

COMMENTARY

Meeting Canada's Subsidy Phase-Out Goal: What it means in Ontario

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In May 2016 the Government of Canada, along with other G-7 countries, committed to a much-needed timeline to phase out fossil fuel subsidies. These countries committed to ending fossil fuel subsidies by 2025, attaching a specific year to the previous commitments to phase out subsidies for fossil fuels.

This is not a new idea for Canada. In the federal election, the Liberals and all other parties committed to fulfilling Canada's G-20 commitment to phase out subsidies for the fossil fuel industry. After the election, the Canadian government followed this up by endorsing an international *communiqué* calling for swift and ambitious action to remove fossil fuel subsidies.

We have a good picture of the scale of this task at the national level in Canada from a recent IISD/ODI/OCI report, *G20 Subsidies to Oil, Gas and Coal Production: Canada*. In this report, we identified CAD 2.9 billion in national subsidies for fossil fuel production.

This, however, is only part of the story. The G-20 report only focused on subsidies to fossil fuel producers, rather than both consumer and producer subsidies. In an effort to better communicate the full scale of what it means for Canada to eliminate fossil fuel subsidies, IISD will be taking a look at both types of subsidies through a series of briefing notes that will consider where action is already taking place and where more can be taken.

We start this examination with Canada's most heavily populated province, Ontario. For context, Ontario is Canada's first province to have **phased out coal**. At present, Ontario is in the midst of launching a cap-and-trade program that will cover a majority of economic sectors as well as a majority of provincial greenhouse gas

(GHG) emissions. These two initiatives are a major step forward for Canadian climate change policy, and indicative of the march towards stronger GHG policy we have been witnessing across Canada in recent years. In fact, with Ontario's carbon pricing commitment, over 85 per cent of Canada's population will be living in a jurisdiction with some form of carbon price (that figure climbs to roughly 90 per cent with Manitoba's recent confirmation it is pursuing pricing as well).

Phasing out the use of coal and setting a price on carbon are two major accomplishments, but there is a third one needed for a truly low-carbon future for the province and for Canada as a whole: the removal of environmentally harmful subsidies that support production and consumption of fossil fuels. Subsidizing fossil fuel use places cleaner fuels at an economic disadvantage, stunting their development and hindering efforts to meet GHG mitigation targets.

Finally, fossil fuel subsidies also represent a budgetary pressure, and their reform can open significant fiscal space for governments. The Environmental Commissioner of Ontario highlights this in her recent report, *Conservation: Let's Get Serious*, where she recognizes the importance of reforming fossil fuel subsidies in Ontario. In the table below, we have included her estimates along with Organisation for Economic Co-operation and Development (OECD) and Finance Ontario figures, indicating an increase in foregone revenue between 2015 and 2016.

The following highlights some of the prominent subsidies in place in Ontario that give preferential tax treatment to the use of fossil fuels, and how Ontario stacks up against other provinces. If Canada is to eliminate fossil fuel



subsidies by 2025, it will have to work with Ontario to address the following subsidies in one manner or another.

Reduced Tax Rates for Aviation Fuel and Kerosene

Aviation fuel in Ontario benefits from a reduced tax rate: the current tax rate on gasoline in the province is 14.7 cents per litre, whereas the rate on aviation fuel went from 4.7 cents per litre in 2015 to 5.7 cents per litre on April 1, 2016, peaking at 6.7 cents per litre from April 1, 2017.¹ This reduced rate represents CAD 320 million in uncollected tax revenues by the Government of Ontario in 2015.²

It is not uncommon for aviation fuel to be either exempt from taxation or to benefit from a lower rate. At the provincial level in Canada, British Columbia scrapped its own aviation fuel tax for international flights in 2012. The same is true in Alberta and Quebec. In this regard, Ontario is certainly ahead of the provincial curve, but there is still a tax preference for the consumption of fossil fuels that could be considered a consumption subsidy.

In 2014, the Government of Ontario increased the province's aviation fuel tax by 250 per cent between 2014 and 2017, partially in order to levy additional funds for public transit and transportation infrastructures. However, even after full implementation of the rate hike, the reduced tax rate for aviation fuel will still be less than half the regular tax rate. In this case, the existing efforts to reduce tax breaks should be commended, but there is certainly more to be done if Canada is truly going to eliminate fossil fuel subsidies completely.

Coloured Fuel Exemption

Coloured diesel fuel in Ontario is fully exempt from the province's tax on diesel fuel, which is currently at a rate of 14.3 cents per litre.³ The main difference between coloured and regular diesel in Ontario stems from a red dye that is added to the former. Coloured fuel can be easily identified, as its use is regulated and limited to specific purposes. Heating oil, one type of coloured fuel, is still the main source of heating for about 4 per cent of Ontario's households, and part of the energy mix for another one per cent of households. Use of coloured fuel is also common in

¹ See *Ontario Budget 2014*, p.325: http://www.fin.gov.on.ca/en/budget/ontariobudgets/2014/papers_all.pdf

² See *Transparency in Taxation*, 2015, Table 5: <http://www.fin.gov.on.ca/en/budget/fallstatement/2015/transparency.html>

³ See *Fuel Tax*: <http://www.fin.gov.on.ca/en/tax/ft/>. Please note that the Fuel Tax is distinct from the Gasoline Tax in Ontario.

the agriculture sector, and permitted in the construction, forestry and mining sectors, as well as for operating business equipment other than licensed vehicles.

In 2015, exemption from Ontario's fuel tax for coloured fuel meant that CAD 215 million in revenues was foregone in the province.⁴

The coloured fuel exemption could be considered a subsidy. It is also a good example of a subsidy whose reform will require a careful consideration of impacts on jobs, business competitiveness or socioeconomic well-being (e.g., access to energy among vulnerable groups). The strategy and schedule of reform need to differ depending on the context of the subsidy, and potentially negative impacts of subsidy phase-out need to be mitigated by well-prepared complementary policies.

Other Prominent Subsidies

Five other fossil fuel subsidies have been identified in Ontario. First, diesel purchased to propel railway equipment for a public transportation system benefits from a reduced fuel tax rate of 4.5 cents per litre, or less than a third of the regular rate.⁵ This reduced rate means that, in 2015, approximately CAD 65 million in Ontario public revenues was foregone.⁶ Second, the use of both methanol and natural gas is fully exempt from Ontario's tax on gasoline,⁷ meaning that the province didn't collect CAD 15 million in tax revenues in 2015.⁸ Third, that same year, CAD 7 million was foregone due to a reduced rate of the tax on the purchase of propane,⁹ which is set at 4.3 cents per litre.¹⁰ Fourth, numerous tax refunds can be claimed for the use of unleaded gasoline and propane in unlicensed equipment and unlicensed vehicles.¹¹ In 2015, such refunds amounted to CAD 3 million in the province.¹² Fifth, motorists who have auxiliary equipment attached to their licensed vehicle may be eligible for a tax

⁴ See *Transparency in Taxation*, 2015, Table 5: <http://www.fin.gov.on.ca/en/budget/fallstatement/2015/transparency.html>

⁵ See *Fuel Tax Act, 1990*, Section 2 "Tax on clear fuel", subparagraph (1)(d): <https://www.ontario.ca/laws/statute/90f35#BK2>

⁶ See *Transparency in Taxation*, 2015, Table 5: <http://www.fin.gov.on.ca/en/budget/fallstatement/2015/transparency.html>

⁷ See *Gasoline Tax Act, 1990*, definition of "gasoline": <https://www.ontario.ca/laws/statute/90g05#BK0>

⁸ See *Transparency in Taxation*, 2015, Table 5: <http://www.fin.gov.on.ca/en/budget/fallstatement/2015/transparency.html>

⁹ See *Gasoline Tax Act, 1990*, Subsection 2(4) "Tax on propane": <https://www.ontario.ca/laws/statute/90g05#BK2>

¹⁰ See *Transparency in Taxation*, 2015, Table 5: <http://www.fin.gov.on.ca/en/budget/fallstatement/2015/transparency.html>

¹¹ See *Tax Exempt Usage (TEU)*: [http://www.forms.ssb.gov.on.ca/mbs/ssb/forms/ssbforms.nsf/GetAttachDocs/013-0546E~1/\\$File/0546E.pdf](http://www.forms.ssb.gov.on.ca/mbs/ssb/forms/ssbforms.nsf/GetAttachDocs/013-0546E~1/$File/0546E.pdf)

¹² See *Transparency in Taxation*, 2015, Table 5: <http://www.fin.gov.on.ca/en/budget/fallstatement/2015/transparency.html>



refund, under specific circumstances, for both of the tax on diesel fuel and of the tax on gasoline that they paid.¹³ With respect to the tax on diesel fuel, such refunds amounted to CAD 3 million in 2015.¹⁴

Conclusion

Ontario has phased out coal use, committed to carbon pricing and taken on an aggressive GHG reduction target, committing to a reduction of 37 per cent below 1990 levels by 2030. We applaud Ontario for these positions and supporting strong action on climate change.

However, as long as fossil fuel subsidies exist, they will continue to undermine efforts to reduce emissions in Ontario and to meet Canada’s G-7 subsidy elimination target.

We suggest for Ontario that this means taking a long, hard look at subsidies, such as those listed above. Ontario must consider their reform as a component of the province’s action on climate change, as well as Canada’s national stance on subsidy elimination. An added benefit of reform would be the fiscal space implications, as these subsidies alone represent foregone revenue of roughly CAD 628 million.

Subsidy reform should be bundled with other policies that help affected industries and workers to adjust. Here, the federal government will need to work closely with the provinces, including Ontario, if it is serious about full elimination by 2025.

We understand that there may be strong reasons for these subsidies, but that does not counteract the fact that they will continue to lead to elevated GHG emissions, as well as stunt the opportunity for cleaner alternatives, not to mention tying up significant budgetary space for governments in terms of foregone revenue.

¹³ See fn 11.

¹⁴ See *Transparency in Taxation, 2015*, Table 5: <http://www.fin.gov.on.ca/en/budget/fallstatement/2015/transparency.html>

Table 1. Fossil Fuel Subsidies in Ontario Primarily Targeting Consumers (estimates are in million CAD)^a

Measures Identified (consumers):	OECD	Finance Ontario	Environment
	(2015) ^b	(2016) ^c	Commissioner of
	Estimates for 2014		Estimates for 2015
Reduced Rate for Aviation Fuel	–	320	320
Fuel Tax Exemption for Coloured Fuel	190	215	215
Fuel Tax Reduction for Railway Diesel	60	65	65
Gasoline Tax Exemption for Methanol and Natural Gas	10	15	15
Gasoline Tax Reduction for Propane	6	7	7
Fuel Tax Refunds for Auxiliary Equipment	4	3	3
Gasoline Tax Exemption for Unlicensed Equipment	3	3	3
Total	273	628	628

^a The table summarizes identified and potential subsidies from the sources identified.

^b OECD’s estimates for 2015 were not available at time of publishing. However, OECD and Finance Ontario’s estimates for 2014 matched each other. See OECD Fossil Fuel Support – CAN: http://stats.oecd.org/Index.aspx?DataSetCode=FFS_CAN

^c See *Transparency in Taxation, 2015*, Table 5: <http://www.fin.gov.on.ca/en/budget/fallstatement/2015/transparency.html>

^d See Table 7.2: Ontario Commodity Tax Concessions for Fossil Fuels: http://docs.assets.eco.on.ca/reports/energy/2015-2016/ECO_Conservation_Lets_Get_Serious.pdf

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