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& E CANADIAN MANUFACTURERS & EXPORTERS

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EC MANUFACTURIERS & EXPORTATEURS DU CANADA

2021 FEDERAL PRE-BUDGET SUBMISSION

CANADIAN MANUFACTURERS & EXPORTERS (CME)

CME-MEC.CA

1400 - 67 Yonge Street, Toronto ON M5E 1J8

RECOMMENDATIONS

1. Recommendation 1: That the government de-risk and encourage manufacturers to digitize, automate, adopt advanced technology, and help drive productivity growth. Specifically: (i) Introduce a 10 per cent refundable investment tax credit on the purchase of new machinery, equipment and technologies, including software; (ii) Recapitalize existing investment support programs, such as the federal Strategic Innovation Fund (SIF), and streamline and speed their application processes to provide business certainty; (iii) Relaunch investment support grant programs for smaller firms, modelled after the successful CME SMART programs that operated after the previous recession.

- Recommendation 2: That the government support R&D spending and scale-up of companies by improving and enhancing the SR&ED program. Specifically: (i) Expand the range of SR&ED-eligible activities; (ii) Introduce a refundable component to the SR&ED credit for all claimants; (iii) Return the SR&ED tax credit rate to 20 per cent; (iv) Support scale-up by reducing the SR&ED grind down for growing companies; (v) Ensure that the Canada Emergency Wage Subsidy (CEWS) does not impact eligibility for SR&ED credits.

- Recommendation 3: That the government implement a patent box regime to reward commercialization and production of goods and advanced technologies in Canada, thus eliminating a key competitive disadvantage between us and a growing number of our international peers.

- Recommendation 4: That the government provide employer incentives to upskill, hire and retain workers, thus creating jobs for unemployed Canadians and helping to address labour and skills shortages in manufacturing. Specifically: (i) Introduce a 50 per cent worker training tax credit that offsets company costs for new hires during their first five years of employment; (ii) Renew and expand funding for CME's Women in Manufacturing initiative to recoup employment losses suffered by women in the sector; (iii) Offer tax credits to companies to create child care spaces for their workers.

- Recommendation 5: That the government help the manufacturing sector adapt to and advance Canada's climate change strategy. Specifically: (i) Introduce a Green Innovation Fund that encourages the development and production of new, leading-edge emissions reduction and clean technologies; (ii) Introduce a green investment tax credit that encourages Canadian manufacturers to invest in emissions reduction and clean technologies; (iii) Create and fund a program that supports SMEs in their efforts to lower carbon emissions, including activities that lower the barriers to energy efficiency investments.

- Recommendation 6: That the government increase Canadian value-added exports. Specifically: (i) Introduce an export tax credit to offset export market development costs; (ii) Fund the creation of an Exporter Concierge Service that enables trade associations to develop programs that link their members to government export agencies and services; (iii) Create a "Trade Barrier Hotline" for exporters to call and report trade barriers and to offer exporters assistance in overcoming trade barriers; (iv) Invest in infrastructure that facilitates trade and industrial development.

- Recommendation 7: That the government continue actions to fight COVID-19 and prepare for future pandemics. Specifically: (i) Keep supporting the economy with emergency measures until the economy improves; (ii) Support Canadian manufacturers of personal protective equipment (PPE) and other critical goods to build domestic capacity to keep Canadians safe and create jobs.

INTRODUCTION

By any measure, manufacturing is critical to Canada. The country's 90,000 manufacturers directly generate over 10 per cent of the country's GDP and nearly two-thirds of its merchandise exports. Including direct and indirect impacts, the sector's footprint amounts to nearly 30 per cent of Canada's economic activity. The sector directly employs 1.7 million Canadians and supports their families and communities through stable, highly skilled, high wage jobs, and supports over 3 million more Canadian jobs through its massive integrated supply chain.

The sector's critical importance has been amplified during the COVID-19 pandemic. As soon as the crisis started, many manufacturers ramped up or shifted production to make more food, PPE, and other health care products that have helped in the fight against COVID-19. And, because the industry was deemed an essential service and allowed to continue operating, it helped to stabilize the economy during the lockdown phase and helped to accelerate the recovery as the economy reopened.

That said, the manufacturing sector has also encountered numerous challenges over the past 12 months, most notably supply chain disruptions and depressed demand for certain key products. These near-term challenges have only exacerbated long-term problems already plaguing the industry. Investment in Canada's manufacturing sector has been very sluggish since the early 2000s, and this compares very unfavourably to trends in other developed economies. For example, in 2019, U.S. manufacturing investment was more than 50 per cent higher than its 2004 level, while it was only 8.5 per cent higher in Canada. As a result, manufacturing output and export growth has been much weaker in Canada compared to its global peers. In fact, Canada's manufacturing sector has had the weakest output performance among the G7 countries since 2005. This all points to an overall decline in global competitiveness for Canada's economy and manufacturing sector.

Although manufacturers are committed to doing all they can to help Canada fight the COVID-19 pandemic, the long-term erosion of our industrial and economic competitiveness has limited the sector's ability to respond. If Canada is to be better prepared for the next crisis, actions must be taken that enable the manufacturing sector to prosper over the long run. To achieve this, the federal government must work with our sector to implement this submission's recommendations. In our view, reigniting Canada's manufacturing sector—a critical engine of the economy—is essential if Canada is to build a more competitive, greener, innovative, inclusive, and resilient economy.

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RECOMMENDATIONS

Recommendation 1: De-risk and encourage manufacturers to digitize, automate, adopt advanced technology, and help drive productivity growth

Canada lags other industrialized countries when it comes to digitization and the adoption of advanced manufacturing technologies. Our record on capital investment in recent years is one of the worst in the entire OECD, and this poor record is directly affecting the competitiveness of our manufacturing sector. CME's latest Management Issues Survey shows that the biggest obstacle to adopting new technologies is linked to cost. Over 60 per cent of businesses stated that the price tag was an important obstacle, while over half also cited a lack of financial and tax incentives as an important hurdle. Both these statements provide yet further evidence of the need for stronger government support to offset costs. Therefore, CME recommends that the government:

1. Introduce a 10 per cent refundable investment tax credit on the purchase of new machinery, equipment and technologies, including software. This could be achieved by extending the Atlantic Investment Tax Credit so that it applies across the country.
2. Recapitalize existing investment support programs, such as the federal Strategic Innovation Fund (SIF), and streamline and speed their application processes to provide business certainty.
3. Relaunch investment support grant programs for smaller firms, modelled after the successful CME SMART programs that operated after the previous recession.

Recommendation 2: Support R&D spending and scale-up of companies by improving and enhancing the SR&ED program

Along with technology adoption, Canada is also a weak performer on R&D spending. In fact, Canada's business expenditures on R&D (BERD) as a share of GDP are well below the OECD average and have continued to fall since its peak in 2001. Reversing this trend would see Canada's spending levels move closer to peer countries internationally, thus encouraging new discoveries and innovation. This could be best accomplished by enhancing the Scientific Research and Experimental Development Tax Credit Program (SR&ED), the main mechanism through which the federal government supports business R&D. CME asks the government to:

1. Expand the range of SR&ED-eligible activities.
2. Introduce a refundable component to the SR&ED credit for all claimants. (This change is particularly important at a time when many firms are struggling to make a profit.)
3. Return the SR&ED tax credit rate to 20 per cent.

4. Support scale-up by reducing the SR&ED grind down for growing companies (the refundable tax credit expenditure limit is grinded down if taxable capital employed in Canada in the previous tax year exceeds $10 million and is eliminated at $50 million).
5. Ensure that the Canada Emergency Wage Subsidy (CEWS) does not impact eligibility for SR&ED credits.

Recommendation 3: Implement a patent box regime to encourage domestic innovation, commercialization and production

Canada also struggles with commercializing ideas and bringing products to markets. Too many of our ideas end up generating wealth for others. One tool available to the government to help Canada overcome its commercialization gap would be to adopt a patent box regime. Patent boxes allow corporate profits related to the sale of patented products or the use of intellectual property to manufacture products to be taxed at significantly lower rates than those applied to ordinary business income. Such a regime provides firms with a strong incentive to undertake innovation, commercialization and production activities locally.

Most empirical studies have found that patent box regimes are associated with an increase in patents, a proxy for innovative activities. Given their apparent effectiveness, patent boxes are growing in popularity, with at least 17 countries having some form of patent box system today. Although Canada is not among this group, Quebec adopted a patent box regime in 2017.

A well-thought out and carefully structured patent box will pay dividends in the long run. Manufacturers would be encouraged to conduct R&D, create intellectual property, and turn it into leading edge commercial products, right here in Canada. This would, in turn, help drive investment growth in the country, and lead to the creation of well-paying manufacturing jobs. It would also help to stop the erosion of Canada's tax base by discouraging the transfer of IP to other jurisdictions with patent box regimes and thus lower tax rates. Accordingly, it is CME's position that the government should:

1. Implement a patent box regime to reward commercialization and production of goods and advanced technologies in Canada, thus eliminating a key competitive disadvantage between us and a growing number of our international peers.

Recommendation 4: Provide employer incentives to upskill, hire and retain workers, thus creating jobs for unemployed Canadians and helping to address labour and skills shortages in manufacturing

The COVID-19 pandemic has had a devastating impact on the Canadian labour market. Employment plunged by almost 3 million in March and April, and the economy has recovered only 2 million of these jobs so far. Despite the government's strong fiscal and monetary response, the unfortunate fact is that some portion of the pandemic-related job losses will be permanent. Indeed, in the previous three recessions, roughly 45 per cent of all laid off workers were permanently laid-off.

Although manufacturers also laid off workers in the spring, the sector had recouped nearly all its job losses by the end of the year. This is a clear signal that labour and skills shortages, which were one of the sector's most pressing challenges before COVID-19 hit, will remain a key challenge after the crisis is over. In fact, in CME's 2020 Management Issues Survey, which was conducted in the middle of the pandemic, 60 per cent of manufacturers reported having immediate labour and skills shortages.

These two opposing trends present a huge opportunity to help transition workers displaced by the COVID-19 pandemic into manufacturing, thus creating good jobs for Canadians. But manufacturers are struggling to keep up with the cost of training and thus need government help. In other words, to jumpstart the transition of displaced workers, governments need to create strong incentives for employers to enhance investments in training.

It is also important to note that, due to the unique characteristics of this recession, many of the workers facing the most difficulties are members of underrepresented groups. For example, the pandemic has been particularly harmful to women's labour market progress. There are two reasons for this: women are more highly represented in sectors that have been most impacted by physical distancing measures and they have shouldered the burden of childcare responsibilities during disruptions to daycare centres, school, and after-school programs. That said, this story is also playing out in traditionally male-dominated sectors, including in manufacturing. In January 2021, female employment in manufacturing was 3.5 per cent below its pre-pandemic level, while male employment was 0.8 per cent above this threshold. Without extra support from the government, working mothers will continue to face the difficult choice of taking care of their children or earning an income.

Thus, CME recommends that the government:

1. Introduce a 50 per cent worker training tax credit that offsets company costs for new hires during their first five years of employment, enabling businesses to quickly up-skill workers and hire and retain workers.
2. Renew and expand funding for CME's Women in Manufacturing initiative to recoup employment losses suffered by women in the sector.
3. Offer tax credits to companies to create child care spaces for their workers and include in the tax credit expenses incurred seeking professional help in developing such support systems.

Recommendation 5: Help the manufacturing sector adapt to and advance Canada's climate change strategy

CME recognizes and believes that all Canadians, including the manufacturing sector, have a responsibility to help address climate change. As such, we support the shift to a clean technology economy. However, the scale and magnitude of the government's climate change plan necessitates proportional countermeasures to help ease the transition for Canadian businesses, especially those in energy-intensive, trade-exposed industries (EITEs). Therefore, we urge the government to fully consider the extent to which these policies are increasing the costs of doing business and harming Canada's competitiveness and, at the same time, increasing the risk of carbon leakage. Carbon pollution pricing, the Clean Fuel Regulations (CFR), and other similar measures must be offset by transformative carbon reduction investment incentives. Also, it is important that these incentives support all the many things that manufacturers do to improve their environmental performance, both big and small, because it is going to take a collective effort to win the fight against climate change. Therefore, we recommend that the government:

1. Introduce a Green Innovation Fund that encourages the development and production of new, leading-edge emissions reduction and clean technologies, including carbon capture, utilization and storage (CCUS), direct air capture (DAC), hydrogen, and small modular reactors (SMRs).
2. Introduce a green investment tax credit that encourages Canadian manufacturers to invest in emissions reduction and clean technologies.
3. Create and fund a program that supports small and medium-sized enterprises (SMEs) in their efforts to reduce carbon emissions, including activities that lower the barriers to energy efficiency investments such as energy audits, technology demonstration projects, site visits, and 'how-to' guidance materials.

Recommendation 6: Provide more support to help Canadian businesses increase their value-added exports

Canada is a trading nation. This is evidenced by the fact that exports account for over 30 per cent of the country's GDP. The manufacturing sector is a key reason why Canada has earned this reputation: it is responsible for roughly two-thirds of the country's outbound goods. Also, of the 45,500 Canadian firms that export goods or services, 16,300 or about 35 per cent are manufacturers. However, Canada's export performance in recent years leaves much to be desired. Over the past 20 years, Canada has posted the slowest growth in exports of manufactured goods among the G7 countries (valued in US dollars). Unfortunately, rising protectionist measures are only making it harder for Canadian businesses to gain a foothold in foreign markets. Clearly, more needs to be done to help Canadian companies, especially SMEs, to go global. Therefore, CME asks the government to:

1. Introduce an export tax credit to offset export market development costs, including those related to advertising and promotion, participating in trade shows and events, market research, and obtaining professional advice related to exporting.
2. Fund the creation of an Exporter Concierge Service that enables trade associations to develop programs that link their members to government export agencies and services.
3. Create a "Trade Barrier Hotline" for exporters to call and report trade barriers and to offer exporters assistance in overcoming trade barriers.
4. Invest in infrastructure that facilitates trade and industrial development, thus creating jobs, stimulating the economy, generating demand for domestic manufactured goods, and paving the way for higher value-added exports.

Recommendation 7: Continue actions to fight COVID-19 and prepare for future pandemics

The government has been very responsive to industry needs during the pandemic, launching significant emergency support measures to address the economic crisis triggered by COVID-19. The Canada Emergency Wage Subsidy (CEWS) has been an especially vital lifeline for manufacturers. Although vaccines offer a realistic hope of ending the pandemic, the strong second wave of the virus, the emergence of more contagious variants, and stricter public health measures imply that the economic road ahead will remain challenging for at least the next few months. Therefore, CME recommends that the government:

1. Keep supporting the economy with emergency measures until the economy improves.
2. Support Canadian manufacturers of personal protective equipment (PPE) and other critical goods to build domestic capacity to keep Canadians safe and create jobs.

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