



Re-thinking Canada's Auto Industry: A Policy Vision to Escape the Race to the Bottom

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Summary

Canada's auto industry has endured incredible economic turbulence in recent years. It was under pressure for years, in the face of growing imports, pressure from low-cost foreign jurisdictions (like Mexico and the deep south of the U.S.), and declining market share for North American-based automakers. Then came the global financial crisis, the resulting plunge in vehicle sales, and a historic make-or-break moment for the North American industry. The Detroit Three survived this unprecedented meltdown (two with government-supported restructurings), and now the industry is clawing its way back. Canada's share of continental vehicle production and employment actually grew during the crisis – largely thanks to effective measures by the federal and Ontario government to protect the Canadian manufacturing footprint through the industry's restructuring.

The recent stability in the industry is welcome, however it is clear that Canada's auto industry is not out of the woods yet. Global pressures on the industry are more severe all the time. Corporate executives are more aggressive, even ruthless, in using their power to relocate investment in order to extract continual belt-tightening from workers, suppliers, and governments alike. The recent events at the former Caterpillar locomotive plant in London, Ontario (where a giant global corporation, enjoying record profits, closed a profitable Canadian facility after its workers refused its demand for a 50 percent cut in compensation) highlights the risks Canadians face in a world in which global corporations are given free reign, with no accountability or obligation to the communities in which they earn their profits. Auto executives, despite an impressive rebound in profitability and strong growth in continental vehicle sales, continue to demand dramatic reductions in future compensation and working conditions from their Canadian workers, on threat of disinvestment. The take-off of Mexico's auto industry, the prospect of new free trade agreements with dominant auto producers (like Japan, Korea, and the EU), and the continued overvaluation of the Canadian currency all heighten the challenges as Canadian auto stakeholders seek to cement future rounds of crucial investment in our plants and products.

This paper reviews the current condition and future prospects of Canada's auto industry. Despite the down-

sizing of recent years, the auto industry still makes a vital contribution to Canada's income, productivity, exports, and innovation. Given worrisome trends in our national performance on all these criteria (evidenced by flagging business investment, innovation, and productivity growth), we can ill afford to lose even more of our foothold in this uniquely valuable industry. The report catalogues the numerous spin-off benefits resulting from automotive manufacturing – including the fact that each job in a major auto facility now supports a total ten jobs throughout the regional and national economy. It reviews the effects of the unprecedented 2009 restructuring of General Motors and Chrysler, showing that Canadian governments (and taxpayers) have actually fiscally benefited from those interventions – which produced stronger budget balances than if government had stayed out of the picture.

The paper considers in detail the impacts of a Canadian dollar which has been driven by petroleum-obsessed financial investors to levels far above its fundamental fair value. Canadian auto workers are paid less (in real consumption terms) than autoworkers in the U.S. and other leading automotive producers, but we look more expensive solely because of the distorted currency; what should be a labour cost advantage for Canada is converted into an apparent cost disadvantage because of speculative financial pressures in oil futures and foreign exchange markets. The overvaluation of the loonie (relative to purchasing power parity benchmarks) imposes a continuing \$3.7 billion annual penalty on domestic value-added in auto manufacturing. This is an enormous burden which the industry cannot continue to shoulder; concerted efforts to bring the currency into line with its real value, along with pro-active strategies to offset the side-effects of overvaluation on auto producers, must feature centrally in any strategy to strengthen this industry into the future. Other global forces have also impacted negatively on the industry's ability to confirm future investments. One-way trade inflows from Mexico, Japan, the EU, and Korea have converted Canada's once-proud automotive trade surplus into a massive, job-destroying deficit. Since Canada can no longer rely on large surpluses with the key U.S. market to cross-subsidize these deficits with all other trading partners, we must adopt a new approach to

facilitating balanced, mutually beneficial automotive trade with these jurisdictions.

The paper concludes by describing in detail a proposed new policy vision that would allow Canada to maintain a profitable, viable, dynamic auto manufacturing industry for decades into the future. Our ten-point policy proposal (see sidebar: ***Re-thinking Canada's Auto Industry***) would mark a significant conceptual shift from the hands-off approach which has governed Canadian economic and industrial policy during most of the past quarter-century. However, our proposals, while innovative in the Canadian context, are neither utopian or untried. Every proposal contained in our strategy has been successfully implemented in other auto-producing jurisdictions (where governments have been more pro-active than Canada in building a strong domestic foothold in auto manufacturing, as well as other key high-tech export industries). And every proposal in our strategy is "legal" under the terms of Canada's existing trade agreements (although we also call for important changes in those agreements). If other countries can pursue pro-active strategies like the ones we propose (including automotive success stories like Korea, Brazil, Germany, China, and even the U.S.), then Canada can and must do the same.

In other words, there is no excuse for inaction on the part of our governments in the struggle to protect Canada's share of this industry, the decent middle-class jobs which it provides, and the enormous spin-off ben-

efits it generates through our communities and our entire national economy. The global "race to the bottom," through which workers in any country are told to accept poverty-level living standards or else lose their jobs altogether, is neither "natural" nor inevitable. Corporations can make these demands today only because governments have organized the rules of the game to give them complete freedom and power. This was done with the promise that all would share in the resulting "trickle-down" benefits. That has not occurred – and Caterpillar's ugly demands are merely the most extreme, and most offensive, manifestation of a policy approach which will continue to drive down the living standards of Canadians until we change course.

We believe that appropriately managed, the auto industry can and should continue to make an important contribution to our employment prospects, our prosperity, our communities, and our environment. The motor vehicle will continue to play a central role in our transportation choices for the foreseeable future (although the *nature* of vehicles will obviously change, to reflect technology, consumer preferences, and environmental considerations). Canadians deserve a fair share of the jobs and prosperity that come with manufacturing the products that we continue to buy, in large numbers. This policy vision, which fundamentally re-thinks how we approach industrial strategy in a globalized economy, would allow us to do just that.

It's about our community.

Re-thinking Canada's Auto Industry: A New Policy Vision

In this document the CAW maps out a ten-point strategy to support a vibrant, dynamic, and profitable auto industry in Canada long into the future.

1. Implement an Integrated National Auto Policy
2. Negotiate Canadian Manufacturing Footprint Commitments
3. A Consistent and Transparent Auto Investment Program
4. Public Minority Equity Shares in OEMs
5. Investigate Possibility of Building a Canadian OEM
6. Rethink Automotive Trade Policy
7. Intervene to Reduce the Canadian Dollar
8. Building a Green Auto Industry
9. A Buy-Canadian Vehicle Procurement Strategy
10. Investing in Human and Physical Infrastructure

Together these policies would ensure that Canada maintains a fair share of the decent jobs and prosperity generated by our own purchases of motor vehicles.

RE-THINKING CANADA'S AUTO INDUSTRY: A Policy Vision to Escape the Race to the Bottom

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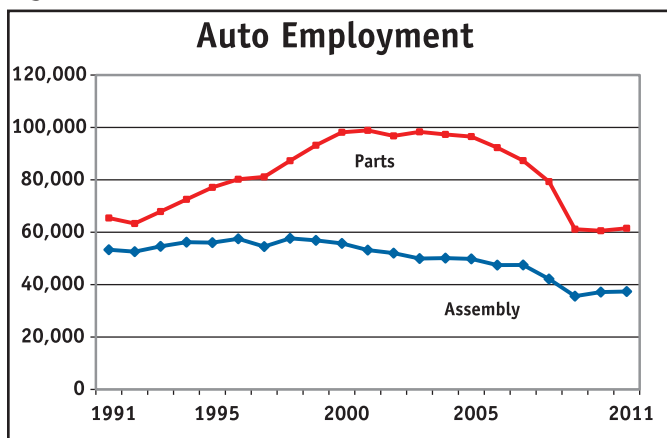
PART I: To Hell and Back – Canada's Auto Industry After the Crisis

It's not news that Canada's auto industry fell on very tough times during the past decade. A visit to any major manufacturing community in the corridor along Ontario's Highway 401 – the artery running from Windsor in the southwest past Oshawa in the east, that is like the "spinal column" of the Canadian industry – readily attests to the scale of economic and social dislocation that has been experienced, as one of Canada's premier export industries entered a sustained, but preventable, decline. The storm clouds had been gathering for years, beginning around the turn of the century. That was when rising global commodity prices, a soaring Canadian currency, and growing offshore vehicle imports to North America all combined to knock the wind out of the sails of Canada's once-unstoppable auto sector. In 1999, Canada ranked as the 4th largest auto producing jurisdiction in the world – an astounding achievement for a country of our size. Within a decade, however, we had fallen right out of the top ten, surpassed by numerous countries, rich and poor alike: by Korea and Mexico, France and Brazil, and (of course) by China and India. With the onset of the global financial crisis in 2008, followed by a bitter worldwide recession (felt particularly acutely in the U.S., the destination for most of our automotive output), a decade of gradual decline risked being transformed into outright collapse.

Figure 1 illustrates the decline in auto manufacturing employment in Canada over the past decade. Following strong growth in both assembly and independent parts production in the 1990s, employment peaked and began to decline slowly.

Canadian employment in the vehicle assembly sector

Figure 1



Source: Statistics Canada, CANSIM Table 281-0024.

peaked in 1998. Over 10,000 jobs were lost by 2007 (as the loonie took flight and the domestic market share of North American producers eroded). This decline accelerated dramatically with the global financial crisis: another 12,000 jobs were lost in 2008 and 2009 alone. In the parts sector, meanwhile, almost 40,000 jobs have been lost since the industry's peak in 2003, most between 2005 and 2009.

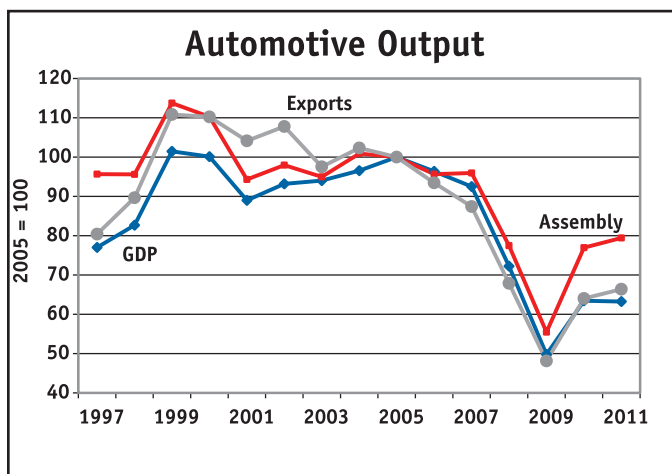
Thankfully, employment in both sectors stabilized after 2009, in large part thanks to extraordinary measures on the part of the federal and Ontario governments (in conjunction with the U.S. government) to prevent outright industrial collapse in the sector. While it's certainly better that jobs are no longer disappearing, very few of the jobs lost up to 2009 have been won back. On the assembly side, only a small share of jobs (about 2000) has returned; on the parts side, meanwhile, hardly any jobs have been regained. In total, about 100,000 Canadians are presently directly employed in auto manufacturing – down by over 50,000 (or one-third) since the turn of the century. Another 13,000 Canadians work in the manufacture of truck and bus bodies.

These direct figures, of course, only tell part of the story of the employment impacts of this industry. Economic studies now suggest that for every job in a major auto facility (like vehicle or powertrain assembly

operations), a *total of ten* jobs are supported throughout the regional and national economy. Considering indirect and spin-off effects (that are described fully in Part III of this paper), therefore, the true number of Canadians owing their employment to automotive manufacturing is closer to 400,000.

Data on output and exports tell a slightly more optimistic story about the industry's rebound since 2009 than the employment numbers do. Figure 2 illustrates the proportional changes in real value-added (GDP), number of vehicles assembled, and the value of automotive exports, from 2005 through 2011 (with the base year set to 100 in each case). By 2009 industry output had collapsed (according to all three measures) to levels just half those recorded in 2005. Since then, the indus-

Figure 2



Source: CAW Research from Statistics Canada, CANSIM Table 379-0027; Industry Canada Strategis database; Ward's Automotive.

try has clawed back close to half the ground it lost between 2005 and 2009. The rebound has been somewhat stronger in assembly, than in overall value-added and exports (since the parts sector has not rebounded as strongly as vehicle assembly).

Productivity is very strong in auto manufacturing. This implies that (absent policies aimed at shortening the work week, which have been fiercely resisted by employers in recent years) auto employment may normally decline gradually over time due to technological change and improved efficiency: in essence, the industry can produce the same output with fewer workers. The sharp decline in employment since 2005 does not reflect pro-

ductivity growth, however: it reflects more urgent cyclical and structural factors. The initial decline in employment during the crisis was not as steep as the contraction in output (since employers, in a downturn, cannot usually cut staff as quickly as they reduce output). By the same token, therefore, the rebound in employment numbers since 2009 has been weaker than the rebound in output. Nevertheless, by any indicator, Canada's auto industry has been to hell and back: the crisis of the last decade (culminating in the freefall of 2008 and 2009) was the most dramatic and violent since the 1930s. Today the industry has stabilized, having lost about one-third of its jobs and output since the turn of the century.

The financial crisis and subsequent recession were felt worldwide, of course, and in every country the auto industry was a barometer of the coming downturn. Auto sales tend to be cyclically sensitive: outperforming the economy during strong years, but doing worse than the overall economy in times of troubled confidence (as fearful consumers defer major discretionary expenditures, like purchasing a new car). Canada was not alone in

Table 1
Global Auto Production Through the Crisis

	Vehicle Assembly		Change
	2007	2010	
U.S.	10,752	7,743	-28.0%
Canada	2,579	2,068	-19.8%
Mexico	2,095	2,342	11.8%
Brazil	2,971	3,648	22.8%
Germany	6,213	5,906	-4.9%
Spain	2,890	2,388	-17.4%
France	3,016	2,219	-26.4%
U.K.	1,750	1,393	-20.4%
Italy	1,284	836	-34.9%
Russia	1,672	1,404	-16.0%
Other E. Europe	3,549	3,357	-5.4%
Japan	11,596	9,626	-17.0%
Korea	4,086	4,272	4.6%
China	8,885	18,265	105.6%
India	2,250	3,554	58.0%

Source: CAW Research from Ward's Automotive.

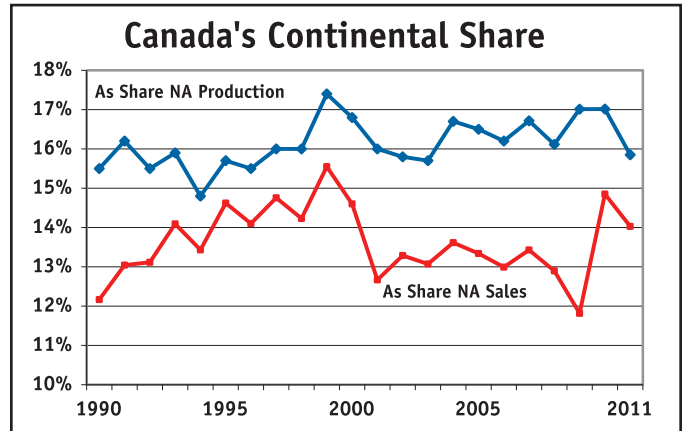
experiencing a shock to its auto industry during this period – although several structural features of our industry (including our total reliance on foreign investment, the soaring value of our currency, and the relatively passive policy response of our governments) made our auto sector particularly vulnerable. Table 1 summarizes the change in motor vehicle output experienced in the major auto-producing jurisdictions around the world through the worst years of the downturn.

Canada’s decline between 2007 and 2010 in vehicle assembly was just under 20 percent. That was considerably less severe than the decline in U.S. motor vehicle output in the same time. Mexico, however, managed to increase its production, on the power of an accelerating migration of investment by automakers to take advantage of that country’s ultra-low labour costs and unfettered access to the rest of the North American market. Most other industrialized countries experienced a decline in production in line with Canada’s during this time, including most of Western Europe, Japan, and Russia. Germany and Korea represent exceptions to this trend. On the strength of outbound exports and strong, pro-active government support in both jurisdictions, the decline in German assembly output was relatively small (only 5 percent between 2007 and 2010) – while Korea’s production actually expanded. In the emerging economies (including Brazil, India, and China), output continued to grow – more than doubling, incredibly, in China between 2007 and 2010.

In the broader context, therefore, Canada’s production decline was on par with that experienced in other OECD countries, and less severe than in the U.S.¹ Mexico’s production, meanwhile, is growing strongly. An implication of these relative comparisons is that despite the painful absolute decline in Canadian production and employment, Canada’s share of the North American market has been stable through the crisis and its aftermath. As Figure 3 illustrates, Canada has maintained its share of

total North American vehicle assembly at around 16 percent right through the crisis and the recovery.² The Canadian manufacturing footprint agreements negotiated between Canadian governments and GM and Chrysler

Figure 3



Source: CAW Research from Ward’s Automotive.

(the two largest assemblers in Canada) as part of their 2009 restructuring (discussed further below) were important in preserving Canada’s share of continental output.

Moreover, this ratio (of Canadian assembly to North American assembly) actually understates the improvement in Canada’s relative position during this time. If we measure Canadian output as a proportion of North American *sales* (rather than as a proportion of North American *production*), Canada’s market share actually increased through the crisis – thanks to a modest but important decline since 2010 in the import penetration of the continental market. The decline in imports largely reflects the rise of the Japanese yen, the tsunami disaster in Japan, and the improved customer appeal of North American-made products. As also indicated in Figure 3, therefore, Canadian-assembled vehicles increased their share of the North American sales market by 2 full percentage points between 2009 and 2011.

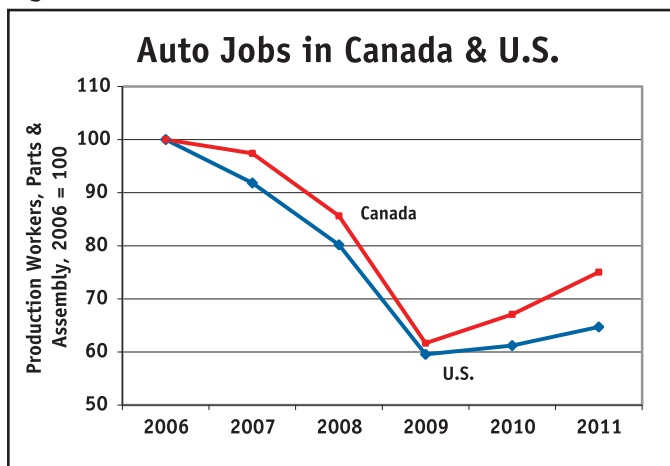
Similarly, relative to U.S. job losses, the downturn in Canadian auto manufacturing employment was also somewhat less severe. Figure 4 compares the trends in

¹ Here is another way to make the point that while the auto industry’s crisis in Canada was horrible, things were even worse in the U.S.: the depressed 2009 level of auto assembly in the U.S. was the lowest recorded by that country since 1958. In contrast, Canada’s assembly that year was “only” the lowest since 1982!

² Canada’s continental production share actually reached a near-record high in 2010, at 17 percent. The subsequent decline in Canada’s share of continental production in 2011 mostly reflects supply-chain problems at Honda and Toyota in the wake of the Japanese tsunami and (for Honda) floods in Thailand; both companies have disproportionately large operations in Canada that were badly affected by these events.

hourly (production) employment in both parts plants and assembly plants, using 2006 as the base year. While the decline in Canadian employment during this time was catastrophic, the rupture in U.S. employment levels was even worse. Just under one-quarter of shopfloor auto jobs in Canada were lost in the five years after 2006, versus a decline of one-third in the U.S.³ It is worth emphasizing that this occurred despite anti-labour

Figure 4



Source: CAW Research from Statistics Canada, CANSIM Table 281-0024, and U.S. Bureau of Labor Statistics, Current Employment Survey,

measures in the U.S. that have been claimed to have contributed to greater job retention there: such as two-tier wage agreements which sharply reduce compensation for new hires at unionized assembly plants, and the continuing migration of investment by offshore manufacturers toward southern states (where so-called “right-to-work” laws effectively prohibit unionization altogether). Despite these measures (both of which will undermine long-run prosperity among middle-class families in the U.S.), Canadian auto employment has actually held up better, and rebounded more strongly, than in the U.S.

Another indicator of the Canadian auto industry’s troubled decade has been the unprecedented contraction in its physical footprint here. Canada lost two more light vehicle assembly plants during the years since the financial crisis hit: the General Motors pickup truck plant in Oshawa (closed in 2008), and the Ford car assembly plant

in St. Thomas (closed in 2011). This brings to 5 the number of light vehicle final assembly plants closed in Canada since the turn of the century.⁴ During this period, one new assembly plant was opened here (Toyota’s second Canadian assembly plant, in Woodstock), leaving Canada a net minus 4 in assembly plants over the decade (with the total assembly plant count falling from 14 in 2001, to 10 today). General Motors has plans to shutter its Consolidated assembly facility in Oshawa in 2013, thus adding to an already painful toll. In addition to the loss of these crucial assembly plants, Canada’s auto parts industry has been hammered with several dozen plant closures over the same time. A related dimension of the industry’s crisis over the last decade (one that does not get its share of public attention or concern) has been the devastating retrenchment in Canada’s once-successful heavy truck manufacturing sector. Two heavy-truck assembly operations were closed in the wake of the financial crisis (the Sterling plant in St. Thomas and the Navistar plant in Chatham – with both companies shifting production to Mexico), meaning that Canada has lost 4 major vehicle assembly operations (two light vehicle and two heavy truck) since the financial meltdown began.

It is interesting in this regard to compare Canada’s sorry record of automotive plant closures with other major jurisdictions, which apparently place a stronger value than Canada on preserving these crucial facilities. For example, in all of Western Europe (a jurisdiction with ten times Canada’s population and economy), just two light vehicle assembly plants were closed during the entire financial crisis and its aftermath (a GM/Opel plant in Belgium, and a Fiat plant in Sicily) – even though the impact of the crisis on European auto sales was as severe as in North America, and the European economy has in fact recovered more slowly (due to the subsequent sovereign debt crisis). In Germany, a country where labour costs are higher than Canada’s, no assembly plant has closed since the end of the Second World War. These jurisdictions recognize that the permanent closure of an assembly plant will impose an enormous, ongoing cost

³ Considering *all* employees, including salaried staff, the Canadian employment numbers have still been more stable than in the U.S., although not by as large a margin. This is because the U.S. industry possesses a larger share of white-collar employees (whose jobs are generally not as insecure during a downturn) by virtue of the U.S. head offices of the automakers and many parts suppliers.

⁴ The others included GM’s car plant in Ste. Therese, Quebec; the Chrysler panel van plant in Windsor; and the Ford pickup truck plant in Oakville.

on the national economy, and hence take extraordinary measures to preserve these “keystone” facilities. Preventing plant closures in Europe is further assisted by the fact that worker representatives are legally entitled (under EU labour laws) to play a role in key management decisions, as well as by Europe’s stronger employment protection rules (which make it extremely expensive, as much as 500 million euros in severance and adjustment costs, for a company to close a large factory). The result is a much higher degree of stability in the physical manufacturing footprint. For example, Ford Motor Co. has not closed a West European vehicle assembly plant since ceasing assembly at its Dagenham, U.K. plant in 2002 (and that complex was then re-tooled to produce more engines, instead). During the same time, however, the company closed nine of its North American assembly plants (including two in Canada). Stronger employment protection rules clearly help to explain why a company like Ford has downsized so much more dramatically in North America than in Europe. Plant closures are also very rare in Japan and Korea.

In this regard, the greater “flexibility” of employment and investment relationships in Canada (whereby manufacturers can easily close facilities, regardless of the resulting costs imposed on workers, communities, and even governments) means that our economy has endured a proportionately more painful contraction in its auto manufacturing footprint than if there was more structural protection for crucial assembly plants (and the network of components suppliers which each assembly plant supports). Even temporarily idling a plant during a cyclical downturn is vastly preferable to closing it permanently; at least idling maintains the option of reopening the facility when market conditions recover.

The most dramatic manifestation of the 2008-09 crisis was the descent into near-bankruptcy by the three major North American-based automakers. All three (General Motors, Ford, and Chrysler) entered the crisis weighed down by years of large losses (reflecting eroded market

share, surging offshore imports, and the resulting weight of excess capacity and higher unit costs). In autumn 2008, in the initial months of the financial crisis, continental sales plunged by more than half, reflecting shocked consumer confidence and frozen credit markets. With liquidity evaporating, all three companies initially appealed for government assistance. Ford subsequently opted to go it alone (assisted by a reserve of liquidity fortuitously raised in 2006 to finance a large restructuring plan) – although it has received billions of dollars in financial assistance from the U.S. government through other channels (including large investment subsidies from the Department of Energy). By the end of the year, General Motors and Chrysler both would have collapsed without injections of emergency government support. Following some months of negotiation, a government-supported restructuring plan under U.S. bankruptcy law was finalized in the spring of 2009.

The Canadian and Ontario governments participated in the plan alongside the U.S. Treasury (although neither company sought bankruptcy protection in Canada). The total funds injected from Canada (split two-thirds from the federal government, one-third from the Ontario government) amounted to \$10.6 billion (U.S.) for GM, and \$3.8 billion (U.S.) for Chrysler, for a total injection of \$14.4 billion. These funds were delivered through a combination of loans, preferred shares, and equity. The Canadian funds provided to each company reflected the estimated Canadian share of the company’s total North American production in the years leading up to the crisis; in return for this aid, the Canadian governments negotiated “Canadian manufacturing footprint” agreements through which the companies pledged to at least maintain that same share of their production in Canada for the first several years following the restructuring.⁵ The governments in both the U.S. and Canada also required, as a condition of their assistance in keeping the two companies alive, the negotiation of new collective agreements on the part of the UAW and the CAW. In the Canadian case, these new agreements consisted of a

⁵ Measuring the Canadian production share is a complex calculation, involving a combination of vehicle assembly and powertrain operations. The Canadian contribution to the Chrysler restructuring amounted to about 20 percent of the total combined cost of the bailout, while in GM’s case the Canadian share represented about 17 percent of the total package. The Canadian footprint commitments in turn respectively required each company to maintain an equivalent share of North American production in Canada – in GM’s case consisting of a mixture of assembly and powertrain, in Chrysler’s case only assembly.

Back in Black

All three of the North American-based automakers undertook dramatic restructuring programs during the years of the financial crisis and resulting recession; in Ford's case, the restructuring was already underway (fortunately for the company) when the crisis hit. And all three firms have returned to profitability more quickly than anticipated in those plans.

Between 2006 and 2008, every one of the three companies incurred huge losses in the face of declining market share, declining sales, record-high gasoline prices, excess capacity and resulting increases in unit costs, and surging offshore imports. Combined losses for the Detroit Three in those years were well over \$100 billion (U.S.), leaving them in precarious shape when the financial crisis hit.

Corporate restructuring reduced capacity (through dozens of plant closures across North America), strengthened balance sheets (including, for GM and Chrysler, through the writing off of significant amounts of debt), restructured employee "legacy costs" (most importantly through the creation of independent trusts in the U.S. and Canada to manage retiree health care), and rejuvenated product development plans, resulting in a more attractive line-up of new vehicles. All three of the companies are once again profitable (strongly so at GM and Ford), despite aggregate vehicles sales levels that are historically weak. If sales levels return to cyclical peaks in coming years, the industry's profits will be enormous: higher than ever in history.

Table 2
Net After-Tax Profit (Loss), Selected Years, (\$ billions U.S.)

	GM	Ford	Chrysler
2004	\$2.7	\$3.5	\$1.9
2005	(\$10.6)	\$1.4	\$2.2
2006	(\$2.0)	(\$12.6)	(\$0.6)
2007	(\$38.7)	(\$2.7)	?
2008	(\$30.9)	(\$14.6)	? (\$8.0)
2009	? (1.2 3Q)	\$2.7	? (\$4.9)
2010	\$4.7	\$6.6	(\$0.65)
2011	\$7.6	\$20.2*	\$0.18

Source: CAW Research from company restructuring plans and financial statements.

* Including a one-time \$12.4 billion deferred tax gain; after-tax profit without that item was approximately \$8 billion.

? Indicates years in which complete public financial reports were not issued.

reduction in active labour costs of several dollars per hour,⁶ enhanced labour productivity, and measures to restructure and stabilize the funding of legacy cost items at the two companies (namely, new agreements regarding the funding of pension plans, and the creation of new independent trust funds to provide supplementary health benefits to retired workers). To preserve the tradition of "pattern" bargaining in the auto industry, the CAW subsequently negotiated parallel revisions to collective agreements at Ford and at the CAMI operation in Ingersoll (a former joint venture with Suzuki, but which was subsequently fully incorporated within GM Canada).

All three North American producers have experienced a very encouraging turnaround in market share and profitability in the three years since the trough of the

2008-09 crisis (see sidebar: **Back in Black**). Ford actually posted an annual profit in 2009, the worst year of the downturn. GM began to generate sizeable profits in 2010, well ahead of its anticipated break-even date, despite a still-depressed level of overall vehicle sales in North America. Chrysler generated operating profits beginning in 2010, and posted an annual bottom-line profit for 2011 – also years ahead of the timeline anticipated in its own restructuring plan. Ford and GM's recent profits have been among the highest in their corporate histories. Indications that the U.S. vehicle market is strengthening in 2012 (both reflecting and leading a broader U.S. economic recovery that is finally gathering serious forward momentum) suggest that these profits will improve further and considerably in coming years.

⁶ These active cost reductions included the loss of several lump-sum bonuses, changes in supplementary health benefits, reductions in paid time off, and other contract changes.

The improvement in the Detroit Three's market position, and associated improvement in unit revenues, have been far more valuable to their financial turnaround than reductions in compensation.

The most important factor in the companies' return to profitability has been a turnaround in their continental market share, and a corresponding rebound in unit revenues and profit margins. All three firms have gained North American market share since 2009, by a combined total of about 4 percentage points of the continental market. Even more importantly, a stronger market position allows stronger pricing. The average net unit revenue of the Detroit Three on their North American sales in 2011 was \$28,300 per vehicle, an increase of almost \$5000 from 2006 (when net revenues were suppressed by huge incentives aimed at preserving volumes and market share in the face of surging imports and weak demand).⁷ The rise of the Japanese yen versus the U.S. dollar has been a key factor in this recovery (making it more expensive for Japanese-based firms to import vehicles to North America, and hence creating a larger competitive cushion for the North American producers to sell their own products at relatively higher prices). Disaster-related supply problems besetting the Japanese-based automakers also affected their market share (although those problems have since been resolved). However, European and Korean-based automakers have expanded their respective market shares in North America, offsetting some of the market share gains of the Detroit Three. Nevertheless, the improvement in the Detroit Three's market position, and associated improvement in unit revenues, have been far more valuable to their financial turnaround than the reductions in compensation that were negotiated during the crisis.⁸ As an indicator of these relative proportions, consider that the total cost of direct labour for the automakers (including vehicle assembly and powertrain) amounts to around \$1500 (U.S.) per vehicle, or less. In that case, even substantial reductions in labour costs

⁷ Data calculated by CAW Research from company reports.

⁸ See Stanford (2011) for more detailed evidence on this point.

would contribute only a small fraction to the turnaround in profits, compared to a \$5000 per unit improvement in revenues. Clearly, in retrospect, the North American automakers faced more of a "revenue problem" (driven by eroding market share in their home market) than a "cost problem." Lower debt service charges for GM and Chrysler have also been crucial to their bottom-line turnaround.

Thanks to their rapid recovery, GM and Chrysler have already repaid most of the emergency funds which were advanced by the U.S., Canadian, and Ontario governments as part of their support for the restructurings of 2009. In Chrysler's case, this included early repayment of government loans (which had been carrying very high interest rates, reflecting Chrysler's precarious financial position in 2009 when the loans were issued), as well as the repurchase by Fiat of the governments' former equity shares of the rescued company. In the case of General Motors, while the loans have been repaid the governments maintain significant equity shares in the company – which may be sold (and hence "monetized") at some future date. Even in that case, the hefty market value of those shares (which is reflected in the governments' balance sheets, even if the shares are not sold) constitutes a positive and partial repayment of advanced funds. Economic studies indicate that when due allowance is made for the indirect fiscal effects of the rescue effort (including the tax revenues generated from the companies' continuing operations), governments in both Canada and the U.S. have in fact made a handsome net profit from their involvement in the 2009 restructuring (see sidebar: *Riding to the Rescue*).

In conclusion, Canada's auto manufacturing industry has endured an unprecedented decade of turmoil and contraction that literally threatened its future existence here. Today the industry has stabilized, making a smaller but still vital contribution to Canada's national prosperity. Government's extraordinary role in responding to the events of 2008-09 has been ratified by historical events – and taxpayers have received their money back (directly and indirectly). While the Canadian industry faces numerous global pressures (including import competition, the unprecedented mobility of capital, and the soaring Canadian dollar), it also boasts many advan-

tages: including superior productivity and quality performance, world-class skills and infrastructure, and the financial benefits of a universal public health system. The strengthening economic recovery in North America suggests the industry will experience very strong results in the next few years.

However, Canada's auto industry is now at a critical historical juncture. Investment mandates are subject to renewal in coming years for several important facilities. The future direction of auto policy from Canadian governments (which have played an important but ad-hoc role in recent years in supporting Canadian auto investments) is uncertain, due to both fiscal and ideological considerations. Some companies threaten disinvestment from Canada unless they win desired additional concessions from government, workers, and other stakeholders.

On the other hand, important new investments and capacity expansions have recently gone ahead in several locations (including by Toyota in Woodstock, Ford in Windsor, and GM in St. Catharines, Ingersoll, and Oshawa), indicating that the Canadian industry maintains a durable appeal for global manufacturers.

In light of the industry's roller-coaster in recent years, what are the best measures that can be taken to solidify future investment, production, and jobs in Canada? Experience (both historical and international) has shown that auto jobs cannot be guaranteed by the outcome of collective bargaining talks between companies and unions. An active, effective, modern approach to policy is essential to a successful auto industry. This document contains our suggestions for how to do that.

Riding to the Rescue

Fearing the broader economic side-effects of a collapse of the auto industry, governments around the world enacted a range of supportive measures beginning in late 2008 and early 2009 to assist their respective auto industries through the worst of the crisis. Table 3 summarizes the major policy interventions undertaken by auto-producing jurisdictions during and since the downturn. Canada's policy response was relatively mild compared to other jurisdictions (the main exception being Canada's participation in the dramatic restructuring of GM and Chrysler). The countries demonstrating the most strongly and broadly interventionist policy responses to the downturn have been the U.S., Brazil, China, Japan, France, Germany, and Russia.

On the demand side, to moderate the downturn in vehicle sales, most countries implemented fiscal incentives for new car purchases, consisting of cash subsidies and/or sales tax exemptions. These incentives were largest in the U.S. (up to \$4500 U.S. per vehicle) and Germany (up to 2500 euros per vehicle). These incentives supported new purchases despite economic uncertainty (and the often-restricted availability of credit). They were also often accompanied by an environmental aspect, being tied in most countries to the scrapping of older, more polluting vehicles

and/or to the purchases of fuel-efficient or alternative-fuel models.

On the supply side, most auto-producing jurisdictions also introduced various measures to ease the financial situation facing auto companies. Aid was focused on the automakers, but in many cases was also channeled to independent parts suppliers. These industry supports included emergency financing and loan guarantees to avoid an immediate liquidity crisis, as well as targeted subsidies or "soft" loans tied to longer-term investments by recipient companies in new technology (again, often with environmental applications), products, or capital equipment. In a few cases (including North America, Korea, and Sweden) government financial support also included measures aimed at preventing the outright collapse of key automakers.

Additional government intervention has been aimed at supporting continued employment in the auto industry (including government subsidies for various work-sharing programs to prevent layoffs); efforts to actively manage exchange rates to enhance the competitiveness of domestic suppliers; and other trade policy interventions (such as emergency tariffs or quantitative restrictions) to shift automotive trade balances in favour of domestic producers.

Table 3
Worldwide Government Automotive Interventions Since the Financial Crisis
 ✓ ✓ : Strong Intervention ✓ : Moderate Intervention

Country	Vehicle Sales Incentives & Tax Credits	Work-Sharing and Labour Adjustmt Help	Incentives for New Capital Spending	Direct Equity in Auto-makers ¹	Other Liquidity Help for Firms	Targeted "Green" Incentives	Exchange Rate Management	Tariffs or Quantve. Limits on Trade ²	Other Domestic Content Rules & Practices ³
U.S.	✓ ✓	✓ ✓	✓ ✓	✓	✓ ✓	✓ ✓	✓	✓	
Canada	✓	✓	✓	✓ ✓					
Mexico		✓	✓		✓				
Brazil	✓ ✓		✓	✓	✓		✓ ✓	✓ ✓	
France	✓	✓ ✓	✓	✓ ✓	✓ ✓				✓
Germany	✓ ✓	✓ ✓	✓	✓ ✓	✓				
Italy	✓		✓		✓				
Spain	✓	✓	✓						
Sweden		✓	✓	✓		✓			
U.K.	✓		✓		✓	✓			
Russia	✓		✓	✓	✓			✓ ✓	
Japan	✓ ✓	✓	✓	✓	✓	✓	✓		✓
Korea	✓		✓	✓	✓ ✓		✓		✓
China	✓ ✓		✓	✓ ✓		✓ ✓	✓ ✓	✓ ✓	✓ ✓
Australia			✓ ✓		✓	✓			
India	✓		✓	✓	✓				

Source: Compiled by CAW Research from OECD (2009), Stanford (2010), and Sturgeon and van Biesebroeck (2009).

1. Including through state development banks.

2. Including components.

3. Including non-tariff barriers to trade.

PART II:

Free Trade, the Petro-Dollar, and the Race to the Bottom

Auto investment, supply chains, and marketing strategies have all become intensively globalized in recent decades – like many other sectors of our economy. Major automakers all oversee global operations, and run their businesses with a global strategic outlook. They allocate investment, design models, and organize supply chains on the basis of conditions and developments in the various locations where they operate.

For this reason, any country's auto industry must be outward-oriented, ready and able to participate beneficially in international trade and investment. Auto assembly is characterized by very strong economies of scale: once billions of dollars are invested in designing and engineering a new vehicle, and then equipping an assembly plant and parts suppliers to manufacture it, the vehicle must be produced in adequate quantities (typically hundreds of thousands of units per year) to justify those large up-front costs. For an economy like Canada, that necessitates an export orientation for the industry – since the domestic market could never absorb such large quantities of specific product lines.

The international orientation of Canada's auto industry was cemented in 1965 with the implementation of the Canada-U.S. Auto Pact. This visionary trade agreement eliminated tariffs on bilateral trade in finished vehicles and components between the two countries (for companies which opted to participate in the arrangement). But it was not a "free trade" agreement, in which tariff-free access would be granted unconditionally. Rather, to qualify under the Auto Pact each participating manufacturer needed to meet Canadian content and value-added targets, thus ensuring that the Canadian industry retained its proportionate footprint as a new, integrated continental auto industry emerged. The Auto Pact was enormously successful, and laid the groundwork for a subsequent 35 years of expansion and prosperity for the Canadian auto industry.

In 1999, however, the World Trade Organization first ruled (following a complaint from Japanese automakers) that the Auto Pact violated commitments to

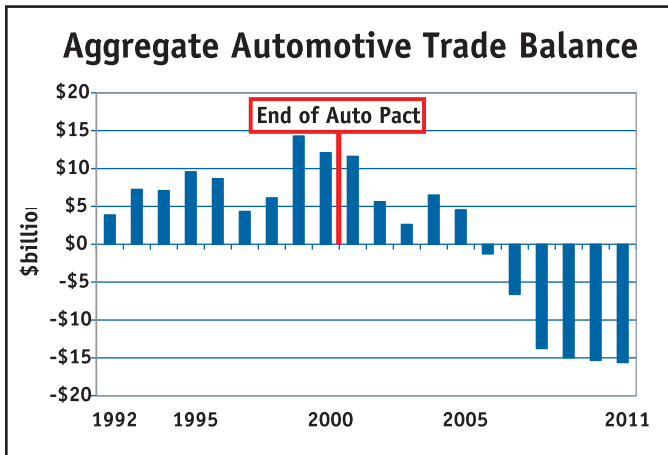
"national treatment" made when Canada joined the WTO as a founding member in 1995. (In retrospect it is odd that Canadian officials did not seem to contemplate this important implication of Canada's membership in the new WTO – or, if they did, their concerns were never communicated to the public.) After a half-hearted appeal, the Canadian government went along with the ruling and the Auto Pact was dismantled in 2001. Much of its force had already been eliminated by virtue of Canada's participation in the Canada-U.S. Free Trade Agreement (implemented in 1989) and the subsequent NAFTA (implemented five years later). Those agreements, by granting unconditional tariff-free access to the Canadian market for any producers operating within North America, eliminated most of the value of belonging to the Auto Pact (and thus maintaining at least a proportional commitment to Canadian value-added).

Nevertheless, the CAW warned at the time that the elimination of even these residual targets for Canadian content would have major long-run implications for the Canadian auto industry, by removing one of the few remaining levers with which government policy could influence investment location. While Auto Pact member firms, for the most part, were producing at that time far more in Canada than they were required to under the terms of the treaty, we recognized that relative advantages can shift quickly, and that national policy should retain the ability to ensure proportionality in trade and investment patterns. Sadly, we were proven correct in this regard: no sooner had the Auto Pact been formally abolished in 2001 than Canada's industry began turning downward. A crucial dimension of the subsequent decline has been the utter reversal of a once-proud international trade success. Today Canada carries much less than its weight in global auto production, evidenced by a large and chronic deficit in our automotive trade.

Figure 5 illustrates Canada's overall automotive trade balance, including both finished vehicles and components. This overall balance reflects the compilation of offsetting sub-balances. Canada maintains a trade surplus in finished vehicles (relatively small now), offset by a larger trade deficit in components. Canada maintains an automotive trade surplus with the U.S. (also relatively small now), offset by larger trade deficits with other major trading partners (including Mexico,

Europe, and Asia). On a combined net basis, Canada's auto exports used to regularly exceed our imports – by as much as \$15 billion in 1999. That trade surplus represented Canada's ability at that time to produce more value-added than we consumed, and hence to attract a larger-than-proportionate share of production and employment in this vital sector.

Figure 5



Source: Industry Canada Strategis database.

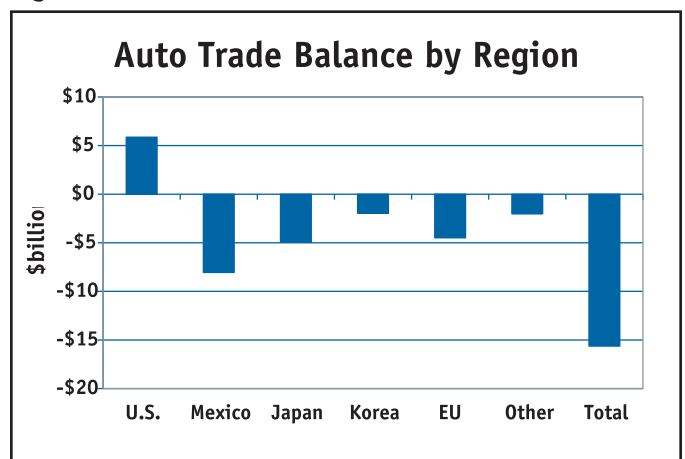
The final demise of the Auto Pact, however, has been associated with a complete reversal of that positive fortune. The aggregate trade surplus evaporated, undermined by both a diminished trade balance with the U.S., and soaring deficits with other trading partners. The overall balance first slipped into deficit in 2006 (Canada's first automotive trade deficit in a generation), and then grew to enormous proportions through the financial crisis and subsequent recession (when Canada's exports were hampered by terrible economic conditions in the U.S., but imports to Canada continued unabated). Last year the automotive trade deficit reached an all-time record of \$15.6 billion. Based on the average job content reflected in a billion dollars of automotive shipments (representing a proportionate blend of finished vehicles and parts), that trade deficit corresponds to the loss of some 23,000 jobs.⁹ Keep in mind that the Canadian industry used to maintain a trade surplus of similar size to today's deficit. Therefore, the reversal of the automotive trade balance (represented first by the disappearance of a \$15 billion surplus, followed by the emergence of a \$15 billion deficit) explains the loss of 46,000 Canadian auto jobs

since 1999. In other words, the vast majority of the jobs lost in the last decade (totalling over 50,000 in assembly and parts, as discussed in Part I of this report) is directly attributable to the collapse of Canada's once-vaunted automotive trade position.

Figure 6 provides more detail regarding the composition of that large overall automotive trade deficit. We maintain a bilateral surplus in automotive products with the U.S. (which was worth just under \$6 billion in 2011). This bilateral surplus is small relative to the enormous two-way trade in automotive products between the two countries (worth almost \$100 billion in 2011). But this success in two-way trade with our neighbour is swamped, now, by very large deficits with all other major auto-producing jurisdictions – and these deficits overwhelmingly reflect largely one-way flows (with hardly any exports from Canada to offset growing imports from our partners).

Substantial bilateral trade deficits exist with Japan (\$5 billion in 2011), the EU (almost \$5 billion), Korea (almost \$2 billion), and a few other suppliers (the largest being China, with whom Canada experienced a \$1.4 billion automotive trade deficit in 2011, all in parts). The fact that the Canadian government has been pursuing free trade agreements with three of those jurisdictions (the EU, Japan, and Korea) gives considerable cause for concern that these already-large imbalances will widen further; this challenge is discussed further in Part IV of this document. Canada's largest single bilateral automotive trade deficit, however, is now with Mexico: reflecting the accelerating southward

Figure 6

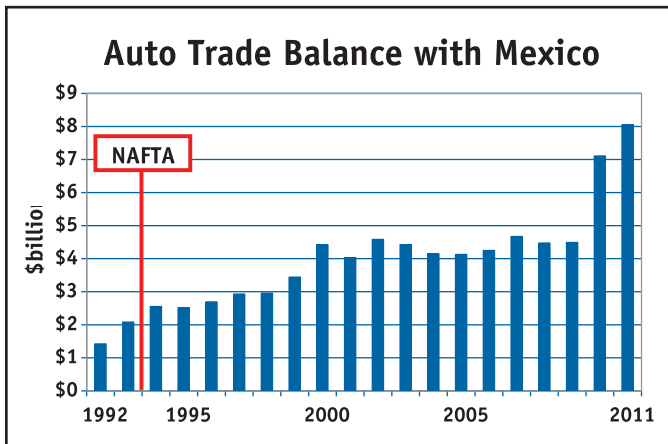


Source: Industry Canada Strategis database; 2011 data.

⁹ CAW Research from data in Statistics Canada, CANSIM Tables 304-0014 and 281-0024.

migration of manufacturing investment to that jurisdiction. Companies are continuing to exploit the opportunities provided them under the NAFTA to manufacture products there with ultra-low-cost labour, and then sell the output without tariff anywhere else in North America. The growing concentration of manufacturing activity in Mexico, and Mexico's modest purchases back from Canada, throws into severe question the standard assumption that Canadians are benefiting from NAFTA. The evolution of Canada's automotive trade balance with Mexico is illustrated in Figure 7. The bilateral automotive deficit surpassed \$8 billion in 2011 (four times its level in 1994 when the NAFTA was implemented). Canada imports 14 times as much automotive value from Mexico as we export there. Worse yet, that \$8 billion automotive deficit represents less than half of an enormous \$19 billion bilateral deficit in merchandise trade. Canada's lopsided free trade relationship with Mexico is destroying tens of thousands of jobs across all of manufacturing.

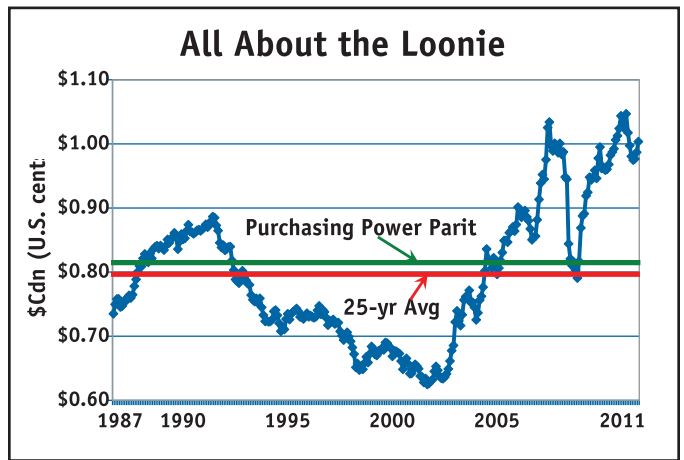
Figure 7



Source: Industry Canada Strategis database.

The dramatic rise of the Canadian dollar has contributed painfully to the erosion of Canada's international automotive trade performance, and heightened the challenge our industry faces in winning future investment. For many years Canada was considered a low-cost destination among developed auto-manufacturing jurisdictions. This partly reflected Canada's strong productivity results, the savings associated with our universal health care system, and other "real" advantages. But Canada's appeal was reinforced by a

Figure 8



Source: Bank of Canada.

currency that traded (through most of the 1980s and 1990s) at levels below its "true" or fair value. In those years, the dollar was held back by investor concerns about Quebec separatism and large budget deficits.

Beginning in 2002, however, Canada's currency began a long ascent, that has added over 60 percent to its value (compared to the U.S. dollar) in a decade (see Figure 8). That means the cost of Canadian-made goods and services (and the cost of Canadian labour) appears 60 percent higher, in relative international terms, than it did in 2002. This shock has negatively affected not only manufactured products, but also any other non-resource product which Canada sells to international purchasers (such as tourism or tradable services).¹⁰ Analysts agree that the take-off of Canada's currency since 2002 reflects the association among financial investors and currency traders between Canada's currency and the price of oil. Indeed, that association is verified by statistical analysis of the correlation between the loonie's exchange rate and the global price of oil; movements in oil prices explain over 85 percent of the variation in the Canadian-dollar exchange rate since the turn of the century (see sidebar: *In Lock Step*).

Some observers contend that an export industry should not ultimately be based on an undervalued currency. Fair enough. That is quite different, however, from the present circumstance, in which Canada's currency is clearly *overvalued*. With the loonie trading around par with its U.S. counterpart, Canadian costs look *artificially* expensive in the eyes of international

¹⁰ Resource exports are generally priced according to international market prices (generally stated in U.S. dollars), and hence their quantity sold is not usually negatively affected by a stronger dollar; the net revenues accruing to Canadian producers, however, can be undermined when the dollar appreciates.

In Lock Step

It isn't just commentary in the financial pages which has linked the value of the Canadian dollar to changes in the exchange rate. The relationship is clearly visible in cold, hard statistics, too.

Table 4 reports on a statistical test of the link between the Canadian dollar exchange rate (measured in U.S. cents) and the U.S. benchmark price of oil (in Cushing, Oklahoma), utilizing econometric regression. Since 2000, variations in the oil price explain 86.2 percent of the variation in the Canadian dollar. Each \$1-per-barrel rise in the price of oil, tends (on average) to generate a 0.45-cent increase in the Canada-U.S. exchange rate.

Table 4
Regression Results, Canadian Dollar and Oil Price

Dependent Variable: EXRATECENTS				
Method: Least Squares				
Sample: 2000:1 2010:4, quarterly data				
Included observations: 44				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	56.36826	1.639462	34.38218	0
OILUS	0.453373	0.027595	16.42949	0
R-squared	0.865354	Mean dependent var		80.69792
Adjusted R-squared	0.862148	S.D. dependent var		12.56845
S.E. of regression	4.666471	Akaike info criterion		5.963072
Sum squared resid	914.5899	Schwarz criterion		6.044172
Log likelihood	-129.1876	F-statistic		269.9281
Durbin-Watson stat	0.608522	Prob(F-statistic)		0

Source: CAW Research.

purchasers – by a factor of close to 25 percent. It is no longer a case of Canadian producers being subsidized by a depressed currency; it is now a matter of them being *penalized* by a currency that makes Canada's relative costs look far higher than its true costs.

How can we estimate the "fair value" of a currency, and thus evaluate whether day-to-day exchange rates are accurately reflecting relative costs? The benchmarking method used most often by economists consists of a concept called *purchasing power parity* (PPP). This concept measures international differences in nominal prices and costs, and then estimates an exchange rate which would equalize the real purchasing power of different currencies in light of those differences in price levels.

There is enormous debate among economists about the value of PPP models as a tool for *predicting* exchange rates. Some argue that real competitive pressures (including "arbitrage," which is essentially a fancy term for cross-border shopping!) should, in the long run, enforce a gravitation of market exchange rates toward their PPP levels. In this regard, it is interesting to note (as illustrated in Figure 8) that the current OECD estimate of the PPP value of the Canadian dollar almost exactly equals its actual 25-year average value. Others, however, argue that this tendency can be overwhelmed, even for long periods of time, by other financial forces (such as speculative pressures from currency traders – who might purchase a currency not

because they need to buy something from that country, but purely because they anticipate its international value to rise in the future). But there is no debate about the validity of PPP benchmarks for accurately facilitating international comparisons. Economists are near-unanimous that market exchange rates are inappropriate for comparing fundamental economic variables (like incomes, productivity, and costs) across countries. That is why international agencies almost always use PPP-adjusted measures to compare GDP, living standards, and other fundamental economic outcomes.

The most comprehensive analyses of international PPP rates are conducted by international economic organizations (such as the Organization for Economic Cooperation and Development and the International Monetary Fund). According to these agencies, the PPP value of Canada's dollar is presently about 81 cents U.S.¹¹ What this means is that, on average, a Canadian dollar in Canada can buy as much real goods and services (composed of a weighted basket of everything produced here) as 81 cents U.S. can buy in the U.S. When the Canadian dollar trades for more than this level, Canadian-made products and services look artificially expensive (and Canadians will cross the border to shop in the U.S.). When the Canadian dollar trades for less than this benchmark (as it did for most of the 1980s and 1990s), Canadian-made products and services look artificially inexpensive (and Americans come to shop in Canada). When the dollar is around 81 cents U.S., our international relative costs accurately reflect our true costs, and there should be little incentive for cross-border shopping in either direction.

The fundamental reason for the lower-than-par purchasing power of the loonie is that average prices in Canada are higher than in the U.S. Any cross-border shopper can immediately attest to this fundamental reality (see sidebar, *Canadians Pay More*). On average, across the entire bundle of goods and services produced in the economy, a set of purchases costing \$100 in the U.S. costs \$123 in Canada. A dollar of Canadian money thus has the same real purchasing power in Canada (rel-

ative to Canadian prices) as 81 U.S. cents in America (relative to U.S. prices). The evolution of the PPP benchmark over time mostly reflects differential rates of inflation in various countries. If prices are rising more quickly in Canada than in the U.S., then the PPP exchange rate will decline over time; if inflation is lower, then the PPP rate will increase. In fact, since inflation in recent years has been somewhat faster in Canada than in the U.S. (reflecting a somewhat stronger economy), the PPP exchange rate for our dollar has declined slightly (by about 2 cents between 2009 and 2011, according to the OECD). Many analysts predicted that a stronger Canadian currency would in fact lead to *decreases* in Canadian consumer prices (since anything that is imported should be cheaper for Canadians when the exchange rate is high). In practice, however, this has not occurred: importers and retailers have kept the larger profit margins from lower import costs, instead of passing them on to Canadian consumers. Varying estimates of PPP values use differing methodologies, and generate differing outcomes.¹² But all analysts agree that the current Canada-U.S. exchange rate (around par) is far above purchasing power parity, which means that Canadian prices and costs (evaluated at that market exchange rate) look artificially expensive by a wide margin.

The implications of this divergence between actual and "fair" exchange rates are very important for evaluating Canadian competitiveness, trying to win future Canadian investments, and determining Canadian economic and industrial policies. Remember, Canadian workers live in Canada, and (except for cross-border shopping expeditions) purchase the goods and services necessary for their subsistence here in Canada – at Canadian price levels. The real wages of Canadians must therefore be evaluated relative to Canadian prices (just as real wages in the U.S. must consider U.S. price levels). For this reason, international comparisons of labour costs calculated at market exchange rates produce very misleading judgments regarding true real labour costs.

¹¹See, for example, "Purchasing Power Parities for GDP," OECD.stat database, Organization for Economic Cooperation and Development, http://stats.oecd.org/Index.aspx?datasetcode=SNA_TABLE4.

¹² See, for example, Macdonald and Baldwin (2009), whose research implies a PPP rate of around 82.6 cents U.S., and Macdonald (2012) who suggests it is higher (closer to 87 cents). The latter estimate utilizes a "gross domestic income" measure to estimate PPP, to capture the effect of lower import prices; the problem, however, is that those lower import prices have not been passed on to consumers, and hence the true PPP value is undoubtedly lower than this.

Canadians Pay More

It is common knowledge among Canadians that at current exchange rates, most consumer prices are significantly higher here than in the U.S. That is the reason why thousands of Canadians in border communities spend hours crossing to the U.S. for routine purchases. Unfortunately, this cross-border shopping represents a significant drain on Canada's economy, and on the fiscal capacity of Canadian governments (yet the federal government, in its recent 2012 budget, actually encouraged more cross-border shopping by raising duty-free limits on short-term visits to the U.S.!). This is another costly manifestation of the substantial overvaluation of the Canadian currency. When the Canadian dollar was undervalued, in contrast, as during most of the 1990s, the bargains were on the Canadian side – and U.S. shoppers flocked to Canada.

Table 5 summarizes just a few examples of current cost differentials between Canada and the U.S.

Item	Canadian Price (\$ Cdn)	U.S. Price (\$ U.S.)	Canadian Premium
Average home price	\$372,763	\$156,600	138%
Litre of gasoline	\$1.29	\$1.02	26%
McDonald's "Big Mac"	\$4.73	\$4.20	13%
Hardcover bestseller (Danielle Steel's latest)	\$21.32	\$16.24	31%
New made-in-Canada motor vehicle (equivalent models)			10 to 20%
GDP composite price index	123	100	23%

Source: CAW Research from Cdn. Real Estate Association, National Assoc. of Realtors, *The Economist*, amazon.com and amazon.ca, gm.com and gm.ca, and OECD.

Automakers charge more in Canada than in the U.S. for identical products – even for vehicles that were manufactured in Canada! Higher prices in Canada reflect the higher nominal price level here (the outcome of decades of economic and financial history), and somewhat stronger market conditions in many products (most notably real estate). It costs about 23% more to live in Canada – so it is normal that Canadians need to receive higher nominal incomes. But that does not mean that their *real wages* are higher, once we have adjusted for higher price levels in Canada.

Adding insult to injury, when an individual takes the tunnel or bridge back to Windsor from their shopping excursion to the U.S., they can pay their toll of \$4 (U.S.) ... or \$4.75 in Canadian currency. Canadians therefore pay a premium of 19% to get back into their own country!

Consider the following illustration. The top hourly rate for production workers in CAW-represented assembly plants in Canada is about \$34 (Cdn.) per hour. The top rate in UAW-represented plants in the U.S. is about \$28 per hour. With the Canadian dollar at par, this implies that wages in Canada are \$6 per hour higher than in the U.S. Right? Wrong! Remember, prices

(across the whole bundle of goods and services produced in the economy) are 23 percent higher in Canada. Thus, relative to respective consumer prices, *real* automotive wages are actually *lower* in Canada than in the U.S. Adjusted for the higher average level of Canadian prices, "real" Canadian auto wages are actually 2 or 3 percent below "real" wages in the U.S. And this com-

parison actually understates the Canadian labour cost advantage. While nominal Canadian hourly wages for autoworkers are higher (in par dollars) than in the U.S., the differential in overall all-in hourly labour costs is smaller. That is because the \$6 difference in hourly wages is partly offset by other Canadian cost *advantages* – including health care savings of \$6 per hour or more on active labour costs, and the absence of profit-sharing bonuses in the Canadian compensation system (which saves another \$3-4 per hour over the year). Government payroll taxes (for CPP, EI, and other public programs) are about \$1 per hour lower here than in the U.S. Pension costs, however, are higher in Canada. At the bottom line, all-in active labour costs for CAW members (at around \$60 Cdn. per hour worked) are only \$3-6 dollars per hour higher (in par dollars) than at the U.S. operations of the Detroit Three, representing an hourly labour cost differential of 5-10 percent.¹³ But if we measure labour costs relative to Canadian consumer prices (that is, we evaluate them at PPP exchange rates instead of market exchange rates), then real Canadian all-in labour costs are actually about *\$7 per hour lower* than in UAW plants.

In real economic terms, Canada enjoys an all-in labour cost advantage.

In real economic terms, therefore, Canada enjoys an all-in *labour cost advantage* compared to U.S. operations (and also compared to auto plants in several other industrialized economies, including Germany, Belgium, and Japan). Canadian autoworkers receive less real consumption possibility as a result of their labour than do their counterparts in these other countries. Our problem is that the operation of private, deregulated financial markets has converted that labour cost advantage into a currency disadvantage. Financial investors have hungered to buy Canadian dollars, and Canadian-dollar-denominated financial assets, in the expectation that

those assets will become even more valuable in the future (due to their link with oil prices, or other speculative judgments). It is important to note that the strong Canadian dollar does not reflect real strength in Canada's international economic performance. Canada's overall trade and current account balances, for example, have deteriorated markedly during recent years, despite the soaring value of petroleum exports. The link between the dollar and oil prices more reflects financial and speculative motivations, not real trade and investment flows. And in contrast to many other jurisdictions (including Japan, Brazil, China, and even the U.S.¹⁴), Canada's policy-makers have been content to accept this speculative, financial outcome as a "natural", even desirable result – rather than acting to push the exchange rate toward a level more compatible with Canada's long-run competitiveness.

What are the long-run implications of this damaging financial distortion? Employers may argue that the exchange rate isn't their doing, and thus balk at paying more for Canadian workers (evaluated at current market exchange rates) than in other countries. Needless to say, the fact that they charge Canadians more for *their own products* (thus contributing directly to the higher average level of prices in Canada), undermines the credibility of their complaint. So too does the fact that because of higher nominal price levels in Canada, the automakers themselves earn extra profits on their retail operations here that offset the higher (apparent) costs on Canadian manufacturing operations. Similarly, the cost of imported inputs used to manufacture vehicles here (including parts, capital equipment, and other purchases) is lower when the dollar is high. So for companies which both manufacture and sell motor vehicles in Canada, the impact of a higher dollar is largely a "wash."

For government, it would seem that the obvious policy implication would be recognition of the need to attempt to eliminate or offset this large, lasting distortion. Reasonable measures which could help to

¹³ According to both internal company data and independent estimates, all-in active labour costs at CAW-represented operations averaged about \$60 (Cdn.) per hour in 2011. Published reports indicate that corresponding all-in active UAW labour costs are in the high-\$50's (U.S.) at GM and Ford, and somewhat lower at Chrysler (due to a higher proportion of new hires working at that company). All-in labour costs include all labour-related expenses (including government payroll taxes, costs associated with plant downtime, and other non-compensation factors), divided by hours worked over the course of a year at factories. This measure should never be confused with compensation; see Stanford (2009) for more discussion of this measure. As discussed below, *unit* labour costs (as opposed to *hourly* labour costs) depend on productivity, which is higher in Canada, and hence the unit labour cost differential between the two countries, even at market exchange rates, is insignificant.

¹⁴ The U.S. can be said to have actively depreciated its currency through its pursuit of unconventional monetary policies, in particular the various incarnations of "quantitative easing" pursued by the U.S. Federal Reserve.

attain this goal (and which have been utilized in other auto-producing jurisdictions) are described in more detail in Part IV of this report. For now, however, it must be noted that the apparently high level of Canadian labour costs does not reflect the real compensation of Canadian workers (which is in fact lower than in the U.S. and several other industrialized countries). And there is no expectation that the problem posed by an overvalued currency will somehow be “adjusted to” over time. The only means through which such an adjustment might occur, in terms of labour market outcomes, would be either for Canadian consumer prices to fall substantially as a result of a strong dollar, or else for Canadian workers to willingly sacrifice their real living standards in an effort (likely fruitless) to offset the distortionary impacts of foreign exchange markets on their apparent costs. Neither of these outcomes seems likely. So for as long as Canadian policy-makers are prepared to tolerate an exchange rate so far out of whack with real prices and costs, Canadian manufacturing facilities (and businesses in any other globally oriented activity, such as tourism or tradable services) will continue to face risks of lost business and outward migration of investment.

As a means of illustrating the negative impact of the overvalued Canadian dollar on the competitiveness of the Canadian automotive manufacturing sector, consider that the industry’s total GDP in 2011 equalled some \$15.8 billion (evaluated in chained 2002 dollar terms; from Statistics Canada, CANSIM Table 379-0027).¹⁵ The apparent cost of that production, in the eyes of international purchasers, was artificially inflated by 24 percent as a result of the overvaluation of the Canadian currency – comparing the actual prevailing exchange rate for 2011 (which averaged just over 1 cent above par) to the OECD’s measure of the PPP exchange value of the Canadian dollar. This is thus equivalent to a \$3.7 billion annual cost penalty imposed on the industry (considering both assembly and parts) by the overval-

ued loonie. This is the price paid by a single crucial manufacturing sector as a result of the financial side-effects of the resource boom in western Canada (and oil sands exports in particular), combined with a continued willingness by policy-makers to allow financiers to so badly distort this crucial price.

Despite this enormous burden posed by an overvalued currency, the dire straits of Canada’s auto industry should not be overestimated. Hourly all-in labour costs are only 5-10 percent higher than those paid in the U.S. industry, even evaluated at market exchange rates. (At a fair-value exchange rate, Canadian labour costs are lower, as argued above.) Direct labour costs for the automakers now account for under 5 percent of total production and sales expenses (see sidebar: ***How Much Labour Is In That Car?***). A cost differential of under 10 percent, on an input accounting for less than 5 percent of total costs, implies an ultimate cost disadvantage of less than one-half of one percent of total costs. That is barely large enough to measure, let alone to motivate a large-scale relocation of investment and production. Moreover, given that this differential is solely the result of an overvalued exchange rate (and does not reflect a real compensation premium), and given that exchange rates tend (in the long run, anyway) to fluctuate around their PPP values, it would be folly to base long-run investment decisions on relative cost differentials that are exchange-rate-driven and hence not likely to persist in the long-run. This probably explains why some automakers (including Toyota recently in Woodstock, Ford in Windsor, and GM in several locations) have moved ahead with significant investments in Canadian production facilities, despite the immediate negative cost implications of the overvalued loonie.¹⁶ It also explains why there was no wholesale migration of investment north to Canada during the 1980s and 1990s – when an undervalued currency, along with other advantages (like superior productivity and public health care), created an apparent labour cost advantage for Canadian operations of as much as

¹⁵We use value-added as the base for this calculation, rather than gross shipments, because the cost of parts, capital equipment, and other inputs will not be affected the same way by the strong dollar; it is only actual value-added in Canada that is directly penalized by the exchange rate.

¹⁶It is interesting to compare Toyota’s views on the strengths and weaknesses of Canadian production facilities with those of some other automakers. Toyota Canada experiences the same cost pressures resulting from the overvalued currency as do the Detroit Three (and its active hourly labour costs are virtually identical to CAW facilities), yet the company has significantly expanded its Canadian footprint with several new investments. Meanwhile, we heard no dire rhetoric from Toyota as has been forthcoming from some other automakers regarding the competitiveness of Canadian operations. Indeed, Toyota’s leadership continues to publicly praise the quality and competitiveness of its Canadian facilities. The fact that Toyota does not engage in collective bargaining (and hence may feel less compulsion to threaten the future employment security of its employees in order to “soften” them up for contract talks) may help to account for this difference in tone.

How Much Labour is in That Car?

Autoworkers' wages tend to capture 99 percent of the attention in public discussions about the problems facing the auto industry. But how important are auto wages in the overall economic circumstances facing the industry? The answer is surprising.

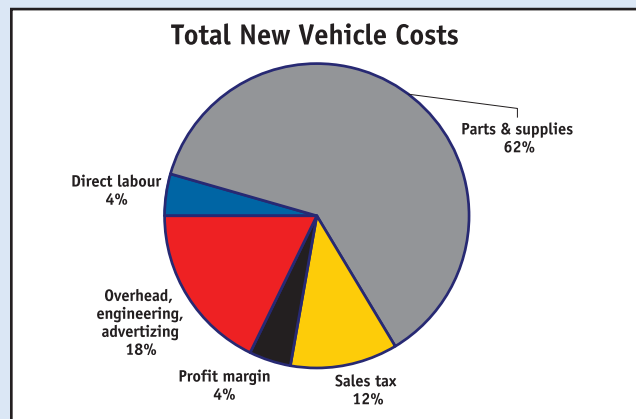
Automotive assembly relies on an incredible and increasingly complex web of suppliers and inputs. Direct labour (in vehicle and powertrain assembly) is a relatively small input to auto production, presently accounting for under 5 percent of the total cost of designing, engineering, producing, assembling, marketing, and selling a new motor vehicle. Direct labour costs at the automakers are thus smaller than the margins paid to motor vehicle dealers, and (in some cases) smaller even than the cost of *advertizing* a new model. For example, General Motors spent an estimated \$1300 in advertizing in the U.S. for each new vehicle it sold there in 2010 (CAW Research calculations based on Schmitt, 2011, and GM financial reports); this exceeds the direct labour cost in many of its vehicles. Automakers may now be spending more on "white-collar" labour (for engineers, managers, marketers, and others) than on "blue-collar" assembly labour. Top executives certainly benefited from enormous compensation gains in recent years. Yet union-bashing commentators ignore all of those other expense items, and focus only on blue-collar labour costs (even salaried labour costs rarely enter their analysis).

How much does a consumer actually "pay" for the labour required to assemble their new vehicle? It typically requires less than 20 hours of direct labour to assemble a new vehicle in a Canadian plant;¹ stamping metal and assembling the powertrain (the other major functions still performed in-house by the automakers) together typically requires another 6-8 hours of labour. CAW members' all-in active labour costs (including wages, bonuses, time off, pensions, benefits, and even government payroll taxes) presently sum to around \$60 Cdn. per hour worked in the factory.²

That implies a total direct unit labour cost of \$1500-1700 per vehicle. In 2010, the average final selling price of a new vehicle sold in Canada was \$33,000 (CAW Research calculations from Statistics Canada CANSIM data, Table 79-0004). Add \$4300 for federal and provincial sales tax (at the average Canadian rate of 13 percent), and the total

price tag exceeds \$37,000. Direct labour thus accounts for well under 5 percent of the total consumer cost of purchasing a typical new vehicle. Indeed, consumers spend almost three times as much on sales tax as on embedded direct labour; more than twice as much for the dealer's margin; around 15 times as much for the parts and raw materials built into in the car; and as much (some times more) for advertizing. In short, direct labour is a very small slice of the total cost of a new vehicle (see Figure 9).

Figure 9



Source: CAW estimates from industry reports and company financial statements.

In fact, even these numbers overestimate the importance of labour costs in Canadian vehicle production. CAW-made vehicles tend to be somewhat larger, more full-featured, and hence more expensive than the average vehicle sold in Canada (since many Canadians purchase smaller, less well-equipped imported vehicles). Suggested retail prices for some of the more fully-featured vehicles made in Canada (such as the Cadillac XTS produced in Oshawa, the Lincoln MKX and MKT from Oakville, or the Chrysler 300 from Brampton) can range up to \$50,000 per unit or more. For these vehicles, the estimated total all-in cost of direct labour is as little as 3 percent.

So even if CAW members volunteered to work for free, it would "save" less than the companies regularly offer in sales incentives, or spend on advertizing their products. Clearly, the single-minded focus of business executives, politicians, and anti-union columnists alike on the wages of auto workers, is truly missing the forest for the trees.

¹ The last public release of the *Harbour Report*, considered the most authoritative review of productivity in automotive plants, occurred in 2008. In that report, 4 CAW assembly plants (Oshawa 1, Oshawa 2, CAMI, and Brampton) ranked among the 10 most efficient assembly plants in all North America, with productivity ranging between 15 and 18 hours per vehicle. The average productivity across all CAW operations that year was 20.36 hours per vehicle (CAW Research calculations from Harbour and Associates, 2008).

² As discussed in the main body of this report, that all-in labour cost is a very difficult concept to measure, and should never be confused with "compensation." See Stanford (2009) for a more detailed critique.

A Good Place to do Business

There has been much made of the global challenges facing Canadian manufacturing (made far more acute by the over-valued Canadian dollar). However, there are many other factors here which are very appealing to global manufacturers:

- Canadian consumers purchase about 1.6 million new vehicles per year (worth \$55 billion). The Canadian vehicle market remained remarkably stable through the global financial crisis.
- While the strong dollar makes Canadian manufacturing look more expensive, it reduces the costs of importing products and selling them here – which the automakers also do. Profits on their Canadian retail operations have been enormous, reinforced by the high loonie. They continue to charge Canadians more for new vehicles, despite our dollar being at par with the U.S. dollar.
- Despite the turbulence affecting the auto sector, Canadian vehicle and parts manufacturers earned positive profits in 9 of 12 years between 1999 and 2010 (in the black every year but 2002, 2008, and 2009). After the financial crisis, the Canadian industry bounced back with a \$2.6 billion operating profit in 2010. Cumulative net operating profits since 1999 for the industry equalled \$30 billion.
- Corporate tax rates are among the lowest of G7 economies. Combined federal and provincial corporate tax rates are now about 26 percent of pre-tax corporate profits – a full 13 percentage points (or one third) below U.S. levels. Canada's value-added sales tax system (recently expanded in Ontario to include the provincial portion) delivers enormous benefits to businesses (through rebates of taxes paid at earlier stages of production). This system is also superior to the U.S. tax structure (in which state sales taxes still utilize a cascading structure).
- International surveys (such as KPMG's annual Competitive Advantage ranking) place Canada among the most competitive of exporting economies in the world, on the strength of recognized workforce credentials and quality, safe liveable communities, and business-friendly tax and regulatory regimes.
- Canada's universal public health care system (paid for by workers through their taxes) reduces employer health care expenses by several dollars per hour in the auto assembly sector. Even more important, of course, the system contributes to a healthier workforce.

\$20 per hour (many times larger than Canada's apparent cost disadvantage today). Billion-dollar investments in fixed, immovable capital are made carefully, with focus on their long-run viability, and the core real attributes of competing locations. Canada's economy possesses numerous other advantages for mobile global producers (see sidebar: **A Good Place To Do Business**) which also help to reinforce the business case for investing here.

Canada's superior productivity performance in the auto industry is another key factor influencing the overall competitiveness of the sector. Manufacturers aim to minimize unit labour costs, considering both the hourly cost of labour and the amount of output produced during that hour of work. Increasing productivity is just as effective as reducing hourly compensation, in this regard. Canada's auto assembly sector has a long-standing productivity advantage relative to U.S. facilities, reflecting the high quality of the workforce,

the relatively modern vintage of capital equipment, and innovative workplace practices (such as three-shift assembly plants, the use of mobile robotics, and other innovations). The traditional reference for automotive productivity comparisons was the *Harbour Report*, no longer released publicly. The last public version of that report (see Harbour and Associates, 2008), confirmed an average productivity advantage in Canadian facilities. CAW-represented assembly plants were the most efficient on the continent, accounting for 4 of the 10 most productive assembly plants in North America. Canada's weighted average productivity advantage relative to all U.S. plants was 11 percent. The weighted average advantage of CAW plants compared to UAW plants was 8 percent. Other, more recent indicators of productivity (such as vehicles assembled per employee, or value-added per hour evaluated at PPP exchange rates) reinforce the conclusion that Canadian opera-

tions enjoy a productivity advantage of 5-10 percent relative to U.S. plants (and a larger advantage relative to Mexican facilities). If Canadian hourly labour costs 5-10 percent more (all-in) than in the U.S., but Canadian workers are 5-10 percent more productive, then obviously there is no unit labour cost disadvantage at all – even at market exchange rates. And at PPP exchange rates (that is, in real terms relative to domestic price levels), Canada’s unit labour cost advantage is as much as 20 percent, with a real hourly labour cost advantage reinforced by a productivity advantage.

Some observers, while conceding that Canada’s current labour costs are not very different from U.S. costs (even at overvalued market exchange rates), assume that a larger disadvantage will emerge in future years as a result of recent labour contracts signed between the UAW and the Detroit Three. Under these contracts, new hires (up to a certain ceiling) can be hired at compensation levels approximately two-thirds of existing levels.¹⁷ Base wages for top-tier workers are frozen for the next four years, although large bonuses (some related to corporate profits) are paid out (adding several dollars per hour to all-in labour costs). The ultimate impact of the two-tier wage system in the U.S. is often misunderstood. Under the terms of the UAW contracts, lower-wage new hires can only make up between 20-25 percent of the total hourly workforce in the U.S.¹⁸ Once that ceiling is reached, additional new hires will cause the “bumping up” of senior lower-tier workers into the upper-tier category. The impact of the two-tier system on weighted average all-in labour costs is thus modest, even when the system is fully phased in: a one-third saving, on 20-25 percent of the workforce, amounts to a total weighted average saving of just 7-8 percent. For this reason, all three of the North American automakers expect (as reported in their respective public financial circulars) their U.S. all-in active labour costs to *increase* in coming years, even as the two-tier system is phased in. Increases in other costs (including expensive U.S. health benefits) will more than outweigh the incremental savings attained from additional lower-tier hiring. If North American vehicle sales continue to improve, then UAW profit-sharing payouts may

Not Everyone is Suffering

While calling for continuing belt-tightening in wages and compensation for autoworkers, auto executives have reaped enormous financial rewards in recent years as the industry turned the corner, and profits soared. Here are the highlights (all figures in \$US):

- **Alan Mulally (Ford):**

- ▶ 2010: \$26.5 million salary & bonus, \$100 million stock
- ▶ 2011: \$29.5 million salary & bonus, awarded \$58 million more stock in March
- ▶ 2011 raise (salary & bonus only): 11 percent.

- **Dan Akerson (GM):**

- ▶ 2010: \$2.53 million salary & bonus (partial year), plus stock
- ▶ 2011: \$9 million salary, bonus, and stock
- ▶ Pay still frozen by U.S. Treasury under terms of 2009 restructuring

- **Sergio Marchionne (Fiat-Chrysler):**

- ▶ 2010: \$4.5 million salary & bonus (from Fiat and Fiat Industrial)
- ▶ 2011: \$22.2 million salary, bonus, and stock (from Fiat and Fiat Industrial)
- ▶ Does not receive pay from Chrysler
- ▶ 2011 raise (from Fiat and Fiat Industrial): 393 percent

The combined cash compensation of these three executives in 2011 was almost \$120 million (U.S.). That’s enough to pay the annual straight-time wages for 1700 Canadian autoworkers – approximately sufficient to staff a two-shift assembly plant for a whole year.

¹⁷ Originally the lower-tier workers were paid half of the basic wage, but the UAW’s 2011 contract significantly improved that. After four years of service, a lower-tier worker will make almost 70 percent of the top-tier production wage. Health benefits and other benefits for lower-tier workers were also improved in 2011.

¹⁸ A 20 percent ceiling applies currently at Ford; a ceiling of between 20 and 25 percent will come back into effect at GM and Chrysler in 2015 (the ceiling at those companies was temporarily suspended on the demand of the U.S. government during the 2009 restructuring).

Going Downhill

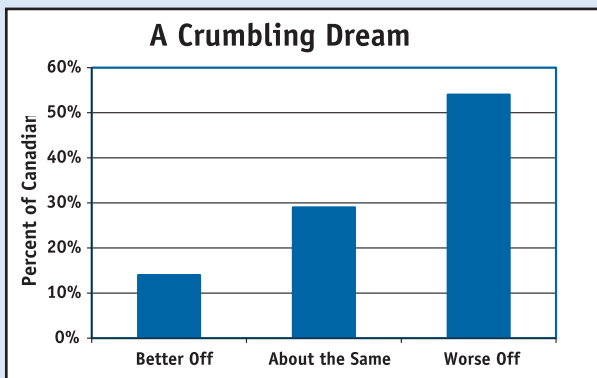
Every parent wants to pass on a good life to their children. It's one of the most powerful motivations in our lives.

Traditionally, we assumed that our children would enjoy a better life than we did – and their children a still better life. That's the whole idea of "progress." In recent decades, however, that vision has been crumbling.

In fact, today's young people may be the first generation in Canadian history whose life prospects are actually *worse* than their parents.

A recent Ekos poll asked Canadians this simple question: "Do you think the next generation will be better off, worse off, or about the same as you are 25 years from now?" The answers were shocking (see Figure 10).

Figure 10



Source: Ekos Research Associates.

Over half of Canadians (54%) expect their children to be worse off. Only 14% expect their children to be better off. Pessimists outnumber the optimists by a 4-to-1 ratio.

This view among Canadians is ratified by real economic experience. Average real household incomes have gone nowhere for the last quarter-century. And with ruthless corporations using their total freedom under globalization to drive down wages and destroy middle-class jobs, there's not much reason to expect that good jobs will be preserved for the next generation – unless government wakes up and starts making it a priority.

become even larger, and all-in labour costs may increase faster than projected by the companies. In this regard, the recent UAW contracts do not materially change Canada-U.S. labour cost differentials.¹⁹

There is no doubt that corporate executives are more aggressive than ever before in using their international mobility to extract concessions from workers, governments, suppliers, and all other stakeholders who depend on their investments. The devastating actions of Caterpillar Inc., in closing its facility in London, Ontario, after demanding a 50 percent cut in compensation, is only an extreme example of this mindset. Many auto executives clearly share Caterpillar's view of the world, and Caterpillar's strategy for further enhancing their already-rich profitability. The fact that executives themselves are paid more extravagantly than ever (see sidebar: **Not Everyone is Suffering**) certainly undermines the moral credibility of their demands for more belt-tightening by workers, but hardly slows their efforts to drive down wages and living conditions. If their demands to continually ratchet down compensation in once-well-paid industries (like auto) are accepted, the very future of what was once called the "middle class" would be jeopardized (see sidebar: **Going Downhill**). And while Canadian labour costs are in the same ballpark as those in the U.S. (especially when taking productivity and differential national price levels into account), they are certainly much higher than those in Mexico and other low-wage production regions which automakers plan to exploit in coming years (including, potentially, future vehicle imports from China and Thailand). For all of these reasons, global trade and investment patterns will continue to pose a threat to the future of Canadian automotive investment, production, and employment – regardless of the best efforts by the CAW and other stakeholders to maintain efficient, top-quality, profitable operations here.

In this regard, it cannot be left to the collective bargaining table to attempt to secure the future of Canada's auto sector. It will require a sensible, effective auto policy framework, learning from the lessons of other successful auto-producing jurisdictions, to ensure that this sector continues to make the rich contribution to our national prosperity that it is capable of.

¹⁹And while the CAW has not accepted the two-tier principle, there are several contract features in Canada that provide significant savings on new hires and non-core work, including the use of temporary, part-time, and supplemental workers in many plants; a supplier park arrangement in Oshawa that provides savings for on-site components work; and a \$1 per hour contribution that new hires make to their pension plan.

PART III

Why Auto Matters

What's so special about the auto industry? Why should governments be concerned with fostering more investment and employment in this particular sector, among all the other sectors in Canada's economy?

There are several reasons why maintaining a strong and sustainable auto industry is essential to the long-run prosperity of the whole country – not just to auto workers and auto communities.

Productivity: Average productivity levels in the Canadian auto assembly sector are extremely high, thanks to the skills, work effort, capital equipment, and complex production systems that are used in auto manufacturing. Table 6 indicates that in 2010 the average auto assembly worker produced close to \$300,000 in value-added (or GDP) per person per year – or about \$142 of value-added *per hour*. That's more than four times as high as the economy-wide private-sector average.

Workers in the auto parts sector produce on average over \$100,000 in value-added per year. That's 12 percent more than the average for all manufacturing, and 90 percent more than the average for the whole private sector.

Table 6		
Labour Productivity, Selected Sectors, 2010		
	Productivity Per Worker	Productivity Per Hour
Auto Assembly	\$270,969	\$142
Auto Parts	\$110,556	\$55
Manufacturing	\$98,565	\$51
All Private Sector	\$58,933	\$35

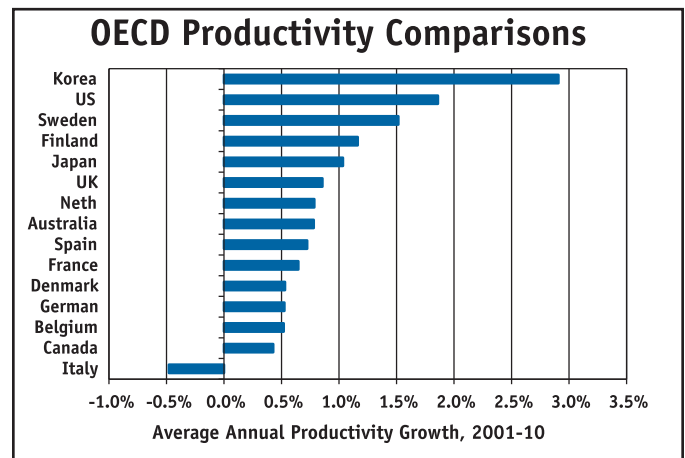
Source: CAW Research calculations from Statistics Canada CANSIM data, Tables 379-0027 and 383-0010.

This data actually underestimates the productivity advantage of Canada's auto industry, because in 2010 the sector was still grappling to recover from the devastating effects of the 2008-09 crisis; many facilities were still underutilized, which tends to reduce hourly productivity. As the industry continues to regain its momentum, these productivity numbers will get even stronger.

Without the superior productivity generated by work-

ers in the auto industry, Canada's overall productivity performance (which has been very disappointing in recent years) would be even worse. Figure 11 indicates that Canada ranked very near the bottom of all developed industrial countries in annual productivity growth over the past decade. Average annual productivity growth during the decade as a whole was a meagre 0.4 percent per year – good enough to rank 30th out of the 34 member countries in the Organization for Economic Cooperation and Development (OECD). The loss of tens of thousands of super-productive auto jobs was a key factor behind Canada's lousy productivity performance over the last ten years. Winning those jobs back, by the same logic, would give a much-needed boost to our future productivity growth.

Figure 11



Source: OECD Economic Outlook.

Supply Chain: The auto industry has a uniquely developed supply chain, based on the inputs of hundreds of different suppliers of parts, materials, and services. Because of geographical factors (like “just-in-time” inventory systems), many of those suppliers must be located relatively close to the auto plants they service. Thus winning investment in a domestic auto facility supports thousands of jobs outside of the plant itself. That's a key reason why the “multiplier” effect of auto production is so high. Ultimately, *each major auto job supports around 10 jobs in total* in the domestic economy: the original job, plus 9 others (see sidebar: **Multiplied Benefits**).

Incomes: Productivity is very high in the auto industry. That, along with the role of the union in protecting wages and working conditions, explains why incomes in the auto sector are also higher than average. Average annual incomes in the auto industry (including both assembly and

parts, blue-collar and white-collar employees) are roughly 50 percent higher than in the Canadian economy as a whole. Those incomes in turn generate higher spin-off benefits from the spending and re-spending mechanisms described in the sidebar (*Multiplied Benefits*). Total employment supported directly and indirectly by the auto industry in 2010 amounted to an incredible 374,000 jobs.

Investment and Technology: The auto industry is a very capital-intensive part of the economy. Each worker in the assembly sector uses, on average, close to \$400,000 worth of machinery and equipment to perform their work (compared to less than \$100,000 for the average industry in Canada).²⁰ These capital investments are essential to the productivity, quality, and innovation performance of the industry; they embody the new technology required to produce modern vehicles with the quality and features that consumers expect and desire.

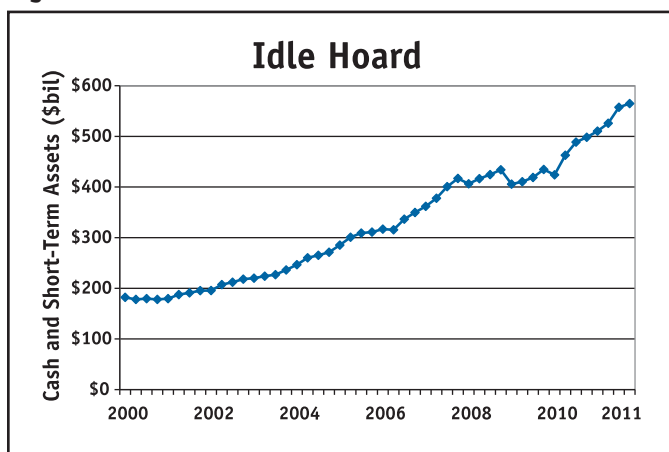
Indeed, a significant weakness in Canada's recent economic performance, that has significantly hampered our national recovery from the 2008-09 recession, has been chronic weakness in overall business investment spending. Business capital investment fell dramatically during the financial crisis and subsequent recession, and still has not regained its pre-recession levels (in real or in per capita terms) despite three years of official economic "recovery."²¹ Business profits and cash flow have remained strong, but the share of those funds reinvested in Canadian capital projects has been weak – with the result that Canadian non-financial corporations have accumulated an unprecedented stockpile of idle cash and short-term financial assets. By end-2011, non-financial corporations possessed close to \$600 billion in short-term liquidity (Figure 12); those idle holdings have actually expanded by close to \$200 billion since the financial crisis (at a time when other stakeholders in Canada's economy, namely consumers and governments, have taken on significant new debts to support spending despite the downturn). Canadian businesses literally are taking in more profit from their existing operations than they know what to do with. Many observers, including Bank of Canada Governor Mark Carney, have highlighted this failure of business investment as a key factor behind Canada's sluggish growth, job-creation,

productivity, and innovation (see Carney, 2011.)

In this context, measures to spur more business capital spending become increasingly important to Canada's overall economic performance. Across-the-board tax cuts and other no-strings-attached incentives to corporations have not done the job. More focused measures, aimed particularly at capital-intensive, high-technology sectors like auto, will be essential to reversing this failure of businesses to invest.

Exports: "Snatching defeat from the jaws of victory." That's a motto that aptly describes the incredible reversal of Canada's automotive trade fortunes over the last decade. During the very time that our exports of raw resources (especially petroleum) were booming, Canada's automotive

Figure 12



Source: Statistics Canada CANSIM Table 378-0087. Non-financial corporations only.

trade balance was going from feast to famine. As described in detail in Part II of this document, we've seen a \$15 billion automotive trade surplus at the turn of the century melt away into an even larger trade deficit today. That \$30 billion decline in automotive trade balances accounts for much of the \$80 billion net deterioration that was experienced in Canada's national balance of payments during the same period.

Despite that deterioration in net automotive trade performance, however, the fact remains that Canadian automotive products are essential to our continuing trade capacity. Close to 90 percent of assembled vehicles made in Canada are exported (almost exclusively to the U.S.). Over 60 percent of Canadian-made parts are also exported. Together, automotive exports worth \$53 billion

²⁰CAW Research calculations based on Statistics Canada CANSIM Tables 31-0002 and 281-0024.

²¹Most economists date the onset of recovery to July 2009 when real national GDP stopped falling and began once again to grow – albeit slowly and hesitantly.

Multiplied Benefits

Winning a major investment in a new auto facility is important not just for the good jobs located in that particular plant. The auto industry demonstrates very strong “multiplier impacts,” which means that additional jobs are created in many other workplaces and industries throughout the regional and national economies.

There are two broad reasons for this multiplier impact:

1. “Upstream” Effects: The auto industry has an intensively developed supply chain. Any major auto assembly or powertrain facility relies on the regular delivery, often on a just-in-time basis, of an incredible array of parts, sub-assemblies, raw materials, energy, and services. Together, those parts and materials account for over 60 percent of the final cost of assembling a vehicle; they collectively represent, therefore, the bulk of the “value added” in the vehicle’s production. The jobs located in those supply industries obviously depend on the jobs in the final assembly operation. Without the assembly plant, they wouldn’t exist.

In Canada, there are nearly 2 jobs in the independent auto parts sector for every job in major auto plants – and that is just the beginning of the supply chain (since there are many other industries which supply automakers and parts suppliers with everything they use in production). Because of the continuing historical trend towards specialization and outsourcing on the part of major producers, these supply chain linkages have become even more extensive than in previous years.

2. “Downstream” Effects: The other manner in which a major auto facility supports other jobs is when auto workers (and other stakeholders in the industry) spend the income that they generated. Auto workers spend their income on personal and family consumption: everything from homes to vehicles to restaurant meals to services. A healthy

share of their incomes go toward tax revenues that support public services (schools, hospitals, libraries, and others) where more people work. All those workers, in turn, spend their own incomes on consumption in their communities, and so on. All that spending and re-spending of income generates a circular chain of new demand, and creates multiple jobs throughout the economy.

The very strong multiplier effects associated with employment in the auto industry have been documented by numerous economic studies (see, for example, Canadian Automotive Partnership Council, 2005; Centre for Spatial Economics, 2008; Hill, Menk, and Cooper, 2010; and Shiell and Somerville, 2012).

One of the most comprehensive recent studies was undertaken in 2010 by researchers at the Center for Automotive Research in Michigan, utilizing economic simulation techniques developed by Regional Economic Models, Inc. Their analysis indicates that every job in a major auto facility (vehicle or powertrain assembly) supports 9 other jobs elsewhere in the national economy: over one-third in upstream supply industries, and the rest in downstream indirect jobs (see Table 7). This implies a total automotive multiplier effect of 10: every major auto job increases total employment by a factor of 10.

Table 7
Multiplier Impacts of Employment in a Major Auto Facility

Stage	Jobs
Direct Employment in a Major Auto Facility	1.0
Upstream Supply Linkages	3.4
Downstream Spin-off Jobs	5.6
Total Employment	10.0

Source: CAW Research calculations from Hill, Menk, and Cooper (2010), Table 2.2.

What the Auto Industry Means to: Canada

The Industry

- Five major automakers operate car and light truck assembly plants in Canada: Chrysler, Ford, General Motors, Honda and Toyota. A further six firms produce buses and heavy trucks.
- Canada's auto industry also comprises a highly-developed parts sector, including manufacturers' in-house engine and transmission plants, and over 400 independent parts facilities.
- 2,135,121 vehicles were built in Canada in 2011 (or 5,850 per day).
- The industry produced vehicles and parts worth \$69 billion in 2011, (or \$189 million per day).

Jobs and the Economy

- The auto industry directly employs 112,000 people in Canada.
- Thousands more jobs are created to supply the industry: jobs in steel, plastics and other manufacturing and services. More jobs are created by the spending power of auto workers' paycheques.
- Auto workers' paycheques pumped \$6.1 billion into the Canadian economy in 2011 (or \$17 million per day).
- The major original equipment manufacturing jobs are estimated to stimulate 337,000 other jobs throughout the economy.
- Including spin-off jobs, the auto industry is responsible for 374,000 jobs across the country.

National Impact

- The auto industry accounted for \$53 billion worth of exports in 2011, 12% of the nation's total.
- Among all of Canada's sources of exports, the auto industry is second only to the oil & gas industry (but as the nation's leading manufacturing exporter the auto industry produces twice as many direct jobs).
- The value of auto industry exports is more than double those from the forestry and agriculture industries, a third more than from primary metals, and a quarter more than from mining.
- As a crucial source of high-technology investment and productivity growth, the industry boosts our national economic performance. The benefits of the auto industry are felt throughout the nation through supplier links, tax revenue and consumer spending.

Supporting Our Communities

- The industry supports services that we all depend upon, like health care, education and social services. Auto workers' fundraising efforts also directly support community organizations such as the United Way, food banks and women's shelters.
- In 2011, auto workers paid \$1.6 billion in income, payroll and sales taxes (or \$4.4 million per day).
- Most auto workers own homes, and based on average property tax rates auto workers also supported \$468 million in municipal taxes in 2011 (or \$1.3 million per day), helping to pay for local services.

Vital for us All

- The CAW fights for good jobs in the auto industry, which are vital for us all.



The CAW represents 200,000 workers in several sectors of the economy.

CAW  TCA
CANADA
www.caw.ca

**Direct Jobs:
112,000**

**Every day
in 2011,
auto workers
in Canada:**

**built 5,850
vehicles**

**produced \$189
million worth of
products**

**earned
\$17 million**

**paid \$5.7 million
in income,
payroll, sales
and property tax**



left Canada in 2011. That accounted for 12 percent of Canada's total merchandise exports last year.

Canadians will continue to purchase new motor vehicles in large numbers; in fact, our domestic market was one of the most buoyant in the world through the global financial crisis and subsequent recession. Therefore, if we are not manufacturing and exporting a healthy volume of this output, the entire country will experience a painful, chronic drain on its balance of payments. A larger domestic foothold in export-oriented industries, naturally implies a stronger performance in exports in general. In this regard, sector-focused industrial policy initiatives aimed at export-intensive industries can contribute to a stronger underlying trade balance and thus help to relax the balance of payments constraint on national income and employment.²²

Total Economic Impacts: Adding up the auto industry's enormous impact on Canada's overall economic performance paints a picture of an industry that is essential to our productivity, incomes, innovation, exports – and even to the fiscal situation of our governments. The summary fact sheet (overleaf) summarizes the overall estimated economic impact of automotive manufacturing (considering both assembly and parts) on all these dimensions of Canada's economic well-being.

All of these structural features – superior productivity, superior incomes, intensive and lucrative supply-chain linkages, capital-intensity, and export-orientation – explain why the auto industry is a logical target for pro-active government interventions aimed at enhancing the domestic production footprint. It is not that we “love cars” (although we do!). It is that this industry demonstrates core structural characteristics, that make its presence here broadly beneficial throughout the regional and national economies. Indeed, those same features

explain why the auto industry has long been a favourite target for pro-active government industrial strategy in countries around the world.

The measures we are calling for are not necessarily unique to the auto industry. There are other industries with similar characteristics which would benefit from similar sector-focused industrial policy interventions.

And remember, the measures we are calling for to strengthen our auto manufacturing footprint are not necessarily unique to the auto industry. There are *other industries* with similar characteristics which would benefit from similar sector-focused industrial policy interventions: other high-value, technology-intensive, export-oriented industries. These include other manufacturing sectors (like aerospace, telecommunications and electronic equipment, energy equipment, pharmaceuticals and medical equipment), as well as specialized service and technology sectors (like film, software, biotech, and health sciences). In every case, intervening to expand Canada's share of desirable industries generates broad benefits that exceed the costs of strategic policy measures such as those we propose in this document.

So the argument is not really “what's so special about the auto industry”? The issue at stake is whether Canada will undertake pro-active measures, in a range of sectors, to diversify our economic base, and carve out a larger foothold in desirable high-value sectors.²³ The alternative to this more pro-active approach is continued passivity by policy-makers in the face of the strong pressures that are pushing Canada back into a dangerous reliance on the extraction and export of raw natural resources.

²²For a discussion of the broader effects of industrial policy on trade balances and other macroeconomic performance indicators, see Arestis and Sawyer (1999).

²³A broader analysis of the need for pro-active sector development strategies in Canada, and a listing of several specific policy measures which could realize that goal, was provided as part of the 2012 Alternative Federal Budget project (Canadian Centre for Policy Alternatives, 2012).

PART IV

Re-thinking Canada's Auto Industry: A New Policy Vision

In the current policy regime, in which the global economy is governed by aggressive corporations with no accountability to the countries and communities where they do business, the outlook for future investment and employment in Canada's automotive manufacturing sector is not promising. Automakers are now capable of producing high-quality output, assembled by desperate and often repressed workers, from jurisdictions where labour costs are a small fraction of those in any industrialized economy (including Canada). Why would they continue, in the long run, to invest in Canada or similar jurisdictions, unless they face some kind of policy or political compulsion to do so?²⁴ Mere inertia – the fact that automakers have major fixed investments here, which are impossible to relocate – ensures there will continue to be an important manufacturing presence for some time into the future. The whole industry cannot disappear overnight. But the industry's centre of gravity within North America is clearly shifting south, and rapidly (see Klier and Rubinstein, 2010), heading toward Mexico and the right-to-work states of the southern U.S. And it won't stop there: as globalization continues to exert its influence, we can expect massive vehicle imports from other low-wage economies (like China, Thailand, or India).²⁵ Trying to slow that southward migration of investment by reducing compensation here in Canada would be fruitless and self-defeating – merely slowing down the inevitable at best, and sacrificing the quality of life which is supposed to be the whole point of economic development. What is ultimately required is a more pro-active policy approach to defend Canada's share of a vital industry, such as the measures we propose in this document.

Moreover, every sacrifice on the part of workers desperately trying to protect future investment can be overwhelmed by a few days of trading on the currency

markets, so long as the upward flight of our loonie is allowed to continue unfettered. For example, in March and April of 2009 CAW members at General Motors and Chrysler ratified emergency contract amendments that reduced active hourly labour costs in Canadian plants by around \$7 per hour (and that also stabilized legacy costs by restructuring pension plan funding and creating new health care trust funds for retiree health benefits). Yet in the six months after those contracts were ratified, the Canadian dollar rose by 15 cents against its U.S. counterpart, adding about \$9 to all-in CAW labour costs (measured in U.S. dollar terms). In terms of international cost competitiveness, therefore, the impact of the unprecedented contract changes in 2009 was more than offset by just six months of unfettered currency speculation. So long as Canada's petro-dollar is allowed to float freely (more beholden to the mood swings of financial traders than to the real fundamentals of our economy), trying to improve cost competitiveness by reducing labour compensation is like swimming against a rip tide: the likely outcome is drowning.

Other important industries have disappeared from Canada entirely, as a result of similar business forces: including manufacturing sectors like textiles, clothing, appliances, and most electronics. The theory was that displaced Canadians would find more "productive" work in other industries, to replace their lost jobs, thanks to the magical workings of supply and demand. That hasn't happened, of course: unemployed manufacturing workers have been forced to seek work in low-wage service industries, or to drop out of the labour market altogether.

For a while, even as other manufacturing sectors imploded around us, the auto industry was spared from the most extreme manifestations of deindustrialization, thanks to a fortuitous combination of circumstances: the carry-over momentum from strong investment in Canadian facilities in the 1980s and 1990s; the competitive value of our public health care system, our superior productivity, and our top-notch infrastructure; and the cushioning effect of a currency which for many years was undervalued (rather than overvalued, as at present). In recent years, however, the unforgiving pressure of the global "race to the bottom" has been experienced in full force by the auto industry in Canada. The continuing

²⁴In the U.S. automakers face some pressure to keep at least some manufacturing presence there because of the latent threat of future protectionism from U.S. lawmakers, as well as to promote a "made in America" image to appeal to U.S. consumers. Neither of these factors has been sufficient to motivate incoming investment into Canada, given our smaller market and more passive lawmakers.

²⁵The latter two countries have already commenced free trade negotiations with Canada at the invitation of the Harper government.

take-off of Mexico's auto industry, the continuing degradation of labour conditions (and labour rights) in the U.S., the coming onslaught of imports from China and other sources, the increasing willingness of corporate executives to destroy entire communities in pursuit of even higher profit margins, all collectively paint a dire long-term outlook for auto manufacturing in Canada.

We do not accept this grim scenario as natural, efficient, or inevitable. The deindustrialization which Canada is experiencing does not reflect normal or efficient "market forces." It reflects the long-run impact of discretionary policy choices which governments have made, influenced disproportionately by the interests of powerful, wealthy corporations and the investors who own them. As indicated earlier in this report, there are plenty of examples from other auto-producing jurisdictions (including high-wage economies such as Germany and Japan) which have refused to accept the long-run demise of this crucial, value-generating sector as a given. Canadian policy-makers have the autonomy and the power to take a different course of action, rather than continuing to justify current and future hardship as a natural, inevitable outcome in a "global economy."

The CAW proposes a 10-point strategy to maintain a viable, profitable, dynamic auto industry in Canada. We believe that, given an appropriate context of policies and regulations, carrots and sticks, it is entirely reasonable to expect – even to *demand* – that Canada retains a fair share of a lucrative industry that depends, after all, on the spending power of our own consumers. The policies we describe below would mark a clear break from the *laissez faire* "free market" approach which has been followed most of the time (not all of the time) by our governments over the past three decades. They would collectively recreate a powerful capacity by government to intervene in determining the location of investment, production, and employment in this vital sector, and hence to protect a proportionate Canadian share of the industry and its prosperity. While this would represent a clear change in direction, our proposals do not constitute utopian dreaming: *every policy we recommend has been successfully implemented in other auto producing jurisdictions* (and many have in fact been used in Canada, in auto or other sectors). And while we recommend fundamental changes to existing free trade agreements and our trade policy approach, *all the measures we propose are "legal" under the terms of our existing international commitments*. (At any rate, complying with trade agree-

ments has not stopped other countries – from China to Brazil to Korea and even the U.S. – from acting decisively to support their respective auto industries.)

#1: Implement an Integrated National Auto Policy.

It is often said that admitting you have a problem is half the solution. And merely acknowledging that we *need* a national auto policy, itself takes us considerable distance towards the end goal. The sad reality is that, despite a decade of meetings, summits, and policy development at both the federal and Ontario levels, Canada still does not have a formal auto policy (see sidebar: **Action or Inaction?**). The need for one has been nominally acknowledged by officials at both levels of government – although in practice, both still maintain the polite free-market fiction that an attractive business environment (marked by free trade, low taxes, weak regulations, and competitive labour costs) eliminates the need for sector-focused strategies. Indeed, the idea of supporting particular targeted sectors is still derided in many circles as "picking winners": something government is supposed to be bad at (although it could hardly do worse in this regard than the stock markets have done!).

In reality, identifying and supporting a range of sectors with positive spill-over effects to the rest of the economy (such as those described in Part III above) does not constitute "picking winners." Favouritism is not shown toward particular companies (beyond the criteria that they must be present and active in Canada). But it makes obvious economic sense to place strategic policy emphasis on those sectors which demonstrate the sorts of characteristics Canada needs more of – like high productivity, strong capacity to generate incomes, strong reliance on capital investment and innovation, export orientation, and strong upstream and downstream spin-off linkages. The auto industry is an obvious candidate according to all of these criteria, but the auto industry is not the *only* sector demonstrating such features. This is why our call for a pro-active, integrated national auto policy is positioned as part of a broader call for active sector development interventions more generally.

By "integrated" national auto strategy, we refer to the need to ensure that all policy levers of government are arrayed and aligned in a consistent, powerful direction. More specifically, we need to ensure that our auto policy considers, in an internally consistent manner:

Action or Inaction?

Strictly speaking, Canada does not have a formal sector strategy for the auto industry. Both the federal government and the Ontario government (since the vast majority of Canadian auto firms are located in that province) have undertaken unfinished initiatives in recent years to consider the possible elements of an auto policy. But neither government has followed through on this work to reach the completion and implementation of a concrete auto strategy.

Similarly, the Canadian Automotive Partnership Council is a multi-partite industry body, with representation from all the major stakeholders in the auto industry (including assemblers, parts makers, the CAW, both levels of government, universities, and dealers). It was formed in 2002 to address the accelerating downturn in the auto industry (in the wake of the abolition of the Auto Pact and the take-off of the Canadian dollar). It has published several important strategy documents with an eye to framing a Canadian auto policy (available at www.capcinfo.ca). However, to date governments have not followed through with any systematic policy formulation. The longer they wait, the greater the risks facing Canada's crucial auto sector.

Politicians, of course, like to claim that they have laid the groundwork for successful investment and growth in any sector of the economy, through their various pro-business policies (see Table 8). Many still claim that we don't need to do anything "special" for the auto industry itself. This view is dangerously wrong. Other jurisdictions tailor their policies to attract crucial high-value industries like auto. If we continue to pretend that a generally business-friendly environment (and there is no doubt that Canada is that) will be sufficient to win future auto investment and jobs, then we will continue to pay a heavy economic and social price for government's lack of vision and action.

Table 8
Action and Inaction: Elements of Auto Policy

	A Genuine Auto Policy	Current Approach
Trade	Use trade policy as a strategic lever to win new investment in Canada.	Sign free trade agreements, let "free markets" decide the rest.
Taxes	Reward companies that invest with tax credits.	Provide across-the-board tax cuts to companies whether they invest or not.
Skills	Push companies to train more apprentices; provide incentives for training.	Wait until a skills shortage develops.
Investment	Provide regular stable support for major capital projects (grants, loans, tax credits).	Engage in ad-hoc subsidies and bailouts when it suits government to do so.
Environment	Recognize and support the need for sustainable vehicles, and combine regulations with made-in-Canada content of green vehicles & components.	Implement some new regulations (eg. fuel efficiency), but with no attention to what it means for Canadian production.
Innovation and Technology	Provide direct support for new projects and facilities in Canada.	Provide generous tax incentives for R&D, no strings attached.

- The policy levers of both the federal and provincial levels of government, to ensure they are not working at cross-purposes.
- Initiatives to support Canadian activities by both original equipment manufacturers and independent parts suppliers.
- Ensuring that our fiscal, trade, skills, technology, environmental, and infrastructure policies as they affect the auto industry are aligned with a consistent view to maximizing Canadian manufacturing activity in a sustainable, socially beneficial manner.

Of course, this is not to suggest that all considerations for government policy must be subsumed underneath the pre-eminent goal of winning new auto investment. There are many other factors that must be also be respected in policy-making, ultimately aimed at enhancing Canadians' right to live quality, secure lives in healthy communities and a sustainable environment. But government must be more systematic and consistent, once our priorities have been determined and weighed, in ensuring that subsequent policy interventions are consistent and not self-defeating. This does not occur at present, largely as a result of the ad-hoc, peripheral nature of most policy interventions in general, and the fact that policies across the various "silos" of government do not always align with consistent effect.

An "integrated" auto policy therefore aims for Canada to "line up our ducks" – federally and provincially, in assembly and parts, and across the various departmental jurisdictions of government – behind an overarching effort to preserve and expand Canada's automotive manufacturing industry.

#2: Negotiate Canadian Manufacturing Footprint Commitments with All OEMs

Canada's new vehicle market is large, vibrant, and lucrative. Canadians purchase over 1.5 million new units per year (the tenth most in the world), worth a combined \$55 billion per year. Canadian vehicle sales remained remarkably steady despite the downturn associated with the global financial crisis in 2008 and 2009. Assuming an average profit margin of 5 percent (typical in the modern auto industry), OEMs thus earn close to \$3 billion profit each year on their sales to Canadian consumers, thanks to their ready access to our market.

Do Canadians, in return, have a right to demand that these companies inject some value-added back into the Canadian economy, rather than viewing Canada solely as

a selling opportunity? We think so. And we think it is increasingly important, as companies become more aggressive in their profit-maximizing decisions regarding investment location, that Canadian policy-makers send the signal that access to the Canadian market is not unconditional and to be taken for granted.

Automotive trade constitutes a large proportion of total international merchandise trade. According to the World Trade Organization, autos and parts accounted for \$1 trillion in total international trade in 2010, or 7.4 percent of total world merchandise trade that year. In developed economies (North America, Europe, and Japan), automotive products account for over 10 percent of total trade. Automotive products are second only to crude oil as the most valuable single commodity trade flow. Any country which allows its participation in this important segment of trade to be dominated by imports, without offsetting domestic production and hence exports, will consign itself to chronic trade deficit and lost income opportunities.

To address Canada's current imbalance in this regard, and to provide governments with leverage to influence future investment location decisions, we propose that Canada seek to negotiate Canadian manufacturing footprint commitments from automakers which sell into the Canadian market. The operating principle is that, ideally, an OEM's value-added activity in Canada should at least match the combined value of its product sales in Canada.

The concept of a Canadian manufacturing footprint has obvious precedent in the operating principle which guided the Canada-U.S. Auto Pact (signed in 1965, and abolished by dictate of the World Trade Organization in 2001). But the concept has other applications in a more modern policy context, as well. For example, the Canadian government recently applied a very similar idea with the domestic content requirements imposed on its recent major shipbuilding contract (see sidebar: *We Can Do It!*). The Canadian and Ontario governments even began to revitalize the principle of domestic content targets in the restructuring agreements they signed with General Motors and Chrysler as part of their bankruptcy process in 2009. Under those agreements, the government required the assisted companies to maintain a proportional Canadian manufacturing footprint (in line with the traditional size of their operations in Canada, and the resulting amount of financial assistance provided from Canada as part of the joint Canada-U.S. rescue effort). These commitments were very important in ensuring that Canada maintained (and even slightly

We Can Do It!

The idea of a conscious government policy to develop a key sector of our economy might sound unusual in this day and age, when so many have swallowed the line that everything in the economy should be left up to the private sector.

However, there are many powerful examples of sector-focused strategies that have indeed been successful in promoting domestic investment and employment in key high-value industries.

Aerospace: Canada is the fourth-largest manufacturer of aircraft and related equipment in the world. This didn't happen by accident. Government has been a key player in making sure we have a strong footprint in this valuable industry, through many different policies: subsidies for developing new aircraft and manufacturing them in Canada, "offset" agreements using our public procurement to leverage more domestic production, even outright public ownership of aerospace companies at key points in the industry's history.

Shipbuilding: The federal government recently announced a massive \$33 billion purchase of ships and related equipment for naval and coast guard purposes. The government decided from the beginning that the ships must be built in Canada, and used an innovative process to push bidders to maximize the Canadian content in all stages of the ship construction. One notable feature was a strong Industrial and Regional Benefits policy, which required contractors to ensure that value-added was produced in Canada (either directly or through "offsets") equal to 100 percent of the awarded contract.

Green Energy: Ontario's Green Energy Act offered lucrative subsidies to electricity suppliers using solar, wind, and other alternative energy sources. But there was a stick to go along with the carrot: providers had to meet high thresholds of made-in-Ontario content in the projects which qualified for the subsidies. The policy has stimulated the creation of a new manufacturing industry in Ontario, supplying components for wind and solar power systems.

Banks: Canada's powerful banks may seem like the epitome of free-enterprise capitalism, but in fact they are very much the product of strategic government

intervention. Federal agencies actively support Canadian banks, including through public mortgage insurance, public deposit insurance, and strict prohibitions against foreign takeovers. Then, when the going got tough in the 2008-09 global financial crisis, Ottawa was there with a \$200 billion injection of funds (that's *15 times as much* as the federal and provincial governments provided to the auto industry at the same time!). The resulting stability of Canadian banks has helped Canada avoid some of the problems experienced in other countries without those government policies.

Auto Industry: Indeed, Canada's auto industry would not exist without similar pro-active measures. The most important of these, of course, was the Canada-U.S. Auto Pact, signed in 1965, which required qualifying companies to meet strong thresholds for Canadian production (including assembling one vehicle here for every vehicle sold here, and manufacturing total value-added equal to at least 65% of all value-added sold). But the government used other measures (including tariff reductions to lure Honda and Toyota here; strategic trade interventions to slow offshore imports in the 1980s; and ongoing support for capital spending, training, and infrastructure) to reinforce the Auto Pact's influence.

When the World Trade Organization over-ruled the Auto Pact (and Canada accepted this ruling) in 2001, our auto industry began to steadily shrink, and has since declined by about one-third. Finding other strategies (such as those outlined in this paper) to support and preserve Canada's share of this vital industry is an essential priority for government policy – or else there's no reason to believe Canada will even have an auto industry in future decades.

expanded) its share of total North American production in the years following that crisis. Unfortunately, however, those commitments were medium-run in nature, and will expire within a few years (by approximately 2017). This means that the current investment decisions being contemplated by the two assisted OEMs will not for long be constrained by those footprint commitments (since upcoming investments would extend beyond the time frame covered by those agreements). Other countries around the world have taken similar measures to enhance domestic manufacturing activity. So this concept is not pie-in-the-sky nostalgia; it is a powerful, fair, and practical principal that would influence future corporate decision-making in Canada's favour.

Moreover, by setting a proportional threshold that is balanced (value-added in Canada must be equivalent, over some period of time, to value-added produced here), we are not pursuing a "beggar-thy-neighbour" policy that seeks to export our industrial and employment problems to our trading partners. Ideally, if every OEM signed and lived up to such a commitment, Canada's automotive trade would only become balanced. The current \$15 billion automotive trade deficit would be eliminated, and most of the 23,000 lost jobs represented by that deficit would be regained. But Canada would continue to trade actively in automotive products – productively so, since the powerful economies of scale associated with auto assembly require that output from specific plants be sold in numerous markets, in order to attain efficient scale of output. Most importantly, that trade would be balanced and mutual, in contrast to the beggar-thy-neighbour one-way import flows which have increasingly dominated our auto trade in recent years.

Government officials would seek to negotiate proportional footprint agreements with OEMs. Companies are not required to sign these agreements, of course. But the government would offer a range of both carrots (incentives) and sticks (penalties) to encourage companies to do so. Companies which participate in the manufacturing footprint strategy would capture the benefits from a range of the policy measures being proposed below. Companies which do not, would incur incremental costs as a result of their failure to contribute something back to Canada's economy, in return for their profitable sales to our consumers.

Some proposed features of the footprint agreements would include the following:

- Credit for Canadian production would be provided for the full value-added associated with Canadian-produced assembly and components (including Canadian-made components purchased from independent contractors).
- Credit could also be granted for "offset" purchases or production by each OEM and associated company in non-automotive manufacturing sectors (allowing, in essence, a company to "trade" genuine Canadian content in other manufacturing sectors for their sales in Canada of automotive products). This would be especially valuable for OEMs (like Hyundai or Honda) which are active in a range of different industries.
- Value-added would be calculated as the difference between input costs and output value at each stage of production, consistent with existing statistical and accounting practices, so no major additional administrative provisions would be required.
- Value-added in Canada would have to meet Canadian sales over a running three-year average period, in order to qualify for the advantages offered to qualifying OEMs (and avoid the costs imposed on non-qualifying firms). This allows some flexibility in the application of the regulations, in the event that a particular company experienced sudden or unexpected sales success in the Canadian market.

All five of the OEMs operating in Canada at present would seem to meet the requirements of the Canadian manufacturing footprint policy (although Ford's footprint here, in light of recent downsizing and strong Canadian sales, is close to the "break-even" point in this regard). In that context, the goal of the policy, as applied to these five firms, is to at least preserve their proportionate footprint here. For other OEMs, which currently sell in Canada but do not produce here, the goal is to encourage them to establish new operations here, so that they begin to contribute to Canada's capacity to produce and generate incomes, at the same time as they sell their products to us. For companies newly acquiring qualifying status under this policy, a transition period will be allowed to gear up to full proportional status. Partial footprint benefits will be allowed when companies begin to commit to new investments in Canada, so long as a ramp-up business plan indicating the future growth of Canadian operations is submitted to and approved by Canadian officials.

The Canadian manufacturing footprint agreements would be supported by the other aspects of the nation-

Carrots and Sticks

Every farmer knows you need both a carrot (an incentive) and a stick (a punishment) to get a donkey to move in the right direction. Our proposal to negotiate Canadian manufacturing footprint agreements with global automakers applies exactly the same philosophy.

Companies which agree to maintain value-added production (through assembly, powertrain, components, or even “offsets” in non-automotive activities) in Canada that is proportionate to the value-added in the products they sell here, would receive benefits or rewards through several of the detailed policy measures described below. Companies which did not make this reasonable commitment, would face additional costs or penalties.

Table 9 summarizes the carrots and sticks that would be utilized to win the support of global OEMs for the Canadian manufacturing footprint concept.

Benefits Provided Companies Which Make Footprint Commitments	Penalties Incurred by Companies Which Do Not Make Footprint Commitments
Fiscal support for new capital investments. Access to trade-in incentives for replacement of old vehicles. Credits to offset cost of end-of-vehicle-life deposits. Participation in national vehicle procurement strategy.	Tariffs or quantitative limits on vehicle imports under trade safeguard measures. Full payment of end-of-vehicle-life deposits.

See text for detailed descriptions of each measure.

al auto policy, in order to give it “teeth” – and hence to give companies reasons to enter into these agreements (see sidebar: *Carrots and Sticks*).

#3: A Consistent and Transparent Auto Investment Program

The current reality in the global automotive industry is for host jurisdictions to provide significant fiscal support for major capital investment projects by OEMs. The rationale for this support is that in a fierce global competition for mobile investment, host jurisdictions need to offer more than just an appealing business environment. They need to participate directly in partially financing the investments. Investment subsidies are paid universally in North America, delivered in a wide range of forms: grants, tax exemptions, payments for infrastructure and training, preferential financing, and other mechanisms. Even in low-cost jurisdictions (such as Mexico and the right-to-

work states of the U.S.), governments step in actively to help attract new investments. Recent federal, state, and municipal subsidies for greenfield auto plants in the U.S. have been supported by a total subsidy rate in excess of 30 percent. In Canada in recent years, support delivered through various federal and provincial programs (such as the federal Automotive Innovation Fund, or Ontario’s Next Generation Jobs program) have amounted to, on average, about 15 percent of the cost of major capital projects.²⁶

The justification for public support for these projects is that the external benefits from the investment (including direct and indirect incomes, exports, and incremental fiscal revenues to government) justify the public’s role. Economic analysis suggests that governments actually earn back their initial investment in the form of incremental tax revenue on the supported facility and associated operations within a relatively short timespan (see, for example, Canadian Automotive

²⁶Shiell and Somerville (2012) compiled an inventory of most of these new investments since 2004, and their data (Table 9) implies an average subsidy rate of 15 percent.

Partnership Council, 2005). In this regard, the public role in major capital projects can legitimately be seen as an *investment*, more than a subsidy: it is an investment that ultimately benefits all the stakeholders in the industry, the broader economy, and ultimately government itself (and taxpayers).

Canada's auto investment policies have been intermittent and relatively ad-hoc. While the public support provided in recent years to major projects by all of the five OEMs currently present in Canada has been important in enhancing the Canadian industry during a turbulent time, each "pitch" to government has had to grapple with fundamental uncertainty regarding the stance and consistency of government policy. This uncertainty is particularly acute at the present time, when the commitment by governments both federally and in Ontario to the future application of investment supports is uncertain (in a context of fiscal restraint and, especially at the federal level, an ideological predisposition against pro-active sector strategies). Worse yet, this uncertainty prevails at a particularly vulnerable time, with the automakers more aggressive and mobile than ever, and with an overvalued Canadian dollar doing great damage to the international cost competitiveness of operations here.

We propose a long-term, stable, and transparent auto investment program, in which the federal and Ontario governments would jointly and evenly share the cost of 25 percent of qualifying capital spending associated with major new capital investments in Canadian automotive facilities. This rate of fiscal support for major projects is demonstrably paid back within the life cycle of a given investment program, hence making this an attractive proposition for Canadian taxpayers. In short, the fiscal position of government under this scheme will be stronger than if the support was not provided (and the investments not made).

Features of the investment program would include the following:

- Investments will be supported only for OEMs which sign Canadian manufacturing footprint commitments, thus providing assurance to Canadians that the supported companies will maintain an overall proportionate presence here. Companies will thus be prevented from receiving support in the context of a broader disinvestment from Canada.
- Governments may negotiate the option to convert a

share of their fiscal support into equity in the supported company, thus reinforcing the strategy of building public minority equity holdings in OEMs (described in item #4 below).

- OEMs may partner with major independent parts suppliers in joint capital programs (involving new supplier facilities, some of which could even be located adjacent to or on-site with OEM assembly operations), in which case those new parts facilities would also qualify for the capital support.
- Capital investments associated with environmentally advanced products or manufacturing processes would receive preferential support under the program.

#4: Accumulate Public Minority Equity Shares in OEMs With Major Canadian Operations

Many automakers around the world have benefited from financial support from host governments, delivered in another form: through equity holdings in the companies by the governments themselves. These investments support the companies with a long-run foundation of "patient" capital, in contrast to private financiers who are prone to jump in or out of a company based solely on the most recent quarterly results. Similarly, they are important in stabilizing an OEM's balance sheet during the inevitable ups and downs of the automotive business cycle. From the investing government's perspective, they can provide the government with a "seat at the table," to influence the company's business decisions – either directly (through representation on the OEM's board of directors) or indirectly (through other communications and dealings with the company's senior management).

There are many examples of OEMs with significant public equity shares. The German state of Lower Saxony holds a 20 percent interest in Volkswagen, perhaps the world's most successful OEM at present. This holding has surely assisted in preserving Volkswagen's large operations in Germany, despite the company's global reach and despite Germany's high labour costs. Similarly, the government of France owns 15 percent of Renault (and consequently holds minority shares of Nissan and AvtoVAZ, too, through those companies' joint ownership structure). Many Korean industrial firms (including Hyundai) have benefited from targeted equity investments by the publicly-owned Korean Development Bank. Similarly, the Development Bank of Japan has played an active role for decades providing equity and other forms of capital to Japanese OEMs and parts suppliers (most

recently including investments and partnerships with Mazda, Mitsubishi, and numerous parts suppliers – who received over \$600 million in preferential investment from the Bank in 2011 after the devastating tsunami hit there). Several domestic automakers in China are still partly owned by state agencies; under Chinese foreign investment rules, incoming direct investments by foreign OEMs must form joint venture partnerships with Chinese firms, and hence the Chinese government owns a share of those ventures, too.

The federal and Ontario governments, perhaps inadvertently, ended up as important minority shareholders of both General Motors and Chrysler, since some of the financial support provided to both firms as part of their 2009 restructuring was converted into equity holdings. The public share of Chrysler, unfortunately, was divested in 2011 through a \$140 million (U.S.) repayment from Fiat, Chrysler's parent. This was a small return on an investment that could have provided both governments with significant leverage in future years regarding Chrysler's business strategy in North America. The governments do retain a combined minority share of just under 10 percent in General Motors. They have stated that their goal is to sell those shares as soon as market conditions allow the best return on them; but given the large market "overhang" on GM stock, in light of other investors who wish to cash out quickly – especially the U.S. government – this condition may not arise for many years. Moreover, so far the Canadian governments have declined to actively "vote" their shares within GM's internal governance practices; this leads to the unseemly scenario of GM's increasingly aggressive management in essence holding one of its own major shareholders hostage, with threats to disinvest from Canada if certain outcomes are not met (such as GM's bellicose and counterproductive language during the recent process to establish its new Canadian health care trust system). Surely an entity which helped the entire company to survive, deserves to play a more active and respected role in its future business decisions.

In our judgment, public equity ownership in OEMs with a substantial manufacturing presence in Canada is a valuable tool for cementing the government relationship with the firms, stabilizing the OEM's financial foundation, and influencing long-run business strategy. The practical experience of other partly state-owned OEMs around the world proves that minority government ownership does not imply these firms become

inefficient, wasteful, or money-losing. Nor does it imply a narrow parochialism in business strategy. Every viable OEM in the current global economy will need to maintain a global network of manufacturing and supply operations. The goal of minority public ownership is merely to help guarantee that the host, owning country receives a reasonable share of desirable investments and opportunities.

We urge the Canadian and Ontario government to maintain their current minority share of General Motors, and to utilize that share in a more pro-active effort to ensure that Canada's economic interests are respected in GM's future business decisions. We also suggest that the governments jointly (operating through an intermediate financing agency, such as Export Development Canada – the public bank which holds the governments' GM shares) and gradually acquire equity stakes in other OEMs which commit to maintaining a proportional Canadian manufacturing footprint. One potential mechanism for doing so is to provide project-specific financial assistance (to support new capital spending in Canada) in the form of purchases of new equity in the investing firms. Another mechanism would be for the governments (again with the financial intermediation of its public bank) to simply purchase shares in these companies as a financial investment. As an investment, these purchases would not affect government's annual budget balance (since they constitute a balance sheet transfer), but they would offer the potential of cementing the Canadian presence of these important companies.

#5: Investigate Possibilities of Building a Canadian OEM

Historically, Canada's auto industry has relied 100 percent on the presence here of foreign-based automakers. While these investments have generated enormous economic and technological benefits for Canada, they have left our industry in a structurally unbalanced and insecure state. For example, Canada possesses much fewer white-collar and scientific jobs in the auto sector than countries with home-grown OEMs, and the industry spends a much smaller share of its total revenue or GDP here on research and development than do the industries of other countries with domestic OEM head offices. For example, Canada's auto industry dedicates one-seventh as much to R&D (measured as a share of sectoral GDP) as does the U.S. auto industry (Canadian Council of Academies, 2009, pp. 178-182). Moreover, by being 100 percent dependent on foreign firms which have no

structural roots in Canada, we are left all the more vulnerable to disinvestment on the part of ruthless executives willing to migrate investment to the lowest cost host.

More broadly, the general failure of Canada's economy to develop and nurture home-grown companies, which can offer innovative high-value products into global markets, has been widely identified as a key structural weakness in our economy. It helps to explain our very poor record of innovation, productivity growth, and export success over the past decade, dominated as it was by dramatic expansion in the extraction and export of unprocessed natural resources.²⁷ Pro-active efforts to nurture and support domestically-based national "champions" would help to address these weaknesses. The auto industry, given its long presence in Canada, and the ready availability of Canadian skilled workers, engineers, and managers with practical experience in this industry, would be a good place to start.

In the independent parts industry, Canada has benefited from the emergence of large, globally-oriented firms with the capacity to undertake complex innovation, design, and marketing functions. Magna International is the most prominent example, and this company has even extended its capacities to include complete vehicle assembly (which it currently performs on a contract basis at a factory in Austria). There would seem to be considerable potential, with the financial and policy support of government, to explore opportunities to develop a Canadian-based OEM capacity (engaging Magna and/or other private firms), perhaps beginning through joint-venture arrangements with other OEMs. It is worth noting that this is the exact strategy that has been followed by the Chinese government in recent years, to support the consolidation of the previous domestic auto industry, and the emergence of a small number of Chinese-owned national "champion" OEMs which are now beginning to extend their reach through the rest of the world. Similar efforts to support the early establishment and growth of domestic OEMs played a crucial role in the early history of the Japanese and Korean auto industries, as well.

#6: Re-think Automotive Trade Policy

This document has described in detail the terrible decline of Canada's automotive trade performance in

recent years. Canada used to punch well above its weight in international auto trade, with a trade surplus that peaked at \$15 billion in 1999. Then global commodity prices took off, the World Trade Organization overturned the Auto Pact, the Mexican auto industry reached critical mass, and our loonie started its flight into the stratosphere. Canada now incurs a large annual trade deficit in excess of \$15 billion. That means that cumulatively we produce \$15 billion less automotive value-added each year than we consume.²⁸ The drain of purchasing power represented by that trade deficit translates into the loss of 23,000 good jobs in auto assembly and parts, multiplied several times over through the broader economy.

Canada's automotive trade relationship with the U.S. can broadly be considered as balanced and mutually beneficial. The two-way flow is huge: \$100 billion per year. Canada maintains a small surplus (in excess of \$5 billion in 2011). Both sides receive ample opportunities to sell their products in each other's market. This broadly mutual structure of trade reflects the ongoing heritage of the Auto Pact – which eliminated tariffs on automotive trade, but contained important safeguards to ensure proportionality in investment and production.

With every other trading partner, however, Canada's automotive trade is precariously unbalanced. Auto trade with these jurisdictions is essentially a one-way street, with foreign-based firms selling vast quantities of product into Canada's buoyant automotive market, but contributing little if anything back to our national capacity to produce and generate incomes. Outside of the U.S., Canada exported just 6.6 cents of automotive products for each dollar imported in 2011. The result is an enormous, destructive trade deficit, equal to \$21.5 billion for all countries other than the U.S. in 2011 (and which vastly swamps the modest surplus we continue to maintain with the U.S.). The utter lack of balance in trade is universally shared with all our non-U.S. trading partners. Our automotive imports from Mexico outstrip our exports there by a 14-to-1 margin; with the EU by an 18-to-1 margin; with Japan by a 135-to-1 margin; and with Korea by a stunning 224-to-1 margin.

One-way flows like these cannot reasonably be defined as "trade" in any meaningful sense of that word. Every time Canada signs another free trade agreement, the government publishes economic simulations which

²⁷For more commentary on this structural "regression" in Canada's economy, see Stanford (2008).

²⁸Canada assembles about one-third more vehicles than are purchased here, producing a modest trade surplus in assembled vehicles. As described in Part x, however, this is overwhelmed by a larger and chronic trade deficit in parts and components. Overall, we thus consume substantially more automotive value-added than we produce.

demonstrate the long-run economic gains expected to result from greater trade. In every one of those economic models, the assumption is that Canadian exports will grow as much as Canadian imports. None of the models allow for a scenario in which our imports explode, but our exports are curtailed – whether that is due to continuing foreign trade policy interventions (such as non-tariff barriers), parochial foreign consumer tastes, or the failure of Canadian-based firms to successfully develop and produce competitive products. The precise reason for the failure to export, on one level, does not matter. The mere fact that the growth in imports is not offset by an equivalent expansion of exports is enough to completely invalidate the optimistic predictions of the free trade theories.

It is a responsibility of trade policy-makers to address and resolve this dramatic, chronic, and growing imbalance in our international trade relationships in automotive products – one of the most important traded commodities in the world economy. The ultimate goal of our automotive trade policy should be to enhance the rationale for Canadian investment and employment in this crucial sector. A vision of mutually beneficial, two-way trade flows is a good one to aim for (and is largely reflected in our large bilateral auto trade with the U.S.). Where that cannot be attained (due to economic, structural, or policy barriers preventing meaningful exports of Canadian automotive products to foreign markets), then the destructive effects of one-way trade imbalances must be fixed anyway, by curtailing the growth of automotive imports to Canada from those jurisdictions.

Importantly, existing international trade law allows plenty of scope for national governments to intervene to manage and curtail trade imbalances and import surges where they are found to be damaging domestic industries. Several countries have utilized these protections in the years since the global financial crisis to curtail import surges and prevent other countries from “exporting” their economic problems through beggar-thy-neighbour export-push strategies. These include Brazil, China, Russia, Vietnam and even the U.S. – all of which imposed unilateral tariffs or other restrictions on automotive imports in order to prevent the destruction of domestic jobs. Canadian trade negotiators have a responsibility to act similarly. Their role is not to

promote an abstract philosophical commitment to “free trade” (which never appears in practice like it is supposed to in the economic textbooks). Their function is to manage Canada’s relationships with other countries in a manner which enhances Canadian prosperity, rather than undermines it.

In this broad policy area, we recommend the following specific measures and strategies:

Cease free trade negotiations with the EU, Japan, Korea, and Thailand.

Each of these countries is a major automotive producer. With the exception of Thailand, each already benefits from enormous one-way trade surpluses with Canada. There is no conceivable scenario under which Canadian automotive exports to these countries would be significantly enhanced under a free trade agreement. Indeed, Japan’s tariffs on automotive imports are already zero (despite which the country is one of the most closed auto markets in the world), so it is hard to imagine a free trade deal having any impact whatsoever on its auto purchasing patterns. Even official government studies confirm that free trade agreements with these countries would promote a much larger increase in Canadian automotive imports from those countries, than in Canadian automotive exports to those countries.²⁹ Trade officials privately acknowledge that each agreement will cause more damage to Canada’s automotive industry; they justify that damage on the basis of additional market access opportunities for certain resource and agricultural products. But the auto industry – and Canadian manufacturing more generally – is too important to be a “sacrificial lamb” in the government’s pursuit of free trade deals, all the more so given the dubious benefit of those deals to Canada’s overall trade balance (see sidebar: ***Not Helping***).

Pursue negotiations to reduce bilateral trade deficits.

Ceasing free trade negotiations with the major “culprits” of Canada’s existing unbalanced automotive trade would at least prevent us from shooting ourselves in our own foot, with respect to future automotive trade balances. However, the status quo in our automotive trade is hardly acceptable to begin with. Tens of thousands of Canadian auto jobs have been lost to the one-way flood of imports. Safeguard and surge protections in existing

²⁹For example, in the case of Canada-EU negotiations, the official joint government study of the expected impacts projects that Europe’s automotive exports to Canada will grow by almost \$400 million more than Canadian automotive exports to the EU, significantly worsening the bilateral automotive trade deficit. See European Commission and Government of Canada (2008), p. 59.

Not Helping!

Canada's international trade performance has been disappointing by any measure. We have experienced large trade deficits in recent years. When we include tourism, services, and other international payments, our total deficit last year was almost \$50 billion. Compare that to a surplus of \$30 billion back in 2000 – when the auto industry was at the top of its game.

Oil and gas exports are an important source of export revenue for Canada, without doubt. However, by driving up the loonie far above its fair value, the oil boom has hurt all other export industries. Our trade balance in *non-petroleum industries* has collapsed from a \$30 billion surplus in 2000, to a \$40 billion deficit today.

Measured as a share of GDP (see Figure X), the improvement in petroleum exports is far outweighed by a deterioration in *everything* else Canada sells to the world: especially manufacturing, but also tourism and services.

Confronted with this deteriorating performance, the federal government can only seem to come up with a single response: sign even *more* free trade agreements. However, empirical evidence shows that the more free trade agreements we sign, the worse our trade performance becomes.

A recent study of Canada's previous free trade agreements shows that they have actually worsened Canada's trade balance (Table 10). Among the countries with long-standing free trade deals, Canada's exports grew by an average of 4.77 percent per year –



Source: CAW Research calculations from Statistics Canada, CANSIM Table 3760001; Industry Canada Strategis.

slower than our exports grew to other countries (with whom we had no trade deal, yet where exports grew 5.11 percent per year). On the other hand, our imports from FTA-partner countries grew faster (by an average of 8.67 percent per year) than our imports from non-FTA-partner countries (7.25 percent per year). Free trade agreements have thus worsened our export performance, and undermined our trade balance. More free trade agreements will do the same.

If the goal of our trade policy is to strengthen our exports and our trade balance (and that is an important goal, because more export success means more jobs at home), then signing more free trade deals is exactly the wrong thing to do. The spate of new trade deals being pursued by the Harper government will undoubtedly contribute to even worse trade deficits, hence destroying more Canadian jobs.

Table 10
Impact of Free Trade Deals On Imports and Exports

Country and Year	Annual Growth in Exports (pre-FTA to 2009)	Annual Growth in Imports (pre-FTA to 2009)
5 Countries with FTAs	4.77%	8.67%
All Other Countries ¹	5.11%	7.25%

Source: *Out of Equilibrium: The Impact of EU-Canada Free Trade on the Real Economy*, by Jim Stanford (Ottawa: Canadian Centre for Policy Alternatives, 2010), Table 11, p.30.

1. Annual growth from 1992 through 2009.

trade agreements give the government full authority to redress these damaging one-way flows. The Canadian government should open discussions with its counterparts in the EU, Japan, and Korea. The goal is to identify means of reducing the bilateral deficit either through enhanced purchases of Canadian-made automotive products, through reduction in import flows to Canada, and/or through productive investments in Canada by OEMs based in those countries which serve to offset the bilateral trade deficit. In the latter case, participating companies could then also qualify for the benefits provided under the Canadian manufacturing footprint policy, enhancing the benefits to them of a successful resolution. Failing an acceptable agreement to reduce bilateral deficits, the Canadian government would have the legal ability to impose tariffs or quantitative restrictions on automotive imports from those jurisdictions.

There are ample real-world precedents for this type of strategy. The government of Brazil, for example, recently did exactly that: concerned by a growing imbalance in automotive trade with Mexico, Brazil initiated negotiations with Mexico that culminated in the implementation of a voluntary quota on Mexico's imports that will limit vehicle exports to Brazil. Compared to Canada, Brazil's auto industry has been buoyant in recent years (Brazil's total vehicle assembly has doubled since 2001, compared to a significant decline in Canada's case), yet the Brazilian government felt both justified and empowered to intervene to ensure that a growing imbalance with Mexico did not undermine domestic production. Surely the Canadian government should feel even more concerned about these imbalances. The governments of China, Vietnam, Russia, and even the U.S. have introduced targeted policies to limit imports of vehicles and components in recent years.

Initiate discussions toward a North American Auto Pact.

Mexico is the source of Canada's largest automotive trade deficit (exceeding \$8 billion in 2011, quadruple the level experienced before the signing of NAFTA). The automotive deficit accounts for about 40 percent of Canada's enormous \$19 billion bilateral trade deficit with Mexico. The promise of NAFTA proponents that growth and rising living standards in Mexico would stimulate mutual expansion in demand and trade has foundered. In reality, Mexico has evolved into a sophisticated export platform for multinational corporations to access low production costs and sell into the rest of North America; continued violence, suppression of labour rights, and

poverty have served to undermine living standards there (not to enhance them). Real wages in Mexican manufacturing are in fact lower than before the NAFTA was implemented, despite a six-fold increase in Mexican exports under NAFTA. But since Canada and Mexico are already joined by a free trade agreement, efforts to tackle that bilateral trade deficit must involve fundamental reforms to the NAFTA itself.

In that regard, we propose that Canada initiate a proposal for a new North American automotive trade agreement, which we dub a "North American Auto Pact." The core idea would be to enhance automotive trade relations within the continent (given the highly integrated nature of the continental industry already), while introducing new safeguards regarding intra-North-American trade imbalances. The current and expanding imbalance in automotive trade flows within the continent is destructive and unsustainable. Mexican demand for vehicles is still constrained by poverty and Mexico's ultra-low costs (labour costs per hour in Mexican auto assembly plants are even lower than those in many plants in China, in the range of \$3 per hour). Continued tariff free automotive trade within the continent would be maintained, with restrictions set on the proportional imbalance in trade (such that a bilateral deficit could never exceed 20 percent of the total bilateral flow). This would impose a constraint on the location decisions of OEMs, who would be prevented from utilizing Mexico solely as a one-way low-cost export platform, and would produce a structure of trade that confirms much more closely to the ideal of mutual, two-way trade.

At the same time as enhancing and stabilizing the structure of automotive trade within North America, the North American Auto Pact would seek to redress the external imbalances between the continent and the rest of the world. Despite some improvement over the last two years (largely the result of the higher yen), offshore imports to North America still constitute over 20 percent of all continental vehicle sales. That represents a much higher degree of import penetration than is visible in other major regional markets. By jointly approaching offshore producers, North American negotiators can wrest a stronger commitment by offshore-based OEMs to North American investment and production – a development which will benefit all three countries (given the integrated nature of the continental supply chain). These efforts will reinforce the efforts by Canadian officials (described above) to attain reductions in our own bilateral automotive trade imbalances with Europe and Asia.

#7: Intervene to Reduce the Canadian Dollar Exchange Rate.

As described in earlier sections of this paper, all Canadian non-resource export industries have been seriously damaged by a currency that has been driven up (by speculative pressures fixated on our petroleum exports) nearly 25 percent higher than its fair value (according to relative costs and prices). This imposes, in essence, a 25 percent penalty on any value-added in Canadian operations, in industries (like auto) for which exports are a major or dominant source of demand. This punishing cost burden cannot be tolerated without a constant drain on Canadian investment, employment, and exports.

There is a naive assumption in some quarters that it will simply “take time” for Canadian producers to adapt to a higher dollar. But how, exactly, would this adaptation occur? Nominal wages might be cut in an attempt to offset the 60% appreciation of the currency in the last decade – as Caterpillar demanded, for example, in its recent confrontation with its workers in London, Ontario (see sidebar: ***Don’t Get Caterpillared!***). This is neither fair nor effective. Companies might attempt to improve their productivity to be able to stay competitive even with artificially expensive relative costs. This has not been manifested in the form of business capital spending (which has been weaker, as a share of GDP, than when the Canadian dollar was undervalued – likely because with an overvalued dollar there is less rationale to locate new capital spending in Canada in the first place). Innovation in products and processes might help, yet companies would still face an incentive to relocate production of that more innovative activity to a location with lower apparent production costs (due to foreign exchange effects). So long as the Canadian dollar remains far above its fair value due to speculative and resource-driven factors, any other industries which sell their output to international markets – including manufacturing, tourism, and tradable service sectors – will face an uphill battle to even hang on to their current footprint.

While in theory the global financial system relies primarily on a system of freely floating exchange rates (which are supposed to equilibrate real outcomes in goods and capital markets), in practice governments and their central banks regularly intervene in currency markets to influence currency outcomes. Many countries have adopted such strategies in recent years, with the goal of achieving exchange rates that enhance the competitiveness of domestic industries. China’s exchange rate

is tightly regulated, through a state-managed banking system, to maintain that country’s super-competitiveness in global markets despite an enormous trade surplus. Other countries (including Japan, Brazil, Switzerland, and others) regularly intervene through central bank asset purchases and sales to manage exchange rates. Even the U.S. could be said to be pursuing a “cheap dollar” trade strategy (in support of the government’s official goal of boosting U.S. exports by 50 percent) through its unconventional “quantitative easing” measures. The depreciation of the U.S. dollar in recent years has been a crucial reason for that country’s renewed competitiveness in international manufacturing trade. In the European case, depreciation has been achieved accidentally through the impact of the enduring Euro-zone debt crisis. The outcome, nevertheless, is a further boost to the competitiveness of manufactured goods from Germany and other Euro-zone exporters; given Germany’s enormous trade surplus (second only to China), one would expect its currency to appreciate, but in fact the reverse has occurred.

In short, exchange rate fluctuations have played a dis-equilibrating role in world trade. It is not realistic for a country to step back from this fray and pretend that markets are working in an efficient manner. With so many other countries actively managing their currencies, and with the costs of the loonie’s overvaluation mounting every year, the Canadian government must take active efforts to attain a currency that is more in line with Canada’s true costs, prices, and trade performance.

There are several options available to the government in pursuit of this goal:

Bank of Canada interventions. So long as the Canadian dollar is in excess demand (whether for purposes of real trade and investment, or more likely as a result of speculative demand by financial investors), there is no limit on the Bank of Canada’s ability to supply more dollars to the market in order to reduce appreciation. That role can be played through the Bank’s intervention in traditional asset markets. It could also be pursued through unconventional methods (such as the quantitative easing strategies pursued by the U.S., U.K., and European central banks). The Bank’s power to bring down the dollar is unquestioned; the only debate is whether the Bank should so do, since this strategy would require the Bank to consider other goals in its policy-making other than the single-minded inflation target which has guided its actions for the past two decades.

Don't Get Caterpillared!



On New Year's Day 2012, Canadians received a very rude awakening to the logic of free trade. Caterpillar, the giant global equipment manufacturer, locked out the 350 CAW members who worked in its locomotive plant in London Ontario. Caterpillar had just purchased the plant only 18 months before from Electro-Motive, which had successfully (and profitably) operated there for decades. But Caterpillar had other plans in mind. After demanding a 50 percent cut in compensation from its workers (which they understandably refused), it locked out the work force. Days later, Caterpillar declared the highest annual profits in its history: over \$5 billion (U.S.) for 2011. The company never denied that its London plant was profitable, too. This was clearly an issue of greed, not need.

Then in February the company shut the plant entirely. Its locomotives will now be assembled in plants in Mexico, Brazil, and a new factory in Indiana. Not coincidentally, just days before Caterpillar's public closure announcement, the Indiana state legislature passed a new "right-to-work" law which will make it effectively impossible to ever organize a union at the Caterpillar plant there. The company is hiring workers for \$12 per hour, to perform skilled work in a heavy industrial facility.

Canadians were rightfully outraged at Caterpillar's "economic home invasion." Sympathetic retailers removed CAT-branded products from their shelves. An enormous demonstration was organized in London.

Politicians, however, mostly wrung their hands. Some, forced by public opinion, mouthed words of distress at the company's destructive actions. But no meaningful policy response has been forthcoming to make sure that this sort of disaster doesn't happen again.

The CAW has proposed several policy reforms that would reduce Canadians' vulnerability to this type of aggressive corporate action. They include:

1. Reforms to the Investment Canada Act to prevent foreign giants from taking over and then shutting down Canadian operations.
2. Reforms to our international trade policies, so that companies like Caterpillar must pay a penalty if they eliminate Canadian jobs.
3. Reforms to our tax system, forcing companies like Caterpillar to pay back the tax assistance they received from government, if they eliminate Canadian jobs.
4. Reforms to our labour laws, to give workers more protection at the bargaining table against lockouts and plant closures.

Auto companies are thinking, and acting, more like Caterpillar every day. They benefit from unlimited ability to move their investment and their product across national borders. They take advantage of desperation, and repressive labour laws, in Mexico and the U.S. right-to-work states to keep wages artificially low. They feel more confident than ever in demanding never-ending concessions from workers – no matter how high corporate profits (like GM's record \$8 billion profit in 2011). They are comfortable to wield the hammer of disinvestment and job loss, blackmailing workers and governments alike, if they don't get their way.

Aggressive corporate irresponsibility like this is the logical outcome of the rules of the game that have been established for the economy. If we give corporations free reign to move their capital and their product, with no restriction and no tariffs, no matter how badly they treat the citizens of any particular jurisdiction, then why should we expect any corporation to behave differently than Caterpillar did?

But those rules of the game are not inevitable. They are the result of conscious decisions by policy-makers, bowing to powerful interests. By pushing back, and demanding fairer rules (under which corporations owe something back to the communities where they make their profits), we can build an economy marked by prosperity and security, rather than perpetual fear and belt-tightening.

Slowing down resource developments (especially in the oil sands). The link between world oil prices and the Canadian dollar was firmly established beginning at the turn of the century, when Canada's oil sands juggernaut (and associated inflows of foreign capital) first began to accelerate. Rightly or wrongly, currency speculators now associate our dollar with oil wealth – even though our national trade balance has actually deteriorated during this period. Establishing a more reasonable pace of resource development, especially in the oil sands, would be beneficial for reigning in the currency (not to mention for environmental and social reasons, too, in order to better manage the significant costs of that unplanned, overheated development boom).

Preventing foreign takeovers of Canadian resource assets. A dominant factor behind the strong dollar has been the dramatic upsurge in foreign takeovers of Canadian resource companies (and hence the resource assets which those companies control). Perhaps the most potent policy lever which government could use to bring down the currency would be to restrict foreign resource takeovers, hence reducing the inflow of hot foreign capital associated with those takeovers. More important, there would be a structural break in the expectations of foreign investors regarding the relationship between oil prices and our domestic financial assets. After all, Canada is unique among major petroleum exporters in allowing virtually unlimited foreign ownership of this non-renewable resource. So the appetite of foreign investors for Canadian assets is whetted all the further (since other petroleum exporters strictly restrict foreign ownership of the asset). Signalling that Canada's petroleum resources are off-limit to foreign takeovers would immediately shift investor perceptions of future movements in the Canadian dollar.

The traditional argument against pro-active efforts to depreciate the currency are that it would spur domestic inflation. This argument is not credible in light of the experience of recent years. The sharp appreciation of the currency did not cause a deceleration of inflation in Canada, since importers failed to proportionately pass through their savings to Canadian consumers. (This is precisely why the overvaluation of the dollar according to PPP criteria has continued unabated.) Canadian inflation has in fact exceeded U.S. inflation in most years since the financial crisis (implying a *reduction* in the PPP exchange rate). Undoing that appreciation can hardly be expected to cause a surge in inflation. Neither would

Bank of Canada actions to increase the supply of Canadian dollars to foreign currency markets. Those owners of Canadian dollar assets are holding them for speculative reasons, not to purchase Canadian-made goods and services. The primary monetary determinant of Canadian inflation will continue to be the pace of domestic credit creation. So long as most of our economy remain mired in stagnant economic conditions, no inflation surge can be anticipated.

#8: Building a Green Auto Industry

Environmental concerns will exert ever-stronger influences over the auto industry of the future, affecting everything from the type of vehicles manufactured, to production methods, to fuel systems and driving behaviour. We do not see a contradiction between environmental protection and prosperity in this regard. In fact, for many reasons, there are positive economic opportunities associated with new investments in environmentally advanced vehicle technologies and production methods (see sidebar: ***Green Jobs Building Green Cars***).

To ensure that our national auto policy is effectively addressing environmental goals in all aspects of its application, we propose the following:

Fuel efficiency standards. Since the election of the Obama administration, U.S. EPA standards on fuel efficiency have been improved substantially. We support the current direction of those standards (and the parallel Canadian rules), which have been designed in close consultation with the auto industry and which will require substantial investments by the industry in new technology and materials. However, in conjunction with the implementation of those standards, it is essential that active support be provided to Canadian facilities to ensure we preserve our share of investment and production as the new rules are phased in. It is not enough to simply proclaim new environmental standards, and just assume that the industry will painlessly adjust – especially in light of increasingly intense international pressures on the industry.

Auto Investment Policy. In approving projects for fiscal support through the auto investment policy, special attention will be paid to leveraging investments which embody advanced environmental features both in the vehicles being produced, and in the processes used in manufacturing (such as greater energy efficiency in man-

Green Jobs Building Green Cars

It is now undeniable that greenhouse gas pollution is contributing to a dramatic and sustained rise in world temperatures, which will cause major hardship and dislocation in the decades ahead: including through rising sea levels, droughts, severe weather disasters, shifting migration and vegetation patterns, and other effects. Vehicle transportation is an important source of greenhouse gas emissions. The operation of light-duty vehicles accounted for 12 percent of Canada's total greenhouse gas emissions in 2008 (most recent data available; Environment Canada, 2010). The manufacture of motor vehicles also emits some greenhouse gas pollution, but does not contribute significantly to Canada's total emissions. The dominant climate problem associated with motor vehicles is in their use, not their production.

Global policy-makers are trying to grapple with the enormous challenges of developing effective, enforceable regulations on greenhouse gas pollution in order to slow down the rise in global temperatures, and assist affected regions in adapting to the coming changes. Sadly, Canada's Conservative government has played a very destructive role in this regard. Its primary goal has been to protect the interests of Canada's powerful, super-profitable petroleum industry. Greenhouse gas emissions associated with the dramatic rise in petroleum exports from Canada (which have doubled in the last decade, mostly due to the huge expansion of bitumen production from Alberta's oil sands) are the dominant source of growth in Canada's own emissions. Harper government diplomats have fought hard against any constraints on future oil sands development and export, culminating in pulling Canada out of the Kyoto process altogether in 2011 (the first country to do so). It is important to note that the auto industry itself is a collateral victim of the oil sands boom, because of the negative impact of an overvalued Canadian dollar which is another outcome of that resource-dominated trajectory.

It is our expectation that motor vehicles will continue to be a core source of personal transport in the future, given their immense convenience and flexibility. They are not optimal in certain settings (for example, transportation in core urban regions must be provided through public transit systems rather than personal vehicles). But most consumers will still desire a vehicle. The challenge is to facilitate improvements in the environmental performance of those vehicles: with better fuel efficiency, alternative fuel systems, better operation and maintenance, better fuel quality, and ultimately through the development and use of non-polluting vehicles.

These efforts need not pose a threat to the future presence of an auto industry in Canada. Indeed, some environmental enhancements in motor vehicles actually imply *more* content, and hence *more* jobs, than existing vehicles. For example, hybrid power systems require the installation of two engines on a car – not just one – and hence would require more work, not less. Other value-enhancing innovations include sophisticated electrical and power systems (including instant on-off engines), lightweight materials, and energy-efficient transmissions.

However, there is no guarantee that merely “greening” the vehicles we produce will somehow magically protect Canadian auto jobs (as some environmentalists claim). Painful proof of this reality was provided by the very first hybrid vehicle ever manufactured in Canada: a hybrid version of GM's pickup truck, assembled for a short time in Oshawa. Production was shifted to Mexico in 2008 (part of the company's continuing drive to exploit cheap labour), and the Canadian plant closed.

We need the same sorts of pro-active policy tools to protect Canadian investment and employment in producing “green” vehicles, as were required to build the auto industry here in the first place. Alongside measures which push automakers to develop and produce more environmentally-conscious vehicles, therefore, we need powerful efforts to ensure that a fair share of that production occurs here in Canada.

The CAW also recognizes the huge economic potential associated with investments in public transit systems and other environmental priorities, again with due attention paid to the necessity of maximizing Canadian content in those projects (including through buy-Canadian policies governing transit equipment).

The CAW has always supported efforts to reduce the environmental footprint of the auto industry, and has advocated Canadian support for international efforts (like Kyoto) to regulate greenhouse gas pollution. For more research and information visit the Environmental section of the CAW web site at <http://www.caw.ca/en/3531.htm>.

ufacturing plants, advanced emissions capture systems in paint shops, and other advances). Special attention, and higher levels of fiscal support, will be provided to new investments aimed at the manufacture of smaller and more fuel-efficient vehicles, and fuel-efficient engines and transmissions, at Canadian facilities. This will assist Canadian-based manufacturers to overcome their traditional focus on larger vehicles and engines, which face declining market opportunities as a result of fuel efficiency standards and high gasoline prices.

Incentives to trade-in polluting vehicles. Because of tremendous advances in emissions control and fuel efficiency, older vehicles emit far greater pollution (both greenhouse gas pollution and smog-creating particulates) than new models. Our policy would implement a \$1000 trade-in allowance for owners of vehicles over 10 years old to dispose of their vehicle (utilizing new auto recycling facilities as described below) and purchase a new model from an OEM which has committed to a Canadian manufacturing footprint. (Vehicles manufactured by OEMs without a footprint commitment would not be eligible for the trade-in incentive.)

Extended Producer Responsibility. We propose phasing in strong end-of-vehicle-life recycling standards governing the sale and eventual disposal and recycling of vehicles. Targets governing recyclable content in new vehicles will be determined and implemented over a ten-year transition. An end-of-life disposal deposit will be collected from the manufacturer on all new vehicle sales in Canada. For OEMs which have committed to a Canadian manufacturing footprint, credits may be provided against those charges to reflect the extent to which environmentally advanced investments in Canadian production facilities serve to reduce greenhouse gas pollution and other environmental effects. OEMs which have no Canadian footprint would not be eligible for those credits; funds collected on their deposit fees would be channelled to support the development of vehicle recycling facilities.

#9: Buy-Canadian Procurement Strategy

A significant proportion of Canadian vehicle sales consist of fleet sales to major purchasers. Agencies in the broader public sector – from government departments to police and emergency forces to the post office – account

for a significant proportion of those fleet sales. Proactive procurement strategies by government have played an important role in supporting Canadian manufacturing activity in other sectors (such as aerospace, telecommunications and computing equipment, and most recently shipbuilding). The same approach can play an incremental role in strengthening Canadian investment and employment in the auto industry.

Unfortunately, Canadian governments have consistently failed to wield this procurement “card” in the effort to preserve Canadian automotive investment and employment. Two recent examples of this failure are both telling and galling. In 2009 the federal government announced it would purchase 1300 heavy-duty trucks for military applications from Navistar International, in a contract worth \$274 million. At that very moment, the U.S. truck-maker which was in the process of closing its Canadian factory in Chatham, Ontario. Meanwhile, a year later Canada Post announced the purchase of 1175 Transit Connect vehicles from Ford. Again, at that very point in time the CAW and other stakeholders were working frantically to try to identify new product opportunities to prevent the closure of Ford’s assembly plant in St. Thomas, Ontario. The Transit Connect (currently imported by Ford from Turkey) was one of the products considered possible for St. Thomas, but Ford shuttered the plant anyway in 2011. In both cases, the potential to use public spending power to protect thousands of Canadian auto jobs, by connecting the dots between procurement and the Canadian investment plans of the companies benefiting from that procurement, was lost.

We propose that the federal government work with other levels of government (with the government of Ontario as a key partner) to implement an integrated buy-Canadian vehicle procurement strategy for purchases across the broader public sector (including Crown corporations and government-financed public services such as education and health care). All vehicle procurement would be directed toward companies which have negotiated Canadian manufacturing footprint commitments. By utilizing the buying power associated with an integrated centralized procurement strategy, the initiative could also help to leverage reduced prices from the manufacturers. For federal and Ontario agencies and Crown corporations, and for public agencies which benefit from direct or indirect federal or Ontario financial

support, buy-Canadian procurement would be mandated as a condition of that funding. For agencies and services fully funded by provincial or municipal governments outside of Ontario, participation in the national vehicle procurement process would be encouraged by waiving federal GST on the purchases.³⁰

#10: Investing in Human and Physical Infrastructure

One of the greatest strengths of Canada's auto industry is the ready availability of superior human capacity and physical infrastructure. The quality, work ethic, and skills of Canadian auto workers are recognized by manufacturers. And access to first-class transportation infrastructure and utilities also cannot be underestimated. A commitment to continuing to invest in these vital inputs is the final element of our proposed national auto policy:

Facilitating the demographic transition in workforce skills. Most of Canada's formally certified skilled trades workers in the auto industry are in the latter stages of their careers, having apprenticed in the industry during the expansionary 1980s and 1990s. These certified tradespeople have upgraded their skills through continuing training and experience, and will be hard to replace when they retire. Superior skilled trade capacities have been especially important to Canada's demonstrated success in rapid launches of new vehicles and other technical challenges. The logistical and operational challenges posed by the coming wave of retirements among skilled workers has been widely recognized, however automakers are very reluctant to invest in advance to prepare for that transition. The opportunity to transfer skills from existing tradespeople to a new generation of apprentices could be lost. We propose an integrated strategy involving provincial colleges, the automakers, and the CAW to get ahead of this transition, by identifying future staffing needs now, linking training and apprenticeship programs more effectively, and providing more effective training credits to manufacturers in Canada to support better apprenticeship planning.

Plant closure legislation and employment standards. Part I of this paper reported on the disproportionate incidence of closures of major assembly facilities which Canada has experienced in the past decade. Compared to the experience of other jurisdictions (like Europe, Japan, and Korea),

it seems that the relative ease with which automakers are allowed to shut facilities here has contributed to their willingness to do so. We propose stronger legislation requiring automakers to provide longer notice of plant closure and other mass layoffs, to invest more substantially in retraining and adjustment programs, and to provide more extensive severance benefits. By thus creating a large upfront financial disincentive for plant closure, government can thus encourage companies to consider alternatives (including temporarily idling facilities, instead of shutting them permanently).

Transportation infrastructure and supply chain. With the continued evolution toward tightly planned just-in-time inventory and supply systems, the importance of reliable, high-quality transportation capacities is greater than ever. Provincial transportation planners would work closely with both assemblers and suppliers around incremental investments in road transportation infrastructure. Investments in innovative structures such as on-site supplier parks, and alternative supply methods (including train connections and conveyers) for both incoming supplies and outgoing vehicles, would be facilitated through the auto investment program. A key infrastructure priority must continue to be moving ahead with the construction of a second bridge crossing in the Windsor-Detroit corridor; the provision of accelerated Canadian financial assistance for the project could help break the political logjam over the issue in Michigan.

Scientific and engineering partnerships. Canadian universities have considerably enhanced their capacities in specialized fields related to automotive research, design, and engineering in recent years. New partnerships with automakers, encouraged by the terms of recent federal-provincial investment subsidies, have been crucial levers in this regard. As part of the broader effort to round out Canada's automotive capacities to include scientific and engineering functions, targeted support for automotive engineering programs (such as those now provided in universities in Windsor, Hamilton, and Oshawa) will be expanded, and closer cooperation facilitated (through work placement opportunities, joint participation in engineering projects, and commercialization opportunities for university-based innovations) with the automakers. These opportunities would also be made available to auto parts suppliers.

³⁰ Many service providers in the broader public sector are exempt from GST payments in which case they would receive an equivalent rebate from the federal government on participating procurement purchases.

Conclusion

Canada's auto industry has survived perhaps the most turbulent decade in its history. Despite significant downsizing, violent uncertainty, and significant barriers thrown up in its way (chief among them a distorted exchange rate which makes every dollar in cost appear 25 percent larger than it is), the industry is still here. And it still makes a crucial, disproportionate contribution to Canadian incomes, productivity, innovation, and exports. Dire talk about Canada's loss of competitiveness relative to the U.S. (and other industrialized jurisdictions) is not justified by real-world factual analysis. In fact, even at current overvalued market exchange rates, Canada demonstrates no unit labour cost disadvantage relative to counterpart facilities in the U.S. However, the continuing lopsided evolution of automotive globalization, whereby increasingly aggressive companies seem willing to sacrifice workers and entire communities in a continuing race to the bottom, certainly poses a continuing threat to our industry and the many stakeholders who depend on it. In this regard, it is the unfettered rise of low-cost export platforms (currently including Mexico, but soon to include Thailand, China, and others) that poses a particular threat; so too does Ottawa's misguided policy of willy-nilly signing new free trade agreements, including with jurisdictions (like the EU, Japan, and Korea) with which our automotive trade relationships are already precariously unbalanced.

We reject the assumption that it is impossible to sustain a viable, profitable, dynamic auto manufacturing industry in a high-wage economy.

We completely reject the common assumption that it is impossible to sustain a viable, profitable, dynamic auto manufacturing industry in a high-wage economy.

The experience of other industrialized jurisdictions, where automotive manufacturing is a continuing source of growth and prosperity (rather than job loss and displacement), provides ample justification for our faith. The key difference between Canada and jurisdictions like Germany, Korea, Japan, and even the U.S. is not labour costs (which are high in all of these countries). The key difference is a willingness by policy-makers to play an active, guiding role in *building* an industry, and *constructing* an international advantage. In Canada, in contrast, policy has relied too much on the assumption that private market forces will automatically create a valuable, appropriate role for us in global economic affairs – and hence government can do no better than to get out of the way. If we continue to follow that course, our future is clear: Canada will increasingly specialize in the extraction and export of raw natural resources (especially bitumen). That business will generate certain economic benefits, of course, but cannot provide the foundation for sustained, shared, regionally and sectorally balanced prosperity. For that Canada needs a different approach.

The policy vision described in this paper would mark a significant change in philosophy and direction on the part of our governments. It would move us closer to the perspectives and practices of most other successful auto-producing jurisdictions (and away from the *laissez faire* assumptions that have dominated policy in most of the Anglo-Saxon world, including Canada, for a generation). But our proposals, while innovative in the Canadian context, are neither utopian nor untried. In our judgment, the only thing holding Canada back is a lack of political creativity – the creativity we need to rethink our policy framework, and rebuild a viable new auto industry that can provide good jobs for another generation of Canadians.

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