

Canada's Auto Industry and the New Free Trade Agreements

Sorting Through the Impacts

Jim Stanford





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Introduction

Ever since attaining a majority in Parliament in 2011, the Canadian government has accelerated its quest for new free trade agreements. At last count there were at least 17 sets of FTA negotiations underway in various stages of progress, from the small (Honduras and Morocco) to the huge (European Union and the Trans Pacific Partnership).

Several of these new FTA negotiations involve other developed countries which are major exporters of motor vehicles to Canada. These include the proposed deals with the EU and Korea, as well as negotiations involving Japan (which could culminate in either a direct bilateral deal, or as part of the broader Trans Pacific Partnership). Despite its challenges over the last decade, Canada's auto industry is still a crucial contributor to national GDP, exports, and productivity, and an important source of well-paying work. Indeed, after petroleum, automotive products still constitute Canada's second largest export. The industry is also influential politically, especially in Ontario (where most automotive manufacturing takes place).

So the potential impacts of these new FTAs on the auto sector are a crucial aspect of the government's continuing trade agenda. Each potential FTA has unique features, and will impact on the Canadian auto industry in particular ways; it is important, therefore, that the impacts of FTAs on the auto sector be analyzed in detail on a case-by-case basis.¹ At the same time, however, there are important commonalities in Canada's automotive trade with major non-NAFTA jurisdictions. These should be understood in a more general sense, in order to contemplate the likely impacts of future trade agreements on this vital sector. Canadian policy-makers should not enter any trade negotiations without a strong understanding of the defining structural features of Canada's auto industry, so that they might shape any trade agreements in a manner that strengthens, rather than weakens, this key export industry.

This paper will briefly review Canada's existing international trade and investment relationships in the auto sector. It will identify the key structural features of the Canadian sector: of particular note is the fact that there is no inherently "Canadian" base or character to this industry. To the contrary, it is 100 percent dependent on decisions by global original equipment manufacturers (OEMs) based in other countries to establish and maintain production facilities here. The long-run impact of trade liberalization on the Canadian auto sector, therefore, will be shaped by this fundamental structural reality — and in particular by whether those trade deals affect future capital investment in Canada by automotive OEMs. How does "free trade" affect the business case for global OEMs to produce motor vehicles in Canada in the first place? Unlike other trade-affected sectors (like agriculture or minerals) there is no particular reason for this industry to even exist in Canada, and hence trade negotiators must be cognizant of the interrelationship between trade and investment (rather than assuming that the industry is a permanent feature of Canada's economic landscape, automatically able to participate meaningfully and positively in new trade opportunities). The question of how new FTAs would affect future automotive investment (and hence the future viability of the sector) has not really been asked by Canadian trade negotiators, let alone convincingly answered. Having a better awareness of the structure of our existing automotive trade and investment relationships, and a better appreciation of the need to conduct trade policy *strategically* (with a focus on boosting investment), will help Canadians better judge whether these additional FTAs will help, or hurt, this crucial sector of our economy.

Canada's Current Automotive Sector

Detailed profiles of Canada's automotive manufacturing industry have recently been published by other sources.² The main features of the industry can be summarized as follows:

- Assembly of light motor vehicles for the mass consumer market is undertaken in Canada by five foreign-based global OEMs (General Motors, Ford, Fiat/Chrysler, Toyota, and Honda), operating a total of 9 different plants.
- All of those assembly operations in Canada are wholly-owned subsidiaries of foreign-based OEMs. This is an obvious and dominant structural feature of this industry, but one that curiously is not much discussed in free trade negotiations.
- An extensive automotive parts and supply industry manufactures inputs for vehicles assembled in Canada and elsewhere. This parts industry includes some important Canadian-owned firms, and many foreign-owned subsidiaries as well. The location of parts plants is increasingly concentrated near to the assembly plants which they serve (as a result of modern "just-in-time" logistics strategies); this structural feature also shapes the impact of trade policy on investment and employment in this part of the industry. The presence of assembly plants in Canada is a key factor in the continuing viability of the parts industry here.
- About 85 percent of vehicles assembled in Canada are exported (almost all to the U.S.), and about two-thirds of auto parts manufactured in Canada are also exported (again mostly, but not as exclusively, to the U.S.).
- By the same token, over 80 percent of vehicles purchased in Canada are also imported, but from a broader range of originating countries. The U.S. is the largest import source, but major flows of finished vehicles also arrive in the Canadian market from Mexico, Japan, Europe, and Korea (in order of importance). China has also begun exporting finished vehicles to Canada, and other emerging market suppliers (such as Thailand) may begin doing so in coming years.
- The automotive manufacturing industry employs about 100,000 workers (about one-third in assembly, and two-thirds in parts). Average

productivity levels in the sector are very high, and hence auto workers earn wages significantly higher than the overall average in the Canadian labour market.

- Spin-off or “multiplier” effects are uniquely strong in the auto industry, due to the highly developed supply chain, and also to downstream spending effects. Research suggests that every job in an OEM facility supports a total of ten jobs up and down the supply chain.³ Fiscal revenues generated directly and indirectly from the automotive industry are also important to the Ontario and federal governments.⁴

The Canadian auto industry peaked in 1999, when it assembled a record of over 3 million vehicles, and ranked as the 4th largest auto producer in the world. Since then the Canadian industry lost about one-third of its footprint (and shed about 50,000 jobs in assembly and parts production). That decline reflects a number of causes, including:

- The declining market share and eventual financial crisis of the three North American-based OEMs (who initially accounted for the lion’s share of Canadian production).
- The impact of the over-valued Canadian dollar (now coming back to earth) on relative costs and hence investment decisions.
- The general and gradual southward migration of North American auto investment and production to Mexico since the implementation of the NAFTA.
- The consequent emergence of a very large trade deficit in automotive products (undermining net demand for Canadian-made products).

The global auto industry reflects a complex mixture of global and regional (ie. continental) production systems. A small number of global OEMs aim to serve markets around the world from complex networks of assembly and supply facilities. Economies of scale are very important; viable assembly factories must usually aim to produce 200,000 vehicles per year in order to meet global benchmarks for unit cost. Hence, assembly investments are contingent on ready and affordable access to markets big enough to absorb that much output (keeping in mind, furthermore, that any given factory can only produce a handful of different models). To reduce unit costs for engineering, development, and marketing, OEMs are standardizing their global product offerings. So even when particular vehicles are manufactured with

custom features for particular markets (reflecting consumer tastes, regulatory requirements, or other market-specific factors), they are increasingly constructed on “global platforms”: that is, using underbodies and core engineering that are standardized and hence amortized across millions of units of output.

OEMs face a choice whether to service particular markets from production facilities located within that destination region, or to import them from production facilities elsewhere. For large-scale markets (such as North America or Europe), sales volumes are sufficient to absorb large-scale output from many assembly plants, and so most production is sourced from within each continent; this has the further advantages of avoiding trans-ocean shipping costs and exchange rate risks. For smaller markets, or for global sales of more specialized or “niche” vehicles (such as high-end, less standardized luxury models), it may make more sense for OEMs to serve the entire global market from a centralized production location. Local production costs, the capability of local supply chains, and the requirement for quality⁵ also affect location decisions (including the specific locations of new plants within large continental markets such as Europe or North America⁶).

Within this complex global manufacturing system, foreign trade and foreign direct investment can be both substitutes and complements.⁷ An investment in a major assembly facility will automatically spark a significant increase in exports for a relatively small country like Canada; the annual output of a single assembly plant is measured in the billions of dollars, and most of that output must automatically be exported (since a small domestic market can absorb a limited amount of each particular model produced). By the same token, a relatively larger manufacturing footprint also boosts the share of domestic sales met from local production (although the capacity to substitute domestic production for imports is inherently constrained by the extensive variety of vehicles offered for sale by OEMs, only a few of which could ever be produced in a small country like Canada). Integration into the global/continental auto manufacturing system is a precondition for the existence of an auto industry in Canada, given our relatively small home market and the absence of any home-grown OEMs. So there is no question about the auto industry being able to exist in an autarkic manner (regardless of the jargon of free trade boosters who derisively dismiss any criticisms of proposed FTAs as “protectionist”). However, integration into that global industry can take different forms, be accomplished and managed using different policy tools, and result in greater or lesser net benefits for Canada.

Strategic Trade Policy and Auto Investment

Canada's complete reliance on incoming FDI for vehicle assembly (and, directly and indirectly, for parts production, too⁸) should tailor our trade policy in obvious and important ways. Trade policy can be used to enhance the incentive for OEMs to maintain and expand their operations in Canada, in which case the impact on the Canadian sector will be positive; there are several examples in the history of the Canadian industry where trade policy has been used effectively in this way. As put by the Canadian Automotive Partnership Council, "smart and strategic trade policy has always been a feature in the development and growth of the industry in Canada."⁹ On the other hand, trade policy might reduce the incentive for investments in Canada (for example, by making it more attractive for firms to import instead of producing here, with no offsetting stimulus to exports), in which case the effect would be negative.

The basic structure of this industry requires, therefore, that a strategic approach to trade policy be taken: trade policy should be used not as an end in itself, but as a means to an end (namely, leveraging more incoming FDI in the auto sector¹⁰). This is distinct from the view that trade liberalization (even unilateral trade liberalization, in the eyes of some adherents) is a welfare-enhancing goal in its own right. Many other countries practice trade policy in a similarly strategic way, especially with respect to identified strategic sectors such as automotive, aerospace, and high-technology. Most auto-manufacturing jurisdictions have traditionally relied on a range of strategic trade policy tools to enhance the viability and success of domestic auto producers. These efforts invoke many different policy levers, ranging from explicit use of targeted tariffs and trade interventions (common in places like Brazil, Russia, China, and the U.S.), to non-tariff barriers and structural bars to imports (Japan and Korea), to public equity ownership, technology supports, and export subsidies (Europe).¹¹

One example of the successful use of strategic trade policy to further domestic investment in the auto industry was the Canada-U.S. Auto Pact. This trade agreement was signed in 1965. Until it was overruled by the World Trade Organization in 1999 (and abolished by the Canadian government in 2001), it played a powerful role in boosting investment and production in Canada. And its legacy is still clearly visible in the structure of Canada's industry today. The Auto Pact removed bilateral tariffs on finished vehicles and parts for participating firms, and allowed Canadian plants to be oriented toward the shared Canada-U.S. market — and hence to operate at com-

petitive scale. But it also required participating OEMs to maintain manufacturing activity in Canada that was broadly proportional to their respective sales in Canada. The deal motivated a critical inflow of direct investment to increase Canadian manufacturing activity by all the participating firms.¹² In that context, Canada's industry evolved from an underdeveloped branch plant structure (marked by poor productivity and chronic trade deficits) to a continentally competitive and diversified industry generating steady trade surpluses. The requirement to meet or exceed Canadian-content thresholds (and the risk of penalties if those targets were not met) inspired participating firms to shoot well above the minimum targets specified in the deal.¹³ Then, by the 1990s, Canada's industry began to demonstrate additional appealing features, including labour cost savings (reflecting an undervalued currency and the benefits of public health care provision¹⁴), and very strong productivity and quality results. That encouraged OEMs, initially brought to Canada by the Auto Pact, to go far beyond the initial proportional content requirements of that deal. Even then, however, the provisions of the Auto Pact were important in securing the long-run presence of OEMs and maintaining a minimum efficient manufacturing footprint here.

Other strategic trade policy interventions (such as duty remission and exemptions on targeted auto parts) were also later used to encourage three Japanese assemblers to establish assembly facilities here in the late 1980s (including Toyota, Honda, and Suzuki¹⁵). The link between trade and investment has been evident in other, more recent auto policy initiatives (including the offering of focused investment incentives tied to export-oriented capital spending and model allocations, and the linkage in the 2009 government-supported restructuring of General Motors and Chrysler between financial support and continued investments in Canada¹⁶). Other potential examples of trade policy initiatives aimed explicitly at attracting investment include duty draw-back schemes (whereby a vehicle importer would receive credit against their import duties for vehicles which they simultaneously export), subsidies for export-oriented facilities or infrastructure, or the use of safeguard or countervail trade remedies to limit import flows and encourage more domestic manufacturing (the U.S. has used these measures repeatedly).

In some cases, a comprehensive FTA could itself constitute a strategic trade policy, if it deliberately and concretely enhanced the business case for export-oriented investments in domestic production facilities (and those effects were stronger than offsetting negative effects of liberalized imports on domestic sales, production, and investment). But there is no automatic link between trade liberalization and investment, and hence not every FTA

will have this positive effect; rather, the goal of boosting domestic investment must be pursued deliberately and strategically. For example, Mexico's web of FTAs with various jurisdictions in North America, Europe, and South America has incrementally enhanced the case for OEM investment in Mexican production facilities, which since NAFTA have been oriented overwhelmingly toward export (rather than domestic) markets. (Of course, Mexico's trade policy builds on top of other domestic features very attractive to incoming FDI, including very low labour costs and government investment subsidies.)

In every case, the key test is whether trade policy enhances the case for investment by global OEMs in domestic production facilities. That is a very different criterion than typically invoked (by free trade adherents, anyway) to judge the ultimate efficacy of a trade deal: for them, liberalizing trade on comparative advantage grounds is an automatic and efficiency-promoting goal in its own right. In traditional free trade theory, there are no "strategic sectors," a country's exports are determined automatically and efficiently according to principles of comparative advantage, and it is counter-productive for governments to try to influence the direction or location of investment decisions through pro-active policy interventions. The more trade policy is driven by this assumed faith in the automatic and mutual virtues of trade liberalization, and less by a concrete case-by-case analysis of whether trade policy is strengthening or weakening investment and production in key industries, the greater is the risk that trade will undermine domestic performance in those strategic sectors rather than strengthen it.

Canada's Current Automotive Trade Patterns

On the strength of growing investment in Canadian production facilities in the wake of the Auto Pact, Canada became a major net exporter of automotive products to the rest of the world. This enviable position in a strategic, high-value industry contributed importantly to Canada's strong overall trade performance, balance of payments, and national income for several decades. The net automotive trade surplus peaked in 1999, at over \$14 billion.¹⁷ It's been downhill ever since, however, for Canada's international automotive trade, as summarized in *Table 1*. Exports have declined (by a combined 31 percent between 1999 and 2013), imports have grown (by 7 percent), and the large trade surplus has melted away into an even bigger auto trade deficit — which reached a record \$18 billion in 2013.

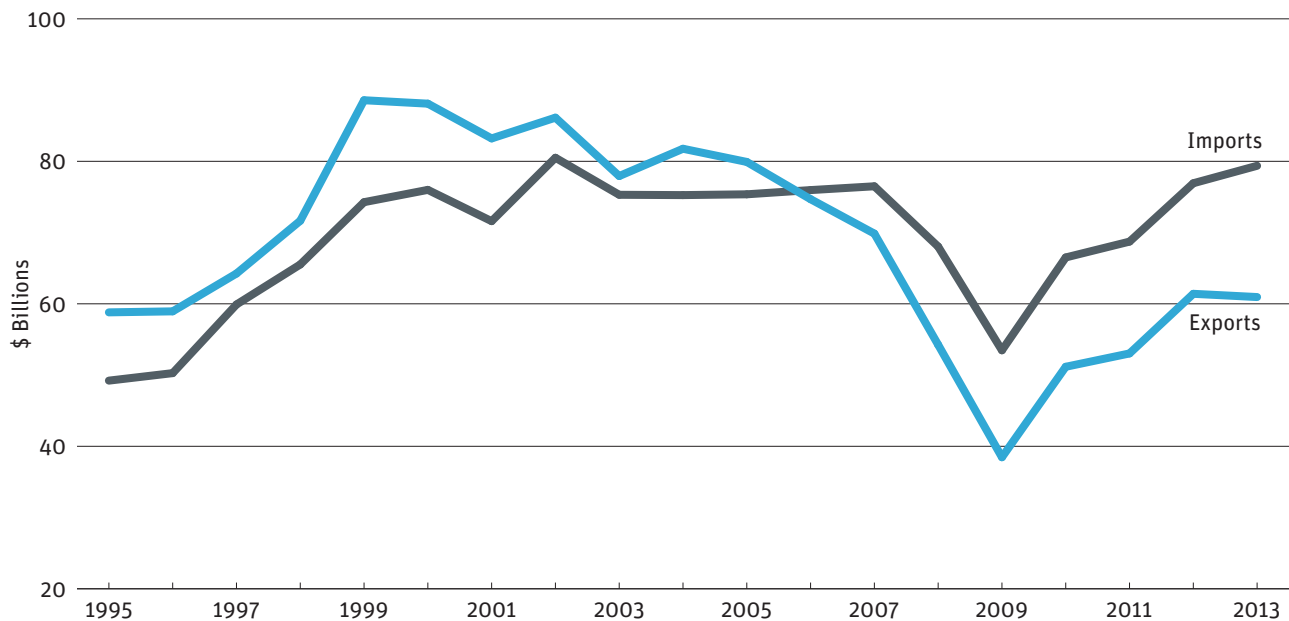
TABLE 1 Canada's Automotive Trade, 1999–2013, \$ Billions

	Exports			Imports			Trade Balance		Ratio of Imports to Exports, 2013
	Level	Change From 1999		Level	Change From 1999		Level	Change From 1999	
	2013, \$	\$	%	2013, \$	\$	%	2013, \$	\$	
U.S.	\$59.01	-\$27.98	-32%	\$52.45	-\$9.24	-15%	\$6.56	-\$18.74	0.9
Mexico	\$0.78	\$0.39	100%	\$9.46	\$5.63	147%	-\$8.68	-\$5.24	12.2
Japan	\$0.03	-\$0.14	-84%	\$5.57	\$0.61	12%	-\$5.55	-\$0.75	212.8
EU	\$0.26	-\$0.22	-45%	\$5.61	\$3.16	128%	-\$5.35	-\$3.37	21.5
Korea	\$0.015	-\$0.07	-82%	\$2.81	\$2.29	447%	-\$2.79	-\$2.36	181.6
China	\$0.18	\$0.09	93%	\$2.06	\$1.84	816%	-\$1.89	-\$1.75	11.6
Other	\$0.68	\$0.32	86%	\$1.41	\$0.82	140%	-\$0.73	-\$0.51	2.1
Total	\$60.95	-\$27.62	-31%	\$79.34	\$5.11	7%	-\$18.42	-\$32.73	1.3

Source: Industry Canada Strategis database. Includes NAICS sectors 3361, 3362, and 3363.

Figure 1 illustrates the contrasting trends in aggregate automotive exports and imports over the last two decades. Keep in mind that Canada's imports of auto parts tend to rise and fall with our exports of finished vehicles, for the obvious reason that imported parts are installed in new vehicles — most of which are then exported. So there is some natural cyclical covariation in the two series portrayed in *Figure 1*. Nevertheless, the longer-run deterioration of Canada's *relative* export position is clearly visible. The export line crossed below the import line in 2006 (when Canada recorded its first automotive trade deficit in decades). Ever since then Canada has consumed more automotive value-added than it has produced, and the resulting trade deficit has grown steadily.¹⁸ That net trade deficit has been an important factor behind the decline of Canadian auto manufacturing output and employment over the same period. This painful reality should be front of mind for Canada's trade negotiators. Trade policy should not be motivated by a naïve faith that liberalization will automatically lift all boats. Rather, trade negotiators should be focused on using trade policy deliberately to enhance domestic investments. To cite the Canadian Automotive Partnership Council again, "New trade agreements should not put Canada's existing automotive production footprint at risk and should focus on markets that provide meaningful opportunities to grow exports of Canadian-produced vehicles on a sustained basis."¹⁹

FIGURE 1 Canada's Automotive Trade



Source: Industry Canada, Strategis database. Includes NAICS sectors 3361, 3362, and 3363.

Aggregate automotive trade statistics mask great structural distinctions between the different countries with which Canada trades. To better understand these distinctions, *Table 1* disaggregates overall automotive import and export flows into the major bilateral relationships. These bilateral relationships are listed in order of relative importance in total bilateral auto trade.

Thanks to the legacy of the Auto Pact, Canada's auto industry still enjoys an important, mutually beneficial, and reasonably stable role within the continental North American auto marketplace. Canada's large two-way automotive trade flow with the U.S. dominates this continental role. We are a net exporter of finished vehicles to the U.S., and a net importer of auto parts. The overall balance is slightly in Canada's favour, but that surplus is small relative to the very large two-way flow. As summarized in *Table 1*, Canada imports about 90 cents of automotive product from the U.S. for every dollar we export.²⁰ Our exports to the U.S. have declined since the Canadian industry peaked in 1999 (reflecting mostly the erosion of market share in the U.S. market for some of the firms assembling vehicles in Canada). But so did our imports (since much of the import flow from the U.S. consists of parts which are assembled into vehicles in Canadian plants, and hence the two flows automatically move in tandem). It is fair to say that the Canada-U.S.

auto trade relationship is substantial, mutual, beneficial, and largely balanced – in other words, exactly what “trade” is supposed to be.

The inclusion of Mexico within the NAFTA in 1994, however, has unleashed a long-run shift in the location of automotive production within North America that is increasingly damaging to Canada’s role within the continental system. Both North American and offshore-based OEMs have expanded their operations in Mexico greatly since the NAFTA, to take advantage of very low labour costs, a developing supply chain, improving quality and productivity, and government investment incentives. At the same time, auto production shrank in Canada and the U.S. This trend accelerated with the global financial crisis of 2008 and 2009, when Mexico passed Canada to become the second-largest auto producer on the continent. Today Mexico is the source of Canada’s largest single bilateral auto trade deficit, a shortfall which totaled almost \$9 billion in 2013. The Mexican market absorbs only small flows of Canadian-made vehicles and parts, but Mexican exports (especially of finished vehicles) back to Canada have grown dramatically. The resulting imbalance between our imports from Mexico and our exports to Mexico is 12-to-1. The full integration of Mexico into the continental auto manufacturing system (facilitated importantly by NAFTA) has had an unequivocally negative effect on the Canadian auto industry (and Canadian manufacturing in general). This should give pause to trade policy-makers who seem to believe that free trade agreements automatically benefit all participants. If an FTA does not enhance the case for investment in Canadian automotive facilities (and Mexico’s inclusion into the NAFTA had a strongly opposite effect), then it can clearly and substantially damage Canada’s auto sector.

With all other auto-producing jurisdictions in the world, Canada’s automotive trade relationships are even more lopsided – and increasingly so. Canada serves as an important market for finished vehicle exports for all three of the major offshore automotive jurisdictions with whom the federal government is currently negotiating FTAs (Japan, Europe, and Korea). Smaller volumes of auto parts are also imported from those countries. Automotive exports flowing back in the other direction are very small (infinitesimal in the case of Japan and Korea), and concentrated in auto parts (rather than finished vehicles). In fact, very few finished vehicles are exported from Canada to any of these three jurisdictions. Canada’s total automotive exports to the EU, Japan, and Korea totalled less than one-half billion dollars in 2013, a fraction of one percent of Canada’s total automotive output. Moreover, our exports to each of those destinations have declined dramatically since

1999: by over 80% for Japan and Korea, and by almost half in the case of the EU. The general expansion of world trade in recent years has not led to greater Canadian exports to any of those jurisdictions — another warning to those who believe that liberalizing trade automatically “lifts all boats.” Our falling exports reflect the structurally closed nature of those markets (especially Japan and Korea), the decline in purchasing power there (reflecting a long economic depression in Japan, a shorter crisis in Korea, and the current problems in Europe), and a general lack of interest on the part of OEMs in serving those markets from Canadian plants in the first place. (Remember: there is no inherently “Canadian” character to our automotive industry; whatever models are assigned to Canadian plants, and the destination for their final sale, are determined fully by the profit-maximizing decisions of the global OEMs who manufacture here.) In 2013, the resulting bilateral automotive trade deficits totaled over \$5 billion each for Japan and the EU, and close to \$3 billion for Korea. The ratio of automotive imports to exports was astronomical for Japan and Korea (around 200-to-1, reflecting the near-zero level of Canadian exports). The imbalance was somewhat smaller, but still precarious, in the case of the EU (20-to-1). These highly unbalanced trade relationships have clearly contributed to the decline in Canada’s automotive industry since the turn of the century.

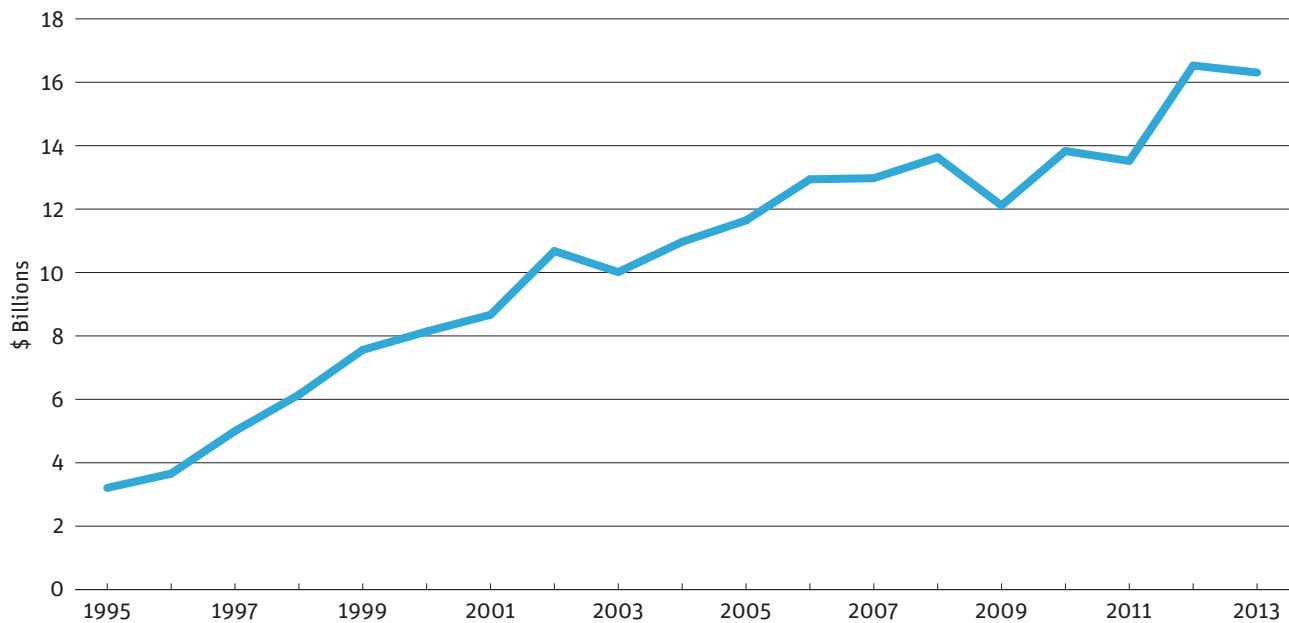
Why are the flows of exports from Canada to Europe and Asia so small — creating effectively one-way trade relationships with each jurisdiction? This outcome should not actually be surprising, given the structural features of Canada’s auto industry outlined above. Canadian assembly plants are established by OEMs who optimize their global operations in the context of economic, geographical, and policy constraints. Canada’s assembly plants (and the vehicles assigned to them) have traditionally been oriented completely to the North American market; again, this reflects OEM decisions and planning, not any “inherent” features of the Canadian industry. Consumer tastes, regulatory factors, and shipping costs make it unlikely that Canadian-made vehicles would suddenly begin to be exported offshore in any significant numbers, without some major change in corporate strategy. After all, every one of the OEMs producing in Canada also operates major production facilities in Europe and Asia; those are the natural places from which they would manufacture vehicles for those markets.

In contrast, the large and growing flow of vehicles coming into Canada from offshore reflects the willingness and ability of European and Asian OEMs to continue supplying a sizeable portion of their North American sales from home plants — despite the barrier of shipping costs and Canada’s existing

6.1 percent tariff on vehicle imports. In the European case, these cross-Atlantic imports consist mostly of high-end and specialized luxury vehicles, produced in smaller runs, for which shipping costs constitute a smaller share of total selling price. These vehicles, popular with wealthier consumers everywhere, can be profitably produced in Europe and shipped around the world.²¹ Japanese and Korean OEMs are willing to ship smaller and less expensive vehicles across the Pacific to meet a share of their market demand within North America. The role of trade policy in influencing European and Asian OEMs to continue producing a significant share of their North America-destined vehicles from their “home” plants is also important. European and Asian OEMs have been encouraged to maintain strong production footprints in their home countries, even for export-destined output, by a range of economic and policy levers (including export promotion, non-tariff limits on imports, currency depreciation, government equity shares, and political suasion). To be sure, most European and Asian OEMs have established and are expanding assembly operations in North America to help serve their growing market here. But in recent years, those plants have been almost exclusively established in lower-cost producing regions of the continent: namely, in Mexico and the southern U.S. (where restrictions on union activity have suppressed wages). Without a major change in Canadian policy, there is no reason to expect any of those firms to locate future investment here. Structurally, therefore, with the exception of Toyota and Honda, there is virtually no link between the Canadian sales of offshore-based OEMs and Canadian manufacturing activity. The growth in offshore imports which will predictably accompany any of these FTAs will have no positive impact on Canadian economic activity, and only a negative impact (driven by the extent to which growing imports from offshore translate into reduced production, and ultimately reduced investment, at Canadian facilities).

There is thus a fundamental and structural asymmetry shaping Canada’s trade in finished vehicles with all non-NAFTA jurisdictions. The growing market share of offshore OEMs within North America attracts substantial and growing flows of offshore vehicle imports into Canada. Growing North American sales are only partly offset by the growth of production at their North American “transplant” operations (and at any rate, with the exception of Toyota and Honda, none of those offshore OEMs have established production footprints in Canada). Meanwhile, OEMs which do manufacture in Canada have shown relatively little interest in exporting vehicles outside of North America. So far it has not been worth the effort (tweaking vehicle design and features for offshore customers, meeting offshore regulatory re-

FIGURE 2 Canada's Non-NAFTA Automotive Trade Deficit



Source: Industry Canada, Strategis database. Includes NAICS sectors 3361, 3362, and 3363.

quirements, investing in the transportation infrastructure required to ship vehicles offshore, and investing in marketing and distribution efforts in those offshore markets) required to build offshore exports — especially since those same OEMs can more easily meet offshore demand from their own facilities located right in those offshore markets.²² All of this explains the secular increase in offshore imports, the stagnation and decline of offshore exports, and Canada's resulting large trade imbalance with all non-NAFTA auto producers. As indicated in *Figure 2*, Canada's overall automotive trade deficit outside of NAFTA has tripled since 1995, reaching over \$16 billion in 2013. Until the turn of the century, that growing offshore imbalance was offset (and perhaps masked) by the large auto trade surpluses which Canada enjoyed within North America. But that is no longer the case; indeed, since 2009 Canada now incurs an auto trade deficit *within* NAFTA (since our deficit with Mexico now exceeds our surplus with the U.S.) that *exacerbates*, rather than offsetting, the much larger deficit incurred outside of NAFTA.

Table 1 also reports Canada's growing (and also unidirectional) automotive trade with China. Initially our auto imports from China consisted solely of low-cost auto parts; recently, however, China has begun exporting finished vehicles to Canada, and that flow will grow as the Chinese in-

dustry (consisting both of joint-venture branch plants operated by global OEMs, and fully Chinese-owned OEMs) continues to improve its productivity and quality. The bilateral auto deficit with China reached almost \$2 billion in 2013, and is becoming another weight dragging down the prospects of Canada's auto sector. As with the other offshore jurisdictions, Canada's auto exports back to China are insignificant, and are outweighed by incoming imports by a 12-to-1 ratio. Canada used to export small volumes of finished vehicles to China (including sedans and minivans), but that flow stopped as Chinese policy-makers emphasized made-in-China production commitments in their dealings with global OEMs. China is another jurisdiction which effectively practices strategic trade policy, rather than naively promoting trade liberalization for its own sake. But this lesson has been lost on Canadian trade negotiators: so far they have shown no interest in attempting to link investment commitments to trade liberalization as China has so successfully done.²³

For all other countries (other than those specified in *Table 1*), Canada incurs yet another, more modest, automotive trade deficit — totaling less than \$1 billion in 2013. Canada does export some finished vehicles to these offshore markets (including central and eastern Europe, Russia, some countries in Asia, and South America). Those exports were worth over one-half billion dollars in 2013: not huge, but larger than our minuscule exports to the EU, Japan, and Korea combined. According to data published by *Ward's Automotive*,²⁴ Canada exported over 70,000 finished vehicles to offshore (ie. non-NAFTA) markets in 2013, or about 3 percent of total Canadian output. The Ford Edge manufactured in Oakville is the most important of these exported vehicles, accounting for about half of total offshore exports of Canadian-assembled vehicles. Almost none of the exported vehicles, however, were sold in the EU, Japan, or Korea — not surprisingly, given the dominance of home-grown vehicle production in those markets.

Could vehicle exports to offshore (ie. non-NAFTA) destinations play a more important role supporting production, employment, and investment in Canada's auto industry in the future? This would certainly help to diversify demand for Canadian products. Some concrete measures which might support greater offshore exports include support for export-oriented transportation and shipping infrastructure (right now it is complex and expensive for vehicles made in southern Ontario to reach offshore shipping ports); financial support for the development of export-oriented versions of Canadian-made vehicles (including features such as right-hand drive); more concrete and aggressive efforts by government to support OEMs in developing

offshore marketing and distribution systems for Canadian-made vehicles; and fiscal tools such as duty remission schemes to enhance the business case for exporting offshore. The most likely destinations for these efforts would be those jurisdictions (like those falling within the “Other” category of *Table 1*) which are *not* major automotive producers themselves. If the Canadian government were serious about promoting offshore automotive exports, therefore (and this is indeed a worthy goal), those are the sorts of measures it would be pursuing – rather than mechanically signing FTAs with existing automotive powerhouses (Europe, Japan, and Korea) which already enjoy an overwhelming dominance in bilateral auto trade relations.

Corporate Interests and National Interests

As we have seen, Canada’s auto assembly sector is 100 percent owned by global OEMs which naturally have their own views and preferences regarding what is best for their shareholders. In this regard, Canadians and Canadian policy-makers must be able to develop their own analysis of what policy changes are likely to enhance production and investment in Canada’s industry, regardless of whether those changes are preferred or endorsed by the OEMs. If FTAs allow global companies to service Canadian consumers more profitably from other jurisdictions (instead of producing here), then the affected companies may indeed endorse those changes.²⁵ But that endorsement hardly confirms that those FTAs would indeed strengthen Canadian auto manufacturing footprint (as distinct from enhancing the profitability of a set of global corporations).

These potentially conflicted interests are most obvious regarding the statements of Canadian automotive importers (such as the Global Automakers of Canada association, most of whose members have no manufacturing presence in Canada at all). This organization has endorsed the Canada-EU CETA, and called on the Canadian government to quickly settle trade agreements eliminating tariffs on imports from other auto-producing jurisdictions – in the interests of creating a “level playing field.”²⁶ Their interest is transparently in facilitating a larger flow of (tariff-free) vehicle imports to Canada. That may be good for GAC-member companies, but obviously not necessarily for Canadian manufacturing.

But a similar mixing of corporate self-interest with policy advocacy is apparent in the stated views of other auto industry participants, even those with production facilities here. For example, the Japan Automobile Manu-

facturers Association of Canada (which includes the Canadian divisions of Toyota and Honda) recently stated their support for the Canada-Korea FTA — an idea they had previously opposed (since it would undermine the competitive position of Toyota and Honda in certain vehicle segments targeted by Korean importers).²⁷ That position, however, was tied to the Canadian government’s commitment to negotiate a parallel FTA with Japan, thus allowing those firms to import their *own* products more cheaply to Canada, as well (once again citing the principle of a “level playing field”). Similarly, the Canadian division of General Motors also gave cautious support to the Canada-Korea deal; this position at least partly reflected its status as an importer of vehicles to Canada from its wholly-owned Korean subsidiary (Daewoo). In contrast, Ford Motor Co. of Canada opposed the Korea FTA, but strongly supported the CETA with the EU. Ford, in turn, is a significant importer of finished vehicles and engines to Canada from Europe, a flow which will directly benefit from the bilateral elimination of tariffs. (At least Ford also emphasized the possibility of expanding offshore exports of Canadian-made vehicles under the European deal — a prospect which has not even been addressed by most other industry commentators.) In every case the positions taken by the Canadian subsidiaries will reflect, first and foremost, the global corporate interests of the parent company. In that regard, OEMs are practicing their own “strategic” trade policy, rather than ever endorsing trade liberalization as a general goal on principle. Those corporate strategic interests may or may not coincide with the interests of Canada in maintaining a vibrant and sustainable auto manufacturing sector.

In other words, the completely foreign-owned nature of the auto assembly sector means that the well-being of global OEMs (even those present in Canada right now) and the well-being of Canadian automotive manufacturing cannot be assumed to be identical. More broadly, of course, global corporations have a general interest in the role of FTAs in cementing business freedom, investors rights, and various other institutionalized corporate protections (such as stronger enforcement of intellectual property and special quasi-judicial investor-state dispute settlement mechanisms), so the general support of these global corporations for NAFTA-style FTAs is also predictable and self-interested. Canadian policy-makers need enough independent information, analysis, and bargaining power to ensure that trade policy does indeed promote the ultimate goal of greater Canadian economic activity, including in strategic sectors like auto. The assumption that what’s good for business, will be generally good for Canadians, is no more true in the automotive sector than in any other part of the economy.

Automotive Provisions of the New Free Trade Agreements

New FTAs with auto-producing offshore jurisdictions (like Europe, Korea, and Japan) would have several implications for Canadian automotive manufacturing. Auto-related provisions of these agreements will include the following:

- **Locking in unrestricted market access:** It may seem obvious, but an important dimension of the FTAs is to lock in full access to bilateral markets for importing companies, regardless of any trade imbalances or economic dislocation. This will constitute a significant qualitative step for Canada in trade policy as it affects the auto industry. Remember, Canada had a tariff-free (but managed) bilateral trade relationship with the U.S. under the Auto Pact, that established an integrated production framework that still exists today. The Canada-U.S. FTA initially grandfathered those provisions. Mexico's integration into NAFTA affected the balance of costs and benefits unfavourably for Canada, as noted above. But *these new FTAs will represent the first time unconditional market access will be granted to offshore automotive jurisdictions with no requirement or meaningful expectation of proportional Canadian production benefits*. In other words, the new FTAs will effectively lock-in auto trade relationships that are enormously unbalanced, to the point of being one-way in nature. The use of trade policy to moderate those imbalances (as is regularly done in other jurisdictions, such as Brazil, Russia, China, and even the U.S., and as has been done in the past by Canada) will be prohibited. This is an important consequence of the new FTAs for the Canadian auto industry that has been little discussed — perhaps because trade negotiators have implicitly accepted the current imbalances as a permanent and inevitable feature of Canada's automotive trade. That resignation to perpetual and damaging bilateral trade imbalances is not taken for granted in other jurisdictions, nor should it be in Canada's case.
- **Mutual elimination of tariffs:** Tariffs on bilateral trade in vehicles and parts will be eliminated over some transition period (ranging up to several years). Canada has a 6.1 percent tariff on imported vehicles, but no tariff on imported parts. The EU has a 10 percent tariff on imported vehicles, while Korea has an 8 percent tariff. Japan has no tariff on imported vehicles. All three jurisdictions impose a range

of tariffs on imported auto parts. The elimination of tariffs will have an incremental impact on trade flows going in both directions, although the deeper structural determinants of trade and investment relationships (described above) will continue to be most important in shaping future trade patterns.

- **Rules of origin:** A standard provision of preferential regional trade agreements (like FTAs) is a set of rules governing the domestic content required in a product before it qualifies for preferential access to the FTA partner's market. These rules are intended to prevent transshipping, "kit assembly," and other strategies aimed at taking unfair advantage of the preferential access provided under the FTA. The stronger are the rules of origin, the more protection is afforded to domestic production in the many parts and components that are inputs to a finished vehicle. On the other hand, unintended consequences of particular rules of origin can arise in ways that negatively impact Canadian producers. For example, negotiators of the EU-Canada deal confronted a structural asymmetry in rules of origin resulting from the fact that the automotive supply chain within Canada (a single country) was necessarily more limited than exists in the EU (an entire continent), making it much harder for a Canadian-assembled vehicle to meet any given rule of origin threshold. To avoid this negative consequence, the proposed CETA includes a "derogation" provision which allows Canada to export a certain number of vehicles to the EU each year with a lower domestic content (20 percent instead of 50 percent).²⁸
- **Investment protections:** Foreign investments made by companies in either direction will be protected under the now-standard provisions of FTAs regarding national treatment, intellectual property, investor-state dispute settlement (ISDS), and others. Since Canada and the developed auto-producing countries (Europe, Japan, and Korea) already have strong and stable legal regimes, these provisions are unlikely to have much direct effect on future auto investments. But the long-run impact of anti-democratic FTA measures like ISDS on the general direction of economic and social policy should not be underestimated.
- **Standards and non-tariff barriers:** Trade negotiators also address the impact of government regulations and rules on ease of access

to bilateral markets. This may include measures aimed at reducing so-called “non-tariff barriers” to imports. These can include measures which indirectly limit imports (such as Korean taxes which impose rising and ultimately punitive taxes on vehicles with larger engines — with the effect of penalizing imports). It can also include measures with a more genuine regulatory motive, such as provisions governing vehicle safety, environmental performance, and other policy goals. FTA provisions may involve harmonization of those standards, mutual recognition of standards, or other ways of streamlining regulation so that importers can have more ready access to the domestic market without requiring additional investments in redesign. Participating governments will trumpet the importance of these regulatory or non-tariff measures, but they must be considered on a detailed case-by-case basis to evaluate whether they will have any significant impact on trade flows.

- **Safeguards and dispute settlement:** Modern FTAs in the NAFTA tradition include various provisions to monitor the implementation of the agreement, resolve disputes (typically through binding arbitration panels), and address concerns in the bilateral relationship that may arise over time. In some cases, more powerful safeguard measures are included to ensure that an FTA does not spark a damaging “surge” in imports and resulting economic dislocation. For example, the U.S.-Korea FTA contained a unique system of auto-related safeguards to address U.S. concerns that the already unbalanced auto trade relationship between those two countries would become even more one-sided after an FTA (and also to ensure that Korea accepted growing vehicle import flows from offshore). These safeguards included a “snapback” provision allowing for the re-imposition of U.S. tariffs in the event that Korean liberalization was not sufficient to allow increased penetration to that market by U.S.-made automotive products. (No similar provision is contained in the proposed Canada-Korea FTA.) Despite this measure, the growth of automotive imports to the U.S. from Korea has vastly outstripped the corresponding boost in U.S. exports to Korea.²⁹ As with measures addressing non-tariff barriers, the real effect of these “safeguards” (as opposed to their symbolic or political value) will need to be carefully evaluated on a case-by-case basis.

Judging the Impact of Trade Agreements on the Auto Sector

Considering these likely automotive provisions of proposed FTAs with major automotive-exporting jurisdictions, their potential impact on automotive manufacturing in Canada can be considered in the following steps:

1. Impact on bilateral exports and imports: Mutual tariff elimination should spark incremental growth in automotive trade in both directions. This effect could potentially be enhanced by measures addressing regulatory harmonization and/or non-tariff barriers (depending on how important these measures are in real practice). Also, in historical experience FTAs have tended to spark growth in bilateral trade larger than can be explained solely by the incremental impact of tariff reduction on relative prices (reflecting perhaps “gravity” effects or other causes). For all these reasons, both bilateral exports and imports of automotive products will likely grow after any FTA.³⁰ However, there are convincing reasons to expect that the increase in Canadian imports from those automotive jurisdictions will be much larger than the offsetting increase in exports going the other way. First, all three of the potential FTA partners (the EU, Japan, and Korea) enjoy a starting market share in Canada many times larger than Canada’s initial presence in their markets. A given proportional increment applied to each flow, therefore, implies a much larger absolute growth in Canada’s imports than our exports. Second, each of those FTA partners possesses a firmly-rooted domestic OEM sector, poised to directly take advantage of new export opportunities. Canada does not have any domestic OEMs, and any decisions regarding strategies to boost offshore exports in the wake of an FTA depend on decisions taken at the head offices of the global OEMs which operate here. Third, Canada’s new vehicle market has been considerably more expansionary than those in the other countries in recent years,³¹ and is likely to stay that way. Stronger domestic sales conditions automatically pull in more imports. Finally, Canada’s exchange rate has been trading at historically high levels for most of the last decade (and even after the decline experienced over the last year is still well above its estimated purchasing power parity equilibrium level³²). A disproportionately strong dollar will continue to undermine Canadian exports after an FTA with any of these jurisdictions. Canada’s tolerance of a strong currency is in sharp contrast to the policy stance in Europe and Asia, where governments have deliberately targeted lower exchange rates (achieved through monetary policy, currency market interventions, and other conduits) as part of a broader export promotion strategy.

2. Impact on bilateral automotive trade balances: Both exports and imports may grow, but it is very likely that bilateral imports will grow much more than exports. That will produce a widening of the existing bilateral automotive trade imbalances. This expectation is shared even by economic research commissioned by the federal government. For example, the Canada-EU Joint Economic Study predicted that the increase in automotive imports from the EU would be 2.5 times larger than the increase in exports back to the EU, boosting the existing bilateral deficit by some \$600 million.³³ Alternative estimates suggest the Canada-EU bilateral auto trade deficit would grow by much more.³⁴ Given the large existing imbalance, and the deep asymmetry in starting points, it is very likely that each of these FTAs will lead to even wider bilateral auto trade imbalances.

3. Impact on Canadian automotive output: Each FTA will therefore reduce net demand for Canadian automotive output, since new imports far outstrip new exports. There may be indirect effects of the FTA on automotive trade with other jurisdictions, however, which could reduce the eventual decline in Canadian output. Some of the new sales by European, Japanese, and Korean automakers in Canada could come at the expense of output from other jurisdictions. Government officials have emphasized this “trade diversion” effect, suggesting that the final contraction in Canadian automotive output will be smaller than the increase in bilateral trade imbalances. This line of reasoning is weak, for several reasons. First, trade diversion is generally considered to be a *drawback* of preferential regional trade agreements (in fact, according to WTO rules FTAs are only compatible with the multilateral trading system if trade creation effects are expected to dominate trade diversion effects). Perversely, however, Canadian trade officials now actually *highlight* trade diversion as a *positive* feature (trying to assuage concerns about bilateral auto trade imbalances). Even conventional economic theory acknowledges that trade diversion can reduce economic welfare (by shifting imported output from one source to another, less efficient, source). Secondly, since the government is simultaneously pursuing FTAs with *all three* of the major non-NAFTA automotive jurisdictions, the only remaining source from which imports could be diverted (thus protecting Canadian output) would be from within North America; yet those imports possess considerable Canadian value-added content (embodied in Canadian-made parts and other inputs). Indeed, if FTAs are implemented with Europe, Korea, and Japan in close succession, then the resulting market pressure will be felt most directly by North American OEMs (including their Canadian production, and

their output from the U.S. and Mexico). It is likely, therefore, that the decline in individual bilateral automotive trade balances which will clearly result from FTAs with any or all of these three auto-exporting powerhouses will indeed translate directly into reductions in Canadian automotive output and employment. A 2012 consultants' report commissioned by the Department of Foreign Affairs and International Trade confirmed that free trade agreements with any of the three automotive jurisdictions would result in reduced output and employment in the Canadian auto industry.³⁵

4. Impact on investment in Canadian facilities: This is the most important potential channel through which the Canadian auto industry could be affected by the new FTAs. As noted above, the Canadian assembly industry (and most of the parts sector, directly and indirectly) is fully dependent on continued inflow of foreign investment by global OEMs into Canadian facilities. The incremental loss of production resulting from the growth of bilateral automotive trade imbalances will result in some immediate decline in GDP, employment, and income in the Canadian auto sector. The bigger risk, however, is if that decline in turn undermines future decisions by OEMs regarding investment in Canadian plants. The decline in Canadian utilization and Canadian sales experienced by these OEMs will undermine the case for new investment. In this regard, it is not just the direct impact of new FTAs on Canadian-made vehicle production that is relevant. A negative impact on Canadian sales by OEMs present in Canada (even if some of those displaced sales were produced at plants outside of Canada) could further undermine their commitment to future Canadian investments. Not all the impact of the FTAs on investment decisions is necessarily negative. It is possible that incremental offshore export opportunities arising from FTAs could enhance the case for investment in Canadian facilities, if OEMs were genuinely interested in trying to penetrate offshore markets with Canadian-made vehicles. In the case of potential FTAs with Europe, Japan, and Korea, however, the potential to expand offshore exports from Canadian plants seems very limited.³⁶

Given the structure of Canada's automotive industry, and our trade and investment relationships with the rest of the world outside of NAFTA, it is virtually certain that trade liberalization with any or all of the major offshore auto-importing jurisdictions will produce a decline in net demand for Canadian-made automotive products, a loss of output, and a loss of employment. The only uncertainty is whether that negative effect will be large or small, and to what extent the decline in immediate output will eventually

translate into a decline in OEM investment in Canadian facilities. By pursuing FTAs on the basis of an assumption that trade liberalization always benefits both sides, rather than on the basis of a concrete sector-by-sector analysis of opportunities and threats arising from bilateral trade expansion, Canadian trade negotiators are rolling the dice with one of Canada's most important export industries.

Conclusions and Recommendations

The question facing Canada's auto industry is not whether trade is good or bad, and should be promoted or inhibited. That is a false choice presented by FTA advocates, who attempt to caricature and marginalize the arguments of FTA critics. As noted above, Canada's auto industry could not exist without strong international trade and investment relationships.

But the single-minded pursuit of free trade agreements modeled on the NAFTA template (featuring full market access, no requirements for proportional domestic content, and no link to future investment decisions) can only make Canada's already-poor automotive trade predicament even worse. FTAs with Europe, Japan, and Korea would cement and exacerbate existing bilateral imbalances, incrementally undermine Canadian automotive production, and have potentially severe consequences for future OEM investment decisions here.

Boosting Canada's automotive exports to non-NAFTA jurisdictions is a valid and important goal. But it is not at all clear that signing more FTAs (especially with these three auto-exporting giants) can further that goal at all — let alone generate gains in exports large enough to offset the resulting surge in offshore imports that is certain to occur after these deals. Instead, a more pragmatic and incremental approach should be taken, informed by the lessons of strategic trade policy, to boost offshore exports of Canadian-made vehicles and parts. First, the Canadian government needs to develop a better understanding of Canada's offshore automotive export potential. Which vehicles do we export right now, where, and in what quantity?³⁷ Where is there most potential for increasing those exports, and what barriers currently stand in the way? Those are more complicated analytical tasks than simply assuming that tariff elimination and the other provisions of FTAs will automatically boost our exports. Then the government should develop specific supports for automakers producing in Canada, to assist them in developing offshore market opportunities. These could include the development of export-oriented transportation infrastructure, subsidies for the de-

velopment of export-oriented features (including right-hand drive vehicles), and support for overseas marketing.

At the same time, the Canadian government should aim to link tariff elimination on automotive imports from offshore jurisdictions, to commitments by European and Asian automakers to invest in Canadian production opportunities. This is another hallmark of strategic trade policy, which has been forgotten by Canada's trade negotiators in their rush to sign new FTAs. Those investments by offshore OEMs could be made either independently, or through joint ventures arrangements with other firms already producing in Canada.³⁸ With this strategy the government could aim to offset the economic losses that will result from growing offshore imports. New output and employment in Canada would be created, through made-in-Canada vehicle assembly, parts manufacturing, or other production offsets, to balance the loss in output and employment resulting from greater imports. The entire postwar history of Canadian automotive policy (from the Auto Pact, to the successful recruitment of Toyota and Honda, to the financial rescue of General Motors and Chrysler in 2009) has recognized the central importance of leveraging more OEM investment here. Yet that goal is not visible in the current Canadian strategy to sign multiple FTAs.

Additional automotive protections and safeguards should also be integrated into future trade agreements, to ensure they offer mutual benefit and produce a balanced expansion of trade in *both* directions. These safeguards could include limits on bilateral imbalances in important sectors (like auto), and provisions addressing the impact of exchange rate misalignments on trade flows.³⁹

To be sure, these types of provisions represent a different vision of how to facilitate and manage trade, than has been reflected in the recent generation of bilateral FTAs (modeled on the unfortunate template established by the NAFTA). Yet there are precedents for all of these strategies in modern trade policy as practiced by many other countries (including, in various forms, three of the automotive jurisdictions discussed in this paper). And they would help to achieve a more balanced and mutually beneficial pattern of trade in this strategically important sector of the economy. In that regard, the approach suggested here is more compatible with the underlying ideals of trade — mutual exchange, to mutual benefit — than the current model of beggar-thy-neighbour competition which will be only cemented with the proposed new wave of FTAs.

Notes

1 To that end, see Unifor, “A Case of Economics Over Politics: Renewed Canada-Korea Trade Negotiations” (http://www.unifor.org/sites/default/files/documents/document/korea_briefing_kit_2014.pdf, January 2014), and a longer report by this author for the Canadian Centre for Policy Alternatives on the automotive implications of the Canada-EU CETA (forthcoming).

2 See especially *Rethinking Canada’s Auto Industry: A Policy Vision to Escape the Race to the Bottom* (Toronto: Canadian Auto Workers, April 2012, <https://d3n8a8pro7vhm.cloudfront.net/caw/pages/29/attachments/original/1335189435/554AutoPolicyDocumentweb.pdf?1335189435>), and *A Call for Action II: A Report by the Manufacturing Competitiveness Committee of the Canadian Automotive Partnership Council* (Ottawa: Industry Canada, 2013, <http://capinfo.ca/en/mcwgreport.html>).

3 See Kim Hill, Debra Menk, and Adam Cooper, *Contribution of the Automotive Industry to the Economies of all Fifty States and the United States* (Ann Arbor: Center for Automotive Research, 2010).

4 See Leslie Shiell and Robin Somerville, *Bailouts and Subsidies: The Economics of Assisting the Automotive Sector in Canada* (Montreal: Institute for Research in Public Policy, 2012), for detailed estimates of the fiscal benefits to governments from automotive manufacturing in Canada.

5 The complexity of automotive assembly is often under-recognized by casual observers. Assembling high-quality motor vehicles, especially with modern value-added features and on-board technologies, is still one of the most complex manufacturing operations undertaken, requiring high-quality labour, facilities, and management systems.

6 For example, there has been a notable migration of new investment in both continents toward lower-wage regions of the two continents: toward Mexico and the southern U.S. for North America, and toward central and eastern Europe for the EU.

7 This point is discussed further in Jim Stanford, “The Geography of Auto Globalization, and the Politics of Auto Bailouts,” *Cambridge Journal of Regions, Economies, and Society* 3(3) 2010, pp. 383–405.

8 In contrast to the 100% foreign-owned assembly sector, there are several Canadian-owned parts companies, some of them quite large (such as Magna and Martinrea). However, even the

Canadian-owned parts companies are dependent (at least in their Canadian operations) on the Canadian presence of foreign-owned OEMs.

9 Canadian Automotive Partnership Council (2013), *op. cit.*, p. 15.

10 Another possible component of automotive policy might be to encourage the development of a greater Canadian-owned presence in automotive assembly, either independently or through joint ventures with existing OEMs. This was one of the suggestions advanced by the former CAW (now part of Unifor) in its 2012 policy program, *Canadian Auto Workers* (2012), *op. cit.*

11 A detailed catalogue of these international practices is provided in *Canadian Auto Workers* (2012), *op. cit.*

12 Not only the traditional Detroit-based OEMs took advantage of this unique recipe; so did several heavy truck manufacturers and Sweden's Volvo. However, all those Auto Pact-inspired factories built by manufacturers other than the three Detroit OEMs have since closed in the wake of the elimination of the Auto Pact. A rich history of the Auto Pact and its effects is provided by Dimitry Anastakis, *Auto Pact: Creating a Borderless North American Auto Industry* (Toronto: University of Toronto Press, 2005).

13 So did the separate imposition of Canadian-content provisions governing both passenger cars and light trucks (including pickups, minivans, SUVs, etc.). The latter factor helps to explain why Canada is still relatively concentrated in those segments, although the extent of that concentration has weakened since the Auto Pact's abolition.

14 Even today, public health benefits reduce fully-loaded active labour costs in the assembly sector by around \$4–5 per hour of labour, compared to equivalent costs of private health insurance in the U.S.

15 Suzuki's investment was a joint venture with General Motors in Ingersoll, Ont., and is now solely-owned by GM.

16 The joint support provided by the federal and Ontario governments to the two companies in 2009 was contingent on each maintaining a proportional manufacturing footprint in Canada, equivalent to the share of financial support provided by the Canadian governments, for several years into the future. This policy was very effective in preserving Canadian facilities through the 2009 crisis, however it will expire in 2017.

17 The data portrayed in Table 1 and Figures 1 and 2 includes trade in assembled vehicles, parts, and truck and bus bodies.

18 Canada still assembles more light vehicles than are purchased in the Canadian market, however that surplus in finished vehicles is more than offset by a deficit in auto parts (which constitute the bulk of value-added in new vehicles).

19 Canadian Automotive Partnership Council (2013), *op. cit.*, p.15.

20 And if the outflow of investment income associated with automotive FDI in Canada back to U.S. owners is considered, then the overall relationship is even more balanced.

21 The focus on higher-end vehicles also explains how European OEMs can profitably produce vehicles while paying labour costs that are significantly higher than in Canada.

22 Chrysler has the least extensive global network of assembly plants. Perhaps it is for that reason that Chrysler has been the most ambitious OEM in investing in the development of offshore sales of North American-made vehicles, especially iconic brands such as Jeep and minivans. Even that may change, however, as Chrysler's operations are more fully integrated with Fiat.

23 Another successful policy for China has been linking liberalization of incoming FDI in the auto sector with the requirement that global OEMs produce in China through joint-venture partnerships with Chinese-owned companies. This policy facilitates the transfer of technology and manufacturing expertise which is now contributing to the emergence of a more capable and globally-oriented Chinese-owned auto industry, which will more aggressively aim to penetrate export markets in the years ahead.

24 See *Ward's U.S./Canada Car and Truck Exports 2012*, which provides a model-by-model breakdown based on shipping records of North American offshore vehicle exports. For models manufactured in both Canada and the U.S., the report does not distinguish country of origin.

25 In addition, automotive OEMs, like other large corporations, will generally favour the institutional features of NAFTA-style FTAs which generally strengthen and protect the rights and powers of corporations, including stronger intellectual property rules, special courts for investor-state disputes, and similar measures.

26 "Statement on the Canada EU Comprehensive Economic Trade Agreement (CETA)", <http://www.globalautomakers.ca/index.html>.

27 "Japanese Automakers in Canada Congratulate Government of Canada on Signing Canada-Korea FTA," <http://www.jama.ca/aq/news/index.asp#A201403110>.

28 This has been interpreted by CETA advocates as a special "advantage" for Canada, but in fact it merely avoids a negative asymmetry that would otherwise have eliminated any advantage to Canadian vehicle exports to the EU under the deal. The provision has been described by EU negotiators as being of "political rather than economic importance," allowing the Canadian government to present the automotive provisions of CETA as balanced; it does not guarantee any increase in Canadian vehicle exports to the EU at all. See "EU Canada Comprehensive Economic and Trade Agreement — update on state of play in key negotiating areas," European Commission Directorate-General for Trade, June 5, 2013, p.1.

29 During the first two years of the U.K.-Korea FTA, the growth of new automotive imports to the U.S. from Korea was 22 times larger than new U.S. automotive exports going back to Korea. See Unifor (2014), *op. cit.*

30 In the case of Canada-Japan free trade, since Japan has no tariff on vehicle imports it is hard to imagine why there would be any increase in Canadian exports there at all.

31 New vehicle sales in Europe and Japan, in particular, have declined in recent years, reflecting poor macroeconomic conditions, demographic ageing, and other factors.

32 According to the OECD, the PPP fair value of Canada's dollar is 81 cents (U.S.), about 10 percent lower than trading levels at time of writing. See OECD, "Purchasing Power Parities for GDP," available at OECD.stat.

33 European Commission and Government of Canada, *Assessing the Costs and Benefits of a Closer EU-Canada Economic Partnership* (Ottawa: Department of Foreign Affairs and International Trade, 2008). Both the modeling assumptions and benchmark data of that study are open to serious question, and it probably underestimates the true imbalance that would result; see Jim Stanford, *Out of Equilibrium: The Impact of EU-Canada Free Trade on the Real Economy* (Ottawa: Canadian Centre for Policy Alternatives), 2010, for a detailed discussion.

34 Stanford (2010), *op. cit.*

35 Johannes Van Biesebroeck, Hang Gao, and Frank Verboven, "Impacts of FTAs on Canadian Auto Industry," Prepared for DFAIT Canada, June 29, 2012.

36 This argument has been made especially regarding the Canada-EU deal. But with the exception of Ford there has been little expression of intent by OEMs present in Canada that actually foresee exporting additional vehicles to the European market, even if EU tariffs were eliminated.

37 Strange as it may seem, Canadian trade negotiators cannot answer these questions today. There are vast discrepancies between our own Canadian data on offshore auto exports, and those produced by the countries we are negotiating FTAs with, and Canadian officials have compiled no detailed information on the composition of our existing auto exports – let alone the real potential that may or may not exist to expand those exports through FTAs.

38 Volkswagen's former contract manufacturing arrangement with Chrysler in Windsor is an example of how this type of arrangement can be feasibly attained even at relatively smaller scale of production.

39 This would be especially important to Canada given the experience with a highly over-valued exchange rate in recent years, in contrast to policies in Europe, Japan, and Korea which have suppressed their respective exchange rates and hence supported exports.



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