

“Productivity: Canada’s Weakest Link”

Notes For An Address

By

The Right Honourable

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Canadian Council Of Chief Executives
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Notwithstanding last week's UN vote, which was unfortunate and disappointing, this has been a good year for Canada, beginning with the stunning, golden performances of Canadian athletes in the Vancouver Olympics. We have weathered the Great Recession better than all of our G-8 colleagues and, in the summer, Canada hosted back to back G-8 & G-20 Summits, using our strong financial position to advantage in shaping a broader consensus on global recovery.

These are a genuine source of pride and optimism but should not be a basis for complacency. As CEO's, you each know that serious risks persist. Vigilance, creativity and innovation are essential to a prosperous future for Canada.

Today, I want to share with you some ideas on what we could do to help our prospects for success.

I want to focus specifically on a topic all too familiar to you – our lagging productivity performance. In fact, in remarks this year Bank of Canada Governor Mark Carney “chastised Canadian companies for being too timid and not investing enough in the future.” He said the government had done its job by “creating the conditions needed for a productivity renewal” and the time had come for business to follow through. Finance Minister Jim Flaherty and Industry Minister Tony Clement can take some considerable pride in this new reality.

Canada ranks only 17th in productivity performance among OECD countries. More pointedly, business productivity was 75% of that in the U.S. in 2007 compared to 90% in the 1990's.

Over the last ten years, Canadian productivity growth has been around one percent annually compared to two percent in the U.S. This is not a formula for success.

It is possible to quibble about the actual statistics, because the inputs vary depending on the make up of individual economies, the rate of employment, etc.. But, by any measure, the trend is troubling and needs attention and not just from government.

It will require a concerted partnership by government and the private sector. Creative approaches by business to help solve public policy challenges must be part of the productivity solution because as the Chairman of the Royal Bank said over 30 years ago, “productivity is what a nation lives on and it's all it lives on.”

1. First and foremost, we need to keep our fiscal house in order. Over the past twenty-five years governments with different political stripes established an impressive framework of policies that served us well during the recent recession. It began with the Progressive Conservative Government that introduced Free Trade with the U.S. and NAFTA, the elimination of the Manufacturers Sales Tax and introduction of the GST, policies for low and stable inflation, financial regulatory reform and a wave of privatizations and deregulations. It was followed by a Liberal Government led by Prime Minister Chrétien that initiated a dramatic policy of deficit reductions, huge investments in university research and significant advances in R&D generally. This was followed by the present Conservative Government with its highly beneficial changes to corporate and personal taxes.

It was the continuum of sensible and effective policy under 3 different governments - avoiding the erratic policy lurches of the past - that changed Canadian attitudes and provided the solid economic foundation on which Prime Minister Harper was able to stand earlier this year.

For example, between 1999 and 2009 Canada recorded the highest growth in income per capita in the G7 and the second highest GDP growth per capita.

Canada entered the recession with the lowest debt-to-GDP ratio in the G7. After the recession, Canada will still have the lowest debt-to-GDP ratio in the G7, and by an even wider margin. In 2010, the IMF estimates that Canada's debt-to-GDP ratio will be approximately 31 per cent compared to the US ratio of almost 67 per cent, 75 per cent in the UK and in Japan, 115 per cent. Their ratios will continue to climb, while Canada's should begin falling in 2011.

Each of these policy initiatives received consistent support from the CCCE and your predecessor organization, the BCNI. That support was and is indispensable to the discipline required from government. And we will need similar examples of courage and conviction to bolster our fiscal foundation against future pressures from an aging population and from increasing health costs, impacted by the same demographic trend.

You as business leaders have a responsibility to help stimulate a rational discussion on how Canada can best meet these challenges. It seems to me that, on health care for instance, we need to strike a better balance between the intrinsic value of universal coverage for basic medical service and the readiness indeed, the capacity of Canadians to pay the necessary taxes to support the system.

The OECD, not exactly known for radical analyses, recently concluded that, because our health care system is not sustainable in its current form, some form of user fees and greater scope for competition within the system will be necessary.

The current federal/provincial funding formula ends in 2014. A serious, adult discussion is called for and I believe a Blue Ribbon panel of medical and financial experts could provide a sensible framework for the debate and for the decisions needed. Not surprisingly, the fundamental assumptions on which Justice Emmet Hall based his recommendations for Medicare almost 50 years ago have changed and we need to adapt accordingly.

2. We need to maintain Canada's position as an attractive place for investment and, as the MacDonald-Laurier Institute recently observed, with a specific corporate tax advantage vis-à-vis the U.S. This was actually a prescription advocated by Laurier more than a century ago. It is equally valid today.

Tax in Canada on new business investment is now the lowest among G-7 countries. We need to preserve and strengthen that advantage.

When it comes to taxes we need, above all, to sustain a powerful, competitive edge for Canada vis-à-vis the U.S. You as business leaders need to take better advantage of that tax benefit and our strong dollar to replace capital stock and invest in advanced technology, machinery and equipment. We need to be more competitive to bolster future prosperity. It is that straight forward.

Important studies have advocated greater liberalization of foreign investment - where we currently are ranked at the wrong end by the OECD. Canada ranked 29th among OECD countries (more restrictive than Turkey, which I visited earlier this year.) Particular attention should be given to telecommunications and transportation industries, and possibly to the financial sector as well.

3. The quality and quantity of labour or human capital is a major driver of productivity. Here, Canada's track record is decidedly mixed. We rank highly in terms of the share of population with post-secondary education and we are among the OECD leaders in the funding of higher education R&D. And yet, there is less collaboration on R& D between business and public research institutions. That gap needs to be filled. Businesses large and small need to take more advantage from the much improved research capacity of our post-secondary institutions. I encourage you to build closer relationships and try to harness this capacity to facilitate longer term business opportunities. If you engage professors and students more in addressing your challenges, their graduates will be better able to contribute to your success.

We have a higher high school graduation rate than the U.S. but a lower ratio of university graduates than the U.S. and a lower proportion as well of graduates with advanced degrees in science and engineering. As Roger Martin of the Rotman School of Management has observed, the managerial class in Canada also falls sharply behind the U.S. in terms of education. Well under 40 percent of Canadian managers have a university degree while close to 60 percent of US managers have a bachelor's degree or higher. This is something your companies should address more urgently. Seek to hire experienced managers who have a vision for the future and are driven to seek competitive advantage through innovation.

There are some unavoidable realities on the human capital front. We do have an aging population and, regrettably, the two fastest growing segments of our population – the aboriginal and new immigrant communities - are the least equipped with skills needed to improve productivity.

Former Prime Minister Paul Martin is doing highly commendable work to spur better education and more entrepreneurial outlets for aboriginals but much more is needed. Talk of property rights on reserves is a constructive step in the right direction and needs more support. We need to ask whether 19th century policies are serving the interests of the aboriginals or the country. I believe that the role of aboriginals in Canada should be a more prominent concern and focus for action by the CCCE.

On immigration, we should enhance our reputation as an open-minded and compassionate nation. But it is also time for reform, adding provisions that would enable us to attract more who can make a constructive contribution to Canada and serve the employment needs of our key economic sectors. We need more, younger (better-educated) immigrants and we need a faster process for validating legitimate educational credentials from immigrants. Our educational facilities are rapidly becoming second to none. They should be used to attract and retain global talent. We should also look at ways to support immigrants to start businesses aimed at trade with their native countries.

4. Equally important as a driver of productivity is the quantity and quality of physical capital. Another hard reality is that we have a much higher ratio of small businesses in Canada than in the U.S. and small firms (while popular politically) are generally less productive than larger firms. That is a fact.

Canada's small businesses are extremely important job creators and are more capital intensive than those in the U.S. but invest less in manufacturing equipment and in new technologies. We are regarded as technology imitators, not innovators. Small businesses invest more in buildings than in IT.

They need to shift the focus from cost minimization to the creation of additional value by engaging with suppliers and customers to better understand their needs and constraints. I know the adage “listen to your customer” is not new but, in today’s fast-moving world, it is more relevant than ever.

The real breakthrough on productivity will be innovation created by companies. In fact, more than 2/3 of productivity growth will come from product and process innovation. We cannot ride on our resources forever and must rise to the challenge of a rapidly transforming and much more competitive global economy.

Because of the smallness of small business in Canada few are able to take advantage of the tax credit program available for R&D.

One thing is clear. The policies now in place provide \$6.9 billion in benefits for research and innovation in 2009-10 but they are not delivering the expected dividends. The rate of business or private sector R&D places us at the lower end of the OECD scale. Canada ranked 16th among OECD countries in 2008 on business spending on R&D as a share of GDP. Canada holds just 1.36% of Patents filed worldwide compared to 30% for the U.S. The Conference Board was reported of the view that Patents “are a solid measure of a country’s capacity to innovate” and consequently gave Canada a D on the state of our innovation.

By contrast, Canada ranked 2nd in government funding of business spending on R&D. Not surprisingly, the government has announced that it is reviewing these programs and I strongly suggest that our senior business community engage directly in the dialogue to inspire a more effective approach.

The recently announced Canada Excellence Research Chairs (nineteen at \$10 million each) on the four priority science and technology sectors give you the opportunity to find better ways of commercializing university research. Many of your companies supplemented the government grants for these Chairs. You need to build on these partnerships. We have some of the best university presidents in the world in Canada. You should work with them to take the research beyond an academic focus. Make these investments work for a better Canada.

5. Canada has had a persistently dismal track record when it comes to venture capital. By removing discriminatory tax treatment on foreign venture capital, the government is trying to address this deficiency, but much more is needed. Venture capital is the lifeblood of innovation.

A recent book on the start up success of new business in Israel highlighted this point. And, while many of the ingredients for Israel's spectacular record are unique to Israel, there are lessons Canada could learn from the manner in which venture capital is deployed to spur innovation and new outlets for growth.

We have a reputation for being risk averse, less competitive and reluctant to tackle global opportunities. Caution may well be the hallmark for the success of our financial sector but it is not necessarily a strength in terms of productivity.

We need a higher tolerance for risk and frankly for failure because lessons from what does not work are often as effective as those that do.

I suggest a three pronged public private partnership that would establish a \$300 million fund, with \$100 million from government, \$100 million from the private sector and a remaining \$100 million over time from individual investment projects. This fund could be modelled on the Israeli example, overseen by an arms-length board of technical and financial experts (from government and the private sector) and designed specifically to kick start a whole new approach to seed capital for innovation in Canada. The government would be protected disproportionately on the risk aspect whereas the private sector and the individual investors would stand to benefit from a greater proportion of the reward from successful ventures.

6. Next, an old chestnut, one that has been studied endlessly but with minimal results. I am referring to the regulatory over-burden in Canada which is seen by foreign investors as the single, biggest impediment and which you all know is a serious drag on productivity.

The automobile sector is one of the most integrated industries in North America. And yet there are more than 150 different regulations on each side of the border affecting the same North American manufacturers, including those now effectively owned by the government!. There are many more in many more sectors that serve to hobble the efficiency of our otherwise integrated economies. The Canadian Federation of Independent Businesses estimates that our companies spend more than \$30 billion annually to comply with various regulatory requirements."

We need to streamline and harmonize what we now have and restrict the tendency to create more uniquely Canadian standards in the years ahead.

To that end, I suggest that the Prime Minister appoint a Regulatory Czar with a specific one-year mandate to act on the serious analyses already on record and cut through the bureaucratic swamp of overlapping and out-dated regulations that serve no real public policy purpose. There should also be a strict "show cause" stipulation for any new regulatory proposal that differs from that in the U.S.

7. Finally, and perhaps most importantly, trade, going global in emerging and advanced economies to spur cross pollination of ideas, improve competitiveness and deliver better products. The benefits to Canadians on employment and investment as a result of our trade policies in the last quarter century can only be described as remarkable. You were instrumental in the success of our FTA and NAFTA negotiations but you need to be as vigorous in supporting similar initiatives today with the EU and the major Asian economies. Government cannot do these by itself.

To accomplish this major task of bringing Canada to a world leadership position on productivity, will require an uncommon degree of political and corporate will.

Some years ago the legendary New York Times columnist Scotty Reston came to lunch with me at 24 Sussex, the Prime Minister's official residence in Ottawa. After an impressive 'tour d'horizon' Mr. Reston said: "You know, Prime Minister, for the last 25 years I have opposed every single policy that your friend Ronald Reagan has ever stood for." Then he added: "And during that same period, Ronald Reagan was twice elected Governor of California and twice elected President of the United States."

This self deprecatory observation - I thought memorable because of its infrequency at the New York Times - was delivered somewhat ruefully as if Mr. Reston were perplexed by his own admission.

But to so wise an observer as Reston the answer surely should have been very clear. It's called leadership - that ineffable, and sometimes magical quality that sets some men and women apart so that millions will follow them as they conjure up new visions and invite their countrymen to dream big and exciting dreams.

In his seminal work on Leadership, James MacGregor Burns segregates "transactional" from "transforming" leadership. He writes that it is the transforming leader who "raises the level of human conduct of both leader and led... who responds to fundamental hopes and expectations and who may transcend and even seek to reconstruct the political system rather than simply operate within it".

Many suggest that great, inexorable currents of history themselves – and not individual leaders - seal our fate. In my judgment, however, Carlyle was on target when he observed that the right man or woman in the right place at the right time can completely change the course of history. I believe that to be true because I was there to see it happen.

In a brilliant address delivered some years ago in Canada, Theodore Sorenson – himself a skilled observer of powerful leaders as Special Counsel to Presidents Kennedy and Johnson – said:

"Once in office those who wish to stand up and stand out and leave something enduring behind must build new institutions, not new images. They must look to the next generation not merely the next election. They must talk in terms of fundamental values, not merely costs. They must appeal to our hopes as well as our needs, to what we long to be and what we know is right. That's leadership".

The impact of significant public policy decisions is often unclear in the early years. It sometimes takes a considerable period – frequently decades – before the full consequences of an important initiative become apparent.

Time is the ally of leaders who placed the defence of principle ahead of the pursuit of popularity. And history has little time for the marginal roles played by the carpers and complainers and less for their opinions. History tends to focus on the builders, the deciders, the leaders, - in government, business, education, culture, etc... - because they are the men and women whose contributions have shaped the destiny of their nations.

Canada like other privileged nations, is often extremely resistant to change. Deep and important structural changes are indispensable however to maintain a growing economy and ensure the flourishing of peace and liberty and they can only be brought about by a firm expression of political will.

As a contemporary observer noted some years ago: "In a nation ruled by polls and ratings, where even newspapers hire focus groups to see what kind of news readers want, we are losing sight of something we should have learned as teen-agers: Just because something is popular doesn't mean it's right."

Presidents and Prime Ministers are not chosen to seek popularity. They are chosen to provide leadership. There are times when voters must be told not what they want to hear but what they have to know.

And what they have to know is a quotation from the book of proverbs inscribed on the Peace Tower in Ottawa: "Where there is no vision, the people perish".

Leaders must have vision and they must find the courage to fight for the policies that will give that vision life. Leaders must govern not for easy headlines in 10 days but for better countries in 10 years – and they must be ready to endure the attacks that often accompany profound or controversial change, while they await the distant and compelling sounds of a verdict that only history and a more reflective nation can render in the fullness of time.

This message should have similar resonance for leaders in the private sector. The CCCE has played a prominent leadership role in the past helping shape and stimulate public policy initiatives that have served Canada well. I hope some of these ideas will prompt further discussion in your deliberations.

If you want government to rise above the depressing Parliamentary machinations of the moment and to deal with policies that are large, grand, futuristic and beneficial to Canada, your voice should be clear, consistent and compelling.

You have each benefited from the promise of Canada as you have each delivered benefits to Canada. You are major contributors to the pride and optimism in Canada today.

I invite you to sustain that pride and deliver tangibly on that optimism.