

Is the Canadian Oil Industry Subsidized?

by Youri Chassin



Environmental activists, and certain political parties, maintain that the Canadian oil industry is heavily subsidized.¹ Is this statement true? And what exactly is meant by “subsidies”? According to the International Energy Agency, fossil fuel subsidies in the world usually take the form of consumption subsidies. These subsidies totalled US\$409 billion in 2010, and led to lower gas prices at the pump and to lower prices for natural gas as well as for electricity produced from fossil fuels.²

Fossil-fuel consumption subsidies are generally found in countries with a non-negligible share of the world's oil and natural gas producers (Iran, Saudi Arabia, Russia, Venezuela) for the purpose of keeping prices below their market levels.

In Canada, there are no fossil-fuel consumption subsidies.³ On the contrary, the use of these energy sources is systematically taxed, which discourages their consumption, the opposite of a subsidy's effect. In 2012, gasoline taxes in Canada averaged 39.3 cents per litre, representing approximately 31% of the pump price.⁴ Federal excise taxes on fuel totalled \$5.4 billion a year, while provincial taxes amounted to \$8.3 billion. As a result, each Canadian pays an average of \$395 a year in taxes related to fuel consumption.⁵

Production Subsidies and Tax Expenditures

The website of the Global Subsidies Initiative estimates that total fossil-fuel production subsidies around the world are on the order of \$100 billion a year, far less than total consumption subsidies.⁶ According to

a 2010 study carried out by this organization, the federal and provincial governments subsidized the oil industry to the tune of \$2.8 billion in 2009, the federal government's share being \$1.4 billion.⁷ It is this contested study⁸ that is the main source of the claim that the Canadian oil industry is heavily subsidized.

A subsidy, as commonly understood, refers to government financial support paid out to an individual, a business or an organization in order to promote a certain activity. The payment can take the form of a direct expense, entailing actual spending on the part of the government, or a tax expenditure, meaning an amount of tax that would normally be due but is not collected.

In order to sketch an accurate picture of the situation, it is essential to verify which expenditures, be they direct or tax expenditures, constitute actual production subsidies. Indeed, the Global Subsidies Initiative study considers a whole series of programs to be subsidies that, for various reasons, are not (see the annex on the MEI's website for details regarding the programs and amounts mentioned).



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Tax Treatment Adapted to Natural Resources Development

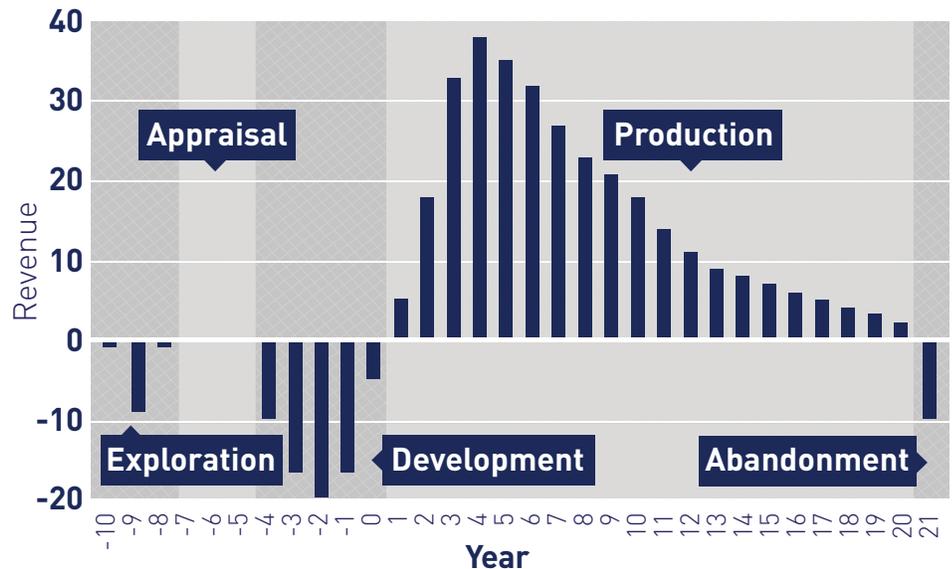
There are two tax expenditure programs that can clearly be considered subsidies. They constitute a transfer of public resources to oil companies and lead to distortions in investment decisions. However, both are in line to be eliminated. Accelerated capital cost allowances for oil sands projects have fallen to approximately \$90 million this year and will be completely eliminated in 2015.⁹ The Atlantic Investment Tax Credit, estimated at \$50 million this year, most of which benefits the oil industry, will no longer be available for assets acquired after 2015.¹⁰

Other tax expenditure programs mentioned in the Global Subsidies Initiative study must however be considered not as subsidies but as a particular tax treatment for an industry faced with a specific economic reality, common to the natural resources sector as a whole:

- The Canadian Development Expenses program, estimated at \$478 million in 2009. These are expenses incurred in the drilling, converting and completing of oil wells or mine shafts in Canada that can be accumulated by an operating company in a Cumulative Canadian Development Expenses pool.¹¹
- The Canadian Exploration Expenses program, estimated at \$233 million in 2009. This program allows oil, gas and mining companies to deduct the entire amount of exploration expenses in the year that they are incurred.¹²
- The flow-through share program, estimated at \$157 million in 2011.¹³ Corporations that have incurred exploration and development expenses can issue what are called flow-through shares in order to transfer to investors the tax deductions related to these expenses, up to the value of the shares.¹⁴

Like the mining industry, the oil industry needs large amounts of start-up capital for its high-risk undertakings. The period between initial investment and commercial production lasts a number of years. The exploration stage does not lead immediately to production revenue, and companies must therefore rely on investors who are ready to support an

Figure 1 — Evolution of oil company revenues over the production cycle



Source: Fidan Aliyeva, Brief Introduction to Oil & Gas Industry.

activity with a high risk of failure, but for which success can mean sizable profits.

The Canadian Development Expenses program allows a company to recuperate most of its initial investments before paying a substantial amount of taxes and royalties at the end of the production cycle (see Figure 1). This tax treatment has only a very limited effect on the total amount of taxes that a corporation must pay.¹⁵

The Canadian Exploration Expenses program and flow-through shares compensate companies and investors that take substantial risks. Despite an initial reduction in government revenue, these tax expenditures have the potential to ensure the economic profitability of certain projects that would never have seen the light of day if the companies involved had had to pay their taxes at the beginning of their production cycles. This means more tax revenue for governments when these projects are finally carried through and wealth is created.

Annual taxation, which is the norm in industries that have the ability to produce profits on an annual basis, would not be well adapted to this kind of industry, and would even constitute a significant handicap for a sector that cannot count on production revenue in the short term. This is why, if we value the neutrality of the tax system, this kind of tax expenditure should not be considered a subsidy.

Direct Expenses

Aside from tax expenditures, there are also some direct government expenditures that cannot be considered oil industry subsidies. This is the case for several programs related to research and development promoting greater energy efficiency and clean energy, as well as infrastructure investments made by the Alberta government in the Fort McMurray region. Oil industry activity in this region certainly explains the need for new infrastructure, but these expenditures cannot be categorized as subsidies to the industry itself.

The direct government expenditures that do appear to be oil industry subsidies consist first of all of amounts granted by the federal government to finance the start of the Hibernia project and of amounts from the government of Newfoundland and Labrador to encourage oil exploration. The annual value of all of these is \$39 million.

According to the Global Subsidies Initiative report, the government of Saskatchewan also devotes \$1.1 million to support research and development activities carried out by the Petroleum Technology Research Centre, while the federal government gives it another \$5.2 million. All of this research deals partly with environmental innovations and partly with oil production. We therefore consider these \$6.3 million to be subsidies.¹⁶

In order to sketch an accurate picture of the situation, it is essential to verify which expenditures, be they direct or tax expenditures, constitute actual production subsidies.

Finally, an analysis by the Commissioner of the Environment and Sustainable Development identified various programs that provide support to the fossil fuel sector financed by federal departments or agencies. Some of these programs, whose purpose is for example to support research and development in the areas of fuel exploration, recovery, and transportation, are subsidies to the industry. Overall, the subsidies identified in this analysis represented some \$26 million a year between 2007-2008 and 2011-2012.¹⁷

All of these subsidies, totalling \$71 million in direct expenses, represent a relatively small amount of money considering

Figure 2 — Government revenue from the Canadian oil and gas exploration, development and production industry



Source: Data from the Canadian Association of Petroleum Producers obtained upon request.

that in recent years, the different governments across Canada have collected \$18 billion a year on average in taxes and royalties from oil and natural gas exploration, development and production activities¹⁸ (see Figure 2). They also constitute a tiny fraction of the subsidies handed out by the federal and provincial governments to various sectors of the economy, which amounted to \$15.8 billion in 2009.¹⁹

Support for Renewable Energy

Among all of these other subsidy programs, several support the production of renewable energy. For example, there is Ontario's Feed-in Tariff Program, which is one of the largest.²⁰ Electricity consumers are stuck with the bill, having to pay, according to one estimate, an extra cost of at least \$18 billion over the next 20 years to finance this program.²¹

Similar programs exist in Nova Scotia and New Brunswick, taking the form of mandatory Renewable Energy Standards that force providers to purchase a minimum percentage of their electricity supplies from renewable energy sources.²² As for Quebec, it grants \$695 million a year in subsidies until 2020 to produce wind power that the province does not need.²³

For its part, the federal government encourages the production and use of biofuels like ethanol and biodiesel as part of its ecoENERGY program, which will have handed out \$1.5 billion in subsidies between 2008 and 2017.²⁴

Conclusion

An analysis of oil industry subsidies leads us to conclude that these amount to approximately \$211 million this year. The gradual elimination of the two largest programs starting in 2011-2012, however, means that only some \$71 million will remain as of 2016, which is a tiny amount relative to the size of the industry. In sum, the Canadian oil industry therefore receives very little in the way of subsidies.

All of these subsidies represent a relatively small amount of money considering that in recent years, governments have collected \$18 billion a year on average in taxes and royalties from oil and natural gas activities.

Contrary to renewable energy production, which could not survive without government help, the industry that develops oil and gas resources is highly profitable and has paid on average \$18 billion a year in taxes and royalties to different governments across Canada for each of the past three years.

A more economically viable approach would be to reduce these subsidy programs as much as possible, or eliminate them altogether, since they only serve to impoverish consumers and taxpayers. On the one hand, the oil industry does not need to be subsidized. And on the other, the transition to renewable energy should be done on the basis of the increasing productivity and competitiveness of these types of energy, not by artificially supporting them with billions of dollars of subsidies, an approach that is being called into question around the world.

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