2017-2018 Pre-Budget Submission

Presented to the House of Commons Standing Committee on Finance

Submitted by:

Canadian Manufacturers & Exporters
www.cme-mec.ca

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Canadian Manufacturers & Exporters

Executive Summary:

Productivity is the single most important determinant of economic growth and prosperity. A productive economy attracts investment, creates jobs, supports wage growth, and improves the standard of living for all Canadians.

Unfortunately, Canada has one of the lowest rates of manufacturing productivity growth within the OECD. As a result, a wide gap has emerged between Canada and many of its global competitors. For example, manufacturers in the United States are 154 per cent more productive today than they were in 1990. In Canada, that figure stands at just 73 per cent.

This trend needs to be reversed. Manufacturing is the lynchpin of the Canadian economy. Directly and indirectly, it accounts for close to 30 per cent of all economic activity nation-wide and about 27 per cent of employment. Low productivity causes domestic and foreign investment to pass Canada by and settle in other countries. The result is a lost opportunity to create high-paying middle-class jobs and stimulate economic growth and wealth creation.

To address the productivity gap in manufacturing and to help put Canada on the path to long-term economic growth and prosperity, Canadian Manufacturers and Exporters recommends the following:

Recommendations:

1. **The Government of Canada should increase direct investments in high-potential firms by creating a risk-sharing funding program aimed at improving productivity and accelerating the commercialization of innovative products.**

2. **The Government of Canada should expand the size of its Strategic Innovation Fund to $2 billion per year, make the program permanent, and earmark half of those funds for innovations tied to manufacturing. The SIF should also be expanded to include tax credits for process improvements and software purchases, and support should be available to all manufacturers on a non-discriminatory basis.**

3. **The Government of Canada should enhance depreciation rates and provide tax credits to encourage investment in machinery and equipment, as well as environmental and advanced manufacturing technologies.**

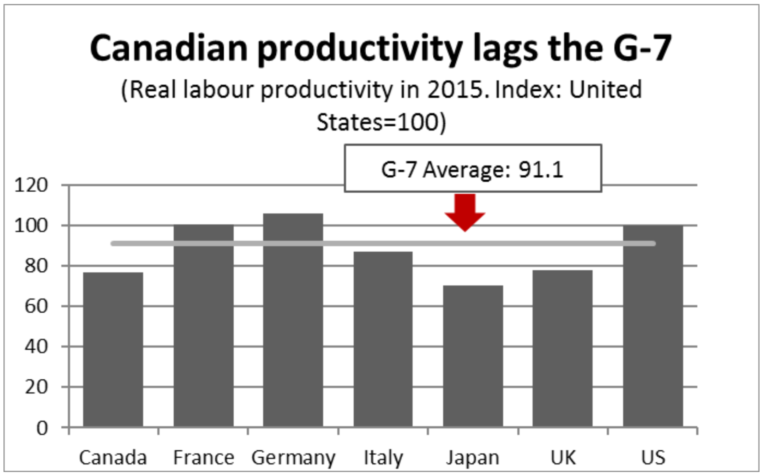
4. **The Government of Canada should create a globally-competitive business tax structure in Canada that supports growth and investment.**

5. **The federal government should increase investment in employer-led workforce training, while also working with industry to attract underrepresented groups to jobs in manufacturing.**

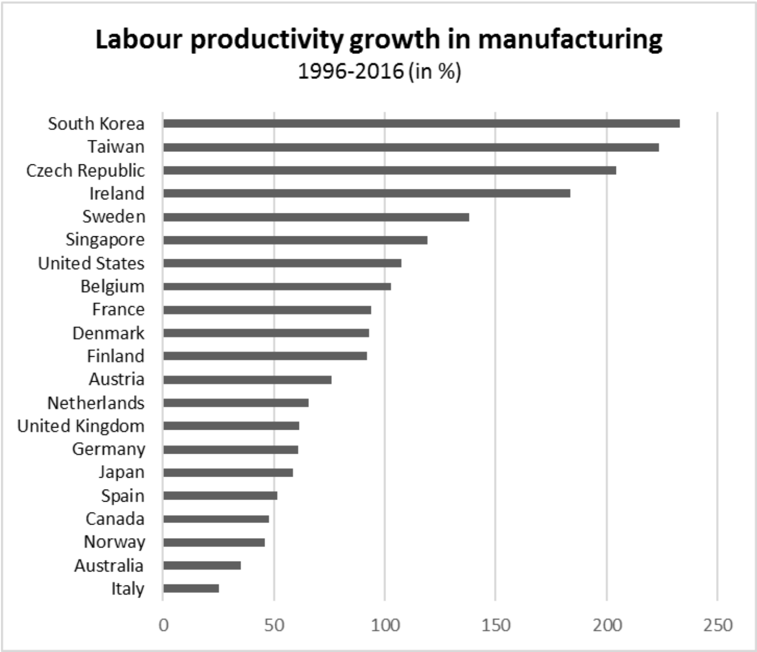
Background/Context:

Canadian Manufacturers & Exporters (CME) is pleased that the House of Commons Standing Committee on Finance is focusing its pre-budget consultations on issues related to productivity and competitiveness in Canada. Productivity is the single most important determinant of economic growth and prosperity. A productive economy attracts investment, creates jobs, supports wage growth, and improves the standard of living for all Canadians.

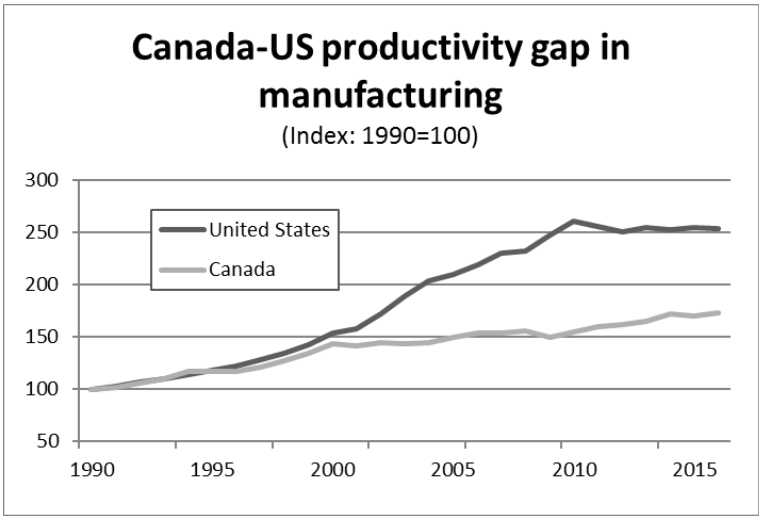
Unfortunately, Canada' productivity record is not strong. According to data from the OECD, overall labour productivity in the Canadian economy is among the worst in the G-7. The United States is 30 per cent more productive than Canada. Germany is 38 per cent more productive.



The situation is much the same within the manufacturing sector. Over the last 20 years, Canada has one of the lowest rates of manufacturing productivity growth within the OECD. As a result, a wide gap has emerged between Canada and many of its global competitors. Absent real productivity growth, our competitiveness increasingly relies on mitigating factors like a low exchange rate, which effectively makes all Canadians poorer in the process.



Perhaps most concerning for Canada is the large gap in manufacturing productivity between this country and the United States. American manufacturers are 154 per cent more productive today than they were in 1990. In Canada, that figure stands at just 73 per cent. Much of that gap emerged in the late 1990s and into the 2000s, when the widespread use of the internet and digital technologies in the workplace first began. Productivity in the United States soared during that period while in Canada growth was tepid at best.



The good news is that this gap has narrowed slightly in recent years. Since 2011, productivity in Canadian manufacturing has risen by 8.1 per cent, while in the US it has fallen by 0.7 per cent. Within the G-7, only Germany has outperformed Canada in manufacturing productivity growth over the last five years. Even so, there is still a considerable gap to overcome. Canada competes with the world to attract manufacturing investment; low productivity creates a disadvantage that causes that investment to settle in other countries. The result is a lost opportunity to create high-paying middle-class jobs and stimulate economic growth and wealth creation.

Moreover, stagnant productivity growth in US manufacturing has not gone unnoticed. American policy-makers have ambitious plans to lower taxes, reduce the regulatory burden and boost business investment – all of which will help stimulate new growth and raise productivity south of the border. Canada needs to respond quickly to this challenge, or it may start widening again.

There are a number of specific areas where steps can be taken to improve productivity in manufacturing and, by so doing, put the country on the path to long-term economic growth and prosperity. These areas include:

- Improving Canada's record on business-sector R&D, innovation, and new product development and commercialization;
- Helping Canadian manufacturers increase investment in productivity-enhancing machinery and equipment, as well as the adoption of new advanced manufacturing technologies;
- Creating a more competitive business environment by reducing the tax and regulatory burden on manufacturers; and
- Addressing skills training and labour shortage issues, including the under-representation of women in the manufacturing workforce.

With that in mind, CME is pleased to present the following recommendations to the Government of Canada.

Recommendations:

A. Improving Canada's record on innovation and commercialization

Productivity and competitiveness is driven by innovation – the ability to convert ideas into new ways of producing goods and commercializing new products. One of the biggest hurdles manufacturers face in this area is the risk that the product will be commercially unsuccessful. The costs of developing and commercializing a new product can be significant and the economic return far from guaranteed. Mitigating those risks would make a tremendous difference for manufacturers in their capacity to innovate and commercialize new products.

To that end, we recommend that:

RECOMMENDATION 1: The Government of Canada increase direct investments in high-potential firms by creating a risk-sharing funding program aimed at improving productivity and accelerating the commercialization of innovative products.

Funds would be provided to businesses through conditionally-repayable loans for the long-term commercialization of R&D projects, market development and business expansion covering up to one third of eligible expenses. The program would be geared to pre-competitive projects across a wide spectrum of technological development, including environmental technologies, life sciences, information and communications technologies, and advanced manufacturing. Repayment terms would be subject to the successful commercialization of the technology.

In early July, the federal government announced the creation of a five-year, $1.26-billion Strategic Innovation Fund intended to boost Canada's innovation record in four areas:

- business research, development and commercialization of new products and services;
- firm growth and scale-up;
- attraction of new investments to Canada; and
- public-private collaboration in developing and demonstrating new technologies.

CME applauds this initiative; it represents a strong step in the right direction to encourage high-quality investments in new technologies and expand the range of goods produced in Canada. However, we have concerns with the size of the program. Total funding of $1.26 billion over five years will not be enough to close the wide innovation gap that presently exists between Canada and our major international manufacturing competitors. In addition, we believe the SIF should be expanded to include process improvement and software purchases, as well as new product development. Finally, funds should be available to all manufacturers, not just those which were covered by the predecessor programs.

We therefore recommend that:

RECOMMENDATION 2: The Government of Canada should expand the size of its Strategic Innovation Fund to $2 billion per year, make the program permanent, and earmark half of those funds for innovations tied to manufacturing. The SIF should also be expanded to include tax credits for process improvements and software purchases, and support should be available to all manufacturers on a non-discriminatory basis.

B. Investment in machinery, equipment and advanced technologies

Investment in new machinery, equipment and advanced technologies is the most important factor in improving manufacturing productivity and competitiveness, as well as reducing greenhouse gas emissions.Unfortunately, Canada is moving in the wrong direction. Investment levels not only lag well behind those of our global competitors, they are falling instead of rising.

To help reverse this trend, we recommend:

RECOMMENDATION 3: The Government of Canada enhance depreciation rates and provide tax credits to encourage investment in machinery and equipment, as well as environmental and advanced manufacturing technologies.

This should be done through two specific initiatives:

a. Introduce a permanent accelerated capital cost allowance tax structure for environmental and advanced manufacturing technologies that allows manufacturers to claim an immediate first-year write-off of all qualifying capital expenditures, including software.
b. Extend the current Atlantic Investment Tax Credit program across Canada and raise the credit level from 10 per cent of eligible expenses to 25 per cent.

C. Creating a more competitive business environment

To be globally competitive requires having a tax and regulatory structure in place that attracts domestic and foreign investment and that encourages small companies to grow into large companies. Unfortunately, Canada's business tax and regulatory competitiveness is eroding. As countries like the US are lowering taxes and reducing the regulatory burden to stimulate investment, Canada is moving in the opposite direction.

To make Canada a more attractive place in which to do business, we recommend that:

RECOMMENDATION 4: The Government of Canada create a globally-competitive business tax and regulatory structure in Canada that supports growth and investment by:

a. Committing to a full review of the corporate tax system to ensure that it is competitive and attracts new investment to Canada, including
    a. Establishing a national manufacturing and processing tax credit that reduces the effective federal corporate tax rate on manufacturers from 15 per cent to 12 per cent;
    b. Reforming the business tax structure to ensure that it does not penalize small companies from growing beyond a certain size; and
    c. Changing the corporate tax structure so that business income that is retained for the purpose of re-investment into new capital is made tax-exempt.
b. Implementing a Regulatory Bill of Rights that increases transparency and predictability and focuses regulations on achieving desired policy outcomes rather than prescribing business processes.

D. Addressing labour and skills shortages in manufacturing

Manufacturers consistently rank labour and skills shortages as the most important issues they face. These shortages are driving up costs, undermining productivity and eroding manufacturers' global competitiveness. They are also causing companies to under-invest in advanced manufacturing technologies because business lack workers with the necessary technical know-how to use those technologies to their fullest potential.

These shortages stem from a range of factors, including: an inability to attract youth, women and other under-represented groups into manufacturing; and a disconnection between the formal training system and industry needs. As a result, job vacancies for certain positions are high, the manufacturing workforce is aging rapidly and the sector's unemployment rate is at its lowest level in more than 40 years.

Manufacturers need help from governments to improve the quality of formal and on-the-job training, as well as to attract underrepresented groups to the sector.

We recommend:

RECOMMENDATION 5: The federal government should increase investment in employer-led workforce training, while also working with industry to attract underrepresented groups to jobs in manufacturing. Specifically:

a. Expand and improve the Canada Job Grant:
    I. Making the program permanent and expanding its funding envelope
    II. Allowing for the funding of multi-year training and expanding the range on-the-job training eligible under the program
    III. Standardizing processes across the country and speeding up approval times.
b. Work with industry to develop new and innovative ways to introduce women, youth, Indigenous Canadians and other under-represented groups to jobs in manufacturing.

Who We Are:

Since 1871, Canadian Manufacturers & Exporters has been fighting for the future of Canada's manufacturing and exporting communities and helping them grow. The association directly represents more than 2,500 leading companies nationwide. More than 85 per cent of CME's members are small and medium-sized enterprises. As Canada's leading business network, CME, through various initiatives including the establishment of the Canadian Manufacturing Coalition, touches more than 100,000 companies from coast to coast, engaged in manufacturing, global business and service-related industries. CME's membership network accounts for an estimated 82 per cent of total manufacturing production and 90 per cent of Canada's exports.

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Contact Us:

Mathew Wilson, Senior Vice President
Canadian Manufacturers & Exporters
mathew.wilson@cme-mec.ca

Mike Holden, Director of Policy and Economics
Canadian Manufacturers & Exporters
mike.holden@cme-mec.ca