Phasing out fossil fuel subsidies: how the debate has to change

GREENPEACE

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Ahead of the G20 Summit in South Korea, a Greenpeace-commissioned study looks at tax and royalty-related subsidies to oil extraction from high-cost fields – and suggests a radical reframing of the discussion.

On November 11-12 2010, the Group of 20 (G20) countries are meeting in Seoul, South Korea. Last year, at the Pittsburgh G20 summit, these countries committed to "rationalize and phase out over the medium term inefficient fossil fuel subsidies that lead to wasteful consumption."

Since then, the worst oil spill in history took place in the Gulf of Mexico. At the same time, oil companies have continued to push the boundaries of their oil exploration by drilling in deeper waters, by moving into remote locations such as the Arctic, and by investing in the tar sands. So-called unconventional oil seems to be on the rise.

In order to better understand the extent of government subsidies being given to unconventional oil exploration of this kind, Greenpeace International has commissioned a review by the Global Subsidies Initiative of the International Institute for Sustainable Development.

The study – entitled *Tax and Royalty-related Subsidies to Oil Extraction from High-cost Fields* – has examined some of these subsidies in five key countries: Canada, Brazil, Mexico, the United Kingdom and the United States.

Too little information, too little analysis – and a debate that remains far too narrow to address the issue properly

The study finds that governments are still providing far too little information for a proper public debate on high-cost oil subsidies to take place.

It points out that policies to meet energy-specific goals, as well as goals such as job creation and industrial development, should maximize benefits across complex energy, economic and environmental systems, not just specific oil projects, as is often the case.

Subsidising oil extraction has a range of secondary effects, the study says, including making investments in oil more attractive compared to lower carbon, lower risk alternatives, thereby increasing the lock-in of economies into fossil fuels.

The review recommends that the discussion of the issue needs to shift away from what is, at this point, a mere discussion on revenue maximisation from specific oil projects.

Instead, the study suggests, there should be a robust debate on whether oil extraction should be subsidised relative to other energy solutions and to other parts of the economy where the money would generate better overarching results – based on a thorough evaluation of existing subsidies that compares them to potential alternatives.

Other findings include:

▪ The study identifies multiple subsidies for oil extraction from high-cost fields in each of the five countries considered – Brazil, Canada, Mexico, United Kingdom and United States. At least one subsidy per country was quantified, with values shown in the table below:

	Brazil	Canada	Mexico	UK	US
Share of subsid which were qua	**One subsidy as reduced royalty certain fields**	**Most significant s quantified in Albe Saskatchewan ar Newfoundland ar**	**One subsidy asses field (Chicontepec,**	**One subsidy as new field allow small fields)**	**Partial analysis of fe subsidies and state Texas)**
Quantified subs million)	**400-800**	**1,361**	**122-183**	**0-450**	**At least 4,000**
Accuracy and re the estimates	**Initial estimate**	**Good**	**Initial estimate**	**Initial estimate**	**Initial estimate**

▪ The estimates in the table do not represent all subsidies granted to the oil sector. There are other subsidies which are not tax and royalty-related, and subsidies are also granted to fields which are not high-cost. A comprehensive study on subsidies to upstream oil in the largest three oil producing provinces in Canada found subsidies worth CAD$ 2,840.[1]

▪ There is a clear trend that low-cost oil reserves are being depleted and that to increase, or even maintain, global oil production at current levels the development of a large number of new reserves will become necessary.

• Production from these sources will be higher-cost than from those that are being replaced, the study says.

[1] Reference GSI Canada study- web link is http://www.globalsubsidies.org/research/fossil-fuels-at-what-cost-government-support-upstream-oil-activities-three-canadian-provinc

- The study finds that, as oil production costs keep increasing on average, governments are progressively easing fiscal treatments in order to identify new oil reserves. It warns that the line between such incentivizing, which is a reality in many places, and a subsidy is a very thin one.

- Subsidies for oil undermine investments in green energy. The report notes that "subsidising oil extraction has a range of secondary effects, including making investments in oil more attractive compared to lower carbon, lower risk alternatives. Investments in fossil-fuel infrastructure could potentially lock economies into reliance on fossil-based energy for many additional decades".

- There is little evidence that governments are conducting sufficient analysis of their fiscal policies when it comes to oil extraction from high-cost fields. The efficiency and effectiveness of their policies are often not fully assessed, and there is little comparison with alternative options.

- Subsidies transfer risks from private companies to governments and thereby reduce investment risks for fossil fuels. Caps on company liability, and an acceptance by a Government that a company won't have to take on full safety provisions (thus saving it money) can also be a significant source of subsidy.

- The current process is not transparent. Data sets are not readily available and there is a severe lack of information from governments on their expenditure and their specific incentives. The study shows that countries could significantly build on what they are currently providing under G20 and WTO obligations.

- The study says it is suspected that Canada, Mexico and the United States have additional fossil-fuel subsidies that were not included in their G20 implementation strategy (see page 4). A memo leaked by Canada's Department of Finance indicates that Canada was aware of many more potential subsidies than they subsequently reported in their G20 submission ([2]).

Greenpeace recommendations

At the G20 Summit in Seoul, leaders have the opportunity – and the responsibility – to move the planet towards a low-carbon economy. The time to take real climate action is now. Greenpeace is asking the G20 world leaders:

- **…to stop financing polluting oil companies**, especially those involved in the exploration of unconventional oil, as the tar sands, deep water or in the Arctic. In their ever more desperate attempts to continue feeding our fossil

fuel addiction, these companies are wreaking ever greater havoc on our environment.

- **…to make the right investments**. The G20 must create the financial and regulatory conditions that incentivise a low-carbon economy and agree on the indicators and reporting mechanisms needed to monitor progress. G20 countries must commit to comparing the cost of achieving particular government goals (energy security, job creation, industrial development, etc) through fossil fuel subsidies with the cost of meeting these goals through alternative methods. Such an evaluation must consider all externalities presented throughout the chain of custody of the different options, such as carbon emissions, air, water and soil contamination, health impacts and the risk of accidents.

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[2] Leaked memo, Canada Department of Finance, March 2010. The memo was written during their considerations under the G20 process leading up to the Toronto Summit.

Alternative methods include renewable energy (such as biomass, geothermal, wind and solar power); energy efficiency measures (e.g. stricter fuel efficiency standards for vehicles); alternative infrastructure investments (e.g. public transit and smart grids); or new technologies that enable the use of alternative fuels or increase efficiency (e.g. electric vehicles powered by low-impact renewable energy sources like wind or solar power/hybrid vehicles).

- **… to switch priorities** from subsidising fossil fuels to providing significant funds so the world's poorest countries can adapt to climate change, switch to a clean energy economy and stop deforestation. Providing climate finance is a condition for the global climate negotiations in Cancun (and beyond) to make progress. However this finance needs to be both new and additional. The UN Secretary General's High Level Advisory Group on Climate Change Financing's new report on innovative sources for climate finance clearly identifies the elimination of fossil fuel subsidies as a source for making good on the commitments in the Copenhagen Accord.*

- …**to increase transparency**. The G20 countries must commit to providing transparent information on their incentives and subsidies. This information is essential for an informed public debate on subsidy reform. Such reform should assess whether subsidies to fossil-fuel production represent an effective use of limited available public expenditure.

* Report from the UN Secretary General's High Level Advisory Group on Climate Change Financing, November 4, 2010

Background information

What have countries submitted to the G-20?

G-20 Member	Summary of Implementation Strategy
Brazil	No inefficient fossil-fuel subsidies. Lists several government measures in the energy sec the production and consumption of fossil fuels.
Canada	Proposes to implement recently released draft legislation to phase out the accelerated ca allowance for oil sands assets over the 2011-2015 period. Although the phase out will co the federal government approximately CA$300 million per year. Previously phased out o preferences applying to fossil-fuel producers.
Mexico	By continuing current policies and based on current market conditions, subsidies to gaso and LPG are expected to be phased out in the medium term.
United Kingdom	No inefficient fossil-fuel subsidies. Previously reformed subsidies for hard coal mining.
United States	Proposes to pass legislation to eliminate twelve federal tax provisions related to producti and natural gas, worth approximately US$ 3.9 billion annually over 10 years.

What fiscal and regulatory regimes are in place?

The five countries in this study were chosen, not only for their range of high cost oil reserves, but also for the varying fiscal and regulatory regimes in place to govern oil extraction.

Brazil has an open competitive market based on a concession regime but is considering a move to production sharing contracts to manage new discoveries of sub-salt oil reserves. Its national oil company, Petrobras, is a major player in the industry.

Canada's regulatory regime is based on competitive bidding for concessions, with provincial governments owning the resources and collecting royalties, and sharing the income tax with federal government.

Mexico's oil production is dominated by the state monopoly, Pemex, with only service contracts being offered out for foreign participation.

The **United Kingdom** has a competitive bidding process with two separate fiscal regimes for fields developed prior to 1993 (large oil fields) and post 1993 (small oil fields). The United Kingdom has repeatedly revised its fiscal regime recently in order to attract new investors who are increasingly small-medium sized operators.

The **United States**' fiscal and regulatory regime is similar to that of Canada's, with state governments managing the resources, and sharing income tax with the federal government.

Who consumes how much oil?

The United States remains the biggest consumer of oil in the world, consuming a significantly higher volume than the other countries studied. The US consumes approximately 19 million barrels of oil per day, compared with Brazil (2.5 mb/d), Canada (2.2 mb/d), Mexico (2.1 mb/d) and the United Kingdom (1.7 mb/d). The United States is also the biggest oil producer by a large margin, ranked third in the world with approximately 9 mb/d, whereas Canada, ranked sixth produced approximately 3.3 mb/d, Mexico ranked seventh produced 3 mb/d, Brazil ranked 12th 2.6 mb/d and the United Kingdom, ranked 55th only 1.5 mb/d.

What promises were made in the Copenhagen Accord?

"The collective commitment by developed countries is to provide new and additional resources (...), approaching USD 30 billion for the period 2010–2012 with balanced allocation between adaptation and mitigation. Funding for adaptation will be prioritized for the most vulnerable developing countries, such as the least developed countries, small island developing States and Africa. In the context of meaningful mitigation actions and transparency on implementation, developed countries commit to a goal of mobilizing jointly USD 100 billion dollars a year by 2020 to address the needs of developing countries. This funding will come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources of finance."

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