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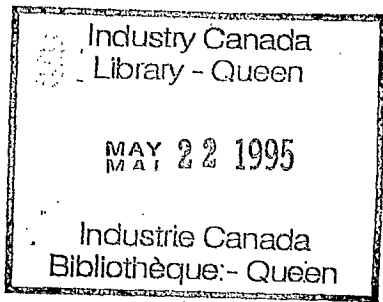
**PROSPERITY  
CONSULTATIONS**  
**Canadian Automotive Industry**

**A Contribution to the**



**PROSPERITY INITIATIVE**

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**CANADIAN AUTOMOTIVE INDUSTRY:  
ISSUES AND SOLUTIONS**

submitted to:

**THE HONOURABLE MICHAEL WILSON  
MINISTER OF INDUSTRY, SCIENCE AND TECHNOLOGY  
AND INTERNATIONAL TRADE**

by the:

**AUTOMOTIVE ADVISORY COMMITTEE TO THE  
MINISTER**

**AS PART OF THE PROSPERITY INITIATIVE**

May 28th, 1992

This report has been prepared by a private sector consultation group at the request of the Honourable Michael Wilson, Minister of Industry, Science and Technology and Minister for International Trade as a contribution to the Prosperity Initiative. This document is one of a series of reports setting out the conclusions and recommendations arising from intensive consultations on the competitiveness challenges facing major industry sectors across Canada.



**ISTC AUTOMOTIVE ADVISORY COMMITTEE**

May 28, 1992

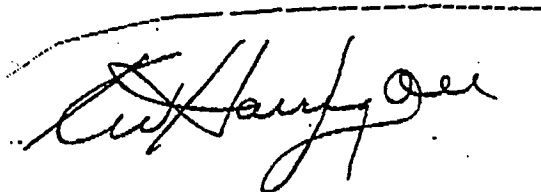
**The Honourable Michael Wilson  
Minister of Industry, Science and Technology  
and International Trade,  
House of Commons,  
Ottawa, Ontario.**

Dear Mr. Wilson:

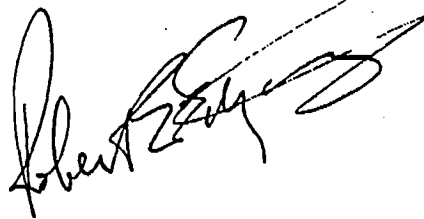
As Co-Chairmen of, and on behalf of all members of your Automotive Advisory Committee, we are pleased to submit to you our Report entitled, "Canadian Automotive Industry: Issues and Solutions".

We ask you to accept this Report both as our sector's contribution to your Prosperity Initiative, and as our sector's action plan which we request your continued support and assistance to implement. The Report is intended to be a "dynamic" document, with action items deleted as completed, and others added as they arise.

Yours sincerely,



**Kenneth W. Harrigan  
Co-Chair, and Chairman and  
Chief Executive Officer  
Ford Motor Company of  
Canada, Limited**



**Robert E. Fitzhenry  
Co-Chair, and Vice-Chairman  
and Chief Operating Officer  
Woodbridge Foam  
Corporation**

### Acknowledgments

The Automotive Advisory Committee is indebted to a number of people and organizations who have made significant contributions to this Report over the past several months. The task would have been much more difficult but for the fact that the Automotive Advisory Committee was already established and working to define the issues, and working on initiatives to improve the sector's competitiveness in the global economy.

We wish to commend officials of the Automotive, Urban Transit and Rail Branch of ISTC (Slawek Skorupinski, Bill Whiting, Don Campbell, John Mitchell, Dan McDougall, and Bill Morris) for their abilities and willingness to accept, qualify and work to resolve industry's concerns. The three annual conferences at the Briars anchored the process - we appreciate ISTC's sponsorship and organization of those events. We acknowledge the co-operation and assistance of officials of the Ontario Ministry of Industry, Trade and Technology (Peter Sadler-Brown and Mike Dube), and officials of the Government of Quebec who participated in a number of AAC sub-committees and ad hoc study groups.

We thank all AAC sub-committee and working group members, and Chairpersons Maureen Kempston-Darkes, Emmett Grant, Mark Nantais, Neil De Koker, Jim Carter, Ray Datt, Dean Wilson, Ken Graydon, and Norm Clark. Their work is just beginning.

We also wish to express appreciation to Norm Clark, President of the Motor Vehicle Manufacturers' Association, who co-ordinated this project, and authored much of the Report, with the able assistance of Felix Pilorusso, Principal, Pilorusso Research and Consulting Inc.

**CANADIAN AUTOMOTIVE INDUSTRY:  
ISSUES AND SOLUTIONS FOR THE 1990S**

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## **1 INTRODUCTION**

For all but the first few years of this century, the automotive industry has played a major role in the lives of Canadians. Few industries have contributed more to the economic growth and prosperity of Canada and the high standard of living that Canadians enjoy. The motor vehicle and parts manufacturing industry is the engine of central Canada's manufacturing economy. The motor vehicle sales and automotive aftermarket parts and service industry is the largest segment of the retail sector, and is a significant part of the economic base of virtually every city, town and village across the country.

Despite its size and importance to the economy, the continued success of the automotive industry is by no means assured. The traditional domestic motor vehicle manufacturers have been losing market share for more than 30 years. With very little growth in the market for the last 10 years, overcapacity has become a major problem. Three Canadian plants, one assembly plant and two major component plants, are scheduled to be closed by 1994. Several more of the domestic vehicle manufacturers' assembly and parts plants in North America will be closed over the next three to five years to eliminate the excess capacity. Before the down-sizing of the industry is complete more Canadian plants may be closed.

While North American plant capacity has been reduced by the domestic manufacturers, there has been some net growth in Canada's motor vehicle assembly capacity. The domestic manufacturers have expanded assembly capacity in Canada and four Asian motor vehicle manufacturers have built assembly plants in Canada, largely to serve the United States market. However, the Asian-owned plants face an uncertain future as it becomes increasingly apparent that secure, duty-free access to the United States market will be difficult to achieve and maintain.

The automotive parts industry is in a period of contraction with plants closing and jobs being lost at a greater rate than new plants are opening and jobs being created. Many of the plant closures were due to rationalization of North American production capacity by multinational companies; that is, Canadian plants were closed and the production moved to plants in the United States and elsewhere. Other parts manufacturers have closed Canadian plants because they were no longer competitive with plants in lower-cost areas of the southern United States, Mexico, and elsewhere. Among those that remain, there is a severe shortage of the capital that is required for investment in new plants and equipment, research and development, and training that is essential to the maintenance of a competitive industry.

The aftermarket parts and service industry is faced with stagnant markets and a loss of business to cross-border shopping. As a result of advances in technology and improvements in quality, modern vehicles consume less fuel and require fewer replacement parts and less service. Higher costs for parts in Canada, at all levels of the distribution chain, higher labour rates for maintenance and repairs, and higher point-of-sale taxes have been largely responsible for the growth of cross-border shopping for fuel, replacement parts and vehicle maintenance and repair services.

We believe that the automotive industry will continue to play a very large role in Canada's economy. The automotive vision for Canada:

*"a sustainable, internationally competitive automotive industry operating in a supportive competitive economic environment and contributing to a high quality of life in Canada through increased efficiency and productivity with management and employees sharing common goals"*

is achievable by the year 2000, but will remain elusive unless industry, labour and government work together to find solutions to the critical issues facing the industry.

In the remainder of this report we have addressed the key issues that affect the future of the Canadian automotive industry. In general, for each section of the report, we have stated the issue, presented a summary of the relevant data and other information in point form, and concluded with a statement of objectives or recommendations, as appropriate. We offer these objectives and recommendations as a blueprint for the prosperity of the automotive industry to the year 2000.

**Recommendation:** The Committee recommends that it continue in its role, to advise the Minister of Industry, Science and Technology and International Trade on automotive industry issues and, using this Report, convenes soon to review, and prioritize issues, and to develop an action plan and organize to implement the recommendations which are contained in the Report.



## **2 IMPORTANCE TO THE CANADIAN ECONOMY**

The automotive industry -- defined as manufacturing of motor vehicles and parts and distribution and retailing of automotive products -- accounts for approximately four percent of Canada's Gross Domestic Product. As measured by value added, automotive parts manufacturing is Canada's largest manufacturing industry and motor vehicle assembly the second largest. Value added from wholesale and retail trade of motor vehicles, parts, and service exceeds the value added from motor vehicle and parts manufacturing. Retail sale of motor vehicles, parts and service accounts for 27 percent of total retail sales.

### **2.1 Manufacturing:**

- Direct employment was 155,000 in 1990, but declined to 137,500 in 1991.
- New capital expenditures in the past decade were over \$15 billion. Average annual capital expenditure over the past 5 years was more than \$2 billion per annum.
- Shipments were \$45 billion in 1990, or 15% of total manufacturing activity.
- The automotive manufacturing industry (Motor Vehicle Industry - SIC 323, Truck and Bus Body and Trailer Industries - SIC 324, and Motor Vehicle Parts and Accessories Industries - SIC 325), accounted for \$11.9 billion of value added, or 9.6% of total Canadian manufacturing value added in 1988.
- Automotive exports represent over 32% of total manufacturing exports.
- Canada has a strong positive trade balance in vehicles with the United States but a deficit in parts trade. The automotive products trade surplus with the United States was \$8.2 billion in 1990.
- Automotive trade with countries other than the United States accounts for 13% of total automotive trade. The deficit was \$6.6 billion in 1990.

### **2.2 Vehicle Retailing:**

- Employment was 90,000 in 1991.
- Total automobile dealer sales of new and used vehicles, parts and service was \$40 billion in 1990. New motor vehicle sales were \$25 billion.
- A typical dealership represents an investment of almost \$4 million..

- There are approximately 3,900 new vehicle dealerships in Canada.

### **2.3 Aftermarket Sales and Service:**

- Employment was 251,000 in 1990.
- Retail sales were \$12 billion in 1990, approximately 60% products and 40% labour.
- There are approximately 500 suppliers of aftermarket products in Canada (manufacturers, re-builders and agents), over 3100 wholesalers and warehouse distributors of aftermarket products, and over 20,000 repair and service outlets.

**Many of the Committee's recommendations, which follow throughout this report, are based on the principle that Governments, Industry and Labour must seriously consider the broader implications of their decisions and work cooperatively to meet the challenges facing the industry. Actions that negatively affect the well-being and prospects of the automotive industry will have serious repercussions throughout the entire Canadian economy.**

### **3 STRUCTURE AND RESTRUCTURING**

The structure of the North American automotive industry has changed dramatically in recent years and is continuing to evolve. The restructuring has resulted in additional motor vehicle and North American parts manufacturers (especially those of Japanese ownership), a reduction in the relative size of the Big 3 (Chrysler, Ford and General Motors) and the North American parts industry, and growth in the national industries of third countries that export motor vehicles and parts to the North American market.

#### **3.1 Structure:**

- The Canadian industry is part of a rationalized North American industry. The Automotive Products Trade Agreement of 1965 (Auto Pact) formed the basis for the development of a rationalized industry.
- The industry is dominated by the Big 3 (85% in assembly and 50% in components). Except for a handful of small specialty vehicle manufacturers, none of the assembly sector and only 20% of the component sector are Canadian owned. The industry is dependent on foreign decision-makers.
- There are 5 heavy truck assembly plants in Canada, all of which are foreign-owned.
- In 1988, the components sector accounted for only 33% of the value of shipments, but was responsible for 58% of the total employment and 53% of the value added.
- Over 85% of all production is exported to the United States. The industry is therefore dependent on United States market conditions. Only a small percentage of United States production is exported to Canada.

#### **3.2 Restructuring:**

- Asian motor vehicle manufacturers have added 1.8 million units of capacity in the United States since 1985 and 470 thousand units of capacity in Canada. In both Canada and the United States, the Asian motor vehicle manufacturers' production capacity accounts for about 16 to 17% of the total.
- Asian manufacturers now produce more than 15% of North American-produced passenger cars.

- In 1991, the Big 3 accounted for 68.2% of the North American light vehicle market, Asian manufacturers accounted for 10.1%, and imports (including vehicles imported by the Big 3) accounted for 21.7%.
- Import penetration is 27% for cars and 13.5% for light trucks. More than 5% of Big 3 sales are imports.
- There has been a major restructuring of United States assembly plants by the Big 3 during the 1980s. According to an Industry, Science and Technology Canada (ISTC), report there have been 18 plant closures and 6 openings. Most plants closed were obsolete, but further closures are still required, particularly of General Motors plants.
- There has been a net capacity reduction in the United States of 3 million units. Canadian Big 3 capacity has been increased by 400,000 units.
- There is a trend to greater in-sourcing of components, a reduction in the number of suppliers and changes in the assembler-supplier relationship.
- Fifty parts plants have closed in Canada since mid 1988. These were mainly United States-based companies that have consolidated operations in the United States.
- Canada has received a commensurate share of Asian investment (in dollar terms) in assembly facilities. Only CAMI, General Motors Canada's joint venture with Suzuki, is a world-scale plant.
- Canada cannot be left behind because of pressure from the U.S. for Japanese investment.
- Canada has a very small number of Asian parts plants. Asian manufacturers have invested in 19 parts plants in Canada, versus more than 250 in the United States.
- Vehicle demand in Canada and the United States is projected to be relatively flat throughout the decade. The Mexican market is projected to grow significantly.

**Objectives:** In order to achieve a sustainable, internationally competitive assembly and components industry some key objectives must be met:

**Assembly:**

- **Big 3 maintain a major presence in Canada. Facilities must be continually up-graded to maintain technological competitiveness.**

- Asian manufacturers expand existing plants, rationalize production and increase value added. The additional production capacity would be used to offset imports and provide additional vehicles for export to third countries.

**Parts (Captive):**

- Big 3 modernize their engine and transmission plants.
- Asian manufacturers establish one or two major value-added facilities.

**Parts (Independent):**

- Restructure to accommodate vehicle assemblers' transfer of R&D and engineering to suppliers and to maintain process competitiveness and obtain product technology. Restructuring will lead to decreases in the number of companies and total employment by weeding out non-competitive facilities. The companies and output of the sector should be maintained.

**Aftermarket:**

- Maintain efficient, reliable, cost effective manufacturing and distribution systems for automotive repair and service. Implement state of the art technologies for inventory management, such as Electronic Data Interchange (EDI), bar coding and electronic cataloguing.

**Market:**

- Produce and deliver products and services that meet customers expectations and needs.
- Achieve a more balanced international automotive trade either through decreased imports or increased exports.

**Recommendation:** The Committee recommends that all levels of government in Canada continuously monitor the investment climate in their jurisdictions and take action to ensure that an attractive investment climate is maintained. Given the high level of foreign ownership of the Canadian automotive industry, Canada is dependent on very large amounts of foreign investment to achieve its objectives. The ability to attract investment is particularly important to Ontario, where more than 90 percent of the automotive manufacturing industry is located.

## 4 STRENGTHS AND WEAKNESSES

In general, the industry has been competitive on a North American basis. As a result, Canada has received an increased share of North American (Canada/United States) production in both light vehicle assembly (increased from 14.5% in 1981 to 17.5% in 1991) and components (increased from 5% in 1981 to 11% in 1991). Further gains in the share of North American production will be very difficult to achieve and losses are possible.

### 4.1 Assembly

- On average, Canadian plants have a slight per vehicle cost advantage over United States plants, mainly due to hourly labour costs (including benefits) in Canada that are about 75 percent of hourly labour costs in the United States. The advantage is mainly due to lower costs to employers for health care and the currency exchange rate.
- At some Canadian plants, the hourly labor cost advantage is largely offset by higher manning levels, higher absenteeism, more restrictive work rules, and other factors that increase the number of hours required to assemble a vehicle.
- Hourly labour costs at Canadian plants are very close to the hourly labor costs at Japanese plants.
- In general, fewer hours per vehicle are required to assemble comparable vehicles in Japanese plants than United States plants, which in turn, require fewer hours than Canadian plants.
- It is recognized that lower hourly labour costs in Canada are not sufficient to ensure that plants will not be closed when the end of their product mandate is reached.
- Most Canadian plants have received new product mandates, but there is still some uncertainty over some General Motors plants since the company announced that as part of a major restructuring, 21 North American assembly and parts plants would be closed.
- The corporate offices of Canada's motor vehicle manufacturers, which are located in the United States or Asia, control the decision-making process. "Internal" needs by a company to "balance" closures between United States and Canada could result in closures, as well as in new investments.

- The value added by Asian manufacturers is relatively low, but is increasing. Since start-up of their North American plants, Japanese motor vehicle manufacturers have increased their North American value added. Efforts are continuing to further increase North American sourcing.
- Employee benefit costs for traditional United States companies, particularly pension, health care, and workers' compensation coverage, are about \$6.00 per hour higher than for Japanese companies operating in North America, due primarily to lower health care and pension costs associated with new, younger work forces. A similar but perhaps smaller difference exists in Canada, although pension funding proposals and other factors could increase that effect.

## **4.2 Parts**

- In general, in all high wage rate countries parts plants that are labour intensive and produce low-technology products using low-technology processes are vulnerable to competition from regions with lower labour costs. (More in Annex 3.)

### **4.2.1 Independent Parts Manufacturers**

- Canadian parts manufacturers are largely high-volume producers of low to medium technology products.
- Plants are very competitive at high production volumes, but vulnerable in the longer term to competition from lower-cost regions.
- Advances in manufacturing process technologies are an effective way to retain a competitive advantage against low-wage competitors.
- Canadian plants are close to many assembly facilities.
- Canadian parts manufacturers have good penetration of Big 3 market, but minimal business with Asian manufacturers.
- There is increased competition for the Big 3 market from Asian parts companies that have established plants in North America.
- Small profit margins and savings obtained by pressure by manufacturers to pass on productivity gains make companies vulnerable. Small economic/policy changes have a major impact on margins and profitability.
- Canadian plants are increasingly facing competition from lower-cost southern United States plants.

- The potential for competition from Mexico is tempered by transportation costs.
- The Big 3 are reducing the number of suppliers with which they contract directly, and require more engineering and technological capability from those designated as direct suppliers.

#### 4.2.2 Captive Parts Manufacturers

- Some plants are still producing low-technology products and are, therefore, vulnerable.
- The products produced in captive facilities are primarily stampings and major drive train components.
- Stampings plants are very competitive and have received major new investments recently.
- Canadian captive drive train facilities have been successful. Their competitive position, however, is not well documented.

**Recommendation:** The Committee recommends that management and labour at vehicle assembly and parts plants continue their efforts to become the most productive, highest-quality plants in the world.

**Recommendation:** The Committee recommends that parts manufacturers put more emphasis on developing higher-value-added products and advanced manufacturing processes.

**Recommendation:** The Committee recommends that analyses of the cost competitiveness of industry segments be continued to ensure that policies and processes are complementary and supportive.



## 5 THE COMPETITIVE ENVIRONMENT

The Canadian motor vehicle and parts manufacturing industry operates in a very competitive and difficult global environment. Global-competitiveness and access to markets are critical to the prosperity of the industry.

### 5.1 The Global Environment

- All major producing countries "manage" auto trade:
  - The European Community (E.C.) limits the number of motor vehicles that are imported from Japan and imposes high content requirements for locally-produced Japanese vehicles before they can be re-classified from imported to originating in the E.C.
  - Mexico is a closed market pending successful negotiation of a Canada-United States-Mexico (North American) Free Trade Agreement, but Mexican goods have duty-free access to the Canadian market (e. g., through the Auto Pact). The rest of Latin America is closed.
  - It is very difficult to gain access to the Japanese market due to the high initial costs of adapting vehicles to the Japanese market and establishing distribution networks. A number of barriers, informal and formal, exist in Japan which present severe difficulties in: gaining approval of vehicles for sale in Japan; establishing distribution systems in Japan; and, investing generally in Japan. The rest of Asia is closed by a variety of restrictive trade practices.
- The United States is pressuring Japan and influencing trade and investment decisions by Japanese firms. These decisions may favour the United States to the detriment of Canada and other countries.
- The worldwide industry is more regionalized than globalized and is becoming increasingly so, but to be competitive one must be globally competitive. While North America is *more* "globalized" than any other area, the "globalization" is based on a one-way flow *into* North America.

### 5.2 The North American Market Environment

- A major expansion of the automotive market, with the exception of Mexico, in the next decade is unlikely.
- The existing excess capacity will intensify competition.

- Asian producers in North America are here to stay (and grow). For the Canadian industry to grow, a full commitment to the Canadian sector from all vehicle companies selling in Canada, including Asian companies, is required.
- Canadian parts manufacturers still rely heavily on the Big 3. Canadian manufacturers have been successful in getting an increasing share of this decreasing market, but further gains are highly unlikely.
- Canadian parts manufacturers need a reasonable share of the Asian vehicle manufacturers' business to grow. Successful entry into that market is proving to be extremely difficult.
- Despite the existence of many Japanese R & D and purchasing liaison offices in North America, the two-way communication of technical and other information that is necessary for parts manufacturers to pursue business opportunities is frequently untimely and ineffective.
- Business in Canadian parts plants is being lost as motor vehicle manufacturers move production in-house in the United States to satisfy the job security provisions in their contracts with the United Auto Workers union.
- The parts sector is extremely sensitive to currency exchange rates and interest rates.

### **5.3 The Canada-U.S Trade Environment**

- The Auto Pact ensured the rationalization of the North American industry. It remains as a very important instrument for participating companies.
- The objective of the Free Trade Agreement (FTA) for the automotive sector was to remove trade irritants and ensure access to the United States market, however:
  - Asian manufacturers were excluded from the Auto Pact benefits; duty drawback and production-based duty remission programs will be eliminated in 1994 and 1996, respectively; which are significant to transplants.
  - Phasing out of bilateral automotive tariffs as of January 1, 1998, reduces the incentive for the Big 3 to continue to fulfil Auto Pact safeguards (i.e. production to sales ratio and 60% value-added conditions). However, duty-free imports from third countries are still a significant incentive for Big 3 activities in Canada, and Auto Pact administration rules are familiar and effective.

- The FTA rules of origin, which determine which products qualify for duty-free trade, have not yet been clarified.
- Auto issues are becoming increasingly "politicized" in the United States with respect to Japan and production of vehicles in Japanese plants in Canada for export to the United States through:
  - increased use and enforcement of rules and regulations; and,
  - unfavourable interpretations of the FTA rule of origin.
- Asian motor vehicle manufacturers in Canada are faced with uncertainty of access to United States market resulting in a "freeze" on Asian auto investment in Canada.
- A higher Most Favoured Nation (MFN) Canadian tariff on parts than the United States will increase manufacturing costs in Canada, relative to the United States, for non-Auto Pact manufacturers after drawback and remission programs are eliminated under the FTA. The tariff differential also increases the cost of importing service parts into Canada from off-shore sources compared with the United States.

#### **5.4 The Mexican Environment**

- The greatest strength of the Mexican automotive industry is low wages. Its advantage is greatest in low-technology, labour-intensive production, however, Mexican workers have proved themselves capable of producing high-quality products. The threat to the Canadian industry is greatest where labour cost savings are greater than increased transportation costs.
- To date Mexico has been perceived as neither a major threat nor a major opportunity. A North American Free Trade Agreement (NAFTA) could change that situation.
- Assuming that the Mexican economy improves, Mexico will provide the most significant potential growth market in North America.
- Mexico's restrictive automotive policies direct investment away from the United States and Canada.
- A more liberalized regime would provide opportunities for Canadian parts companies to undertake complementary investment, thereby improving their competitive position.

**Recommendation:** The Committee recommends that the Federal Government monitor and periodically report on:

- (i) any Japanese voluntary export restraint agreements administered directly or indirectly by the Japan Ministry of International Trade and Industry; and/or
- (ii) the degree of import substitution of direct automotive exports from Japan by the production of so-called transplant operations. (Asian manufacturers do not concur with this recommendation.)

In other countries, including the U.S. and E.C. member states, Japanese imports are restrained by various means. The monitoring and reporting, as described above, would be the first step to ensure that Canada's automotive manufacturing base is not eroded for lack of similar restraints being exercised by the Japanese manufacturers in the Canadian market.

**Recommendation:** The Committee recommends that Canada's anti-dumping legislation be amended to recognize the integrated nature of the North American automotive manufacturing industry. For example, the definition of "domestic manufacturers" that may be harmed by dumping should include manufacturers with integrated production in Canada and the United States.

**Recommendation:** The Committee recommends that Canada continue to make every effort to gain access to export markets through the General Agreement on Tariffs and Trade (GATT), NAFTA negotiations and other means, as appropriate.

**Recommendation:** The Committee recommends that Canadian industry continue, and expand, its efforts to penetrate the Japanese markets for both vehicles and original equipment and replacement parts.

**Recommendation:** The Committee recommends that new ways and means be investigated to establish a sales and engineering liaison office in Japan to serve Canadian parts manufacturers and Japanese motor vehicle manufacturers.

**Recommendation:** The Committee recommends that Asian motor vehicle manufacturers continue their efforts to integrate their North American operations into the traditional North American automotive economy by expanding more rapidly their North American content.

## 6 COMPETITIVENESS ISSUES

"Global competition" for the Canadian motor vehicle and parts manufacturing industry has historically been limited to the United States, with the main measure of the Canadian industry's global competitiveness being a comparison of its production cost elements with those of the United States industry. With the integration of the Canadian and United States industries under the Auto Pact, common ownership of the majority of the production capacity in both countries, limited competition from imports, and only a small portion of output exported to third countries, this limited comparison was valid in the past.

However, as outlined in the earlier discussion on the structure and re-structuring of the North American industry, fundamental changes have occurred during the last decade. Imports have gained a large market share and the market has become more open and competitive. In the process, the definition of global competitiveness of the Canadian industry has changed irrevocably. In order to be globally competitive, the Canadian industry must be able to compete with the most cost-effective producer in the market.

Growth in the market and a weak Canadian dollar were largely responsible for the growth and prosperity of the industry from 1983 to 1988, and masked any weaknesses in its cost structure. The current recession and the strong dollar has exposed the industry's weaknesses.

Improving the cost-competitiveness of the industry is the major challenge of the 1990's, but industry actions alone may not be sufficient to achieve the benchmarks for global competitiveness that have been established by Japan. Even if direct costs of production, product design, production quality, and productivity are world-competitive, and some direct costs (such as those associated with Canada's medical care system) are reduced because they are financed by broadly-based taxation, factors such as the cost and availability of capital, taxation forms and rates, pension liabilities, workers' compensation, and legislated social equity programs, can outweigh the aforementioned positive factors, and prevent the achievement of the goal of global competitiveness.

Another set of factors vital to Canada and Canadian manufacturing generally, and to the automotive industry specifically, relate to education. Criticisms of the educational system are diffuse, covering:

- the lack of literacy and numeracy skills displayed by public, high school, and university students,
- apparent shortfalls in guidance counsellors' awareness of career opportunities in manufacturing and retailing, and
- widespread questioning of the teaching methods which have evolved in Canada, which have moved away from the "hard" discipline of rote learning and frequent testing to more holistic or "soft" methods with fewer checks on or accountability for results.

Globalization of competition, deep recession, deficits, debts, unemployment, and unemployability of some unemployed, all point to the need for change, the rate of which is accelerating and the cost of which is increasing. As in industry, educators and the education system need to be more precise in their market objectives, while building in the flexibility to adjust to change. There is an overriding need for all players to participate in the management of the education process and system.

**Recommendation:** The Committee recommends that ISTC invites, on behalf of the Committee, the Minister of Employment and Immigration to participate in discussions of training and skills development initiatives and issues as they pertain to the automotive sector.

## 6.1 Human Resources

Canada's future competitiveness relies heavily on the cultivation of human resources. There is unanimous agreement among all members of the committee that education and training, in their broadest definitions, are the first priority. There is a pressing need for basic skills training, upgrading the image of the skills trades, automobile retailing and other careers in the automotive industry, and increased automotive research and development at universities. The following are areas of activity that address these issues.

### 6.1.1 Skills Training and Apprenticeship Programs

Canadian industry has relied for too long on educators to define and provide the needed skills of the work force. The automotive sector is actively redressing the situation, with the assistance of Employment and Immigration Canada and the provinces:

- Training of motor vehicle service technicians, including apprenticeship, is progressing under the Canadian Automotive Repair and Service (CARS) Council.
- A report on human resource and skills needs of the auto parts segment is the basis for a comprehensive training proposal prepared jointly for the Automotive Parts Manufacturers Association (APMA) and the CAW. This project is being pursued through the Automotive Parts Sectoral Training Council (APSTC) and is being funded by the Federal and Provincial Governments.
- Motor Vehicle Manufacturers' Association (MVMA) member companies, as well as other companies, carry out extensive training as new products and new technologies and processes are introduced.

- The training required for tradesmen in automotive assembly plants is highly specialized and is generally not available through province-wide apprenticeship programs. As a result, much of the training of tradesmen is provided in-house by the motor vehicle manufacturers.

**Recommendation:** The Committee recommends that all industry segments act in recognition of the increasing importance of a well-trained and involved workforce. For many parts manufacturers this will require significant increases in the amount of employee training.

**Recommendation:** The Committee recommends that impediments to the implementation and effectiveness of training and skills development programs be defined and eliminated:

- Programs should be responsive to industry's needs, and eligibility criteria for program funding should be straightforward and simple.
- Canadian Labour Force Development Board organizational links to provincial and local training boards must be established with minimum delays and must not be so bureaucratic as to be unresponsive, costly, or inefficient in delivering training programs.
- Programs and criteria must recognize collective agreement provisions, and vice-versa, to help to create a system of training for the sector.
- Inter-provincial standards, and reciprocal recognition of accreditation and credits will be necessary for a system to work efficiently.
- Taking into account industry needs, and with the assistance provided by industry involvement, the system can and should be developed within present expenditure limits and with present educators, trainers, and infrastructure.
- A review of restrictions on apprenticeship is required in order to identify and remove impediments to the effective functioning of the apprenticeship system.

### 6.1.2 Labour Relations

- Most motor vehicle and parts manufacturers and their employees function within the bounds and with the balance negotiated in collective bargaining.
- Those comprehensive contracts and the balance that they represent should not be altered by arbitrary legislation.

- Universal or horizontal initiatives such as those in Ontario under Industrial Standards, Occupational Health and Safety, Workers' Compensation, and Labour Relations Acts, and Pension Reform, will increase costs and widen the competitive gap between Canada and other countries, as well as between Canadian companies with work forces of different compositions.
- Costs diverted from governments to industry directly, via payroll and other taxes, as well as initiatives such as employment and pay equity, add directly to corporate burdens, and to the already declining perception of Canada and Ontario as positive investment locales.
- Essential present and future production techniques such as "Just in Time" inventory flows are vulnerable to legislation that generates work place interruptions.

**Recommendation:** The Committee recommends that labour and management become partners to achieve the common goals of customer satisfaction, and being competitive in a global industry environment.

**Recommendation:** The Committee recommends that where legislation is needed to correct a condition in the work place, a means be found to take into account and avoid disturbing already-in-place provisions in a collective agreement.

**Recommendation:** The Committee recommends that social legislation and programs extending beyond corporate or sectoral collective agreement provisions be measured on the basis of their economic impact as well as social impact.

### 6.1.3 Labour Adjustment

Training and skills development is one of the primary elements in our efforts to secure the future of Canada's automotive industry. If timely and effective, and with progress on the other competitiveness factors, employee adjustment needs will not require extraordinary actions and programs.

- In the event of plant closures, openings, new product mandates, or the introduction of new production technologies, vehicle manufacturers will work closely with their unions, and agencies at all government levels, to effect an orderly transition.
- Other segments of the sector, comprising more numerous companies of various sizes and circumstances, may require more assistance, both in planning and implementing adjustment programs.



- At minimum, awareness of the adjustment assistance programs and legislative requirements must be more widespread as the re-structuring of the industry proceeds.

#### **6.1.4 Unionization**

Canadian (CAW) and United States (UAW) collective agreements diverged following the CAW separation from the international union in 1984.

- With certain exceptions, the UAW priority of job security established significant potential costs in the event of plant closures.
- The CAW emphasis was on economic gains. The CAW was able to achieve wage increases because of lower non-wage labour costs in Canada (which is in large part due to Canada's universal health care system, which reduces employee benefit costs to employers) and the weakness of the Canadian dollar at that time.
- The results have been a continued erosion of Canada's labour rate advantage compared with the United States.

#### **6.1.5 Manufacturing Unit Labour Costs**

Between 1980 and 1988, unit labour costs (based on wages as a percentage of the value of shipments) declined in the automotive industry.

- For the assembly sector, unit labour costs declined by 11.5 percent in Canada, and by 28 percent in the United States over the 8 year period.
- For the parts sector, unit labour costs declined by 8 percent in Canada, and by 4 percent in the United States over the period.

#### **6.1.6 Management Training**

The most important determinants of auto manufacturing performance are a combination of advanced automation and an "Agile/Lean" production system. A production system is defined as "agile" where it is dependent on a skilled, flexible and motivated work force for problem solving and continuous improvement, and is "lean" in its avoidance of problem-hiding buffers such as inventory stocks, large repair areas, etc.

Assemblers, primarily Japanese companies, who established a foundation of Agile/Lean production and then integrated advanced technology were much better performers than U.S. and European assemblers who have invested in high levels of technology but have not changed their production systems. Technology is a much smaller indicator of quality performance than the management of variables which are the strongest predictors of high productivity/high quality performance.

Adapting to a global economy requires well-trained, up-to-date managers as well as highly-skilled employees and engineering talent.

- Managers that are not part of an international organization need broader access to courses that will impart the sense of need for review and likely change, as well as assist in effecting change.
- Industry must define its sectoral needs, and, with governments and educators, develop programs to serve them.
- Smaller companies may find management training more difficult than larger companies, though it is likely that the needs of smaller companies are similar and could be served by generic training.

All segments of the automotive industry, including the automobile dealers associations, joined together to establish the national Canadian Automotive Institute at Georgian College in Barrie, Ontario to provide training in the retail automotive field.

**Recommendation: The Committee recommends that all segments of the industry continue to support the Canadian Automotive Institute, and in particular, the entrepreneurial, sales and product management training that it provides.**

#### 6.1.7 Engineering training

A number of new directions taken by the North American automotive industry dictate a continuing demand for engineering talent:

- adoption and adaptation of new technologies in the vehicle as a product, in manufacturing processes, and in service procedures;
- the principle of continuous improvement;
- new assembler/supplier and supplier/supplier relationships, which call for more engineering activities on the part of suppliers;
- just-in-time inventory controls, and "synchronized" manufacturing;
- niche product development and quicker response to consumer demand;
- increased CAD/CAM applications;
- increased concerns about environmental, safety, and health considerations, within and outside production facilities, as well as regarding the vehicle itself; and
- increasing demands on suppliers due to the introduction of new materials, technologies, and services while a rationalization of the supplier industry is taking place.

**Recommendation:** The Committee recommends that management and skills training be developed in the context of, and sensitive to engineering training, employment equity regulations and programs, and co-op programs through which students can gain essential practical experience as they learn.

**Recommendation:** The Committee recommends that secondary school and university priorities be re-ordered to provide more engineering and technical education to better equip students with knowledge and skills of practical application to industry.

## 6.2 Trade

### 6.2.1 Canada - United States Free Trade Agreement (FTA)

The onset of the recession shortly after the FTA came into effect has made it easier for critics to blame the FTA for job losses, company transfers and plant closures. However, the FTA was not the cause of the automotive industry's economic problems. Some of those problems are related to the recession, others are due to competitive pressures.

- Modernization, improvements in: productivity, technology, and quality, and reductions in costs were essential regardless of a Canada-United States FTA.
- Moreover, the FTA was required to secure the Canadian industry's long-term access to United States markets.
  - The Auto Pact, including the Canadian Duty Remission program which was promoted as an attachment to the Auto Pact, was endangered prior to the FTA for various reasons.
  - Access to the United States market was, therefore, also endangered.
- However, the FTA has not insulated Canada from the effects of the United States trade and competition policies and practices.
  - "Buy American" may not always include Canadian products.
  - Dispute settlement processes absorb more resources than would focussed bilateral working group discussions.
- Continuing Canadian "safeguards" in the Auto Pact are visible and widely-known, but not necessarily understood, while United States actions to protect its industries are much less transparent, but very effective, nonetheless.

- Higher external, third country tariffs in Canada than the United States are expected to be reduced under the GATT, and could be lowered unilaterally. That would not resolve trade disputes based on claims of subsidies, or on Rules of Origin questions, but would provide a benefit to Asian manufacturers by lowering the duty on imported parts.
- Regardless of the trading treaties and agreements with the United States, Canada has been in the past and will likely in the future be "sideswiped" by United States actions, particularly when such actions are introduced by the Congress. United States parents of Canadian auto companies assist in minimizing the adverse effects of any such actions on the fully-rationalized automotive manufacturing industry.

**Recommendation:** The Committee recommends that permanent Canada - United States working groups be formed to address bilateral trade and competitiveness issues. For example, one such working group could be given the mandate to develop common definitions of terms in the FTA rules of origin and common guidelines in applying them. The working groups should be comprised of representatives of all stakeholders. If the FTA is subsumed or superseded by a NAFTA, the composition and mandate of the working groups should be expanded to deal with trilateral issues.

## 6.2.2 North American Free Trade Agreement (NAFTA)

The Canadian automotive industry, with the exception of the CAW, supports participation in the NAFTA discussions, with particular interest in: Market Access, Auto Pact or Country safeguards, and Rules of Origin.

### Market Access

- The opening of the potentially-dynamic Mexican market would provide opportunities for Canadian-produced vehicles and parts, especially with traditional markets being stagnant.
- Most automotive imports from Mexico enter Canada duty-free under the Auto Pact, while Canadian exports to Mexico encounter various barriers, including provisions of the Mexican Auto Decree.
- The Decree also presents additional cost impediments to its own domestic industry.
- Immediate removal of the Decree would prejudice and jeopardize existing Mexican automotive production investments.

**Recommendation:** The Committee recommends that one of the objectives of the Canadian negotiating team be a phasing out of the present Mexican system under a NAFTA. Gradual elimination of the present Mexican system in favour of a more liberalized trade environment will be required. (Certain Asian companies favour immediate elimination of the Mexican system.)

### Auto Pact/Country Safeguards

- The Canada-United States Auto Pact has, since 1965, been Canada's basic automotive economic and trade policy instrument.
- The Auto Pact transformed the Canadian automotive industry into a competitor, internationally.
- The production-to-sales ratio requirement assured vehicle assembly and attendant jobs in Canada. The Canadian value added requirement assured a base market for parts and components producers.
- For qualifying companies, the value of duty-free, multilateral sourcing of vehicles and parts, that is allowed under the Auto Pact, added significantly to investments in Canada.
- It remains critical that Auto Pact companies retain the ability to leverage global resources, in order to be able to compete with imports from low-cost countries, and to pay for higher employee costs than those faced by new Asian manufacturers.
- The automotive industry relies upon the Auto Pact principles for its strength.
- Auto Pact companies (i.e., those that qualified prior to January 1, 1989 when the FTA came into effect) provide substantially more economic activity relative to their share of the market than the Asian manufacturers.
- Economies of scale are a major factor in the competitiveness of the automotive industry. Country safeguards, such as those in the auto pact, ensure a level playing field with the United States.

**Recommendation:** The Committee recommends that the operating principles of the Canada-United States Automotive Products Trade Agreement (Auto Pact) be retained in any future Canadian trade regime.

## **Rules of Origin**

- **Firstly, rules of origin are used to determine the "nationality" or country of origin of a product to be traded internationally.**
- **Secondly, they provide a test, value-based and/or otherwise, to determine if the product of a given nationality is eligible for preferential tariff treatment under a trade agreement between two or more countries.**
- **In effect, the preference is intended to attract investment and sourcing to member countries by providing benefits to those making such commitments.**
- **Rules-of-origin effects are only applicable to internationally-traded goods. Asian producers in the United States export little to Canada, so rules of origin have an insignificant impact on them. Canadian Asian manufacturers, however, do export to the United States, but in small volumes relative to North American producers. If a company chooses not to build content through local sourcing and investment, and decides to export over the low United States tariff, then the rules of origin are inapplicable, at any content level.**

### **Objectives for rules of origin agreed to by NAFTA Sub-committee members:**

- **The rules should be value-based, providing greater certainty and flexibility of planning and production actions to companies, than would a requirement that certain production processes be performed within the free trade area.**
- **Corporate-wide averaging provides additional flexibility, whereby a value-based rule is permitted to be applied over a corporation's entire production rather than on each segment, plant, or product line; and even more flexibility is available if joint ventures or affiliated company operations are included.**
- **Increasingly fragmented markets, requiring niche products, preclude large additional investments to produce high-value powertrain components. Without broad averaging, firms would have less incentive to assemble lower-volume niche vehicles in North America or would be inclined to assemble them in the dominant market.**
- **The Canada-United States FTA rules are unnecessarily ambiguous. NAFTA rules should be clear, concise, auditable, accompanied by an agreed lexicon of terminology, and with a mechanism for quick adjudication of disputes about the rules and their meaning.**

**Recommendation:** The Committee recommends that as an integral part of the implementation of a NAFTA it include a provision for timely interpretation bulletins, advance rulings, and a permanent trilateral body to discuss issues of interpretation and administration. The objective is to anticipate and resolve issues before they become major problems.

### 6.3 Market

Canada and the United States continue to represent the most open markets in the world. Therefore, they are the most competitive markets, as well. As a result the consumer has benefitted from a wide range of products, higher quality and lower prices. Consumers have responded with higher expectations, which has intensified the challenge for automobile designers, manufacturers and dealers.

#### 6.3.1 Sourcing Patterns

- Automotive markets are national, although free trade may be altering the degree to which that has been true. Production sourcing patterns, however, have been international, especially given production rationalization under the Auto Pact.
- Slow growth of motor vehicle sales in most industrialized countries is expected to characterize the future, ensuring heightened competition for market share.
- Consumer demands, encompassing an increasing total number of factors, are personalized, but responsive to environmental, energy, and safety concerns as those take priority in government and public policy areas.

#### 6.3.2 Consumer Issues

Customer satisfaction with the purchase and after-sale service of automobiles is the paramount issue for all segments of the industry. The industry has made significant progress in meeting customer expectations, but:

- Affordability is becoming a problem for the new car buyer. As used car prices have been depressed, consumers have less equity to put towards the purchase of a new vehicle.
- Taxation of the new vehicle has also become a difficult "sell" to the consumer when air conditioning taxes, battery taxes, tire taxes, gas guzzler taxes and sales taxes are added on to the vehicle price after it has been negotiated. These taxes equate to roughly 17% of the purchase price, and are likely to reduce the size of the Canadian market.

- Apart from a house, a vehicle is the largest purchase most people make in their lives and there is an increasing desire for compensation when problems occur with the vehicle in which the consumer has invested thousands of dollars.
- The Ontario Motor Vehicle Arbitration Plan (OMVAP) has been in operation since 1986 providing Ontario consumers with a mechanism to have an independent third party resolve disputes relating to alleged manufacturing defects.
- For the consumer, OMVAP is seen as more efficient, in terms of both time and cost, than small claims court while the manufacturers benefit from reduced costs and reduced bureaucracy than would otherwise be the case if United States-style "Lemon Laws" were imposed.

**Recommendation: The Committee recommends that all vehicle-specific taxes be re-evaluated with a view to simplifying the tax system and improving the affordability of vehicles by shifting the burden of taxes from vehicles to other forms of taxation.**

**Recommendation: The Committee recommends that The Ontario Motor Vehicle Arbitration Plan be expanded into a national program.**

#### 6.4 Regulations and Taxes

The Canadian auto industry must not be jeopardized by unsound, unnecessary, conflicting, or redundant policies or regulations. Rather, efforts should be directed to achieve consensus, allowing voluntarism to replace regulation, shared data to replace reporting and penalties, and realistic, clear targets to replace arbitrary measures.

- Taxation policies will be ineffective, can be damaging, and may be unnecessary, if the goal is not well-defined and publicly accepted. For example, automobiles are subject to GST, weight tax, PST, Air conditioner tax, and, in Ontario, Tire Tax, and a Tax for Fuel Conservation. Little or no account is taken of the fact that total passenger vehicle fuel consumption is about at the level of 1975, despite an increase of over 40 per cent in automobiles in use.
- Unique Canadian vehicle standards can work against trade and market access and production economies. They should be avoided without a defined need. Where unique Canadian vehicle standards are employed, they must meet the test of cost-effectiveness.



**Recommendation:** The Committee recommends that unique Canadian standards be considered only if a defined need exists which cannot be met by harmonizing with U.S. requirements. If and when such a need is defined, industry and government should cooperate to develop optional responses which are measured by cost-benefit criteria.

**Recommendation:** The Committee recommends that Canada's environmental Green Plan be the primary focus of federal, provincial, and municipal governments in developing environmental and energy conservation initiatives. Resources are too precious to waste on proposing and reacting to the unnecessary burden of fragmented, un-coordinated actions.

**Recommendation:** The Committee recommends that the Goods and Services Tax and provincial sales taxes be integrated to reduce administrative cost and complexity, and consumer confusion and animosity.

**Recommendation:** The Committee recommends that unique and extra costs incurred by manufacturers, sellers, and consumers in Canada as a consequence of governmental requirements be defined and offset to assist corporate efforts to compete. Examples include: the time and other costs involved in obtaining various permits and certificates of approval for capital projects in Ontario, the costs of testing specified chemicals in Canada compared with corresponding costs in other countries (including redundant testing of products already tested and approved for use in other countries), pension funding proposals, employment and pay equity requirements, employment standards which conflict with collective agreement provisions in matters of health and safety, overtime scheduling, and Ontario's employers health tax applied to finance health care.

**Recommendation:** The Committee recommends that criteria be established by which regulatory proposals can be measured as to their cost effects on Canadian companies and their products, as well as on their ability to compete at home and abroad with products from other countries.

**Recommendation:** The Committee recommends that governments consider the establishment of an agency to provide "turnkey" government liaison services to companies planning major capital investments. The agency would assist companies to negotiate agreements on training assistance, provision of site services, and other participation by various levels of government, as appropriate, and obtain all of the necessary zoning, environmental, building code and other government approvals for the project.

## **6.5 Technology**

### **6.5.1 Research and Development Tax Credits**

Financial incentives, in the form of Scientific Research and Experimental Design (SR&ED) tax credits, are available to organizations carrying out R&D in Canada. The program has the potential to significantly increase the amount of R&D carried out by the automotive industry, but eligibility and administrative problems have limited its effectiveness in encouraging motor vehicle and parts manufacturers to carry out more R&D in Canada.

#### **Eligibility**

- Access to Canada's SR&ED tax incentives has been hindered by eligibility problems as identified by the ISTC Sub-Committee.
- Eligibility problems relate to the "all or substantially all" rule for capital equipment credits where a firm develops equipment initially for R&D, but subsequently employs the equipment in a productive capacity.
- Further eligibility problems are encountered when determining the incremental overhead and administration charges associated with R&D activities.
- The federal government acknowledged the eligibility difficulties in the 1992 budget.

#### **Administration**

- Administrative problems have occurred in terms of assessing eligibility.
- The 1992 Federal Budget seeks to streamline the administration of the SR&ED tax credit system.
- Relaxed tests for capital expenditures used in both research and production would be welcomed as well as some relief in the area of documenting the allocation of overheads and administrative expenses.

**Recommendation:** The Committee recommends that certitude of project eligibility be improved, by issue of Advance Tax Rulings or an alternate form of advance decision, prior to project commencement. A study should be made of the relative benefits of assigning ISTC the responsibility to issue Eligibility Certificates/Rulings, with standardized documentation, in the manner of previous research incentive programs.

**Recommendation:** The Committee recommends that the "all or substantially all" rule for capital equipment credits should be amended. A fair proration of Investment Tax Credits (ITC) and Capital Cost Allowance (CCA), reflecting the time in use of equipment for R & D purposes, should be allowed. This change would improve project cost certainty and encourage more R & D.

**Recommendation:** The Committee recommends that a standard overhead factor be allowed when legitimate R & D projects are undertaken in mixed use facilities. This would encourage more R & D, as dedicated premises are generally not economically practical.

**Recommendation:** The Committee recommends that project cost definitions be clarified by Revenue Canada Taxation (RCT).

**Recommendation:** The Committee recommends that RCT allow R & D Investment Tax Credits to be used to offset all corporate taxes including the large corporation tax and surtaxes.

**Recommendation:** The Committee recommends that simple, standard documentation requirements be developed, with the help of industry representatives, for R & D projects.

**Recommendation:** The Committee recommends that used equipment be eligible for the ITC.

**Recommendation:** The Committee recommends that the time between planning, implementation, the science advisor's review and final audit be reduced.

**Recommendation:** The Committee recommends that the period of eligible R & D be extended to the time of commercial production.

**Recommendation:** The Committee recommends that RCT consider projects on a program (several vehicles) rather than a single vehicle basis.

### 6.5.2 Financing of Industrial Innovation

The Committee on the Financing of Industrial Innovation reviewed the sources and cost of capital available to finance industrial innovations and made a number of recommendations that are intended to support increased industrial innovation through improvements in how it can be financed. The Committee's recommendations address the following subject areas:

- returns for investors, owners and managers of firms that create real wealth;
- supply of funds for industrial innovation;
- risk involved in industrial innovation by established firms;
- access to capital for start-up of early-stage technology-intensive firms;
- investor knowledge about technology-intensive enterprise;
- communication and understanding between financial institutions/investors and technology-intensive firms; and
- availability within small technology-intensive firms of the full spectrum of management skills.

**Recommendation:** The Committee recommends the implementation of the recommendations of the Committee on the Financing of Industrial Innovation (contained in its report dated March 31, 1991).

**Recommendation:** The Committee recommends that the Federal and Provincial Governments support the efforts of the Statistics Sub-committee to develop benchmarks that can be used to compare the competitiveness of Canada's automotive industry to those in competing jurisdictions. The benchmarks might include unit labour costs, material costs, other costs of doing business, investment in product and process R & D, investment in facilities, investment in transportation and communications infrastructure, etc.

## **7 ENVIRONMENTAL ISSUES**

### **7.1 Environmental Principles**

- **Environmental programs must be harmonized across Canada and with those of the United States where possible, fully recognizing the integrated nature of the North American Automotive Industry.**
- **Environmental programs must be based on sound environmental science and economics.**
- **Voluntary compliance schemes provide flexibility and resource efficiencies for both government and industry and must be considered as the preferred method of compliance when all of the involved parties are in agreement.**
- **Market-based approaches must be utilized where possible. Strategies which harness market forces are much more effective and efficient than command and control based regimes.**
- **Solutions to global problems must be based on international agreements. Canada cannot afford to "go it alone."**

### **7.2 Fuel Economy**

- **Domestic manufacturers have more than doubled vehicle fuel economy since the mid 1970s, while achieving substantial reductions in vehicle emissions.**
- **Historical data clearly shows that the price of gasoline has been the major force influencing new car fuel efficiency, vehicle miles driven and the overall amount of gasoline consumed. Fuel prices have significantly affected consumer behavior. Fuel economy standards have not.**
- **Fuel economy standards have proven to be a very ineffective, inefficient and unfair approach to conserving fuel. They disadvantage full-line domestic automotive manufacturers, while doing little to address consumer behaviour, which is the key factor influencing fleet fuel economy and overall fuel use.**

- Vehicle technology is not commercially available to achieve radical improvements in vehicle fuel economy. To do so would entail massive down-sizing of the entire fleet, quite possibly at the expense of occupant safety. The required shift to smaller vehicles in all size categories runs counter to current consumer demand trends. Unless there is a major technological breakthrough, with commercial application, future gains in fuel economy will be incremental and at substantial cost.

**Recommendation:** The Committee recommends that instead of focusing on fuel economy standards, the government pursue a broader, market-based strategy aimed at reducing all consumer demand for fossil fuels in Canada.

### 7.3 Vehicle Emissions

- The automotive industry has already reduced passenger car emissions by 90% on average from uncontrolled levels.
- Based on current vehicle standards, it is estimated that total Canadian passenger car emissions will decrease by 43% for hydrocarbons and 57% for nitrogen oxides by the year 2005. Hydrocarbons and nitrogen oxides contribute to the formation of ozone.
- Canadian Manufacturers have already signed a Memorandum of Understanding with the federal government stating their commitment to voluntarily phase-in the more stringent U.S. federal emissions standards beginning with the 1994 model passenger cars. This voluntary undertaking will result in a further emission reduction of NO<sub>x</sub> by 60% and hydrocarbon (HC) by 29% for new vehicles by the 1996 model year.
- Measurable, cost-effective reductions in overall light duty vehicle emissions can now only be expected to come from removing older vehicles from the road and by ensuring that owners operate and maintain their new vehicles properly.
- The automotive industry is willing to make available new, heavy duty vehicles in Canada, starting with the 1994 model year, which will meet tighter, new United States emission standards, provided that 100 percent of high-sulphur diesel fuel currently available in Canada is replaced with low-sulphur diesel fuel, as in the United States.

- It appears that the Federal government will not mandate 100% availability of low sulphur fuel in Canada until the 1996 model year, at the earliest. This will delay the availability of these new technology vehicles and the implementation of new heavy duty vehicle emission standards which are very much dependent on the fuel regulation.

**Recommendation:** The Committee recommends that tighter vehicle emissions standards in the future be supported with tighter fuel regulations. The low sulphur diesel fuel issue illustrates the need to recognize that as emission standards become more stringent, governments must take a total systems (vehicle and fuel) approach to vehicle emission regulations.

#### 7.4 Gas Guzzler Taxes

- Like fuel economy standards, guzzler taxes are ineffective at reducing fuel use. They apply only to new vehicle efficiency while providing no incentive to change how vehicles are operated, which is the major determinant of overall fuel use.
- Since gas guzzler taxes do not increase the cost of driving, any fuel economy improvements induced by such a tax are partially "taken back" through increased driving.
- Gas guzzler taxes have potentially perverse and negative side effects on the environment. Because they increase capital and financing costs, they discourage consumers from purchasing new, fuel efficient vehicles which are equipped with the most up-to-date emissions systems, providing consumers with less incentive to replace their older, less fuel efficient, higher polluting vehicles.

**Recommendation:** The Committee recommends that rather than imposing fuel economy standards and/or gas guzzler taxes, reduction of overall fuel use is better addressed through the use of broad-based policy measures, such as carbon taxes, which would efficiently and equitably reduce fossil fuel use by all sectors of the Canadian economy.

## **7.5 Alternative Fuels**

All original equipment manufacturers are currently involved in the development of vehicles for the primary candidate alternate fuels. Each of the Big 3 auto makers have defined world product mandates resident in Canada for the development of either methanol "flex-fuel" vehicles or propane and natural gas vehicles. The retention and possible further development of these mandates in Canada is desirable as they represent an opportunity to gain a position in an emerging, technology-based sector, with high Canadian value added. Success will depend on the accelerated introduction of these vehicles so as to achieve the necessary high-volume markets.

A number of key issues must be addressed through the critical linkages established between vehicle manufacturers, federal/provincial governments, research centres and fuel suppliers, in the following areas:

- Federal and Provincial governments must decide on a long term, coordinated, alternative fuels strategy, clearly indicating which alternative fuels will be supported with long term commitments.
- Alternative fuel infrastructures need to be developed in support of new products and to ensure that alternative fuel vehicle programs are market driven. In this regard, alternative fuels must be made readily available in the marketplace and must be priced competitively.
- Alternative fuel vehicle regulations/standards must be harmonized across North America recognizing the integrated nature of the automotive industry and allowing manufacturers to leverage technical, manufacturing and investment resources.
- The Federal government must be responsible for regulating alternative fuel vehicles. Allowing the provinces to set individual standards increases complexity and cost and reduces the feasibility of original equipment manufacturer (OEM) produced vehicles.
- Alternative fuel regulations need to be performance based as opposed to design based. Historically, alternative fuel vehicles have been required to meet design standards which have primarily been developed for aftermarket retrofitters. Requiring OEMs to meet similar design-based standards eliminates competitive design advantage.
- All OEMs and aftermarket converters must meet the same requirements.



**Recommendation:** The Committee recommends that an alternate energy sector campaign be undertaken in partnership with the involved industries and government to identify key obstacles and appropriate actions of redress through carefully defined studies. Alternate energy technologies could make an important contribution to Canada's productivity and long term prosperity provided that barriers are minimized or eliminated.

## 7.6 Mandatory Periodical Vehicle Inspection

- Data shows that older vehicles, while representing the smaller portion of the on-road fleet and are driven fewer kilometers contribute a much higher percentage of total emissions than more-fuel-efficient, late-model-year vehicles which are equipped with more advanced emission control technology.
- Policies to remove the high-emitting vehicles and increase the market for new, cleaner vehicles would more effectively achieve the emission reductions desired and improve the fuel efficiency of the overall on-road fleet.

**Recommendation:** The Committee recommends that the provincial governments contribute to the NO<sub>x</sub>/VOC management plan objectives and institute mandatory periodic vehicle emissions inspection programs that are consistent in their requirements nationally, as supported by the vehicle manufacturers.

## 7.7 Federal-Provincial Cooperation on the Environment

- Canada's green plan provides for a comprehensive set of environmental protection initiatives representing the culmination of views solicited from a diverse group of stake-holders, including those of the business community, provincial governments, and non-government organizations. It sets forth the framework for collective and cooperative approaches involving all of the stakeholders and calls for regional action on the part of provincial governments necessary to meet specific environmental objectives, ie. NO<sub>x</sub>/VOC Management Plan.
- Efficient and effective achievement of the stated environmental goals calls for improved federal-provincial relations, to ensure consistency in requirements between jurisdictions and give consideration to non-traditional strategies such as economic instruments and voluntary commitments.

## **7.8 Other Environmental Issues**

The other environmental issues that the automotive industry is actively addressing are in regard to:

- recycling,
- chlorofluorocarbons (CFCs),
- pollution prevention,
- waste management,
- Ontario Clean Air Program, and
- Ontario Clean Water Program - Municipal-Industrial Strategy for Abatement (MISA).

Information on the industry's activities in these areas is in Annex I to this report.

## 8 ELECTRICITY - SUPPLY AND COST

To date, the sustained growth of the auto industry in Ontario is attributable to a number of factors, an important one of which is the availability of electricity for our plant facilities. It is critical that we continue to have a reliable and affordable source of power for our manufacturing activities so that Ontario may retain existing investments and be attractive for new production and job opportunities.

- MVMA companies have voluntarily monitored their energy productivity improvements and set annual energy efficiency objectives under the Canadian Industry Program for Energy Conservation (CIPEC), an industry-administered/government-sponsored and funded program.
- We have taken significant steps in our industry to reduce power consumption in our production processes with commensurate savings in energy costs. For example, our member companies have voluntarily installed energy conserving, high efficiency lighting and motors in many locations, variable speed drives, new state-of-the art technologies in paint applications and installations of the Canadian developed and Ontario manufactured "Solar Walls". Other initiatives taken to conserve energy include peak load shifting where possible, government/industry sponsored energy conservation programs, technology transfer seminars and potentials for co-generation.
- Traditionally, Ontario Hydro rates have provided a competitive advantage. This advantage is now eroding. From being the lowest cost electric utility amongst automotive producing provinces and states in 1984, Ontario slid to 7th place in 1990 with cumulative rate increases of 61 percent over that period. Accelerated rate increases will disadvantage Ontario facilities even further.
- MVMA member companies currently spend over \$100 million annually on electricity for their Ontario operations. The 11.8% increase for 1992 will result in an additional charge of over \$12 million for our members.
- In terms of the future, we are faced with extreme competition, a declining market and debilitating overcapacity. In addition, environmental issues are more than ever a major component of corporate planning. Solutions to these problems will be expensive and the technology utilized to reduce emissions and make our plants more environmentally acceptable will also require additional energy.
- We are continuing to work diligently to conserve energy, but continue to be concerned about Ontario Hydro's ability to meet future electricity demand through conservation and refurbishing existing facilities.

**Recommendation:** The Committee recommends that an objective re-evaluation of the future supply, demand, price and security of supply of electricity in Ontario and Quebec be carried out.

## **9 FISCAL AND MONETARY ISSUES**

### **9.1 Cost and Availability of Capital**

Cost and availability of capital had not been at question in North America, until brought into stark relief by this recession, and the manufacturing re-structuring which has been forced by competition.

- Industry profits are non-existent or critically-low for North American-based companies, as are internal cash flows.
- Investment and working capital must be raised from outside sources.
- Spending must increase, by more companies, even as sales and profits decline.
- Competition for capital is heightened by the actions of governments, which in Canada and the United States are financing record debt loads and budget deficits precisely when businesses, large and small, also require access to debt financing.
- Credit-worthy ratings become a decisive factor in capital cost, and access to capital pools.
- Balance sheet ratios are closely scrutinized, forcing significant decisions upon management, which are even more difficult if equity issues are not an option.
- Cost of capital differentials amongst auto industry host countries and amongst automotive companies within a country are magnified as borrowing needs mount.
- The phasing out of programs of tool cost assistance for suppliers by vehicle companies will place an added burden on parts manufacturers and must be re-evaluated.
- Most automotive companies, being active international traders, are required to be knowledgeable and nimble in financial markets, to minimize capital costs and to hedge against currency fluctuations.

The upshot of these issues and more is the growing reticence of financial institutions to assist automotive enterprises. In regard to smaller suppliers and dealers, the difficulty is amplified by being "small business" as well as automotive businesses.

**Recommendation:** The Committee recommends that governments and the automotive parts manufacturing industry take the initiative to provide the financial community with the information that it requires to objectively assess the future prospects for the industry.

**Recommendation:** The Committee recommends that firms that are planning to raise debt or equity capital pay particular attention in their business plans of the need to provide convincing evidence that they will emerge from the current consolidation as stronger, more profitable companies.

**Recommendation:** The Committee recommends that motor vehicle manufacturers and their suppliers work together to reduce the financial risk across the customer/supplier boundary.

**Recommendation:** The Committee recommends that the Federal and Provincial governments consider ways and means of creating pools of risk-sharing capital, possibly through funds that allow tax deductions on contributions.

## 9.2 Tax Regimes

- In taxing corporations in Canada, the government must be sensitive to the effective rates of corporate tax imposed in other jurisdictions, against which Canada must compete for new investment.
- Federal and provincial governments need to work in concert in order to ensure that the tax decreases of one level of government do not become the tax increase of another.
- Payroll and capital taxes are direct expenses that must be incurred by the taxpayer to earn income, therefore they should be fully deductible in computing profits or income tax.
- Recent tax incentives outlined in the 1992 federal budget (reduced corporate tax rates on manufacturing and processing profits, increased CCA rate (from 25% -30%) for Class 39 property, the announced willingness to reduce withholding taxes on dividends paid to foreign corporations), and the previously announced changes to the application of the Large Corporations Tax are moves in the right direction, towards an internationally competitive investment climate.
- With a generous SR&ED credit environment it would seem that to the extent that companies are able to take advantage of this system that some highly skilled job creation would be a likely outcome, not to mention the spinoff effects that will ripple through other industrial sectors.

**Recommendation:** The Committee recommends that any taxation initiatives put forth by governments be assessed in light of a long term cost-benefit analysis, otherwise, short term revenue considerations have the potential to down play the long term impact on the investment potential for the country.

### 9.3 Exchange Rates

Fluctuations in the value of the Canadian dollar is a significant factor in the cost-competitiveness of Canadian manufacturers and the level of cross-border shopping.

- The investment cycle for the motor vehicle and parts manufacturing plants is five to seven years. Investments that are made on the assumption of, for example, a \$0.75 dollar are likely to be much less attractive at an \$0.85 dollar.
- Exchange rate fluctuations can have a profound effect on the cost-competitiveness of Canadian plants, especially if a significant amount of costs are incurred in Canadian dollars while revenues are received in U.S. dollars.
- Currency-hedging strategies are often insufficient to offset the impact of exchange rate fluctuations. As the Canadian and United States economies become more integrated, a stable exchange rate is increasingly important to the development of Canada's manufacturing industry.

**Recommendation:** The Committee recommends that the Federal Government and the Bank of Canada take action to ensure a stable Canada-United States currency exchange rate.

## 10 FEDERAL-PROVINCIAL ISSUES

### 10.1 Trucking

Trade agreements have or will secure access to the North American marketplace. However, access secured by a trade agreement is different from secure access flowing from the unimpeded transportation of goods across open international borders.

- 1990 and 1991 witnessed several occasions during which truckers shut down international border points (primarily between Ontario and the United States) resulting in down time at both Canadian and American automotive assembly facilities utilizing JIT production systems.
- Such action threatens the security of supply of finished vehicles from assembly facilities in Canada and the supply of parts produced for American assembly facilities by Canadian parts manufacturers.
- With the integrated North American market, length and weight restrictions for tractor trailers must not be out of step with those of the United States.

**Recommendation:** The Committee recommends that measures be taken to ensure unimpeded transportation across international borders otherwise Canada risks losing contracts for its parts manufacturers initially, and contracts for new product at assembly facilities eventually.

**Recommendation:** The Committee recommends that length and weight restrictions be harmonized across all Canadian provinces in order to improve the efficiency of truck transportation in Canada.

### 10.2 Infrastructure

There is no questioning at any level of government of the economic value of an up-to-date, efficient infrastructure of roads, bridges, tunnels, sewers and water systems. A number of points of debate, centering on who pays, are holding up progress.

- Municipalities have quantified the cost of necessary infrastructure maintenance and upgrading at some \$15 billion, and are awaiting funding assistance from the senior governments.
- Environmental groups question present methods of waste and sewage treatment, water use, cost, and quality, and resist road and vehicle population expansion and fuel use.



- Private motorist groups oppose large commercial vehicle configurations which offer economic efficiencies and reduced fuel use and air emissions.
- Railways protest that trucks do not pay commensurately for the road damage they cause, while railways maintain their own rights-of-way.

The automotive industry supports analyses of the Transportation Association of Canada which show significant spending shortfalls by most jurisdictions on road infrastructure, and that motor vehicle and driver fees, and fuel taxes, generate revenues well in excess of those spending needs. Also supported are the development of a National Highway System by the Council of Ministers of Transport, and of an electronic, interactive vehicle-highway system of traffic monitoring and control.

**Recommendation: The Committee recommends that governments support the development and application of Intelligent Vehicle Highway Systems (IVHS).**

## **ANNEX I**

### **OTHER ENVIRONMENTAL ISSUES**

#### **Recycling**

- All auto-makers are currently working on recycling programs. These programs encompass both recycling in the manufacturing process and improving the recyclability of products themselves.
- With respect to vehicles, almost all of the steel and iron in the automobile is recovered and recycled, representing 75% of the vehicle mass.
- An increasing amount of the plastic, which now constitutes 6-12% of the automobile is also being recovered. But auto manufacturers are using more and more plastics to address the fuel economy/greenhouse gas issue. The desire to promote recycling of automobiles must be balanced with other competing environmental priorities such as tailpipe emissions, safety and fuel economy. Additionally, the question of how willing are consumers to pay for higher levels of recyclability must also be answered.
- General Motors, Ford and Chrysler have recently formed a consortium to develop ways to reduce the waste from scrapped autos, particularly from those items which are not currently generally recycled such as plastics, glass, cloth, leather, carpeting etc. About 50 types of plastic are used in modern automobiles. There is a tremendous challenge to achieve "design for disassembly" including identifying, labelling and separating the different plastics, and finding ways to make them more easily detachable from the steel and iron support structures.
- The environmentally best use for scrapped vehicles is to reuse the constituent parts without having to expend energy to crush and melt them down. The major manufacturers have programs in place to rebuild major components such as engines and transmissions to reuse these parts.

## **Chlorofluorocarbons (CFCs)**

- CFCs (Freon) are used as a refrigerant in automotive air conditioning systems, while other derivatives are used as solvents in various manufacturing operations.
- CFCs used in mobile air conditioning systems are to be phased out by the 1995 model year, a process which has already commenced in selected 1992 model vehicles. These plans are consistent with Canada's recent announcement to accelerate its Montreal Protocol commitments to phase out CFCs by the 1995 calendar year.
- Service requirements call for the continued use of CFC-12 for mobile air conditioning systems 7 to 10 years into the future. Aftermarket service must have assurance that CFC-12 and/or acceptable blended refrigerants will continue to be allowed for servicing of the existing fleet.
- CFC recycling machines have been installed in dealerships and other aftermarket outlets to recapture and reuse CFCs from automobile air conditioning systems during service. This was done voluntarily by General Motors well before legislation required it to be done.

## **Pollution Prevention**

- Members of the Motor Vehicle Manufacturers' Association have agreed to participate in the Great Lakes Pollution Prevention program for the auto sector, a bilateral program (Canada/U.S.) directed at voluntary reduction of toxic substance use or production. This pollution prevention program is a means of achieving the objectives of the virtual elimination of persistent toxic substances in motor vehicle manufacturing facilities located in the Great Lakes basin.
- The Canadian Automotive Pollution Prevention program is the first cooperative pollution prevention initiative illustrating a positive partnership approach involving the province of Ontario, the federal government, and one of Canada's largest industries.
- The program is intended to be consistent with and supportive of participating member company management plans for long-term competitiveness and prosperity in an overall global environment.

## **Waste Management**

- A national waste reduction program with uniform standards is required.
- Ontario's unilateral initiative (Bill 143) may disadvantage businesses in the Province.
- A voluntary program should be given the opportunity to work in lieu of the regulated approach. Companies are not being given enough credit for what has already been done.
- Ontario's proposal creates onerous reporting requirements and will increase operating, capital and training costs. The timetables for waste audits and waste reduction work plans are also unrealistic.

## **Ontario Clean Air Program**

- The Clean Air Program (CAP) changes the focus from regulating at "point of impingement" to "bottom of stack" controls.
- Proposed changes to the regulations will rank emissions based on toxicity, environmental impact, and the level of hazard.
- Companies will have to monitor and model emissions, install new pollution control equipment, and revise production processes.
- The economic impact of the CAP on industry will be significant.
- National standards are required.
- Provincial regulatory authorities need to be cognizant of United States Clean Air Act standards so that Ontario facilities are not disadvantaged by stricter standards in the Province than those in the United States.

## **Ontario Clean Water Program, Municipal-Industrial Strategy for Abatement (MISA)**

- The goal of MISA is the virtual elimination of persistent toxic contaminants from discharges into Ontario waterways.
- Monitoring data will be used to develop effluent limits.
- The limits, based on available technology, will get stricter as periodic reviews assess new and evolving technology in each sector.
- The industry agrees with the principle of MISA, but there is some concern with the timing of expenditures, given the current economic climate.

## **ANNEX 2**

### **INITIATIVES AND ACTIVITIES OF AAC SUB-COMMITTEES: SUMMARY STATUS REPORTS:**

#### **Automotive Parts Sectoral Training Council (APSTC)**

The Council was formally established in October, 1991. With funding from Employment and Immigration Canada and the Ontario Ministry of Skills Development, Council staff will, through its committees, complete the design of a curriculum for training production workers to a level recognized by issuance of an "Automotive Parts Certificate", and an attendant communications and marketing plan. A three-year Funding Proposal has been submitted to the federal and Ontario governments for consideration. Quebec interest is being developed.

Founded jointly by the Automotive Parts Manufacturers' Association and the Canadian Auto Workers, the certificate course will commence in January, 1993, following pilot testing in mid-1992. The program is designed to provide training of eight hours in each of five courses per year for three years, a total of 40 hours per year, and 120 hours in total, to a maximum of 10,000 new trainees per year.

#### **University Programs Specialty Sub-committee**

As described in the pamphlet, "Gearing Up for the Future: Industries and Universities Working Together to Build Automotive Technology Competence", four key activities can achieve that objective:

- obtaining the information necessary to develop new concepts in product and process design;
- working with other experts on automotive research and development opportunities;
- understanding the technology that accompanies the concepts; and,
- training others to use the concepts.

As examples of these initiatives in action:

- University of Windsor's graduate program within Mechanical Engineering which concentrates on Automotive Manufacturing. A research chair is also being contemplated;
- University of Toronto's companies-supported automotive engineering research, with attendant programs to train students through placement with supporting companies;
- McMaster University's research and development facility for product and process design optimization;
- Ottawa University's preparation for an industrial chair in Electromotive Engineering, to work with industrial partners on battery and fuel cell systems for motor vehicles; and,
- University of Waterloo's many auto-related activities including Statistical Process Control, technology management, materials, fatigue, energy, and environmental studies, and a GM/NSERC chair in Productivity and Quality.

These and other auto-related activities are cited in the ISTC publication, "Automotive Research and Development Capability in Canada".

### **Automotive Components Initiative**

Under the ACI Program, funded to a maximum of \$6.27 million to March 31, 1996, some 208 company-specific projects have been approved, are ongoing, have been completed, or were aborted. These have generally focussed on productivity enhancements that, in addition to shop floor activities may include electronic and other networks, activity-based cost accounting, searching out and applying appropriate technology, and developing product and business planning.

### **OEM Auto Parts Outlook Study**

Under the ACI, this survey-based review of expectations, to and beyond the year 2000, covers a range of factors including trends in market, materials, sourcing, trade, and business relationships. Views compiled and conclusions drawn will provide information relevant to consideration of a possible Technical Centre, and as input to the ACI program, University relationships, and to the APSTC. (See Annex 3.)

## **Investment Tax Credit - R & D Expenditures**

The Working Group has achieved a considerably improved understanding of the administration by Revenue Canada of this ITC. Publication of an interpretation bulletin by the government was valuable, as were the proposals in the 1992 federal budget. The Working Group intends to continue to push for improvements in the administration of the ITC and make it more pertinent to automotive manufacturing.

## **Automotive Technical Centre**

The consensus of the sub-committee reviewing this issue, as reported at Briars III on April 14, 1992, was: (A) There is a need to find best technology via "networking", "clearing house" and "technology brokering" functions, (B) these must be industry driven and competitive market focused, and (C) world class benchmarking of emerging technologies must be available to Canadian manufacturers ahead of other North American and international competitors.

A needs analysis for a Technical Centre disclosed a greater interest by smaller, independent firms, with support for assistance of the type available from the former OCAPT.

While funding a Technical Centre activity is not yet settled, there is agreement on the principles of: linkages with existing technical resource centres in Canada, the U.S. and abroad; continuous upgrading of technology information, government programs; and the emphasis on training to assimilate new technologies.

## **Environment**

The sub-committee monitors all automotive-related environmental initiatives, regulatory and non-regulatory. Its members serve on various other forums as well, and ensure mutual awareness and complementariness of effort. Its points of reference include the Green Plan, international undertakings such as the various protocols on specific contaminants, motor vehicle emissions reduction commitments such as for light-duty vehicles during the 1994-6 model years which will meet U.S. 49-state requirements, and 1994 heavy-duty vehicle U.S. levels if low sulphur diesel fuel requirements are met in Canada. Vehicle emissions inspection/maintenance programs are favoured.

Fuel economy progress through new vehicle technology, fleet turnover, and the use of alternate fuels continues to be monitored and promoted. The sub-committee favours market-driven programs to gain defined objectives, believing that regulation may not be necessary or advisable where consumer demand is consonant with government and industry directions or goals.

Stationary or plant sources of emissions, hazardous materials and waste management, and recycling issues are all being addressed in the context of federal-provincial-regional-municipal cooperation and coordination to utilize available resources to greatest benefit and effect.

## **North American Free Trade Agreement**

On the assumption of a successful conclusion to the tripartite negotiations, this sub-committee first reviewed the primary elements of an agreement, agreed on where consensus amongst the members was not possible, and subsequently concentrated upon the consensus-possible elements. Most of its collective efforts have been with regard to the Rule of Origin/Preference, its criteria, clarity, auditability, lexicon of terms, and adjudication procedures as necessary, with a view to avoiding the uncertainty which has characterized the Rule under the bilateral FTA.

The sub-committee also has been of considerable benefit as a resource to the Canadian negotiating team, and has assisted the International Trade Advisory Committee (ITAC), the bilateral Select Panel, and the Sector Advisory Group on International Trade (SAGIT) through overlapping memberships among those groups and the Automotive Advisory Committee to the Minister of Industry, Science and Technology and International Trade.

## **Information and Statistics**

Suggestions for improvements to the ISTC Statistical Review of the Canadian Automotive Industry have been incorporated, with more to come. A quarterly publication of current, available data has been developed by ISTC, as has a detailed compilation of trade-related statistics, developed after Statistics Canada eliminated a number of auto-related series of data.

More attention is being given to data needs under a NAFTA, to ensure trends are detected and Canada's performance quantified.

Additional emphasis will be given to electronic links between related banks of data, government and industry, to avoid duplication of effort, and ensure a common base of information, sources, and analyses.



## ANNEX 3

### OE PARTS OUTLOOK WORKING GROUP

**Background:** Dramatic structural changes, largely due to intense competition among the foreign and domestic assemblers, are impacting on North American parts manufacturers with consequences that are far from clear at present. Although the growth in the auto parts sector was strong during the 1980s, in Canada the sector passed a watershed in the 1989-90 period, since indications are that future growth will be less substantial and that the sector may in fact be diminished. Consequently, the uncertainty of the mid- and long-term markets made it vital to obtain insights from the best possible sources about the probable evolution of the auto parts sector in North America and Canada from which a perspective of the future could be developed.

**Mandate:** The OE parts outlook was commissioned by the Minister's Automotive Advisory Council to examine the factors driving the evolution of the automotive industry in North America, and in particular, the potential effects of current trends on the auto parts sector in Canada, for the next decade.

**Approach:** Strategic factors or issues and primary sources of information (interest groups) were identified at the outset so that a representative sample of each group would provide their perspective on these issues and their views of the evolution of the auto parts industry. Structured, in-depth interviews, were conducted with key industry decision makers and other industry experts, based on the premise that while no one can accurately predict the future, the strategic perspectives of key executives will guide their decisions, and thus shape the future of the auto industry.

Over sixty interviews were conducted in person with senior executives of eight assemblers, 18 parts suppliers and executives and experts from labour groups, financial institutions, associations and government organizations to obtain their views of the future of the auto parts sector in Canada.

#### **Findings: 1993 - 2000**

- All Canadian production is in high-cost areas, and will continue to be so. To continue to generate high income jobs in this industry, Canada needs to maintain appropriate training and career path incentives.

- US vehicle assembly and supporting parts production is becoming more geographically diversified, and as a sector, is bringing down operating costs.
- The OEs are dealing directly with fewer companies to better control cost and quality. The high cost environment in Canada places Canadian companies at risk of being priced out of their markets and Canadian companies could see a substantial drop-off in business after current car models are phased out. New car platforms, 1995 models and later, could have significantly less Canadian content. It appears that there will be a major impact on body and trim components manufacturers in Canada.
- Due to overcapacity in North America and greater capacity utilization, the Big 3 will build no additional assembly plants in Canada or the US, indefinitely. Also, they do not have the resources to respond to all the cost pressures imposed by the regulatory environment, nor have they been able to fully recover their costs through the pricing of their vehicles in North America.
- If NAFTA proceeds it will be on the basis of a rough trade balance. Rationalization of production will continue. Low-cost Mexican production will be used as a high-volume exports platform, particularly for low-tech, labour-intensive parts. Canada and the US must absorb an appreciable proportion of future Mexican car and parts output.
- Vehicle sales will be flat for the decade and there will be no market share growth by the Big 3. Their profitability depends on achieving significant cost reduction through continuous productivity improvement, rather than growth. Only Mexico is expected to experience rapid market growth, which will be matched by rapid vehicle and parts production growth; although costs will rise in Mexico as skill levels rise and strong consumer markets develop.
- Current technology trends are insufficient to significantly accelerate sales; whereas a significant change in the function of the vehicle, and thus, the design of the vehicle, might expand the market significantly. Governments would have to play a prime role in creating the necessary infrastructure, e.g., the IVHS, which would create the market for appropriately modified special purpose vehicles.
- The lean production paradigm is the emerging global standard. The Japanese companies are leading and all companies must converge on the same methodologies. Independent Tier 1s will be given greater responsibility for sub-system development. The effect in North America, due to the implementation of lean production, is that huge and wrenching sourcing decisions must be implemented by the Big 3 to achieve the same low-cost structure (in-house vs outsourced production).

- Lean production dictates that fewer companies will be supplying directly to the OEs, and as a consequence, most auto parts producers must find a new supply relationship with a Tier 1. They will be organizing the supply chain, policing the quality aspect, and assuming the responsibility for warranty costs.
- OEs will achieve cost reductions from less in-house production and instead will concentrate on sub-system design, systems integration, and final assembly. There will be constant emphasis on continuous improvement everywhere. Parts producers will be establishing horizontal linkages to further optimize the effectiveness of the OE supply system.
- The general industry picture is trending towards being undercapitalized, and is generating insufficient capital and reserves. In order to maintain a competitive flow of new product developments, creative financing mechanisms will be needed for assemblers and parts suppliers.
- Aluminum usage will grow only modestly from current levels; there will be little further displacement of steel by aluminum due to cost and concerns for the durability of highly stressed primary structures and joints. Fibre-reinforced plastics usage will grow only modestly from current levels because of the lack of repetitive, predictable, cost-efficient technology for primary load-bearing members in both before-use assembly and after-use disposal.
- For engines, only slow evolutionary changes that fully address cost and reliability concerns, are expected; but, significant performance improvements in fuel efficiency are expected with advanced designs of automatic transmissions.

#### **Findings: 2000+**

- There will be opportunities for Tier 1 suppliers, with proprietary technology, to follow a global car company into other regional markets.
- The Big 3 will have implemented the methodology of lean production, have less in-house production, have delegated more responsibility to independent Tier 1s, and have attained parity in quality, cost and profitability with the transplant assemblers.
- Tier 1 companies will all have product and process engineering capabilities, and assume responsibility for the parts supply chain. These arrangements will involve more vendor-owned tooling. The OEs will have awarded their auto parts business to independent Tier 1s for years on the assumption of an indefinitely long-term, relationship.

- Although there will still be room for entry to Tier 1 status, the prospective entrant must have design and development capability and offer product innovations with the potential to significantly reduce costs, increase quality or give the vehicle a cost-effective performance enhancement, not readily available to the OEs from their established suppliers.
- There will be growing opportunities for companies whose main competencies are the design of electro-mechanical sensor and telecommunications systems.
- The Mexican economy will have developed substantially and fit into an Americas regional market. Equally rigorous environmental regulations enforcement will have been attained with the US and Canada.
- In summary, labour-management relations are much improved; lean manufacturing is all-pervasive; management and employees consider changes in their work place to master new job requirements to be the norm and thus participate in continuous and extensive training; the applications engineering interface between the Tier 1 and OE ensures that the best available technology is applied to new platform requirements, and with target pricing and transparency in costs a strong bond between the customer and the supplier, including financial support, is maintained.

#### **Recommendations:**

1. Governments should take a systems approach to setting regulations that affect the car industry.
2. Because of the highly integrated car production, the Canadian government must harmonize regulations with US requirements and not attempt to lead.
3. Government policies must ensure that the Big 3 continue to manufacture in Canada, and that transplants are encouraged to expand their manufacturing operations.
4. Ontario must reconfirm its ability to reward investment in the province, so that Canadian producers continue to make high value-added products in high volume.
5. Management and labour must learn to cooperate fully for continuous productivity improvement.
6. Since all other countries manage their trade in automotive products, countries supplying the open North American market must reciprocate.

7. Examine laws governing financial institutions to enable new financing methods, besides simple debt, (such as equity positions and tradeable securities measures, among others) to allow the Canadian industry to raise the capital it needs to evolve in a rapidly changing competitive environment.
8. Ease cross-border problems in the movement of prototypes, blueprints, etc.
9. Support a programme of continuous skills training, including both remedial and more advanced technical skills, and a multi-level technical training regime with career paths from toolmaking through technical design capability in applications engineering to financial and marketing expertise needed by general management in order to foster the emergence of entrepreneurs at the Tier 1 level and technically-competent general managers of manufacturing plants.
10. Create the infrastructure for more small companies to learn effective means to engage in applications engineering to obtain entre to these opportunities as they emerge.

## ANNEX 4

### PRELIMINARY RECOMMENDATIONS OF THE AAC SUB-COMMITTEE ON AUTOMOTIVE DISTRIBUTION COMPETITIVENESS

#### Background

The Automotive Distribution Competitiveness Sub-Committee was formed in October 1991 with the mandate to examine the competitiveness of Canadian distribution of new and used vehicles, and automotive parts vis-a-vis U.S. Of particular interest is the possibility that, as a result of the Free Trade Agreement, large numbers of used vehicles could be imported into Canada from the U.S. starting January 1, 1993. A study by Ernst & Young - and full consideration of it by the Committee - are in the final stages of completion. In the interim the Committee is prepared to make the following preliminary recommendations for industry and government actions.

#### Industry Action

1. New Vehicles - manufacturers should continue their current efforts to minimize or eliminate price differences between Canada and the U.S. At the same time it is recognized that exchange rate shifts could cause distortions which will complicate their efforts.
2. Auto Dealers - should take aggressive action in the marketplace to create and/or reinforce the fact that Canadian dealers and their prices are competitive.
3. Personnel - dealers should accelerate their efforts to maintain trained and competent staff, and to attract qualified sales, management and technical people to the industry.
4. Education and Training - colleges and universities need urging to create more course emphases on retailing skills and to foster innovation in Canadian distribution channels to ensure ongoing competitiveness.
5. Aftermarket Parts - encourage intermediaries to be price competitive with similar U.S. manufacturers.
6. Aftermarket Parts - consider or encourage unbundling prices by breaking out prices rather than by stating one price with the extra included.
7. Aftermarket Parts and Service - educate the consumer to the true cost of importing, so that product comparisons are fair (apple to apple), e.g. some manufacturers and border retailers have stated their prices in U.S. equivalents for better comparison of prices.
8. Aftermarket Parts and Service - special border location strategies, e.g. more loss - leaders in promotion, offer lower price, lower quality items as well as normal stock and regional/local promotional programs to target or address regional U.S. competitors.

## Government Action

1. Used Vehicle Import Requirements - imports of used vehicles from the U.S. should comply or be made to comply with vehicles standards of the same year. Non-complying vehicles to enter Canada, but required to be modified and certified to meet standards for Canadian manufactured vehicles of the same year. Such standards/requirements and the level of enforcement should be the same for all importers whether individuals or commercial operators.
2. GST/PST - the federal and provincial governments should develop mechanisms to collect both the GST at the border, and preferably combine the two taxes into one.
3. Statistics - better industry statistics would help Canadian companies become more competitive, by helping them to better understand changes in the market and benchmark their individual and aggregate performance against their counterparts in the U.S. There is a need to collect more timely and complete data on used vehicle imports. This could be done through Statistics Canada, Revenue Canada, ISTC, or by helping trade associations directly.
4. Tire and Battery Taxes - ensure that all consumers pay the equivalent of tire and battery tax levies by adding environmental levies to the cost of annual vehicle registrations (rather than provincial and environmental taxes), or assess equivalent amounts at customs at time of importation.
5. MFN Tariff Aftermarket Parts - consider lowering the MFN tariff rate on specific aftermarket products, especially those not made in Canada. Include this issue in proposed automotive aftermarket outlook study to determine consequences of tariff removal.
6. Certified Standards Aftermarket Parts - for products having some impact on safety or the environment, consumers should be obligated to prove that their purchases in the U.S. meet or exceed national certified standards, an approach already adopted in the U.S.

**CANADIAN AUTOMOTIVE INDUSTRY:  
ISSUES AND SOLUTIONS  
THE RECOMMENDATIONS**

submitted to:

**THE HONOURABLE MICHAEL WILSON  
MINISTER OF INDUSTRY, SCIENCE AND TECHNOLOGY  
AND INTERNATIONAL TRADE**

by the:

**AUTOMOTIVE ADVISORY COMMITTEE TO THE  
MINISTER**

**AS PART OF THE PROSPERITY INITIATIVE**

May 28th, 1992



## 1 INTRODUCTION

**Recommendation:** The Committee recommends that it continue in its role, to advise the Minister of Industry, Science and Technology and International Trade on automotive industry issues and, using this Report, convene soon to review, and prioritize issues, and to develop an action plan and organize to implement the recommendations which are contained in the Report.

## 3 STRUCTURE AND RESTRUCTURING

**Recommendation:** The Committee recommends that all levels of government in Canada continuously monitor the investment climate in their jurisdictions and take action to ensure that an attractive investment climate is maintained. Given the high level of foreign ownership of the Canadian automotive industry, Canada is dependent on very large amounts of foreign investment to achieve its objectives. The ability to attract investment is particularly important to Ontario, where more than 90 percent of the automotive manufacturing industry is located.

## 4 STRENGTHS AND WEAKNESSES

**Recommendation:** The Committee recommends that management and labour at vehicle assembly and parts plants continue their efforts to become the most productive, highest-quality plants in the world.

**Recommendation:** The Committee recommends that parts manufacturers put more emphasis on developing higher-value-added products and advanced manufacturing processes.

**Recommendation:** The Committee recommends that analyses of the cost competitiveness of industry segments be continued to ensure that policies and processes are complementary and supportive.

**Recommendation:** The Committee recommends that the Federal Government monitor and periodically report on:

- (i) any Japanese voluntary export restraint agreements administered directly or indirectly by the Japan Ministry of International Trade and Industry; and/or
- (ii) the degree of import substitution of direct automotive exports from Japan by the production of so-called transplant operations. (Asian manufacturers do not concur with this recommendation.)

In other countries, including the U.S. and E.C. member states, Japanese imports are restrained by various means. The monitoring and reporting, as described above, would be the first step to ensure that Canada's automotive manufacturing base is not eroded for lack of similar restraints being exercised by the Japanese manufacturers in the Canadian market.

**Recommendation:** The Committee recommends that Canada's anti-dumping legislation be amended to recognize the integrated nature of the North American automotive manufacturing industry. For example, the definition of "domestic manufacturers" that may be harmed by dumping should include manufacturers with integrated production in Canada and the United States.

**Recommendation:** The Committee recommends that Canada continue to make every effort to gain access to export markets through the General Agreement on Tariffs and Trade (GATT), NAFTA negotiations and other means, as appropriate.

**Recommendation:** The Committee recommends that Canadian industry continue, and expand, its efforts to penetrate the Japanese markets for both vehicles and original equipment and replacement parts.

**Recommendation:** The Committee recommends that new ways and means be investigated to establish a sales and engineering liaison office in Japan to serve Canadian parts manufacturers and Japanese motor vehicle manufacturers.

**Recommendation:** The Committee recommends that Asian motor vehicle manufacturers continue their efforts to integrate their North American operations into the traditional North American automotive economy by expanding more rapidly their North American content.

## 6 COMPETITIVENESS ISSUES

**Recommendation:** The Committee recommends that ISTC invites, on behalf of the Committee, the Minister of Employment and Immigration to participate in discussions of training and skills development initiatives and issues as they pertain to the automotive sector.

### 6.1.1 Skills Training and Apprenticeship Programs

**Recommendation:** The Committee recommends that all industry segments act in recognition of the increasing importance of a well-trained and involved workforce. For many parts manufacturers this will require significant increases in the amount of employee training.

**Recommendation:** The Committee recommends that impediments to the implementation and effectiveness of training and skills development programs be defined and eliminated:

- Programs should be responsive to industry's needs, and eligibility criteria for program funding should be straightforward and simple.
- Canadian Labour Force Development Board organizational links to provincial and local training boards must be established with minimum delays and must not be so bureaucratic as to be unresponsive, costly, or inefficient in delivering training programs.
- Programs and criteria must recognize collective agreement provisions, and vice-versa, to help to create a system of training for the sector.
- Inter-provincial standards, and reciprocal recognition of accreditation and credits will be necessary for a system to work efficiently.
- Taking into account industry needs, and with the assistance provided by industry involvement, the system can and should be developed within present expenditure limits and with present educators, trainers, and infrastructure.
- A review of restrictions on apprenticeship is required in order to identify and remove impediments to the effective functioning of the apprenticeship system.

### 6.1.2 Labour Relations

**Recommendation:** The Committee recommends that labour and management become partners to achieve the common goals of customer satisfaction, and being competitive in a global industry environment.

**Recommendation:** The Committee recommends that where legislation is needed to correct a condition in the work place, a means be found to take into account and avoid disturbing already-in-place provisions in a collective agreement.

**Recommendation:** The Committee recommends that social legislation and programs extending beyond corporate or sectoral collective agreement provisions be measured on the basis of their economic impact as well as social impact.

### 6.1.6 Management Training

**Recommendation:** The Committee recommends that all segments of the industry continue to support the Canadian Automotive Institute, and in particular, the entrepreneurial, sales and product management training that it provides.

### 6.1.7 Engineering training

**Recommendation:** The Committee recommends that management and skills training be developed in the context of, and sensitive to engineering training, employment equity regulations and programs, and co-op programs through which students can gain essential practical experience as they learn.

**Recommendation:** The Committee recommends that secondary school and university priorities be re-ordered to provide more engineering and technical education to better equip students with knowledge and skills of practical application to industry.

### 6.2.1 Canada - United States Free Trade Agreement (FTA)

**Recommendation:** The Committee recommends that permanent Canada - United States working groups be formed to address bilateral trade and competitiveness issues. For example, one such working group could be given the mandate to develop common definitions of terms in the FTA rules of origin and common guidelines in applying them. The working groups should be comprised of representatives of all stakeholders. If the FTA is subsumed or superseded by a NAFTA, the composition and mandate of the working groups should be expanded to deal with trilateral issues.

## 6.2.2 North American Free Trade Agreement (NAFTA)

**Recommendation:** The Committee recommends that one of the objectives of the Canadian negotiating team be a phasing out of the present Mexican system under a NAFTA. Gradual elimination of the present Mexican system in favour of a more liberalized trade environment will be required. (Certain Asian companies favour immediate elimination of the Mexican system.)

**Recommendation:** The Committee recommends that the operating principles of the Canada-United States Automotive Products Trade Agreement (Auto Pact) be retained in any future Canadian trade regime.

**Recommendation:** The Committee recommends that as an integral part of the implementation of a NAFTA it include a provision for timely interpretation bulletins, advance rulings, and a permanent trilateral body to discuss issues of interpretation and administration. The objective is to anticipate and resolve issues before they become major problems.

## 6.3.2 Consumer Issues

**Recommendation:** The Committee recommends that all vehicle-specific taxes be re-evaluated with a view to simplifying the tax system and improving the affordability of vehicles by shifting the burden of taxes from vehicles to other forms of taxation.

**Recommendation:** The Committee recommends that The Ontario Motor Vehicle Arbitration Plan be expanded into a national program.

## 6.4 Regulations and Taxes

**Recommendation:** The Committee recommends that unique Canadian standards be considered only if a defined need exists which cannot be met by harmonizing with U.S. requirements. If and when such a need is defined, industry and government should cooperate to develop optional responses which are measured by cost-benefit criteria.

**Recommendation:** The Committee recommends that Canada's environmental Green Plan be the primary focus of federal, provincial, and municipal governments in developing environmental and energy conservation initiatives. Resources are too precious to waste on proposing and reacting to the unnecessary burden of fragmented, un-coordinated actions.

**Recommendation:** The Committee recommends that the Goods and Services Tax and provincial sales taxes be integrated to reduce administrative cost and complexity, and consumer confusion and animosity.

**Recommendation:** The Committee recommends that unique and extra costs incurred by manufacturers, sellers, and consumers in Canada as a consequence of governmental requirements be defined and offset to assist corporate efforts to compete. Examples include: the time and other costs involved in obtaining various permits and certificates of approval for capital projects in Ontario, the costs of testing specified chemicals in Canada compared with corresponding costs in other countries (including redundant testing of products already tested and approved for use in other countries), pension funding proposals, employment and pay equity requirements, employment standards which conflict with collective agreement provisions in matters of health and safety, overtime scheduling, and Ontario's employers health tax applied to finance health care.

**Recommendation:** The Committee recommends that criteria be established by which regulatory proposals can be measured as to their cost effects on Canadian companies and their products, as well as on their ability to compete at home and abroad with products from other countries.

**Recommendation:** The Committee recommends that governments consider the establishment of an agency to provide "turnkey" government liaison services to companies planning major capital investments. The agency would assist companies to negotiate agreements on training assistance, provision of site services, and other participation by various levels of government, as appropriate, and obtain all of the necessary zoning, environmental, building code and other government approvals for the project.

### 6.5.1 Research and Development Tax Credits

**Recommendation:** The Committee recommends that certitude of project eligibility be improved, by issue of Advance Tax Rulings or an alternate form of advance decision, prior to project commencement. A study should be made of the relative benefits of assigning ISTC the responsibility to issue Eligibility Certificates/Rulings, with standardized documentation, in the manner of previous research incentive programs.

**Recommendation:** The Committee recommends that the "all or substantially all" rule for capital equipment credits should be amended. A fair proration of Investment Tax Credits (ITC) and Capital Cost Allowance (CCA), reflecting the time in use of equipment for R & D purposes, should be allowed. This change would improve project cost certainty and encourage more R & D.

**Recommendation:** The Committee recommends that a standard overhead factor be allowed when legitimate R & D projects are undertaken in mixed use facilities. This would

encourage more R & D, as dedicated premises are generally not economically practical.

**Recommendation:** The Committee recommends that project cost definitions be clarified by Revenue Canada Taxation (RCT).

**Recommendation:** The Committee recommends that RCT allow R & D Investment Tax Credits to be used to offset all corporate taxes including the large corporation tax and surtaxes.

**Recommendation:** The Committee recommends that simple, standard documentation requirements be developed, with the help of industry representatives, for R & D projects.

**Recommendation:** The Committee recommends that used equipment be eligible for the ITC.

**Recommendation:** The Committee recommends that the time between planning, implementation, the science advisor's review and final audit be reduced.

**Recommendation:** The Committee recommends that the period of eligible R & D be extended to the time of commercial production.

**Recommendation:** The Committee recommends that RCT consider projects on a program (several vehicles) rather than a single vehicle basis.

## 6.5.2 Financing of Industrial Innovation

**Recommendation:** The Committee recommends the implementation of the recommendations of the Committee on the Financing of Industrial Innovation (contained in its report dated March 31, 1991).

**Recommendation:** The Committee recommends that the Federal and Provincial Governments support the efforts of the Statistics Sub-committee to develop benchmarks that can be used to compare the competitiveness of Canada's automotive industry to those in competing jurisdictions. The benchmarks might include unit labour costs, material costs, other costs of doing business, investment in product and process R & D, investment in facilities, investment in transportation and communications infrastructure, etc.

## 7 ENVIRONMENTAL ISSUES

### 7.2 Fuel Economy

**Recommendation:** The Committee recommends that instead of focusing on fuel economy standards, the government pursue a broader, market-based strategy aimed at reducing all consumer demand for fossil fuels in Canada.

### 7.3 Vehicle Emissions

**Recommendation:** The Committee recommends that tighter vehicle emissions standards in the future be supported with tighter fuel regulations. The low sulphur diesel fuel issue illustrates the need to recognize that as emission standards become more stringent, governments must take a total systems (vehicle and fuel) approach to vehicle emission regulations.

### 7.4 Gas Guzzler Taxes

**Recommendation:** The Committee recommends that rather than imposing fuel economy standards and/or gas guzzler taxes, reduction of overall fuel use is better addressed through the use of broad-based policy measures, such as carbon taxes, which would efficiently and equitably reduce fossil fuel use by all sectors of the Canadian economy.

### 7.5 Alternative Fuels

**Recommendation:** The Committee recommends that an alternate energy sector campaign be undertaken in partnership with the involved industries and government to identify key obstacles and appropriate actions of redress through carefully defined studies. Alternate energy technologies could make an important contribution to Canada's productivity and long term prosperity provided that barriers are minimized or eliminated.

### 7.6 Mandatory Periodical Vehicle Inspection

**Recommendation:** The Committee recommends that the provincial governments contribute to the NO<sub>x</sub>/VOC management plan objectives and institute mandatory periodic vehicle emissions inspection programs that are consistent in their requirements nationally, as supported by the vehicle manufacturers.



## 8 ELECTRICITY - SUPPLY AND COST

**Recommendation:** The Committee recommends that an objective re-evaluation of the future supply, demand, price and security of supply of electricity in Ontario and Quebec be carried out.

## 9 FISCAL AND MONETARY ISSUES

### 9.1 Cost and Availability of Capital

**Recommendation:** The Committee recommends that firms that are planning to raise debt or equity capital pay particular attention in their business plans of the need to provide convincing evidence that they will emerge from the current consolidation as stronger, more profitable companies.

**Recommendation:** The Committee recommends that motor vehicle manufacturers and their suppliers work together to reduce the financial risk across the customer/supplier boundary.

**Recommendation:** The Committee recommends that the Federal and Provincial governments consider ways and means of creating pools of risk-sharing capital, possibly through funds that allow tax deductions on contributions.

### 9.2 Tax Regimes

**Recommendation:** The Committee recommends that any taxation initiatives put forth by governments be assessed in light of a long term cost-benefit analysis, otherwise, short term revenue considerations have the potential to down play the long term impact on the investment potential for the country.

### 9.3 Exchange Rates

**Recommendation:** The Committee recommends that the Federal Government and the Bank of Canada take action to ensure a stable Canada-United States currency exchange rate.

## 10 FEDERAL-PROVINCIAL ISSUES

### 10.1 Trucking

**Recommendation:** The Committee recommends that measures be taken to ensure unimpeded transportation across international borders otherwise Canada risks losing contracts for its parts manufacturers initially, and contracts for new product at assembly facilities eventually.

**Recommendation:** The Committee recommends that length and weight restrictions be harmonized across all Canadian provinces in order to improve the efficiency of truck transportation in Canada.

### 10.2 Infrastructure

**Recommendation:** The Committee recommends that governments support the development and application of Intelligent Vehicle Highway Systems (IVHS).

**CANADIAN AUTOMOTIVE INDUSTRY:  
ISSUES AND SOLUTIONS  
THE REPORT IN BRIEF**

submitted to:

**THE HONOURABLE MICHAEL WILSON  
MINISTER OF INDUSTRY, SCIENCE AND TECHNOLOGY  
AND INTERNATIONAL TRADE**

by the:

**AUTOMOTIVE ADVISORY COMMITTEE TO THE  
MINISTER**

**AS PART OF THE PROSPERITY INITIATIVE**

May 28th, 1992

## 1 INTRODUCTION

For all but the first few years of this century, the automotive industry has played a major role in the lives of Canadians. Few industries have contributed more to the economic growth and prosperity of Canada and the high standard of living that Canadians enjoy. The motor vehicle and parts manufacturing industry is the engine of central Canada's manufacturing economy. The motor vehicle sales and automotive aftermarket parts and service industry is the largest segment of the retail sector, and is a significant part of the economic base of virtually every city, town and village across the country.

Despite its size and importance to the economy, the continued success of the automotive industry is by no means assured. Before the down-sizing of the industry is complete more Canadian plants may be closed.

The automotive parts industry is in a period of contraction with plants closing and jobs being lost at a greater rate than new plants are opening and jobs being created.

The aftermarket parts and service industry is faced with stagnant markets and a loss of business to cross-border shopping.

We believe that the automotive industry will continue to play a very large role in Canada's economy. The automotive vision for Canada:

*"a sustainable, internationally competitive automotive industry operating in a supportive competitive economic environment and contributing to a high quality of life in Canada through increased efficiency and productivity with management and employees sharing common goals"*

is achievable by the year 2000, but will remain elusive unless industry, labour and government work together to find solutions to the critical issues facing the industry.

## 2 IMPORTANCE TO THE CANADIAN ECONOMY

The automotive industry -- defined as manufacturing of motor vehicles and parts and distribution and retailing of automotive products -- accounts for approximately four percent of Canada's Gross Domestic Product. As measured by value added, automotive parts manufacturing is Canada's largest manufacturing industry and motor vehicle assembly the second largest. Value added from wholesale and retail trade of motor vehicles, parts, and service exceeds the value added from motor vehicle and parts manufacturing. Retail sale of motor vehicles, parts and service accounts for 27 percent of total retail sales.

### **3 STRUCTURE AND RESTRUCTURING**

The structure of the North American automotive industry has changed dramatically in recent years and is continuing to evolve. The restructuring has resulted in additional motor vehicle and North American parts manufacturers (especially those of Japanese ownership), a reduction in the relative size of the of the Big 3 (Chrysler, Ford and General Motors) and the North American parts industry, and growth in the national industries of third countries that export motor vehicles and parts to the North American market.

**Objectives:** In order to achieve a sustainable, internationally competitive assembly and components industry some key objectives must be met:

#### **Assembly:**

- **Big 3 maintain a major presence in Canada. Facilities must be continually up-graded to maintain technological competitiveness.**
- **Asian manufacturers expand existing plants, rationalize production and increase value added. The additional production capacity would be used to offset imports and provide additional vehicles for export to third countries.**

#### **Parts (Captive):**

- **Big 3 modernize their engine and transmission plants.**
- **Asian manufacturers establish one or two major value-added facilities.**

#### **Parts (Independent):**

- **Restructure to accommodate vehicle assemblers' transfer of R&D and engineering to suppliers and to maintain process competitiveness and obtain product technology. Restructuring will lead to decreases in the number of companies and total employment by weeding out non-competitive facilities. The companies and output of the sector should be maintained.**

#### **Aftermarket:**

- **Maintain efficient, reliable, cost effective manufacturing and distribution systems for automotive repair and service. Implement state of the art technologies for inventory management, such as Electronic Data Interchange (EDI), bar coding and electronic cataloging.**

## **Market**

- **Produce and deliver products and services that meet customers expectations and needs.**
- **Achieve a more balanced international automotive trade either through decreased imports or increased exports.**

## **4 STRENGTHS AND WEAKNESSES**

In general, the industry has been competitive on a North American basis. As a result, Canada has received an increased share of North American (Canada/United States) production in both light vehicle assembly (increased from 14.5% in 1981 to 17.5% in 1991) and components (increased from 5% in 1981 to 11% in 1991). Further gains in the share of North American production will be very difficult to achieve and losses are possible.

## **5 THE COMPETITIVE ENVIRONMENT**

The Canadian motor vehicle and parts manufacturing industry operates in a very competitive and difficult global environment. Global-competitiveness and access to markets are critical to the prosperity of the industry.

### **5.1 The Global Environment**

- All major producing countries "manage" auto trade:
  - The European Community (E.C.) limits the number of motor vehicles that are imported from Japan and imposes high content requirements for locally-produced Japanese vehicles before they can be re-classified from imported to originating in the E.C.
  - Mexico is a closed market pending successful negotiation of a Canada-United States-Mexico (North American) Free Trade Agreement, but Mexican goods have duty-free access to the Canadian market (e. g., through the Auto Pact). The rest of Latin America is closed.

- It is very difficult to gain access to the Japanese market due to the high initial costs of adapting vehicles to the Japanese market and establishing distribution networks. A number of barriers, informal and formal, exist in Japan which present severe difficulties in: gaining approval of vehicles for sale in Japan; establishing distribution systems in Japan; and, investing generally in Japan. The rest of Asia is closed by a variety of restrictive trade practices.

## **5.2 The North American Market Environment**

- A major expansion of the automotive market, with the exception of Mexico, in the next decade is unlikely.
- The existing excess capacity will intensify competition.
- Asian producers in North America are here to stay (and grow). For the Canadian industry to grow, a full commitment to the Canadian sector from all vehicle companies selling in Canada, including Asian companies, is required.
- The parts sector is extremely sensitive to currency exchange rates and interest rates.

## **5.3 The Canada-U.S Trade Environment**

- The Auto Pact ensured the rationalization of the North American industry. It remains as a very important instrument for participating companies.

## **5.4 The Mexican Environment**

- To date Mexico has been perceived as neither a major threat nor a major opportunity. A North American Free Trade Agreement (NAFTA) could change this.
- A more liberalized regime would provide opportunities for Canadian parts companies to undertake complementary investment, thereby improving their competitive position.

## **6 COMPETITIVENESS ISSUES**

"Global competition" for the Canadian motor vehicle and parts manufacturing industry has historically been limited to the United States, with the main measure of the Canadian industry's global competitiveness being a comparison of its production cost elements with those of the United States industry.

However, as outlined in the earlier discussion on the structure and re-structuring of the North American industry, fundamental changes have occurred during the last decade. Imports have gained a large market share and the market has become more open and competitive. In the process, the definition of global competitiveness of the Canadian industry has changed irrevocably. In order to be globally competitive, the Canadian industry must be able to compete with the most cost-effective producer in the market.

Growth in the market and a weak Canadian dollar were largely responsible for the growth and prosperity of the industry from 1983 to 1988, and masked any weaknesses in its cost structure. The current recession and the strong dollar has exposed the industry's weaknesses.

Improving the cost-competitiveness of the industry is the major challenge of the 1990's, but industry actions alone may not be sufficient to achieve the benchmarks for global competitiveness that have been established by Japan. Even if direct costs of production, product design, production quality, and productivity are world-competitive, and some direct costs (such as those associated with Canada's medical care system) are reduced because they are financed by broadly-based taxation, factors such as the cost and availability of capital, taxation forms and rates, pension liabilities, workers' compensation, and legislated social equity programs, can outweigh the aforementioned positive factors, and prevent the achievement of the goal of global competitiveness.

### **6.1 Human Resources**

Canada's future competitiveness relies heavily on the cultivation of human resources. There is unanimous agreement among all members of the committee that education and training, in their broadest definitions, are the first priority. There is a pressing need for basic skills training; upgrading the image of the skills trades, automobile retailing and other careers in the automotive industry, and increased automotive research and development at universities.

#### **6.1.1 Skills Training and Apprenticeship Programs**

Canadian industry has relied for too long on educators to define and provide the needed skills of the work force. The automotive sector is actively redressing the situation, with the assistance of Employment and Immigration Canada and the provinces:



### **6.1.3 Labour Adjustment**

Training and skills development is one of the primary elements in our efforts to secure the future of Canada's automotive industry. If timely and effective, and with progress on the other competitiveness factors, employee adjustment needs will not require extraordinary actions and programs.

### **6.1.6 Management Training**

Adapting to a global economy requires well-trained, up-to-date managers as well as highly-skilled employees and engineering talent.

## **6.2 Trade**

The onset of the recession shortly after the FTA came into effect has made it easier for critics to blame the FTA for job losses, company transfers and plant closures. However, the FTA was not the cause of the automotive industry's economic problems. Some of those problems are related to the recession, others are due to competitive pressures.

The Canadian automotive industry, with the exception of the CAW, supports participation in the NAFTA discussions, with particular interest in: Market Access, Auto Pact or Country safeguards, and Rules of Origin.

### **Objectives for rules of origin agreed to by NAFTA Sub-committee members:**

- **The rules should be value-based, providing greater certainty and flexibility of planning and production actions to companies, than would a requirement that certain production processes be performed within the free trade area.**
- **Corporate-wide averaging provides additional flexibility, whereby a value-based rule is permitted to be applied over a corporation's entire production rather than on each segment, plant, or product line; and even more flexibility is available if joint ventures or affiliated company operations are included.**
- **Increasingly fragmented markets, requiring niche products, preclude large additional investments to produce high-value powertrain components. Without broad averaging, firms would have less incentive to assemble lower-volume niche vehicles in North America or would be inclined to assemble them in the dominant market.**
- **The Canada-United States FTA rules are unnecessarily ambiguous. NAFTA rules should be clear, concise, auditable, accompanied by an agreed lexicon of terminology, and with a mechanism for quick adjudication of disputes about the rules and their meaning.**

### **6.3 Market**

Canada and the United States continue to represent the most open markets in the world. Therefore, they are the most competitive markets, as well. As a result the consumer has benefitted from a wide range of products, higher quality and lower prices. Consumers have responded with higher expectations, which has intensified the challenge for automobile designers, manufacturers and dealers.

Customer satisfaction with the purchase and after-sale service of automobiles is the paramount issue for all segments of the industry.

- Affordability is becoming a problem for the new car buyer. As used car prices have been depressed, consumers have less equity to put towards the purchase of a new vehicle.
- Taxation of the new vehicle has also become a difficult "sell" to the consumer when air conditioning taxes, battery taxes, tire taxes, gas guzzler taxes and sales taxes are added on to the vehicle price after it has been negotiated. These taxes equate to roughly 17% of the purchase price, and are likely to reduce the size of the Canadian market.

### **6.4 Regulations and Taxes**

The Canadian auto industry must not be jeopardized by unsound, unnecessary, conflicting, or redundant policies or regulations. Rather, efforts should be directed to achieve consensus, allowing voluntarism to replace regulation, shared data to replace reporting and penalties, and realistic, clear targets to replace arbitrary measures.

### **6.5 Technology**

Financial incentives, in the form of Scientific Research and Experimental Design (SR&ED) tax credits, are available to organizations carrying out R&D in Canada. The program has the potential to significantly increase the amount of R&D carried out by the automotive industry, but eligibility and administrative problems have limited its effectiveness in encouraging motor vehicle and parts manufacturers to carry out more R&D in Canada.

## **7 ENVIRONMENTAL ISSUES**

### **7.1 Environmental Principles**

- **Environmental programs must be harmonized across Canada and with those of the United States where possible, fully recognizing the integrated nature of the North American Automotive Industry.**
- **Environmental programs must be based on sound environmental science and economics.**
- **Voluntary compliance schemes provide flexibility and resource efficiencies for both government and industry and must be considered as the preferred method of compliance when all of the involved parties are in agreement.**
- **Market-based approaches must be utilized where possible. Strategies which harness market forces are much more effective and efficient than command and control based regimes.**
- **Solutions to global problems must be based on international agreements. Canada cannot afford to "go it alone."**

### **7.2 Fuel Economy**

- **Domestic manufacturers have more than doubled vehicle fuel economy since the mid 1970s, while achieving substantial reductions in vehicle emissions.**

### **7.3 Vehicle Emissions**

- **The automotive industry has already reduced passenger car emissions by 90% on average from uncontrolled levels.**

### **7.4 Gas Guzzler Taxes**

- **Like fuel economy standards, guzzler taxes are ineffective at reducing fuel use. They apply only to new vehicle efficiency while providing no incentive to change how vehicles are operated, which is the major determinant of overall fuel use.**

## **7.5 Alternative Fuels**

All original equipment manufacturers are currently involved in the development of vehicles for the primary candidate alternate fuels. Each of the Big 3 auto makers have defined world product mandates resident in Canada for the development of either methanol "flex-fuel" vehicles or propane and natural gas vehicles. The retention and possible further development of these mandates in Canada is desirable as they represent an opportunity to gain a position in an emerging, technology-based sector, with high Canadian value added. Success will depend on the accelerated introduction of these vehicles so as to achieve the necessary high-volume markets.

## **7.6 Mandatory Periodical Vehicle Inspection**

- Data shows that older vehicles, while representing the smaller portion of the on-road fleet and are driven fewer kilometers contribute a much higher percentage of total emissions than more-fuel-efficient, late-model-year vehicles which are equipped with more advanced emission control technology.

## **7.7 Federal-Provincial Cooperation on the Environment**

- Canada's green plan provides for a comprehensive set of environmental protection initiatives representing the culmination of views solicited from a diverse group of stake-holders, including those of the business community, provincial governments, and non-government organizations. It sets forth the framework for collective and cooperative approaches involving all of the stakeholders and calls for regional action on the part of provincial governments necessary to meet specific environmental objectives, ie. NO<sub>x</sub>/VOC Management Plan.

## **8 ELECTRICITY - SUPPLY AND COST**

To date, the sustained growth of the auto industry in Ontario is attributable to a number of factors, an important one of which is the availability of electricity for our plant facilities. It is critical that we continue to have a reliable and affordable source of power for our manufacturing activities so that Ontario may retain existing investments and be attractive for new production and job opportunities.

## **9 FISCAL AND MONETARY ISSUES**

### **9.1 Cost and Availability of Capital**

Cost and availability of capital had not been at question in North America, until brought into stark relief by this recession, and the manufacturing re-structuring which has been forced by competition.

- Industry profits are non-existent or critically-low for North American-based companies, as are internal cash flows.
- Spending must increase, by more companies, even as sales and profits decline.
- Cost of capital differentials amongst auto industry host countries and amongst automotive companies within a country are magnified as borrowing needs mount.

The upshot of these issues and more is the growing reticence of financial institutions to assist automotive enterprises. In regard to smaller suppliers and dealers, the difficulty is amplified by being "small business" as well as automotive businesses.

### **9.2 Tax Regimes**

- In taxing corporations in Canada, the government must be sensitive to the effective rates of corporate tax imposed in other jurisdictions, against which Canada must compete for new investment.
- Recent tax incentives outlined in the 1992 federal budget (reduced corporate tax rates on manufacturing and processing profits, increased CCA rate (from 25% -30%) for Class 39 property, the announced willingness to reduce withholding taxes on dividends paid to foreign corporations), and the previously announced changes to the application of the Large Corporations Tax are moves in the right direction, towards an internationally competitive investment climate.

### **9.3 Exchange Rates**

Fluctuations in the value of the Canadian dollar is a significant factor in the cost-competitiveness of Canadian manufacturers and the level of cross-border shopping.

- Currency-hedging strategies are often insufficient to offset the impact of exchange rate fluctuations. As the Canadian and United States economies become more integrated, a stable exchange rate is increasingly important to the development of Canada's manufacturing industry.

## **10 FEDERAL-PROVINCIAL ISSUES**

### **10.1 Trucking**

Trade agreements have or will secure access to the North American marketplace. However, access secured by a trade agreement is different from secure access flowing from the unimpeded transportation of goods across open international borders.

### **10.2 Infrastructure**

There is no questioning at any level of government of the economic value of an up-to-date, efficient infrastructure of roads, bridges, tunnels, sewers and water systems. A number of points of debate, centering on who pays, are holding up progress.

The automotive industry supports analyses of the Transportation Association of Canada which show significant spending shortfalls by most jurisdictions on road infrastructure, and that motor vehicle and driver fees, and fuel taxes, generate revenues well in excess of those spending needs. Also supported are the development of a National Highway System by the Council of Ministers of Transport, and of an electronic, interactive vehicle-highway system of traffic monitoring and control.

