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From: Glen Hodgson

To: Canadian Clean Investment Observers

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Re: **Unfinished Business: After Budget 2023, Gaps Remain in Climate Industrial Policy**

April's federal budget took some positive steps to level the playing field with the US for clean investment.

Its initiatives are selective, concentrating on providing fiscal support for investment in clean electricity, hydrogen, and clean tech manufacturing. However, some important policy gaps and questions remain, as I examined in a recent C.D. Howe Institute E-Brief, which may constrain clean investment in specific areas.

First, investment subsidies. There has been blowback in traditional and social media on both the fiscal cost and advisability of using tax credits and subsidies to attract clean investment. Much of this commentary has focused on the high price of the Volkswagen battery plant subsidy while questioning the need for subsidies to encourage clean investment in Canada.

It can be hard to determine if any particular economic activity would have occurred without a subsidy, or if the subsidy has helped to shift business and consumer behaviour as desired. The fiscal cost is an obvious issue too. However, the subsidy debate often neglects the cost of not acting, especially to address a competitive challenge. As discussed in the e-brief, not levelling the investment playing field with the US would mean lost investment, production, jobs and export opportunities; it could also impair Canada's ability to achieve GHG reduction targets. A more complete argument should consider the opportunity costs of both acting and not acting, not just the direct fiscal costs. In this case – and particularly for a new Canadian market entrant like Volkswagen – not responding to US clean manufacturing incentives would have meant investment capital locating south of the border.

Next, there are gaps in Budget 2023, such as no added fiscal support for clean fuels. As a reminder, the new US legislation takes a technology-neutral approach to tax credits for investment in energy with low or no GHG emissions. Its coverage includes sustainable aviation fuel, biofuel, biodiesel, and renewable diesel, in addition to new clean hydrogen, nuclear power, renewable and other new "clean" electricity.

Why were clean fuel tax credit not provided in the budget? There are various factors to consider. Clean electricity, hydrogen, and clean manufacturing were obviously seen as immediate priorities and that is where the bulk of the fiscal support was provided via tax credits. A $1.5-billion clean fuels investment fund was created in 2022 and offers access to federal financing – but which also seems small compared to the scale of tax credits for clean electricity and hydrogen. Perhaps most importantly, the federal government's Clean Fuel Regulations are ramping up, with their binding requirement that fuel GHG emissions must be reduced. Fuel producers will need to invest to meet the rising standard, even without tax incentives.

Thus, the plan is to use a regulatory stick, plus an investment fund, to reduce fuel emissions without offering any additional tax incentive carrot. Is that enough? Some sectors, such as like inland shipping, are already trying out clean fuels as a low-emission substitute for conventional sources, but those clean fuels are apparently being imported, suggesting limited domestic supply capacity. The clean fuel regulation will spark some investment in Canada to meet the demand, but the IRA's tax credits still tilt the playing field for clean fuel investment toward the US.

In addition, tax credits were not provided in the Budget for emerging clean technologies that could develop commercially. Similarly, there is no federal commitment to expand the use of green procurement, such as for emerging clean tech or purchases of direct air capture or zero emission vehicle fleets. These gaps mean Canadian clean tech firms are not being explicitly positioned for commercial success, and hard-to-reduce federal emissions such as from military activity are not being addressed.

Finally, there are implementation questions to consider. The Canada Growth Fund is to be managed by the Public Sector Pension Investment Board (PSPIB), separate from its pension assets, which is a new and surprising mandate. Experts on pension management say that PSPIB is a competent organization that should be able to take on the financial role of managing the growth fund, reducing start-up time. Deputy Finance Minister Michael Sabia recently made this point before a Senate committee. That said, the new fund should aim to maximize the economic and social return from its clean investments, not just the financial return. PSPIB therefore should be expected to develop methodologies and metrics focused on the economic, climate and social benefits to Canada from growth fund investments, in addition to financial performance.

Similarly, the Canada Revenue Agency will need to demonstrate the competencies required to effectively administer the new clean investment and manufacturing tax credits introduced in recent budgets, including the labour standards that would provide access to additional credits.

There is still work to do on many fronts.

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