Policy Briefing Paper

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Federal Subsidies to Fossil Fuel Producers

John Dillon and Ian Thomson

An overwhelming majority of Canadians now insist on prompt action to reduce greenhouse gas (GHG) emissions. Yet during a recent seven-year period, 1996–2002, the federal government spent $8.3 billion on subsidies to the oil and gas industries. For the most part these subsidies continue today at around $1 billion a year. Canada also subsidizes the expansion of fossil fuel industries in the global South, both directly and through multilateral financial institutions like the World Bank.

KAIROS submitted a petition to the Commissioner of the Environment and Sustainable Development in the Auditor General's office to obtain more up to date information on the actual amount of current subsidies. The petition asked six government Ministers for an explanation of the contradiction between subsidies that encourage fossil fuel production and spending on measures aimed at reducing GHG emissions. While the government provided answers to some questions, it gives no indication that it plans a major shift in spending away from tax breaks for big oil towards spending on green, renewable energy sources.

Domestic subsidies

In his response the Minister of Finance confirmed that the Accelerated Capital Cost Allowance for tar sands operators (allowing them to defer taxes on 100% of the capital costs of new projects until they are paid off) will be worth on average $300 million a year over the period 2007 to 2011. Although a phase out of the ACCA was announced in the March 2007 budget, this subsidy will not end until 2015. This will only encourage companies to speed up the pace of tar sands development before this subsidy disappears.

Production of synthetic crude from tar sands releases three times as much CO_2 as conventional petroleum production. If tar sands operations continue to expand, it will be impossible to reach our Kyoto commitments. Tar sands operators withdraw between 2 and 4.5 barrels of water for each barrel of synthetic crude oil they extract. Most of this water ends up in huge toxic tailings ponds, so large that they are visible from space.

Devoting enormous amounts of Canada's dwindling supplies of natural gas to tar sands extraction constitutes yet another subsidy.

Already tar sands operations consume as much natural gas every day as is used by half the homes across Canada with gas furnaces.

During 2006 and 2007, the federal government announced $8.6 billion in new spending on 20 energy efficiency and GHG reduction initiatives over the next two to nine years.

Our analysis of these spending programs is described in KAIROS' study *Pumped Up: How Canada subsidizes fossil fuels at the expense of green alternatives*. That report shows how - even if we accept Environment Canada's optimistic estimates of the effects of this spending - these initiatives will reduce just 34.4 megatonnes (Mt) of GHG in 2012.

Other measures involving reductions in the intensity of GHG emissions by large industrial emitters, passenger vehicle emission standards and energy product standards are expected to reduce emissions by over twice as much—70.4 Mt in 2012. These results indicate that direct regulation is more effective than subsidy programs for reducing GHG emissions.

Yet the regulatory initiatives announced to date are far from sufficient. Even if Environment Canada's estimates proved accurate, all these subsidy and regulatory programs together would only reduce total GHG emissions by 105 Mt in 2012. As a result, total Canadian emissions would remain 31% above Canada's Kyoto targets.

Independent analysts, including members of the National Roundtable on the Environment and the Economy, say the government's predictions overestimate the likely effect of their programs.

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International subsidies

Export Development Canada (EDC), a Crown corporation that promotes Canadian trade and investment internationally, provides significant financial support (e.g. project financing, loan guarantees, risk insurance) to Canadian companies, including fossil fuel producers, subcontractors and equipment suppliers.

In 2007, EDC supported transactions in the oil and gas sector valued at $13.2 billion, the largest of any industry. By contrast, EDC business transactions for alternative fuels were only $12 *million* and for renewable energy just $7 *million*. Hence, for every dollar of exports EDC facilitated in the alternative fuels and renewable energy sectors, it facilitated $696 of business in oil and gas. Likewise, EDC's EnviroExport initiative to promote environmental technologies is marginal compared to its oil and gas related business.

To date, EDC has not measured the total GHG emissions associated with the business activities that it supports (e.g. carbon footprint), or conducted a comprehensive assessment of portfolio risks and impacts related to climate change.

The Canadian International Development Agency (CIDA) supports energy-related projects of three major kinds: natural resource governance; fossil fuel extraction; and climate change adaptation and mitigation.

CIDA supports initiatives to assist developing countries in rewriting their natural resource regulatory regimes, with over $130 million reported in energy-related spending since 2000. While CIDA asserts that such policy changes can help countries to direct resource wealth towards poverty reduction efforts, some critics

claim that reforms in some cases have led to energy sector deregulation and privatization.

Although the agency downplays its direct support to the industry, CIDA has financed oil exploration in Northern Africa and the privatization of the energy sector in Senegal through the $212-million Canada Investment Fund for Africa (CIFA), a partnership with private investors. In the Americas, CIDA has invested in a heavy oil project in Venezuela involving Phillips Petroleum and Chevron/Texaco.

Regarding climate change adaptation, a $110 million Canada Climate Change Development Fund (CCCDF) was launched by CIDA in 2000 "to promote activities addressing the causes and effects of climate change in developing countries, while helping to reduce poverty and promote sustainable development." By 2006, the CCCDF had funded over 100 projects in more than 50 countries and contributed $10 million to the Least Developed Countries Fund (LDCF) managed by the United Nations and the Global Environment Facility. The LDCF helps low-income countries prepare and implement national programs for adaptation to climate change.

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The World Bank is the most important international financial institution involved in financing energy projects in the global South. Regional development banks in Asia, Africa and Latin America are also involved. About 40% of Canada's official development assistance is channelled through multilateral financial institutions.

Between 1992 and late 2004, the World Bank approved US$28 billion in financing for fossil fuel-related projects. These projects will ultimately lead to more than 43 billion tonnes of CO_2 emissions, many times more than all the CO_2 emission reductions required by the Kyoto Protocol for the years 1990 – 2012. This lending was 17 times more than financing for energy efficiency and renewable energy projects over the same period.

In 2000, in response to critics who showed how lending for oil, gas and mining industries contributes to poverty and environmental destruction, the World Bank appointed a panel to conduct an Extractive Industries Review (EIR). In 2003, the EIR report recommended the Bank "phase out investments in oil production by 2008 and devote its scarce resources to investments in renewable energy resource development, emissions-reducing projects, clean energy technology, energy efficiency and conservation, and other efforts that de-link energy use from greenhouse gas emissions. During this phase-out period, World Bank Group investments in oil should be exceptional, limited only to poor countries with few alternatives." Unfortunately World Bank management rejected this recom-mendation and instead has ramped up its investments in fossil fuel production.

In 2006, World Bank spending on the energy sector reached US$4.4 billion. Spending on oil and gas increased by 93% over the previous year, while spending on renewable sources of energy such as wind, solar, and small-scale hydro grew by only 1.4% and accounted for just 5% of the total.

The oil and gas industry is the most profitable of all Canadian industries and does not need further government subsidies with oil prices above US$100 a barrel.

Recommendations

KAIROS calls on the Canadian government to:

1) Redirect subsidies from fossil fuels to energy efficiency, conservation and renewable alternatives.

The 2008 federal budget only made small changes to these subsidies – extending the Accelerated Capital Cost Allowance for clean energy to investors in systems that generate heat from geothermal sources and from animal and sewage waste.

In general, programs that promote public transportation, improved vehicle technology, more efficient freight transport, and the retrofitting of buildings are among the most effective options.

Redirecting subsidies alone will not be sufficient to achieve the GHG emission reduction targets set by the Harper government, let alone Canada's commitments under the Kyoto protocol. We also need more direct regulatory measures combined with economic incentives to reduce fossil fuel consumption.

2) Cap GHG Emissions and Put a Tax on Carbon

The Environment Minister's update to his *Turning the Corner* plan for GHG emission reductions promises 'tough' new rules for tar sands operations and eventually requirements for unproven Carbon Capture and Storage potentially costing billions more in government subsidies. The slow phase-in of these new rules could also have the perverse effect of encouraging oil-sands developers to accelerate their plans to get in under the wire.

Unlike British Columbia, the federal government refuses to implement a carbon tax that would promote energy efficiency, conservation and markets for low-carbon alternatives. When a carbon tax is introduced measures must also be taken to protect low-income Canadians and those living in remote communities without alternatives to fossil fuels so they are not penalized financially.

3) Promote exports and foreign direct investment in renewable energy, not fossil fuel production

The government must refocus the energy priorities of EDC by redirecting support from fossil fuel production into greener alternatives. EDC should also develop policies on GHG emissions reporting and reductions, improved public disclosure, and respect for human rights by its client companies.

The Canada Investment Fund for Africa (CIFA) should redirect investments from fossil fuel extraction into energy efficiency and renewables in Africa.

4) Promote changes to policies of the International Financial Institutions

Two key changes are needed:

- Ending public subsidies for fossil fuels, and redirecting such financing to renewable technologies and energy efficiency projects;
- Stepping up efforts to meet the basic energy needs of the poor, which includes not imposing any policy conditions that would prevent subsidizing electricity connections and tariffs for the poor.

For more information, see the KAIROS study, Pumped Up: How Canada subsidizes fossil fuels at the expense of green alternatives, April 2008. *www.kairoscanada.org/e/ecology/PumpedUpInsides080415.pdf*

John Dillon is the Debt and Finance Program Coordinator for KAIROS. He may be reached by email at jdillon@kairoscanada.org Ian Thomson is the Corporate Social Responsibility Program Coordinator for KAIROS. He may be reached by e-mail at ithomson@kairoscanada.org KAIROS: Canadian Ecumenical Justice Initiatives unites eleven churches and religious institutions in work for social justice in Canada and around the globe.