CENTRE FOR NET-ZERO INDUSTRIAL POLICY
LE CENTRE DE POLITIQUE INDUSTRIELLE POUR LA CARBONEUTRALITÉ

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Canada's Innovative Tax Credits: Fostering Supply Chain Integration and Enhancing Canadian Content in EV Production | April 26th, 2024

This week sees yet another set of investments in Canada's growing electric vehicle (EV) sector—but this one comes with a significant difference. It will be the first in Canada to take a full supply chain approach, using the new federal EV supply chain investment tax credit.

The federal government is contributing ITCs valued at $2.5 billion towards the $15 billion project, which will see Honda build a new EV assembly plant and a battery manufacturing plant in Alliston, Ontario. The facility will have a production capacity of 240,000 vehicles per year by 2028. Together in a joint venture with POSCO, the car manufacturer will also build a plant to produce cathode active material and precursor material (CAM/pCAM). In addition, Honda will build a separator plant in partnership with Asahi Kasei. This is an investment in not just batteries, but the high value-added midstream segment of the battery supply chain.

Focusing on the wider supply chain is an important distinction from an industrial policy perspective. As an emerging and rapidly evolving sector, scaling the production of EVs faces a number of hurdles. OEMs such as Honda need some certainty that batteries and thus their components will be available before committing to major investments in assembly. Similarly, producers further upstream such as POSCO and Asahi Kasei require more certainty that any investments they make in new production capacity will be located close to their EV assembly customers. Vertical integration and joint ventures are critical strategies in removing this chicken-and-egg dynamic and changing the project economics at each stage of the value chain.

The EV supply chain ITC, recently announced in Budget 2024, recognizes the need to incentivize linked investments up the supply chain. Without explicitly requiring Canadian content, it creates an incentive for firms to include Made-in-Canada midstream materials and battery components. This is smart industrial strategy from the Government. It marks a shift from an earlier strategy that focused just on the downstream. While downstream manufacturing is good for employment, the margins in battery factories will be squeezed due to a glut of assembly plants globally. This investment promises to capture more durable value addition further upstream.

The EV supply chain ITC achieves this by covering an additional 10 per cent of the costs of buildings at various stages of the supply chain: EV assembly, battery production, and cathode active material (CAM) production. This comes over and above the clean manufacturing ITC of 30 per cent for machinery and equipment previously announced in last year's budget.

Critically, to qualify for the new EV supply chain ITC, a manufacturer must also be claiming the clean manufacturing ITC in all three of the segments of the supply chain. One of these segments may be through another company in which the manufacturer is at least a part owner. This new measure clearly intends to incentivize coordinated investments up the value chain.

The Transition Accelerator's work with Accelerate, the Battery Metals Association of Canada, and other partners has emphasized the importance of such an approach, with targeted incentives, to ensure that Canada captures a wider share of the value-add in the growing EV value chain. Investments up the supply chain are key for providing market signals that reach even further—to critical minerals production and refining, and metals processing.

The midstream of metals processing and battery precursor material production represent the most innovative stages of the value chain, where R&D is concentrated in pursuit of efficiencies, material improvements, reduced impacts, and alternative battery chemistries.

As highlighted in the Roadmap for Canada's Battery Value Chain, Canada has potential, in terms of both natural resources and industrial capabilities ("rocks and brains"), to be a major player in the EV market, with activities at all stages of the value chain.

Budget 2024 goes beyond just recognizing this potential by also providing a fiscal incentive that ties together investments across the supply chain. The announcement of Honda's investment in Alliston, with additional provincial contributions of $2.5 billion, showcases the relevance of linking incentives at different stages of production. The EV ITC is expected to cost the federal government just $80 million over the next five years and $1 billion from 2029-2034, relatively modest in comparison to large one-off subsidies, which can also have strings attached to encourage linked investments or objectives such as local content requirements.

This new measure represents a positive step forward in Canada's net-zero industrial policy. More can be done. For instance, further targeted measures are certainly needed for mining and metals processing. Nonetheless, the new EV supply chain ITC represents a welcome evolution in Canada's industrial policy for the net-zero transition—an evolution in line with what key industry players have called for, and also more consistent with what we understand as smart, modern industrial policy.