

Introduction

The news about Canada is very upbeat these days. The long-term prospects, on the other hand, are downbeat, or, as a friend of mine used to say, "If things are so good, why are they so bad?"

We survived the '90s. We weathered a tough recession, kept inflation at bay, put our fiscal house in order, narrowly avoided defeat in the 1995 Québec referendum, and endured the high tech crash that ended the decade.

By contrast, and especially after the harrowing events of the past six months, the outlook for Canada in the new century seems very positive. The headlines tell us that we are at the forefront of the global economic recovery, positioned to top the G7 countries, including the United States, in job growth. The soaring job market has propelled our dollar to its highest level since September. Moody's, who had stripped us of our triple A credit rating in 1994, gave it back to us two weeks ago. Moreover, our international trade has expanded vigorously.

Conference Board surveys find that recent low interest rates and rising employment are boosting consumer confidence. People are out buying cars and looking at houses.

Our own forecast at the Conference Board for Canada's economic growth is quite bullish. In fact, the employment surge and high retail sales led us to revise upwards our earlier forecast, an unusual step for us, to 3.1% for 2002, and to forecast even stronger growth of 4.4% for 2003.

So, the short-term picture looks rosy. But my message today is that we face serious challenges.

At times like this, I feel we're caught in Plato's Cave. In a metaphor that can be read on many levels, Plato said we are like prisoners fettered in a cave and all we can see are giant shadows cast on the cave wall before us. We can't turn our heads to see the objects that cast these shadows, nor do we realize we are in a cave and separate from the real world. In the metaphor, one of the cave dwellers escapes to the surface and returns to tell those who remained behind that they have been deluded. They kill him for his troubles – I hope you'll give me a warmer welcome.

At the Conference Board, we consider a broad range of data in order to understand what is really happening in Canada and the world.

Imperatives for Change: Canada

There are six powerful danger signals on the home front.

- **One.** The steady decline in our relative income per capita. We are falling behind our American neighbour. Twenty years ago, our income measured in American dollars was \$2,000 per person less than that of Americans. In the year 2000 we had fallen

behind by \$7,600. By 2010, the gap could rise to \$15,000. Our ranking on standard of living among OECD countries has fallen from 4th in 1980 to 9th in 2001.

- **Two**, the Canadian dollar has fallen from 81 cents US in 1980 to 65 cents US twenty years later. This erodes the purchasing power of Canadians, both as individuals and as employers seeking to recruit the best talent abroad or to purchase equipment. This has sparked a lively debate on the merits of keeping our own currency versus pegging it to, or even surrendering it to, the US greenback.
- **Three**, the increasing loss of corporate head offices in Canada, which we described in a 2001 report as “the hollowing out of corporate Canada”. This trend reflects mergers and acquisitions by foreign companies, mostly American, the down-sizing of foreign-owned Canadian head offices, and the relocation of some Canadian businesses south of the border. The results include a loss of opportunities for top Canadian talent as head office jobs disappear and less independent decision-making in the branch plant subsidiaries that remain.
- **Four**, chronic income and employment gaps within Canada, notwithstanding years of regional development and social support policies aimed at correcting these trends. Six of Canada’s 10 provinces rely on transfers for up to 20% of their personal income. The obvious question is how can we balance our regional development goals with the benefits of having people move to where the jobs are. Meanwhile, interprovincial barriers to trade and labour mobility persist.
- **Five**, we’re getting older and we’re not replacing ourselves. Canada’s fertility rate is well below the average 2.1 children needed to maintain population levels – in 2010 it will be just 1.6, which means that Canada will depend increasingly on immigration for population growth in the future. Adding to this is the fact that our population is aging and, besides driving up the cost of health care, old age is thinning the ranks of our labour force. The bottom line is that we will depend more and more on immigrants and the talents and skills they bring for our future economic performance. And so will other countries who will compete with us for that top talent. Yet we haven’t figured out how to integrate new arrivals into the workforce as effectively as we could. We can and must do better.
- **Six – and a sign of trouble that worries me especially—the plight of our cities.** Canada’s cities now account for about 80% of the nation’s population and economic activity. The TD Bank, the most recent group to speak out on behalf of Canada’s cities, concluded:

“It is becoming overwhelmingly apparent that the long-term performance of the Canadian economy and Canadian living standards will hinge on the fortunes of our cities.”

But our cities are under immense pressure. Close to 60% of the 2.5 million more people predicted to live in Canada by 2010 will live in Canada’s three largest cities—

Toronto, Vancouver, and Montreal. Cities must bear more of the costs for smoothing out the hard edges created by social and economic inequities – poverty, homelessness, crime. At the same time, they must create the economic, social, and environmental climate to stimulate innovation and competitiveness. And they must do all this with inadequate resources.

So these are several of the most serious concerns here in Canada – our declining relative standard of living as measured by per capita income, the decline in our dollar, the hollowing out of Canada's head offices, persistent regional income and unemployment rate differentials, the changing demographic mix and distribution of our population, and the plight of our large cities.

Imperatives for Change: North America

Turning to Canada's position within North America, our economic position threatens to become even more vulnerable. But, alas, most Canadians seem to be blissfully unaware of the risks.

- September 11 changed our world in several ways: it underscored Canada's dependence on both America's markets and military power. It also underscored the tension between U.S. and Canadian priorities, with the U.S. understandably preoccupied with security coordination in its fight against terrorism, while Canada's focus is on the maintenance of cross-border trade. This tension highlights public policy questions that strike at the heart of Canada's sovereignty, but for which Canada lacks clear answers – questions about deepening economic integration, coordination of security across the continent, immigration, human rights, defence, even our currency.

Ironically, given its security-driven impulses to harmonize and coordinate, the U.S. has taken steps recently on economic and trade matters that are in the opposite direction; U.S. protectionist actions regarding softwood lumber, farm subsidies, steel, and the proposed subsidies for Alaska natural gas development are undermining NAFTA and putting Canada again on the defensive.

- Also relevant to Canada's economic position within North America is the rise of Mexico as a formidable player in terms of trade flows and foreign investment. With a population of 97 million, more than three times Canada's, and a rising middle class, Mexico's potential for growth in manufacturing, consumption, and attracting investment is enormous.

You may be surprised to learn that Mexico manufactures Volkswagen's best-selling car, the Jetta – which receives high ratings for quality and reliability. With the Auto Pact now history, and with global over-capacity, new investment in automotive manufacturing could well go to Mexico instead of Ontario. By 2010, Mexico will be a much more important customer to the U.S. than it is now, and Canada's long held "special relationship" with the U.S. may be correspondingly diminished.

Given longer-term trends, another decade of drift will take us to a future where Canadians are increasingly less able to afford the social policies that we cherish and the standard of living we desire. But this does not have to happen.

Modern history has many examples of economies that have risen and fallen very quickly. Most recently, Argentina—which, at the beginning of the 20th century was as rich as Canada and has since gone through a number of ups and downs -- captured world attention with its catastrophic collapse, while Ireland has gained legendary fame through its dramatic turnaround.

The Irish reversal was not a matter of “Irish luck”. Ireland now has a higher per capita income than Canada, moving from 21st position in OECD world rankings in 1990 to 4th place today – compared with Canada’s ninth place standing. To be sure, Ireland benefited from a suite of financial and tax incentives supported by the European Union’s regional development policies. But its astounding rise is the result of a deliberate and aggressive national strategy to attract foreign direct investment into technology intensive industries, a strategy built on a base of public investment in state-of-the-art infrastructure, research, and education.

Canada on a Slippery Slope

With our rich endowment of natural resources, proximity to the U.S. markets, solid base of advanced technology, and well-educated, skilled, talented, truly diverse workforce, Canada has what it takes to be a world leader in this highly competitive global economy.

But it is our view at the Conference Board that Canada is facing an uncertain future with no clear sense of direction on how to proceed. Canada is on a slippery slope, but with a concerted national effort we can reverse these trends and chart a new course to excellence.

Cornerstones for a New National Agenda

With action needed on so many fronts, where do we begin? My suggestion for two cornerstones of a broader national agenda are investment in **innovation** and **cities**. Both innovation and cities are multi-faceted themes with extensive potential leverage and impact on many of the issues that impede our competitiveness and threaten our quality of life. Both innovation and cities encompass economic, environmental, and social goals, thereby integrating economic success with sustainability. And, of course, the two are linked because it is mainly in our cities that innovation occurs.

Innovation

Innovation is the best way for Canada to address the productivity challenge. At the Conference Board, we’ve been emphasizing the need to improve our productivity since the mid-1990s. This does not mean, as some have held, that we should be trying to compete in the world on the basis of low wages and fewer jobs. Canada cannot cut its way to greatness. The solution, we believe, is to create goods and services that add

value in the marketplace. And that's innovation: the creation and application of knowledge to generate added economic and social value.

Canadians have done it. Take the example of Research in Motion, which created the Blackberry—my personal favourite electronic assistant. This is an excellent example of how knowledge workers and research and development labs can invent new technologies that “push” the market.

Innovation is a win-win strategy. Enhancing productivity through innovation will mean that as a country we will have more to invest in education and research, in health and social programs, in environmental projects, the arts, and infrastructure. And it will create higher value jobs with more income for individuals.

The Government of Canada recently released its Innovation Agenda, which combines the Department of Industry's innovation goals for business with the skills and learning policy objectives from Human Resources Development Canada. We think that this joint approach is a good thing. The first stage is an ambitious dialogue and engagement strategy designed to involve all sectors and culminate in a fall Summit – and the Conference Board is pleased to be a partner in this process.

Innovation is Canada's road to global best, the key to improving our productivity and value creation. Our work at the Conference Board on Canada's innovation performance, gaps, and strategies for improvement has convinced us that Canada can become a world leader in innovation, if all sectors take action.

Governments can provide a positive environment for innovation by investing more in research and development, changing the regulatory regime to remove needless impediments to innovation, and modifying the tax system to encourage creativity and risk-taking, for instance by removing the taxes which Canada - alone among the G8 – currently levies on the capital of corporations.

But governments alone cannot effect the transformation. Business leaders must re-orient their internal cultures towards the goal of being first in world markets with new products and services, increase investment in research and technology acquisition, and spend more on learning and employee development.

Academics should work collaboratively with the business community to promote the commercialization of inventions in the world marketplace.

And Canada's labour unions must embrace change and flexibility that are key to creating truly innovative organizations.

Cities

Equally important and inextricably linked to innovation is the importance of investing in Canada's cities.

Economists have been making the link between successful cities and successful societies for many years now.

Several decades ago, Jane Jacobs, North America's guru on the subject, wrote "Whenever and wherever societies have flourished and prospered, rather than stagnated and decayed, creative and workable cities have been at the core of the phenomenon." It is even more true today. Compelling research demonstrates that a nation's competitive advantage is directly related to the creative benefits of proximity or clusters. New research, too, demonstrates how and why highly mobile, talented knowledge workers are attracted to cities – cities that offer opportunity, quality of life, and diversity.

There is no need to describe in detail the litany of problems that currently bedevil our great cities. Our infrastructure – from schools to transportation – is aging, even crumbling; who ever thought that Canadians would question drinking their tap water? We not only continue to allow, we subsidize inefficient urban sprawl. For the past decade both the federal and provincial governments have sought to balance their budgets by off-loading costly obligations, like social housing and public transit here in Ontario, on to local governments. Canada's largest cities are experiencing high levels of poverty, and homelessness has become a national shame.

It wasn't that long ago that Canadian cities, and specifically Toronto, served as the global model for the ideal metropolis. Our large cities can be places where people and businesses that can choose to be anywhere choose to be.

Six years ago, in the Task Force Report on Greater Toronto, we envisaged a city-region that would be a prosperous, livable, humane, civil, and decent society. Toronto, we said, would be:

"...the economic engine that drives not only Ontario but the whole of Canada. Businesses, both domestic and international, will be attracted by our highly educated, motivated, and disciplined work force, by our sophisticated and integrated communications and transportation systems, by our enviable health-care system, by our concentration of excellent universities and colleges, by our cultural pluralism, and by our reputation as one of the world's most dynamic centres of arts and entertainment."

I'm often asked whether there is any hope that Ottawa and the provinces will take the necessary actions to ensure prosperous and livable cities. Cynics point to long-standing procrastination in the face of a remarkable degree of consensus that has been reached on the urgent need for a new deal for Canada's cities.

My answer is "yes" – and for at least two reasons (besides my naturally optimistic temperament). The first is that we seem to be reaching a new level of collective understanding that Canada's economic competitiveness strategy must embrace both economic and social dimensions. A decade ago the prevailing message focussed on

cost-cutting as the fundamental strategy for competitiveness, on the need for each of us to be self-reliant, even selfish. The talk was all about cutbacks, not strategic investment. Today, several of Canada's business leaders are linking competitiveness to a broader, more inclusive agenda – including innovation and investment in cities – rooted in values that Canadians hold dear.

The second reason for optimism is that the chorus of voices calling for change is growing. Championing the cause of our cities and city-regions doesn't feel as lonely anymore.

- The Federation of Canadian Municipalities is providing critical leadership through research and political mobilization.
- Jane Jacobs has inspired the C-5 initiative to draw attention to the financial problems of Canada's five major city-regions.
- Judy Sgro, Chair of the Prime Minister's Caucus Task Force on Urban Issues, released her first report this month, hitting the right notes by calling for expanded federal investment in urban infrastructure, housing, and transit.
- Canada's business elite – Charlie Baillie, John Tory, John Hunkin, Gord Nixon, to name a few - have taken up the cause.
- The Federal Finance Minister is on record as calling for "a new deal for cities".
- Next month, Toronto is hosting a City Summit, chaired by civic leaders including David Crombie and Frances Lankin, which should increase the pressure.

Momentum and focus – the two critical ingredients for change – are intensifying. The real risk to these prospects for change is complacency on the part of the general public.

Conclusion

The challenges facing Canada are serious and real. This fall the Conference Board will release its 7th annual report on Canada's Performance and Potential and it will show that despite our current standing in the world as a prosperous and desirable place to live, our performance on a whole range of indicators is average at best and slipping in some areas, our trade competitiveness is too dependent on our low dollar, and our favoured position in North America is at risk.

My concern is that too many Canadians are by and large unengaged and complacent, a misplaced optimism which buoyant, short-term economic forecasts may reinforce.

Hopefully, if you do choose to remain in Plato's cave, you will feel a little less comfortable than you did before lunch.

