

Toward an Era of Sustainable Mobility

**Automotive Industry Issues, Strategy
and Policy in Canada**

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Japan Automobile Manufacturers Association of Canada

August 2004

Summary

JAMA Canada has prepared this paper to contribute to the discussion and debate about policies and measures necessary to attract investment and sustain a vibrant, globally competitive industry in Canada into the 21st century.

Twenty years ago, no Japanese automaker had yet begun production in Canada. Today, Honda, Toyota and CAMI account for about 27% of total vehicle production in Canada. There is no doubt that the Canadian auto industry is stronger, more globally competitive and better able to meet the ever-increasing demands of the consumer than it has ever been. With a long-term commitment to Canada and Canadian consumers, Japanese automakers and parts makers have become an integral part of the social and economic fabric of Canada.

Automakers and parts makers are being challenged by demanding consumers, intense competition, shift to flexible manufacturing and global platforms, new technology, environmental issues and globalization to name a few of the most significant issues. The recent growth of investments in the southern US, and the ongoing restructuring of motor vehicle and auto parts production in Canada has created a debate about the future of the Canadian auto industry. In response to these changes, federal and provincial governments are prepared to offer various incentives to attract new investment. However, based on a KPMG analysis of auto assembly operations in Ontario, Quebec and several US states, Canada compares favourably as an investment location, even though the rising Canadian dollar presents challenges adjusting to rapid currency fluctuations in the short term. At the same time, government and industry initiatives are needed to foster innovation and promote high value-added production capability, particularly in the auto parts sector.

At the present time, there are some shared industry concerns that governments should address:

- further infrastructure improvement, especially at the Windsor-Detroit border
- adopt balanced policies to reduce GHG emissions
- expand the focus on skills training & education
- enhance R&D incentives in the parts sector for both product and process capabilities
- ensure industry has a reliable and competitive supply of energy
- international harmonization of technical standards & regulations

All industry stakeholders in Canada will need to cooperate on resolving common issues with fair, open and transparent policies to ensure the auto industry will be economically vibrant, environmentally sustainable and globally competitive.

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Introduction

The Japan Automobile Manufacturers Association of Canada is a non-profit trade association established in 1984 to promote greater understanding on economic and trade matters pertaining to the motor vehicle industry and to encourage closer cooperation between Canada and Japan. JAMA Canada's members include the following companies who import, distribute, manufacture and export automotive products:

Hino Motors Sales Canada Ltd.,
Honda Canada Inc., (Honda of Canada Manufacturing)
Mazda Canada Inc.,
Nissan Canada Inc.,
Subaru Canada Inc.,
Suzuki Canada Inc.,
Toyota Canada Inc., and
Toyota Motor Manufacturing Canada Inc.

The Impact of Japanese Automotive Investment in Canada:

Japanese automakers set up distribution and sales offices in Canada starting in the mid 1960's. Sales for small, fuel-efficient cars only began to pick up after the two 'oil shocks' in the 1970's. By the early 1980's sales volumes in North America reached a critical stage that would support major investments in vehicle manufacturing in Canada and the US.

Twenty years ago, Japanese automakers had not yet begun production in Canada. Today, Honda, Toyota and CAMI account for about 27% of Canada's total light vehicle production (**Chart 1**). With integration of the auto sector in North America as a result of NAFTA, Canada's share of North American auto production stands at about 15%. By contrast, Canada accounts for about 8% of North American vehicle consumption, a situation that has given Canada a structural automotive trade surplus for all but three of the past 22 years (**Chart 2**). Canada's overall auto trade surplus stood at \$8 billion in 2003.

To get a clear picture of automotive trade flows in Canada, one must necessarily look beyond a simple bilateral analysis and take a multilateral perspective. On a bilateral basis, Canada has always had an auto trade deficit with Japan, as well as other auto producing countries in Europe and Asia. But consider the fact that 510,000 vehicles were exported from Japanese affiliated plants in Canada last year compared to the 192,000 that were imported by JAMA Canada members from Japan (**Chart 3**).

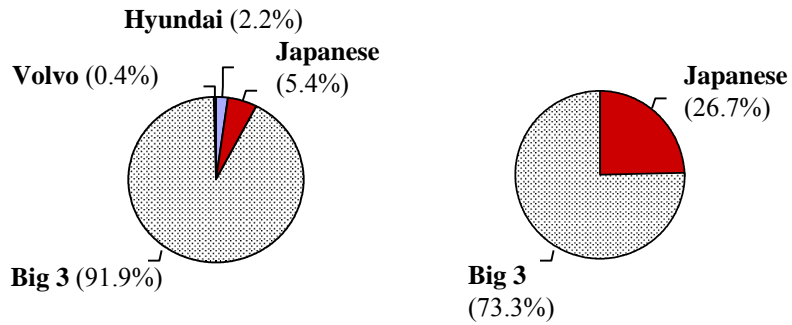
Combined production capacity at HCM, TMMC and CAMI today stands at 840,000 vehicles per year. In 2003, over 510,000 of the 671,000 units produced in Canada were exported to the US and several other countries. Since 1986, over 6.4 million vehicles have been built in Canada. Over 4.3 million of those have been exported. Canada has been a net exporter of 'Japanese' vehicles since 1993 (**Chart 4**). Moreover, on average three of every five vehicles sold by JAMA Canada members are built in North America. Current employment (**Chart 5**) in Canada stands at 56,000 comprised of 10,400 in vehicle plants, 14,100 in parts-related plants, 1,895 at head & regional offices and 30,000 at about 1,000 dealerships across Canada.

Chart 1

Light Vehicle Production in Canada

1989 – 1.9 million units

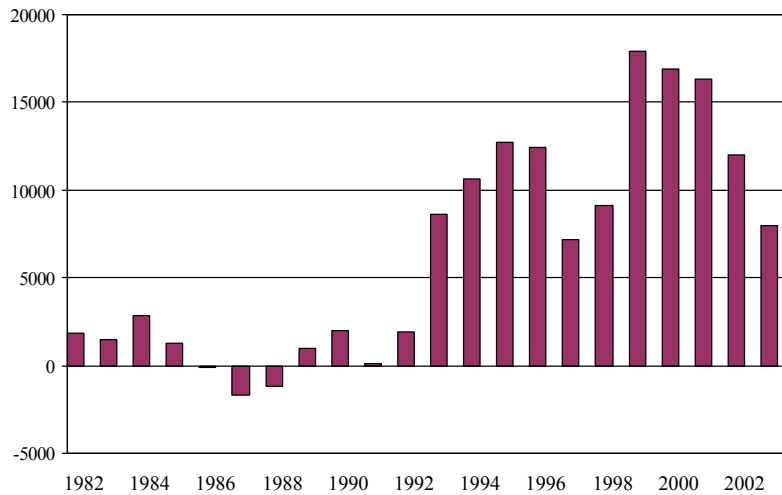
2003 – 2.52 million units



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Chart 2

Canada's Automotive Trade Balance, 1982 - 2003



The steady growth of the Japanese auto industry in Canada over the past 25 years and the now expanding Canadian automotive presence in Japan has added depth to the range of mutual benefits. More intense competition ultimately improves products and broadens choice, which benefits consumers. Closer cooperation offers new business opportunities, technology sharing, lower costs and efficiency gains to name a few.

There is no doubt that today the Canadian auto industry is stronger, more globally competitive and better able to meet the ever-increasing demands of the consumer. With a long-term commitment to Canada and Canadian consumers, Japanese automakers and parts makers have become an integral part of the social and economic fabric of Canada.

For example:

- Collectively, over 1.4 vehicles are built in Canada at HCM, TMMC and CAMI for every vehicle sold in Canada by our members (*Charts 6 & 7*).
- About 80% of Canadian produced vehicles are exported to the US and several other countries.
- Exports of finished vehicles have exceeded imports from Japan, US & Mexico every year since 1993. Over the past nine years, exports have exceeded imports by 1.5 million units.
- Japanese auto parts manufacturers have also been active in Canada in pursuit of new business opportunities with Japanese as well as other automakers in North America. In 2004, there are 46 plants operating in Canada supplying parts, materials and machine tools.

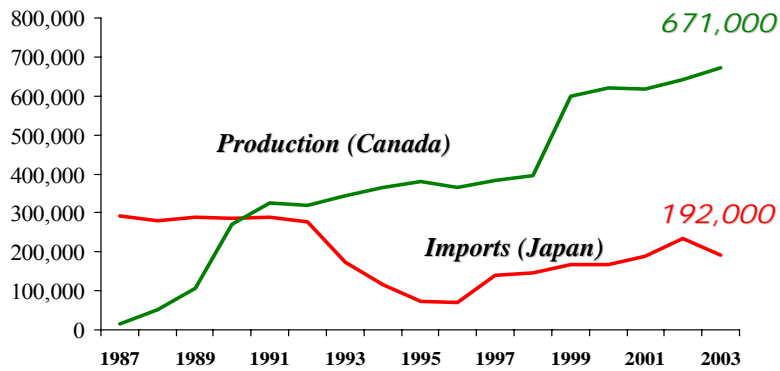
Summary of Parts-related Investments	Auto Parts	Materials & Machine Tools	Total	Employees
Joint Ventures	12	8	20	4,341
Direct Investments, wholly-owned	24	2	26	9,769
Total	36	10	46	14,110

JAMA Canada

While vehicle manufacturing in Canada in 2003 totaled about 2.5 million units, retail sales in Canada was the second best year to date at 1.56 million units. With an export to output ratio of over 80%, production in Canada largely depends on demand in the US and other foreign markets, while over 70% of current sales in the Canadian market are comprised of vehicles made in other countries.

Chart 3

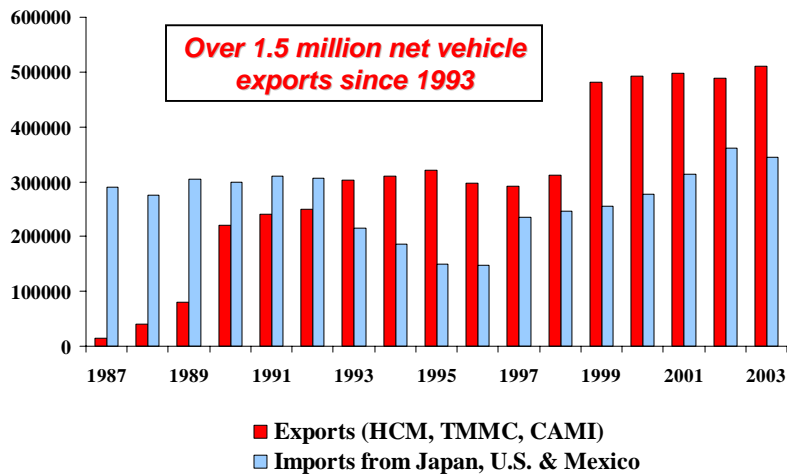
Current production in Canada is triple the volume of imports from Japan



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Chart 4

Exports & Imports of Japanese-brand Vehicles in Canada



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Restructuring for Global Competition

The recent growth of new vehicle assembly investment in the southern US, and the ongoing rationalization of production in Canada, has created a debate about the future of the Canadian auto industry. While some companies are dealing with declining market share or lower profits, other companies are struggling to meet current demand in North America with more local production.

Without a doubt, the sector is changing. Automakers and parts makers are facing numerous challenges: demanding consumers, intense competition, flexible manufacturing and global platforms, new technology, environmental issues and globalization to name a few of the most significant issues.

With global competition and more flexible manufacturing, three vehicle assembly plants in Canada, all of which were operating on only one shift, have closed over the past few years. At the same time, the Toyota plant in Cambridge launched the first Lexus vehicle to be built outside of Japan, Honda is preparing to launch a new 2005 model pick-up at the HCM plant in Alliston later this year and output at CAMI is recovering with the launch of the 2005 Chevrolet Equinox for General Motors earlier this year. Furthermore, Suzuki is likely to produce a new compact sport utility vehicle at CAMI in the next year or so.

Rather than an industry in crisis, these changes are due to three key factors: the industry's traditional business cycle, the ongoing restructuring as a result of globalization and the market mechanism at work. Fundamentally, automakers do well when they make attractive vehicles at reasonable costs that meet the needs and the desires of the consumer.

A New Vision for the 21st Century

In order for industry and government to forge a consensus on a strategic vision for the industry in the 21st century, the Canadian Automotive Partnership Council (CAPC) was formed in 2002 to undertake an objective and thorough diagnosis of the key issues facing the industry. While not exhaustive, the following illustrate some of the fundamental questions being investigated:

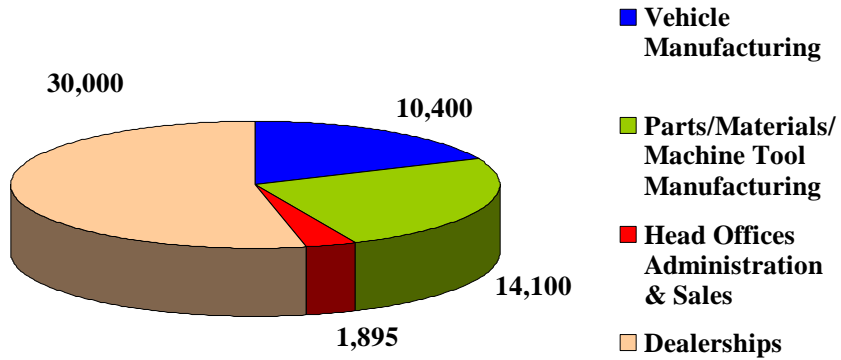
- **What are the strengths and weaknesses of the auto sector in Canada?**

- *There is a common view among industry stakeholders and analysts that, while the Canadian auto industry has both strengths and weaknesses, historically and by international comparison it is performing quite well. However, over the longer term, as capacity and production rises in other countries with developing vehicle markets, the relative position of Canada in the global industry is likely to change, due to the fact that markets in North America, as well as Europe and Japan, are mature, while those in China, Southeast Asia and South America are poised for significant growth over the long term.*

- *While Canadian component manufacturers are generally smaller and less diversified than the US parts sector, there is a higher proportion of small manufacturers in Canada that lack both the financial resources and engineering expertise for high value-added product development.*

Chart 5

Employment – 2004

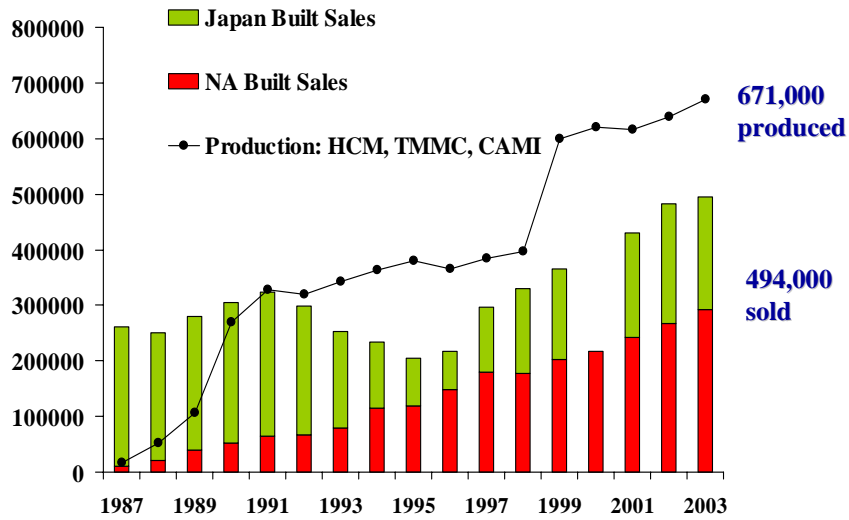


Total employment in Canada over 56,000

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Chart 6

Vehicle Production & Sales in Canada (1987-2003)



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- There is a well-educated, enthusiastic pool of labour for auto assembly, but too few HQP (highly qualified personnel) for design engineering and emerging technologies. While more can be done, this is changing as a result of a number of university-based programs such as CAMM (Centre for Automotive Materials and Manufacturing), MMO (Materials and Manufacturing Ontario), ADMI (Advanced Design & Manufacturing Institute) and AUTO21. There are several leading companies in fuel cell technology, hydroforming technology and light materials, including aluminium, magnesium and steel in Canada.

- **What are the risks and opportunities facing automakers and parts makers in Canada?**

- While the rising value of the Canadian dollar is often cited as a key competitiveness challenge for export-based manufacturing, according to a recent study for the Ontario Government, the greatest vulnerability for the auto parts sector in Canada was its 'dependence on the low value of the Canadian dollar to maintain cost competitiveness ... Some Canadian components manufacturers have become mired in low-margin commodity products without the means and/or incentive to invest in higher value-added products and more efficient manufacturing processes.' (Pilorusso, 2002)

- The auto industry faces major challenges in the quest for sustainable mobility. Key elements include alternative fuels and fuel cell technology, lower emissions, traffic congestion in urban areas, increased safety for both vehicle occupants and pedestrians and end-of-life vehicle recycling. There are several Canadian SMEs engaged in leading edge fuel cell technology development.

- Large vehicle production in Canada (including minivans, trucks and SUVs) could be at risk in the event of a sudden fuel shortage, a sharp rise in fuel prices or some other exogenous event that could swiftly change consumer demand from large to small, fuel efficient vehicles. With a high ratio of production exported to the US, Canadian production is vulnerable to shifts in consumer demand in the US.

- The auto parts sector is seriously concerned about the long-term availability of skilled trades and other highly qualified personnel. As a result of the work undertaken by CAPC, a new Sector Council on Human Resources specifically for the automotive industry has recently been launched.

- **What should be the role of government in attracting foreign auto investment to Canada?**

- The primary role for government is to make Canada a competitive and attractive location for business investment through, among other things, prudent fiscal management of the economy (low interest rates, a stable currency, debt reduction and balanced budgets), competitive corporate and personal tax policies, a well educated and skilled workforce, stable and competitive-cost energy supply, well-maintained infrastructure, as well as open and efficient borders.

- Recent federal government studies have shown, based on a comparative cost analysis between Ontario and several southern US states, that Canada compares favourably as an investment location, however, there are challenges in adjusting to rapid shifts in currency values, particularly for smaller companies, as well as the perceived need for competitive government incentives.

Chart 7

Vehicles Made in Canada - 2004

HONDA

New Honda pickup at HCM - 2005



Civic



Pilot



Acura MDX



Acura 1.7EL

TOYOTA



Corolla



Matrix



Lexus RX 330

CAMI
Automotive Inc.

SUZUKI



Vitara/Tracker 4 dr



Vitara/Tracker 2 dr



2005 Equinox

as of February 2004, only the Equinox will be built at CAMI

- *Government incentives should be limited to R&D activities, infrastructure development up to the plant door and training for new hires. Subsidies and other cash incentives to attract new plants or to keep old plants operating are costly and usually politically motivated interventions that are paid for by consumers and taxpayers. Moreover, unless distributed equally, subsidies tend to be company-specific, which puts those without subsidies at a competitive disadvantage.*

- *As a signatory to the GATT and WTO, the Canadian Government is obliged to treat all companies equally. In recognition of those obligations, the Canadian Government repealed the discriminatory provisions of the Auto Pact in 2001. Having dispensed with a managed trade approach to auto policy through the FTA, NAFTA and WTO, all automakers in Canada should continue to be accorded fair and equal treatment.*

- **What should industry and governments do to encourage innovation and automotive R&D in Canada?**

- *Being innovative and productive depends to a large degree on having the appropriate people with both advanced technical skills as well as highly qualified managerial expertise. Industry and government both have critical roles to play. Industry needs to focus on creating new innovative products along with improved manufacturing processes, both of which are critical to sustainable global competitiveness. Governments play a key role in providing a pool of highly qualified people through support for life long education and skilled training, in cooperation with industry.*

- *Government can also support innovation and productivity growth through enhanced incentives for R&D in the auto parts sector for both product and process capabilities, as well as funding in support of pre-production demonstration projects to introduce new technologies.*

Next Steps

Given the growing interest among industry stakeholders, as well as federal and provincial governments to generate a new strategic vision for the auto sector and build a policy framework to support the long term vitality and international competitiveness of the industry, a rational process for discussion of these key issues and questions now rests with the CAPC.

At the same time, there are a number of immediate concerns that are shared among industry stakeholders which are priorities that governments need to address to maintain Canada's competitive edge and enhance the climate for future investment. JAMA Canada supports the following government led initiatives that we believe are non-discriminatory, forward-looking measures that will help the industry as a whole:

- **further infrastructure improvement, especially at the Windsor-Detroit border**

Well maintained roads as well as open and efficient border crossings are critical for the auto industry in Canada which exports over 80% of all production. At the same time, manufacturers and consumers in Canada rely heavily on imports of parts and finished vehicles. The tragic events of 9/11 brought the problems of border congestion and security into sharp relief, but the dramatic growth of bilateral trade was anticipated with the implementation of NAFTA back in 1994.

While \$300 million has been allocated for the Windsor Gateway by the Federal and Ontario governments, the pace of implementation has been slower than expected. Moreover, as cross-border trade is expected to more than double over the next decade or so, the longer term need for new border crossings also needs to be accelerated and given higher priority.

- **adopt balanced policy measures to reduce GHG emissions**

To support Canada's commitment to the Kyoto Protocol, a balanced array of policy initiatives will be necessary to effectively reduce vehicle related GHG emissions, including incentives for advanced technology vehicles, clean fuels, measures to address congestion particularly in urban areas and enhanced consumer awareness of the impact of vehicle usage and proper maintenance.

In light of the Federal Government's strategy to seek lower vehicle emissions and advances in the fuel efficiency of the Canadian vehicle fleet, consumer incentives can help accelerate market acceptance of new, advanced technology vehicles and through such growth, encourage the production of these vehicles in North America.

At the same time, we share the concern of the auto industry in Canada about appropriate fuel quality. To be effective in reducing emissions, new vehicle emission systems require fuel that is properly blended and consistent with the World Wide Fuel Charter (WWFC) specifications, including sulphur-free gasoline that does not contain any metal-based additives, such as manganese.

Due to the high cost of developing and producing advanced technology vehicles, such as gas-electric hybrids, offering tax incentives will not only stimulate consumer demand by making such vehicles cost competitive with conventional ones, but also will help pull into the market vehicles with significant improvements in fuel efficiency and lower emissions. Automakers are constantly striving to provide vehicles that meet the needs of evermore demanding consumers. But at the end of the day, it is consumers who determine the fuel economy of the whole fleet through their purchase decisions.

Recent surveys have shown that while consumers express strong interest in acquiring environmentally-friendly, fuel efficient vehicles, they balk at paying more for advanced technology than they would for a comparable conventional vehicle. In addition to a handful of gas-electric hybrid vehicles currently on the market, more new advanced technology vehicles will be available in the near future. Governments can play a supportive role with consumer-based incentives where clear environmental benefits are attainable.

- **expand the focus on skills training & education**

As the industry becomes more knowledge intensive, the demand for skilled and educated personnel will rise in lock step. The challenge is for industry and educational institutions (universities and community colleges in particular) to find ways to cooperate more effectively to ensure the availability of highly qualified people. The shift to an innovative, knowledge-based industry will require both technological skills and communication capabilities.

- **enhance R&D incentives, particularly in the auto parts sector**

Innovation is the application and development of the creative process in either making a better product or improving the way it is made. Higher education and technical skills are necessary building blocks in developing more innovative organizations. Governments can assist organizations focus on innovation through more effective incentives in support of research and development activities, to enhance both product and process capabilities. Even though Canadian R&D tax credits are among the most generous, companies are often dissuaded from applying for tax credits due to the administrative burden of the application and reporting process.

- **ensure industry has a reliable and competitive supply of energy**

A stable supply of energy (both electricity and natural gas) at competitive rates, particularly for motor vehicle and auto parts companies in Ontario, is a critical factor to sustain current manufacturing and to attract prospective future investment in the auto sector.

- **international harmonization of technical standards & regulations**

As the auto industry becomes more global in trade, investment, purchasing and vehicle platforms, the need for harmonized technical standards and regulations increases. Harmonization is not a search for the lowest common denominator, but rather a cooperative undertaking by industry and governments to find the most effective ways to address, among other things, safety and environmental concerns.

In facing the global challenges of the 21st century, all industry stakeholders will need to cooperate on resolving issues of common concern to ensure the Canadian auto industry will be economically vibrant, environmentally sustainable and globally competitive.

In a global economy, the challenge for Canada, as with other auto-producing nations, is to have innovative business leaders, creative scientists and engineers, as well as highly skilled workers. To reach the ultimate goal of sustainable mobility may well depend on an enlightened trade policy that, among other things, invests in human, social and cultural capital.
