The Conference Board of Canada
Insights You Can Count On

Performance and Potential 2002–03 Key Findings

Canada 2010
Challenges and Choices at Home and Abroad

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Performance and Potential 2002–03—Canada 2010: Challenges and Choices at Home and Abroad
Key Findings
by *The Conference Board of Canada*

About The Conference Board of Canada

The Conference Board of Canada is the foremost independent, not-for-profit applied research organization in Canada. We help build leadership capacity for a better Canada by creating and sharing insights on economic trends, public policy issues, and organizational performance. We forge relationships and deliver knowledge through our learning events, networks, research products, and customized information services. Our members include a broad range of Canadian organizations from the public and private sectors. The Conference Board of Canada was formed in 1954, and is affiliated with The Conference Board, Inc. that serves some 3,000 companies in 67 nations.

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Team for the Preparation of *Performance and Potential 2002–03*

This report was produced under the direction of Jim Frank with assistance from Brenda Lafleur.

Contributors: Charles Barrett, Kip Beckman, Prem Benimadhu, Michael Bloom, Doris Chu, Paul Darby, Jim Frank, Anne Golden, Tabinda Haider, Gavin Hales, Brenda Lafleur, Mario Lefebvre, Judith MacBride-King, Nicholas Neuheimer, Gilles Rhéaume, Stephen Vail, Hugh Williams

Editing: Marilyn Campbell, Mary Jean McAleer
Library and Data Resources: Beth Laporte, Brenda Taylor
Design: Jean Barsona
Graphics and Production: Janice Longpré

Foreword

The success of a nation ultimately rests on the quality of life of its citizens.
—Performance and Potential 1996

The September 11, 2001, terrorist attacks on the United States jarred our nation, with many saying, in the days following the attacks, that Canada would never be the same again. Canadians' sense of physical security was diminished when a conflict seemingly being fought in distant lands arrived so close to Canada's doorstep. But our sense of economic security changed as well, with a more profound awareness of how dependent Canada is on the free flow of goods and services across the border.

Ensuring access to the U.S. market is, arguably, the single most important policy consideration facing Canada in the coming decade. Access to U.S. markets affects both immediate trade flows and future investment location decisions. Investors will have less incentive to invest in the productive capacity of Canada if access to the full North American market is uncertain.

Performance and Potential is our flagship publication, and anyone wanting to understand Canada's position in the world can read this single document to comprehend our current challenges and future choices. With this year's *Performance and Potential* report we break new ground in three ways. First, we broaden and deepen our benchmarking of Canada's performance. In this year's report, we examine the performance record of the 12 best-performing OECD countries using 95 indicators in each of six categories—Economy, Innovation, Environment, Education and Skills, Health, and Society. This is an increase in both the number of indicators and comparator countries analyzed over previous years. It remains faithful to a long held Conference Board conviction that a nation can be successful only when it integrates its social and economic policies.

As in previous years, we find Canada solidly in the middle—neither setting the pace nor bringing up the rear. Canada earns three silver and three bronze medals in the six categories when compared with the 12 best performing countries.

Second, this year's report looks ahead to Canada in 2010 and constructs a scenario based on the major trends affecting our nation. These trends include demographic changes, evolving values, and widening income gap disparities both within Canada and between Canada and the United States.

We expect Canadians' values to evolve towards "post-materialism" that emphasizes freedom, self-reliance, and quality of life. Linked with an ongoing decline in trust in public and private institutions, this value shift will drive demands for greater accountability and performance from government and corporations and reduced support for universal social programs. As integration with the United States deepens on economic, regulatory, and security matters, a "made in Canada" social policy will become the new litmus test for Canadian sovereignty.

Canadians' incomes depend on our productivity and on the value of the goods and services that we produce and sell at home and around the world. On a positive note, our unemployment rate in 2010 will be very low. However, Canadians' gross domestic product (national income) will be about U.S. $40,000 per capita compared with Americans' at about U.S. $52,000—a gap of U.S. $12,000 per person, double what it was in 2000!

We know that a high national income is not the only goal a society strives for. But Canadians' expectations are influenced by what they see in the United States and other countries. If we were able to generate a higher income, as they do in the United States or Norway for example, we would be better able to finance the public policy choices that enable us to maintain and build upon our high quality of life. Without improved income growth, these aspirations will not be attainable.

Within Canada, the per capita employment income gap among the provinces will widen. In 2000, Alberta and Ontario had the highest per capita incomes at $26,000, and Newfoundland and Labrador had the lowest at $16,000. In 2010, the provinces with the lowest employment income per capita and the highest unemployment rates will remain the same as those recorded in 1970.

Regional inequality will remain a prominent feature of the Canadian economy, and the poorer provinces will have greater difficulty providing public goods and services at equivalent levels, financed at similar tax rates.

Immigration will be the dominant source of population growth through to 2010, underscoring the challenges of integrating new Canadians into our workforce and society. Most immigrants will settle in our three largest cities, particularly in the city of Toronto, where immigration is expected to fuel most of the projected growth to 5.6 million by 2010, up from 4.8 million in 2000. The imbalance between the resources available to cities and their responsibilities, so obvious in 2002, will only worsen by 2010 without major changes.

Third, we assess Canada's changing role in the world and conclude that Canada will likely see its prestige and influence dwindle further on the world stage. This is due to the declining relative size of our economy among those of the nations of the world, compounded by our cuts in development assistance and defence spending. That said, our record of leadership in building consensus to develop the International Landmines Treaty and our support for the International Criminal Court show that we can have influence in areas where we choose to channel our efforts. Given limited resources and our values favouring domestic spending, it will be important for Canada to select niches on the international stage where we can make a difference.

Performance and Potential is made possible through the contributions of many individuals and the collective knowledge of their research teams. Since the report's inception, James G. Frank, Vice-President and Chief Economist at the Conference Board, has had overall responsibility for the work of this report. He has been ably assisted throughout by Brenda Lafleur and the many other colleagues who are acknowledged elsewhere in this publication. I thank them all for their excellent work.

Anne Golden

Anne Golden
President and Chief Executive Officer
October 2002

KEY FINDINGS

Canada 2010
Challenges and Choices at Home and Abroad

INTRODUCTION

One year later the world is both reflecting on the tragic events of September 11, 2001, and coming to grips with their long-term implications. Canadians responded on a number of levels. The immediate shock was followed quickly by the realization that, as North Americans, we shared the vulnerability of our American neighbours. For the first time since the Korean War, Canada committed ground troops to battle. The closing of the border also drove home to Canadians how dependent our economy has become on trade with the United States.

After September 11, 2001, Canadians shared the vulnerability of our American neighbours.

This new environment presents challenges for both Canada today and the Canada of 2010, the focus of this seventh report on Canada's performance and potential. With the spotlight so firmly focused on Canada–U.S. relations, the debate over the meaning of sovereignty in this country became more intense. Many spoke about a loss of sovereignty if Canada should harmonize its border, immigration, and security policies to "suit" the Americans. Yet the need to develop a common border strategy to ensure both physical and economic security became a top priority in the aftermath of September 11. Canadians supported the Smart Border Declaration of December 2001, a document that helped secure access to the U.S. market for our industries and ensured our own security, both of which are critical to our future.

Not only will 2001 be remembered as the beginning of a war on terrorism, it will also be remembered as a year of very slow economic growth, and the year of the collapse of the stock market "bubble," especially after September 11. Even though the economy was rebounding with good employment gains, the mood was becoming more pessimistic in the money markets as billions of dollars were lost and major companies saw their once mighty stock turn to penny-stock status.

As the year ended, we saw the emergence of corporate scandals in the United States. By mid-2002, the consequences of these scandals had reached Canadian corporations listed on U.S. stock exchanges in the form of new regulations affecting accounting and directorship practices. The "bubble" had burst and many feared the worst—a bear market and protracted weak economic growth.

THE STAGE IS SET FOR *PERFORMANCE AND POTENTIAL 2002–03*

All this set the stage for this year's *Performance and Potential*. In this report, among other topics, we devote attention to four key factors that will affect Canadian values, and therefore choices, through 2010. We also analyze the structural causes of the long-term decline in our currency. We build the case for significant investment and improvement in our human resource development practices. We conclude with suggestions of policy priorities to improve the outlook for Canada in 2010.

This year's benchmarking process was more extensive.

Our report breaks new ground in three ways:

- We broaden and deepen our benchmarking of Canada's performance.
- We construct a scenario of Canada in 2010, based on major trends.
- We assess Canada's changing role in the world.

BENCHMARKING SHOWS CANADA HAS ROOM TO IMPROVE

In this *Performance and Potential* report, we broaden our benchmarking, which compares performance across countries, from our Top 40 of previous years. We now examine 95 indicators, in six categories—Economy; Innovation; Environment; Education and Skills; Health; and Society—for 12 Organisation for Economic Co-operation and Development (OECD) countries. The mix of countries that we have benchmarked changes in each category because we chose the *top* 12 countries. The expansion of indicators and countries supports our objective of comparing Canada's performance to the best.

Canada's performance varies among the six categories.

Our results show that Canada is a top-12 performer in all six categories. Countries that are powerhouses in their geographic regions, such as the United States, Japan, and Germany, are not in the top 12 in all categories. For example, the United States is not among the top 12 performers in the Environment, Health, and Society categories. Japan is not among the top 12 in Environment, Education and Skills, and Society. And Germany is not among the top 12 in the Economy category.

We rank the top 12 performers as having gold, silver, or bronze performances. Canada turns in three silver medal performances (Economy, Education and Skills, and Health) and three bronze medal performances (Innovation, Environment, and Society) (see Table 1).

Table 1
Canada's Socio-economic Performance
(number of medals by category)

Categories	Canada's overall performance	Gold	Silver	Bronze
Economy	Silver	2	4	4
Innovation	Bronze	5	2	7
Environment	Bronze	4	6	5
Education and Skills	Silver	7	4	6
Health	Silver	9	8	8
Society	Bronze	3	5	6

Source: The Conference Board of Canada.

Some countries deserve special mention because of their outstanding performances. For example, Ireland has done remarkably well in Economy. Sweden performs at the top in Innovation, Environment, and Society; Norway in Education and Skills; and Iceland in Health.

In doing its benchmarking, the Conference Board is conscious of the difficulties of drawing quick conclusions from such comparisons due to variability in contexts and measurement. This said, we believe that benchmarking for countries, just as for companies, is valuable because it shows us what is possible.

Although Canada's overall benchmarking record in 2002 is very good, we know that our performance is uneven across the land. The status of our Aboriginal population on many of the indicators in this report would be closer to that of a poor country than to one of the richest. Homelessness, incidence of poverty, and employment incomes vary significantly from one part of Canada to another.

To solve these problems by 2010, Canadians need to appreciate the complex interdependencies that support our quality of life. We must also have a clear vision of where we would like to be in 2010. As we look ahead and examine the individual indicators in each category, we can see the positives for Canada. And we can see that once seemingly invincible economies are now struggling. The clear lesson is that past performance is no guarantee of future success.

CANADA'S ROLE AND INFLUENCE IN THE WORLD HAS DECLINED

The current *Performance and Potential* report expands last year's analysis of Canada's place in North America to include a review of our changing role in the world. Canadians perceive themselves as "influential beyond our size," of "punching above our weight." Our review shows otherwise. The declining relative size of our economy among the nations of the world and cuts in development assistance as well as in military spending have contributed to the diminution of Canada's influence abroad. The prospects for 2010 are for a continuation of this trend.

Our economic weight has diminished not because Canada's economy is shrinking, but because other countries have caught up to or surpassed us. Canada emerged from World War II as the fourth largest industrial economy and with the second highest per capita income in the world after the United States. This economic position did not last, as Europe and Japan recovered and some developing countries industrialized. Today, Canada is about the 12th largest economy in the world, and our real per capita income has slipped to seventh place.

By 2010, with military spending plateaued at 1.1 per cent of gross domestic product (GDP), our capacity will be further reduced, along with our international reputation as peacekeepers. The same prospect applies to overseas development aid where our contribution record has been one of slow erosion. To illustrate, in 1969, we set a target of 0.7 per cent of GDP for development assistance, which has not been met in over 30 years. And currently we are spending less than 0.3 per cent of GDP in this area (see Chart 1). Despite the increase in development assistance by $1 billion over three years in the 2001 federal budget, a major increase in line with our traditional target appears highly unlikely.

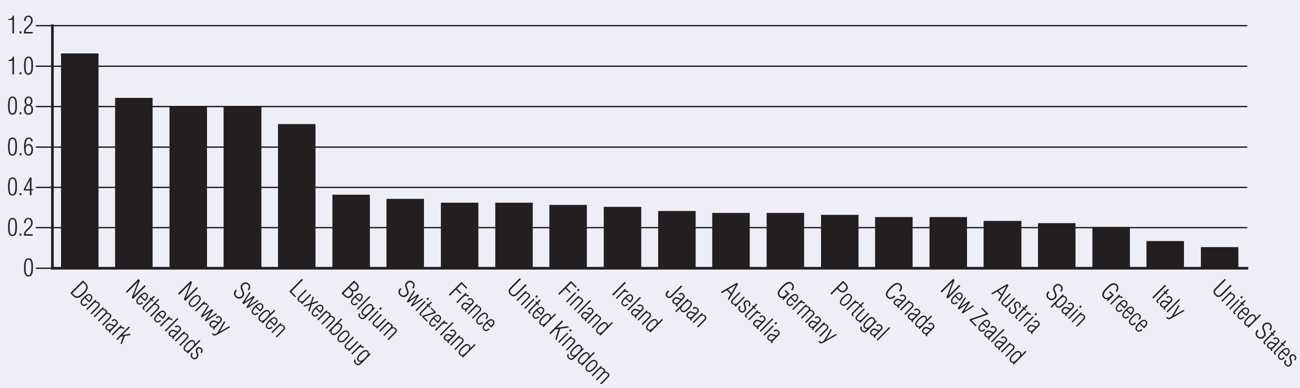
During the 1990s when Canadians accepted the need to end their record of deficit-financing, priorities shifted away from international to domestic spending. As a result, we are less internationally focused and generous than we would like to think we are and used to be. Though there is little evidence to suggest that Canadians favour major increases in military spending, we do seem to take pride in our role in peacekeeping and other international forums. We are the ultimate "joiners," and very few other countries are members of as many international organizations as we are.

As a "middle power," Canada can exercise global leadership by promoting "the Canadian Way in International Affairs," the key elements of which are our desire to protect human rights, ensure the rule of law, help develop democratic institutions, and ensure sustainable development. Our record of leadership in developing consensus for the International Landmines Treaty and in promoting the International Criminal Court are consistent with Canadians' values and show that we can have influence in areas where we choose to channel our limited resources.

Canada can be a leader by promoting "the Canadian Way in International Affairs."

The primary focus and critical motivator of Canadian diplomatic efforts and international activities has been and still is to ensure Canada has access to the U.S. market. This focus has been pursued mainly through active participation in all the multilateral rounds of trade negotiations since World War II. More recently Canada has also pursued access to the U.S. market through regional arrangements, such as the North American Free Trade Agreement (NAFTA).

Chart 1
Official Development Assistance by Major Donor Countries, 2000
(percentage of GDP)



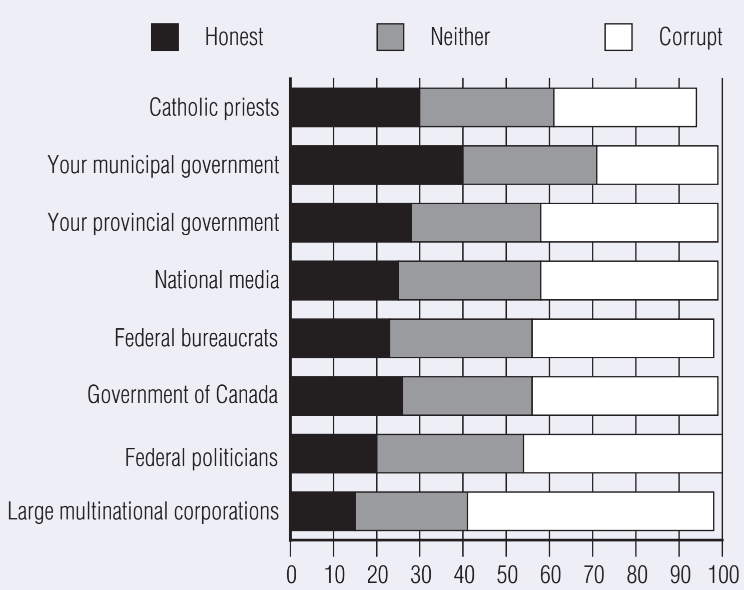
Source: OECD, *Development Co-operation Report*, 2001.

Looking to 2010, increasing North American integration will remain Canada's dominant reality. As noted, the impact of the border closing immediately after September 11 brought into sharp relief how dependent Canada has become on the American market. The risk for Canada lies in simply letting the process evolve, without having a clear view of our interests and pursuing them proactively before decisions are made that hurt Canada's interests.

Minimizing trade barriers is critical.

To accomplish this, Canada should begin serious discussions on strategies to minimize the barriers to the north–south flow of goods and services. Such discussions should include debate on the merits of various options for further trade and investment liberalization up to and including a North American customs union. The goal would be to help reduce the risk of investment being redirected out of Canada to the United States or Mexico. This emphasis on North America need not preclude the pursuit of opportunities with trading partners outside North America. Given the time frame required, the debate needs to be started soon—and it must begin in Canada.

Chart 2
Honesty of Key Institutions
(per cent rated on a scale from 1–7 with 4 being neither corrupt nor honest)



Source: Ekos, 2002.

"THE CANADIAN WAY" IS BEING RESHAPED

"The Canadian Way" is the term the Conference Board has coined to describe the distinct policy framework that defines Canada. This framework includes the size and role of government; the balance between collective and individual responsibility; and our broad social policy.

The Canadian Way will be different in 2010 compared with today because of the following trends:

- increased demand from Canadians for greater accountability and performance from governments and corporations;
- a shift towards post-materialist values that place greater emphasis on freedom, self-esteem, and quality of life;
- demographics changes;
- increased North American economic integration; and
- major technological developments.

Over the past three decades, there has been marked erosion in public confidence in our institutions. This erosion has been amplified by numerous reports of mishandled government funds, tainted blood, polluted drinking water, sex abuse scandals, and corporate malpractice and accounting scandals. As a result, public and private institutions are failing the public's "trust test" (see Chart 2). To rebuild trust Canadians will demand greater accountability and performance from governments and corporations.

The shift towards post-materialist values, associated with increased levels of education and wealth, will mean that Canadians will take more interest in quality-of-life issues such as health care, urban matters, and their local environment—issues that are largely domestic. This will result in more pressure being put on government budgets and taxpayers to fund services related to ageing and to congestion and pollution in our cities.

But Canada's continuing emphasis on prudent fiscal management implies that governments are unlikely to introduce major new universal social programs by 2010. In light of our income growth prospects through 2010, we will not be able to afford them. And a majority of Canadians will not support the increased taxes or the deficit-financing that we used in the past to develop such programs. But Canadians' values do include helping those most in need and ensuring equitable opportunities. To allow for this, Canadians will support an approach to social policy that emphasizes more targeted programming rather than the current universal approach.

Canada's population size and demographic mix will have major effects on the Canada of 2010. The Canada of 2010 will be an "older Canada" as the baby boomers just start to reach the conventional retirement age of 65 years in 2012. Canada's population will increase by 2.5 million people by 2010, about 58 per cent of whom will reside in the three largest cities, intensifying urban concentration. Net immigration will account for about 68 per cent of the population increase in 2010, up from 61 per cent in 2000. We will need to integrate immigrants more effectively if we are to take advantage of their skills and ensure social harmony.

Canada's population size and demographic mix will have major effects on the Canada of 2010.

Though the events of September 11 shocked everyone, they also confronted us with a choice, and we made it—Canadians are now more willing to accept increased North American economic integration, because it creates jobs and high incomes. However, Canadians will not support political integration or threats to their ability to develop a "made in Canada" social policy, broadly defined. This has become the new litmus test for Canadian sovereignty.

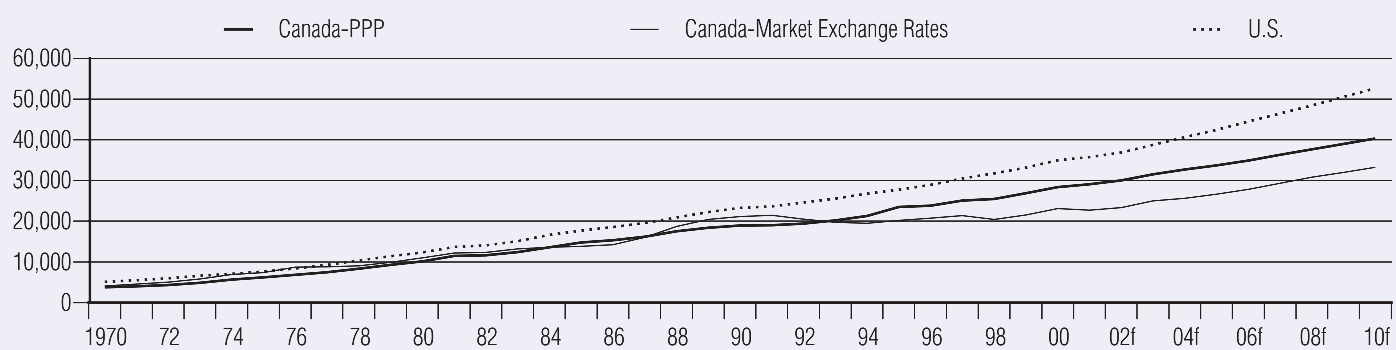
CANADA IN 2010 WILL BE SLIGHTLY OLDER WITH THE SAME OLD PROBLEMS

In looking ahead to Canada in 2010, we worked from a "base case forecast" by looking at demographics, trade performance, fiscal performance, inter-provincial performance, and social policy challenges. We foresee a nation with very low unemployment rates and a solid federal fiscal position, but also one where the income gap between Canada and the United States is about double what it was in 2000.

Our incomes as Canadians depend on our productivity and on the value of the goods and services that we produce. The dilemma we face is this: although our unemployment rate in 2010 will be very low, Canadians' gross domestic product (national income) will be about U.S. $40,000 per capita, compared with Americans' at about U.S. $52,000—a gap of U.S. $12,000 per person, double what it was in 2000 (see Chart 3). The absolute size of the gap is important. It widens steadily in our base case forecast because there is no evidence that we will be able to increase our national income per capita faster than the United States between now and 2010.

We know that national income alone is not the only goal of a society. Nevertheless, incomes matter. If we were able to earn higher incomes, we would be better able to finance programs we would like to maintain, or undertake new policy initiatives to build upon our high quality of life. Expanding public education and health care, addressing the pressing infrastructure needs in our cities, reversing environmental deterioration, or adding

Chart 3
Canadian GDP Per Capita in U.S. $ at PPP* and Market Exchange Rates, 1973–2010



*Purchasing power parity
f = forecast
Sources: The Conference Board of Canada; OECD *Economic Outlook,* 1998.

national elder care, day care, or pharmacare are simply beyond our financial capacity without significant increases in income per capita.

The per capita employment income gap will also widen among Canadian provinces. In 2000, Alberta and Ontario had the highest income at $26,000, and Newfoundland and Labrador had the lowest at $16,000. By 2010, the provinces with the lowest employment income per capita and the highest unemployment rates will be the same provinces that experienced these hardships 40 years ago. We will have made little progress in solving regional inequalities, so these will remain a prominent feature of the Canadian economic landscape. The poorer provinces will still be unable to provide public services to the standards of the richer provinces at comparable tax rates.

Regional inequalities will remain a prominent feature of the Canadian economic and political landscape.

The effects of the post-war population bulge are well known, but the most important is its labour market impact. By 2010, Canada will have an unemployment rate of about 5.5 per cent, a level not achieved in decades. This is considered to be full employment and reflects the gradual tightening of labour markets through the previous years driven largely by structural factors and demographics.

Canada's trade performance in the North America of 2010 will be critical to our ability to increase incomes, create new jobs, and reduce unemployment levels. By 2010, Mexico will be an even more important customer of the United States than it is today. Mexico stands to gain considerably in incomes as the decade unfolds, promising expanded opportunities for Canadian economic interests. At the same time, Mexico promises to be a more formidable competitor for new investment.

During the 1990s, Canadian exports to Mexico were dominated by food and related products, whereas Mexican exports to Canada were dominated by manufactured products—particularly autos and parts and electronic equipment. Mexico is a huge potential market for Canada, and its people need not only food but also other goods and services. Another 10 million people will be added to Mexico's current population of 100 million by 2010, about four times the increase we expect in Canada's population. It will require a concerted effort for Canadians to take advantage of this situation, considering the United States has the obvious geographic advantage relative to business relationships.

The fiscal picture for public finances in 2010 is generally positive (see Chart 4). At the federal level, Canada has entered the world of the "virtuous circle of government finance" where debt loads are reduced, interest costs fall, and operating surpluses "free up" money for either tax cuts, spending increases, or debt reduction. The outlook for federal government finances is expected to remain positive through 2010.

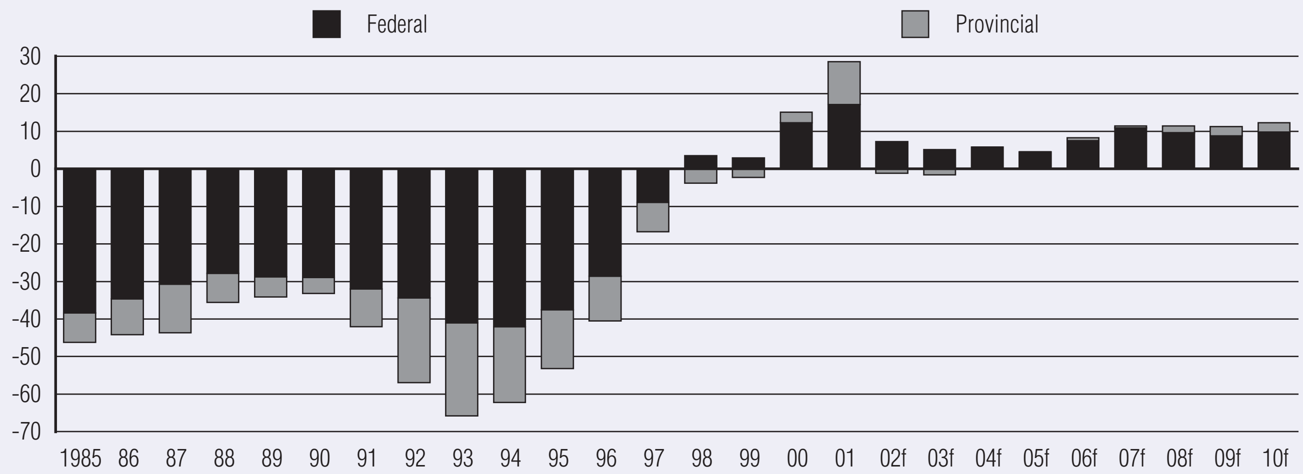
On the provincial front, the outlook is different, because most of the provinces are outside the "virtuous circle of government finance" except Alberta and Ontario, where small surpluses should occur over the next decade. British Columbia, our third largest province, is experiencing serious economic difficulties and will have large deficits at least through fiscal 2004.

Canada's social programs are now more sustainable, from the perspective of their share of GDP, than at any time in the past 15 years. However, with slow employment growth, the costs per taxpayer are rising. By 2010, they could well reach the same level as in the early 1990s, when taxpayers came together at the polls to demand tax cuts. The revenue available, given current tax rates, will be sufficient to sustain current policy commitments but will not be adequate to support bold new programming.

The outlook for federal government finances is expected to remain positive through 2010.

Health care became the single largest social policy program in 1997–98, when more money was spent on health than on education. By 2010, public spending on health care will hit $118 billion, up from $69 billion in 2000, and will account for about 7.2 per cent of GDP, up from 6.4 per cent in 2000. The real volume of spending per capita will rise steadily, much as it

Chart 4
Federal and Provincial Government Balances (Public Accounts Basis), 1985–2010
($ billions)



f = forecast
Sources: The Conference Board of Canada; Statistics Canada; various government budgets.

did prior to the early 1990s correction that generated the so-called health care crisis. Little change in the structure of the health care system is expected by 2010, and no new programming will be added.

We are a long way from the lifelong learning society we require for higher incomes.

The challenge that Canada faces in the area of education is significant—the "bar has been raised" to gain entry into the workforce, with 94 per cent of all jobs in Canada requiring at least a high school diploma. By 2010, the share of GDP devoted to education will decline from a peak of 8.1 per cent in 1970 to about 5 per cent—while the real resources devoted per student will grow slightly. Whether this is going to be adequate, given the critical need to invest in human resource development, is debatable.

Numerous social programs redistribute income based on financial need or specific characteristics, such as pregnancy, blindness, veteran status, Aboriginal status, or having dependent children in the household. These programs together cost the public purse about $86 billion in 2000—roughly $17 billion more than we spent on health care and $25 billion more than on education. The most significant change in Canada's social policy since medicare was the introduction of the National Child Benefit in 1998. As a share of GDP, we forecast that these programs will steadily decline from the peaks reached in the 1990s recession to about 7.5 per cent of GDP in 2010. This trend reflects demographic changes—low birth rates and an ageing population—and the assumption that there will be no new major social programs established in the next decade.

LONG-STANDING PROBLEMS HAVE AFFECTED OUR DOLLAR

The lessons of the past are compelling for our Canadian dollar outlook to 2010. Today, the value of the Canadian dollar reflects two factors: the policy mistakes we made over the past 25 years (and should not make again); and the constraints we face given our position in North America as a small country next to the world's most powerful nation, a reality we have to accept and manage.

Investment flows have a far greater effect than trade flows on our currency's value. Looking at the events of the late 1990s clarifies their impact: currency crises on at least three occasions caused a flight to quality in the U.S. dollar, and the high-tech investment boom caused huge inflows into the United States and drove down our currency as it did the currency of other countries.

Today, prospective investors in Canada see a country with substantial potential but also one with significant risks that have become more prominent since September 11. For many of them, the investment risks outweigh the potential rewards, so they discount Canada and invest elsewhere. These individual decisions show up collectively in the surplus in our current account and the deficit in our capital account. We expect this situation to remain essentially unchanged through 2010.

The investment climate must become more favourable over a long period of time, or our potential in 2010 will not improve over what we now foresee. As travelling Canadians know, the weakness of the Canadian dollar goes well beyond differences in price levels in Canada and other countries. It has been discounted 25 per cent below its purchasing power parity rate of about U.S. $0.85.

There are several causes for this discounting. The history of deficit-financing and constitutional crises has left a legacy that has shaken investors' confidence and will take years to fade away. Given that we have had only five years without deficit-financing and seven years without a national unity referendum, it is to be expected that investors are still cautious about investing in Canada.

For many investors, the risks of investing in Canada outweigh the rewards.

The long-term decline in commodity prices has also hurt our dollar, but it is a factor over which we have no control. And there is no likelihood that this trend will be reversed by 2010. So we must learn to deal with it by developing further high value-added production in Canada. Well-off countries usually specialize in creating products for the earlier stages of the product cycle using innovative technologies, and this provides higher incomes. For instance, Canada has shown its ability to be innovative through its information and communications technology industries and its bio-technology industries by creating products that will provide growing incomes and rates of return for the 21st century.

Negotiations for the Canada–U.S. Free Trade Agreement (FTA) and NAFTA trade deals did not achieve all of Canada's objectives, and the limitations of these deals will present ongoing problems for Canada through 2010. For example, because NAFTA does not exempt Canada or Mexico from U.S. trade remedy laws, we do not have assured access nor are we immune from new trade restrictions. American sovereignty and the unwillingness of Congress to surrender its right to make and interpret trade policy have always been problems. International investors are well aware of this "half-a-loaf" nature of Canada's trade deals. Under FTA and NAFTA, therefore, Canadian access to the American market is dependent on the prevailing political mood in Washington.

The limitations of the FTA and NAFTA trade deals will present ongoing problems for Canada through 2010.

However, American trade policy is not consistently protectionist. The United States is a leading promoter of free trade in the early-product cycle sectors it dominates, such as high-technology products, including services, and the protection of intellectual property rights, patents, and copyright. But it has become highly protectionist in late-product cycle sectors, most recently steel, softwood lumber, and agriculture.

The future value of our currency will reflect the views of financial markets on our economic prospects. To improve the investment climate and opportunities in Canada, Canadians must make economic and political choices that support the productivity and competitiveness of the Canadian economy. This will lead to the increased income growth that Canadians will need to finance the long list of social policy and infrastructure needs that are emerging.

CANADA FACES SERIOUS SKILLS AND LEARNING CHALLENGES

By 2010, we will be experiencing the beginnings of the baby boomers' exodus into retirement, and labour markets will be very tight. People with marketable skills will be making high incomes; but those without marketable skills will have very little hope of having an income at a level sufficient to support themselves. Canada will have to address the issues of labour shortages and the mismatch in the labour market between the number of low-skilled workers and jobs available for them.

Since qualifications are being raised to get a job, the problem of adult literacy will be more important to address. According to the International Adult Literacy Survey, over 40 per cent of adults have inadequate literacy skills—that is, they have trouble understanding or using basic printed information. Literacy deteriorates unless it is maintained, and many workers actually lose some of their capacity because there is too little money spent on workplace training and development. Although some organizations have innovative lifelong learning programs, there is not a broad approach being taken to address these problems. Thus, we need to build a "learning culture" and ensure that people have access to learning opportunities throughout their working lives.

There is still a major "learning recognition gap" that affects well over half a million Canadians—and they are unemployed or underemployed because of it. Educators, employers, and governments can correct this by making the elimination of institutional and provincial barriers to accreditation a top priority.

This gap also affects immigrants to Canada. About 60 per cent of immigrants have post-secondary credentials (see Table 2), because our selection criteria target highly educated people. Since annual immigration will comprise about 68 per cent of our population increase and virtually all of our labour force growth by 2010, we need to evaluate and recognize immigrants' credentials in a timely manner.

Table 2
Immigration by Level of Education, 2001
(15 years of age or older)

Education Level	No.	%
0 to 9 years of schooling	28,223	14.61
10 to 12 years of schooling	32,708	16.94
13 or more years of schooling	16,906	8.75
Trade certificate	9,196	4.76
Non-university diploma	18,084	9.36
Bachelor's degree	66,013	34.18
Master's degree	18,467	9.56
Doctorate	3,523	1.82
Total	193,120	100.00

Source: Citizenship and Immigration Canada, *Facts and Figures,* 2001.

Forty per cent of Canadian adults have inadequate literacy skills.

Barriers to labour mobility in Canada also contribute to the skills shortage. As previously noted, provinces and the federal government need to eliminate all interprovincial barriers to certification. In addition, a state-of-the-art information system would help people learn of job opportunities far from home. And increased assistance with individual relocation expenses would also help increase mobility.

The Aboriginal population of Canada, at over 1.3 million, has too many within it who are poorly equipped to work. As has been repeatedly documented, the high-school dropout rate for Aboriginal people is about 70 per cent in some provinces, and too few are going on to post-secondary programs and developing employability skills. Without change, there is little prospect of improvement for this segment of our population.

As we look to 2010, we know that our reliance on innovation and employment in knowledge industries will increase. Yet the outlook is still that too many young people will not graduate from high school. Only 6 per cent of jobs require less than high school graduation, yet 18 per cent of our youth will not graduate. All students should earn a diploma consistent with their aptitudes and abilities; otherwise they will not be able to support themselves. And a far greater effort should be made to change negative attitudes towards the skilled trades and to build more natural pathways between high school and trades programming.

More generally, the school-to-work transition is difficult for our young people. Canada could make great strides in developing its human capital if it had significant increases in co-operative programs and if businesses were more willing to hire young apprentices and youth during their education years.

KEY CHALLENGES FOR 2010

Although the outlook for Canada to 2010 is positive in many respects, the scenario points to a number of challenges that we must address. There are six that we have highlighted in this year's *Performance and Potential* report:

- By 2010, our income gap with the United States will have doubled. Our income growth will be too slow to allow us to finance the range of public and private goods and services that most Canadians want. Our expectations for world-class goods and services, influenced by what we observe in the United States and Europe, will exceed our financial capacity.

The outlook for Canada to 2010 is positive in many respects, but there are also serious challenges.

- Interprovincial employment income gaps will widen by 2010. Affordability of comparable public and private goods and services will increasingly be a problem for poorer regions and exacerbate the tensions around Canada's longstanding equalization and redistribution policies.
- Canada will face both labour and skills shortages. Current human resource policies and practices will not supply either the calibre of people needed or sufficient flexibility in Canada's labour markets.
- Canada will be a nation of diverse cultures and backgrounds, with over 1.75 million immigrants arriving between now and 2010. This will challenge us to find ways to better integrate new Canadians and to allow them to work at their potential.
- Border management is critical to Canada's economic and physical security. Without assured access to U.S. markets, trade flows will be at risk. Moreover, future investment decisions will be made that locate plants and equipment outside of Canada.
- Canada will have a reduced international reputation and influence, the result of the continued decline in our relative economic size among the major nations of the world and our reluctance to significantly increase spending on peacekeeping and overseas development.

KEY POLICY CHOICES

The values of Canadians will determine how we respond to these challenges. Recognizing that the following policy thrusts are sweeping in their scope and that difficult trade-offs would be required if pursued, the Conference Board suggests that Canada should focus its energies on the following:

- Building our innovation capacities so that Canadian businesses can produce high value-added goods and services that will allow us to earn higher incomes.
- Promoting greater trade liberalization and labour mobility within Canada, so that people can more easily move to where the jobs are and business can invest without concern about impediments to the sale of goods and services in all Canadian markets.
- Ensuring that the international border permits the free flow of goods and services. Making Canada more attractive to foreign and domestic investors will remain a priority through 2010.
- Managing the ongoing Canada–United States relationship to minimize the negative impact of U.S. protectionism. Canada should start to debate the merits of various options for securing access to the U.S. market that range up to, and include, a North American customs union.

The values of Canadians will determine how we respond to these challenges.

- Boosting public investment in knowledge development with the goal of increasing the capacity of every Canadian to compete in a knowledge-driven world. Making lifelong learning a reality and accessible are important elements of good public policy for people born in Canada, as well as for the 1.75 million new Canadians who will arrive by 2010.

- Building on our international legacy by applying our efforts strategically. Canada can exercise global leadership, based on our values, to protect human rights, ensure the rule of law, help develop democratic institutions, and promote sustainable development.

CONCLUSION

The Canada of 2010 will be a very comfortable place with a high quality of life. But comfort may breed complacency and undermine our resolve to make the policy and behaviour changes necessary to strengthen our performance and potential by 2010 and beyond. Our hope is that this report will stimulate vigorous and thoughtful debate and inspire action.

The Conference Board of Canada
255 Smyth Road
Ottawa, ON K1H 8M7 Canada
Tel. 1-866-711-2262 • *Fax* (613) 526-4857
www.conferenceboard.ca

The Conference Board Inc.
845 Third Avenue, New York, N.Y.
10022-6679 U.S.A.
Tel. (212) 759-0900 • *Fax* (212) 980-7014
www.conference-board.org

The Conference Board Europe
Chaussée de La Hulpe 130, Box 11
B-1000 Brussels, Belgium
Tel. (32) 2.675 54 05 • *Fax* (32) 2.675 03 95

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Insights You Can Count On

255 Smyth Road, Ottawa, ON K1H 8M7 Canada
Tel. (613) 526-3280 • *Fax* (613) 526-4857 • *Inquiries* 1-866-711-2262

www.conferenceboard.ca