CANADA'S OIL & NATURAL GAS PRODUCERS

Inefficient Fossil Fuel Subsidies and Canada's G20 Commitment

Standing Committee on Environment and Sustainable Development (ENVI)

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Canadian Association of Petroleum Producers

About CAPP

The Canadian Association of Petroleum Producers (CAPP) represents companies, large and small, that explore for, develop and produce natural gas and oil throughout Canada. CAPP's member companies produce about 80 per cent of Canada's natural gas and oil. CAPP's associate members provide a wide range of services that support the upstream oil and natural gas industry. Together CAPP's members and associate members are a solution-oriented partner to the world's needs for affordable, clean, safe and secure energy, and an important part of a national industry with revenues from oil and natural gas production of about $116 billion a year. CAPP's mission, on behalf of the Canadian upstream oil and natural gas industry, is to advocate for and enable economic competitiveness, with environmentally and socially responsible performance and is dedicated to advancing reconciliation with Indigenous peoples. CAPP is committed to ensuring that Canada is positioned to help meet global climate commitments as the supplier of choice in a world that demands a lower carbon energy future.

Introduction

Canada's oil and gas industry is not subsidized, especially when we look to the original G20 commitment to remove inefficient fossil fuel subsidies that encourage wasteful consumption, impede investment in clean energy sources, and undermine efforts to fight the threat of climate change. In fact, Canada has been a leader in the G20 both before and since signing onto the 2009 commitment to eliminate inefficient fossil fuel subsidies.

There is targeted support for all sectors to invest in emissions reduction technology in partnership with government. The Government of Canada has adopted an approach to drive government objectives through strategic and targeted support for all industries across the economy that are aiming to decrease their GHG footprint and improve their overall environmental performance. This is not an inefficient subsidy: This is national industrial policy to encourage behavior that may otherwise not occur and adheres to the terms of Canada's G20 commitment on inefficient fossil fuel subsidies.

Phasing out public financing for oil and gas would be inequitable and unprincipled relative to other industries as it would contravene the government's own inefficient subsidy assessment framework put forth by ECCC in 2019. Further, it would also work against government commitments to meet their targets and obligations under the Paris Agreement given that government funding helps improve industry emissions performance with the potential for Canada to displace global emissions. Strategic investment in our industry continues to be necessary and prudent in achieving these objectives. Limiting access to capital or increasing taxes will only have negative effects on Canada's economy, energy affordability, emissions reduction progress, and global energy security.

It is because of this approach and the efforts of our industry that Canada is making meaningful progress to achieving our global climate commitments, while preserving

economic prosperity. Natural gas emissions intensity decreased 33 per cent from 2009 to 2020, and oil sands emissions intensity decreased 8 per cent for in situ and 14 per cent for mining.[1] The oil sands pathways alliance declared an ambition to work together and with governments to achieve net zero emissions by 2050. From an economic perspective, in 2020 our sector contributed $105 billion and 5.6% to Canada's GDP[2]. Canada's upstream oil and natural gas industry directly and indirectly employs approximately 520,000 Canadians across the country. The success of our industry benefits all Canadians, as recently evidenced in Budget 2022: As a result of higher commodity prices and a faster overall economic recovery than originally anticipated, corporate income tax revenues for 2021-22 are forecast to be 45 per cent higher[3] than their pre-pandemic level in 2019-20 putting more money in government coffers for spending demands.

This submission is provided in response to the Standing *Committee on Environment and Sustainable Development's* mandate:

> "To conduct a study of the government's commitments to accelerate Canada's G20 commitment to eliminate fossil fuel subsidies from 2025 to 2023 and to develop a plan to phase out public financing of the fossil fuel sector, including by federal Crown corporations; that the study include a review of the definition of a subsidy and the criteria used to determine if a subsidy is inefficient, how those commitments contribute to achieving Canada's climate targets and obligations under the Paris Agreement, and how Canada plans to meet those commitments."

1. Context: Progress by the Government of Canada

1.1. Tax & Non-Tax Measures

In 2019, Environment and Climate Change Canada (ECCC) reviewed 36 federal programs (non-tax measures) that benefit oil and gas across 24 federal departments and agencies and although four programs were deemed a "subsidy", none were deemed "inefficient." [4] Citing and adhering to G20 terms and global subsidy definitions, the reasoning deployed by ECCC was that programs were 1) not specific to oil and gas hence available to all sectors, 2) they moved the needle on government priorities in improving environmental performance, and 3) provided support access to affordable energy to vulnerable communities.

This reflects the definitions set by our original 2009 G20 commitment that government policy aimed to increase environmental performance and reduce GHG's *is not* an inefficient subsidy therefore exempt from the G20 commitment.

As stated by ECCC, since Canada signed on to the G20 commitment in 2009, Canada has taken significant action to address its promise to phase out inefficient fossil fuel subsidies

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[1] https://www.capp.ca/wp-content/uploads/2021/07/Canadas-Natural-Gas-and-Oil-Emissions-Ongoing-Reductions-Demonstrable-Improvement-394473-1.pdf

[2] Statistics Canada, 2021.

[3] https://budget.gc.ca/2022/pdf/budget-2022-en.pdf

[4] https://www.canada.ca/content/dam/eccc/documents/pdf/climate-change/discussion-document-assessment-framework-inefficient-fossil-fuel-subsidies.pdf

at the federal level as nine significant tax measures specific to the oil and gas sector have been eliminated.

The government has acknowledged the progress made on subsidies, at both the bureaucratic and political level. For example, as stated by the Department of Finance in the 2017 Auditor General's Report "*remaining oil and gas tax measures are a part of the benchmark income tax system and they would not generally be considered subsidies covered by the G20 commitment to eliminate inefficient fossil fuel subsides."*[5] Further, Minister McKenna stated in June of 2020, her government has "*eliminated oil subsidies in the federal tax system.*"[6]

1.2. The Government of Canada's Definition on Subsidies

The Government of Canada has defined a fossil fuel subsidy as *"federal non-tax programs that provide preferential treatment that specifically supports the production or consumption of fossil fuels."*[7] Their framework includes a two-step process that would be applied to identify measures that 1) could be considered a subsidy and 2) could be considered an inefficient subsidy.

For Step One, the ***Provision of Support*** principle is applied to measures that could support the production or consumption of fossil fuels. Next, if the measure meets this test, the ***Specificity*** principle is applied assessing if the measure is largely directed to this sector, as opposed to being a provision that is generally applicable to all or many sectors. Finally, if the measure meets the specificity test, the ***Normality*** principle is applied, and would only be considered a fossil fuel subsidy if it provides a preference or benefit to those affected, relative to others. In other words, a measure could be specific to the fossil fuel sector, but if it aligns with the Government's general approach to treatment of industry, it should not be considered a fossil fuel subsidy.

Included in this review was public financing from both the Export Development Canada (EDC) and the Business Development Bank of Canada (BDC) that provide financial products and services to Canadian business. In ECCC's analysis, products provided on commercial terms would not constitute a subsidy to the fossil fuel sector as there is no additional benefit provided by the government. Further, ECCC concluded both EDC and BDC services are widely available to the general economy and are not specific to the fossil fuel sector. In addition, both organizations operate at a profit, and in some cases return dividends to the government and neither agency requires budgetary outlays from the government to operate.

The Step One definition used by the Government of Canada aligns most closely with The World Trade Organization (WTO) definition which defines a subsidy as *"If there is a*

[5] 2017 Spring Reports of the Auditor General of Canada to the Parliament of Canada: Report 7-Fossil Fuel Subsidies

[6] https://www.nationalobserver.com/2020/06/19/news/facing-spending-attacks-federal-minister-catherine-mckenna-doubles-down-social

[7] https://www.canada.ca/content/dam/eccc/documents/pdf/climate-change/discussion-document-assessment-framework-inefficient-fossil-fuel-subsidies.pdf

financial contribution provided by a government or a public body (both directly/indirectly) or any kind of income or price support where a benefit is thereby conferred."

For measures that are deemed a subsidy via the above test, Step Two is to deem whether it is "inefficient." The framework then assesses the policy objectives that the measure intends to achieve. These include social, economic, and environmental objectives. A fossil fuel subsidy that is also achieving a social or economic objective may not necessarily be an inefficient one. This is consistent with the G20 commitment, which stated in the 2009 G20 Leaders' Communique, that "*This reform will not apply to our support for clean energy, renewables, and technologies that dramatically reduce greenhouse gas emissions.*"[8]

2. The Three Pillars of the G20 Commitment on Inefficient Fossil Fuel Subsidies

In 2009, the G20 countries committed to phase out and rationalize inefficient fossil fuel subsidies, recognizing that these subsidies can 1) "*Encourage wasteful consumption*", 2) "*Impede investment in clean energy sources*", and 3) "*Undermine efforts to fight the threat of climate change*"[9]. In short, these three pillars comprise the lens for member countries to assess whether a subsidy is "inefficient." In that vein, let's put this lens to the test here in Canada:

2.1. Do Canada's policies *Encourage Wasteful Consumption of fossil fuels*?

Regarding "*Encouraging Wasteful Consumption*," it is critical to distinguish between subsidies targeted to the production of fossil fuels, versus subsidies targeted to the consumption of fossil fuels. It is the latter, (namely subsidies that reduce the cost of fossil fuels to the end user that lead to increased consumption and increased GHG emissions) where most global fossil fuel subsidies reside[10]. Contained in the **Figure 1**[11] below are IEA estimates of global fossil fuel subsidies that are targeted to/consumed directly by end users or consumed as inputs to electricity generation, ranked by country.

Fossil fuel consumption subsidies are profound in many countries with Iran, Saudi Arabia, Russia, Venezuela, China, and India leading the pack. Examples in the IEA study include the Egyptian Government directly setting fuel prices below the cost of supply, the Indonesian Government setting the prices for gasoline and diesel below market prices, and the Nigerian Government setting the domestic prices of gasoline, kerosene, natural gas, and electricity below the cost of supply. In Venezuela, government subsidies are said to have made gasoline "*cheaper than water and candy*."[12]

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[8] https://www.canada.ca/content/dam/eccc/documents/pdf/climate-change/discussion-document-assessment-framework-inefficient-fossil-fuel-subsidies.pdf

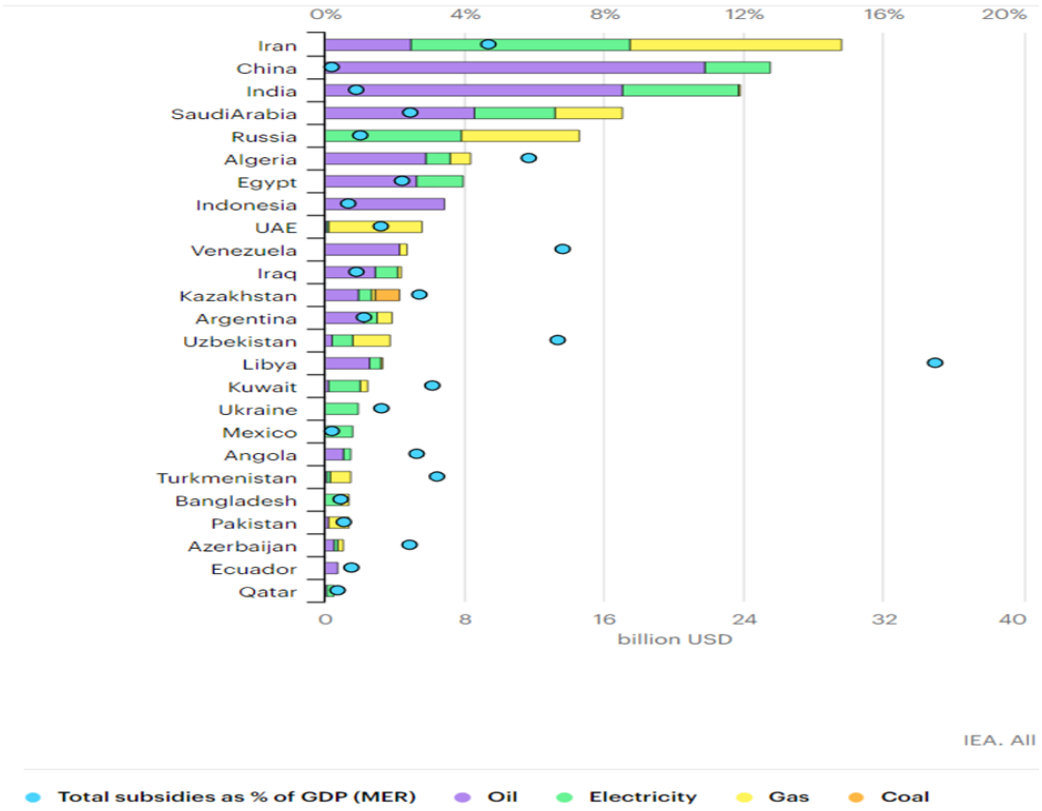
[9] March 2017 Budget, Minister of Finance, Government of Canada

[10] IEA, OPEC, OECD, The World Bank, Joint Report: Analysis of the Scope of Energy Subsidies and Suggestions for the G20 Initiative 2010

[11] https://www.iea.org/topics/energy-subsidies

[12] The Telegraph (UK) "Venezuelans Fume as Government Signals End to 'Free' Petrol, 2014

Figure 1: Value of fossil-fuel subsidies by fuel in the top 25 countries, 2020



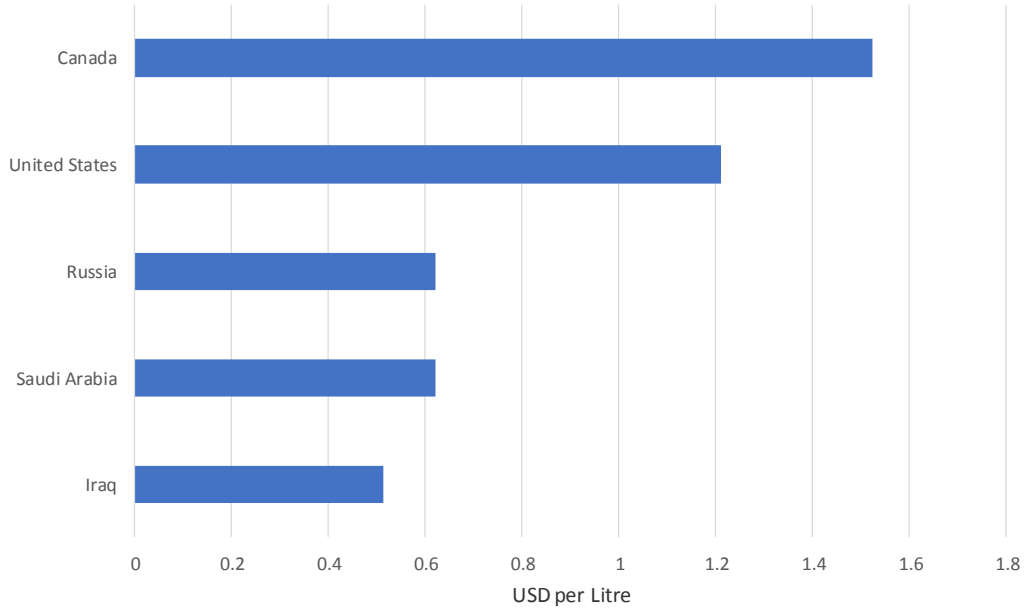
Whereas in Canada (*not even mentioned in the report, but note Canada's peer review partner Argentina*), not only are fossil fuel consumption subsidies not prevalent, but to the contrary, the consumption of fossil fuels is heavily taxed by government which *discourages* consumption, hence is the *opposite* of a subsidy.

Approximately 36% of what Canadians pay at the pump for gasoline in Canada are taxes to levels of government.[13] In fact, based on current world oil production levels, of the top five oil producing countries in the world, Canadians *pay the highest* prices for gasoline as seen in **Figure 2** below[14]**:**

[13] https://www.taxpayer.com/media/CTF%20-%20GTHD%202021%20Report%20-V5%20-%20May%2018,%202021.pdf

[14] *https://www.globalpetrolprices.com/gasoline_prices/#hl218*

Figure 2: Gasoline prices in USD per litre (April 2022 prices)



In addition to these taxes, Canada has further taxes on end use in the form of carbon taxes with a steadily increasing price. In addition, the Clean Fuel Standards regulations from the federal government will also increase costs to end users for liquid fuels.

Purely on the production side, not only does the federal government not subsidize producers[15], but we apply carbon taxation at the production source on companies across federal and provincial regimes. Canada has also introduced regulations to reduce methane emissions in addition to pricing mechanisms. CAPP notes that there have been additional announced policies including the emissions cap on the oil and gas sector which will increase costs on producers to get to Net Zero. In summary, Canada does not subsidize either consumption or production of fossil fuels, as we do the opposite, in the form of taxation and regulations where both producers and consumers bear the cost.

On the production side, in addition to carbon taxation and regulation, oil and gas companies in Canada submit a long list of payments to provincial, municipal, and federal levels of government. In addition to royalties, oil and gas companies pay municipal tax, federal and provincial corporate tax, various sales taxes, and a number of other levies such as various land fees, land rentals, land bonuses, among others.

Studies have shown that the tax treatment of oil and gas companies is such that they face a higher marginal effective tax rate (after including the effects of all payments made to government) than other sectors.[16]

[15] https://climatechoices.ca/wp-content/uploads/2022/02/Fossil-Fuels-Main-Report-English-FINAL-1.pdf
[16] Bazel, Phillip, Mintz, Jack, Whether it is the U.S. House or Senate Tax Cut Plan-It's Trouble for Canadian Competitiveness. 2017

2.2. Do Canada's policies Impede Investment in Clean Energy Sources?

While subsidies can help address market failures, respond to social needs, and encourage environmental improvements, they can also give rise to market and pricing distortions that can have negative impacts on the environment.

The Government of Canada has a long history of recognizing the importance of improving the interaction between economic and environmental objectives thereby ensuring that fiscal and environmental objectives are complementary.

As far back as the year 2000, Canada has been looking into this very issue of whether the fossil fuel sector received preferable treatment when compared to the renewable sector via federal measures. Specifically, the Commissioner of the Environment and Sustainable Development concluded (in 2000) that "*Overall, we found that with a few exceptions, federal government support today for energy investments, including support through the tax system, does not particularly favor the non-renewable sector over the renewable sector."*[17]

In 2003, the Department of Finance, Environment Canada, Industry Canada, and Natural Resources Canada noted that since the mid 1990's, direct financial support to the fossil fuel sector had fallen sharply and that the direction of policy had been toward reforming the treatment of the fossil fuel sector relative to the renewable sector, to improve the attractiveness of the latter.[18]

Further, these conclusions were before many measures specific to oil and gas were removed and before many measures for renewables were introduced, as outlined below.

Even prior to Canada's G20 commitment in 2009, Canada had already begun to phase out various measures available for the extraction of oil and gas. Examples include the:

- The elimination of the Earned Depletion Deduction in 1989
- Expiry of the Syncrude Remission order on December 31, 2003
- Phase-out of the resource allowance (equal to 25% of a corporation's resource profits) and phase in of a deduction for actual royalties and mining taxes paid (Budget 2003)
- Phase out of the accelerated capital cost allowance for tangible assets in oil sands projects (Budget 2007)

The G20 national implementation strategies in 2009 did not establish clear timeframes for phasing out inefficient fossil fuel subsidies as it left it up to member countries to define "medium term." Of the 13 countries that reported to have at least one inefficient fossil fuel subsidy, only Canada, Germany, and South Korea set specific timeframes.[19]

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[17] Office of the Auditor General: Report from Commissioner of the Environment and Sustainable Development, 2000

[18] Office of the Auditor General: Report from Commissioner of the Environment and Sustainable Development, 2012

[19] Phasing Out Fossil Fuel Subsidies in the G20: Progress, Challenges, and Ways Forward, 2017
https://www.ictsd.org/sites/default/files/research/phasing_out_fossil_fuel_subsidies_in_the_g20-henok_birhanu_asmelash.pdf

Countries have been slow to phase out those fossil fuel subsidies that they deem "inefficient" with the exception being Canada. Since Canada's commitment at the G20 in 2009, this trend of removing measures available to the oil and gas sector has only accelerated. The OECD even stated that the "*Income tax treatment of the oil, gas and mining sectors in Canada has been undergoing fundamental reforms*."[20]

Post 2009 changes to oil and gas taxation include:

- Reduction in the deduction rates for intangible capital expenses in oil sands projects, to align with rates for conventional oil and gas therefore expenses that were previously treated as Canadian CDE, now treated as COGPE hence reduction in annual deductibility from 30% to 10% (Budget 2011)
- Reduction in the deduction rates for intangible capital expenses in oil sands projects, to align with rates for conventional oil and gas therefore expenses treated as CEE, now treated as CDE hence reduction in annual deductibility from 100% to 30% (Budget 2011)
- Phase out of the Atlantic Investment Tax Credit for the oil and gas and mining sectors, which was a 10% credit for investments in buildings, machinery, and equipment for businesses in the Atlantic and Gaspe regions (Budget 2012)
- Phase out of the accelerated capital cost allowance for tangible assets in mines (including coal mines) (Budget 2013)
- Reduction in the deduction rate for pre-production intangible mine development expenses (including coal mines), to align with rates for the oil and gas sector therefore expenses previously treated as CEE, now treated as CDE hence an annual reduction in capital deductibility from 100% to 30% (Budget 2013)
- The accelerated capital cost allowance that effectively allows a 30% annual depreciation rate for equipment used in natural gas liquefaction instead of the normal rate of 8%, and a 10% rate for buildings at a facility that liquefies natural gas instead of the normal rate of 6%, will be eliminated in 2025 (Budget 2015)
- The removal of accelerated deductibility of expenses (CEE) for successful oil and gas exploratory drilling by treating them instead as CDE, hence reduction in annual deductibility from 100% to 30% (Budget 2017)
- Removal of the tax measure that allowed small oil and gas companies to reclassify CDE as CEE when they are passed on to flow-through share investors hence reduction in annual deductibility from 100% to 30% (Budget 2017)
- Phase out of flow through shares for oil and gas (Budget 2022)

It is important to note, the above comparison between oil and gas and renewable/clean tech sectors includes tax measures only. It does not include the abundance of non-tax measures aimed at renewables and clean tech by way of direct government funding hence the larger current suite of direct support innovation programs, many of which are not available to the oil and gas sector.

[20] OECD: "Inventory of Estimated Budgetary Support and Tax Expenditures for Fossil Fuels", 2011

Over the past several years and changes in government, the federal government has expanded measures for renewable energy/clean tech investment while simultaneously removing measures for the oil and gas sector. Accordingly, pursuant to our G20 commitment, Canada is not "*Impeding Investment in Clean Energy*."

2.3. Do Canada's policies *Undermine Efforts to Fight the Threat of Climate Change*?

Policies that support investment in technologies that reduce GHG emissions while enabling a prosperous economy are essential to enabling Canada to achieve its GHG reduction ambitions and targets.

Carbon leakage is an unintended consequence of uncompetitive government policies that diminish domestic economic activity but do not diminish global emissions. Carbon leakage occurs when investment, and therefore oil and natural gas production, shifts from places with higher regulatory standards and other costs (i.e., Canada) to places with lower or no standards and associated costs (i.e., Saudi Arabia, Russia). This means no reduction of overall global emissions because international demand that could be met with responsibly produced Canadian oil and natural gas will be filled by other global sources that are likely to be produced with less environmental regulation and higher emissions.

Canada urgently needs policies that enable the industry's commitment to innovation and technology before other suppliers with weaker environmental standards capture global markets without addressing climate concerns. Reduced investment in turn delays or halts the commercialization of promising innovative technologies that could significantly reduce emissions. Canada's policies must be developed in parallel with attracting investment, spurring innovation, job growth, and maintaining economic benefits across the country. Commitments such as the Carbon Capture Utilization and Storage Investment Tax Credit available to all industry announced in Budget 2022 are critical in this regard.

Recommendations

In summary CAPP offers the following recommendations as part of Canada's review process on inefficient fossil fuel subsidies**:**

- Through the internal and Peer Review process, confirm that remaining oil and gas tax measures are part of the benchmark tax system, therefore not subsidies pursuant to our G20 commitment and implement ECCC's 2019 recommendations which created a framework for evaluating inefficient fossil fuel subsidies.
- Confirm that the Minister's Mandate Letter directive to "*develop a plan to phase out public financing of the fossil fuel sector, including by federal Crown corporations"* remains consistent with our G20 commitment and the framework put forth on inefficient fossil fuel subsidies by ECCC in 2019, and will not fundamentally change and/or unfairly disadvantage government financing of the oil and gas industry relative to other sectors.