

CME 2023 FEDERAL PRE-BUDGET SUBMISSION
BY: CANADIAN MANUFACTURERS & EXPORTERS
(CME)

PILLARS OF AN ADVANCED MANUFACTURING STRATEGY

- Pillar 1: Get the workers we need.
- Pillar 2: Stimulate innovation, investment and the adoption of advanced technologies.
- Pillar 3: Encourage domestic production and exports.
- Pillar 4: Support manufacturers to help them adapt to and advance Canada's climate change plan.

INTRODUCTION

Manufacturing is one of Canada's key economic drivers. The country's 90,000 manufacturers directly generate almost 10 per cent of Canada's GDP and more than 60 per cent of our merchandise exports. Including indirect and induced impacts, the sector's footprint amounts to one-quarter of Canada's total economic activity. As well, the sector directly employs 1.7 million Canadians and supports 3.4 million more Canadian workers through supply chain activity and employee spending.

Although its presence is still large, Canada's manufacturing sector has struggled for most of this century, with output and merchandise exports growing at a much slower pace than that in other advanced economies, a consequence of very sluggish investment. Several factors explain the reluctance of firms to invest in Canada: labour and skills shortages, a relatively high tax burden, a sub-optimal regulatory environment, and the absence of a national advanced manufacturing strategy.

The erosion of our industrial competitiveness has left Canada in a vulnerable position. This became all too evident when the COVID-19 pandemic erupted in March 2020, and governments were forced to scramble to find masks, ventilators, and later vaccines. Thankfully, despite the challenging environment, many Canadian manufacturers stepped up and shifted production to make PPE and other supplies needed to protect front line workers and to help patients dealing with the deadly virus. If anything, the pandemic has been a wake-up call for Canada, reminding us of the vital need to rebuild our industrial capacity.

Much work is left to be done. Canada's competitiveness challenges, especially a lack of workers, have hampered the ability of the manufacturing sector to recover from the COVID crisis. They also threaten the sector's ability to attract future investment from reshoring and foreign companies. Indeed, while numerous trends and disruptions like the pandemic, the Russian-Ukraine war, growing unease with China, and the emerging opportunities associated with clean technology may have kickstarted talk of reshoring manufacturing production to Canada, the reality so far tells a different story. Surveys indicate that, as of today, manufacturing investment has only achieved a partial rebound.

Fortunately, the solution is at our fingertips. Canadian Manufacturers & Exporters (CME) fully supports Finance Minister Chrystia Freeland's recent pronouncement that Canada needs "a real muscular industrial policy." It is also fully behind the government's commitment in the 2022 Fall Economic Statement to invest in "[Canada's advanced manufacturing competitiveness](#)." But these words need to be quickly put into action, especially since the US passed the Inflation Reduction Act (IRA), a landmark clean energy and industrial policy bill. The Government of Canada must respond by making a comprehensive advanced manufacturing strategy a key focus of the 2023 federal budget, and it must be underpinned by the following four pillars:

1. Get the workers we need.
2. Stimulate innovation, investment and the adoption of advanced technologies.
3. Increase domestic production and exports.
4. Support manufacturers to help them adapt to and advance Canada's climate change plan.

RECOMMENDATIONS—PILLARS OF AN ADVANCED MANUFACTURING STRATEGY

Pillar 1: Get the Workers We Need

Manufacturers often cite labour and skills shortages as one of their most pressing challenges. A key solution involves increasing the intake of economic class immigrants, reforming Canada's immigration point system to better align it with the skills needed in the manufacturing sector, and improving the Temporary Foreign Worker (TFW) program to make it easier for Canadian employers to access the workers they need. While CME was pleased to see the government commit to welcoming a total of 500,000 immigrants per year by 2025, Canada's working-age population is still not growing fast enough to replenish the substantial number of workers set to retire in the coming years, so even more ambitious targets should be set.

Another solution involves reskilling and upskilling the existing workforce. While businesses are eager to upgrade the skills of their workers, they tend to underinvest in training and development due to concerns over turnover and poaching. Given the wider societal benefits of workforce upskilling, it makes sense for governments to provide financial assistance to firms to increase their training activities.

A third solution entails increasing the labour market participation of underrepresented groups—women, Indigenous peoples, persons with disabilities, and visible minorities. In 2022, CME's Women in Manufacturing (WIM) campaign reaffirmed its goal of increasing the number of women in the sector by 100,000 by 2030. While the program has made good progress so far, more funding to support WIM and other inclusion programs would help achieve so much more.

Thus, CME recommends that the government:

1. Increase the intake of economic class immigrants to 500,000 a year by 2025 and reform Canada's immigration point system to better align it with the skills needed in the manufacturing sector.
2. Expand the Foreign Credential Recognition Program to include the manufacturing industry and work with provincial governments to speed up credential recognition.
3. Improve the Temporary Foreign Worker (TFW) program by creating a trusted employer program that pre-approves qualifying companies and by streamlining the Labour Market Impact Assessment (LMIA) application.

4. Provide employer-led training benefits including a 50 per cent tax credit to offset half the costs of employee training.
5. Increase funding of the Canada Job Grant to \$1 billion annually, make it permanent, and expand it to include on-the-job training.
6. Renew and increase funding for programs that encourage more members of underrepresented groups to seek a career in manufacturing, including CME's WIM initiative.
7. Given Canada's critical labour and skills shortages, amend the *Prohibition on the Purchase of Residential Property by Non-Canadians Act* to provide an exemption for any foreign national with a valid work permit who is working and residing in Canada, thus limiting the regulation's detrimental effect on Canada's critical labour and skills shortages.

Pillar 2: Stimulate Innovation, Investment and the Adoption of Advanced Technologies

Canada lags other industrialized countries when it comes to business investment, digitalization, and the adoption of advanced manufacturing technologies. Data from the OECD show that, in recent years, Canada has ranked near the bottom of advanced economies in terms of business investment growth. Indeed, from 2016 to 2020, non-residential investment fell by an average of 1.8 per cent per year in Canada, the second worst performance among 31 OECD countries.

Given the reluctance of Canadian businesses invest in their operations, it should not come as a surprise that advanced technology adoption in manufacturing is still more the exception than the rule. According to Statistics Canada's 2019 *Survey of Innovation and Strategy*, less than half (49.2 per cent) of Canadian manufacturers said they are using advanced technologies, while just 19.4 per cent reported using emerging technologies. A nationwide manufacturing investment tax credit would be an important means to helping boost investment levels.

At the same time, attracting clean energy investment will be an especially tough challenge for Canada if the government fails to respond to certain provisions in the US IRA. In particular, the law extends the Advanced Energy Project Credit (Section 48C), which provides a tax credit of up to 30 per cent on investments of advanced energy projects, including facilities that produce or recycle wind turbine blades, manufacture energy storage equipment, refine renewable or low-carbon fuels, and refine or recycle critical minerals. Projects that re-equip an industrial or manufacturing facility with technology designed to reduce GHG emissions by at least 20 per cent may also qualify. This credit is expected to provide \$6.3 billion in support over ten years.

Canada also suffers from a low rate of business R&D spending, which is another factor holding back our ability to grow the economy and create jobs. Reversing this trend could be best accomplished by enhancing

and reforming the Scientific Research and Experimental Development Tax Credit Program (SR&ED), the main mechanism through which the federal government supports business R&D.

Canada also struggles with commercializing ideas and bringing products to markets. A patent box significantly reduces the corporate tax rate on revenue from qualifying intellectual property, providing firms with a strong incentive to undertake innovation, commercialization and production activities locally. Many of Canada's international competitors have adopted patent box regimes to overcome these challenges, but Canada has yet to follow suit and is therefore leaving economic opportunities on the table.

To address all these challenges, CME recommends that the government:

1. Introduce a 10 per cent refundable manufacturing investment tax credit for investments in new buildings and new machinery, equipment, and software. This could be accomplished by extending the Atlantic Investment Tax Credit—currently only eligible for capital projects in the Gaspé Peninsula and the Atlantic provinces—across the whole country.
2. Introduce wide-ranging investment and production tax credits that apply to all forms of clean energy generation and transmission projects, matching incentives included in the IRA.
3. Extend the Accelerated Investment Incentive's current rate for three more years. In line with Canada's Critical Mineral Strategy, the incentive should be expanded to include mining and metal manufacturing activities (included in tax classes 41, 41.2 and 43).
4. Expand and make permanent the Strategic Innovation Fund (SIF) and commit at least \$2.5 billion per year in funding to support large capital projects in manufacturing.
5. Enhance and reform the SR&ED program to close the commercialization gap by expanding the list of eligible activities beyond early-stage R&D to include capital improvements and product and process innovations, increasing the refundable portion of the tax credit, streamlining administration to improve certainty in claims, and by raising the tax credit rate to 20 per cent.
6. Implement a patent box regime to incentivize the commercialization and production of goods in Canada.
7. Expand the Canada Digital Adoption Plan (CDAP) by creating a dedicated manufacturing stream including a non-repayable component to offset the high cost associated with software critical to process automation. This would help small and medium-sized manufacturers accelerate the shift to Industry 4.0, the next generation of manufacturing.

Pillar 3: Encourage Domestic Production and Exports

Along with enacting reforms to encourage business investment, governments can also do more to stimulate domestic production and exports. Several approaches are worth pursuing, including targeted tax

credits, procurement reform, and actions that create more favourable conditions for Canadian businesses to compete and succeed internationally.

A tax credit that encourages clean technology production is needed to match the incentives provided by the IRA's Advanced Manufacturing Production Credit (Section 45X), valued at \$30.6 billion over ten years. This credit applies to eligible equipment produced and sold in the US, including any solar energy components, wind energy components, inverters, qualifying battery components, and applicable critical minerals, with the amount of credit available depending on the component. Without a response, Canada's goal of developing an electric vehicle battery ecosystem would be put in jeopardy.

More generally, the government can do a better job of leveraging government procurement to enhance domestic industrial capacity, especially by modernizing it to include local economic, societal, and environmental benefits. Governments are major consumers of manufactured products and, through their vast purchasing power, can shift corporate behaviour. In this sense, government supply chains across the world are expected to move toward net-zero emissions in the coming years, enabling them to leverage their procurement spending to drive green innovation. However, when Canadian governments make purchases today, the focus is often on cost minimization and risk avoidance. CME has long argued that government procurement should take more than cost into consideration. Instead, other factors should be considered, including local economic effects such as encouraging innovation, commercialization, production, and job creation. Along the same lines, governments should also include a set of criteria that address GHG emissions reduction and broader environmental impacts, as proposed under the Treasury Board's Greening Government Strategy. Given Canada's high environmental standards, our products tend to have lower carbon footprints than those from many other countries. In other words, if Canada adopted a green procurement policy, domestic industry would be a prime beneficiary.

Staying on the topic of procurement, the Government of Canada has implemented a mandatory requirement for federal departments and agencies to ensure that a minimum of 5 per cent of the total value of contracts is held by Indigenous businesses by 2024. CME and its members fully support this initiative to help grow Indigenous businesses and improve the socio-economic conditions of Indigenous communities. However, this upcoming mandate is raising concerns about the ability of Canadian manufacturers to bring Indigenous businesses into their supply chains. The government will need to work closely with industry to help initiate business partnerships with Indigenous firms. As well, to meet the fast-approaching deadline, government support measures will also play a key role.

Finally, Canada is a trading nation, with exports accounting for over 30 per cent of the country's GDP. The manufacturing sector is a key reason Canada has earned this reputation: it is responsible for roughly two-thirds of the country's outbound goods. Indeed, Canada's manufacturing sector has such an outsized

economic footprint because it is export-oriented—by selling its goods abroad, it brings new income into Canada as opposed to simply recirculating the income already present within the country.

Unfortunately, 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. While encouraging manufacturing investment and domestic production will help improve the country's export performance, more needs to be done to help Canadian companies, especially SMEs, to go global.

Therefore, CME asks the government to:

1. Introduce a wide-ranging production tax credit that provides credits for the production of clean technology products, matching the incentives included in the IRA's Advanced Manufacturing Production Tax Credit.
2. Introduce domestic procurement reforms that promote domestic innovation and production while eliminating the lowest bidder rule. This could be achieved by including economic and environmental performance as part of the bidding process.
3. Introduce a tax credit to help Canadian manufacturers bring Indigenous businesses into their supply chain, enabling them to meet the 2024 mandate.
4. Increase and accelerate investments in critical transportation and trade infrastructure to drive growth in industrial capacity and to improve manufacturers' ability to get goods to global markets.
5. 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.
6. Expand funding for existing programs and services—RDAs, EDC, CCC, BDC—to help SMEs go global.
7. Reduce the red tape involved in administering Canada's export permits system so that it not only protects Canada's foreign policy interests, but it also streamlines export procedures.
8. Improve Canada's anti-dumping regime, including its normal value and anti-circumvention systems, to better protect Canadian manufacturers from unfair trade practices and increase investment competitiveness.

Pillar 4: Provide More Support to Manufacturers to Help Them Adapt to and Advance Canada's Climate Change Plan

The scale and magnitude of the government's climate change plan requires strong government support to help ease the transition to a net-zero economy for Canadian businesses, especially those in energy-intensive, trade-exposed industries (EITEs) and small and medium-sized enterprises (SMEs) that lack the financial resources and expertise to get started. The right government policies and supports will also be

needed if Canadian manufacturers are to compete and win in the rapidly growing global market for clean technology. As detailed in this submission, a greater focus on incentives is needed now more than ever in light of the recent passage of the US IRA. This legislation earmarks nearly \$400 billion for clean energy and climate change mitigation initiatives. While the Government of Canada has already invested billions of dollars in the fight against climate change and has pledged billions more, it will need to ramp up its commitment to match the IRA's incentives if we are to have any hope of maintaining and growing our industrial base through the net zero transition.

Therefore, we recommend that the government:

1. Provide direct investment supports for emitters of all sizes to help them adopt emissions-reduction technologies, ensuring that support approaches are technology-agnostic.
2. Expand and make permanent the Net Zero Accelerator Fund, providing a minimum of \$5.0 billion annually in funding to support large-scale investments that reduce emissions in manufacturing.
3. Provide financial support for the creation, commercialization, and manufacture of low and no-carbon products in Canada through tax incentives and government procurement.
4. Increase funding for an EV charging infrastructure network to enable the broad adoption of electric vehicles.
5. Create an effective and targeted SME net-zero transition strategy that focuses on education and awareness campaigns, operational assessments and strategic business plans, and global supply chain competitiveness.