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Unleashing innovation

Canadians know what needs to be done to make us all better off a decade from now

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Canada has made some smart moves over the past decade and that is why the Canadian economy remained relatively strong through a punishing global recession. But our country is immune neither to the relentless evolution of global competition nor to the march of population aging, and we need to move quickly to address unfinished business in honing Canada's competitive edge in the decade ahead.

In our 2001 book *Northern Edge*, we made the case that Canada had all the right ingredients to flourish in the global economy. What was needed was a better recipe for success and a winning attitude where second best is not an option. We proposed a strategy with 12 elements that together could move our country to the global forefront of growth and prosperity. These included accelerated debt reduction; bold tax reform; smarter public spending; improvements to our educational system and talent pool; emphasis on lifelong learning; more efficient governance; more adept

engagement in North American and global trade and investment; and better leveraging of our energy and environmental advantages.

On a couple of fronts, notably public debt and tax reform, Canada has made major progress. The string of federal budget surpluses that began in the late 1990s extended all the way until the recession. Tax rates, especially on corporate income and capital, dropped steadily through the decade at both the federal and provincial levels and regardless of the party in power.

It is no coincidence that Canada not only achieved the lowest debt/GDP ratio in the G7 both before and after the recession, but that we also had the highest per capita income growth in the decade to 2009 and that we have seen employment quickly recover and surpass its pre-recession high.

That's the good news. But while debt and taxes are down, public spending has ballooned. Despite lip service to review and reallocation, six years of minority government have led to a relentless rise in federal spending. And at the provincial level, unsustainable

health care costs are eating up an ever greater share of revenue, with willingness to explore innovation and efficiencies undermined by the 10-year deal boosting federal transfers at about triple the rate of inflation.

In many of the other elements of national strategy that we laid out, there has been some progress, but at a pace well short of what the country needs to achieve its full potential.

Perhaps the most troubling marker of failure is the country's continuing poor performance in raising productivity, the effective measure of how much money each Canadian can generate for each hour of work. As the population ages and leaves relatively fewer Canadians in the labour force, it is obvious that each worker has to generate much higher income if the economy as a whole is to keep growing.

In 2001, we said Canada should aim for productivity growth a full percentage point higher than that of the United States. Instead, the country has continued to lag, falling behind by a further percentage point a year through the decade. If this performance is not reversed quickly, all Canadians will suffer in the years ahead.

To turn this trend around, we need to address some key issues, both at home and abroad. One major challenge that we did not anticipate was the impact on North American integration of the terrorist attacks of 9/11, which occurred just after our book was

published. Despite a series of important initiatives, including the Smart Border Accord and the Security and Prosperity Partnership of North America, the Canada-United States border today is more of a barrier to the efficient movement of people and goods than it was a decade ago. Ongoing efforts to shift more security screening to the continental perimeter seem unlikely to make much difference in the near term.

The security situation, combined with the stalling of multilateral trade and investment talks through the World Trade Organization, reinforces the urgency of our recommendation that Canada vigorously expand its bilateral and regional efforts beyond North America. Canada's business community has taken the lead here, notably in working with its counterparts abroad to enable the launch of major bilateral initiatives with the European Union and with India. Building a closer relationship with a rising China remains an obvious priority for government and business alike. It is essential for Canada to fast forward these initiatives and continue expanding engagement with the countries and regions that will lead global growth in the decade ahead.

Within Canada, the central imperative remains the one we identified in 2001: more robust innovation in the public and private sectors alike.

Canada has made major public investments in research, primarily through universities, but private-sector

innovation has remained relatively weak. The OECD ranks Canada as 16th in business spending on R&D as a share of the economy, despite having the second-highest level of government support for such investment.

The overall policy and economic environment has become much more encouraging over the past decade. The marginal tax rate on new business investment has dropped sharply, making Canada more attractive internationally and opening a significant tax advantage over the United States. The steady rise in the Canadian dollar against its U.S. counterpart has both added a major incentive for greater investment in technology and made imports of the necessary machinery and equipment cheaper — and recent trade figures suggest that Canadian businesses are responding.

But work we did with the Canadian Council of Chief Executives suggested that many other factors are still holding back investment in innovation. Some, like restrictions on competition and foreign investment, are sectoral. Others, like the complex and adversarial administration of research tax credits, are procedural. And our conversations with many CEOs over the years have raised a wide variety of explanations specific to individual companies, from inconsistencies in the way universities handle research partnerships to internal accounting policies within global firms.

The most obvious policy drivers of business innovation have been addressed. The onus now is on business leaders to talk bluntly about what still holds them back and what further measures would drive them to invest more in innovation, and to do so in Canada rather than in other countries.

Moreover, Canada's business leaders must work harder to capitalize on our country's many strengths in building enterprises of global scale. We have been successful in creating global champions, but we can do better. We want to see more Canadians acting as hunters, rather than the hunted, in the global game of mergers and acquisitions.

While head offices do matter, we must recognize that their value flows from their role as centres of decision-making and high-value work. These are corporate functions that we can and must attract to our communities, regardless of where a company's shares are owned. Indeed, both human and financial capital from abroad are spurs to innovation and growth, and Canada therefore must continue to strongly encourage inflows of both investment and skilled people. A retreat towards protectionism should not enter our minds.

A dynamic and innovative private sector, however, is not enough. We also need to unlock innovation in the public sector. Innovation in how governments work together is vital. It is no easy task for a major energy

producer and exporter like Canada to demonstrate global leadership on an issue as complex as climate change without undermining its competitive interests. Trying to do so when it cannot even reach consensus within its own borders on a coherent and consistent approach to targets and mechanisms is plainly impossible.

Similarly, we should not need to wait for a Supreme Court ruling in order to end decades of wrangling over creation of a single regulator for securities markets. And more effective collaboration among governments is essential across almost every facet of the strategies Canada needs to pursue in the years ahead.

We remain highly optimistic about Canada's potential to triumph in the global economy, but on too many fronts, the past decade has seen talk rather than action. More business innovation, smarter government spending, greater engagement abroad, better collaboration at home, a winning attitude — Canadians understand what needs to be done to ensure that we all are better off a decade from now. We just need to get on with the job.

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