



True North in
Canadian public policy

A MANDATE FOR CANADA

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In advance of the 2019 federal election, MLI has released a new series designed to offer practical public policy recommendations for the post-election government. Titled “**A Mandate for Canada**,” this series of short analyses will cover a range of pressing issues that any incoming government will need to address, including Indigenous affairs, foreign and security issues, and economic and fiscal policy.

A real innovation agenda for Canada: How to stop playing the innovation game and boost productivity and creativity

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Introduction

Canada has innovation sickness.

Its symptoms are well-known. We patent too little. We invest relatively little in research and development, and that investment has recently, with some ups and downs, declined – in which respect we are almost uniquely, among OECD nations, failing (OECD 2010; Globerman and Emes 2019; CCA 2018). Our R&D is less capital-intensive than that of competing countries (Globerman and Emes 2019).¹ Our economy is not as competitively productive as it should be, and a lack of innovation is a key reason (Canada 2019a).

Our innovation economy needs work, but our politicians are unable or unwilling to focus on the core elements necessary to support and encourage innovation. Canada spends billions on programs purporting to make Canada more innovative that, by all measures, have not. This is not a surprising outcome if we think about the economic and behavioural dynamics at work.

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1 COMMENTARY: A real innovation agenda for Canada: How to stop playing the innovation game and boost productivity and creativity

This paper sets out to critique the innovation policies of Canada's federal government, current and past, and to consider a framework for improving them. As part of the Macdonald-Laurier Institute's "A Mandate for Canada" series of publications, this paper is intended to give any party that takes power following the upcoming federal election ideas for doing a better job of encouraging innovation. Its lessons apply to other levels of government, but they are not its subject.

The paper makes the case that government deficit spending to subsidize certain businesses in the hope of innovation and productivity gains is largely wasted. If a new government wants to really boost innovation in Canada, it should do more to strengthen IP rights and curb IP theft and counterfeiting, lower taxes, direct funding to basic research, and encourage commercialization of university research.

Productivity

Innovation is, simply put, the understanding that better is always possible. It is the key that unlocks possibilities and opportunities. From urban centres to rural farms, from researchers looking to secure new patents to entrepreneurs working to bring their products to market, innovation is what allows Canadians to adapt to change and prepare for the future. (Budget 2017)

According to Webster's dictionary, "Innovation in its modern meaning is 'a new idea, creative thoughts, new imaginations in form of device or method'." While one associates innovation with information technologies, sustainable development, and biotechnology, it is important in Canada to consider innovation more broadly, including in agriculture, fisheries, and resource extraction. Innovation is, of course, about the generation of intellectual property (IP) in these and other fields.

The putative justification for government involvement in innovation is to increase the GDP through productivity gains (Canada 2019h). The higher the level of productivity, the more wealth generated per hour of work, and the more competitive the country. Innovation then relates essentially to improved technologies that generate productivity gains in the economy. That is largely cover; as this paper will show, in Canadian government-speak "innovation" is a word more often used to sanitize methods of distributing corporate welfare and regional handouts than it is a well-founded strategy for increasing productivity gains.

Slovenian academic Tea Petrin states that the public good aspects of knowledge and the inability of the full value of research and development investment to be captured by a firm are also often advanced as justifications for interventionist innovation policy (Petrin 2018). However, productivity gains are still the ultimate reason for government to help to overcome the public good problem.

While productivity gains are a worthy goal, there must also be plausible policy methods to actually create these productivity gains. There are, but in Canada they are currently ignored in favour of more politically palatable innovation subsidies.

There is some evidence in fact that government innovation subsidies "crowd out" private monies (Petrin 2018). This is not surprising. Worse, the damage caused by crowding out private investment is undoubtedly amplified by all the investment delayed and effort wasted playing the subsidy game. It makes too much sense for firms to take free money if they can get it, in spite of the downsides of delay, wasted effort, costs of program compliance, and damage to corporate culture that go hand-in-hand with government handouts. The damage to the innovation economy caused by innovation subsidies is not just caused by high taxation, waste, loss of competition, and big government expense, but also by creating an "innovation" economy in which companies typically waste time and energy competing for federal dollars rather than for private funds and achieving market entry.

Government subsidies corrupt firms. When firms focus on pleasing government and not the market, they are badly corrupted. Chen and Gupta's study, for instance, found that firms commonly game R&D tax credits by timing incremental research to qualify (Chen and Gupta 2017).

Culture is a major factor in entrepreneurialism. The United States by and large possesses a greater appetite for risk-taking and for commensurate commercial success than Canada does. Improving Canadian culture along these lines will improve our innovation metrics. Excessive government intervention in the economy has the opposite effect. People don't become innovative because they are told to be, or because they are given money; they become innovative in the faces of need and opportunity. We are sabotaged by our own government

Nationalism

Hey, we paid for it

Pundits often make nationalistic arguments to influence innovation policy. One of these arguments is based on the fact that so much Canadian research is publicly funded. The results of that research, the argument goes, should stay in Canada. This is a parochial view. Putting that argument into effect means either the spendthrift allocation of public dollars to keep them here, or forbidding researchers from attracting foreign buyers or licensees for their technologies. Unlimited investment in emerging entities is unthinkable, of course. And the results of prohibitions would be perverse; value would be lost because of the smaller market and lack of access to production efficiencies.

A focus on Canadian IP is limiting; the IP needed to grow a Canadian business might in fact originate in the US or elsewhere. There is nothing necessarily useful or appropriate about Canadian technologies per se. If we want to freely acquire others' technologies, and we should want to, then ours should trade freely too. Indeed, the exceptionally small size of Canada's research base militates strongly in favour of exceptional openness to trade and international markets, not protectionism.

If a Canadian discovery can best be put to use, exclusively or otherwise, in a foreign business, we ought to want it to find its home there - for, of course, the best possible price. When it does, the world and the country will be better off. Other free-trading nations also invest large amounts in publicly funded research, so it balances out. Also, if governments stuck to funding basic rather than applied research, the force of this branch of the nationalist argument would vanish. The federal government has responsibility for IP, of course, and provides substantial funding for research and education in the area. Unfortunately, all (or virtually all) IP academics in Canada are opposed to IP. The federal government should take measures to see that a more balanced and factual approach to IP is at least available at Canadian institutions.

It should be noted in this context that the free trade of technologies needs to be strictly subject, more than it now is, to security concerns. China, Russia, Iran, and too many others are all too willing to turn our discoveries against us. Why on Earth did Canada recently send Ebola and Nipah viruses to authoritarian China (Blackwell 2019)? This country's distribution of seed stocks for biological warfare (which may have involved infiltration

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of Winnipeg's pathogens lab) is very poor policy indeed. Moreover, why on Earth would we allow equipment developed by Chinese telecom giant Huawei into our 5G communications networks?

Retention of economic benefits and intellectual property (IP) should be managed on a transaction-by-transaction basis. If benefits to Canada are to inhere in research project outcomes, IP and data sharing agreements negotiated at a project's outset should settle parties' entitlements. That way Canada will see its returns, unlikely though they may be in any given project. This is particularly the case if the research is collaborative, and even more so if the collaborative partner or partners are commercial entities. This may sound obvious, but the reality is that negotiation of IP entitlements in publicly funded research projects is too often happenstance and inadequate.

Head office hunting

The other quasi-nationalistic argument is that companies formed on the back of Canadian technological innovations ought to have their head offices and facilities located in this country. There is, in fact, real economic benefit to having large companies headquarter in Canada. They provide more and better jobs and invest more in research and development than do small or medium-sized companies (SMEs) (Atkinson and Lind 2018; Narwhal Project 2019). Canada has few such large, technology-centric companies headquartered here.

Our record of creating and retaining large technology companies has been poor. We do have CGI, Shopify, and OpenText, but they are few relative to the number of large technology companies per capita in countries such as the US. Histories of companies like Nortel and Research in Motion suggest we are not very good at retaining those that are built here.

No government policy can predict which enterprises will prove to be winners, nor can it influence the outcome at a sustainable price. Look at the money wasted on Bombardier year after year. The timelines for the creation of an industrial behemoth are too long and the input factors and contingencies for their sustained success far too various and large for government to meaningfully manage or predict. Were a new Shopify to spring up, how would we keep it in Canada anyway if it wanted to move?

The trick is to make these enterprises not want to move in the first place. This trick is not performed by maintaining an alphabet soup of innovation agencies dispensing corporate lolly. What is most required are low taxes, strong IP laws, and a skilled workforce.

Research funding

Should any scholarly or scientific research be publicly funded? The answer seems to be yes. This funding obligation is attendant somewhat on having a public post-secondary education system. But it is mostly predicated on the lack of funding, particularly for basic research, that would result if government did not invest. Other than some philanthropic foundations, there is not a lot of funding for basic research. Also there is a world of difference between funding for basic research coming from the Tri-Council (and similar) agencies (i.e., The Canadian Institutes of Health Research (CIHR), the Natural Sciences and Engineering Research Council of Canada (NSERC), and the Social Sciences and Humanities Research Council of Canada (SSHRC)), which are arm's length from government, and ministerial interventionism. While the imperfections and biases of such funding agencies must be managed, they are far better than whimsical, ministerial programs. They have relatively strict granting processes and rely on peer review. A recent study suggested that government funding for basic research needed to be substantially increased (Naylor, 2017).

Still, money in public accounts is coercively taxed and taken mostly from people who have more immediate financial concerns than to fund scientific discovery. Yet perhaps there is something in the national project that aspires to more than to meet basic needs; greatness does not arise from just a "chicken in every pot" (although

there is certainly a collective genius in elimination of poverty). We need other aspirations, too. They do not include helping relatively fortunate and well-off businesses and entrepreneurs. Government ought not to fund for-profit research. Either such research is valuable for private enterprise or it is not, based on internal, cost-benefit analyses. If it is profitable, government shouldn't be funding it; the enterprise should. If it isn't profitable, government shouldn't be funding it; it isn't worthwhile.

Policy formation and evaluation

What are the key factors the government of Canada should consider if it wants an innovative economy? To a large extent these factors are uniform across economies. The following are key:

Strong intellectual property rights

Strong IP rights encourage research and development spending, innovation, and trade in innovative goods. They encourage investment and also increase access to capital for small, innovative enterprises. They are one of the greatest contributors to an innovation economy and have the benefit of being a non-fiscal measure. Along with these, of course, we need able courts willing to defend IP rights in Canadian law, and effective IP registry offices.

Encourage finance for growth companies

We have to compete internationally, especially with the US, to create jobs, attract foreign investment, and retain human capital. Canada's policies must not only strongly encourage innovation, but be strong relative to our competitors. We should have not only strong IP rights, but the strongest; not only low taxes, but the lowest.

Low taxes, which result in higher savings rates and more available capital, permit pools of private risk-capital to form, which in turn fund technological entrepreneurialism. Low taxes also spur foreign direct investment.

The poor availability of risk capital has long been a problem for Canadian entrepreneurs. Our (sparse) venture capital community is known for its unwillingness to take on real risk (Plant 2018; Plant 2017; McLeod 2018; BDC 2017), often, in my experience, even expecting start-ups to have repeating cash flow as a criterion for investment. While angel investors help to fill the gap at very early stages, there are not enough of them.

A detailed analysis of the relative effects of lowering different types of taxes is beyond this paper, but personal, corporate, and in particular capital gains taxes should all face the knife. This is particularly important given the impacts of recent tax reform in the United States (Amadeo 2019). Private investment of savings and retained earnings bring private resources to the investment management process. These are going to be more able and more focused investing their own monies than government can be investing tax dollars. That the federal government itself is directly investing millions of dollars in venture capital funds is about as bad a solution to the problem as one could come up with (Canada 2019b).

We should also accept an efficient failure rate for Canadian financial institutions and allow them to inject more risk capital into the financial markets in Canada. Canada's banks and other financial institutions are regulated too



“Canada's banks and other financial institutions are regulated too prudently and this hampers innovation.”

prudently and this hampers innovation. Domestic competition and foreign entrants should be encouraged and fintech – that is non-institutional, technology-based financial services providers – should be left unhindered to develop its markets.

Push technologies out of universities

Our universities should be better organized to commercialize their technologies. So much research funding originates with the federal government that it should consider using its funding conditions, and/or its constitutional power over IP, to change the situation. To do so will involve a multi-pronged approach. Many of the steps involved will require the cooperation of the universities themselves and the various provincial governments.

Most important for the federal government is the need for laws, policies, and procedures to make it clear who owns the technologies that are developed within a university. The rules are a mess now. They are formed on a university-by-university basis out of faculty collective agreements, employment contracts, institutional policies, employment law, and research-specific agreements. A great number of commercialization ventures founder on uncertain claims of ownership – by graduate students in particular. Tracing and opining on ownership need not be necessary costs in transactions in which university research is used.


Faculty should be encouraged to create start-ups. Perhaps surprisingly, a substantial body of research demonstrates that entrepreneurial professors are usually better scholars, as judged by the number of publications and number of citations of their publications, as well as by teaching success (see, for instance, Crespi, D’Este, Fontana, and Geuna 2011; Azoulay, Ding, and Stuart 2006).

Universities should not try to take a financial cut from faculty start-ups. It isn’t worth it. It is difficult to police, and returns are negligible. Better to let those technologies spur development of corporations around the university, which get rich and give back, as they are wont to do. The interpenetration of enterprise in and around Stanford University is a great example, such as its decision to provide land to start-up Hewlett Packard. The growth of such companies will best fulfil another goal of commercialization policy: to demonstrate to the public and government that there can be returns on public research dollars.

If a university maintains a commercialization office, use of it should be optional. It could charge modestly to recover its costs. Such offices are not sufficiently sophisticated to do more than give an enterprise a leg up to help them move on to better service providers outside the institution.

University investment in start-ups is a mistake. Like government, universities cannot attract sufficient investment expertise to manage a portfolio of start-up investments. They will always lose money. The institutional incentive is to build the portfolio by number of investments, not by return; this is only a cost, not a benefit, to the institution.

We need foreign representation on research peer review panels. We are too small a country and our research community too cohesive for effective peer review to occur without, in most cases, international participation. Without effective peer review we won’t maintain our research to international standards and without that, we won’t have a basis for economic growth and exports. That said, it should be noted that our research generally is regarded to be of high value internationally (CCA 2018).



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Keep the innovation economy private

Governments should not risk tax dollars by investing in private companies. Innovation must be driven by the private sector.

Governments must accept that they cannot pick industrial winners, either by sector or company. They are reluctant to accept this because governments invest for political, not economic, reasons. Public choice theory explains government investment in innovation; the true needs of an innovative economy do not. Hard-earned tax money paid out under the banner of “innovation” is paid to party donors, into politically sensitive ridings or districts, or for other political gain, even if only publicity. Regional dispersal of funds is a motive, too, that is at odds with innovation purposes. Innovation usually demands geographical concentration and cluster formation, the exact opposite of the “spray and pray,” regional investment methods of government programs. Indeed, Canada’s innovation strategy has failed so convincingly and for so long that its persistence can only realistically be explained by reference to motives outside of producing innovation, specifically, political patronage and other political gain.

Other factors also help to explain why government investment won’t work:

- Outsized productivity returns entail outsized risk. Productivity gains are at best proportional to losses in a high-risk investment environment. Where investment management is as inadequate and unskilled as in the federal government, one would expect investment performance to be considerably worse. Governments are inevitably bad at making high risk investments. People who are good at managing risk capital are few, and they do not do it for civil-service salaries. It is very hard, time-consuming work. When governments take on the task, they end up taxing the poor to pay the rich.
- It is notoriously difficult to tell if there is any actual return or social benefit to government-funded innovation investments. The goals are too diffuse or unrealistic, often covering political motivations. Reporting and analysis of the impacts of innovation investments is dreadful. Government does not want them to be measured. These subsidy programs are essentially ungovernable.
- Innovation is very difficult. The Phoenix pay system is just one example of innovation gone wrong. It was not, admittedly, fully a government program, but it was as badly managed on the government side as possible. And that was just payroll software.
- Subsidies distort market effects and are needlessly distracting to the recipients who compete for them. Moreover, by encouraging rent-seeking and delaying market outcomes they frustrate competition and hinder innovation.

If any private sector investment with public money is nonetheless made, it should only ever be when clear and measurable success metrics are in place and are transparently reported to the public. If such investments had to happen at all, purchase of listed shares would provide the best data on investment impact because share price changes and growth in the value of stocks could be tracked; researchers would have such data to determine program efficacy. Repayment of loans on open and commercial terms is another means by which private sector investments might be made with public money.

Strong borders, Piracy

Counterfeit goods and copyright piracy are huge problems for Canadian markets. Piracy robs Canadian artists, software companies, and streaming entities of billions of dollars (Owens 2018). Counterfeit goods, with annual sales estimated in 2018 in Canada to be \$20 to 30 billion (Drewa 2018), endanger Canadians and rob Canadian companies. Border interdiction of counterfeit goods is essential. So too are strong measures to take down and punish pirate web sites. The FairPlay initiative, recently put forward by a coalition of media companies, would, if

implemented, be a big step towards diminishing piracy. Unfortunately the Canada Radio-television and Telecommunications Commission (CRTC) declined to implement it on jurisdictional grounds (Canada 2018b).

Consistency

Another important aspect of innovation policy is that government uphold innovation values across the board. That is, that other, non-innovation specific policies take innovation into consideration. They don't. They get caught up in consumer or other values instead. One example is proposed changes to the regulations governing the setting of prices for new drugs by the Patented Medicine Prices Review Board, which will reduce innovation (Critchley and Owens 2018).

I'm From the Government and I'm Here to Help

In light of the proscriptions of this paper, we might well ask ourselves whether or not innovation is properly framed as a public policy problem at all.

The answers are yes and no. Innovation is nationally important because it has a lot to do with the wealth and well-being of a nation. It affects retention of human capital, with resulting impacts on families. Productivity gains through technological innovation lift all boats. Therefore, yes. But the answer is also no, because current innovation-specific policies are wasteful and ineffective. Government's role is not to intervene in the innovation economy, but to tailor the marketplace to best encourage it.

Innovation is not some essential quality of the ether; people have to want it, to live it. Canadians could just head into a future of diminishing wealth and opportunity. There are other pursuits: family, religion, play.

But Canadians are ambitious and able. They want to be innovative and productive. Government, professing to help, keeps getting in the way. Our government does not believe in Canadians' skills, intellect, and abilities. It takes a patronizing approach that implies, "you cannot do it without us." Government wants to be needed. It wants to play in the innovation sandbox. To the extent it does so, it actively discourages the development of entrepreneurial self-reliance.

Types of Current Innovation Programs

While the inescapable conclusion of numerous studies and much research is that government innovation programs are wastes of money and excessively prone to public choice manipulations, there are nonetheless lots of them. An exhaustive survey of federal government innovation programs would take too long to conduct and produce little value. Those programs apply various policy levers. Below are a few characteristic examples. Some are less bad than others.

Services to innovators

One type of government intervention is the symbiotic use of existing government resources - the National Research Council (NRC) - for private purposes. Offering, as it does, testing and other services to companies and inventors on commercial terms is relatively benign, but it also gives away money, and indeed, as the following quote from the NRC website advertises, is giving away more of it. That should stop.

The National Research Council of Canada Industrial Research Assistance Program (NRC IRAP) is Canada's leading innovation assistance program for small and medium-sized businesses.

If you operate an innovative small or medium-sized business in Canada, we can help you build your innovation capacity and take your ideas to market. We do this through financial assistance, advisory services and connections to the best business and R&D expertise in Canada. It's a winning model we've been using to drive business growth — and Canada's innovation system — for over 70 years.

...

In 2018-2019, NRC IRAP was mandated to expand its support to include funding for larger research and development projects. This increased funding support will make it easier for small and medium-sized Canadian businesses to access the support they need to grow and expand their companies (Canada 2019j).

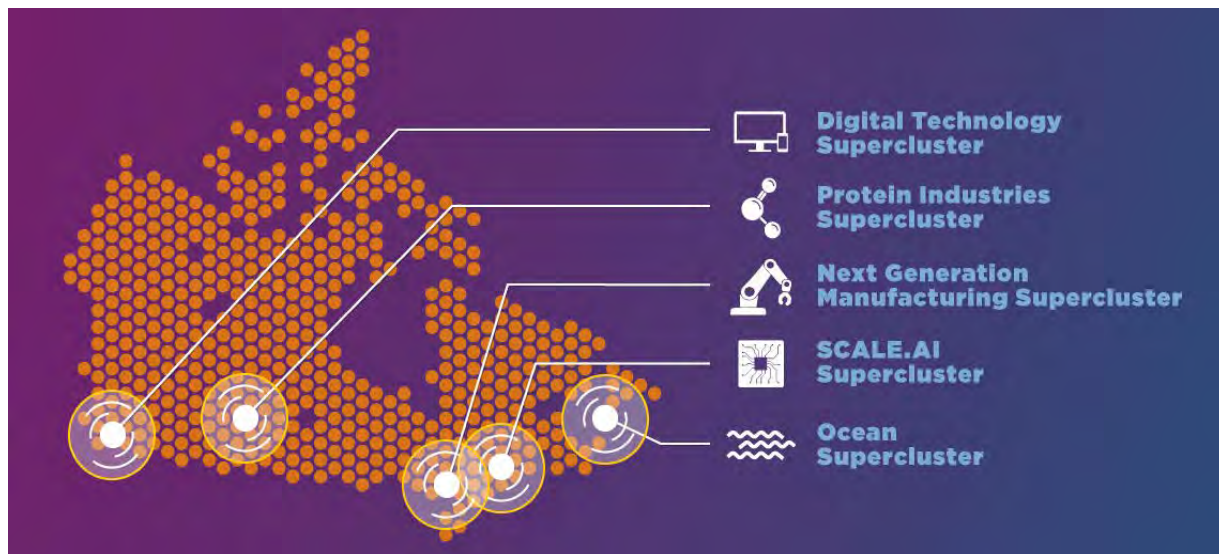
Leverage/cluster

The idea of “leverage” is to use public money to seed private or institutional investment (i.e., a project is chosen into which government will invest \$x million on the condition companies or institutions invest \$y million and \$z million. This is also a common feature of research and other types of grants). A paradigmatic example is Canada's “Supercluster” program. The program is described as follows:

The Innovation Superclusters Initiative is investing up to \$950 million to support business-led innovation superclusters with the greatest potential to energize the economy and become engines of growth. Through a small number of high-value, strategic investments this initiative is co-investing with industry in bold and ambitious proposals to strengthen Canada's most promising clusters and build superclusters at scale. (Canada 2018a)

The following diagram lists the “superclusters” and demonstrates their geographic distribution.

Diagram 1: “Superclusters” in Canada and their geographic distribution



Source: Canada 2019c.

Superclusters appear, in my view, to have started as an intention to give money away without any clear idea of what a supercluster might be. It is as though there is an assumption that if the label “innovation” is affixed, the project will magically spin money regardless of its inherent viability. The reality is very different. Speculative projects are dreamt up by private companies that they either wouldn’t fund on their own, or they would but opportunistically use our money to do so instead of their own. And why wouldn’t they? We can hardly blame a rent-seeker for taking free money. It doesn’t help the vaunted middle class put food on the table, though.

Most salient among the characteristics of the superclusters is their geographical distribution. By what was undoubtedly a happy fluke there is a supercluster in each major region of Canada! Imagine the political fortuitousness that the very best applications should mirror the most politically agreeable way to distribute corporate lolly. It’s uncanny.

Sá very nicely summed up the Supercluster program this way:

...this is a poorly conceived initiative that promises too much and specifies too little, and ... such carelessness is hard to justify for a billion-dollar program. In his ongoing attempts to make innovation an appealing idea to the broader public, Minister Navdeep Bains trivializes the key concepts underpinning this initiative, including its namesake. Even the most charitable observer knows superclusters will not create made-in-Canada Silicon Valleys, as the minister promised in his announcement speech. This general outlook is apparent in the supercluster initiatives program documentation, which mixes definitions of standard technical terms (e.g. clusters) with imaginary ones and wishful thinking (e.g. “a supercluster is an innovation hotbed” that has “exceptional performance, including an outsize impact on job creation and GDP”). The problem with all of this is not academic nitpicking – proposals will be as tight in their goals, strategies and evaluation frameworks as the program requires them to be. And what we have in display does not look great. (Sá 2018)

Indeed, Petrin’s finding that general innovation funding works better than sectoral funding would itself militate against this sort of cluster approach (Petrin 2018).

Pure subsidy

The Strategic Innovations Fund (SIF) is an example of a pure government subsidy that despite its name seems to have little to do with innovation. To cast one’s eye over the list of funded entities and projects is to see a list of widely varied entities and a lot of very expensive “job creation/retention.” The most recent project, Nova Tube, for instance, used over \$33 million (\$14 million of which was from the SIF) to create 27 jobs and retain others (Canada 2019d).

The program is described as follows, evidencing rather loose categories of a slush slough:

Program objectives

The Strategic Innovation Fund’s objective is to spur innovation for a better Canada. Specifically, it serves to simplify application processes, accelerate processing, and provide assistance that is more responsive and focused on results.

The program has five Streams, each with its own precise objective:

- **Stream 1:** Encourage R&D that will accelerate technology transfer and commercialization of innovative products, processes and services;
- **Stream 2:** Facilitate the growth and expansion of firms in Canada;
- **Stream 3:** Attract and retain large scale investments to Canada;

- **Stream 4:** Advance industrial research, development and technology demonstration through collaboration between the private sector, researchers and non-profit organizations; and
- **Stream 5:** Support large-scale, national innovation ecosystems through high impact collaborations across Canada.

In July 2018, the Government of Canada made available up to \$250 million in new support through SIF. The objective of the Program is to enable steel and aluminum producers to enhance their production capabilities to better meet the product demand from end-users within Canada. (Canada 2019e)

Tax credits

The Scientific Research and Experimental Development (SR&ED) Tax Credit program is highly complex and tax-driven:

The Scientific Research and Experimental Development (SR&ED) program uses tax incentives to encourage Canadian businesses of all sizes and in all sectors to conduct research and development in Canada. There are two main benefits of the SR&ED tax incentives:

- You can pool your SR&ED expenditures and deduct them against your current-year income or keep them and deduct them in a future year.
- You can earn the SR&ED investment tax credit (ITC) and use it to reduce your income tax payable. In some cases, the Canada Revenue Agency (CRA) can refund the remaining ITC.

Whatever eligible SR&ED work you are doing, your investment tax credit will be at least 15% and can be as much as 35% of your qualified SR&ED expenditures. If you have any unused ITCs, you can carry them back 3 years or forward 20 years and apply them against tax payable for other years.

Corporations, individuals, trusts and members of a partnership can use these Government of Canada incentives.

Canadian-controlled private corporations: Generally, a Canadian-controlled private corporation (CCPC) can earn a refundable ITC at the enhanced rate of 35% on qualified SR&ED expenditures of \$3 million. You can also earn a non-refundable ITC at the basic rate of 15% on an amount over \$3 million. However, if you are a CCPC that also meets the definition of a qualifying corporation, you also earn a refundable ITC at the basic rate of 15% on an amount over \$3 million and 40% of the ITC can be refunded.

Other corporations: You can earn a non-refundable ITC at the basic rate of 15% on qualified SR&ED expenditures. You can use the ITC to reduce tax payable. (Canada 2019f)

Research and development expenses are, of course, tax deductible but SR&ED provides more than deductibility – it provides an actual credit. In other words, a cheque. It is expensive and difficult to comply with SR&ED requirements, however. It is also somewhat unpredictable, as budget restrictions result in shifting policy statements which limit availability of SR&EDs for various types of technology.

Petrin (2018) and Cin, Kim, and Vonortas (2016) suggest that there may be somewhat greater innovation returns from this type of program than others; Chen and Gupta (2017) find tax losses and opportunism.

From my discussions with smaller companies, it appears clear that SR&ED is a very expensive and complex waste of time and money for all involved. Compliance takes enormous resources. Usually a considerable portion of the return also goes to outside personnel retained to help file a claim.

Procurement

Innovative Solutions Canada (Canada 2019g) uses \$100 million to subsidize businesses by having government as a first customer. This follows on the heels of, and in fact has absorbed, the Build in Canada Innovation Program, which essentially makes government purchasing a tester for unproven technologies. The use of government purchasing as an innovation lever is an idea with considerable currency, and no apparent value. Not only is government bound to be poor at assessing unproven technologies, participants have complained about great difficulties working at the slow pace of government schedules and timelines.

Industrial strategy

The Clean Growth Hub (CGH) resembles the Strategic Innovations Fund in that it gives away billions of dollars, albeit for specifically bad reasons – innovation in the so-called clean economy. Investment in green technologies has by and large been a disaster in Canada and around the world, especially in the energy sector (Cross 2018). In Canada the results include \$12 million to Loblaws to invest in new freezers for its stores – something they clearly ought to have bought themselves and which creates an unfair advantage over other grocers (Flanagan 2019). As the website says:

The global transition to a low-carbon, low-pollution and resource-efficient economy is an economic opportunity for Canada. Canada's clean technology producers and users are well positioned to compete and win in this global market. That's why Budget 2017 announced more than \$2.3 billion to support clean technology in Canada and the growth of Canadian firms and exports (Canada 2019k).

Training

The government is providing substantial monies for training. Training high-value technology careers should properly be the responsibility of individuals and companies, not government – especially not the federal government.

Intellectual property policy

The government's Intellectual Property Policy (Canada 2019h) is relatively modest fiscally and an unusual mix of projects. The most unfortunate characteristic of the current government's Intellectual Property Policy is that it does not do what an IP policy should do for an innovative economy – that is, strengthen IP rights. Beyond that there are some measures that are interesting and others that are perverse. None of them are likely to have a significant impact on innovation metrics.

Measuring Success

Government innovation programs exploit fashionable theories about cluster formation, productivity increases through government innovation investment, and Keynesian interventionism. The results of these programs are not measured or reported. How should we know if they are succeeding especially given that, by all national measures, they are evidently failing miserably (Globerman and Emes 2019).

Proper measures of efficacy are GDP growth, productivity growth, increases in R&D investment, and issuance and citation of domestically created Canadian patents.

Another way to be able to predict success is to use proven mechanisms. Strong IP rights, for instance, are well-proven by empirical data to correlate strongly with favourable innovation outcomes (Owens 2018; Owens and Robichaud 2017a, 2017b; Owens 2019)?

Innovation programs ought to be strictly reviewed by the Parliamentary Budget Office, the federal Auditor General, and the responsible ministries. When the government reports that the Strategic Innovation Fund "...investments to date are expected to secure 50,000 jobs" (Canada 2019i), the cost of those jobs should be audited and reported, as should whether or not they actually arise, what their value is, and their duration. None of that appears to happen. Data should be published by the federal government; as the Council of Canadian Academies has noted:

Data limitations continue to constrain the assessment of R&D activity and excellence in Canada, particularly in industrial R&D and in the social sciences, arts, and humanities. (CCA 2013)

In *Building a Nation of Innovators* (Canada 2009k) the government of Canada sets out with some detail the components of its innovation policies - training, superclusters, subsidies, etc. The plan is highly aspirational, stating, for instance, in the executive summary, "The Innovation Superclusters Initiative is expected to grow Canada's economy by \$50 billion over the next 10 years."

I cannot imagine who genuinely holds such an expectation. While the document laudably tries to provide a comprehensive perspective on innovation measures, it is a promotional document more than a reasoned policy.

A government web site measures the outcomes of a few of these innovation programs (Canada 2019i). Some of these metrics are more on point than others but interestingly, none seems to show significant success even in accordance with the very limited criteria used, such as doubling private R&D to \$30 billion by 2025 (an ambitious and appropriate goal, albeit one unlikely to be met). It doesn't say whether the target is inflation adjusted or whether it includes government grants. The goals and the means of tracking the metrics are generally not helpful, for various reasons. Some measure expenditures only, not success. Several start from time periods long before the programs they are meant to track started, and so on.

What the web site specifically does not do, however, is to compare progress with the many, and unrealistic, goals set out in the plan. Why not? Are they supposed to be mere puffery? Many of its goals are plainly unverifiable. Many or most are on a 10-year horizon, long after the initiating government will be accountable.

Alternatives

The federal government has several opportunities to address the roadblocks to innovation that it largely has created. Perhaps the most innovative step it could take is to abolish innovation programs. These factors should allow it to at least get the ball rolling with tax reductions. Because tax reductions encourage additional economic activity which itself generates tax revenues, there will be room for more reductions than amount to innovation program savings alone. This opportunity for additional tax reductions should be used. Innovation is actually about capitalism, it's about high rewards for risk takers, it's about keeping more of what one earns by contributing value to the economy. In other words, less socialism and more income inequality. That, of course, is a choice for the country to make. I think personally it is the right choice. However, the purpose of this paper is not so much to argue for the choice for innovation over income distribution, as to argue for consistency of approach; to drop the innovation sham it engages in now, and engage in consistent policy-making one way or the other.

“The federal government has several opportunities to address the roadblocks to innovation that it largely has created.”

Besides tax reduction, opportunities exist to take another important step to improve innovation outcomes, and that is to improve IP protections. These opportunities include the current review of the *Copyright Act*, for which Heritage Canada has provided a useful roadmap, and implementation of the improved IP protections set out in the US-Mexico-Canada Agreement (USMCA).

Conclusions and Recommendations

Ultimately, our collective goal, and the goal of government policy, should be to raise the overall well-being and wealth of our citizens. This occurs in large part through productivity gains. In fact, the impact of innovation on total factor productivity points to it as the major lever for increases in wealth and well-being.

It is past time for both the public and the federal government to focus realistically on “innovation” and government investment. Most of the programs supporting innovation should be dramatically pared along with the people supporting them. The federal government should turn a cold eye on assessing the value of those programs that remain. It should focus on the proper elements of its innovation policy, specifically:

- strong IP rights
- funding for research through arm’s length research agencies
- strong courts
- border interdiction of counterfeit, pirate, and infringing goods
- a better financing environment including low taxes and better financial institution regulation
- better policies to encourage commercialization of university IP

This paper has dealt only with federal government initiatives; all this policy churn and expenditure is also happening at provincial and municipal levels. The waste is enormous. It is ironic perhaps that the tried and true basics, those listed just above, rather than the fashionable and innovative innovation policies, are the real drivers behind innovation. But results are what matter. It is time to make them happen.

The above half-dozen priorities for developing a real innovation agenda for Canada could lead us to any number of specific policy recommendations. But implementing the following 10 recommendations would get us well on our way to curing Canada’s innovation illness.

1. Canada should ratify the USMCA trade deal as soon as possible to gain the advantages of its stronger IP protections, such as a 70-year term of protection for copyright, and 10-year data protection for biopharmaceuticals. Better, Canada should extend its term of data protection for biopharmaceuticals to 12 years, as in the United States, or longer
2. Canada proposes to forcibly and dramatically reduce drug prices in Canada by changing the regulations by which the Patented Medicine Prices Review Board sets pharmaceutical prices in this country. Such a move would be bad for innovation and bad for patients. These proposed changes should be abandoned immediately.
3. Canadian artists and others are badly hurt by piracy on the Internet. The FairPlay web site blocking proposal was a carefully conceived and measured response to piracy. The CRTC is well placed to oversee this measure and the government should direct the CRTC to implement it as soon as possible. Canada should also improve interdiction of counterfeit goods at its borders.

4. The Heritage Committee of Parliament released an insightful and rights-positive report on how to update Canada's *Copyright Act* (House of Commons 2019). This report should be the basis for amendments to be made to the Act. Its many important recommendations include extending the term of copyright protection; fighting piracy; and reviewing the scope of fair dealing for educational purposes.
5. Remove from the National Research Council the power to give grants to businesses on any terms.
6. Wind up the SR&ED tax credit scheme.
7. Wind up the Strategic Innovation Fund, the Clean Growth Hub fund, and other corporate welfare subsidies and return their budget allocations to general revenues, or allocate them to deficit reduction or basic research funding.
8. Pass legislation such as the Bayh-Dole Act in the United States to allow universities to assert ownership of intellectual property created using federal research grants, encourage them to file patents and commercialize technologies. Such legislation has had a tremendously beneficial impact in the US and, properly tailored to Canada, could be expected to in this country as well. Many other countries, inspired by the success of the Bayh-Dole Act in the US, have themselves enacted similar legislation; Canada should join them.
9. Maintain funding for basic research in Canada and, if feasible, increase it in accordance with recommendations of the Fundamental Science Review (Naylor Commission). Also use federal powers over IP and research and education about IP to cause institutions to present a more factual and innovation-oriented view of IP, instead of the negative views that are now in vogue.
10. Reduce taxes wherever possible but especially corporate taxes and capital gains taxes (which are better done away with altogether), to make Canada more competitive with the United States, and to enlarge the pools of risk capital in Canada and to make it a more attractive home for entrepreneurs.

About the Author



Richard Owens is a Munk Senior Fellow with the Macdonald-Laurier Institute and a lawyer who has specialized in business and commercial law, regulation of financial institutions, intellectual property and technology. He has served financial services providers, technology companies, drug companies and others in Internet, technology, intellectual property strategy and patent law, M&A, outsourcing, strategic alliance and joint ventures, licensing and other areas. He has been repeatedly recognized as among Canada's best lawyers in technology law and attained the highest rating on Martindale Hubbell. He conducted his practice with three of Canada's leading law firms.

Richard is past chair of the board of directors of the University of Toronto Innovations Foundation, and member of the advisory committee to the Office of the Privacy Commissioner of Canada. He is a member of the board of the Center for Innovation Law and Policy at the University of Toronto Faculty of Law, and served as a director of the International Technology Law Association. He is on the boards or advisory boards of other companies and not-for profit enterprises.

Richard is an adjunct professor, teaching courses on the law of information technology and electronic commerce, innovation law and policy, intellectual property, digital content and the creative economy, and the law and policy of biotechnology, all at the University of Toronto Faculty of Law, where he has taught for over twenty years and also served as the Executive Director of the Centre for Innovation Law and Policy. Richard has written and published widely on intellectual property law, the law of information technology, privacy, and the regulation of financial institutions.

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Endnotes

- 1 The recent and excellent Fraser Institute report *Innovation in Canada, An Assessment of Recent Experience* does a good job setting out Canada’s innovation statistics and those interested should refer to it.



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