

Building Economic and National Security Value

Will Canada maximize taxpayer return on military procurements through strategic industrial benefits?

The Conservative Government's decision to begin much needed re-investment in the Canadian military is good for national security and the ability of Canada to promote and defend its interests and values internationally. In an era of failed and failing states and their related threat to Canadians at home and in theatre in Afghanistan, there are few public policy issues that deserve more attention. Every effort must continue to be made to ensure the timely delivery of new military equipment to the Canadian Forces that meets the government's security priorities; and to do so in a way that also maximizes economic value to Canada and to the Canadian taxpayer.

Canada also faces another type of global challenge – to attract and retain knowledge-based industries and workers to sustain Canada's competitive edge internationally. It is for this reason that CADSI has been advocating a defence and security industrial strategy that effectively aligns Canada's world-class industrial and technological capabilities with the government's military and security and S&T program priorities.

It is also why we are advocating a holistic government-wide approach to the use of Canada's regional and industrial benefits (IRB) program to support government objectives, maximize taxpayers return on investment, and achieve strategic, high value-added and sustainable benefits to the Canadian economy. The federal government has announced its intention to invest \$17 billion in new equipment for the Canadian Forces. CADSI understands that these new procurements will facilitate a corresponding

investment in the Canadian economy in the form of IRBs. These investments have the potential to transform Canada's defence and security industrial landscape.

How successful the government will be in leveraging meaningful, long-term benefits that support a globally competitive, knowledge-based national economy depends, in part, on the execution of its strategy and on the political will to achieve real and lasting benefits for Canadian industry. Success also depends on how effectively the IRB tools, and the policy and administrative guidelines that direct their use, act as a catalyst rather than as an impediment to success.

A successful IRB policy would position competitive Canadian capabilities for domestic and international sales. It would enhance trade and high-value knowledge-based jobs – strengthening innovation in our industrial base and stimulating the Canadian economy. It would also promote Canadian leadership, and industry participation in all major defence and security procurements, thus facilitating access to global supply chains and world product mandates.

It is in this context that CADSI recently asked a cross-section of its membership for their recommendations to the government on how best to achieve these objectives through the use of the IRB program. Their feedback is captured in the following recommendations.

Encourage direct investments, transfers of technology, R&D and the provision of Intellectual Property Rights from IRB contractors to Canadian-based companies in areas of strategic value to Canada.

Canada's knowledge economy competes successfully in the global marketplace based on innovation, productivity and world-class capabilities. The building block of these competitive strengths is access to, and generation of, investment capital, IP, technology and R&D.

Canadian industry's access to, and exploitation of, these competitive levers can be the single most valuable outcome of IRBs when combined with a strategy to encourage domestic and export sales.

To encourage companies with IRB obligations to invest in areas of strategic technology interest to Canada, they will, at least, have to be satisfied that the technology, IP or R&D has been fairly valued and that appropriate credit is provided for their upfront investment. Current IRB practice only credits downstream sales of the recipient company and not the contractor's initial investment.

Technology, sales and new business relations are key industry measures of IRB success

Depending on the procurement, there may be more or less latitude for the government to find direct industrial benefits. The earlier industry is aware of defence and security capability planning priorities, the sooner Canadian industry can develop partnerships and teaming relationships to participate directly in procurement programs. At a minimum, Canada must be able to operate and properly service its equipment when, where and as required. It is, therefore, essential that Canada's in-service support industry (ISS) has the access it needs to the IP, data packages and technical documents required to adequately maintain, repair and overhaul purchased military and security equipment in Canada in accordance with the government's procurement strategies.

Develop IRB guidelines to help – not hinder – long-term business relationships in technology and product development areas of strategic interest to Canada.

Major defence procurements offer Canadian industry a range of direct and indirect IRB opportunities. These opportunities will vary depending on the type of equipment, the maturity of the platform being acquired, the extent of existing prime and sub-contractor commercial relationships in Canada and the depth and breadth of the contractor's global business

reach. IRB obligations provide a unique opportunity to deepen existing commercial relationships and to initiate new ones of strategic value to Canada. These relationships take time to identify and develop and often many more years for the best strategic outcomes to materialize.

CADSI believes that IRB outcomes will be maximized when the concept of banking of credits is accepted, when credits can be shared between different programs, and when contractors can look for IRB opportunities across the breadth of their corporate businesses. To provide more time for contractors to develop strategic, value-added opportunities for Canadian business, the eligibility start date for IRB credits should be lengthened, perhaps in relation to approved long-term federal defence and security capabilities documents. High quality IRB outcomes will be secured when the administration of the IRB program encourages and more closely parallels normal business practices and cycles rather than requiring high percentages of locked in commitments in an unrealistically short timeframe.

Better engage Small and Medium-sized Businesses in the IRB process.

Small and medium-sized businesses remain concerned about their access to opportunities in federal government programs. Indeed, ensuring that prime contractors are aware of the capabilities of Canada's SME sector is an on-going challenge. Continuing efforts must be made to facilitate meetings between Canada's SME community and OEMs and prime contractors. CADSI commends the IRB program for including Canadian small business as a priority area for investment. Yet, the program's ability to support the SME community is significantly weakened today by something beyond its operating mandate – the International Traffic in Arms Regulations (ITAR) which, if left unaddressed by senior political ranks of the federal government, will have a destructive impact on the viability of Canadian technology companies and the tens of thousands of Canadians employed in the sector in the years to come.

SMEs are recognized for their ability to produce technical excellence and innovation and, often, for their challenge of bringing new technology to market exploitation. In this respect, we acknowledge the current IRB program's inclusion

ITAR must be fixed if quality IRBs are to be available to Canadian industry

of Venture Capital programs with a multiplier as eligible investment opportunities for contractors with IRB obligations. We encourage the government to aggressively pursue this opportunity on behalf of Canadian small business by providing upfront incentives for contractors to invest in existing venture capital funds for emerging technology companies.

Mandate defined IRB obligations to the defence, security and aerospace sectors

CADSI endorses Industry Canada's IRB policy which targets defence, security and aerospace as areas of specific interest. As unique partners to the federal government in national security, this is an appropriate recognition of the strategic value to Canada of a viable defence and security industries sector.

Targeted and significant percentages of IRB obligations tied to the defence, security and aerospace sectors, when combined with obligations that are aligned with approved long-term capabilities plans and federal S&T strategies, should be applied on a go-forward basis to all IRB programs.

Contract with Business, Technology, Offset, and Financial Professionals to support IRB managers during peak IRB transaction periods.

The cyclical nature of Canada's defence spending inevitably places great stress on Industry Canada's ability to manage the tasks of identifying, negotiating and validating quality-based IRB transactions. In these periods, it may be prudent to seek external help from the private sector to support the IRB process to Canada's maximum benefit. CADSI members suggest that IC develop, maintain and choose from a list of private sector professionals with business, offset, financial and technology expertise to bolster the resources of the Industry Sector Branch and IRB managers as programs are executed.

Create a Business-Government Consultative Forum

CADSI would welcome the creation of a Joint Industry-Government Consultative Forum to contribute to the development of IRB strategies that best meet the equipment needs of the Canadian Forces and security agencies, and which achieve best qualitative outcomes in areas of strategic national security and economic interest to Canada. Much can be achieved, and nothing lost, to Canada's benefit if key stakeholders are engaged in a meaningful way.

IRB guidelines can act as a catalyst rather than an impediment to economic success

Conclusion

The IRB program is an important and practical tool to involve Canadian industry in Canada's defence and security programs. Opportunities to maximize the taxpayers' return on investment must not be squandered through IRB practices that limit business to business development. The establishment of a vibrant indigenous defence and security industrial capacity will stimulate innovation in the Canadian economy; enhance trade opportunities and generate sustainable knowledge-based jobs in Canada, while concurrently strengthening Canada's industrial base in areas of strategic national security interest.

These recommendations can be applied to current defence procurements, as well as to future requirements by applying the current IRB policy through more business-friendly guidelines. With the potential for \$17 billion of new investment in the Canadian economy flowing from the IRB obligations of these recently announced defence procurements, now is the time to ensure that the IRB program is administered to maximize economic and security returns to Canada. **FL**



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