



**Canadian Vehicle
Manufacturers' Association**
**Association canadienne
des constructeurs de véhicules**

2008 Pre-Budget Submission

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INTRODUCTION AND SUMMARY

The Canadian Vehicle Manufacturers' Association (CVMA) is the national association representing Canada's leading manufacturers of light and heavy duty vehicles. Our membership includes Chrysler Canada Inc., Ford Motor Company of Canada, Limited, General Motors of Canada Limited and International Truck & Engine Corporation Canada. Through their sales, manufacturing, research and development (R&D) and head office activities, our members directly employ over 100,000 Canadians and support an additional 50,000 retirees. In total, Canada's automotive industry, led by vehicle manufacturers, employs over 570,000 Canadians from coast to coast in every province and city.

In 2006, CVMA member companies produced over 70% of the 2.55 million light duty vehicles built in Canada and accounted for 54% of all light duty vehicles sold. Our members purchase over 80% of all automotive parts produced in Canada for vehicle production across North America. CVMA member companies currently produce 17 different light duty vehicles in Canada.

Despite significant restructuring within the automotive sector, these companies, in partnership with the federal and provincial governments, have contributed roughly 80% of the over \$10 billion in new automotive (parts and assembly) investment announced in Canada since 2002. These investments in Canada have gone into advanced flexible manufacturing, leading edge environmental technologies, and greatly expanded R&D activities.

Since the 1965 Auto-Pact, CVMA member companies have served an integrated North American market with annual sales of over 19 million vehicles, of which Canadian sales comprise only 8% of the total. This tightly integrated market has produced economies of scale and allowed our members to undertake capital-intensive vehicle development to provide vehicles of the highest quality and safety, and those needed to meet new demands for environmental technology improvements, at the affordable prices demanded by Canadians. Such development would be impossible if our members were only producing to meet the needs of the significantly smaller Canadian marketplace.

Competitive challenges, business realities and broad policy imperatives continue to shape the ongoing investment decisions of Canadian vehicle manufacturers and their supplier networks. Three significant factors currently affect the Canadian auto sector: (1) a significant appreciation in the value of the Canadian dollar which increases the relative cost of locally purchased goods, services, and labour; (2) global industrial restructuring and new global supply chains which provide competition for Canadian-produced and sourced goods and services; and, (3) uncertainty concerning the vehicle assemblers' ability to respond to new regulations and increasing cost arising from the significant regulatory disharmony across the integrated North American vehicle market. These factors, and others, have led Canada to become one of the highest cost automotive manufacturing jurisdictions in the world.

Our recommendations are aimed at strengthening Canada's competitive position and to enhance the business climate to secure the necessary continued large scale investments necessary to grow Canada as a global automotive leader in environmental responsibility, research and development, and production.

In this regard, the CVMA recommends that the Government of Canada focus on three core priorities in Budget 2008:

1. Accelerate Greenhouse Gas (GHG) reductions by eliminating the counterproductive ecoAuto/Green Levy program and replace it with policies and tax measures that will accelerate GHG reductions in Canada and support green vehicle technology development. This includes measures to remove the oldest vehicles from Canada's roads and to accelerate the use of clean renewable fuels, including E85.



2. Counter the negative impacts of the rapid rise of the Canadian dollar through a re-commitment to a large-scale Canadian automotive investment fund, changes to further enhance an investment-friendly tax environment and additional measures to encourage Canadian automotive innovation activity. All of these measures can assist in drawing critical new product and plant investments to Canada.

3. Accelerate the development of critical trade and border infrastructure improvements at the Windsor-Detroit gateway to reduce the barriers to the efficient movement of goods and people along Ontario's 400-series highway system.



DETAILED RECOMMENDATIONS

1. Accelerate GHG reductions

Accelerate Greenhouse Gas (GHG) reductions by eliminating the counterproductive ecoAuto/Green Levy program and replace it with policies and tax measures that will accelerate GHG reductions in Canada and support green vehicle technology development. This includes measures to remove the oldest vehicles from Canada's roads and to accelerate the use of clean renewable fuels, including E85.

In 2007, the CVMA and our member companies announced and launched a realistic, integrated approach to accelerate GHG reductions in Canada. Our plan focuses on accelerating the introduction of new green vehicle technology, expanding cleaner, renewable fuel choices for Canadians, removing old polluting vehicles from Canada's roads, greening Government fleets, and changing driver behaviour. While we are already making progress in some of these areas within the industry's control, we require the support of governments to achieve greater success.

Since signing the auto industry GHG memorandum of understanding with the Federal Government in 2005, Canada's auto manufacturers have introduced over 70 advanced fuel saving technologies into the marketplace for Canadian consumers – in addition to significant Canadian based R&D and assembly of green automotive technologies. Given the significant cost of commercializing these new technologies relative to traditional gasoline engines, the CVMA and several other organizations have recommended that governments introduce consumer incentives to speed the adoption of these advanced fuel-saving technologies in the Canadian marketplace. While Budget 2007, introduced ecoAUTO/Green Levy program, the program has been largely viewed as a complicated and ineffective and one that has not impacted consumer choice, and hence not met its environmental objectives.

The CVMA has consistently and vigorously recommended against the adoption of so-called "feebate" programs, such as ecoAUTO/Green Levy, given their inability to meet their stated environmental objectives. Our position on this issue is supported by several government and respected third-party studies which have assessed the impact of such policies in the marketplace. The National Roundtable on the Environment and Economy (NRTEE), the Government of British Columbia, and Natural Resources Canada (NRCan) have all expressed significant concern over the effectiveness of feebates. NRCan noted that "feebates keep older vehicles on the road" and stated that feebates produce a "rebound effect" with little, if any, impact on reducing CO₂ and GHG emissions from vehicles. Experience with similar taxation programs in Ontario and British Columbia has shown that little or no material shift in consumer vehicle purchasing habits occurs, aside from delaying new vehicle purchases, which keeps older vehicles on the road longer and delays the introduction of new environmental and safety technology.

The experience of the ecoAUTO/Green Levy program throughout 2007 underlines the need to eliminate this program:

- As expected, the program has not shifted consumers' vehicle purchases to more fuel efficient vehicles. Canadian consumers already purchase the vehicle that suits their needs. Canadians overwhelmingly choose small and mid-sized cars, mini-vans, and small utility vehicles. During the first six months of the program, sales of vehicles with levies have outperformed those vehicles without levies and in general, sales of vehicles with rebates have underperformed those vehicles without rebates. Given this result, and counter to the intentions of the program, the ecoAUTO program has delivered no discernible environmental result despite the application of levies as new taxes that have been passed along to the consumer.
- Significant consumer confusion and frustration is being relayed to CVMA members through their dealer networks. This is attributed to the lack of clarity with respect to the program for 2008



model year vehicles which are already in the market.

- Since the ecoAUTO program offers rebates on vehicles that use traditional gasoline engines and is based on arbitrary fuel consumption levels, anti-competitive market distortions are occurring within Canada. In fact, many of the eligible ecoAUTO rebates will be distributed to consumers who purchased a single foreign-produced, conventional gas automobile which employs no advanced vehicle technology.
- The ecoAUTO program significantly disadvantages and targets those companies with the most employment and investment in Canada. It also sends a negative investment message to all Canadian automobile manufacturers which could, in the foreseeable future, impact large-scale investment decisions. We estimate that CVMA members alone will pay over \$55 million in feebate taxes in 2007. This tax also penalizes vehicles produced in Canada as well as those assembled with a significant amount of Canadian-made components.

Budget 2008 should eliminate the ecoAuto/Green Levy program. Further, the Government should immediately eliminate the worst anti-competitive elements by eliminating all rebates for 2008 subcompact vehicles as these vehicles are already considered 'green'. Rather, the greater opportunities to deliver environmental results can be found in measures aimed at getting the oldest and most polluting vehicles off the road and encouraging the use of clean and renewable fuels.

Budget 2008 should incentivize the removal of the oldest and most polluting vehicles from Canada's roads. Removing the oldest vehicles from Canada's on-road fleet and replacing them with new vehicles offers the greatest opportunity to improve air quality and provide greater GHG reductions. In terms of smog-causing emissions, one 1987 model year vehicle is equivalent to 37 current model year vehicles. There are over 1 million 1987 model year or older vehicles on Canada's roads. Budget 2007 introduced limited government support for the retirement of older, less environmentally-friendly vehicles from Canada's roads by providing incentives to consumers. While this signals a good start, the resources allocated in Budget 2007 to this project were limited. As such, we recommend that this program be significantly expanded through the use of approved scrappage programs meeting government-set criteria that offer a cash incentive directly to consumers to spur the retirement older vehicles.

Budget 2008 should accelerate the use of clean and renewable fuels. Government can also assist automotive manufacturers and their customers to accelerate GHG reductions in Canada by expanding the availability and use of clean and renewable fuels. The very limited availability of bio-fuels, such as E85 (fuel containing 85% ethanol and 15% gasoline) and bio-diesel is a significant barrier to the achievement of accelerated GHG reductions from on-road vehicles in Canada. According to the NRCan GHGenius model, E85 blends can offer a 46% - 64% reduction in 'well to wheel life cycle emissions' as compared to regular gasoline. While lower ethanol blends are becoming more available across the country, there are only two retail E85 Ethanol stations in Canada (Chatham and Guelph Ontario). By comparison, over 1,200 ethanol pumps are available the United States, over 800 in Sweden and virtually every fuel station in Brazil sells E100 Ethanol.

Government policies mandating that 5% of the Canada's fuel base be renewable by 2010 offer a good start to transitioning consumers away from non-renewable petroleum products to clean and renewable fuels. The achievement of longer term objectives (converting 10% or more) of Canada's fuel base to ethanol will require E85 fuel and Ethanol Flexible Fuel Vehicles (FFVs). Today, there are several hundred thousand FFVs on Canada's roads and an increasing number of vehicle models available to consumers to purchase – including eight built here in Canada.

Our specific recommendations to expand the availability and use of clean bio-fuels are:

- A. **Reinstate the Fuel Tax Exemption for E85 fuel** – While existing Canadian Ethanol fuel tax support may no longer be required for low level blends (E5 and E10), maintaining fuel tax



- support for non-mandated E85 fuel is essential to support the fuel's commercialization. This recommendation is consistent with policies adopted by other leading ethanol-consuming jurisdictions and is also supported by the CRFA's (Canadian Renewable Fuels Association) 2006 policy paper.
- B. **Continue existing support mechanisms for conventional ethanol and provide additional focus on cellulosic ethanol production in Canada.**
 - C. **Create a Canadian tax credit incentive similar to the United States' Alternative Fuel Infrastructure (Pump Conversion) initiative** – The U.S. tax credit support model provides up to \$30,000 per retail pump conversion to E85 fuel (up to 10 fuel pumps per company). This is a low-cost measure aimed at initiating the conversion of conventional gasoline pumps to E85 across Canada. As a starting point, the Budget should introduce a pilot project aimed at supporting a limited number of station conversions.
 - D. **Continue to support the purchase and use of FFVs by government fleets.** There are over 20,000 government fleet vehicles in Canada, many of which are concentrated in small geographical areas. Governments should not only purchase FFVs, they should also invest in the necessary fuelling infrastructure and open their fuelling stations to individual consumers as well.

2. Support new automotive investment

Support continued investment in the critical automotive sector through a large-scale automotive investment fund, an investment-friendly tax environment, and the encouragement of Canadian automotive research and development.

Multiple factors drive the investment decisions of global automobile producers: market access, labour and other costs of production, political stability and, of course, after-tax return on investment. Within NAFTA, the U.S. has the advantage of market size to encourage investment while Mexico has labour cost advantages. In recent history, Canada's advantage was based on a low dollar which ensured that Canadian exports to the U.S. were cost competitive. This has changed dramatically in recent months. Indeed, several automakers have noted that Canada is now the highest-cost jurisdiction for auto manufacturing in the world with the recent rise in value of the Canadian dollar despite Canada's health care advantage. Consequently, the federal government must work to implement policies which provide a competitive advantage and improved taxation environment.

Auto assembly plants require continuous and significant investment to remain globally competitive. A positive business environment including regulatory consistency, taxation and investment funds, is more critical today than ever. Through the Canadian Automotive Partnership Council (CAPC), industry, labour, and academia, along with the federal government and the governments of Ontario and Quebec, set forth an ambitious agenda to drive automotive investment and strengthen the industry in Canada. This partnership achieved a significant number of policy, taxation and other support mechanisms, including a \$400 million large scale investment fund that helped drive nearly \$7 billion in automotive assembly investment in Canada since 2002. CAPC also undertook a calculation of the return on investment for such programs and determined that payback would be received federally and provincially on a combined basis within 6 years or less.

The federal government has not yet committed to support future automotive investment as it has with other sectors such as aerospace. In June 2007, the Province of Ontario announced the establishment of the \$650 million Next Generation Jobs Fund. This fund should help drive further automotive investment and help to secure Canadian jobs while enhancing the industry's environmental performance. It also aims to establish Ontario as a global leader in the emerging advanced vehicle technology market. **We recommend that the Federal Government should seek to match the Ontario automotive investment fund to ensure that**



Canada remains a preferred location for new large-scale automotive investment.

In addition to the need for funds to attract large-scale automotive investment, the federal government must also continue to create a competitive tax environment which improves after-tax return on investment. By leveraging the corporate tax system to encourage capital investment, Canada could help secure, numbers of high skilled, high tax-paying jobs which, in turn, support spending in government priority areas such as health care, education, the environment and infrastructure.

Based on the recommendations of the Standing Committee on Industry's report on manufacturing in Canada, Budget 2007 introduced several measures to support manufacturing investment, most notably the accelerated two year capital cost allowance (CCA) write down period. While we support the Committee's report, we also believe that much more needs to be done with domestic tax policy to create a competitive advantage that encourages further investments.

Therefore, the CVMA recommends that the federal government should direct its tax policies toward:

- A. **Immediately reduce corporate income tax rates to maintain international competitiveness.** Canada's average combined (federal/provincial) corporate income tax rate of 35% is significantly greater than the EU average rate of 25%, the OECD average rate of 28%, the Asia Pacific average rate 30% and the Latin American average rate of 28%. This should be done in conjunction with expanding the manufacturing and processing profit deduction to reduce the overall effective tax rate for manufacturers.
- B. **Extend the window on Capital Cost Allowance as announced in the 2007 Budget.** Large scale automotive investment can range from several hundreds of millions of dollars to several billion dollars and take many years to plan and implement. Ideally, the measure should not be time-limited but a five year window would be more suitable than the current two year allowance.
- C. **Strengthen support for industry-based innovation activities consistent with CAPC's recommendations.** This should be accomplished through four means: 1) the establishment of new government supports focused on accelerating private company-based research and development activities in advancing product and manufacturing process/productivity innovation; 2) the continuation and expansion of federal programs that support innovation across the Canadian manufacturing sector (such as NSERC and the Canada Foundation for Innovation); 3) by broadening the eligibility criteria for the SR&ED tax credit to include automotive sector product and process development activities; and 4) SR&ED refundability should be extended to all taxpayers.
- D. **Follow through on the promise Budget 2007 to refund provinces that reduce/eliminate their capital taxes.** This measure will encourage provinces including Ontario to further reduce or accelerate the elimination of capital taxes.
- E. **Establish a refundable Investment Tax Credit (20%) for new investments in machinery and equipment.**

3. Critical Trade and Border Infrastructure Improvements

Accelerate the development of critical trade and border infrastructure improvements at the Windsor-Detroit gateway to reduce the choke points to the efficient movement of goods and people along Ontario's 400-series highway system.

As a highly integrated industry within North America, the automotive industry relies on seamless transportation of goods between Canada and the U.S. and points offshore to ensure that assembly lines



operate at peak efficiency and output. Canada's automotive sector accounts for 12% of Canada's manufacturing GDP and over 20% of Canada's total yearly merchandise trade – roughly \$150 billion annually. Roughly \$359 million in trade passes through the Windsor-Detroit corridor each day, largely over the Ambassador Bridge, but also through the Detroit River rail tunnel, the Windsor-Detroit tunnel and the truck ferry. The auto sector accounts for nearly one-third of the total.¹ These shipments are mainly comprised of production parts required to feed several manufacturers' two and three-shift daily production schedules, which are organized on the principles of lean manufacturing.

The Ambassador Bridge at the Windsor-Detroit gateway is the lifeline for Canada's automakers, their suppliers and customers. The four-lane bridge was built in 1926 to handle a fraction of the shipping volumes crossing its span today. Shippers are forced to drive through congested, built-up urban neighbourhoods, stopping at no less than 17 traffic lights between the Ambassador Bridge and highway 401.

Border and highway delays are estimated to cost the Canadian economy more than \$5 billion annually.² Much of this burden is shouldered by Canada's vehicle manufacturers, placing them at an unfair competitive disadvantage as global competitors opt to avoid costs and congestion at the land borders by turning to the import of finished automobiles and parts from offshore sources.

While the federal government has launched several infrastructure initiatives over the past decade in concert with its provincial partners, Canada's auto sector has seen minimal, if any, improvement in border congestion at the Windsor-Detroit Gateway. In order to remain competitive, attract investment, and grow the nation's trade volumes through increased manufacturing activity, the Government of Canada must expand its efforts and work to accelerate critical trade corridor and infrastructure improvements. In particular, we believe that the government must focus efforts on:

- A. **Establishing adequate funding resources to complete the proposed new international crossing between Windsor and Detroit**, including the expansion of highway 401 to provide uninterrupted highway to interstate traffic flow.
- B. **Partner with the Government of Ontario to expand and improve the 400 series highways on which auto manufacturers depend.** These trade arteries are too often congested, leading to increased production costs and shipment delays.

¹ Department of Foreign Affairs and International Trade, "Notes for an Address by Marie-Lucie Morin, Deputy Minister of International Trade to the Canada-U.S. Business Association," February 15, 2007.

http://www.international.gc.ca/department/dm_speeches/dm_speech_itc_2007-02-15-en.asp.

² Ontario Chamber of Commerce (Borders and Trade Development Committee), "Cost of Border Delays to Ontario," May 2004. <http://occ.on.ca/private/121>.



SUMMARY

The recommendations presented here are aimed at creating a comprehensive policy supporting new large-scale investments, environmental progress and greater productivity throughout Canada's automotive manufacturing sector.

Our recommendations reflect the calls of other leading industry associations, such as the Canadian Manufacturers and Exporters, the Canadian Manufacturers' Coalition, and support the aims of the Canadian Automotive Partnership Council (CAPC), of which the Government of Canada is a founding and active member.

We believe that these recommendations will go some distance in strengthening Canada's position as a global leader in the development and application of leading edge environmental technologies, research and development and increased manufacturing output. Additionally, the recommendations should form the basis of a new automotive manufacturing strategy for Canada.

Canada's long term prosperity and competitiveness is inextricably tied to a healthy and vibrant automotive industry, the touchstone of its manufacturing sector. Implementing our recommendations would send a clear signal that the Government of Canada is committed to strengthening this country's competitive position as a productive, green and innovative international leader.

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