CCPA-NS Presentation to the Public Review Commission on Oil and Gas Exploration off the Coast of Cape Breton

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INTRODUCTION

I would like to start with following question: given the environmental risks and unpredictable effects on a number of industries, why would we be contemplating allowing inshore oil and gas exploration?

The answer lies with the possible economic development opportunities and the increased government revenues and employment, that it is hoped, will flow if oil and gas are discovered.

I am going to argue that, based on a review of the Hibernia project in Newfoundland, we would be well advised to be skeptical of the potential benefits from oil and gas development. This is primarily due to the volatility of oil and gas commodity prices and the limited number of local jobs that are associated with the industry.

My comments are based on a policy brief that the BC Office of the Canadian Centre for Policy Alternatives released in December entitled: "Should BC lift the offshore oil moratorium? A policy brief on the economic lessons from Hibernia."

Table 1: Government contribution to Hibernia project

	Level of Gov.	Amount
Grants		
Re-negotiation of Accord (1988) (a)	federal	$1.04 billion
Offshore Technology Transfer Fund (for	federal and	$11 million

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Newfoundland design engineers) (a)	Nfld.	
Canada-Newfoundland Offshore Development Fund (for Bull Arm facility) (a)	federal and Nfld.	$95 million
Operating grant for Canada-Newfoundland Offshore Petroleum Board (b)	federal and Nfld.	$2.6 million/year
Equity position		
Buying 8.5% equity from Gulf (1992) c	Federal	almost $1 billion
Tax exemptions		
Waiving PST on start-up capital expenditures (d)	Nfld.	$186 million
Waiving PST on operating expenditures (e)	Nfld.	$1 million/year
Fuel tax exemption on Hibernia, Terra Nova, and transshipment terminal (f)	federal and Nfld.	Not calculated
Waiving retail sales tax on transshipment terminal (f)	Nfld.	Not calculated
Tax credit on provincial corporate income tax (a)	Nfld.	Not calculated
Loans and Loan guarantees		
Loan guarantee, re-negotiation of Accord	Federal	$1.66

(1988) (a)		billion
Loan guarantee for Murphy Oil Corp. (1992) (c	Federal	$700 million
Interest-free loan, if price of oil below US$25/barrel (a)	Federal	up to $300 million

SUBSIDIES

Hibernia was to be constructed and operated without government money. In the end the project relied heavily on government grants, loan guarantees, and tax exemptions (see Table 1).

Most of the subsidies came in the form of tax exemptions. The government of Newfoundland and Labrador waived the sales tax on the start up capital costs and then the provincial sales tax on operating expenses were also waived. The Hibernia Management Development Corporation (HMDC) also received a tax credit on corporate income tax payable.

In 1988 when low oil prices put the project in jeopardy, the Canadian government came up with a $1.04 billion grant and a $1.66 billion loan guarantee. When Gulf Oil pulled its 25% share of the project, the federal government saved the project with an 8.5% share totaling nearly a billion dollars and guaranteeing over $700 million in loans to Murphy Oil Corp. from Arkansas so that it could pick up a 6.5% interest in the project. .

These subsidies highlight the vulnerability of a project so dependent on global commodity prices. However, what most captures this dependence is an interest-free loan extended by the federal government– for as much as $300 million – to help the consortium make interest payments when the price of oil drops below US$25/barrel (in 1987 dollars). Currently the price of oil is less than US$20/barrel. Ten independent industry analysts forecast that the price of oil over the next 15 years will range from US$14/barrel to US$23/barrel, with the majority predicting an average of less than US$20/barrel.

GOVERNMENT REVENUES

Royalties are also contingent on a high price for oil. The HMDC is required to pay the federal government 10% royalty on the project net revenue with

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the percentage declining when the price of oil drops below US$30per barrel (in 1987 dollars). At current prices the project pays the federal government 3.3% of net revenues.

The Newfoundland and Labrador government receives statutory and contractual royalties. The statutory royalty equals one cent per barrel produced, which will bring in $7.7 million during the duration of the project. Contractual royalties are based on sales revenues less transportation costs and are also indexed to the price of oil. Even when ignoring transportation costs and discounts for oil prices below US$30/barrel, the basic royalty will total CAN$1.5 billion over the life of Hibernia. To put this number in perspective – this $1.5 billion is less than the amount the two governments put into the project. Net royalties, to the provincial government from Hibernia, will only be paid if the project's revenue exceeds its eligible costs, including a 15% rate of return for the HMDC.[1]

Equalization

Most of us are by now aware how current equalization legislation between Ottawa and the provinces determines that most of the royalties due to Nova Scotia would be clawed back leaving the province with limited return in the form of royalties.

Corporate Tax

Another source of government revenue is through corporate income tax, but the HMDC can use expenditures on petroleum projects unrelated to Hibernia to reduce or eliminate tax obligations.

The provincial government also collects personal income tax from Newfoundlanders employed on the Hibernia project.

EMPLOYMENT

Hibernia has been able to generate some employment for Newfoundlanders. The jobs created during the Hibernia project to date have resulted in only 7.5 (person-years of employment) per million dollars invested. Of those two thirds or 5 jobs per million invested have gone to Newfoundlanders.

The exploration phase, though expensive has limited opportunities for local involvement. For example, Chevron estimated employment for a 3-year West Coast exploration program peaking at 202 employees, with a maximum of 81 local hires, but a more likely total of 27, since locals often do not possess the requisite skills.

The construction phase of offshore projects is the most expensive and has created the most jobs related to Hibernia. Key to gaining the jobs is an agreement between the HMDC and the provincial government, to hire locally. The HMDC agreed to employ 70% of their workforce from Newfoundland and Labrador. Sixty-six percent of the platform construction workforce was made up of Newfoundlanders.

Such agreements with the oil and gas companies would be more difficult and costly to reach in the context of the NAFTA. The Canada-Newfoundland Atlantic Accord Implementation Act (an Act enshrining the Atlantic Accord, the regulatory and royalties agreement between Newfoundland and Canada) was specifically exempted from NAFTA. With Respect to future projects, NAFTA significantly restricts the ability of governments to impose performance requirements – such as requiring a company to hire locally – on an investor except in exchange for a subsidy. In other words if the Nova Scotia government wants to ensure that offshore oil and gas jobs go to Nova Scotians or that equipment, such as platforms be built in Nova Scotia it better be ready to pay oil and gas companies for that concession.

Governments bargaining power is undermined in a global environment where companies according to a recent report prepared for the BC government states that "companies can terminate their efforts for a variety of reasons including….a local jurisdiction being 'unreasonable' in its requirements for local preference, taxation, and /or environmental performance." In the production of exploration and development equipment, such as drilling platforms Nova Scotia will be forced to compete with other international jurisdictions with lower wages and higher production subsidies such as ship yards in China and South Korea. Even given Newfoundland's investment in platform construction, the platforms to be used in the Terra Nova and the new White Rose development are being constructed by shipyards in Asia.

Even if Nova Scotians are hired for construction or operations, the location of these jobs within the province is important in determining potential

socio-economic benefits. With Hibernia, for example, a social impact assessment suggested that the short-term nature of construction employment would have disruptive consequences for any community in Newfoundland. The decision was made, therefore, to house the employees in a temporary work camp outside existing communities. This plan essentially turned construction phase employees into migrants. Currently during operations, only 38.6% of the remaining jobs are onshore.

CONCLUSION

I want to return to my initial question: what are the incentives that would have us consider accepting the environmental risks associated with inshore oil and gas exploration?

I have noted two main ones:

- Revenue and royalties for the provincial government

- local employment

Our review of the economic aspects of the Hibernia development in Newfoundland and Labrador suggests Nova Scotians should think twice before taking environmental risks based on these potential benefits of increased jobs and revenue.

While the project was intended to be viable without government subsidies the federal and provincial governments ended up providing substantial supports to the tune of $1.25 to $1.5 billion. In spite of early predictions by supporters, the project was not viable without government support. Part of the reason for this is beyond the control of the project proponents due to the volatility of oil and gas commodity prices. With Hibernia governments absorbed part of the risk from fluctuating oil prices and subsidized the project.

Revenues

Royalties are contingent on a high price of oil as most of the royalties are calculated based on the project's revenue. As the oil prices remain low or decrease governments receive very limited royalties. When taken in the context of government subsidies the royalties are indeed minimal.

Jobs

The exploration phase provides very limited opportunities for local employment.

Over all the Hibernia is providing some employment to Newfoundlanders. To date the project has created, including spin off jobs, 5 person-year jobs, for Newfoundlanders per million dollars invested. Many of the jobs for Newfoundlanders were the result of an agreement between the HMDC and the province that was exempted from NAFTA. In the future, in the context of NAFTA, specific local/provincial employment objectives will need to be directly subsidized by governments.

Our review of Hibernia shows that on balance the net overall benefits of oil and gas exploration and development are minimal at best. In themselves the potential employment and royalty benefits don't appear to outweigh the risks to the environment various industries and communities in Cape Breton. Greater benefits can be derived through government subsidies to projects/enterprises that contribute to a more environmentally sound economy and more sustainable employment and communities.

ENDNOTES

1. Eligible costs include capital and operating costs, plus 1% of capital costs, plus 10% of operating costs, plus gross royalties paid, plus a 15% rate of return. From Locke, Wade. 1992. "Economic issues related to taxation of offshore oil projects: Hibernia as a case study." Institute of Social and Economic Research. Memorial University. St. John's, Newfoundland. p. 22.