

Presentation by Mark A. Nantais, President, CVMA
Study on Canada's Industrial Strategy
Standing Committee on Industry, Natural Resources, Science &
Technology
Ottawa, April 4th, 2005

On behalf of the Canadian auto industry thank you for the opportunity to provide our comments as part of your study on Canada's Industrial Policy.

My name is Mark Nantais, I am the president of the Canadian Vehicle Manufacturers' Association (CVMA). The CVMA is the national association for Canada's leading automobile manufacturers including DaimlerChrysler Canada Inc., Ford Motor Company of Canada, Limited, General Motors of Canada Limited and International Truck & Engine Corporation Canada. I understand the committee's interest particularly in the undertakings of the Canadian Automotive Partnership Council or CAPC. Many of the perspectives I will be providing today will be those of the Canadian Automotive Partnership Council. CAPC was created as a partnership in the fall of 2002 by then Industry Minister Allan Rock and brings together leaders from the federal government, the governments of Ontario and Quebec, labour, academia and the entire auto industry.

Industry Background and Economic Impact:

The automotive industry is the engine that drives Canada's economy. Our industry:

- employs over half a million Canadians in virtually every community across the country; not including hundreds of thousands retired Canadians;
- accounts for 12% of Canada's manufacturing GDP;
- represents 22% of Canada's merchandise trade;
- generates an annual trade surplus of \$11.5 billion, _ of Canada's total;

- purchases over \$30 billion annually from Canadian suppliers; roughly 3 times the amount of procurement for the federal government including defence spending; and
- contributes billions annually to government revenue through corporate, capital and payroll taxes as well as the taxes on new vehicles sales.

While our industry has a major manufacturing footprint in Ontario, our industry has wide reaching impact on most parts of the Canadian economy in almost every region of Canada through our retail, distribution, and supplier base.

Canada's Policy Framework:

Strategic public policies, such as the Autopact and free trade agreements, have played a crucial role both in developing this large and productive automotive industry and in terms of creating assembly and auto parts jobs in Canada. These policies, along with economic and business realities, have resulted in an automotive sector that has become highly competitive, highly integrated, and truly global in nature. However, significant changes to domestic and international policy throughout the 1990s have had an impact on the ability to draw new investment into Canada. The result is that Canada's automotive industry is at a critical juncture. Over the past several years, the Canadian auto industry has been stalled by many key measures including vehicle sales, greenfield investments, vehicle production, exports, and employment

It was pertinent to this reality the Minister of Industry helped create the CAPC in 2002. CAPC's mandate has been to develop a modern policy framework aimed at creating an environment that facilitates the strengthening and growth of the auto industry in Canada. In October 2004, CAPC released its strategic report entitled *A Call to Action* which outlines a detailed strategy for the Canadian automotive manufacturing sector. The strategy outlines priority policy areas and recommendations including:

- large scale investment incentives;

- infrastructure improvements;
- innovation;
- regulatory harmonization; and
- human resources.

Each of these areas is a target for the improvement or development of policies to attract and retain investment. The strategy also details specific industrial growth targets. These specific targets are:

- Rebuild the share of Canadian-assembled vehicles to 15% of the North American new vehicle sales market by 2010;
- Expand the total value of Canadian-made components shipments by \$20 billion by 2015;
- Maintain total employment in automotive assembly and components manufacturing at 150,000 positions or more; and
- Improve Canada's automotive trade balance to \$15 billion or better by 2010.

Today I would like to highlight some of the recommendations stemming from CAPC and the CVMA that we believe will help meet these targets and should form the basis of a Canadian Automotive Strategy. My comments will focus on Smart Regulations and attracting inward investment as two key aspects of this strategy.

Smart Regulations and the Canadian Auto industry:

New motor vehicles are sophisticated and technologically complex products composed of over 8,000 individual parts. The state-of-the-art technology represents more than 100 years of development, improvement and refinement. The manufacture of new motor vehicles is a complex, carefully orchestrated sequence of operations that provide consistently high quality product in high volumes.

Canada has benefited greatly because of manufacturing and market integration across North America. Canada is a relatively small market with roughly 8%, or 1.5 million, of the total North American vehicle sales of 20 million units annually. However, Canadians produce over 2.5 million light duty vehicles, or roughly 15.5% of the annual North American total of 16 million units. As a result of the economies of scale enabled by the NAFTA market, Canadians enjoy vehicles meeting the most stringent national emissions standards in the world and the most comprehensive and advanced safety standards at some of the lowest prices.

Because North America is considered to be a single market with shared driving conditions and a shared environment, coordinated product regulations makes good business and practical sense. Like the vehicle itself, the regulatory regime is mature, having developed over many decades, and is highly technical in nature. Historically, there has been considerable cooperation between Canadian and U.S. government departments on the technical issues which drive regulatory development. In Canada, product standards are defined by the federal government with in-use requirements being defined by provincial governments. While the regulatory development process in both countries has been successful in addressing public policy objectives in the safety and environmental arenas, these processes have not been entirely successful at ensuring a consistent regulatory regime across North America; as a result regulatory differences continue to emerge in North America.

One of the best avenues our industry has found for eliminating or avoiding these complex regulatory traps have in the signing of memoranda of understanding (MOU) between industry and government in both Canada and the U.S. on technical regulatory issues. While the motor vehicle is a highly regulated product, much advancement in both safety technology and emissions controls have been voluntarily introduced in Canada through memoranda of understanding agreements with manufacturers. We see MOU's a positive step in

the regulatory development environment and an area where greater attention should be paid by governments to solve future challenges and avoid the differences that we are faced with today.

Rightfully, we as a nation have a sovereign right to develop regulations to public policy objectives, but only when there is a justifiable cost-benefit to do so. But there is virtually no practical reason for unique Canadian standards, regulatory differences have emerged, that distinguish our market from others. I will spare you the lengthy technical discussions on differing product regulations between Canada and the U.S. right now, but I would be happy to answer any questions you might have on any specific issue. Instead, I will focus on the mechanisms that have resulted in the un-coordinated regulatory environment in which we do business. In short however, the regulatory differences cover a wide range of vehicle issues including frontal occupant protection, vehicle safety certification, running lights, seatbelts, bumpers, and immobilizers, to name but a few.

In many cases, technical regulatory differences may appear minor, but in aggregate they have a significant impact on the Canadian market. The small size of the Canadian market, combined with the massive costs associated with the design, development and implementation of new vehicle programs (many hundreds of millions of dollars), makes designing vehicles for unique-to-Canada standards unrealistic. Unique to Canada standards typically either increase the cost of a new vehicle or limit the product offerings available for Canadian consumers. The end result of increased cost to consumers is typically a decrease in the rate of the vehicle fleet turnover, which in itself, may limit the desired benefit of the regulations. Additionally, this may limit vehicle production opportunities for Canada. If a vehicle cannot be sold in a marketplace it will typically not be produced in that jurisdiction.

Given this reality, we have been pleased with the recent developments and actions by the federal government to improve the Canadian regulatory

environment including the September 2004 report by the External Advisory Committee on Smart Regulation (EACSR); the commitment by Prime Minister Paul Martin and President George Bush for “a New Partnership for North America”; which was further strengthened with the inclusion of Mexico and President Vicente Fox at the most recent NAFTA summit; and the delivery of the Smart Regulation: Report on Actions and Plans by the President of the Treasury Board, Reg Alcock just two weeks ago. We fully support these initiatives and will continue to work with the government to ensure success.

We believe that Canada’s priorities in these efforts should be aimed not only at the resulting regulation, but at reform to the regulatory development process itself to ensure that a smart, efficient, and coordinated approach is implemented both for existing and future regulations. In this regard we recommend the following:

- Mechanisms must be established that will allow for joint regulations to be promulgated so that these largely unwarranted or unjustifiable differences in standards and regulatory requirements do not continue to manifest themselves in the future to the same extent as they do today.
- Existing automotive regulations must be reviewed by the NAFTA trading partners in order to make these regulations consistent between jurisdictions.
- Create a product standard environment that respects self-certification to one set of regulatory requirements across North America (and ultimately globally), that satisfies societal needs efficiently.
- Perhaps most importantly, changes to the regulatory framework must continue to be driven at the highest levels and set out clear guidelines for the development of regulations that are recognized and supported across all government departments having any responsibility for the automotive sector.

I want to make myself very clear about these recommendations. We are not advocating the wide spread adoption of United States regulations on safety, emissions, or any other area. We are simply stating that where there is no reason for the differences in regulations and product standards between our countries that we need to work closer together to create a common set of regulations based on the agreed upon best practices.

Attracting Inward Investment:

Trade and Infrastructure Funding:

As a highly-integrated industry across North America, the automotive industry relies on seamless transportation between Canada and the U.S. to ensure that our facilities operate efficiently. With our close integration, the automotive industry accounts for roughly 25% of two way trade with the U.S. This includes roughly \$150 billion annually in finished vehicles and assembly parts.

As a result, the automotive industry has long advocated for strategic infrastructure investments to effectively process existing trade volumes between Canada and the United States and meet future trade growth demands for our intertwined economies.

Another crossing in the Detroit-Windsor gateway is imperative and the processes to establish this crossing must be expedited. Investors must feel confident that the border is not an impediment to trade. The Schwartz Report has been completed by the City of Windsor and has received the support of the local community in Windsor, the CAW, the Trucking Associations, Chambers of Commerce, and Canadian Manufacturers & Exporters, to name a few organizations. Now is the time for the federal government to engage cooperatively with its provincial and local counterparts to ensure that this opportunity for action is not lost.

The money announced to date by the federal government was a good start but very little of the announced money has been spent on infrastructure improvements at Canada's most critical crossings from an economic and trade perspective. We recommend the following as a basis for an improved investment climate in Canada:

- Provide adequate funding, and work in partnership with all governments to establish a new border crossing into the U.S. in the critical southern Ontario region. The current bi-national project looking at this project must be expedited where possible in order to shorten estimated timelines for project completion.
- Work in partnership with all governments to create an uninterrupted access from highway 401 through to the U.S. interstate system.
- Work with all governments to improve critical trade corridors, such as the 400 series highways through Ontario.

Canada's Tax and Innovation Environment:

Multiple factors drive investment decisions by corporations including: market access, labour and other costs of production, political stability, and after-tax return on investment. Within NAFTA, the United States has the advantage of market size to encourage investment while Mexico has labour cost advantages. One clear area for Canada to create an investment advantage and become a more attractive location for foreign direct investment is by creating a hemispheric competitive tax policy that improves after-tax return on investment.

Capital Cost Allowance Adjustments:

It is important for the Government to consider measures which would assist Canadian businesses in improving and upgrading their capital stock. Measures such as accelerating the Capital Cost Allowance (CCA) for manufacturing equipment and production machinery would assist in improving Canada's productivity. While Canadian productivity has been modestly improving against that of the United States recently, labour productivity in the manufacturing sector

has increased at about half the pace that it has in the U.S. over the last number of years. Up until the last year, the productivity gap of Canadian businesses were cushioned to a great degree by a depreciated currency. While the recent surge in the value of the Canadian dollar has reversed this advantage, it may assist in spurring productivity improvements. Continuous improvement with respect to our nation's productivity is one of the key factors to maintaining our high standard of living together with the level of social programs that Canadians value.

Competitive Corporate Taxes:

By leveraging the corporate tax system to encourage capital investment, Canada can maintain and create a large volume of highly skilled and high wage jobs. While recent studies have indicated that Canada is performing well in international competitiveness for corporate tax rates, the competition is not stagnant and a continuously moving target. We were pleased to see that the federal government committed to reduce the corporate tax rate by two percentage points from (21% down to 19%) in the recent federal budget. This was done to maintain the 4.5% corporate tax rate differential between the U.S. and Canada and as a result of the recent changes announced by the United States to reduce its corporate taxes by 2010. Nonetheless, much can happen between now and 2010 and it may be more advantageous for Canada to move more aggressively to reduce taxes to 19% in order to further stimulate domestic and foreign investment to generate and sustain economic growth and jobs.

Likewise, while it is very much appreciated (and consistent with CAPC recommendations) that the federal surtax is being eliminated, a more expeditious elimination of this tax – rather than the 2008 timeframe – would provide Canadian businesses with a competitive advantage.

These measures will help cultivate a corporate tax base that could provide significant additional government revenue for other priority items; such as health care, education, infrastructure and the environment.

The 2005 Federal Budget tax reduction announcements should also be complemented by an accelerated phase out of the capital tax – which is currently scheduled for elimination by 2008. This tax, more than any other, unfairly targets capital intensive industries, such as vehicle manufacturing and assembly operations and it acts as a disincentive to investment.

Innovation and Research and Development:

In the federal Budget, the government acknowledged that “the best way to increase national well- being is to improve Canadian productivity through an emphasis on new skills and knowledge, increased physical investment, effective markets and commercial innovation.” We fully support this assessment. While accelerated Capital Cost Allowance adjustments and a very competitive corporate tax structure will assist in increasing physical investment and creating effective markets, high value-added R&D, the commercialization of that research and the cultivation, education and retention of highly skilled workers will assist in ensuring that Canadian workers – our human capital – can be fully employed to improve productivity.

Up until the last decade or so, the automotive industry in Canada was not known for being particularly innovative or for undertaking a lot of R&D. Canada made a decision with the signing of the AutoPact in 1965 to become part of an integrated, North American automotive industry. We accepted as part of this deal a substantial increase in the amount of production facilities and production jobs. The subsequent investments in production facilities have leveraged ongoing product mandates and have also served to cultivate a large and productive Canadian automotive parts supplier base.

There is nothing particularly unique about Canada as a venue for automotive production. The key that will differentiate Canada as jurisdiction to attract its fair share of investment, to build new and/or to modernize existing facilities, and to attract ever higher wage jobs, will be our ability to undertake and become the source of corporate expertise for niche SR&ED automotive projects. This is underlined in our ability to work cooperatively with our universities and colleges as well as our suppliers to undertake research, cultivate knowledge and bring that knowledge to fruition through the commercialization of products and processes that will be the staple of the next generation of motor vehicle. And we've made a good start. Both DaimlerChrysler and General Motors have established Engineering Centres, while Ford of Canada has established the Powertrain Engineering Research and Development Centre in Windsor Ontario. All companies have forged linkages with the Canadian academic community through initiatives such as Auto21. Finally, innovation, research and development and collaboration with the academic community were key components of the recently announced \$2.5 Billion Beacon Project investment by General Motors in Oshawa and Ford's \$1 Billion Centennial Project announced last fall for Oakville.

Conclusion:

In conclusion, let me emphasize a point that we have been making for several years and indeed is the focus of our session today, the need for a modern Canadian industrial policy. Canada needs a modern, focused automotive policy that deals with the current realities of our industry and that focuses attention on attracting investment to this critical sector. We believe the work and recommendations found in the CAPC Strategic Vision Report, which I have provided to the Committee Clerk, should form the basis for this policy and we are looking to the government for action. Together we can drive investment, jobs, growth, and prosperity. Thank you for your time, I look forward to your questions.