-based taxation system was neutral; his view was that it was back-end loaded, which allows Norway to levy such a high marginal tax rate. He noted further that Norway has benefitted from considerable bits of luck at various times in the development of their oil and gas sector, but that this did not necessarily result in the best policy choices. Aarsnes stated that there were definitely examples of preferential treatment in the oil and gas sector, and the impact of this treatment should be studied further.

Henrik Harboe, chief climate negotiator, Norwegian Ministry of Environment, stated that he was not able to comment on whether Norway's fiscal regime was optimal. He noted the interest of Kjetil Lund and the Ministry of Finance in the debate and how they had stated their support of him presenting at the seminar. He welcomed the study, the seminar and the debate, noting that Norway showing its position would give it the credibility to demand the same of other countries, a parallel to the Extractive Industries Transparency Initiative issue. Norway's prime minister had a personal and particular interest in putting a price on carbon, and stands firmly behind the need to engage with the subsidy issue worldwide. Subsidy analysis and reform efforts are complex, linking into vested interests, politics and development strategies. Harboe also appreciated that the study had contributed to the debate on climate change. He noted the important role that the Friends of Fossil Fuel Subsidy Reform group could play in stimulating the debate internationally.

Bjørn Harald Martinsen, manager of economics, Norwegian Oil Industry Association, questioned how the oil and gas sector could be construed as being heavily subsidized when this year it is contributing over NOK350 billion (US$55 billion) to the Norwegian treasury. He stated that the WTO definition of "subsidy" as used was very wide, and that GSI had influenced this. Specific to the findings of the study, he noted that the analysis of the largest subsidy identified—fast depreciation of investments—must be seen together with the high tax rate in the petroleum sector (78 per cent). The authorities have to strike a balance between taxes and deductions, assuring that investments that are profitable under a 28 per cent mainland tax regime will also be profitable under a 78 per cent tax regime. The treasury's job is to collect as much of the resource rent as possible. With the treasury's part of the cash flow from the petroleum sector at close to 90 per cent, it is difficult to find a subsidy at this rate. If depreciation rates in the petroleum sector are lowered, in order to restore balance, the tax rate should be as well. Exploration rebates served only to remove a disadvantage that new entrants without a tax position faced, to level the playing field among exploration companies. This scheme (initiated in 2004) successfully opened up the Norwegian continental shelf for several newcomers, driving a tremendous growth in new resources, and increasing exploration wells drilled from 15 in 2004 to a record high 72 in 2009. The tax reimbursement initiative should therefore be seen as an investment by the government with a large profit return for the treasury. Martinsen noted that more research and development (R&D) should be financed, even if it is considered a subsidy. Comparing value creation among different sectors of the economy, R&D programs for the petroleum sector should be increased from present levels. The report also omits the fact that the oil and gas sector is the only one both paying carbon tax and buying emission quotas, which

should be seen as a negative subsidy.[1] The report concludes that seismic investigations done by the Norwegian Petroleum Directorate (NPD) is considered a subsidy, but it should be noted that information collected is later sold to oil companies. The report wrongfully states that the price only reflects NPD administration cost. The NPD's target is total cost coverage, which is often obtained.

Svend Søyland, senior advisor, Energy and Climate Change, Bellona Foundation, congratulated Norway for undertaking the study. He noted that Norway's US$4 billion was only a tenth of the US$40 billion that the Obama administration was unsuccessfully trying to repeal in the U.S. He also spoke to the semantics issue, suggesting that we should just refer to "money that is being provided." He stated that subsidies in Norway were a policy choice, and one that was being dealt with by a small and closed circle. Søyland noted the inconsistency between Norway's climate commitments and speeding up a process to extract oil that would result in the combustion of more carbon dioxide than the environment can safely absorb. His view was that Norway should ensure it has fully depleted existing fields before it considers moving into new ones. He brought up the negative impacts of the "oil bonanza" that the subsidies had created, including engineers' wages that priced them out of renewables and other sectors, and wasteful consumption. He noted that that exploitation of loopholes was hard to confirm, but gave the examples of fields retaining "R&D" status (and thus government support) and exploration companies with no intention of ever reaching a taxable position.

Arild Skedsmo, head of the Climate and Energy Department, Worldwide Fund for Nature (WWF) Norway, was very pleased that the study had been undertaken and has led to a NOK25 billion debate. He noted that the subsidy debate had previously been very difficult for the public to engage in because the figures were not available in financial reports and the Ministry of Finance had kept the debate at a technical and inaccessible level. Skedsmo asked two key questions. First, is Norway walking the walk internationally, given how vocal it has been in suggesting that developing countries reform their consumer subsidies? He answered that national discussions about regulations were harder to conduct. Second, do incentives increase activity in the sector? Here he responded that they clearly do, and therefore that the Norwegian tax system is not value-neutral.

Questions from the floor saw discussions about:

- The need to look at marginal analysis, which suggested that the industry is being paid to do too much at present
- Whether the cash flow taxation system is neutral or not
- The desirability of conducting analysis for the system as a whole, rather than single elements
- Whether supplying electricity to offshore rigs would constitute a subsidy if market prices for this electricity were less than long-run marginal costs
- How Norwegian public opinion favours both a strong oil and gas sector and climate change action, without necessarily noting the inherent contradiction

[1] Frian Aarsnes had earlier noted that the study erroneously omitted the cost of carbon in its analysis, but that this did not alter any of the findings of the study, which were based on an analysis of individual policies and measures.

Next Steps

Leiv Lunde asked the speakers to sum up and to suggest next steps. Frian Aarsnes questioned whether there could be a deep public debate, and speculated that cross-border discussions on issues of common interest may be the catalyst needed for change. Bjørn Harald Martinsen noted the need for the people to decide what their priorities are. Svend Søyland said that the debate seemed to be crystallizing around what was desirable and undesirable, with the potential that processes could be driven too hard, resulting in an overheating economy. Arild Skedsmo stated that no one questions if there are subsidies, and noted that there needs to be a fuller debate.

Summing up, Peter Wooders stated how educational, useful and complex he had found the debate and thanked the panel and participants. Regarding next steps in Norway, he recommended that analysis and debate focus on the three main subsidies identified by the study: fast depreciation of investments, exploration refunds and the Snøhvit LNG project. These subsidies should be assessed against Norway's endpoint goals—security of supply, net job creation, etc.—not simply against whether they contribute to increased production in the short term. The analysis could usefully be extended to a wider discussion of Norway's oil and gas resource management strategy, asking at what rate, and when, resources should be extracted, and potentially how incomes from extraction should be invested. Internationally, Norway is looked to as an example of best practice and it has a unique opportunity to positively impact policy formation in countries such as the United Arab Emirates and Iran. Norway's membership in the Friends of Fossil Fuel Subsidy Reform group could also be used to support change internationally, for example, through forums and processes that include the United Nations Framework Convention on Climate Change, the 2012 United Nations Conference on Sustainable Development (Rio +20) and the WTO.

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About GSI

GSI is an initiative of the International Institute for Sustainable Development (IISD). GSI puts a spotlight on subsidies—transfers of public money to private interests—and how they impact efforts to put the world economy on a path toward sustainable development. In cooperation with a growing international network of research and media partners, GSI seeks to lay bare just what good or harm public subsidies are doing; to encourage public debate and awareness of the options that are available for reform; and to provide policy-makers with the tools they need to secure sustainable outcomes for our societies and our planet.

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