FRASER RESEARCH BULLETIN

FRASER INSTITUTE

December 2015

Investor Perceptions of Alberta's Oil and Gas Policy Changes

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Summary

- Alberta's new government has implemented, or plans to implement, many policy changes that will affect the oil and gas sector. Some of these changes include increases to the corporate income tax (CIT), increases in the carbon levy, and a panel review of the province's oil and gas royalties and climate change policies.
- The 2015 edition of the Global Petroleum Survey was conducted from May 29, 2015 to July 31, 2015, presenting a unique opportunity to assess how Alberta's policy changes have affected investor confidence.
- Alberta experienced a large negative shift from 2014 to 2015 in the Global Petroleum Survey. On the Policy Perception Index, a comprehensive measure of the extent of policy-related investment barriers within each jurisdiction, where a high score reflects negative sentiment on the part of respondents and indicates that they regard the jurisdiction in question as relatively unattractive for investment, Alberta's score deteriorated from a value of 26.57 in 2014 to 34.21 in 2015. The province's rank in 2014 was 16th (of 156 jurisdictions), deteriorating to 38th (of 126) in 2015.
- The investment driver that experienced the largest shift in negative sentiment from 2014 to 2015 was political stability. In 2014, only 5% of respondents viewed political stability as a deterrent to investment; that increased to 51% of respondents in 2015.
- Another large negative shift was in the fiscal terms policy category, which includes the royalty framework. In 2014, only 14% of Alberta's respondents found this factor to be a deterrent to investment; that rose to 39% in 2015.
- These negative shifts may not bode well for Alberta considering that the province's immediate geographical competitors are perceived to be either attractive jurisdictions to invest in, or are improving.

Introduction

On May 5, 2015, Alberta held a general election that led to a change in government. The Alberta New Democratic Party (NDP) was awarded a majority, ousting the Progressive Conservatives who had held power in the province for almost 45 years. Since the election, Alberta's new government has implemented, or plans to implement, many policy changes that will affect the oil and gas sector. Some of these changes include increases to the corporate income tax (CIT), increases in the carbon levy, and a panel review of the province's oil and gas royalties.

Many of these policies have the potential to add sizable costs to the upstream petroleum industry. These changes come at a time when the industry has been experiencing considerable turmoil due in large part to a steep decline in oil prices. In July 2014, the West Texas Intermediate (WTI) spot price was US$103.59 per barrel. A year later in July 2015, the price of WTI had more than halved to US$50.90 per barrel (EIA, 2015). The fallout from the decline in prices has been widespread. Most serious have been the substantial layoffs in the industry and the suspension of some capital investment and planned projects. One industry executive recently remarked that oil and gas companies are now in a "survivor scenario" (Cattaneo, 2015, Aug. 24).

Adding additional costs to an industry already hampered by declining prices could lead to further reductions in investment in the near term or deter investment that would likely occur when oil prices eventually rise.

For the past nine years the Fraser Institute has conducted an annual survey of upstream oil and gas executives to identify provinces, states, and countries, as well as offshore regions, and other geographic areas with the greatest barriers to investment in oil and gas exploration, development and production. This year's survey was conducted after the Alberta election, from May 29, 2015, until July 31, 2015 (see Jackson, Ramsbottom, and Green, 2015). The 2015 edition of the survey presents a unique opportunity to assess the perceptions of oil and gas executives regarding the policy changes that were implemented or discussed after the election.

This bulletin will begin by discussing how policies pertaining to the oil and gas sector have been changing since the new government came to power. It will then describe how investor attitudes to and investment in Alberta changed in 2007 when the province conducted its previous royalty review. The next section will analyze how perceptions of industry executives regarding Alberta's investment climate shifted between 2014 and 2015.

Alberta's policy changes

In the wake of the May Alberta election, changes to policies and various other proposals that influence the oil and gas sector have been widespread. Ted Morton identifies 13 "specific policy risks" that the new government poses (2015: 3). These (proposed) changes not only pose risk, but more importantly, uncertainty, both of which can deter investment in the province.

Three policy areas stand out as having the greatest potential impact on sector investment. These are the new royalty review, corporate tax increases, and new regulations regarding greenhouse gas (GHG) emissions.

Royalty review

The new government has implemented a review of Crown royalties on oil and gas production.[1] In her throne speech after taking power, Alberta Premier Rachel Notley stated that "[w]e need to review how the people of Alberta—including our grandchildren and great-grandchildren, many years from now—will be rewarded for the development of their own energy resources" (Henton, 2015, June 15).

The outcome of the review is as yet unknown—it may entail increases or reductions in royalty rates and/or a simplification of the current royalty system. Important ancillary factors such as "royalty holidays" for certain forms of production may also be affected. Recently, when she was announcing who the review panelists were to be, Energy Minister Margaret McCuaig-Boyd said that there would be no changes to royalties until the end of 2016 (Cattaneo, 2015, Aug. 28). While some took short-term comfort from this statement, considerable uncertainty remains about the nature of the changes. Indeed, it appears that this uncertainty may already be deterring some investment. Canadian Natural Resources Ltd. (CNRL) said in a news release at the end of May that:

> due to the current uncertainty surrounding the government of Alberta's review of royalty, taxation, environmental and greenhouse gas policies, detailed future capital allocation plans for each of the company's assets cannot be finalized at this time. (CNRL, 2015, May 27)

Corporate taxes

Another of the new government's policy shifts has been to raise corporate income tax rates from 10% to 12%, an increase of 20% (Morton, 2015). This increase will further reduce the profitability of firms that are already facing challenges to their bottom lines in the wake of steep declines in oil prices. Economist Jack Mintz recently looked over financial reports from the top 10 oil and gas firms and estimated that the total impact of the corporate tax increases to these companies was \$1.85 billion (Mintz, 2015, Aug. 28). Ted Morton (2015) also notes that not only will the tax increase affect Alberta's ability to attract capital, but it may also lead to corporate head office relocations.

GHG emissions

Alberta's new government has made a strong commitment to implement policies that will lower the province's CO_2 and other GHG emissions in order to contribute to climate change mitigation efforts. At the outset of the government's mandate, two separate policy initiatives fall under this category. The first is that the new government has committed to doubling the province's carbon levy from \$15 per tonne of CO_2e, first to \$20 per tonne of CO_2e in 2016, and finally to \$30 per tonne of CO_2e in 2017. The government has also increased the emissions reduction intensity requirement from 12% to 20%.[2] This change will also be phased in so that by January 1, 2016, large emitters will have

[1] Note that the Alberta Crown only owns the mineral rights on approximately 81% of Alberta's total land area. The remaining rights are freehold mineral rights held by private individuals and companies or by the federal government (Alberta, n.d.)

[2] Facilities emitting more than 100,000 tonnes of CO_2e are required to reduce their emissions intensities (GHG/unit of output) by these targets. Baseline emissions are determined for facilities in operation before January 1, 2000 to be the average emissions intensity over the years 2003-2005. For facilities in operation after this, the baseline is determined by the emissions intensity in the facility's third year of operation (Leech, 2012).

to reduce their emissions intensity by 15%, with the full change coming into effect on January 1, 2017. The policy works by requiring emitters to pay the levy if emissions are not cut by the set amount relative to a baseline (Giovannetti, 2015, June 25). The Canadian Association of Petroleum Producers (CAPP) expects the rules to add almost $800 million in industry costs over the next two years (CAPP, 2015, June 25).

The Alberta government also recently established an advisory panel on climate change that will review the province's current measures and provide advice on ways to reduce GHGs (see Alberta, 2015a), which released its findings on November 22. When survey participants were responding there was considerable uncertainty about the panel's potential outcomes, and the accompanying discussion document suggested that significant changes may be coming to Alberta's environmental policies (Green, 2015, Aug. 19). It remains to be seen how the government will implement the proposals of the climate change panel.

Other changes

In addition to the three policy shifts discussed above, Morton (2015) has identified other policy risks that could have varying effects on the oil and gas industry and different probabilities of being enacted. Some of these proposed changes include new regulations on hydraulic fracturing, splitting up the Alberta Energy Regulator (AER), new railway industrial transportation regulations, and providing government support for refineries or upgraders. Many of these potential changes have in common a significant uncertainty as to what the end policy environment will look like once they have been fully implemented.

Fallout from the 2007 Alberta royalty review panel

When the new Alberta government announced that it was going to launch a review of oil and gas royalties, one of us, (Kenneth Green, 2015) analyzed how the review conducted in 2007 affected both the perceptions that industry executives had of the province's investment attractiveness and the allocation of investment after the new royalty scheme was implemented. The 2007 royalty review concluded that Albertans were not receiving their "fair share" of revenues from Alberta's resources, leading to increases in the royalties on conventional oil, raw and upgraded oil sands bitumen, and natural gas. Green found that the 2007 royalty review, and subsequent royalty rate increases, adversely affected investors' perceptions of the province and deterred investment.

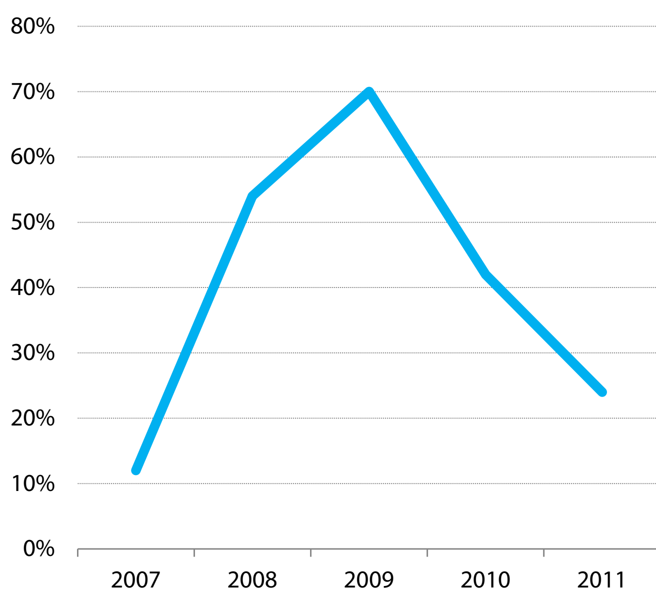
One of the questions that the Fraser Institute's *Global Petroleum Survey* asks upstream petroleum executives is whether a jurisdiction's fiscal terms[3] encourage, do not deter, or deter investment, rated on five response choices as seen below:

- Encourages investment
- Is not a deterrent to investment
- Is a mild deterrent to investment
- Is a strong deterrent to investment
- Would not invest due to this criterion

Figure 1 shows how survey respondents perceived the fiscal terms component of the factors affecting the investment climate in Alberta after the 2007 royalty review. Note that on a

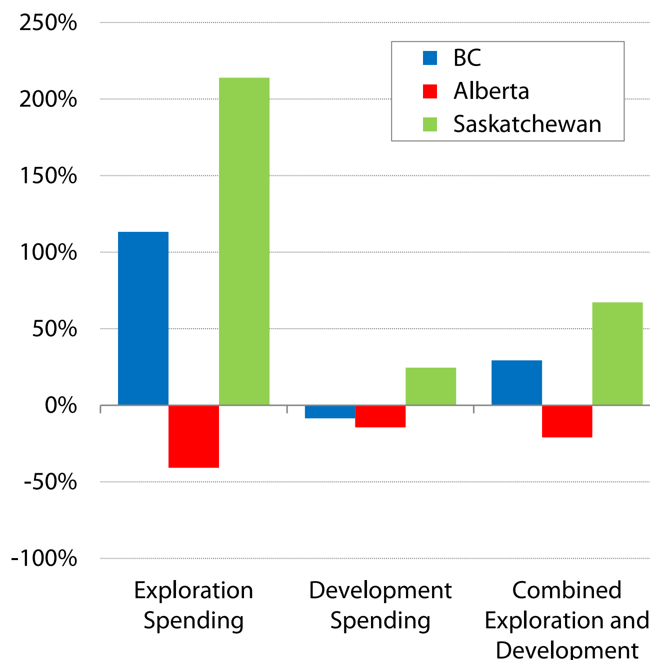
[3] Fiscal terms refers to licenses, lease payments, royalties, other production taxes, and gross revenue charges, but not corporate and personal income taxes, capital gains taxes, or sales taxes.

Figure 1: Percentage of Responses Indicating Fiscal Terms were Percieved as a Deterrent to Investment, 2007-2011



Source: *Global Petroleum Survey* (2007-2014, various authors). Fraser Institute.

Figure 2: Percentage Change in Petroleum Industry Exploration and Development Spending from 2006 to 2008



Source: *Canadian Association of Petroleum Producers, 2015.*

combined basis, the "deterrent" or negative responses jumped sharply in 2008 and again in 2009, only later gradually returning to the 2007 levels. By 2009, 70% of the survey responses to the question about Alberta's fiscal terms indicated that they were a deterrent to investment in oil and gas development and production. In the 2010 survey, after the government had announced it would reverse many of the royalty changes brought in in 2008-09, investor attitudes began to turn around (Green, 2015).

Most telling, though, is how the amount of investment changed in Alberta when the new royalty regime was being implemented compared to its neighbours, Saskatchewan and British Columbia. Figure 2 presents the percentage change in exploration and development spending from before and after the royalty review. The data show that while exploration and development spending in BC and Saskatchewan were increasing, investment spending in Alberta was declining. Overall, the analysis of the 2007 royalty review shows that the new NDP government should understand that uncertainty and policies that add costs can reduce investment.

Investor perceptions of Alberta in 2015

The 2015 edition of the *Global Petroleum Survey* was conducted between May 29 and July 31, 2015. This survey period fell after the Alberta election and was subsequent to many of the new policy announcements. This presents a unique opportunity to gain some insights into policy

Table 1: Alberta Petroleum Survey Comparision 2014-2015

Year	Mild deterrent to investment	Strong deterrent to investment	Would not pursue investment due to this factor	Percent Deterred	Change in Percent Deterred
Fiscal terms					
2014	12%	1%	1%	14%	25%
2015	28%	11%	0%	39%	
Taxation in general					
2014	17%	1%	1%	19%	14%
2015	26%	6%	0%	32%	
Environmental regulations					
2014	33%	5%	0%	38%	14%
2015	40%	12%	0%	52%	
Regulatory enforcement					
2014	24%	3%	1%	28%	11%
2015	28%	9%	1%	39%	
Protected areas					
2014	17%	10%	0%	27%	15%
2015	37%	4%	1%	42%	
Labour availability and skills					
2014	25%	4%	0%	29%	-12%
2015	18%	0%	0%	18%	
Political stability					
2014	4%	1%	0%	5%	46%
2015	24%	24%	3%	51%	

Source: Jackson, Angevine, and Fathers (2014); Jackson, Ramsbottom, and Green (2015).

shifts and how they may be influencing investor perceptions of Alberta's attractiveness.[4]

A total of 439 people responded to the survey from companies located around the globe. Participants were asked to evaluate jurisdictions on 16 different policy factors; those factors can influence company decisions about whether or not to invest in various jurisdictions.[5]

Overall, Alberta experienced a large negative shift from 2014 to 2015 in the *Global Petroleum Survey*. On the Policy Perception Index, a comprehensive measure of the extent of policy-related investment barriers within each jurisdic-

[4] All of the Global Petroleum Survey data can be accessed free of charge at www.fraserinstitute.org.

[5] For an overview of all questions, see Jackson, Ramsbottom, and Green (2015).

tion where a high score reflects considerable negative sentiment on the part of respondents and indicates that they regard the jurisdiction in question as relatively unattractive for investment, Alberta's score deteriorated from a value of 26.57 (out of 100) in 2014 to 34.21 in 2015. The province's rank in 2014 was a relatively attractive 16th (of 156 jurisdictions), deteriorating to 38th (of 126) in 2015.

Table 1 presents the 2014 and 2015 Alberta data from the two surveys for the policy areas that experienced a shift of 10 or more percentage points in the percentage of respondents who were deterred from investing (where "deterred" is defined as the sum of the three negative responses: mild deterrent, strong deterrent, and would not invest).

One of the largest negative shifts for Alberta was in the area of fiscal terms, a policy category that includes the royalty framework. In 2014, only 14% of Alberta's respondents found this factor to be a deterrent to investment. But in 2015, the percentage of negative responses increased to 39%, a 25 percentage-point increase. This is the survey question that likely best reflects attitudes towards the new royalty review. It should be noted that, while dramatic, the 2014-2015 shift is smaller than that between 2007 and 2008, the last time a royalty review was conducted. Nevertheless, it does amount to a significant swing.

Respondents also exhibited increased concern between 2014 and 2015 over Alberta's general tax system and regulations, likely reflecting a change in attitudes to the new policy mandates. These shifts could reflect the effects that the corporate income tax increase and new greenhouse gas discussions and regulations have had on investor confidence.

The investment driver that experienced the largest shift in negative sentiment from 2014 to 2015 was political stability. In 2014, only 5% of respondents viewed Alberta's political stability to be a deterrent to investment, and only 1% perceived it to be a strong deterrent or greater. In 2015, 51% of respondents viewed Alberta's political stability to be a deterrent to investment, and a full 27% viewed it to be a strong deterrent or worse. Investors now perceive political stability to be one of the greatest barriers to investment in the province. This 46 percentage-point change (from 5% to 51%) is likely attributable to the considerable uncertainty that continues to surround many of the new government's policies and much of its mandate pertaining to the oil and gas sector.

On only one factor affecting investment decisions—the availability of labour and skills—did Alberta experience a large positive shift, likely due to the increase in the available pool of labour following the significant layoffs that have taken place in the wake of deteriorating oil prices.

These negative shifts may not bode well for Alberta given that the province's immediate geographical competitors remain attractive as jurisdictions in which to invest, or are improving. Saskatchewan continues to be a top performer, ranking in the global top 10 on the policy perception index for the last three years. It also appears that Saskatchewan has already begun trying to lure some investment away from Alberta (Bakx, 2015, Jun. 10). North Dakota also ranks in the global top 10, doing so for the past five years. In 2015, British Columbia improved considerably (it now has fewer barriers) as evidenced by a policy perception index score that is lower than in 2014 by almost 10 points, very nearly securing the province a place in the relatively attractive second quintile. Any or all of

these jurisdictions could attract highly mobile investment away from Alberta.

Conclusion

In Alberta, there is currently considerable risk and uncertainty surrounding the policies that will affect the petroleum industry. While low oil prices are most certainly driving some of this risk and uncertainty, some of it is a result of policy changes and proposals that Alberta's new government has introduced. Based on responses to the *Fraser Institute Global Petroleum Survey* by upstream oil and gas executives, it appears that these shifts in policy have already adversely influenced perceptions of the province's attractiveness for investment.

To make matters worse, the changes come at a time when oil prices have sharply declined, as has investment in the province's oil and gas sector. The government's recent fiscal update mentions these changes. Rig activity declined by almost 50% in the first seven months of the year, and oil and gas investment as a whole is expected to fall by more than 30% in 2015 (Alberta, 2015b).

If negative sentiment on the part of potential investors continues, Alberta may risk exacerbating the investment decline in the short term and/or losing out on investment when oil prices eventually rise. This should concern the new government as it moves forward with additional policy changes that will add costs to the industry. Reducing uncertainty in the short-term would help mitigate some of the effects of lower oil prices.

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ISSN 2291-8620

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Acknowledgments

The authors would like to acknowledge the anonymous reviewers for their comments, suggestions, and insights. Any remaining errors or oversights are the sole responsibility of the authors. As the researchers have worked independently, the views and conclusions expressed in this paper do not necessarily reflect those of the Board of Directors of the Fraser Institute, the staff, or supporters.