

Government Spending on Canada's Oil and Gas Industry

Undermining Canada's Kyoto Commitment

Executive Summary and Preface

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Foreword by CAN Canada

The oil and gas industry is the fastest growing and largest source of greenhouse gas emissions in Canada. Industry leaders were among the most outspoken opponents of Canada's decision to ratify the Kyoto Protocol, predicting major negative economic impacts. Chief among industry claims was the contention that Kyoto would lead to huge expenditures for the purchase of foreign credits depriving Canadians of the capital needed to make "real" reductions in pollution in Canada.

This was in spite of estimates by the federal government and others that the economic impact of the Kyoto Protocol on the oil and gas industry would amount to no more than \$0.25 per barrel of oil.

A few days after Canada ratified the Protocol the then Minister of Natural Resources wrote to the oil industry and provided it with a guarantee that it would not be required to reduce its emissions more than 15% below the business as usual forecast. This "relative" target allows emissions from oil and gas to rise substantially between 2002 and 2012. Further, the industry was assured the government would assume all costs of emissions reduction in excess of \$15 a tonne.

The federal *Climate Change Plan for Canada* describes a number of subsidies and incentives for wind energy and other forms of renewable energy. It was the view of the Climate Action Network — Canada (CAN) that these initiatives were insignificant in comparison to the subsidies and other government support presently being provided to the oil and gas industry. CAN asked the Pembina Institute to conduct a study to determine the extent of government support for Canada's oil and gas industry and to recommend changes to federal and provincial government policy.

It turns out that the industry's real fear may well be that Canadian taxpayer will object to the huge corporate welfare that is being provided to the country's richest and biggest polluters. While proclaiming its desire to combat global climate change by ratifying the Kyoto Protocol and promising to reduce greenhouse emissions, the Government of Canada provided the oil and gas industry with \$1,446 million in subsidies in 2002. The increase in subsidies between 1996 and 2000 was 33%. Total expenditure between 1996 and 2002, inclusive, was equal to \$8,324 million (2000\$). Federal government expenditure on oil sands alone is estimated to be approximately \$1,193 million (2000\$) from 1996 to 2002, inclusive.

Executive Summary

Governments in Canada, as well as elsewhere, subsidize a number of socially beneficial services. These include, for example, health care, education and energy services. To the extent that subsidies provided to the energy sector are for oil and gas developments, however, they are contributing to increased environmental impacts and hindering developments of environmentally friendly alternative energy options. The purpose of this study is to investigate government expenditure on the oil and gas sector in Canada. To that end, we identify and document the various forms of public support provided to this industry by the federal government. We focus on federal government support provided through grants (direct expenditure), the tax system (tax expenditure) and government departments (program expenditure) for conventional oil and gas as well as for oil sands between 1996 and 2002. We also discuss provincial support for oil sands. This special focus on oil sands is important for two reasons: One, growing oil sands production is the principal cause of increasing environmental impacts from Canada's oil and gas sector and, two, previous research by the Commissioner of the Environment and Sustainable Development concluded that investments in oil sands receive significant tax concessions relative to other forms of energy.¹

In the late 1980s and early 1990s, the federal government supported energy megaprojects. This included, for example, the Hibernia Development Project and heavy oil upgraders.² Since 1995, federal spending on non-renewable energy resources has been significantly reduced. While it is true, then, that current subsidies are lower than in the past, they are still substantial.

Government expenditure on the oil and gas sector including tax, program and direct expenditure totalled \$1,085 million (2000\$) in 1996 and \$1,446 (2000\$) million in 2002. The increase in expenditure over this time period was 33%. Total expenditure from 1996 to 2002, inclusive, was equal to \$8,324 million (2000\$). The vast majority of the expenditure is associated with tax initiatives and in particular the Canadian Development Expense, the Canadian Exploration Expense, the Resource Allowance and the Accelerated Capital Cost Allowance for oil sands. Other research has demonstrated relatively low taxation levels for the oil and gas sector,³ high tax concessions for oil sands⁴ and relatively high profits of oil and gas companies.⁵ In addition, previous research comparing the amount of revenue collected from oil and gas developments in Canada with that collected in Alaska and Norway revealed that, relative to these international benchmarks, companies extracting Canada's oil and gas, most of which belongs to the public, are receiving an implicit subsidy in the form of excessive profits that governments are failing to capture through taxes, royalties and other revenue generating policy options.⁶

¹ Commissioner of the Environment and Sustainable Development. 2000. *Report of the Commissioner of the Environment and Sustainable Development*.

² Commissioner of the Environment and Sustainable Development. 2000. *Report of the Commissioner of the Environment and Sustainable Development*.

³ The Technical Committee on Business Taxation. 1997. *Report of the Technical Committee of Business Taxation*. Submitted to the Honourable Paul Martin, Minister of Finance.

⁴ Commissioner of the Environment and Sustainable Development. 2000. *Report of the Commissioner of the Environment and Sustainable Development*.

⁵ Statistics Canada, CANSIM Table 180-0001 for 1995 to 1998 and CANSIM Table 180-0003 for 1999 to 2002.

⁶ Taylor, Amy, Chris Severson-Baker, Mark Winfield, Dan Woynillowicz and Mary Griffiths. 2004. *When the Government is the Landlord*. Pembina Institute for Appropriate Development.

Federal government expenditure on oil sands, including tax expenditure, research and development support and the Syncrude Remission Order,⁷ is estimated to be approximately \$1,193 million (2000\$) from 1996 to 2002, inclusive. The government of Alberta does not track tax expenditure associated with any form of oil and gas development. Neither does it track research and development support or direct expenditure. A similar discovery was made by a past investigation into this topic.⁸

The trends in government expenditure on the oil and gas industry described above are particularly worrisome in light of Canada's commitment to reduce greenhouse gas emissions under the Kyoto Protocol. In 2002, 20% of Canada's GHG emissions came from the oil and gas industry, up from 16% in 1990. Upstream oil and gas production and natural gas transmission, which now account for 16% of Canada's GHG emissions, saw their emissions increase by 56% between 1990 and 2002. Petroleum refining and natural gas distribution, which now account for 4% of Canada's GHG emissions, saw their emissions increase by a more modest 17% over the same period. Total GHG emissions from Canada's oil and gas industry rose by 47% between 1990 and 2002. Oil and gas production is also associated with other environmental impacts. Exploration and development of oil and gas results in land disturbance as wells are drilled, roads are built and pipelines are constructed. Oil and gas production is associated with significant water consumption and results in emissions of criteria air contaminants including acidifying emissions of nitrogen oxide and sulphur dioxide.

Over the last two decades there has been growing interest in the value of subsidies provided by governments around the world to various sectors. Concurrently, there has been mounting pressure to reduce and/or remove perverse subsidies — that is, subsidies associated with environmentally damaging activities. To date, in Canada little progress has been made in this regard. According to the Organization for Economic Cooperation and Development (OECD), "incentives for natural resource development and use [in Canada] raise sustainability concerns."⁹ The OECD has criticized Canada in the past because "direct subsidies and fiscal incentives to the energy industry continue to undermine efforts to improve energy efficiency."¹⁰ More recently, the OECD called for a "[s]ystematic review of environmentally harmful subsidies in sectors such as transportation and energy"¹¹ — a task yet to be completed in Canada. This study is intended to be a first step in that direction.

Based on the evidence presented in this study, we recommend a number of actions related to public expenditure on oil and gas developments:

- **Complete a systematic review of all subsidies on a regular basis.** This important task should be undertaken periodically to ensure that the subsidies in place are in the

⁷ In 1976, the federal government granted a remission order allowing participants in the Syncrude oil sands project to deduct royalty payments while still making use of the resource allowance. This remission order expired in 2003, but was associated with federal expenditure over the 1996–2002 study period.

⁸ Pigeon, Marc-Andre. 2003. *Tax Incentives and Expenditures Offered to the Oil Sands Industry*. Parliamentary Research Branch.

⁹ Organisation for Economic Co-operation and Development. 2000. *Economic Survey of Canada*. Paris, France: OECD.

¹⁰ Organisation for Economic Co-operation and Development. 1995. *Environmental Performance Review: Canada*. Paris, France: OECD.

¹¹ Organisation for Economic Co-operation and Development. 2004. *Environmental Performance Review: Canada*. Paris, France: OECD.

best interest of society given current conditions. For example, many of the subsidies associated with oil and gas production were established when oil and natural gas prices were different than they are today. Changes in prices and other national/international conditions should trigger regular assessments of existing subsidies.

- **Eliminate federal subsidies to the oil and gas sector.** In doing so, fiscal objectives will be aligned with environmental objectives. This is an important component of any policy package intended to reduce GHG emissions. To determine which subsidies are most appropriate for removal, a complete assessment of federal subsidies to the oil and gas sector should be undertaken by appropriate government authorities with input from other relevant stakeholders. The assessment should be accompanied by the establishment of a specific timetable for the elimination of environmentally harmful subsidies associated with oil and gas developments, including oil sands.
- **Redirect environmentally harmful oil and gas subsidies towards environmentally beneficial energy options.** Government support for energy conserving, energy efficient and low-impact renewable energy technologies needs to be expanded until such time as they have gained substantial market share and are able to compete with conventional technologies on their own.
- **Develop and implement a just transition strategy for communities highly dependent on oil and gas production.** As subsidies are phased out, funds should be made available to facilitate a transition away from oil and gas for communities highly dependent on oil and gas production.
- **Reconcile government support for oil sands developments with international obligations to reduce GHG emissions.** The preferential treatment for oil sands development currently taking place is at odds with environmental objectives and, specifically, Canada's obligations to reduce GHG emissions under the Kyoto Protocol and the United Nations Framework Convention on Climate Change. Immediate reform of this support is needed as part of government policy action to reduce GHG emissions in Canada.
- **Implement the polluter pay principle.** Government intervention is required to facilitate the internalization of environmental costs into market prices. The most appropriate way to ensure this internalization is through the implementation of the polluter pay principle, whereby those that cause environmental harm are required to incur associated costs. For example, the federal government could reduce the number of GHG emission permits to be granted free-of-charge to the oil and gas sector under its proposed "Large Final Emitter" policy. It could also remove the "emissions intensity" basis of that policy so that industry will have to pay for permits to cover emissions associated with production increases.
- **Maximize revenue generation from oil and gas developments.** To the extent that governments in Canada are not maximizing revenue collection from the development of oil and gas resources, they are instead providing an implicit subsidy to the oil and gas sector. Governments in Canada need to ensure that they are providing maximum compensation to the citizens of the country for the development of these non-renewable, largely publicly owned resources.

- **Provide comprehensive estimates of federal expenditure, including tax expenditure, at the sectoral level.** Expenditure associated with all forms of government support should be tracked and published by the Department of Finance on an annual basis.
- **Provide accurate and up-to-date estimates of provincial expenditure on a sectoral basis in Alberta.¹²** The government of Alberta does not currently track expenditure on oil and gas developments. Informed public debate requires public knowledge of the level of government support provided through tax breaks, reduced royalties and support for research and development on an annual basis.

¹² Similar estimates are needed for other oil- and gas-producing provinces, such as Saskatchewan and British Columbia, although these regions were outside the scope of this study.