HOUSE OF COMMONS

CANADA

A STUDY OF THE CRISIS IN THE AUTOMOTIVE SECTOR IN CANADA

Report of the Standing Committee on Industry, Science and Technology

Hon. Michael D. Chong, MP
Chair

MARCH 2009

40th PARLIAMENT, 2nd SESSION

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THE STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY

has the honour to present its

SECOND REPORT

Pursuant to the Order of Reference from the House of Commons of Thursday, February 26, 2009, and the motion adopted by the Standing Committee on Industry, Science and Technology on Tuesday, March 3, 2009, the Subcommittee on Automotive Industry in Canada has studied the crisis faced by the automotive industry in Canada and the Standing Committee on Industry, Science and Technology has agreed to report the following:

A STUDY OF THE CRISIS IN THE AUTOMOTIVE SECTOR IN CANADA

This report is not intended nor was the Committee given the responsibility for recommending whether or not the Government of Canada advance loans to the automotive industry in Canada. It was instructed to review the current state of the industry and make recommendations.

An Integrated Continental Motor Vehicle Manufacturing Industry

The Auto Pact and Continental Integration

The North American automobile industry is particularly illustrative of the economic implications of regional integration. Before 1965, relatively large tariffs on imported automobiles engendered separate Canadian and U.S. automotive industries. In the relatively smaller Canadian auto industry,[1] production runs were shorter and the models manufactured and sold were less varied, resulting in relatively higher prices and less product selection for Canadians.

The 1965 Canada-U.S. Auto Pact significantly changed this duplicative structure and allowed the three major U.S. automobile firms – the so-called "Detroit Three" – to rationalize their production along North American lines. Later, Japanese automobile companies set up production facilities across North America, further broadening and expanding the industry; they have subsequently been dubbed the "New Domestics". Canada today boasts six foreign automobile manufacturers (i.e., Chrysler, Ford, General Motors, Honda, Suzuki and Toyota) with production facilities that include 12 assembly plants, mostly clustered in southern Ontario, producing for the North American market. At the same time, Canadians import a significant number of vehicles to meet their diverse automotive needs.

Although not part of a comprehensive industrial strategy, federal and provincial governments have funded some of the more recent investments in automotive assembly plant and equipment. Federal government funds, amounting to $434 million and taking the form of a repayable contribution through the former Technology Partnerships Canada (TPC) program, were provided in 2004 and 2005. Non-repayable provincial financial support of $513.8 million was also provided to these projects. Additionally, in 2008, the Government of Canada created a new Automotive Innovation Fund (AIF) to provide automotive firms $250 million over five years to support strategic, large-scale research and development (R&D) projects to build innovative, greener, more fuel-efficient vehicles. Later in the same year, the Government of Canada announced that it would invest up to $80 million in the Ford Motor Company of Canada's Renaissance Project, a $730 million initiative that will establish a state-of-the-art flexible engine assembly plant in Windsor, Ontario, and replace and expand the company's Powertrain Engineering Research and Development Centre.

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[1] In 1960, Canadian motor vehicle production amounted to 395,855 units and accounted for 4.7% of North American production. Source: DesRosiers Automotive Consultants Inc., Submission to House of Commons Subcommittee on Automotive Industry of the Standing Committee on Industry, Science and Technology, 12 March 2009.

In 2007, two-way automotive trade between Canada and the rest of the world totalled $152 billion, leaving Canada in a $5.9 billion deficit position. Canada, nevertheless, recorded an automotive trade surplus with the United States of about $12.0 billion, with Canadian exports valued at $70.4 billion and Canadian imports valued at $58.4 billion in 2007. These aggregate trade data, however, mask important intricacies of this integrated industry. As the Conference Board of Canada points out, the Canadian content of a Canadian-made car can be as low as 35%, meaning that some automobiles rolling off Canadian assembly lines rely more on foreign inputs, mostly from the United States, than on Canadian inputs.[2]

The integration of the Canadian auto sector, most notably with that of the United States and Mexico but also with that of Japan, has led to a number of milestones that a separate Canadian auto sector probably would not have achieved. For Canada, since 1965 the benefits include a significant international presence as an auto producer and exporter and a high level of productivity, with the latter being a force for higher wages and benefits across the sector's workforce. From the testimony and information gathered at subcommittee meetings, it was opined that Canadian autoworkers are the most productive in the world. But most of all, Canadians and Americans enjoy lower prices, higher quality products and greater product selection than they otherwise would.

The North American Market at a Glance

The growth in the North American market for cars and trucks was rather flat in the first half of the 2000s, with sales peaking at 20.2 million vehicles in 2005 (see Table 1). This peak was very close to the market's previous, all-time peak of 20.3 million units reached in 2000. Unfortunately, sales turned negative in the second half the 2000s. The slide in sales was at first modest. North American sales declined by about 940,000 units by 2007, representing less than 5% of total sales in 2005. In 2008, however, motor vehicle sales plummeted, falling by 3.1 million units to 16.2 million units or by about 16% in just one year. By 2008, the cumulative decline in sales since 2005 was more than 4 million units or 19.8%, and most industry observers are of the opinion that the sales figures for North America have not yet bottomed out.

The sales data clearly show that falling North American demand for motor vehicles originates in the United States. Indeed, motor vehicle sales in Canada and Mexico held up rather well in 2008; they were down only marginally from 2007. But an integrated North American automotive industry means that both Canadian and Mexican motor vehicle production will be tied to North American sales developments and, thus, both industries cannot avoid the consequences of declining sales in the U.S. market, by far the dominant North American market.

[2] Conference Board of Canada, *Making Integrative Trade Real: Creating a Value Chain Trade Policy for North America*, December 2008, p. 3.

Table 1
North American Sales of Motor Vehicles, 2000-2009F
(number of units)

Year	Canada	United States	Mexico	North America	Canada as a % of North America
2000	1,586,054	17,811,673	902,372	20,300,099	7.8%
2001	1,597,875	17,472,378	942,431	20,012,684	8.0%
2002	1,731,823	17,138,652	974,297	19,844,772	8.7%
2003	1,625,050	16,967,442	999,106	19,591,598	8.1%
2004	1,574,803	17,298,573	1,119,585	19,992,961	7.9%
2005	1,630,142	17,444,329	1,162,158	20,236,629	8.1%
2006	1,666,008	17,048,981	1,177,100	19,892,089	8.4%
2007	1,690,345	16,460,315	1,144,305	19,294,965	8.8%
2008	1,673,522	13,493,165	1,068,736	16,235,423	10.3%
2009F	1,480,000	11,500,000	950,000	13,930,000	10.6%

Source: Industry Canada; forecast provided by Scotiabank Group.

Table 2
North American Production of Vehicles, 2000-2009F
(number of units)

Year	Canada	United States	Mexico	North America	Canada as a % of	
					North America	Canada & U.S.
2000	2,963,097	12,773,714	1,922,889	17,659,700	16.8%	18.8%
2001	2,532,363	11,424,689	1,857,114	15,814,166	16.0%	18.1%
2002	2,626,916	12,274,917	1,833,342	16,735,175	15.7%	17.6%
2003	2,550,270	12,077,892	1,579,700	16,207,862	15.7%	17.4%
2004	2,710,683	11,955,044	1,552,718	16,218,445	16.7%	18.5%
2005	2,689,224	11,948,598	1,682,125	16,319,947	16.5%	18.4%
2006	2,571,366	11,260,854	2,045,518	15,877,738	16.2%	18.6%
2007	2,578,790	10,752,310	2,095,245	15,426,345	16.7%	19.3%
2008	2,082,241	8,673,091	2,167,944	12,923,276	16.1%	19.4%
2009F	1,800,000	7,300,000	1,900,000	11,000,000	16.4%	19.8%

Source: Industry Canada; forecast provided by Scotiabank Group.

North American motor vehicle production peaked coincidentally with North American motor vehicle sales in 2000 and 2005 (see Table 2). But after reaching a peak of 16.3 million units in 2005, North American motor vehicle production fell by 3.4 million to 12.9 million units in 2008, representing a fall of 20.9%. The decline was greatest in the United States (-27.5%), followed by Canada (-22.6%), but Mexico actually increased its production by 28.9% between 2005 and 2008.

Finally, the data show that, on an annual basis, North Americans import from offshore sources between 2.5 and 4.0 million more motor vehicles than the rest of the world imports from North America. Canada and Mexico are net exporter countries within North America. Canadian production accounts for about 16% of North American production, while Canadian sales represent only about 8% of North American sales. Additionally, Canadian motor vehicle production as a percentage of total Canada-U.S. production has trended upward from about 17% towards 20% between 2000 and 2008.

Market Developments among the "Detroit Three" and the "New Domestics"

Japanese motor vehicle manufacturing companies began investing in manufacturing plants in North America as early as in the 1970s; other overseas automobile manufacturers followed but would eventually withdraw from North America. Nevertheless, ever since the 1970s, these foreign-owned automobile companies have taken away market share from the "Detroit Three", but this loss had always been slow, gradual and not unexpected. Beginning in 2003, however, the "New Domestics" have not only taken away market share from the "Detroit Three," they have captured so much market share that the "Detroit Three" have had to reduce its overall production (see Table 3). In only six years, the "New Domestics" have substantially improved their market share in North America from just less than 25% in 2002 to more than 42% in 2008. More importantly, in the growing North American market between 2002 and 2005, the "Detroit Three" not only saw their combined market share decline from about 74% to 64%, their combined production declined by more than 1.1 million vehicles in this period. By 2008, the "Detroit Three" held only a 56% market share of total North American motor vehicle production. Clearly, the "Detroit Three" must take bold steps to address and reverse this declining market performance for a continuation of such a huge loss in market share at such a dramatic rate may mean bankruptcy for one or all of the "Detroit Three".

Table 3
North American Motor Vehicle Production and Market Share, 2000-2008

Year	GM, Ford & Chrysler		New Domestics	
	Units	Market Share	Units	Market Share
2000	13,196,873	74.7%	4,117,212	23.3%
2001	11,593,637	73.3%	3,997,567	25.3%
2002	12,281,894	73.5%	4,168,305	24.9%
2003	11,499,933	70.9%	4,422,906	27.3%
2004	11,060,100	68.2%	4,805,539	29.6%
2005	10,372,739	63.6%	5,511,476	33.8%
2006	9,676,079	60.9%	5,714,369	36.0%
2007	9,200,835	59.6%	5,961,536	38.6%
2008	7,248,444	56.0%	5,521,947	42.6%

Source: DesRosiers Automotive Consultants Inc.

Canadian Motor Vehicle Industry Profile (2008)

The spotlight will now be shone on the Canadian automobile industry. The Canadian automotive assembly industry can be divided into two segments: the light-duty vehicle segment and the heavy-duty vehicle segment. The light-duty vehicle segment is comprised of 12 high-volume assembly plants that produce cars, minivans and light trucks with a total production capacity of 2,770,000 units (see Table 4). The heavy-duty vehicle segment is comprised of 25 low-volume assembly plants that produce heavy-duty trucks and buses.

Table 4
Major Motor Vehicle Assembly Plants in Canada

Company	Plant Location	Products	Harbour Report Productivity Ranking
CAMI Automotive Inc. (GM and Suzuki)	Ingersoll	Chevrolet Equinox Pontiac Torrent Suzuki XL-7	Harbour Report: 5th place at 17.59 labour hours per vehicle (lhpv).
Chrysler Canada	Brampton Windsor	Chrysler 300 Dodge Magnum Dodge Charger Dodge Caravan, Pacifica Chrysler Town & Country	Harbour Report: 9th place at 18.78 lhpv.
Ford Motor Company of Canada Ltd.	Oakville St. Thomas	Ford Freestar, Ford Edge Lincoln MKX Ford Crown Victoria Mercury Grand Marquis	
General Motors of Canada Ltd.	Oshawa Oshawa Oshawa	Chevrolet Monte Carlo Chevrolet Impala Buick LaCrosse (Allure) Pontiac Grand Prix GMC Sierra Chevrolet Silverado	Harbour Report: 2nd place at 15.18 lhpv. Harbour Report: 3rd place at 16.17 lhpv.
Honda Canada Inc.	Alliston Alliston	Civic, Acura CSX Acura MDX, Pilot Ridgeline	
Toyota Canada Inc.	Cambridge Cambridge	Corolla, Matrix Lexus RX350	

Source: Industry Canada and Harbour Report, North America 2008.

In 2008, the automotive assembly industry manufactured 2.1 million vehicles and employed 45,091 people. The highly regarded Harbour Report ranks four Canadian assembly plants in the top-10 across North America (see Table 4). Finally, in 2007, Canadian assembly plants have won more than one third of all J.D. Power plant quality awards for North America despite accounting for about one-sixth of North American production.

Two Foreign Storms Blow Into Canada

Since the turn of the second millennium, two very powerful external shocks have, one after the other, hit the Canadian economy. First, a worldwide "commodities boom" took hold in 2003 that sent many commodities prices and the Canadian dollar soaring to record levels and forced a restructuring of the Canadian economy away from manufacturing and towards primary commodities. The second external shock, a worldwide economic recession that began in late 2008, put an end to the first shock only by broadening the dampening effect on demand – both domestic and foreign – from Canadian manufactured products to include all Canadian goods and services. Matters, nevertheless, did get worse for the Canadian manufacturing sector. For example, the Canadian automotive industry is probably Canada's most integrated manufacturing industry with the United States and has been undergoing a significant long-term transformation that requires extraordinary financial dexterity in the intervening or investment phase. To this industry, the first economic shock appeared manageable to all of its participants, but the second shock, which has severely restricted the operation of credit markets across North America, has already proven to be unmanageable for two of the "Detroit Three" (without considerable outside financial assistance). Indeed, some industry observers believe that should the recession deepen and persist much longer, it will not be long before the third company of the "Detroit Three" will submit a request for government financial assistance. Both of these economic events, as they have affected the Canadian automotive sector, are the topic of this section.

The Commodities Boom and the Rise of the Canadian Dollar

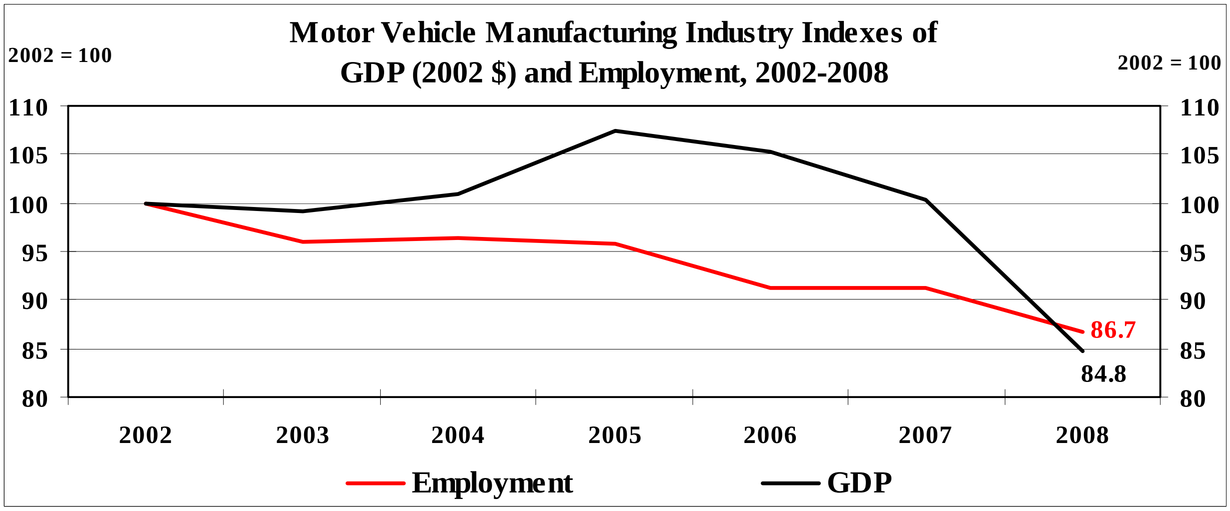
Beginning in 2003, rapid world economic expansion, led largely by China, India and Southeast Asia, fuelled the demand for primary commodities, most notably energy and base metals, and led to rapidly rising commodity prices. For a commodity export country like Canada – goods in which it possesses a comparative advantage – rapidly increasing and high base metal, crude oil and natural gas prices were accompanied by a large and rapid appreciation of the Canadian dollar, particularly against the U.S. dollar. In turn, an appreciating Canadian dollar, along with soaring energy costs, squeezed manufacturing profit margins and drove down the competitiveness of Canadian manufacturers relative to their foreign rivals. Canadian shipments of manufactured goods subsequently declined then floundered, and profits plunged sharply across the sector and even turned to losses for many manufacturing companies.

Although it is clear that an appreciating Canadian dollar, which rose from about 62.5¢ US in January 2002 to more than US$1.09 in November 2007 before settling back in the 77-84¢ US range since November 2008, adversely impacted the sales of all manufacturers, some products proved more sensitive to changes in the value of the Canadian dollar than others (see Figure 1). The motor vehicle manufacturing industry was hit the hardest among Canada's major manufacturing industries; its sales have declined by $11.9 billion in sales in just five years. The motor vehicle parts manufacturing industry also saw its sales decline by $2.2 billion in the past five years.

Figure 1

Source: Statistics Canada, CANSIM Table 304-0014.

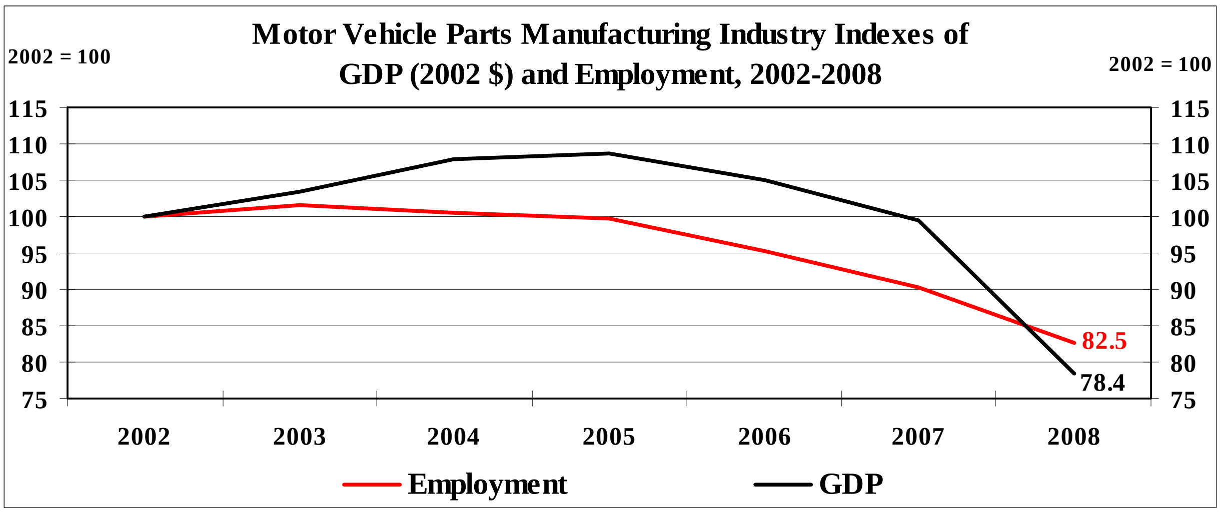
Figure 2



Source: Statistics Canada, Industry GDP and Labour Force Survey, various issues.

The performance of the automotive industry in this period can also be measured in terms either of its contribution to Canada's gross domestic product (GDP) or of its employment. Beginning with the motor vehicle manufacturing industry, its contribution to Canadian GDP had grown from \$13.4 billion in 2002 to \$15.1 billion in 2005, but it has since contracted to \$11.9 billion in 2008. Employment within the industry steadily declined from 53,204 in 2002 to 45,091 in 2008. Thus, while the industry made an equivalent contribution to GDP in 2007 relative to 2002, it contracted by 8.8% in terms of employment by 2007 (see Figure 2). Clearly, the loss in competitiveness of the Canadian motor vehicle manufacturing industry as a result of the rather large and quick appreciation of the Canadian dollar had forced these manufacturers to raise their labour productivity levels principally through shedding labour. With the onslaught of the U.S. recession in 2008, however, motor vehicle production in Canada declined precipitously and more layoffs ensued – but the contraction in labour was not as dramatic as that of production in this period. In the end, whether measured in terms of contribution to GDP or employment, the motor vehicle manufacturing industry declined by about 15% between 2002 and 2008.

Figure 3



Source: Statistics Canada, Industry GDP and Labour Force Survey, various issues.

Finally, the motor vehicle parts manufacturing industry experienced much the same fate as the motor vehicle manufacturing industry in this period, but its contraction was slightly more pronounced (see Figure 3). The automotive parts manufacturing industry declined by about 20% between 2002 and 2008, whether measured in terms of its contribution to GDP or employment.

A Global Recession and a Credit Crunch

In autumn 2008, the U.S. economy began a relatively unexceptional slowdown that, by the end of the year, would accelerate to a pace unprecedented since the Great Depression of the 1930s; it would also encompass a greater breadth of the economy than most recessions. At its origin was the unexpected and huge losses incurred on U.S. subprime mortgages or asset-backed commercial paper (ABCP) that had sparked a financial crisis in the summer of 2007 and would eventually set in motion a string of failures of several prominent global financial institutions. These most recent high profile corporate collapses have led many observers to suspect the liquidity crisis has grown into a solvency crisis. Declining confidence in financial markets would next spill over into housing markets, consumer products markets and, through trade markets, would channel the recession from the United States to all other major advanced economies of the world, including Canada. The fourth quarter of 2008 marked the beginning of a rather abrupt and deep global recession that is expected to further deteriorate throughout the first half of 2009, if not the entire year.

Canadian exports of manufactured goods to the United States and elsewhere that had already been weak and declining (due to the rapid appreciation in the value of the Canadian dollar) began to plunge further in response to the global economic downturn. Indeed, in December 2008, Canada recorded its first merchandise trade deficit since March 1976. The contraction in demand did not stop at Canadian borders, however. Reductions in real income related to the sudden and pointed decline in commodity prices, the reduction in household net worth, and lost consumer and investor confidence also contributed to a decline in domestic demand. Keeping with the automotive industry example, light vehicle sales in Canada, whose growth performance had been rather flat since 2003, began to crash in November 2008 (see Table 5). January and February 2009 sales were also down 25.3% and 27.7%, respectively, over the same month in 2008, with the “Detroit Three” nameplate vehicle sales down 36.7% in these two months over the same two months in 2008. This decline and that of the demand for all other goods and services have adversely affected overall production in the country: Canadian GDP declined by a startling 3.4% annual rate in the fourth quarter of 2008. Many forecasters now predict a long and slow period of economic recovery in Canada beginning either in late 2009 or in 2010, but all forecasts of economic recovery are predicated on the stabilization of the global financial system.

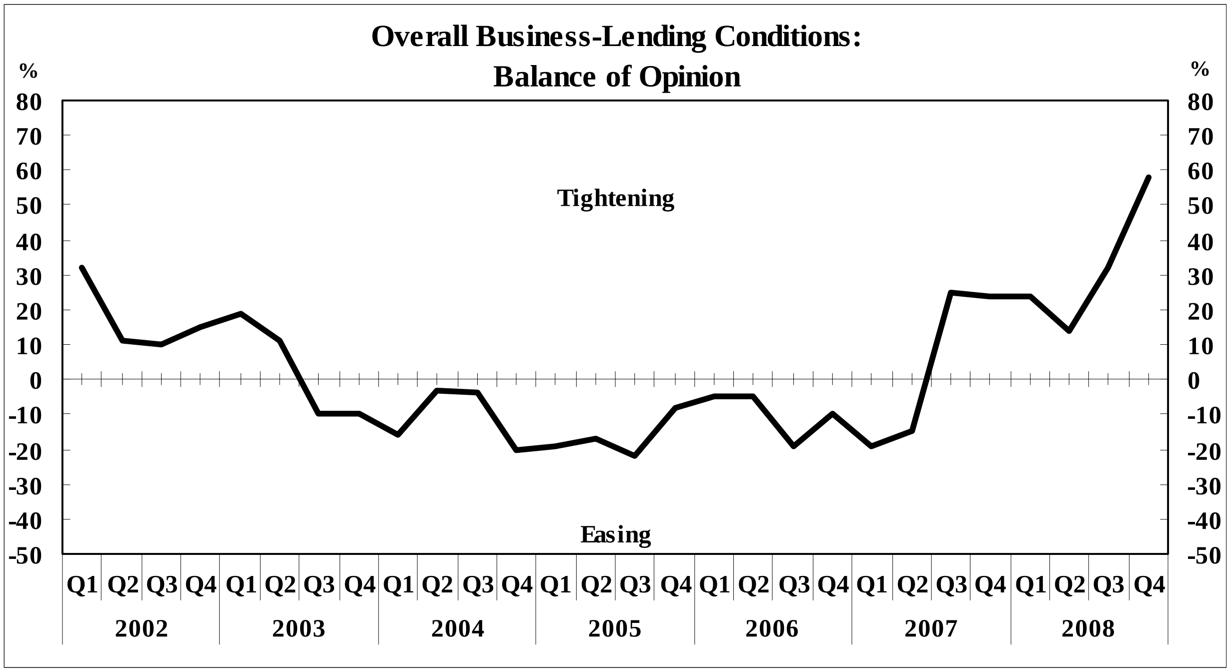
Table 5
Light Vehicles Sales in Canada, 2002-2009
(in thousands of units)

Period	2002	2003	2004	2005	2006	2007	2008	2009	09/08
January	110.3	93.5	82.7	79.2	86.2	91.2	102.8	76.9	-25.3%
February	102.2	103.2	92.3	102.7	97.4	97.0	111.0	80.2	-27.7%
March	148.1	146.2	146.0	144.5	151.3	150.7	150.0		
April	165.2	150.1	156.8	163.2	155.1	169.0	175.2		
May	183.5	182.7	162.6	157.6	168.2	185.5	184.5		
June	166.0	147.3	150.4	161.4	157.3	169.2	159.5		
July	138.6	146.1	132.8	154.8	141.6	142.4	149.5		
August	148.1	142.1	132.5	142.5	153.6	158.4	147.0		
September	141.5	138.7	127.2	124.2	135.8	131.8	134.1		
October	134.7	121.1	119.8	115.2	118.4	120.9	122.7		
November	124.3	112.4	116.7	120.2	123.5	117.3	105.2		
December	140.7	110.1	114.5	117.8	126.3	119.9	94.4		
Year	**1,703.2**	**1,593.5**	**1,534.4**	**1,583.3**	**1,614.7**	**1,653.4**	**1,636.0**		

Source: DesRosiers Automotive Consultants Inc.

Part and parcel with any recession will be a contraction in both the demand for, and the availability of, credit. Referring to the Bank of Canada’s most recent *Senior Loan Officer Survey*, the balance of opinion on credit conditions – that is, the percentage of people who reported a tightening minus the percentage of people who reported an easing of credit conditions – reached a record high in the fourth quarter of 2008 (see Figure 4). Most firms reported that the tightening came in the form of higher borrowing costs. So it seems that, in Canada as elsewhere, the supply of credit has contracted more than the demand for credit with the onslaught of the recession.

Figure 4



Source: Bank of Canada, *Senior Loan Officer Survey*, Winter 2009.

If credit conditions are too tight, it can pose a threat to the economic well-being of a country. Indeed, without access to funding, consumers are less likely to purchase homes, automobiles or many other big-ticket items. Without access to credit, businesses will find it harder to finance inventories, exports or investment in machinery and equipment or, as in the current predicament of the "Detroit Three", finance the necessary restructuring of their businesses – an undertaking that cannot be avoided. Without a doubt, the flow of funds or credit is an important lubricant of commerce. It allows the gears of the economy to turn effortlessly and, without sufficient access to financing, the economic engine can seize up. In fact, such a situation appears to exactly describe the current circumstance of the North American motor vehicle manufacturing industry.

The Road to Economic Recovery: Monetary and Fiscal Stabilization

At the outset, it should be acknowledged that the financial crisis is global in nature and began beyond Canada's borders; so most solutions will not likely be found in Canada but in other countries or at the international level. Moreover, the Canadian banking system does not face the same challenges as those in the United States, Europe or Japan, because Canadian banks were not significantly involved in the U.S. subprime market (like others were) and thus had only modest exposure to the ABCP market meltdown. Many major banks in the United States and Europe face enormous pressure to scale back their assets and liabilities to bring them into line with their capital – and some of them have even required either significant capital injections by governments or nationalization in order to successfully complete the restoration of their balance sheets. Canadian banks, on the other hand, are better capitalized and less leveraged than their peers in other countries, but they too have had to raise private capital to grow their businesses. In the past year, Canadian banks have raised more than $15 billion in Tier 1 capital from the private capital markets. Thus, while Canada's more robust financial system – in October 2008, the World Economic Forum declared that Canada has the soundest financial system in the world – translates into better credit conditions than elsewhere since the onset of this global recession, some unprecedented monetary and fiscal actions were needed to cope with this recession.

Monetary Policy Actions and the Short Term

Pursuant to its own Act, the Bank of Canada is charged with conducting monetary policy to achieve a number of objectives, but the relevant ones in the current situation are: (1) price stability; and (2) the regulation of credit. In terms of the first objective, the Government of Canada and the Bank of Canada have formally agreed to an annual inflation target of 2%, bounded by a floor of 1% and a ceiling of 3%. In terms of the second objective, the Bank of Canada discharges its role as "lender of last resort" by routinely providing liquidity to facilitate payments settlement and responds in a number of ways to exceptional or emergency situations. Under current economic conditions, the Bank of Canada's inflation-targeting and lender-of-last-resort responsibilities are complementary. Inflation falls in a recession or in the wake of a financial crisis, so there is no conflict or trade-off in attempting to achieve both objectives. A monetary expansion is called for on both counts.

In terms of interest rates, the Bank of Canada has lowered its policy rate, the overnight rate, by 375 basis points from 4.25% in December 2007 to 0.50% in March 2009. Given that interest rates are rationally zero-bounded, on this count the Bank of Canada has little room left to manoeuvre. Furthermore, it is worth noting that the Bank of Canada's overnight rate reductions have largely been passed on to credit facilities with short maturities. For example, the prime rate charged by Canadian chartered banks has fallen by 350 basis points over this same period and it currently stands at 200 basis points above the overnight rate, which is slightly above the average difference between the two interest rates of 174 basis points between January 2000 and March 2009. However, the chartered banks have been somewhat slower and have fallen far short in passing on reductions in the overnight rate on to credit facilities with longer maturities. The reason is obvious. The Bank of Canada's overnight rate has much less influence on the market for longer-term interest rates charged by financial institutions since the costs to banks of raising longer-term funds are more likely to be influenced by bond market prices and costs of longer-term borrowing through guaranteed investment certificates (GICs). The costs of these funds are significantly higher than the overnight rate, and the growing spread between long- and short-term interest rates reflects the perceived greater risk which would be based on expected increases in loan default and bankruptcy rates that usually accompany an economic recession.

In addition, the Bank of Canada has provided the financial system with more liquidity through term purchase and resale agreements (PRAs), without resorting to an expansion of the monetary base. Term PRAs provide liquidity (for up to three months) to key financial institutions against a wide range of securities. The Bank of Canada is also in the process of introducing two new loan facilities aimed at providing liquidity to a broader range of participants against a broader range of eligible securities. Moreover, one of these new facilities is expected to provide indirect support to credit growth in Canada by improving secondary-market liquidity and increasing demand for corporate securities.

Although the Bank of Canada's liquidity operations are focused on short-term financing facilities, the Government of Canada has introduced a number of measures aimed at supporting medium- and long-term financing for businesses and consumers – to which the next subsection turns.

Fiscal Policy Levers and the Medium Term

The International Monetary Fund has suggested that countries in a position to do so should inject fiscal stimulus of 2% of GDP to reduce the adverse economic effects of the global recession. The Government of Canada agreed with this suggestion and presented its budgetary plan in February 2009. This plan includes program spending of $206.8 billion in fiscal year 2008-09 to grow to $229.1 billion and $236.5 billion in 2009-10 and 2010-11, respectively. Planned program spending is, therefore, projected to grow by 14.4% over the next two years. With annual budgetary revenues falling and not expected to recover to $239.9 billion until 2010-11, the Government of Canada projects a deficit of $33.7 billion and $29.8 billion in 2009-10 and 2010-11, respectively. The cumulative deficit over the next four fiscal years is projected to reach $83.8 billion. Consequently, the federal government's debt-to-GDP ratio is expected to rise from 28.6% to 32.1% between fiscal years 2008-09 and 2010-11, after which the government projects it to return to a downward track.

The Government of Canada further estimates that its budgetary plan will provide an economic stimulus of $29.3 billion and $22.3 billion in 2009-10 and 2010-11, respectively. These estimates represent 1.9% and 1.4% of GDP.

Of particular interest to the business sector is the federal budget's planned contribution to arresting the "credit crunch" that has been imposed on Canadian consumers and businesses. According to its budget plan, the Government of Canada intends to provide up to $200 billion through the Extraordinary Financing Framework to improve access to financing for Canadian households and businesses. Two programs are particularly noteworthy in this regard: (1) the Insured Mortgage Purchase Program (IMPP); and (2) the Canadian Secured Credit Facility (CSCF).

The Government of Canada will extend the Insured Mortgage Purchase Program by authorizing the purchase of up to an additional $50 billion in insured mortgages in the first half of 2009-10. This authorization is in addition to the $75 billion to be purchased in 2008-09. Extending and enhancing this successful program is intended to reassure lenders that stable long-term financing will continue to be available, helping them to continue lending to Canadian consumers and businesses.

The Government of Canada will also create the Canadian Secured Credit Facility (CSCF). The credit facility will be allocated up to $12 billion to purchase term asset-backed securities (ABS) backed by loans and leases on vehicles and equipment. This facility will be priced on commercial terms, and will therefore be expected to generate a positive return for the Government of Canada.

The Road to Industrial Renewal: "Detroit Three" Restructuring Plans

Structural Overcapacity and "Detroit Three" Problems

With current annual demand forecast to be in the range of 10 to 11 million units and production capacity in the vicinity of 16 million units, there is an estimated production overcapacity of approximately 5 to 6 million vehicles per annum across North America. North American automotive assembly plants cannot continue to run at two-thirds capacity, on average, for long. Plant closures and business reorganizations are a prerequisite for survival going forward, particularly for companies experiencing shrinking demand for their products (i.e., the "Detroit Three").

The huge loss in combined market share of the "Detroit Three" at the hands of the "New Domestics" signals, at the very least, troubles in the business model of the "Detroit Three". What exactly is the problem? Consumers or industry experts have not mentioned nor complained about the pricing of the "Detroit Three" products relative to the pricing of the "New Domestics" products. Product pricing *per se* is, therefore, not likely the problem. Furthermore, given that the "Detroit Three" have production facilities that are well placed or highly ranked in terms of their labour productivity, one cannot infer that the organization of their plants and production facilities are, in the main, the problem. Industry observers and experts have identified a number of issues facing the "Detroit Three":

1. An inferior business model;
2. Product programs that are not in step with the needs of the market;
3. A higher cost structure than to the "New Domestics";
4. Large legacy costs related to pension plans; and
5. An excessive debt load.

These problems are hard to quantify. What is known is that, in 2008, workers engaged in the assembly segment of the industry were paid a starting wage of $24 per hour and a top wage of about $34 per hour. Wage rates are comparable across the "Detroit Three" and the "New Domestics". Legacy costs of the "Detroit Three" are higher than those of the "New Domestics", which presents a difficulty for the "Detroit Three". On the other hand, witnesses provided conflicting evidence on the issue of non-wage benefits for existing workers that suggests there is either no gap or a gap of up to $20 per hour in favour of the "New Domestics" over the "Detroit Three".

Although all "Detroit Three" companies are well down the road to restructuring their businesses, only two of them have requested government financial support to help them see their plans to fruition. A very brief description of both plans follow.

General Motors Restructuring Plans

General Motors of Canada Ltd. submitted a restructuring plan to both federal and Ontario governments that:

- Maintains GM Canada's share of Canada/U.S. production which is expected to range between 17% and 20% between 2009 and 2014;
- Enables the launch of five new vehicles in Oshawa and Ingersoll, including new hybrid vehicle production, new flexible transmission production in St. Catharines and significant advanced environmental research and development (R&D) for next generation electric car systems, with suppliers and universities in Canada;
- No further GM Canada plant closures, reflecting restructuring actions already announced;
- Enables GM Canada to remain Canada's top selling automaker and offer more 2009 hybrid models than any competitor;
- Shared sacrifices such as a 10% reduction in executive salaries and reduced benefits and pay for salaried workers; and
- Secures pensions for GM Canada retirees and would establish a "VEBA-like" structure for health care benefits.

General Motors has requested US$22.5 billion in loans from the U.S. government, of which US$13.4 billion has already been advanced, and should total U.S. motor vehicle sales in 2009 deteriorate further than forecasted, it is requesting an additional US$7.5 billion for a total of US$30 billion. General Motors of Canada is requesting a loan from Canadian governments (federal and provincial) equal to 20% of the loans provided by the U.S. government, which equates to $5-7 billion.

Chrysler Restructuring Plans

Since Cerberus Capital Management assumed controlling interest in Chrysler LLC, a number of restructuring actions were taken, including:

- Fixed costs were reduced by $3.1 billion;
- Workforce was reduced by 32,000 employees;
- Manufacturing capacity was reduced by 1.2 million units by cancelling 12 shifts and closing two plants;
- Sold $700 million in non-earning assets;
- Closed the Vancouver, Winnipeg and Moncton distribution centres; and
- Concessions were garnered from all key Chrysler shareholders.

Chrysler LLC has recently signed a non-binding agreement to pursue a strategic alliance with Fiat S.p.C. of Italy. The proposed alliance would provide Chrysler with substantial cost saving opportunities, as well as provide Chrysler with distribution capabilities in key growth markets. The proposed Chrysler-Fiat Alliance would also further help Chrysler achieve fuel economy improvements as it gains access to Fiat's smaller, fuel efficient platforms and powertrain technologies.

Chrysler Canada intends to continue with investments in Windsor and Brampton assembly plants:

- Windsor investments: 2008 Minivan program = $969 million

2008 paint shop = $236 million
2009 manufacture vehicles for international market = $153 million

- Brampton investments: 2008 Dodge *Challenger* program = $332 million
  2011 products = $1.1 billion.

Chrysler LLC Viability Plan further includes a $3 billion investment in new fuel-efficient vehicle platforms, 24 new product launches, and the development of five electric vehicles to be ready for production in 2010. This plan also includes concessions on behalf of dealers, suppliers, unions, second lien debt holders, and shareholders.

Chrysler has requested US$7 billion (or approximately $9 billion in Canadian funds) in loans from the U.S. government, of which US$4 billion has already been advanced. Chrysler Canada has requested about $2.3 billion in loans from the Canadian governments (federal and provincial), as well as prompt resolution of its transfer pricing disagreement with Canada Revenue Agency (CRA). In 2007, the CRA issued assessments for 1996 through 1999 asserting that Chrysler Canada should have earned greater profits than reported in Canada and correspondingly should have reported reduced profits in the United States. When Daimler sold the controlling interest in Chrysler, Daimler agreed to indemnify Chrysler against, among other things, these transfer pricing tax assessments. Chrysler Canada then became obligated to post cash and assets to secure 50% of the assessed amounts until the dispute is resolved. This obligation to pay or secure these assessments has severely affected the company's ability to operate at this critical time.

Finally, the Committee is aware that Industry Canada has requested more information from Chrysler Canada regarding the expected benefits to Canada of its restructuring plan and, therefore, General Motors of Canada's request is, at this time, more advanced than that of Chrysler Canada.

Avenues of Government Assistance: Industry-Specific Measures

An Automotive Industry Strategy and the Long Term

The automotive industry is a key driver of Canada's economy, a fact that the Government of Canada emphasized in its budget plan of 2009. The industry currently faces significant challenges in the form of the U.S. economic recession, changing consumer preferences and increased global competition. The Government of Canada has thus decided in favour of taking action. Its action begins with the Minister of Industry who is charged with developing a strategy to position Canada's automotive sector for sustainable, long-term success. The principles of this strategy were laid out in the budget plan:

- **Looking beyond immediate challenges to factors for long-term success.** This means helping firms strategically invest in areas in which Canada will have a competitive advantage in the years ahead, which may not be areas of traditional strength.
- **Protecting taxpayers.** This includes providing adequate security for government lending.

- **Ensuring support is based on strong business cases.** To encourage a market focus, private sector lenders should also be involved where appropriate in order to position the automotive industry for sustainability and independence.
- **Making support available to the range of automotive firms.** This includes Canadian-based assemblers, parts manufacturers and suppliers, and firms not yet located in Canada that are looking to invest here.
- **Recognizing that Canada is part of a highly integrated and increasingly global market.** Canada's role as an automotive-producing nation must be understood in this context and levered to generate the greatest benefits for Canadians.
- **Ensuring that all stakeholders are involved.** The Government cannot and should not help the automotive industry restructure on its own. The Province of Ontario has signalled its support. All stakeholders will need to play a significant role in creating solutions.

Motor Vehicle Assembler Financial Assistance

As part of this strategy, on 20 December 2008, the Governments of Canada and Ontario promised General Motors of Canada and Chrysler Canada with up to $4 billion in short-term repayable loans managed by Export Development Canada. The federal government's contribution was to be $2.7 billion. These two companies have not, however, taken up either of these loan offers. Instead, both have decided to independently submit a business restructuring plan that includes a request for financial assistance from both Canadian governments. The total financial assistance requested is believed to be between $7.3 and $9.3 billion in loans.

These two requests for Canadian government financial assistance are loosely tied to similar requests made of the U.S. government by their parent corporations, though the latter requests are between four and five times greater in size than the former. If the U.S. government decides against any further financial assistance – the least likely case – clearly any financial assistance offered by the Canadian governments would involve considerable risk. If the U.S. government instead decides in favour of providing further financial assistance – the more likely case – whether in the amounts requested or in a scaled back version, then the Canadian governments must weigh many potential scenarios that include, in addition to a sound and viable industry and other positive outcomes that may result from the implementation of the proposed corporate restructuring plans, the possibility of bankruptcy, the extent of plant closures and shutdowns, the number of potential job losses, a smaller motor vehicle parts manufacturing industry that employs far fewer people, the possibility of a complete or partial failure to repay any loans advanced, as well as redistributive effects such as other parties acquiring existing Canadian assets, other automobile and automotive parts manufacturers increasing their production and partially offsetting lost production by others, and the rehiring of a portion of the previously laid-off workers.

Both General Motors and Chrysler proposals assume a rebound in U.S. motor vehicle sales beginning in late 2009. Their proposals also assume success in their new product launches. But no government loan could possibly guarantee that these companies will succeed in their transition. Indeed, it is very conceivable that such loans might merely buy them more time and forestall the possible events set out above.

At the same time, the U.S. government loans are likely to include conditions on the application of these funds, ensuring that there are no formal financial leakages to places beyond U.S. national borders. Such loans (with their protectionist-like conditions) can have similar economic effects to a tariff: they can separate or split an integrated continental market into two national markets, in which case Canada could end up the loser. For this reason, Canadian governments might want to make loans available to GM Canada and Chrysler Canada in the same proportion as their production makes up North American production and on similar conditions to the U.S. government loans. In such a case, a competitive balance is maintained.

The Committee notes that the witnesses appearing at its hearings were generally in support of the Canadian governments providing loans to GM Canada and Chrysler Canada, particularly given that the U.S. government was already doing so and is committed to do more. Even GM Canada and Chrysler Canada's competitors – Ford, Honda and Toyota – did not object to the financial assistance with the proviso that the loans are strictly provided to finance their corporate restructurings and cannot be used either to extend a competitive advantage or finance car leases or loans to its customers. At the same time, the Committee would be remiss if it did not acknowledge that the witnesses appearing at its hearings were not representative of the nation's population at large. Given that these witnesses were drawn exclusively from the Canadian automotive sector, it is a highly skewed distribution of the population.

In the end, the Canadian governments face a dilemma. However, without access to the confidential elements of both proposals and, therefore, being unable to undertake the due diligence review itself, the Committee cannot (at this time) offer a fully informed opinion on whether or not the Government of Canada should extend the requested financial assistance or a scaled down amount to GM Canada or Chrysler Canada.

Automotive Parts Manufacturers and Consumer Credit Facilities

The Government of Canada is also targeting support to automotive parts manufacturers by improving their access to credit through Export Development Canada's (EDC) accounts receivable insurance. While generally supportive of this extension of EDC credit, Canadian automotive parts manufacturers are further requesting financial support. The Automotive Parts Manufacturers Association (APMA) is seeking $1 million in repayable loans for Canadian firms from Canadian governments. By way of example, APMA pointed to the United States, where the U.S. Treasury recently announced a US$5 billion aid package for U.S. automotive parts suppliers.

Tool, die and mould makers argue that the current payment terms under the Production Part Approval Process (PPAP) used by the "Detroit Three" are inequitable. Traditionally, the automobile manufacturers or original equipment manufacturers (OEM), typically the largest customers of tool companies, place a production program with its preferred Tier-1 supplier, who in turn would place a tool to be built with their preferred tool shop. The tool would be built and the parts that are produced from that tool would be approved for installation in cars by the OEM. The Tier-1 supplier would receive monies from the OEM to pay for the tool or the mould. Payment typically takes from 18 to 48 months, depending on PPAP or delays. The Canadian Association of Mold Makers (CAMM) and the Canadian Tooling and Machining Association

(CTMA) propose an end to the current PPAP payment term system and have advanced an alternative, what they call the Tooling Proposal. The Tooling Proposal would have payment of 90% of the price of the tooling upon delivery to parts supplier with a holdback of 10% until the final payment date.

The Government of Canada will create the $12-billion Canadian Secured Credit Facility (CSCF) that will improve credit availability for consumers to purchase and lease new vehicles. Industry officials generally praised the government for the creation of the CSCF and the targeting of access to EDC credit for accounts receivable insurance to automotive parts manufacturers. Some witnesses were satisfied with the CSCF as planned, but insisted that it not be made complex or too bureaucratic so that credit could start flowing as soon as possible and before the current car and truck buying season begins. Other witnesses were quick to remark that motor vehicle leasing was, most recently, a $60 billion business. Some recommended an augmentation of the credit facility.

Motor Vehicle Scrappage Incentive Program

In January 2009, the Government of Canada unveiled the Vehicle Scrappage Program (VSP) that will be delivered by the Clean Air Foundation and will provide a $300 credit to individuals who scrap their cars and trucks of 8 years or more. The incentive is meant to be an environmental measure but several witnesses questioned its effectiveness in stimulating new vehicle sales. One witness claimed that a 10-year-old car has a resale value of about $3,500, so $300 provides little incentive to scrap one’s car or truck. In Germany, on the other hand, the government offers up to €2,500 or about $4,000 for scrapping a car or truck of 9 years or more. It was suggested that the incentive was at least partly responsible for a 22% increase in February motor vehicle sales, and is forecast to increase motor vehicle sales by 200,000 units, or by 10%, in 2009. Witnesses thus proffered a number of proposals that were similar to the German program. One proposal was for the Government of Canada to offer a scrappage fee of $4,000. Another proposal included a graduated fee, whereby a lower fee would apply to a motor vehicle that is 8 years old and that this fee would increase with the age of the motor vehicle until it reaches the maximum set at $4,000 for a motor vehicle of 10 years or more. Another proposal would have the federal government establish a $300-million scrappage incentive program for a period of one year, with the goal of removing 100,000 motor vehicles that are 10 years or older from Canadian roads.

Some witnesses appearing before the Committee pushed for such a measure and argued that it would be good for the economy, the environment and safety. Industry experts claimed that a 10-year-old car pollutes at a rate of 12 to 18 times higher than a new car and a 20-year-old car pollutes at a rate of 37 times higher than a new car. It was further claimed that about 30% of the car fleet in Canada – that is, about 6 of 20 million cars on the road – are 10 years old or older.

Although it is clear that such a measure would create a one-time increase in the retail sales of new motor vehicles that would give the retail segment of the industry a much needed “shot in the arm”, it is not sure if it would be of much help to the Canadian automobile assembly industry. The Canadian automobile assembly industry exports about 90% of the value of its production to the United States, meaning that the scrappage incentive may not significantly affect the wholesale sales of Canadian-made vehicles. Indeed, the majority of cars and light trucks sold in

Canada are made elsewhere and, therefore, a Canadian scrappage program in isolation would entail considerable leakages in sales to foreign-based automobile manufacturers. An effective Canadian scrappage program that would be of benefit to Canadian automobile manufacturers would have to be part of a coordinated North American-wide program. The scrappage incentive might also lead some consumers to substitute their planned purchases away from other consumer goods and services and towards motor vehicles since a car or truck is a big-ticket item that significantly affects a family's budget. Hence, the increased retail sales of motor vehicles induced by a scrappage incentive program may come largely at the expense of decreased sales of other consumer goods and services.

Not everyone supported the belief that a scrappage program was the best way to deal Canada's environmental challenges or would improve road safety. The Automotive Industries Association of Canada (AIA) claimed that a scrappage program either as an environmental or safety measure was flawed. Although its members supported the federal government in offering incentives for Canadians to purchase new vehicles, it opposed taking older cars off the road for a number of economic reasons:

- Replacement parts purchased for repair of older cars are often recycled or remanufactured components which keep replacement parts prices competitive and are good for the environment by reducing waste and saving energy costs;
- A strong inventory of recycled and remanufactured parts keeps repair prices down for consumers and provides options for keeping their cars on the road. Motorists in this economic downturn do not want to take on more debt and added insurance costs with the purchase of a new vehicle;
- Scrappage incentives would hurt thousands of independent repair shops, auto restorers, customizers and their customers across the country who depend on the used car market. The automotive aftermarket provides thousands of Canadian jobs and generates millions of dollars in local, provincial and federal tax revenues;
- The program will reduce the number of used vehicles available for low-income individuals and drive up the cost of the remaining vehicles; and
- The premise that existing trucks and SUVs must be scrapped in order to save energy is short-sighted. The reduced "carbon footprint" argument does not factor-in the energy and natural resources expended in manufacturing the existing car, spent scrapping it and manufacturing a replacement car.

Obviously, if the scrappage incentive program is effective and leads to the scrapping of many vehicles, then it will also, by definition, be expensive to the government's treasury, possibly displacing the provision of other government goods and services. Finally, since the second-hand market for older cars is disproportionately used by low-income individuals within society, it may also have an adverse impact on the lower-income individuals or the "poor".

GST Tax Holiday

Some witnesses before the Committee argued for a sales tax holiday on the purchase of a new motor vehicle. Specifically, Toyota Motors Manufacturing Company proposed the suspension of the goods and services tax (GST) and the federal portion of the harmonized sales tax (HST) in the three provinces to which it applies on the purchase of a new motor vehicle for a period of four months. The cost to the federal treasury of such a measure was not provided.

Such a provision could stimulate the current demand for cars and light trucks. It has but four things working against it, however. Such a measure is likely to lead some consumers to substitute their planned purchases away from other consumer goods and services and towards motor vehicles – the retail automotive industry's gain, once again, comes largely at the expense of lost sales of other consumer goods and services. Furthermore, any increase in demand resulting from a GST holiday would likely be short-lived and possibly coming at the expense of lost future sales. Similar to a scrappage program, since the majority of cars and light trucks sold in Canada are made elsewhere, a GST holiday would entail considerable leakages in sales to foreign-based automobile manufacturers. Finally, there is the loss in government revenue that funds public goods and services that must also be assessed.

Canada-Korea Free Trade Agreement

Some witnesses took the opportunity to advance their opinion on a prospective Canada-Korean free trade agreement that Canadian trade officials have put some time in negotiating. They believe that a Canada-Korea free trade agreement would not be the right deal for Canada. Most of them claimed to be believers in free trade, but they argued not only for free trade but also for what they called fair trade. The primary problem with free trade with Korea, they said, is that it systematically uses regulatory and other non-tariff barriers to restrict vehicles coming into their domestic market.

In consideration of all of the above, the Committee therefore recommends:

1. **Given the highly integrated nature of the industry, the development of a coordinated North American approach is essential to ensuring the sustainability of the industry in Canada. In order to effectively address the current and future issues faced by the industry, the Committee recommends that the Government of Canada further engage with its North American partners and industry stakeholders on issues including: investment in innovation and new technologies, investment in infrastructure, the implementation of harmonized regulatory regime (including harmonized regulations regarding fuel consumption, safety standards, and emission standards) the training and development of an appropriate workforce, and other issues affecting the industry.**

2. **The Government of Canada has proposed to implement a $12 billion secured credit facility aimed at easing the restrictions on credit in the industry and measures to increase access to credit for auto parts manufacturers. The Committee recommends that the Government of Canada implement these initiatives as soon as possible. Immediate action would help ease the restrictions faced by producers and consumers in the industry and should serve to foster demand in Canada.**

3. **That the Government of Canada consider introducing new vehicle incentive programs to stimulate consumer demand in Canada in consultation with provinces,**

territories and the Government of the United States. Any such programs should recognize the potential effects on the aftermarket industry.

4. **The Committee recommends that the Government of Canada ensure that any provision of public funds to industry participants would be subject to a strict reporting regime aimed at holding recipients accountable to the people of Canada.**

5. **That the Government of Canada review the other issues raised in the auto subcommittee.**

APPENDIX A
LIST OF WITNESSES WHO APPEARED BEFORE THE SUBCOMMITTEE ON THE AUTOMOTIVE INDUSTRY IN CANADA

Organizations and Individuals	Date	Meeting
Automotive Parts Manufacturers' Association	2009/03/04	1
Atul Bali, Member		
Gerald Fedchun, President		
Canadian Automobile Dealers Association		
Richard Gauthier, President and Chief Executive Officer		
Michael Hatch, Chief Economist		
Huw Williams, Director, Public Affairs		
General Motors of Canada Ltd.		
Arturo Elias, President		
David Paterson, Vice-President, Corporate and Environmental Affairs		
John Stapleton, Vice-President and Chief Financial Officer		
Association of International Automobile Manufacturers of Canada	2009/03/09	2
David Adams, President		
Don Romano, Vice-Chair, President and Chief Executive Officer of Mazda Canada Inc.		
Canadian Association of Moldmakers		
Angelo Carnevale, Vice-President		
Canadian Auto Workers Union		
Ken Lewenza, National President		
Jim Stanford, Chief Economist		
Canadian Vehicle Manufacturers' Association		
Mark Nantais, President		
Ford Canada		
Caroline Hughes, Director Government Relations		
David Mondragon, President and Chief Executive Officer		
James Rowland, Manager Government Relations		
Japan Automobile Manufacturers Association of Canada		
David Worts, Executive Director		

Organizations and Individuals	Date	Meeting
Honda Canada Inc.	2009/03/10	3
Jerry Chenkin, Executive Vice-President		
Louis Gaëtan, Director, Government Relations		
Toyota Canada Inc.		
Stephen Beatty, Managing Director		
Toyota Motor Manufacturing Canada Inc.		
Adriaan Korstanje, General Manager, External Affairs		
Auto21 Inc.	2009/03/11	4
Peter Frise, Chief Executive Officer and Scientific Director, AUTO21 Network of Centres of Excellence		
Chrysler Canada Inc.		
Reid Bigland, President and Chief Executive Officer		
Lorraine Shalhoub, Vice-President, General Counsel, External Affairs and Public Policy		
Chrysler LLC		
Thomas LaSorda, Vice Chairman and President		
DesRosiers Automotive Consultants Inc.		
Dennis DesRosiers, President		
Doucet McBride LLP		
Percy Ostroff, Partner		

APPENDIX B
LIST OF BRIEFS SUBMITTED TO THE SUBCOMMITTEE ON THE AUTOMOTIVE INDUSTRY IN CANADA

Organizations and Individuals

Association of International Automobile Manufacturers of Canada

Automotive Industries Association of Canada

Bourdeau F1

Canadian Auto Workers Union

Canadian Tooling and Machining Association

Clubb Finance Corporation

DesRosiers Automotive Consultants Inc.

General Motors of Canada Ltd.

Green Automotive Resource Cluster

Japan Automobile Manufacturers Association of Canada

Maxtech Manufacturing Inc.

Patterson, Scott

Tooling and Equipment Capital Solutions Inc.

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings of the Standing Committee on Industry, Science and Technology (Meetings Nos. 5, 9 and 10) is tabled and a copy of the relevant Minutes of Proceedings of the Subcommittee on the Automotive Industry in Canada (Meetings Nos. 1, 2, 3, 4, 5 and 6) is tabled.

Respectfully submitted,

Hon. Michael D. Chong, MP

Chair

Dissenting Opinion
Of the Conservative Party

To the Standing Committee on Industry, Science and Technology
REPORT OF THE SUBCOMMITTEE ON THE AUTOMOTIVE INDUSTRY IN CANADA

Respectfully submitted by:
Mike Lake, MP

INTRODUCTION

The Conservative Party of Canada (CPC) wishes to submit a dissenting opinion concerning the report to the Standing Committee on Industry, Science and Technology from the Subcommittee on the Automotive Industry in Canada.

The CPC would like to thank those witnesses who appeared before the Subcommittee for their on-going interest in ensuring a strong and successful automotive industry in Canada. This dissenting opinion is not meant to diminish the work of the Subcommittee but rather to correct the record on a single point in the final report which the Committee could not find the consensus to address; and, to further emphasize this government's strong action and decisive vision for the auto sector.

The mandate of the Subcommittee was to review the current state of the automotive industry in Canada and make recommendations. In coming to a consensus it is important for committee members to focus as much as possible on the facts and substance of information presented and the testimony of witnesses. Avoiding opinion and potentially biased re-interpretation of facts presented to the committee is essential to providing sound advice and recommendations to the House of Commons.

Paragraph four (4) of the subcommittee report begins with the assertion: "*Although not part of a comprehensive industrial strategy, federal and provincial governments have funded some of the more recent investments in automotive assembly plant and equipment*." Regrettably, the first clause of this sentence is open to many possible interpretations. This opening to paragraph four could leave the unfortunate impression with the reader that the federal government has no strategy for the automotive industry in Canada. The subcommittee's overview of the automotive industry covers a much longer period than just the last three years and while it may be true that the previous Liberal government had no automotive industry strategy to speak of, nothing could be further from the truth when it comes to the current Conservative government.

In fact, many witnesses repeatedly praised the government both for its actions during the current global crisis and for its long-term vision.

CANADA'S AUTOMOTIVE STRATEGY

Canada's strength as an automotive nation has been built on a powerful value proposition. We use this value proposition to attract global capital and mandates from multi-national giants. In addition to our highly skilled workforce, we provide a stable investment climate, including solid economic fundamentals and a comprehensive Economic Action Plan that are helping strengthen the Canadian industry even in the midst of the current global economic climate.

All of the stakeholders in the automotive industry are looking for new approaches and initiatives that will keep Canadian industry at the forefront. As one of the partners, the Government of Canada will continue to do its part.

In 2006, the government introduced Advantage Canada, a comprehensive strategic action plan not only for individual industrial sectors, but for the entire Canadian economy. In February, 2008, the Minister of Industry announced important new initiatives that broaden and deepen our approach to the Canadian automotive industry. The approach outlined in this strategy is built on four pillars:

- sustaining sound fiscal and economic framework policies;
- supporting integration of the North American auto sector;
- investing in research and development; and
- creating an Automotive Innovation Fund.

Thus, as can be plainly seen, the federal government has provided details of its comprehensive strategy for the automotive industry. Today, the automotive industry in Canada continues to restructure itself and the Government of Canada continues to play a key role in this process.

Stakeholders and industry analysts agree that the Conservative government has established a clear automotive policy. Mr. Dennis DesRosiers, perhaps Canada's leading auto expert and one of the esteemed witnesses who gave testimony to the subcommittee, said the following regarding a National Automotive Policy:

"I was asked by the Committee last night what are some policy areas that Canada needs to address to help this industry and I was also asked to respond to the many who appeared in front of the Committee that said Ottawa needs a National Automotive Policy for Canada.. On the plane ride home l got to thinking and asked myself a very simple question? In what area of the automotive sector doesn't Canada have a well defined policy? And I couldn't think of any. Our tax policy for innovation is one of the most generous in the world. I can't identify an area where there isn't a very clear and usually positive policy initiative for the automotive sector.

"So most criticism of the lack of a National Automotive Policy is misplaced. The criticism is actually that the group doesn't like the policies in place disguised as the Government doesn't have a policy at all. For instance, our Government will never put a protectionist trade policy in place .. period. So the CAW criticizes them for not having an Automotive strategy. We do have a trade policy it just isn't the ones our unions prefer. It is the correct policy but they can't accept that."

He said in an earlier interview that "Mr. Flaherty and Mr. Clement have been brilliant in how they've handled this going way back ... They came out weeks ahead of the American government."

The committee heard from Stephen Beatty, managing director of Toyota Canada, that "There's no other country I'd rather be in. The Canadian automotive marketplace last year grew. It is unlike every other industrialized nation. There has been some fundamental health in the Canadian economy and that has been the result of hard work by government and by industry."

Many witnesses specifically praised the government for investing in innovation through the Automotive Innovation Fund and for establishing the $12 billion Secured Credit Facility. Huw Williams, for example, from the Canadian Auto Dealers Association said, "We've been impressed with the fact that finance is absolutely seized with trying to get this program rolling as fast as possible. They seem seized in a very real way more than I've ever seen before from finance officials about trying to get this Secured Credit Facility out in the market place."

Reid Bigland, president of Chrysler Canada said "the Canadian Secured Credit Facility that was pledged is some of the exact medicine the automotive industry in Canada, from a sales perspective, needs in order to get back to health."

CONCLUSION

In a period of significant global economic instability and industrial restructuring the federal government is working to keep the Canadian automotive sector strong and at the forefront of innovation. The Conservative Party of Canada believes that the Canadian automotive industry can and should remain a source of pride to Canadians, and a powerful engine of growth for our economy, for many generations to come.

DISSENTING REPORT OF THE LIBERAL PARTY OF CANADA TO THE SUBCOMMITTEE REPORT

SUBCOMMITTEE ON THE AUTOMOTIVE INDUSTRY OF CANADA
(THE "**SUBCOMMITTEE**")
OF

THE HOUSE OF COMMONS COMMITTEE ON INDUSTRY, SCIENCE, AND TECHNOLOGY

MARCH 26, 2009

At the request of the Liberal Party of Canada, the Subcommittee on the Automotive Industry in Canada was formed in order to (i) identify the issues currently affecting the automotive industry in Canada, (ii) to gather information to help the Subcommittee, the government and Canadians better evaluate the reorganisation proposals of General Motors of Canada ("**GM**") and Chrysler Canada ("**Chrysler**"), and (iii) to recommend measures that the government should consider as it attempts to address the issues faced by the thousands of Canadian jobs dependent upon the industry.

The Liberal Party has chosen to include this supplementary report as it believes it cannot support much of the main report prepared by the Subcommittee (the "**Report**"). The Liberal Party believes the majority of the analysis contained in paragraphs 2 through 32 of the Report is predicated on information neither heard nor discussed by the Subcommittee. Among others, the policies inferred in paragraphs 57, 59 and 61 highlight this concern. Policy statements such as those on the impacts of a scrappage program on consumer budgeting, on low-income individuals, and the effects on sales of a GST holiday, while possibly correct, were never discussed by the Subcommittee. The work done by the Subcommittee does not enable it to make such determinations.

Overall, the Liberal Party believes the work of the Subcommittee should be commended. Members asked important questions and were successful in raising significant issues in the public eye and in highlighting the complexity of the challenges posed by the industry. We, and more importantly, the public, are now much more informed. We are also now able to make significant recommendations to the government as to the questions and issues that it must address.

<u>Challenges</u>

1. **Cyclical Issues**: The downturn in the global economy has limited the availability of credit to both consumers and manufacturers and has adversely affected demand for cars all over the world. The lack of available credit has affected the ability of car companies to borrow and limited the ability

of financial institutions to lend for the purchase of new vehicles. This has adversely affected manufacturers throughout the automotive supply chain.

2. **Structural Issues**: The Detroit Three, in particular GM and Chrysler, face significant structural challenges from (i) high costs associated with wage, benefit and legacy cost obligations and (ii) declining competitiveness and market share due to changing global demand. These structural problems are not new, which makes the government's failure to develop any comprehensive auto strategy over the last three years all the more unfortunate.
3. **North American Integration**: The auto industry in Canada is part of a highly integrated North American market for parts, manufacturing and sales. The problems affecting the industry in Canada are indivisible from those affecting the American market. Upwards of 85% of the vehicles assembled in Canada are sold in the US, and an equally significant number of vehicles bought by consumers in Canada are manufactured abroad. Also, auto parts manufactured in Canada are routinely used in the assembly of vehicles in America and *vice-versa*.

Recommendations

First and foremost, the Liberal Party believes, in making its decisions on the provision of public funds to support the auto industry, the government of Canada must balance the need to protect Canadian jobs with prudent, principled, and wise expenditure of tax payers' funds. While the work of the Subcommittee raised awareness of the challenges and issues that must be addressed, the Subcommittee was not mandated, and did not, conduct the comprehensive due diligence review required to recommend for or against the provision of public assistance to GM or Chrysler. Examination of the proprietary information required to assess the viability of the long-term business proposals of GM and Chrysler was not within the mandate of the Subcommittee. The ultimate decision on the provision of federal public assistance to GM and Chrysler rests with the current Government of Canada. We recommend that as the government makes its decisions with respect to the industry, GM and Chrysler, it carefully review and seek answers to all of the issues and questions that the Subcommittee identified.

In general, the Liberal Party is in agreement with the recommendations made within the main report. However, with regards to the need for greater coordination with its North American partners the Liberal Party believes the recommendation in the main report did not go far enough.

The Development of a North American Auto Forum:

The highly integrated nature of the industry throughout North America requires the creation of a North American Auto Forum to engage industry and governments in formal discussions about issues affecting the industry. The establishment of this forum would more meaningfully and formally provide governments and industry stakeholders a venue to collectively monitor the industry and would, through engagement, enable governments to develop harmonized continental policies and regulations affecting the industry.

In addressing the industry's cyclical credit challenges and structural challenges, the current federal government has not engaged sufficiently with its North American counterparts. This failure has sadly forced Canada to be reactive to action in the US with little input into its outcomes. These reactive responses will not serve to protect the industry's sustainability in Canada. Rather, the Canadian government should be involved in the development and the co-ordinated implementation of policy with its North American counterparts.   Without the North American Auto Forum, the industry's problems will continue to persist and will remain uninfluenced by the actions of the Canadian government alone. The establishment of a North American Auto Forum could have, at this time, served to coordinate action to resolve issues related to the:

- Examination of the integrated viability plans of GM and Chrysler;
- Provision of emergency credit support for parts manufacturers and Tier 2 tool, die and mould parts suppliers;
- Consideration of a North American scrappage incentive;
- Development of border infrastructure to facilitate trade;
- Implementation of coordinated fuel, safety and emission standards; and
- Investment in the technology development and progression of the North American auto industry to address fuel and energy efficiency.

Such proactive measures by the government, fostered by the establishment of the North American Forum, would better serve the competitiveness of the Canadian economy and the maintenance of jobs. Accordingly, and for the above reasons we urge the government of Canada to pursue the creation of the aforesaid forum.

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Bloc Québécois Complementary Opinion

First of all, the Bloc Québécois would like to thank the various witnesses who appeared before the Subcommittee on the Automotive Industry of Canada of the Standing Committee on Industry, Science and Technology. Their generous participation has made it possible to present a report that will help parliamentarians continue their examination of the state of and challenges facing the automotive industry.

The report raises various points of view on the viability of the automotive industry and the assistance measures needed to support it. The Bloc Québécois recognizes that this essential industry for Ontario must undertake major restructuring for it to become profitable again and move past the crisis. The Bloc Québécois regrets however that the Committee did not recommend in the report that the federal government should offer the forestry and manufacturing sectors, which are vital to Quebec's economy, assistance and loan guarantees comparable to those offered to the automotive industry in Ontario. Such a recommendation would have pressured the federal government to show fairness so that it does not once again give undue preferential treatment to Ontario at Quebec's expense.

The Bloc Québécois is aware of the responsibility for the oversight of government spending incumbent on it as the third party in the House of Commons. This is why the Bloc Québécois would have liked the report to contain a recommendation to the government that all Canadian assistance should be provided jointly with the United States. In the opinion of the Bloc Québécois, if the US government refuses to introduce additional financial assistance measures beyond those announced during the current session of Parliament, any financial assistance provided by governments in Canada would carry considerable risk, making such loans unreasonable. Yet the report does not include any recommendation to this effect.

Finally, to ensure that the federal government and in turn Canadians and Quebeckers are not left with a financial sinkhole should the restructuring of the big three automakers fail, the Bloc Québécois would have liked the Committee's report to recommend that the government attach conditions and clauses to the loans and guarantees in order to preserve as many direct (manufacturing) and indirect (suppliers and parts) jobs in Canada as possible. The Bloc Québécois maintains that the government should require guarantees in the form of capital and considerable assets to offset the financial risk. This way it could recoup some of its financial commitments if the restructuring plan fails.

Brian Masse, M. P.
Windsor West

<u>NDP Dissenting Opinion</u>

The global financial credit crisis has reduced the lending of banks and financial institution to businesses and consumers. As a result car and truck buyers can't get loans to make purchases or leases. Sales in the North American market have fallen from 17 million vehicles to only 10.5 million. Every vehicle manufacturer in the world has been affected. This drop in revenue is what has created the crisis for the industry as a whole and has eliminated the funding necessary for their operations and their elemental role in the financing of consumer vehicle purchases. A government policy action is required to assist in this unforeseen industry crisis brought about by the failures in the global financial markets as a result of greed and deregulation.

Additionally, the lack of a comprehensive government sector strategy for the past decade has lead to the significant decline in the relative economic standing of the industry. From record trade surpluses in automotive vehicles and parts in 1999 to a growing trade deficit for the sector during past few years has tracked the policy neglect the previous and present governments have had toward the sector since the demise of the Auto Pact.

The NDP believes the committee report is deficient in addressing the requirements the industry needs. This short sighted and inadequate attempt by the committee demands a response. The following is the NDP's recommendations to the government with regards to the necessary policy actions. The NDP recommendations are not inclusive of our overall policy but rather focus upon the mandate of the committee.

GOVERNMENT POLICY ACTIONS REQUIRED:

<u>A new National Auto Policy to replace the former Auto pact</u>

The Auto Pact was the core policy instrument of Canada's auto strategy for 35 years. It was a powerful and effective demonstration of how regulations and protocols can make trade deals assist in the building of an industry. Companies had to assemble one vehicle in Canada for every vehicle sold here to obtain tariff-free access to the Canadian market while at the same time increase the percentage of Canadian value added content in their total Canadian sales. These rules established new assembly plants and promoted the expansion of Canadian auto parts sector. In 2001 the federal government eliminated the Auto pact to comply with a decision by a World Trade Organization dispute panel. This has precipitated a significant decline in Canada's auto production. We have fallen from being the 4th largest vehicle assembler in the world to the 10th today. The fundamental policy instrument of the Auto Pact of linking market access to the investment in new domestic production and jobs needs to be brought back into force. This is what a new National Auto Policy, working with the United States, will establish in the restoration of balance in the North American vehicle marketplace. This is the essential component to ensuring long term sustainability to the vehicle production in Canada. No other automotive market place anywhere on globe has such an open market. This has lead to the lack of significant new value added investment in Canada by global manufacturers as compared with other countries with more regulated market access. The government needs take the necessary steps to establish this policy framework.

Automotive Sector Strategy

The government of Canada must immediately convene the Canadian Automotive Partnership Council on a regular basis. In 2004 CAPC produced a plan for the industry. The previous and present federal governments have not acted on this initiative at all. This has lead to CAPC being almost operationally defunct. CAPC needs to be the part of the core of any policy development and implementation framework for a new national automotive strategy.

Extended Producer Responsibility

After the considerations and concerns raised during the sub-committee hearings, the government of Canada must conduct a study to develop a framework for the future establishment and implementation of Extended Producer Responsibility protocols and procedures

PPAP Payment Model

The deficiencies, defects, and the resultant financial instability created by the PPAP payment model for mould, tool, and die vendors to Tier 1 suppliers of the vehicle manufacturers was outlined during the sub-committee hearings and in the previous HOC Industry Committee Report on Manufacturing in Canada (2006). Accordingly, the government of Canada must include the condition that any vehicle manufacturer/assembler receiving any financial assistance (loan or credit market support) eliminate the PPAP payment model from any supplier or vendor in their supply chain.

Parts Suppliers Financial Assistance

Parts Suppliers are an essential component of the automotive manufacturing sector in Canada. Their financial difficulties have arisen along with their customers, the vehicle manufacturers, due to the challenges in obtaining credit based on the outstanding invoices. To alleviate this market failure the Government of Canada must introduce a program to assist Canadian parts suppliers to the vehicle manufacturers. An example of this form of support is the recently instituted US Treasury initiative (Auto Supplier Support Program)

South Korean Trade Negotiations

After an almost unanimous consensus presented by witnesses at the sub-committee that any potential trade pact with South Korea would damage the Canadian and North American auto industry, the government of Canada must remove the automotive sector talks from any negotiations with South Korea.

Market Access

With vehicle manufacturing now a global endeavor there are countries around the world that do not meet the labour standards, environmental regulations and intellectual property protections that are established in North America. Accordingly, the violations *are in effect a hidden subsidy to those manufacturers in those countries. This unfair trade advantage must be corrected and to do so restrictions on the import of vehicles from these countries into the Canadian marketplace must be implemented until compliance with the standards and protections in the areas of labour rights, the environment, and intellectual property are obtained.*

Innovation

Research and development are essential for the long term sustainability and transition of the auto industry in Canada. Accordingly, the government must implement incentives and programs to attract the investments in innovation and next generation technologies the industry will need to produce in Canada so that production and assembly remains in this country. An example of this is the $ 25 Billion Advanced Technology Vehicle Manufacturing loan program administered by the US Department of Energy.

Credit Market Support for Consumer vehicle purchases/leases

Any governmental financial assistance that is provided for increasing the availability and accessibility of credit for consumer vehicle purchases/leases should be directed to the captive finance units of the vehicle manufacturers. A requirement as part of this assistance is that the loans or leases made to consumers is provided at the equivalent borrowing cost that the federal government pays. The operations of the Secured Credit facility that government plans to institute would have the same mandate as well.

Autoworkers

From the testimony and information presented at the sub-committee hearings it was determined that autoworkers in Canada are amongst the most productive in the world and that the crisis enveloping the auto industry had nothing to do with the workers in the sector. Through no fault of their own, autoworkers have become victims of the global credit market problems impacting corporations in every country including the vehicle manufacturers.

Bill C-273 the Right-to-Repair

Bill C-273, the Right to Repair legislation, should be passed by parliament and implemented immediately. This bill protects consumer rights, the environment, and public safety as well as ensuring a competitive auto repair marketplace is maintained in Canada.

Financial Accountability

All financial assistance provided by the federal government whether by direct loans or credit market support programs must have their complete and comprehensive documentation submitted for analysis and evaluation by the Parliamentary Budget Officer. This will provide a level of transparency and accountability to parliament of the government of Canada’s actions.