Intelligence MEMOS

From: Glen Hodgson

To: Canadians Concerned About Climate Policy and Competitiveness

Date: March 13, 2023

Re: **Budget 2023 Needs to Meet the US Industrial and Climate Policy Challenge**

The Canadian economy is facing a competitive threat from ambitious US industrial and climate policy in the *Inflation Reduction Act* (IRA) and the upcoming federal budget can be used in a targeted way to level the playing field.

It should build on recent commitments and provide a tech-neutral Canadian package of investment tax credits for clean tech such as batteries and components, zero-emission fuels, and strategic inputs. Clean finance capacity should be doubled, and selective spending can also be used. At the same time, Canada's carbon pricing framework means there is no compelling competitive reason to provide additional subsidies for vehicles, or for built structures and production processes, if carbon prices are at a sufficient level. The initiatives should fit within a medium-term fiscal framework with no need for additional revenue sources.

The IRA represents the most significant initiative by the United States so far to address climate change and the low-emissions transition. It relies heavily on expensive fiscal tools, particularly tax credits for investment in, and production of, an array of energy sources with low or no GHG emissions. These include clean hydrogen, nuclear power, renewable electricity, new clean electricity and fuel, sustainable aviation fuel, biofuel, biodiesel, and renewable diesel. There are also subsidies for purchasing green personal and commercial vehicles. The IRA secures significant new federal government lending authority totalling $290 billion, as well as budgetary funding of another $33 billion for credit subsidies and grants.

The federal government is well aware of the competitive threat and has already made some climate-related fiscal commitments which help to offset initiatives under the IRA.

Budget 2022 included:

- a new refundable investment tax credit for carbon capture, utilization, and storage, with direct air capture also eligible.
- a proposal to create a new tax credit of up to 30 percent for investments in clean technology, focused on net-zero technologies, battery storage solutions, and clean hydrogen.
- extending incentives for zero-emission vehicle purchases to March 2025, and financing to build a national network of electric vehicle charging stations.

The subsequent 2022 Fall Economic Statement announced:

- the launch of the $15-billion Canada Growth Fund, which is a response to the IRA's provision to make significant new clean finance capacity available from US government entities.
- confirmation that a refundable tax credit will be made available in Budget 2023 equal to 30 percent of the capital cost of clean tech investments. It is to be used for: electricity generation systems with low or no GHG emissions; stationary electricity storage systems that do not use fossil fuels; low-carbon heat equipment such as active solar heating and heat pumps; and industrial zero-emission vehicles and related charging or refueling equipment.
- an investment tax credit to support investments in clean hydrogen production based on the lifecycle carbon intensity of hydrogen.
- A commitment to announce new measures to maintain competitiveness in clean technology manufacturing.

What else is required? There is no need to match the IRA across the board. Canada already has a comprehensive carbon pricing framework in place, which can reduce GHG emissions from energy at a much lower cost than subsidies and grants. Carbon pricing at a sufficient level is an effective substitute and will help reduce emissions from vehicles, built structures, and production processes. There is no compelling competitive reason to provide additional green subsidies in these areas.

Budget 2023 should build on the earlier announcements and focus on three elements:

(1) Broaden tax credits to promote technology-neutral investment in clean fuels and clean tech. They should be available across the value chain, including key inputs such as vehicle batteries and components. Since electricity production is largely under provincial jurisdiction, Ottawa should be ready to share with provinces the cost of tax credits for investment in innovative zero-emission electricity.