Intelligence MEMOS

From: Charles DeLand

To: Natural Resources Minister Jonathan Wilkinson, and Finance Minister Chrystia Freeland

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Re: **Fewer, Stronger Policies Would Help Fill Emissions Investment Gap**

Last month, Canada's Minister of Natural Resources declared he'd like to see more green investment action by industrial greenhouse gas emitters, specifically those in the oilsands.

Around the same time, a new report indicates that policy uncertainty is holding back investors from investing in industrial emissions reduction.

The federal government has proposed several policies to reduce industrial carbon emissions, including those from the oil and gas sector. It mostly relies on a price mechanism to stimulate reductions, with a certain allowance that tightens over time. It's also introduced an investment tax credit (ITC) designed to increase carbon capture and storage (CCUS) investment in industrial facilities.

Why the gap between wish and reality? More precisely, from the government's point of view: How can we prod companies to move faster?

If industry isn't investing, there is a reason. Hectoring companies has rarely proved an effective long-term policy. Clearly, potential emission-reduction investors need something more compelling.

Unfortunately, the government has responded to slower-than-desired action not with greater incentives, but with more policies, such as its new oil and gas sector emissions cap. This is a bad idea for several reasons. It's inefficient, it draws unproductive resources from government and industry, and it counteracts or undermines existing policies.

Treating emissions from some sectors differently than others undermines carbon pricing's principle. While the emissions cap proposes to allow oil and gas emitters to trade emission allowances, restricting reductions and trading to a small corner of the economy gravely damages Canada's ability to reduce emissions at the lowest possible cost.

Compounding the problem with more policies (which takes both government and emitters enormous resources to create, promote, understand, assess, and respond to) makes things worse, not better. Fewer and simpler programs should be the overriding goal.

In addition, investors may interpret the introduction of another policy as a lack of confidence in the existing rulebook. Why make decisions on one set of rules when it will just be superseded? This raises investor uncertainty instead of lowering it. It exacerbates the problem.

The oil and gas emissions cap also works against the effectiveness of the tax credit. Tax credits mean little if a company can't sell its products and make money. It's possible that a price on emissions could eventually result in lower production but at least that would affect those costing the most to abate, a more efficient outcome.

Rather than simply layering on more complexity, why not fix existing policies? The federal government should scrap the proposed oil and gas emissions cap and use its limited resources more productively.

How to do that?

First, the government should recognize the strengths of the current industrial price system yet acknowledge reasonable fears that the policy might change in the future, radically reducing the value of emissions reductions. The fears aren't new – and nearly three years ago Dale Beugin and Blake Shaffer suggested that "locking in" future carbon price assumptions would address that.

To do that, the government should greatly increase its backing of, and speed the implementation of, so-called "carbon contracts for difference" by which companies are able to insulate themselves from future policy changes. These agreements act as insurance for companies to hedge carbon price risk (no responsible board of directors would allow a company to spend shareholder capital without expecting future revenues or cost reductions).

As well, the $7 billion set aside as part of the Canada Growth Fund does not match the scale of investment needed. If the government is serious, it needs to come up with more money, and faster. The first agreement was announced in December 2023. While welcome, it's small ($200 million) and so far stands as one of a kind. This is insufficient for transformative change.

The government has hinted there isn't enough money to back all the projects needed. Acknowledging that is not a bad thing: Canadians ought to know the true costs of that kind of backing. The total cost ought to be estimated and shared publicly. It will be expensive to reduce emissions (money that generates little short-term productive investment), and more honesty is needed about the tradeoffs.

Secondly, Finance Canada could improve the terms of the carbon capture tax credit. Large industrial projects take a long time to develop, win approval, plan and build: the window for the maximum credit should be extended by at least five years. In addition, its "prevailing wage" requirement should be eliminated because it only adds unproductive administrative burden and construction costs to firms, and corresponding extra costs to taxpayers.

Trying to speed emissions-reducing investment by burdening investors with more complexity is counterproductive. Let's give the tools we have a chance to work and make them better. Eliminating the oil and gas emissions cap, getting serious about increasing investor certainty through contracts, and strengthening the carbon capture tax credit are good places to start.

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