THE CANADIAN CHAMBER OF COMMERCE
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TOP 10
Barriers to Competitiveness

Tackling the Top 10 Barriers to Competitiveness 2014

TOP 10

Barriers to Competitiveness

A MESSAGE FROM YOUR PRESIDENT

Canada is struggling to stay competitive. In fact, our country's ability to remain a leader among nations is stagnating. For the second consecutive year, the World Economic Forum ranked Canada 14th in global economic competitiveness—down two places from 2011 and sliding five places since 2009. Restoring Canada's competitiveness requires an ambitious, aggressive and innovative private sector. Strategic thinking and smart public policies are also needed to address long-standing structural impediments that hinder businesses at a time when they need much greater flexibility to compete.

Since 1925, the Canadian Chamber has fought for a strong, competitive economic environment that benefits all Canadians. To further our mandate, every year we identify the *Top 10 Barriers to Competitiveness*. This ongoing initiative aims to direct attention to the key impediments holding back Canada's progress and to urge all levels of government to act more swiftly in increasing our country's ability to compete globally.

Since launching this initiative in cooperation with our network of chambers of commerce, we have made great progress in furthering our competiveness agenda, particularly in addressing the barrier our members identified as being the greatest impediment to the success of Canadian business: the growing skills gap. The federal government and several provincial and territorial governments have also named this issue as the country's biggest challenge.

The document that follows sets out our *Top 10* list for 2014, which was determined in consultation with our members. I thank our members for their help in identifying the 10 critical policy and regulatory barriers that will be the focus of our advocacy efforts this year. As you will see, the skills issue remains, for the third year in a row, a main priority.

The need for action is urgent. The standard of living of every Canadian depends on how well we as a people respond to the challenge. We must identify and implement real, tangible solutions to break down the barriers to our competitiveness and create more opportunities and greater prosperity for Canadian businesses and families.

I urge all to endorse and actively support this important initiative and I look forward to sharing our successes with you.

Sincerely,

Perrin Beatty

Perrin Beatty
President and CEO

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In Summary

Skills shortages

Canada's labour market is affected by a demographic shift resulting in retirements and a growing gap between the skills needed and those available. Business, governments and academia must work together to address the current and future skills needs of the workplace, concentrating particularly on four key areas: upskilling; education and employment connections; immigration; and Aboriginal workforce development. To better address skills shortages, Canada also needs improved data on the skills gap and the mobility of individuals.

Uncompetitive travel and tourism strategies

Canada has declined from the seventh largest tourist destination in the world to the 18th. Today, it is too often a high-cost, high-hassle destination with aging attractions infrastructure and inadequate marketing. Canada's travel and tourism sector is critical to its economy, and the government must both invest in national marketing initiatives and address Canada's inefficient visa system, the very high cost of air travel in Canada and its layers of regulations, fees and taxes.

Inadequate plans for addressing deficiencies in public infrastructure

Public investment in infrastructure has not kept up with Canada's economic needs. Now Canada's investment needs far exceed the availability of public funds. Bringing infrastructure in Canada back to the level needed to support prosperity will require an ongoing commitment by all levels of government, an active engagement with private sector stakeholders and a greater appreciation of the opportunities that exist for Canada to be more competitive through more modern public infrastructure.

Barriers to success in global markets

Faced with a small domestic market, Canada's ability to compete depends on reliable access to foreign customers and production capabilities. But due largely to policy and regulatory barriers and operating challenges in foreign markets, Canadian businesses are not globalizing as quickly as their OECD peers. Canada must successfully negotiate trade agreements with key markets, renew its commitments to trade promotion and commercial diplomacy and update its tariff and customs policies.

Internal barriers to trade

The lack of a single domestic market in Canada is a serious and self-imposed weakness in the Canadian economy. Tariff barriers amongst provinces are banned by the Canadian constitution, yet the national economy is fractured by a host of non-tariff barriers, particularly in procurement, energy, agriculture and transportation, and in the mobility of labour. The federal government must promote more meaningful sanctions against jurisdictions that practice protectionism against other Canadians while supporting those that embrace free internal trade.

A complex and costly tax system

Canada over-relies on income and profit taxes rather than on taxes on consumption, which are relatively easy to collect and are least harmful to growth. Canada's tax code is also overly complex and imposes significant compliance costs on businesses and consumers while governments spend billions of dollars each year administering and enforcing convoluted tax laws. Canada must undertake a comprehensive review of its tax system with the aim of reducing its complexity and improving the way it raises tax revenue.

Lack of clear sustainability policies

Public concerns over Canada's ability to responsibly develop its natural resources has led to project delays, constrained investment and limited access to some markets. International concerns have also overshadowed Canada's diplomatic and trade initiatives on occasion. For Canada to claim its rightful place as the world leader in responsible resource development, it must establish a credible climate policy, clarify businesses' duty to consult with Aboriginal peoples and aggressively contest unfounded allegations about its environmental stewardship.

The severe shortage of economic development tools for businesses in Canada's territories

The federal government has a critical decision to make regarding Canada's territories if it is to fully leverage their economic potential. That decision is whether or not to provide them with tools to become more financially independent in the belief that doing so will unleash their ability to help the entire country be more competitive. Businesses see themselves as the means for the territories to achieve more financial independence from the federal government if they are provided with additional tools to enable them to do so.

Inconsistent regulatory policies between Canada and the U.S.

Inconsistencies between regulatory standards in Canada and the U.S. cost unnecessary time and money as these minor differences result in additional verification, inspection or testing of goods once they cross the border. Given the integrated nature of the two countries' economies, greater alignment and better mutual reliance in their regulatory approaches would lower costs for businesses and consumers, create more efficient supply chains, facilitate cross-border trade, reduce regulatory administrative costs for government and make Canada a more attractive location for foreign investment.

Insufficient support for innovation in Canadian manufacturing

Manufacturing, the largest sector of the Canadian economy, has not yet fully recovered from the 2008 recession and remains significantly reduced from its pre-recession size. Canadian companies can no longer rely on traditional manufacturing processes to solve this problem. They must innovate to capitalize on new technology and processes that improve productivity in order to remain competitive. Businesses also need a policy framework that reflects the importance of the innovation ecosystem imperative.

Barrier I: Skills shortages

The issue

Canada's labour market is affected by a demographic shift resulting in retirements and a growing gap between the skills needed and those available.

Skills gaps cost the economy billions of dollars annually in foregone GDP.[1] Tight labour markets are evident in parts of Canada, despite high unemployment levels elsewhere. A high proportion of businesses are projected to face skills shortages in the workforce.[2] In fact, the gaps between job seekers and job openings anticipated in the next 10 years are considerable for some occupations projected to face shortages.[3] These shortages threaten economic growth as companies, large and small, cut back production and turn down contracts when they lack employees with the requisite skills.

Given the demographic reality of an aging population and shrinking labour force growth, combined with the policy complexity of Canada's labour markets, these projected shortages and gaps will take time and collaborative action to resolve.

The barriers

Social biases and education policy are affecting the pool of entrants into skilled trades and science-based occupations. The chronic shortage of highly qualified and skilled trades professionals stems from a social bias against the skilled trades as occupations. Despite growing registrations of apprentices, insufficient numbers are becoming certified, creating a shortfall in journeymen to train future apprentices. For in-demand science-based occupations, including engineers and IT professionals, the education system is failing to engage enough students. A lack of essential skills is also holding back many existing employees who could become more productive through training. Employers recognize the need to develop their employees, but cost, time and the lack of human resource capacity are key barriers to employee training.

For many small businesses without Canadian candidates to fill short-term positions, a stricter temporary foreign worker program is cutting off employers from the foreign skilled workers necessary for projects in Canada.

1 Skills gaps cost Ontario's economy up to $24.3 billion in forgone GDP annually, as estimated in: Stuckey, James and Daniel Munro. The Cost of Ontario's Skills Gap. The Conference Board of Canada. June 2013.

2 Tal, Benjamin. "The Haves and Have Nots of Canada's Labour Market." CIBC Economics. Dec. 3, 2012.

3 Employment and Social Development Canada, Canadian Occupational Projection System (COPS), "Imbalances Between Labour Demand and Supply - 2011-2020" available at www.23.hrsdc.gc.ca/l.3bd.2t.1ilshtml@-eng.jsp?lid=16&fid=1&lang=en

The way forward

The Canadian Chamber will focus on four priority areas that are currently of high concern to members:

Upskilling

Upskilling of the labour force needs to cover the gamut if Canada is to make progress in tackling the skills gap. Improved data and analysis are sorely needed to help us capture a more detailed picture of Canada's skills mismatch. Increasing apprenticeship completions, advancing essential skills learning in the workplace and providing more employer-sponsored training are a few of the necessary actions. Small business requires separate consideration to overcome its lack of financial and human resource capacity for training.

Both younger workers who are recent entrants into the workforce and older workers approaching retirement are important segments in the current labour market composition. Canada needs to direct more attention to retaining older workers in flexible employment arrangements and without tax disincentives. Intergenerational workplaces will facilitate the transfer of knowledge and skills between age groups and the transition to a post-boomer workforce.

Immigration

The government must ensure its immigration policy changes respect regional differences in labour markets. Measures to tighten the Temporary Foreign Worker Program must be reconsidered, especially for small employers and in areas of low unemployment.

As Citizenship and Immigration Canada moves to introduce the new "expression of interest" system for permanent residents, it must not lose sight of where and why there will be ongoing needs for temporary foreign workers. The Canadian Chamber will press government to take those needs into account and ensure a transition to the new system without losing immigration programs that serve smaller centres or remote locations, in particular.

Education

Youth unemployment and underemployment numbers highlight a critical gap: Canada has a highly educated population of young people but too many of them are not qualified or skilled for entry-level vacancies in the workforce.[4] Business and post-secondary institutions need to expand their connections between classrooms and workplaces. The Canadian Chamber's network will continue to be an important avenue for those relations.

The Canadian Chamber will take action with its members and advocate foreign and interprovincial credential recognition; job-readiness initiatives for youth; better integration of international students; and coordinated government attention to how educational policy can better resolve gaps.

Aboriginal workforce development

In certain regions of the country and in key sectors of the economy, Aboriginal peoples are an important source of potential employees. The Canadian Chamber will continue to advocate increased investment educating and training Aboriginal peoples. Increasing Aboriginal youth participation in the workforce is a critical economic and social opportunity.

4 The lack of skills is the main reason for entry-level vacancies for almost 40 per cent of the employers in nine countries surveyed by McKinsey. McKinsey Center for Government. Education to Employment: Designing a System that Works. 2013.

Barrier II: Uncompetitive travel and tourism strategies

The issue

The travel/tourism sector is one of Canada's largest generators of GDP, contributing $85 billion to its economy annually, and accounting for more than 600,000 jobs. Visitors to Canada spend more than $15 billion annually. So important is the sector that most municipalities and provinces have tourism marketing organizations, including many of the chambers of commerce across Canada.

A decade ago, Canada was one of the top five international tourist destinations; now Canada is in danger of forfeiting its spot in the top 20.

The barriers

High costs

Visitors from every country except the northern U.S. rely on air travel to come to Canada. But Canada has one of the most expensive air transport markets. User fees and levies on aviation add hundreds of millions to passenger costs. These non-carrier charges typically account for 40 to 70 per cent of passenger costs. Governments then tax those user fees, extracting nearly an additional $100 million from passengers.

As a result of these imposed costs, departures from Canadian airports are roughly 30 per cent more expensive than U.S. departures. Many Canadians avoid the higher costs by driving across the border to start their travel—as many as five million per year, removing their money from this user-financed sector.

Because the air mode enables all the other sectors of the tourism community, policies undermining this one sector damage all the others. The various businesses that benefit, directly or indirectly, when tourism volumes are strong include:

- Transportation: air, rail and boat passenger services; charter and inter-city buses; tour services and car rentals.
- Real estate and realty finance: tourism-related realty investment in Canada represents billions annually.
- Accommodations: including hotels, inns, hostels, camping and rental properties.
- Food and beverage: restaurants, bars and food services.
- Meetings and events: conventions and business meetings, major sporting events and art festivals.
- Attractions: recreation and entertainment activities, as well as cultural, natural and historical attractions.

In March 2012, EuroMonitor International's country report for Canada stated, "The principal concern in the Canadian transportation market is the increasing lack of price-competitiveness of Canadian air travel compared with its U.S. counterpart. Flights in and out of Canadian airports are significantly more expensive than those to and from U.S. airports."

Tax

Only one export sector in Canada is not zero-rated for GST—tourism. Canada is the only G8 nation that does not rebate its value-added tax. The Crown collects nearly half a billion dollars of GST, which would be rebated in other countries.

Marketing

Canada should be redoubling its marketing efforts to overcome its high costs and the decline in U.S. tourism. Instead, the budget for the Canadian Tourism Commission (which conducts Canada's tourism marketing) has been repeatedly cut. Today the Commission spends $58 million promoting Canada in 11 markets. Meanwhile, Canada's rivals are outspending it—Ireland, Australia, Mexico and tiny New Zealand outspend Canada. Not surprisingly, each of those countries has seen steady increases in their volumes of foreign visitors (Ireland up 14 per cent in 15 years, Australia up 30 per cent, New Zealand up 83 per cent). Canada lost 10 per cent of arrivals from key markets in those years.

The way forward

In 2002, Canada welcomed 20 million foreign visitors and was the seventh largest tourist destination in the world. In 2012, only 16 million visitors came to Canada. Canada now ranks 18th in the world. Canada is becoming increasingly uncompetitive within this sector.

In 2014, the Canadian Chamber will advocate:

1. The implementation of the federal government's tourism strategy. Whether it is financial or regulatory support, or just ensuring federal agencies and departments consider the tourism sector in their existing mandates, Canada needs measures that reshape the sector so it can compete.

2. The creation of a positive climate for investment. As Canada's tourism infrastructure ages, the competitive pressure increases. Creating a climate in which major tourism and hospitality investors commit to Canada, ahead of other nations, is a central policy challenge. The federal government needs to engage with such investors to understand and respond to their needs as they select the locations for the multi-billion dollar investments that characterize this sector.

3. A federal marketing strategy. Canada's marketing efforts must be substantially increased. Even doubled or tripled, the Canadian marketing budget would only represent a fraction of the revenues lost by the federal government as foreign visitors continue to rapidly decline.

4. A cross-sectional examination of the travel sector. Canada has a serious cost competitiveness problem that must be better understood and addressed aggressively. The Canadian Chamber calls on the federal government to conduct a wide-range examination of the travel sector with special attention to the high public costs borne by aviation customers.

5. Reinvestment in the visa application process. Upgrading Canada's visa application process to increase its capacity and reduce its complexity and inconvenience for potential visitors would attract growth from countries such as Brazil, China, India and Mexico. The government should reinvest some of the $400 million it collects annually from visa administration fees and reinvest a portion in Canada's visa processing capacity.

The chambers of commerce across Canada are encouraging the government to make tourism a national priority. This past October, the Canadian Chamber was delighted to that the government included tourism as a significant industry that requires federal attention in the Speech from the Throne. This commitment directly impacts all players within the Canadian tourism sector, and the Canadian Chamber stands ready to support any efforts to strengthen the industry.

Barrier III: Inadequate plans for addressing deficiencies in public infrastructure

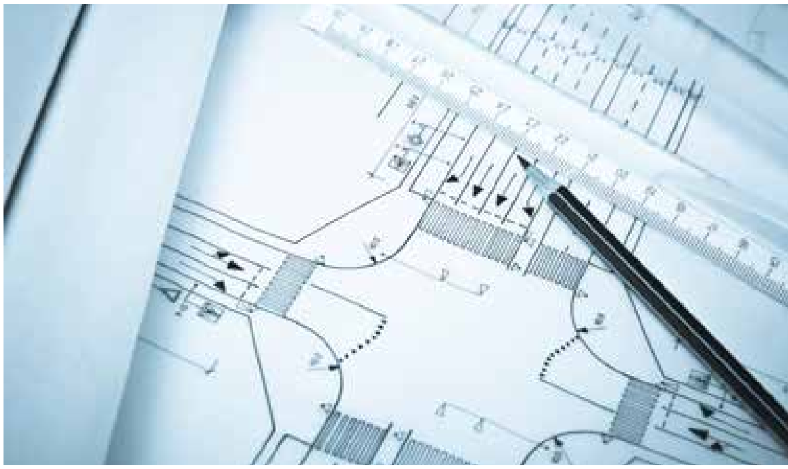
The issue

Modern, reliable and sustainable infrastructure is a cornerstone of productivity and economic success. It is essential for the quality of life of citizens and for the success of businesses. Unfortunately, Canadian public infrastructure has suffered from chronic underfunding and a lack of long-term planning. A large percentage of Canadian publicly-owned infrastructure needs to be refurbished or completely retired. While increasing usage, growing demand and environmental stressors have all contributed to this decay, much of the decline can be attributed to decades of underinvestment and poor maintenance. To make matters worse, thanks to the prolonged period of underinvestment, the costs of updating and maintaining existing infrastructure are increasing.

Canadian economic success depends on a long-term, strategic and predictable infrastructure investment plan. While the 2013 federal budget earmarked over $53 billion for provincial, territorial and municipal infrastructure, it will not be enough to cover the huge bulge of necessary investment. Furthermore, Canada continues to lack an overall strategy for infrastructure planning, development and maintenance.

The barriers

Public infrastructure, including roads, bridges, highways, water systems and the electrical grid, provide services critical to economic competitiveness, sustainability and a high quality of life. The service life of most public infrastructure extends only four or five decades. This poses a significant challenge for Canada, where much of the existing public infrastructure was built at least a generation ago.



In Canada, infrastructure investment has typically been tied to budgetary cycles. This inconsistent approach to infrastructure investment is not only inefficient but also makes long-term planning difficult. Other sectors deemed vital to the quality of life of Canadians, such as healthcare or law enforcement, are permanent components of government budgets. A longer-term vision for Canadian infrastructure would provide stability during periods of fiscal uncertainty. The Canadian government should examine ways to make infrastructure a permanent component of the budgetary cycle.

Unfortunately, the funds needed to cover the necessary investments will exceed government capacity. In order to overcome this challenge, Canada must examine innovative approaches to infrastructure investment and maintenance. Despite the fact that some of the largest infrastructure financiers are Canadian, very few are investing in Canadian assets. Canada needs to ensure its policies and regulations are designed to attract this type of investment. Better coordination among all levels of government and with private sector stakeholders is required if Canada wants to remain competitive. While public-private-partnerships are not the only available option, these partnerships have the potential to bring international investment to Canada and to call on the best innovation the global market can offer.

Any national infrastructure plan must be flexible enough to adapt to changes in technology, to allow Canadians to learn from their experiences and to adjust to the needs of the future. Canada should identify best practices for infrastructure investment, design and maintenance. Canada's policies must be transparent, predictable and designed to encourage innovation.

Beyond a long-term investment strategy, Canada needs to have a dialogue on how it will plan, build and maintain its infrastructure for the foreseeable future. Having a clear and accurate picture of its current infrastructure stock is the first step in the process. Improving the productivity of its infrastructure means being more strategic about the types of infrastructure it invests in, ensuring new builds are delivered as efficiently as possible and Canada has dedicated plans on how to manage infrastructure once it is in place.

The way forward

In 2014, the Canadian Chamber will advocate:

1. A long-term, transparent and predictable infrastructure strategy. This strategy should identify best practices in infrastructure finance and should promote the use of innovative fiscal tools such as P3s. It should encourage strategic infrastructure investments in key areas across Canada and ensure all new builds include long-term asset management plans.

2. A full review of Canada's infrastructure related policies and regulations in order to attract private sector investment and to maximize cooperation between all levels of government and the private sector.

Barrier IV: Barriers to success in global markets

The issue

Faced with a small domestic market, Canada's competitiveness and productivity depend heavily on having easy access to international customers and supply chains. Exporting is an effective way to expand sales and build economies of scale, while working with international suppliers and investing in operations abroad allows companies to take advantage of unique local technologies, skill sets and cost advantages.

But, Canadian businesses are not globalizing as quickly as their peers. Despite a 70 per cent increase in world trade over the past decade, the value of Canadian exports has been flat. Diversification to new, high-growth markets has also stalled: the share of exports sold outside the United States grew until 2009, but has been largely unchanged since. Canada has fared better as a source and recipient of foreign direct investment, ranking among the top 10 countries globally in each category, according to UNCTAD. However, researchers at Export Development Canada have found that sales by Canadian subsidiaries abroad remain significantly lower than those of their counterparts from the UK, the U.S., Japan and Australia—even when adjusted for population and size of economy.

The barriers

Policy and regulatory barriers in foreign markets are a big part of the story. Tariffs and quotas, discriminatory or diverging regulations, subsidies, ownership restrictions, local content requirements and poor protection of physical and intellectual property all make it difficult for Canadian businesses to compete abroad. The federal government hopes to reign in these barriers through an aggressive program of bilateral and regional trade and investment agreements, which complement renewed efforts at the WTO.

Accordingly, the recent announcement of an agreement in principle with the European Union is an important step forward. But other trade talks are dragging on. Furthermore, existing agreements have proven difficult to enforce, and they often do not address new issues affecting cross-border business, such as those related to the digital economy.

Even when with effective trade agreements in place, the operational challenges of doing business globally can be daunting. This is especially the case in emerging markets, which make up an increasing share of global growth. Businesses must build relationships with new customers and suppliers, access capital, navigate red tape and manage their risks—all in a new political, cultural and legal landscape. Business success also depends on the broader diplomatic relationship between countries. Canada's foreign service and trade promotion programs are therefore essential in this context, providing business development services, financing support as well as marketing programs and public advocacy. But in many cases, these efforts lack resources and coordination, are poorly communicated or are not adequately tailored to companies' needs.

Finally, the competetiveness of a company's global supply chain depends on the smooth movement of goods and inputs across borders. It is important that Canada have efficient, transparent and predictable tariff policies and customs processes that place minimal burdens on importers and exporters. Unfortunately, this is increasingly not the case. The federal government announced last year, with minimal notice, that imports from 72 different countries would be subject to higher duties. Businesses have also raised a number of concerns about administrative practices by the customs authorities.

The way forward

The Canadian Chamber of Commerce endorses the federal government's recently announced Global Markets Action Plan, which seeks to address a number of these barriers. The plan has called for ongoing consultation with industry to ensure its effectiveness.

In 2014, the Canadian Chamber will advocate:

1. Progress on the bilateral trade agenda, including the signing of a final text with the European Union, completion of agreements with Japan, Korea and India as well as continued political engagement with China to address trade irritants and identify next steps in the relationship.

2. Canadian leadership to advance regional and multilateral talks, including completion of an ambitious and comprehensive Trans-Pacific Partnership, progress on the Trade in Services Agreement and a roadmap for ongoing and future WTO negotiations.

3. Enhanced enforcement action and regulatory cooperation to facilitate the acceptance of Canadian goods and services by major trading partners.

4. Implementation of the concept of 'economic diplomacy' across Canada's missions abroad, including through renewed commitment to the Trade Commissioner Service and its partners.

5. Better coordination and communication across government agencies and industry groups to improve the effectiveness of trade promotion programs and services.

6. A more clearly defined role for business in Canada's international development and aid strategy.

7. A comprehensive review of Canada's tariff policies and customs administration.

Barrier V: Internal barriers to trade

The issue

As Canada pursues the most ambitious trade agenda in its history, it must simultaneously break down the remaining barriers to internal trade. To succeed globally, Canada needs a domestic business environment that fosters productivity and increases its ability to compete against burgeoning foreign competition. A competitive national economy requires the free flow of people, goods and services across the country. Interprovincial trade and mobility stimulates a strong, more resilient business environment. It also provides important employment opportunities for Canadians and helps address skilled labour shortages.

The barriers

While the Canadian constitution prohibits tariffs between the provinces, the country nonetheless remains divided. Most of these barriers result from minor differences in regulations and standards and, in some cases, direct market distorting programs. Today, barriers remain in areas like procurement, energy, agriculture and transportation.

The free movement of professionals also remains an issue. While there has been significant progress in recent years, these changes have not yet been fully implemented. Discriminatory hiring practices that favour local labour, and minor differences in licensing and standardization continue to limit Canada's ability to grow. A recent study by the Bank of Canada found that barriers to labour mobility continue to be a major impediment for professionals looking to relocate to another region in Canada. The same study also found that removing these barriers could increase overall migration by over 60 per cent, thereby allowing us to better match skills with needs.

Canada is a small market, and imposing unnecessary barriers only limits growth and innovation. In Canada, domestic trade is regulated by the Agreement on Internal Trade (AIT), which entered into force in 1995. The AIT was designed to reduce and eliminate internal barriers to trade, investment and labour mobility in Canada and to create an open and efficient domestic market.

Over the years, there has been progress to eliminate domestic barriers to trade and mobility, albeit at a pace that remains far too slow. There remains the need to improve the accessibility and efficiency of the dispute resolution mechanism in the AIT. While 2012 saw some progress in this area, the process continues to be long and cost prohibitive. Furthermore, there are areas where the existing AIT could be expanded upon, such as the implementation of a chapter on technical barriers to trade. Movement in this area would not only help to improve Canada's international trade but would also reduce a significant amount of red tape.

Another area calling for attention is energy. In 1995, the Agreement on Internal Trade committed the provinces and territories to a chapter on energy that would facilitate investment in the infrastructure required to distribute Canada's natural resources. Over the next two decades, Canada needs approximately $15 billion per year in investment in its electricity infrastructure to maintain current levels of service and to bring the next wave of generation capacity online. A reinvigorated AIT process would spur investment and job creation and enable Canada's electricity sector to continue to provide a competitive edge for Canadian industries.

The way forward

Canada can no longer afford to slowly whittle away at the remaining barriers to trade. The federal government must show leadership by working with the provinces to create a true domestic market.

In 2014, the Canadian Chamber of Commerce will advocate:

1. Further strengthening of the Agreement on Internal Trade, particularly in the areas of energy and technical barriers to trade.
2. Improving the efficiency and accessibility of the dispute resolution process of the AIT.
3. Examining ways to go beyond the AIT and to create a new, more comprehensive agreement on internal trade.

Barrier VI: A complex and costly tax system

The issue

The World Economic Forum's *Global Competitiveness Report 2012 – 2013* cites tax rates and tax regulations among the top 10 most problematic factors for doing business in Canada.

Canada can significantly boost its international competitiveness by simplifying its tax system to facilitate administration and reduce compliance costs and by rethinking the structure of its system.

The barriers

The tax code is overly complex as a result of piecemeal changes to tax legislation by successive governments and the enactment of temporary provisions and hundreds of tax preferences. The Fraser Institute estimates it costs Canadians up to $6.7 billion annually to comply with their personal income tax obligations and businesses as much as $17.8 billion to comply with theirs. Additionally, governments spend an estimated $6.6 billion each year administering and enforcing convoluted tax laws. This means a nation of about 35 million people incurs up to $31 billion in costs each year to comply with, administer and enforce personal and business taxes.

A lack of a formal system to consolidate the tax reporting of corporate groups or to otherwise transfer corporate profits and losses among related companies is also hindering competitiveness. Businesses are forced to use various tax-planning strategies to transfer tax attributes between related entities that are time consuming and entail significant and costly internal reorganization. Businesses' competitiveness would be significantly enhanced if Canada created a formal loss-transfer system to address corporate group taxation. While the Canadian Chamber appreciates the federal and provincial/territorial governments likely have concerns about the short-term fiscal costs, re-engaging stakeholders in a more open dialogue can help the government resolve these and other concerns.

Governments could further enhance Canada's competitiveness by striving to achieve a business tax system that does not favour or disadvantage particular sectors of the economy. The marginal effective tax rate (METR) on capital investment, which encompasses taxes on corporate income, retail sales taxes on business inputs as well as deductions and credits available in the corporate tax system that impinge on investment decisions, varies greatly by sector. Service providers (e.g., the retail trade, wholesale trade and communications sectors) face a rate that is substantially higher than that faced by other sectors of the economy, including forestry and manufacturing. This results in a less than optimal allocation of capital throughout the economy as capital tends to flow to those sectors with the most favourable tax treatment rather than to those where growth prospects may be higher.

When it comes to Canada's personal income tax system, change has been sporadic and there is much unfinished business. In international comparisons, Canada stands out as having a relatively high burden of personal income tax as a percentage of GDP. Punishingly high marginal personal income tax rates, that are especially affecting Canadians with modest incomes, reduce incentives to work, save, invest in education and skills and undertake entrepreneurial activities, all of which form the basis of a productive and growing economy.

Finally, Canada over-relies on income and profit taxes, which are most harmful to the economy, rather than taxes on consumption, which are relatively easy to collect and least harmful to growth. Switching the tax mix toward consumption-based taxes would encourage work and capital formation and would stimulate productivity and economic growth.

The way forward

In 2014, the Canadian Chamber will advocate:

1. A comprehensive review of Canada's tax system with the central objective of reducing its complexity and improving the way Canada raises tax revenue. An expert panel would (among others) review and clarify the language used in tax law; recommend changes to existing legislation that is not achieving its purpose or entails costs that outweigh the revenue being raised or protected; examine the processes used to formulate tax policy and to draft the legislation to give effect to that policy; and evaluate all tax preferences (credits, deductions, exemptions, rebates) with a view of eliminating those that are not cost effective or are not achieving their intended purpose. A broader tax base would make the tax system simpler, fairer and more efficient and would allow general tax rate reductions without loss of revenue.

2. A multi-year plan to reduce personal income rates, especially for low- and middle-income Canadians. Rate reductions can be financed by eliminating the various tax credits and other exemptions offered through the personal income tax system that are not cost effective or are not achieving their intended purpose.

Barrier VII: Lack of clear sustainability policies

The issue

The risky nature of the global energy, metals and minerals, and forest product businesses means that a country's resource endowment will only get it a seat at the table. Building world-class resource companies and attracting foreign investment depends almost as much on having the right intangible 'assets'—the institutions, knowledge, human capital and government regulations and policies—to extract resources efficiently. Increasingly, public acceptance and support for natural resources projects, also referred to as social licence, is one of those intangible factors that impacts the competitiveness of energy, mining and forest product industries by influencing access to resources, markets and labour. Having clearer sustainability policies at the federal level would play an important role in assuring Canadians that the development of Canada's resource endowment is being conducted in an environmentally responsible manner.

The barriers

Public perception of the environmental and social impacts of natural resource production and transport is an increasingly important issue for the competitiveness of the sector, and by extension, the Canadian economy as a whole. These 'social license' issues have several direct impacts on competitiveness:

- Access to resources: Within Canada, public opposition to resource projects can delay or prevent projects from going forward.
- Access to markets: Perceptions of the environmental performance of Canadian firms can impact markets aboard. The proposed EU Fuel Quality Directive would require European importers of Canadian bitumen to purchase additional offsets than would be required from other sources, limiting access to European markets and possibly influencing U.S. policy makers. The reputation of Canadian firms is vital when operating abroad, as governments are influenced by a firm's experiences in other jurisdictions when granting concessions.
- Access to labour: The idea that public perception of resource production as a 'dirty' dissuades many Canadians from pursuing a career in these industries. Anecdotal evidence exists to suggest that this perception, as well as a general undervaluation of the trades, has contributed to the ongoing skills gap in the resource sectors.

The way forward

The rapid economic development in emerging economies that will lift millions of people out of poverty will also increase demand for raw materials extracted from nature. By definition, the extraction or harvesting of energy, metals, minerals and forest products significantly impacts the environment. In many ways, these industries are the front lines of environmental responsibility and will be leading the way towards a more sustainable future. Canada is well positioned to lead the world in sustainable resource development, which can contribute to both its economic prosperity and environmental protection. Federal policy will play an important role in realizing this future.

In 2014, the Canadian Chamber will advocate:

1. Greater clarity on federal GHG regulations.

2. Engagement with the provinces, territories, industry and Aboriginal groups to establish a clear process around the duty to consult with Aboriginal groups and a clearer demarcation of industry, government and Aboriginal roles and best practices.

3. Balancing the promotion of Canada's resource exports with support for Canada's clean technology sector through research, commercialization and access to export markets.

Barrier VIII: Severe shortage of economic development tools for businesses in Canada's territories

The Issue

The federal government has a critical decision to make regarding Canada's territories if it is to fully leverage their economic potential. That decision is whether or not to provide them with tools to become more financially independent in the belief that doing so will unleash their ability to help the entire country be more competitive. Businesses see themselves as the means for the territories to achieve more financial independence from the federal government if they are provided with additional tools to enable them to do so.

The Barriers

Businesspeople in the territories have much in common with those elsewhere in Canada. However, their barriers are magnified because of geography and the territories' relationship with the federal government.

With the forces of international economic power shifting and the hunger for natural resources rising in the fastest-growing economies, Canada is going to need strong territorial economies to compete. Reducing the territories' dependency on the federal government is critical to building that strength.

The Way Forward

In 2014, the Canadian Chamber will advocate:

1. Providing new economic development tools to businesses in Canada's territories, such as:
    a. public infrastructure and infrastructure funding and investments;
    b. making it possible/easier for northern businesses to become suppliers to the federal government;
    c. opportunities businesses of all sizes to participate in the Arctic Council's Arctic Economic Council;
    d. federal employee recruitment programs that acknowledge the additional hurdles territorial businesses face in attracting and retaining talent; and,
    e. clarity in regulatory oversight of onshore natural resources after devolution in the Northwest Territories.
2. Establishing a new constructive relationship with Aboriginal peoples that acknowledges the economic potential of their lands and peoples.

Barrier IX: Inconsistent regulatory policies between Canada and the U.S.

The issue

Differences between Canadian and U.S. regulatory policies result in considerable time, money and human resources spent on additional verification, inspection or testing of goods once they cross the border. Given the integrated nature of the two countries' economies, greater alignment and mutual recognition of their regulatory approaches would lower costs for businesses and consumers, create more efficient supply chains, facilitate cross-border trade, reduce regulatory administrative costs for government and make Canada a more attractive location for foreign investment. In essence, a more coordinated approach to Canada-U.S. regulatory regimes would improve the overall competitiveness of Canada's economy.

In 2011, Prime Minister Stephen Harper and President Barack Obama announced the Canada-United States Regulatory Cooperation Council (RCC) Joint Action Plan. It includes 29 specific initiatives (at the federal level) for greater regulatory alignment in four key sectors: agriculture and food; health and consumer products; transport; and, the environment. While a step in the right direction, the RCC action plans are limited to specifically identified areas. A more comprehensive and permanent mechanism for bilateral regulatory alignment is needed.

The barriers

There are a number of sectors where closer regulatory alignment with the U.S. makes sense.

The automotive sector

This sector accounts for more than 20 per cent of the trade between Canada and the U.S. Furthermore, the high degree of integration in the North American auto industry means that parts are generally designed, tested and produced for use in either Canada or the U.S.

Recognizing the importance of the auto sector, the RCC has done some good work in this area. For example, the Canadian government confirmed in June 2013 that it will match the U.S. on rules regulating emissions from vehicles. The new standards will be phased in between 2017 and 2025. Canadian regulations on the amount of sulphur in gasoline will also be harmonized with U.S. rules.

The Canadian government has also agreed to a common regulation for occupant crash protection (MVSS 208). This single change will result in estimated savings to industry and consumers of over US$350 million. Yet, this change only affects one in over 50 different regulations.

Although motor vehicle safety standards are, for the most part, aligned between Canada and the U.S., the remaining differences result in duplicative testing and increased production and design costs for manufacturers. The Canadian Chamber of Commerce estimates that, as a result of security and regulatory differences, the cost of reporting, compliance and delay at the border adds up to $800 per vehicle. Greater harmonization of vehicle safety standards would facilitate cross-border trade in vehicles and parts, lower costs to consumers and enhance the competitiveness of the automotive industry as a whole.

Health and personal care products

Both Canada and the U.S. have among the highest standards of health and safety in the world. Nevertheless, despite the integration of the Canadian and U.S. markets, subtle regulatory differences hinder two-way trade in health and personal care products and limit consumer choice. For example, in Canada lipstick labelled as containing SPF is classified as a drug. The estimated annual cost to import SPF lipstick into Canada is approximately $170,000. Without the SPF label, the lipstick is classified as a cosmetic and costs approximately $1,000 annually to import.

Unnecessary regulations and duplicative activities increase costs for manufacturers. Efficiency gains can be realized by reducing unnecessarily duplicative activities and by further leveraging each country's regulatory capacities and scientific expertise without compromising the safety, efficacy and quality of products.

Agriculture and food

Canada and the U.S. have very robust food safety systems to safeguard food to protect consumers. Thus, it should not always be necessary to reverify, reinspect or retest goods once they cross the border. Both countries should focus on leveraging each other's expertise and on relying primarily on the controls and mitigation measures rooted in each other's systems to enhance food safety outcomes while minimizing potential impacts on trade. Reducing the duplicative verification activities would allow food safety protection resources to focus on areas of higher risk. Additionally, the removal of costly trade irritants would reduce prices paid by consumers.

The way forward

In 2014, the Canadian Chamber will advocate:

1. Faster results on regulatory harmonization at the joint Canada-U.S. Regulatory Cooperation Council.

2. The identification of new areas for regulatory harmonization.

3. The creation of a permanent, bilateral and institutionalized mechanism for regulatory policy.

Barrier X: Insufficient support for innovation in Canadian Manufacturing

The issue

Although manufacturing remains the largest sector of the Canadian economy, it has not yet fully recovered from the 2008 recession and remains significantly reduced from its pre-recession size. Canadian companies can no longer rely on traditional manufacturing processes to solve this problem. Canadian business must innovate to capitalize on new technology and processes that improve productivity in order to remain competitive. Business must also have a policy framework that reflects the importance of the innovation ecosystem imperative.

A recent study[5] by the Conference Board of Canada defines a country's development of its knowledge base as its "innovation ecosystem" and argues that innovation is an essential element to drive economic growth, productivity and competitiveness. Canada has dropped five places to 14th on the Global Competitive Index.[6] Continuing to focus on low value-add, commodity-based products instead of leveraging high value-add, knowledge- or serviced-based products is identified as a key factor in Canada's decline. Competing on cost inputs leaves Canada at a disadvantage.

Manufacturing was once the life blood of the economy of central Canada. Things have changed. In 2012, the Laurentian Bank reported that "in 2011, Ontario's and Quebec's manufacturing sectors accounted for 47 per cent and 26 per cent, respectively, of total Canadian production" and that "the sector's relative importance to the real economies of Ontario and Quebec has dropped by approximately 25 per cent in the last 10 years.[7] According to Statistics Canada, manufacturing has seen the greatest declines of all business sectors over the past decade, measured by industry growth (by a factor of two) and aggregate input to industry growth (by a factor of 10).[8]

How can Canadian manufacturing reverse this trend? In May 2013, the McKinsey Global Institute released a report[9] on the top 10 disruptive technologies. These technologies have the potential to transform the global economy. Of the 10, these seven will have a direct impact on the renaissance of manufacturing for those companies with the foresight to innovate over the next decade:

- The automation of knowledge work
- The "internet" of things (production monitoring)
- Cloud technology
- Advanced robotics
- Energy storage
- 3D printing
- Advanced materials

McKinsey also notes that "more than 70 per cent of the value added created by the internet is in traditional industries."Capitalizing on these disruptive technologies to create high value add, knowledge-based products is essential to Canada's competitiveness. Both the Conference Board of Canada and PWC's Global CEO survey indicate that the Canadian manufacturing sector has not kept pace with the accelerated technology cycle by making the necessary R&D investments.

5 www.conferenceboard.ca/temp/a306d2f6-6aa3-4adc-bab7-c4ba900c627c/14-012_addingvalue-globalmanufacturing_rpt.pdf
6 http://reports.weforum.org/global-competitiveness-report-2012-2013/
7 www.vmbl.ca/Economics/16/ProvincialMonitor_Oct2012.pdf
8 www.statcan.gc.ca/pub/15-206-x/2013030/t002-eng.htm
9 www.mckinsey.com/insights/business_technology/disruptive_technologies

The barriers

1. According to the PWC's *Canadian Manufacturing Barometer Business Outlook Q3 2012*, which is a survey of global CEOs, some of the major barriers to growth in the manufacturing sector are competition from foreign markets, lack of qualified workers and capital constraints.[10]

2. The OECD frequently cites R&D spending as a key indicator of economic performance. From 2007 to 2010, Canada's gross domestic R&D spending decreased in every year; whereas countries like Korea have increased gross domestic R&D spending by over 25 per cent in the same time period.[11] Where most countries are investing heavily in R&D, Canada is forecast to reduce R&D spending in 2014 by 3.3 per cent. This reduction is combined with the reduced tax credits available through the Scientific Research and Experimental Development Program, which has already resulted in a decline in R&D spending within the private sector.

3. Canada's intellectual property rights (IPR) system is problematic. Canadian manufacturers find IPR unclear, rigid and complicated. Specifically, participants felt that IPR negotiations with post-secondary institutions or agencies are a labour-intensive process with the added challenge of differing philosophies or objectives.

4. While Canada's immigration policies have improved in the last three years, more can be done to encourage the incredible wealth of talent that exists within Canada's foreign student community to remain in the country past graduation, where the work experience requirements are still difficult to meet. In an examination of productivity growth, the Conference Board of Canada[12] notes that Canada lags in productivity. In addition to technology and innovation, a key factor in this productivity lag is human capital.

5. The technology cycle has accelerated. The technological shifts that once took decades are now measured in months. Canada's post-secondary institutions' curriculum structures were never designed to accommodate this rapid pace of change. R. Buckminster Fuller explained in his book *Critical Path*[13] that up until the 16th century, it took approximately 1,500 years for mankind's collective knowledge to double. The next doubling of knowledge took only 250 years. By 1900, 150 years later, knowledge had doubled again. By extension, the doubling speed of knowledge is now about 18 months, taking the example of the product cycle and speed of consumer adoption of technology items such as smart phones. If a conventional university education takes four years to complete, the sum of all human knowledge will quadruple in the time between frosh week and convocation—overwhelming for both student and institutions. Canada's educational system has not yet evolved to the point of a culture of life-long learning where relationships between institution and student continue well past entry into the workforce—a dynamic link between institution and industry.

The way forward

The barriers to manufacturing success in Canada all point to a decline in Canada's innovation ecosystem. In 2014, the Canadian Chamber will advocate:

1. Policies that encourage development and innovation in the manufacturing sector. Most studies propose policy alternatives, including immigration strategies, tax incentives, improved IPR, procurement strategies and more open foreign direct investment. The Canadian Chamber will conduct a critical examination of these policy alternatives and validate them through a series of roundtables populated by corporate Canada's manufacturing thought leaders. The results of this process will be compiled in a summary of recommendations for both business and government.

10 www.pwc.com/ca/industrial-manufacturing

11 Factbook 2012 - ISSN - © OECD 2012

12 www.conferenceboard.ca/hcp/details/economy/measuring-productivity-canada.aspx

13 Fuller, R B. Critical path. New York, N.Y: St. Martin's Press, 1981. Print

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