

# ELIMINATE PRODUCTION SUBSIDIES TO THE FOSSIL FUELS SECTOR IN CANADA

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Submission by Oil Change International, Environmental Defence, Équiterre, International Institute for Sustainable Development, Climate Action Network

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## Environment Canada and Climate Change: Climate Change Portal Recommendation to the Carbon Pricing Working Group

### **Recommendation: Pan-Canadian Fiscal Reform of subsidies to oil, natural gas and coal**

As part of the pan-Canadian framework on clean growth and climate change, we recommend that First Ministers agree in November to eliminate federal and provincial subsidies to oil, gas and coal by 2020, and commit to publicly releasing a detailed schedule in their respective 2017 budgets outlining the specific fiscal measure to be eliminated.

We welcome the opportunity to submit recommendations to support the development of an ambitious pan-Canadian framework on clean growth and climate change.

In December 2015, more than 190 nations adopted the Paris Agreement — a legally binding international agreement committing countries to significant reductions in global greenhouse gas (GHG) emissions to limit global warming to less than 2°C and to pursue efforts to limit it to 1.5°C above preindustrial levels. Building on the success of COP21, 175 nations signed the Paris Agreement on its opening day at the UN headquarters in New York City on April 22.

Canada, for its part, signed the Paris Agreement on opening day and has committed to ratifying the Agreement in the fall of 2016.

In Paris, the Government of Canada, along with 39 other countries and major corporations, endorsed the Fossil Fuel Subsidy Reform Communiqué.<sup>1</sup> Supporters of this Communiqué have recognized that the elimination of fossil-fuel subsidies would contribute significantly to reducing global greenhouse gas emissions and that accelerating the reform of fossil-fuel subsidies is therefore an urgent priority. In its campaign Platform, the Liberal Party of Canada committed to phasing out fossil fuel subsidies,

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<sup>1</sup> <http://ffsr.org/communique/supporters/>

starting with changes to the Canadian Exploration Expenses tax deduction.<sup>2</sup>

In Paris, the Government of Canada also signed on the Carbon Pricing Leadership Coalition committing countries and partners to work with each other towards the long-term objective of a carbon price applied throughout the global economy.<sup>3</sup> At their meeting in March, First Ministers committed to a “[t]ransition to a low carbon economy by adopting a broad range of domestic measures, including carbon pricing mechanisms,”<sup>4</sup> while Canada’s Minister of Environment and Climate Change has described carbon taxes as the “most efficient mechanisms” to reduce greenhouse gas emissions.<sup>5</sup> Fossil fuel subsidies, however, function as a negative price on carbon<sup>6</sup> - public funds that incentivize emissions, rather than their reduction. If Canada’s fossil fuel subsidies persist, they risk weakening or undermining carbon pricing commitments.

We welcome the federal and provincial governments’ recent investments to promote clean technologies through Mission Innovation, where Canada seeks to double clean energy investment to \$775 million by 2020. However, policy and fiscal coherence is necessary to make the Canadian clean energy sector attractive to domestic and foreign investors, and maximize the return on federal and provincial governments’ support for the clean energy sector. As such, remaining federal and provincial subsidies to the production and consumption of oil, gas, and coal must be eliminated.

GHG emissions reduction achieved through those increased federal and provincial

investments in clean energy risks being dwarfed by continued oil and gas exploration and development. There are oil and gas and liquefied natural gas projects in the application stage in Canada, with some start-up dates for these projects extend out to 2030 and beyond. The current trend of growth in GHG emissions in the oil and gas industry will continue if facilitated by governments’ support for continued exploration and development.

In addition, with these tax preferences still in place, the Government of Canada risks foregoing billions of dollars in additional tax revenues from accelerated deduction rates for pre-production costs for new projects over decades to come. Phasing-out of fossil fuel subsidies will allow governments to reap significant fiscal benefits over the medium and long-term by recouping foregone tax revenues.

A 2015 report by Oil Change International, the Overseas Development Institute and the International Institute for Sustainable Development estimates that Canadian federal production subsidies to the fossil fuel industry amounted to a minimum of \$CAN 1.8 billion annually. Provincial subsidies to fossil fuel producers in Canada could amount to a minimum of \$CAN 1.1 billion annually.

The Government of Canada has a long-standing commitment to phasing out production subsidies to the fossil fuel industry, starting with the commitment in the G20 Leaders’ Statement at the 2009 G20 Summit in Pittsburgh. This commitment was reiterated again at the recent G7 meeting in Japan, which urges all countries to phase out fossil

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<sup>2</sup> <https://www.liberal.ca/files/2015/10/New-plan-for-a-strong-middle-class.pdf#40>

<sup>3</sup> <http://www.carbonpricingleadership.org/leadership-coalition/>

<sup>4</sup> <http://www.scics.gc.ca/english/Conferences.asp?a=viewdocument&id=2401>

<sup>5</sup> <http://www.ottawacitizen.com/news/local+news/mckenna+great+climate+rest+laurels/11845241/story.html>

<sup>6</sup> <http://2015.newclimateeconomy.report/wp-content/uploads/2015/10/Implementing-Effective-Carbon-Pricing.pdf>

fuel subsidies by 2025 – suggesting that leading economies, like Canada, will have to act earlier if they expect all countries to follow suit within a decade. At the North American Leaders’ Summit in June 2016, Canada, along with Mexico and the United States, reiterated this commitment to eliminate fossil fuel subsidies by 2025. These international commitments must now be met through immediate reform of federal and provincial fiscal measures on fossil fuel production.

The First Ministers Meeting on the pan-Canadian framework on climate change and clean growth offers the opportunity for Canada to deliver on its promises to phase-out fossil fuel subsidies.

Delivering on this long-standing commitment requires a transparent and predictable phase-out schedule released by provincial, territorial and federal finance ministers, thus providing certainty to investors, and certainty to Canadians, that all levels of governments intend to eliminate tax preferences to the oil, natural gas, and coal industries.

The Government of Canada must lead the way. We cannot afford another 9 years of continued government support to the oil and gas industry if we are to truly begin the clean energy transition in Canada today. In light of the urgent pace and scale of the climate challenge, we call on First Ministers to complete this phase-out no later than 2020.

A list of currently-identified fossil fuel subsidies at the federal and sub-national level can be found in the annex attached to this document.

## **Recommendations:**

### **Federal fossil fuel production subsidies**

- Federal government to publicly release, ahead of Budget 2017, a comprehensive list of current accelerated capital cost allowances (ACCA) and other tax preferences available to the oil, natural gas, and coal industries in Canada, including estimates of foregone tax revenues;
- Federal government to announce, in Budget 2017, a schedule for phasing out remaining federal production subsidies by 2020, including the ACCA to Liquefied Natural Gas, the duty exemption for imports of mobile offshore drilling units in the Atlantic and the Arctic, the Canadian Development Expense, the Canadian Exploration Expense Tax deductions, the Canadian Oil and Gas Property Expense, the Foreign Resource Expense and Foreign Exploration and Development Expense.

The Minister of Finance and the Minister of Environment and Climate Change were both mandated to work together to fulfill the G-20 commitment to phasing-out fossil fuel subsidies to over the medium-term as outlined in their Mandate Letters. However, Budget 2016 maintained a new ACCA to the natural gas industry to 2025, and contained no changes to federal tax policies to eliminate fossil fuel subsidies.

### **Provincial fossil fuel production subsidies**

- First Ministers to commit, as part of the pan-Canadian framework on climate change and clean growth, to publicly releasing an accounting of remaining provincial subsidies by end of 2017, including estimates of foregone tax revenues;
- First Ministers to announce in their respective provincial budgets for 2017, a

schedule for phasing out remaining provincial subsidies by 2020, including Alberta's relief programmes on royalties for oil and gas projects, British Columbia's Deep Drilling Credit Program.

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<b>ANNEX – Canada’s fossil fuel subsidies</b>	<b>Targeted energy source</b>	<b>Estimated annual amount, million USD</b>	<b>2013 estimate</b>	<b>2014 estimate</b>
<b>Tax expenditures – federal-level</b>				
Canadian Development Expense: 30% deductible on a declining-balance basis	Oil	785	785	Not available
Canadian Development Expense: 30% deductible on a declining-balance basis	Gas	196	196	Not available
Atlantic Investment Tax Credit (AITC): 10% (2013) and 5% (2014) tax credit on energy investments	Oil & Gas	136	200	72
Canadian Exploration Expense: 100% deduction for costs incurred for geological, geophysical, and geothermal (G3) surveys and exploratory drilling (in the coal sector this includes the intangible costs of mine development)	Oil, gas, coal	127	127	Not available
Accelerated capital cost allowance (ACCA) for tar-sands projects and accelerated write-offs for some intangible tar-sands costs	Oil	122	167	77
Flow-through share deductions	Oil, Gas & Coal	119	126	111
Canadian Exploration Expense	Gas	32	32	Not available
Canadian Oil and Gas Property Expense (COGPE): 10% deduction for the cost of acquiring an oil or gas well; an interest or right to explore, drill, or extract oil or natural gas; or a qualifying interest or right in oil or gas production (excl. Crown royalties)	Oil	28	28	Not available
Canadian Oil and Gas Property Expense (COGPE): 10% deduction for the cost of acquiring an oil or gas well; an interest or right to explore, drill, or extract oil or natural gas; or a qualifying interest or right in oil or gas production (excl. Crown royalties)	Oil & Gas	7	7	Not available
Duty exemption for offshore exploration equipment imports	Oil & Gas	Not available	Not available	Not available
Foreign resource expense (FRE) and foreign exploration and development expense (FEDE): 30% deduction for exploration costs overseas	Oil, Gas & Coal	Not available	Not available	Not available
Exploration limited partnerships: proceeds taxed as capital gains at just 50% the rate of regular income	Oil, Gas & Coal	Not available	Not available	Not available

Introduction of ACCA for Liquefied natural gas (LNG) assets	Gas	n.a.	n.a.	n.a.
Addition to CEE of the following expenses: environmental studies and community consultations that are required in order to obtain an exploration permit or licence	Oil	n.a.	n.a.	n.a.
<b>Total (National)</b>		1552	1669	260
<b>Tax expenditures, sub-national level</b>				
Alberta Crown Royalty Reductions (Alta.)	Oil & Gas	604	631	578
Deep Drilling Credit (unspecified, likely BC)	Gas	249	260	238
Mining Exploration Tax Credit (BC)	Coal	61	64	59
Road and Pipeline Infrastructure Credit (BC)	Oil & Gas	23	24	22
Fuel Tax Exemption for Transmitting Waste Gas (BC)	Gas	14	15	14
Sales Tax Exemption for Exploration Equipment (Like MB + BC)	Oil	7	15	< 1
Summer Drilling Credit (BC)	Oil & Gas	14	14	Not available
Saskatchewan Petroleum Research Incentive	Oil & Gas	5	6	5
Manitoba Drilling Incentive Program	Oil & Gas	Not available	Not available	Not available
Total (Sub-national)		979	1028	916
Total (Combined)		2531	2697	2092
<b>Direct spending – federal and sub-national levels</b>				
Energy Alberta CCS projects (Carbon Trunk Line + Shell Quest)	Oil	103	108	99
Boundary Dam CCS (Federal share in form of grants)	Coal	51	53	49
Petroleum Technology Research Centre (Federal + Saskatchewan)	Oil & Gas	18	19	17
Heartlands Oil and Gas Road Rehabilitation (BC)	Oil & Gas	19	20	18
Orphan Well Abandonment	Oil & Gas	13	12	14
Oil and Gas R&D Funding (Newfoundland and Labrador)	Oil & Gas	4	5	4
Total direct spending		208	108	101
<b>Total National Subsidies</b>			<b>2738</b>	<b>2805</b>

Source: Overseas Development Institute, Oil Change International, International Institute for Sustainable Development, November 2015. Data Sheet with data sources and further information for Canada's production subsidies is available at: <http://www.odi.org/publications/10091-G20-subsidies-oil-gas-coal-production-Canada>