GOVERNMENT RESPONSE TO THE REPORT OF THE STANDING COMMITTEE ON INTERNATIONAL TRADE: *THE UNITED STATES' INFLATION REDUCTION ACT OF 2022: TRADE IMPACTS ON CERTAIN CANADIAN SECTORS*

INTRODUCTION

The Government of Canada is pleased to respond to the Report of the House of Commons Standing Committee on International Trade (CIIT), entitled: *The United States' Inflation Reduction Act of 2022: Trade Impacts on Certain Canadian Sectors*.

The Government of Canada appreciates the work of the Committee and welcomes its analysis, views, and recommendations, based on the consultations that the Committee undertook with a wide range of stakeholders. The study identifies the priorities of Canadian stakeholders with an interest in the *Inflation Reduction Act* (IRA) and its impacts on Canada, and it recommends specific Government of Canada actions. The response is set out below by individual recommendation.

The Government would like to thank the Committee and the witnesses for this report and for their continued interest in trade and investment issues.

Recommendation 1

That the Government of Canada develop and implement a national industrial strategy that has specific, measurable and timely actions. Recognizing the need to consider the requirements and preferences of multiple domestic sectors, parts of this strategy should focus on the following three priorities: Canada's ongoing transition to clean technologies and energy sources, as well as achievement of net-zero greenhouse gas emissions by 2050; the domestic manufacturing of certain essential goods; and the ongoing competitiveness of Canada's sectors and the country's ability to attract new investments. In developing and implementing the strategy, the Government should consult with relevant stakeholders, including other governments in Canada, as well as representatives of business trade associations and organized labour groups.

Response: The Government agrees in principle with the Committee's recommendation. The priorities identified by the Committee in its recommendation were integral to the design of industry support measures. In developing these measures, the Government engaged business trade associations, organized labour groups, and many diverse groups and concerned individuals through pre-budget consultations, roundtable discussions, direct meetings with businesses and trade associations, and carefully considered all correspondence received on these matters. As always, the Government will continue to consult with relevant stakeholders as measures are finalized and implemented.

The Government acknowledges the need to continue to support a thriving, sustainable and clean economy. Following the passage of the U.S. *Inflation Reduction Act* (IRA), the Government committed to the actions needed to provide a competitive investment environment in Canada.

That is why the Government acted decisively, with initial actions in the 2022 Fall Economic Statement, and with a comprehensive Made-in-Canada Plan in Budget 2023. This plan is the backbone of the Government's industrial policy to build Canada's clean economy—one that is good for workers, good for business, good for the environment, and which makes life more affordable for Canadians from coast-to-coast-to-coast. Building on Canada's solid foundation of measures to fight climate change, this plan includes a new tiered model of incentives to attract investment, including an anchor regime of clear and predictable investment tax credits, low-cost strategic financing, and targeted programming, where necessary, to respond to the unique needs of sectors or projects of national economic significance. This approach is already yielding results and third-party analyses have confirmed that Canada has established a competitive value proposition for investment.

This approach complements other actions taken by the Government, in response to global supply chain challenges and geopolitical uncertainty, to enhance Canada's economic resilience and security by strengthening domestic capacity in key sectors such as biomanufacturing and life sciences and building supply and value-chains in key industrial sectors such as critical minerals, electric vehicles, and semiconductors.

Recommendation 2
That the Government of Canada consider creating a special manufacturing blue ribbon panel that would include representatives from the private sector and organized labour groups. Among its goals, the panel should work to ensure that future federal support programs designed to meet the evolving needs of Canadian firms are made available expeditiously, and that—with a view to high levels of participation—such firms are made aware of new measures. As well, when creating future federal tax credits and subsidies for the private sector, attention should be paid to implementing measures that would support the ability of Canada's firms to compete with their United States counterparts following the enactment of the United States' Inflation Reduction Act of 2022.

Response: The Government agrees in principle with the Committee's recommendation. The Government agrees with the importance of timely implementation and engagement with Canadian companies and stakeholders to ensure high degree of participation and awareness of federal support programs designed to help them compete. The Government has heard clearly from industry, including Canadian manufacturers and labour groups, that time is of the essence to fully implement Canada's response.

The Made-in-Canada Plan announced in Budget 2023 was informed by the unique circumstances and perspectives of manufacturers and organized labour groups across Canada. The Government is engaging a broader set of interested parties through its real-time engagements and consultations that are already underway. To support timely implementation of measures and avoid duplication of outreach and consultation, the Government will continue to use its existing fora and planned consultation mechanisms to solicit the perspectives of manufacturers and organized labour as key contributors as measures are finalized and implemented.

Ensuring Canadian firms can compete with those in the U.S. and around the world remains a top priority for the Government.

Recommendation 3
That the Government of Canada ensure that federal support measures provided to people, firms and communities—whether in the form of program spending or tax expenditures—are developed with due consideration given to adequacy, accessibility and timely delivery. As well, measures announced in federal budgets and economic statements should be as detailed as possible concerning eligibility requirements and any required application process.

Response: The Government agrees in principle with the Committee's recommendation. The principles of adequacy, accessibility, and timely delivery are key considerations as measures are developed and choices made about their design through the policy development and funding process.

While considerable attention is paid to being as detailed as possible when measures are announced, including those that respond to time-sensitive global developments, the Government also must balance the requirements of properly designed, cost-effective measures, which can require further development and refinement after initial policy announcements are made. For tax measures proposed in the Budget, the Government will typically publish additional supplementary information in an annex to the Budget which elaborates on measure design, including details surrounding eligibility and application.

Moreover, in addition to the considerations raised by the Committee, the Government also takes into account the impacts of policies, programs, and legislation on diverse groups of Canadians through the application of Gender-based Analysis Plus, as enshrined through the *Canadian Gender Budgeting Act 2018*. This analytic lens provides a means to understand the anticipated outcomes and impacts of new measures and informs the design of measures. This is done with a view to maximizing eligibility and realizing other objectives such as reducing barriers to accessing and benefitting from government programs and services by underrepresented groups.

Recommendation 4
That the Government of Canada—alone and in collaboration with other relevant stakeholders, as appropriate—continue with and enhance its advocacy efforts in the United States regarding that country's legislation, policies and measures that could have intended and unintended consequences for Canada. Advocacy concerning the United States' Inflation Reduction Act of 2022 should continue to be part of those efforts.

Response: The Government agrees in principle with the Committee's recommendation. Canada continues to advance its advocacy and engagement efforts with the U.S. as key elements of our approach to addressing trade-related challenges, including efforts regarding U.S. legislation, policies, and measures that could have intended and unintended consequences for Canada. Canada will continue to monitor potential measures that could negatively affect Canadians with a view to ensuring timely advocacy and engagement with U.S. interlocutors in areas of concern. These efforts are critical for continued partnership and collaboration in support of common economic and trade goals, including addressing vulnerabilities and working to increase the resiliency of our integrated economies.

A key component of the Government's advocacy work abroad is the use of a Team Canada approach. This approach has a proven track record of advancing Canadian interests through aligning efforts and working alongside relevant stakeholders, such as representatives from provinces and territories, municipalities, businesses, industry associations, labour groups and others for engagement at all levels. This approach has already helped ensure strong outcomes, such as ensuring that Canadian vehicles, batteries and critical minerals are now eligible under the IRA's U.S. Clean Vehicle Credit (CVC).

Advocacy concerning the IRA will continue around areas of concern with the ongoing implementation of the IRA. Canada has also undertaken other actions, including submitting formal comments to the U.S. Department of Treasury and the Internal Revenue Service in November 2022 on the domestic content requirement "boosters" regarding certain IRA tax credits. Canada's submission noted the economic and security goals shared by Canada and the U.S. and pointed to concerns in a number of areas that would be discriminatory.

Recommendation 5
That the Government of Canada consider designing and implementing federal policies to ensure that goods the Government procures have been produced using low-carbon emitting technologies.

Response: The Government agrees in principle with the Committee's recommendation. The Government is playing an important role in supporting the transition to a net-zero carbon economy by leveraging its purchasing power to drive demand for low-carbon products and services. This is demonstrated by commitments in the Greening Government Strategy (GGS) that address the greenhouse gas (GHG) emissions impact of the Government's procurement in three main ways. First, the GGS requires criteria that address GHG emissions reduction, sustainable plastics, and broader environmental benefits to be integrated into procurements by departments for goods and services that have a high environmental impact. Second, it incentivizes major suppliers to adopt a science-based target in line with the Paris Agreement, and to disclose their GHG emissions and environmental performance information. Third, it strengthens support for green procurement, including guidance, tools, and training for public service employees.

The GGS also commits to reduce the carbon footprint of materials and products used in major federal construction projects by: disclosing the amount of embodied carbon in the structural materials of major construction projects by 2022, based on material carbon intensity or a life-cycle analysis; reducing the embodied carbon of the structural materials of major construction projects by 30%, starting in 2025, using recycled and lower-carbon materials, material efficiency and performance-based design standards; and conducting whole building (or asset) life-cycle assessments by 2025 at the latest for major buildings and infrastructure projects.

Additionally, the Government updated its Policy on Green Procurement in 2018 to include requirements that deputy heads of all federal departments be accountable to buy environmentally preferable goods and services where value for money is demonstrated (i.e., environmental performance), as well as to integrate life-cycle principles in procurement practices. In 2022, two procurement standards were also published as appendices to the Policy on Green Procurement to support the implementation of GGS commitments relating to green procurement: 1) the Standard on the Disclosure of Greenhouse Gas Emissions and the Setting of Reduction Targets, which induces suppliers of procurements greater than $25 million to adopt a science-based GHG emissions target aligned with the Paris Agreement; and 2) the Standard on Embodied Carbon in Construction, which requires the providers of design and construction services on major government projects to disclose and reduce the embodied carbon of structural materials used.

Recommendation 6
That the Government of Canada undertake advocacy efforts with the Government of the United States with the goal of ensuring that all batteries for zero-emission vehicles that are manufactured in North America are eligible for the Advanced Manufacturing Production Credit provided under Section 45X of the United States' Inflation Reduction Act of 2022.

Response: The Government agrees in principle with the Committee's recommendation. The Government will always undertake advocacy efforts to defend Canadian trade interests and will continue to monitor potential measures that could negatively affect Canadian market access. Through ongoing dialogue with partners in the U.S. at all levels, Canada works to ensure that Canadian interests are accounted for. These efforts include the recent advocacy campaign concerning the CVC. The Government will continue to advocate for Canadian interests and look for opportunities to position Canadians and businesses in Canada to benefit from industrial policy changes in other jurisdictions, including the IRA.

While Canada emphasizes the importance of a strong Canada-U.S. trade relationship in all of its interactions with the U.S., it must at the same time continue to consider how best to maintain its competitiveness as a result of incentives adopted by the U.S., and to build its own secure supply chains. To that end, Canada has taken steps to make significant investments domestically into the manufacturing of batteries and battery materials, as well as in developing a secure, affordable supply of critical minerals, including those required for electric vehicles. These steps have also been taken to strengthen Canada's position in the global battery chain, and to cement its place as a global leader in the production of electric vehicle batteries. In fact, Budget 2023 announced a Made-in-Canada Plan to secure these and other clean growth investments through three tiers of federal financial incentives: 1) an anchor regime of clear and predictable investment tax credits; 2) low-cost strategic financing; and 3) targeted investments and programming, where necessary, to secure projects of national economic significance.

Recommendation 7

That the Government of Canada provide incentives for Canadian production of low-cost green hydrogen by expanding the scope of two measures proposed in the 2022 federal fall economic statement: the investment tax credit for clean hydrogen; and the Clean Growth Fund. In particular, their scope should be expanded to include operational costs for the first three years of an eligible firm's operations. As well, the details of the proposed investment tax credit for clean hydrogen should be made clear, partly with the goal of ensuring that investors clearly understand the implications for eligible firms.

Response: The Government agrees in principle with the Committee's recommendation. As an investment tax credit, the proposed Clean Hydrogen Tax Credit (CH Tax Credit) supports Canadian businesses in clean hydrogen production, specifically for their investments in eligible equipment. Under the proposed CH Tax Credit, green hydrogen produced at a low carbon intensity that is under 0.75 kilogram of carbon dioxide equivalent per kilogram of hydrogen would be eligible for the highest level of support (a 40% tax credit on eligible equipment). Investment tax credits typically become available to taxpayers in the year that eligible equipment is available for use.

The proposed CH Tax Credit would support the operation of eligible clean hydrogen production facilities by lowering capital outlays. This would free capital that would then be available and could be used to meet operational costs in the first three years of a firm's operations. The main design details of the CH Tax Credit were announced in Budget 2023. In particular, the supplementary information on tax measures provided in the annex to Budget 2023 includes detailed information on specific project requirements and supported equipment. It also outlines how the Government would measure the carbon intensity of a project.

Recommendation 8

That the Government of Canada ensure that new infrastructure that has been constructed—wholly or in part—with federal funding does not contain high carbon construction materials, particularly imported aluminum or steel produced in emissions-intensive sectors. As well, the Government of Canada should implement relevant measures—including rules, tools and compliance systems—to ensure that imports of such materials are not used in the manufacturing of any equipment or machinery that is eligible for federal tax credits created in response to similar measures contained in the United States' Inflation Reduction Act of 2022.

Response: The The Government agrees in principle with the Committee's recommendation. In the 2030 Emissions Reduction Plan (ERP), the Government committed to introducing a new Buy Clean Strategy for federal investments in infrastructure projects to support and prioritize the use of made-in-Canada low carbon products. The Buy Clean Strategy would harness federal Government procurement and investments in public infrastructure to support existing and new jobs, drive GHG emissions reductions in the construction and industrial material sectors and support the Government’s efforts to achieve net-zero emissions by 2050.

A Government of Canada Buy Clean Strategy would build on the foundation that the Government has already put in place through the GGS and its requirements to disclose and reduce the amount of embodied carbon in the structural materials of major federal government construction projects. This includes the Treasury Board Secretariat (TBS) Standard on Embodied Carbon in Construction, which sets a commitment to using lower carbon concrete in Government procurement and came into effect December 31, 2022. While federal Government procurement serves as a major tool to support the adoption of lower carbon materials, projects funded by the provincial, territorial and municipal levels of government are also important to lower emissions. Indeed, the majority of expenditures used to fund public infrastructure projects are led by provincial, territorial and municipal governments (including federal transfers), government business enterprises (including Crown corporations), and the health and education sectors (Clean Energy Canada 2022 report, ‘Money Talks’).

The Government is consulting with Canadians and Canadian businesses on design parameters for its clean economy measures, including the potential reciprocal treatment of certain eligibility conditions included in the IRA. These include the additional local content requirement “boosters” included in some tax credits if 100% of iron and steel and not less than 40% (increasing to 55% by 2026) of other manufactured products used in a project are produced in the U.S.