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From: Glen Hodgson

To: Canadian Budget Observers

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Re: **Budget 2023 Makes a Big Bet on the Zero-Emission Economy**

Last week's federal budget 2023 contains a number of initiatives aimed at ensuring competitive balance with the US *Inflation Reduction Act* (IRA) while promoting the low-carbon energy and industrial transition. Faced with the competitive threat from sweeping US climate and industrial policy, a Canadian federal government response was unavoidable.

The climate and industrial policy package in Budget 2023 is both selective and expensive. The IRA is not matched in terms of overall coverage, and there is bound to be pressure to expand Canadian coverage further from clean fuel and clean tech sectors that were excluded. Nevertheless, a significant level of fiscal support is provided over the next decade where policy action is being taken. In those areas, Canada should be able to maintain and perhaps even strengthen its competitive position.

Federal action is broadly aligned with my earlier advice although with important differences in the detail and at a high price tag. Highlights include:

Clean electricity investment: a 15-percent refundable tax credit for eligible investments in non-emitting electricity generation system, abated natural gas-fired electricity generation, stationary electricity storage systems, and equipment for interprovincial electricity transmission. I like the use of refundable tax credits for zero-emission electricity investment (but not its production), which should help mitigate uncertainty and accelerate decisions to invest. Provinces and territories will be engaged on the design of the tax credit and its level will depend on meeting labour requirements, which is a new feature in Canadian tax policy and mirrors an approach used in the IRA. Added restrictions, however, could reduce the effectiveness of the tax credit and complicate its administration.

This tax credit will accelerate the electrification of the Canadian economy and creates the potential for expanded exports of zero-emission electricity to the US.

This entails federal intervention in a space that has been largely provincial – but we expect provinces and power utilities will be happy to take the tax credit. To our knowledge, this is the first time that tax credits of this sort have been extended to public utilities, setting another precedent. The overall fiscal cost is significant, projected at $25.7 billion to 2034-35.

Investment in clean manufacturing: a 30-percent refundable tax credit for investments in new machinery and equipment used to manufacture or process key clean technologies, and extract, process, or recycle key critical minerals. This tax credit will position Canadian manufacturers and suppliers for success in the zero-emission economy, but it comes with a hefty fiscal price tag of $11.1 billion to 2034-35.

Investment in clean hydrogen: detail was provided on the refundable investment tax credit for clean hydrogen. The level of support will vary between 15 and 40 percent of eligible costs, with the highest levels of support going to projects that produce the cleanest hydrogen. A 15-percent tax credit will be extended to equipment needed to convert hydrogen into ammonia, in order to transport the hydrogen. The projected fiscal cost is considerable at $17.8 billion to 2034-35.

Green finance: the budget announced the Canada Growth Fund would be managed by the Public Sector Pension Investment Board, separately from its pension fund responsibilities. An enhanced mandate was also provided for the Canada Infrastructure Bank (CIB) to invest at least $20 billion to support major clean electricity and clean growth infrastructure projects. *De facto*, CIB has been given a mandate to be the federal green bank.

The Budget also announced forthcoming consultations on the development of carbon contracts for difference, which are federal government contracts with firms intended to build confidence by making carbon pricing and carbon credits more predictable. However, no additional subsidies are provided for personal or commercial vehicles, a clear signal that carbon pricing will be used to nudge consumer and business behaviour.

Providing refundable tax credits for clean energy and industrial investment comes with a fiscal high price, but is clearly focused on supporting the push toward zero emission activities, where there could be upside potential. And the economic cost of not levelling the playing field with the US in these areas was bound to be high as well.

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