



CANADIAN ASSOCIATION  
OF PETROLEUM PRODUCERS

Canada's Oil and Natural Gas Producers

## **2015 Budget Submission to the House of Commons Standing Committee on Finance**

**Canadian Association of Petroleum Producers**

**August 2014**

---

2100, 350 – 7 Avenue S.W.  
Calgary, Alberta  
Canada T2P 3N9  
Tel 403-267-1100  
Fax 403-261-4622

1000, 275 Slater Street  
Ottawa, Ontario  
Canada K1P 5H9  
Tel 613-288-2126  
Fax 613- 236-4280

403, 235 Water Street  
St. John's, Newfoundland and Labrador  
Canada A1C 1B6  
Tel 709-724-4200  
Fax 709-724-4225

310, 1321 Blanshard Street  
Victoria, British Columbia  
Canada V8W 0B5  
Tel 778-410-5000  
Fax 778-410-5001

## Introduction

The Canadian Association of Petroleum Producers (CAPP) represents companies, large and small, that explore for, develop and produce natural gas and crude oil throughout Canada. CAPP's member companies produce about 90 per cent of Canada's natural gas and crude oil. CAPP's associate members provide a wide range of services that support the upstream crude oil and natural gas industry. Together CAPP's members and associate members are an important part of a national industry with revenues of about \$110 billion a year.

CAPP welcomes the opportunity to provide input into the federal government's 2015 budget consultations. With over \$67 billion of investment in 2013, the oil and gas industry is the single largest sectoral investor in the Canadian economy. These numbers are well in excess of the next highest industries including utilities (\$32 billion), transportation (\$23 billion), and manufacturing (\$18 billion).<sup>1</sup>

While these investments are significant, CAPP members are increasingly concerned about the economic competitiveness of Canada's economy. CAPP's 2014 Crude Oil Forecast estimates total Canadian oil production will increase to 6.4 million barrels per day by 2030 from 3.5 million barrels per day in 2013.<sup>2</sup> This is lower than the 2013 forecast, which estimated total 2030 production at 6.7 million barrels per day. While continued growth is anticipated, this reduced forecast reflects increased uncertainty related to cost competitiveness and capital availability.

The outlook for natural gas is also challenging, as Canadian gas continues to be displaced in traditional markets in the east as new infrastructure is constructed to access U.S. shale gas. The absence of access to new markets could constrain production by as much as 37 per cent by 2030.<sup>3</sup>

This trend is part of a broader competitiveness challenge for Canada. In July the Bank of Canada downgraded its near term forecast with real GDP growth expected to average 2.25 per cent up to mid-2016, when the economy returns to full capacity.<sup>4</sup>

With the federal government poised to return to balanced budgets, yet subdued economic growth expected for the foreseeable future, now is the time for strategic investments to strengthen competitiveness and position the economy for long-term sustained growth.

---

<sup>1</sup> Statistics Canada. 2014. Capital Spending, Construction and Machinery and Equipment, Industrial Sectors. Available at: <http://www.statcan.gc.ca/daily-quotidien/140226/t140226a001-eng.htm>

<sup>2</sup> Canadian Association of Petroleum Producers. 2014. 2014 Crude Oil Forecast, Markets and Transportation. Available at: <http://www.capp.ca/forecast/Pages/default.aspx>

<sup>3</sup> Derived from internal CAPP analysis

<sup>4</sup> Bank of Canada. 2014. Monetary Policy Report. July. Available at: <http://www.bankofcanada.ca/2014/07/mpr-2014-07-16/>

The enclosed pre-budget submission seeks to achieve these objectives in alignment with the following priority themes of the Standing Committee on Finance:

- Improving Canada's taxation and regulatory regimes
- Maximizing the number and types of jobs for Canadians.

## **1 Expanding Market Access through Improved Taxation and Regulatory Regimes**

Canada has large reserves of crude oil with significant potential for production growth that can best be realized through diversification and growth of domestic and export markets to the south, west and east. Canada also has a vast wealth of natural gas reserves with over 100 years of supply; however, natural gas resources have faced a challenging business environment in recent years. Innovative technologies have unlocked vast new supplies across North America, reducing U.S. demand for Canadian exports, and depressing prices and royalties.

With growing U.S. energy self-sufficiency, diversifying our energy export markets is critical to strengthening the long-term competitiveness of Canada's energy sector. The federal government can assist by establishing a competitive tax climate to attract investment, maintaining an effective and efficient energy regulatory regime, and addressing issues related to Aboriginal consultation and accommodation.

### **1.1 Liquefied Natural Gas (LNG) Liquefaction Facilities Tax Reclassification**

Canada has a substantial opportunity to develop its fledgling LNG industry. Natural gas demand in the Asia-Pacific is forecast to grow by over 60 percent by 2025.<sup>5</sup> Canada has an opportunity to build and supply several LNG facilities meet a portion of this demand growth. However, Canada is a latecomer to this market and Canadian export projects must compete in an increasingly challenging global environment.

Currently, nine projects in BC have secured LNG export licenses from Canada's National Energy Board, and another three applications are under review. The total approved export capacity is 249 BCM (8790 BCF) per annum or 24 BCF/d.<sup>6</sup> Assuming one-half of the proposed projects proceed

---

<sup>5</sup> Pacific Northwest LNG and Petronas. Forthcoming. Statis and Dynamic Economic and Tax Revenue Impact of Four Federal Tax Incentives for LNG Facilities

<sup>6</sup> Moore, et al. 2014. Risky Business: The Issue of Timing, Entry and Performance in the Asia-Pacific LNG Market. University of Calgary School of Public Policy. p. 66 available at: <http://policyschool.ucalgary.ca/?q=content/risky-business-issue-timing-entry-and-performance-asia-pacific-lng-market>

(12 BCF/d), economic benefits over twenty-five years approximate \$1.2 trillion in GDP, 7.2 million years of employment, \$301 billion in wages, \$289 billion in taxes and \$60 billion in royalties.<sup>7</sup>

Despite this potential no projects have reached a final investment decision, and competing proposals in the U.S., Australia, Mozambique and elsewhere are under review. With more LNG export projects proposed than required to meet demand, it is critical that the fledgling Canadian LNG industry be developed expeditiously to seize this opportunity. However, the current tax classification for LNG liquefaction facilities does not provide an equitable capital cost allowance compared to similar manufacturing facilities in Canada, and it is not competitive with that of other jurisdictions.

LNG liquefaction facilities manufacture and process natural gas into LNG. These facilities process and treat natural gas to effect a physical and chemical change, not only through liquefaction of methane, but also separation and recovery of other liquid hydrocarbon productions inherent in the gas. Canadian LNG liquefaction facilities are categorized as Class 47, which assigns an eight percent declining balance tax depreciation rate. The Class 47 categorization dates to when Canadian LNG facilities were first built for regasification or peak shaving –simple processes consistent with the risk profile and capital intensity of an eight per cent declining balance tax depreciation rate.

Conversely, LNG liquefaction involves more complex processing in the manufacture of LNG and commercial quantities of natural gas liquids, and longer capital recovery timelines. CAPP contends these processes meet the definition of “manufacturing or processing” as determined by case law and pursuant to CRA IT-145R and should, therefore, be categorized as Class 43 with a 30 percent declining balance tax depreciation rate.

Comparatively, Class 47 status disadvantages Canadian LNG facilities relative to competitors in the U.S. and Australia. On an undiscounted basis, it takes 27 years to substantially (90 percent) depreciate a Class 47 asset. A similar analysis of a straddle plant (Class 43) takes approximately 7 years. An LNG liquefaction facility in the U.S. or Australia takes approximately 13 years to substantially depreciate.<sup>8</sup>

Preliminary estimates suggest that the net benefit of this change would approximate \$3 billion in Canadian GDP from 2015-2035.

### **Recommendation**

- That the federal government change the tax treatment for LNG liquefaction facilities from Class 47 (8 per cent declining balance) to Class 43 (30 per cent declining balance) tax depreciation rate.

---

<sup>7</sup> Derived by CAPP from Moore, et al. 2014, and Canadian Energy Research Institute. 2013. Global LNG: Now, Never, or Later. Available at [http://ceri.ca/images/stories/2013-02-04\\_CERI\\_Study\\_131\\_-\\_Global\\_LNG.pdf](http://ceri.ca/images/stories/2013-02-04_CERI_Study_131_-_Global_LNG.pdf) .

<sup>8</sup> Felesky Flynn LLP. 2012. Capital Cost Allowance Rates For Natural Gas Liquefaction Facilities

## 1.2 Regulatory Reform to Facilitate Business Investment

An efficient and effective regulatory regime is key to business competitiveness. CAPP supports the reforms in Bills C-38 and C-45, and encourages Canada and the provinces to continue regulatory reforms through an equivalency model based on the principles of “best-placed regulator” and “single-window” approach.

One area in need of further reform is Aboriginal consultation. The duty to consult and accommodate Aboriginal communities is one of the most challenging regulatory issues, with specific jurisdictional responsibilities spread across federal departments, provinces and regulators. This complexity creates confusion for business, Aboriginal groups and government in executing this duty. There is a need for greater clarification and strengthening of these processes, along with increased federal visibility to enhance the positive steps already taken in BC, and expand these to other regions.

Sensible, consistent and transparent processes that clarify the rights, roles, responsibilities and expectations of proponents, governments and Aboriginal communities would improve the predictability and effectiveness of the consultation process. This approach would save companies time and money, improve the national investment climate and, create a meaningful process for Aboriginal communities to engage in resource development projects.

For example, Aboriginal groups have a responsibility to participate in consultation processes.<sup>9</sup> However, in some cases, Aboriginal communities have interpreted the Crown’s duty to consult and accommodate as a right to veto development. This leads to confusion and mistrust among Government, business and Aboriginal communities, creating conflict, project delays and lost economic opportunities.

### Recommendations

That the federal government:

- Continue to improve the regulatory process through an equivalency model based on the principles of “best-placed regulator” and “single-window” approach;
- Invest sufficient resources to evaluate, coordinate and apply provincial, territorial and industry consultation processes, where appropriate, to fulfill its consultation obligations.
- Actively steward Aboriginal consultation policy leadership, by supporting federal departments in embracing their consultation responsibilities, and implementing the Eyford report recommendations;<sup>10</sup>

---

<sup>9</sup> Ibid:13.

<sup>10</sup> Eyford, Doug. 2013. Forging Partnerships, Building Relationships. Report to the Prime Minister. Available at: <https://www.nrcan.gc.ca/sites/www.nrcan.gc.ca/.../ForgPart-Online-e.pdf>

- Ensure timely coordination with industry proponents on consultation, as they are best positioned to respond to accommodation requests, mitigate impacts and strengthen partnerships;
- Better communicate and clarify roles, responsibilities and expectations of the consultation process to all stakeholder groups, including Aboriginal peoples and industry.

## 2 Maximizing the Number and Types of Jobs for Canadians

Canada’s energy sector is in an expansionary phase and Canadian natural resource developments are expected to create sustained demand for skilled labour over the next decade.<sup>11</sup> The Petroleum Labour Market Information Service estimates oil sands activity alone will generate 98,000 jobs in construction, maintenance and operations over this period.<sup>12</sup> Ensuring we have the right people with the right skills is crucial to delivering energy projects safely, on time and on budget.

At \$2 billion annually, the Labour Market Development Agreements (LMDAs) are the largest federal labour market transfer program to the provinces/territories, funding employment programs for current and past claimants under the *Employment Insurance (EI) Act*. Given the recent reforms limiting access to the *Temporary Foreign Worker (TFW)* program, combined with government’s emphasis on prioritizing Canadians first, the LMDAs need to be as targeted and effective as possible at connecting under and unemployed Canadians to the jobs and training to meet labour demands in the Canadian economy.

### 2.1 Prioritizing Skills Training and Work Experience Programs to Increase Labour Productivity

Skill development and work experience programs are the most effective intervention for improving employment and income levels among under and unemployed Canadians. According to the 2013 *Evaluation of the Labour Market Agreement (LMA) report*, of those involved in the LMA work experience and skills development programs, 86% had a job within two years, 72% experienced increased weekly earnings, and 87% received credentials.<sup>13</sup> Moreover, the 2013 LMDA program evaluation indicated that “skills development is the most effective intervention in increasing the earnings of active EI claimants”, with empirical evidence suggesting employer productivity improvements and lower EI use as well.<sup>14</sup> Comparatively, other LMDA programs such as the

---

<sup>11</sup> Construction Sector Council. 2013. Construction Looking Forward. 2013-2021 Key Highlights.

<sup>12</sup> Petroleum Labour Market Information Service. 2014. The Decade Ahead: Oil Sands Labour Demand Outlook to 2022 <http://www.careersinoilandgas.com/labour-market-information/reports/#>

<sup>13</sup> Employment and Social Development Canada. Evaluation of Labour Market Agreements. (March 31, 2013)

<sup>14</sup> Chapter 6: Impacts and Effectiveness of Employment Insurance Program. (n.d.).Government of Canada, Human Resources and Skills Development Canada. Section IV. Retrieved July 9, 2014, from <http://www.esdc.gc.ca/eng/jobs/ei/reports/mar2011/chapter6.shtml>

*Targeted Wage Subsidy, the Self-Employment Program, the Job Creation Partnership, and Employment Assistance Services* did not experience as consistent and comprehensive overall benefits.

### **Recommendation**

- That the federal government reform the LMDA program to prioritize skills development and work experience programs, similar to the LMA approach, and in a manner that is strongly connected occupations in demand.

## **2.2 Reforming Income Support Programs to Facilitate Labour Mobility**

In an unencumbered labour market, regional dispersion of unemployment rates would decline as workers move from areas of high unemployment to areas of low unemployment; however, in Canada, this has not necessarily occurred. Currently, all employers and employees pay the same amounts into the EI program, but differential benefits are paid out based on regional employment conditions. This effectively creates labour market distortions and disincentives for both employers and employees to address chronic regional unemployment issues.

Some jurisdictions have addressed this issue by introducing experience-rated EI premiums for employers (whereby contribution rates depend on the past record of layoffs) to discourage repeat usage.<sup>15</sup> Another option is to adopt variable premium payments for the EI program, based on the program's 58 established economic regions. Areas of consistently high unemployment (and higher benefits paid) would pay relatively higher premiums. Correspondingly, areas of low unemployment, with lower benefits paid, would pay lower premiums. This approach is consistent with a true insurance model, and would eliminate the redistributive properties of the EI program that discourage employers and employees from finding solutions to chronic unemployment challenges.

### **Recommendation**

- That the federal government introduce experience-rated EI premiums for employers, and reform the income support component to better link benefits received to amount paid, thereby reducing disincentives for workers to migrate from areas of high unemployment to areas of low unemployment.

---

<sup>15</sup> OECD. (2014, June 1). OECD Economic Survey June 2014. . Retrieved July 3, 2014, from [http://www.oecd.org/eco/surveys/Overview%20CANADA\\_2014.pdf](http://www.oecd.org/eco/surveys/Overview%20CANADA_2014.pdf)