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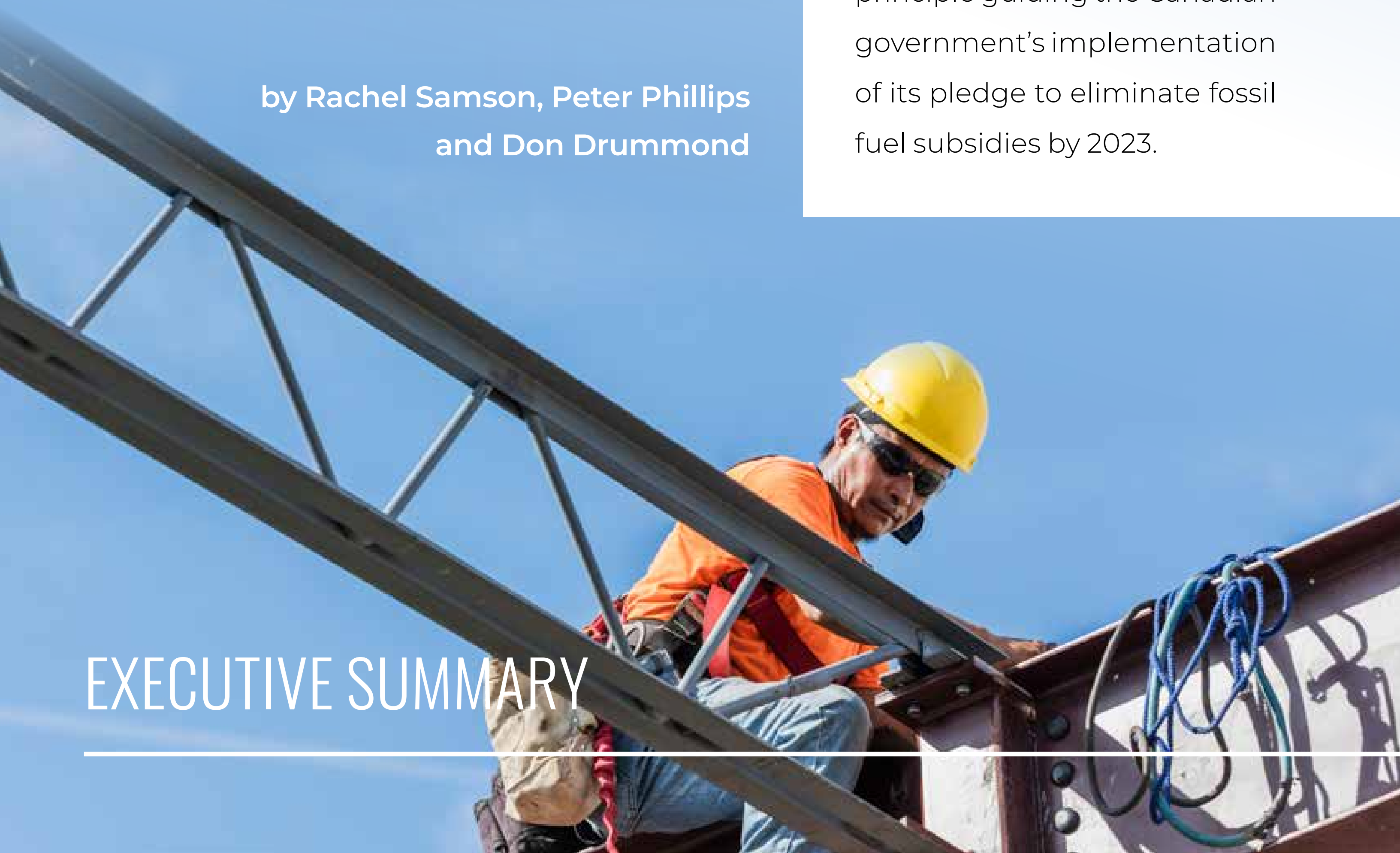
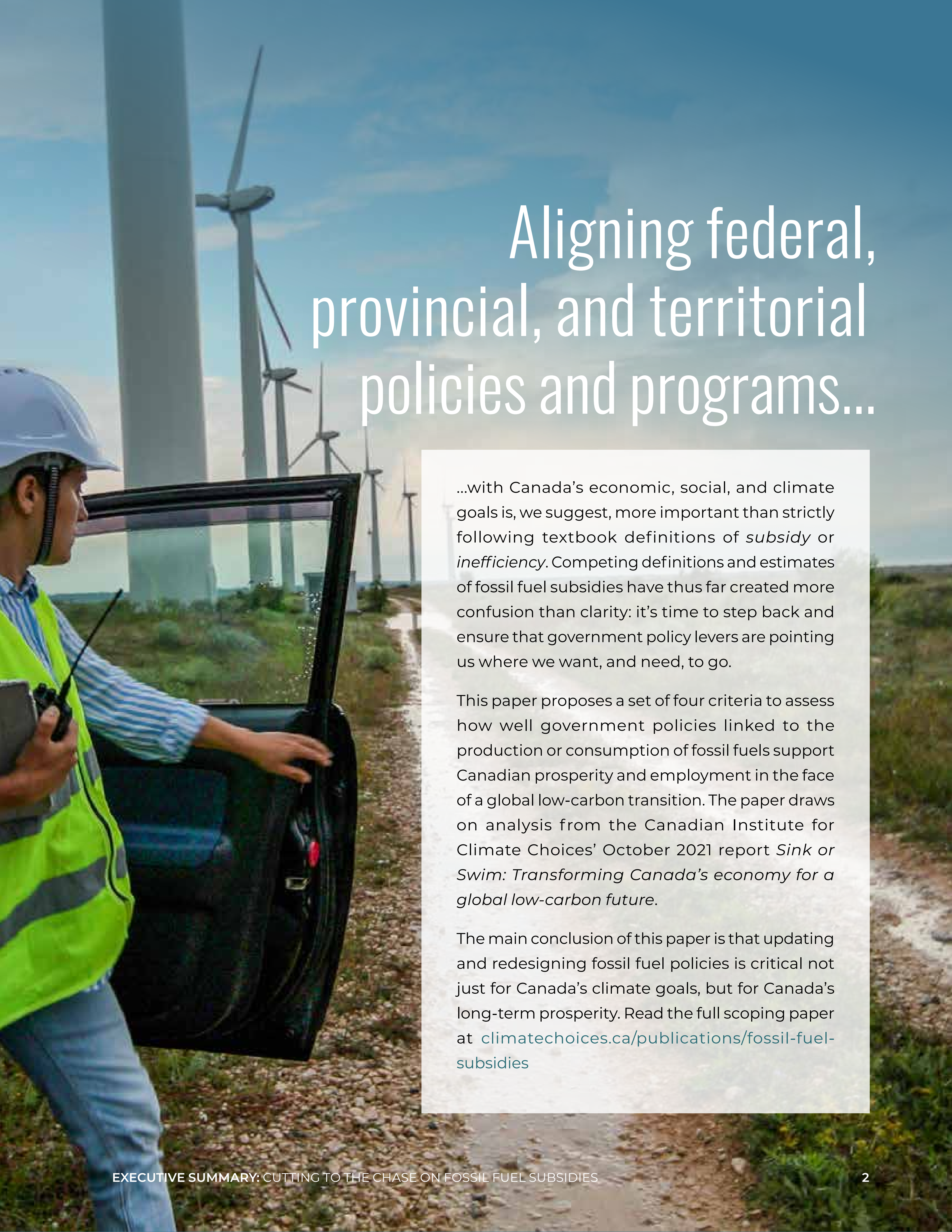
CUTTING TO THE CHASE ON FOSSIL FUEL SUBSIDIES

by Rachel Samson, Peter Phillips and Don Drummond

Government spending, lending, taxes, and royalties should support—and not hinder—Canada's success in the face of the global low-carbon transition that is sweeping across economies and industries. This commitment to ensuring Canada's future prosperity in a rapidly changing world should be the underlying principle guiding the Canadian government's implementation of its pledge to eliminate fossil fuel subsidies by 2023.



EXECUTIVE SUMMARY



Aligning federal, provincial, and territorial policies and programs...

...with Canada's economic, social, and climate goals is, we suggest, more important than strictly following textbook definitions of *subsidy* or *inefficiency*. Competing definitions and estimates of fossil fuel subsidies have thus far created more confusion than clarity: it's time to step back and ensure that government policy levers are pointing us where we want, and need, to go.

This paper proposes a set of four criteria to assess how well government policies linked to the production or consumption of fossil fuels support Canadian prosperity and employment in the face of a global low-carbon transition. The paper draws on analysis from the Canadian Institute for Climate Choices' October 2021 report *Sink or Swim: Transforming Canada's economy for a global low-carbon future*.

The main conclusion of this paper is that updating and redesigning fossil fuel policies is critical not just for Canada's climate goals, but for Canada's long-term prosperity. Read the full scoping paper at climatechoices.ca/publications/fossil-fuel-subsidies

Findings

Combining climate, economic, and job creation objectives in assessment criteria allows for a more practical assessment of policies. Moving away from strict definitions of *subsidy* and *inefficiency* allows for measures to be assessed according to their transition consistency, value for money, employment outcomes, and policy fit.

Provinces and territories have largely been left out of commitments to phase out fossil fuel subsidies, despite playing a significant role. Many provincial and territorial measures are working at cross purposes to the policy and market signals required to drive transformation.

Global low-carbon transition is a structural shift, not a temporary shock, and policies should be adjusted accordingly. While governments are often tempted to insulate businesses, workers, and communities from market change, impacted sectors and regions will ultimately be better off with strategies that help them prepare for, and thrive in, the emerging low-carbon economy.

The fossil fuel sector is no longer the secure source of economic growth and job creation it once was. Coal, oil, and gas demand will inevitably decline globally, though there is uncertainty on the exact timing and slope of decline over the next decade. Public investment in long-lived fossil fuel assets now carries significant risk and less certain benefits for society.

Governments will need to make some tough choices in allocating scarce funds to support large, transformative capital investments, and decarbonizing fossil fuel production may not produce the best long-term economic outcome. Public investment in assets at elevated risk of being stranded in global low-carbon scenarios could generate less economic and job benefit than investment in areas that could capture a share of growing, transition-opportunity markets.

Assessessment of selected policies

The paper uses **four criteria** to assess if a government measure is or is not supporting Canada's transition success:

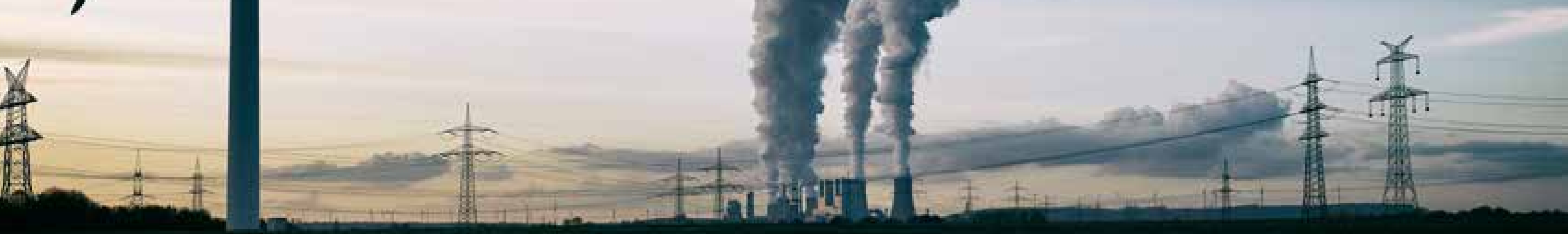
TRANSITION-CONSISTENCY: Does the measure support economic activity that will remain competitive across multiple global low-carbon scenarios? Does the measure enhance or dilute market and policy signals driving transformation?

VALUE FOR MONEY: Do the measure's economic benefits exceed the costs associated with raising or forgoing revenue? Does the measure help to mobilize multiple sources of private investment, generating increasing economic activity over time? Does it avoid supporting activities and assets that are at risk of becoming stranded from declining demand?

EMPLOYMENT OUTCOMES: Does the measure decrease worker or community vulnerability to transition-related market disruption? Does the measure help to smooth the transition by improving the transition-readiness of companies or attracting new investment to vulnerable communities?

POLICY FIT: Is there an alternative policy tool or design that would achieve the same policy objective in ways that align more closely with the other three criteria?

The paper applies the criteria to a selection of federal, provincial, and territorial policies that could be considered fossil fuel subsidies. The table below summarizes the assessment.



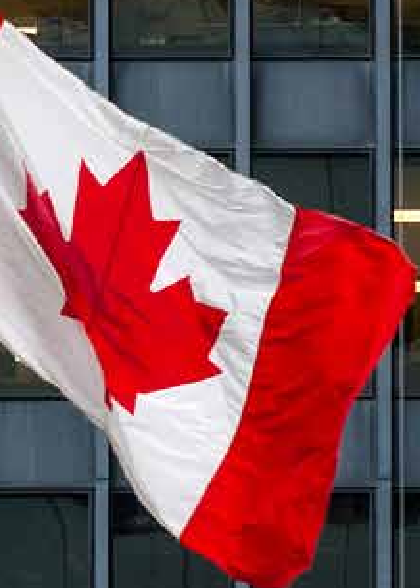
Assessing government measures for transition success:

MEETS CRITERIA
COULD MEET CRITERIA with changes or implementation
MEETS CRITERIA IN SHORT TERM but not long term
DOES NOT MEET CRITERIA
INSUFFICIENT INFORMATION to assess

	Transition-consistent?	Good value for money?	Improved employment outcomes?	The best policy fit?
Alberta royalty reductions for enhanced oil recovery	Could meet criteria	Could meet criteria	Insufficient information	Meets criteria
British Columbia tax credits and funding to encourage new oil, gas, and coal development	Does not meet criteria	Meets criteria in short term	Meets criteria in short term	Does not meet criteria
Provincial residential energy use rebates	Does not meet criteria	Meets criteria in short term	Insufficient information	Does not meet criteria
Provincial tax-exempt fuels for farmers, loggers, fishers, and other businesses	Does not meet criteria	Does not meet criteria	Insufficient information	Does not meet criteria
Export Development Canada financing and insurance for oil and gas exporters	Could meet criteria	Could meet criteria	Could meet criteria	Could meet criteria
Federal funding to clean up orphan wells	Meets criteria in short term	Meets criteria in short term	Meets criteria	Meets criteria in short term
Federal support for Newfoundland and Labrador offshore oil industry	Could meet criteria	Could meet criteria	Meets criteria	Meets criteria in short term
Federal TMX pipeline purchase	Meets criteria in short term	Meets criteria in short term	Could meet criteria	Meets criteria in short term
B.C. and federal support for LNG Canada	Could meet criteria	Meets criteria in short term	Meets criteria in short term	Does not meet criteria
Alberta support for Sturgeon refinery	Meets criteria in short term	Does not meet criteria	Meets criteria in short term	Meets criteria in short term
Federal Emission Reduction Fund	Could meet criteria	Does not meet criteria	Insufficient information	Does not meet criteria
Federal carbon capture utilization and storage investment tax credit	Could meet criteria	Could meet criteria	Could meet criteria	Does not meet criteria
Underpricing externalities associated with fossil fuels (e.g., federal and provincial fuel tax reductions and carbon levy exemptions)	Meets criteria in short term	Does not meet criteria	Does not meet criteria	Does not meet criteria

RECOMMENDATIONS

Based on the assessment, the paper makes four overarching recommendations:



1. **Canadian governments should pivot their economic development strategies to support success in the face of changing market conditions.** Oil and gas companies can participate in this pivot by decarbonizing assets that have a strong chance of remaining competitive and moving into new, transition-consistent business lines.

2. **Provinces and territories should make their own commitments on fossil fuel subsidy reform to support long-term prosperity.** In most cases, the original economic and social policy goals can be achieved through different or revised policy tools that better support long-term prosperity and job creation.

3. **Governments should develop a clear decision-making framework for public investment in emission-reducing projects and technologies.** Maximizing scarce public dollars means making investments complementary to carbon pricing and regulatory policies rather than financing company compliance with those measures. It means considering future global and domestic market conditions and the risk of stranded assets. And it means focusing on mobilizing private investment and shared risk rather than fully shifting risk from private companies to public entities.

4. **Governments should first ensure new measures support transition success before addressing established policies.** The first priority for governments should be getting new and recently launched measures right (e.g., the federal carbon capture, utilization, and storage investment tax credit). The second priority should be tackling measures that are most significantly hindering transition success (e.g., British Columbia's support for oil, gas, and coal development). Then governments can move towards some of the more difficult measures, such as phasing out fuel and carbon tax exemptions for agriculture.