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Environmental Defence Canada

Comments on Canada's approach on non-tax inefficient fossil fuel subsidies

Submitted to:
Environment and Climate Change Canada

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About Environmental Defence Canada

Environmental Defence Canada (ED) is a leading Canadian advocacy organization that works with government, industry and individuals to defend clean water, a safe climate and healthy communities.

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Thank you for this opportunity to submit written comments on Canada's approach on non-tax inefficient fossil fuel subsidies. The G20 review process is a crucial opportunity for Canada to meet its commitment to eliminate inefficient fossil fuel subsidies by 2025.

At the outset, we would like to note that we are encouraged that Environment and Climate Change Canada (ECCC) has launched public and targeted stakeholder consultations to gather feedback on their approach to phasing out inefficient fossil fuel subsidies. However, we have serious concerns with the definitions and methodology proposed by ECCC in their draft framework, and how these are being used to circumvent meaningful action on phasing out non-tax support to the production and consumption of fossil fuels.

Summary of Recommendations

Environmental Defence recommends that ECCC:

- Adopt a definition of "fossil fuel subsidy" in line with international best practices (WTO, OECD) and drop the specificity and normality requirements.
- Align the definition of "inefficient subsidy" with Canada's Paris Agreement commitments.
- Count the Trans Mountain Pipeline and the Pipeline Expansion purchase and financing provided by Export Development Canada as fossil fuel subsidies.
- Develop an implementation plan with timelines to meet Canada's fossil fuel subsidies commitment that reflects the required urgency.
- Follow the timeline precedents of previous G20 peer reviews (12-18 months) and complete the peer review with Argentina no later than 2020.
- Improve transparency with regards to Canada's approach to eliminating fossil fuel subsidies; including make the self-review report public and full disclosure of all federal fiscal support for fossil fuels.
- Coordinate with Finance Canada to phase out remaining federal tax subsidies as well as with the provinces and territories to tackle subsidies at sub-national levels.
- Commit to no new subsidies for fossil fuels, which includes not spending additional public funds on the expansion of the Trans Mountain pipeline.

Introduction

This year marks the tenth anniversary from when all G20 countries including Canada first committed to phasing out inefficient fossil fuel subsidies. Much has changed in our understanding of climate change from when Canada first made this commitment. For instance, last fall the Intergovernmental Panel on Climate Change (IPCC) released a report calling on countries to halve their emissions by 2030 and highlighting a number of devastating impacts that could be avoided by limiting global warming to 1.5°C compared to 2°C.[1] Earlier this spring the government released Canada's Changing Climate Report, which demonstrated that Canada is warming at twice the global rate, and will face severe impacts if steps to reduce greenhouse gas emissions are not taken swiftly. Last week, the government of Canada took the important step of declaring a climate emergency.

Despite all of this, Canada remains the largest provider of subsidies to oil and gas production in the G7 per unit of GDP.[2] Eliminating fossil fuel subsidies is a critical step to ensure a climate-safe future and transition to a low-carbon economy. Fossil fuel subsidies encourage wasteful consumption and undermine policy and regulatory approaches that seek to address climate change. Canada's fossil fuel subsidies make it that much harder to meet our climate commitments under the Paris Agreement. Fully phasing out fossil fuel subsidies could bring Canada up to 12% closer to meeting its climate change commitments[3].

Fossil fuel subsidies are also deeply unpopular with Canadians. Polling shows that more than two-thirds of Canadians believe that oil and gas companies should not receive subsidies from Canadian governments.[4]

In April of this year, the Commissioner of the Environment and Sustainable Development (CESD) released a report on non-tax subsidies and concluded that the work of ECCC – as well as that of the Finance Canada - to identify inefficient fossil fuel subsidies was incomplete and not rigorous[5].

Environmental Defence agrees with the conclusions of this report. Though appreciative of the opportunity to submit feedback on ECCC's preliminary analysis for Canada's self-review, we are very concerned that ECCC has used unclear definitions for fossil fuel "subsidy" and "inefficient" to come to the conclusion that only four of the government programs that the department reviewed qualify as

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[1] IPCC, 2018: Global warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty [V. Masson-Delmotte, P. Zhai, H. O. Pörtner, D. Roberts, J. Skea, P.R. Shukla, A. Pirani, W. Moufouma-Okia, C. Péan, R. Pidcock, S. Connors, J. B. R. Matthews, Y. Chen, X. Zhou, M. I. Gomis, E. Lonnoy, T. Maycock, M. Tignor, T. Waterfield (eds.)]. In Press. https://www.ipcc.ch/sr15/

[2] Whitley, S. (2018) G7 fossil fuel subsidy scorecard: tracking the phase-out of fiscal support and public finance for oil, gas and coal. Overseas Development Institute. https://www.odi.org/publications/11131-g7-fossil-fuel-subsidy-scorecard

[3] Dobson, S. & Asadollahi, A. (2014) Fossil Fuel Subsidies: An analysis of federal financial support to Canada's oil sector. The Pembina Institute. https://www.pembina.org/reports/fossil-fuel-subsidies.pdf

[4] #StopFundingFossils Coalition (2018) #StopFundingFossils: Canadians want to end public subsidies for oil and gas companies. https://environmentaldefence.ca/report/stopfundingfossils/

[5] Commissioner of the Environment and Sustainable Development (2019) Report 4—Non-Tax Subsidies for Fossil Fuels—Environment and Climate Change Canada. Office of the Auditor General of Canada. http://www.oag-bvg.gc.ca/internet/English/att__e_43318.html

subsidies, and that none of them are considered to be inefficient. A country should not use definitions of subsidies or inefficient as a way to skirt the review and phase-out of particular subsidies.

Response to ECCC's approach to Canada's non-tax measures in the context of phasing out inefficient fossil fuel subsidies

1. ***Is the definition of "fossil fuel subsidy" and its associated criteria clear and practical? If not, what are your suggestions for improving them?***

Recommendations:

- Align Canada's definition with international best practices, by adopting the definition used by either WTO or OECD.
- Drop the requirements for specificity and normality from the definition to ensure all potential subsides are captured.

ED has several concerns with the definition proposed by ECCC which would be circumvented by adopting the internationally recognized definitions. The most widely used definitions and approaches are those of the World Trade Organization (WTO) [6] and the Organisation for Economic Co-operation and Development (OECD). The WTO definition is straightforward and has been used in past G20 peer reviews.

The definition provided by ECCC for fossil fuel subsidies includes requirements for specificity and normality, which are not present in WTO's definition[7]. Including these requirements has led to a restrictive interpretation of subsidies which has excluded a number of measures from review. For example, several measures identified by the International Institute for Sustainable Development (IISD) as non-tax subsidies[8] were reviewed by ECCC but not defined as subsidies. This includes programs run by Natural Resource Canada's Energy Innovation Program, Sustainable Development Technology Canada (SDTC) and Export Development Canada (EDC). While some of these programs may have positive impacts for climate change, they are still fiscal supports for the development of oil and gas. The same is true of environmental protection programs, which ECCC did not include as subsidies. These programs provide services which oil and gas companies could be expected to cover themselves and confer financial benefits to these companies by lowering their costs of doing business. They are therefore subsidies to the oil and gas sector and should be subject to transparency and review as part of the self- and peer-review process. Unduly restricting this first level of analysis will undermine the ability of the peer review process to contribute to efficient and effective policy development across the Canadian economy.

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[6] Gerasimchuk *et al.* (2017) A Guidebook to Reviews of Fossil Fuel Subsidies: From self-reports to peer learning. International Institute for Sustainable Development. https://www.iisd.org/sites/default/files/publications/guidebook-reviews-fossil-fuels-subsidies.pdf

[7] Although the WTO definition does have articles related to specificity (Article 1.2 & Article 22), they are only meant to apply in a legal sense related to trade within the WTO context as part of assessing subsidies that WTO members can challenge under trade rules.

[8] Touchette, Y. & Gass, P. (2018) Public Cash for Oil and Gas: Mapping federal fiscal support for fossil fuels. International Institute for Sustainable Development. https://www.iisd.org/sites/default/files/publications/public-cash-oil-gas-en.pdf

ECCC's description of 'specificity' includes measures that "disproportionately" benefit fossil production or consumption. As pointed out by the CESD, despite a lack of clarity around the term "disproportionate", ECCC excluded some programs from their list of non-tax subsidies because their benefit to the fossil fuel sector was not "disproportionate." The "normality" definition is unclear and unnecessarily restrictive, nor does it add value to the analysis.

Relying on such a narrow definition of subsidy runs counter to ECCC's stated objective of taking the broadest approach to the G20 commitment (i.e., considering any measures that could support the production or consumption of fossil fuels) in order to ensure a comprehensive analysis of all measures that could be considered a fossil fuel subsidy. This approach – which ED agrees with – falls in line with the approach taken by the OECD, which deliberately uses the term "support" rather than "subsidy" in order to avoid debates over what should or shouldn't be included.

It is worth noting that the definition used by the International Monetary Fund is much broader and includes "post-tax subsidies" (externalities) with the logic that the financial burden which falls on society due to the effects of air pollution or climate changed caused by fossil fuels should be included. [9] Given recent analysis of the billions of dollars that will be required to clean-up abandoned oil wells in Alberta alone, this type of analysis deserves real consideration by ECCC.

2. Is the criteria proposed to assess "inefficiency" clear and practical? If not, what are your suggestions for improving them?

Recommendations:

- Align the definition of "inefficient subsidy" with Canada's Paris Agreement commitments.
- Adapt the approach so that all fossil fuel subsidies are inefficient – and the burden is placed on proving that there are no feasible alternatives to reaching a policy objective before a subsidy can be considered efficient.

It is concerning that ECCC has proposed for adoption a definition of inefficient that is too vague to be functional, and has nonetheless used that definition to classify all existing non-tax subsidies as efficient.

ED is discouraged by a lack of explicit reference to Canada's international commitments under the Paris Agreement in the criteria proposed to assess "inefficiency". We believe that alignment with our climate commitments—to reduce greenhouse gas emissions by 45 per cent below 2010 levels by 2030— should in fact be the most important criteria for whether a subsidy is deemed to be efficient or not, so that any measures that are not aligned with these commitments are considered inefficient.

In fact, the starting premise should be that all subsidies to the oil and gas sector are considered inefficient. All subsidies impede the transition to low carbon and therefore slow down progress on

[9] Coady. D., Parry, I., Le, N-P & Shang, B. (2019) Global Fossil Fuel Subsidies Remain Large: An Update Based on Country-Level Estimates. International Monetary Fund. https://www.imf.org/en/Publications/WP/Issues/2019/05/02/Global-Fossil-Fuel-Subsidies-Remain-Large-An-Update-Based-on-Country-Level-Estimates-46509

reaching our Paris Agreement targets. The bar for allowing a fossil fuel subsidy to be considered efficient should be high and this should only be the case if there are absolutely no alternative policy options to achieve the policy objective. For example, subsidies that exist to incentivize producers to reduce greenhouse gas emissions should be compared against regulations that require the cost of emissions reductions to be borne by producers.

As proposed by ECCC, as long as there is some environmental, social or economic benefit to subsidy, then it is considered efficient. We agree with the conclusion of the CESD that the department failed to consider the economic, social and environmental sustainability of subsidizing the fossil fuel sector over the long term in their analysis. Any meaningful analysis of sustainability would find subsidies to be inefficient given the enormous economic and social costs of climate change.

Export Development Canada and the Trans Mountain Pipeline

Recommendation:

- Count the Trans Mountain Pipeline and the Pipeline Expansion purchase and financing provided by Export Development Canada as fossil fuel subsidies

The weakness in the proposed approach to assessing non-tax subsidies is particularly evident in the fact that the financing given by Export Development Canada (EDC) to the oil and gas sector was not captured by the framework. The purchase of the Trans Mountain pipeline and expansion project occurred after the period covered in ECCC's review, which is unfourtunate and was flagged in the CESD audit as well. It is unclear that the proposed framework would recognize many of the ways the purchase is currently a subsidy or could eventually constitute a subsidy.

These are two of the largest components of non-tax federal support to the fossil fuel sector and having them transparently and fully accounted for should be a minimum test for a draft framework.

EDC continues to provide on average over $10 billion in government-backed support for oil and gas companies every year. Up to 30 percent of EDC's support for oil and gas is aimed at financing the domestic operations of Canadian companies, rather than fulfilling EDC's original mandate of export-focused international finance. Between 2012 and 2017, EDC provided twelve times more support for oil and gas than it did for clean technologies.[10] Underwritten by Canadian taxpayers, EDC's subsidies are make-or-break support for many fossil fuel businesses and large oil and gas projects. It is irresponsible of ECCC to not include EDC financing as fossil fuel subsidies and out of line with international best practices. Last year, the United Kingdom's Environmental Audit Committee launched an inquiry into the country's UK Export Finance (UKEF) following claims that the body's financing of fossil fuels was at odds with the aims set out in the UK's Clean Growth Strategy. The Environmental Audit Committee investigated the scale and impact of UKEF's financing of fossil fuels and recommended that UKEF publish an inventory of its support the industry using the OECD method. EDC's ongoing public backing for the

[10] Doukas, A. & Scott, A. (2018) Risking it All: How Export Development Canada's support for fossil fuels drives climate change. Oil Change International. https://environmentaldefence.ca/report/exportfossilfuelsubsidies/

expansion of fossil fuels is entirely incompatible with Canada's commitments under the Paris Agreement and thus should be catalogued as an inefficient subsidy and phased out urgently.

There continues to be a lack of transparency around the financial aspects of the purchase of the Trans Mountain pipeline and expansion project. A complete project cost, which should include acquisition costs and updated construction and development expenses, has not yet been made public. In addition to the $4.5 billion spent to purchase the pipeline and related assets, the expansion of the twinned pipeline is estimated to cost well over $9 billion.[11] ED is concerned that there will be a significant subsidized element of the sale, such as the government's commitment to indemnifying TMX or the possibility that the newly-acquired assets could be sold to a private buyer for an amount that is substantially below what the Government of Canada paid. For example, economists have also identified that the toll agreement constitutes a subsidy as it does not cover the full cost of the line.[12] Any subsidies associated with the pipeline must be considered as inefficient and the government should commit to not spending additional funds on the expansion of the pipeline.

3. Are there any other considerations that should be included in our approach?

ED has a number of other concerns with regards to Canada's approach to assessing and eliminating fossil fuel subsidies:

a) Timelines
b) Transparency
c) Coordination with Finance Canada as well as with the provinces and territories
d) Proactive approach to ensure that no new subsidies to oil and gas are adopted

a) Timelines: Expedited timelines for peer review and implementation plan

Recommendations:

- Follow the timeline precedents of previous G20 peer reviews (12-18 months) and complete the peer review with Argentina no later than 2020.
- Develop an implementation plan with timelines to meet Canada's fossil fuel subsidies commitment that reflects the required urgency.

As previously mentioned, Canada first committed to phasing out inefficient fossil fuel subsidies in 2009. Since then, Canada has made only modest progress on reforming a number of tax measures and has not yet developed an implementation plan with established timelines to phase out remaining supports for

[11] Laxer, G. (2019) Billion Dollar Buyout: How Canadian taxpayers bought a climate-killing pipeline and Trump's trade deal supports it. Council of Canadians. https://canadians.org/sites/default/files/publications/report-billion-dollar-buyout.pdf
[12] Laxer, G. (2019) Billion Dollar Buyout: How Canadian taxpayers bought a climate-killing pipeline and Trump's trade deal supports it. Council of Canadians. https://canadians.org/sites/default/files/publications/report-billion-dollar-buyout.pdf

oil and gas. The strongest self-reviews are the ones where countries have already identified pathways to phase out.[13]

One year after the G20 peer review with Argentina was first announced (and six years after G20 leaders agreed to set up a voluntary peer-review mechanism), Canada has yet to announce a timeline for completion of its peer review. According to recent conversations with government officials, the peer review process with Argentina is scheduled to take 2-3 years and therefore may not be complete before 2021. To date, most other peer review processes have taken between 12 and 18 months.

The lack of urgency with which Canada is approaching its commitment to eliminate fossil fuel subsidies is very concerning, and not in line with the actions the government took just last week in declaring a climate emergency. We cannot afford to wait additional years for the results of this review process to be completed before phasing out the billions of dollars still being handed out to the fossil fuel sector. It has been 10 years since Canada first pledge to end fossil fuel subsidies. In another 10 years, the window to avoid the worst of the climate crisis will have closed.

Canada should consider that EU Member States have set a 2020 deadline for ending fossil fuel subsidies, with phase-out plans to be developed under their National Energy and Climate Plans.

b) Transparency

Recommendation:

- Improve transparency with regards to Canada's approach to eliminating fossil fuel subsidies; including make the self-review report public and full disclosure of all federal fiscal support for fossil fuels.

Estimating and openly reporting the extent of government support for the fossil fuel sector is an essential step towards reform of fossil-fuel subsidies[14]. However, the federal government continues to give billions of dollars in subsidies to oil, gas and coal companies, without disclosing to the public the value of the tax provisions available to the industry. In fact, Canada has been criticized by the environmental community for a lack of transparency on its fossil fuel subsidies.[15] Similarly, in a May 2017 audit, Canada's Auditor General reported that he was unable to obtain key documents and budget analyses from Finance Canada to determine what progress has been made toward this commitment.

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[13] Gerasimchuk *et al.* (2017) A Guidebook to Reviews of Fossil Fuel Subsidies: From self-reports to peer learning. International Institute for Sustainable Development. https://www.iisd.org/sites/default/files/publications/guidebook-reviews-fossil-fuels-subsidies.pdf

[14] OECD/IEA (2019), "Update on recent progress in reform of inefficient fossil-fuel subsidies that encourage wasteful consumption", https://oecd.org/fossil-fuels/publication/OECD-IEA-G20-Fossil-Fuel-Subsidies-Reform-Update-2019

[15] Whitley, S. (2018) G7 fossil fuel subsidy scorecard: tracking the phase-out of fiscal support and public finance for oil, gas and coal. Overseas Development Institute. https://www.odi.org/publications/11131-g7-fossil-fuel-subsidy-scorecard

Nearly all Canadians (96 per cent) agree that the federal government should disclose how much oil and gas companies receive in subsidies. [16]

In terms of the framework and preliminary analysis, ECCC should have made available a complete analysis of the measures considered and a detailed rationale for each measure, including an analysis of alternative measures to meet the policy objective.

In order to win public trust that meaningful action on this file is being taken, Canada should commit to full transparency. This includes ensuring all data related to government supports the fossil fuel sector be made publicly available. It is not clear based on the information provided why only four measures were determined to be fossil fuel subsidies, and why none were determined to be inefficient. The review should also include new policy developments that have occurred since April 2018 to provide as timely a review as possible.

A commitment to transparency also includes making both the process, analysis and results of the peer review publicly available in full in a timely manner, as well as ensuring that the self-review is made public as well – prior to completion of the peer review. The publicly available data should include a complete inventory of federal fossil fuel subsidies, estimated annual costs and plans to eliminate or reform these subsidies.

c) Coordination with Finance Canada as well as with the provinces and territories

Recommendation:

- Coordinate with Finance Canada to phase out remaining federal tax subsidies as well as with the provinces and territories to tackle subsidies at sub-national levels.

While we recognize that this process was launched by ECCC to examine non-tax measures, there is a lack of information in the assessment framework that describes how ECCC will work in tandem with Finance Canada for the purposes of this review. Unfourtunately, despite recommendations to do so, Finance Canada has not collaborated with ECCC in this process or launched a public consultation process of its own. Finance Canada's analysis should also be subject to public consultation and expert review. We recommend greater coordination between departments in order to ensure consistency in approach and that all remaining federal non-tax and tax supports to oil and gas are eliminated. Tax subsidies, including flow-through shares for development expenses, Foreign Resource Expense Claims, and other tax provisions, make up one of the largest portions of Canada's fossil fuel subsidies.

Federal subsidies are only one part of Canada's subsidies to the fossil fuel sector. In fact, more than half of Canada's subsidies to fossil fuels occur at the provincial level[17]. Thus, as a country, Canada cannot

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[16] #StopFundingFossils Coalition (2018) #StopFundingFossils: Canadians want to end public subsidies for oil and gas companies. https://environmentaldefence.ca/report/stopfundingfossils/

[17] Touchette, Y. (2015) *G20 subsidies to oil, gas and coal production: Canada.* ODI, IISD, and OCI https://www.iisd.org/library/g20-subsidies-oil-gas-and-coal-production-canada.

phase out financial support for the fossil fuel sector without expanding the discussion to include the elimination of subsidy programs in existence at the provincial and territorial levels. The WTO definition of subsidies also includes sub-national measures in its scope. We encourage a collaborative approach with the provinces and territories in order to ensure that subsidies at the sub-national level are also reviewed and phased out.

d) Proactive approach to ensure that no new subsidies to oil and gas are adopted

Recommendation

- Develop a proactive strategy in order to ensure no new subsidies: Commit to no new subsidies for fossil fuels, which includes not spending additional public funds on the expansion of the Trans Mountain pipeline.

We were very disappointed to see a new non-tax measure announced during the consultation period. Through the Strategic Innovation Fund, the government has committed to spending $220 million on gas turbines for LNG Canada. This is in addition to a number of other non-tax financial supports given the oil and gas sector since the end of the period considered for the draft inventory in April 2018:

- $1 billion in tariff exemptions for the LNG Canada project;
- Accelerated Investment Incentive in the Fall Economic Statement that allows oil and gas companies to immediately write off the full costs of new machinery and equipment;
- The announcement of $1.65 billion in new supports for the oil and gas sector on December 18th, 2018,
- The extension of Arctic Exploration Licenses through Bill C-88 that allows operators to not lose their deposits on licenses for exploration in the Beaufort Sea.
- The purchase of the TMX pipeline, discussed above.

It is insufficient for the government's approach to rely solely on analyzing measures that are already implemented. The government must also adopt a proactive approach to ensure that no new inefficient subsidies to oil and gas are committed to. The recommendations for definitions and process included above need to be applied proactively to new measures across organizations under the Government of Canada as well.

This includes ensuring that mechanisms with the stated aim of assisting the energy transition do not support fossil fuel production and consumption (such as clean innovation funding and energy efficiency measures for oil and gas companies).

Conclusion

ED looks forward to continuing to work with the government to ensure the timely elimination of fossil fuel subsidies in Canada. If you have any questions about the contents of this submission, do not hesitate to get in touch with me using the contact information below.

Sincerely,

Julia Levin

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