Energy Revenues: Are Canadians Getting Fleeced?

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The Council of Canadians
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Introduction

For over 20 years, Canada has lived with free trade agreements and free market rules that keep our energy resources flowing out of the country with little or no direction from government. As energy resources are depleted, extraction becomes more costly and environmentally destructive. Governments all over the world are taking an active role in developing strategies and policies to ensure their energy security, to maximize revenues and to limit the impacts on the environment. Sadly, that is not the case in Canada. In one of the coldest countries on earth, the government continues to rely on the whims of the markets and the big oil companies to dictate energy developments and policy direction.

Relying on the markets, we are told by our political leaders, creates wealth for Canadians. Two recent reports, one written for a government appointed panel in Alberta[1] and another from a firm of tax experts in Quebec[2], point to a different and troubling reality. They show that despite the appearance of financial health as illustrated by larger than expected surpluses in Edmonton and Ottawa, the citizens of this country are not getting their fair share of the energy revenues.

Are we getting enough?

In strict financial terms, Alberta's energy is now a major driver of Canada's economy and the energy sector makes significant contributions to the national and provincial economy. However, several studies have clearly demonstrated that, although very lucrative, the oil and gas industry – and the tar sands especially – are very costly on the environmental and social fronts. Some of the well-known examples of these costs are the devastation to the boreal forest; the vast amounts of water required for the mining process; the fact that the tar sands are already the largest contributor to the growth of greenhouse gas emissions in Canada; the use of relatively clean-burning natural gas to extract heavy crude; and the lack of infrastructure and public services in affected northern communities.

If Albertans are to pay the environmental and public health costs associated with tar sands developments, the province must now start to recuperate more of the economic benefits of its own resources.

Likewise in Ottawa, where the Prime Minster just announced a budget surplus of some $14 billion to be dedicated to the debt, one has to wonder about the long-term prospects of an economy increasingly tied to resource development – where prices are historically volatile – and rapidly less on manufacturing. In a country where social programs such as health care are under great strain and infrastructure is crumbling after years of neglect, is the government planning ahead and making reserves for these and other unexpected expenses?

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1 *Our Fair Share: Report of the Alberta Royalty Review Panel,* September 18, 2007

2 *Nos pétrolières canadiennes paient-elles leur juste part d'impôts,* Agora services de fiscalité Inc. September 16, 2007

What is fair?

The Alberta Royalty Review Panel completed its long awaited report last September. According to their website, their objective was to “ensure that Albertans are receiving a fair share from energy development through royalties, taxes and fees.” The review focused on “all aspects of the royalty system, including oil sands, conventional oil, and natural gas including coal-bed methane.”[3]

Using surprisingly strongly-worded language, the panel members concluded that Albertans have been shortchanged by the oil companies and have not received their fair share of oil revenues. The report calls for a $2 billion increase per year in revenues by the province, to be raised through increased royalties, taxes and other fees. The report also recommends “in the strongest terms” that more transparency, accountability and enforcement be implemented in the royalty regime.[4] Clearly, the panel members are not satisfied that the current measures – or lack thereof – ensure that every dollar that should go to the owners of the resource actually does.

Likewise, a group of tax specialists recently looked at the level of taxation of oil and gas companies in Canada. Their starting point was the rather simple question of whether or not these companies pay a “fair share” of taxes in the country relative to their profits. According to a report by tax specialist Brigitte Alepin[5], the oil and gas industry in Canada has a lower taxation levels than all other major industries in Canada, including most small and medium-sized businesses. The report exposes an industry that is raking in record profits but still receives tax breaks and subsidies by the federal government. Alepin concludes that because oil and gas companies are some of the most profitable companies in Canada, they should be taxed accordingly.

Here are a few of the report’s findings:

- Oil companies pay less tax in Canada than in the United States.
- Using various strategies, including tax shelters and tax deferrals, oil companies create a significant gap between their theoretical and effective tax rates. In other words, they pay a lot less tax than they are supposed to.
- In 2005, oil and gas companies operating in Canada had a net profit margin of 14 per cent on average. By comparison, the nine largest companies in the world had a net profit margin of 8.2 per cent on average, for operations in the rest of the world.
- The Canadian government has announced further corporate tax breaks that will allow oil companies to gradually lower their tax rate from 22.04 per cent to 19 per cent over the next three years.

More facts on industry profits:

- Despite the fact that the industry recorded record profits this year, the federal government will continue to subsidize oil companies through the Accelerated Capital Cost Allowance (ACCA) until 2015.

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3 *Op cit,* Alberta Royalty Review Panel
4 *Ibid,* p. 5
5 *Nos pétrolières canadiennes paient-elles leur juste part d’impôts,* Agora services de fiscalité inc. September 16, 2007

- A Pembina Institute report points out that the oil industry received $1.4 billion from the federal government alone in 2002. [6]
- In 2006, Encana Corp. made the biggest profit in Canadian corporate history ($6.58 billion).
- In 2007, Exxon Mobil and Royal Dutch Shell, to name but two, announced their largest corporate profits ever.
- Statistics Canada reports that companies involved in oil and gas extraction increased their profits by 50 per cent in 2005 earning over $30.3 billion.[7]

Some facts on royalties and revenues in Alberta:

- Alberta receives only a 1 per cent royalty until they recover all their capital costs. After all the costs of bringing a project on stream have been covered, the companies pay a 25 per cent royalty on net project revenue.
- Alberta's take in the tar sands is lower than other projects in North America and much lower than in oil producing countries around the world.
- From 1995 to 2002, Norway captured 88 per cent of revenues after production costs as opposed to roughly 50 per cent for Alberta.
- With a shift away from conventional oil and gas and the lower royalties mentioned above for the tar sands, royalty revenues will decline from roughly $11 billion in 2006-07 to $7 billion by 2009-10 according to the Pembina Institute.[8]
- According to the Parkland Institute, the current value of Alberta's Heritage Fund, started in 1976, is approximately $12 billion US compared to $38 billion US for Alaska and almost $300 billion for the fund Norway started in 1996. [9]

Maximizing revenues for the owners of the resource

Mechanisms used by energy producers to maximize resource revenues for their citizens include higher royalties, production-sharing agreements, joint ventures, equity purchases, fiscal tools and public ownership. While taxation is often a weak alternative – because the big oil corporations and their army of accountants know all the tricks of the trade to ensure paying as little as possible – it is still a very direct tool available to governments to promote proper distribution of the wealth created by our natural resources.

It is also worth nothing that the trend around the world goes beyond these fiscal tools, in favour of more direct public control of energy resources. As stated at the outset, Canada has chosen to go against this trend to the detriment of its own financial and ecological future, not to mention its citizens' energy security.

Over the last 20 years, Canada and the United States have closely integrated their energy policies. And the room for governments to act on behalf of their citizens is shrinking even more due to NAFTA and to rapid developments contained in the Security and Prosperity Partnership (SPP), an

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6 A. Taylor, M. Bramley, M. Winfield, *Government Spending on Canada's Oil and Gas Industry,* Pembina Institute, 2005

7 Miles Ryan Rowat, *Boom Times: Canada's Crude Petroleum Industry,* Statistics Canada, 11-621-MIE-# 047

8 A. Taylor, *Thinking Like an Owner: Overhauling the Royalty and Tax Treatment of Alberta's Oil Sands,* Oil Sands Issue Paper no. 3, November, 2006

9 D.Gibson, *Taming the Tempest: An Alternate Development Strategy for Alberta,* Parkland Institute, May 2007

agreement that calls for complete integration of North American energy markets. Nevertheless if the political will exists, federal and provincial governments can still take concrete steps to improve Canada's energy security.

The Council of Canadians recommends these immediate actions:

- The Alberta government should implement the recommendations of the Alberta Review Panel. We endorse it as a first – although by no means definitive – step toward revenue fairness for Albertans.[10]
- The federal government should end the Accelerated Capital Cost Allowance (ACCA) in the next budget and not continue to subsidize the oil companies until 2015, as they have announced.
- The federal government should cancel plans for additional corporate tax cuts scheduled to be phased in starting in 2008.
- Both federal and provincial governments should strengthen oversight and enforcement to ensure royalty and tax payments reflect the reality of industry profits.
- The federal government should put a stop to the energy integration strategy contained in the SPP in order to develop an energy security strategy for Canadians.

Conclusion

When one starts to look at other energy-producing nations around the world, it is clear that Canada and Alberta have been overly generous to the industry in recent years. That often-repeated industry argument about investment drying-up and lost jobs does not reflect the reality of the world oil market. Today, oil is increasingly produced in politically volatile regions of the world and where state intervention is omnipresent. By those standards, Canada will always be a good place to invest. The oil companies realize their playground is shrinking and are less likely to pull up stake because their profit margins are slightly reduced.

Those who argue for the exclusivity of free market rules fail to acknowledge that the oil industry is dominated by a very limited number of large transnational corporations that often act as an oligopoly. They do this with the blessing and often the financial support of governments in Canada, to the detriment of citizens.

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10 The Council of Canadians considers the report of the Alberta Review Panel to be a starting point. The Parkland Institute has notably exposed various weaknesses with the report, not the least of which is the fact that if the panel's recommendations were fully implemented, provincial revenues from the oil and gas would still fall by $2 billion by 2016. We seriously doubt the industry will see its revenues drop over the same period given projected developments. Like the Parkland Institute, we question, for example, why the report chose to maintain a base royalty rate of 1 per cent for the tar sands at a time when record oil prices already provide overwhelming investment stimulus. We urge the Alberta government to consider the recommendations provided by organizations such as the Parkland and Pembina institutes.

British energy consultancy firm Wood Mackenzie has said that even if the Royalty Review panel's recommendations were implemented, "Alberta would remain one of the cheaper places to do business in the world." *Globe and Mail* columnist Jeffrey Simpson also put things in perspective when he wrote, "Even if the new proposals were adopted, Alberta's take would still remain below … good old right-wing places such as Dick Cheney's Wyoming and George Bush's Texas."

In the midst of record industry profits, it is high time for the federal and provincial governments to reclaim a fair share of the revenues created by our own natural resources.

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