# Written Submission for the Pre-Budget Consultations in Advance of the 2019 Budget


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Canada's energy industry is in a unique position today but has reached an inflection point in determining its future. The oil and gas sector is one of Canada's largest industries and plays a key role in the Canadian economy. With the adoption of the latest extraction technologies the resource has grown significantly in Canada. At the same time global energy demand for all types of energy continues to grow at a rapid pace creating a significant market opportunity for Canada. This is occurring while there is also an international consensus on the need to address global climate change and to reduce carbon emissions from the global energy system. At the same time our largest energy market has been the US but they are now our largest competitor. There are a number of competitiveness gaps the Canadian industry faces relative to other jurisdictions, especially the United States, which need to be addressed.

**Growing Global Energy Demand**

Global energy usage of oil and natural gas is growing and will continue to do so for the foreseeable future. Renewable energy in the electricity sector is growing but not yet at a pace to meet demand growth. There are no known substitutes for jet fuel in the airline industry and electric cars are in their infancy and still expensive to adopt. In the meantime the developing world is continuing to grow their economies and grow their consumption of energy including their usage of coal. This will continue with or without Canada's oil and natural gas in the global marketplace. Reducing Canada's oil and natural gas production, or not allowing it to grow, will have no effect on global consumption since other suppliers will simply fill the void. Today the other suppliers that can meaningfully grow their oil and gas production outside of Canada are primarily OPEC nations, Russia and the US shale producers. Canada has a better environmental track record in our energy sector than any of these countries including the US. Canada's energy is produced in the safest and most environmentally stringent fashion compared to anywhere in the world.

Confirming this energy demand growth is the recent International Energy Agency's (IEA) World Energy Outlook New Policies Scenario which projects that global energy demand by 2040 will have increased by about 30% from today's level. This demand growth is driven by population increases and by greater urbanization and industrialization, largely in Asia. There will be significant increases in the usage of coal over this period in many of these countries, primarily in the power sector, which will increase greenhouse gases. Canada and the world are currently facing a significant challenge in meeting this growing demand for safe, reliable and affordable energy, while also responding to the impacts of climate change and the need to transition to a lower carbon energy system/economy over the next several decades. These two imperatives are not incompatible if addressed in a balanced and responsible manner over time. In fact, for Canada they should go hand-in-hand and we are a leader in this regard.

**Economic Opportunity For Canada**

Canada's energy industry is among the largest economic engines driving our economy, both directly and through its linkages to other industries such as petrochemicals, power generation and the manufacturing sector. For Canadians, our oil and gas resources can continue to provide secure, reliable and affordable energy supply, while sustaining employment and economic prosperity throughout the value chain. Furthermore, oil and gas development presents a tremendous opportunity for inclusive economic growth and further tangible progress in reconciliation with Canada's Indigenous peoples.

The timing is opportune for Canadian supply to capture new markets, with the next cycle of LNG demand emerging over the 2022-2030 period. As the fifth largest producer of natural gas Canada should be responsive to this market opportunity and continue to play a very important role in meeting global energy demand and reducing global energy poverty. Canada can do so in a manner that contributes to reducing global carbon emissions and positions Canada among the global leaders in environmental and social performance standards. If Canadian supply does not meet this demand, then supply will be provided by other jurisdictions that are likely to have lower environmental and social standards.

## Balancing the Environment

At the same time as this economic opportunity presents itself, there is also an international consensus on the need to address global climate change and to reduce carbon emissions from the global energy system. Canada has committed to work toward significant reductions in greenhouse gas emissions, through its commitment to the 2015 Paris Climate agreement and through the Pan-Canadian Framework on Clean Growth and Climate Change. The Canadian oil and gas industry recognizes the need to address global climate change and is broadly supportive of the climate policy goals and policy frameworks being implemented by Canadian governments, provided that such policies are implemented in a manner so as to provide incentive for industry to reduce greenhouse gas emissions, while addressing the competitiveness impacts for sectors that are competing in the open market with companies operating in jurisdictions with less stringent climate policies.

Canadian oil and gas producers are collaborating on technology and innovation to reduce GHG emissions intensity and decouple production growth from emissions growth. For natural gas, with extensive electrification and methane emissions reductions, there is potential to grow production by 50% while holding absolute GHG emissions at or below current levels. However, there are transmission infrastructure and commercial challenges that will need to be addressed to enable the required scope of electrification. Canadian oil and gas exports with lower emissions than competing alternative energy sources in the market will have the effect of reducing overall global GHG emissions. These actions to ensure the carbon competitiveness of Canadian oil and gas production, along with use of verified offsets and international credits, would also contribute to aligning Canada's energy and climate aspirations.

Canada therefore has the opportunity to play a leadership role in the global transition to a lower carbon energy system/economy, with the Vision being: ***Canada is a preferred supplier of cost and carbon competitive oil and gas to domestic and global markets, produced with leading environmental and social performance standards.***

## Competitive Issues

To realize this opportunity, the oil and gas industry is of the view that there is a near term imperative for actions by industry and governments to address significant and systemic competitiveness gaps relative to competing jurisdictions, particularly the United States. This urgency arises from a confluence of several factors, most notably the increasing momentum toward migration of investment capital to other jurisdictions, challenges in attracting new capital to Canada and the timing of the next window of opportunity to participate in global natural gas markets. Once established, this negative momentum is difficult and time-consuming to reverse. The oil and gas industry in Canada is at a critical juncture in terms of near term decisions on several large investment projects.

Canada continues to have a number of positive attributes in terms of investment attraction, among them the size and quality of the resource, world-class environmental standards, and competitive royalty regimes. However, both industry and the investment community are of the view that the competitiveness of Canada's oil and gas sector is increasingly challenged. Investment is leaving Canada's oil and gas sector and the sector is having difficulty attracting new investment capital. While valuations fluctuate, recent industry data indicates that Canadian LRNG companies are being valued at discounts to their U.S. peers. Many larger producers and service companies are shifting investment capital and associated jobs to other jurisdictions. At the same time, small to medium Canadian operators are having significant difficulty attracting financing. Since 2012 the number of junior companies has been reduced by almost 50% (from 49 to 25 companies).

These competitiveness challenges arise from several factors, including cost structure, changes in the business investment climate such as tax policy changes in the U.S., constraints on market access and resultant negative impacts on prices, regulatory timelines and complexity, and public perception issues. In particular, Canada faces significant market access problems, preventing growth of production and the associated benefits. For natural gas, Canada is losing market share to the U.S. in areas of Canada and the U.S. traditionally supplied by Canadian gas and to date has not participated in the rapid growth of liquefied natural gas ("LNG") export markets. This lack of market access options is being manifested in significant price discounts for both Canadian oil and natural gas.

Ensuring that Canada remains competitive would re-establish the investor confidence required to attract the capital to sustainably grow the Canadian industry and economy. Potential actions to address this issue are within the purview of both industry and governments, working collaboratively with Indigenous peoples and stakeholders.

For its part industry has reduced, and continues to reduce, cost structure and address GHG emissions intensity across all areas of the business by seeking efficiencies, and by applying new technology and innovative systems and processes.

However, industry is of the view that these actions alone cannot overcome the competitiveness challenge. For natural gas, industry modeling of representative play economics demonstrates a measurable competitiveness gap between Canadian Liquids Rich Natural Gas (LRNG) investments and similar opportunities in the U.S. Modeling shows that comparable U.S. LRNG investments have approximately double the rate of return and 1 to 2 year faster payout than Canadian investments. Most of this gap arises from recent U.S. tax regime changes, plus the incremental compliance costs of climate policies in Canada.

Therefore, actions by government, including the following, are urgently required to address competitiveness challenges:

1. The allowance of immediate deductibility of capital costs for tax purposes, to be applied broadly across the economy in a manner that aligns with similar tax reforms in the U.S.;

2. Joint examination of innovative approaches to financing for small/medium sized firms in the upstream oil and gas sector: As one example, liability and environmental concerns related to inactive wells, facilities and pipelines is growing. The federal government could introduce policy and fiscal tools such as a flow-through share instrument similar to the Canadian Exploration Expense (CEE) to incent and facilitate capital investment for decommissioning inactive wells, facilities and pipelines, and inclusive of a new well drilling component for economic upside and

longer-term sustainability. This type of approach could help create many jobs, provide Indigenous business opportunities, manage an existing historical environmental issue, and generate royalty revenues at the same time;

3. Increasing the level of protection to approximately 80% coverage of the aggregate compliance cost for EITE industries, including the oil and gas sector;

4. Proceeding with the commitment to review the SR&ED tax credit program, with inclusion of operational innovation within scope;

5. Taking a leadership role in gaining international recognition of Canada's progress in reducing global GHG emissions via its natural gas exports, and in seeking international credits under Paris Agreement Article 6;

6. Enabling accelerated collaborative technology, infrastructure and innovation in the sector, particularly as it relates to commercializing electrification of upstream Liquid Rich Natural Gas and downstream Liquified Natural Gas.

Canada should be the global hydrocarbon supplier of choice to meet increasing future demand because of its world class resources, leadership in reducing carbon emissions through technology, workers and human rights, and a robust environmental regime. The recommended actions would help to ensure Canada remains globally competitive and in turn restore investor confidence, attract investment and provide the platform for a broader consensus on the future of the Canadian oil and gas industry. All of this could lead to significant growth of the sector – protecting Canadian jobs and working people, providing opportunities for Indigenous Canadians and contributing to the economic prosperity necessary to support our standard of living and quality of life and to enable transition to a lower carbon energy system/economy.