CANADIAN MANUFACTURERS & EXPORTERS

MANUFACTURIERS & EXPORTATEURS DU CANADA

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Sent: Wednesday, November 14, 2018 12:53 PM
To: Engages-Mobilisation (WD/DEO) <wd.engages-mobilisation.deo@canada.ca>
Subject: Western Canada Growth Strategy Submission

On behalf of Canadian Manufacturers & Exporters, I am pleased to offer the attached document as our submission to Western Economic Diversification's Western Canada Growth Strategy consultation exercise.

CME believes in the importance of a competitive business landscape in western Canada. In our view, a successful growth strategy is one that:

- builds on the region's strong resource base;
- results in increased innovation and technology adoption;
- spurs growth in business capital spending;
- generates more value-added exports;
- addresses persistent workforce skills gaps; and
- attracts more increased foreign direct investment to western Canada.

We would be pleased to discuss our submission in person or to participate in any follow-up consultations.

Thank you for the opportunity to engage in this exercise.

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Western Economic Diversification Submission

INTRODUCTION

Canadian Manufacturers & Exporters is pleased to participate in the process of developing a Western Canada Growth Strategy and, to that end, offers this submission to Western Economic Diversification (WD).

Canadian Manufacturers & Exporters (CME) is Canada's largest and oldest industry association. We have a strong presence in each of the four western provinces and believe that a healthy and vibrant western Canada – driven by value-added production and exports – can continue to drive Canadian economic growth and prosperity for decades to come.

Western Canada is not a homogenous region. The Asian focus of the BC export market is far different from the energy-based Alberta economy. Saskatchewan and Manitoba may share a common foundation in agriculture, but the energy and resources endowments of the former are contrasted with the hydro capacity and diversified manufacturing base of the latter.

For this reason, drafting a pan-western Canada growth strategy is not a simple task. Given the vastly different strengths and challenges across the region, we believe that the best approach for such a strategy is to focus on basic principles – creating the policy conditions needed for businesses to grow, invest in their own future, and expand into new markets. Such a strategy should also leverage the region's existing strengths and focus on expanding value-added production and export in those areas.

In short, an effective economic growth strategy for western Canada is one that addresses common regional challenges, leverages our natural advantages, and improves the overall business climate. Attracting new industries to the West is desirable, but that should be done by putting in place the conditions needed for those industries – or others – to grow and develop organically.

CHALLENGES FACING WESTERN CANADA

Through extensive research and industry consultations, CME has identified a number of overlapping issues that are preventing the western provinces from reaching their full economic potential. These include:

- Chronic labour and skills shortages;
- Underinvestment in business capital – facilities, machinery & equipment and new technologies;
- A high business cost structure and eroding tax competitiveness;
- Poor (non-crude-oil) export growth, especially in value-added goods; and
- Declining foreign direct investment.

To be sure, these issues are hardly unique to western Canada; similar concerns are evident all across the country.

However, there are several additional challenges that are unique to, or more prevalent in, the West. These must also be considered in the development of a long-term growth strategy. They include:

- Resistance to resources development and significant business uncertainty surrounding the approval process for major projects;
- The impact that the above resistance has on limiting growth potential in the region's manufacturing sector;
- A large Indigenous population characterized by relatively low economic participation;
- A lack of tidewater access that is costing the country tens of billions of dollars in foregone revenue and GDP each year; and
- A high reliance on resource extraction that generates significant volatility in economic growth and government revenues.

An effective Western Canada Growth Strategy must address all these issues.

What does a stronger western Canadian economy look like 10 years from now?

Simply put, a stronger western Canadian economy is one which is vibrant, innovative and growing. It is more stable and more diverse; globally competitive; environmentally sustainable; and it offers ample job opportunities and the highest possible quality of life for its residents. More specifically, it has the following characteristics:

- **Business capital investment is strong.** Capital spending drives innovation, efficiency, productivity gains, and competitiveness. Those, in turn, spur business expansion and growth, and create resilience to downturns in economic conditions.
- **Exports drive economic growth.** A strong western Canadian economy is one where our businesses are competitive in global markets, where more companies (especially SMEs) export, where markets are more diversified, and where value-added goods make up a significantly larger share of the region's export mix.
- **More value-added activity takes place in the West.** A medium-term goal for any economic development strategy must be to capture more added value from western Canada's resources – whether in food processing, petrochemicals, metals and minerals, or wood/paper products.
- **Companies can find the workers they need.** Western Canada is young compared to the rest of Canada, but labour markets are tight; labour force participation is high; and skills shortages are common. These shortages can severely limit growth, productivity and competitiveness. A healthier regional economy has a much closer match between the skills employers are looking for and those available in the workforce.
- **Businesses are growing.** Compared to other countries, Canada has a disproportionately large share of SMEs and the West is no exception. A vibrant regional economy is one where small businesses are growing into medium-sized companies, and where medium-sized companies are growing into large global corporations.
- **Resource development is healthy and sustainable.** A stronger western Canadian economy requires a strong resource sector. The region needs once again to become an attractive place in which to invest in energy and resource development – as well as in the associated manufacturing spinoffs that result. That requires a more competitive business cost structure, improved project approval processes, reduced GHG emissions, and tidewater access for oil and gas.
- **Vulnerability to commodity price swings is diminished.** The downside to western Canada's enviable resource endowments is that (most of) the region is vulnerable to commodity price swings. A stronger

regional economy is one that still benefits from natural resource development, but where the economy is more resilient/diversified against those price swings, and where governments are less reliant on royalty revenues to finance program spending.

ESSENTIAL COMPONENTS OF AN EFFECTIVE WESTERN CANADA GROWTH STRATEGY

Investment, innovation and productivity are the foundation of healthy and sustainable economic growth. Enabling private-sector gains in these areas must be the sole focus of any federal growth strategy for western Canada – or any other part of the country. As such, an effective growth strategy cannot be restricted by the limited resources, scope and mandate of a regional economic development agency; it requires a whole-of-government approach. Half measures will only waste taxpayers' money and produce little in the way of meaningful results.

What, then, can the federal government do to spur economic growth in the West?

A. DEVELOP A COORDINATED ALL-OF-GOVERNMENT STRATEGY

The first step is to not set such a process up for failure. CME fully supports the development of a Western Canada Growth Strategy. However, we have concerns about the limited scope of Western Economic Diversification to undertake such an exercise.

There are two issues that must be addressed. The first is that WD needs to be equipped with the same tools and resources as other regional economic development agencies. The federal government operates six such agencies across the country, but their mandates and scope for action vary. Organizations like the Atlantic Canada Opportunities Agency are able to pursue initiatives that WD cannot. CME believes this is unfair. While needs may vary across the country, there is no reason why access to policy levers should also vary. We thus recommend:

Recommendation 1:

All federal government regional economic development agencies should be given identical mandates and responsibilities, as well as access to the same suite of policy instruments.

Second, even with an expanded suite of policy tools at its disposal, too many essential components of a growth strategy lie outside of WD's jurisdiction. An effective growth strategy has at its core making the region an attractive place in which to do business. However, issues like tax competitiveness, investment attraction, resource development, and addressing skills shortages require co-ordinated participation from the entire federal government, as well as the region's provincial governments, business community and other stakeholders.

Recommendation 2:

A federal Western Canada Growth Strategy must extend beyond the limited policy tools available to WD. It should focus on improving economic competitiveness in the region through coordinated policy changes across the entire range of federal and provincial government activities.

For this reason, many of the recommendations found below fall outside the mandate of Western Economic Diversification. However, they remain within the purview of the federal government writ large. Moreover, they are essential to an effective growth strategy for the West. A strategy that fails to address the issues and challenges outlined below will be of little value to the region.

B. LEVERAGE THE REGION'S RESOURCE STRENGTHS

Natural resources – especially energy, mining, forestry and agriculture – are the cornerstone of the region's economy. Our resources drive exports and economic growth; and are the foundation of much of the value-added manufacturing activity that takes place in western Canada. Most of western Canada's largest and most important manufacturing industries have direct ties to our resource base. These are strengths to be cultivated, not industries to be ignored, taken for granted, or allowed to whither on the vine.

The energy sector, in particular, is facing enormous challenges. Business confidence in the regulatory approval process for resource projects has evaporated, approval timelines have ballooned, and energy companies face stiff and co-ordinated resistance to development, combined with lukewarm support from the federal government. As a result, business capital is fleeing the sector. In 2014, prior to the decline in energy prices, capital spending in Alberta's energy sector totalled about $58 billion. That has fallen by more than 60 per cent, to just $22.5 billion in 2018. Energy sector investment continues to decline even as prices have begun to recover.

A Western Canada Growth Strategy must recognize that energy and resources have been the backbone of the regional economy for generations and will continue to be so for generations to come. Neglecting our biggest strength will only result in a lower standard of living and fewer jobs across the region. It will also do nothing to address issues of environmental sustainability. If western Canadian resources are not used to satisfy global demand, production will simply rise elsewhere, leaving the environment unaffected and western Canada worse off.

In addition to resource development, more work is also needed to increase the amount of value-added activity in the region that is directly tied to our natural resources. Increasing exports of value-added goods is critical to economic diversification, smoothing out the impact of commodity price fluctuations, and extracting maximum value from our resource base. Western Canada has made some important strides in these areas – notably in exports of lumber and other value-added forest products. Unfortunately, raw goods like crude oil, natural gas, wheat, canola seeds, coal, and metal ores continue to dominate the region's exports. Failure to add more value to those products is costing the region billions of dollars in foregone activity every year.

For this reason, we recommend that:

Recommendation 3:

A Western Canada Growth Strategy needs to be based on the foundation of the region's existing resource strengths – oil and gas, forestry, mining, hydroelectricity and agriculture. It must include policies that promote growth and investment in these industries, as well as policies that result in more resource-based value-added activity taking place in the region.

C. IMPROVE BUSINESS COMPETITIVENESS

Improving business competitiveness must be a foundational element of a Western Canada Growth Strategy. While issues related to competitiveness are not unique to the West, they are central to attracting investment and growth to the region. There are two areas where government action is needed: tax and regulatory reform; and policies that encourage private-sector capital investment in western Canada.

CME has written extensively on the issues of tax and regulatory reform. We believe that Canada needs comprehensive pro-growth tax reform. The current tax system rewards companies for being small. We need a tax system that rewards *growing* companies, regardless of their size. On the regulatory side, we believe that Canada needs to modernize and streamline its regulations. Regulations should be simplified and focus on achieving desirable social outcomes rather than following established processes.

Recommendation 4:

Improving business competitiveness should be the central focus of an economic development strategy for western Canada. This includes tax and regulatory reform that encourages business growth and reduces overall costs.

In addition to a more competitive tax and regulatory structure, steps are needed to improve the capital investment climate in the region. Investment in machinery, equipment and new technologies is critical to unlocking productivity gains, lowering greenhouse gas emissions intensity and allowing western Canadian businesses to compete domestically and around the world.

Unfortunately, like their counterparts in other provinces, western Canadian businesses underinvest in their operations. The issues that are limiting business investment in the West – and elsewhere in Canada – include the following:

- Government tax and regulatory policies that are increasing the cost of doing business in the region – these actions are leaving less money in the hands of businesses to invest in their own future;
- The investment climate is significantly more attractive in the United States;
- Lengthy and uncertain approval processes are deterring investment in the energy sector; and
- The cost of purchasing new machinery and equipment is high and the return on investment, uncertain.

These issues are not only limiting investment in capital, equipment and technologies, but they are hampering investment in value-added production activity as well. As noted above, western Canada tends to export raw materials and let others add value to those goods. A competitive business cost structure is vital to bringing more value-added production to the West.

Capital investment and technology adoption are critical to western Canada's future. They improve productivity, reduce costs, lower greenhouse gas emissions intensity, and allow the region's businesses to compete more successfully in domestic and foreign markets. To encourage business investment and improve competitiveness in the region, CME offers the following recommendations:

Recommendation 5

The Government of Canada should match 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.

Recommendation 6

Through WD, the federal government should create an investment incentive program modelled after the Atlantic Investment Tax Credit and apply it to western Canada.

Recommendation 7

Through WD, the federal government should reinstate the SMART Program operated by FedDev Ontario and apply it to western Canada.

Recommendation 8

All federal carbon tax revenues collected from companies in western Canada should be returned to the business from which they were collected – dollar-for-dollar – in the form of incentive programs to improve environmental performance and increase investment in emissions-reducing machinery, equipment and technologies.

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.

RECOMMENDATION 9

Western Economic Diversification should work to 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.

D. INCREASE EXPORTS

Canada prides itself on being an exporting country, but our record on trade growth has been remarkably poor. Canadian exports have risen by an average of about 1.7 per cent per year since 2000. According to the WTO, Canada has had one of the worst export growth performances in the OECD over that period, and in the G-7, ranks ahead only of Japan.

The story is slightly better in the West; exports have risen by an average of 3.0 per cent per year since 2000. However, much of that growth has been driven by higher-volume sales of crude oil and basic agriculture and forest products. Crude oil exports have risen by an average of 7.7 per cent over that period, and renewable resources by 5.3 per cent per year. Meanwhile, exports of value-added manufactured goods have grown by an annual average of just 1.4 per cent.

Expanding exports – especially of value-added goods – needs to be a central focus of a Western Canada Growth Strategy. As discussed earlier, improving domestic business competitiveness is central to achieving this goal. Other initiatives that would help – additional free trade agreements, infrastructure investment and government support programs, to name a few – will be of little value if western Canadian businesses cannot compete with foreign producers.

Another important step to increasing exports is to improve the capacity of the region's SMEs to sell their goods in global markets. SMEs face a wide range of barriers to trade, including the need for assistance with market research, export-readiness, business development, and financing.

As a solution, CME proposes the creation of a 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 gaps related to training, technology, productivity, access to supply chains, or financing. It would be delivered by the private sector with support from the federal government. We recommend:

Recommendation 10

Western Economic Diversification should work with trade and industry exporters to create a Manufacturing Export Accelerator Program to help western Canadian 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 structure 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 foreign investment to Canada because of the tax benefits of using Canada as an export platform.

We recommend:

Recommendation 11

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.

E. ADDRESS LABOUR AND SKILLS SHORTAGES IN WESTERN CANADIAN MANUFACTURING

Manufacturers consistently rank labour and skills shortages as the most important issues they face. According to CME's 2018 Management Issues Survey, 69 per cent of respondents face labour and/or skills shortages today and nearly 75 per cent expect to see such shortages within the next five years.

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 skills to use those technologies to their fullest potential.

Skills 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.

To address these issues, we recommend the following:

Recommendation 12

The Government of Canada enhance the availability of work-integrated learning programs in high-demand occupations by building partnerships between current programs and established organizations.

Recommendation 13

The Government of Canada fund "Open Doors" programs in the western provinces showcasing careers in manufacturing to young students, women, Indigenous Canadians and other underrepresented groups.

Recommendation 14

The federal government should expand and improve 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; and*
- *Standardizing CJG processes across the country and speeding up approval times.*

Western Canada is home to a large and underemployed Indigenous population. There is a potential for a tremendous win-win outcome if economic participation from that population can be improved: individuals gain access to high-paying skilled jobs, and businesses are better able to find the people they need. To achieve that outcome, however, more work is needed to improve access to high-quality education and training programs in Indigenous communities.

RECOMMENDATION 15

The Government of Canada should increase funding of, and access to, basic education and post-secondary training programs for Indigenous Canadians in cooperation with Indigenous communities. Post-secondary programs should be developed in partnership with private-sector stakeholders, industry associations, and Indigenous communities to ensure that individuals are learning relevant, in-demand skills that will lead employment and greater labour market participation.

CONCLUSION

CME believes that to be effective, an economic growth strategy for western Canada must address the existing barriers that are preventing the region from reaching its full economic potential. These barriers include a high business cost structure; stagnant investment; underdeveloped value-added exports; and chronic and severe labour and skills shortages.

In many cases, the solutions to these problems lie outside the scope or mandate of Western Economic Diversification; they require coordinated action from a wide range of federal government departments and agencies, as well as from the region's provincial governments, businesses and the broader stakeholder community.

However, this coordinated approach must not lose sight of the overarching goal: improving business conditions in western Canada and creating a policy environment that supports and sustains investment, innovation and growth. It is only with that primary focus in mind that a regional growth strategy will be successful.