

## COMMENTARY

# Meeting Canada's Subsidy Phase-Out Goal: What it means in Quebec

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In May 2016 the Government of Canada, along with other G7 countries, committed to a much-needed timeline to phase out fossil fuel subsidies. These countries committed to ending fossil fuel subsidies by 2025, attaching a target year to the commitments to phase out subsidies for fossil fuels repeatedly made by G7, G20 and Asia-Pacific Economic Cooperation countries.

This is not a new idea for Canada. In the 2015 federal election, the Liberals and [all other parties](#) committed to fulfilling Canada's G20 commitment to phase out subsidies for the fossil fuel industry. After the election, the Canadian government followed this up by endorsing an international [communiqué](#) calling for swift and ambitious action to remove fossil fuel subsidies.

If Canada is to eliminate fossil fuel subsidies by 2025, it will have to work closely with the provinces, where most of the fossil fuel subsidies in the country originate. With the foregoing in mind and in an effort to better communicate the full scale of what it means for Canada to eliminate fossil fuel subsidies, IISD will publish a series of briefing notes that look at subsidies to both production and consumption of fossil fuels at the provincial. These briefing notes will consider the effort that provinces may have to contribute, and consider both where action is already taking place and where more can be done.

## Federal Level Outlook

IISD's [most recent estimates](#) identified CAD 3.3 billion in subsidies for fossil fuel production across Canada, giving an indication of the scale of the challenge. Canada is not facing this challenge alone: [a recent report by IISD, Overseas Development Institute and Oil Change International](#) finds over CAD 100 billion in annual fossil fuel subsidies among G20 countries.

This, however, is only part of the story, as both estimates only focused on subsidies to fossil fuel producers, rather than both consumer and producer subsidies. In Canada, consumer subsidies are also commonplace, although none of the measures targeting consumers originate from the federal government. It is thus crucial to consider the role that provinces can play in reforming, if not altogether phasing out, fossil fuel subsidies.



## Quebec Outlook

This briefing note focuses on the role that Quebec can play by reforming its fossil fuel subsidies to consumers. Quebec has had proactive climate policies for quite some time now, setting a provincial [emissions reduction target of 20 per cent below 1990 levels by 2020 and 37.5 per cent by 2030](#). Additionally, the province's most recent energy policy, [released in 2016](#), prioritizes both an energy transition and a low-carbon economy. The province aims to reduce its current consumption of petroleum products by 40 per cent by 2030 and increase current renewable energy production by an additional 25 per cent over the same time period. Simply by implementing all aspects of its energy policy—to the count of five—the province aims to reduce greenhouse gas (GHG) emissions by 18 per cent below 1990 levels by 2030. In addition, Quebec has successfully implemented a cap-and-trade scheme that now covers 85 per cent of its provincial GHG emissions, and created a [Green Fund](#) to manage the funds raised from the emission credits.

Nevertheless, in Quebec, fossil fuel consumption receives numerous subsidies. It is estimated that these amounted to CAD 270 million in 2015 (as shown in Table 1). These subsidies are generally in the form of a reduced provincial fuel tax granted to various economic sectors across the province. This preferential treatment acts as a negative price on carbon and stunts the provincial government's efforts to reduce GHG emissions.

## Focusing on Subsidies and the Rationale for Reform

Consumer subsidies take various forms, including tax reductions and exemptions, direct financial supports and other fiscal policies that encourage the burning of fossil fuels. These policies in turn lead to greater GHG emissions by lowering the cost of fuels.

The removal of environmentally harmful subsidies that support the production and consumption of fossil fuels is a companion to carbon pricing that should also be examined. Subsidizing fossil fuel use places cleaner fuels at an economic disadvantage, stunting their development and hindering efforts to meet GHG mitigation targets. These reforms have double the impact when they are combined with revenues from a carbon price, which can be invested in clean growth.

## Consumer Subsidies in Quebec

In Quebec, consumer fossil fuel subsidies are mainly in the form of preferential tax treatments that are all related to the province's fuel tax, which during the 2014/15 fiscal year netted CAD 2.2 billion in revenues for the province.<sup>1</sup> Since 2013, gasoline has been taxed at CAD 0.192 per litre and heating fuel at CAD 0.202 per litre; revenues from this tax depend mostly on provincial consumption levels. For example, during the 2014/15 fiscal year, revenues fell by approximately CAD 100 million due to a decrease in taxable transactions.<sup>2</sup>

Currently, the provincial government grants more than 10 tax preferential treatments for provincial fossil fuel consumers, through exemptions, rebates or reductions of the fuel tax. In 2015, the two main reductions led to nearly CAD 200 million in foregone revenues for the Quebec government (as shown in Table 1).

We have included estimates of some prominent supports for fossil fuel use in Quebec in Table 1 below that have been cross-referenced with figures published by the Organisation for Economic Co-operation and Development (OECD).<sup>3</sup>

<sup>1</sup> Finances Québec. (2015). Comptes publics 2014-2015 — Volume 1, Annexe 6. Retrieved from [http://www.finances.gouv.qc.ca/documents/Comptespublics/fr/CPTFR\\_vol1-2014-2015.pdf](http://www.finances.gouv.qc.ca/documents/Comptespublics/fr/CPTFR_vol1-2014-2015.pdf)

<sup>2</sup> *Ibid.*, p. 26.

<sup>3</sup> OECD.Stat. (2016, July 1). Fossil Fuel Support – CAN. Retrieved from [http://stats.oecd.org/Index.aspx?DataSetCode=FFS\\_CAN](http://stats.oecd.org/Index.aspx?DataSetCode=FFS_CAN)



**Table 1.** Fossil Fuel Subsidies in Quebec Mostly Benefit Consumers<sup>4</sup>

Subsidies (Consumers)	2014 Estimates (CAD)	Estimates (CAD)	
		2014	2015
	OECD (2016)*	Finances Québec (2016)	Finances Québec (2016)
1. Fuel Tax Reductions for Air and Rail Transport	\$98 M	\$98 M	\$99 M
2. Fuel Tax Reductions in Certain Regions	\$87 M	\$82 M	\$88 M
3. Fuel-Tax Rebates Farming, Forestry and Mining	\$39 M	\$38 M	\$38 M
4. Fuel-Tax Concessions for Farmers and Fishers	-	< \$2 M	< \$2 M
5. Fuel Tax Rebate for Public Carriers	\$27 M	\$27 M	\$28 M
6. Fuel-Tax Rebate for Certain Stationary Engines	\$20 M	\$19 M	\$19 M
7. Fuel-Tax Concessions for Certain Industrial Activities	-	-	-
8. Fuel-Tax Exemption and Rebates for Aviation Sector	-	-	-
9. Fuel-Tax Exemption for Commercial Vessels	-	-	-
10. Fuel-Tax Exemption for Propane Gas	-	-	-
<b>Total (Consumers)</b>	<b>≈ \$271 M</b>	<b>≈ \$264 M</b>	<b>≈ \$272 M</b>

\* Data extracted July 11, 2016

## 1. Fuel Tax Reductions for Air and Rail Transport

Since 2006, annual fiscal expenditures resulting from fuel tax reductions for air and rail transport are increasing; from CAD 68 million in 2006, the reductions were worth nearly CAD 100 million in 2015. This is the province's largest fiscal expenditure on fossil fuels and represents a value equal to 4.5 per cent of annual revenue stemming from the provincial fuel tax.

Whereas since 2013 taxes on gasoline and heating fuel are CAD 0.192 per litre and CAD 0.202 per litre, respectively, taxes on aircraft and locomotive fuel have remained fixed at CAD 0.03 per litre since 1972 for the former and 1980 for the latter. This is meant as an incentive for these industries to remain in Quebec.

## 2. Fuel Tax Reductions in Certain Regions

The second largest fiscal expenditure related to fossil fuels is the fuel tax reduction made available to consumers in certain regions in Quebec, namely areas bordering New Brunswick, Ontario and the United States, as an incentive for citizens not to leave Quebec to purchase cheaper fuel. This tax cut also applies to remote areas, the benchmark being urban centres.

Depending on the region, the fuel tax reduction can reach almost CAD 0.12 per litre, such as in areas located less than 5 km away from the United States border.<sup>5</sup> This has led to annual foregone revenues fluctuating between CAD 82 million and CAD 93 million since 2006. In 2015 the amount was CAD 88 million, equivalent to 4 per cent of total revenues generated by the fuel tax in the 2014/15 fiscal year.

## 3–4. Fuel Tax Rebates for Farming, Forestry and Mining, and Fuel-Tax Concessions for Farmers and Fishers

In 2015 the fiscal expenditure resulting from fuel tax rebates for farming, forestry and mining was CAD 40 million, or approximately 2 per cent of total revenues from the fuel tax in 2014/15. That same expenditure was worth CAD 30 million in 2006. The rebates are a tool to reduce production costs for firms operating in these sectors.

Farmers and fishers benefit from an additional CAD 2 million in tax concessions covering heating fuel and gasoline necessary for the vehicles and vessels used in their economic activity.

<sup>4</sup> This table uses data from multiple sources to present a partial analysis of fossil fuel subsidy. An in-depth and exhaustive analysis may find other measures in place or may lead to another understanding of subsidies in place.

<sup>5</sup> Revenu Québec. (2016). *Tableau des taux de taxe applicables dans les différentes régions du Québec en vigueur à partir du 1er avril 2015 : Loi concernant la taxe sur les carburants*. Retrieved from [http://www.revenuquebec.ca/documents/fr/formulaires/ca/ca-1\(2016-05\).pdf](http://www.revenuquebec.ca/documents/fr/formulaires/ca/ca-1(2016-05).pdf)



Several similar measures are found in other provinces, where they aim to support economic sectors that are important to the provincial economy and whose activity is often primarily located in rural areas. It is clear that the planning and implementation of reforms to reduce, and potentially altogether remove, these measures must take place gradually in order to prevent any negative impacts on sectors and workers that risk being affected by these reforms. As governments implement these reforms to reduce the fiscal burden that the subsidies engender, and encourage better fossil fuel consumption and low-carbon energy, it is important that they are able to put in place other fiscal measures to reduce such negative impacts that the energy transition may have on these sectors. Possible solutions are considered below (as shown in Table 2).

## **5. Fuel Tax Rebates for Farming, Forestry and Mining, and for Public Carriers**

With regards to public transit, there is a full rebate on the fuel tax for fuel used to power public transit bus engines. This full rebate serves multiple purposes, including to promote regular public transit use, as it is a more environmentally friendly transportation option, and to reduce traffic, which can also have a positive impact on GHG emissions from transportation. This fiscal expenditure was worth CAD 28 million in 2015, which is more than double its 2006 value, then at CAD 12 million.

## **7–10. Other Undefined Supports**

There are three other exemptions and refunds that aim to make Quebec more competitive on the Canadian and international markets. However, the total value of fiscal expenditures linked to these measures is unavailable. These are the fuel tax concessions for certain industrial activities, a complete exemption on fuel used for international flights (as in Alberta and British Columbia as well) and a rebate for tests of aircraft engines, and an exemption for commercial vessels. All three concessions aim to make these sectors more competitive by lowering firms' production costs.

## **Addressing Unwanted Impacts of Reform**

It is important to acknowledge that these subsidies and fiscal supports may have been put in place for specific and justified reasons. The removal of consumer energy subsidies can have a direct impact on vulnerable communities, including those that may not have the income to easily adjust to the elimination of these subsidies. This also applies to the private sector, including energy-intensive industries that will see their profits affected by any changes in energy price. For this reason, it is necessary to look at how to combat the negative impact of subsidy removal and ensure that programs, policies and supports are in place to aid transition. IISD looks at some options below.

One of the biggest challenges in reforming fossil fuel subsidies is addressing unwanted impacts. Communities, employees and business owners can be assisted in a transition away from fossil fuels that may require them to change usage patterns or fuel sources. It helps to understand that there are viable options that can assist these groups and mitigate unwanted impacts. Identifying these early also helps to keep minds open and solution-oriented in the face of reforms.

While these are unique to each jurisdiction, IISD has offered some general guidance that is a useful starting point. The IISD publication *A Guidebook to Fossil-Fuel Subsidy Reform*<sup>6</sup> offers a number of options, as outlined in Table 2.

<sup>6</sup> Beaton, C., Gerasimchuk, I., Lann, T., Lang., Vis-Dunbar, D., & Wooders, P. (2013). *A guidebook to fossil fuel subsidy reform for policy-makers in Southeast Asia: Executive summary*. Retrieved from [https://www.iisd.org/gsi/sites/default/files/ffs\\_guidebook\\_exec.pdf](https://www.iisd.org/gsi/sites/default/files/ffs_guidebook_exec.pdf)

**Table 2:** Common Mitigation Measures: Addressing Unwanted Impacts of Reform<sup>7</sup>

<b>Fiscal</b>	
<b>Mechanism</b> <ul style="list-style-type: none"> <li>• Redirect a proportion of subsidy savings into measures that can mitigate impacts (e.g., funding for implementation of renewable energy, or energy-efficiency retrofit programs)</li> </ul>	<b>Desired Impact</b> <ul style="list-style-type: none"> <li>• Depends on focus of expenditure</li> </ul>
<b>Macroeconomic</b>	
<b>Mechanism</b> <ul style="list-style-type: none"> <li>• Gradual phase-out approach</li> <li>• Temporary reduction in other fees or taxes (e.g., business taxes)</li> </ul>	<b>Desired Impact</b> <ul style="list-style-type: none"> <li>• Dampens GDP and inflationary impact</li> <li>• Counteracts price increase</li> </ul>
<b>Business and economic sectors</b>	
<b>Mechanism</b> <ul style="list-style-type: none"> <li>• Gradual phase-out</li> <li>• Short-term compensation for key sectors (e.g., increased sectoral investments)</li> <li>• Support energy-efficiency audits</li> <li>• Extend and increase access to credit facilities, favourable loans</li> </ul>	<b>Desired impact</b> <ul style="list-style-type: none"> <li>• Industries can adapt, less shock for exporting sectors</li> <li>• Helps cope with price increase, gives time to adapt</li> <li>• Helps identify energy-efficiency opportunities</li> <li>• Helps businesses spread impact over a longer period or pay for energy-efficiency investments</li> </ul>
<b>Households and social welfare</b>	
<b>Mechanism</b> <ul style="list-style-type: none"> <li>• Increase budget of agencies or funds with purview over social assistance and energy access</li> <li>• Health and education assistance (e.g., facilities and programs, supplies, improve access)</li> <li>• Infrastructure programs (e.g., expanded/improved public transport)</li> <li>• Welfare transfers: increase non-taxable income, minimum wage, cash transfers (conditional and unconditional), subsidize certain socially important goods</li> </ul>	<b>Desired Impact</b> <ul style="list-style-type: none"> <li>• Addresses social impacts using existing capacity, scales up existing mechanisms</li> <li>• Lowers cost of living; improves health-related welfare and economic prospects in medium to long term</li> <li>• Improves welfare by: i) increasing access to goods and services; ii) promoting general economic prosperity, related to infrastructure; and iii) providing employment associated with construction.</li> <li>• Reduces social impacts on cost of living by supplementing household incomes with cash (directly or indirectly) or other goods by lowering costs of other goods.</li> </ul>
<b>Environment</b>	
<b>Mechanism</b> <ul style="list-style-type: none"> <li>• Invest in enforcement of existing regulations (i.e., preventing cheating, levelling the playing field)</li> <li>• Programs to foster sustainable fuel (e.g., biomass supports)</li> <li>• Investment in clean energy technologies (e.g., geothermal, off-grid renewables)</li> </ul>	<b>Desired impact</b> <ul style="list-style-type: none"> <li>• Sustainable exploitation of natural resources</li> <li>• Sustainable biomass</li> <li>• Reduces or prevents negative impacts of fuel switching</li> </ul>

Not all of these mechanisms may be applicable to Quebec, but they provide a starting point for discussion on not only where and how we should look for reforms, but also how unwanted impacts can be mitigated.

<sup>7</sup> Ibid.





## Conclusion

Almost all of the energy generated in Quebec comes from carbon-neutral sources and the province has set itself the most ambitious GHG emission reductions target in the country: to reduce emissions by 37.5 per cent below 1990 levels by 2030. The province created the Green Fund in 2006 and implemented a cap-and-trade scheme in 2013, which is complemented by a new low-carbon energy policy for 2030. We commend these initiatives aimed at implementing concrete and ambitious actions to combat climate change.

However, as long as fossil fuel subsidies and other financial supports exist, they will continue to challenge efforts to reduce emissions in Quebec as well as meeting Canada's G7 subsidy elimination target.

The supports for fossil fuel use identified here are a good place to start to look at reforms. They are not the only support measures in place, and we also suggest increased transparency on the foregone revenues represented by the additional, unquantified items.

Subsidy reform should be bundled with other policies that help affected industries and workers to adjust. Here, the federal government will need to work closely with the provinces, including Quebec, if it is serious about full elimination by 2025.

We understand that there may be strong reasons for these subsidies, but that does not counteract the fact that they will continue to lead to elevated GHG emissions, as well as stunt the opportunity for cleaner alternatives and green jobs, not to mention tying up significant budgetary space for government in terms of foregone revenue.

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