

BUREAU DE COORDINATION DES ÉTUDES
Fiche d'identification de la mise à jour

COMMISSION : Commission d'étude des questions afférentes à l'accession du Québec à la souveraineté.

ÉTUDE ORIGINALE

Référence : Volume 3, pages 307 à 355

Auteur : Dennis DesRosiers (DesRosiers Automotive consultants)

Titre : The Impact of Quebec's Accession to Sovereignty on the Automotive Industry in Quebec

MISE À JOUR

Auteur : Dennis DesRosiers (DesRosiers Automotive consultants)

Titre : The Impact of Quebec's Accession to Sovereignty on the Automotive Industry in Quebec

2001-12-19

Table Of Contents

- Executive Summary 3
- 1.The Impact of Quebec’s Accession to Sovereignty on the Automotive Industry in Quebec 9
 - 1.1 Summary of key issues and conclusions from previous study 9
- 2.The Automotive Industry in Quebec / Canada 15
 - 2.1 Introduction..... 15
 - 2.2 Canada / Quebec’s Position in the N.A. Automotive Manufacturing Sector 15
 - 2.3 Canada / Quebec’s Position in the North American Market..... 24
 - 2.4 Outlook for Canada / Quebec Market..... 29
- 3.Quebec’s Accession to Sovereignty: Issues for the Automotive Sector..... 36
 - 3.1 Introduction..... 36
 - 3.2 Automotive Specific Issues with Accessions to Sovereignty 36
 - 3.3 Conclusions & Policy Issues..... 45

List of Tables

Table 1: North American Vehicle Production 1991 – 2000	16
Table 2: North American Vehicle Production 1991 – 2000	18
Table 3: North American Production to Sales Ratio	19
Table 4: Motor Vehicle Parts Manufacturing	20
Table 5: Canadian Parts Production Relative to North American OE Parts Market	21
Table 6: Canadian Productivity Value-Added per Production Employee	22
Table 7: Capital Expenditures in the Automotive Sector - \$ Million	22
Table 8: New Capital Expenditure Canada and U.S.	23
Table 9: Vehicle Production and Exports in Canada - Units	25
Table 10: Vehicle Sales and Imports in Canada – Units	25
Table 11: Canada - United States - Mexico Automotive Trade.....	26
Table 12: Canadian Light Vehicle Sales - Autopact Vs. Non-Autopact - Units	28
Table 13: North American Sales of Vehicles - Units	30
Table 14: Vehicle Ownership – Canada vs. U.S.....	31
Table 15: North American Vehicle Sales, Usage & Durability.....	32
Table 16: Peak to Peak Increases in North American Vehicle Sales.....	33
Table 17: Long-Term Vehicle Production Forecast	34
Table 18: Parts Production.....	35
Table 19: Vehicle Price Differentials – Canada – U.S.	44

Executive Summary

- Summary of key findings from the previous study undertaken in the early 1990's are outlined in section one of this report. These issues include:
 - Economic Performances
 - Cost of Capital
 - Currency
 - Training/Education/Labour Pool
 - Government Grants
 - St. Lawrence Seaway
 - Duplication
 - Regulatory Standards
 - Border Problems/Paperwork
 - Legal Issues/System
 - Language
 - Dealer Distribution Network
 - Advertising and Promotion
 - Unions and Associations
 - Social Policy
 - Intervention/Nationalization
 - Trade Policy
 - Conclusions

- The automotive sector in North America over the decade of the 1990s achieved record success. Some have called it the “Golden Age” of the automotive sector. Virtually every variable monitoring the industry was at record levels; sales, production, employment, productivity, capital expenditures, etc.

- Over the last four decades production of vehicles in Canada has steadily increased. During the 1960s, Canada accounted for only 7.7 percent of North American production. This increased to 12.0 percent in the 1970s, 13.8 percent in the 1980s and 15.9 percent in the 1990s. During the last decade Canada's share of North American production has been consistently 15 to 17 percent with relatively minor changes year over year. Indeed, there has been a slight increase in our share of vehicle production over the last ten years.

- GM's Ste. Therese plant was established in 1965 as a result of the Autopact provisions requiring GM to produce one vehicle for every one they sell. In its 35 years of operation it was never able to reach its full potential. Indeed, production averaged only 127,000 units per year during the 1980s and only 104,000 units per year during the 1990s. In only

three years, 1985 to 1987 did the plant exceed 200,000 units of production or operate close to capacity. The plant was scaled back in the late 1980s to 170,000 units of capacity and for most of the last decade did not operate near capacity. In September 2001, GM announced the plant will close in September 2002.

- Canadian production is also increasing relative to the size of our market. For most of this past decade Canada has produced about two vehicles for every vehicle that was sold in the country. Although somewhat volatile, the production-to-sales ratio has been very stable for the last eight years. Mexico has shown very strong growth in production relative to the size of their market and produces well over two vehicles for every vehicle sold. This is due to the combination of strong vehicle production in Mexico as well as a relatively weak market.
- Quebec in its best years during the 1990s (1994-95) only produced about one half vehicle for every vehicle purchased in Quebec. And during the last five years Quebec produced only about one fifth a vehicle for each one purchased in the province.
- The Canadian automotive parts sector accounts for about 10 percent of Canada/U.S. employment and about 9 percent of the value of shipments. Using the classic one-in-ten formula for Canada/U.S. comparisons it appears the automotive parts sector is barely attracting its fair share of Canada/U.S. activity.
- There are about 50 dedicated OE parts suppliers in Quebec. Most specialize in light metals castings technology and rubber components. Woodbridge Foam and Thuna Industry would be two good examples. There also are a number of lower tier suppliers tied to the Ste. Therese plant, which will become vulnerable as a result of the closing of this plant.
- Productivity growth in both the vehicle assembly sector and the automotive parts sector has shown significant improvement over the last decade. Value-added per production worker in the assembly sector has almost tripled growing from a low of \$97 thousand per worker in 1991 to \$287 thousand per worker in 1998.
- Capital expenditures in all aspects of the automotive sector have been exceptionally strong over the last five years. Total investment has averaged \$4.4 billion per year over the last five years, up from \$2.9 billion per year during the early 1990s.
- Quebec did not participate in this investment boom in the vehicle assembly sector and only partially participated in the OE parts sector. No Quebec data is available but with some exceptions in the OE parts sector, Quebec has not received any significant investments for more than a decade.
- By most accounts, Canada's automotive sector is sound from a structural point of view. But almost all of Canada's strength is in Ontario not Quebec. If there is a weakness it is in the automotive parts sector, which appears to be losing ground relative to Mexico.

- The Canada, United States and Mexican automotive markets are almost totally integrated. The Canadian and U.S. automotive industry began this integration process in 1965 with the signing of the Autopact.
- This integration of our markets means that our production system has also become integrated to the extent that any production system can become integrated. It also means that any assessment of the outlook for employment in Canada and indeed Quebec has to examine the North American market for vehicles and not any individual country's market.
- The "Big Three" have exported close to 90 percent of their Canadian vehicle production each year over the last decade.
- The degree of integration of our markets and production systems is also clearly evident in automotive trade patterns. Both Canada and Mexico are highly dependant on the U.S. market for their vehicle exports. Canada exports \$69 billion in vehicles to the U.S. while importing only \$23 billion from the U.S. for a trade surplus of \$46 billion in the year 2000. Mexico exports \$31 billion in vehicles to the U.S. while importing only \$6 billion from the U.S. for a trade surplus of \$25 billion in the year 2000.
- The Canadian-U.S.-Mexico markets are highly integrated on a North American basis. This has resulted in a very high integration of our vehicle assembly and automotive parts sector with 90 percent of Canadian production annually exported.
- Although there has been an unprecedented cyclical upturn in sales over the last nine years, new vehicle markets in North America are considered to be mature, growing less than 1 percent per year over the last two decades.
- Another factor behind slower peak-to-peak growth is increased vehicle durability or expected useful life and consumer rejection of planned obsolescence. Over the past few decades, there has been a continuous trend in both Canada and the United States to greater distances traveled in a given year, and higher mileage on vehicles being scrapped.
- Our production and sales forecasts call for a continuation of recent trends toward slow long-term growth. In the first decade of the Millennium, North American (including Mexico) sales are expected to be 8.3 percent higher than in the 1990s, averaging 18.1 million units per year.
- Our North American vehicle production forecast is directly related to our sales forecast. About 90 percent of vehicles sold in North America are manufactured here and we believe this should stay at the 90 percent level over the next decade.
- North American vehicle production is expected to average 16.3 million units per year over the next decade, an increase of 10.5 percent over the 1990s.

- Canadian production is expected to continue to be stable at 2.69 million per annum between 2000 and 2009, and account for 16.5 percent of the North American total.
- Canada's share of North American parts market more than doubled from 4.0 percent in the 1960s to 8.4 percent in the 1980s before falling back to 7.6 percent for the 1990s. We forecast Canada's share of parts production will stay the same at 7.5 percent for 2000-2009.
- The market for vehicles in North America is mature and is forecast to grow by only 8.3 percent during the next decade versus the 1990s. The growth however is off of a relatively high base so total sales will average over 18 million units per year, up from 16.7 million units per year during the 1990s.
- The implications of sovereignty from a market perspective would be more negative today than during the early 1990s. This is dependant on Quebec's ability to negotiate itself into the NAFTA and WTO trade regimes.
- Over the last decade Canada's automotive trade policy has undergone a complete transformation. Up to January 1, 1989, Canada's auto sector was governed by the Autopact with the United States. Non autopact trade was governed by WTO rules (GATT at the time). From 1989 to January 1, 1994, Canada's automotive trade policy consisted of both the Autopact rules and FTA rules for North American players as well as WTO rules for the overseas companies. In early 2001, Canada lost a ruling at WTO and was forced to terminate the Autopact. Today North American production and trade falls under NAFTA rules and overseas production and trade falls under WTO rules.
- In the 1950s, automobile production in Canada was protected by a combination of tariffs and domestic content provisions. The resulting Canadian auto industry was characterized by an excess number of models produced, small scale, short production runs and high costs.
- The Autopact required Canada and the United States to accord duty-free treatment to imports from each other of specified motor vehicles and parts for use as original equipment.
- To qualify for duty-free entry into Canada for a given class of motor vehicles and original-equipment parts, a Canadian manufacturer of motor vehicles of that class must meet three criteria as set out in Annex A of the agreement:
 1. The Canadian manufacturer must have produced vehicles of that class, i.e. passenger cars, buses and special commercial vehicles, in each "quarter" of the base year (1964) and in any subsequent model year.
 2. The ratio of net sales value of the vehicles in that class produced including those for export by the manufacturer in Canada to the net sales value of all

vehicles of that class sold in Canada sold by the manufacturer for consumption in Canada (usually referred to as the production-to-sales ratio) must at least be equal to its corresponding ratio for the base year (but no less than 75 to 100); and,

3. The “Canadian valued added” (CVA) in the production of vehicles in that class in Canada must at least be equal to its level in the base year, in most cases, 1964-65.

- The Autopact created a two tier trade regime in Canada. Tier I companies operate under the Autopact and Tier II companies operate under MFN trade rules. The major Tier I companies included GM, Ford, Chrysler, Volvo and AMC but also include dozens of specialty vehicle companies, heavy duty truck producers, buses and off-highway equipment. Many of which are in Quebec. All the other light vehicle importers are considered Tier II companies.
- In the late 1980s, Honda, Toyota, CAMI and Hyundai each signaled their intention to build a plant in Canada. To accommodate these investments Ottawa negotiated a new series of Remission orders which were commonly referred to as Type I and Type II Remissions.
- The Canada-U.S. Free Trade Agreement (FTA) came into effect on January 1, 1989. The FTA established a duty free zone between Canada and the U.S. for all products provided certain provision were met. Special terms were negotiated for the automotive sector.
- The FTA took away the Federal Government’s negotiating power under the Autopact. The FTA gives the Autopact producers an option which was not allowed before the FTA. They can operate duty free under the terms of the Autopact and/or under the terms and conditions of the FTA. It was still advantageous to be in the Autopact but much of the Autopact became redundant.
- Subsequent to the FTA, the U.S. and Canada negotiated the North American Free Trade Agreement (NAFTA) with Mexico to create an integrated North American market. It came into effect on January 1, 1994.
- NAFTA also introduced a new method for calculating content under the Rule of Origin. Under the FTA, the companies were allowed to “roll-up” their content in vehicles and automotive parts to 100 percent once a vehicle or part achieved 50 percent content. Under NAFTA a “net cost” method for content was established which only allows actual content achieved to be used for NAFTA purposes.
- In 1999 the Japanese government petitioned the WTO to examine the Autopact as an unfair trade subsidy program. After a two year review the WTO ruled against Canada and on February 16, 2001 Canada cancelled the Autopact. Thus there are now two trade

policy regimes. NAFTA for North America production and WTO for overseas production.

- From a Quebec perspective this is important in that the power of the safeguards provided for with the Autopact is no longer valid. Thus GM could close their assembly plant. NAFTA also focuses much of the new investment in North America on Mexico rather than Canada. Thus Quebec's ability to attract assembly investment is limited and indeed the same can be said for Canada.

1. The Impact of Quebec's Accession to Sovereignty on the Automotive Industry in Quebec

The automotive industry in Quebec is a vital piece of Quebec's economy and any success and or failure in this industry is felt throughout the province. This report will attempt to outline the various components of the Quebec automotive industry and the impact that sovereignty would have on the industry. The report will be broken down into three sections with the first section reviewing the previous study, which was completed in the early 90's. The second section will outline structural and cyclical variables affecting the industry on a North American level first and on a provincial level second. The final section will draw conclusions from the initial and current study to help define some of the issues that Quebec would face in the event of accession to sovereignty.

1.1 Summary of key issues and conclusions from previous study

The automotive industry in Canada is a significant force within the Canadian and indeed the North American economy. This importance, combined with the high profile of the industry has led to the development of distinct and complex trade and regulatory environment specific to the industry. Issues that were raised in the previous study included several non-auto specific issues as well as issues specific to the industry. Many of the non-auto issues were raised during interviews with executives from various facets of the industry not just analysis of DesRosiers Automotive Consultants.

Economic Performances

The primary concern of respondents was the short-term outlook for economic performance in the Province. Without a positive economic outlook, the likelihood is low of auto-related companies in and outside Quebec making a major investment or capital expenditure in Quebec. The instability with regard to the future of Quebec and the Republic of Canada (ROC) was seen as greatly contributing to the uncertain economic outlook for the province.

Cost of Capital

Closely related to this issue of the general economic performance of the Quebec economy, is the cost of capital. A number of industry representatives raised concerns as to the ability of a sovereign Quebec to raise capital at reasonable interest rates. Short-term uncertainty, it was felt, would create pressures that would inevitably result in high interest rates in Quebec and in the rest of Canada.

Currency

The introduction of a separate Quebec currency was viewed with concern. Currency fluctuations are already viewed as problematic in the automotive industry. Any further complication of this area would be viewed as additional costs to the industry.

Training/Education/Labour Pool

The Federal and Quebec governments are actively involved in educational and skills development programs in Quebec to meet the industry's needs. Auto and auto-related companies are concerned that these programs are continued by the Quebec government to ensure an adequate base of skilled labour is available.

Companies also expressed concern as to possible net loss in the Quebec labour pool resulting from sovereignty, as to the type of immigration policy Quebec may adopt. Vehicle manufacturers and parts manufacturers currently import into Quebec a number of employees with unique skills, which are essential to their manufacturing operations. The ability to continue this free immigration and to continue to attract employees was both questioned.

Government Grants – Federal Funding

To-date a number of auto-related companies in Quebec have received government funding and assistance. The Quebec and Federal governments have also jointly sponsored some of these government grants.

If Quebec secedes from Canada, companies who are currently operating under funding programs with Quebec and the Federal government are concerned that no adverse reactions will occur. As well, the extent of support that will be available to auto-related companies from the Quebec government is questioned.

St. Lawrence Seaway

A number of companies are concerned as to what restrictions and delays would occur in accessing the St. Lawrence Seaway for the incoming and outgoing flow of raw materials and finished product.

The main issues appear to be who would have jurisdiction over the various parts of the waterway system and what complications would arise that may impede traffic flow? A number of sectors of the automotive industry in Quebec import product from offshore via the seaway.

Duplication

Groups within the automotive industry are concerned with the duplication of activities and resources that may be required to effectively operate in Quebec. For example, will new administration, sales and distribution facilities be required for a sovereign Quebec...down to the establishment of new trade associations or affiliations with new rules and regulations.

Regulatory Standards

What changes to regulatory standards will Quebec introduce that will be unique to Quebec and in turn, what impact will these changes have on automotive related companies in Quebec or companies wishing to sell in Quebec?

Regulations standards can relate to areas such as safety standard requirements for automobiles being sold in Quebec down to regulations affecting factory workers on the shop floor. Concern was expressed as to whether changes to existing standards would add an additional cost burden to companies operating inside Quebec and impact the cost competitiveness of these businesses.

Border Problems/Paperwork

One of the major concerns to vehicle manufacturers and parts manufacturers in Quebec is the potential delays that could be experienced in crossing the border and the additional paperwork problems.

Vehicle assembly operations and parts manufacturers are operating on “Just in Time” manufacturing and delivery systems. Any serious risk to the delay or blockage of product was viewed as having the potential to jeopardize the operations of these businesses in Quebec.

Legal Issues / System

Within Canada the legal system is interwoven on a Provincial and Federal basis. With accession to sovereignty by Quebec there are questions in the automotive industry as to the complexities that will result in defining and implementing a legal system for Quebec.

Language

There is concern with Quebec becoming “uni-lingual” and the impact this will have on communications with Quebec and labelling and packaging legislation.

There were perceptions in the industry that Quebec accession to sovereignty may introduce additional language requirements and add costs for companies currently operating in Quebec or wishing to do business with Quebec.

Dealer Distribution Network

Car dealers in Quebec are continually shifting new and used cars between dealers and with other provinces to get the right balance in vehicle types, colour, etc.

Dealers are concerned that with accession to sovereignty by Quebec, restrictions will be imposed on their ability to move product between provinces to meet the needs of their customers and, in turn, impact on the overall performance and profitability of their operations.

Advertising and Promotion

It was perceived that a number of auto-related companies in Quebec take advantage of national advertising programs and rates.

Under sovereignty, companies are concerned that their advertising and promotional costs will increase. The low national advertising rates will no longer apply and additional costs will be incurred.

Unions / Associations

Within the automotive industry in Quebec, companies belong to associations such as the Automotive Parts Manufacturers Association, Canadian Association of Japanese Auto Dealers etc. as well as the employees of these businesses being affiliated with unions such as the Canadian Auto Workers.

There was a perception that the benefits of these associations may be lost should Quebec secede to sovereignty.

Social Policy

Many auto-related companies view Quebec as being “pro-consumer”. There was concern expressed as to what changes would be made to the social legislation and labour laws in Quebec should the Province secede to sovereignty.

Any changes to social legislation and labour laws (i.e., job security, unemployment insurance, welfare) is viewed as leading to additional indirect taxes and costs that business will have to absorb.

Intervention / Nationalization

A number of respondents expressed concern over what was seen as the interventionist nature of the Quebec government. It was perceived by some respondents that with accession to sovereignty there may be more of a tendency by the Quebec government to be involved in key industry segments including the automotive sector.

In the previous study concern was also expressed within certain automotive specific issues that would be impacted with Quebec’s accession to sovereignty.

The Canada – U.S. Automotive Products Trade Agreement (Autopact)

The Autopact allowed for duty-free entry of new vehicles and original equipment parts, provided certain conditions were met. Canada stipulates that only “qualified manufacturers” are eligible to import vehicles and original equipment parts duty-free. The criteria that had to be met included:

- They must have been a manufacturer in Canada in the base year 1965 and in each subsequent year.

- They had to meet a production-to-sales ratio for passenger cars separate from trucks equal to that achieved in the base year, or a minimum of 75 percent, whichever is greater. In effect, this meant that each of the “Big Three” had to achieve a production-to-sales ratio in dollars of 1:1 for each class of vehicle.

- The level of Canadian Value Added achieved in the base year has to be maintained.

Canada, in contrast to the U.S., made the agreement multilateral and accorded duty-free status to the import of vehicles and OEM parts from any country provided the importing company complied with Autopact safeguards.

Canada-U.S. Free Trade Agreement (FTA)

The Canada – U.S. Free Trade Agreement (FTA) changed the nature of automotive policy in Canada by establishing a two tiered trade structure. The existing Autopact producers together with CAMI were given permanent Autopact membership. All other vehicle companies including the three new assemblers in Canada at the time (Toyota, Honda, and Hyundai) were permanently excluded from operating under the rules of the Autopact. Moreover, existing duty remission schemes, which had been negotiated with the new producers, were rescinded by the FTA over a set period of time. The duty remission schemes allowed the new producers to lower the duties paid on their imported components in exchange for the creation of Canadian value added.

The FTA allowed all producers in North America to eventually operate duty free between Canada and the U.S. provided a new 50 percent North American content rule was achieved. This new content requirement was very different from the Canadian value added requirements in the Autopact. First, it was legally binding and will be vigorously enforced. Second, it was North American based instead of Canadian. Third, it was production based rather than the “market” based safeguards in the Autopact. Fourth, what counted as “content” was narrowly defined.

Government Compliance

Government compliance issues will be a major concern for the auto industry as Quebec examines its options regarding sovereignty. The automotive sector is a highly regulated industry with complex rules in North America governing various facets of the industry including environmental standards, fuel efficiency standards, and occupant safety and inspection programs.

These programs can be expensive to implement and costly to the consumer of vehicles. In this regard, it should be noted that the vehicle companies already have issues related to competitiveness as a result of differences, which currently exist between U.S. and Canadian Standards.

Several policy alternatives were drafted and discussed within the original study with Quebec's accession to sovereignty in mind. These included Quebec operating only under the GATT, Quebec operating under the GATT but with no import tariffs on automotive products and Quebec continuing to operate as part of Canada with regard to APTA/FTA. These alternatives were offered as several options that Quebec could possibly work under and by no means were these the only options.

In the previous study several conclusions were made regarding the industry and implications that accession to sovereignty would have on the province of Quebec.

- Of the various trade regimes considered, all but one would provide significant competitive barriers to Quebec manufacturers of vehicles and parts. These additional costs would, in the automotive environment at the time, likely be sufficient to lead to a relatively short-term decline of the industry, unless offsetting competitive and cost advantages were to be found.
- The only trade regime that would not provide additional costs to the Quebec industry was one where Quebec would continue as part of Canada for APTA/FTA purposes. It should be noted that it was questionable whether such a trade regime was possible. At the time there was growing protectionist elements in the U.S. automotive industry, which would welcome the opportunity to renegotiate or remove the Autopact.
- From a consumption perspective, the benefits of a continuation of the current regime are also positive. Under the current regime, by the end of the decade, tariffs will remain only on those vehicles and parts imported from overseas by non-APTA qualified manufacturers and on products from the U.S. that do not meet FTA content requirements.

2. The Automotive Industry in Quebec / Canada

2.1 Introduction

The automotive sector in North America over the decade of the 1990s achieved record success. Some have called it the “Golden Age” of the automotive sector. Virtually every variable monitoring the industry was at record levels; sales, production, employment, productivity, capital expenditures, etc. Canada was an equal partner in this success. Indeed, Canada’s share of the North American automotive sector increased through much of the decade. However, Quebec did not fully participate in Canada’s success. Production at GM’s assembly plant in Ste. Therese was scaled back and more recently GM has announced its intention to close this plant in September 2002. In addition, the assembly plant built by Hyundai in Bromont never reached its full potential and also eventually closed in 1993. Quebec’s automotive parts sector was much more successful. A number of original equipment parts suppliers have emerged as global suppliers to the vehicle assemblers especially in the area of rubber components and light metals technology.

This section of the report outlines the size and structure of the automotive industry in Quebec, and in Canada as a whole. The Canadian and Quebec automotive sector is part of an integrated North American industry so it is also necessary to review the entire North American industry, Canada, U.S. and Mexico. The report then discusses where Canada fits within this structure and where Quebec’s automotive sector fits within Canada.

2.2 Canada / Quebec’s Position in the N.A. Automotive Manufacturing Sector

The modern era of the automotive sector in Canada began in 1965 with the signing of the Canada/U.S. Automotive Trade Agreement (the Autopact). Before the Autopact, the Canadian automotive sector was very small and inefficient. It also ran large trade deficits with the U.S. Canadians paid substantially more for their vehicles than Americans and investment was very weak.

The exact opposite is true today. The Canadian auto sector produces close to twice as many vehicles relative to the size of the market, productivity is high, there is a substantial trade surplus and investment is strong. The average MSRP of a new vehicle in Canada is close to \$4,000 less than in the U.S. if adjusted for exchange rates. By most economic performance variables the industry is healthy.

Table 1: North American Vehicle Production 1990 – 2000

	United States (Units)	Canada (Units)	Mexico (Units)	Total North American (Units)	Canadian Percentage of Total N.A.	Mexico Percentage of Total N.A.	Quebec Percentage Of Canada
1990	9,767,439	1,947,410	820,558	12,535,407	15.5%	6.5%	124,728
1991	8,789,840	1,887,573	989,373	11,666,786	16.2%	8.5%	68,978
1992	9,691,443	1,958,236	1,080,863	12,730,542	15.4%	8.5%	15,855
1993	10,855,462	2,246,640	1,080,687	14,182,789	15.8%	7.6%	136,320
1994	12,239,288	2,321,674	1,109,338	15,670,300	14.8%	7.1%	192,054
1995	11,995,248	2,407,155	934,733	15,337,136	15.7%	6.1%	159,838
1996	11,830,157	2,397,211	1,222,711	15,450,079	15.5%	7.9%	88,535
1997	12,130,575	2,567,750	1,356,360	16,054,685	16.0%	8.4%	90,397
1998	12,002,663	2,570,321	1,459,891	16,032,875	16.0%	9.1%	80,173
1999	13,024,978	3,056,616	1,534,160	17,615,754	17.4%	8.7%	81,145
2000	12,770,714	2,961,636	1,922,889	17,655,239	16.8%	10.9%	74,987
2000/1999	-2.0%	-3.1%	25.3%	0.2%			
1960s	92,519,749	7,815,054	990,393	101,325,196	7.7%	1.0%	N/A
1970s	110,377,743	15,489,430	3,058,654	128,925,827	12.0%	2.4%	N/A
1980s	99,095,015	16,592,233	4,552,285	120,239,533	13.8%	3.8%	1,275,895
1990s	112,327,093	23,360,586	11,588,674	147,276,353	15.9%	7.9%	1,038,023
% Change	13.4%	40.8%	154.6%	22.5%			-18.6%

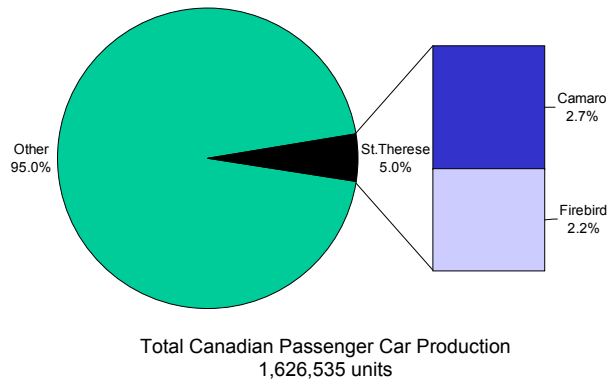
Source: DesRosiers Automotive Consultants

Over the last four decades production of vehicles in Canada has steadily increased. During the 1960s, Canada accounted for only 7.7 percent of North American production. This increased to 12.0 percent in the 1970s, 13.8 percent in the 1980s and 15.9 percent in the 1990s. During the last decade Canada's share of North American production has been consistently 15 to 17 percent with relatively minor changes year over year. Indeed, there has been a slight increase in our share of vehicle production over the last ten years.

Canadian production over the last decade increased from 1.9 million units to 3.0 million units but almost all of this increase was due to the cyclical improvement in sales and thus production. Canada's share of North American production remained relatively stable increasing from 16.2 percent in 1991 to 16.8 percent in the year 2000.

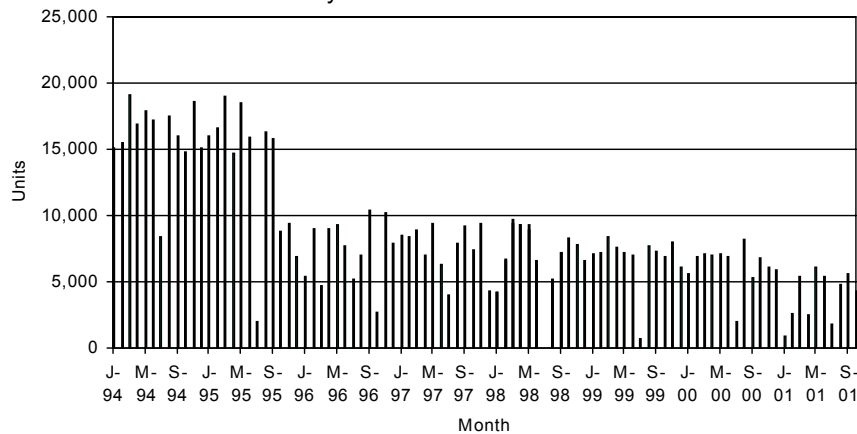
GM's Ste. Therese plant was established in 1965 as a result of the Autopact provisions requiring GM to produce one vehicle for every one they sell. In its 35 years of operation it was never able to reach its full potential. Indeed, production averaged only 127,000 units per year during the 1980s and only 104,000 units per year during the 1990s. In only three years, 1985 to 1987 did the plant exceed 200,000 units of production or operate close to capacity. The plant was scaled back in the late 1980s to 170,000 units of capacity and for most of the last decade did not operate near capacity. In September 2001, GM announced the plant will close in September 2002.

GM's St. Therese Assembly Plant
Share of Canadian Passenger Car Production
1999



GM St. Therese Assembly Plant

Passenger Car Production History
January 1994 - October 2001



St. Therese Assembly Plant			
Established:	1965	Employees:	1,500
Location:	2500 Grande Allee Boisbriand, PQ J7E 4K6	Number of Shifts:	1
Plant Size:	1.7 million sq. feet	Current Products:	Chevrolet Camaro Chevrolet Firebird
Investment:	N.A.	Past Products:	Chevrolet Celebrity Oldsmobile Ciera
Capacity:	170,000 units/year	Platform:	CF4

Canada has actually performed very well and has been able to maintain its production share despite Mexico becoming a major producer of vehicles. Mexico has increased its share of North American production from 6.5 percent in 1990 to 10.9 percent in 2000. Mexico almost tripled its production during the 1990s compared to the 1980s. Production increased from just under 1 million units in 1991 to just under 2 million units in the year 2000. But little if any of Mexico's success has been the result of a deterioration of vehicle production in Canada whose share of North American production grew slightly. The outlook for vehicle production will be discussed in a later section of this report but there appears to be no fundamental reason why Canada would not be able to maintain most of its share of North American production over the next decade. Only about 10 percent of assembly capacity is vulnerable to closing including the Ste. Therese plant. Other vulnerable plants would be Chrysler's full size van plant in Windsor and Ford's F-series pick up plant in Oakville.

Table 2: North American Vehicle Production 1991 – 2000

	Total North American Units	Total NNAM Units	NNAM % of Total N.A.	NNAM			
				U.S. (Units)	Mexico (Units)	Canada (Units)	Canada % of NNAM
1991	11,666,786	2,242,740	19.2%	1,548,662	351,725	342,353	15.3%
1992	12,739,784	2,356,109	18.5%	1,687,852	361,050	307,207	13.0%
1993	14,178,335	2,612,165	18.4%	1,827,912	424,925	359,328	13.8%
1994	15,669,029	2,972,785	19.0%	2,153,137	448,802	370,846	12.5%
1995	15,337,136	2,999,468	19.6%	2,312,675	299,426	387,367	12.9%
1996	15,450,034	3,109,769	20.1%	2,367,082	369,634	373,053	12.0%
1997	16,057,288	3,237,965	20.2%	2,394,972	440,100	402,893	12.4%
1998	16,032,875	3,487,433	21.8%	2,509,846	542,753	434,834	12.5%
1999	17,615,754	3,783,283	21.5%	2,562,499	586,804	633,981	16.8%
2000	17,671,323	3,987,492	22.6%	2,609,685	759,594	618,213	15.5%

Note: NNAM are vehicles produced in North America by traditional offshore companies

Source: DesRosiers Automotive Consultants

Over the last two decades a considerable volume of vehicle production has moved into North American by the traditional importers including Hyundai producing vehicles in Quebec between 1989 and 1993. We call these plants New North American Manufacturers (NNAMs). Some analysts refer to these plants as “transplants” but since 100 percent of Canada's assembly sector is foreign owned, all plants in Canada would be considered transplants. We prefer to identify these new assemblers as NNAMs.

NNAM production in North America has increased from 2.2 million units to 4.0 million units over the last ten years. Their share of production has increased from 19.2 percent to 22.6 percent of production over the same period. This is indicative of the globalization of the automotive sector. It is critical for countries like Canada to receive its fair share of these investments. Canada's share of NNAM production began the decade at 15.3 percent, fell back to a low of 12.0

percent in 1996 and then grew again to 15.5 percent in the year 2000. Production by the NNAMs has doubled during the past ten years to over 600 thousand units per year.

NNAM production in Mexico has outpaced NNAM production in Canada over the last decade increasing from 350 thousand units in 1990 to 760 thousand units in the year 2000. While this could be viewed as a concern, Canada over the same timeframe has been able to at least maintain its share of NNAM production and has increased its share over the last few years. Canada appears to have been structurally sound relative to attracting assembly investments from the NNAMs over the last decade even with the loss of the Hyundai plant in Quebec.

Table 3: North American Production-to-Sales Ratio

Year	United States	Canada	Mexico	Total	Quebec
1990	69.0%	148.1%	150.6%	78.3%	0.37%
1991	70.0%	146.7%	153.9%	80.5%	0.20%
1992	74.0%	158.9%	152.9%	84.6%	0.05%
1993	76.6%	188.7%	179.2%	88.9%	0.45%
1994	79.7%	184.9%	185.7%	91.0%	0.62%
1995	79.6%	207.1%	503.3%	93.5%	0.56%
1996	76.8%	199.8%	348.8%	91.2%	0.30%
1997	78.3%	181.0%	269.8%	92.2%	0.26%
1998	75.2%	180.0%	220.9%	88.8%	0.23%
1999	75.1%	198.4%	223.8%	90.1%	0.22%
2000	73.6%	187.0%	235.0%	89.4%	0.20%
1960's	97.2%	107.3%	99.5%	97.9%	
1970's	86.4%	129.4%	104.2%	90.3%	
1980's	73.2%	124.2%	120.1%	78.8%	
1990's	75.6%	179.3%	211.5%	88.1%	

Source: DesRosiers Automotive Consultants

Canadian production is also increasing relative to the size of our market. For most of this past decade Canada has produced about two vehicles for every vehicle that was sold in the country. Although somewhat volatile, the production-to-sales ratio has been very stable for the last eight years. Mexico has shown very strong growth in production relative to the size of their market and produces well over two vehicles for every vehicle sold. This is due to the combination of strong vehicle production in Mexico as well as a relatively weak market.

Quebec in its best years during the 1990s (1994-95) only produced about one half vehicle for every vehicle purchased in Quebec. And during the last five years Quebec produced only about one fifth a vehicle for each one purchased in the province.

The structural integrity of Canada's automotive parts sector is harder to quantify because of the lack of statistical data. However, some information is available from the annual census of manufacturers, which indicates that the original equipment (OE) parts industry has not performed as well as our assembly sector.

Table 4: Motor Vehicle Parts Manufacturing

Year	Employment			Value of Shipments		
	U.S. (000's)	Canada (000's)	Canada %	U.S. (Billions)	Canada (Billions)	Canada %
1990	628.0	75.9	10.8%	110.3	12.7	10.3%
1991	590.7	67.6	10.3%	105.6	11.5	9.8%
1992	645.5	72.3	10.1%	131.2	12.8	8.9%
1993	671.9	73.2	9.8%	158.4	17.7	10.1%
1994	721.4	76.6	9.6%	194.1	17.4	8.2%
1995	750.2	84.9	10.2%	206.1	19.7	8.7%
1996	734.2	86.7	10.6%	212.2	21.1	9.0%
1997	788.2	92.4	10.5%	248.6	24.1	8.8%
1998	802.6	94.3	10.5%	273.5	26.0	8.7%

Source: Statistics Canada

The Canadian automotive parts sector accounts for about 10 percent of Canada/U.S. employment and about 9 percent of the value of shipments. Using the classic one-in-ten formula for Canada/U.S. comparisons it appears the automotive parts sector is barely attracting its fair share of Canada/U.S. activity. However, overall employment growth has been strongly increasing from about 70 thousand workers in the early 1990s to over 94 thousand workers in 1998. Preliminary Statistics Canada data for 1999 and 2000 also indicate continued strong growth in employment in Canada's OE parts sector.

Quebec specific information is not available but secondary information indicates that Quebec's OE parts industry has performed better than Quebec's assembly sector. There are about 50 dedicated OE parts suppliers in Quebec. Most specialize in light metals castings technology and rubber components. Woodbridge Foam and Thuna Industry would be two good examples. There also are a number of lower tier suppliers tied to the Ste. Therese plant which will become vulnerable as a result of the closing of this plant.

On a share basis, the performance of the OE parts sector has been inferior to the assembly sector. One encouraging sign for the OE parts is that Canada is maintaining its position relative to the U.S. There has been no deterioration over the last decade. However, because we don't have Mexican data for the OE parts sector we do not know whether Canada has been able to maintain its relative position within the North American OE parts industry. We know there has been a lot of OE parts investment activity in Mexico, which implies growth in their automotive parts sector. If we factored in Mexico there would appear to be a slight long-term deterioration in Canada's OE parts sector relative to U.S. and Mexican performance.

Table 5: Canadian Parts Production Relative to North American OE Parts Market

	North America OE Parts (\$ '000)	Canadian OE Parts Production (\$ '000)	Canadian Share of OE Parts (Percent)
1982	86,935	5,877	6.8%
1983	110,184	8,358	7.6%
1984	143,210	11,494	8.0%
1985	158,793	12,924	8.1%
1986	160,186	12,922	8.1%
1987	159,535	13,004	8.2%
1988	161,715	14,539	9.0%
1989	158,171	15,447	9.8%
1990	156,949	12,681	8.1%
1991	140,551	11,495	8.2%
1992	176,531	12,833	7.3%
1993	212,214	14,741	6.9%
1994	264,311	17,360	6.6%
1995	268,406	19,750	7.4%
1996	269,714	21,059	7.8%
1997	293,378	24,121	8.2%
1998	348,037	26,045	7.5%
1999 Estimate	404,295	30,420	7.5%
2000 Estimate	433,317	31,110	7.2%

Source: Statistics Canada

For instance, Canadian parts production as a percent of the size of the OE parts market has declined over the past 15 years. In 1989, the Canadian parts industry peaked at 9.8 percent of the OE parts market but by the year 2000 this had dropped to only 7.2 percent and there has been years when it was below 7 percent of the market. Since the Canadian OE parts sector has maintained its position relative to the U.S. this drop in market share must have come at the expense of either Mexico or imports. Indeed, the U.S. now imports considerably more OE parts from Mexico (\$28 billion in 2000) than from Canada (\$23 billion in 2000). This was certainly not the case at the beginning of the decade. Both of these performance variables indicate that the Mexican automotive parts sector has outpaced Canada's automotive parts sector over the last decade.

This is problematic for Quebec. The chances of attracting new assembly investments into Quebec is very low. The same can be said for the rest of Canada. The chances of attracting new OE parts investments is a lot higher but Canada and Quebec are losing market share to Mexico.

Table 6: Canadian Productivity Value-Added per Production Employee

Year	Vehicle		Truck Body		Automotive	
	Assembly (\$)	% Change	& Trailers (\$)	% Change	Parts (\$)	% Change
1990	115,620	-	56,891	-	82,939	-
1991	97,930	-15.3%	57,226	0.6%	85,660	3.3%
1992	121,540	24.1%	58,560	2.3%	84,622	-1.2%
1993	147,673	21.5%	66,161	13.0%	100,255	18.5%
1994	194,563	31.8%	70,504	6.6%	107,777	7.5%
1995	200,297	2.9%	74,216	5.3%	112,582	4.5%
1996	243,160	21.4%	71,774	-3.3%	119,907	6.5%
1997	260,604	7.2%	72,026	0.4%	129,371	7.9%
1998	287,097	10.2%	77,956	8.2%	139,232	7.6%

Source: Statistics Canada

Productivity growth in both the vehicle assembly sector and the automotive parts sector has shown significant improvement over the last decade. Value-added per production worker in the assembly sector has almost tripled growing from a low of \$97 thousand per worker in 1991 to \$287 thousand per worker in 1998. During most of the last decade assembly productivity in Canada has increased by 20 percent plus per year.

The automotive parts sector has also increased value-added per worker by about 7 percent per year during the last decade. In 1990 value added per production worker was \$82 thousand and by 1998 this had increased to \$139 thousand.

The strong productivity growth is another indicator that the Canadian automotive assembly sector is structurally sound. And, again the OE parts sector has not shown the same level of improvement as the vehicle assembly sector although its performance has been respectable.

Table 7: Capital Expenditures in the Automotive Sector - \$ Million

	Vehicle Assembly	Truck Body & Trailer	Automotive Parts	Total Automotive	Percent New Capital	Percent Repair Capital
1961-65 Avg. Annual	\$58.3	\$0.6	\$59.8	\$118.7	71.7%	28.3%
1966-70 Avg. Annual	\$66.1	\$8.4	\$138.7	\$213.2	74.8%	25.2%
1971-75 Avg. Annual	\$68.3	\$20.2	\$148.3	\$236.8	61.4%	38.6%
1976-80 Avg. Annual	\$152.4	\$36.1	\$433.6	\$622.0	70.2%	29.8%
1981-85 Avg. Annual	\$488.6	\$28.7	\$515.9	\$1,033.2	67.1%	32.9%
1986-90 Avg. Annual	\$1,733.5	\$32.4	\$922.3	\$2,688.2	78.5%	21.5%
1991-95 Avg. Annual	\$1,531.5	\$49.2	\$1,293.6	\$2,874.3	79.8%	20.2%
1996-2000 Avg. Annual	\$2,835.1	\$89.2	\$1,445.1	\$4,369.5	76.0%	24.0%

Includes New & Repair Capital Expenditures

Source: Statistics Canada

One of the most important economic performance variables is capital expenditure. Capital expenditures largely represent the future direction of the industry in that companies invest for the future. Companies would not put hard assets in place if they did not intend to use these assets to increase production and become more efficient.

Capital expenditures in all aspects of the automotive sector have been exceptionally strong over the last five years. Total investment has averaged \$4.4 billion per year over the last five years, up from \$2.9 billion per year during the early 1990s. Investment pre-the-Autopact was relatively weak. There was an initial increase in the years following the Autopact, but then there was little improvement for almost ten years. Investment started to show significant growth during the late 1970s and early 1980s and reached new peaks for the 10-year period 1986 to 1995 exceeding \$2 billion per year for the first time. This was the era when the Japanese began to invest in new plants in Canada and the automotive parts sector was completely reorganizing its production base to meet the new tough standards in the sector. With few exceptions, there has been an entire overhaul of our assembly plants in Canada during the last five years with annual investment of close to \$3 billion per year. The automotive parts sector has also seen long term stable growth in capital expenditure increasing to \$1.45 billion per year during the last half of the 1990s from \$1.29 billion per year during the first half of the 1990s.

Quebec did not participate in this investment boom in the vehicle assembly sector and only partially participated in the OE parts sector. No Quebec data is available but with some exceptions in the OE parts sector, Quebec has not received any significant investments for more than a decade. This fundamentally means that with or without succession Quebec is going to struggle maintaining a presence in the vehicle and OE parts manufacturing sector.

Table 8: New Capital Expenditure Canada and U.S.
(\$ Canadian Millions)

Year	Automotive Parts Manufacturers			Vehicle Assembly Manufacturers		
	U.S.	Canada	Canadian % of N.A.	U.S.	Canada	Canadian % of N.A.
1990	5,704.0	421.0	6.9%	3,622.8	797.4	18.0%
1991	5,330.9	485.8	8.4%	3,927.0	1,154.5	22.7%
1992	5,573.2	424.5	7.1%	3,735.6	1,162.0	23.7%
1993	6,914.5	593.8	7.9%	5,390.5	1,472.8	21.5%
1994	8,351.9	1,674.1	16.7%	6,192.2	1,298.5	17.3%
1995	10,904.0	1,491.3	12.0%	6,553.1	1,522.0	18.8%
1996	10,278.4	729.6	6.6%	6,247.9	2,404.1	27.8%
1997	9,739.0	941.7	8.8%	5,848.4	2,898.0	33.1%
1998	9,476.0	1,330.3	12.3%	5,686.1	2,465.0	30.2%

Source: Statistics Canada

Canada, but not Quebec, has also been receiving a very high percentage of Canada/U.S. new investment in the assembly sector through most of the 1990s. No Mexican data is available. Between 1990 and 1998 the Canadian assembly sector averaged over 20 percent of Canada/U.S. total assembly sector investment and indeed in 1997 and 1998 received over 30 percent of Canada/U.S. new investment. The automotive parts sector has also increased its share of Canada/U.S. parts industry investment through much of the 1990s although the relative weakness

of the parts sector versus the assembly sector is also evident in these capital expenditure statistics. Interestingly, Quebec has received many smaller OE parts investments although no hard data is available.

In conclusion, by most accounts, Canada's automotive sector is sound from a structural point of view. But almost all of Canada's strength is in Ontario not Quebec. If there is a weakness it is in the automotive parts sector, which appears to be losing ground relative to Mexico. Quebec actually has some success in the OE parts sector. Canada's OE parts sector appears to be holding its own relative to the U.S. automotive parts sector. We have a high share of assembly sector activity and at least a representative share of the automotive parts sector. Our performance within the North American automotive assembly sector has been growing or at the very worst remaining stable. Productivity growth has been excellent; indicating the Canadian auto sector, both assembly and OE parts, are efficient. Finally, capital expenditures, particularly in the assembly sector are very strong. This should mean that the assembly sector is very well positioned to continue to grow relative to the U.S. over the next five to ten years. Mexico's assembly and OE parts sector will likely outperform Canada over this time period, but their growth in the assembly sector over the last decade did not accrue at the expense of Canada. Mexico's OE parts sector has outpaced Canada's OE parts sector and this should be a serious concern to policy makers.

Not to discount the seriousness of the current cyclical downturn, which will be discussed later in this report, but the Canadian assembly sector is structurally sound today and will likely remain so in the next five to ten years. Quebec is unlikely to participate in the assembly sector. The OE parts sector is considerably weaker than the assembly sector and is thus more vulnerable during the current cyclical downturn. Although Quebec would appear to have some upside potential in the OE parts sector.

2.3 Canada / Quebec's Position in the North American Market

The Canadian, United States and Mexican automotive markets are almost totally integrated. The Canadian and U.S. automotive industry began this integration process in 1965 with the signing of the Autopact. The Autopact provided for conditional duty free status for our vehicle assembly sector and our OE parts sector. The automotive aftermarket remained dutiable. This was reinforced with the signing of the Canada/U.S. Free Trade Agreement (FTA) in 1989, which provided duty-free treatment for all goods produced in Canada or the U.S. The North American Free Trade Agreement in 1994 brought Mexico into the free trade zone and provided Mexico with a stable trade regime in which to grow its automotive sector. With these trade agreements, the North American automotive sector now operates as a highly integrated market.

This integration of our markets means that our production system has also become integrated to the extent that any production system can become integrated. It also means that any assessment of the outlook for employment in Canada and indeed Quebec has to examine the North American market for vehicles and not any individual country's market.

Table 9: Vehicle Production and Exports in Canada - Units

	"Big Three Manufacturers"			Japanese Manufacturers		
	Production	Exports	Percent Exported	Production	Exports	Percent Exported
1990	1,624,336	1,394,906	85.9%	270,368	208,259	77.0%
1991	1,532,653	1,311,341	85.6%	306,057	257,404	84.1%
1992	1,626,877	1,496,956	92.0%	285,733	254,217	89.0%
1993	1,862,539	1,678,252	90.1%	332,022	295,140	88.9%
1994	1,914,362	1,730,664	90.4%	364,410	310,327	85.2%
1995	1,979,373	1,786,151	90.2%	379,779	281,920	74.2%
1996	1,994,899	1,743,757	87.4%	365,414	330,968	90.6%
1997	2,209,431	1,908,913	86.4%	373,903	295,851	79.1%
1998	2,110,351	1,841,454	87.3%	396,545	299,614	75.6%
1999	2,397,769	2,117,448	88.3%	598,304	424,061	70.9%
2000	2,297,177	2,033,098	88.5%	621,006	442,480	71.3%

Source: DesRosiers Automotive Consultants and Wards Automotive Reports

The "Big Three" have exported close to 90 percent of their Canadian vehicle production each year over the last decade. Most of these exports are to the U.S. and Mexico. Exports to other countries remain very small. During the year 2000, production by the "Big Three" was 2.3 million units and 2.0 million units or 88.5 percent of this production was exported. The Japanese also export a high percentage of their production in Canada. During the year 2000 they produced 621 thousand units and exported 442 thousand units or 71.3 percent of production. Most of these exports were for the U.S. market although a small percentage were also exported to Japan.

Table 10: Vehicle Sales and Imports in Canada – Units

	Big Three Manufacturers			Japanese Manufacturers		
	Sales	Imports	% Imported	Sales	Imports	% Imported
1990	908,101	665,667	73.3%	305,163	297,718	97.6%
1991	870,894	666,799	76.6%	323,649	311,046	96.1%
1992	842,340	584,136	69.3%	299,059	313,752	104.9%
1993	841,798	581,464	69.1%	251,755	226,460	90.0%
1994	930,770	677,319	72.8%	234,300	187,154	79.9%
1995	878,664	574,671	65.4%	204,037	145,900	71.5%
1996	895,169	654,402	73.1%	218,230	156,562	71.7%
1997	1,016,452	690,705	68.0%	297,056	237,750	80.0%
1998	964,710	627,086	65.0%	329,459	246,626	74.9%

Source: DesRosiers Automotive Consultants and Wards Automotive Reports

Because of the Autopact we often forget that vehicles imported from the U.S. are actually imports. Monthly analysis of sales often point to imports in Canada having between 30 and 35 percent of the market. These market share calculations are based on sales by nameplates rather than by country of origin. Actual import penetration in Canada is close to 70 percent. In 1998, the "Big Three" imported 627 thousand vehicles or 65.0 percent of their Canadian sales. The Japanese imported 247 thousand units or 74.9 percent of their Canadian sales. During the last

five years, both the “Big Three” and the Japanese have consistently imported about 70 percent of their vehicle requirements for Canada.

This is very important for Quebec since with the closing of Ste. Therese, Quebec technically will have to import all their vehicles. About 15-20 percent will originate from Ontario, about 60-70 percent will originate from the U.S. and the remainder from overseas, primarily Japan.

Table 11: Canada - United States - Mexico Automotive Trade
(\$ Cdn. Millions)

	1994	1995	1996	1997	1998	1999	2000	Avg. Ann Growth
U.S. Imports								
From Canada								
- Vehicles	43,229.0	47,021.0	46,979.0	50,686.0	57,040.0	70,239.0	68,986.0	6.9%
- Parts	13,193.0	13,212.0	14,825.0	16,208.0	18,922.0	22,248.0	22,969.0	8.2%
- Total	56,422.0	60,223.0	61,804.0	66,894.0	75,962.0	92,487.0	91,955.0	7.2%
From Mexico								
- Vehicles	6,538.6	10,746.1	15,145.5	16,765.1	19,562.1	22,448.3	31,192.2	25.0%
- Parts	13,252.0	14,413.7	15,879.1	18,431.9	21,475.3	24,903.8	27,718.3	11.1%
- Total	19,790.5	25,159.8	31,294.6	35,197.0	41,037.4	48,352.2	58,910.5	16.9%
U.S. Exports								
To Canada								
- Vehicles	15,717.0	16,009.0	16,865.0	20,347.0	21,146.0	22,757.0	23,167.0	5.7%
- Parts	23,739.0	26,056.0	26,283.0	29,949.0	34,658.0	39,941.0	39,043.0	7.4%
- Total	39,456.0	42,065.0	43,148.0	50,296.0	55,804.0	62,698.0	62,210.0	6.7%
To Mexico								
- Vehicles	896.0	525.7	1,708.6	2,738.3	3,504.6	3,782.8	5,640.8	30.1%
- Parts	10,466.9	9,247.2	9,651.6	13,265.3	14,092.4	13,769.3	18,652.6	8.6%
- Total	11,362.9	9,772.9	11,360.2	16,003.7	17,597.0	17,552.1	24,293.4	11.5%
Balance of Automotive Trade								
With Canada								
- Vehicles	(27,512.0)	(31,012.0)	(30,114.0)	(30,339.0)	(35,894.0)	(47,482.0)	(45,819.0)	7.6%
- Parts	10,546.0	12,844.0	11,458.0	13,741.0	15,736.0	17,693.0	16,074.0	6.2%
- Total	(16,966.0)	(18,168.0)	(18,656.0)	(16,598.0)	(20,158.0)	(29,789.0)	(29,745.0)	8.4%
With Mexico								
- Vehicles	(5,642.5)	(10,220.4)	(13,436.9)	(14,026.7)	(16,057.5)	(18,665.5)	(25,551.4)	24.1%
- Parts	(2,706.0)	(1,569.7)	(4,421.1)	(4,690.9)	(5,739.3)	(7,210.8)	(11,644.3)	18.4%
- Total	(8,348.5)	(11,790.1)	(17,858.0)	(18,717.6)	(21,796.8)	(25,876.4)	(37,195.7)	22.4%
Total Automotive Trade Balance								
	(25,314.5)	(29,958.1)	(36,514.0)	(35,315.6)	(41,954.8)	(55,665.4)	(66,940.7)	14.2%

Source: DesRosiers Automotive Consultants and Wards Automotive Reports

The degree of integration of our markets and production systems is also clearly evident in automotive trade patterns. Both Canada and Mexico are highly dependant on the U.S. market for their vehicle exports. Canada exports \$69 billion in vehicles to the U.S. while importing only \$23 billion from the U.S. for a trade surplus of \$46 billion in the year 2000. Mexico exports \$31 billion in vehicles to the U.S. while importing only \$6 billion from the U.S. for a trade surplus of \$25 billion in the year 2000.

Canada and Mexico are the exact opposites when it comes to OE parts trade. Canada runs a large deficit in OE parts trade while Mexico runs a large surplus in OE parts trade with the U.S. Once again this reflects the weakness of Canada's OE parts sector relative to Canada's assembly sector and Mexico's OE parts sector. During the year 2000 Canada exported \$23 billion in OE parts to the U.S. while importing \$39 billion for a trade deficit of \$16 billion. Mexico exported \$27 billion in OE parts to the U.S. while importing \$19 billion for a trade surplus of \$9 billion.

Table 12: Canadian Light Vehicle Sales - Autopact Vs. Non-Autopact – Units

	Auto Pact	Percent Change	Market Share	Non Autopact	Percent Change	Market Share	Total All Vehicles	Percent Change
1991	891,668		70.4%	374,845		29.6%	1,266,513	
1992	860,719	-3.5%	71.5%	343,684	-8.3%	28.5%	1,204,403	-4.9%
1993	869,156	1.0%	72.4%	331,149	-3.6%	27.6%	1,200,305	-0.3%
1994	940,170	8.2%	76.8%	284,598	-14.1%	23.2%	1,224,768	2.0%
1995	879,861	-6.4%	77.8%	250,350	-12.0%	22.2%	1,130,211	-7.7%
1996	907,176	3.1%	77.2%	268,448	7.2%	22.8%	1,175,624	4.0%
1997	1,036,766	14.3%	74.7%	351,180	30.8%	25.3%	1,387,946	18.1%
1998	985,517	-4.9%	70.9%	404,328	15.1%	29.1%	1,389,845	0.1%
1999	1,055,022	7.1%	70.3%	446,169	10.3%	29.7%	1,501,191	8.0%
2000	1,058,983	0.4%	68.3%	490,556	9.9%	31.7%	1,549,539	3.2%
2000/1999	0.4%			9.9%			3.2%	

	Non-Autopact By Origin Of Vehicle				Non-Autopact By Origin Of Vehicle			
	From Canada <i>Note #2</i>	From U.S./Mexico	From Japan	From Overseas	From Canada <i>Note #2</i>	From U.S./Mexico	From Japan	From Other Overseas
1991	5,159	60,624	248,934	60,128	1.4%	16.2%	66.4%	16.0%
1992	4,944	71,234	223,610	43,896	1.4%	20.7%	65.1%	12.8%
1993	40,439	86,380	167,823	36,507	12.2%	26.1%	50.7%	11.0%
1994	40,258	93,979	115,172	35,189	14.1%	33.0%	40.5%	12.4%
1995	40,258	94,619	81,191	34,282	16.1%	37.8%	32.4%	13.7%
1996	57,062	110,372	67,125	33,889	21.3%	41.1%	25.0%	12.6%
1997	77,270	120,870	114,717	38,323	22.0%	34.4%	32.7%	10.9%
1998	73,389	138,499	149,117	43,323	18.2%	34.3%	36.9%	10.7%
1999	109,471	120,755	154,073	61,870	24.5%	27.1%	34.5%	13.9%
2000	110,752	136,063	157,619	86,122	22.6%	27.7%	32.1%	17.6%
2000/1999	1.2%	12.7%	2.3%	39.2%				

Note #1: Honda & Toyota's From Canada Included In U.S. Until 1993

	Autopact By Origin Of Vehicle			
	From U.S./Mexico	From Overseas	From U.S./Mexico	From Overseas
1991	817,047	74,621	91.6%	8.4%
1992	788,825	71,894	91.6%	8.4%
1993	820,226	48,930	94.4%	5.6%
1994	912,042	28,128	97.0%	3.0%
1995	863,596	16,265	98.2%	1.8%
1996	897,161	10,015	98.9%	1.1%
1997	1,027,294	9,472	99.1%	0.9%
1998	975,116	10,401	98.9%	1.1%
1999	1,027,842	27,180	97.4%	2.6%
2000	1,030,434	28,549	97.3%	2.7%
2000/1999	0.3%	5.0%		

Source: DesRosiers Automotive Consultants and Wards Automotive Reports

The integration of our markets is also evident from the source of vehicles sold in Canada by country of origin. About 70 percent of light vehicle sales in 2000 were by Autopact members with most of these (97.2 percent) originating from U.S., Mexico or Canada. The Autopact was a multilateral trade agreement, which allowed members to import vehicles from any country duty-free. The Autopact was terminated on February 19, 2001. At that time all these products (28,549 vehicles in 2000) became dutiable.

The non-Autopact producers now account for over 30 percent of the Canadian market up from a low of 22 percent in 1995. Their sales originate from a variety of sources with about half their vehicles originating from their plants in Canada, U.S. or Mexico. Non-Autopact sales from Japan have declined from 66.4 percent in 1991 to 32.1 percent in the year 2000. Sales originating from plants in Canada account for 22.6 percent of sales compared to 12.2 percent in 1993. Those from the U.S. and Mexico now account for 27.7 percent of sales compared to 16.2 percent in 1991. Those from other overseas countries account for 17.6 percent of sales compared to a low of 10.7 percent in 1998.

In conclusion, the Canadian-U.S.-Mexico markets are highly integrated on a North American basis. This has resulted in a very high integration of our vehicle assembly and automotive parts sector with 90 percent of Canadian production annually exported.

Any assessment of Quebec's prospects under a succession regime has to evaluate Quebec's position within the North American automotive sector and to a degree the global automotive sector.

2.4 Outlook for Canada / Quebec Market

Although there has been an unprecedented cyclical upturn in sales over the last nine years, new vehicle markets in North America are considered to be mature, growing less than 1 percent per year over the last two decades. During the first two decades following the Second World War, many households acquired vehicles for the first time. The process was extended as baby boomers came of age and established households. Today, ownership or leasing of at least one vehicle is almost universal among North American households. However, the rate of household formation has declined as a direct result of the fall in birth rates after the early 1960s.

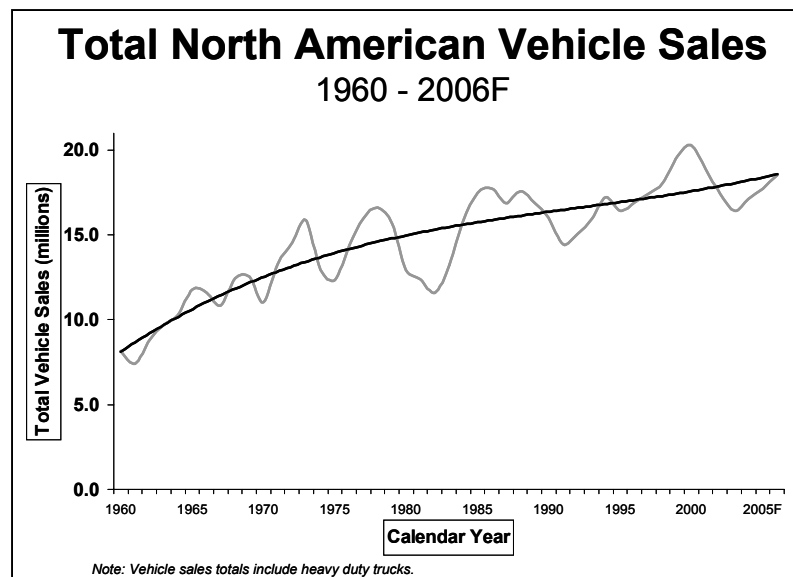
Table 13: North American Sales of Vehicles - Units

Calendar Year	Quebec	U.S.	Canada	Mexico	North America
1960-69	N/A	95,223,800	7,281,436	995,759	103,500,995
1970-79	3,332,737	127,804,942	11,972,193	2,935,928	142,713,063
% Change	N/A	34.2	64.4	194.8	37.9
1980-89	3,496,031	135,364,952	13,360,844	3,791,418	152,517,214
% Change	4.9	5.9	11.6	29.1	6.9
1990-99	3,311,563	148,587,761	13,022,715	5,480,414	167,090,890
% Change	-5.3	9.8	-2.5	44.5	9.6

Note: Includes Heavy Duty Trucks

Source: DesRosiers Automotive Consultants

The trend is evident through slowing rates of peak-to-peak and decade-over-decade growth in unit sales. During the 1970s, total vehicle sales for the decade in Canada were 64.4 percent higher than in the 1960s. In the United States, the corresponding increase was 34.2 percent and in Mexico, 194.8 percent. During the 1980s, the decade-over-decade increase in new vehicle sales was 11.6 percent in Canada, 5.9 percent in the United States and 29.1 percent in Mexico. In the 1990s unit volume increased by 9.8 percent over the previous decade in the United States, 44.5 percent in Mexico but actually declined by 2.5 percent in Canada and by 5.3 percent in Quebec. The decline in Canada is due to this country's much slower recovery from the 1990-91 recession. The United States experienced a strong recovery in new vehicle sales beginning in 1992, and annual sales have been near historic peak levels since 1994. In Canada, domestic consumer markets and new vehicle sales, did not really recover before 1997. As employment growth and consumer confidence lagged, Canadians held onto their old vehicles and deferred new vehicle purchases.



Another factor behind slower peak-to-peak growth is increased vehicle durability or expected useful life and consumer rejection of planned obsolescence. Over the past few decades, there has been a continuous trend in both Canada and the United States to greater distances traveled in a given year, and higher mileage on vehicles being scrapped.

During the 1970s, North American (Canada and the United States) drivers logged a total of 23.4 trillion km., an increase of 53.9 percent over the previous decade. In the 1980s, this figure grew to over 30.8 trillion, an increase of 31.7 percent. For the 1990s, total distance traveled by U.S. and Canadian motorists totaled over 41 trillion km., a further increase of 34.6 percent. In the first decade of the Millennium, vehicle usage is expected to be 54.0 trillion km., an increase of 30.0 percent. Rising incomes during the 1970s and 1980s prompted increased travel. Urban expansion increased commuting distances from homes to workplaces, and the growing preponderance of two-income households has increased the number of consumers driving to work.

Table 14: Vehicle Ownership – Canada vs. U.S.

	Population (In Millions)		Units in Operation (In Millions)		Vehicles Per Person	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
1960	N.A.	181	N.A.	68	N.A.	0
1970	N.A.	205	N.A.	98	N.A.	0
1980	25	228	13	140	0.51	0.61
1990	28	250	15	179	0.54	0.72
2000	31	275	17	213	0.55	0.77
2010	33	300	19	230	0.57	0.77
60 - 70	N.A.	13.5%	N.A.	44.5%	N.A.	27.3%
70 - 80	N.A.	11.1%	N.A.	42.5%	N.A.	28.3%
80 - 90	13.0%	9.7%	20.5%	28.2%	6.6%	16.8%
90 - 00	11.2%	10.2%	12.8%	19.0%	1.5%	0.7%
00 - 10	8.1%	8.9%	11.5%	7.8%	3.2%	-0.1%

Source: Statistics Canada and Polk Canada Inc.

Multiple income families together with the wealth effect during the 1990s, significantly increased vehicle ownership in the U.S. This was less evident in Canada. Americans now own .77 vehicles per person compared to only .55 vehicles per person in Canada. About 25 percent more consumers own vehicles in the U.S. than in Canada. We have conservatively forecast vehicle ownership to remain stable in the U.S. at .77 vehicles per person and to grow slowly in Canada at .57 vehicles per person by the end of the decade.

With population expected to grow about 8 percent per year during the 2000 to 2010 timeframe, these vehicle ownership patterns mean that vehicles on the road will also have to increase to meet demand for transportation. Since used vehicles are not imported into North America from any other country this growth in units in operation can only occur by consumers purchasing more new vehicles. Therefore, all other things being equal, increases in vehicle usage can be expected

to result in commensurate increases in vehicle sales, as cars and trucks wear out faster the more they are driven. During the 1980s and 1990s, however, growth in vehicle usage was partially offset by increases in the expected useful life of vehicles. Consumers are getting more overall use from their vehicle over its lifetime and have to purchase vehicles less often. Odometer readings on scrapped vehicles have increased steadily, from 148,000 in the 1960s, to 167,000 in the 1970s and 207,000 for the 1980s. For the 1990s, average durability of vehicles was 259,000 km.; in the first decade of the Millennium this figure is expected to be around 300,000 km. This represents the continued increase in the quality of vehicles. This increase in vehicle durability acts as a dampening effect in the vehicle market.

In each recent ten-year period, the decade-over-decade percentage increase in unit new vehicle sales was roughly equivalent to the growth in kilometres traveled less the increase in vehicle durability. During the 1970s, usage increased by 53.9 percent, durability by 12.8 percent and vehicle unit sales by 37.9 percent. Over the following two decades, growth in kilometres traveled was increasingly offset by increases in expected vehicle life. In the 1980s, vehicle usage grew by 31.7 percent, but vehicle durability in kilometres increased by 23.8 percent, and unit sales rose by only 5.6 percent. For the 1990s, the corresponding figures were 34.6 percent, 25.1 percent and 9.6 percent respectively. For the 1990s, one can see how important vehicle usage is as a factor in new vehicle sales. Vehicle quality increased by similar levels in the 1990s versus the 1980s (25.1 percent vs. 23.8 percent), which normally would have resulted in stable sales at best. But with a strong economy and lower gas prices usage increased by 34.6 percent. The resulting wear and tear on vehicles forced consumers to increase sales by 9.6 percent in the 1990s versus an increase of only 6.9 percent in the 1980s.

Table 15: North American Vehicle Sales, Usage & Durability

Time Frame	North American Vehicle Sales (Units)	Vehicle Usage (Billions of KM)	Vehicle Durability (KM)
1960-69	103,500,995	15,212	148,407
1970-79	142,713,063	23,405	167,447
% Change	37.9	53.9	12.8
1980-89	152,517,214	30,834	207,324
% Change	6.9	31.7	23.8
1990-99	167,090,890	41,505	259,373
% Change	9.6	34.6	25.1
2000-2009	180,089,275	53,957	298,279
% Change	8.3	30.0	15.0

Note: Includes heavy-duty trucks

Source: DesRosiers Automotive Consultants

To a large extent, the increase in expected useful vehicle life reflects the quality revolution and the end of planned obsolescence in the automotive industry, a trend that was spearheaded by the “Japanese invasion” of the North American vehicle market during the 1980s. The abandonment of planned obsolescence has been confirmed by a number of market and social developments.

Greater vehicle longevity and longer trade-in cycles carry significant implications for the medium to long-term outlook for the automotive sector. Growth in vehicle sales between cyclical peaks in North America has been slowing since the 1960s. With the long upward trend in sales beginning in 1992, unit sales in 2000 were only 10.4 percent higher than those recorded in the previous peak year of 1986, but it took 14 years to reach that level versus eight years between the 1978 and 1986 cycle and about four to five years between previous peaks. Therefore, unit volumes in Canada and the United States are not likely, on a population-adjusted basis, to match the peak-to-peak growth rates recorded in the 1980s within the next ten years.

Table 16: Peak to Peak Increases in North American Vehicle Sales

Peak Year	North American Unit Sales	Average Annual Growth Percent	Years Between Peaks	Absolute Growth Percent
1965	11,793,853			
1969	12,537,385	1.5	4	6.3
1973	15,865,841	6.1	4	26.5
1978	16,637,006	1.0	5	4.9
1986	17,715,618	0.8	8	6.5
2000	19,561,117	0.7	14	10.4

Note: Includes heavy-duty trucks ; Source: DesRosiers Automotive Consultants

Our production and sales forecasts call for a continuation of recent trends toward slow long-term growth. In the first decade of the Millennium, North American (including Mexico) sales are expected to be 8.3 percent higher than in the 1990s, averaging 18.1 million units per year. Kilometres driven will continue to grow over the next decade but at a slower rate (30.0 percent) than previous decades as higher gasoline prices are expected to curb overall usage of vehicles. In addition the vehicle companies have made significant improvements in overall fuel economy over the last two decades but we do not anticipate similar levels of improvements in the next decade. Thus higher fuel prices will result in a softening of overall use of vehicles on the road. Offsetting this, however, is continued growth of population and stability in ownership of vehicles at about .77 vehicles per person in the U.S. and .57 vehicles per person in Canada. This results in more units in operation, which helps maintain total usage of vehicles.

We also do not anticipate a similar level of improvement in vehicle durability to that which has been achieved over the last two decades. We forecast that vehicle durability will only increase 15 percent during the next decade. If vehicle quality were to increase at a greater rate then our vehicle sales would have to be lowered to compensate.

Table 17: Long-Term Vehicle Production Forecast

Time Frame	North American Vehicle Sales (Units)	Vehicle Usage (Billions of KM)	Vehicle Durability (KM)	North American Production (Units)	Production To Sales Ratio	Percent Canadian Production	Canadian Production (Units)
1960-69	103,500,995	15,212	148,407	101,325,196	97.9%	7.7	7,815,054
1970-79	142,713,063	23,405	167,447	128,925,827	90.3%	12.0	15,489,430
% Change	37.9	53.9	12.8	27.2			98.2
1980-89	152,517,214	30,834	207,324	120,239,533	78.8%	13.8	16,589,233
% Change	6.9	31.7	23.8	-6.7			7.1
1990-99	167,090,890	41,505	259,373	147,276,353	88.1%	15.6	22,942,194
% Change	9.6	34.6	25.1	22.5			38.3
% Change	8.3	30.0	15.0	10.5			17.1
Average Per Year	18,089,275	5,396		16,280,348			2,686,257

Note: Includes heavy-duty trucks

Source: DesRosiers Automotive Consultants

Our North American vehicle production forecast is directly related to our sales forecast. About 90 percent of vehicles sold in North America are manufactured here and we believe this should stay at the 90 percent level over the next decade. This is the result of a number of factors including:

- The NAFTA Agreement which allows companies in the free trade zone to be very competitive from a trade perspective and encourages global producers to manufacture in the trade zone.
- Stable international currencies.
- Continued political pressure from the U.S. to have Japan and other nations manage their trade.
- No significant competitive threat from companies operating in newly industrialized countries (NIC's) such as the Asian countries and Eastern Europe.
- Significant market advantages to producing vehicles near where they are purchased.

North American vehicle production is expected to average 16.3 million units per year over the next decade, an increase of 10.5 percent over the 1990s. There are currently about 80 assembly plants in North America with capacity in total to produce between 20 and 22 million units per annum. A production level of 18 million units per year could be achieved with a capacity utilization rate of about 80 to 85 percent. It would appear that there are between six and 10 excess assembly plants in North America. The prospects for new assembly investments are low for both Canada and Quebec.

Canadian production is expected to continue to be stable at 2.69 million per annum between 2000 and 2009, and account for 16.5 percent of the North American total. This may be conservative in that Canada is currently producing approximately three million units per year.

It should be noted that the data set for vehicle assembly is statistically very “lumpy”. One assembly facility growing or closing would have a significant impact on Canadian production levels. As a result, while the forecast assumes a relatively steady outlook, it is important to note that a small change in competitive factors could have a major impact both positive and/or negative on Canadian vehicle production and thus, the Canadian economy. This is particularly true given the international nature and highly competitive dynamics of the vehicle assembly industry.

Table 18: Parts Production

Time Frame	Average Content Per Vehicle in North America	North American OE Parts Market (\$Cdn. Millions)	Canadian Share of N.A. OE Parts Market	Canadian Parts Production (\$Cdn. Millions)
1960-69	1,806	183,028	4.0	7,321
1970-79	3,904	503,320	6.0	30,199
% Change	116.1	175.0		312.5
1980-89	10,686	1,237,414	8.4	103,478
% Change	173.7	145.9		242.7
1990-99	16,093	2,516,186	7.6	190,504
% Change	50.6	103.3		84.1
2000-2009	24,754	3,788,894	7.5	284,430
% Change	53.8	50.6		49.3
Average Per Year		378,889		28,443

Canada’s share of North American parts market more than doubled from 4.0 percent in the 1960s to 8.4 percent in the 1980s before falling back to 7.6 percent for the 1990s. We forecast Canada’s share of parts production will stay the same at 7.5 percent for 2000-2009.

The average annual value of parts production is expected to increase from \$19.1 billion during the 1990s to \$28.4 billion for 2000-2009.

This forecast assumes an expected annual increase of 1.0 percent in average content per vehicle (i.e. the total value of all OE parts, on average, in each vehicle produced in North America) in North America for 2000-2009 (bringing the average content per vehicle for the decade to \$24,754). This growth rate is based on the belief that content per vehicle has leveled (i.e. technology growth has slowed) and is not expected to grow substantially in the foreseeable future.

In summary, the market for vehicles in North America is mature and is forecast to grow by only 8.3 percent during the next decade versus the 1990s. The growth however is off of a relatively high base so total sales will average over 18 million units per year, up from 16.7 million units per year during the 1990s. It must be kept in mind that vehicle sales have always been cyclical and will always be cyclical. Therefore the current downturn in vehicle sales will result in a catching up period over the last half of the decade where sales will be above the long-term trend line.

About 90 percent of vehicles sold in North America are produced in North America, so vehicle production will average over 16 million units per year following the identical cyclical pattern as the North American market. This level of production would be considered healthy by long-term standards. This level of vehicle production translates through the entire value chain and results in a sizable OE parts market, raw material sector, tool, mold and die sector and machinery sector.

Although Quebec and indeed the rest of Canada will find it difficult to expand vehicle assembly capacity, both jurisdictions have considerable opportunity in the rest of the value chain especially production of OE parts, the raw material sector and tools, molds and dies.

3. Quebec's Accession to Sovereignty: Issues for the Automotive Sector

3.1 Introduction

To determine the issues for the automotive sector of Quebec's accession to sovereignty, DesRosiers Automotive Consultants undertook a limited number of interviews with industry representatives. The interviewees were chosen, however, to reflect the views of both the OE parts sector and the assembly sector. The overall response from all aspects of the industry was consistent, that the implications of sovereignty for the industry from a manufacturing perspective would be less negative today than during the early 1990s.

This is primarily due to the fact that Quebec has already lost most of its vehicle assembly sector and has only a small albeit vibrant OE parts sector.

The implications of sovereignty from a market perspective would be more negative today than during the early 1990s. This is dependant on Quebec's ability to negotiate itself into the NAFTA and WTO trade regimes.

3.2 Automotive Specific Issues with Accessions to Sovereignty

Over the last decade Canada's automotive trade policy has undergone a complete transformation. Up to January 1, 1989, Canada's auto sector was governed by the Autopact with the United States. Non-autopact trade was governed by WTO rules (GATT at the time).

From 1989 to January 1, 1994, Canada's automotive trade policy consisted of both the Autopact rules and FTA rules for North American players as well as WTO rules for the overseas companies. In early 2001, Canada lost a ruling at WTO and was forced to terminate the Autopact. Today North American production and trade falls under NAFTA rules and overseas production and trade falls under WTO rules.

Automotive Trade Policy in Canada over the years has become very complex with numerous rules and regulations. Vehicles can enter into Canada under a wide variety of policies involving the Canada-U.S. Automotive products Trade Agreement up to February 2001, (the Autopact), the

Canada-U.S. Free Trade Agreement (FTA), the North American Free Trade Agreement (NAFTA) and GATT (now WTO) rules. The latter allows vehicles into Canada at tariff levels set by MFN (Most Favoured Nation) rates, British Preferential rates (For Australia and New Zealand) and General Preferential Tariff (GPT) rates for less developed countries. Moreover, there are many exceptions to the rules which have arisen over the last 30 years which offset duty rates and other trade rules in the automotive sector today. Indeed, Canada has a different entry rule for virtually every major vehicle company currently manufacturing and/or selling vehicles in Canada. Because of this complexity, it is necessary to review all these policies and to put them into a historical context.

Pre Autopact

In the 1950s, automobile production in Canada was protected by a combination of tariffs and domestic content provisions. The resulting Canadian auto industry was characterized by an excess number of models produced, small scale, short production runs and high costs. All major auto assemblers in Canada were U.S. multi-nationals. There was little trade in finished automobiles across the U.S. Border. Because of preferential British tariffs, domestic Canadian producers were threatened by “low cost” British auto imports. Canada faced a growing deficit in its balance of payments on auto trade.

Canada also imposed substantial tariffs on the entry of assembled passenger cars as well as parts. These tariffs were designed to protect the domestic Canadian industry from imports from the United States. Completed vehicles faced a 17.5 percent tariff. In 1960, in the face of a large and growing deficit on auto trade, the Canadian Federal government established a Royal Commission on the automobile industry. The Bladen Commission’s major recommendations were accepted in the main by the Canadian Federal government, and the Canadian government introduced several of the Report’s recommendations in 1962-1963. New remission orders suggested by Bladen were the subject of a countervailing duty investigation by the U.S. government in 1964. In order to avoid the imposition of duties the two governments negotiated The Autopact which was ratified by the legislations in both countries and signed on January 16, 1965. It was terminated on February 16, 2001.

The Autopact

The Autopact required Canada and the United States to accord duty-free treatment to imports from each other of specified motor vehicles and parts for use as original equipment. Canada implemented the agreement multilaterally so that vehicles and parts could enter duty-free from any country in the world as long as the conditions of the Agreement were met. In contrast, the United States implemented The Agreement bilaterally so that only parts and vehicles from Canada qualified for duty-free entry.

Canada implemented The Agreement through two Orders-in-Councils (P.C. 1965-99 and P.C. 1965-100, the Motor Vehicles Tariff Orders of 1965). The United States implemented The Agreement with the signing of the Automotive Products Trade Act of 1965 on October 21, 1965.

Canada's obligation to accord duty-free treatment to imports applied to specified motor vehicles and original-equipment parts but excluded "special-purpose" motor vehicles, replacement parts, tires and tubes. Canada restricted duty-free entry to motor vehicles and eligible parts imported into Canada by qualified manufacturers of motor vehicles in Canada.

To qualify for duty-free entry into Canada for a given class of motor vehicles and original-equipment parts, a Canadian manufacturer of motor vehicles of that class must meet three criteria as set out in Annex A of the agreement:

1. The Canadian manufacturer must have produced vehicles of that class, i.e. passenger cars, buses and special commercial vehicles, in each "quarter" of the base year (1964) and in any subsequent model year.
2. The ratio of net sales value of the vehicles in that class produced including those for export by the manufacturer in Canada to the net sales value of all vehicles of that class sold in Canada sold by the manufacturer for consumption in Canada (usually referred to as the production-to-sales ratio) must at least be equal to its corresponding ratio for the base year (but no less than 75 to 100); and,
3. The "Canadian Valued Added" (CVA) in the production of vehicles in that class in Canada must at least be equal to its level in the base year, in most cases, 1964-65.

These criteria were protectionist in nature since they effectively limited duty-free entry rights to manufacturers already established in Canada to the agreement.

In Canada, qualifying vehicle manufacturers who did not meet the commitments outlined in The Agreement for each class of vehicle had to pay duty on all their automotive imports into Canada for that class of vehicle including original equipment parts imported to produce that class of vehicle. The "all or nothing" nature of this penalty was an incentive for the vehicle manufacturers to meet their commitments.

There were also collateral commitments made by the Canadian vehicle manufacturers to the Canadian government in the form of "letters of undertaking" involving essentially two different commitments to increase the production of motor vehicles and original-equipment parts, whether for consumption in Canada or for export to the United States.

These are the basic formal terms of the agreement. However, the original document is merely the starting point for automotive trade policy in Canada. The agreement's true significance came from continued reinterpretations, revisions and changes that reflect evolving economic needs of the two signatories and the vehicle manufacturers.

The Autopact created a two tier trade regime in Canada. Tier I companies operate under the Autopact and Tier II companies operate under MFN trade rules. The major Tier I companies included GM, Ford, Chrysler, Volvo and AMC but also include dozens of specialty vehicle companies, heavy duty truck producers, buses and off-highway equipment. Many of which are in Quebec. All the other light vehicle importers are considered Tier II companies.

This two Tier trade system remained relatively intact between 1965 and the signing of the Canada – U.S. Free Trade Agreement in January 1989. During this time frame the Autopact companies were able to operate duty-free for all their vehicles and their original equipment parts.

As outlined above, each vehicle company is required, on a dollar value basis, to meet a one to one production to sales ratio for passenger cars, separate from trucks and separate from buses. This in essence meant that an eligible company had to have an assembly plant for each class of vehicle they marketed in Canada.

A requirement for eligible companies to have as a light truck as well as passenger car plant was very significant for Canada. In the 1960s and 1970s, light trucks accounted for less than 25 percent of the market but Canada had to have a much higher percentage of their production base focused on light trucks because of the production to sales ratio. When the light truck market grew to over 40 percent of the North American market in the 1990s, Canada was perfectly positioned to capitalize on this trend and today over half of the Canadian production base is focused on light trucks, the hottest segment of the market.

Another safeguard was a Canadian Value Added to Sales ratio committed to in the “Letters of Undertaking”.

It is important to note that this safeguard is based on Canadian Value Added not North American Value Added or North American “Content”. It is also CVA relative to Sales (ie: the Canadian Market) and not CVA relative to production. Since Quebec annually purchases about 300,000 to 400,000 vehicles this meant that offsetting production had to be located in Canada and gave Quebec considerable power in investment decisions. Thus GM’s decision in 1965 to build a plant in Quebec. Now that the Autopact has been cancelled, Quebec has also lost its power to use trade policy to force investment into the province.

Tier II companies operated under GATT rules. Vehicle companies simply paid the MFN duty rate which in 1965 was 17.5 percent.

The MFN rate has come down under each round of GATT. The Kennedy round lowered automotive tariffs from 17.5 percent to 15.0 percent. The Tokyo round lowered automotive tariffs from 15.0 percent to 9.2 percent. The Uruguay round lowered tariffs to 6.1 percent.

The political importance of the industry together with the Autopact penalty inevitably led to situations where the government and the industry found it in their mutual best interests to sit down quietly behind the scenes and discuss ways to meet each other’s objectives and solve problems.

Although there were probably elements of moral suasion in the late 60’s post Autopact period, the first major use of these levers came in the early 1970s. Through no fault of their own Chrysler found themselves in violation of their production-to-sales ratio for commercial vehicles. The production-to-sales ratio requirement is for one light truck to be produced for every one sold. Chrysler’s van sales exploded overnight and they did not have offsetting production

capacity. As such they were in violation of a critical Autopact requirement. They owed the government millions in duties. At the same time there was considerable debate over whether Canada was getting its “fair share” of jobs from the Autopact. The three elements were in play. Chrysler was in violation of a regulation, the government was looking for jobs and the duties owed were high.

The solution was very innovative and demonstrated to all the players a new approach to trade policy that was win-win. Chrysler agreed to build a new full size van plant (ie: the Pillette road van plant) in Windsor to give them the necessary commercial vehicle production. In exchange the Federal government provided Chrysler a one time change in their production-to-sales ratio. Instead of a year to year ratio they were allowed a seven year ratio which was backdated to the years they missed their Autopact requirements. Since they were building a new plant they would be able to exceed their ratio in the later years which would offset their underperformance in their earlier years.

All objectives were met. Chrysler ended up with flexibility in their production-to-sales ratio and avoided paying a duty penalty. Canada received a sizable investment which meant jobs and employment growth which was the primary government objective.

The Chrysler case also clearly demonstrated to the Federal and provincial governments that trade policy levers were available which gave them true power in negotiations with the vehicle companies. Over the last 20 years, numerous situations developed similar to the Chrysler situation and each and every time the government took the same approach. They would find a way to help the vehicle companies but in exchange they would lever investments into Canada. This helped Quebec maintain their GM assembly plant through the 1980s and 1990s. Without the Autopact, GM was free to close this plant although there were serious union and political issues which needed to be considered.

Production Based Remission Orders (PBROs)

In the late 1980s, Honda, Toyota, CAMI and Hyundai each signaled their intention to build a plant in Canada. To accommodate these investments Ottawa negotiated a new series of Remission orders which were commonly referred to as Type I and Type II Remissions.

The basic benefits provided a 70 percent reduction in the value for duty on automobile imports for every dollar of CVA in automotive parts exported. The conditions of Type I Remissions were that the vehicle companies had to purchase and export original equipment automotive parts but no investments were required. The export destination was universal.

Type II Remission also was on a dollar for dollar basis but required a significant investment and automotive parts procurement which, in essence, meant an assembly plant in Canada. There also was a requirement that the CVA generated from direct manufacturing and parts procurement be at least 15 percent of the cost of Sales. It is also generally viewed that qualifying companies had to commit to meet Autopact status within five years. This requirement became redundant when the FTA was signed in 1989.

The new arrangements, usually called production Based Remission Orders (PBRO's), were negotiated with Honda, Toyota, Hyundai and CAMI as part of their Memorandum Of Understanding (MOU) with the Canadian government. CAMI subsequently became a full Autopact member and did not use the remission orders to operate duty-free in Canada. Hyundai eventually closed their Canadian production facility. Honda and Toyota were eligible to join the Autopact but were not able to qualify before the signing of the FTA which froze Autopact status.

The Canada-U.S. Free Trade Agreement (FTA)

The Canada-U.S. Free Trade Agreement (FTA) came into effect on January 1, 1989. The FTA established a duty free zone between Canada and the U.S. for all products provided certain provision were met. Special terms were negotiated for the automotive sector.

First, participation in the Autopact was frozen to the companies which met the Autopact safeguards in the 1989 model year which effectively meant only existing players could qualify. CAMI, the joint venture between GM and Suzuki, took the opportunity to meet the Autopact safeguards for model year 1989 and after meeting the requirements was included as a full Autopact participant. Toyota and Honda would also have been eligible if they had met the Autopact provisions. They did not and were excluded from Autopact participation.

Second, Tier I Autopact companies were allowed an option as to whether to enter vehicles into Canada under the Autopact or under FTA.

Third, a new North American Rule of Origin of 50 percent was established before companies were allowed to use the FTA tariff rate. If companies do not meet the 50 percent rule of origin, their automotive products entering Canada use the MFN tariff rates. This new 50 percent Rule of Origin was very narrowly defined and related only to "in-plant" activity. It is difficult to calculate precisely but the new Rule of Origin was considered more difficult to meet than the 50 percent North American Rule of Origin under the Autopact. All imports into the United States had to meet the more restrictive NAFTA 50 percent Rule of Origin and could no longer enter under the Autopact 50 percent Rule of Origin.

Fourth, tariffs on aftermarket parts and warranty parts were phased out over a five year period. The aftermarket became duty-free provided they meet the Rule of Origin beginning January 1, 1993.

Fifth, under the FTA the used car embargo was lifted over a five year period provided the vehicles meet the 50 percent Rule of Origin, Canadian Safety Standards. Duties on used vehicles were lifted over a 10 year period.

Sixth, the general duty drawback provisions were scheduled to be phased out by January 1, 1994, the Export Based Remission Orders Type I were scheduled to be phased out by January 1, 1998 and the production Based Remission orders Type II were scheduled to be phased out by January 1, 1996.

Finally the duties on original equipment parts and vehicles imported into Canada from the U.S. by Tier II companies provided they meet the 50 percent Rule of Origin were phased out over a 10 year period.

The imposition of a new Rule of Origin and the phase out of the various duty remission orders were considered to be protectionist and thus a threat to the Tier II importers in Canada.

The duty-free “option” under FTA on the Autopact also merits further explanation. As mentioned earlier, until the signing of the FTA, Autopact participants could only receive duty free access to Canada if they met the safeguard requirements in full. If for any reason they did not fulfill the requirement of a safeguard they were assessed duties on all vehicles and O.E. parts for that class of vehicles. Autopact members were not allowed to import some vehicles under MFN tariffs and the remainder under the Autopact. Companies had to be either in the Autopact or out of the Autopact. The “all or nothing” penalty structure of the Autopact is therefore very punitive and Quebec had considerable leverage over GM.

The FTA took away the Federal government’s negotiating power under the Autopact. The FTA gives the Autopact producers an option which was not allowed before the FTA. They can operate duty-free under the terms of the Autopact and/or under the terms and conditions of the FTA. It was still advantageous to be in the Autopact but much of the Autopact became redundant.

The North American Free Trade Agreement (NAFTA)

Subsequent to the FTA, the U.S. and Canada negotiated the North American Free Trade Agreement (NAFTA) with Mexico to create an integrated North American market. It came into effect on January 1, 1994. NAFTA made a number of further changes to automotive trade policy. NAFTA replaced the relevant clauses which were negotiated between Canada and the U.S. under FTA but did not change any of the terms and conditions of the original Autopact.

Mexico was allowed to continue their protectionist Auto Decrees until January 1, 2004 at which time all trade would fall under NAFTA terms and conditions. With this date fast approaching it has focused most OE investments on Mexico rather than Canada or Quebec.

Mexico agreed to immediately open their market and eliminate all restrictions that limit the number of motor vehicles that Mexico’s current manufacturer’s could import from the U.S. and Canada for GM, Ford, Chrysler, Nissan and Volkswagen. These five companies currently manufacture vehicles in Mexico. Restrictions on all other vehicle companies were allowed to remain in place for the first 10 years of The Agreement.

The North American Rule of Origin was increased to 62.5 percent for vehicles and OE parts. These increases are being introduced in two phases over eight years.

NAFTA also introduced a new method for calculating content under the Rule of Origin. Under the FTA, the companies were allowed to “roll-up” their content in vehicles and automotive parts to 100 percent once a vehicle or part achieved 50 percent content. Under NAFTA a “net cost”

method for content was established which only allows actual content achieved to be used for NAFTA purposes.

The duty for passenger cars imported into Canada and the U.S. from Mexico by non-Autopact producers under NAFTA was 2.3 percent becoming duty-free on January 1, 2003. For light trucks the duty is 1.5 percent becoming duty-free on January 1, 1998.

The duty for about 75 percent of original equipment and aftermarket automotive parts imported into Canada and the U.S. from Mexico was 2.4 percent becoming duty free on January 1, 1998. For the remainder of the O.E. and aftermarket parts the duty rate was 4.2 percent becoming duty free on January 1, 2003. Engines for motor vehicles imported from Mexico were immediately free for all producers. All O.E. parts from Mexico into Canada were later provided duty free status.

Special Order in Council

Partially to offset the duty penalty for Honda and Toyota as a result of the phasing out of the various Duty Remission Orders, the Federal government passed a Special Order in Council which came into effect on January 1, 1994. This allowed Honda and Toyota to import certain parts, which are not made in Canada, duty-free and part for engines and transmissions duty free. Engine and transmission duties were dropped to 2.5 percent which is the U.S. rate of duty for parts imports. All other parts remained dutiable at the MFN rate.

Special Original Equipment (O.E.) Parts Exemption

Even with the Special Order in Council it was estimated that the loss of the duty drawback allowed under the various remission orders, which were scheduled to be phased out on January 1, 1996, would cost Honda and Toyota about \$200 to \$300 per vehicle or an estimated \$40 to \$50 million per year on their Canadian production. This was viewed by Honda and Toyota as a penalty for producing vehicles in their current Canadian plants and a disincentive to making further investments in Canada.

To correct this situation the Canadian Federal government announced in December 1995 a Special Original Equipment Parts Exemption effective January 1, 1996. The Order in Council allows all O.E. parts to enter into Canada duty-free on a multilateral basis. Duties on vehicles imported from overseas and aftermarket parts imported from overseas remained at their MFN rate. The move to duty free auto parts now puts Canada at a competitive advantage for new assembly plant investments relative to the U.S. which still imposes a 2.5 percent duty on O.E. parts. The move to duty free O.E. parts is one of the reasons Toyota and Honda announced major assembly plant expansions.

Autopact Cancellation

In 1999 the Japanese government petitioned the WTO to examine the Autopact as an unfair trade subsidy program. After a two year review the WTO ruled against Canada and on February 16,

2001 Canada cancelled the Autopact. Thus there are now two trade policy regimes. NAFTA for North America production and WTO for overseas production.

From a Quebec perspective this is important in that the power of the safeguards provided for with the Autopact is no longer valid. Thus GM could close their assembly plant. NAFTA also focuses much of the new investment in North America on Mexico rather than Canada. Thus Quebec's ability to attract assembly investment is limited and indeed the same can be said for Canada. It is negative for both jurisdictions but at least Quebec is now on an equal footing to Canada. There is more opportunity for both jurisdictions in the O.E. parts sector. Each has some strengths but each also has many weaknesses. Accession to sovereignty would not change this situation although Quebec would almost certainly have to negotiate entry into NAFTA and establish tariffs for the rest of vehicle trade at WTO levels which for the rest of Canada is 0.0 percent for OE parts and 6.1 percent for vehicles.

The issues for Quebec on the market side are more negative. Vehicle prices in Canada are very low compared to the U.S. The average passenger car retails in Canada for \$3,595 less than in the U.S. and the average light truck retails for \$3,072 less.

Table 19: Vehicle Price Differentials – Canada – U.S.

	Dollar Amount	Percent
Passenger Car		
Sub-compact	\$1,401	11%
Compact	\$2,848	16%
Intermediate	\$3,540	15%
Luxury High	\$4,150	8%
Luxury	\$4,325	12%
Sport	\$2,976	13%
Total	\$3,595	13%
Light Truck		
Small Van	\$5,849	21%
Compact Sport Utility	\$2,563	10%
Intermediate SUV	\$3,475	10%
Large SUV	\$5,546	11%
Luxury SUV	\$2,071	4%
Small Pick-up	\$857	5%
Large Pick-up	\$1,334	6%
Total	\$3,072	10%

The primary reason for these lower prices is that consumers in Canada just can't afford to pay higher prices. The Canadian market is also super competitive amongst the OEMs and this leads to lower prices. But the primary reason is the consumer level in Canada. We know the Canadian consumer is very disadvantaged relative to U.S. consumers. Canadian consumers have a higher personal tax burden than American consumers. The differences are even more marked with higher income consumers who are the prime buyers of new vehicles. Most lower income

consumers, where governments have targeted tax breaks, purchase used vehicles, not new vehicles.

Canadian consumers are also more conservative than Americans with their vehicle purchases. The top selling vehicles each year in Canada are compact cars versus the intermediate sized cars sold in the U.S. On a market share basis Canada purchases almost twice as many mini-vans and about half as many sport utility vehicles. So vehicle companies are forced to be more competitive in this market.

The issue for Quebec is that it is more costly for the OEMs to operate in Quebec than the rest of Canada. The primary reason is the need to be in two languages but there are also additional costs for warehousing and marketing. The rest of Canada actually subsidizes the Quebec consumer since vehicle prices are the same across Canada despite the high cost of operating in Quebec. With separation the rest of Canada would certainly not be willing to subsidize Quebec and it is uncertain to what degree the vehicle companies would maintain these lower vehicle prices given the small size of the Quebec market. Operating costs in Quebec would also increase because of the need for additional distribution capacity, head office staff, legal and regulatory compliance, etc. It is not possible to calculate a cost differential but the average vehicle price in Quebec would have to be higher to the disadvantage of the Quebec consumer.

3.3 Conclusions & Policy Issues

In ensuring the future for the automotive industry in Quebec, it is important to note a number of key elements that have been discussed in this report which will play a significant role in shaping the implications of Quebec's accession to sovereignty:

- The automotive market in North America (Canada and the U.S.) grew significantly in the previous four decades. In the next decade, the market outlook will be reasonably healthy growing about 0.8 percent per year albeit by most standards this would be considered slow growth.
- From a production standpoint, total North American production is likely to show limited growth. What growth that will occur over the next decade will be from the New North American Manufacturers. The "Big Three", facing extreme pressures regarding profitability, will be further rationalizing their operations in North America.
- The Canadian industry has grown rapidly since the signing of the APTA in 1965. This growth has been due to a positive cost environment – a key element of which was provided by the Autopact. But Canada's ability to grow its assembly sector is now threatened and will likely experience a slight deterioration in its assembly sector. It is unlikely Quebec or the rest of Canada could attract a new vehicle assembly plant into their jurisdiction.
- The automotive market in Quebec is small (300,000 – 400,000 units per year) – and not large enough to support an indigenous original equipment, aftermarket or vehicle assembly industry. Economies of scale necessitate that any automotive manufacturing within the Province will have to rely on export markets if it is to

survive. Thus, it is much more likely that Quebec would be able to grow its OE parts sector where the Province has some areas of technical expertise.

- If Quebec fully participated in NAFTA and WTO the opportunities with the OE parts sector would be very similar within Canada or as a separate country.
- Quebec benefits from relatively low vehicle prices compared to the U.S. Prices are about \$3,500 lower (exchange rate adjusted). To some extent the rest of Canada subsidizes the Quebec consumer. With separation, the cost of distributing vehicles in Quebec would likely increase and Quebec would lose the subsidy it receives from the rest of Canada. Vehicle prices would be higher for all Quebecers.