Business Council of Canada

August 2018

Economic Growth: Ensuring Canada's Competitiveness

Pre-budget submission to the House of Commons Standing Committee on Finance

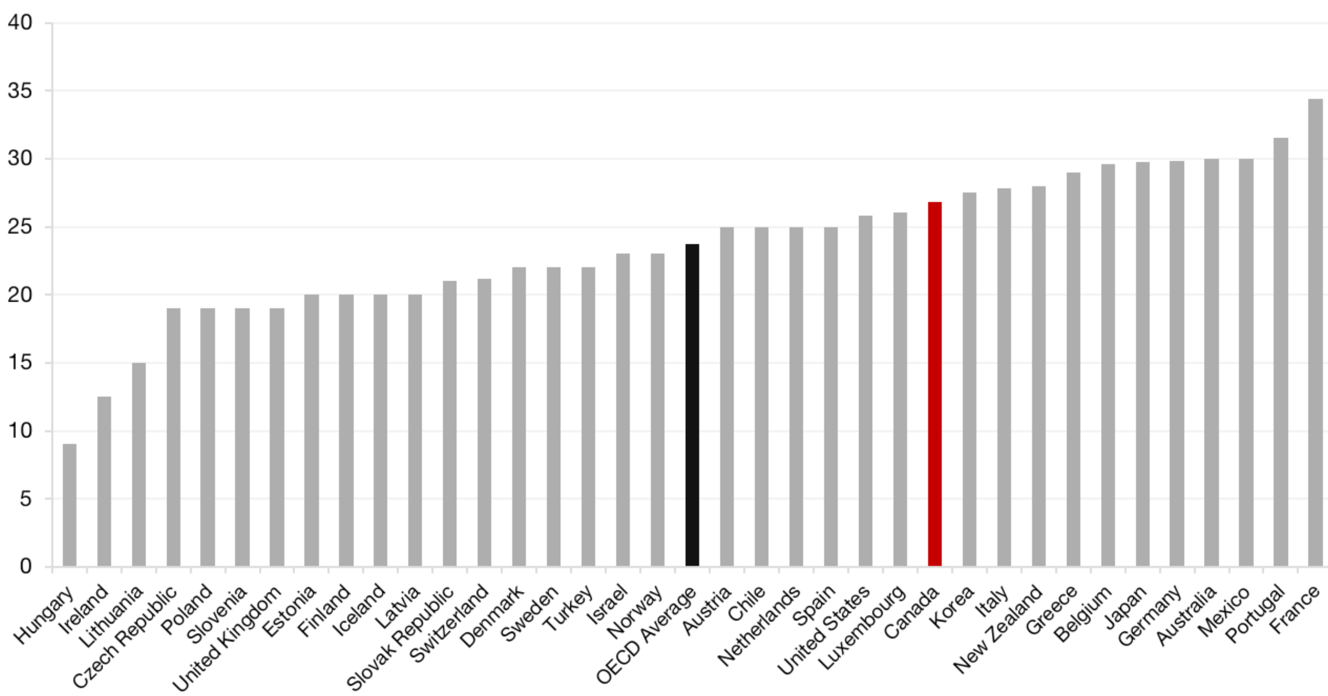
Canada's economy has performed relatively well over the past year but now faces significant headwinds. Eroding tax and regulatory competitiveness, combined with an uncertain trade environment, threaten growth and continued job creation. Only one in seven CEOs surveyed by the Business Council express confidence in the competitiveness of Canada's business climate.[1] To preserve our country's quality of life and standard of living, Canada urgently needs a strategy to improve competitiveness, diversify trade and attract private sector investment.

In Budget 2019, the federal government should put forward a plan to protect and grow the Canadian economy in the face of increasing international competition and uncertainty. We recommend action in the following areas:

Tax competitiveness

Canada's tax competitiveness has slipped over the past decade as other countries have moved to reform their tax systems. Canada's average combined federal/provincial corporate tax rate sits over three percentage points higher than the average of the 36 member countries of the Organisation for Economic Cooperation and Development (OECD): 26.8 per cent compared to 23.7 per cent.

Combined corporate income tax rates



Source: Organisation for Economic Cooperation and Development

Effective January 1, 2018, the United States reduced its federal corporate income tax rate from 35 per cent to 21 per cent and allowed for full expensing of investments in machinery and equipment. The reform package also introduced new international tax rules that encourage multinationals to shift capital to the United States.

[1] Anonymous survey of 90 CEOs between April 24 and May 4, 2018.

These changes have given the United States a significant tax advantage over many advanced economies but in particular Canada, given our country's proximity and high level of dependence on the U.S. market. Canada's long-held corporate tax rate advantage over the United States has been eliminated, exacerbating other competitiveness challenges. The Council is currently undertaking a detailed study of U.S. tax reform and implications for Canadian companies, the results of which will be released in the coming month.

In the survey cited above, we asked 90 Business Council members whether they agreed that, "Canada's tax rates are attractive". Only one said yes, while five (5.7 per cent) offered no opinion. In contrast, 33 per cent "disagreed" with the statement and 60 per cent "strongly disagreed".

We also asked CEOs whether U.S. tax reform would influence their companies' future investment plans. Nearly two-thirds said it "definitely" (30 per cent) or "probably" (33 per cent) would have an impact. Considering that the pace of direct investment in Canada was already at an eight-year low as of 2017, this is an alarming finding.

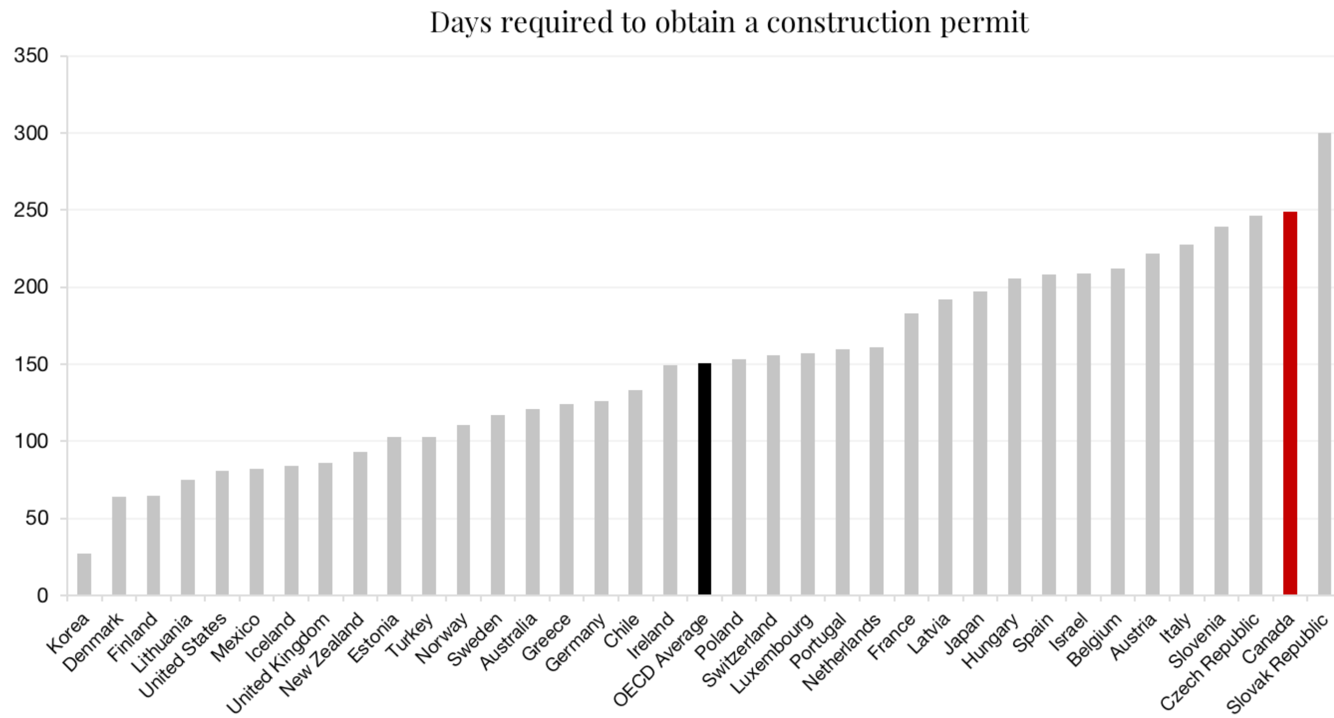
The federal government should move swiftly to shore up Canada's tax competitiveness. The most direct way to signal Canada's resolve to foreign investors would be to announce an immediate reduction in the corporate tax rate and commit to achieving, over the medium term, an average combined statutory rate in line with, or below, the OECD average. We also recommend a review of the tax system by an independent panel of experts, as proposed by the federal Advisory Council on Economic Growth. The objective of such an exercise should be to broaden the tax base, lower rates and simplify the tax code.

To attract and promote new business investment, we recommend that Budget 2019 include a temporary tax measure allowing companies to immediately deduct the full amount of capital expenditures. Consideration should be given to applying the immediate deduction to structures and intangibles in addition to equipment. These measures would reassure businesses and investors that Canada is committed to tax competitiveness and open to new investment.

Regulatory reform and internal trade

Canada's business leaders are deeply concerned about Canada's regulatory environment. The CEOs who participated in our survey identified the regulatory burden as the single most important factor affecting their investment plans. Fully 66 per cent strongly disagreed, and another 27 per cent disagreed, with the suggestion that Canada's regulatory environment "is efficient and does not impose substantial additional costs on my company".

Independent studies provide further confirmation that Canada's regulatory environment is uncompetitive. For example, Canada ranks 35 out of 36 advanced economies in the time required to obtain a permit for a new general construction project – roughly three times longer than in the United States, the United Kingdom or Mexico. A separate World Bank study compares business regulation on domestic firms in 190 countries around the world. In 2009, Canada ranked 8th for the ease of doing business. By 2018 we had fallen to 18th place. Economist Paul Boothe of the Institute for Competitiveness and Prosperity calls Canada's performance "dismal", adding: "By setting a goal of rejoining the top 10 countries in the ranking, Canadian governments might do more to help our businesses compete in the global marketplace."



Source: The World Bank

Governments at all levels urgently need to improve Canada's regulatory environment. This means removing key bottlenecks to investment and innovation, while implementing reforms to make the regulatory system more agile and responsive. The federal government can support this agenda in Budget 2019 by:

- Implementing a package of federal regulatory changes to resolve specific irritants identified through the targeted regulatory reviews that were announced in Budget 2018;
- Working with the provincial and territorial governments to reconcile one-third of the 23 regulatory measures that have been identified as priorities by the Regulatory Reconciliation and Cooperation Table, which was established under the Canada Free Trade Agreement;
- Establishing an expert body to advise the federal, provincial and territorial governments on regulatory modernization and coordinated responses to new technology trends;
- Continuing to support international regulatory cooperation initiatives such as the Canada-U.S. Regulatory Cooperation Council.

Energy infrastructure

Canada needs to send a strong signal to the world that it is committed to the long-term development of the country's oil and gas sector provided it is done in an environmentally responsible way. The recent fight over the Trans Mountain pipeline project has seriously undermined investor confidence and raised questions about our country's ability to carry through with major energy infrastructure projects.

Investors need to know that, once a project has satisfied all regulatory requirements and received approval, it can proceed without the risk of encountering additional hurdles. The principle of "one project, one review" remains far from reality. The federal government should deliver on its promise to reform approval processes for major private-sector infrastructure projects, ensuring that such processes are transparent, predictable, fact-based and capable of rendering decisions in a timely manner.

Trade diversification

The Canada-U.S. trade and investment relationship is by far Canada's largest and most important, yet it is currently under siege from an increasingly protectionist U.S. administration. The NAFTA negotiations are all but stalled and President Trump has imposed arbitrary tariffs on steel and aluminum products – and may go even further by slapping tariffs on autos. Securing a modernized NAFTA as quickly as possible must remain the federal government's top priority.

At the same time, we strongly support the government's efforts to diversify Canada's trade and help companies find new markets and customers. Canada should immediately ratify the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), redouble efforts to forge a closer economic partnership with China, and move from exploratory talks to formal trade negotiations with the Association of Southeast Asian Nations (ASEAN).

We also recommend additional support for Canada's Trade Commissioner Service (TCS). More resources and increased autonomy for the TCS in Budget 2019 would strengthen its ability to help Canadian companies and entrepreneurs succeed globally. The TCS performs an invaluable service by ensuring that firms of all sizes – but in particular SMEs – can take advantage of Canada's expanding suite of trade agreements.

Talent

One of the country's competitive strengths is the quality of its labour force. While the federal government has made significant progress in promoting Canada as a destination for high-skilled workers, more needs to be done to enhance talent development.

In a number of sectors critical to the Canadian economy – including information technology, manufacturing, construction and natural resources – the demand for skilled, entry-level employees consistently outstrips supply. In 2015, our Council worked with leaders in Canada's post-secondary education sector to launch the Business/Higher Education Roundtable (BHER). BHER's mission is to strengthen Canada's long-term economic performance and promote skills development by deepening collaboration between large employers and post-secondary institutions.

One of BHER's goals is to ensure that, by 2018, every post-secondary student in Canada has access to at least one work-integrated learning (WIL) opportunity before he or she graduates. The Council fully endorses this goal and encourages the government to embrace the recommendations put forward by the Roundtable in its pre-budget submission.

Conclusion

U.S. trade and tax policies have put the Canadian economy at risk. This comes at a time when direct investment in Canada had already plummeted to $33.8 billion last year from a high of $126.1 billion in 2007. To reverse this trend and grow the economy Canada needs to adopt a clear strategy to improve competitiveness. The recommendations contained in this submission will help Canadian companies grow while attracting new investment from abroad.

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