Institute for
COMPETITIVENESS & PROSPERITY

Institute urges Canadians to invest more for future prosperity

Institute for Competitiveness & Prosperity recommends that the new government shift priorities toward investment and away from consumption to raise Canada's productivity and prosperity

Ottawa – Canadians need to rebalance our economic priorities and policies by investing more today to achieve our full economic potential and prosperity in the future. That is the conclusion of *Rebalancing priorities for Canada's prosperity,* the Report on Canada 2006 released today by the Institute for Competitiveness & Prosperity.

Canadians have built one of the most successful economies in the world. Nevertheless, the Institute's report establishes, Canada has a widening prosperity gap with the United States. The key to closing this prosperity gap, the Institute argues, is higher productivity – the increased capability of Canadians to add more value to the physical, human, and capital resources in the nation. But to achieve this, Canadians need to shift from the "consume today" path we're on. We need to rebalance our priorities to "invest for tomorrow", the path to increasing future prosperity.

The Institute is the research arm of Ontario's Task Force on Competitiveness, Productivity, and Economic Progress, a group of industry and academic leaders, chaired by Roger Martin, Dean of the Rotman School of Management. It was established in 2001 to stimulate business, governments, educational institutions, and individuals to increase the pace of innovation and competitiveness. That will ensure that our standard of living continues to rise.

In *Rebalancing priorities for Canada's prosperity*, the Institute shows that Canada's prosperity ranks second in the world among countries with a third of Canada's population or more. However, compared to the United States, we are less successful in creating an innovative and prosperous economy. In 2004, the gap in Gross Domestic Product (GDP) per capita – the recognized measure of a country's economic performance – was $8,700. This means that our GDP per capita was 18 percent lower than that in the United States.

"Closing this prosperity gap would have real benefits for Canadian families," said Martin. "On average, each family would gain $12,100 in disposable, after tax income – every year." "And closing this gap is not an unrealistic aspiration. As recently as 1981 our prosperity gap was less than half the current gap," added Martin.

Today, Canadian individuals, businesses, and governments are under investing in their future prosperity. By limiting our investment in post secondary education, Canadians are under investing in themselves. More education increases people's productivity and capacity for innovation – and helps them earn higher wages. Relative to their US counterparts, businesses continue to under invest in machinery, equipment, and software, which are important contributors to higher productivity and higher wages. Governments are shifting their spending balance away from investment in infrastructure, and post secondary education toward consumption, mainly in health care and social services.

"The flawed logic that we have in place is that we can enjoy to the maximum the fruits of our prosperity today – and that prosperity will just continue without ongoing investment," said Martin. "Better logic concludes that investing today and forgoing some consumption of current prosperity will create even higher prosperity down the road."

The Institute sees nothing fundamental that would block Canada from closing the prosperity gap. Instead, the report calls for the rebalancing of key priorities required to achieve greater productivity and prosperity. These include:

- Businesses need to invest more in physical and human capital. More modern machinery, equipment, and software will strengthen productivity for businesses and the economy as a whole. Managers and workers with more education and training will be more innovative.

- People have to invest more in themselves through more education, particularly at the post secondary level and through a commitment to life-long learning.

- Government spending needs to be re-oriented so that it invests more in future prosperity and consumes less of current prosperity. "Our governments have got their fiscal houses in order by attacking investment spending, such as higher education, more than current consumption spending, like health care and social services," said Martin. "If we return to a more balanced investment-consumption pattern, we will increase our prosperity and ultimately have greater ability to fund our important social programs."

- Governments need to shift taxation, encouraging firms to invest in productivity-enhancing capital instead of discouraging business investment. Canada currently has among the highest taxation of business investment in the world. Unfortunately, the issue of high taxation of business investment was hardly addressed in the last federal election.

- Governments also need to reduce the effective tax rate paid by the working poor. The combination of increased income tax rates and the loss of social benefits through clawbacks means that a single earner family of four faces an effective marginal tax rate of 60 percent as income passes $31,000. Smarter taxation would motivate individuals and businesses to work and invest more.

- Fiscal federalism needs to be fixed by shifting to a system that encourages investment for higher long-term prosperity potential in all regions and away from the current system that emphasizes the narrowing of current regional income disparities. We have built a self-perpetuating system of regional transfers that limits investment. By making fiscal federalism more effective, Canada will be able to invest more in our own future prosperity.

- Innovation policies need to change course to build more pressure for the demand for innovation to balance the current emphasis on supporting the supply of innovation. As Martin explained, "Currently, too much of federal and provincial innovation policy is aimed at support mechanisms, like R&D spending and tax incentives. But we haven't balanced this with policies that build pressure for innovation from capable business managers, demanding customers, and competitive rivals. A better balance would result in more commercialization of our research efforts into innovative products and services."

- Venture financing needs to focus more on achieving higher quality investment and less on increasing the quantity of capital. Public policy emphasizes creating the supply of risk capital and then funneling it into organizations that have neither the incentives nor the capability to help Canada succeed in commercialization and innovation. A more balanced public policy would increase commercialization of our R&D and lead to a more innovation-based economy.

Through its recommendations the Institute is encouraging businesses, governments, and individuals to work together over the next few years to realize Canada's prosperity potential for generations to come.

About the Institute for Competitiveness & Prosperity
The Institute is an independent not-for-profit organization established in 2001 to serve as the research arm of Ontario's Task Force on Competitiveness, Productivity, and Economic Progress. The Institute and the Task Force are supported through the Ministry of Economic Development and Trade. Since its inception, the Institute has published four annual reports for Ontario and Canada and eight working papers, all available on the website.

About the Task Force
The creation of the Task Force on Competitiveness, Productivity and Economic Progress was announced in Ontario's April 2001 Speech from the Throne. Roger L. Martin, Dean of the Joseph L. Rotman School of Management at the University of Toronto, is the Chairman. The mandate of the Task Force is to measure and monitor Ontario's competitiveness, productivity, and economic progress compared to other provinces and US states, and to report to the public on a regular basis. Members of the Task Force were announced on October 17, 2001. See www.competeprosper.ca for further information.