Written Submission for the Pre-Budget Consultations in Advance of the 2019 Budget

Canadian Manufacturers & Exporters

August 2018

List of Recommendations:

Recommendation 1: That the government take immediate steps to restore Canada's business tax advantage over the United States.

Recommendation 2: That the government develop a new approach to regulatory modernization that includes a Regulatory Bill of Rights for a world-class system of regulations that are predictable and focused on achieving desired policy outcomes rather than prescribing business processes.

Recommendation 3: That the government 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.

Recommendation 4: That the government 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 manufacturers on a non-discriminatory basis.

Recommendation 5: That the government reinvest all federal and provincial carbon-pricing revenues back into offsetting the cost of purchasing new technologies and machinery & equipment.

Recommendation 6: That the government work with trade and industry exporters to create a National Manufacturing Export Accelerator Program to assist SMEs become export-ready and fully realize their growth potential.

Recommendation 7: That, provided it does not violate WTO commitments, the government reduce corporate tax payable on business profits generated from exports. To encourage trade diversification, the reduction should be greater for exports to non-US destinations.

Recommendation 8: That the government work in partnership with businesses to address labour and skills shortages in manufacturing

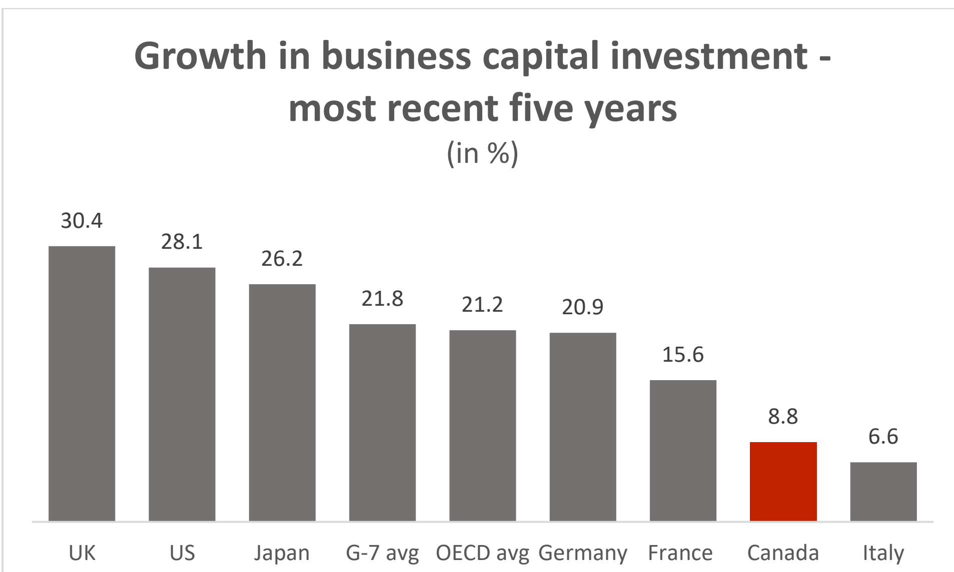
Background/context

CME would like to congratulate the House of Commons Standing Committee on Finance for focusing its pre-budget consultations on issues relating to business competitiveness and economic growth. A competitive business environment is critical to the success of manufacturing in Canada. Good tax and regulatory policy encourages local companies to invest in their future; it attracts new manufacturing opportunities and new foreign investment; and it puts our businesses in a position to compete and succeed in global markets.

Unfortunately, there is clear evidence that Canada is trending in the wrong direction on all three of these fronts.

1. **Businesses are underinvesting in their operations**

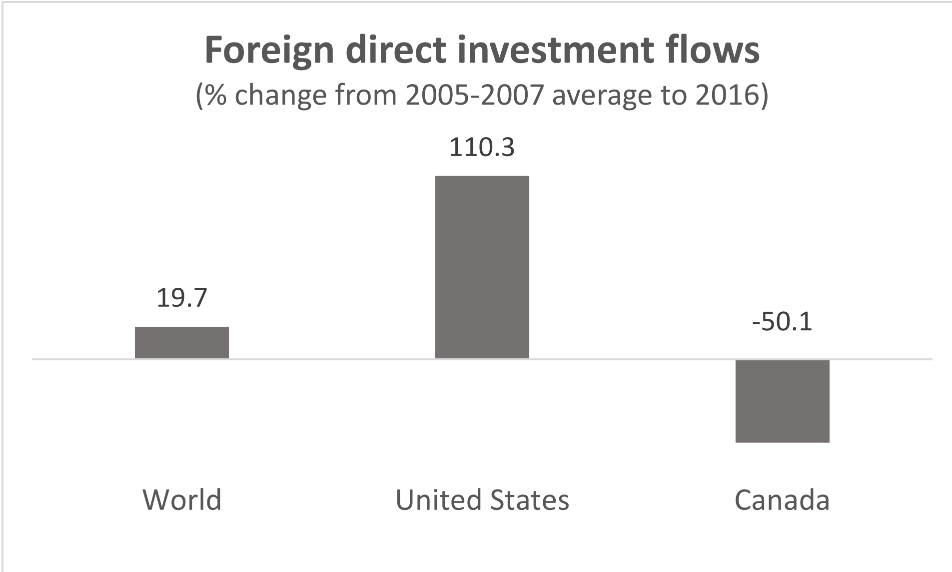
Canada has one of the worst records in the entire OECD when it comes to business capital spending. In US-dollar terms, gross fixed capital formation in Canada rose by 8.8 per cent over the last five years. The average across the OECD was 21.2 per cent. Among the G-7, only Italy performed worse than Canada.



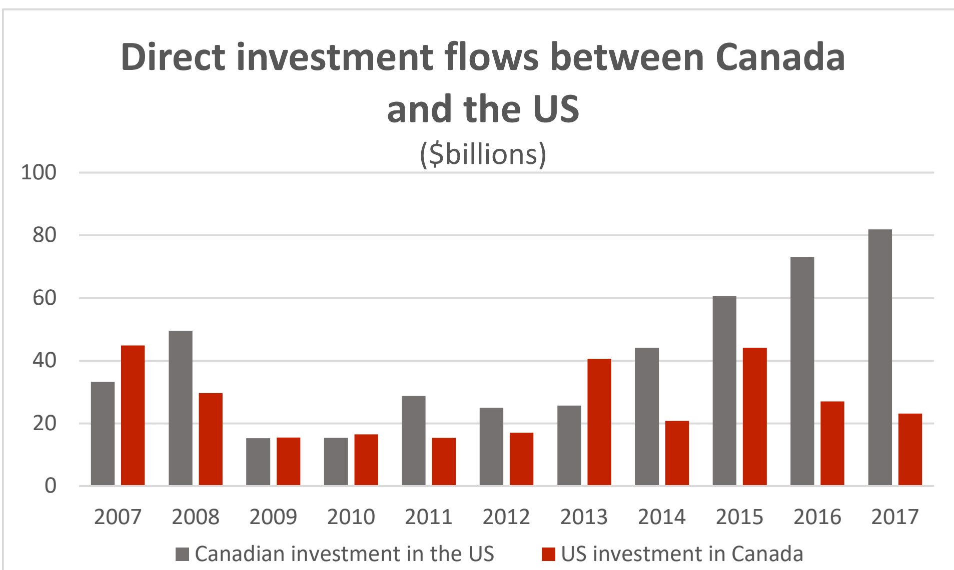
This chronic underinvestment in capital, machinery and equipment has two effects on Canadian businesses. First, it is contributing to our lagging productivity compared to other countries. Second, it is creating capacity constraints in Canadian manufacturing; our companies are not investing in new facilities, severely limiting Canada's ability to expand manufacturing production.

2. **Canada is losing out on foreign investment**

Canada's share of global foreign direct investment is falling precipitously. Global FDI flows in 2016 were 20 per cent higher than the pre-recession average in 2005-2007. In the United States, they were up by more than 110 per cent. Canada, however, is heading in the opposite direction; investment fell by 50 per cent over that period.



The situation is even more stark when comparing investment flows between Canada and the United States. In 2013, US businesses invested $40.6 billion in Canada, while $25.7 billion in capital flowed south. Just four years later, US investment in Canada has dropped by nearly half (to $23.1 billion), while Canadian businesses are rapidly funnelling cash into US-based operations. Canadian investment in the United States has more than tripled in just four years – reaching $81.9 billion in 2017.



3. Value-added exports are stagnant

Canadian manufacturers have struggled in recent years to expand their global market presence. As exports have stagnated, our manufacturing trade deficit has ballooned, hitting a record $136 billion in 2017

This imbalance is the result of a combination of factors, including a lack of meaningful market access gains in new trade agreements and a general lack of export-readiness among Canadian SMEs. Equally important, however, is the impact of lagging investment and our generally high cost base. Our widening trade deficit in manufacturing can only be reversed if these issues are addressed.

Over the last several years, a wide range of policy changes at the federal and provincial levels have added to the already-high cost and complexity of doing business in Canada. Meanwhile, tax reform south of the border has eliminated Canada's previous tax advantage over the US and is threatening our competitiveness even further. CME is concerned that unless immediate action is taken, the trends outlined above will only accelerate.

The federal government needs to focus its 2018 budget on improving the business environment in Canada and, by so doing, put the country on the path to long-term economic growth and prosperity. With that in mind, Canadian Manufacturers & Exporters is pleased to offer the following recommendations:

Recommendations:

1. Restore Canada's business tax advantage over the United States

Canada's previous business tax advantage over the US was critical to offsetting our numerous other cost disadvantages. We are a smaller market with a higher non-tax cost base. Few foreign businesses invest in Canada to access the Canadian market; they invest to access the US. However, the combination of an improved tax structure in the US, along with continued NAFTA uncertainty, threatens business investment in this country. We recommend:

Recommendation 1: The Government of Canada should take immediate steps to restore Canada's business tax advantage over the United States by:

- Working with the provinces to immediately lower combined corporate tax rates from about 28 per cent to 20 per cent; and
- Matching the accelerated capital cost allowance provisions now in place in the United States, giving businesses an immediate 100 per cent tax write-off on qualifying capital asset purchases.

2. Modernize Canada's regulatory regime

The regulatory burden in Canada is a major impediment to business growth, investment and competitiveness. Canada needs a world-class, agile regulation system that supports innovation and competitiveness, while protecting the environment, and the health and safety of Canadians.

To address this issue, we recommend that:

Recommendation 2: The Government of Canada develop a new approach to regulatory modernization that includes a Regulatory Bill of Rights for a world-class system of regulations that are predictable and focused on achieving desired policy outcomes rather than prescribing business processes.

3. Improve Canada's record on innovation and commercialization

Productivity and competitiveness are driven by innovation – the ability to convert ideas into new products and processes. However, this is a risky undertaking; the costs 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 3: 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. Repayment terms would be subject to the successful commercialization of the technology.

The creation of the federal Strategic Innovation Fund was an important step forward in terms of dealing with Canada's innovation challenges. However, we believe the program needs to be expanded if we are to fully close the wide innovation gap that exists between Canada and our major international manufacturing competitors. We recommend:

Recommendation 4: The Government of Canada 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 manufacturers on a non-discriminatory basis.

Finally, the federal government is working to implement its national carbon pricing backstop, as well as a proposed new Clean Fuel Standard. These steps could play an important role in reducing GHG emissions, but they also add to the competitiveness challenges facing Canadian manufacturers – especially those in trade-exposed industries. Canada's carbon pricing policies must not result in lost investment and carbon leakage. We recommend:

Recommendation 5: The Government of Canada reinvest all federal and provincial carbon-pricing revenues back into offsetting the cost of purchasing new technologies and machinery & equipment.

- The federal government should create a new initiative modelled after Ontario's previous SMART Green Program to assist manufacturers investing in new technologies that have environmental benefits.
- The initiative should be financed by 100 per cent of carbon pricing revenues collected from manufacturers.
- Manufacturers should be eligible for funding in direct proportion to how much they pay into the pricing scheme.

4. Increase SME export-readiness and export incentives

Canadian manufactured goods exports have been effectively stagnant since 2000 and recent events have demonstrated the importance of expanding our export presence in non-US markets. On top of that, data clearly show that foreign companies are not choosing to invest in Canada – either as an export platform or to access our domestic market.

One of the underlying issues is that more work is needed to improve the export-readiness of Canadian SMEs. To assist with export-readiness, CME proposes the creation of a National Manufacturing Export Accelerator Program similar to Canada's existing Technology Accelerator Program and comparable trade programs delivered by TAP Canada. This program would focus on preparing successful applicants for new markets and addressing company-specific barriers to exporting, including training, technology gaps, productivity gaps, access to value or supply chains or financing gaps. It would be delivered by the private sector with support from the federal government. We recommend:

Recommendation 6: The Government of Canada work with trade and industry exporters to create a National Manufacturing Export Accelerator Program to assist SMEs become export-ready and fully realize their growth potential.

CME also believes that the tax system can be used to accomplish a range of trade-related goals. Specifically, we propose adjusting the corporate tax system so that companies pay a lower tax rate on profits generated from foreign sales. Provided that it does not violate WTO rules, such a proposal would offer several benefits. It would:

- Encourage more Canadian companies to export;
- Advance trade diversification goals if the tax savings were greater for exports to non-US destinations; and
- Attract more foreign investment to Canada because of the tax benefits of using Canada as an export platform.

We recommend:

Recommendation 7: Provided that it does not violate WTO commitments, the Government of Canada should reduce corporate tax payable on business profits generated from exports. To encourage trade diversification, the reduction should be greater for exports to non-US destinations.

5. Address 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.

Recommendation 8: The Government of Canada work in partnership with businesses to address labour and skills shortages in manufacturing by:

- Enhancing work-integrated learning programs by building partnerships between current programs and established organizations
- Funding CME's "Open Doors" program that showcases careers in manufacturing to young students
- Expanding and improving the Canada Job Grant by:
    - Making it permanent and expanding its funding envelope;
    - Allowing for the funding of multi-year training and expanding the range of eligible on-the-job training training; and
    - Standardizing CJG processes across the country and speeding up approval times.