GOVERNMENT, FOREIGN DIRECT INVESTMENT AND THE CANADIAN AUTOMOTIVE INDUSTRY, 1977 – 1987

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VOLUME 1

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Declaration of Author's Rights

Acknowledgements

The addition of new entrants to Canada's automotive manufacturing industry in the 1980s has had a major impact on what is arguably Canada's most important manufacturing sector. Until now, little effort has been made to fully tell their story. I believe this thesis represents a good dint at pulling it together. But to suggest that I alone am responsible for the pages that follow would represent an inflated sense of self. Instead, it is the culmination of dozens, many of which I must expressly give thanks.

I am particularly grateful for the continuing interest and support of my family. I have valued my wife's ongoing encouragement. Mary patiently allowed me explain every new wrinkle I thought I uncovered and she read and edited (with apparent interest) each chapter I wrote. Not once, did she betray a hint of boredom when I emerged from the office to proclaim I had cobbled another 500 words. My young sons, Jack and Cameron, were similarly supportive. How many pages Dad? How many times did you have to read it? Thanks guys. It's done. I'm back.

My supervisor, Dr. Charles Harvey, has been wonderful. Holding an innate ability to criticize, question, motivate and protect, Dr. Harvey kept me focused on what it was I was trying to achieve and made sure I met all my (self-imposed) deadlines. I can be stubborn and disciplined, but without Charles' carefully balanced diet, none of these pages would have been possible. Staff at the Strathclyde Business School has been equally supportive. Every question, request or assurance sought was handled in a prompt, professional and cheerful manner. Anne Scott and Val Turner stand out.

I must also acknowledge the cast from the University of Windsor's Odette School of Business, which Roger Hussey had pulled together to help secure similar degrees. They have represented a benchmark for me and a consistent reminder that I was not alone. Also from the University of Windsor, I need to recognize the continuing guidance of Dr. Peter Frise. Peter was one of the first people I consulted when I started to think about pursuing a Ph.D. Not once did Peter give me any sense of just

how much work it would be. By the time I figured it out for myself, I couldn't turn back. Thank you Peter (and others) for keeping me in the dark for so long.

Other academics from Canada from whom I have sought support and guidance include Terry Flynn who, like me, pursued a Ph.D. "mid-career" and Dimitry Anastakis. Dimitry's own Ph.D. thesis forages in similar territory. I read it early in the process and it represented a form of yardstick by which I would consistently assess my own contributions. I hope I measure up. As well, Professors Colin Mason and John Wilson offered carefully-considered and much-appreciated observations. The result is a much richer contribution.

Finally, this thesis will argue that catalyzing personalities play a critical role in investment decisions. Many of the personalities associated with the period under study were interviewed as part of the research. These are busy, busy people, invariably having more important things to do than entertain probing questions from an academic researcher. However, each were open, generous with their time and sincerely interested in shedding light on what I continue to believe was a fascinating period in the business history of Canada. You helped build something remarkable. I hope I have captured your contributions.

So, while the path to a Ph.D. is never lonely it can be quite selfish. Sometimes other priorities – other people – take a back seat. Even the front page of this thesis contains just one name: my own. Anyone involved, however, will understand that this truly is the result of many contributors and several concessions. I wish to express my sincere thanks for both.

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Tables and Figures

Abbreviations and Acronyms

AMC	American Motors Corporation
APMA	Automotive Parts Manufacturers Association (Canada)
APTC	Automotive Parts Technical Centre
Auto Pact	Canada-US Automotive Products Trade Agreement
CAR	Center for Automotive Research
CAW	Canadian Auto Workers
CLC	Canadian Labour Congress
CPI	Consumer Price Index
CUSFTA	Canada - US Free Trade Agreement
CVA	Canadian Value Added
FDI	Foreign Direct Investment
FIRA	Foreign Investment Review Agency
GFCF	Gross Fixed Capital Formation
GPM	Global Product Mandates
GATT	General Agreement on Tariffs and trade
ITC	Department of Industry, Trade and Commerce (Canada)
JAMA	Japan Automobile Manufacturers Association
MFN	Most Favoured Nation
MIT	Ministry of Industry and Tourism (Ontario)
MITI	Ministry of International Trade and Industry (Japan)
MITT	Ministry of Industry, Trade and Technology (Ontario)
MNC	Multinational Corporation
MVMA	Motor Vehicle Manufacturers Association (Canada)
NAFTA	North American Free Trade Agreement
NDP	New Democratic Party
NIC	Newly Industrialized Country
OAIS	Ontario Automotive Investment Strategy
ODC	Ontario Development Corporation
OECD	Organization for Economic Cooperation and Development
OEM	Original Equipment Manufacturer
OIC	Order in Council
PAC	Pacific Automotive Cooperation
R&D	Research and Development
SAE	Society of Automotive Engineers
TAB	Transitional Assistance Benefits Program
UAW	United Auto Workers
USITC	United States International Trade Commission
USTR	United States Trade Representative
VER	Voluntary Export Restraints
VRA	Voluntary Restraint Agreement
WTO	World Trade Organization

Abstract

This thesis contends that the Canadian automotive assembly industry was transformed by the entry of offshore-based investors in the 1980s. It makes a significant contribution to a little documented period in the business history of Canada's most important manufacturing sector. It is demonstrated that during the period under study Canada received inward foreign direct investment (FDI) in the automotive sector disproportionately large relative to the size of its market. Evidence is presented to show that had offshore-based firms not invested, the size and shape of the industry in Canada would be substantively different today. The antecedents of these events are traced, providing fresh perspective on the industry's development. For example, it is established that the industry's profile represents the culmination of decisions, events and conditions resulting from trading patterns and anxieties dating back as far as 1854. In addition, a new perspective is provided on the origins of the 1965 Canada-US Auto Pact, including the conditions leading to the appointment of Vincent Bladen to the position of Royal Commissioner in 1960 and the paradigmatic change his selection inspired. Indeed, it is argued that throughout the history of the Canadian automotive industry, only when rising import sales are accompanied by declining absolute sales on the part of North American owned companies have protectionist pressures mounted and major automotive policy levers been brought into play.

This thesis proposes that the development of public policy with respect to the Canadian automotive industry has been far less orderly than the results would suggest. It is demonstrated that the Canadian federal government played the crucial role as events unfolded, flexibly using its power to provide substantial support to foreign companies. In addition to direct financial assistance, its role included adjusting conditions surrounding Canada's Foreign Investment Review Act, the Auto Pact and duty remission. This contrasts with the situation in the US, its major rival for FDI. Hitherto, the influence of the Canadian federal government has been underestimated.

At the theoretical level, the thesis highlights the importance of processes and individual agency in attracting inward FDI. Beyond the rational choices associated with FDI decisions, it is demonstrated that catalyzing personalities in both governmental and industrial organizations played critical roles in the process of attracting large-scale FDI to Canada. Without them, the results achieved during the period under study and subsequently would be dramatically different. A model is put forward to explain the interaction of forces involved in the FDI attraction process. It suggests that a suitable investment climate – economic, political, demand and factor preconditions – must exist. It makes prominent the role of individual actors. It is argued that large scale investment decisions are not made based on numbers alone, but on perceptions and agendas extending beyond the here and now, thus calling for goal congruence between actors in a visionary long-term sense.

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Chapter One

Offshore Investments of the 1980s and Their Impact on the Canadian Automotive Manufacturing Industry Today

The Canadian automotive industry is large, diverse, robust and dynamic. It is by many standards already well on its way to realizing the vision assigned to it in 2004 by a group of leaders from the private sector, academia, labour and government known as the Canadian Automotive Partnership Council: "to be the location of choice for automotive manufacturing within North America" (Canadian Automotive Partnership Council, 2004, p 1). But the vision as stated in 2004 is really nothing new. It has been in existence for decades. According to automotive analyst Dennis DesRosiers, "from day one, all the Canadian government cared about was investment and jobs. Every step of the way in our auto policy we were willing to trade something for investment and jobs."[1] By means of wise policy and tenacious, inventive action by private and public sector actors, the industry has grown to a level that places Canada among the international leaders in terms of automotive production.

This thesis argues that much of this evident vitality is related to a new set of offshore-based manufacturers that entered Canada in the 1980s. How did Canada set the preconditions to compete so effectively for offshore investment? What role did government play to facilitate the process of encouraging inward Foreign Direct Investment (FDI) during the 1980s? Can individual personalities and the relationships they forge influence the FDI attraction process? Answering these fundamental questions is the focus of subsequent chapters. In so doing, it will be demonstrated that the role of successive governments in Canada was crucial to the success the industry has enjoyed. Indeed, it will be established that policy directions put in place starting more than one hundred years prior, and strengthened

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[1] DesRosiers, D. (2004). Interview with the author on 24 August, Toronto.

subsequently, had an influence on the investments that were made in Canada by offshore producers in the 1980s. The motivations, messages and messengers that helped shape events will be explored with reference to the policies and practices of governments and other industry stakeholders.

In Canada, it is likely that no other collection of geographically proximate economic activity has attracted as much interest as the cluster of automotive manufacturing that exists in the southern parts of the provinces of Ontario and Quebec. However, the research reported in this thesis is original and important because those studying the Canadian automotive assembly industry have largely ignored the foundations for growth laid between 1977 and 1987. One area that researchers have focused on is the Canada-US Automotive Products Trade Agreement (Auto Pact) of 1965. The Auto Pact integrated the automotive industries of the two countries and by the mid-to-late 1970s the process was largely complete. A second focus for research has been the era since the late 1980s following the signing of the Canada-US Free Trade Agreement (CUSFTA) and shortly thereafter the North American Free Trade Agreement (NAFTA). However, while the decade between 1977 and 1987 has been largely neglected, it will be shown in this thesis that it witnessed very significant changes as non-US automotive companies entered Canada. This thesis documents the significant and lasting impact those actors have had and demonstrates the pivotal role governments in Canada have had in supporting the development of the industry. Supple (1977, p 1) reminds us, "systematic historical studies of business behaviour, structures, and policies ... not only comprise a proper activity in themselves, but are also of considerable relevance to a broader understanding of economic processes." The experiences of offshore-based automotive manufacturers in Canada provide important lessons regarding the FDI attraction process. These include improved understanding about the role of incentives, the influence of personalities and relationships, and the impact of FDI on host countries and their indigenous industries.

The purpose of this chapter is to set the context for what follows. It describes the research setting and the topic of the thesis. Tangible evidence is presented to

demonstrate that the process of attracting FDI during the period 1977-87 substantially transformed the Canadian automotive industry. The precise research questions the research sets out to answer are articulated, and the structure of the thesis is explained.

1.1 The Research Setting and Topic Under Study

The setting for this thesis is the Canadian automotive industry in general and final assembly manufacturing in particular. Although the specific era under study is 1977-87, relevant context is provided by considering the antecedents of this period of development (Chapters Five and Six). Certainly, the era under review has been under-researched relative to its importance to the Canadian manufacturing sector. However, the story that unfolds has significance beyond the proper chronicling and explanation of the events at hand. The fact is that the Canadian automotive industry would be substantively different today if the inward FDI that arrived during the 1980s had not materialized. It is thus important to describe the scale, scope and nature of the industry, as it exists today (Chapters One and Four). While automotive manufacturing is the setting for the research that follows, the actual topic revolves around the processes and personalities engaged in the practice of attracting overseas-based FDI. Therefore, the specific topic of this thesis is the incentivization of FDI as considered through the case of overseas-owned automotive manufacturing in Canada.

Assembly is the final activity that occurs in the automotive manufacturing value chain. It typically takes place in large, sprawling manufacturing complexes covering between 1 million and 4 million square feet, employing several thousand people and with capacity to produce 200,000 units or more annually.[2] As the last link in the chain of automotive manufacturing, final automotive assembly signifies economic potential beyond the direct employment provided in the large final assembly complexes. These plants signal potential benefits in terms of employment and

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[2] For example, Canada's largest single facility, DaimlerChrysler's van plant in Windsor, Ontario, covers 4.1 million square feet. In 2003, its 4,837 employees produced an average of 1,325 vehicles per day on a three-shift pattern (Harbour and Associates, 2004, pp 36, 44, 50).

investment in feeder enterprises. It is estimated that final assembly operations have a job creation multiplier of 7.6 (McAlinden et al, 2003, p 14). It is for that reason that communities, states, provinces and in some cases national governments compete so vigorously for these types of investments. For example, one database of investments made by Original Equipment Manufacturers (OEMs) over the period 1993–2003 reveals that government incentive packages in the southern US averaged US$143 million or US$87,700 per direct job created, and US$84 million in the northern US or US$50,180 per direct job created (Hill and Brahmst, 2003, p 10).

1.2 Why is this Topic Interesting?

The topic this thesis explores has interest and relevance on two levels: the outcomes achieved and the processes employed. From an outcomes perspective, Canada is now home to twelve of North America's 82 full-scale assembly plants. In 2003, the country produced 2.5 million of the 16.2 million vehicles produced in North America (including Canada, the US and Mexico) giving it 15.7 per cent of North America's production while representing just 8.3 per cent of the continent's total sales (Table 1.1). The production to sales ratio that year was 1.57:1. Relative size, therefore, represents one reason why this topic is worth considering.

Table 1.1

Canada's Share of Production and Sales: 2003

	Canada	United States	Mexico	North America
Production: Total Units	2,548,193	12,075,931	1,578,772	16,202,896
Production: % of North America	15.73	74.53	9.74	-
Sales: Total Units	1,624,022	16,922,478	977,870	19,524,370
Sales: % of North America	8.32	86.67	5.01	-
Ratio: Production to Sales	1.57	0.71	1.61	0.83

Sources:

Production data from *DesRosiers Automotive Yearbook: 2004 Edition*, North American Production of Vehicles 1960-2003 – Number of Units, p 119.

Sales data from *DesRosiers Automotive Yearbook: 2004 Edition*, North American Sales of Vehicles 1960-2003 – Number of Units, p 23.

A second reason the outcomes are worthy of interest is demonstrated in Table 1.2. This table shows that in 2003, without the four new producers that entered Canada during the 1980s, the Canadian industry today would be appreciably different.

Canadian plants would have produced 1.7 million units, just 207,000 or 13.8 per cent more than in 1983 (the year 1983 was selected because prior to then, offshore-based manufacturers had announced no significant investments). This situation would have been the case despite a Canadian market in 2003 that, with sales of 1.6 million, was more than 50 per cent larger than it was twenty years prior. Further, with sales in 1983 of 1.08 million (DesRosiers, 2004, p 23), the production to sales ratio that year was 1.39:1. Had the flurry of investments that arrived during the 1980s not occurred, the Canadian production to sales ratio in 2003 would have been just 1.05:1 (1.709 million production as per Table 1.2 ÷ 1.624 million sales as per Table 1.1). However, as shown in Table 1.1, by 2003, in a much larger market of 1.62 million, the production to sales ratio had climbed to 1.57:1.

Table 1.2

Comparison of Assembly Production in Canada: 1983 to 2003

		1983 Production		2003 Production	
		Production	Share (%)	Production	Share (%)
1983 Participants	Chrysler (1983) DaimlerChrysler (2003), without Bramalea	1,502,000	100	307,202	67.8
	General Motors			940,400	
	Ford			461,429	
	Volvo			0	
	Sub-Total			1,709,031	
New Entrants in 1980s	CAMI	0	0	51,475	32.2
	Bramalea (built by AMC-Renault, now DaimlerChrysler)			140,349	
	Honda			392,230	
	Toyota			227,543	
	Sub-Total			811,597	
	TOTAL	1,502,000		2,520,628	

Sources:

1983 production for American Motors, Chrysler, General Motors, Ford and Volvo from *Report on the Canadian Automotive Industry in 1986*, p 32.
2003 production for Honda, Toyota and CAMI from JAMA Canada website. Available from: http://www.jama.ca/jamastats/annual/index.asp?t=0. (Accessed on 17 August 2004.)
2003 production for General Motors, Chrysler, Ford and Bramalea from the *Harbour Report: 2004*, pp 34, 35.

As indicated, the subject matter that this thesis explores is of interest not just because of the outcomes achieved, but also because of the processes employed. Many of the issues explored are similar to those encountered in other periods when concentrated bursts of automotive manufacturing investment occurred. Common threads are

evident, the most important of which is the strong and leading role of government. Further, when governments in Canada backed away from the deployment of incentives and other policy tools, the base, which had been built during the period under study, started to erode. Subsequently, the re-engagement of policy makers in the early years of the twenty-first century coincided with the renewal of automotive manufacturing investment in Canada. Additionally, it will be shown that the active role by the federal Government of Canada has consistently represented a unique feature of the Canadian approach to FDI vis-à-vis US competitors.

The processes employed are also of interest because of the contributions of specific personalities. It will be demonstrated that beyond the application of policy tools, messages and messengers play a much more important role in attracting FDI than is commonly assumed. Who were these players? What motivated them? How did the relationships they formed and the messages they sent impact the process? By answering these questions, this thesis makes an original contribution to the literature and provides lessons to researchers and economic development practitioners alike.

1.3 Who is Interested in the Topic?

Clearly, the stakes in the FDI game are high, the costs of entry daunting, and the research questions important. Providing answers to these questions will improve understanding of this specific case: the factors influencing the attraction of overseas FDI to the Canadian automotive manufacturing industry during the period 1977-87. However, it also provides a means for exploring broader issues with respect to the processes and influences inherent in the process of attracting FDI. As a result, the topic this thesis explores impacts on the interests and concerns of a variety of stakeholders.

In 2004, after several years of refusing to offer direct incentives, the largest province in Canada, Ontario, re-engaged in the process of enticing automotive FDI through the offer of incentive packages. This period followed the Ontario policy of detachment that came into place in 1995 with the election of a Progressive

Conservative provincial government.[3] While southern US states like Alabama, Mississippi and Texas gained new assembly plants and in some cases built brand new industries from the ground up, Ontario watched from the sidelines throughout the period 1995-2003 when the Progressive Conservative government was in place.

Ontario's strategy of disengagement and its subsequent about-turn has excited the interest of a variety of stakeholders. The direct participants from the era under study represent one constituency of interest. Patrick Lavelle was Deputy Minister of the Ontario Ministry of Industry, Trade and Technology (MITT) in the mid 1980s when many of the offshore investors established operations in Canada, and he is critical of the previous provincial government's approach: "I don't think that Ontario was in the running for any of these assembly plants. When Ontario comes to the conclusion that it doesn't need an auto industry, a parts industry, then the economy is going to really suffer."[4] Another direct participant from the era is former Canadian Federal Industry Minister Ed Lumley:

> I decided, when I became Industry Minister to form Task Forces and the first one I picked was the auto industry with a very simple criteria: What do each of us have to do to ensure the economic viability of the sector? I chose the auto industry because I thought it was the most important.[5]

A second group with an interest in the topic is labour. Canadian Autoworkers Union (CAW) president Buzz Hargrove's assessment of the policy of direct engagement with automakers is similar to that of Messrs. Lavelle and Lumley and reveals a passionate interest in the topic:

> I first have to compliment [Ontario Premier] Dalton McGuinty because it was with his election that we got rid of the naysayers that said this industry was a smokestack industry, was dying, that the government shouldn't put money in. I was never so happy in my life to see the tail end of [former Progressive

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[3] The Progressive Conservative Party was elected in June 1995. Their policy was to eschew direct incentives and instead focus on the creation of an environment that was favourable to business at large. They were defeated in a general election in September of 2003 by the Liberals led by Dalton McGuinty.

[4] Lavelle, P. (2004). Interview with the author on 2 October, Six Mile Lake, ON.

[5] Lumley, E. (2005). Interview with the author on 8 February, Toronto.

> Conservative Enterprise, Opportunity and Investment, and Finance Minister] Jim Flaherty and others who poisoned the air for this industry for far too long.[6]

He also observed: "This is a positive and welcome change from previous governments who took our sector for granted, when other jurisdictions were stepping up to attract investment and jobs that we want for Ontario. This is good news for this industry and great news for the Province of Ontario."[7]

A third group with an interest in the topic is government itself. With the election of a new provincial government in Ontario in 2003, an era of active intervention ensued, punctuated by the announcement in April 2004 of a five-year, $500 million Ontario Automotive Investment Strategy (OAIS). Premier Dalton McGuinty declared: "By investing in our workers and their skills, we can attract new investment and create high-wage jobs in the province's largest manufacturing sector. It's a real, positive change that will strengthen our economy."[8] McGuinty's Minister of Economic Development and Trade (MEDT) Joe Cordiano claimed: "Not enough can be said about the importance of the auto sector, not only to Ontario's economy but to the entire country. It's not just throwing money at the sector. We're making some strategic investments."[9] The new provincial strategy targeted projects worth more than $300 million to create or retain more than 300 jobs at large assemblers and automotive parts suppliers. Two months later, in June 2004, with a federal election looming, the federal Liberal government joined the effort, introducing its own $500 million fund. In announcing the package, federal Human Resources Minister Joe Volpe declared: "With due regard to others, the biggest driver in the manufacturing

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[6] Brennan, R. and Van Alphen, T. (2004). Ford agrees to employment guarantees; clawbacks possible on government aid feds, province to commit $200 Million. *Toronto Star*. 30 October, p D01.

[7] Available from: http://www.premier.gov.on.ca/english/news/AutoInvestment041404.asp. (Accessed on 7 March 2006.)

[8] Available from: http://www.premier.gov.on.ca/english/news/AutoInvestment041404.asp. (Accessed on 7 March 2006.)

[9] Keenan, G. (2004). Ontario pressing for auto help from Ottawa. *Globe and Mail*. 4 June, p B1.

sector today is the auto industry. It is vital to Canada's economy and the mainstay of Ontario's prosperity."[10]

Private sector actors also have an interest in the incentivization of offshore FDI. It should be noted, however, that their views on the matter span the continuum, including principled opposition, strong support and calculated ambivalence. Honda, for example, discounts the role of incentives, its executive vice president for Canada, Jim Miller explaining: "Basically, when Honda goes into a country, the decision has already been made. We don't ask the government for anything. We make our business case and we proceed on the basis that we're just doing it."[11] Conversely, this research shows that other private sector actors view incentives as decisive. For example, in Chapter Nine, it will be shown that Ford and General Motors considered them to be essential in securing investments during the period this thesis explores. For others, it would appear that, while they were prepared to accept government largesse, one might question whether incentives were crucial in the decision making process.

The research presented here also offers lessons for governments of other countries and at other levels (e.g. municipalities). Although this thesis deals explicitly with the attraction of automotive FDI into Canada, the case investigated is of relevance to others seeking to replicate the successes documented here. Certainly, it applies to their pursuit of automotive FDI, but it also has relevance for other sectors of the economy.

Finally, while the primary focus of the story told here revolves around the processes of attracting FDI, including the tools utilized and a description of the relationships forged, the literature that has been reviewed in the research carries important lessons. The catalyst for this research is the high volume and disproportionate success Canada achieved in terms of gaining inward automotive FDI during the period under study.

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[10] Thompson, R. (2004). Ottawa injects $400 million into auto sector: bid to keep jobs: incentives bring new Oakville flex plant closer to reality. *Financial Post.* 15 June, p FP3.

[11] Miller, J. (2004). Interview with the author on 28 September, Toronto.

Therefore, much of the story is premised on many of the direct participants' notion that any form of inward FDI is desirable. However, the literature reviewed in Chapter Two offers many lessons for audiences interested in the process. It will be shown that the issue of FDI and its impact on domestic stakeholders is considerably more nuanced. It should serve as a warning that the impact of inward FDI is not uniformly positive and that policy makers should be circumspect in their approach.

1.4 Key Research Questions and Overall Thesis Structure

The fundamental questions tackled in this thesis are threefold:

1. How did Canada set the preconditions to compete so effectively for offshore investment?

2. What role did governments play to facilitate the process of encouraging inward FDI during the 1980s?

3. Can individual personalities and the relationships they forge influence the FDI attraction process?

With some exceptions, the answers are not provided in concise statements or presented in clearly demarcated locations. Rather, they are infused throughout the pages that follow. The approach is to add depth to the analysis progressively as the thesis unfolds, chapter by chapter.

In broad terms, however, the issues explored in Chapters Five and Six are particularly instructive in establishing the setting for the direct period under study, thereby answering the first question above: 'how did Canada set the preconditions to compete so effectively for offshore investment?' Subsequent chapters hone in on the latter part of the 1970s through to the late 1980s and consider the specific policy measures that were enacted. However, to compete for the investments that Canada won in the 1980s, the country needed to be in a position to do so, to have the policy

tools in place, to have trading patterns that were well established, to have market access guaranteed, and to have supportive legislation already in place. Chapter Five makes the argument that the foundations for future success were laid over preceding decades. In so doing, fresh light is shed on the antecedents of the Auto Pact of 1965.

Chapter Six continues the process of identifying the factors that enabled Canada to vie for offshore investment. It documents the growth of the automotive industry in Canada in the decade and a half following the Auto Pact, and dispels misconceptions that persist regarding the health of the industry in Canada during that period. Particular emphasis is placed on the decline of the industry in North America in the late 1970s, what prompted the decline, and how that informed consumer-buying patterns. It will be argued that the decline was not as precipitous in Canada as it was in the US, but the fact it was perceived as such prompted far-reaching consequences. In fact, it will be demonstrated that the perception of decline was instrumental in laying the foundation for a series of important policy decisions – decisions with long-term ramifications.

The second key question, revolving around the role of governments in encouraging FDI during the period 1977-87, permeates this entire thesis. However, Chapters Seven, Eight and Nine focus closely on government's role in the process. Chapter Seven considers the introduction of Voluntary Export Restraints (VERs) on Japanese automotive exports. It will be shown that the Canadian system in all essentials mimicked that of the US. Until now, little has been written about the Canadian scheme, researchers apparently concluding the Canadian environment was too similar to that of the US to warrant special attention. This thesis argues, however, that such was not the case, proposing instead that the Canadian system of voluntary restraints had little direct impact on existing Canadian manufacturers. It makes a somewhat paradoxical case that, even though no correlation exists between the Canadian system of restraints and subsequent new capital spending by the existing automotive manufacturers, the system did have a profound effect on potential offshore-based investors and helped prepare the ground for their entry into Canada.

Chapter Eight further investigates the role of governments in facilitating inward FDI. It demonstrates that policy makers did not follow a systematic, disciplined program or plan. Instead, they fumbled from one objective to another and the tools they employed shifted and evolved as circumstances demanded.

Chapter Nine deepens the analysis of the policy making process, focusing on specific, tangible policy tools that helped Canada outperform its rivals as a destination for automotive FDI. In Chapter Nine it will be argued that one of the primary reasons for Canada's unusual success in attracting automotive investments was the willingness of the federal government to get involved in creating the conditions supportive of offshore-based investment. Such was not the case in the US. It will be shown that the government of Canada was well positioned to offer both cash and until now, the less well-understood and less transparent 'near cash' inducements. Tangible values are assigned to each of the mix of incentives on offer.

Finally, although it is obvious that policy formulation and execution are driven by personalities, the energy with which they pursue their goals, the commitment they attach to their role and the effort they extend to establishing and exploiting relationships can vary considerably. Exploring these aspects represents the essence of question three: 'Can individual personalities and the relationships they forge influence the FDI attraction process?' With some candour, this question was not identified at the outset, but was instead formed over the course of the research. It eventually became apparent that personalities and relationships are key explanatory variables. This question is considered most explicitly in Chapter Eight. It converges on the messages and messengers that dominated the era and argues that there were occasions when, even though actors held conflicting objectives, they were sending similar messages and expressing complementary expectations. In particular, the contributions made by former Canadian politician Ed Lumley will be explored in depth.

It is important to understand that the process of attracting FDI in Canada was not without setbacks and miscalculations. Chapter Ten provides balance by analyzing a

series of investments that did not come to fruition during the period 1977-87. Chapter Ten adds context and dispels any illusion that the process in which actors were engaged proceeded without frustration.

Various conclusions are drawn in Chapter Eleven, structured around these three key research questions. A model is presented to advance understanding of the processes and influences involved in the attraction of FDI. Lessons for the various stakeholders will also be offered.

1.5 Conclusion

The purpose of this chapter has been to define the research topic, identify who might be interested and why they should pay attention. The initial impetus for the thesis has been shared: the Canadian automotive manufacturing industry was substantively transformed by the arrival of new, overseas-based entrants during the 1980s, and that hitherto the period has received limited attention. The key research questions have been posed and an outline provided as to how the thesis has been structured to answer them.

By the 1980s, the Canadian automotive manufacturing industry's capacity to generate employment, contribute to the balance of payments, and support communities was already well established. This chapter has demonstrated that the addition of new entrants, headquartered in offshore locations, recharged the industry and provided it with an expanded base upon which to build and grow. Had the investments that were made by those companies not come on stream, the industry that exists today would be smaller, less diverse and less energized by the intensity of competition that geographic proximity and successful new entrants have provided. The remainder of this thesis will explore the conditions that enabled Canada to compete successfully for automotive FDI in the 1980s, and will consider the policy makers and policy measures that have supported such growth and development to occur.

The over-riding purpose of the chapters that follow is to answer the three related research questions enumerated. For those interested in the history of the Canadian automotive manufacturing industry, it will fill gaps in understanding. For those concerned with broader themes, it offers new perspectives on the role of governments and personalities in the attraction of FDI and the impact of aligning economic and commercial forces with political action. Such understanding is guided and informed by a range of themes and disciplines, a review of which is offered next.

Chapter Two

Economic Clusters, Foreign Direct Investment and the Canadian Automotive Industry

Over the period 1977–87, the Canadian automotive assembly industry changed in form and substance from a collection of four American-based companies controlling what was by then an integrated North American marketplace to one in which new entrants, mainly Asian-based, commanded a growing share of the market, assembling an increasing numbers of vehicles in North America. As signalled in Chapter One, Canada eventually won a disproportionate share of the investments made by these offshore-based producers. It will be argued in following chapters that government policy played a pivotal role in guiding and influencing automotive investment patterns, providing answers to the research questions outlined in Chapter One.

The purpose of this chapter is to step back and review the literature that informs the thesis. It includes a review of previous writings on the subject, covering their authors' interests, approaches, paradigms and methodologies. It requires one to move beyond the proximate – material specific to the Canadian automotive industry – and to draw upon parallel and related fields of research as well. In so doing, this chapter will first review important contributions to the field of business history. Next, research that exists around economic clusters will be considered before shifting focus in the third section to concentrate on foreign direct investment and its impact on indigenous industries. The third section also considers related research streams, including global product mandates and Canada's Foreign Investment Review Agency (FIRA). Following that, studies of the Canadian automotive industry are examined. Contributors to the research reviewed in this fourth section come from a range of disciplines, including trade theory, economics, business history, economic geography and political science. Some writers have focused specifically on Canada while others have taken wider geographical points of reference. The time period from which the material is drawn is similarly diverse.

2.1 Business History

Before a detailed review of the specific literature informing this thesis can be provided, the evolution of the field of business history must be considered. The books and articles generally thought to fall within the realm of business history do not explicitly inform the chapters that follow, but it is important to provide an overview of seminal works because they provide context, supporting the tone, structure and methodologies that follow. As Canadian business can be seen as representing a composite of its dominant US neighbour and its British origin, key contributors from the US and UK are considered before important Canadian literature is presented.

The work referenced here tends to be concerned less with the accumulation of mere facts and anecdotes and more with the identification of trends and the advancement of theories. Such an approach is entirely consistent with Harvey and Wilson's articulation of a key issue impeding the growth of the business history field within the purview of business schools: "Intensifying resistance is the perception that business historians are fact-mongers without theory, more concerned with the particular than the general and unable to dovetail with other higher-profile subjects" (Harvey and Wilson, 2007, p 3). However, in *Breakout Strategy* (2006), Finkelstein et al demonstrate that business history can indeed intersect with theoretical ideas. A similar approach is taken in this thesis.

Any catalogue of significant literature guiding business history research starts with Alfred Chandler of Harvard University. Three contributions stand out: *Strategy and Structure* (1962), *The Visible Hand* (1977), and *Scale and Scope* (1990). Each explores the evolution and influence of management structures, seeking patterns from extensive empirical research to explain the rise of large, multinational businesses. Broad macroeconomic developments are connected with the microeconomic performance and the organization of the firm. Later contributions point to technological foundations as pivotal. Chandler, however, downplays the role of government, a perspective that is refuted by the cases presented here. Like

Chandler, Mira Wilkins also explores the origins and evolution of American business organizations and similar to Chandler, her work is infused with recognition of the dominant role internationalism has played in the development of business. Also, like Chandler, Wilkins is influenced by research derived from a variety of disciplines, including sociology, history, political science and economics. However, unlike Chandler, the effect of government policy on business strategy and structure is given greater prominence. Wilkins' ideas materialize in *The Emergence of Multinational Enterprise: American Business Abroad from the Colonial Era to 1914* (1970), in *Maturing of Multinational Enterprise: American Business Abroad from 1914-1970* (1974), and in *The History of Foreign Investment in the United States, 1914-1945* (2004). An important source of secondary data for this thesis is Wilkins and Hill (1964), *American Business Abroad: Ford on Six Continents.*

The British perspective on the organization and evolution of business is instructive. Many observe that the development of business history in the UK was slower to build than it was in the US (Supple, 1977; Amatori and Jones, 2003). Until recently, when contributors like Edgerton (1997) and Jones (1997) change tack, the pervasive theme in the literature has been one of decline. Williams et al (1994) and Church (1995) narrow their focus on the deterioration of UK's automotive industry. Others have taken a broader view (Coleman and Macleod, 1986; Kirby, 1992; Wilson, 1995). In *Scale and Scope*, Chandler (1990) devotes a full section to analyzing the development, success and failure of British industry. Beyond his direct study, Chandler's influence has been widespread in British business history as well. For example, his approach is demonstrated by Hannah (1976), who traces the transition of the typical British manufacturing firm from the Victorian era, as primarily family owned and internally financed, to that of today, a professionally managed and externally financed organization. Also, like Chandler, Hannah posits that the growth of British firms was a consequence of technological progress. Channon (1973) also demonstrates a Chandler-like approach in his study of Britain's 100 largest firms between 1950 and 1970, including an assessment of competitive strategies and organizational structures employed. However, even though many British business historians' analysis build from a Chandler-like foundation and virtually all are, on

balance, admiring, many do have criticisms. Jones (1997), for example, argues that Chandler's position that British firms struggled because they avoided professional management is too narrowly focused, claiming that British firms in the interwar years were actually quite competitive vis-à-vis Europe, observing that it was not until after 1945 that the full force of the UK's decline was experienced. He notes, paradoxically, that this situation was in the same period when UK business started to move away from personal capitalism. Others are similarly cautious in transferring Chandler's views to the UK experience. These include Supple (1991) who questions Chandler's focus on manufacturers to the detriment of other more dynamic aspects of the economy, and his tendency to discount the role of external factors (e.g. legal and educational systems, cultural aspects, the role of government). Wilson (1995) also contends that Chandler's approach is flawed due to attempts to impose a theory that, while suitable to the US, strains when applied to the UK experience and does little to explain the growth experienced in Germany and Japan. Meanwhile, Lloyd-Jones and Lewis (1994) acknowledge a connection between the decline of Sheffield's steel mills and the persistence of personally managed firms. However, they suggest that a variety of exogenous factors were also at play, one of which is culture. The influence of culture is explored more fully by Lewis et al (1996), who review the role of culture on national economic performance, including the role of Protestantism in the development of capitalism in Europe and Confucianism in East Asia. Lazonick (2003) argues that social and cultural conditions are as important to the creation of industrial innovations as managerial aspects. Jones (1997) likewise considers the impact of cultural differences between countries. He acknowledges that even though British firms assimilated many of the palpable elements of the American business model, they did so within the British cultural context and therefore yielded dissimilar results.

Business history focused on the Canadian experience has been much more sporadic. Articles either for or by Canadians occasionally appear in journals like *Enterprise and Society*, *Business History Review* and *Business History*. However, they tend to be focused on specific companies or personalities and are much less inclined to uncover patterns or interpret trends. That does not mean that Canadian businesses

and their management have not inspired well-regarded literature. Examples include Harold Adams Innis' work on the fur trade in Canada (1956). Innis introduces the Staples Thesis, contending that the socio-economic fabric of economies like Canada is a function of their being built around the export of natural resources. As well, Neufeld's history of farm implements maker Massey-Ferguson (1969) draws from Chandler to explain the growth of what was at the time of publication the archetype of the large, multinational, Canadian firm. More recently, Anastakis (2005) provides an exhaustive account of the negotiations around the Canada-US Auto Pact, representing an excellent secondary source for the topic this thesis examines. A limited number of more far-reaching compilations also exist. These include Daniells' (1957) *Studies in Enterprise; A Selected Bibliography of American and Canadian Company Histories and Biographies of Businessmen*, Bliss' (1987) review of key periods in the history of Canadian business since the country's inception, and Taylor and Baskerville's (1994) contribution tracing the history of business institutions in Canada, connecting capitalism in Europe and North America, and describing the influence of public figures and policy makers. However, the vast majority of these Canadian business history contributions have sprung from history departments rather than business schools. The benefit of bringing a business-centred approach to the study of business history is offered by Bliss (1992):

> The intellectual merit of bringing the expertise of economists, scholars of management, organization behavior, industrial relations and other business-related disciplines to bear on the study of business is also self-evident. A process of cross-fertilization has been generally lacking and greatly missed in the circle of the historians and journalists, who seldom enough talk to one another let alone to real live economists.[12]

Only occasionally do the books and articles of the various contributors registered above explicitly inform the work this thesis contains. However, they do represent a point of reference and implicitly guide the thesis' overall tone and structure which, when coupled with original enquiry, advance knowledge and understanding.

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[12] The concerns expressed by Bliss may be starting to erode. Recently, business history chairs have been endowed in Canada at York University and the University of Toronto, supported by funding of $5 million. From: Globe and Mail. (2006). Forward-looking CEOs are looking to the past. *Globe and Mail*. 13 March, p B12.

2.2 Cluster Theory

Cluster theory is concerned with the geographic concentration of related economic activities such as those found in the Canadian automotive industry. Michael Porter, one of the most important proponents of cluster theory, refers to "geographic concentrations of interconnected companies, specialized suppliers, service providers, firms in related industries, and associated institutions (for example, universities, standards agencies, and trade associations) in particular fields that compete but also co-operate" (1998, p 197).

Before Porter (1990) popularized the term 'cluster', the concept was little known outside the realm of economic geography. But Porter was not the first writer to examine the phenomenon. Alfred Marshall's *Principles of Economics* originally explored the "concentration of specialized industries in particular locations" (Marshall, 1966, p 233) exactly 100 years before. Marshall offers a number of reasons to explain the localization of industries, including physical conditions, hereditary skills, growth of subsidiary trades, improved communications and inertia.[13] Marshall's brief, ten-page chapter, written in 1890, represents a launching pad for the renewal of interest that occurred a century later. It is unlikely, however, that in writing about agglomerated economic activity in 1890, Marshall considered the possibility that it would take a full century for his views on the matter to gain currency. Yet, almost anticipating the later work of Kuhn (1970), Marshall did acknowledge the propensity of academic communities to rebuff new views:

> Some of the best work of the present generation has indeed appeared at first sight to be antagonistic to that of earlier writers; but when it has had time to

[13] Philosophers of research would describe Marshall's epistemological paradigm as that of a constructivist. In fact, in the preface to his first edition, he explains: "The function of the science is to collect, arrange and analyse economic facts, and to apply the knowledge, gained by observation and experience, in determining what are likely to be the immediate and ultimate effects of various groups of causes" (1966, Preface to First Edition). This is fully in keeping with the description of socially constructed knowledge claims offered by Creswell (2002, p 8) who explains that "rather than start with a theory, inquirers generate or inductively develop a theory or pattern of meaning." Such descriptions are relevant because, as shall be seen, the work that follows through the remainder of this thesis derives from the same constructivist bearing.

> settle down into its proper place, and its rough edges have been worn away, it has been found to involve no real breach of continuity in the development of the science. (Marshall, 1966, Preface to First Edition)

Marshall and economic geographers apart, the notion of agglomerated clusters of economic activity did not gain popular currency until after Porter's *Competitive Advantage of Nations* was published in 1990. It quickly caused many governments to think again about international competitiveness. Until Porter, it could be argued that most nations based their concept of such on the factor input-based foundation offered in Ricardo's theory of comparative advantage:

> Under a system of perfectly free commerce, each country naturally devotes its capital and labour to such employments as are most beneficial to each. ... By stimulating industry, by rewarding ingenuity, and by using most efficaciously the peculiar powers bestowed by nature, it distributes labour most effectively and most economically (Ricardo, 1963, p 70).

With respect to the automotive industry in the context of an integrated North American market, it shall be seen that the development of the Canadian automotive assembly industry demonstrates elements of the thinking of both Porter and Ricardo.

Although Porter reinvigorated the cluster idea, economic geographers Martin and Sunley claim that the potential paradigm change associated with Porter should not be attributed solely to him. In fact, Martin and Sunley (2003, p 7) ask: "Why it is that Porter's notion of "clusters" has gate-crashed the economic policy arena when the work of economic geographers on industrial localization, spatial agglomeration of economic activity, and the growing salience of regions in the global economy, has been largely ignored?" Despite these concerns, Porter's work was instrumental in giving life and exposure to the cluster idea. How did that happen? How was Porter able to launch a wave of research almost single-handedly? Martin and Sunley believe that the reason Porter's business strategy-based approach gained currency, while their own discipline – foraging in a comparable area – did not was because Porter offered an "easy and business and policy friendly writing style, at once both accessible and commonsense ... self-confident, authoritative and proselytizing style" (Martin and Sunley, 2003, p 9). In fact, Porter himself has claimed that his purpose

has not been to merely develop rigorous academic theory, but to make that theory accessible and useful to practitioners, stating that it is his goal to "develop both rigorous and useful frameworks for understanding competition that effectively bridge the gap between theory and practice" (Porter, 1998, p 2 in Martin and Sunley, 2003, p 9).

There are many definitions of clusters favoured by dozens of writers. As a result, finding qualitative consistency in the definition is problematic. Further, uncovering quantitative reliability is even more challenging. By its nature, a cluster is a loose coalition of mutually supportive public and private sector activities. Therefore, obtaining agreement on a standard and measurable quantitative tool has proven elusive. For example, Birkinshaw and Hood (2000) utilize a combination of export intensity and on-the-ground experts to identify clusters in Canada, Sweden and Scotland. The UK Government's Cluster Policy Steering Group offers a formula measuring the relative concentration of employment in a given industry or sector in a region (1999). Others make use of Standard Industrial Classification (SIC) codes (Harrison et al, 1996). The problems researchers invariably encounter when seeking to apply such positivistic, quantitative definitions to such a fluid qualitative concept are numerous. Invariably, their work becomes focused on the end product of the cluster rather than the range of elements most observers recognize as inherent in cluster development and sustainability, for example, the system of networks, supporting industries and rivalries that Porter's Diamond Model (1990) seeks to explain. However, despite the diversity of positivistic definitions, any formula that has been developed to definitively judge the existence or absence of a cluster and applied to the automotive industry in Canada in general and the province of Ontario specifically, affirms that a cluster of automotive manufacturing does indeed exist in Canada and, more specifically, in Ontario. Further, these quantitative, positivistic tools often have direct application to proximate automotive manufacturing. For example, via survey and statistical representations, Harrison et al (1996) demonstrate that innovation in manufacturing establishments is not related to the density of related businesses. Talmud and Mesche (1997) utilize trade data and national account statistics to show that an industry's corporate volatility is negatively associated with

its market and political embeddedness. Birkinshaw and Hood (2000) and Andersson et al (2002) cover similar territory, employing surveys to explore issues of embeddedness, autonomy and the international orientation of subsidiaries operating in clusters. Hence, notwithstanding the fact that the foundation upon which the cluster concept is built lacks tight definitional boundaries, the tools of positivism have usefully been employed to advance the field.

Most empirical studies, however, are cross-sectional, offering a snapshot of a fixed position in time. As such, they struggle to capture the inter-dependencies that are essential to understanding clusters in general and the automotive manufacturing industry more specifically. As a result, additional epistemologies and forms of enquiry are also called for. For example, Holm (1995) employs case analysis in his study of the networks of three foreign subsidiaries of a Swedish multinational (1995). Offerings by Saxenian (1994) and Sturgeon (2003) also employ the case study to probe the origins, growth, dynamics and success of California's Silicon Valley. Wolfe and Gertler (2004) have identified 26 Canadian clusters and, in a five-year case study, assess how participants within these clusters have managed the transition to more knowledge-intensive forms of production. Such large-scale studies involving several clusters over many years invariably use multiple research methods. Wolfe and Gertler have combined statistical tools with detailed interviews. Similarly, the UK government's Clusters Policy Steering Group (United Kingdom, 2001), the National Governors' Association (2002) in the US, and Michael Porter's work for the US Council on Competitiveness (2001) are based upon longitudinal studies involving several clusters with consistent methodologies. Because they are large, well funded and sustained, they provide an improved capacity to compare the development of one cluster to another over an extended period of time.

Clearly, clusters have an appeal that transcends scholarly rigour. Seventeen years after Michael Porter took the concept of agglomerated economies introduced by Alfred Marshall 100 years before, and mixed in contributions from economic geography, cultural anthropology and economics, researchers and practitioners have continued to explore and challenge nuances of the theory. Despite the anomalies and

the incongruities that occasionally call into question the practical application of the cluster phenomenon, the concept that Michael Porter rediscovered, resurrected and reconstructed has invoked too many disciples for anything other than its proliferation to continue. The period this thesis explores actually predates the publication of Porter's *Competitive Advantage of Nations* (1990). However, whether policy makers were consciously doing so or not, it will be clear that the activities in which they were engaged were directed at the creation and expansion of a more dynamic automotive cluster in Canada.

2.3 Foreign Direct Investment and Domestic Industries

Proponents of cluster theory suggest a variety of benefits and are thus supportive of their development. One method of encouraging the concentration of related economic activity is through the kind of FDI attraction efforts that characterized the Canadian automotive industry in the 1980s. Direct investment, unlike portfolio investment, entails at least some modicum of strategic commitment because it is less easily liquidated and has the potential to have some impact on the host country in terms of cultural and political issues as well as employment, technological transfer and tax and trade policy (Rugman and Tilley, 1987; OECD, 2003). Micro level benefits of foreign multinational corporation (MNC) participation in host economies include their capacity to improve access to foreign markets through intra-firm trade as well as their proximity to parent company management systems, technology, infrastructure and R&D (Bellak, 2004). In many ways, research on inward FDI parallels that of cluster analysis with such overlapping themes as the impact on domestic firm competitiveness, productivity and technology diffusion, the accumulation of marketing knowledge, and economic growth and development. While the overwhelming perception is that FDI, particularly inward FDI, is desirable, how the benefits are conferred, which economies and what firms are best equipped to profit, and how public policy might influence the process are much more ambiguous.

The preponderance of FDI-related research argues that the reason for countries to support inward FDI, particularly in developed economies, is its capacity to increase

productivity and the overall competitiveness of domestic firms (Caves, 1974; Globerman, 1979; Harris and Robinson, 2003; Chung et al, 2003; Javorcik, 2004; Helpman et al, 2004). However, research in support of this thesis has consistently demonstrated that the primary motivation of Canadian governments' pursuit of inward automotive FDI was investment and jobs (as per the observation of Dennis DesRosiers expressed in Chapter 1). In fact, this research shows many actors were antipathetic to new entrants entering their market or jurisdiction. Regardless of the Canadian automotive industry experience and the motivations driving public and private sector actors, Blomstrom and Sjoholm (1999) summarize the benefits that are perceived to be conferred, including their capacity to strike imbalance in the market, thereby causing domestic actors to improve performance. As well, they maintain that spillover effects, such as the tendency for new entrants' technology and systems to become infused upstream, downstream and horizontally within the market, also generates positive effects. In addition to the demonstration and competition-inspiring effects, Markusen and Venables (1999) propose that another positive consequence of inward FDI is its potential to increase demand within the host country's supplier community, which increases those firms' profits and investment. This situation, in turn, contributes to lower prices in the sector, which ultimately causes lower prices for the final goods-producing firm, a development that further increases demand.

Research on the impacts of inward FDI in developing versus advanced countries shows differing results. Findlay's (1978) model anticipates less developed economies accepting and adopting technological change as a result of inward FDI at a quicker pace than more developed countries. Subsequent study, however, has not borne that out. Research on correlations between the presence of inward FDI and the productivity of domestic firms in developing economies does not support the notion that FDI assists host country industries (Haddad and Harrison, 1993; Aitken and Harrison, 1999; Konings, 2001). In fact, Grosse (1988) finds no difference in the capital / labour ratio in indigenous Venezuelan firms versus foreign MNC's operating there, thus calling into question the likelihood of inward FDI in developing countries generating spillover effects. Similar to Markusen and Venables (1999), Tomohara (2004), though, says that inward FDI does generate positive outcomes in

developing economies, but says those benefits pivot on local consumers, not technological spillover, explaining that MNCs are able to provide goods at a lower price, thereby creating new demand and an expanded market for all goods. It is for that reason, not the generation of spillover effects or the augmentation of competitive forces, that Tomohara concludes that inward FDI is preferable to the protection of local industries. Kosova (2005) also assuages concerns about inward FDI in developing or transitional markets, finding that in the Czech Republic, the entry of foreign firms initially caused an increased exit of domestic firms. However, after this initial crowding out effect, the growth rates and survival of remaining firms increased.

Research shows the impact of FDI on developed countries is generally more positive, a result that holds promise for countries like Canada. Important studies include those of Caves (1974) who shows an inverse relationship between host country profits and the existence of competition from FDI in Australia, a situation deduced to represent increased competition and improved allocative efficiency. Globerman (1979) uses Canadian data to demonstrate a positive correlation between labour productivity and inward FDI. Catherin (2000) also finds significant evidence of knowledge spillovers in developed countries. Of further significance, Catherin shows that spillovers from Japanese FDI are even greater. However, Catherin also notes that investments of a Greenfield variety, the type that characterized the Canadian automotive manufacturing sector in the 1980s, generate significantly less impact, a phenomenon also noted by Co (2000) in her study of US R&D activities by foreign-based firms. Further, like Kosova's analysis of the Czech Republic, a transitional economy, De Backer and Sleuwaegen's (2003) longitudinal study finds that inward FDI in Belgium was accompanied by an initial crowding out of host country actors, but its impact was mitigated over the longer term via networking, demonstration and other cluster-enhancing activities. Fotopoulos and Louri (2004), however, warn that the positive effects of technology spillover or networking do not always offset negative influences.

Discrepancies between the impacts of FDI in developed versus developing nations appear to hinge on the capacity of host nations and their organizations to gain spillover effects. Xu (2000) and Liu et al (2000) observe that developing and transitional economies, with their lower levels of education, are less equipped to assimilate new technologies and techniques. Both are consistent with the following: Lapan and Bardwell (1973) who argue that a negative relationship exists between knowledge spillovers and technology gaps between the investing country and the inward host, Cantwell (1989) who shows that spillovers are most likely to occur when technology gaps between investing and host countries are small, and Wang and Blomstrom (1992) who emphasize the need for domestic firms to invest in learning activities if they are to benefit from FDI and eventually close gaps between themselves and investing MNCs. All suggest domestic firms require minimum levels of absorptive capacity before the benefits from inward FDI may accrue. Again, although it was never apparent that Canadian policy makers were motivated by the potential for inward FDI to bring about knowledge spillover, Canada, as one of the world's most educated workforces, would be well-positioned to gain advantage from inward FDI.

Other research specific to the US would appear to suggest that inward FDI there may produce outcomes contrary to those experienced by other developed nations. Chung's (2001) study of inward FDI in US manufacturing from 1987-91 asserts that when FDI occurs, less competitive host country industries' productivity increases while more competitive industries' productivity stagnates. If less productive, less competitive industries in developed countries are comparable to the industries of lesser-developed countries considered in the research of Haddad and Harrison (1993) Aitken and Harrison (1999) and Konings (2001), one might expect Chung (2001) to affirm that less competitive industries in the US would experience less of a productivity boost after inward FDI than would more competitive actors. It is possible that some minimum level of capability or absorptive capacity is necessary to derive benefit, but that after a certain point benefits are no longer evident, a phenomena discussed by Girma (2005). This is explained by Chung (2001). He references Florida (1997) who explains that spillover is not a one-way phenomenon,

suggesting that foreign MNCs establish operations in the US to access the technology and skills the world's most research-intensive economy provides. This suggests a preponderance of less productive foreign-based MNCs investing in the US for the purpose of gaining proximity to more sophisticated US expertise. The propensity for foreign firms in the US to spend more on R&D than domestic firms is also found by Kim and Lyn (1990). Co (2000) builds upon the premise that foreign firms invest in the US to access advanced technology and processes and further suggests that less advanced foreign firms investing in the US are obliged to augment R&D spending to adopt and/or adapt their existing or acquired technology to US conditions. Such explanations suggest that the motivations of investors are fundamental. It also implies that the nature of inward FDI in the US is different from other developed nations. As per Hejazi and Pauly (2003) and Frost and Zhou (2000), understanding investor motivations is fundamental to predicting the impact of FDI. The need for public policy makers to correctly interpret those motivations is essential. Co's (2000) and Chung's (2001) findings affirm that US industries respond differently to FDI than do other nations, including Canada which, it has been shown, receives a productivity boost from FDI (Caves, 1974; Globerman, 1979). More broadly speaking, those who view the Canadian economy as an extension of the US, one that responds to stimuli in manners that replicates that of its continental partner, do so at risk of oversimplification.

When inward FDI occurs, where are the benefits most likely to be received? What is the process? The implications for policy makers are significant and the literature, even regarding FDI within and between developed countries, is less than conclusive. Caves (1996), for example, calls attention to the fact that productivity improvements related to FDI are a result of both technology transfer and the heightened competition the new entrants represent. However, he says separating the two phenomena of increased competition and technology transfer is difficult. Similarly, Hejazi and Safarian (1999) remind us that because international trade and FDI are highly correlated, and because, in developing countries, FDI and productivity are also highly correlated, a tendency may exist to explain productivity improvements by trade increases, not FDI. Balasubramanyam (1994), Liu et al (2000), and the United

Nations Conference on Trade and Development (UNCTAD) (2001) all find that backward linkages, where foreign investors develop relationships with local suppliers, are the most effective means to engender spillover effects, a situation having application for the Canadian automotive industry whereby offshore automotive OEM investors may share technologies with Canadian vendors. Chung (2001) explains that technology transfer can occur in any number of ways, including reverse engineering as well as purposeful transfer of knowledge to affiliated firms and suppliers.

By corollary, if inward FDI in developed economies enhances economic growth, does outward FDI represent an export of production and hence harm to the outward investing nation's economy? Stevens and Lipsey (1992) say it does and find an inverse relationship between outward FDI and domestic Gross Fixed Capital Formation (GFCF), a position affirmed by Feldstein (1995). These studies refute earlier findings by Noorzoy (1980) who argues that a positive relationship exists between domestic investment and outward FDI, and Porter (1990) who posits that even after companies develop international operations, those firms continue to prefer to deal with the suppliers they originally dealt with in their home base. Porter's premise is affirmed in the supplier relationships propagated by Japanese OEM investment in Canada, which, as predicted, sees Japanese investors replicating relationships originally forged in their home base (although Japanese-based suppliers have subsequently established operations in North America, including Canada). These studies have important implications for Canada. Rugman and Tilley (1987), for example, discuss Canada's transition from a net importer of FDI to net exporter commencing in 1975, a trend that persisted even with the prevalence of inward automotive FDI in the 1980s. As well, Burgess (2000) argues that Canada's rate of inward FDI lags behind that of many developed nations, even in the aftermath of Canada-US and North American free trade regimes. He claims that that situation, in combination with the high outward rate of FDI, makes Canada much less a captive of international investor impulses (as many Canadians believe) and much more a source

of global economic influence.[14] Hejazi and Pauly (2003) more fully explore Canada's transition from net importer to net exporter and offer new perspectives on how conflicting results on the impact of outward FDI might arise. They say that, depending upon the motivations driving outward FDI, such investment may have a positive, negative or neutral impact on domestic GFCF. Their work is consistent with Ray (1977) who suggests that outward FDI is often triggered by an ambition to gain market access in the foreign market where the investment is directed, which Noorzoy (1980) and Hejazi and Pauly (2003) affirm may be complementary to domestic investment. Similarly, outward FDI aimed at gaining access to resources might also engender domestic investment in processing capabilities. However, if the motivation or rationale for outward FDI is lower labour costs, then its impact on domestic GFCF may be adverse. As Hejazi and Pauly's research utilizes Canadian data, it has direct application for Canadian policy makers. However, because some of the underlying motivations they consider resonate with the concerns expressed by Japanese MNCs and the Japanese government during the 1980s as debate churned regarding automotive investment, the research is relevant to the issues explored in this thesis. Each of Ray, Noorzoy and Hejazi and Pauly claim that when the investment is motivated by issues of market access, which was in fact a primary motivation or threat during the 1980s, then outward FDI has a positive impact on the investing nation's economy. However, it can be assumed that, because Japanese automotive companies operating in the 1980s were motivated not by *gaining* access, but rather, *maintaining* it, it is more likely that that the opposite could be said, hence explaining the concerns and reluctance many Japanese automotive OEMs initially had about investing in North America.

This review now returns to the principal motivation of Canadian policy makers insofar as inward FDI was concerned in the 1980s, its perceived potential to create employment in Canada, a motivation also shared by UK-based actors during the same timeframe (Morgan et al, 2000). At the macro level, GDP growth and hence

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[14] Meanwhile, during the same timeframe in which Canada transitioned to a country generating a net outflow of FDI, the US shifted to one that generated a net inflow. For example, Kim and Lyn (1990) show that between 1975 and 1986, FDI inflows into the US increased by 7.5 times. US global economic influence did not wane during that period.

employment growth, is strongly correlated with export growth (Edwards, 1993; Bernard and Jensen, 1999; Hejazi and Safarian, 1999) and studies have long demonstrated that foreign-owned firms have a greater propensity to export (European Round Table, 1994; Anderson and Fredriksson, 1996; Kneller and Pisu, 2004). Conversely, detractors of inward FDI point to its potential to displace existing industries and the employment such operations provide (Walker, 1999). Such concerns are most prevalent at the micro or firm level. However Wagner (2002) and Girma et al (2004) demonstrate a positive correlation between employment and trade at that level as well. Further, despite the potential that foreign investment may replace local investment and hence jobs, Grosse (1988) also concludes that FDI has a positive impact on host country employment.

Alter (1994) allows that a range of opinions exists regarding outward FDI and its impact on employment in the originating nation. As other aspects of research on FDI have revealed, it is not possible to make broad, universal statements regarding benefits and costs. Certainly, outward FDI has the potential to improve domestic companies' competitiveness by exploiting factor advantages outside the domestic market and potentially supporting the investing nation's employment levels. Blomstrom et al (1988) verify that the effect of foreign production is increased exports and a positive net effect on home country employment, a tendency that is affirmed by Knoedler (2000) in his study of outward FDI on West Germany. Alternatively, outward FDI may also represent the export of jobs beyond the investing country's border. Swaim and Torres (2005) say that when outward FDI has a negative impact on the originating country, manufacturing jobs of a low skilled variety such as those in automobile manufacturing are primary targets. Meanwhile, Glickman and Woodward (1989) argue outward FDI was responsible for a loss of jobs in the US between 1977 and 1986, a position that would seem to be complementary to Zhao (1998) who finds that outward FDI depresses wages in both unionized and non-unionized industries. Clearly, universal statements are not possible. Instead, a more nuanced view is necessary. In that regard, it is possible that Blomstrom and Kokko's (2000) characterization of outward FDI and its role as either complementary to or supplementary to home country activities is the most

appropriate means by which to judge and predict its impact. This approach causes one to reject broad generalizations and instead, consider individual country, sector and firm-level attributes.

The question emerges, then, what are the implications for policy makers? Many observers infer that FDI is always beneficial, an assumption, it has been demonstrated, that may not always be correct, but one that has resulted in a steady escalation of direct and indirect supports to foreign firms prepared to invest (Tewder-Jones and Phelps, 2000). The reality is that FDI and globalization can impact countries in very uneven ways. Despite the importance of FDI to the world economy, formal agreements or protocols dealing with FDI are much less prevalent than those on international trade (OECD, 2003). Nov (2006) warns that the provision of incentives to generate inward FDI distorts the efficient allocation of resources and argues that a global regime to constrain such inducements is necessary. In fact, Yu and Ito's (1990) study of the US tyre industry, an oligopoly having many parallels with the Japanese automotive manufacturing industry, reveals that firms match the leader's investments in foreign jurisdictions, thus calling into question the value of national governments engaging in programs to incentivize foreign FDI following the leader's initial foray (unless, of course, the incentives are further targeted to direct investment to specific geographic regions within the jurisdiction). Meanwhile, both Harris and Robinson (2003) and Javorcik (2004) explain that because foreign owned plants are more productive than domestic, support from government for FDI is thus warranted. Further, UNCTAD (2001) and Elmawazini et al (2005) encourage governments to facilitate and provide incentives for the promotion of FDI-domestic company relationships. De Backer and Sleuwaegen (2003) affirm that the development of linkages between domestic and foreign firms is a positive outcome of inward FDI, but that it is not a natural process. They, too, recommend the introduction of programs to facilitate such linkages. Andersson et al (2002), however, warn that such benefits do not necessarily extend to the investor. They say that business embeddedness – the degree of contact that exists between the customer (the MNC subsidiary) and suppliers – and the market performance of the subsidiary are not related. Chung (2001), too, warns that the effect of FDI is not universally

positive for host markets and cautions policy makers to incentivize FDI to targeted sectors only. He counsels that foreign investors who are less productive than host country actors should not be incentivized, a situation that, in light of research on North American automotive productivity levels during the period under study (Perry, 1982, Abernathy et al, 1980 and MacDonald, 1980) would appear to support the actions of Canadian governments during the time period this thesis explores. Chung (2001) also cautions that foreign subsidiaries engaged only in research should be encouraged to take steps to broaden the scope of their activities. This recommendation would seem to be contradictory to current Canadian government policy which, given supports provided to automotive and other actors, appears to assign greater value to foreign investment in research than any other endeavour. Like Chung (2000), Liu et al (2000) also advocates a more targeted approach and advises that FDI from developed countries to developed countries (e.g. France to Canada or Japan to Canada as was the case in the automotive industry in the 1980s) should occur alongside measures to increase local firms' spending on knowledge accumulation, as doing so will facilitate the diffusion of technology and knowledge. Further, Porcano (1993) suggests firms from different countries are influenced by their culture, that this fact can affect their FDI location decisions, and that countries seeking inward FDI should be aware of such subtleties.

Even though higher levels of protectionism exist in industries that are politically organized (Lavergne, 1983 and Grossman and Helpman, 1995) most research recognizes the doubtful efficacy of restricting FDI. Blomstrom and Kokko (2000), Coe and Yeung (2001) and Swaim and Torres (2005) warn that restricting the location decisions of firms is not tenable and that multinationals would be unable to sustain market shares and employment over the long term if they were not allowed to produce abroad. Burgess (2000) also argues that Canada, as a 'core' economy, one capable of exerting independence and influence in global economic circles, should eschew nationalist tendencies.

The literature reviewed regarding the impact of FDI and the propagation of benefits has thus far revolved around impacts that can be described as oblique, certainly not

mandated, directed or requested. However, during the period under study, Canadian policy makers did delve into a scheme known as Global Product Mandates (GPM) whereby subsidiaries of MNCs would gain comprehensive, worldwide authority for the development and delivery of a specific product or service offered by that MNC. In that regard, early contributions were made by The Science Council (1980), Rugman and Bennett (1982) and Poynter and Rugman (1982). These were generally optimistic about the potential applicability of GPMs to Canada. Indeed, many of the writers had a Canadian connection. Later contributions, however, were less positive or less ambitious. Birkinshaw (1996) describes the impact of reduced tariffs on the scope of subsidiaries; a development that one might assume would weaken the potential for Canadian automotive firms to gain expanded roles. Meanwhile, Crookell (1984, 1990), Kobrin (1991) and Morrison and Roth (1992) focused on global subsidiary rationalization to help subsidiaries obtain responsibility for specific activities in the value chain. Additionally, research regarding networks and the roles of subsidiaries in decision-making, such as that presented by Hedlund (1986) and Malnight (1996) is also supportive of the notion that subsidiaries may play expanded roles in program development and delivery. In many ways, such notions are incompatible with the cluster-based writings described earlier in this chapter, which stress the importance of head office locations and consign subsidiaries to roles of lesser consequence. Frost et al (2002), however, consider the impact of the strength and dynamism of the local 'diamond' (Porter, 1990) in subsidiaries' roles as centres of excellence within the MNC structure. Sadik and Bolbol's (2001) contribution complements that of researchers of GPMs. They suggest that governments should support companies participating in export markets because such participation encourages innovation.

A second more specific policy measure related to inward FDI that is explored in the literature – and one that manifested itself in actual legislation – was the establishment and outcomes of Canada's Foreign Investment Review Agency (FIRA). Two researchers who have written enthusiastically about the concept of global product mandates also contributed to the debate about FIRA. The legislation establishing FIRA was passed in 1974, its purpose being to review and approve or reject any FDI

that did not satisfy the requirement of providing a "net benefit to Canada." FIRA's passage also closely coincides with the period this thesis explores and matches the phase in which Canada was transitioning from a net importing nation of FDI to net exporter. Alan Rugman (1983 and 1990) and Harold Crookell (1983) are sharply critical of FIRA. Later, they were supported by Globerman and Shapiro (1999). It can readily be understood that opposition to FIRA would come from writers engaged in cluster research, a stream that applauds the stimulative effect that close and vigorous competition has on organizational competitiveness. It will be demonstrated, however, that from the perspective of Canadian automotive investment attraction, this research more closely aligns with the work of Deigan (1991) who recognizes that, in order to conduct business in Canada, firms were prepared to adjust and expand their investment plans to satisfy FIRA's 'net benefit to Canada' requirement.

The literature on FDI has revealed inconsistencies across and within developing and developed nations and explanations for some of the contradictions are offered here. According to Supple (1989, p 3), "In the real world, which history attempts to describe, simple categorisations rarely exist; everything does seem connected with everything else; dense variety seems universal." The most prevalent basis for the support and incentivization of inward FDI has been the stimulative effect that inward FDI may provide host economies and industries. These include the potential for both horizontal and vertical spillover effects, heightened competition and improved allocative efficiency. To gain such benefits, however, it has been shown that host countries and their industries must hold sufficient absorptive capacity, a requirement that Canada would appear to possess, both currently and during the period this thesis explores. Although Canadian policy makers during the period this thesis considers did not appear to be motivated by the less direct benefits many writers have ascribed to FDI, they were clearly very concerned about the potential negative outcomes inward FDI might represent. Although writers have been almost universal in their criticism of Canada's policy in that regard, this thesis will demonstrate that insofar as the Canadian automotive industry is concerned, measures to influence inward FDI in Canada yielded significant benefits.

2.4 The Canadian Automotive Industry

As stated in Chapter One, in Canada, it is likely that no other collection of geographically proximate economic activity has generated as much investigation as the cluster of automotive manufacturing that exists in the southern parts of the provinces of Ontario and Quebec. There are, however, segments of the industry and periods within its development that have escaped rigorous scrutiny. The period this thesis explores, 1977-87, is one. Any detailed study of the era, however, will be informed and guided by research conducted by others covering different eras. A review of that work can take the researcher in several directions, including economic development, competitiveness, trade and globalization. The authorial mix includes economists, political scientists, business strategists, historians, engineers, lawyers and sociologists. The epistemologies with which they approach the subject are equally diverse.

To gain a proper appreciation of the Canadian automotive industry, one must return to the roots of Canadian automotive policy. That necessitates a review of the Canada – US Automotive Products Trade Agreement of 1965 (known in Canada as the Auto Pact), including the events leading up to its signing in January 1965. In fact, the process leading to the Auto Pact was launched five years earlier when the Government of Canada commissioned Dean Vincent Bladen of the University of Toronto to oversee a Royal Commission on the Canadian auto industry (Canada, 1961). Bladen's report is written in the detached, dispassionate style that typifies academic writing. His mandate compelled him to accept briefs and presentations from the various interested parties and perhaps, by the nature of his mandate, his report is largely constructivist in nature. However, when one reviews his larger body of work – the books and articles where the initiative was his – one would also conclude that the true Bladen paradigm was one of social construction (1941, 1942, 1974).

Government archives are full of the briefing notes, cabinet submissions, statistical notes, cases and trends that informed and shaped public policy. As shall be seen,

those documents have been essential to the preparation of the contribution this writer seeks to make. They provide insights into the true motivations and interactions of the actors. However, rather than commenting on these documents, observations in this chapter will be restricted to the major government commissioned reports. The collection of work, research and writing associated with the auto industry, particularly research commissioned or generated by government, tilts toward critical theory. Government is not merely interested in understanding what is going on in certain areas. The expectation is that they engage, contribute and attempt to improve. The major offerings from the period include those prepared by Reisman (Canada, 1978), White (1980), MacDonald (1980), and Lavelle and White (1983). Unlike Bladen, these writers were not steeped in academic discourse. Their methodologies are tangled, not just from one document to another, but often within each document, mixing qualitative and quantitative, surveys and interviews. Each advocates, to varying degrees, a particular point of view.

Contributions from one writer infuse most others. Paul Wonnacott's first contribution regarding the Canadian automotive industry appeared about the same time as the Auto Pact was being enacted. His 1965 paper focused on the analysis of a scheme initiated by the Canadian government in 1963 that was intended to increase employment in the Canadian automotive sector and reduce the balance of payments deficit. In fact, Wonnacott claimed, the automotive policy arena had become so complex as to be problematic in itself. Wonnacott was not alone in reviewing the so-called 'Drury Plan' named after the federal Industry Minister, E.C. Drury, whose department conceived and shepherded it through the public policy process. Johnson (1964) had also reviewed the plan and he too was critical. Years later, Anastakis (2001) also examined the process by which the plan was devised and the pressures that were brought to bear upon its implementation.

Wonnacott's contributions appear over an extended period of time. A review of his contributions over three decades reveals a subtle adaptation in approach. His 1965 article employs tools associated with positivism. Another contribution from the same time period, co-authored with his brother Ronald (Wonnacott and Wonnacott, 1967),

adopts a similar approach to foretell the implications of the Auto Pact. However, twenty years later he appears to be less intent on building and testing hypotheses and more inclined to establish broader frameworks. By the late 1980s he is calling for the elimination of Canada's duty remission program (Wonnacott, 1987; Wonnacott, 1988) after examining not just the empirical results, but by assessing political, commercial and economic trends as well. These articles are written in the constructivist vein, described by Creswell (2002, p 8) as seeking "the complexity of views rather than narrowing meaning into a few categories or ideas." In a 1996 article, he advocates a stepped approach to free trade within the Americas (Wonnacott, 1996). Here again, he is looking to a range of disciplines and an array of geographically diverse cases to build his position. Raw data is critical to Wonnacott's research early in his career. By the mid to late career stages, such data tends to be secondary to the theories.

In the years following the Auto Pact's coming into force, much work was done by economists to assess its impact. These include Beigie (1970), Flynn (1979), Wilton (1976), Emerson (1975) [15] and Fuss and Waverman (1985, 1986a, 1986b). All explore specific outcomes like efficiency gains, trade balances, employment gains, wage differentials and the impact on gross domestic product. Most are written relatively early in the careers of the individuals in question and all are positivistic in nature. However, while Fuss and Waverman (1986b) built detailed models to reach the conclusion that the Auto Pact had only limited impact on the growth of the industry in Canada, Emerson, from the same positivistic foundation, built a model that concluded the Auto Pact's impact was extensive.

At the other extreme of those writing about the Auto Pact are Anastakis (2001) and Keeley (1983). Their paradigm is clearly that of the social constructivist. By combining a range of tools including interviews, historical trends, and archival documents, both Anastakis and Keeley investigate the role that government played in the implementation and evolution of the Auto Pact. In fact, it is in the accounts of

[15] Nearing thirty years after its creation, Emerson's obscure offering gained a modest level of renewed interested when he was appointed Canada's Minister of Industry in July 2004, including responsibility for overseeing public policy regarding the auto industry.

Keeley and Anastakis that one may obtain a sense of how important the Auto Pact eventually became in terms of national pride, a strange phenomenon indeed for what is essentially an elaborate duty remission scheme. They use a range of methods to build their theories and construct their version of events. Both can be described as a bricoleur: "learning how to borrow from many different disciplines" (Denzin and Lincoln, 2003, p 4). As shall be seen, it is in this tradition that this thesis may be located.

A review of the literature reveals that it is Canadian researchers and therefore the Canadian experience and perspective that dominate assessments of the Auto Pact. This preoccupation is quite likely the result of the enormous impact the auto industry has had on the Canadian economy, and a perception among Canadians that they gained disproportionately from the agreement vis-à-vis the US. By contrast, the American perspective regarding the Auto Pact comes primarily from government sources, including the legislatively mandated annual reports (US Congress 1968, 1972, 1974 and 1979) and the US International Trade Commission (1976) as well as from contributors with connections to The Lyndon B. Johnson School of Public Affairs at the University of Texas, whose figurehead was the US signatory. The University of Texas-affiliated contributions include Anderson (1983) and a second project overseen by Anderson attributed to the Lyndon B. Johnson School of Public Affairs (1985).

While the Auto Pact is considered the turning point in the evolution of the automotive industry in Canada, and hence is the focus of much of the work that has been undertaken, it is by no means the only object of enquiry. Starting in 1987, researchers renewed their interest in the Canadian auto industry. As it was a quarter century earlier, trade policy was to the fore during the negotiations in 1987 of the Canada – US Free Trade Agreement (CUSFTA) and the North American Free Trade Agreement (NAFTA) of 1992. The renewal of interest in the industry in Canada in the latter part of the 1980s saw the emergence of a new generation of writers such as Maryse Roberts, Maureen Irish, John Holmes, Pradeep Kumar and Maureen Molot. They approached the field from a range of epistemologies, a mix of disciplines and

employed a diversity of methodologies. Roberts (2000), for example, employs case studies to assess the influence of four industries, including auto, on the development of the NAFTA. Roberts' interest is in dissecting the NAFTA negotiations; however, she also provides a review of how the auto industry in Canada evolved over time. Therefore, it is complementary to Anastakis' multi-method approach. Meanwhile, from a social constructivist base, Kumar and Holmes (1998) describe how the NAFTA could be expected to impact the Canadian industry. Years later, Maureen Irish's compilation (Irish, 2004) brings together a varied collection of contributors – some academic, most not – to document the Auto Pact and how the World Trade Organization (WTO) ruling striking the Auto Pact down would impact various communities. Most contributions are quite personal and engaged with the material. Many are ethnographic in nature and, even though the writers may not strictly adhere to rigorous ethnographic conventions, they add texture to the discussion. According to Atkinson et al (2001, pp 6, 7), "While theoretical fashions can come and go, the products of ethnographic research remain extraordinarily durable … It captures the essential tension at the heart of the ethnographic enterprise: the local has general significance, and the temporally specific has lasting value."

Hufbauer and Schott (1992) also profile the automotive industry in their examination of the implications of a broader North American free trade framework, as does Michael Hart (1998). Hart's work captures Canada's role in the development of the General Agreement on Tariffs and Trade (GATT) and the WTO, and reviews the role bilateral agreements such as the Auto Pact and the CUSFTA played in Canada's steps to a nation of free and open traders.

Many of the major events and policy tools explored in this thesis have had little if any previous investigation. For example, examinations of Voluntary Export Restraints (VERs) in the Canadian context are non-existent. Contributions by Fujii (1984), Cohen (1997), Dryden (1995) and Crandall (1987) are focused exclusively on the American experience. Certainly there were similarities, but it will be demonstrated that many distinctions exist that speak to the unique circumstances of Canada. Greater understanding of the Canadian situation can also be gathered by

considering parallels with European experiences. In that regard, Williams et al (1994) and Shimokawa (1994) consider the range of issues confronting the global auto industry, including an overview of protectionist proclivities in Europe. Hogg (1982), Gabel and Hall (1985) and Monica (1991) focus more specifically on such inclinations and the effect on European manufacturers in the 1980s.

To comprehend the rationale behind some of the flashpoints – measures such as VERs, port blockages, local content thresholds and other protectionist instruments – one must consider the relative competitiveness of the industry and the perceptions of such during the timeframe in question. A contribution by Abernathy et al (1981) raised the issue of competitiveness and productivity in early 1981 when a $1,500 cost advantage was estimated for Japanese manufacturers in the production of small cars. Subsequent research, particularly that of Fuss and Waverman (1986a), discounted the study by Abernathy et al. However, the Abernathy et al findings were influential because they were released in February 1981 at the height of the US – Japan discussions which eventually led to Voluntary Restraint Agreements (VRAs) in the US, and which formed the basis for a similar tool known as Voluntary Export Restraints (VERs) in Canada in the same year. Ross Perry (1982) adapted the Abernathy et al framework to produce an estimate of Canada's cost disadvantage. The Perry book offers a useful point of discussion. It received considerable attention at the time of its release because it contended that it was inevitable the automotive assembly industry in Canada would disappear, arguing that, while productivity in Japan had risen during the 1970s, it had deteriorated in Canada. It gained notice and traction, both publicly from newspaper editorialists[16] and columnists,[17] as well as within government[18] because, not only did its release coincide with a severe downturn in the industry, its conclusions appeared to be based on reasoned, quantifiable methodology. Of course, in light of the successes and growth the

[16] Globe and Mail. (1982). Conscious of quality. *Globe and Mail.* 3 November, p A6.

[17] Anderson, R. (1982). It is Better to fight than to give in easily. *Globe and Mail.* 28 October, p B2.

[18] Archives of Ontario. RG 9-2, Accession 22206, Box 2DM, File "Automotive Industry General" M.J. Dube "The Future of Canada's Auto Industry".

industry subsequently experienced in Canada, it is hard to imagine how Mr. Perry could have been more wrong.

Several others sought to quantify the competitiveness of the industry in North America and other European jurisdictions versus that of Japan. In the early 1990s, Williams et al (1994) studied the issue through the lens of value added analysis. De Jong (1996) also conducted value added analysis combed from Statistics Canada data in his review of Canadian industry, including the automotive industry. Research specific to Canada includes that of MacDonald (1980) who considers value added analysis as well as vehicles produced per man-year of employment. Although MacDonald acknowledges his calculations are somewhat crude, his basic premise, that Japanese producers were considerably more productive than their North America competitors, is difficult to dispute. Although the MacDonald offering was timely, its primary audience was government and unlike the Perry research from 1982, no external, non-government audience saw or recognized the urgency of its message. A few years later, Womack et al (1990) conducted similar research. Their focus in *The Machine that Changed the World* was Toyota and the lean manufacturing system the company had pioneered to reduce production hours per vehicle.

Fuss and Waverman's contributions from the mid 1980s are clearly different and provide important lessons. In contrast to the majority of studies, Fuss and Waverman find that the productivity gap between the major auto producing nations was significantly less than earlier research had concluded. However, by the time the Fuss and Waverman studies were published, the Abernathy et al study of 1981 had already informed and influenced the debate. On another level, Fuss and Waverman's contributions assume a foundation of knowledge in economics and statistical analysis that renders the research inaccessible – indeed incomprehensible – to all but a very small percentage of readers. Policy makers would not, indeed could not, take heed. Therefore, in giving consideration to the work of Abernathy, Perry and others rather than that of Fuss and Waverman, two lessons emerge. First, timing truly is everything. Second, if, as a researcher, an individual does have an important message, offering that message in complex or opaque language poses the significant

risk that his or her message will be ignored. Van Maanen (1995, p 135) reminds us that communication "implies that we are also and necessarily concerned with persuading our readers – the more the better – that not only do we have something to say but that what we have to say is correct, important and well worth heeding."

Contributions from writers exploring the history of the automotive industry from a non-Canadian perspective are also relevant to this thesis and include Dassbach (1989), Wilkins and Hill (1964) and Reingold (1999). Of more direct importance, however, is research conducted on aspects of the Canadian industry. In this regard, Dykes (1970) provides valuable perspective, as does Anastakis (2001). Additionally, a Ford of Canada publication commissioned to coincide with its one-hundredth anniversary (Ford Motor Company of Canada Limited, 2004) is very informative.

But to create new knowledge and answer the core questions posed in this thesis, it must be recognized that the most important sources of data are not secondary but primary, to be found in corporate and public archives and statistical databases. Relevant sources include company annual reports and accounts for the period under study and for preceding periods. Ford of Canada, for example, maintains copies from its earliest years. Similarly, because the automotive industry has been such an important part of the fabric of the Canadian economy for so long, statistical data has been maintained for a considerable period. Important sources include the following: trade associations in Canada, the US and Japan; government departments in Canada and the US; private sector organizations like Harbour and Associates, DesRosiers Automotive and Ward's Automotive; and non-governmental organizations like the Center for Automotive Research (CAR). Even richer data can be found in government archives. How that data is accessed and triangulated with other primary and secondary sources is considered in Chapter Three.

2.5 Conclusion

This chapter has offered a discussion of the writing and literature that informs the research this thesis contains. It has been demonstrated that researchers working in the areas that inform and guide this research approach their subjects from a variety of disciplines and a range of epistemological foundations. This thesis represents an original essay in business history, and because the Canadian business environment evolved from the blending of British traditions and proximity to its US neighbour, important contributions from both countries are considered. Additionally, because the thesis and the questions it seeks to answer are set against the backdrop of an agglomerated collection of economic activity, previous research conducted around the notion of economic clusters and its antecedents is pivotal. It has been shown that a review of the contributions of Michael Porter and his contemporaries is essential, but that the earlier, related work of others from a range of disciplines also informs the discussion. There can be no denying that such contributions add context to the themes and ideas presented here. In a related vein, this study is also guided by the rich and sometimes contradictory research that exists around FDI and its impact on host countries and indigenous industries. It has been shown within this chapter that this field has many nuances and that one should be wary of broad generalizations about the impact of FDI. Finally, previous research dealing directly with the automotive industry has also been considered. As a key engine of the Canadian economy, the automotive industry has already been the subject of much enquiry. Although, this thesis considers an under-explored era, previous research on the industry has guided and supported the original contributions offered in the chapters that follow. The sources accessed and methodology employed to develop these contributions are described in Chapter Three.

Chapter Three

Sources and Methodology

In the previous chapter the epistemological constructs of many of the authors whose works inform this thesis were offered. The purpose in doing was to provide the reader with increased understanding of how their research was developed and interpreted. This chapter builds upon that by articulating the approach to research taken in this thesis, including an assessment of the epistemological paradigm and methodologies that characterize the study. It will be demonstrated that even though some aspects of the thesis demonstrate elements of positivism, the author's overall approach leans towards social constructivism. Similarly, it will be shown that the research employs multiple methods, considers the perspectives of a range of stakeholders, and draws upon a diversity of primary and secondary sources of data.

The research is rooted in business history. By gathering and constructing data from a variety of primary and secondary sources, a substantial empirical contribution is made to the business history of Canada. However, the data collected and the methodologies employed have also facilitated the construction of theoretical models with broader relevance. Oral history represents a crucial source of primary data as do various archival sources. The risks associated with these primary sources are described as well as the steps taken to mitigate concerns. Additionally, a perspective is offered on how interviews, when conducted in a temporally detached business history context, can represent a more candid, less guarded and therefore more valuable source of data to help fill gaps in our knowledge and in building theoretical models.

3.1 Epistemology

Interpretivism starts from the premise that reality is not established with an objective mind, but rather is socially constructed. Blaikie (2003, p 17) states:

> Social reality is regarded as a social construction that is produced and reproduced by social actors in the course of their everyday lives ...This social reality does not exist as an independent, objective world that stands apart from the social actors' experience of it ... It is the product of the processes by which social actors together negotiate the meanings of actions and situations.

In contrast, positivism "consists primarily of turning facts derived from observation into sciences organized according to theories formulated as general laws" (Malhotra and Shapiro, 1998, Appendix). Positivism, then, is most closely aligned with the use of quantitative tools to capture reality, test it and understand it. The contextual aspects of the Chapter Four, which describe in quantitative terms the changes prompted by investments by foreign companies in the Canadian automotive assembly industry in the 1980s, would appear consistent with a positivistic epistemological bearing. In fact, one cannot describe the dramatic downturn that gripped the North American automotive industry in the late 1970s and early 1980s without turning to quantitative analysis. Further, if one is seeking to argue that the Canadian experience during the period was unique, set apart from the experience of other countries, then statistics and models – the tools of positivism – are an essential requirement. However, drawing upon such tools is uncommon among business historians, a tendency that Harvey (1989, p 2) laments. He observes that many business historians "seem unaware that statistical techniques, however simple, are nowadays routinely applied in many branches of historical research." It must be acknowledged, however, that even though the research presented here employs such instruments, they are not at the core of the research. Consistent with the social constructivist approach, quantitative data is used less in testing theory than in developing arguments. Therefore, positivistic tools are used to add context and texture, but do not overshadow what is a primarily inductive process, building upwards from data to generalization.

The research that follows employs multiple methods. Levi-Strauss uses the term bricoleur to describe a "jack of all trades or a kind of professional do-it-yourself person" (Levi-Strauss, 1966, p 17 in Denzin and Lincoln, 2003, p 5); a description that suggests the employment of a variety of methods, approaches and sources to construct a representation of a past or present reality. However, while the Levi-

Strauss' description is suggestive of the approach to knowledge creation taken in writing this thesis, it does not adequately capture the depth and range of material and methods employed. For that, Miller and Crabtree's concept of multiplism is more useful: "Multiplism refers not only to multiple methods but also to multiple triangulation, multiple stakeholders, multiple studies and multiple paradigms and perspectives" (2003, pp 410, 411).

The notion of multiple triangulations refers to the various types of triangulation identified by Denzin (Denzin, 1978 in Janesick, 2003), and upon which others have subsequently expanded. In this thesis, the use of data triangulation will be evident. At times, for instance, arguments are supported using multiple sources of data. Often, several databases were used to create a single table or graph. This can be seen in Chapter Six, which explores the evolution and composition of the Canadian industry in the first few years following the implementation of the Auto Pact. It is evident again in Chapter Seven where the differences in the Canadian and US industries in the late 1970s and early 1980s are underscored, and in Chapter Nine where the true size and scope of the incentives granted to offshore investors is reviewed. The multiple stakeholder approach of Miller and Crabtree is illustrated in this thesis when similar and related issues and events are triangulated from the perspectives of various actors from the period, from the private sector, government and labour. Finally, interdisciplinary triangulation, a term coined by Janesick (Janesick, 1994 in Janesick, 2003), provides another instrument to clarify meaning. For example, in assessing the impact of the voluntary export restraints in the early 1980s, it was necessary to review the contributions of economists, engineers and political scientists.

As this thesis is located within the realm of business history, Penrose's observation (1989, p 7) is particularly suitable: "Economic historians can only ask relevant questions of the past with the help of other social sciences, just as other social sciences cannot generally answer interesting questions about the present without the help of history." Penrose goes on to suggest (1989, p 9) that "Practitioners from each specialization approach the analysis of the nature, purpose, function and effect ... from different points of view, with different tools of analysis, different theories about

the world they see. All are relevant for an understanding of the phenomena." As Robert Stake (2003, p 148) asserts, triangulation is "a process of using multiple perceptions to clarify meaning … triangulation serves also to clarify meaning by identifying different ways the phenomenon is being seen." It will be demonstrated that the use of a range of tools, methods and data has, when considered together, enabled a more definitive and detailed understanding of what really transpired during the period under study.

3.2 Sources, Evaluation and Interpretation of Primary Data

This thesis is based on three main sources of primary data. First, quantitative data were drawn from multiple sources including automotive yearbooks and private and public sector reports. The numerous tables and charts in the thesis were constructed on the basis of these sources. Second, the author had access to data contained in the archives of the Federal Government of Canada and the Provincial Government of Ontario. Not all documents are currently released and available for consultation. Nonetheless, the author considered a wealth of policy documents that enable the reconstruction of process, perspectives and personalities. Third, the author set out to locate and interview one-time industry actors with a view to constructing an original set of oral histories that in themselves might be of interest to future generations. The authenticity of oral history sources has not gone without challenge, and this requires some explanation about how informants were selected and their testimony solicited.

Semi-structured interviews proved an important tool for primary data collection. Although less prevalent in studies of management and business, oral histories are well-placed in sociological and historical research. For example, the practice is prevalent in feminist literature (Stewart, 1993; Langhammer, 2000), black history (Perks and Thomson, 1998; Wallis, 1998) and labour history (Halpern and Horowitz, 1996; Bruno, 1999; Minchin, 2006). Oral histories in business history can also be found, including those of journalist cum historian Allan Nevins (1934), Anastakis (2005) and Robertson et al (2007).

A list of interview subjects is provided in Table 3.1 together with relevant biographical details. Although researchers often find that access to targeted subjects can be difficult (Bourne and Jenkins, 2005; Scraton and Holland, 2006), the experience of this researcher has been very different. Most subjects were generous with their time, interested in the material, and anxious to share their story. Their enthusiasm is characterized by former Ontario government official David Girvin: "It was a very interesting and rewarding time ... I know there has never been another period of time like it. I'm proud to have played a role and to have led a team of people that were dedicated, talented and successful."[19] A cross-section of participants was targeted and representation from key groups was sought. Seventeen interviews were conducted. The backgrounds of nine can be characterized as in government exclusively and four exclusively in the private sector. While it would appear that the private sector perspective is under-represented, it should be recognized that another four interviewees had profiles straddling both the public and private sectors. In fact, nearly half of the seventeen subjects were able to recount and interpret their experiences through a private sector lens. For example, although Ed Lumley is best recognized as a former federal cabinet minister, he also served on the Board of American Motors Canada and is currently a board member of international automotive parts manufacturer Magna International as well as the Bank of Montreal. Similarly, while Pat Lavelle's experience as Deputy Minister of the Ontario Ministry of Industry, Trade and Commerce provides a valuable perspective, his experience in the private sector is equally beneficial. He too has served in a senior executive position at Magna International as well as a board member for several Canadian and international organizations as well as President of the Automotive Parts Manufacturers Association. Additionally, Dennis DesRosiers was an analyst in the Ontario Treasury and Economics Ministry in the late 1970s. However, he subsequently went on to create what is arguably the largest automotive consulting business in Canada. Finally, Marc Santucci was with the State of Michigan during the period under study. Subsequently, he formed an automotive research and consulting firm. Even so, it is acknowledged that the research may have benefited from access to more private sector actors, particularly direct participants from the

[19] Girvin, D. (2005). Interview with the author on 19 January, Toronto.

investing organizations. However, many have passed away or were not geographically proximate. This makes the archival evidence consulted all the more valuable.

Preparations for each interview were extensive and involved researching the backgrounds, contributions and roles of the participants. Key themes were identified for each respondent and specific aspects of those themes were identified. Robert Weiss (1994) has identified a number of reasons why the interview is particularly helpful in qualitative analysis and many resonate with the author's direct experience. Weiss cites the interview's capacity to facilitate the development of detailed descriptions, integrating multiple perspectives, learning how events are interpreted, as well as identifying variables and framing hypotheses for quantitative research. It is the obligation of the researcher to develop an intimate, comprehensive understanding of each interview (Miles and Hubermann, 1994; Weiss, 1994). It is this author's experience that interviews provided an opportunity to gain deeper understanding of the assumptions upon which decisions were made. Common themes and specific events were often probed over the course of several interviews with different informants, leading to triangulation of various perspectives and claims, including those formed through quantitative and archival research. For example, Messrs. Lumley and Lavelle provide conflicting interpretations on the inspiration for a strategy to block shipments of Japanese made vehicles into Canada in 1982. As well, interviewing former Chrysler Canada executive Mike Walker, former Ontario official David Girvin and former federal Industry Minister Ed Lumley provided valuable perspectives on the motivations of the various actors insofar as the Chrysler Corporation's actions were concerned. Meanwhile, Marc Santucci, Herb Gray, John Tennant and Tayce Wakefield represent different stakeholder groups, and not surprisingly offer different perspectives on the underlying motivations in Canada with respect to its forceful utilization of policy tools to attract foreign direct investment (FDI). In all cases, it is the researcher's responsibility to triangulate the various sources to derive meaning.

One of the challenges of constructing oral histories is the reluctance of interviewers to confront challenging, difficult or uncomfortable issues (Ritchie, 2003, p 55). Moreover, just as interviewers might occasionally avoid difficult themes, interview subjects might also avoid the truth. Another problem is that both interviewer and subject may display bias (Trapp-Fallon, 2003). As well, interviewees may, with the passage of time, lose capacity to recall details. Despite such challenges, the researcher may still put the responses into the proper context by seeking consistency and consensus between various sources (Topping et al, 2006; Mitchell, 1996). This recognizes that "understanding an oral history is more of an interpretive event, than a fact-finding mission" (Topping et al, 2006, p 156). For example, Minchin's (2006) and Bruno's (1999) triangulation of semi-structured interviews, in combination with archival sources and media accounts to interpret labour issues in mid-twentieth century America represents an approach that parallels the research reported in this thesis.

For this research, all interviews were recorded and transcribed, a step that allowed the researcher to concentrate during each interview on extracting information and perspectives from the subject, rather than making notes. As suggested by Miles and Hubermann (1994), data irrelevant to the topic were not transcribed. Recording and subsequent transcription liberates the researcher from the process of making notes during the interview and mitigates the risk of losing the flow of the discussion, a turn of events that could compromise the comfort of the interview subject. Ritchie (2003, p 111) agrees that making notes can also distract the researcher and cause key elements of the discussion to be missed. Similarly, the interviewer who remains fixed on a prescribed inventory of questions may overlook opportunities subjects present to change the direction of the interview when new, interesting topics arise. For example, a comparison of the pre-interview questions and the actual transcripts reveal that, in all cases, several new, unanticipated themes emerged. In this case, the role of the Canadian UAW and its leadership in the investment attraction process was unanticipated and emerged from a detour in the interview of retired Canadian diplomat Larry Duffield. In addition, an awareness of the fact that Canada and Ontario originally held much more modest goals with regards to the attraction of

automotive FDI emerged in the interview with Pat Lavelle, not from the original set of questions, but rather from another seam that emerged through discussion. Finally, it is the experience of this researcher that elements revealed during the course of the interview are often only apparent upon subsequent re-listening and reading, making taping and transcription essential.

Admittedly, despite the passage of time, the direct participants occasionally revert to the tried and practiced arguments they might have presented to support the position to which they were duty bound to support at the time. More frequently, however, participant interviews at this stage – twenty years on – allow the researcher to more deeply explore the true motivations and pressures experienced by the various actors. A simple reliance on media and other accounts from the period would not have enabled understanding of these deeper motivations as one would have had to depend exclusively on tried and practiced stories or constructions, often referred to as spin. Had this research been conducted in the 1980s, those participants would have been restricted in their ability to acknowledge fully the rationale for taking the positions they did, as doing so would have amounted to exposing their motivations and potentially jeopardizing their strategies. However, with more than twenty years having elapsed since the height of the various debates, engagements and scuffles, most of the actors displayed a willingness to speak more frankly about what it was they were actually trying to achieve and how they hoped the tools they adopted might support their objectives. It is observed that the separation of time also affords participants the opportunity more freely to consider and critique the positions they adopted and the actions they took. Additionally, it spurs reflections on the motivations of other players and the effectiveness of their positions and strategies. Therefore, the process certainly contributes to identifying and closing an important empirical gap in the business history of Canada. Equally important, however, is that by conducting business history – well removed from the trials and challenges more proximate in time to the events under study – a significant opportunity exists to advance knowledge on a theoretical basis as well. Studying present day trends or cases would not have offered the depth or accuracy that access to the rich oral histories and archives have provided. Academic researchers would have access to

essentially the same primary data sources as journalists. Further, company and government archives remain off limits for several years.

Journalistic accounts often represent a logical starting point and a means by which to gain overview and insight into milestones and events. However, even though journalists pursue subjects dealing with the here and now, they rarely gain access to information regarding the development of strategies and decisions. To interview subjects, the media is less a conduit for the thorough and unbiased dissemination of data, but rather a tool for the dissemination of the messages they choose to convey. Therefore, business historians should avoid, where possible, accepting media accounts as exhaustive, without bias. It must be acknowledged, however, that a journalist's challenges and motivations differ in many ways from the academic researcher. For example, Ritchie (2003) reminds us journalists' time horizons are often quite limited and their engagement in the details generally less robust. It is for these reasons that much of the research presented here – with the benefit of various sources of data and devoid of many of the pitfalls of the here and now confronted by journalists – is in many ways richer than what might have resulted had similar research been undertaken nearer to the time of the events under review.

Table 3.1
Interview Subjects

Subject	Relevant Role(s) During Thesis Period	Subsequent, Relevant and / or Current Role(s)
Herb Gray	• Member of Canadian Parliament for Windsor, Ontario area riding (1962-2002). Longest continuously serving member in Canadian parliament history • Minister of Consumer and Commercial Affairs (1972-74) • Minister of Industry, Trade and Commerce (1980-82) • Minister of Regional Economic Expansion (1982) • President of the Treasury Board (1982-84)	• Leader of the Official Opposition, Canadian House of Commons (1990) • Government House Leader (1993-97) • Solicitor General (1993-97) • Deputy Prime Minister of Canada (1997-2002) • Canadian Chair, International Joint Commission (2002 – Current)
Ed Lumley	• Federal Member of Parliament of Canada, Stormont-Dundas (1974-84) • Parliamentary Secretary to Minister of Regional Economic Expansion (1976-77) • Parliamentary Assistant to Minister of Finance (1977-78) • Minister of State for Trade (1980-82) • Minister of Regional Economic Expansion (1982-83) • Minister of Industry, Trade and Commerce (1982-83) • Minister of Regional Industrial Expansion (1983-84)	• Vice-Chairman, Bank of Montreal Nesbitt Burns (1991 – current) • Other board memberships include: o Magna International o Canadian National Railway o Air Canada • Chancellor, University of Windsor (2006- current)
David Girvin	• Assistant Deputy Minister, Industry Division, Ministry of Industry, Trade and Technology, Government of Ontario (1983-88)	• Assistant Deputy Minister, General Services Management Board Secretariat (1988-96) • Retired from Government of Ontario (1996). Currently works as consultant.
Jack Delaney	• Manager of Site Selection Service (and its successor organizations), Ministry of Industry, Trade and Technology, Government of Ontario (1970s and 1980s)	• Retired (1989)

Subject	Relevant Role(s) During Thesis Period	Subsequent, Relevant and / or Current Role(s)
Patrick J. Lavelle	• President, Automotive Parts Manufacturers' Association (1974-86) • Agent General for Ontario in France (1980-81) • Deputy Minister, Ontario Ministry of Industry, Trade and Technology (1986-88)	• Vice President, Corporate Development, Magna International (1988-91) • Chair, Business Development Bank of Canada, Government of Canada (1994-97) • Chair, Export Development Corporation, Government of Canada (1997-2002) • Independent Board Member, Various public corporations in Canada, e.g.: o Slater Steel, o Geac o Soligen o Lions Gate Entertainment o Westport Innovations o Algoma Steel
Michael Dube	• Senior Policy Advisor, Industry Policy Branch (and its successor organizations) Ministry of Industry, Trade and Technology and its successor organizations, Government of Ontario (1970s-current)	• Special Advisor, Automotive Strategy Branch, Ontario Ministry of Economic Development and Trade (current)
Dennis DesRosiers	• Research Analyst, Ministry of Treasury, Economic and Intergovernmental Affairs, Government of Ontario (to 1979) • Director of Research, Automotive Parts Manufacturers' Association of Canada (1979-85)	• President, DesRosiers Automotive Consultants (1985-current)
Tayce Wakefield	• Joined General Motors of Canada in 1984 in Government Affairs Department, becoming Director of Government Relations in 1989	• Various roles in General Motors of Canada, including: o Director of Public Relations (1991-93) o Director of Corporate Affairs (1993-94) o Vice President of Corporate Affairs (1994-2003) • Executive Director, Environment and Energy, General Motors Corporation in Detroit, Michigan (2003-05) • Executive Director, European Union Affairs, General Motors Corporation in Brussels, Belgium (2005-current)

Subject	Relevant Role(s) During Thesis Period	Subsequent, Relevant and / or Current Role(s)
Paul Lau	• Various roles in Canadian Department of Industry and its successor organizations between 1973 and 1987, including o Manager of the Canada-U.S.A. Auto Pact o Chief Analyst with the Royal Commission on the Automotive Industry o Chief Negotiator, Automotive, Canadian Embassy in Japan	• Director, Industrial Trade Policy, Department of Industry, Government of Canada (1987-91) • Executive Director (Pacific), Department of Industry (1991-95) • Canadian High Commissioner in Brunei Darussalam (2002-current)
Larry Duffield	• Manufacturing Program Manager of Automotive, Canadian Embassy in Japan (1981-87)	• Following Japan posting and prior to retirement (2004), served in Ottawa at the Department of Foreign Affairs as well as in the role of Trade Commissioner with postings in Hungary and the Ukraine.
Erech Morrison	• Joined Canada's Department of Industry in its Automotive Branch (1978) as Senior Sector Development Officer, Subsequently held a variety of positions within branch	• Various appointments in versions of the Automotive Branch of Department of Industry, Government of Canada. Appointed Director, Trade and Investment, Automotive Branch (2006)
Jim Miller	• American Motors Corporation, Canada (1970s-1983) • Joined Honda Canada in 1983	• Executive Vice President, Honda Canada (current)
Mike Walker	• Member of Chrysler Canada's Finance Department (1970s–early 1980s). Eventually became the company's Director of Government Relations through 1980s and 1990s.	• Citizenship Court Judge, Government of Canada (current)
Marc Santucci	• Office of the US Trade Representative (1973-83) • Director of the Michigan Commerce Department's Office of International Development (1983-88)	• President, ELM International, Lansing Michigan based market research and consulting firm (1988–current)

Subject	Relevant Role(s) During Thesis Period	Subsequent, Relevant and / or Current Role(s)
John Tennant	• Chief, Pacific Division, Canadian Department of Industry Trade and Commerce (1974-78) • Commercial Councillor, Canadian Embassy, Tokyo (1978-81)	• Deputy Consul General, Chicago (1981-85) • Deputy Consul General, New York (1985-90) • Director General, Asia-Pacific, Canadian Department of Foreign Affairs and International Trade (1990-94) • Minister, Canadian Embassy, Tokyo (1994-98) • Director General, Asia Pacific North Bureau, Department of Foreign Affairs (1990-94) • Consul General, Detroit (1998-2002) • President, Canada's Technology Triangle (2002-current)
Maureen Enge	• Site Selection Services, Ministry of Industry, Trade and Technology, Government of Ontario	• Senior Business Consultant, Manufacturing Investment Unit, Ministry of Economic Development and Trade (current)
David Worts	• Executive Director, Japan Automobile Manufacturers' Association of Canada (1984-current)	

The memoirs of direct participants have also informed the research and influenced the arguments made in this thesis. These might be regarded as secondary rather than primary sources, but the materials they contain and perspectives they offer are in many ways similar to those obtained from interviews. Memoirs by former Chrysler chairman Lee Iacocca (1984 and 1988), American United Autoworkers chief Victor Reuther (1976), and Canadian Autoworkers president Robert White (1987) are good examples.

It has been remarked that "Historical silences ... can at times be marginalized (or at best excluded) by a sensitive configuration of material evidence with oral history" (Alexander, 2006, p 1). Therefore, archival sources also inform, interplaying with oral history and other data to build the empirical and theoretical basis for this thesis. Archival sources accessed include those of the government of Canada, the province of Ontario and Ford of Canada. Wilkins' (1990, p 4) observation that "most business historians still follow others' footnotes (and their own contacts) in locating relevant

collections" resonates. At the most basic level, the archival material has contributed to the development of the project database. More importantly, various briefing notes, notes to file, correspondence and meeting minutes have led to a deeper understanding of the policy development process, including an appreciation of the amount of communication that existed between various levels of government (including the governments of Canada and Ontario as well as with the US Treasury and Department of Commerce), what prompted the subtle and not so subtle policy adjustments that occurred over the period, and an inventory of the key advisors. Archival searches also prompted the researcher to locate some of those advisors for subsequent interviews alongside the better-known public players. It is in the archival material where differences between public pronouncements (such as those that might appear in media) and the true motivations of actors can be discerned. It should be acknowledged, however, that at present, relevant government archives are not fully open. For example, important and highly relevant cabinet documents in many cases are required to remain closed for a period of thirty years. Moreover, any information that might be considered proprietary for private sector participants remains off limits.

The contributions of this thesis are built on a foundation of rich empirical data. Within this section, two key sources of primary data, including oral histories and government and industry archives, have been described and evaluated. Next, we consider how these data were analyzed.

3.3 Grounded Theory, Case Studies and Longitudinal Research

One way of analyzing data is through content analysis, involving taking the information contained within interviews, for example, and quantifying it by measuring the frequency that certain words or phrases are mentioned. Such an approach might have some appeal, particularly among those holding a positivistic epistemology, but is rather too confining to yield answers to the types of research questions being explored herein. However, an alternative method of analysis is to draw upon the concepts of grounded theory. But to suggest that the research offered here represents a pure manifestation of grounded theory would be misleading as only

some aspects have been adopted. Easterby-Smith et al (2002, pp 123, 124) offer a concise seven-stage process of conducting grounded analysis involving familiarization, reflection, conceptualization, cataloguing concepts, re-coding, linking and re-evaluation. Its appeal lies in the fact it is not rigid or prescriptive and many of those elements have been followed here and applied to both interviews and archival data. Such flexibility is supported by Alvesson and Skoldberg (2000, pp 34, 35) who suggest researchers should make their own decisions regarding the efficacy and applicability of relevant tips and techniques associated with the theory. But while grounded theory is flexible, it also contains explicit guidelines about approaches and procedure, effectively "demystify[ing] the conduct of qualitative enquiry" (Charmaz, 2006, pp 3, 4)

Grounded theory is characterized by its focus on generating theory from data. By collecting and generating a range of secondary and primary data and subsequently engaging in a systematic process of intense analysis, concepts are devised and coded. The premise of grounded theory is that the processes and methodology employed in the development of theory is inductive, moving from rich and specific empirical data and ultimately to broader theories and trends. This is consistent with Glaser and Strauss in their original development of Grounded Theory. As Glaser and Strauss (1967, p 23) remark: "In generating theory, it is not the fact upon which we stand, but the conceptual category that was generated from it."

The career and experiences of this researcher might suggest that the research represents a form of ethnography or participant observation. That, however, would not be accurate. It is true that the writer has been employed by one of the Japanese automotive investors that entered Canada in the 1980s. However, the period under study predates the researcher joining the company. Yet despite this fact, it would be naïve to suggest that the author's position did not have advantages. On a very practical level, it opened doors. For example, many of the interview subjects were already known to the researcher and were agreeable to being interviewed. This advantage has allowed for unprecedented access to a range of actors that research on the Canadian automotive industry has heretofore not been granted. As well, being a

participant in the automotive industry has afforded the researcher elevated knowledge about actors, programs and policies, as well as their motivations and limitations. These are nuances that it might take other researchers a considerably longer period of time to be alerted to, if ever. Therefore, even though the writer's entry into the industry post-dates the period under study, the writer was exposed to opportunities that only direct actors or those engaged in long-term participant observation might be exposed.

Paul Rock (2001, p 32) captures many of the advantages of participant observation, several of which match the experience of this writer:

> He or she may have to spend considerable time in the field, seeing what happens, doing what the subjects do, reading what the subjects read, eating what the subjects eat, noting, recording, thinking, learning and gaining trust, being able to replicate some of the subjective knowledge of the world under view.

Of course, the images of participant observation evoked by Rock are somewhat different than that practiced in business and government offices. Further, the methodology employed cannot be described as participant observation in the formal sense. The point, however, remains: a fuller, richer, more textured view of how decisions were made, what motivated those decisions and who influenced them was achieved by having greater access to the environment than most writers researching projects of this nature would normally be afforded.

The result is a triangulation based largely on case study analysis. It is acknowledged that "Attempts to reconcile evidence across cases, types of data ... and between cases and literature, increases the likelihood of creative reframing into a new theoretical vision" (Eisenhardt, 1995, p 85). Yin (2003, p 1) tells us that case studies are beneficial when "how and why questions are posed" as well as "when the investigator has little control over events and when the focus is on a contemporary phenomenon with some real-life context." These conditions closely describe the research undertaken with the focus upon the five major investments made by offshore automotive manufacturers in Canada during the 1980s.

According to Stake (1995, p 3), case study research may be categorized as instrumental or intrinsic. Instrumental inquiry occurs when one adopts a case or cases to obtain a general understanding on the basis of the case(s) under study. Intrinsic inquiry occurs when the case(s) are selected, "not because by studying it we learn about other cases or about some general problem, but because we need to learn about that particular case." Both drive this research. The original intention was to engage in intrinsic inquiry, as the motivation was to better-understand an under-explored period in the history of the Canadian automotive industry. However, as the research ensued, elements of instrumental inquiry also emerged as it will be seen that the five cases studied offer broader lessons on the process of attracting FDI. However, adopting an organic or bottom-up approach can cause idiosyncratic events or issues to assume prominence unjustified by broader forms of enquiry (Eisenhardt, 1995). That risk is mitigated here, however, by virtue of the fact all substantial automotive FDI targets during the period under study – successful and otherwise – have been considered.

The fundamental questions posed in this thesis (articulated in Chapter One) are consistent with Van de Ven and Huber (1994, p vii) who suggest that studies of organizational change invariably centre on the antecedents of changes in organizational practices as well as how organizations emerge and adjust over time. Such conditions and trends are best analyzed through longitudinal study. Good examples include Saxenian (1994), Sturgeon (2003) and Wolfe and Gertler (2004), each of whom has conducted longitudinal studies in analyzing the development of economic clusters.

As an original piece of business history, this thesis is a particular form of longitudinal study, distinguished by deep empirical research on the forces and trends that were both an influence on, and consequence of, a specific period. Longitudinal study is uniquely designed and capable of measuring change as well as establishing strong causal interpretations (Menard, 2002, p 1). Although Menard submits that it is possible to study change though other means, Hedecker and Gibbons (2006), Singer and Willett (2003), Ruspini (2002) and Ragosa et al (1982) argue that other forms of

enquiry, specifically, cross-sectional analysis, are insufficient. Because it has been considered a critical piece of the fabric of the Canadian socio-economic environment for nearly a century, the automotive industry has long been the object of data collection. Hence, it is uniquely well-placed for the kind of analysis longitudinal study provides. Despite the advantages and inherent logic, longitudinal study does present challenges. For example, similar to the challenges incumbent in instrumental case study analysis articulated by Eisenhardt (1995): the tendency to exaggerate certain events and milestones, Hedecker and Gibbons (2006) explain that researchers conducting longitudinal study must battle problems of incomplete data as well as the management of inconsistent exogenous factors.

Similar to the longitudinal studies described above, this thesis also represents an example of how research adopting a longitudinal approach might contribute to the development of theory. Eisenhardt (1995) suggests a process synthesizing qualitative methods, case study and grounded theory, as well as engaging in multiple forms of triangulation. Her approach involves viewing data from varied perspectives, until a framework for inducing theory is devised. The process and rigour of ensuring data credibility through multiple collection strategies and sources is consistent with that suggested by Miles and Hubermann (1994, p 266) and very closely matches the one adopted here.

Therefore, key elements of grounded theory, along with some of the qualities of participant observation have been employed to study the important cases relevant to the study of FDI during the period under study. Ultimately, this research results in a longitudinal study, examining the processes and personalities associated with the development of the Canadian automotive industry.

3.4 Conclusion

This thesis has some of the features of positivistic research, but in the main it derives primarily from a social constructivist leaning. Multiple research methods and multiple forms of triangulation are employed to generate new perspectives on

important issues and fields of study. Of course, these interpretations inform the backdrop for the study, the Canadian automotive industry itself, but in doing so, broader concepts are also advanced such as those surrounding the processes of industrial globalization and the influences on it.

New, unique and valued perspective has been added through primary data sources, specifically oral histories and government and industry archives. Certainly, these contribute to the provision of a deeper understanding of the factors and forces influencing the period under study. However, they also support the development of theory. It has been demonstrated that had such study occurred in nearer temporal proximity to the events under study, neither the empirical nor theoretical contributions contained in this thesis would have been possible. The result is a longitudinal study demonstrating the processes and personalities associated with the attraction of FDI.

Chapter Four

Industrial Context

This chapter provides context to the overall study. It builds upon some of the material offered in Chapter One and further demonstrates that if inward foreign direct investment (FDI) into the Canadian automotive industry had not taken place on the scale achieved, it would today be much smaller, less dynamic and less capable of holding its own against international competition. To advance this argument, the industry is reviewed and assessed against a range of metrics, many of which represent fresh ways of understanding its component elements.

It will be demonstrated that by most standards of measurement, final assembly dominates the Canadian automotive industry and that it is disproportionately important to Canada vis-à-vis the US. Further, the significance of final assembly activity to Canada is magnified when the industry is analyzed through the prism of value added analysis. It will be argued that one of the reasons for the focus on final assembly is that labour costs in Canada are significantly lower than in the US. However, despite the preponderance of such activity, employment data confirms automotive parts manufacturing prevails. Regardless, the fact of the matter remains that much of the employment generated in the parts and components segment is contingent upon the health of proximate final assembly operations, a turn of events that was perpetuated and intensified by the FDI attraction process that occurred during the 1980s.

Despite its relative success, a continentally-oriented regulatory framework combined with a long-term tendency to generate growth by leveraging lower order factor advantages has meant that the Canadian industry has gained few specialized, higher order roles. The industry has become narrowly focused, consisting primarily of subsidiary operations. As a result, policy makers have long sought to elevate the Canadian automotive industry's standing from that of successful "industrial district" to the status of "cluster", characterized by higher order endeavours and closer intra-

network transfer of knowledge. In what is arguably an increasingly globalized and competitive arena, altering the Canadian industry's profile is assuming a heightened level of urgency, influencing the focus and intent of automotive policy makers.

4.1 The Primacy of Final Assembly in Canada

In this chapter, it will be shown that the Canadian automotive industry continues to be reliant on final assembly activity and that this feature was reinforced by the inward FDI sought and gained during the 1980s. It will also be made evident that Canada is engaged in a level of manufacturing activity that meets its longstanding national goal of securing a 'fair share' of world automotive manufacturing activity.[20] As was demonstrated in Table 1.1, of the three signatories to the North American Free Trade Agreement (NAFTA), only Mexico is obtaining a greater relative share. In 2003, for every vehicle sold in Mexico, fully 1.61 was built there. In Canada, the ratio was only marginally less with 1.57 vehicles assembled for every one sold, and in the US the ratio was a comparatively modest 0.71:1. Further context for the study will be added by utilizing a broader range of data and considering it from previously under-explored perspectives. Trade data will be scrutinized, employment trends assessed, and the industries' sub-elements will be dissected. Additionally, rather than analyzing the industry by considering shipments data alone (as most previous studies have done) value added analysis will be conducted. Doing so will provide new insights into the state and evolution of the Canadian automotive manufacturing industry.

Final assembly activity is the most common barometer by which to gauge whether a particular jurisdiction is getting its fair share. In fact, the 1965 Auto Pact made final assembly to sales ratios for individual companies, along with Canadian Value Added (CVA) for those companies, one of two critical assessments or hurdle criteria. Further, export restraint agreements adopted by Canada and the US in the 1980s to

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[20] The concept of fair share is a theme that surfaces throughout the history of the Canadian automotive manufacturing industry. The term appeared in the Bladen Royal Commission Report of 1961 and in subsequent reports and commentaries it became a recurring theme. 'Fair share' will be considered from a variety of perspectives and measures in Chapter Five.

limit what was perceived to be a growing surge of imports were focused exclusively on final assembly. More recently, in 2004, when the Canadian Automotive Partnership Council (CAPC) was establishing a vision for the Canadian automotive industry, the membership agreed that assembly was the critical element. In fact, the first report of the Council expressed the primacy of final assembly:

> A large, proximate supply base is insufficient as an investment consideration. A perception exists that OEMs are attracted to mature supplier bases. The fact is, however, that assemblers may develop relationships with local suppliers, but history has demonstrated that they are quite prepared to replicate longstanding relationships in their new locale. (Canadian Automotive Partnership Council, 2004, p 10)

While the amount or proportion of final assembly activity that a nation holds or attracts is a useful measure of manufacturing vitality or health, it should not be seen in isolation from other activities. The manufacturing part of the automotive industry in any jurisdiction is much more complex than simply an assessment of the production to sales ratio. A large portion of the value added of an automobile is not generated at the source of final assembly, but rather from the hundreds and thousands of parts and components makers spread throughout the country and indeed the world. In 2002, for example, Canadian motor vehicles parts and accessory shipments totalled $33.6 billion and provided employment for 98,000 Canadians (Table 4.2). By comparison, motor vehicle manufacturing during the same year provided employment for just 51,500 people. However, at $67.6 billion, completed vehicle shipments were more than twice as large as shipments of parts and components.

Table 4.1
Canadian Automotive Shipments and Employment

	Shipments			Employment		
	Total Automotive Shipments (2003 $ Billions)	% of Total Automotive Shipments from Motor Vehicles	% of Total Automotive Shipments from Parts	Total Employment	% of Total Automotive Employees from Motor Vehicle Assembly	% of Total Automotive Employees from Automotive Parts
1965	17.59	73.7	26.3	71,700	55.5	44.5
1970	22.09	67.8	32.2	76,400	49.1	50.9
1975	30.40	70.2	29.8	86,000	50.5	49.5
1976-80	37.98	68.4	31.7	98,940	41.7	50.3
1981-85	45.06	66.2	34.2	116,206	42.4	57.6
1986-90	57.16	64.9	35.0	144,148	37.5	62.5
1991-95	65.78	68.4	31.5	138,415	39.5	60.5
1996-2000	99.12	68.5	31.3	139,787	37.1	62.9
2001	96.60	67.7	32.3	144,951	34.4	65.6
2002	101.26	66.8	33.2	149,099	34.2	65.8
2003				152,557	32.3	67.7

Sources:

Shipments data for 1965 -75 from *Statistical Review of the Canadian Automotive Industry: 1996 Edition*, p 28.
Shipments data for 1976-80 from *Statistical Review of the Canadian Automotive Industry: 1992 Edition*, p 26.
Shipments data for 1981-97 from Statistics Canada *CANSIM* Table 301-0001, Manufacturing Activities, by Standard Industrial Classification, 1980 (SIC), Annual.
Shipments data for 1998 - 2002 from *DesRosiers Automotive Yearbook: 2003 Edition*, p 189.
Data for Shipments was normalized to 2003 on the basis of Statistics Canada *CANSIM* Table 326-0002, Consumer Price Index (CPI), 2001 Basket, Annual.
Motor Vehicle Assembly Employment data for 1965-80 from *Report on the Canadian Automotive Industry in 1986*, p 48.
Motor Vehicle Assembly Employment data for 1981-97 from Statistics Canada *CANSIM* Table 301-0001, Manufacturing Activities, by Standard Industrial Classification, 1980 (SIC), Annual.
Motor Vehicle Assembly Employment data for 1997 - 2001 from *DesRosiers Automotive Yearbook: 2004 Edition*, p 202.
Motor Vehicle Assembly Employment data for 2002 and 2003 from presentation to JAMA Canada by Dennis DesRosiers, 21 January 2004.
Motor Vehicle Parts Employment data for 1965, 1970, 1975, 1980-90 from *Statistical Review of the Canadian Automotive Industry: 1992 Edition*, p 42.
Motor Vehicle Parts Employment data for 1976-79 from *Report on the Canadian Automotive Industry in 1986*, p 48.
Motor Vehicle Parts Employment data for 1991 from *DesRosiers Automotive Yearbook: 1994 Edition*, p 108.
Motor Vehicle Parts Employment data for 1992-94 from *Statistical Review of the Canadian Automotive Industry: 1996 Edition*, p 54.
Motor Vehicle Parts Employment data for 1995-2003 from presentation to JAMA Canada by Dennis DesRosiers, 21 January 2004.

From an employment point of view, the Canadian parts and accessories sector, then, is the predominant component of the Canadian industry, representing a greater source of employment than does assembly. It is also a segment that has grown in importance. Table 4.1 confirms that, expressed in constant 2003 dollars, by 2002 the parts industry was 7.3 times the size it was when the Auto Pact was signed in 1965 and employed 3.2 times as many Canadians. By contrast, final assembly shipments had jumped by a more modest 5.2 times with employment up by only 28 per cent. By 2003, the parts sector provided two-thirds of the industry's employment, up from 44.5 per cent in 1965. Final assembly's share of total automotive manufacturing employment in Canada had dropped to less than one third from 55 per cent over the

same 37 year period. However, the fact of the matter remains – and the CAPC statement underscore the point – that much of the employment in the parts and components segment of the industry is contingent upon the continued health of nearby assembly operations. Naturally, the final assembly plants in Canada will be the most important customers, though Michigan based facilities are also significant, representing an additional proximate source of $7 billion in sales for the Canadian parts industry.[21]

Although the primacy of final assembly, both from an employment and total shipments point of view, has declined in Canada over the years, final assembly retains a greater relative importance in Canada than in the US. For example, as Table 4.2 illustrates, in 2001, even though final assembly represented just 34.2 per cent of automotive manufacturing employment in Canada, in the US it had dipped to 22.5 per cent. The concentration of final assembly activity in Canada may be verified through several measurements including the production to sales ratio, the percentage of North American automotive production in Canada versus the US or other NAFTA partners, or the proportion of automotive manufacturing activity – as measured by both shipments and employment – in Canada devoted to assembly compared to others. All represent important gauges of the success of Canadian efforts to attract investment. Later chapters will trace the origins of that process with a particular emphasis on the activities and results of the 1980s and the messages, motivations and incentives that influenced the results.

4.2 The Competitive Underpinnings of the Canadian Industry: A Shipments Approach

As indicated, researchers examining the strengths, weaknesses and growth patterns of the Canadian auto industry consistently utilize shipments as the main comparative (Holmes, 1993 and 2004; Doh, 1998; and Hufbauer and Schott, 1992). Subsequent sections of this chapter will consider additional, richer forms of analysis, but because

[21] Statistics Canada. (2004). Unpublished data provided by Statistics Canada staff.

a shipments-based approach is straightforward and generally provides a correct overview of trends and developments, it represents a logical starting point.

Table 4.2 compares shipments between Canada and the US in Canadian dollars at the mean exchange rate in 2001. It illustrates that overall Canadian shipments per employee were almost the same as those of American operations. This occurred despite the fact that each segment of the industry actually demonstrated much greater shipments per employee in the US than Canada during the year. This paradox can be explained by the fact that the Canadian industry is disproportionately represented by the final assembly or motor vehicle manufacturing component, the portion of the industry where shipments per employee are significantly higher than the parts manufacturing segment.

Table 4.2
Canada-US Production and Shipments (2001)

Canada	Shipments ($ Billions CDN)	Number of Employees	Proportion of Employment to National Industry (%)	Shipments per Employee (C$)	As a % of N.A. Benchmark (US)
Motor Vehicle Manufacturing	62.23	49,891	34.42	1,247,319	79.76
Motor Vehicle Parts Manufacturing	29.71	95,060	65.58	312,539	79.51
TOTAL: AUTOMOTIVE	91.94	144,951	100	634,283	96.57
United States					
Motor Vehicle Manufacturing	334.65	213,981	22.52	1,563,924	100
Motor Vehicle Parts Manufacturing	289.30	736,003	77.48	393,069	100
TOTAL: AUTOMOTIVE	623.95	949,984	100	656,801	100

Note:
Rate of conversion of Canadian $ to United States $ for 2001 was 1.5484.

Sources:
Shipments data for Canada from *DesRosiers Automotive Yearbook: 2003 Edition*, p 189.
Motor Vehicle Manufacturing Employment data for Canada from *DesRosiers Automotive Yearbook: 2004 Edition*, p 202.
Motor Vehicle Parts Employment data for Canada from presentation to JAMA Canada by Dennis DesRosiers, 21 January 2004.
Shipments data for US from *DesRosiers Automotive Yearbook: 2004 Edition*, p 208.
Employment data for US from *DesRosiers Automotive Yearbook: 2004 Edition*, p 202.

Expanding upon the data contained in Table 4.2, it can be seen from Table 4.3 that labour costs per paid production hour were significantly lower in Canada than they were in the US. Table 4.2 shows that American workers shipped 25.4 per cent more assembled vehicles per employee than did Canadian workers in 2001. However, Table 4.3 indicates that in 1999, Canadian workers earned C$26.74 per hour compared to their US counterparts who earned C$42.31 at prevailing exchange rates, a 36.8 per cent differential. In 1999, then, hourly wages in the final assembly portion

of the manufacturing value chain represented 3.57 per cent of the value of shipments in Canada while it constituted 4.59 per cent in the US. The Canada – US differential, therefore, represented a premium of 28.6 per cent. Similar differentials are noted in subsequent years.

Table 4.3
Canada and US Labour Costs and Contributions to Value Added (1999)

	Canada		United States	
	Motor Vehicle Manufacturing	Motor Vehicle Parts Manufacturing	Motor Vehicle Manufacturing	Motor Vehicle Parts Manufacturing
Number of Production Employees – 1999	45,833	82,833	204,911	646,319
Production Wages (C$000s) – 1999	2,915,333	3,639,035	18,249,575	38,763,954
Wages per Employee – 1999	63,608	43,932	89,061	59,977
Production Hours (000s) – 1999	109,038	171,527	431,353	1,362,409
Hours Per Production Worker – 1999	2,379	2,071	2,105	2,108
Hourly Labour Cost Per Employee – 1999 (C$)	26.74	21.22	42.31	28.45
Shipments (C$000s)	81,580,000	33,670,000	397,280,000	301,300,000
Production Labour Cost as a Per cent of Shipments	3.57	10.81	4.59	12.87
Value Added (C$000s)	21,905,970	11,977,856	115,029,850	114,748,122
Value Added Per Production Hour (C$)	201	70	267	84
Labour Cost Percentage of Value Added	13.31	30.38	15.87	33.78

Note:
Canada stopped separating hourly and salaried workers by NAICS code in 2000 so comparisons across Canada and the US cannot be continued. Therefore, 1999 data was selected.

Sources:
Number of Production Employees for Canada and US from *DesRosiers Automotive Yearbook: 2004*, p 203.
Production Wages for Canada and US from *DesRosiers Automotive Yearbook: 2004*, p 205.
Production Hours for Canada and US from *DesRosiers Automotive Yearbook: 2004*, p 204.
Value Added from *DesRosiers Automotive Yearbook: 2004*, p 209.

A salary differential also exists in the parts segment of the industry. As Table 4.2 indicates, Canadian parts producers' shipments per employee were 79.5 per cent of those of their American competitors. However, Table 4.3 shows an hourly wage differential of C$7.23 or 34 per cent. Again, as in the case of final assembly, labour's share of the value of shipments is lower in the Canadian parts segment than in the US. In Canada, labour costs comprise 10.81 per cent of the value of parts shipments compared to 12.87 per cent in the US.

Therefore, although shipments data alone may provide some indications of trends, context for growth within the Canadian automotive industry is added when comparative data regarding Canadian and US labour costs and employment levels are incorporated. Doing so demonstrates that relatively low cost labour underpins the Canadian industry's growth.

4.3 The Competitive Underpinnings of the Canadian Industry: A Value Added Approach

While utilizing shipments data allows one to gain an appreciation of the relative size or growth of either the final assembly or parts segments of the industry in one jurisdiction versus another, shipments data alone can be deceptive. The Ontario Ministry of Treasury, Economics and Intergovernmental Affairs understood these problems as early as 1978: "Use of factory shipments in analyzing the North American industry can be misleading since they incorporate the value of inputs, and double counting results" (Ontario, 1978, p 17). For example, final assembly involves the consolidation of automotive parts. Therefore, final assembly shipments statistics will also include shipments by parts makers. This situation also makes shipments based data on trade and trade balances subject to misinterpretation. Despite the shortcomings, such an approach persists. For example, government publications consistently refer to the fact that Canada has, for a number of years, held a substantial net automotive trade surplus with its major trading partners, particularly the US. As well, the Canadian Automotive Partnership Council (2004, p 16) has established as one of its four key performance metrics the target of improving "Canada's automotive trade balance to $15 billion or better by 2010." Further back, in the early 1970s, Canada held a substantial combined trade surplus with the US and some concern existed that the US might take action to abrogate the agreement due to the imbalance. In all cases, final assembly and parts shipments were combined for the sake of analysis.

Deeper understanding can be obtained by reviewing the sources of value added generated. Value added consists of – and is apportioned to – labour, depreciation and net profit. It is the method at the core of the work of Williams et al (1994) who used a value added approach to assess the strengths and weaknesses of various participants in the international automotive industry up until the early 1990s. Value added is a particularly appropriate means by which to assess the Canadian automotive manufacturing industry because measures based on shipments of final goods or trade flows mask the nature and intensity of productive activities. Any

consideration of shipments alone would lead to an overstatement of the size of the overall Canadian industry and lead to the conclusion that final assembly dominates by an overwhelming margin.[22] Amplification occurs because shipment numbers are distorted by final assembly results, which as Table 4.4 demonstrates, contributes less to manufacturing value added on a dollar-for-dollar shipment basis than does the parts segment of the industry.

Table 4.4 shows that in 2001 the total value of shipments from Canadian final assembly and parts manufacturing operations was $98.1 billion. From that amount, value added totalling $30.9 billion was generated. As a result, value added was generated in Canada at a rate of 31.54 per cent. By comparison, the US industry generated $199.3 billion of value added on shipments of $624 billion, a rate of 31.94 per cent. However, when one considers the source of value added and the differing rates at which it is generated within the different components of the industry, a fuller story emerges. On both sides of the Canada – US border parts manufacturing generated the highest rate of value added (about 40 per cent of sales in both Canada and the US). Vehicle manufacturing, meanwhile, generated value added at a rate of between 25 and 28 per cent of shipments in the two countries.

While it may be accurate that final assembly provides a foundation for the Canadian industry, jumping to the conclusion that it dominates the industry in Canada would not be accurate. When considered from the perspective of value added, it can be seen that the make up of the industry in both Canada and US is substantially different. The final assembly segment of the Canadian industry remains dominant, but to a lesser degree than what a consideration of shipments alone might cause one to conclude. The figures presented in Table 4.4 show that final assembly value added constituted a more modest 62 per cent of total value added generated by the Canadian automotive manufacturing industry, whereas final assembly shipments comprised 71 per cent of automotive shipments. Meanwhile, in the US, final assembly represented 53 per cent of total auto industry shipments but generated just 42 per cent of value

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[22] For example, in 2001, assembly shipments surpassed parts shipments by a rate of 2.45:1, based on final assembly shipments in 2001 as per Table 4.4 of $69.5 billion and parts shipments of $28.6 billion.

added. In short, value added analysis confirms that final assembly has primacy in Canada, but to a lesser degree than a review of mere shipments data would indicate. On the other hand, in the US the parts industry has pre-eminence, although a review of shipments data would suggest otherwise.

Table 4.4
Canada and US Value Added ($000s) – 2001

	Canada			United States		
	Shipments	Value Added	Value Added Rate (%)	Shipments	Value Added	Value Added Rate (%)
Final Assembly	69,543,403	19,437,847	27.95	334,652,169	83,881,204	25.07
Parts Manufacturing	28,587,593	11,508,869	40.26	289,300,911	115,405,779	39.89
TOTAL	98,130,996	30,946,716	31.54	623,953,080	199,286,983	31.94

Sources:
Shipments data for Canada and US from *DesRosiers Automotive Yearbook: 2004*, p 208.
Value Added data for Canada and US from *DesRosiers Automotive Yearbook: 2004*, p 209.

If value added is a function of three elements – labour in the form of wages and benefits, capital charges in the form of depreciation, and profits – then an evaluation of how much each of these elements represents in terms of total value added might shed more light on the nature of the work being conducted in Canada compared to the US. It could also confirm the appropriateness of investment decisions made by various producers regarding their Canada – US production. For example, Table 4.6 reinforces the argument put forth above – that labour is less expensive in Canada than it is in the US, not just on a hourly wage basis, nor simply as a percentage of total shipments (both of which are demonstrated in Table 4.3). Table 4.6 shows that, when one considers the cost of labour as a percentage of total shipments, the importance of labour is obscured by other costs that are larger and beyond the control of local management. For example, when confronted with the knowledge that labour costs constitute 3.57 per cent compared to 4.59 per cent of shipments in Canada and the US respectively (as per Table 4.3) the relative impact of the labour cost differential is concealed by other elements which make up more than 95 per cent of revenues. However, when viewed in the context of value added, the impact of the cost of labour is magnified. Table 4.6 shows that in 2001 the portion of manufacturing value added absorbed by production labour costs in the vehicle manufacturing segment was 13.7 per cent in Canada versus 19.5 per cent in the US.

In parts manufacturing, labour costs absorbed 31.8 per cent and 30.6 per cent of manufacturing value added in Canada and the US respectively. It is when one considers value added, and specifically the share of value added apportioned to labour, that the importance of low cost labour to the growth and success of the industry in Canada – and particularly to final assembly– becomes more visible.

In the vehicle manufacturing segment, value added per production hour is lower in Canada than it is in the US. Table 4.6 shows a differential in 2001 of 14 per cent ($214 per hour in the US against $184 per hour in Canada). In 1999 Table 4.3 showed the differential to be 24.7 per cent on value added in the US and Canada of $267 and $201 respectively. These facts in isolation might lead to the conclusion that more final assembly should be concentrated in the US. However, Canadian employees earned 36.8 per cent less than their US counterparts in 1999 (Table 4.3). That differential grew to 39.3 per cent by 2001 based on hourly production wages of $41.68 and $25.26 in the US and Canada respectively (Table 4.6). As a result, labour's share of total value added in vehicle manufacturing is lower in Canada, which helps explain why final assembly activity continues to be concentrated in Canada and why final assembly production growth in Canada has consistently exceeded that of the US. This fact is substantiated in Table 4.5, which shows that Canada has generally outperformed the US in terms of growth of the final assembly segment of the industry. During the eight five year increments between 1960 and 1999 and the final four-year stage (2000-03), period-to-period unit production growth rates in Canada exceeded that of the US in eight of the nine periods in question. As a result, the share of Canada and US produced vehicles manufactured in Canada grew from 5.95 per cent during the pre Auto Pact 1960-64 period to 9.21 per cent in the immediate five year post Auto Pact signing era of 1965-69 and eventually to 18.02 per cent by the 2000-03 period.

Table 4.5
Canada and United States Unit Production Growth

	United States		Canada		
	Five Year Average Production (Units)	Five Year Growth (%)	Five Year Average Production (Units)	Five Year Growth (%)	Canadian Share of Canada - US Production (%)
1960-64	8,214,741	-	519,342	-	5.95
1965-69	10,289,208	25.25	1,043,668	100.96	9.21
1970-74	10,571,337	2.74	1,437,462	37.73	11.97
1975-79	11,504,212	8.82	1,660,424	15.51	12.61
1980-84	8,620,283	-25.07	1,444,636	-13.00	14.35
1985-89	11,205,665	29.99	1,873,211	29.67	14.32
1990-94	10,295,090	-8.13	2,069,470	10.48	16.74
1995-99	12,196,372	18.47	2,610,707	26.15	17.63
2000-03	12,135,463	-0.50	2,667,907	2.19	18.02

Source: Annual unit production figures from *DesRosiers Automotive Yearbook: 2004 Edition*, p 119.

Value added analysis also helps explain the relative growth of parts manufacturing in the US relative to Canada. In the parts sector, value added per production hour was only 16.7 per cent less in Canada in 1999 than in the US ($84 per hour in the US versus $70 per hour in Canada as per Table 4.3). However, the gap had climbed to 25.5 per cent by 2001 ($94 per hour in the US versus $69 per hour in Canada as per Table 4.6). Meanwhile, Tables 4.3 and 4.6 show that wage differentials in Canada and the US were also less pronounced in the parts segment than they were in assembly. Hourly rates were $7.23 or 25.4 per cent less in Canada than the US for parts manufacturing in 1999 and $6.68 or 23.2 per cent less in 2001. These facts meant labour's share of manufacturing value added was 33.8 per cent in the US compared to 30.4 per cent in Canada in 1999 (as per Table 4.4). By 2001, labour consumed 30.64 per cent of value added generated in the US and 31.77 per cent in Canada (as per Table 4.6).[23]

[23] The reason that labour's share of total value added each year shows relative consistency across the two periods (1999 and 2001) is because total value added (the denominator) in 1999 was higher than in 2001. In 1999, both profits and total labour costs were considerably higher across the combined parts and motor vehicle manufacturing industry than they were in 2001. In 1999, combined industry after tax profits were C$5.8 billion against just C$3 billion in 2001 (From Statistics Canada data for 2004, unpublished data provided by Statistics Canada staff.) By 2001, both profits and labour costs had dropped, resulting in labour's share of value added remaining relatively stable.

Table 4.6

Labour's Share of Value Added: 2001

	Value Added (C$000s)	Wages and Benefits (C$000s)	Number of Employees	Hours Per Production Employee	Value Added Per Production Hour (C$s)	Hourly Production Wage (C$s)	Value Added Per Employee (C$s)	Labour's Share of Value Added (%)
Canada								
Motor Vehicle Manufacturing	19,437,84	2,661,841	44,298	2,379	184	25.26	438,797	13.69
Motor Vehicle Parts Manufacturing	11,508,86	3,656,599	80,230	2,071	69	22.01	143,448	31.77
United States								
Motor Vehicle Manufacturing	83,881,20	16,336,718	186,209	2,105	214	41.68	450,468	19.48
Motor Vehicle Parts Manufacturing	115,405,77	35,354,829	584,613	2,108	94	28.69	197,403	30.64

Note:

Hours per production employee not available for 2001. Most recent year available was 1999. Figures quoted here determined as per Table 4.3.

Sources:

Value Added from *DesRosiers Automotive Yearbook: 2004 Edition*, p 209.
Wages and Benefits from *DesRosiers Automotive Yearbook: 2004 Edition*, p 205.
Number of Employees from *DesRosiers Automotive Yearbook: 2004 Edition*, p 203.

Clarity on the nature and evolution of the Canadian automotive industry is also improved by considering trade flows from a value added perspective. On a shipments basis, Appendix A shows that in 2003, Canadian automotive exports of motor vehicles totalled $59.6 billion, with imports measuring just $37.5 billion. The trade surplus for motor vehicles, therefore, was $22 billion. The surplus in completed vehicles, however, was almost entirely consumed by a deficit in automotive parts. In 2003, the deficit in automotive parts and accessories was $14.1 billion consisting of imports of $38.8 billion, which were necessary to support the final assembly operations and exports at $24.7 billion. The overall result, then, was an automotive trade surplus of $7.9 billion. However, expressed in value added terms, Appendix A indicates that the surplus was just $1.7 billion in 2003. Appendix A further shows that in the 34 years between 1970 and 2003, on a shipments basis, Canada recorded an automotive trade deficit on 13 occasions, the most recent of which was 1988. However, on a value added basis, 20 deficits were recorded, four since 1988 with the most recent in 1992. The disparity between shipments and value added occurs because of the nature of the industry in Canada and the different rates at which value added is generated in the vehicle manufacturing segment versus the rate it is

generated in the parts manufacturing segment of the industry. In 2001, for example, it took $1.44 of assembly shipments from Canada to generate the same value added as $1.00 of shipments from the parts sector (40.26% ÷ 27.95% as per Table 4.4).

Viewing trade data through the prism of value added analysis eliminates the double counting that occurs with a shipments-based approach when parts are subsequently incorporated during the final assembly process. Assessing the automotive industry by way of value added analysis, therefore, provides a superior means of understanding the true nature of the industry's individual elements. Further, when the components of value added are analyzed, the importance of labour cost differentials between Canada and the US are magnified, thus shedding light on why final assembly dominates in Canada to a degree that does not exist in the US. It also offers a more accurate measurement of the industry's constituent elements, leading to improved understanding and appreciation of the trends that have emerged both during and subsequent to the 1980s.

4.4 The Influence of Offshore Investment in the 1980s on the Current Canadian Automotive Industry

One of the key themes this thesis explores is the effect of government policy on offshore-based investment in vehicle assembly operations in Canada in the 1980s. In Sections 4.1 – 4.3 it was examined through both shipments and value added analysis. This section will elaborate by building on the foundation presented in Table 1.2. Moving forward, the data contained in Table 1.2 will be further refined and enhanced by exploiting the tools and perspectives presented in Sections 4.1 – 4.2. The purpose is to further substantiate the extent to which the investments made in the 1980s have affected the industry. It will be demonstrated that the component elements of the Canadian automotive industry have been substantially altered by the investments made during that era. It will also show that the net effect is a significant increase in the trade surplus expressed in shipment terms. However, a more modest net impact is observed when value added analysis is performed.

To support such analysis, a series of assumptions and formulas are needed. Again, the foundation comes from Table 1.2, which demonstrates that in 2003, 811,597 additional vehicles were built in Canada in facilities that offshore-based investors constructed in the 1980s and which have subsequently expanded. To generate the estimates made here, it is assumed that all 811,597 vehicles were manufactured for the overall North American market and, had they not been built in Canada, they would have been manufactured elsewhere in North America. Further, if built elsewhere, some would have been imported into Canada. In that regard it is reasonable to hypothesize that, because Canada's share of total North American sales is 8.32 per cent (as per Table 1.1), in the absence of incremental Canadian production of 811,587 units, imports of completed vehicles would have risen by 67,524 (811,587 x .0832).

It is also assumed that the facilities built in Canada by offshore manufacturers in the 1980s have similar export ratios to the industry overall. Additionally, it is assumed that the average per unit value of the shipments from the new entrants would be the same as those shipped from Canadian facilities overall. Therefore, of the export shipments of manufactured vehicles of $59.6 billion in 2003 (as per Appendix A), 32.19 per cent or $19.19 billion would have come from these facilities (811,587 units ÷ 2,520,638 units as per Table 1.2). In turn, average per unit value of shipments for manufactured vehicles can be assumed to be $23,645 ($59.6 billion ÷ 2,520,638 units).

Assumptions and deductions may also be drawn about how the parts and components sector of the Canadian automotive industry would have evolved had offshore-based manufacturers not arrived. For example, had those vehicles not been built in Canada, it is assumed that parts exports would have risen to support the 811,587 units that were now being produced elsewhere in North America. In that regard, it is calculated that Canadian parts exports would have risen by 5.9 per cent had the new entrants not come to Canada.[24]

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[24] Per Cent Increase in Canadian Partsmakers' Exports
= Canadian Production by Offshore-Owned Manufacturers ÷ Non-Canadian North American Production
= Canadian Production by Offshore-Owned Manufacturers ÷ (US Production + Mexican Production)

It should be stressed that the 5.9 per cent increase in parts exports assumes that Canadian parts makers would have achieved similar content levels in non-Canadian-made offshore-owned vehicles to those currently achieved. In 2003, non-Canadian-assembled vehicles in North America (i.e. vehicles assembled in the US or Mexico) had an average of $1,807 worth of Canadian content (assessed on the basis of $24.67 billion in parts exports as per Appendix A ÷ US and Mexican vehicle production of 13,654,703[25]). It is assumed then that, had the 811,587 vehicles in question been made outside of Canada, they too would have had $1,807 of Canadian content. Obviously, more final assembly production outside of Canada contributes to increased exports by parts makers and lower imports of parts by Canadian final assembly operations. Therefore, from the narrow perspective of the balance of trade in parts, lower levels of final assembly production in Canada would have resulted in a positive contribution to Canada's balance of trade on both a shipments and value added basis.

For the purposes of the calculations provided in Table 4.7 below, it is also assumed that the 811,587 additional vehicles generated value added at the same rate as the rest of the industry. Likewise, it is assumed that the parts purchased by all segments of the industry generated value added at a constant rate.

In Chapter One it was demonstrated that the Canadian automotive assembly industry would have been significantly smaller had the offshore-based firms not entered Canada in the 1980s. Table 4.7 takes this notion further. A series of assumptions are constructed that contribute to the supposition that the balance of payments for the Canadian automotive industry would have been appreciably altered had new actors not entered the industry during the 1980s. As Table 4.7 demonstrates, total exports would have been lower by 18.4 per cent in consequence of two factors. First, exports

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= 811,587 ÷ (12,075,931 + 1,578,772)
= 5.91 per cent

[25] DesRosiers, D. (2004). *DesRosiers Automotive Yearbook: 2004 Edition.* Toronto: DesRosiers Automotive Consultants, p 119.

of motor vehicles would have dropped by an estimated 32.2 per cent (as per Table 1.2). Much lower exports of completed vehicles would have been mitigated somewhat by increased parts exports. This outcome would have occurred because, if new investment in final assembly had not happened in Canada, it may be assumed that production would have been located elsewhere in North America and that Canadian parts makers would have gained a part of the market. At an estimated $1.5 billion,[26] however, the jump in parts exports would have mitigated to only a minor extent the $19.2 billion drop in exports of motor vehicles.

On the imports side, Table 4.7 suggests that motor vehicle shipments would have climbed modestly due to the fact that a small portion of the vehicles built in Canada as a result of the investments that did occur – an estimated 67,524 as calculated earlier – would have been imported. And because Canadian motor vehicle production would have declined by about one-third, from 2.5 million to 1.7 million, parts imports would drop by a similar amount to an estimated $12.5 billion.

The net result would be an adjustment to the balance of payments that, on a shipments basis, would have yielded a surplus of just $1.1 billion compared to the 2003 actual level of $7.9 billion. These discrepancies stem from the fact that the main drivers of the line-by-line adjustments relate to the conflicting impacts caused by a large reduction in motor vehicle exports and a concurrent substantial drop in the import of parts. Although both dropped by 32.2 per cent, the drop in motor vehicle exports comes from a much higher base; the decline measuring $19.2 billion compared to the parts import drop of a more modest $12.5 billion. The differential then, between the motor vehicle export decline and the drop in parts imports of $6.7 billion is the primary explanation for the decline in the total automotive trade balance of $6.8 billion, from the actual level $7.9 billion to $1.1 billion in the hypothetical case.

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[26] Change in Parts Exports If No New Entrant Investment in 1980s
= 2003 Parts Exports x Per Cent Increase in Canadian Partsmakers' Exports
= $24.67 billion x 5.9 per cent
= $1.46 billion

Further, even though Table 4.7 shows the balance of trade expressed in value added terms would have stayed virtually unchanged at $1.5 billion, Table 4.8 shows the component elements would have been substantively altered. Imports of parts accounted for 50.3 per cent of total automotive imports in 2003. However, had the investments of the 1980s not been made, parts would have accounted for only 40.2 per cent of total imports. In addition, Table 4.8 shows that in 2003, exports of parts represented just 29.3 per cent of total exports, but had the investments of the 1980s not been made, parts would have accounted for 39.3 per cent of total exports. In both Canada and the US, parts production generates value added at a higher rate than does vehicle manufacturing. Therefore, even though vehicle exports would have been reduced by a much greater sum than did parts imports ($19.2 billion versus $12.5 billion); the changes expressed in value added terms would have been very nearly the same. Had vehicle exports dropped by the $19.2 billion figure projected, the impact on value added would have been $5.4 billion ($19.2 billion x 27.95 per cent). By comparison, the impact of the $12.5 billion slide in parts imports, when expressed in value added terms, would have been $5 billion ($12.5 billion x 39.89 per cent). The remaining differential can be explained by an increase in value added derived from growth in parts exports, offset partially by increased value added measuring approximately $400 million associated with higher vehicle imports. Hence, the similarity in balance of payments impacts on a value added basis.

This analysis has further confirmed that the inward automotive FDI Canada attracted during the 1980s has had a significant effect on the composition of the industry today. The quantifiable estimates provided here also explain the motivation for more recent efforts to replicate the success generated in the 1980s. Those efforts are discussed next.

Table 4.7
Balance of Trade if No Offshore-Owned Final Assembly Investment in Canada

			2003 (Actual Results)	2003 (Without Offshore-Owned Production)	Per Cent Change (2003 Actual Versus 2003 Hypothetical)
Exports:	Motor Vehicles	Shipments: Exports ($000,000s)	59,577	40,394	-32.2
		Canadian Value Added Rate (2001)	27.95	27.95	-
		Value Added Generated from Exports ($000,000s)	16,652	11,290	-32.2
	Parts	Shipments: Exports ($000,000s)	24,670	26,128	5.9
		Canadian Value Added Rate (2001)	40.26%	40.26%	-
		Value Added from Exports ($000,000s)	9,932	10,519	5.9
	Total	Shipments: Exports ($000,000s)	84,247	66,522	-21.0
		Value Added from Exports ($000,000s)	26,584	21,809	-18.0
Imports:	Motor Vehicles	Shipments: Imports ($000,000s)	37,544	39,141	4.3
		US Value Added Rate (2001)	25.07	25.07	-
		Value Added Generated from Imports ($000,000s)	9,412	9,813	4.3
	Parts	Shipments: Imports ($000,000s)	38,814	26,316	-32.2
		US Value Added Rate (2001)	39.89	39.89	-
		Value Added from Imports ($000,000s)	15,483	10,498	-32.2
	Total	Shipments: Exports ($000,000s)	76,358	65,457	-14.3
		Value Added from Exports ($000,000s)	24,895	20,310	-18.4
Balance:		Shipments Balance of Trade ($000,000s)	7,889	1,065	-86.5
		Value Added Surplus / (Deficit) ($000,000s)	1,526	1,499	-1.8

Source: Derived from previous tables contained in Chapter Four

Table 4.8

Component Elements of Automotive Trade Balance (Per Cent)

		2003	2003 (Without Offshore-Owned Production)
Exports	Parts	29.3	39.3
	Motor Vehicles	70.1	60.7
Imports	Parts	50.3	40.2
	Motor Vehicles	49.7	59.8

Source: Derived from previous tables contained in Chapter Four

4.5 Recent Trends in Final Assembly Investment and Incentivization: From Industrial District to Cluster?

When General Motors closed its operation in Ste. Therese, Quebec in 2002, all of Canada's final assembly became concentrated in the southern portion of the Ontario between the cities of Oshawa, approximately 50 kilometres east of Toronto, and Windsor on the Ontario-Michigan border, a stretch of approximately 350 kilometres. Only Honda's Alliston, Ontario operations, located about 80 kilometres north of the City of Toronto, is more than a few kilometres from Ontario's busy Highway 401. With Canadian vehicle production located exclusively in Ontario, the province

produced more vehicles in 2004, 2005 and 2006 than any other North American jurisdiction, including the perennial leader and traditional home of the global automotive industry, the state of Michigan. The synergistic nature of the assembler – parts maker relationship has created a collection of automotive manufacturing activity in Ontario that is virtually without parallel in North America. It has been established that much of that capability and capacity arose from investments made in the 1980s.

Following the investments that occurred during the period this thesis explores, Canada received no new Greenfield final assembly investments for almost 20 years. The subsequent period witnessed shifting investment patterns in the automotive industry, including recognition by former non-players like Mississippi and Alabama that they might compete for investment through generous incentives. Canada and Ontario only started to re-engage in the process of providing direct incentives in 2003 when a new provincial government was elected in Ontario and it became increasingly apparent that Canada was a prospective destination for new capital spending. At the time, the most imminent and publicly acknowledged candidates for investment were from North American-based Ford and General Motors.

As explained in Chapter One, the Province of Ontario and the Government of Canada formally committed funds to a rejuvenated automotive investment incentive program in 2004. In October of that year, six months after a provincial announcement and four months following the federal initiative, Ford responded with a $1 billion re-investment in its Oakville, Ontario assembly operation, supported by $200 million in public funding. Then in March 2005 General Motors came forward with what it labelled its Beacon Project, a $2.5 billion program which included new production mandates for its various Canadian facilities, enhanced vehicle engineering and research and development activities and broadened relationships

with Canadian research institutions.[27] The project was supported with combined federal and provincial funding of $435 million.[28]

Unlike the investments that dominated the 1980s – which form the core of the research that follows – the Ford and General Motors investments of 2004 and 2005 mostly represented the renewal of existing sites and the maintenance or modest expansion of current employment levels. The Ford investment, for example, provided no additional jobs. Meanwhile, the General Motors project promised incremental increase in employment of a relatively modest 500 jobs.[29] Neither General Motors nor Ford attempted to characterize the 2004-05 investments as incremental job creation vehicles. The Ford investment was largely presented as an opportunity to anchor 3,900 existing positions at its Canadian manufacturing operations. Indeed, rather than trumpeting the job creation aspects of their involvement, politicians defended their participation on the basis of their success in guaranteeing a base of automotive employment. Premier McGuinty stated, for example, that "This agreement commits Ford to not reducing the size of their footprint in the Province of Ontario."[30] The General Motors projects were presented as a means by which to support the existing 16,000 jobs the corporation provided in Canada by updating the manufacturing infrastructure as well as deepening the research and engineering capabilities in the country. Therefore, unlike the 1980s, the investments that Ford and General Motors announced in 2004-05 – and which governments in Canada supported – were driven by the more defensive motivation of protecting the existing base.

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[27] General Motors of Canada news release. Available from: http://www.newswire.ca/en/releases/archive/March2005/02/c0447.html. (Accessed on 7 March 2006.)

[28] McNeil, M. (2005). The new cost of doing business. *Hamilton Spectator*. 7 March, p A17.

[29] Although 500 incremental jobs were indicated at the time of the March 2005 Beacon project announcement, subsequent challenges confronting General Motors resulted in the acknowledgement in November 2005 that General Motors of Canada would shut one of its Oshawa, Ontario final assembly operations and a powertrain parts facility by 2008, a move that would result in the loss of 3,700 jobs.

[30] Brennan, R. and Van Alphen, T. (2004). Ford agrees to employment guarantees; clawbacks possible on government aid feds, province to commit $200 million. *Toronto Star*. 30 October, p D01.

The investments of the early twenty-first century also represent a tangible signal that concerns first identified in the mid 1970s were starting to be addressed. Evidence presented in Chapter Six will demonstrate that by the mid 1970s, the Auto Pact had been in place for just over a decade and integration of the automotive industries in the two countries had been attained. What policy makers had observed, however, was that in adopting a 'continental' approach to the development of its auto industry (Holmes, 1993; Holmes, 2004; Anastakis, 2005), the Canadian industry had become truncated (MacDonald, 1980; Reisman, 1978), developing a profile as a relatively low-cost location for final assembly (Yates, 1993; Cross, 2004). Sturgeon and Florida (1999) characterize countries like Canada, Spain and Portugal as cost effective, peripheral platforms for automotive assembly within a continental or regional structure. In the late 1970s, policy makers viewed the profile of the Canadian industry with a sense of ambivalence. They were satisfied with the level of production and employment generated, but frustrated with the dearth of high skill, research-intensive positions. Eventually, by the turn of the twenty-first century, policy makers also came to view the role to which Canada had been consigned as increasingly tenuous. As a result, they sought expanded roles which they believed could leverage the cluster of automotive manufacturing they believed had developed and thus shield the economy from emerging global competition.

The literature on globalization and trade has important implications for Canada's automotive manufacturing industry. Globalization and the rise of supranational bodies cause international competition for investment to intensify and the size of incentives to grow (Markusen, 2007; Thomas, 1997), a phenomenon that North American automotive investment closely reflects. Meanwhile, the competitive forces of globalization also provoke nations to pursue independent measures to pursue globally competitive, stable and responsible fiscal and economic policy (Porter, 1991, Martin and Porter, 2000; IMF, 2002; Pouder and St. John, 1996). For example, the Porter study on Canada's macroeconomic environment (Porter, 1991) helped stir the Canadian government to pursue a fiscal and economic policy based on low inflation and balanced federal budgets. Therefore, rather than blurring and dimming the importance of regional economies, it is argued that globalization is making local

economies more important than ever (Coe and Yeung, 2001; Fujita et al, 2000; Porter, 1998; Malmberg et al, 1996).

Meanwhile, however, it is also possible to view some aspects of trade flows and conclude that the forces of globalization and trade are no more pronounced today than they were in the past (International Monetary Fund, 2002; Crafts, 2000; Anderson and Fredriksson, 1996). Such data may be used to dismiss those who fear that globalization will destroy the manufacturing base of more developed nations. They are reassured by data showing that as trade within blocks becomes freer, trade between blocks becomes less prevalent (Chortareas and Pelagidis, 2004; Walker, 1999; Emerij, 1992). Their complacency is supported by the fact that the proliferation of regional trade blocks like NAFTA and the EU has encouraged companies to devise regionalized strategies as part of their global plans (Florida and Sturgeon, 1999), pursuing both market access as was evident during the period this thesis considers, as well as economies of scale. Those who are less alarmed by globalization also question the long-term capacity of low cost nations like China, Brazil, Russia and India to maintain gaping cost advantages (Leonard, 2003; Walker, 1999). For example, Leonard (2003) notes that a generation ago, Korea was a low wage, low value added economy. If current trends continue, its costs will soon pass those of the US. Even China has experienced manufacturing wage increases of 16 per cent per year since 1991. Rather than an impediment to development, high wages are considered to be a product of it (Walker, 1999). If these factors prevail, automotive manufacturing in peripheral countries like Canada will persist.

Despite the factors and conditions which could cause some to dismiss the threat of globalization and low wage nations, various threats may be identified. Fears arise due to the reliance on lower order factor elements inherent in the Canadian automotive industry (Florida and Sturgeon, 1999; Macdonald, 1980). Bernard et al (2003) demonstrate that the likelihood of a plant's continued existence and growth decreases with an industry's exposure to imports from low-wage countries, and that the likelihood of a plant's survival increases if it is capital and skill intensive. However, Leonard (2003) demonstrates that notions of what constitutes less capital

or knowledge intensive production are changing. Perceptions that the principle imports from newly industrialized countries (NICs) are products like textiles, apparel, footwear and furniture are no longer relevant with NICs moving into more technologically intensive manufacturing including transportation equipment, industrial machinery and electronic equipment. With no headquarters to protect its position or enhance its profile (Porter, 1990), Canadian automotive manufacturing has struggled to elevate the nature of its profile. Hence, the willingness of the Governments of Canada and Ontario to incentivize the Ford and General Motors announcements of 2004-05 and deepen the automotive cluster that is believed to exist.

Also known by such terms as innovative milieu, regional innovation systems and learning networks, clusters represent "producers of strongly interdependent firms (including specialised suppliers) linked to each other in a value-adding production chain" (Roelandt and den Hertag, 1999) or "specialized organizations whose production processes are closely linked though the exchange of goods, services and/or knowledge" (Van den Berg et al, 2001). By contrast, due to its truncated, lower order nature, it may be argued that the agglomeration of automotive manufacturing activity concentrated in Canada in general and the southern portion of the province of Ontario more specifically, may more accurately be described as an industrial district or community, evoking a concentration of similar activity, but deficient of the "commonalities and complementarities" (Porter, 1998) cluster-type definitions suggest. By tying R&D commitments to the package of incentives, the Ford and General Motors announcements of 2004-05 had taken explicit, but tentative steps to address these shortcomings, effectively seeking to elevate the Ontario industry from automotive "district" to that of automotive "cluster".

Effecting such transformations and gaining such mandates has been a challenge … and will continue to be. Global automotive cost-cutting and restructuring increases pressures in the automotive supply chain, thereby undermining cluster enhancing efforts (Rutherford and Holmes, 2007). Therefore, Canada, which has evolved as a low cost platform in the North American automotive milieu will struggle to expand

its remit and incentives may be necessary to alter the natural course. Additionally, studies show that the innovation process tends to keep R&D confined (Porter, 1990; Malmberg et al, 1996). The fact that the Canadian automotive industry is comprised of subsidiaries means that fewer high order activities exist and that gaining traction for such activities is difficult. Subsidiaries are much less embedded and the existence of clusters is relatively meaningless to foreign investors (Andersson et al, 2002; Birkinshaw and Hood, 2000; Kobrin, 1999; Dicken, 1994; Hood and Young, 1988; Beigie and Steward, 1986). Indeed, the majority of cluster research and the benefits its disciples promote are based on elite or highly skilled workers (Florida, 2002; Glaeser, 2000; Eaton and Eckstein, 1997; Porter, 1990). This, undeniably, does not reflect the profile of the Canadian automotive industry.

Hejazi and Pauly (2003) suggest that in gauging the nature of subsequent development one must consider the motivations of the actors. During the period under study, little evidence is available to support the notion that either governments' or investors' investment decisions were motivated by the pursuit of the types of benefits cluster devotees allege. Governments were driven by the quest for investment and jobs and investors were attracted because they needed to invest to maintain market access in North America. Ontario also offered a favourable menu of factor inputs for automobile production. The desire to become embedded in a cluster was not a factor. Today, inter-firm cooperation remains weak (Rutherford and Holmes, 2007). As a result, the desire to provoke cluster-oriented commonalities and complementarities that have surfaced during the run-up to more recent investments is a relatively new phenomenon. It would seem, however, that they remain much more meaningful to public policy officials than private sector actors.

Before the spring of 2005, no new Greenfield operations of the nature that Ontario and Quebec competed so successfully for in the 1980s had been announced since 1986. The Canadian Autoworkers Union's Hargrove regularly lamented that 12 of 13 final assembly plants that had been constructed in North America since the 1980s

had been built in the southern US.[31] As a result, even though policy makers were seeking to broaden the scope of automotive activity occurring in Canada, they also recognized that building the base of investment and jobs consistent with its historical advantage should persist. The drought was reversed on 30 June 2005 when Toyota announced its intention to proceed with a new 1000 acre, $800 million project in Woodstock, Ontario to open in 2008, employing 1,300 people and having the capacity to produce 100,000 vehicles annually.[32] The Toyota project was supported by a provincial grant of $70 million[33] and a refundable contribution from the Government of Canada totalling $55 million.[34]

With the Ford, General Motors and Toyota investments, the popular perception is that Canada has reversed a long period of decline; a decline that could be traced to 1989 when the last of the five major final assembly investments of the 1980s started production. However, regardless of the absence of capacity expansion, Figure 4.1 demonstrates that investment, in fact, continued to grow. Therefore, judging economic development policy and success through the standard of whether or not it results in new greenfield investment is insufficient. Greenfield investment occurs just once, whereas significant re-investment occurs at model change, which typically takes place on a five-year cycle. Figure 4.1 underscores the importance of

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[31] Sorensen, C. (2004). Ford flex plant signals new era: McGuinty, other carmakers mulling expansion. *Financial Post*. 30 October, p FP4.

Note: Some (including Mr. Hargrove) characterize the doubling in the size of Honda's Alliston, Ontario plant in 1998 as a new plant and by many standards it is as it includes incremental assembly, welding and painting faculties. However, this plant is adjacent to the original facility opened in 1986 and by that standard should not be considered a Greenfield operation.

[32] Toyota Motor Manufacturing Canada. (2005). Toyota breaks ground in Woodstock. 11 October. (Press release from Toyota Motor Manufacturing Canada.)

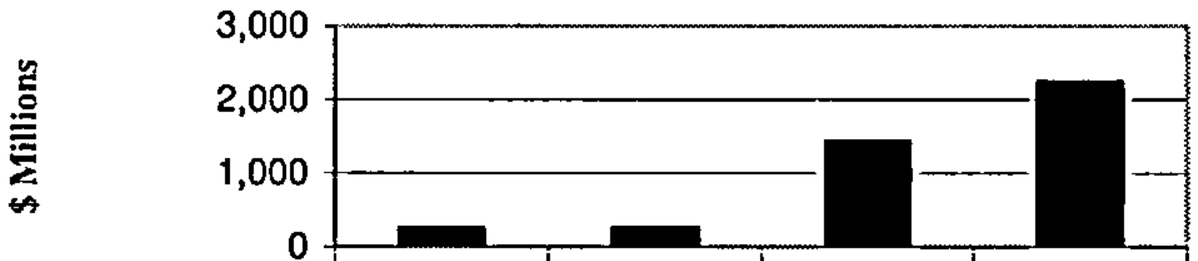
Subsequently, in February 2006, Toyota announced its intention to increase the investment in the Woodstock plant to $1.1 billion to boost capacity to 150,000 units annually and add another 700 jobs, bringing employment to 2,000. From: Toyota Motor Manufacturing Canada. (2006) Toyota to expand Woodstock facility. 7 February. (Press release from Toyota Motor Manufacturing Canada.)

[33] Ontario Ministry of Economic Development and Trade. (2005). Ontario attracts first new auto assembly plant in over a decade, 30 June. (Press release from Ontario Ministry of Economic Development and Trade.)

[34] Department of Industry Canada. (2005). Government of Canada announces support for new Toyota plant, 30 June. (Press release from Department of Industry Canada.)

reinvestment. Despite the flurry of new greenfield investment activity that occurred in the 1980s when five brand new facilities came on stream (AMC-Renault, Honda, Toyota, Suzuki and Hyundai), it was during the 1990s, a period when no new greenfield investments came to Canada, which actually proved to be more active in terms of new capital spending. Indeed, one Canadian industry executive was quoted as saying "The renewal of our investment base is every bit as important as investment for growth" (Canadian Automotive Partnership Council, 2003, p 26).

Figure 4.1
Motor Vehicle Assembly Industry
Average New Capital Expenditure
(2003 $s)



	1961-70	1971-80	1981-90	1991-2000
Capital Spending	260.2	246.5	1,434.7	2,243.6

Sources:
Capital Expenditure data compiled from:
- *DesRosiers Automotive Yearbook: 1994 Edition*, Capital Expenditure Statistics – Motor Vehicle Assembly Industry (New Capital Expenditures only), p 103, and
- *DesRosiers Automotive Yearbook: 2004 Edition*, Capital Expenditure Statistics – Motor Vehicle Assembly Industry (New Capital Expenditures only), p 186.

Data for new capital expenditure decisions was normalized to 2003 on the basis of Statistics Canada *CANSIM* Table 326-0002, Consumer Price Index (CPI), 2001 Basket, Annual.

The higher level of capital spending in the 1990s compared with other periods is a function of two factors. The first explanation is offered by Tayce Wakefield of General Motors: "Most of our investments in Canada had been made between '65 and '72 or so – immediately post-Auto Pact to take advantage of that. So … those investments were due for the major renewal."[35] The second reason is that the larger base of investment that existed at the end of the 1980s meant more models that needed re-investment in tooling and equipment at intervals of approximately five years. For example, capital spending for the period 1985-89 – the period of time when Honda, AMC-Renault, Toyota, Suzuki and Hyundai were adding capacity of 470,000 units (Canada, 1992, p 55) – averaged $2.2 billion annually normalized to

[35] Wakefield, T. (2004). Interview with the author on 18 October, Cambridge ON.

2003 $s (from figures derived for the creation of Figure 4.1). By comparison, throughout the 1990s – a decade of no new greenfield investment – annual capital spending also averaged $2.2 billion normalized to 2003 dollars. Over the period 1985-89, for example, the five new assembly plants that were built by offshore-based manufacturers added, at a minimum, five new models. Model changeovers, occurring at five-year intervals, require capital outlays of approximately $400 million. Therefore, the new entrants' combined capital spending averaged at least $400 million annually, contributing at least 17.8 per cent to the average annual capital spending in the 1990s. However, it must also be recognized that, during the 1990s, Honda doubled its Alliston plant's size, requiring a capital outlay of $300 million[36] and Toyota undertook a similar expansion, spending another $600 million.[37] Those two projects alone would have increased average annual capital spending over the course of the decade by $90 million.[38] Therefore, due to the arrival of the new entrants in the 1980s, average annual capital spending in the 1990s increased by at least $490 million[39] and had those companies not made their investments in the 1980s, average annual capital spending would have dropped by 21.8 per cent.[40]

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[36] Jiji Press English News Service. (1995). Honda to produce new minivan in Canada, *Jiji Press English News Service.* 20 December.

[37] Strathdee, M., Cannon S. and Reinhart, T. (1994). Toyota Cambridge to grow: 1,200 workers to be hired in $600-million expansion that would more than double production. *Kitchener-Waterloo Record.* 4 November, p A1.

[38] Calculated as follows:

(Honda capital investment + Toyota capital investment) ÷ 10 years
= $90 million

[39] Average Annual Capital Expenditures Attributed to New Entrants

$$= \text{Average Annual Spending to Support New Entrants' Model Changes} + \text{Annual Spending to Support New Entrants' Capacity Increases}$$

$$= \frac{\left\{ \left(\text{Number of New Plants 1980 – 1989} \times \frac{\text{Number of Years Under Study}}{\text{Number of Years Between Model Changes}} \right) \times \text{Average Cost of Model Change} \right\} + \text{Capacity Increasing Expenditures by Honda and Toyota in 1990s}}{\text{Number of Years Under Study}}$$

$$= \frac{\{5 \times (10 \div 5) \times \$400 \text{ million}\} + \$300 \text{ million} + \$600 \text{ million}}{10}$$

$$= \frac{\$4 \text{ billion} + \$900 \text{ million}}{10}$$

$$= \$490 \text{ million}$$

[40] Average Annual Drop in Capital Expenditures in 1990s with no New Entrant Investment in 1980s

Therefore, spurred by motivations similar to those that existed in the 1980s, the efforts of governments in Canada in the early years of the twenty-first century to revive efforts to attract large scale inward automotive FDI have achieved significant results. The results are largely a function of the same formula of committed leadership and generous incentives that characterized the 1980s. However, rather than the single-minded pursuit of investment and jobs which characterized earlier undertakings, efforts in the twenty-first century incorporated attempts to generate and anchor more advanced and specialized factor inputs: elevating Canada's automotive industrial district to that of automotive cluster.

4.6 Conclusion

Within this chapter a context for what follows has been provided. Although the specific focus of the thesis is the period 1977-87, this chapter has shed light on the importance of the period and its antecedents by fast-forwarding to the Canadian automotive industry, as it exists today. It has been shown that the Canadian industry is dominated by final assembly manufacturing that is disproportionately large relative to the US industry. It has also been established that this aspect was perpetuated by the events that unfolded during the 1980s. Additionally, it has been made clear within this chapter that had Canadian policy makers failed to attract major investments from offshore-based actors, the Canadian automotive industry would be vastly different today. Clearly, those efforts resulted in considerable success and the automotive industry looms large as an engine of Canadian economic health. However, as the global industry continues to mature and evolve the continued success of the Canadian automotive industry, with its reliance on subsidiaries and lower order factor advantages, may cause fissures to emerge.

$$= 1 - \frac{\text{Average Annual Capital Spending in 1990s - Average Annual Capital Expenditures Attributed to New Entrants}}{\text{Average Annual Capital Spending in 1990s}}$$

$$= 1 - \frac{\$2.2436 \text{ billion} - \$490 \text{ million}}{\$2.2436 \text{ billion}}$$

$$= 21.8 \text{ per cent}$$

Chapter Five

The Evolution of Policy: Constructing the Environment for Offshore Assembly Investment

Research on factors that influenced offshore automotive manufacturers to establish operations in Canada in the early to mid 1980s has tended to be incidental to other research, the majority of which has centred on bilateral and trilateral trade treaties, such as the Auto Pact of 1965, the Canada-US Free Trade Agreement of 1987 and the North American Free Trade Agreement of 1992. There has been some research on specific initiatives, but the greater part of the work has focused on specifics rather than on the general forces and conditions that prevailed at the time.

What has not hitherto been done is provide an understanding of the context in which policy decisions and directives were made. This chapter will begin to show how numerous events and principles informed and influenced the investment decisions made in the 1980s. Analyzing them will help answer the first question this thesis raises: "how did Canada set the preconditions to compete so well for investment?" In fact, this chapter will demonstrate that the growth and development of the automotive manufacturing industry in Canada in the 1980s, and the factors that influenced that growth, emerged from policy decisions and principles established a full half-century before the first volume automobile producer began operating in Canada, commencing with the Elgin Marcy reciprocity treaty of 1854. It will be shown that the abrogation of that treaty by the US 12 years later set the stage for what became known in 1879 as Canada's National Policy, the principles of which played a pivotal role in the establishment of Canada's first automotive manufacturing operations at the turn of the twentieth century, and whose impact can be recognized in subsequent tariff adjustments.

Within this chapter, key events influencing how offshore investors viewed Canada as an automotive investment location will be discussed. These include the Canada-United States Automotive Products Trade Agreement (Auto Pact) of 1965 and the automotive tariff studies and policies that preceded its enactment in the earlier parts

of the 1960s. It will also be demonstrated that the impetus to consider new trading mechanisms in the early to mid 1960s stemmed in large part from anomalies created in 1932 through a preferential tariff system with Britain and other members of the Commonwealth.

The purpose of this chapter is not to explore in detail or isolation each of the singular events, characters or companies that helped define either specific events or periods within the Canadian automotive manufacturing industry. Nor is it to explore broader issues that informed Canadian economic policy in Canada's pre-and early post-Confederation period. Rather, the aim is to delve more deeply to reveal longstanding factors shaping public policy in Canada. They include, for example, the conditions leading to Vincent Bladen's influential Royal Commission on the automotive industry (Canada, 1961) in 1960 and how his study provided the impetus for paradigmatic change. This chapter also includes research heretofore not incorporated into studies of the Canadian industry regarding aspects such as exchange rate setting in and around 1950 and again a decade later. The argument will be made that no other phenomenon has had the capacity to disrupt and influence the policy framework and production environment than rising import market shares. This chapter will review how this condition arose in the 1920s and again in the 1950s. A subsequent chapter will explore how the phenomenon was repeated in the 1970s and early 1980s.

The overall intention of this chapter is to provide an overview of the evolution of government policy over a period of more than 100 years, and how this history facilitated the introduction of new policy tools in the late 1970s to mid 1980s: tools that enabled Canada to win a disproportionately large share of automotive assembly production in North America from offshore producers.

5.1 From Elgin-Marcy Reciprocity to National Policy

In March 1879, when Finance Minister Sir Leonard Tilley released his first Budget following his Party's electoral victory of 1878, there was no doubting what would be

the centerpiece. During his years in Opposition (1873-78) Tilley's Conservative Party, under the leadership of Sir John Macdonald, had made it clear that tariffs would be key. For example, in the House of Commons on 10 March 1876, Macdonald had stated that, "the United States should be dealt with as they deal with us and we would be craven if from fear of offending our neighbours we took any other alternative. If they do not grant us reciprocity in trade we should give them reciprocity in tariff."[41]

Macdonald's stance can in turn be traced to the collapse of the Elgin-Marcy Reciprocity Treaty. Forged in 1854, the treaty provided for the free passage of a variety of commodities between the US and Canada. Editorial writers greeted its passage with optimism on both sides of the border. For example, the *Toronto Examiner* predicted that "The advantages to both countries will be immense as every approach in a free and unrestricted interchange of the products and manufactures of nations must be."[42] Meanwhile, the *Rochester Union* forecast that, "The confirmation of the Reciprocity Treaty by the Senate of the United States opens a prosperous future to us. If we are true in ourselves, if we labor in this new channel of enterprise with our old native energy, there is in store a future almost without limit." [43]

The Elgin-Marcy Treaty remained in place for 12 years, and despite the disturbance of the American Civil War, trade flourished, rising from $20 million annually in 1853 to $68 million by 1864.[44] When the US Congress abrogated the agreement it did so as a rebuke to the British for their support of the US South during the Civil War (Hart, 1998, p 11) and to appease Northern US manufacturers and farmers (Flynn, 1979, p 9).

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[41] Sir John A. Macdonald. 10 March 1876. House of Commons Debates, Session 1876, Volume 1, p 573.

[42] Toronto Examiner. (1854). The treaty of reciprocity ratified. 1854. *Toronto Examiner.* 16 August, p 2.

[43] Toronto Examiner. (1854). The treaty of reciprocity ratified. 1854. *Toronto Examiner.* 16 August, p 2. (Appeared originally in the Union published in Rochester, New York.)

[44] London Times. (1866). House of Commons, Friday May 18. *London Times.* 19 May, p 6.

In Canada, the abrogation of Elgin-Marcy lent support to the cause of Confederation. The *Hamilton Evening Times* stated "Recent events are sweeping away the last elements of opposition to the scheme, and when Confederation is at last complete, we cannot refuse to our American friends the thanks that are their due for having so unilaterally contributed to its success."[45] The *Canadian News* echoed that view: "People begin to see that the very existence of the country depends upon our becoming united, and not only for purposes of mutual defence but also for the arrangement of new commercial treaties with foreign nationals as well as for facilitating intercolonial trade."[46]

The collapse of Reciprocity in 1866 helped propel Macdonald to the position of Canada's first Prime Minister a year later. However. Macdonald attempted on several occasions to revive open trading relationships with the US, but was regularly rebuffed. Meanwhile, he witnessed the US Congress progressively increasing tariffs. Hence, his resolve upon return to Government in 1878 to gain redress. His remedy came in the form of the National Policy, a policy framework that shaped and influenced the Canadian automotive industry for nearly a century. The National Policy contained three primary elements. First, it unified the country physically by way of a transportation policy that led to the Canadian National Railway. Second, it encouraged immigration. Third, it strengthened domestic manufacturing through higher tariffs (Hart, 1998 p 12). However, as Lanigan (1937) reminds us, in establishing a high tariff regime, Macdonald's motives went beyond retribution. Macdonald also realized that Canada's future prosperity would be based not simply on the export of raw materials, but also on higher value added processing. Macdonald's remarks in Montreal in July 1877, while still in Opposition, provide additional clues as to his motivations:

> You are going to adopt the policy of the party who declare that they will keep Canada for Canadians, that they will have a national policy, that they are no

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[45] Hamilton Evening Times. (1866). What the United States has done for us. *Hamilton Evening Times*. 26 April, p 2.

[46] Canadian News. (1866). Upper Canada (from an occasional correspondent). *Canadian News*. 15 March, p 4.

> longer going to kiss the foot of Uncle Sam ... They are going to say we must either have a reciprocity of trade or a reciprocity of tariffs. If they are going to build a Chinese wall, we will subscribe to the erection of that wall.[47]

Certainly, the National Policy – and particularly the elements dealing with tariffs – was not without its detractors. Macdonald came under heavy criticism at home and abroad. British newspapers, for example, were scathing.

> The action of the Canadian government is very pitiable. *The Times* cannot approve of the tariff. It thinks it unwise, and is thoroughly convinced that it will disappoint the Canadians, proving an injury instead of a benefit to them ... Since the Canadians wish to have this tariff they must have it and go their own way; but the result is none the less deplorable.[48]

The *Pall Mall Gazette* declared: "The Budget realizes the worst fears entertained as to the late election. A heavy blow has been struck at British trade."[49] And the Manchester *Guardian* held: "In England there is a feeling of profound amazement and sorrow at the great retrograde fiscal movement of a people so closely allied to Great Britain by ties of kindred social intercourse."[50]

In Canada, Opposition Liberals derided the high tariff policy and its impacts, foretelling a variety of damaging consequences. Sir R.J. Cartwright, Finance Minister in the previous Liberal Administration was scathing: "I have no doubt the honourable gentleman has fostered some industries – for instance the industry of smuggling, which was depressed some years ago, and is rapidly reviving under the fostering influence of the honourable gentleman."[51] He also claimed:

> A large number of the best of our manufacturers are fully convinced that this policy is of a great injury to them. They find that the cost of the raw material has increased, that in addition they will have to raise the wages of their

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[47] Toronto Globe. (1878). Sir John double-face. *Toronto Globe*. 27 July, p 4.

[48] Toronto Globe. (1879). The new tariff. *Toronto Globe*. 21 March, p 1.

[49] Ibid.

[50] Ibid.

[51] Sir R. J. Cartwright, 9 March 1880. House of Commons Debates, Second Session – Fourth Parliament, p. 537.

> workmen; while, on the other hand, they find that the power to buy of the customers with whom they deal has diminished under the effect of the Tariff. They find they cannot raise their home prices sufficiently to compensate them for the increased taxation, and that they fight at a disadvantage in the struggle for foreign markets.[52]

Despite political and media opposition, Macdonald's high tariff policy took hold. It resulted in a 35 per cent tariff being established on carriages, a rate later extended to automobiles, helping promote automotive investment in the early twentieth century. Over the years, the National Policy also laid the foundation for Canada's fixation on protecting domestic business and a tendency to discourage inward FDI. This trend might be seen to have continued even into the 1970s and 1980s with the advent of Canada's Foreign Investment Review Agency (FIRA). FIRA's role will be considered in the development of the automotive manufacturing industry in Chapter Nine, including a discussion of the perception of the agency's anti-FDI bias.

With respect to the automotive industry, not only did the National Policy of 1879 protect Canadian industry, and as Macdonald had assured, "keep Canada for Canadians" behind a wall of high tariffs, it also set the foundation for policies that were hostile to the notion of FDI. For example, Larry Duffield, who served as program manager in the Canadian Embassy in Japan between 1981 and 1987, suggests that prior to his arrival in Japan, investment promotion activity was desultory; in fact, Canadian policy at that time seemed to implicitly discourage non-Canadians from investing in Canada.[53]

Yet Macdonald's policies did spur the establishment of foreign owned automotive manufacturing in Canada in the early twentieth century. Some pioneering firms endured and became the bedrock of the industry that exists in Canada today. Further, the investment barriers that the National Policy inspired eventually influenced decisions by offshore investors to enter the Canadian industry in the early to mid 1980s. Therefore, the policy framework initiated in 1879, which in turn was stirred

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[52] Ibid, p. 541.

[53] Duffield, L. (2004). Interview with the author on 8 December, Windsor, ON.

by events that can be traced as far back as 1854, has thus impacted automotive manufacturing in Canada today.

5.2 The Origins of Automobile Manufacturing in Canada

Although foreign ownership became predominant in Canadian automotive manufacturing, the early years at the turn of the twentieth century were not unlike those of other nations. The new industry inspired entrepreneurs from across the country, but particularly southern Ontario and Quebec, to enter the fray. Many companies started operations and quickly closed. These efforts are well documented by Dykes (1970) and include a number of firms that independently sought to establish manufacturing operations in Ontario cities and towns like Toronto, Orillia, Galt, Brockville, Brantford, Chatham, and Berlin (now Kitchener), where Canada's first production-model automobile was built in 1899.

True and sustainable success did not occur, however, until well-capitalized Canadian carriage makers forged relationships with already established American operations.[54] By aligning themselves with the Americans, Canadian firms gained access to the technology and design capabilities of their partners. In return, the larger American firms gained access to not just the protected Canadian market, but also to much of the British Empire. Indeed, this same pattern was to be repeated decades later: recognition that Canada represented an access point for larger markets was crucial in attracting offshore manufacturers. Ironically, instead of granting US firms access to foreign markets, by the 1980s Canada was attractive to foreigners seeking access to the US market.

When Gordon McGregor of Walkerville, Ontario established a relationship with Henry Ford in 1904, The Ford Motor Company of Detroit had been manufacturing vehicles for just over a year. McGregor recognized that his small carriage business

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[54] But even a strong capital underpinning, combined with a solid background in carriage manufacture and cross-border affiliations was not enough to keep manufacturers like the Brockville Atlas Automobile company, from bankruptcy, albeit 10 years after formation. Available from: http://www.modelt.ca/atlas.html. (Accessed on 30 May 2005.)

would find it difficult to survive the advent of the automobile. Automobiles and the automobile industry were in their nascent stage, particularly in Canada where sales were much lower than in the US. In 1903, for example, just 178 passenger cars were registered in the entire Dominion of Canada, and by 1910 only 5,890 vehicles were registered (Motor Vehicle Manufacturers Association of Canada, 1968, p 28). In the towns and regions beyond the major cities, proliferation was even slower. As late as 1911, for example, the purchase of a new automobile still passed as news in the eastern Ontario lumber town of Renfrew where the arrival of the community's second vehicle was reported on page two of the local newspaper.[55] In the US, by contrast, 8,000 passenger cars were registered as early as 1900, growing to 458,377 by 1910 (Motor Vehicle Manufacturers Association of Canada, 1968, p 37). However, as early as 1904, McGregor recognized that the trend to motorized vehicles was clear with US sales presaging the impending trend in Canada.

McGregor's approach to Ford in 1904 would appear to be a masterstroke, but the fact of the matter is that at the time McGregor approached him, linking oneself to the automotive industry in general and Henry Ford in particular was not without risk. Ford had already overseen the collapse of two automotive ventures and was just one of dozens of entrepreneurs in the US seeking their fortune in the emerging field. Even as late as 1909, Ford was not considered the industry leader. General Motors chairman, William Durant, for example, negotiated the purchase of Ford for $9.5 million and the General Motors Board voted approval, but the company's bankers stopped the deal on deciding Ford was not worth $9.5 million.[56] Further, according to Sam McLaughlin, a member of General Motors Board of Directors from 1910 to 1967:

> It is putting it mildly to say that in 1909 the auto industry was in a state of flux ... At the time of the Ford negotiations, for example, General Motors was also considering the purchase of the E.R. Thomas Co., makers of the then

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[55] Renfrew News. (1911). District news. *Renfrew News.* 28 July, p 2.

[56] McLaughlin, S. *My Eighty Years on the Road.* Available from: www.gmcanada.com/inm/gmcanada/gmcanada/english/about/OverviewHist/RSbioPart3.html. (Accessed 27 May 2005.)

> famous Thomas Flyer, and in automobile circles this deal was considered a much more important and promising one than the Ford negotiations.[57]

Ford – and now McGregor – was competing in what was a crowded field. Even as early as 1906, for example, an automobile show in Toronto, Canada in March of that year boasted a demonstration of 126 automobiles valued at $150,000.[58] Despite the intense competition, Anastakis (2004) posits that if McGregor had not approached Ford when he did he would probably have been rebuffed. Having built just a few hundred vehicles in 1904 and having declared a profit for the year of $98,000 (Dassbach, 1989, p 54), Henry Ford's third attempt to establish a major automotive business had not yet resulted in success. Just four years later, production reached 10,000 vehicles and a dividend of $2.5 million was paid (Anastakis, 2004, p 225).

The deal signed with McGregor in August 1904 was not Ford's first foray outside the US. In fact, the sixth Model A Ford manufactured was sent to Canada in August 1903 (Dassbach, 1989, p 65). Moreover, the Canadian Cycle and Motor Company had already been appointed the company's agent in Canada. However, Canadian sales were struggling. The 35 per cent tariff meant that Ford's American-made cars were considerably more expensive in Canada than in the US, partially explaining the slower proliferation of the automobile in Canada. A vehicle costing $800 in the US, for example, cost almost $1,100 in Canada with the addition of the duty. Ford recognized that gaining a toehold in Canada could best be achieved by establishing operations in that country, and so McGregor's approach was timely.

The experience of Sam McLaughlin and General Motors in many ways parallels that of Gordon McGregor and Ford. Like McGregor, McLaughlin recognized that the long-term viability of his family's successful carriage business was threatened by the advent of the automobile. At the time, McLaughlin was the largest carriage

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[57] Ibid.

[58] Toronto Globe. (1906). Automobile to be a great blessing. *Toronto Globe*. 24 March, p 23.

This was at a time when 10 and 20 horsepower Ford vehicles were being advertised in Canada for $1,100 and $2,700 respectively. (Toronto Globe. 1905. Advertisement. *Toronto Globe*. 18 March, p 21.)

manufacturer in the British Empire with branch offices across the country and sales agents in South America and Australia. In 1908, after researching potential American partners, McLaughlin negotiated a contract with William Durant, who had started out as carriage maker. It was a 15-year agreement that provided the McLaughlin Carriage Company with rights to purchase Durant's Buick engines and other parts (Dassbach, 1989, p 120). By the late 1910s, however, McLaughlin perceived that it was unlikely that General Motors would be willing to extend the agreement, and that going it alone was not a viable option. Hence, the decision he made to sell the business in 1918. His firm was the last Canadian owned volume automaker.

The arrangements made by McGregor and McLaughlin with American companies in the early years of the twentieth century laid the foundations of the Canadian automobile industry. There is no evidence that governments at the federal or provincial levels were actively engaged in attracting FDI during the early years although a number of municipalities competed aggressively for McLaughlin's carriage business when its Oshawa, Ontario facilities burned to the ground in 1899.[59] But the tariff regime put in place by Macdonald following his return to power in 1878, including the 35 per cent tariff on carriages, undoubtedly lent impetus to manufacturing in Canada. Although it was the carriage industry that was the original focus of the 35 per cent tariff, its impact on the burgeoning automobile industry was realized at an early date. Cowan (1972, p 5) quotes Finance Minister W.S. Fielding describing its impact in the House of Commons in 1904:

> I think, Sir, as to whether or not it is adequate protection (the 35 per cent tariff to protect the thriving carriage industry), we have some evidence of a gratifying character that the tariff, without being evasive, is high enough to bring some American industries into Canada and looks very much like a tariff which affords adequate protection.

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[59] When the McLaughlin Carriage Company burned in December 1899, potentially putting the company's then 600 employees out work, 15 municipalities and towns around Ontario offered to float bonds and provide bonuses in return for McLaughlin rebuilding its operations in their town or city. Oshawa, where the company was located at the time of the fire, offered $50,000; an offer they accepted. From McLaughlin, S. *My Eighty Years on the Road.* Available from: www.gmcanada.com/inm/gmcanada/gmcanada/english/about/OverviewHist/RSbioPart3.html (Accessed 27 May, 2005.)

5.3 Canada's Emergence as an Auto Producing Nation

As shown in Table 5.1, the 35 per cent tariff persisted in Canada until 1926. At 35 per cent, it was lower than the rate assigned by the US and France, but higher than that of Great Britain. During the period, production in Canada grew steadily and the industry gradually narrowed from one where many small firms sought to establish themselves to one dominated by just four: General Motors, Ford, Studebaker and Chrysler. In 1923, Canada was the fourth largest auto-manufacturing nation in the world (Colling, 2004, p 43).

Certainly, the Government of Canada's 35 per cent tariff represented an incentive to manufacture in Canada. A further attraction was the preferential access Canada represented to US manufacturers as a gateway to the Commonwealth. This advantage was recognized as early as 1904 when Gordon McGregor conducted his negotiations with Henry Ford. McGregor not only won the right to manufacture and sell Ford products in Canada, he was also extended these privileges to the rest of the British Empire. In fact, McGregor's first export sale was made in 1905 when a Model C was shipped to Calcutta (Ford Motor Company of Canada Limited, 2004, p 50).

Table 5.1
General Preferential Tariff Rates on Automobiles

Dates	Duty Rates (%)		
	<$1200	$1200-$2100	>$2100
To April, 1926	35	35	35
April, 1926 – June 1931	20	27.5	27.5
June, 1931 – December, 1935	20	30	40
January, 1936 – May 1936	17.5	22.5	30
May, 1936 – June 1962	17.5	17.5	17.5
June, 1962 – March 1963 (temporary surcharge)	27.5	27.5	27.5

Canadian automakers' access to Commonwealth markets ensured that its automotive assembly industry grew to a size beyond what the domestic market alone could support. In the five-year period before 1926 when the Government of Canada overhauled automotive tariffs, Table 5.2 shows imports averaged 10,900 per year while exports averaged 49,900, 4.6 times more. The production to sales ratio stood at 1.19:1. In the absence of exports, the production to sales ratio would have dipped to

0.7:1. Certainly, with exports representing 40 per cent of production, productivity was improved in consequence of economies of scale. As well, without favourable market access agreements, smaller manufacturers may not have produced in Canada, electing when possible to sell into the country and absorb the 35 per cent tariff.

Table 5.2
Average Annual Sales, Production and Trade: Completed Vehicles, 1904-65

Year	Passenger Cars		Commercial		Average Total		Overall	Domestic	Domestic	Import	Exports as a
	Exports	Imports	Exports	Imports	Exports	Imports	Balance	Production	Sales	Share	% of Production
1904-10	161	596	*	*	161	596	-435	NA	NA	NA	NA
1911-15	3,566	5,930	*	*	3,566	5,930	-2,365	NA	NA	NA	NA
1916-20	14,961	9,980	1,659	813	16,619	10,793	5,826	NA	NA	NA	NA
1921-25	40,814	9,864	9,068	1,055	49,882	10,919	38,963	121,800	NA	NA	41.0
1926	53,628	26,345	20,696	2,199	74,324	28,544	45,780	204,727	NA	NA	36.3
1926-30	48,593	31,705	22,885	4,403	71,478	36,108	35,370	208,294	NA	NA	34.3
1931-35	22,555	2,973	8,134	831	30,690	3,804	26,886	99,786	66,505	5.7	30.8
1936-40	36,646	14,147	27,734	2,116	64,380	16,263	48,117	182,829	124,844	13.0	35.2
1941-45	3,575	825	144,502	1,119	148,077	1,943	146,134	193,446	37,851	5.1	76.5
1946-50	26,766	37,653	26,034	4,936	52,801	42,588	10,212	275,198	257,527	16.5	19.2
1951-55	25,216	43,506	17,798	5,941	43,014	49,447	-6,433	428,154	419,451	11.8	10 0
1956-60	14,144	115,155	3,450	10,994	17,594	126,149	-108,555	400,639	485,761	26.0	4.4
1961-65	30,608	98,028	10,601	8,180	41,209	106,208	-64,999	608,213	661,710	16.1	6.8

Notes: Until 1932 the Dominion Bureau of Statistics did not collect automotive retail sales data
NA Not Available
* Included with passenger cars

Sources: Trade data to 1960 from *Facts and Figures of the Automotive Industry, 1961 Edition*, p 37.
Trade data from 1960 on from *Facts and Figures of the Automotive Industry, 1968 Edition*, p 18.
Domestic production to 1926 from *Facts and Figures of the Automotive Industry, 1968 Edition*, p 14.
Domestic production from 1926-60 from *Facts and Figures of the Automotive Industry, 1961 Edition*, p 3.
Domestic production from 1961 on from *Facts and Figures of the Automotive Industry, 1968 Edition*, p 14.
Sales data to 1960 from *Facts and Figures of the Automotive Industry, 1961 Edition*, p 13.
Sales data from 1960 on from *Facts and Figures of the Automotive Industry, 1968 Edition*, p 22.

5.4 Tariff Modifications: 1926-36

Table 5.2 shows that by 1926 the automobile industry in Canada was producing 205,000 vehicles per year and exports had reached 74,000 vehicles. Employment in the industry, not counting those employed in parts and materials, was 12,000 (Canada, 1961, p 6). As the industry grew, pressure mounted on the Government to ease tariff rates. There were several reasons for this pressure. To begin with, the minority government of Mackenzie King was largely dependent upon the pro free trade Progressive Party for its survival beyond the 1926 election (Anastakis, 2001, p 34). Second, the industry had coalesced in the area around southern Ontario and the continued protection of the booming southern part of the province had become increasingly hard to justify. Third, Canadian consumers were becoming increasingly

unconvinced that the gap in automobile prices between Canada and the US was due to the small size of the domestic marketplace (Canada, 1961, p 7 and Dykes, 1970, p 41). Dykes (1970, pp 41, 42) reports that on 15 April 1926, Finance Minister James Robb announced, "There is a pronounced sentiment throughout Canada that the automobile industry enjoys more protection than is needed to maintain it on a reasonably profitable basis, and in deference to that sentiment we propose a downward readjustment of automobile, motor truck and motor cycle duties." At this time, then, as Table 5.1 shows, the 35 per cent General Tariff that had originally been put in place to protect Canada's carriage industry was reduced to 20 per cent for vehicles with retail value under $1,200 and to 27.5 per cent for those above $1,200. At the same time, the British Preferential Tariff rate was reduced from 22.5 per cent for vehicles valued under $1,200 to 12.5 per cent and to 15 per cent for those valued above the $1,200 threshold.

Not surprisingly, the domestic industry felt aggrieved. In response, it established the Canadian Automobile Chamber of Commerce with the stated purpose of "acting with the Government to promote the manufacture of automobiles in Canada and the development of this business throughout the world but more particularly in the British Empire" (Motor Vehicle Manufacturers Association of Canada, 1964, p 2).[60] The Conservative Premier of Ontario Arthur Meighan expressed the industry's angst over the 1926 tariff adjustments. In a speech in Midland, Ontario on 3 August of that year, he declared:

> Nothing better illustrated the utter sham of the King Administration than the alleged reduction in the duties on automobiles. In the very first month of the new rate of duty, the importation of automobiles doubled and in the next month, that of May, they had doubled again. Just that many more millions poured into the lap of the United States.[61]

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[60] The establishment of a trade organization may appear of little consequence to the development of the industry, and, as such, has large been ignored by critics and commentators (including the history of the Canadian automotive industry written by the association's general manager, James Dykes in 1970). Notwithstanding, the Canadian Automobile Chamber of Commerce, which subsequently became the Motor Vehicle Manufacturers' Association in 1964, has in fact been an influential body for nearly 80 years; one that has sought to influence government and has been actively consulted on practically every major piece of policy impacting the industry since its formation.

[61] Toronto Globe. (1926). Cut on auto tariff nothing but sham declares premier. *Toronto Globe*. 4 August, p 1.

The analysis presented by Premier Meighan was correct. Imports swelled from 14,632 in 1925 to 28,544 in 1926 and 36,630 in 1927; a two-year increase of 250 per cent. However, this period was also an era of rapidly increasing sales. For example, there were 724,000 motor vehicles registered in 1925; climbing to 832,000 one year later, and by 1927, 940,000 vehicles were on Canadian roads (Motor Vehicle Manufacturers Association of Canada, 1959, p 20), an increase of 29.2 per cent in just two years. However, the essential premise of Meighan and other opponents to the tariff reductions was correct: imports were taking an increasing share of the market. In 1925, for example, 18.6 per cent of new car registrations were imported; by 1927, 34.1 per cent were made outside of Canada.

In the mid 1920s, the main source of automotive imports was the US. However, as will be demonstrated in later chapters of this thesis, further waves of import penetration would occur as the industry matured. In fact, it can be shown that in the history of the Canadian automotive industry, rising imports trends consistently prompted concern and debate followed by restrictive policy measures. For example, increasing imports from the UK in the late 1950s spurred a chain of events that ultimately led to a Royal Commission led by Vincent Bladen in 1960-61 and the Canada-United States Automotive Products Trade Agreement of 1965. Then, in the late 1970s, it was perceptions of market disruptions arising from increasing Japanese imports that set in motion a series of policy deliberations that eventually led to a rush of inward FDI.

The next major round of tariff adjustments occurred in 1936. However, before then a number of minor changes were enacted. Those changes can be categorized into two types. The first were designed to buttress an industry weakened by the Depression, when production fell from 262,000 vehicles in 1929 to 61,000 by 1932. At market leading Ford of Canada losses grew from $1.4 million in 1931 to $5.2 million in

1932, representing a loss of $118 per vehicle over the two-year period, equivalent to $1,804 in 2003 money.[62]

The Depression caused nations to act unilaterally and restrict international trade, a development that Ashworth (1975, p 250) claims simply prevented conditions from further degenerating rather than offering any hope of prolonged improvement. He cites the UK Import Duties Act of 1932 as a notable symptom of the era as it introduced duties of between 10 and 33 per cent. Kenwood and Lougheed (1971, pp 204, 205) contend that the US Smoot Hawley Act of 30 June 1932, which substantially increased American tariffs, severely restricted the capacity of many nations to export manufactured goods and thereby further exacerbated their ability to service debts. Additionally, the proliferation of import quotas in the 1930s is cited by Kenwood and Lougheed (1971, p 216) as further impairing the ability of manufacturing nations to purchase raw materials, precipitating depression in primary producing nations.

Canada, like others, proved unable to avoid the impulse to shore up tariff walls. To bolster the parts industry, tariff rates were raised on a number of imported parts and components in 1930. In addition, excise taxes on imported parts were introduced in 1931 and then raised in 1932. As Table 5.1 indicates, the assembly industry was supported in 1931 by hiking the General Tariff on imported vehicles valued between $1,200 and $2,100 from 27.5 per cent to 30 per cent and by establishing a third category for tariff classification: a 40 per cent rate for vehicles valued above $2,100.

The tariff changes of the early 1930s did not arrest the industry's slide. Table 5.3 shows that production bottomed out in 1932 at just 61,000 units and was 66,000 in 1933 before bouncing back to 117,000 in 1934. The tariff barriers may, however,

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[62] Assessed using Statistics Canada *CANSIM* Series V737344, Table 326002, Consumer Price Index (CPI) 2001 Basket Content. Figure of $804 arrived at by dividing 2004 scaled rate by 1932 scaled rate and multiplying by 1931 & 1932 losses per vehicle. Therefore (122.3 ÷ 8.0) x $118 = $1804.

By comparison, in 2003, Harbour and Associates (2004, p 152) reports that GM, the global sales leader, showed a loss of US $50 per vehicle; Ford lost US $291 per vehicle; while profit leader Toyota earned US $2,118 per vehicle.

have moderated the depth of the slide. Table 5.3 indicates that during the five-year period 1926-30 sales of imported vehicles represented 17.3 per cent of Canadian production. During the period 1931-35, however, that figure dropped to just 3.8 per cent. Dykes (1970, p 8) also reminds us that the elevated tariff hurdles also coincided with the establishment of the Canadian production operations of Hudson Motors, Graham-Paige and Packard.

Table 5.3
Import Penetration: 1926-35

Year	Production	Imports-Cars	Imports - Commercial	Total Imports	Imports (% of Production)
1926	204,727	26,345	2,199	28,544	13.9
1927	179,054	32,826	3,804	36,630	20.5
1928	242,054	40,226	7,182	47,408	19.6
1929	262,625	39,446	5,278	44,724	17.0
1930	153,372	19,683	3,550	23,233	15.1
Total: 1926-30	1,041,832	158,526	22,013	180,539	17.3
1931	82,559	7,492	1,246	8,738	10.6
1932	60,789	1,160	289	1,449	2.4
1933	65,852	1,093	683	1,776	2.7
1934	116,852	1,988	917	2,905	2.5
1935	172,877	3,133	978	4,111	2.4
Total: 1931-35	498,929	14,866	4,113	18,979	3.8

Sources: Production Data: *Facts and Figures of the Automotive Industry, 1962 Edition*, p 8.
Import Data: *Facts and Figures of the Automotive Industry, 1958 Edition*, p 37.

The extent of the slide in the US was similar to that experienced in Canada with production dropping from a high of 5.3 million vehicles in 1929 to 1.3 million in 1932 (Automobile Manufacturers Association, 1970 p 3), a three year decline of 75 per cent. The US did not regain its 1929 levels of production again until 1949. In Canada, record production levels in 1929 of 263,000 declined by 76.8 per cent to 61,000 in 1932 and did not reach 1929 levels again until 1948.

The second and ultimately more important adjustment, because it contributed to the events which resulted in the Auto Pact three decades later, came in 1932 when a five way trade pact was tabled in the House of Commons involving Canada, the UK, South Africa, the Irish Free State and Southern Rhodesia. Among the 223 items the trade pact impacted in Canada were British made vehicles, which could now be imported free of duty. At the time, British firms were not active in the Canadian marketplace, and remarkably, they ignored the opportunities now presented for two

decades. In his 1961 Royal Commission Report on the Canadian automotive industry, Vincent Bladen, observed "so unimportant did this concession appear to be for the Canadian automobile industry that little attention was paid to it in the Tariff Board Inquiry of 1936" (Canada, 1961, p 8). Since then, Bladen's observation has gained a wider interpretation. For example, Simon Reisman's Royal Commission into the Canadian automotive industry (Canada, 1978, p 8) observed, "This concession was considered of little consequence at the time." Bladen and Reisman may have been correct if they had limited their comments to the observation that the changes had little, if any, *impact* at the time. But the idea that the tariff reductions generated little *interest* is not accurate. Both the overall tariff reduction program and the aspects dealing with the automotive industry generated much comment in 1932. In commenting on the pact overall, the *Toronto Globe* went so far as to describe it as "staggering in its immensity and absolutely uncircumscribed as to its potentialities."[63] Assessments within the industry were more circumspect. Canadian executives understandably used the occasion to extol the virtues of their own offerings vis-à-vis those of their UK competitors. General Motors' R.S. McLaughlin declared: "We have spent years in building cars to suit Canadian conditions and the small automobile of British manufacturers could not, in any way, come up to the standards of performance demanded by motorists in the Dominion." [64] T.A. Russell, president of Willys Overland Limited supported McLaughlin's claim stating: "English cars have not yet found very much favor in this country. They are so different."[65]

Both Bladen and Reisman correctly observed that the full impacts of the 1932 tariff reforms were not felt for more than two decades. British made vehicles did not gain significant market share until after the Second World War when passenger car production was resumed and consumer spending regained momentum. By the early

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[63] Toronto Globe. (1932). Major tariff schedules revised as Bennett lays corner-stone of all British economic edifice. *Toronto Globe*. 13 October, p 1.

[64] Toronto Globe. (1932). Horsepower tax hits motor sales in British Isles. *Toronto Globe*. 13 October, p 1.

[65] Ibid.

1950s, British manufacturers were earning increasing shares of Canada's growing market. However, it was only towards the end of the decade, when the growth in British imports outstripped the growth in the market, that a major threat to North American automakers was perceived. It was then that the 1932 tariff came under fire. The inroads made by British manufacturers, in combination with other factors, prompted a series of events that in a few short years changed the face of the industry.

The tariff hikes of the early 1930s obviously ran counter to the consumer interests expressed by Finance Minister Robb when his government lowered tariffs in 1926 and by 1935 the same concerns had resurfaced. With tariffs now standing at between 20 and 40 per cent, Colling (2004) says that Canadians were paying at least $265 more than Americans for the same vehicle. Facing an election within months, in 1935 the Bennett administration turned to the Tariff Board and invited its chairman to thoroughly review the situation and make recommendations. Finance Minister Rhodes' mandate letter to Tariff Board chairman Sedgewick stated:

> It is my thought that such investigation should not be restricted merely to those specific items of the customs or excise schedules which relate to the manufacturing of motor vehicles, but should be general in scope and character ... Such an inquiry should embrace the matter of the relationship of the production of parts to the larger industry, and of both to the general consuming interest: it should have regard for the principles and operations of drawbacks for domestic consumption, as well as for such matters as content and costs of distribution, and it should endeavor to appraise the various factors which determine the prices at which motor vehicles shall be sold.[66]

Even though the Conservative Government of R.G. Bennett delivered the mandate to the Tariff Board, the Board's recommendations were accepted and implemented by the new Administration of Mackenzie King in the Budget address by Finance Minister Charles Dunning on 1 May 1936. The 1936 adjustments are important because they persisted for the next quarter century. As spelled out in Table 5.1, a 17.5 per cent Most Favoured Nation (MFN) tariff on most vehicles was established

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[66] Letter from Edgar Rhodes to George Sedgewick dated 13 March 1935. Letter appeared in: Toronto Globe. (1935). Tariff board to probe prices of motor cars. *Toronto Globe*. 14 March, p 2.

and the zero duties set out in 1932 under the British Preferential tariff were maintained.

Auto dealers were generally pleased. The remarks of A.D. O'Donnell, president of the O'Donnell-Mackie Company, were representative of the dealers: "It means the gap between high and low priced automobiles will now be bridged to a degree that will give the dealer of expensive cars more of a chance to do business."[67] Canadian automakers, however, were less sanguine. Harry Carmichael, vice president and general manager of General Motors of Canada pointed to the 20,000 American-made vehicles imported into Canada in 1937 and claimed that if a higher tariff was applied an additional 10,000 workers could be hired.

> What a fallacy it is to accuse our industry of hiding behind tariff walls ... As a result of the present low tariff, one company discontinued Canadian operations last year, a second company with considerably larger production has practically ceased to operate in Canada, and a third will cease to manufacture here within the next few months. Only the three major car manufacturing companies will be left in Canada.[68]

Carmichael's comments proved prophetic. Graham-Paige, which had established operations in 1931 in Windsor, Ontario, shut down its Canadian production operations in 1935.[69] Meanwhile, the two other American owned manufacturers, which had set up Canadian operations during the depths of the Depression in the early 1930s to avoid higher tariffs, also closed their doors. Packard, which started Canadian operations in Windsor in 1931, closed its Canadian production facility in 1939.[70] Hudson in nearby Tilbury, Ontario ceased Canadian operations in 1941.[71] Dykes (1970, p 49) concludes that these companies' Canadian production facilities

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[67] Toronto Globe. (1936). Dealers expect little change in auto trade. *Toronto Globe*. 2 May, p 1.

[68] Toronto Globe. (1937) Auto tariff boost urged for Dominion. *Toronto Globe*. 7 December, p 4.

[69] Available from: http://www.windsorpubliclibrary.com/digi/wow/plants/graham-paige.htm. (Accessed 7 June 2005.)

[70] Available from: http://www.windsorpubliclibrary.com/digi/wow/plants/packard.htm. (Accessed 7 June 2005.)

[71] Ibid.

were rendered uneconomical because they were low volume producers which were only viable with tariffs between 20 and 40 per cent.

Despite the challenges presented by the new, lower duty, the Canadian industry continued to expand, due in large part to exports to Commonwealth countries. Table 5.2 shows that between 1935 and 1939 export markets accounted for more than 35 per cent of Canadian production. The advent of war, however, changed the profile of the Canadian automotive industry considerably. Passenger vehicle production was largely diverted to the war effort. New vehicle sales had dropped to just 4,800 by 1943 (Motor Vehicle Manufacturers Association of Canada, 1950, p 16). Yet so great was the surge in new forms of production that the total number of employees in the automotive industry grew from 14,400 in 1939 to 24,300 in 1943 (Motor Vehicle Manufacturers Association of Canada, 1950, p 8). Ford's Canadian plants focused on casting and machining components as well as assembling trucks, armoured vehicles and heavy-duty artillery tractors (Ford Motor Company of Canada Limited, 2004, p 64). Chrysler produced combat units, water-purifying units and tanks as well as gun parts and special motors. GM's contributions included specialty trucks, armoured cars and mobile offices, as well as gun parts, anti-tank gun carriages and bomber fuselages (Dykes, 1970, pp 57, 58). When the country and its economy emerged from the war, it faced a new set of challenges. Tariff policies introduced years earlier, coupled with changing economic conditions were to result in fundamental shifts in the structure of the Canadian automotive industry.

5.5 The Bladen Royal Commission

Despite the challenges, the adjustments that the tariff board put in place in 1936 persisted for the next 25 years. That is when University of Toronto economist Vincent Bladen was appointed as Royal Commissioner charged with reviewing the Canadian automotive industry and its future. Bladen's appointment in August 1960 and his report, published in June 1961, provoked a series of policy adjustments that led to the signing in 1965 of the Canada-US Automotive Products Trade Agreement (Auto Pact). Those writing about the history of the Canadian automotive industry

have focused considerable energies explaining the nuances of the Auto Pact. Some have dug more deeply, scrutinizing the progression of events and policy adjustments that predated the Auto Pact's negotiations beginning with the Bladen report of 1961. They have also explained the policy adjustments that Bladen inspired, such as changes to excise taxes and the implementation of various content related schemes enacted in 1962 and 1963. Only occasionally do those writing about the industry or the Auto Pact refer to the conditions leading to Bladen's appointment and even then, their comments are limited to broad generalizations about the challenges facing the industry in 1960. Emphasis is given to the increasing market share of foreign manufacturers, primarily from the UK. However, no satisfactory account exists of the complexities or competing priorities that existed prior to Bladen's appointment. This paper more deeply explores those aspects and provides new perspective on how the Auto Pact emerged by focusing on events of the 1950s rather than picking up the story, as most have done, with Bladen's appointment in 1960.

The formation of the Royal Commission was prompted by perceived difficulties that vehicle makers believed could only be mitigated through government intervention. The sales side of the industry had been growing for several years, but healthy sales had served to mask a creeping decay on the manufacturing side. Table 5.2 shows that average annual sales were 257,000 per year in the five-year period 1946-50. They climbed by 63.4 per cent to 419,000 per year from 1951-55 and from 1956–60 they climbed another 15.7 per cent to reach an annual average of 486,000. In fact, sales reached the half million mark for the first time in 1959, a floor below which the industry never dipped again. By 1960, however, concerns were being expressed about the long-term viability of domestic manufacturing. This thesis explains the factors contributing to those concerns and describes how they led to the establishment of the Bladen Commission.

The first factor contributing to the establishment of the Royal Commission was the fact that imports were on the rise, particularly in the passenger car area. Table 5.2 shows that imports had previously occupied more than 20 per cent of Canadian automotive sales only once (in 1950), but had jumped to 25.5 per cent, 32.9 per cent

and then 34.9 per cent in 1958, 1959 and 1960 respectively. At 34.9 per cent, imports now represented more than 180,000 units annually.

Second, by 1960, the Canadian automotive industry had completed a full reversal of the pattern established in earlier eras when executives like Gordon McGregor had strengthened his company through heavy reliance on export sales. In the years prior to the war, as can be seen in Table 5.2, exports regularly accounted for more than 30 per cent of Canadian production. By 1960, however, international governments had recognized the importance of automotive assembly as an economic development tool. High tariffs and/or local content restrictions had impelled manufacturers to establish local assembly. By 1961, Ford of Canada had six manufacturing and assembly subsidiaries in Australia and one each in New Zealand, Malaya, Rhodesia and South Africa (Ford Motor Company of Canada Limited, 1961, p 18). Ford Canada, for example, which in 1904 had secured the sales rights for Ford products throughout the British Empire, had in the early years filled international demand largely through Canadian production, aided by preferential tariff regimes in overseas (primarily Commonwealth) jurisdictions. In the years before and immediately after the war, Ford of Canada alone regularly exported more than 40,000 vehicles annually to its foreign subsidiaries and was usually responsible for more than 50 per cent of Canada's automotive exports. However, by the late 1950s, Ford of Canada had established foreign operations in many of these far-flung places and by 1960 Canada export sales had dropped to just 11,770 (Wilkins and Hill, 1964, Appendix 6). Therefore, by 1960, Canada, which had produced a positive balance of trade in completed vehicles every year from 1919 to 1949, was now experiencing a significant and growing deficit. Table 5.2 shows that the 183,000 foreign built vehicles that Canadians purchased in 1960 were offset by exports of just 21,000, a ratio of almost nine to one.

The third area of concern was much less visible but equally compelling. A significant balance of trade deficit had accumulated in the parts portion of the industry. Canada had long experienced a large deficit in parts, related primarily to the fact that low production runs and economies of scale precluded capital intensive parts

manufacturing from occurring for certain components. Bladen, for example, acknowledged that optimum economies of scale for automatic transmission production were approximately 400,000 units annually (Canada, 1961, p 28). At the time, total Canadian vehicle production was just 397,000. The tariff revisions from 1936 accommodated this reality by establishing the same duty rates of 17.5 per cent on motor vehicle parts as had been set for vehicles, but only if the imported parts were of a class or kind made in Canada.

Between 1950 and 1959 the Canadian parts industry grew more slowly than did final vehicle sales, although more rapidly than domestic production, which actually declined from 390,000 vehicles in 1950 to 368,000 in 1959, a drop of 7.3 per cent. As Table 5.4 demonstrates, in 1965 dollars, the parts industry did manage to grow its sales by 16.1 per cent in real terms over the ten-year period despite the contraction in demand for Canadian produced vehicles. The result was that local content in Canadian produced vehicles rose from an average of $779 per vehicle in 1950 (expressed in 1965 dollars) to $960 per vehicle (in 1965 dollars), an increase of 23.2 per cent. As well, throughout the 1950s, vehicles got larger and more expensive. For example, the average retail value of a financed vehicle in 1950 was $2,037. By 1960 it had climbed to $2,879 (Motor Vehicle Manufacturers Association of Canada, 1961, p 16), an increase of $842 or 41.3 per cent, which when adjusted for inflation represented a real increase of 16.4 per cent. Therefore, on the plus side, Canadian parts production and local content had both climbed over the decade. These increases more than compensated for the drop in overall vehicle production in Canada.

Yet the parts industry was not without anxiety. Its leadership perceived that it was missing opportunities and losing ground. As has been explained, European vehicle brands with practically no Canadian content were seizing ever-increasing portions of the Canadian market, a situation that translated into lost sales for the parts industry. "Every time I see a European car drive by, I think there goes $10 we should have got, but didn't" grumbled J.S. Munro, general manager of Raybestos Manhattan, a Peterborough, Ontario manufacturer of brake linings and clutch facings.[72]

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[72] Toronto Star. (1960). UK car parts tariff demanded. *Toronto Star*. 30 April, p 46.

Furthermore, despite the fact that Canada enjoyed positive net trade balances with all of the major European economies, European – Canadian trade in automotive goods was entirely one way. For example, in 1960, when 92,000 UK made vehicles captured 17.7 per cent of the Canadian vehicle market, only $167,000 worth of parts were exported from Canada to the UK (Motor Vehicle Manufacturers Association of Canada, 1961, p 14). In other words, if spread out over the 1.8 million vehicles produced in the UK in 1960 (Canada, 1961, p 105), Canadian parts content represented slightly less than 11 cents per vehicle.

Table 5.4
Automotive Parts: Average Annual Exports, Imports and Content Levels, 1921-65

Year	Parts Exports ($000s)	Parts Imports ($000s)	Balance ($000s)	Ratio of Parts Imports to Exports	Average Consumer Price Index (1992 = 100)	Parts Exports (in 1965 $000s)	Parts Imports (in 1965 $000s)	Export of Parts as a % of Import of Parts	Domestic Vehicle Production (Units)	Domestic Motor Vehicle Metal Parts Production ($000s)	Domestic Motor Vehicle Metal Parts Production ($000s in 1965 $s)	Domestic Motor Vehicle Metal Parts Per Vehicle (in 1965 $s)**	Imported Parts Per Vehicle (in 1965 $s)
1921-25	3,570	14,610	-11,040	4	11.1	6,550	26,441	24	161,970	-	-	-	163
1926-30	3,002	35,258	-32,256	12	10.9	5,519	64,818	9	208,294	-	-	-	311
1931-35	1,871	16,172	-14,301	9	8.9	4,266	36,533	12	99,786	-	-	-	366
1936-40	4,356	30,880	-26,524	7	9.2	9,400	67,109	14	182,829	46,857	-	-	367
1941-45	106,068	73,427	32,640	1	10.6	198,029	138,610	144	193,446	154,144	290,773	1,583	717
1946-50	15,876	111,423	-95,547	7	13.4	24,670	164,101	14	275,198	152,628	224,307	830	596
1951-55	27,207	233,973	-206,765	9	16.7	32,567	279,884	12	428,154	274,355	328,190	767	654
1956-60	144,437	1,538,276	-1,393,839	11	17.9	160,664	1,719,425	9	400,639	316,021	356,470	892	851
1961-65	81,821	584,489	-502,668	7	19 3	83,542	602,192	14	608,213	*	*	*	990

Notes: * Denotes that new Standard Industrial Classification (SIC) System in 1960 rendered comparisons from prior years irrelevant.
** Calculated on the basis of Motor Vehicle Metal Parts Production less exports divided by annual production.

Sources: Export and import data to 1950 from *Facts and Figures of the Automotive Industry, 1961 Edition*, p 37.
Export and import data from 1951 on from *Facts and Figures of the Automotive Industry, 1966 Edition*, p 16.
CPI data from Consumer Price Index (CPI), 2001 Basket Content from Statistics Canada *CANSIM* II Series V735319 Table Number 3260001. Available from: http://dc2.chass.utoronto.ca proxy.lib.uwaterloo ca/cgi-bin/cansim2/getSeriesData pl?s+V73. (Accessed 22 September 2005.)
Domestic production to 1960 from *Facts and Figures of the Automotive Industry, 1961 Edition*, p 3.
Domestic production from 1961 on from *Facts and Figures of the Automotive Industry, 1968 Edition*, p 14.
Domestic parts production, 1938-48 from *Facts and Figures of the Automotive Industry, 1950 Edition*, p 10.
Domestic parts production, 1948-53 from *Facts and Figures of the Automotive Industry, 1955 Edition*, p 10.
Domestic parts production, 1953-59 from *Facts and Figures of the Automotive Industry, 1961 Edition*, p 10.

By the end of the 1950s, Canadian parts makers felt they were falling behind. In addition to lost opportunities from imported vehicles with no Canadian content, imported parts had become an increased threat to the industry. As evidenced in Table 5.4, parts imports were growing more rapidly than domestic parts production. Between 1950 and 1959, parts imports had grown in real terms by 60.8 per cent compared to the 16.1 per cent growth in shipments from domestic producers. Combined with slightly lower vehicle production in Canada, that meant that imported parts had climbed from $558 per vehicle in 1965 dollars in 1950 to $966

per vehicle in 1965 dollars by 1959, a jump of 73.1 per cent. By the end of the decade, foreign parts claimed an equal share of automotive value added to that of Canadian parts manufacturers.

During the summer of 1960 – just one month before the appointment of Vincent Bladen to the post of Royal Commissioner – the parts industry converged upon Ottawa to press its case. Meetings were arranged with several key Cabinet ministers, including Prime Minister Diefenbaker. The parts makers' brief implored the Government to provide protection against imported cars and parts: "If cars are not produced in Canada, the parts manufacturer has no market for his products. ... Action is urgently needed to save the jobs of Canadians working in the automotive industry. The industry cannot survive without tariff protection."[73]

A fourth source of pressure for government involvement was that, by the close of the 1950s, the growing trade imbalance – in vehicles and parts – had begun to affect employment. The total number of employees in the motor vehicle manufacturing and parts industry dropped from a post war high of 56,570 in 1956 to 47,346 in 1959 (Motor Vehicle Manufacturers Association of Canada, 1961, p 10), a decline of 16.3 per cent.[74] The drop in employment corresponded with a 15.4 per cent decline in domestic vehicle production.[75] Of course then, as now, the auto industry represented a desirable source of employment and government was motivated to maintain employment levels. Average salaries and wages in the Motor Vehicle Industry in 1960 were $5,400 annually or $103.85 weekly and, in the Motor Vehicle and Metal Parts Industries, average salaries and wages were $4,800 or an average of $92.31 per

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[73] Toronto Star. (1960). European cars killing us, say parts makers. *Toronto Star*. 14 July, p 12.

[74] The Standard Industrial Classification was adopted in 1960 by the Dominion Bureau of Statistics and was reflected in that year's figures. This meant that statistics previously assigned to the categories of Motor Vehicle Industries and Motor Vehicle Metal Parts industries were now also assigned to a new category: the Truck Body and Trailer Industry. As such, for the purposes of consistency, statistics cited for 1960 incorporate the Truck Body and Trailer Industry and therefore cannot be judged against earlier data.

[75] Employment data incorporates all aspects of the automotive industry, including both production and sales.

week (Motor Vehicle Manufacturers Association of Canada, 1962, pp. 16, 17). Meanwhile, national average weekly earnings stood at $72.22.[76]

A fifth reason for establishing the Bladen Commission was related to the competitive positioning of the North American owned manufacturers. The Big Three had tried to respond to the growing market shares of the Europeans with compact cars of their own; including, for example, the Plymouth Valiant, Chevrolet Corvair and Ford Falcon. In Canada, the aim was to stem the creeping market share of smaller sized European vehicles. In the US, where the vehicles that Canadian subsidiaries would eventually produce and sell were designed, a different phenomenon was underway. There, European imports were of lesser concern because imports occupied a more modest 7.6 per cent of the new car market in 1960 (Ward's Automotive Yearbook, 1965, p 177). In the US, the Big Three's sights were set more squarely upon the AMC Rambler, which had topped sales of 401,000 in 1959, representing 7.1 per cent of the entire new US passenger car market (Ward's Automotive Yearbook, 1960, p 57). In the US, the smaller cars designed by the Big Three emphatically reflected US tastes. The special features of the Canadian marketplace were not fully understood at the time. Canadian Prime Minister John Diefenbaker, for example, believed that the new Big Three smaller cars would arrest the decline in Canadian production and pressured the Big Three to build compacts in Canada rather than importing them from the US.[77] This thesis contends that the failure to fully grasp the unique nature of the Canadian marketplace was demonstrated when the new US compact vehicles failed to do well in Canada. As Table 5.5 indicates, Canadians seeking small cars were being drawn to low cost European-built vehicles like the Vauxhall (from the UK) priced at $1853, the Simca (from France) at $1845 and the top selling Volkswagen (from Germany) at $1595. North American owned companies were offering their new compacts at an average price of $2,554, a premium of $706 or 38.2 per cent above the average priced imported vehicle.

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[76] From Statistics Canada, *CANSIM* Table 281-0014 - Average weekly earnings, industrial composite, by selected urban areas, monthly (Dollars).

[77] Toronto Star. (1959). Failure to sell small cars here could mean disaster. *Toronto Star*. 15 June, p 7.

Table 5.5
Suggested Retail Prices (CDN $) of Small Cars: 1960

North American Compacts		Offshore Imports	
Corvair	2,642	Anglia	1,504
Falcon	2,496	Austin A-55	1,899
Frontenac	2,510	Consul	2,079
Lark	2,586	Hillman	1,865
Rambler	2,454	Morris	1,650
Valiant	2,636	Morris 850	1,295
Average	2,554	Renault	1,798
		Simca	1,845
		Triumph	1,895
		Vanguard	2,149
		Vauxhall	1,853
		Volkswagen	1,595
		Volvo	2,595
		Average	1,848

Prices shown are suggested retail prices at Toronto for lowest priced model with heater

Source: Toronto Star. (1960). Compacts haven't stalled yet. *Toronto Star*. 26 March, p 10.

The North American makers were being trumped in their own backyard, and it was naïve of policy makers like Diefenbaker to believe that US firms could match the success they enjoyed at home. First, as with all Canadian made product, low production runs proved uneconomic. For example, even when AMC Rambler production in Canada reached 30,000 in 1963 (Motor Vehicle Manufacturers Association of Canada, 1966, p 12), new registrations of the same model in the US totalled 427,000 (Wards Automotive Yearbook, 1965, p 159). As well, not only were the European vehicles much more reasonably priced, the North American offerings were priced too close to their companies' larger, standard-sized offerings. At C$2,642, for example, the compact General Motors Corvair was priced just 7.5 per cent or C$213 less than the standard sized Chevrolet.[78] By comparison, in the US, the gap between the Corvair and the lowest cost standard sized Chevrolet (the Biscayne Six) was US$236 or 11.2 per cent (Ward's Automotive Yearbook, 1960, p 30). Third, the combination of scale economies and tariff policy rendered US-built vehicles more expensive than European imports. For example, even after accounting

[78] Toronto Star. (1960). Compacts haven't stalled yet. *Toronto Star*. 26 March, p 10.

for exchange rates[79], in the US, the Corvair was more than C$700 cheaper than it was in Canada at just US$1,810. Meanwhile, the Vauxhall was available in New York for US$1,957 (Ward's Automotive Yearbook, 1960, p 178). In the US, therefore, there was no premium for a Corvair over a Vauxhall. In fact, the Corvair was US$147 or 7.5 per cent less expensive. By comparison, in Canada, the Corvair came with a premium over the Vauxhall of C$789 or 42.6 per cent. The price differential meant that new compact cars offered by the Big Three in Canada in the 1960 model year captured just 14 per cent of the Canadian market. By contrast, in the US compacts regularly accounted for more than 25 per cent of production.[80]

A sixth reason for government pressure to appoint Bladen was that imports were taking an increasing share of the market, the main source of which was the UK. The market share spike in the late 1950s has been briefly reviewed by Dykes (1970), Reisman, in his Royal Commission Report (Canada, 1978), by Holmes (2004), and in slightly more detail by Anastakis (2001). All argue that the root cause was the 1932 treaty that conceded duty free entry for British vehicles. While contributory, it is argued here that more important was a UK currency devaluation in 1949 which resulted in a reduction in the value of the pound sterling vis-à-vis the Canadian dollar of 19.1 per cent. This action came on top of a 15.5 per cent relative decline that had occurred since the end of the war.[81] In a statement announcing Ford UK's results for 1950, chairman Sir Rowland Smith acknowledged the part that currency devaluation had played in his company's export success:

> It is clear that during 1950 the rising level of world-wide economic activity stimulated the demand for motor products. In this country we reaped the benefits of the relatively stable costs and prices of the past few years and

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[79] Statistics Canada, *CANSIM II* Series V37694, Table Number 1760049, Foreign Exchange Rates, United States and United Kingdom, for January 1960. Available from: http://dc2.chass.utoronto.ca.proxy.lib.uwaterloo.ca/cgi-bin/cansim2/getSeriesData.pl?s=v3. (Accessed 16 June 2005.)

[80] Toronto Star. (1960). Kind of car you will purchase may depend on prof's report. *Toronto Star.* 18 August, p 12.

[81] Statistics Canada, Series J560-567, Foreign Exchange Rates, 1913 to 1977. Available from: http://www.statcan.ca.proxy.lib.uwaterloo.ca/english/freepub/11-516XIE/sectionj/sectionj.htm#J560_567. (Accessed 16 June 2005.)

> sterling devaluation in the latter part of 1949 gave a further price advantage and impetus to export sales.[82]

In 1950, import market share jumped to 20 per cent from 13.5 per cent in 1949. Meanwhile, though, Canadian auto sales climbed by 50 per cent to reach 430,000. Therefore, the increase in imports could be ignored as overall sales emerged from the shadows of wartime. In a year-end review of the industry with *The Globe and Mail* newspaper, GM Canada president William Wecker expressed satisfaction with sales and limited his worry list to steel shortages and international currency devaluation. Rather than highlight the impact international currency devaluations might have on imports to Canada, he expressed concern about the impact it was likely to have on Canadian exports: "Currency restrictions and devaluation will likely continue to bar Canadian auto manufacturers from the once lucrative market overseas for an indefinite period,"[83] he observed. During a high profile speech to the Canadian Club on 15 January 1951, Ford's Canadian president Rhys Sale focused his attention on defence spending and inflation, not auto sales in general or increasing imports in particular.[84]

The Canadian executives' initial lack of concern over rising imports existed despite the fact that even though retail sales grew by 50.3 per cent, import sales grew even more. Data from Table 5.2 shows imports jumped from 38,697 units in 1949 to 88,528 in 1950, a one-year rise of 128.8 per cent. However, it was possible to overlook import growth of almost 50,000 when overall sales were up by more than 140,000 and production had swelled almost 100,000. Had more notice been taken, auto executives might have recognized that fully 99 per cent of the rise in imports in 1950 originated from the UK.[85] In 1946, the 731 motor vehicles that the UK exported

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[82] Times of London. (1951). Ford Motor Company: record production in spite of supply difficulties. *Times of London*. 31 May.

[83] Globe and Mail. (1951). Auto production at all-time peak in 1950: GM head. *Globe and Mail*. 5 January, p 20.

[84] Globe and Mail. (1951). Plain words, well said. *Globe and Mail*. 17 January, p 6.

[85] Calculated on the basis of the rise in UK imports from 1949 – 1950 of 49,376 divided by the rise in all exports from 1949-1950 of 49,831 as drawn from *Facts and Figures of the Automotive Industry, 1959 Edition*, p 39.

to Canada represented just 3.2 per cent of total automotive imports (Canada, 1961, Table IV, p 104). By 1949, however, the UK represented 86.4 per cent of automobile imports to Canada and by 1950 UK imports reached 82,839 and accounted for 93.6 per cent of all automotive imports. Yet, because the period was one of general stability and growth, and because UK based imports had gained traction when Canadian production and sales had grown by even more in absolute terms, the rising trend of imports escaped widespread notice for several years.

Even when the size and impact of the UK brands did gain visibility, the chorus of complaints from the Canadian automakers was generally muted. It is suggested here that the reason Canadian automakers were quiet was because each of them had relationships with European brands. For example, when import sales reached 166,000 and captured 32.9 per cent of the market in 1959, some of the biggest importers were the North American owned Big Three. Big Three imports of 69,551 (Canada, 1961, Appendix VI, p 103) represented 42 per cent of all vehicles imported into Canada that year. It took until the late 1950s, a period when the absolute growth of import sales outstripped the absolute growth in overall sales, for the issue to generate significant interest. By then North American-owned production had started to fall even though overall sales remained on the ascent. Over the period 1957–60, overall sales grew by 65,000. Import sales, however, grew by 100,000 over the same period. Therefore, during a time of relative health, the production portion of the industry – the main generator of employment and value added – was on the decline. So even though data from Table 5.2 demonstrates that the Canadian market had jumped by 15.8 per cent to reach annual average sales of 486,000 for 1956–60 over 1951-55, production had dipped by 6.4 per cent between the two periods, from 428,000 to 401,000. Chrysler Canada president Ron Todgham, whose firm's reliance on sales of European made vehicles was significantly lower in both absolute and relative terms than his Big Three competitors[86] was somewhat freer to be blunt, even

[86] In 1960, of the 129,527 new passenger cars registered from Europe, only 3,756 or 2.9 per cent were from Fiat-Simca, which were distributed in Canada by Chrysler. Chrysler Canada's overall sales (as represented by new motor vehicle registrations) including Fiat-Simca were 44,834 (Motor Vehicle Manufacturers Association of Canada, 1961, p 30). That meant that European imports represented just 8.4 per cent of Chrysler Canada's sales of passenger cars. By contrast, UK-based Vauxhall-Envoy, which was distributed in Canada by General Motors had 35,165 new passenger car registrations that

contemptuous, in his assessment of the role of imports in the Canadian marketplace. He distributed French and Italian made vehicles, which arrived in Canada at a 17.5 per cent rate of duty compared to GM and Ford whose Vauxhalls and Fords were made in the UK and entered Canada with zero tariff. In commenting on imported automobiles he sneered: "that word, compounded of colonialism and dripping with the essence of snobbery, leads countless Canadian purchasers to betray their country every day in the marketplace."[87]

The conclusion reached here is that by 1960 the consequences of policies and practices dating back to the 1930s were being felt across the Canadian automotive industry. Significant structural inefficiencies had been created that could no longer be countenanced. They included uneconomic production runs in Canada and a Canada – US price gap that was compelling Canadians to purchase lower priced European imports. At the same time, imported vehicle sales were growing faster than overall sales and the response that the new North American compacts had generated in the Canadian marketplace was disappointing. Export markets for Canadian-made automotive product were declining at the same time as domestic demand for Canadian-made autos was falling. Finally, lucrative auto sector employment was on the decline in Canada. Consequently, pressure had grown to the point where the Conservative Government of John Diefenbaker felt compelled to take action. It was against this backdrop that Diefenbaker appointed Vincent Bladen in August of 1960 to lead a one-man Royal Commission into the auto industry.[88]

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year representing 27.1 per cent of all European passenger cars registered in Canada and 18.3 per cent of GM's total new passenger car registrations of 191,990. Ford, too, had a more pronounced dependence on European built Fords to meet North American market demands. New registrations of European built Fords were 15,356 in 1960, 11.9 per cent of total European built new passenger car registrations in Canada and 15.2 per cent of the 100,850 new passenger car registrations from Ford that year.

[87] Toronto Star. (1961). Traitorous to buy foreign car? *Toronto Star.* 14 April, p 10.

[88] The Bladen appointment was made after it was discovered that the Tariff Board was booked for an extended period with other business. From: Globe and Mail. (1960). Bladen one-man prober of auto industry. *Globe and Mail.* 3 August, p 18.

5.6 Bladen's Recommendations: Sliding to Auto Pact

The recommendations that Bladen gave to the Government in April 1961, and published alongside the Budget Statement in June of that year, were far-reaching. Bladen's package contained seven specific recommendations, although he warned: "these are not discrete items from which a selection is invited; they constitute a unitary plan" (Canada, 1961, p 57). The reality was that some of the items were so extensive and so complex that the Government was compelled to treat them as separate measures. As a result, in the Budget Statement of Finance Minister Donald Fleming in June 1961, only a single recommendation was accepted; the effect of which, in concert with another policy measure Fleming also announced that day, helped arrest the surge in imports. The single Bladen proposal Fleming accepted at the time was the removal of the 7.5 per cent excise tax on passenger cars, which the auto companies had argued for and Bladen accepted was an anachronism. The tax had been applied on both domestic and imported vehicles, but because Canadian-made cars were typically more expensive than imported brands, the measure would have a greater absolute impact on domestic brands than imports. At various times, the Canadian presidents for GM,[89] Ford,[90] and Chrysler[91] promised price cuts should the excise tax be removed. Had the Big Three's price cuts actually matched Fleming's tax cut, the typical North American compact listed in Table 5.5 at an average price of $2,554 would have dropped by $192. Meanwhile, an average European import, priced at $1,848 would have been reduced by just $139. The premium for a North American compact over offshore competition, therefore, would also decline by 7.5 per cent or $53, from $706 to $653. It is contended here, however, that the companies' actions did not match the executives' promises, as price cuts did not always reach the value of the previous excise tax. As a result, the true impact on foreign versus domestic sales was muted.[92]

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[89] Globe and Mail. (1961). Car manufacturers, dealers surprised and delighted. *Globe and Mail.* 21 June, p 11.

[90] Toronto Star. (1960). May build Vauxhalls here. *Toronto Star.* 24 October, p 1.

[91] Globe and Mail. (1961). Car manufacturers, dealers surprised and delighted. *Globe and Mail.* 21 June, p 11.

While the elimination of the excise tax would help make domestic vehicles more price competitive vis-à-vis European imports and was acknowledged as such by Bladen (Canada, 1961, p 60), the real benefit lay in the stimulative effect the potential and immediate 7.5 price reduction would have on sales. The chairman of British Motors Industry in Canada, Alfred Coventry, reflected the view of the industry when he declared, "I think the change is a very good thing. It should help local industry and employment. All motor cars will be cheaper and I don't think it will have much effect on British motor sales."[93]

In point of fact, the measure was a success. As indicated in Table 5.6, in the 12 months immediately prior to the excise tax removal (June 1960 – May 1961) compared to the 12 months immediately after the announcement (July 1961 to June 1962) Canadian sales of new motor vehicles jumped by an average of 5,091 vehicles per month or 12 per cent.

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[92] The GM price cuts, for example, did not quite match the 7.5 per cent as the federal excise tax elimination might suggest. New GM prices listed in the Globe and Mail newspaper dated 21 June 1961 were down by just 4.8 per cent.

Model	Previous Price	Actual Reduction
Corvair	2,346	123.97
Belair	2,992	148.37
Oldsmobile Dynamic 88	3,756	185.25
Cadillac Fleetwood 75 Limousine	12,625	585.38
Average	5,430	260.74

Vehicle prices from: Globe and Mail. (1961). Car manufacturers, dealers surprised and delighted. *Globe and Mail.* 21 June, p 11.

[93] Globe and Mail. (1961). Car manufacturers, dealers surprised and delighted. *Globe and Mail.* 21 June, p 11.

Table 5.6
Canadian New Motor Vehicle Sales Before and After Excise Tax Removal, 1961-62

	12 Months Immediately Prior to Excise Tax Removal (June 1960 - May 1961)		12 Months Immediately After Excise Tax Removal (July 1961 - June 1962)	
	Passenger Cars	Motor Trucks and Buses	Passenger Cars	Motor Trucks and Buses
June	50,747	8,464		
July	33,920	6,271	39,492	5,800
Aug	29,265	7,112	31,139	5,793
Sept	26,173	5,663	23,552	5,352
Oct	33,473	4,672	31,550	5,928
Nov	36,603	6,290	42,574	6,822
Dec	31,792	4,642	31,626	4,664
Jan	27,505	4,992	36,295	5,946
Feb	30,277	6,009	33,497	5,453
March	38,916	7,296	50,572	7,370
April	44,210	7,650	54,995	7,602
May	50,438	7,658	65,275	9,547
June			52,162	8,122
Sub-Total	433,319	76,719	492,729	78,399
Total	510,038		571,128	
Monthly Average	42,503		47,594	

Source: Motor Vehicle Manufacturers Association of Canada. 1964, p 19.

By the time of the Budget in June 1961, Finance Minister Fleming was confronted with demands for tariff increases from several quarters, including textile manufacturers and chemical makers. In addition to overtures received directly from the auto industry, Fleming was wrestling with Bladen's recommendation for the imposition of a 10 per cent tariff on British made vehicles (Canada, 1961, p 58). Even Bank of Canada Governor James Coyne had proposed a temporary across the board 10 per cent tariff increase as a means by which to stimulate Canadian industry and provide jobs. Of course, such measures would have invited serious retaliation from Canada's trading partners. For example, when the parts manufacturers released their case for tariff measures in July of 1960 – before Bladen had even been appointed to his role as Royal Commissioner – the Canadian Association of British Manufacturers and Agencies quickly reminded the media that "trade must be two-way affair and if Canada is planning on increasing its exports to the UK, it must continue to buy more and not less from that country."[94] Within days of the release of Bladen's plan in June of 1961, Donald Stokes, then general sales manager of Leyland

[94] Toronto Star. (1960). European cars killing us, say parts makers. Toronto Star. 14 July, p 14.

Motors, reminded the public that despite auto exports, the UK suffered a large trade deficit with Canada and that Bladen's recommendation for a 10 per cent tariff on British made vehicles would exacerbate the imbalance.[95] The same conflicts were played out two decades later when Canadian policy makers were considering potential responses to growing market share by Japanese manufacturers.

What Fleming did instead – and what was more effective and potentially less damaging in international circles – was use his Budget statement as a platform to announce the Government's intention to devalue the Canadian dollar by encouraging lower interest rates and using foreign reserves to buy US dollars. Before the House of Commons, he stated: "The policy which I am placing before the House tonight is in terms of real economic incentives more significant, more powerful and more pervasive than anything that could be implemented in the way of subsidies and controls."[96] His policy proved successful. In June 1961, when the Diefenbaker Government's intention was announced, the spot rate for the Canadian dollar against the US dollar was near parity at 100.55. By the end of the year, it had dropped to 104.27 and by the following June stood at 108.79,[97] a one-year fall of 8.2 per cent. Against the pound sterling, a similar devaluation occurred. The spot rate for the Canadian dollar against the UK pound dropped by 4.4 per cent between June and December 1961 from 280.55 to 290.33 and by a total of 8.9 per cent over the full 12 months to 305.53.[98] The ultimate effect, of course, was that Fleming's currency devaluation very nearly matched the 10 per cent British Preferential Tariff rate that Bladen had recommended in his report. The effect on vehicle imports was tangible.

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[95] Globe and Mail. (1961). Bladen car tariff plan not fair to Britain. Spokesman protest. *Globe and Mail*. 5 July, p 19.

[96] Globe and Mail. (1961). Dollar to drop. *Globe and Mail*. 21 June, p 2.

[97] Statistics Canada, *CANSIM II* Series V27694, Table 1760049, Foreign Exchange Rates, United States and United Kingdom. Available from: http://dc2.chass.utoronto.ca.proxy.lib.uwaterloo.ca/cgi-bin/cansim2/getSeriesData.pl?s=v3. (Accessed 15 June 2005).

[98] Statistics Canada, *CANSIM II* Series V27696, Table 1760049, Foreign Exchange Rates, United States and United Kingdom. Available from: http://dc2.chass.utoronto.ca.proxy.lib.uwaterloo.ca/cgi-bin/cansim2/getSeriesData.pl?s=vs3. (Accessed 15 June 2005).

As Table 5.2 shows, import penetration quickly dropped by 50 per cent from 35 per cent per cent of sales in 1960 to 17.6 per cent by 1962.

Following the June 1961 Budget, the Diefenbaker Government's desire to devise a coherent automotive policy waned.[99] Meanwhile, the manufacturers clamoured for more. By the fall of 1961, the principal non-government actors had staked out their position on Bladen's recommendations and almost without exception were urging the government to respond. Chrysler Canada president, Ron Todgham declared, "my contention ... is that the entire Bladen report should be implemented for the good of the Canadian automotive industry, the parts manufacturers and the Canadian economy generally."[100] Ford of Canada's Karl Scott was equally effusive. On 30 October 1961, he publicly endorsed the report:

> The Bladen plan is no panacea – for there is no easy solution to the economic ailments plaguing Canada. But it does provide us with an opportunity to achieve volume and the benefits that come to industry and the consumer with the economies of scale, if we are prepared to seize that opportunity.[101]

Smaller vehicle manufacturers were also advocating action. They included Studebaker, International Harvester and American Motors Canada. Fifteen months after the Bladen report was released, AMC Canada president, Earl Brownridge complained: "It's unfair for the Bladen report to be sitting there. We don't know whether it's going to be implemented or not. We could be building Americans and sending them to the United States."[102] Two key players, however, remained ambivalent. General Motors claimed that because the company was the biggest and produced the broadest range of vehicles, it would bear a disproportionate share of the costs of enactment. Donald Woods of the parts manufacturers was obliged to balance the wide and often competing interests of his membership. Four months after its

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[99] Anastakis (2001). catalogs a number of competing issues on the national agenda in the June 1961 – August 1962 timeframe including clashes with Bank of Canada Governor Coyne, the Cold War, questions about nuclear arms for Canadian forces and an electoral setback in June 1962 for the ruling Conservatives that reduced their strong majority to a minority.

[100] Toronto Star. (1961). Our auto men are split over Bladen blueprint. *Toronto Star*. 31 October, p 8.

[101] Toronto Star. (1961). Bladen auto shake-up approved by Ford. *Toronto Star*. 30 October, p 8.

[102] Toronto Star. (1962). Shelving Bladen unfair – Brownridge. *Toronto Star*. 28 September, p 28.

release, Woods was still claiming, "there are many gray areas in the report which should be clarified before further action is contemplated."[103]

As Table 5.6 shows, by the end of 1961, the industry was beginning to exhibit signs of recovery from the difficulties in the late 1950s and early 1960s. The fact, remained, however, that six of the seven recommendations that Bladen had put forward had not been directly dealt with. It is not necessary to provide a review of his recommendations as these are covered at length by several authors, notably by Wonnacott (1965), Beigie (1970), Flynn (1979) and Anastakis (2001). Ultimately, however, only two of his recommendations were implemented: the excise tax which was removed almost immediately and a 10 per cent British Preferential tariff which was imposed on a temporary basis in June 1962.[104]

The more lasting consequence of Bladen's report was the wide-ranging reform embedded in his extended content plan, the consequences of which reverberate down to the present. Bladen's proposal was that Canadian content in automotive parts sold to foreign buyers, including affiliates of Canadian producers, should be taken into account in measuring the Canadian content achieved. If a producer met Bladen's new content thresholds, it would be allowed to bring in vehicles or parts free of duty. Bladen's extended content plan was never directly implemented. However, his report – the process and hearings, as well as the end product – generated significant discussion and spawned an appetite for the kind of fundamental structural reform that proved difficult to ignore. Ultimately, it led inexorably to the integration of the Canadian and US automotive industries.

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[103] Toronto Star. (1961). Our auto men are split over Bladen blueprint. *Toronto Star*. 31 October, p 8.

[104] As part of a general austerity plan announced on 24 June 1962, Prime Minister Diefenbaker announced a temporary 10 per cent increase in tariffs on all imported vehicles. This was consistent with Bladen's recommendations released one year earlier, however, it extended to all products. The announcement, therefore, also meant tariffs on American made vehicles jumped from 17.5 per cent to 27.5 per cent. Canadian producers were pleased. Ronald Todgham of Chrysler called the measure "long overdue and should help the Canadian auto industry." Earl Brownridge of American Motors said "he was tickled to death." However, S.H. Fletcher of British importer, Rootes, claimed the announcement "has taken the wind completely out of my sails" (From: Toronto Star. 1962. "Body blow" says car importer of 10 P.C. increase in tariff. *Toronto Star*, 25 June). As the plan was always considered temporary, the surcharge was removed at the end of fiscal 1962-63 (31 March 1963).

In retrospect, there are a number of reasons why the shift that occurred should not have caused surprise. First, the Order in Council establishing the Royal Commission's mandate, which is provided in Appendix B, would in several aspects appear to direct the Commissioner to consider some form of cross-border amalgamation. For example, Bladen had been directed to:

> Inquire into and report upon … the competitive position of the Canadian automotive industry … as compared with automotive industries in other countries; to examine the relations between companies producing motor vehicles and parts in Canada and parent … companies in other countries and the effect of such relations; to consider the ability of the Canadian industry to produce … economically the various types of vehicles demanded or likely to be demanded by the Canadian consumers (Canada, 1961, Appendix I).

The second reason Commissioner Bladen's recommendation to move toward an integrated industry could have been expected is that he had demonstrated a leaning to some form of cross-border integration throughout the hearings. Indeed, during the first day of public hearings on 24 October 1960, he requested each of the Big Three to produce reports on the propriety of such a direction.[105] In fact, the following exchange with GM Canada president E.H. Walker regarding the potential integration of Canadian and US production illustrates Bladen's interest:

> Walker: I can't see how you would do it without having a dictator.
> Bladen: It doesn't require any more of a dictator than the president of General Motors. We'll admit your goods duty free. It would be profitable for GM Canada and GM US. I hope you'll explore this with your parent company.[106]

Despite strong pockets of discontent, the United Auto Workers (UAW) produced a similar report, as did other groups including the Council of Forest Industries of British Columbia, advocating continent wide integration of the industry.[107]

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[105] Toronto Star. (1960). What cure for auto industry. *Toronto Star.* 27 October, p 6.

[106] Toronto Star (1960). May build Vauxhalls here. *Toronto Star.* 24 October, p 1.

[107] Globe and Mail. (1960). Integrated car industry proposed. *Globe and Mail.* 27 October, p 1.

The third reason an integration recommendation should have been considered inevitable was because Vincent Bladen's free market proclivities were already well established before his appointment. For example, Bladen had declared his admiration for the writings of Adam Smith, as recently as 1959, when he acknowledged:

> Much as I approve of aid, I believe most strongly in the importance of trade ... Self-interest is still the most effective means of promoting the wealth of nations, and the individual pursuit of wealth is the most effective way to promote the increase of social wealth .... We can and must rely on public spirit for much achievement in all spheres of activity, but we must still rely on self-interest to get the bulk of the work done.[108]

Bladen had expressed such opinion throughout his academic career. In writings years earlier, Bladen (1941) had warned of monopoly and near monopoly situations, including the automotive industry. His discussion of combines and public policy was consistently critical of the reluctance of Canadian regulators to stamp out collusion and other forms of anti-competitive behaviour.

Surely, no one should have been surprised by his recommendations. While Bladen would entertain short-term measures to support the industry, he favoured free trade and structural adjustment as the long-term solution. It would have been quite properly and accurately anticipated that his recommendations to build a stronger Canadian industry would be built upon a foundation of exposure to international competition and the markets they represented. His recommendations prompted a demand for significant change, a course which fundamentally altered the structure of the industry.

5.7 Confronting Structural Challenges: 1962-65

The Auto Pact eventually emerged after a succession of attempts by first the Diefenbaker Government, in 1962, then the Pearson Government, starting in 1963, to implement the substance if not the whole of the structural reforms called for by Bladen. Bladen, in effect, set the industry on a course of controlled integration of

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[108] Toronto Star. (1959). Still a long way to go to abolish poverty. *Toronto Star*, 3 June, p 7.

Canadian and American automotive production. He rejected the notion of an all-Canadian car. Conversely, he could also see that pure reciprocity would lead to US domination as had happened in the farm implements sector in 1944: "Employment in the agriculture industry fell 36 per cent in Canada between 1947 and 1957, and fell only 20 per cent in the US" (Canada, 1961, p 50). On the issue of reciprocity, he wrote, "any proposal for promoting such a plan must be combined with some protective device to assure Canada obtains a fair share in the manufacture of automobiles for the expanding market. Moving from proposals for reciprocal free trade, one comes to a proposal for integration with guarantees" (Canada, 1961, p 50).

Under Bladen's plan, all US made motor vehicles and parts would be admitted free of duty, provided certain levels of Canadian content were met. Those levels would be determined on the basis of the number of automobiles produced and imported into Canada.[109] But as indicated, Finance Minister Fleming did not use the occasion of the

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[109] Many have misinterpreted the actual mechanics of Bladen's plan. For starters, they have assumed that the content provision were to be assessed only on the volume of vehicles produced in Canada. In point of fact, content provisions would be calculated on the basis of vehicles produced in Canada (including those for export) plus vehicles imported by those companies into Canada. For example, in the case of Ford of Canada in 1960, content thresholds as envisioned by Bladen would have been assessed as follows:

Production in Canada:	94,200 (Ford Motor Company of Canada Limited, 1961, p 19)
Imports from Ford England:	15,149 (Ford Motor Company of Canada Limited, 1961, p 6)
Imports from Ford Germany:	775 (Ford Motor Company of Canada Limited, 1961, p 6)
Imports from Ford US:	1,660 (Ford Motor Company of Canada Limited, 1961, p 6)
TOTAL	111,784

(Note: An earlier note within this chapter indicated that Ford's 1960 sales in Canada were 100,850. The discrepancy exists because in that instance the reference was to consumer sales. Bladen's extended content plan, however, utilized company level production and import figures.)

The second oversight noted has been that the volume number (e.g. 111,784 in the case of Ford) would be applied against Bladen's sliding scale. For example, because GM produced more than 150,000 vehicles in Canada in 1959, Anastakis (2001, p 51) explains that the company would be required to meet a Canadian content standard of 70 per cent. In fact, content levels were to be applied on a stepped basis. Therefore, a company like Ford, whose total production in Canada in 1960 and imports in 1960 amounted to 111,784, would be required to meet a content level assessed on the basis of:

< 5,000	30 per cent
On the next 15,000	50 per cent
On the next 30,000	60 per cent
On the next 50,000	65 per cent
On the next 100,000	70 per cent
On the next 200,000	75 per cent

June 1961 Budget to tackle the structural solutions Bladen proposed. By the time of Fleming's next Budget in April 1962, his Government was still not prepared to act. In his Budget speech that year he acknowledged the delay, stating: "because the implementation of the remaining recommendations would require extensive modifications of Canada's existing international commitments respecting automobiles and parts, no further action is being proposed in this Budget" (Canada. House of Commons, 1962, p 21).

In fact, the government remained silent on Bladen and any form of cross border integration until October 1962. At that point, the first tentative, unilateral steps toward integration were taken. Over the previous decade, automatic transmissions had become increasingly popular. However, because auto companies and parts makers had agreed they could not be built in Canada in sufficient quantities to be economic, the Government waived the prevailing 25 per cent duty through a special Order in Council (OIC). In early October 1962, reports were starting to emerge that the Government was preparing to forego the annual OIC exempting automatic transmissions from duty. With the OIC set to expire at the end of the month, media reports were speculating that the Government was considering the establishment of a crown corporation to manufacture automatic transmissions.[110] Rather, what they were considering – and what they had been working on for a number of months – was a means by which some of the principles embedded in Bladen could be efficiently and unilaterally manifested into policy. Meanwhile, they were also influenced by an offer that GM Canada president E.H. Walker had first made before Bladen had completed his report. Anastakis (2001, pp 52, 53) recounts that Walker had approached the Department of Industry in February 1961 with a proposal to assemble automatic transmissions in Canada provided the parts needed for its manufacture were imported duty free and provided the duty waiver on automatic

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As a result, the Canadian content threshold for Ford for duty free importation of parts and passenger automobiles would be 60.6 per cent, much lower than the 70 per cent threshold, which some have assumed.

[110] Globe and Mail. (1962). *25 p.c. tariff urged on U.S. transmissions*. Globe and Mail. 16 October, p B3.

transmission would no longer be extended. However, rather than pre-empt Bladen, the Government chose not to react immediately.

The government response to Bladen was issued on 29 October 1962, a full 18 months after publication of the report. The policy decision involved adjustments to the treatment of both automatic transmissions and engines. A decision was made that the OIC would be allowed to expire so that automatic transmissions and engines would face the 25 per cent duty starting November 1 of that year. However, companies would be able to reduce their duty paid by the extent they were able to increase exports over the 1961-62 base year. Duties would be remitted on a dollar for dollar basis on automatic transmissions and stripped engines. The duty remittance on stripped engines was limited to 10,000 engines for each producer. The plan was designed to reduce a deficit in auto parts that by 1961 had reached $314 million. Indeed, Table 5.4 indicates that by 1961, parts imports exceeded exports by a factor of 18.7 to one. According to Finance Minister Nowlan, the new provisions were "designed to offer a substantial inducement to the automobile companies and the parts manufacturers to achieve a better balance between exports and imports of automotive parts." He also predicted they would "encourage additional production and longer production runs in Canada by stimulating the manufacture of those parts and components which can most effectively be made in Canada." He stressed:

> These measures will make clear to the Canadian automotive industry the determination of this Government to reduce the imbalance in the automobile sector of our trade and to do this by reducing costs through increasing production for export rather than by increasing protection at the expense of the Canadian consumer.[111]

Eventually, the auto manufacturers were able to point to actions, which have been accepted as evidence, that the policy measures of October 1962 were having the desired impact. By the spring of 1963, General Motors, for example, had announced plans to proceed with its transmission facility in Windsor; Chrysler started to export Canadian-made engines overseas; Ford began sending Canadian-made wheel hubs

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[111] Honourable George C. Nowlan, 29 October 1962, House of Commons Debates, First Session – Twentyfifth Parliament, Volume II, 1962, Queen's Printer and Controller of Stationary, p. 1008.

and drums to the US; American Motors initiated the shipment of right hand drive cars from Canada overseas; and Studebaker Canada began exporting hub caps as well as forgings and interior plastic mouldings. Table 5.4 shows that in the calendar year that followed the adjustment, parts exports steadily increased, growing by 77.4 per cent from $33.6 million in 1962 to $59.6 million in 1963. At the same time, however, imports also climbed. Table 5.4 shows total automotive parts imports jumped by 24.2 per cent (the same percentage gain as the year over year vehicle unit production increase) from $463 million in 1962 to $575 million in 1963, effectively increasing the automotive parts trade deficit from $430 million to $516 million.

Despite this mixed success, the Government determined to forge ahead. The Liberal government of Lester Pearson replaced Diefenbaker's Conservative regime in April 1963 and brought new leadership to the automotive policy arena. Walter Gordon, the respected Bay Street Toronto icon from the accounting firm of Clarkson Gordon, became the minority government's Finance Minister and his brother-in-law from Montreal, E.C. Drury, was appointed Minister of Defence Procurement, a position that was soon extended to include the new Department of Industry.

The first hint that the October 1962 plan would be expanded came in August of 1963 when Chrysler Canada president Todgham predicted that the one-year program initiated in November 1962 would be extended beyond automatic transmissions and engines.[112] When it was eventually released on 25 October 1963 it provided for the remission of duties on imports of motor vehicle parts to the extent that an increase in exports was achieved over the twelve months ended 31 October 1962. Remission credits were to be earned by vehicle manufacturers through exports by themselves or by independent parts makers to affiliated firms. In other words, one dollar of exported Canadian content above that which occurred during the base year would earn the remission of duties of one dollar of dutiable imports of motor vehicle parts. The program superseded the 1962 scheme, which pertained only to the remission of duties paid on automatic transmissions and 10,000 stripped engines. Further, while the 1962 plan had a one-year renewable timeframe, Drury's new scheme was

[112] Toronto Star. (1962). Expect more auto tariff changes. *Toronto Star.* 15 August, p 16.

extended to cover a three-year window, in order to allow companies to engage in the kind of medium-term planning necessary to adjust to, and benefit from, the new system. If fully exploited, Drury projected that the plan could lead to increased production of between $150 million and $250 million due to longer production runs and resultant economies of scale from increased sales in US markets. Further, to deflect foreign charges that the measure was protectionist, Drury pointed to the measure's capacity to stimulate foreign trade, claiming the action was "consistent with Canada's policy of solving our trade and balance of payments problems by constructive measures and not through restrictive actions." He predicted that his policy enhancement would "contribute to a greater flow of trade between Canada and its trading partners, and will place Canadian producers in a much better position to compete efficiently and effectively in Canadian and international markets."[113]

Reaction was swift in both Canada and the US. In Canada, the Automotive Parts Manufacturers Association (APMA) president Don Wood called it "a good plan and will make lots of production and jobs in Canada" and the heads of the Big Three operations in Canada expressed their commitment to reducing the automotive trade deficit that had accumulated.[114] A few days later, the Canadian UAW also publicly added its support.[115] In February 1964 Chrysler Corporation president Lynn Townsend ventured north of the border to address the Empire Club of Toronto. He confirmed that the Drury Plan, as it was by now called, was "providing a very strong stimulant to our business imaginations" adding that, "any liberalization that can be achieved from the constricting limitations of tariffs will help the businessman of the United States and Canada move toward a more logical integration of production and distribution." He went on to say, "a bold move has been made toward something

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[113] Honourable C.M. Drury, 25 October 1963. House of Commons Debates, First Session—Twentysixth Parliament, Volume IV, 1963, Queen's Printer and Controller of Stationary, p. 4001.

[114] Toronto Star. (1963). Car men back Ottawa export incentive. *Toronto Star*. 26 October, p 14.

[115] Globe and Mail. (1963). Auto plan supported by UAW. *Globe and Mail*. 29 October, p B1.

better and economically sounder than we have had. The job now is to keep the process of evolution in motion."[116]

Certainly the evolution of policy continued, but not in the manner envisioned by Townsend and others. Instead, the process was fed by antipathy from several quarters in the US. Even as Drury was releasing his plan, US Commerce Secretary Luther Hodges was widely quoted as encouraging US firms to "get up on their hind legs and speak out against it."[117] Richard Holton, Assistant Commerce Secretary, warned that the Canadian action "will color our negotiations with the Canadians on other trade matters."[118] The US opposition that accompanied the program's launch would linger and grow and ultimately result in the negotiation of the Auto Pact 15 months after the Drury Plan was announced. From a legal perspective, opposition to the Drury plan was based on the belief that it constituted a bounty or grant on exports to the US under Section 303 of the Tariff Act of 1930. If found to be true, the US Secretary of the Treasury would be obliged to assess countervailing duties on Canadian automotive equipment entering the US. That process was started on 15 April 1964 when the Modine Manufacturing Company of Racine, Wisconsin petitioned the US Commissioner of Customs alleging the breach. On 3 June 1964 the Treasury Department launched an investigation. Further pressure was applied on 21 July 1964 when the Automotive Services Association filed a brief on behalf of its 5,000 members in support of the Modine petition.

Reaction among academics and economists was mixed. Those who claimed the Drury Plan was not protectionist (McLeod from the Toronto Dominion Bank, MacDonald from the University of Toronto) did so on the basis that, even if exports did increase, increased spending would result in Canada and hence greater imports. As Drury had done in the House of Commons, they also argued the plan could not be considered to be protectionist because it was designed to increase exports and thus

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[116] Available from: http://www.empireclubfoundation.com/details.asp?SpeechID=1160&FT=yes. (Accessed on 8 November 2004.)

[117] Toronto Star. (1963). Car men back Ottawa export incentive. *Toronto Star*. 26 October, p 14.

[118] Globe and Mail. (1963). Ottawa proposal called a low blow. *Globe and Mail*. 26 October, p 31.

trade with the US.[119] Conversely, others (Eastman from the University of Toronto, Neufeld from the Bank of Canada) contended the scheme was indeed countervailable as it was designed to transfer expenditure, consumption and employment from the US to Canada.[120] Articles by Johnson (1964) and Paul Wonnacott (1965) were also critical of the Canadian approach. In fact, Wonnacott claimed, the automotive policy arena had become so complex as to be problematic in itself.

All sides of the argument on both sides of the border recognized that extending and escalating the growing dispute would be counterproductive. The perspective of the US was documented in briefing notes to the Senate Finance Committee studying the Auto Pact in September 1965 (United States Senate Committee on Finance, 1965, p 53). Those notes reveal that the Americans recognized that an alternative for the Canadians was the imposition of even higher local content levels.[121] They also understood that their option of using countervailing duties could have provoked a more damaging trade war between the two countries. Further, even though the US was confident in the soundness of its legal argument, it recognized that the levelling of countervailing duties would result in a lengthy period of uncertainty for the industry.

The Canadians and other proponents also recognized the risks of a protracted dispute. As a result, negotiators were pulled together around the negotiating table. Starting in April 1964 and ending in January 1965, a series of negotiations were held between representatives of the two nations. The process culminated in the signing by US President Johnson and Canadian Prime Minister Lester Pearson on 16 January 1965 of an agreement on the framework for the Auto Pact. The strategies and brinkmanship associated with the process over those few months have been well documented and need not be repeated here. However, the actual contents of the

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[119] Globe and Mail. (1963). Four Canadian economists split on auto-parts policy effects. *Globe and Mail*. 6 November, p B5.

[120] Ibid.

[121] In Argentina, Australia and Brazil, for example, local content levels were already in excess of 90 per cent.

agreement that was forged must be reviewed as it provided the foundation for the development of the automotive industry for the next thirty-five years, including the period when offshore-based producers started producing vehicles in North America.

The Auto Pact provided for a managed form of sectoral free trade between Canada and the US. It was to be of unlimited duration, but could be terminated by either the Canadian federal government through an Order in Council (OIC) or through the US Congress on 12 months notice. Under the agreement, licensed manufacturers were allowed to import into Canada assembled vehicles and parts for Original Equipment Manufacturers (OEMs) free of duty provided:

- The ratio of net factory sales value of any class of vehicle produced in Canada to the net factory sales value of vehicles of the same class sold in Canada remained equal to the ratio in the base year of 1964 or 75 per cent, whichever was higher, and
- Canadian in-vehicle value added was at least as great in absolute terms as the Canadian Value Added (CVA) in the base year of 1964.[122]

Over the years, additional companies came to operate in Canada under conditions similar to those of the Auto Pact. These companies gained duty free treatment through an OIC and included such companies as AMC, International Harvester and White as well as small kit manufacturing facilities such as those established by Toyota, Renault and Volvo.[123] The Canadian Government actively recruited such operations. Letters to prospective companies under such arrangements explained how the program functioned, as well as the documentation required and a commitment to assisting the organizations work through the mechanics of establishing operations.[124]

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[122] Inflation was not factored into this second safeguard. As a result, this feature became increasingly meaningless over time.

[123] Archives of Ontario, RG 6-121, TB8, Box 2, Issues Briefing Notes, 28 October 1980.

[124] National Archives of Canada, RG 20, Accession 93-94/195, Box 268, File 4958.6 Part 9, Letter from Charlie Pruner to Raymond Parsons dated March 28, 1983.

The penalties for violations of the Auto Pact were severe: the potential imposition of relevant duties on all vehicles within the class. It was the Government of Canada that monitored performance and the implication of any failures were to be reviewed by the Department of Industry or its successor organizations. Although there were several occasions when companies failed to meet performance floors, the federal government never chose to impose tariffs in a retrospective manner. Instead, the Department of Industry extracted from the offending parties a series of incremental investment commitments. The result was that according to Canadian automotive policy consultant Dennis DesRosiers, the foundations for much of the assembly portion of the Canadian automotive assembly industry were laid. According to DesRosiers, investments of that nature included those by Ford in Oakville, Chrysler in Windsor, AMC-Renault in Bramalea and GM in Scarborough.[125]

The Auto Pact was by no means a reciprocal measure. Certainly it provided for the duty free flow of vehicles and original equipment parts (but not aftermarket parts) between Canada and the US, but the provisions and standards necessary were quite different on both sides of the border. For example, the two safeguards outlined above were unique to Canada and the US argued consistently for the duration of the agreement that those safeguards were designed to be temporary in nature and should disappear. Unlike the US, which sought and received a GATT waiver thereby making the Auto Pact bilateral only, Canada did not seek such a waiver, which made the Canadian treatment multilateral in nature. As a result of the Canadian government's approach, duty free access to the Canadian market was allowed from anywhere in the world as long as the importing producer was able to meet the requirements of the Auto Pact as stipulated by the Government of Canada. So, for example, while so-called captive imports from companies like Mitsubishi were allowed to enter Canada free of duty if imported by Chrysler, they would be subject to the Most Favoured Nation (MFN) tariff if entering the US under similar corporate arrangements. In addition, Japan-produced Hondas or Nissans, UK-made Triumphs, and German made-BMWs – companies that had neither a Canadian manufacturing footprint nor a captive import-like arrangement with an Auto Pact producer – could

[125] DesRosiers, D. (2004). Interview with the author on 24 August, Richmond Hill, ON.

only enter Canada at the MFN rate, which at that point was 17.5 per cent. Gaining duty free access to the US was much more straightforward. The GATT waiver meant that non-North American made vehicles or parts (defined as Canada or US in 1965) would remain subject to duty with no exceptions. The US required North American content of at least 50 per cent to avoid what was then a 3 per cent tariff. The US Treasury and Commerce Departments monitored performance. Further, unlike Canada, the US did not require an importer of vehicles to manufacture in the US (as the Canadian safeguards stipulated). Therefore, an overseas producer like Toyota, Honda, Hyundai or Renault would be allowed to locate in Canada and export to the US duty free provided each vehicle it was exporting from Canada to the US could demonstrate 50 per cent North American content. Meanwhile, the converse would not be true. A producer without manufacturing operations in Canada would be subject to the duty (as was the case, for example, when Mazda located in Flat Rock Michigan, Subaru in Normal Illinois or Nissan in Smyrna Tennessee), even if that producer was well above the 50 per cent North American content threshold.

An additional means by which the Canadian implementation differed from the US was the Letters of Undertaking the Canadian Government requested and received at the time the Auto Pact was being negotiated. To gain what the Canadian Government termed "a fair and equitable share of the expanding North American market"[126] each of the Canadian subsidiaries of the major motor vehicle manufacturers sent letters to the Government of Canada committing to the terms of the agreement as well as to undertaking additional measures. Those measures included assurances they would invest a combined $260 million in new ventures in Canada prior to the end of the 1968 model year as well as an assurance that in each model year the value added in Canada would reach at least 60 per cent of the growth in the value of the cars they sold in Canada.

The Auto Pact opened a new and flourishing phase in the development of the Canadian automotive industry. In the years immediately following the Auto Pact's

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[126] Archives of Ontario, RG 9-10, TB101, Accession 12740 Box 81, File Automotive Program Outline, News Release from Department of Industry, 15 January 1965.

coming into force, many positivistic studies were conducted to assess its impact. These included Beigie (1970), Cowan (1972), Emerson (1975), Wilton (1976) and Flynn (1979). Each was interested in specific outcomes like efficiency gains, trade balances, employment gains, wage differentials and impact on GDP. It is uncommon to find a contribution that does not endorse its outcomes. Only Fuss and Waverman (1986b) minimize its impact. Chapter Six will capture some of the elements of the adjustments and growth that occurred in the immediate post Auto Pact implementation timeframe and bring focus to the factors leading offshore manufacturers to consider investments in North America.

5.8 Conclusion

Those studying the development of the Canadian auto industry have focused considerable attention on the Auto Pact, either on the months immediately prior to its signing or on its long-term impact. A significant body of work also exists surrounding subsequent trade agreements involving Canada and the US and Mexico, specifically, how those undertakings could and would impact the Auto Pact. However, while there can be no question that the Auto Pact represents a critical milestone, it should also be viewed as the culmination of more than 100 years of policy evolution. As such, government policy invoked decades earlier and the conditions that prompted those measures must also be considered. That is what this chapter has sought to provide. In doing so, certain aspects that have not been considered in previous work covering the evolution of the industry in Canada have been brought to the fore. For example, this chapter has included a broader enumeration of the importance that Canada's unique access to other markets afforded its automotive industry throughout its first few decades, it charts the substantial impact tariff modifications have had on imports of both vehicles and parts, and it provides context to the tariff adjustment that afforded duty free treatment to UK-built vehicles in 1932. It also offers a more comprehensive outline of the conditions leading to the appointment of Vincent Bladen to head a Royal Commission into the automotive industry in 1960, and in that vein, documents the impact on import market share of the devaluation of the UK pound sterling in the late 1940s and a

similar program to devalue the Canadian dollar in 1961. It also puts forward the unique view that Bladen and the process associated with his Royal Commission made an indelible contribution in creating a paradigmatic change. Previously, industry actors preferred an isolationist approach. Bladen compelled the industry to consider integration within the broader North American milieu. There would be no turning back.

This chapter has done much to answer the first research question this thesis considers: How did Canada set the preconditions to compete so effectively for offshore investment? In order to compete for large-scale FDI, the country needed a comprehensive policy framework in place with trading patterns established and legislative measures entrenched. It has been shown that these measures were established over decades, providing a fascinating example of ideological and policy continuity amidst tumultuous change in the structure and fortunes of the economy.

Subsequent chapters will focus on the late 1970s and early 1980s and will review the specific policy measures that were enacted to attract offshore automotive investment during that period. However, before the specific tools could be developed, the Canadian automotive industry adjusted to the new opportunities and challenges the Auto Pact of 1965 presented. How the industry grew and evolved during this period will be the focus of Chapter Six.

Chapter Six

Fair Share and the Canadian Automotive Industry in the Auto Pact World: 1965-80

> Living next to you is in some ways like sleeping with an elephant: no matter how friendly and even-tempered is the beast, if I may call it that: one is affected by every twitch and grunt. Even a friendly nuzzling can sometimes lead to frightening consequences.
>
> Pierre Trudeau[127]

Those words were delivered by then Prime Minister Pierre Trudeau in Washington in 1969. He was not speaking specifically about the auto industry, but he could have been because the signing of the Auto Pact in 1965 brought Canada more closely within the sphere of the US with all the hazards and benefits such proximity represents.

There exists a general perception that because the Auto Pact established a form of managed, sectoral free trade that the industry in Canada evolved and matured in a manner that mimicked that of the US. But those who assume that the Canadian and US industries evolved in a similar manner are incorrect. The Auto Pact may have helped integrate the industry, but the integration process was uneven. It caused the industries in the two countries to diverge and in so doing helped continue to build the preconditions for what happened in the 1980s.

Although there were clashes, scuffles and frustrations, the first few years following the Auto Pact's signing brought expansion and prosperity. The lofty goals enumerated in 1965 were being met: Canadian production, employment and value added were all up and differentials in prices and wages were down. By most standards, the Auto Pact was a considerable success. Canada was indeed moving

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[127] Globe and Mail. (1969). Trudeau fields hawkish question and calls for U.S. dialogue with Cuba. *Globe and Mail*. 26 March, p 1.

towards obtaining its fair share of the riches generated by the North American automotive industry. Sleeping next to the elephant had proved worthwhile.

By the time the Auto Pact was approaching its fifteenth anniversary, however, fissures had started to emerge. The North American industry had turned downward: the industry was haemorrhaging sales, production, and jobs, while offshore imports were gaining an increasing share of a shrinking market. Canadian automotive operations were inextricably tied to those of the US, and sleeping next to the elephant had become demanding and uncomfortable.

This chapter focuses on the first wave effects of the Auto Pact: the expansion and prosperity experienced between 1965 and 1980. It reflects on the notion of 'fair share': what it meant, how it was interpreted, and the extent to which it influenced the actions of industry actors. It explores the seeming incongruities between the growth in employment, value added and shipments vis-à-vis the US, with the relative stagnation in capital investment that occurred. The growth of the parts industry in relation to the assembly industry will also be examined. The intersection of these developments created pressures and prompted a range of policy directives, which subsequently influenced the direction of the industry. The efficacy of those efforts will be examined, the majority of which centred on the ongoing debate over fair shares. The issues explored and the perspective provided contributes to understanding the preconditions that allowed Canada to compete so effectively for automotive FDI.

6.1 Fair Share and the Canadian Automotive Industry

For decades, Canadian automotive policy makers were gripped by the notion that the country should secure its fair share of the spoils. But what did the term 'fair share' really mean? How was it defined? What were its parameters? Because it has placed such a pall over so many automotive policy debates, it is important to understand how and why the notion became pivotal to the thinking of policy makers.

For a half-century or so after the beginning of the industry in Canada, the notion of fair share did not surface explicitly as a policy objective. A combination of factors kept the issue obscured. Principle among them was the insular nature of the industry. A high tariff wall shielded the Canadian automotive industry from foreign competition and there were few evident concerns to drive the kind of anxiety a fair share fixation would denote. For example, on only one occasion before 1954 did Canadian sales exceed the number of vehicles assembled in the country. As a result, it appeared that Canada was indeed gaining a fair share. However, once tipped, the balance did not tilt back in Canada's favour until after 1965 when companies started to realign their operations to reflect the new continent-wide opportunities provided by the Auto Pact. The period of low production in Canada relative to sales sowed the seeds for the fair share fixation.

Once the industry, the public and policy makers awoke to the question of 'fair share' – not long after the production to sales ratio tipped against Canada after 1954 – the industry began a three decade long fixation with the concept. The Auto Pact of 1965 provided fuel for conflicting interpretations. Canadian interests, which sought to promote the notion that production, employment, investment and other indices should rise proportionately to sales, found ammunition in Article 1 (b) of the Auto Pact, which stated that the two countries should lower trade barriers "with a view to enabling the industries of both countries to participate on a fair and equitable basis in the expanding total market of the two countries." However, Article 1 (c) cited another, potentially conflicting objective, which could be interpreted as favouring American interests. It stated that the aim of the agreement was "the development of conditions in which market forces may operate effectively to attain the most economic patterns of investment, production, and trade". This aspiration was closer to the free trade scenario advocated by American interests than the managed trade alternative supported by Canadians.

The remainder of this chapter examines the development of the industry between 1965 and 1980, the evolving policy context, and the meanings and significance attached to the notion of fair share. It will also be shown how the fixation with fair

share ultimately was widened to include foreign manufacturers from outside North America.

6.1.i Fair Share and Production

The most direct means of assessing whether a country is obtaining a fair share of automotive industry-related benefits is the number of vehicles produced in the country. A cursory review of year on year production patterns for the period 1965 - 1980 suggests impressive growth of the Canadian industry. Table 6.1 reveals that production climbed from an annual average of 518,000 vehicles in the five years prior to the signing of the Auto Pact to almost 1.3 million by 1980. Meanwhile, US production was near constant, climbing by less in absolute terms than in Canada, even though the US market was 12 times the size. However, this simplistic analysis does not carry the fair share debate very far. It is more important to set the number of vehicles produced against domestic purchases. That standard is the one used by most commentators. Even Lyndon Johnson, in his letter to House Speaker John McCormack sponsoring the Auto Pact's enabling legislation, recognized the appeal of the yardstick. "Historically, Canada's share in North American automotive production has lagged far behind her share in automotive purchases" (United States, 1976). A publication produced by the Province of Ontario (Ontario, 1978, p 12) took a similar view:

> The determination of Canada's fair share of economic activity requires a definition of the term "fair." The spirit of the auto agreement suggests that relative shares of economic activity should be judged with respect to market shares. Thus, a "fair" share of economic activity for Canada requires production growth that moves in pace with domestic demand. Otherwise, growing trade deficits are inevitable.

By this standard, Canada did very well out of the Auto Pact, with its share of combined Canada-US production rising from just under six per cent in the five year period predating the Auto Pact to almost 13 per cent between 1976 and 1980. Table 6.1 shows that by 1980 Canada was assembling approximately 1.1 vehicles for every one sold in the country.

Table 6.1
Production Share

	Canada		US		Total: Canada and US		US Production		Canadian Production	
	Average Annual Production (000s)	Average Annual Sales (000s)	Average Annual Production (000s)	Average Annual Sales (000s)	Average Annual Production (000s)	Average Annual Sales (000s)	% of Canada & US Production	% of Canada & US Sales	% of Canada & US Production	% of Canada & US Sales
1960-64	518	600	8,233	8,864	8,751	9,464	94.08	86.99	5.92	5 47
1965-69	1,147	976	11,936	13,609	13,083	14,585	91.23	81.84	8 77	7.87
1970-74	1,437	1,051	10,571	13,546	12,009	14,597	88 03	72 42	11 97	9 85
1975-79	1,660	1,343	11,504	14,997	13,165	16,340	87.39	70 41	12 61	10.16
1980	1,340	1,264	8,011	12,966	9,380	14,230	85.40	56 29	14 60	9 62

Sources: Canadian production data from 1960 -64 from *Facts and Figures of the Automotive Industry, 1968 Edition*, p 14.
Canadian production data from 1965-80 from *DesRosiers Automotive Yearbook: 2005 Edition*, p 120.
Canadian sales data from 1960-64 from *Facts and Figures of the Automotive Industry, 1968 Edition*, p 22.
Canadian sales data from 1965-80 from *DesRosiers Automotive Yearbook: 2005 Edition*, p 120.
US sales data from 1960-80 from *DesRosiers Automotive Yearbook 2005: Edition*, p 22.
US production data from 1960-80 from *DesRosiers Automotive Yearbook 2005: Edition*, p 120.

By the standards set forth by the Province of Ontario, Canada had secured a fair share of the industry. Following the Auto Pact's implementation, Canadians began assembling more vehicles than they bought. However, it is necessary to dig deeper and consider the totality of the Ontario definition. That definition called for production growth in tandem with market share growth, but it also warned that failure to meet that standard could lead to growing trade deficits. It is to that issue we next turn.

6.1.ii Fair Share and Sectoral Balance of Trade

In the years predating the Auto Pact, Canada experienced a chronic deficit in the value of its automotive trade with the US. Table 6.2 shows that the trough was reached in 1960 – the year Vincent Bladen was appointed to lead a Royal Commission into the future of the Canadian auto industry – when almost 183,000 vehicles entered the country, representing 35 per cent of the market. Meanwhile, Canadian vehicle exports were just over 20,000, making for a ratio of imports to exports of 9:1. In fact, over the five years prior to the Auto Pact coming into force, imports outnumbered exports by 445,000 vehicles, and as Table 6.2 indicates, Canada experienced an average annual deficit in automotive products of $565 million.

Table 6.2
Balance of Trade and Fair Share

	Exports: Annual Average ($ millions)			Imports: Annual Average ($ millions)			Balance: Annual Average ($ millions)		
	Total Motor Vehicles	Total Automotive Parts	Total All Automotive Products	Total Motor Vehicles	Total Automotive Parts	Total All Automotive Products	Total Motor Vehicles	Total Automotive Parts	Total All Automotive Products
1960-64	39	46	90	178	477	655	-139	-427	-565
1965-69	1,262	595	372	874	1,517	478	388	-922	-107
1970-74	2,917	1,853	4,770	2,062	3,296	5,358	855	-1,443	-588
1975-79	6,210	4,019	10,229	4,714	7,230	11,943	1,496	-3,210	-1,714
1980	7,304	4,087	11,391	5,764	8,309	14,073	1,540	-4,222	-2,682

Source: *DesRosiers Automotive Yearbook: 2000 Edition*, Canadian Automotive Trade with All Countries ($millions), p 189.

The signing of the Auto Pact in 1965 did not immediately end this persistent run of deficits, but it did alter the size and composition of the deficit. After 1965, the deficit in completed vehicles started to disappear. In fact in 1966, for the first time since 1952, the balance of trade in completed vehicles tipped from deficit to surplus. This structural shift has continued ever since. By 1980, as Table 6.2 shows, exports of completed vehicles had grown by a factor of 185 over the pre Auto Pact period, from $39 million to $7.3 billion. Meanwhile, vehicle imports also grew rapidly. However, because they grew by a relatively modest 32 times – from an average of $178 million per year to $5.8 billion – the 5:1 vehicle import to export ratio for 1960-64 was transformed to 0.79:1. In other words, the substantial deficit in assembled vehicles shifted to a significant surplus. This change occurred because the Auto Pact imposed upon the Canadian auto industry a focus on assembly through its stipulation that the ratio of net factory sales value for any class of vehicle produced in Canada to the net factory sales value of vehicles of the same class sold in Canada should remain equal to the ratio in the base year of 1964 or 75 per cent. The result was that to avoid punishing duties on both imported vehicles as well as parts, production of both passenger cars and trucks needed to grow in step with sales.[128]

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[128] For example, Chrysler Canada failed to meet the production to sales ratio for trucks in 1973, 1974 and 1975. However, rather than pay duties the federal government estimated at $17 million, Chrysler agreed to invest $40 million to construct a new van plant. (National Archives of Canada, RG 20, Accession 93-94/195, Box 175, File 4958-1 PT25, Inquiry of Ministry by Mr. Dean re. Chrysler, 17 July 1980.) The new plant in Windsor opened in 1977 and produced full sized vans until it closed in 2003.

When Chrysler failed to meet Auto Pact standards again in 1980 and 1981, $245 million in unpaid duties loomed. However, a report prepared by Felix Pilorusso for the Ontario Ministry of Industry, Trade and Technology acknowledges "no serious attempt was made to collect the $245 million owing since the company was in dire financial straits at the time, and it would have likely been driven into

Clearly, the incentive to focus on assembly was compelling; the penalties were serious and the industry responded accordingly. As Table 6.1 shows, Canadian vehicle output grew from an average of just over 500,000 in the five years prior to the Auto Pact to a high of 1.8 million in 1978. By comparison, in the decade and a half following the signing of the Auto Pact, US production grew at a much more moderate rate, rising from an average of 8.2 million between 1960 and 1964 to a high of 12.9 million in 1978 before sliding back to 8 million in 1980. Table 6.1 shows that over the period 1976-80, even though Canada represented just 8 per cent of combined Canada-US sales, its share of North American production climbed to 13 per cent from 5.9 per cent in the 1960-64 period. Perhaps more telling, average annual Canada-US production increased by 4.2 million between 1960-64 and 1975-79. Of that increase, 1.1 million or 27 per cent of the increase was accounted for by Canada.

Meanwhile, however, the Auto Pact entrenched a trade deficit in parts. As Table 6.2 shows, the parts deficit grew from an average of $427 million per year prior to 1965 to $4.2 billion by 1980. As the tendency for Canada to concentrate on assembly intensified – and as the surplus in completed vehicles grew – the parts industry complained that it was not sharing in the success. In a presentation to Federal Industry, Trade and Commerce Minister, Robert De Cotret in 1979, APMA president, Pat Lavelle declared:

> In a period when governments are seeking new growth to offset the decline of older and less competitive industries, the failure to recognize the growth potential of the independent parts industry, particularly by the Federal Government, is almost incomprehensible ... These arrangements are not good enough and do not or should not serve to cover up the real problem that exists

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bankruptcy if it was forced to pay the penalty." (Archives of Ontario, RG 69-2, Accession 22206, Box 2DM, File: Automotive Industry General, Canada – United States Automotive Trade in the Context of a Free Trade Agreement, 3 September 1987, pp 25, 26.)

AMC failed to meet Auto Pact standards in 1980 and 1981, creating a $30 million liability. These duties subsequently were rolled up in the company's investment with Renault in a new $764 million assembly plant in Bramalea, Ontario. (Archives of Ontario, RG 69-2, Accession 22206, Box 2DM, File: Automotive Industry General, Canada – United States Automotive Trade in the Context of a Free Trade Agreement, 3 September 1987, p 25.)

> – we don't produce enough parts in Canada – not because we can't, but because the Agreement won't allow it.[129]

In an interview a quarter century later, he continued to complain: "The so-called domestic producers were consistently negative on doing anything that would alter their preferred position in the Canadian market. I don't believe they were ever helpful in terms of allowing us to open up the opportunities for parts manufacturers, or for incoming vehicle producers from some other country."[130] Holmes (1993 and 2004) has observed that Canada became focused on assembly to the detriment of parts manufacturing. Robert White (1980, p 10), the Canadian director and international vice-president of the UAW, sought to draw attention to the parts deficit:

> The parts deficit – already intolerably high in 1965 – doubled by 1969, doubled again by 1975, and was more than six times as high in 1979 as compared to 1965.
>
> The problems posed for Canadians by such an imbalanced industry are: (a) the loss of jobs; (b) the loss of particular jobs – those involving high levels of skill and providing potential spin-offs to other sectors; (c) the vulnerability to a future involving major technological changes; and (d) the limitation on the options we face.

However, a more thorough examination and deeper understanding of the data does not support such an interpretation. Certainly the deficit in auto parts grew, but the parts industry grew commensurately with the Canadian industry as a whole. Table 6.1 shows that between 1965 and 1980, Canadian assembly production grew by 60.3 per cent. Had the parts industry not received a fair share of this success, its growth would have been significantly lower. Table 6.4 shows that not to have been the case. In fact, employment in the Canadian parts industry grew from 30,500 in 1964 to an average of 46,500 between 1976 and 1980, an increase of 52.5 per cent; this situation occurred at a time when employment in the assembly portion of the industry grew by just 40.5 per cent. Similarly, the value added generated in the parts industry by the four major vehicle manufacturers operating in Canada grew from $676 million in

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[129] Archives of Ontario, RG 9-85, Accession 15627, Box 1, File: Auto Parts; A Presentation by the Automotive Parts Manufacturers Association of Canada to the Honourable Robert De Cotret, P.C. Minister of Industry, Trade and Commerce, 12 October 1979, pp 1 and 11.

[130] Lavelle, P. (2004). Interview with the author on 1 October, Six Mile Lake, ON.

1965 to $2.8 billion by 1980 (Canada, 1992, p 37). When adjusted to 1980-dollar equivalents this outcome represents an overall increase of 60.4 per cent.[131]

The parts deficit climbed due to a combination of related factors. Auto Pact members chose to meet both the Auto Pact's CVA and production to sales ratio requirements by over-performing on the production to sales ratio aspect. They understood that purchases from Canadian parts makers would directly support the CVA aspect only. However, concentrating on final assembly would contribute to both the CVA *and* the ratio. The parts deficit also appeared to grow because increasing final assembly production meant increased parts imports from the US. Those parts were subsequently incorporated into vehicles, which were shipped back to the US and would then be reflected in statistics documenting completed vehicles. Even Ontario Treasurer and Minister of Economics Frank Miller lost sight of the multi-faceted nature of the trade statistics. When speaking to the Automobile Dealers Association in 1980, he pointed to the $4 billion deficit in auto parts trade and claimed, "The elimination of this deficit would create up to 25,000 new jobs in the Canadian auto-parts industry."[132] This claim ignored the fact that the elimination of the deficit in automotive parts would denote a drop in the US vehicle market, which in turn would signal a decline in Canadian production and exports of completed vehicles. It is for this reason that individual elements of automotive trade data should not be viewed independent of trade data documenting the performance of the sector as a whole.

Therefore, assessing the health of the industry through the prism of trade data may be informative. However, some pitfalls must be avoided. These include making the assumption that the trade-related performance of individual segments is representative of either the segment or the industry overall.

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[131] Calculated on the basis of Statistics Canada, *CANSIM* Table 326-0002 - Consumer price index (CPI), 2001 basket content, computed annual total.

[132] Archives of Ontario, RG 6-21, TB8, Box 2, Remarks The Honourable Frank S. Miller Treasurer of Ontario and Minister of Economics, 2 June 1980, p 2.

6.1.iii Fair Share and Investment

Closely related to the notion of fair share and production, and fair share and trade, is that of fair share and investment. It was by the measure of investment that many observers defined the fair share concept. For example, a Cabinet submission in January 1977 titled "Proposals to Increase Ontario's Share of North American Employment and Investment in the Automotive Sector" outlined a series of policy options including pressuring the North American-based vehicle manufacturers for investment, improving the investment climate through incentives, adjusting duty remission programs and revising the terms of the Auto Pact. This latter option was rejected because it was projected that the likelihood of success would be slight given the sharply divergent positions of Canada and the US over the issue: "The U.S. would like to see free trade in automotive products whereas Canada is concerned with securing its "fair share" of North American, production, employment and investment."[133] In 1978, Ontario Premier William Davis used the platform of a meeting of the Prime Minister and Premiers of each of the provinces to describe some of the components of Ontario's vision of fair share in the automotive industry: "The securing of a fair share of automotive investment and employment continues as a major concern. We believe that all Canadian governments should support the Canada / U.S. Automotive Products Trade Agreement as an ongoing reality within which both Canada and the U.S. strive for balanced trade."[134] In preparing its reply to the Reisman Royal Commission on the auto industry, the Province acknowledged that significant benefits had accrued to Canada and Ontario since the inception of the Auto Pact yet went on to argue: "The Canadian automotive market has been growing more rapidly than the level of industry activity. As a result, Canada's share of investment, employment and other industrial benefits has not been commensurate with its contributions to overall North American sales."[135]

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[133] Archives of Ontario, RG 9-88, Box 3C, Binder: Proposals to Increase Ontario's Share of North American Employment and Investment in the Automotive Sector, p iii.

[134] Archives of Ontario, RG 9-88, Accession 22211, Box 4D, Binder: Statement by the Premier of Ontario to the Conference of First Ministers on the Economy and Industrial Development, p 11.

[135] Archives of Ontario, RG 9-85, Accession 15627, Box 1, File: Auto Pacts, Draft of Submission to the Reisman Commission Enquiry in the Auto industry, 11 October 1978, p 3.

At the federal level, New Democratic Party leader Ed Broadbent expressed similar views on what constituted an appropriate distribution of the spoils. Following a meeting with members of the APMA in October 1977, he declared: "Despite intended safeguards of the Auto Pact, the fact is Canada has not received a fair share of the growth of the industry in terms of job creation, investment and research and development expenditures." He went on to urge the Canadian government to "make it clear to the automakers that Canada receives a reasonable distribution of investment, research and development expenditures, overall employment and skilled jobs consistent with our share of the overall North American market."[136] A draft letter to President Carter from Prime Minister Trudeau in May 1978 focused exclusively on investment. His hope was that the Big Three manufacturers would "see their way clear to place a fair and equitable share of their proposed new investment in Canada, so as to contribute to the revamping and upgrading of automotive development and production in Canada and to re-dressing in some reasonable measure Canada's persistent bilateral trade deficit in this sector."[137]

Municipal leaders, with much riding on the continued health of the industry, also waded in. When a Chrysler assembly plant was at risk of closing in Windsor, Ontario in 1978, the City interpreted fair share with respect to the Auto Pact in terms of "investment in research and development and capital expenditures in both countries, to provide for the auto industry workers based on markets and sales in their respective countries."[138] A subsequent response to Mayor Bert Weeks from Minister Horner rebuffed the City's interpretation of the Auto Pact, and clarified the federal position:

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[136] National Archives of Canada, RG 20, Accession 93-94/195, Volume 160, File 4958-1 PT17, Broadbent Urges Fair Share of Auto Jobs, 12 October 1977, p 1.

[137] National Archives of Canada, RG 20, Accession 93-94/195, Volume 160, File 4958-1, PT 19, Draft Letter to President Carter from Prime Minister Pierre Trudeau, 30 May 1978, p 2.

[138] National Archives of Canada, RG 20, Accession 93-94, Volume 160, File 4958-1, PT 18, Letter to Honourable Jack Horner from City Clerk, p 1.

> The Automotive Agreement does not state that Canada is entitled to a fair share. It does refer to the industries in both countries participating in an expanding total market on a fair and equitable basis and to market forces determining the pattern of production, trade and investment. The intention was thus that such factors as production costs and return on investment would determine the share of each country.[139]

Minister Horner's response reflected the language of the Auto Pact but not necessarily the mythology that had grown up around it. In 1965 federal Industry Minister Drury and others did not shy away from predictions about the impact the Auto Pact would have on investment flows. Certainly, the Auto Pact document itself did not explicitly refer to specific investment levels or on what basis such investments would be shared. Instead, it adopted the kind of language contained in the Horner letter to Weeks. In fact, the US State Department took pains to tone down the confident tones of the Canadian press release (Anastakis, 2001, p 221). However, in speeches and on other occasions, industry actors expressed considerable optimism. For example, when the Auto Pact was signed in January 1965 American Motors chief, Roy Abernathy, predicted the Auto Pact "would accelerate the anticipated growth of both the US and Canadian automobile industries."[140] Gerald Mitchell of Hayes Steel Products forecast that "eventually it means a great deal more parts and automobiles will be produced in Canada."[141] Ford's Canadian president, Karl Scott observed, "The Canadian automotive industry for 60 years has seen its growth retarded by protective tariffs and high content requirements. This plan enables us to adapt to a North American industry."[142] Meanwhile, Industry Minister, Charles Drury, in a tone consistent with the guarded manner encouraged by his US counterparts warned: "the test will be whether the Canadian automotive industries have adequate opportunity to participate fully and equitably in the expanding North American market."[143]

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[139] National Archives of Canada, RG 20, Accession 93-94, Volume 160, File 4958-1, PT 19, Letter to Mayor Bert Weeks from Honourable Jack Horner, p 1.

[140] Globe and Mail. (1965). Industry leaders hail auto agreement. *Globe and Mail.* 16 January, p 39.

[141] Ibid.

[142] Ibid.

[143] Globe and Mail. (1965). Drury lists potential gains, says other fields could benefit too. *Globe and Mail.* 16 January, p 29.

Earlier, it was demonstrated that in the 15 years following the Auto Pact's signing, Canada was indeed gaining its fair share of benefits in both final assembly and the production of parts. However, as suggested, several industry players and observers also believed that gaining a fair share of investment was also a legitimate demand. Table 6.3 provides an important and at first glance contradictory glimpse into how the automotive industry in Canada performed from an investment point of view in those years. It shows that despite the rapid increase in production, over the longer-term Canada did not earn investment proportionate to the size of its market. In 1964, for example, Canada accounted for 6.6 per cent of the combined Canada – US market for automobiles; however, the more inefficient Canadian production environment received 7.6 per cent of combined Canada-US capital investments by motor vehicle manufacturers. Thus, the ratio of Canadian investment share to Canadian market share was 1.15:1. The Auto Pact era witnessed a steady stream of investments as companies responded to the opportunities and commitments the new environment represented. In 1965 and 1966, the ratio of Canadian investment share to Canadian market share swelled to 1.2:1, the highest levels that would be reported in any of the 15 years following the Auto Pact's inception. Investments in those years were focused in the assembly sector, but significant parts capacity was added as well. Ford added a 1 million square foot truck plant to their car facility in Oakville, Ontario in 1965 and a 1.6 million square foot facility for passenger car assembly in St. Thomas, Ontario in 1967. In 1965, General Motors opened a 1 million square foot facility in Ste. Therese, Quebec and a trim plant covering 625,000 square feet in Windsor, Ontario. That same year, Volvo in Halifax, Nova Scotia and Renault in St. Bruno, Quebec, opened much smaller kit operations. Other manufacturers responded to the new environment with investments in the parts sector. American Motors, for example, built an engine plant in Brampton, Ontario in 1965 and Chrysler, which already exceeded production to sales ratio requirements by a relatively safe measure, purchased a number of Canadian owned firms for aluminum casting, spring manufacturing and trim between 1965 and 1968.[144]

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[144] In 1965, for example, Chrysler built 136,000 vehicles in Canada (Motor Vehicle Manufacturers Association of Canada, 1966, p 12), but had sales of just 88,000 (Motor Vehicle Manufacturers

Table 6.3
Fair Share of Canada - US Investment by Motor Vehicle Manufacturers

	Market Share		Investment Share		
	Canada: % of Canada US Total Sales	US: % of Canada US Total Sales	Canada: % of Canada - US Total	US: % of Canada - US Total	Ratio of Canadian Investment Share to Canadian Market Share
1964	6.6	93.4	7.57	92.43	1.15
1965	6.6	93.4	7.85	92.15	1.19
1966	6.7	93.3	7.86	92.14	1.18
1967	7.0	93.0	5.85	94.15	0.83
1968	6.7	93.3	3.64	96.36	0.55
1969	6.8	93.2	4.00	96.00	0.59
1970	6.5	93.5	7.52	92.48	1.15
1971	6.6	93.4	4.26	95.74	0.65
1972	6.8	93.2	3.87	96.13	0.57
1973	7.2	92.8	4.14	95.86	0.58
1974	8.8	91.2	4.89	95.11	0.56
1975	9.7	90.3	8.51	91.49	0.88
1976	8.2	91.8	5.39	94.61	0.65
1977	7.8	92.2	7.78	92.22	1.00
1978	7.6	92.4	4.26	95.74	0.56
1979	8.2	91.8	5.52	94.48	0.67
1980	8.9	91.1	5.62	94.38	0.63
1976-80 avg.	8.1	91.9	5.71	94.29	0.70

Sources: The underlying data was standardized by using exchange rate data from Pacific Exchange Rate Service, Foreign Currency Units per 1 U.S. Dollar, 1948-2004. Available from: http://fx.sauder.ubc.ca/etc/USDpages.pdf. (Accessed 4 August 2005.)
Investment figures from 1964-74 from: US International Trade Commission (1976). *Report on the United States-Canadian Automotive Agreement: Its History, Terms and Impact.* Washington: US Government Printing Office, p 323. The data was generated from Big 4 (General Motors, Ford, Chrysler and American Motors) responses to a questionnaire from the United States International Trade Commission.
Investment figures from 1975-80 from: Lavelle, P. and White, R. (1983). *An Automotive Strategy for Canada.* Ottawa: Ministry of Supply and Services, p 168.

Notes: To maintain consistency year to year across Canada and the US two different sources were utilized to build the data contained above. Data for the period 1964-74 was derived from a survey conducted by the US International Trade Commission of the Big 4 manufacturers (General Motors, Ford, Chrysler and American Motors). Data for the period 1975-80 came from Statistics Canada and US Department of Commerce for the SIC categories of Motor Vehicle Manufacturers (in Canada) and Motor Vehicles and Car Bodies (in the US).
Absolute numbers have not been provided because comparisons between the two periods (1964-74 and 1975-80) would not be valid due to the discrete data sources. More important is the distribution between Canada and the US, which this chart demonstrates.

Table 6.3 reveals that during the 16-year period, 1965-80, the ratio of Canadian investment share to Canadian market share was 0.76:1. After the initial boom in 1965 and 1966 investors paid less heed to Canada. By contrast, Table 6.3 indicates that the US received an average of 94.5 per cent of the capital expenditures of the combined

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Association of Canada, 1966, pp 24, 25). Its production to sales ratio, therefore, was a comfortable 1.55:1. Ford, by contrast, had experienced a much narrower ratio. In 1965 it produced 169,000 passenger cars (Motor Vehicle Manufacturers Association of Canada, 1966, p 12), but sold 162,000 (Motor Vehicle Manufacturers Association of Canada, 1966, p 24) for a ratio of just 1.04:1.

Canada – US industry even though the US share of the combined North American market was lower. Therefore, despite the significant investments made in the immediate post Auto Pact signing era, Canada did not become a main centre for investment. Once the base to sustain the Auto Pact safeguards was established, investments in Canadian facilities slipped.

6.1.iv Fair Share and Employment

In contrast to investment, employment growth can be seen to have met the fair share test. Employment growth occurred in both the assembly and the parts segments by equal measure. The fact that employment in the parts industry grew in tandem with assembly has been overlooked or misrepresented by many commentators, In 1977, for example, former federal NDP Leader Ed Broadbent called the Auto Pact outdated because it did nothing to ensure that the Canadian industry grew in proportion to the growth in the Canadian market. He insisted that there would have been 20,000 more jobs if the Auto Pact was "operating as it should."[145] The Canadian arm of the UAW agreed stating: "We need protection not only to safeguard the jobs we have but to ensure our fair share of development under the Auto Pact. We expect our government to insist on job for job value, rather than dollar for dollar value."[146]

Beigie (1970, p 85) agreed:

> The Automotive Agreement has, to date, been of primary stimulus to the level of Canadian output rather than to the level of Canadian employment. Put another way, the Agreement has not caused a marked shift of jobs away from the United States to Canada, but has instead made the Canadian segment of the automotive labour force considerably more efficient.

These pressures caused the government to remain firmly fixed on the maintenance and growth in employment. For example, when it appeared that the Chrysler Corporation might face bankruptcy unless governments provided financing

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[145] National Archives of Canada, RG 20, Accession 93-94, Volume 160, File 4958-1, PT 17, Press Release from New Democratic Party, Broadbent Urges Fair Share of Auto Jobs, 12 October 1977, p 1.

[146] National Archives of Canada, RG 20, Accession 93-94/195. Volume 160, File: 4958-1, PT 18, Presentation to Windsor City Council by Messrs. LaSorda and Parent of Local 444 of UAW, 3 April 1978, p 2.

guarantees in 1980, the Canada – Ontario negotiations hinged on job guarantees: specifically, that Chrysler's Canadian employment levels would average nine per cent of total US employment in 1980-81 and increase to a minimum of 11 per cent between 1982 and 1986.[147]

Yet, despite the rhetoric from certain quarters of the industry and the early analysis from Beigie (1970), this thesis maintains that the Auto Pact was successful in first attracting new assembly investment to Canada and then in prompting additional orders for parts from Canadian vendors, thereby securing employment levels. As Table 6.4 shows, Canada's share of North American auto employment consistently surpassed its share of the market by about 30 per cent. Its share of combined automotive employment grew from 8.5 per cent in 1964 to 10.6 per cent in 1980. Total employment in Canada swelled by 31 per cent compared to 2.8 per cent in the US. Further, despite the perception (and complaints) that the Auto Pact had forced a concentration on assembly to the detriment of the parts sector, it is argued here that the make up of the industry in both Canada and the US remained fixed for 15 years after its inception. Both Canada and the US entered the Auto Pact with an automotive employment structure comprised of approximately 52 per cent assembly and 48 per cent parts and 15 years later the same ratio applied. The shift in favour of the parts sector described in Chapter Three did not occur until after 1980.

This section has demonstrated that, from an employment perspective, Canada did quite well attracting a fair share of increased employment generated by the North American automotive industry. Moreover, despite perceptions to the contrary, the balance within the Canadian industry between assembly and parts manufacturing did not change. The gains made in employment were across the board and not exclusively in assembly operations. This balanced growth scenario, as we shall see, was later to change.

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[147] Archives of Ontario, RG 9-2, Accession 22205, Box 1, File: Automotive Industry – General #2, Statement by the Honourable Larry Grossman Minister of Industry and Tourism on Chrysler, 10 May 1980, p 4.

Table 6.4
Fair Share and Employment

		1964	1965-69	1970-74	1975-79	1980
Share of Canada - US Market	Canada	6.6	6.7	7.2	8.3	8.9
	US	93.4	93.3	92.8	91.7	91.1
Annual Average Employment: Canada	Assembly (000s)	34.3	40.2	42.5	49.1	43.9
	Automotive Parts (000s)	30.5	37.7	42.8	47.6	41
	Canada: % of Employment in Assembly	52.93	51.7	49.9	50.8	51.71
	Canada: % of Employment in Parts	47.07	48.3	50.1	49.2	48 29
	Total Employment: Canada (000s)	64.8	77.9	85.3	96.7	84.9
Annual Average Employment: US	Motor Vehicles and Car Bodies (000s)	362	425.9	419.1	429.4	368
	Motor Vehicle Parts and Accessories (000s)	337	370.3	385.7	412.8	350
	US: % of Employment in Motor Vehicles and Car Bodies	51.79	53.5	52.1	51.0	51.25
	US: % of Employment in Parts	48.21	46.5	47.9	49.0	48.75
	Total Employment: US (000s)	698.4	796.2	804.7	842.2	718
Annual Average: Overall	Total Employment: Canada - US	763.2	874.1	890.0	938.9	802.9
	Canadian Share of Total Canada - US Employment (%)	8 49	8.91	9.57	10.3	10.57
	Ratio: Canadian Employment Share to Canadian Market Share	1.29	1.32	1.34	1.3	1.19

Sources:

Canadian employment data 1964 - 1980 from *Report on the Canadian Automotive Industry in 1986*, p 48.
US employment data from US Bureau of Labour Statistics.
Available from: htt//data.bls.gov/PDQ/servlet/SurveyOutputServlet. (Accessed on 25 August 2005).

Canadian production data from 1960 - 1964 from *Facts and Figures of the Automotive Industry, 1968 Edition*, p 14.

Canadian and US production data from *DesRosiers Automotive Yearbook: 2005 Edition*, p 120.

6.2 Canada's Truncated Auto Industry

Thus far, this chapter has demonstrated that Canada generated automotive production and employment beyond that which the domestic market alone could have supported. Yet one charge levelled against the Auto Pact was that it had caused the Canadian industry to become truncated. A memorandum from Campbell Stuart, who served as chairman of a Canadian Automotive Task Force in the early 1980s, to a colleague in the Canadian Department of External Affairs described it as "the tendency for Canadian subsidiary firms to rely very heavily on their US parent companies for research and development, engineering and design, management functions and investment and sourcing decisions."[148] This phenomenon had been identified by Neil Macdonald (1980, pp 57, 58): "Prior to 1965, the motor vehicle companies' Canadian subsidiaries tended to operate as separated (not independent) entities." Macdonald listed a series of functions that were performed in Canada before the

[148] National Archives of Canada, RG 20, Accession 93-94/195, Volume 30, File 4958-11, PT 4, Memo from Campbell Stuart, Chairman of Automotive Task Force to M. Wodinsky, US General Relations Division, Department of External Affairs, 10 February 1981.

signing of the Auto Pact, but which disappeared in the new, integrated environment. These included the design and adaptation of parts to allow for manufacture at much lower volumes, building and maintaining flexible manufacturing lines that were capable of producing low volumes with a much wider production mix, unique to Canada purchasing and logistics functions, and much more sophisticated, standalone marketing and product planning functions. The Auto Pact's original architect, Simon Reisman, in his Royal Commission study into the industry in 1978 (Canada, 1978, p 232) concluded: "Under the Auto Pact, the Canadian industry lost none of its satellite characteristics. If anything, this condition became more pronounced as the US side took advantage of the free trade arrangements to rationalize its overall activities, including those in management, professional and scientific areas of its operations." The Province of Ontario also fretted about the reduced status of Canadian operations. A Cabinet Submission in 1977 asserted that the Auto Pact had "increased the vulnerability of the industry to decisions taken outside the country by large US-based multinational corporations. While the corporations could not, in their own interests, ignore Canada interests, they are more responsive to US interests."[149]

The seemingly narrow role that subsidiary firms played in Canada called forth a series of critical comments. In 1978, for example, the Province of Ontario (Ontario, 1978, p i) stated that "a fair share research, design and development target would require Canada be allocated research, design and development jobs and expenditure proportionate to its market share." The Ontario study went on to suggest that, based on 1976 data, Canada should have received an additional $200 million in research and development expenditures and an extra 2,500 research, design and development jobs (Ontario, 1978, p 26). According to a 1980 Ontario Treasury and Economics briefing note:

> A fair share of auto R&D for Canada would better reflect the aspirations and abilities of our highly educated workforce. It would provide opportunities for gaining experience, "learning by doing," and recognizing potential spin-offs. Such a significant expansion in the scale of industrial R&D would increase the depth of the labour market for experienced scientists, engineers and

[149] Archives of Ontario, RG 9-88, Box 3C, Binder: Proposals to Increase Ontario's Share of North American Employment and Investment in the Automotive Sector, 11 January 1977, p 26.

> technicians, to the benefit of all technology-based Canadian manufacturing.[150]

The same paper estimated that in 1977, the Big Four subsidiary auto manufacturers in Canada spent just $2 million on R&D in Canada, while paying more than $300 million in royalties for R&D carried out at US installations.[151] Reisman (Canada, 1978) acknowledged the disparity. For 1977, he reported that the US automotive industry spent approximately $3.4 billion on R&D in the US, but only $8 million in Canada. Parts makers were responsible for most of the Canadian expenditures. He went on to propose, "these figures suggest strongly that there is a serious and growing imbalance in the technological composition of Canada's automotive industry. The imbalance is particularly severe in the automotive assembly industry, where if anything, there has been a reduction in real R&D activity since North American assembly was rationalized" (Canada, 1978, p 211).

In 1980, Ontario Treasurer and Minister of Economics Frank Miller noted that energy efficiency, safety and emission standards were fundamentally changing automobile design.[152] Earlier that year, his government, in concert with the APMA, established the Autoparts Technical Centre (APTC) to help Canadian parts makers adjust to the changing landscape. As well, Miller was urging the federal government to negotiate with the auto companies and the US government on the basis that "a fair share approach must be taken to the allocation of investment and research spending in North America."[153] Neil MacDonald's report for the Science Council of Canada later in 1980 offered further evidence in support of the notion that Canada's automotive industry was indeed restricted by the failure to win a fair share of research and design expenditures. His report brought into focus the issue of employment quality in Canada vis-à-vis the US. For example, in an analysis of the

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[150] Archives of Ontario, RG 9-95, Accession 21520, File: Background Paper for an Automotive R&D Policy, August 1980, p 2.

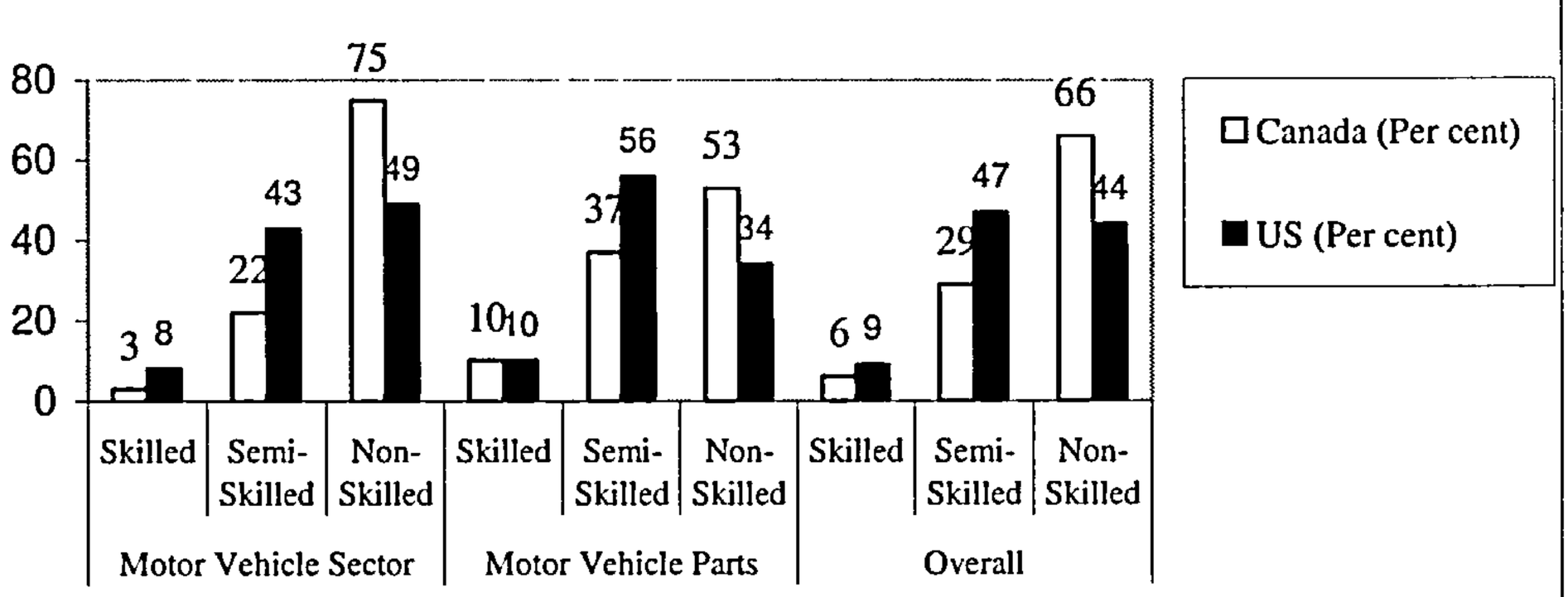
[151] Ibid.

[152] Archives of Ontario, RG 6-121, TB8, Box 2, File: Remarks by Honourable Frank Miller, Treasurer and Minister of Economics at the Grand Opening Ceremonies 33rd Annual Convention Automobile Dealer Association of Ontario, 2 June 1980, p 2.

[153] Ibid, pp 1, 2.

roster of the Society of Automotive Engineers (SAE) and its membership from General Motors, MacDonald (1980, pp 63-65) discovered that just 74 or three per cent of GM's 2,474 SAE members were based in Canada. Further, only 0.7 per cent of GM's product engineers were from Canada, while 13.3 per cent of GM's manufacturing engineers were located in the country. More prosaically, just three per cent of Canadian automotive jobs in 1977 were skilled compared with eight per cent in the US. Employment in the Canadian automotive industry had become concentrated on a narrow range of relatively low skill activities when compared to the US.

Figure 6.1:
Skill Levels in the Automotive Industry in Canada and the US (1980)



Source: MacDonal, N.B. (1980). *The Future of the Automotive Industry in the Context of the North American Industry*, p 73.

The Province of Ontario was consistently troubled by the lower skill requirements of the Canadian industry. A 1979 Ontario Ministry of Industry and Tourism (MIT) briefing note stated that the "profile of jobs in Canada is inferior to that of US – too many low skill assembly jobs, not enough high skill jobs in captive OEM parts, design, development etc."[154] The same complaint was echoed five years later. A

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[154] Archives of Ontario, RG 9-85, Accession 19897, Box 1C, Binder: Position on Auto related Trade, Investment Employment Issues, February 1979, p 1.

1984 Cabinet submission by the Ontario Ministry of Industry and Trade observed: "There is very little design and product development work done by Canadian-based companies. All of the vehicles and most of the parts produced in Canada were and are designed and engineered in the United States."[155] The author went on to observe that "with few exceptions the indigenous Canadian-owned automotive parts companies do not have the strength, technological capability, or managerial resources required for international joint ventures."[156] A 1987 Cabinet submission prepared by the same ministry laid blame at the door of the Auto Pact, stating: "Negative aspects of the Auto Pact are that the bulk of the new jobs were low-skilled, assembly-line jobs, there was a reduction in engineering activity in Canada and decision-making was further centralized at the U.S. head offices of the motor vehicle manufacturers."[157]

These concerns led the Province of Ontario in the early 1980s to introduce the policy of Global Product Mandating. The policy stemmed from the near bankruptcy of the Chrysler Corporation in 1980. A key condition of Chrysler being granted loan guarantees was the participation and support of all affected governments, including those outside the US. Former Chrysler Canada executive, Mike Walker explains:

> The Canadian organization was ... in a very solid financial position. We had investments in terms of Auto Pact and were in good shape ... we also had product that was selling all right at that time. But, in order for the parent to get the guarantee in the United States from the federal government, the federal government of the United States of America said every state and province that you have a plant operation in, you have to get support from them. So, Iacocca hammered out his deals in the United States and then he had to come to Canada and Ontario.[158]

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[155] Archives of Ontario, RG 69-23, Accession 22735, Box 9, File: Ministry of Industry, Trade and Technology – Automotive Industry, Cabinet Submission: Programs and Policies for Ontario's Automotive Industry, 17 September 1984, p 2.

[156] Archives of Ontario, RG 69-23, Accession 22735, Box 9, File: Ministry of Industry, Trade and Technology – Automotive Industry, Cabinet Submission: Programs and Policies for Ontario's Automotive Industry, 17 September 1984, p 6.

[157] Archives of Ontario, RG 69-160, Accession 35705, Box 12, File: Canada – USTR: Trade Negotiations Issues Sector Analysis – Manufacturing Auto January – June 1986, Cabinet Submission: Industry, Trade and Technology, 30 January 1987, p 85.

[158] Walker, M. (2004). Interview with the author on 28 December, Windsor, ON.

The lead Ontario negotiator, David Girvin, likewise explained the developments from the Province of Ontario's perspective:

> At the time, there was much back and forth communication between the federal government and the province ... What it came down to was a case where Ontario was the last jurisdiction to potentially sign on. Before Ontario agreed to make funding available, Washington, Ottawa and all of the affected states had agreed to sign on. Ontario was the lone hold-out.[159]

Ontario sought to leverage its position in the Chrysler negotiations by attempting to free the local industry from the restrictions the Auto Pact had imposed. Chrysler agreed to restructure its operations to increase the "autonomy of Chrysler Canada Ltd. with respect to purchasing, marketing and production functions."[160] An offer of $10 million was also made by the Province for Chrysler to construct a Canadian R&D centre. Yet, while the offer was a widely trumpeted part of the deal, the facility was never built as Chrysler eventually declined the offer and instead built a new R&D centre in Michigan. Herb Gray, who was Industry Minister in the Trudeau cabinet, commenting on the Chrysler negotiations, wryly observed:

> Cabinet agreed that they were a major factor of the Canadian economy. We entered discussions with them about what you might call a rescue package or maybe a bailout, or if you're in the private sector, it's called a restructuring and people get awards from the Chamber of Commerce to do that.[161]

Ontario's efforts to extend and deepen the industry persisted for the next few years. It clung hard to the preferential status the Auto Pact conferred, while angling for an expanded range of functions. The drive to secure global product mandates was part and parcel of this initiative. One month after the Chrysler deal was announced in May 1980, Ontario's MIT established an Advisory Committee on Global Product Mandating under the chairmanship of Lorne Lodge, president of IBM Canada. The Committee solicited input from eight foreign owned subsidiaries "given

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[159] Girvin, D. (2005). Interview with the author on 19 January, Toronto.

[160] Archives of Ontario, RG 9-2, Accession 22205, Box 1, File: Automotive Industry – General #2, Statement by the Honourable Larry Grossman on Chrysler, 10 May 1980, p 5.

[161] Gray, H. (2004). Interview with the author on 2 November, Ottawa.

responsibility for developing, marketing, and exporting a specific range of products for the international market on behalf of the parent company."[162] Roger Hill, the MIT's director of program planning and analysis, had foreseen that "production dedicated to serving the Canadian market alone will become increasingly uncompetitive; especially in industries where the Canadian market is suboptimal to the realization of economies of scale or specialization, this will call into question the viability of the traditional branch plant form of operation in Canada."[163]

Birkinshaw (1996) points out that foreign subsidiaries were often set up to placate host governments and avoid tariffs, but that as tariffs dropped, the role accorded to subsidiaries changed. Some began to take on specialized roles with greater market scope. In extreme cases they might win a world product mandate, defined by Birkinshaw as one where "the subsidiary acts more like an equal partner of the multi-national corporation than a subordinate entity. It can also expect a much higher level of operational autonomy" (Birkinshaw, 1996, p 470). This description is in accord with the approach adopted by the Province of Ontario in the early 1980s, which stemmed from research undertaken by the Science Council of Canada (1980) into the limited scope of Canadian industry. The Council explained that receipt of a broader mandate allowed for greater economies of scale, resulting in lower unit costs and increased sales at home and abroad. Improved trade balances, more jobs and increased tax revenues would all follow. Federal Economic Development Minister Donald Johnston was also captivated by the prospect: "What carrots do we have to make them (foreign-owned companies) transfer or create world product mandates? It strikes me that the world product mandate is a very fundamental question that has to be pursued."[164]

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[162] Archives of Ontario, RG 9-88, Accession 18468, File: Multinational, Multinational Branch-Plants Urged to Specialize, 21 April 1981, p 2.

[163] Archives of Ontario, RG 9-895 Accession 21520, File: Planning and Priorities Secretariat policy Files: Japan Canada Trade Investment; Remarks by Roger Hill, to the TABLE Symposium on Ontario Manufacturing in Crisis? 1 December 1980, p 7.

[164] Globe and Mail. (1982). Cabinet may be shown hi-tech plan by year-end. *Globe and Mail.* 16 November, p B1.

When the Ontario Advisory Committee published its report in April 1981, the responsible minister, Larry Grossman, endorsed the Global Product Mandate approach, predicting companies would be able to "achieve the economies of scale they need, which would translate into increased export earnings for Canada and higher-paying and higher-quality jobs for Canadians."[165] But rather than adopt a specific legislative or regulatory framework to support the vision – a vision that by 1983 had manifested into a target of 20 global product mandates to the province each year[166] – the ministry simply developed a range of promotional tools to sway senior managers of foreign owned subsidiaries and their head office counterparts.

Gaining such mandates was not easy. Both Co (2000) and Catherin (2000) demonstrate that inward FDI generates little R&D. Studies conducted by the Ontario Ministry of Treasury, Economics and Intergovernmental Affairs (Ontario, 1978), Reisman (Canada, 1978) and MacDonald (1980) each concluded that direct interventions by governments would be needed to secure broader mandates. This advice was accepted and both the provincial and national governments devoted significant resources to the objective. But even before official studies confirmed the necessity of intervention, officials had already started to target the Canadian automotive industry as one in which members might potentially make expanded economic contributions. A Cabinet submission in 1977 from the Ministry of Industry and Tourism recommended, "vehicle manufacturers be approached with a view to obtaining from them a commitment to increase their production of capital intensive parts in Ontario."[167] Meetings with federal counterparts in March of 1977 resulted in federal officials agreeing to participate in a strategy to encourage automakers to extend broader mandates and more research and capital-intensive activities to

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[165] Archives of Ontario, RG 9-88, Accession 18468, File: Multinational, Multinational Branch-Plants Urged to Specialize, 21 April 1981, p 2.

[166] Archives of Ontario, RG 9-85, Box 3C, Binder: Proposals to Increase Ontario's Share of North American Employment and Investment in the Automotive Sector, 1 January 1977, p 7.

[167] Archives of Ontario, RG9-88, Accession 18468, File: Multinational, Multinational Branch-Plants Urged to Specialize, 21 April 1981, p 2.

Canadian operations.[168] When it became clear that massive investments were about to be made in the North American industry, Ontario Premier William Davis highlighted the need for a coordinated strategy and intervention, imploring officials to "work with the auto companies to increase the level of Canadian value added."[169] In fact, during April and May of 1978, the Premier, the Treasurer and the Ministers of Labour and Industry and Tourism held meetings with all the vehicle assemblers, parts makers and the UAW in Detroit to argue in favour of Canada receiving a significant share of impending investments, including R&D.

Later, in 1980, in a background paper on automotive R&D, the Ministry of Treasury and Economics recommended a number of incentives to encourage more R&D in Canada, including penalties for insufficient spending,[170] tax credits, direct subsidies and moral pressure.[171] Such intervention was potentially helpful, but the Science Council of Canada (1980), Birkinshaw (1996) and Crookell and Morrison (1990) have each demonstrated that mandates are more likely to be won through the efforts of subsidiaries rather than being mandated by government or simply being conferred by parent companies. According to Ronald Keating, president of Litton Systems Canada in 1980 a multi-pronged approach is necessary:

> A world product mandate can only be given to a foreign subsidiary that has in place the technological capability to handle it. It requires energy, confidence and aggressiveness on the part of the subsidiary, along with justification for

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[168] Archives of Ontario, RG 9-88, Box 1, Accession 17886, Binder: The Auto Industry – An Update, 7 April 1977, p 2.

[169] Archives of Ontario, RG 9-88, Accession 22211, Box 4D, Binder: Statement by the Premier of Ontario to the Conference of First Ministers on the Economy and Industrial Development, April 1978, p 11.

[170] By 1980, the Government of Ontario had signalled an intention to promote a much more rigid, target-oriented stand with the automakers, including seeking commitments to increase their level of CVA to 100 per cent of sales, assuring balanced intra-corporate trade between Canada and the US and commitments to assist Canadian parts makers gain access to US and world markets; all to be scrutinized by a public monitoring system. From Archives of Ontario, RG 9-2, Accession 22205, Box 1, File: Automotive Industry – General 3, Memo to Dr. E.E. Stewart, secretary to Cabinet from D.M. Allan, Assistant Deputy Ministry, Ministry of Industry and Tourism, 31 July 1980, p 6.

[171] Archives of Ontario, RG 9-95, Box 3, Accession 21520, File: Background Paper for an Automotive R&D Policy, August 1980, p 3.

> that confidence and finally, it requires a constructive, supportive attitude on the part of the government in the host country.[172]

The results of Ontario's policy of placing the automotive companies under pressure to adopt global mandates have never been assessed. However, several companies in the high tech field did appear to embrace the concept.[173]

The Ontario initiative sparked significant interest in the concept among the academic community during the 1980s and 1990s. Not surprisingly, much of the work involved Canadians or researchers from countries that, like Canada, were recipients on a large scale of inward FDI. Crookell (1984), Rugman and Bennett (1982), Poynter and Rugman (1982), D'Cruz (1986), Birkinshaw (1996), Birkinshaw and Hood (1997) and Birkinshaw et al (1998) all explored the potentialities of global mandates. The master themes were those of power relations between parent and subsidiaries and spatial clustering, as first given prominence by Porter (1990).

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[172] Globe and Mail. (1981). Big business in the 1980s. *Globe and Mail.* 31 March, p 8.

[173] Canadian subsidiaries which did appear to embrace the global product mandate concept included:

- Westinghouse Canada, which ran of series of advertisements in 1982 and 1983 trumpeting its commitment to a world product mandate strategy, claiming that it: "gives us the opportunity to develop, manufacture and market specific products worldwide ... by developing Canadian products that compete with the best the world has to offer in terms of design, performance and price." (From: Globe and Mail. 1982. A strategy for jobs. *Globe and Mail.* 24 March, p B3).

- NCR in Waterloo, Ontario, which gained a global mandate to produce machinery to read, encode, sort and process documents (Globe and Mail. 1981. NCR Canada's mandate aids R and D. *Globe and Mail.* 23 February, B3).

- Pratt and Whitney, which was given a global mandate to design and build turboprops by parent United Technologies of Connecticut (Globe and Mail. 1982. Pratt, Whitney cuts work force as orders slow. *Globe and Mail.* 14 July, p B2).

- Hewlett Packard Canada, which was given license to develop and produce a line of microprocessor-based control devices and software for HP computers (Globe and Mail. 1983. Hewlett-Packard to start manufacturing operation. *Globe and Mail.* 17 May, p B1).

- AEL Microtel of British Columbia, which won a global mandate to produce cellular radio telephone systems (Globe and Mail. 1983. AEL to manufacture cellular radio telephone systems. *Globe and Mail.* 29 October, p B3).

- Litton Systems Canada, which was granted authority by its US parent to manufacture and market a number of high technology products for commercial and military aircraft (Globe and Mail. 1981. Litton wins $30.6 million order to build components for CF-18. *Globe and Mail.* 28 May, p B2).

It is possible that the lure of global mandates would have been lessened had more research been available in the early 1980s when federal and Ontario policy makers were extolling its virtues. Hedlund (1981), for example, reveals that high intra-network transfer of goods reduces subsidiary autonomy. This warning would have been particularly relevant to the auto industry, which by then was fully integrated with that of the US. Ironically, therefore, the industry that had drawn policy makers' attention to global mandates – the automotive industry – was by virtue of the Auto Pact perhaps the least well equipped to benefit. Moreover, the connection between global mandates and R&D spending was unproven (Morrison and Roth, 1992), weakening the case made by policy makers for their promotion.[174] As early as 1982, Rugman and Bennett warned that world product mandates would prove unsuccessful, pointing to the reluctance of multinationals to release control of R&D and ultimately the capacity to control subsidiary actions. They disputed the pioneering Science Council of Canada study (1980), claiming that multinational corporations would be hard pressed to decentralize R&D ... a reality the Government of Canada was effectively forced to acknowledge when the nationalistic Quebec Government began to complain that it received too little automotive investment relative to the size of the local market.[175] In 1978, 12 years before Michael Porter popularized the term clusters (Porter, 1990), Simon Reisman (Canada, 1978, p 212), in bemoaning the absence of automotive R&D spending in Canada, allowed: "R&D activities are clustered close to head office locations because of the importance of communications between key personnel. The directors and senior staff of R&D facilities must have well-forged links with top management, marketing executives, production engineers, and other technical people in the design sector of the automotive industry." The Motor Vehicle Manufacturers' Association agreed: "Ours is a continental industry, created by the Automotive Products Trade Agreement. R&D is a highly rationalized

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[174] Later work by Feinberg (2000), though, established a connection between world product mandates and affiliates' vulnerability to downsizing and that R&D spending was indeed important in building world product mandates.

[175] National Archives of Canada, Volume 160, File 4958-1, PT 20, Memo from Gordon Osbaldeston, Deputy Minister of Industry to Minister, Honourable Jack Horner, 19 June 1978. According to the memo, "with 25-30% of the Canadian market the Province has only about 7% of Canadian automotive production."

feature of the industry. The advantages of centralized research in vehicle production are material to the extent of over-riding importance."[176]

Later, Hedlund (1986) rejected the notion that R&D was necessarily a concentrated activity. Instead, he proposed a heterarchical model where responsibility and management sovereignty is polycentric and where the diversity of skills and resources within the multinational firm are leveraged across the firm to better effect. Malnight's (1996) version is similar, defining a network-based model as one "reflecting an integrated worldwide strategy through globally distributed but interdependent resources and activities." His model envisages a transition from duplicated resources within each decentralized operation, as the global product mandate formulation suggests, to one where specialized centres across a multinational corporation are linked via enabling horizontal exchange mechanisms. Consistent with Malnight's model, it could be argued that, by the early 1980s, the Canadian automotive manufacturing sector had evolved into a network-based system, utilizing and leveraging common systems and processes to improve competitiveness across the integrated North American industry. Alternatively – and less dramatically – a case could also be made that manufacturing had not so much moved to a network-based model, but rather had simply adjusted to share information within the confines of a pre-existing centralized model. This kind of ambiguity is also noted in discussions surrounding world product mandates. Crookell (1984, 1990), Kobrin (1991) and Morrison and Roth (1992) write of global subsidiary rationalization as a similar but somewhat less grand version of global subsidiary mandates. Global subsidiary rationalization arises when "the subsidiary specializes in a narrowed set of value activities or the performance of the subsidiary's activities is dependent on other subsidiaries. The subsidiary is primarily an implementor of headquarters-developed strategy" (Morrison and Roth, 1992, p 716). The Hedlund and Malnight models represented an alternative to the traditional home based, headquarters model, which Porter (1986, 1990) described and then

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[176] Archives of Ontario, RG 20, Accession 93-94/195, Box 175, File 4958-1, PT 24: A Submission to The Honourable Jack Horner Minister of Industry, Trade and Commerce by the Motor Vehicle Manufacturers' Association on the Report of the Inquiry into the Automotive Industry, 5 January 1979, p 6.

Porter and Martin (1991) extended specifically to consider the Canadian situation. That model documented the factors associated with innovation and ultimately the success of an organization, and did so around a model that positioned the home base as paramount to success.

By 1980, the Auto Pact had led to broad-based growth in terms of jobs and production. However, it had also caused the Canadian automotive industry to narrow in scope. Therefore, although the automotive industries in the two signatory nations had been integrated, the process and results of that integration were quite uneven, causing concern and frustration among Canadian industry actors.

6.3 Canadian Value Added

Regardless of the mechanism – global product mandates, decentralization, R&D incentives or heterarchies – what Canadian policy makers were seeking was the generation of value added in Canada commensurate with the size of the Canadian market. Over the years, the policy tended to adjust and adapt to changing conditions and expectations. What was consistent, however, was the perception at virtually all levels of government that Canada was not quite gaining a fair share of the value added generated within the industry.

When the Auto Pact was signed, one of the key pillars was value added: specifically that CVA, in absolute terms, would be at least equal to the CVA generated in the base year of 1964. However, because inflation was not factored into this second safeguard, over time this goal increasingly became a concept without foundation. However, through additional letters of undertaking, automakers pledged that value added in Canada would reach at least 60 per cent of the growth in the value of the vehicles they sold in Canada. This safeguard was consistently met even though significant ambiguity existed concerning the legality of the provision. Canadian policy makers, not surprisingly, insisted that the provisions contained in the safeguards were fundamental elements of the Auto Pact, while US policy makers

disagreed.[177] For example, in 1970, both the House Ways and Means Committee and Senate Finance Committee recommended that if there was not a shift toward true free trade in automotive products, including the elimination of the safeguards, the US should move towards abrogation of the Auto Pact. Numerous internal documents from the Province of Ontario, while supportive of the value added approach, acknowledged they could not be considered legally binding.[178] Yet, even without legal foundation, Canadian policy makers pushed for a fair share of value added in relation to sales. In 1983, the Ontario Ministry of Industry and Trade acknowledged: "The criteria for determining what is fair have never been convincingly articulated, but a common interpretation has been that CVA should be a minimum of 85 percent of the value of Canadian sales."[179] The 85 per cent standard, however, was a lower threshold than the ministry's announced standard or expectation, which stood at 100 percent.[180]

Implicit in the communication of such standards and targets was the presumption that Canada was not receiving a fair share of the value added generated by the automotive industry. It is contended here, however, that such perceptions were mistaken. In fact, as Table 6.5 shows, Canadian value added rose at a rate that not only matched the growth of the market, but surpassed it by a significant margin. For example, during the period 1960-64, the percentage of value added produced in Canada was less than the size its market might suggest was appropriate. Even though Canada represented 6.3 per cent of the combined Canada – US retail market, it generated just 5.8 per cent

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[177] Archives of Ontario, RG 20, Accession 93-94/195, Box 175, File 4958-1, PT 24: Telegram from N. Villeneuve to Canadian Embassy in Washington D.C. regarding 21 September 1978 meeting with US officials in Ottawa on performance and future of Canada – USA auto trade, 5 October 1978, p 3.

[178] Archives of Ontario, RG 69-23, Accession 22735, Box 9, File Ministry of Industry Trade and Technology – Automotive Industry, Discussion Paper on the Automotive Industry and Public Policy, February 1983, pp 8, 9. Also, Archives of Ontario, RG 69-2, Accession 22206, Box 2DM, File Automotive Industry General, Canada – United States Automotive Trade in the Context of a Free Trade Agreement, Prepared for Ministry of Industry, Trade and Technology, 3 September 1987, p 1

[179] Archives of Ontario, RG 69-23, Accession 22735, Box 9, File Ministry of Industry Trade and Technology – Automotive Industry, Discussion Paper on the Automotive Industry and Public Policy, February 1983, p 29.

[180] Archives of Ontario, RG 9-95, Accession 21520, Box 4, File Auto industry – Reports, Speeches, Background Material etc. Speech by Honourable Larry Grossman to the Special Emergency meeting of the Canadian Automotive Industry, 9 February 1982, p 1.

of the continent's automotive value added, a ratio of 0.92:1. In the US, the ratio was 1.01:1. In contrast, in the years following the Auto Pact's signing, Canada generated rising levels of value added. By 1980, as Table 6.5 shows, Canada's share of the total value added in the North American auto industry in relation to its market had climbed to 1.54:1 compared to 0.95:1 in the US.

By 1980, however, an important new issue had emerged: offshore imports containing no Canadian content. Non Auto Pact vehicles were capturing increasing levels of market share and North American automakers and parts manufacturers were exporting virtually nothing outside North American borders in return. By 1980, the share of the Canadian market claimed by offshore imports had reached 20.5 per cent (Canada, 1987, p 57). The Canadian industry, though, was still generating 22.4 per cent more automotive value added than domestic consumption.[181] In the US, however, where offshore imports had claimed a 26.7 per cent market share (Canada, 1987, p 58), the industry was generating less than 70 per cent of value added relative to domestic consumption.[182] It can be seen that the Canadian industry not only grew faster than the US industry, but also grew more quickly than the market. This growth was sufficient to offset the inroads made by offshore producers, in contrast to the situation in the US.

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[181] Calculated on the basis that in 1980 Canada had a share of the value added generated in North America equal to 154 per cent of the size of its market. However, this calculation did not consider value added generated offshore for vehicles imported from non-North American jurisdictions. Therefore, when offshore imports containing no CVA and representing 20.5 per cent of the market are considered, the 1.54:1 ratio reduces to 1.22:1. Calculated as 1.54(1-.205) = 1.224.

[182] Calculated as .95(1-.267) = .696

Table 6.5
Fair Share of Value Added: Motor Vehicles and Equipment

	Share of Canada - US Market: Annual Average		Value Added: Annual Average					Ratio: Value Added Share to Market Share	
	Canada	US	Canada (expressed in CDN $000,000s)	Canada: Per cent of Canada - US Total	US (expressed in CDN $000,000s)	US: Per cent of Canada - US Total	Total Canada-US Value Added (expressed in CDN $000,000s)	Canada	US
1961-64	6.3	93.7	866	5.83	13,993	94.17	14,859	0.92	1.01
1965-69	6.7	93.3	1,660	7.6	20,177	92.4	21,837	1.12	0.99
1970-74	7.2	92.8	2,595	11.0	21,067	89.0	23,662	1.53	0.96
1975-79	8.3	91.7	4,386	11.3	35350.0	88.7	39,736	1.37	0.97
1980	8.9	91.1	4,830	13.65	30,558	86.35	35,388	1.54	0.95

Notes: Motor Vehicles and Equipment category includes Motor Vehicles and Passenger Car Bodies, Truck and Bus Bodies, Motor Vehicle Parts and Accessories, Truck Trailers and Motor Homes.
US values adjusted to Canadian dollar equivalents.

Sources: US value added data from Industry Economics Division, Bureau of Economic Analysis (BEA), U.S. Department of Commerce (June 2004).
Canadian value added data from Statistics Canada, *CANSIM* Table 379-0001 - Gross Domestic Product (GDP) at factor cost, system of national accounts benchmark values, by industry, computed annual average (Dollars x 1,000,000).
Canada-US Exchange rate from Pacific Exchange Rate Service, Foreign Currency Units per 1 U.S. Dollar, 1948-2004. Available from: http://fx.sauder.ubc.ca/etc/USDpages.pdf. (Accessed 4 August 2005.)

6.4 Conclusion

This chapter has continued to contribute to answering the first question this thesis has raised: "What were the preconditions that allowed Canada to compete so effectively for offshore automotive investment?" The 15 years following the signing of the Auto Pact witnessed the transformation of the Canadian automotive industry. Despite well-documented anxiety over the performance of the sector, it has been made clear that by most reasonable standards, the Canadian industry performed well. This chapter has demonstrated that the assembly industry grew more quickly in Canada than in the US, underpinning the growth of the Canadian automotive industry as a whole. What contemporaries did not recognize was the concomitant growth of the parts industry. It has been demonstrated that in parts manufacturing, Canada did much better than earlier researchers have proposed. The popular notion that the parts industry suffered in consequence of the Auto Pact is without foundation. In focusing purely on trade data, analysts have failed to recognize the extent to which the Auto Pact boosted domestic parts production. This chapter has demonstrated that in fact employment, shipments and value added in the parts industry grew fully in tandem with the

assembly industry. More parts may have been imported from the US, but these were later re-exported in completed vehicles. This tariff reclassification was ignored or misinterpreted by many as symptomatic of the decline of the Canadian parts sector following the introduction of the Auto Pact.

This chapter has also demonstrated that, while the industry experienced impressive growth, there remained significant anxieties among industry actors. Not all elements of the industry expanded at a uniform rate. Once the initial investments had been made to raise assembly capacity after the signing of the Auto Pact, investment levels tailed off. This situation was a major source of uncertainty and dissatisfaction. Unlike the trends in employment and production, which revealed Canada to have outperformed the US, there was a disparity between investment rates and the size of its market. The argument made in this chapter is that Canada settled into a role as the North American base for high labour, low capital automotive manufacturing functions. Ultimately, that niche proved to be successful and profitable. However, by its nature, it also meant the industry became more narrowly focused. Certain functions that before 1965 were performed in Canada as well as in the US were consolidated in the parents' headquarters. Upstream automotive functions like product development or R&D virtually disappeared from the Canadian landscape in the Auto Pact era.

It has been demonstrated that the restricted nature of the industry caused significant unease among policy makers. The response was to press for broader roles: notably global product mandates. Various initiatives were launched in support, including financial assistance for the establishment of central research institutions, pressuring US parents, the provision of tax incentives, and the consideration of negotiated adjustments to the Auto Pact. However, an analysis of research around Global Product Mandates and related ideas reveals that the concept was ill suited for the Canadian automotive industry, given the way it had evolved by the early 1980s.

In the 15 years following the Auto Pact's signing, the fortunes of the Canadian industry became inextricably tied to that of the US. Overall, the policy had been a

significant success and sleeping with the US elephant had provided comfort and given strength. At the same time, however, tying such an important industry so closely to that of the US elephant had also increased Canada's susceptibility to the policies and performance of its mighty neighbour. It is to this issue that we turn in Chapter Seven.

Chapter Seven

Divergent Conditions, Parallel Solutions: Voluntary Export Restraints on Japanese Automobiles in Canada

The integrated nature of the Canadian and American economies in general and the North American automotive industry in particular might cause observers to conclude that the two economies are so intertwined as to be one and the same thing. For instance, a cursory assessment of the policy of extracting Voluntary Export Restraints (VERs) from Japanese car makers pursued by the Canadian government in 1981 might cause one to assume that it was motivated by similar factors as those prevailing in the US. At the time, North American auto production operated in what was perceived to be a free market and the industry was performing poorly. It was losing money, sales were down, the market shares of domestic manufacturers had declined, and large layoffs had occurred. When the US reached an agreement with the Japanese to voluntarily restrain imports, it was felt that Canada should immediately follow suit.

Yet obvious commonalities notwithstanding, the Canadian and US automotive industries of the early 1980s were in several ways quite distinct. However, once the US negotiated a managed trade agreement for automobiles, the pressure grew for the Canadians to follow course. Canada was Japan's second largest auto market behind the US, and Canadians were convinced that the partial closing of the American market would result in a diversion of Japanese-built product to Canada, destroying jobs and reducing investment.

Remarkably, little has been written about the introduction of VERs in Canada. This chapter goes some way towards rectifying that situation. It explores the economic, market and political conditions influencing industry stakeholders in their pursuit of a managed trade solution for Canada. It considers the benefits sought and the results achieved. It looks at the conditions that compelled the various players – in both government and industry – to take the actions they did, and it explains why the Canadian situation demanded an approach that differed from that adopted by the US.

This chapter shows that the imposition of voluntary restraints contributed to the decisions taken by Japanese and other manufacturers to make significant investments in Canada. In doing so, it starts to answer the second question this thesis seeks to answer: "What role did governments play to facilitate the process of encouraging inward FDI during the 1980s?"

7.1 Statistical Assessment of the Initial Premise of Voluntary Restraint in Canada

The basic premise underlying the imposition of VERs was that protection would improve the profitability and investment capacity of North American firms. It was proposed that this outcome would in turn produce the rise in productivity needed for those firms to effectively compete with Japanese manufacturers.

By early 1981, during the run-up to the imposition of restraints, then American Motors of Canada president, and chairman of the Motor Vehicle Manufacturers Association of Canada (MVMA), William Pickett commented:

> We cannot go on losing money the way we are or we are not going to have an industry left ... and if we are going to continue as an industry we will need some protection. Otherwise it means a loss of production, a loss of employment and a loss of revenues. [183]

He suggested that the North American automakers receive "a four year breathing space, to 1985, to complete its small car programs and be able to compete with the imports on a more balanced scale."[184] Pickett's and the MVMA's position was consistent with the policy direction of the US. For example, the Transportation Secretary in the Carter Administration, Neil Goldschmidt, championed the introduction of temporary restraints. He advocated for a program that reflected the amount of time it would take for "U.S. automakers to accomplish the transition. This would define a reasonable period of time for our domestic industry to re-tool without

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[183] Romain, K. (1981). Car makers starting campaign to discourage buying imports. *Globe and Mail.* 21 February, p B20.

[184] Ibid.

facing the permanent loss of additional market share to Japanese producers. However, the expiration of the agreement would indicate the need for expeditious investments to meet the re-opened competition."[185] In the US, the tool for such restraints was a Voluntary Restraint Agreement (VRA): a temporary measure to provide breathing space while structural adjustments occurred.

By way of statistical analysis, this section assesses the premises upon which the program of restraints in Canada was established. A number of hypotheses are tested concerning the relationships between variables such as sales, profits, new capital expenditures and import market share. [186] Each hypothesis helps in explaining the relationships underpinning the system. A four-stage procedure is applied in each case:

1. Stating a hypothesis,
2. Explaining the relevancy and justification for that hypothesis,
3. Testing the hypothesis, and
4. Explaining the outcomes

Hypothesis 1: That a positive relationship exists between sales and profits

This hypothesis was implicit in the case made by the US and Canadian administrations in 1981 for limiting imports. It was reasoned that protection would help in reviving the sales of North American owned vehicle manufacturers by taking market share from foreign manufacturers. This result would, in turn, lead to greater profits and consequent benefits for investment and employment.

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[185] National Archives, RG 20, Accession 93-94/195, Box 268, File 4958-1, PT 28: Letter from Secretary of Transportation, Neil Goldschmidt to President, 11 January 1981, p 7.

[186] In order to contextualize and interpret the adoption of voluntary import restraints, a database was constructed by accessing data from a number of sources including Statistics Canada, government publications, the US Bureau of Labour Statistics, the US Bureau of Economic Analysis, the US Census Bureau, company annual reports, and several annual yearbooks from DesRosiers Automotive Consulting and Ward's Automotive.

Profits data were gathered for the Canadian automotive for the period 1972-2003, and converted to 2003 prices utilizing the Canadian Consumer Price Index (CPI). Sales data likewise were gathered and normalized to 2003 prices applying the Canadian CPI. (See Appendix C: Hypothesis 1)

An examination of the data shows an R^2 of .244. From that it is concluded that 24.4 per cent of the variation in net profits is explained by variation in sales. And with a p-value of .0004, the hypothesis is accepted and it is concluded that there is indeed a positive relationship between net profit and sales. Therefore, from this starting point, the Canadian government in 1981 based at least part of its decision to introduce VERs on the basis of an appropriate assumption.

Hypothesis 2: That a positive relationship exists between profits and new capital expenditures

This theory is an extension of hypothesis 1, the premise being that a restoration of profits in the automotive industry would encourage manufacturers to make fresh capital investments in order to better compete with foreign car makers. Losses in the automotive industry had reached unprecedented levels: Chrysler was on government-sponsored life support, and Ford was performing little better. The perception was that these companies had reached a stage where their long-term viability was in doubt unless they could make the large-scale investments needed to raise productivity to Japanese standards.

To test hypothesis 2, profits and capital expenditures were again normalized to 2003 on the basis of the Canadian CPI. Because it is capital expenditure decisions that are of primary interest rather than actual capital expenditures, actual capital expenditures were backed up by two years to align more closely with the times at which investment decisions were made (see Appendix C: Hypothesis 2).

An examination of the data shows an R^2 of .187. From that it is concluded that 18.7 per cent of the variation in new capital spending is explained by net profits after

taxes. And with a p-value of .022 at the 5 per cent level of significance the hypothesis is accepted and it is concluded that there is indeed a positive relationship between new capital expenditures and net profits after taxes. (It is worth noting that when a similar model was developed to consider the relationship between normalized net profits after taxes and normalized capital expenditures, but without the lag built into the model between decisions and expenditure, the results were quite similar producing an R^2 of .198 and p-value of .0138.

Hypothesis 3: That a negative relationship exists between profits and imported vehicle market shares

The assumption made by proponents of a managed trade solution was that escalating import market shares was a major contributor to declining profitability in the North American automotive industry. The premise was that if imports could be limited, then profits might be restored and the long-term viability of the North American industry assured.

In order to test this proposition, data on the share of vehicles coming from non-North American jurisdictions was gathered. This data was set against net profits after taxes in the Canadian automotive industry. Profit levels were normalized to 2003 on the basis of the CPI (see Appendix C: Hypothesis 3). An examination of the data shows an R^2 of .111. From that, only 11.1 per cent of the variation in new profits is explained by import market share. With a p-value of .0715 the null hypothesis is accepted and it is concluded that there is not a relationship between import market share and net profit after taxes.

The findings for the null hypothesis are also fully consistent with the ruling of the United States International Trade Commission (USITC), which on 11 November 1980 rejected the position advanced by the United Auto Workers (UAW) and the Ford Motor Company, ruling that rising imports of Japanese passenger cars and trucks were not damaging the American auto industry.[187] The findings are also

consistent with the opinion of then US Commerce Secretary Malcolm Baldridge. On 9 March 1981, just before Japan agreed to restrain automotive exports, he indicated that, of the 2.6 million-unit decline in domestic auto sales from 1976 to 1980, only 400,000 sales could be attributed to import substitutions.[188] This situation has significant implications for the final assumption upon which many stakeholders built their case and upon which the government explained its decision to promote VERs.

Hypothesis 4: That a negative relationship exists between new capital expenditures and imported vehicle market share

Hypothesis 4 represents the culmination of hypotheses 1 – 3. Hypotheses 1 and 2 were accepted: that profits within the Canadian automotive industry were positively related to both sales and capital spending. Once the relationship between profits and sales and profits and capital spending was established, a further hypothesis could be explored. Had a negative relationship been found between profits within the Canadian automotive industry and import market share, the stage would have been set for Hypotheses 4: that import market share and capital expenditures are also inversely related. However, it has already been demonstrated that alternative hypothesis 3 was not supported.

Presumably, it was the notion that reduced penetration of vehicles in the Canadian automotive marketplace produced by offshore manufacturers would provide the traditional North American/Big Three manufacturers with the "breathing space" they needed to increase sales, boost profits and subsequently make the kind of productivity enhancements and winning products required to restore competitiveness and stabilize employment. However, once Hypothesis 3 was not accepted, the likelihood of Hypothesis 4 being accepted was called into question.

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[187] Dow Jones News Service. (1980). Trade panel rejects US auto industry bid for import curbs. *Dow Jones News Service*. 10 November.

[188] New York Times. (1981). Three oppose car import bill. *New York Times*. 10 March, p D6.

For Hypothesis 4, new capital expenditure data was gathered and normalized to 2003 dollars. Then, it was tested against import market share (see Appendix C, Hypothesis 4). The result is an R^2 of .0012, meaning just over one per cent of the variation in capital expenditure can be explained by variation in import market share. With a p-value of .853 the null hypothesis is accepted and it is concluded that there is not a relationship between import market share and new capital expenditures within the Canadian automotive industry. The acceptance of the null hypothesis – that there is no relationship between new capital expenditures and import market share – draws attention to the fundamental flaw in the logic underpinning VERs.

It is possible, however, that the conclusion arrived at here could only have been reached with the benefit of hindsight. It may be useful to an assessment of the program, but it does not reflect the immediate pressures of the times. With this consideration, a more limited run of data was taken (1972–1980 rather than 1972 to the end of the 1990s). The idea behind this exercise is that policy makers may reasonably have been able to anticipate the outcomes of policy within a more immediate context. The results are represented below.

Relationship	R^2	p-value
Normalized Net Profit After Tax and Normalized Sales (normalized to 2003)	.128	.344
Normalized Net Profit After Tax and Normalized Capital Expenditures (normalized to 2003)	.192	.238
Normalized Net Profit After Tax (normalized to 2003) and Import Vehicle Market Share	.002	.903
Normalized New Capital Expenditures (normalized to 2003) and Import Vehicle Market Share	.037	.620

Using the data available at the time, the decisions taken in 1981 remain ill founded. The set of premises upon which the policy was founded was imperfect. Further, as no relationship can be established between import market share and industry profits, the restraints that were instituted to curtail import market share in general and Japanese market share in particular could not have driven the hoped for resurgence in industry profits and capital spending. At this stage, then, it is necessary to more fully review

the pressures, conditions and expectations that confronted the North American automotive industry during the late 1970s and early 1980s.

7.2 Factors Contributing to the Introduction of Voluntary Export Restraints

It was a complex set of inter-related factors that set the stage for the US Government and subsequently the Government of Canada to extract from Japan a commitment to work with its automakers to limit vehicle exports to North America. These factors – which were treated as indistinguishable in each jurisdiction – will be examined in some detail. Globally, they included worldwide economic malaise and declining auto industry profitability. In North America, there were significant declines in vehicle sales, increasing imports and falling levels of automotive employment. While Canada was not immune, it will be demonstrated that these factors were particularly acute in the US.

By 1980, inflation in the US had reached 13.5 per cent,[189] the prime lending rate was 15.26 per cent (US Census Bureau, 2001, p 737), unemployment had climbed to 7.1 per cent (US Census Bureau, 2003, p 373) and real GDP had fallen by 0.5 per cent since 1979 (US Census Bureau, 1995, p 453). Meanwhile, the Canadian economy was in similar upheaval with inflation at 10.1 per cent over 1979,[190] consumer annual loan rates had climbed to 16.6 per cent,[191] and unemployment stood at 7.3 per cent (US Census Bureau, 2003, p 852). North America was experiencing economic challenges similar to those experienced throughout the Western world. The combination of slow growth and generally rising prices that had engulfed the global economy had become known as stagflation.

When viewed over the ten-year horizon of the 1970s, the automotive industry's crisis of the early 1980s was confounding. Over the previous 10 years, North American

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[189] Statistics Canada *CANSIM*, Table 451-0009.

[190] Ibid, Table 326-0002.

[191] Ibid, Table 176-0043.

automotive sales had demonstrated reasonable growth. Table 7.1 shows that in the US sales had grown by 13 per cent, from 10.2 million in 1970 to 11.5 million in 1980. Meanwhile, Table 7.2 reveals that sales in Canada had jumped by 63 per cent over the previous decade, from 774,000 units in 1970 to 1,264,000 by 1980. However, below the surface, significant weaknesses could be detected. In 1970, the industry may have been smaller, but American-owned firms dominated the marketplace. Combined Canada - US sales in 1970 were just 10.9 million, but as Table 7.3 shows, 9.5 million vehicles were made in North America. By 1980, the market had grown to 12.5 million, but Canada - US production had dropped to 9.4 million.[192]

Table 7.1
US Automotive Sales

	Automobiles				Trucks			Total	
	North American Made (000s)	Overseas Imports (000s)	Total (000s)	Import Market Share (%)	North American Made (000s)	Overseas Imports (000s)	Total (000s)	Total Sales (000s)	Import Market Share (%)
1970	7,120	1,285	8,405	15.29	1,746	65	1,811	10,216	13.21
1971	8,681	1,570	10,251	15.32	2,011	85	2,096	12,347	13.40
1972	9,327	1,623	10,950	14.82	2,486	143	2,629	13,579	13.01
1973	9,676	1,763	11,439	15.41	2,916	228	3,144	14,583	13.65
1974	7,454	1,413	8,867	15.94	2,512	171	2,683	11,550	13.71
1975	7,053	1,587	8,640	18.37	2,249	231	2,480	11,120	16.35
1976	8,611	1,498	10,109	14.82	2,944	237	3,181	13,290	13.05
1977	9,109	2,075	11,184	18.55	3,353	323	3,676	14,860	16.14
1978	9,312	2,000	11,312	17.68	3,776	337	4,113	15,425	15.15
1979	8,328	2,300	10,628	21.64	3,000	500	3,500	14,128	19.82
1980	6,578	2,398	8,976	26.72	2,002	484	2,486	11,462	25.14

Source: Derived from *Report on the Canadian Automotive Industry in 1986*, Table 1.1, Retail Sales of Motor Vehicles in Canada and the United States, p 20.

By 1980, as Table 7.1 shows, the US had witnessed a growth in imports of motor vehicles from non North American sources over the previous decade of 113 per cent, from 1.35 million units in 1970 to 2.88 million units in 1980. Imported automobiles, which claimed 13 per cent of the US market in 1970 held 25 per cent in 1980. Put simply, the US industry was perceived as being under siege.

Japanese motor vehicle exports to all countries rose from 1.1 million units in 1970 to 2.7 million in 1975 and accelerated to reach almost 6 million in 1980 (Japan

[192] In 1970, the North American production to sales ratio – the number of vehicles made in North American to the number sold – stood at 0.85:1.By 1980, it had dropped to 0.74:1. In the US, the ratio had slumped from 0.82:1 in 1970 to 0.71:1 in 1980, whereas in Canada, the ratio fallen from 1.53:1 in 1970 to 1.08:1 in 1980.

Automobile Manufacturers Association, 2004, pp 14, 15). Meanwhile, Japanese production had climbed from 5.3 million units in 1970 to 6.9 million in 1975 and 11 million in 1980 (Japan Automobile Manufacturers Association, 2004, pp 7, 8). In other words, 86 per cent of the growth of the Japanese industry had come by way of international trade. In just 10 years, Japan had started to rival the US for leadership of the world industry.

Over the same period, Japanese manufacturers made significant strides in raising levels of productivity. For example, between 1970 and 1980, the Japanese industry reduced the number of hours it took to build a vehicle from 254 to 139, an improvement of 45 per cent. Over the same period, the number of hours required in the US jumped 7 percent from 189 to 202 (Williams et al, 1994, pp 216, 217). Further, by 1980, labour costs per hour in the US were $12.67 versus just $7.40 in Japan (Williams et al, 1994, p 237). As a result, by 1981 it was estimated that Japanese automakers could manufacture a small car for $1,500 - $2,000 less than their US counterparts (Abernathy et al, 1981).

Although, Canadian policy makers ultimately adopted a policy measure that was similar to that of the US, the situation in Canada was different. By the end of the 1970s, overseas-built passenger cars and trucks controlled less than 11 per cent of the market, down from 20 per cent in the early 1970s. Even at 16.8 per cent market share in 1980, imports were only marginally above the 15.3 per cent level averaged during the 1970s. Therefore, by 1980, while imports were on the rise, it was from a historically low base, barely above the 10-year average, and substantially below that experienced in the US. Internal documents reveal Canadian officials knew that the rising market share of Japanese makers in Canada was far from becoming inexorable:

> The import share in the small car market was lower in 1980 than in 1976, 1977 or 1978 (1979 was an anomaly due to extreme exchange rate fluctuations). In other words, the increase in the market share captured by imports is due more to a shift in consumer tastes for small fuel-efficient

vehicles than an increased consumer acceptance of foreign manufactured vehicles.[193]

Table 7.2
Canadian Sales and Import Market Share

	Total Sales in Canada (units)	Passenger Car and Trucks (Made Overseas)	Import Market Share (%)
1970	774,241	152,392	19.68
1971	940,332	201,012	21.38
1972	1,065,621	222,111	20.84
1973	1,226,698	208,335	16.98
1974	1,249,304	164,778	13.19
1975	1,316,629	170,360	12.94
1976	1,291,463	167,235	12.95
1977	1,344,959	209,293	15.56
1978	1,366,544	186,309	13.63
1979	1,396,402	151,286	10.83
Decade	11,972,193	1,833,111	15.31
1980	1,263,807	212,767	16.84

Source: Derived from Statistics Canada *CANSIM* Table 079-0001- New Motor Vehicle Sales, Canada, Provinces and Territories.

The production situation was also different between Canada and the US. In 1980, for example, as Table 7.3 shows, unit production in Canada was still almost 90 per cent of its 11-year average. By contrast, in the US, production was just 74 per cent of its 11-year average. When Canadian production fell by 16 per cent between 1979 and 1980, US production dropped by more than 30 per cent. Further, Canada and the US generated record levels of production in 1978. By 1980 Canadian production dropped by 25 percent while US production plunged by 38 per cent. Similarly, total shipments in the Canadian auto industry (including both assembly and parts) were also reasonably stable. At $20.3 billion in 1980, they were down 11 per cent from the record high experienced just one year prior, but were more than twice as high as they had been eight years before. By 1981, the year in which VERs were negotiated, total industry shipments in Canada actually jumped by 18 per cent to $24 billion.[194] Therefore, during the 1980-81 timeframe, while there can be no question that the

[193] Archives of Ontario, RG 9-95, Accession 21520, Box 4, File: Auto Industry – Reports, Speeches, Background Material Etc. Ministers Briefing Notes for Meeting – July 16, 1981 with Motor Vehicle Manufacturers' Association, 15 July 1981, p 1.

[194] Statistics Canada. *CANSIM*, Table 180-002.

Canadian industry was experiencing a downturn, it was less severe than experienced in the US.

Table 7.3
North American Sales and Production

	Sales				Production			
	US		Canada		US		Canada	
Year	Units (000s)	% of 11 Year Mean (1970-80)	Units (000s)	% of 11 Year Mean (1970-80)	Units (000s)	% of 11 Year Mean (1970-80)	Units (000s)	% of 11 Year Mean (1970-80)
1970	10,093	100.80	774	64.32	8,264	76.78	1,187	77.9
1971	12,151	96.13	940	78.12	10,650	98.95	1,371	90.0
1972	13,281	105.07	1,066	88.59	11,298	104.97	1,365	89.6
1973	14,380	113.77	1,227	101.97	12,663	117.66	1,585	104.1
1974	11,358	89.86	1,249	103.80	9,984	92.76	1,561	102.5
1975	10,659	84.33	1,317	109.45	8,965	83.30	1,441	94.6
1976	12,809	101.34	1,291	107.29	11,486	106.72	1,647	108.1
1977	14,336	113.42	1,345	111.78	12,699	117.99	1,775	116.5
1978	14,909	117.95	1,367	113.61	12,895	119.81	1,818	119.3
1979	13,828	109.40	1,396	116.02	11,476	106.63	1,632	107.1
1980	11,237	88.90	1,264	105.05	8,011	74.43	1,374	90.2
Mean	12,640		1,203		10,763		1,523	

Sources: US and Canadian sales data from *DesRosiers Automotive Yearbook: 1994 Edition*, North American Sales of Vehicles 1960-1993 - # of Units, p 1.
US and Canadian production data from *DesRosiers Automotive Yearbook: 1994 Edition*, North American Production of Vehicles 1960-1993 - # of Units, p 41.

Meanwhile, insofar as the employment situation was concerned, Table 7.4 confirms that employment in the Canadian automotive industry had grown rapidly throughout most of the 1970s. Over the period 1970 to the peak in 1979, assembly employment grew by 40.2 per cent to almost 53,000. Parts employment was also strong, expanding by more than 43 per cent between 1970 and the peak in 1978. However, as the industry turned downward in the latter part of the 1970s, the labour intensive assembly portion of the sector shed more than 8,400 jobs between 1978 and 1980, a decline of 16 per cent. The parts sector shed 11,100 jobs or 21.3 per cent of the workforce. In fact, by March 1981, the Big Three in Canada had almost 10,000 employees on indefinite layoff, including 5,000 at Ford and 4,600 at Chrysler. However, the General Motors workforce in Canada emerged relatively intact with just 175 laid off across the country.[195] Despite the challenges, in 1980 Canada

retained 86.5 percent of its 1970-80 employment mean. By comparison, employment in the US automotive industry had dipped to 718,000 by 1980, a one year drop of 20.9 per cent from 1979 and was just 80.9 per cent of the 11 year mean.

Table 7.4
North American Automotive Employment

	Canada						US		Total
	% Assembly Employment of 11 Year Mean		% Parts Employment of 11 Year Mean		% Total Employment of 11 Year Mean		% Total Employment of 11 Year Mean		
	Assembly (000s)	Mean (1970-80)	Parts (000s)	Mean (1970-80)	Total (000s)	Mean (1970-80)	Total (000s)	Mean (1970-80)	Canada – US (000s)
1970	37.5	75 7	36.4	74.8	73.9	75.3	733	82.7	807.3
1971	41	82.8	41.3	84.8	82.3	83.8	781	88.1	863 6
1972	41.9	84 6	41.4	85.0	83.3	84.8	798	90 0	881.3
1973	45.2	91.3	48.8	100.3	94	95.7	892	100 6	986
1974	47.1	95.1	45.9	94.3	93	94.7	819	92.3	912
1975	43.4	87.7	41.2	84.6	84 6	86.2	728	82.1	812.6
1976	46.6	94.1	46.2	94.9	92.8	94.5	815	91.9	907.8
1977	50.6	102.2	48.6	99.8	99.2	101.0	864	97.4	963.2
1978	52.3	105.6	52.1	107.0	104.4	106.3	896	101 0	1000.4
1979	52.6	106.2	49.8	102.3	102.4	104.3	908	102.4	1010 4
1980	43.9	88.7	41	84 2	84.9	86.5	718	80.9	802.9
Mean	49.5		48.7		98.2		887.0		985.2

Sources: Canadian employment data 1964-80 from *Report on the Canadian Automotive Industry in 1986*, p 48.
US employment data from US Bureau of Labour Statistics. Available from: htt//data bls gov/PDQ/servlet/SurveyOutputServlet. (Accessed 25 August 2005.)

Canadian production data from 1960-64 from *Facts and Figures of the Automotive Industry, 1968 Edition*, p 14.

Canadian and US production data from *DesRosiers Automotive Yearbook: 2005 Edition*, p 120.

Despite these differences, the Canadian automobile industry was perceived as being in crisis. Because of the integrated nature of the North American industry, it was assumed Canadian operations were as beleaguered as those in the US. Chrysler had just emerged from near bankruptcy supported by government loan guarantees; the second oil shock had caused gas prices in the US to rise by 88 per cent in just two years,[196] and the Big Three turned profits of C$3.5 billion in 1979 into losses of more than $6.2 billion over the years 1980 and 1981. In Canada, industry-wide profits had stood at $443 million in 1979. In 1980, however, the industry recorded a net loss of

[195] National Archives, RG 20, Accession 93-94/195, Box 268, File 4958-1, PT 27: Letter from Herb Gray, Minister of Industry, Trade and Commerce to C.J Young, 25 November 1980, p 1.

Note: The number on indefinite layoff was greater than the total number of job losses because the losses were not uniform across the country. For example, in 1981, assemblers were simultaneously adding employment in some locations while decreasing employment levels in others.

[196] Statistics Canada. *CANSIM*, Table 451-0009.

$85.5 million. Losses of $37.5 million and $60.2 million followed in 1981 and 1982 respectively before the industry reported profits in excess of $1 billion in 1983.[197] The biggest financial problems were experienced in the assembly segment where more than 98 per cent of production in Canada was in the hands of US subsidiaries (Canada, 1984, pp 5, 6). In fact, throughout the downturn of the early 1980s, Canadian parts and components makers actually managed to stay profitable. Meanwhile, the Canadian operations of the Big Three registered losses of $217 million, $168 million and $184 million in 1980, 1981 and 1982 respectively, before emerging in 1983 with a profit of $946 million (Canada, 1987, p 20).[198] Any problems that the Canadian automotive industry was seen to be experiencing in the early 1980s were clearly concentrated in the assembly side of the industry.[199]

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[197] Ibid, Table 180-0002.

[198] Ibid.

[199] It is worth noting that, while General Motors experienced a downturn during this period, its situation was not as acute as those of its major North American rivals. GM reported a company-wide loss in 1980, its first since 1920, but made profits of $380 million in 1981 and $1.17 billion in 1982. By contrast, Ford made consecutive losses in 1980, 1981 and 1982. Chrysler regained profitability in 1982 (Lavelle and White, 1983, p 41).

General Motors was also much less vocal in pushing the US and Canadian administrations to issue import controls. They did not join Ford and the UAW in the US in their case for import controls with the USITC in 1980 and took a similar approach in Canada. During an Empire Club Speech in Toronto in December 1980, the president of General Motors of Canada, Alan Smith, remarked: "Local content and other forms of protectionism present a serious problem. They may seem attractive on a short-term basis, but they reduce efficiency, shrink markets, and invite retaliation" (Smith, 1980, p 148). During a speech in Toronto in February 1981, GM Canada's finance vice president, Robert Waugh, also spoke for open borders with a unique appeal to Canadian sensitivities: "One cannot help but wonder if Canada would not have continued to be the leader in world hockey if it had focused its attention on the emerging world competition instead of on the national hockey league. The parallel in the automotive industry seems obvious" (Waugh, 1981, 73).

It may be speculated that General Motors considered its relative financial stability a source of competitive advantage that might ultimately translate into increased market share should either of its North American competitors collapse. Alternatively, General Motors may have tacitly supported import restrictions, allowing Ford and others to take the lead. The Province of Ontario raised a third possibility: that GM wished to avoid retaliatory measures, which might hurt prospects for its world car strategy (Archives of Ontario, RG 6-121, TB 8, Box 2, File: Procedures for Preventing Unfair Foreign Competition in Autos (B.N), June 1980, p 6). A fourth and more straightforward possibility is that offered by former GM Canada vice president, Tayce Wakefield: "We really did have this ideological basis that if you are going to sell here, you need to build here and there was this sort of fundamental sense of 'Canadianness' that was, I think, in the company at the time" (Wakefield, T. 2004. Interview with the author on 18 October, Cambridge, ON).

Therefore, by the early 1980s, the North American automotive industry was under pressure. While not immune, it has been demonstrated that the Canadian industry's predicament was less dire than that experienced in the US. However, because the industries in the two countries were now fully integrated, it was perceived that the Canadian industry's challenges were just as serious as those in the US. Thus, an environment was built for a Canadian response that mirrored that of the US.

7.3 The Tenuous Connection Between Export Restraints and Capital Renewal

Before export restraint agreements were reached by the US and Canada, there was extensive discussion of the renewal of the capital stock of the North American automakers. Large-scale investments were seen as necessary for two reasons. First, they would improve productivity and the ability of the North American manufacturers to compete with import brands. Second, they would assist in the process of retooling to build small vehicles to meet the changing demands of the marketplace, again improving competitiveness. But to make such commitments, North American industry actors insisted that relief from offshore competition was crucial. It will be shown here, however, that by the time the negotiations regarding imports restraints were reaching a conclusion in May 1981, the Big Three had already begun to renew their capital infrastructure.

On an international level, by early 1981, General Motors had announced a $40 billion program of global investment and capital stock renewal (General Motors Corporation, 1980). According to then GM Canada president Alan Smith: "The money is going to increase our capacities, it's going to increase our productivity and help us to achieve even higher quality levels. This prudent investment is going to bring about higher customer satisfaction that is the lifeblood of our business" (Smith, 1980). The General Motors announcement was made in 1980, the same year that the company recorded its first loss in 60 years. A few months later, Chrysler chairman Lee Iacocca outlined his company's modernization program, including the conversion of the company's entire product range to front-wheel drive technology,

its pursuit of fuel economy, its drive to higher quality, and its commitment to reducing costs and establishing closer working relations with its labour unions (Iacocca, 1981). The General Motors and Chrysler initiatives are entirely consistent with the view promoted by Michael Porter (1990) regarding the role of competitors in spurring competitiveness, specifically the role which vigorous competition plays in terms of innovation and growth.

In Canada, by May 1981 when the program of import restraints on Japanese product was negotiated, each of the Big Three North American assemblers had already made significant capital investments or had committed to do so. For example, GM was preparing to launch front wheel drive mid sized cars in Oshawa, Ontario, was opening a front wheel drive automatic transmission plant in Windsor, Ontario and was adding capacity at its foundry operations in St. Catherines, Ontario. Ford, meanwhile, was preparing to open new engine and aluminium casting plants in Windsor and had just launched a new generation of small vehicles at its St. Thomas, Ontario assembly facility. At Chrysler, plans had been announced to spend $681 million to build a small van in Windsor commencing in 1983.[200] Indeed, Canadian policy makers were well aware of these commitments. Canadian Industry, Trade and Commerce Minister Herb Gray acknowledged his awareness in a letter sent to a constituent in November 1980, more than a half year prior to the imposition of VERs in Canada. At the time, Minister Gray held that the domestic producers were already engaging in renewal: "I feel that the recent changes in design and engineering by the domestic automobile manufacturers will make them more competitive with the foreign manufacturers, and decrease the need for tariffs and/or quotas on imported foreign automobiles."[201]

Table 7.5 details the Canadian automotive industry's capital spending over the 15-year period 1970-84. Its focus is on new capital spending. The data suggest that the

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[200] Romain, K. (1981). Auto industry cautiously optimistic about improvement. *Globe and Mail.* 30 March, p B20.

[201] National Archives, RG 20, Accession 93-94/195, Box 268, File 4958-1, PT 27: Letter from Herb Gray, Minister of Industry, Trade and Commerce to C.J Young, 25 November 1980, p 1.

immediate financial difficulties of the industry in Canada in the early 1980s did not diminish the automakers' ability to undertake new capital projects. Indeed, capital spending during these years was clearly well above the 15-year average, indicating the auto industry in Canada was not sitting back and waiting for protectionist measures as the primary means of its salvation.

Table 7.5
Canadian Automotive Industry New Capital Expenditures: 1970-84

	Assembly		Parts and Accessories		Total	
	New Capital Spending ($000,000s)	% of 15 Year Average (1970-84)	New Capital Spending ($000,000s)	% of 15 Year Average (1970-84)	New Capital Spending ($000,000s)	% of 15 Year Average (1970-84)
1970	31.8	23.79	169.6	78.74	201.4	57.70
1971	22.6	16.91	71.1	33.01	93.7	26.84
1972	33.1	24.76	55.9	25.95	89	25.50
1973	43.2	32.32	78.7	36.54	121.9	34.92
1974	73.8	55.21	119.9	55.67	193.7	55.49
1975	61	45.63	81.2	37.70	142.2	40.74
1976	59.6	44.58	62.5	29.02	122.1	34.98
1977	153.4	114.75	109.6	50.89	263	75.34
1978	83.6	62.54	203.9	94.67	287.5	82.36
1979	111.4	83.33	330.9	153.63	442.3	126.71
1980	136.4	102.03	780.9	362.56	917.3	262.79
1981	272.9	204.14	666.5	309.44	939.4	269.12
1982	203.1	151.93	188.5	87.52	391.6	112.18
1983	463.2	346.50	140.5	65.23	603.7	172.95
1984	256.1	191.58	171.1	79.44	427.2	122.38
Mean	133.7	-	215.4	-	349.1	-

Sources: All Data compiled from *DesRosiers Automotive Yearbook: 1994 Edition*:
- Assembly data drawn from New Capital Spending data from Canadian Automotive Industry Capital Expenditure for Motor Vehicle Assembly Industry, p 103. It includes expenditures for construction and machinery and equipment, but not spending for repair capital expenditure.
- Parts and Accessories data drawn from New Capital Spending data from Canadian Automotive Industry Capital Expenditure for Parts and Accessories, p 104. It includes expenditures for construction and machinery and equipment, but not spending for repair capital expenditure.

7.4 The Scapegoating of Japanese Auto Manufacturers

The challenges confronting the North American auto industry prompted a search for scapegoats that ultimately focused on Japan. This section considers how Japan became that focus. It outlines why large exporting nations like Canada and Europe escaped the attention of US legislators and how the political will to curb Japan was mustered and translated into policy.

By 1980, the Canadian and US automotive industries had become fully integrated with practically all completed units and most new parts travelling across the Canada – US border free of duty. Table 7.6 shows that total (two-way) Canada-US trade in automotive products grew extensively during the ten-year period, 1970-80, climbing from $6.3 billion in 1970 to $22.7 billion by 1980. However, even though the American industry was experiencing difficulties, the importation of vehicles from Canada attracted little critical comment. There were several reasons. One explanation was that by the latter part of the 1970s, the US was enjoying a substantial surplus in automotive trade with Canada, amounting to $3.1 billion in 1979 and $2 billion in 1980. A second reason related to the fact that even though many in the US had serious reservations about their country's continued participation in the agreement, a general consensus had emerged that the Auto Pact was preferable to any of the alternatives. Alternatives included enhanced local content schemes of the kind the Australian, Mexican and Brazilian administrations had instituted (Anastakis, 2001). Perhaps the most important factor in mitigating the urge of US legislators to cast protectionist glances in Canada's direction was the fact that the principle agitators for action in the US were the American owned final assemblers, all of whom had extensive operations in Canada. Similarly, the UAW might have raised alarms, but its Canadian branch represented most of the workers in the industry north of the border. Then Canadian Industry, Trade and Commerce Minister Herb Gray noted the common interests of the Canadian and US industries at a press conference in Washington in 1980:

> I want to observe that Mr. Fraser is the president to the International UAW and I had always presumed that his responsibility was to work equally on behalf of the Canadian and American workers of the UAW; and it would come as a surprise to the Canadian members of the UAW were we to accept your impression that he was in Japan dealing with the matter of Japanese imports solely from the point of view of the American members of the UAW.[202]

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[202] National Archives, RG 20, Accession 93-94/195, Box 175, File 4958-1, PT 24: Press Briefing by the Honourable Herb Gray, Minister of Industry, Trade and Commerce with Members of the Press, June 1980, pp 12, 13.

Table 7.6
Canada – US Automotive Trade: 1970-80

	Canadian Exports ($000,000s)			Canadian Imports ($000,000s)			Balance of Trade ($000,000s)		
	Total Motor Vehicles	Total Auto Parts	Total All Auto Products	Total Motor Vehicles	Total Auto Parts	Total All Auto Products	Total Motor Vehicles	Total Auto Parts	Total All Auto Products
1970	2,127	1,142	3,269	934	2,131	3,065	1,193	-989	204
1971	2,536	1,504	4,040	1,321	2,521	3,842	1,215	-1,017	198
1972	2,752	1,801	4,553	1,551	2,957	4,508	1,201	-1,156	45
1973	3,060	2,240	5,300	2,082	3,620	5,702	978	-1,380	-402
1974	3,408	2,027	5,435	2,517	4,110	6,627	891	-2,083	-1,192
1975	3,790	2,113	5,903	3,125	4,599	7,724	665	-2,486	-1,821
1976	4,774	3,105	7,879	3,287	5,588	8,875	1,487	-2,483	-996
1977	5,996	3,865	9,861	3,952	7,001	10,953	2,044	-3,136	-1,092
1978	7,048	4,945	11,993	4,360	8,222	12,582	2,688	-3,277	-589
1979	6,709	4,723	11,432	5,699	8,821	14,520	1,010	-4,098	-3,088
1980	6,670	3,636	10,306	4,605	7,746	12,351	2,065	-4,110	-2,045

Source: *DesRosiers Automotive Yearbook: 2003 Edition*, p 197.

Other countries also managed to escape the protectionist impulses of influential American lobby groups and legislators because the penetration of the US auto market by all nations, other than Japan, had actually declined over the previous decade. As Table 7.7 shows, during the period 1970-75, vehicles imported from countries other than Japan occupied about 10 per cent of the American market. By the latter half of the decade, the market share of non-Japanese imports had fallen to around 5 per cent.

Table 7.7
North America Sales of New Passenger Cars By Origin

	Total Import Market Share (%)		Japanese Market Share (%)	
	Canada	US	Canada	US
1970	22.3	14.9	10.2	3.7
1971	24.1	15	13.7	5.7
1972	23.9	14.6	13.6	5.8
1973	19.4	15.2	11.5	6.5
1974	15.5	15.7	9.3	6.7
1975	15.5	18.2	9.7	9.4
1976	16.2	14.8	10.7	9.2
1977	19.5	18.5	13.6	12.5
1978	17.5	17.7	11.4	12.5
1979	13.9	21.8	8.0	17.2
1980	20.5	26.7	14.8	21.3

Sources: Total Import Market Share and Japanese Market Share in Canada from *Report on the Canadian Automotive Industry, 1985*, Table 1.4, Canadian Sales of New Passenger Cars by Origin, p 57.
Total Import Market Share and Japanese Market Share in US from *Report on the Canadian Automotive Industry, 1985*, Table 1.5, US Sales of New Passenger Cars by Origin, p 58.

Therefore, by 1980 the conditions were aligned for protectionist forces to converge on Japan and Canada would escape unaffected. The US was enjoying a surplus in

automotive trade with Canada. Further, key actors from the US had interests in Canada they were not prepared to compromise.

7.5 The Risks to Canada of a Protectionist Approach

As the 1970s drew to a close, Japan became the target of critics, lobbyists and legislators in the US. There were several reasons why Japan was an easy target. Vehicle imports from that nation had shot up from just 313,000 units, just one quarter of total imports and less than four per cent of the total American market in 1970, to 1.9 million and 21.3 per cent of the total US market by 1980. Eighty per cent of all offshore made vehicles sold in the US now came from Japan, up from 25 per cent in 1970. As well, for most Americans, targeting Japan was relatively risk-free. Neither the US based OEMs nor the UAW were encumbered by concerns about the possibility their targeted campaign might incite retaliation on their operations in Japan.

Canadian circumstances, however, were different from those of the US and suggested a more cautious approach. The US trade deficit with Japan was large and growing, whereas Canada enjoyed a surplus on account of its exports of coal and other primary commodities. This difference was understood. Herb Gray, the Minister responsible for VER negotiations with the Japanese, described the balance he was seeking in a letter to one of his constituents:

> Japan is one of Canada's largest trading partners and we do about $5 billion in trade annually. In 1979, we had a surplus in our balance of trade with that country of $1.8 billion and in 1980 to the end of July we exported $2.7 billion to Japan and imported only $1.5 billion giving us a surplus of $1.2 billion.[203]

Ed Lumley was Minister of International Trade in 1982, and was quick to remind a Toronto audience that "beggar thy neighbour tariff walls, artificial props for inefficient sectors and band-aid solutions do not provide effective or convincing alternatives. Canada, because of our dependence on trade and our small domestic

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[203] National Archives, RG 20, Accession 93-94/195, Box 268: Letter from Herb Gray to Mrs, Joanne Airey, 19 January 1981, p 1.

market, has much to lose and little to gain through bilateral trade wars or rigid concepts of reciprocity."[204] By 1983, Gerald Regan had assumed the same portfolio. The VER program was moving into its third year, but Regan shared Lumley and Gray's concerns about the need for balance and restraint. Under questioning from NDP Leader Ed Broadbent in the House of Commons about the relative lack of investment by the Japanese in the Canadian automotive sector, Regan retorted that his opponent failed "to show any concern about the jobs of people who work in plants that depend upon export orders. He never takes the trouble to think through the consequences as to whether every other country would lamely lie back and buy our goods regardless of how we treat its goods." He went on to remind the NDP Leader that Canada sold "a great deal more to the Japanese than we buy from them, while the Americans have the reverse situation. Therefore, the Americans are in a different negotiating position."[205]

The Province of Ontario shared the federal government's caution. When in 1983 a panel recommended the imposition of higher Canadian content in vehicles sold in Canada (Lavelle and White, 1983), an internal briefing note prepared within the Economic Development Branch of the Ontario Ministry of Treasury and Economics warned that Canada was the most export-oriented of all major Western industrial countries and that anything that increased protectionism could threaten the country's vital interests.[206] Prime Minister Trudeau agreed. Though admitting he had not yet read the report, he nonetheless declared in the House of Commons:

> As a principle of international trade, surely it is impossible for a trading country like Canada to assert that anything that is sold in Canada must be counter balanced by investment for jobs in Canada ... It would be impossible for Canada itself to meet those standards in our sales in every country. We would not want them to demand of us that we would have to create a certain

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[204] National Archives, RG 9-88, Accession 18468, Box 3, File: GATT – General, Notes for a Luncheon Address by the Honourable Ed Lumley, Minister of State (International Trade), to the Toronto Chamber of Commerce, 22 June 1982, p 2.

[205] Honourable Gerald Regan, 25 May 1983, House of Commons Debates, First Session – Thirty-second Parliament, p 25,691.

[206] Archives of Ontario, RG 9-2, Accession 22206. Box 2DM, File: Automotive Industry – General. Summary Briefing on the Automotive Task Force Report, 8 June 1980, p 7.

> number of jobs in their country or to bring a certain amount of investment to their country in order to have the privilege of selling to their consumers.[207]

Trudeau's quick response disappointed one of the task force's co-chairs, Pat Lavelle, who recalls that the Prime Minister's categorical rejection of his task force's recommendations forced policy makers to consider different, firmer positions in terms of dealing with Japanese imports.[208]

In addition to concerns about the total trade picture, Canadian policy makers were also acutely aware that the use of quotas would reduce consumer choice. In November 1980, the Ontario Ministry of Treasury and Economics warned its minister that quotas would cause the price of both imported cars and domestically produced vehicles to rise.[209] "The consumer is king," wrote Ontario Trade Advisor, Rodney Grey to Industry and Tourism Minister Larry Grossman. "This means in effect that restriction on imports (e.g. the Japanese voluntary export restraint measures) cannot be a permanent feature of policy. More radical proposals to protect the Canadian industry by putting on high tariffs or quantitative controls on imports would contradict this basic premise."[210] The Ontario Ministry of Industry and Trade also warned "in the absence of long term industrial goals they lead to higher consumer costs, cause an inefficient allocation of resources and are hard to dismantle once they are in place."[211]

Clearly, even if Canadian policy makers did not fully appreciate differences between the Canadian and US automotive industries, they did understand that Canada – Japan

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[207] Right Honourable Pierre Trudeau, 20 May 1983, House of Commons Debates, First Session – Thirty-second Parliament, p 25,621.

[208] Lavelle, P. (2004). Interview with the author on 2 October, Six Mile Lake, ON.

[209] Archives of Ontario, RG 9-95, Accession 21520. Box 3, File: Background Paper on the Motor Vehicle Parts and Accessories Industry in Ontario, November 1980, p 67.

[210] Archives of Ontario, RG 9-95, Accession 21520, Box 11, File: Rodney Grey. Memorandum to Honourable Larry Grossman from Rodney C. Grey Re the Canadian/US Automotive Products Agreement and the Canadian Industry, 3 September 1981, p 5.

[211] Archives of Ontario, RG 69-23, Accession 22735, Box 9, File: Ministry of Industry Trade and Technology – Automotive Industry. Presentation to Management Committee on Policy Options Re: The Automotive Industry, February 1983, p 5.

trade patterns called for a more subtle approach. Meanwhile, pressure persisted from both industry and labour for a protectionist response.

7.6 Devising a Solution

It is possible that had the American economy been stronger, offshore automakers may have avoided the pressure meted out by American automakers, the union, and ultimately the US government. For much of the 1970s, the fact of steadily rising Japanese imports had been obscured by generally buoyant production and sales by the Big Three. However, in 1979-80, echoing what had happened in Canada in 1959-60 when UK imports began to rise, depressed sales conditions made it difficult to ignore the situation. Further, as in the 1950s, the domestic producers' declining sales in the face of offshore producers' gains triggered the application of a series of policy levers that had a significant and lasting impact. But, unlike in the 1950s, when Canada stood alone, the integrated nature of the US-Canadian industry meant that the country could not act independently from the US. This section describes the political environments in the US and Canada in the period leading to the imposition of measures to limit Japanese vehicle imports.

7.6.i The Political Environment In the United States

The United States International Trade Commission (USITC) announced on 10 November 1980 that Japanese imports were not responsible for the woes of the US auto industry. However, in the popular imagination, Japanese firms were seen to be predatory and political pressures for intervention continued to mount. The Big Three and the UAW made common cause in opposition to Japanese imports. It was a presidential election year and as a result, political interest in the industry intensified with politicians of all hues pledging support for the ultimate icon of American industry.

One source of pressure was a Presidential Task Force. In May 1980, then President Jimmy Carter established a task force on the American auto industry led by

Transportation Secretary Neil Goldschmidt. When the task force presented an interim report to President Carter in July 1980, just prior to a trip by the President to Japan, it included several options for consideration. Among the alternatives proposed were export restraints, voluntary or otherwise. It was calculated that if vehicle imports were cut back to 1979 levels, the burden on US consumers could be as high as $1 billion, but as many as 100,000 unemployed American auto workers might be re-employed.[212] The report received considerable attention at the time. In his covering letter to the President issued with the full report in early 1981, Goldschmidt painted a bleak picture: "Because of its scale and reach, the auto industry has played a central role in the definition and accomplishment of our broadest national goals: work for Americans; energy security; and perhaps most important, national security." He went on to warn that the fate of the industry might "determine our country's future economic well-being, our capacity to respond to the aspirations of our people and of future generations, and to our power and influence in the world."[213] Plainly, the stakes were high.

A second source of pressure was the US Congress where the Trade sub-committee, led by Democrat Charles Vanik of Ohio, was also investigating the situation. Its report, released 5 September 1980, urged "the Japanese to understand the 'critical mass' dangers created by the current auto trade imbalance and unemployment in the United States and to show voluntary restraint during this period of domestic restructuring."[214]

The USITC had also been drawn into the fray when the UAW petitioned for restraints on Japanese imports in June 1980. Later, Ford joined the UAW action. The UAW/Ford petition called for limits on Japanese vehicle imports of 930,000 units[215]

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[212] Farnsworth, C. (1980). Carter gets car-industry aid study. *New York Times*. 3 July, p D1.

[213] National Archives, RG 20, Accession 93-94/195, Box 268, File 4958-1, PT 28: Letter from Secretary of Transportation, Neil Goldschmidt to President, 11 January 1981, p 2.

[214] New York Times. (1980). Report criticizes Toyota and Nissan. *New York Times (Late Edition)*. 5 September, Section 2, p 28.

compared with the 1.8 million Japanese-built vehicles imported in 1979. A telex in September 1980 from the Canadian embassy in Washington to colleagues in Ottawa revealed that Ford was pressing for Canadian government involvement in the case. Specifically, Ford wanted Canada to appear before the USITC to request that Auto Pact trade remain exempt.[216] The government of Canada declined. A letter from federal Industry, Trade and Commerce Minister Herb Gray to his Ontario counterpart, Larry Grossman, in October 1980, affirmed the federal government's intention to make its views known through the channel of the US administration rather than appear before the tribunal. Gray expressed optimism that Canadian companies, unions and interest groups would make representations to the USITC.[217] Earlier that year, when the battle was being waged exclusively by the UAW, the government of Ontario had considered taking action. However, rather than appear directly before the Commission, it too opted to remain detached.[218] Eventually, on 10 November 1980, the Trade Commission turned down the petitions for import restrictions. Its ruling was that neither imported passenger cars nor trucks were the major cause of the domestic industry's troubles.[219]

The USITC decision limited justification for action. But rather than put the issue to rest, the Ontario government immediately anticipated that the USITC ruling would prompt the Canadian and US government to step up pressure on the Japanese government.[220] If the issue was going to be resolved, it would require intervention by

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[215] Farnsworth, C. (1980). Administration studying cutbacks on Japan autos. *New York Times (Late Edition)*. 27 October, p D38.

[216] National Archives, RG 20, Accession 93-94/195, Box 268, File 4958-1, PT 9: Telex from Canadian Embassy in Washington to Motor Vehicles Division of Department of Industry, Trade and Commerce, 22 September 1980, p 1, 2.

[217] Archives of Ontario, RG 9-2, Accession 22205, Box 1, File: Automotive Industry – General #3, Letter from Honourable Herb Gray to Ontario Minister of Industry and Tourism, Larry Grossman, 23 October 1980, p 3.

[218] Archives of Ontario, RG 6-121, Box 12, File: Possible Automotive Sector Lobbying Options in Washington D.C., spring 1980, p 1-3.

[219] Dow Jones News Service. (1980). Trade panel rejects US auto industry bid for import curbs. *Dow Jones News Service*. 10 November.

[220] Archives of Ontario, RG 9-2, Accession 22205, Box 1, File: Automotive Industry – General #3, Petition by Ford and UAW to the US International Trade Commission (ITC), 10 November 1980, p 1.

policy makers and their political masters. The fact that the USITC ruling came days after the defeat of President Carter meant that the problem was handed down to the incoming Reagan administration.

As the Government of Ontario anticipated, the USITC decision did not mute those calling for protection. By March 1981, Missouri Republican John Danforth and Democrat Lloyd Bentsen of Texas had introduced legislation calling for limits on vehicle imports from Japan. However, the Senators' bill called for a much more modest reduction to 1.6 million vehicles per annum for a period of three years.[221] Meanwhile, the new Administration became the target of the protectionist cause, an expectation Ronald Reagan had himself established. During a campaign stop at a Chrysler plant in September 1980 he staked out a position in favour of managed trade. This prior commitment no doubt was a substantial factor in his administration's need to offer a solution several months later:

> There is a place where government can be legitimately involved and this is where I think government has a role it has shirked so far and that is to convince the Japanese one way or another, and in their own best interest, the deluge of cars into the United States must be slowed while our industry gets back on its feet (Washington Post in Cohen, 1997).

Shortly after taking office, President Reagan appointed Transportation Secretary Drew Lewis to head another task force. Its membership was deeply divided over the issue of restraining trade, but it eventually recommended a so-called voluntary formula to be administered by Japan (Cohen, 1997). It was a solution that Lewis and others, at various times, indicated would need to be tempered with wage restraints in the US[222] and a "good faith" pledge by the automakers not to drive up prices.[223]

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[221] Farnsworth, C. (1981). Panel briefs Reagan on auto aid. *New York Times*. 20 March, p D6.

[222] From:

- Holusha, J. (1981). Lewis supports car import curbs. *New York Times*. 21 February, Section 2, p 29.
- Business Week. (1981). Agreeing on options for helping Detroit. *Business Week*. 30 March, p 44.

[223] Clines, F. (1981). Eight states urge talks with Japan on autos. *New York Times*. 6 March, Section 2, p 30.

In March 1981, following a meeting between the President and the task force, the White House notified reporters that the President would take "a week or two" to determine what measures the administration would take to reduce imports of Japanese automobiles.[224] Within hours, however, Japan's Minister of International Trade and Industry Rokusuke Tanaka waded in, stating that his ministry would use "administrative guidance" to persuade Japanese automakers to curb exports.[225] Tanaka's statement was a sure sign that Japan and the US were moving towards a managed solution. Eventually, Japan agreed that it would voluntarily agree to cut exports to 1.68 million units in the twelve months commencing 1 April 1981, a 7.7 per cent reduction from sales of Japanese-built vehicles in the twelve months prior.[226]

7.6.ii The Political Environment in Canada

Meanwhile, in Canada, political circumstances also moved in favour of intervention. However, a solution had to be pursued with a lighter touch than the US case. The need for tact and sensitivity was a result of a number of factors. As already demonstrated, the Canadian industry's downturn was not as severe as that in the US, so the validity of any Canadian argument for intervention was more open to challenge. Second, Japanese vehicles claimed a smaller share of the Canadian market and this share stood just marginally above historical trends. Third, Canada's overall trade balance with Japan was in surplus. Finally, Canada was simply a lower level priority for Japan than was the US.

Windsor Ontario, which is located directly across the river and international border from Detroit, was then, as now, the home of the auto industry in Canada. In 1980, the city was the location of Chrysler Canada's head office and two of that company's

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[224] Jiji Press Ticker Service. (1981). Reagan may decide on auto import issue in one week or two. *Jiji Press Ticker Service.* 19 March.

[225] Seaberry, J. (1981). US given warning on import curbs; US warned import curbs may trigger trade war. *Washington Post.* 19 May, p C1.

[226] It was expected that the reduction in imports would cause Japanese market share in the US to hold at approximately 17 per cent. However, because the US market degenerated further and because Japanese automakers were able to sell product already on hand when the limits were imposed, market share of Japanese automakers climbed to 22 per cent.

final assembly plants, as well as the site of key parts and components operations of General Motors and Ford. The Liberal Prime Minister Pierre Trudeau had just been re-elected with a majority government. During the election campaign, the Liberal Party had taken a particularly nationalistic stance, promising active intervention with respect to energy and foreign investment. As well, two of Prime Minster Trudeau's most senior ministers came from the City of Windsor. Marc MacGuigan was in charge at the Department of Foreign Affairs and Herb Gray was at Industry, Trade and Commerce. The well being of the Canadian automotive industry was close to the heart of both men.

Yet for all the indications of rising economic nationalism, the Trudeau government in practice pursued a far more patient and sophisticated approach. It might have been tempting to follow the US lead and adopt a strident, confrontational approach. Such a ploy would have played well with the affected communities, including Windsor, and large parts of the industry. But even as the issue became more heated in late April, 1981, the most aggressive language Minister Gray dared utter at a press conference was that he expected Japanese officials to respond "quickly" to the situation and extend "similar and parallel cuts to Canada."[227] Effectively, Canadian policy was to press for natural justice and a deal similar to that granted the US.

Had a rigid strategy been adopted earlier – before the US had reached agreement with Japan – it would have been at odds with Canada's traditional conciliatory approach. David Worts of the Japan Automobile Manufacturers' Association of Canada (JAMA Canada) reflects on the trading relationship between Canada and Japan:

> [It] had been rather complementary and more balanced. For the most part, it was one where Canada sent natural resources to Japan and in return we got back a lot of manufactured goods. But, it was a relationship that worked rather well and there was certainly less animosity and less adversarial kinds of posturing than there was in the US.[228]

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[227] Brady, S. (1981). Canada will ask Japan to voluntarily restrain auto exports. *United Press International.* 1 May.

[228] Worts, D. (2004). Interview with the author on 24 August, Toronto.

Adopting a confrontational approach, mirroring the strategy employed by the Americans, would have been out of character with Canada's traditional role. As events unfolded, the approach that was ultimately adopted was one of quiet diplomacy. Canadians like John Tennant, who was in the foreign service at the time and stationed in Tokyo, were well aware that "General Motors, Ford and Chrysler after all, were foreign companies every bit as much as Toyota or Honda were."[229] However, policy makers were also obliged to be seen as shielding the existing industry and its employees:

> The need to work out voluntary export restraints was dictated mainly by being 100 per cent sure you weren't going to get whip-sawed and having something that you could hold out to the public, to politicians, to the industry in Canada, that you have achieved the same thing that the Americans had.[230]

Tennant went on to say: "You had to make sure that you were on the Japanese radar. You had to make sure that the measures the Japanese were considering weren't discriminating against you and you had to have in place measures that would entice the Japanese, but fit enough with the North American environment."[231] In Dennis DesRosiers' view: "Canada had to change its auto policy from being one that was totally biased to the American industry and quite deliberately move to an auto policy that was more international, more focused on the global arena. That was very difficult."[232] This carefully measured approach was a source of regular frustration for some industry members. "If you go back over our trade history," comments former APMA president and Ontario Deputy Minister of Industry, Trade and Technology, Pat Lavelle, "there are very few times that you could look and say that the Government of Canada actually took some sort of a definitive decision."[233]

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[229] Tennant, J. (2004). Interview with the author on 17 September, Waterloo, ON.

[230] Ibid.

[231] Ibid.

[232] DesRosiers, D. (2004). Interview with the author on 24 August, Toronto.

[233] Lavelle, P. (2004). Interview with the author on 2 October, Six Mile Lake, ON.

Yet, while Canadian policy makers understood the delicacy of their situation, they were nonetheless under pressure to reach a deal with the Japanese. Their fear was that if Japanese vehicle imports into the US were curtailed, excess production might be targeted at Canada. Briefing notes from the Province of Ontario indicate that concerns were raised on several occasions, commencing more than a year before the introduction of voluntary restraints.[234] In March 1980, Ontario's Treasurer was advised: "The Canadian federal government should participate as far as possible in the US-Japan talks and should adopt safeguards similar to the Americans. A united front for North America might be the best policy to pursue, provided other participants in the negotiations are amenable."[235] The same anxiety was expressed in a letter from Ontario Premier Davis to Prime Minister Trudeau: "Lower imports into the United States could mean increased imports to Canada."[236] Canada's federal government was also concerned about the potential for diversion of vehicles to Canada and the matter was raised during a meeting with Deputy US Trade Representative Robert Hormats on 19 November 1980. A telex from the Canadian embassy in Washington to the Motor Vehicle Division of the Department of Industry, Trade and Commerce reported that during the meeting it had been explained to the Americans that earlier bilateral meetings with the Japanese revealed "no indications from the Japanese that they are prepared to treat auto exports to Canada with the same degree of quote prudence unquote as exports to the USA."

The danger of diversion persisted throughout the time the program remained in place. In fact, when the CAW, along with the parts association and the Canadian vehicle manufacturers sought an extension and expansion of the program in 1986, the Province's Special Advisor for Trade Policy, Bob Latimer, observed: "I could not constrain myself from commenting ... The Japanese restraint arrangement is no

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[234] Archives of Ontario, RG 6-121, Box 2, File: The Automobile Industry for the Budget Briefing Book, 16 April 1980, p 4. Similar concerns also expressed in Archives of Ontario, RG 9-95, Accession 21520, Box 3, File: Auto Industry: Structural Policy Recommendations, May 1980, p 1.

[235] Archives of Ontario, RG 6-121, Box 5, File: Briefing Notes: Automobiles 28, Briefing Notes for the Treasurer on the Automobile Industry, 28 March 1980, p 1.

[236] Archives of Ontario, RG 9-2, Accession 22205, Box 1, File: Automotive Industry- General 3, Letter from Premier William Davis to Prime Minister Pierre Trudeau, 30 July 1980, p 3.

longer a defensible trade policy since its initial credibility to prevent trade diversion as a result of US restrictions has disappeared with the termination of negotiated restraints on sales to the US and Japan."[237]

Deeper examination of the issue of diversion, however, underscores the ultimate futility of limiting automotive imports to Canada. On the sales side, for example, it can be assumed that restricting imports would cause little if any overall impact. Shifting market shares might cause some dislocation, but it requires the same number of people to market and distribute a Japanese-built vehicle in Canada as it does to market and distribute one built in the US. In terms of production, even massive market share adjustments in Canada would have had little, if any, real impact on Canadian production and jobs. For example, even if Japanese imports to Canada doubled from 1980 levels of 138,000 to 276,000, equal to 29.6 of the new passenger car market in Canada, the increase would amount to just 1.4 per cent of the total North American new car market. Although it was ultimately rejected, the limited impact of a Canadian import restraint program was raised in a memorandum of July 1980 from Ontario Industry and Tourism Assistant Deputy Minister Duncan Allan to Ed Stewart, Secretary of the Cabinet:[238] "The Canadian market is not of sufficient size to severely hurt the offshore car manufacturers. However, Canada could be badly hurt if West Germany and Japan were to retaliate."[239] The Ontario Treasury Department's Office of Economic Policy, in a briefing note exploring various alternatives wrote: "Quotas can really only be effective domestically when the home nation can, and does, produce viable substitutes. This is not the situation for auto imports in Canada. A Canadian system would be in a peculiar position of protecting American industries while allowing retaliation to be directed at Canada."[240] For the

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[237] Archives of Ontario, RG 9-160, Accession 35705, Box 12, File: C-USTR: Trade Negotiations Issues Sector Analysis 1985 and Prior. Memo to Deputy Minister, P.J. Lavelle, from R.E. Latimer, Special Trade Policy Advisor, 13 February 1986, p 1.

[238] The Cabinet Secretary is the highest ranking civil servant in the Province of Ontario.

[239] Archives of Ontario, RG 69-2, Accession 22205, Box 1, File: Automotive Industry – General #3. Memo from D.M. Allan to E.E. Stewart Re. Cabinet Meeting with United Auto Workers, 31 July 1980, p 3.

[240] Archives of Ontario, RG 6-121, TB 8, Box 2, File: Procedures for Preventing Unfair Foreign Competition in Autos (B.N), June 1980, p 7.

1981 model year, only Ford, which produced the EXP/LN-7 line in St. Thomas, Ontario, made the kinds of small cars in Canada that Japan was sending to the Canadian market.

Canadian policy makers also recognized that while it might superficially have been expedient to impose restraints on the Japanese, doing so would represent a significant risk for a country of Canada's stature. Canada could not act first. It could only follow the US lead. It was not until after Japanese International Trade and Industry Minister Tanaka strongly hinted that his government would respond to the overtures to restrain exports to the US that Canadian officials started to publicly consider the prospect for a similar approach in Canada. The official process commenced in April 1981 with a mission of Canadian government officials to Japan, led by Campbell Stuart from the Department of Industry, Trade and Commerce. In a memorandum to a colleague in External Affairs, Stuart indicated that he was well aware that the Canadian situation was unique and that the country would be ill served by merely aping the approach taken by the US.[241] The mission was followed by a four member task force in early May, designed to lay the groundwork for a meeting between Canadian Prime Minister Trudeau and Japanese Prime Minister Suzuki later in the month.

The Trudeau – Suzuki meeting came and went without an agreement, but both sides continued discussions throughout May 1981. Toyota improved the spirit of the negotiations when on 18 May 1981, at the annual meeting of the Japan-Canada Businessmen's Meeting in Vancouver, it announced its intention to send a survey team to Canada to study the feasibility of constructing an auto parts plant in Canada.[242] This trip eventually resulted in Toyota building an aluminium wheel manufacturing operation in Delta, British Columbia in 1983. Paul Lau, who was Canada's Chief Negotiator for Automotive at the Canadian Embassy in Tokyo at the

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[241] National Archives, RG 20, Accession 93-94/195, Box 30, File 4958-11, PT 4: Memo to M. Wodinsky, US General Relations Division, Department of External Affairs from Campbell Stuart Re Canada – US Automotive Trade, 10 February 1981, p 3.

[242] Jiji Press Ticker Service. (1981). Toyota to send survey team to Canada on parts plant construction. *Jiji Press Ticker Service*. 18 May.

time, insists that Toyota's announcement, though timely, was purely a commercial decision.[243] However, former Toyota Canada president, Yuki Togo, has acknowledged that the announcement was designed to get Toyota more entrenched in Canada by addressing the balance of trade issue (Reingold, 1999, p 75). Despite the Toyota announcement, Minister Gray pressed forward, using a luncheon speech at the May conference to urge Japan to voluntarily curb exports to Canada.

Eventually, the Japanese Ministry of International Trade and Industry (MITI) announced on 5 June 1981 that it would impose voluntary restraints on passenger car exports to Canada at a level of 174,000 units for the period 1 April 1981 – 31 March 1982. This figure was announced as a cut of 6 per cent for the fiscal year ended 31 March 1981.[244] Although never formally announced, it was also understood that Japanese manufacturers would limit imports of trucks into Canada to 51,000 per year.[245] Mr. Lau characterizes these numbers as guidelines and notes they were never written down.[246] Despite the public pronouncements about the restrained level of imports, 174,000 units actually represented a 10 per cent increase from calendar 1980. Japanese manufacturers had increased exports to Canada and hence inventories in the January to March 1981 period, perhaps in anticipation of such an agreement. By contrast, the US agreement one month earlier called for a 7 per cent decrease from calendar 1980. The less stringent Canadian settlement reflected the underlying weakness of its case for restraint.

Regardless of the weakness of the argument for the VER program in Canada, once it was in place policy makers defended it with vigour. Ultimately, its effect was much different than what was anticipated at the time of introduction. Long-lasting market disruptions occurred as the new entrants entered markets they had previously

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[243] Lau, P. (2004). Interview with the author on 22 October, Cambridge, ON.

[244] Jiji Press Service. (1981). Canada hails Japan car export curb. *Jiji Press Service*. 6 June.

[245] Morrison, E. (2004). Industry Canada, Canada/Japan Program of Activities A Chronology. (Notes from a file of Erech Morrison, Department of Industry, Government of Canada.)

[246] Lau, P. (2004). Interview with the author on 22 October, Cambridge, ON.

ignored. The VER program also prompted Japanese manufacturers to more seriously consider Canadian investment. The contradiction between initial motivations and the ultimate impact of the program is the focus of the next section.

7.7 The Impact of Voluntary Export Restraints in Canada

So what were the specific impacts of export restraints in Canada? There were two main outcomes. The first was on the domestic manufacturers. It is proposed here that the ultimate impact of voluntary import restraints was that rather than providing short-term breathing space for North American manufacturers – the kind of relief originally anticipated – they did long-term damage to the indigenous Big Three. Import restraints were not established on the basis of value but on the number of units sold. As a result, Japanese producers moved upmarket, shipping larger and higher value vehicles to Canada and the US, effectively broadening the scope of their offerings. In moving into the intermediate class, they started to compete head on in the core markets of the Big Three. Meanwhile, the Big Three imported small or compact vehicles from Japan and other lower-cost offshore jurisdictions in much greater quantities and badged them as their own (so-called "captive" imports), effectively ceding the small car segment to offshore manufacturers. In 1980, for example, the average value of a vehicle imported into Canada from Japan was $6,605; by 1986, it was $13,756,[247] a rise of 108 per cent. Meanwhile, prices in Canada of North American made vehicles rose over the same period by a more modest 58 per cent, from $8,194 to $12,958. Elements of this phenomenon were acknowledged by the then Assistant Deputy Minister of the Automotive, Marine and Rail Branch of the Department of Regional Industrial Expansion, John Banigan, in 1986: "Increasing pressure is coming to bear on the intermediate cost segment of the market that has been the traditional strength of the North American producers as the Japanese move upmarket with new and more expensive models."[248] This trend

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[247] Statistics Canada, *CANSIM* Table 079-0002 - Other Estimates of New Motor Vehicle Sales, Canada, Provinces and Territories, Computed Annual Average.

[248] National Archives, RG 9-160, Accession 35705, Box 12, File: C-USTR Trade Negotiations Issues Sector Analysis, Manufacturing Auto January – June 1986. Competitiveness Profile Motor Vehicles, 14 April 1986, p 6.

occurred at the same time European firms were starting to compete more aggressively at the upper end of the market. Ironically, therefore, rather than assisting domestic manufacturers, VERs created market disruptions and manipulations that worked to the ultimate disadvantage of the domestic producers the policy was designed to assist.

A second impact of VERs became more evident with the passage of time. During 1980 and 1981, when import restraints came into vogue, the main idea was to halt the rise in Japanese imports and thereby protect domestic manufacturers. Paul Lau, who was then at the Department of Regional and Industrial Expansion recalls: "VERs had nothing to do with getting them [the Japanese] to invest as such. They were used to address the downturn of the industry at that time because of the oil shock."[249] Eventually, however, government began to see that VERs, in concert with other policy tools, might encourage Japanese investment in Canada. According to Mike Dube, an Ontario government official close to the automotive file in the early 1980s: "It was seen by Industry and Commerce, as it was called at that time, that if we wanted to attract Japanese investment, we had to do something to show that we wanted it. The trade restraints helped demonstrate that we wanted – expected – investment by the Japanese."[250] Lau says that was certainly not the intention at the outset and that the switch from blocking Japanese imports to actively seeking Japanese investment did not occur until Ed Lumley succeeded Herb Gray as federal minister in 1982. The available evidence supports Lau's view. A briefing note of May 1980 reveals that the government believed Canada was unlikely to attract an offshore assembler and that Canada's efforts should be to get higher value added parts production.[251] A Treasury and Economic Briefing note in October 1980 also pointed out that the fact that the Auto Pact could be abrogated by the US at one

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[249] Lau, P. (2004). Interview with the author on 22 October, Cambridge, ON

[250] Dube, M. (2004). Interview with the author on 26 August, Toronto.

[251] Archives of Ontario, RG 6-121, Box 2, File: Treasury Briefing Notes for Premier's Advisory Committee on the Economic Future Meeting. 26 May 1980, p 10.

year's notice reduced the likelihood of Canada attracting an offshore-based assembler.[252]

Yet even though the original intention was not to encourage FDI, it was interpreted as such by the Japanese. Yuki Togo's comments regarding the fact-finding tour by Toyota in May 1981 is one example of how the policy pressured Japanese automakers. One Honda official also suggests that VERs were a factor in the decision to invest in Canada. When the company was preparing to launch its Acura brand, it was recognized that VERs meant that sufficient numbers could not be imported to make the launch feasible. Production of more Honda vehicles in Ohio and subsequently in Canada eventually solved the problem.[253]

VERs were also a factor in Suzuki's foray into North American manufacturing. In 1981, General Motors had purchased about five per cent of Suzuki and by 1984 both parties were eager to exploit the relationship. Between then and 1986, Suzuki and GM contemplated a joint venture automotive assembly investment in Ontario. However, to make the investment viable, imports of Suzuki products from Japan were necessary to round out the Suzuki product line-up. The problem was that under the VER program, exports were allocated to manufacturers on the basis of the market shares they held in 1980. Because Suzuki sales in Canada were negligible in the base year, it was limited to just 3,000 exports, not enough to make the venture viable. The two companies sought an export allocation of about 25,000 units, but other Japanese companies with much larger allocations were loath to relinquish any of their share.[254] Until the situation was resolved, General Motors and Suzuki were unwilling to commit to investment in the new plant. With no ability to import in sufficient quantities, their options were limited. One option was to produce almost all the vehicles they wanted to sell in North America within North America. Not only would

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[252] Archives of Ontario, RG 6-121, TB 8, Box 2, File: Issues Briefing Notes. 28 October 1980, pp 1, 2.

[253] Miller, J. (2004). Interview with the author on 28 September, Toronto.

[254] Daw, J. (1986). Talks to resume with Japanese on auto curbs. *Toronto Star*. 31 July, p C3.

that take time, it was also unfeasible. Another option – the one they pursued – was to seek a much larger export allocation to complement North American production.

The task of negotiating the new plant was assigned to General Motors Canada. Throughout the spring and summer of 1986, the company regularly threatened to pull out of the venture unless the situation was resolved.[255] Japanese competitors, however, were not sympathetic. "There would be absolutely no support for their position in Japan,"[256] declared Toyota senior managing director, Hideyo Tamura. Only after the Canadian government intervened in 1986 did the Japanese government agree to increase the overall quota by 36,000 to 240,000 for the year ended March 31, 1987, augmenting allocations to all companies, including the provision of an additional 14,000 units to Suzuki.[257] Shortly thereafter, GM and Suzuki announced the building of a new $500 million facility.

Hence, VERs had several unanticipated outcomes. They caused adjustments to product line-ups that had long term implications and they sent messages that Japanese manufacturers interpreted as strong encouragement to invest.

7.8 Conclusion

By 1980-81 the North American automotive industry faced significant challenges. However, it has been demonstrated in this chapter that these challenges were not uniformly severe. In particular, it has been established that sales, employment and production issues confronting the industry in the US were different, and in many ways more severe, than those in Canada.

By 1980-81, the North American industry was frantically searching for both solutions and scapegoats. The growth in Japanese imports over the previous decade

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[255] From: Ferguson, J. (1986). GM, Suzuki close to deal on Ontario minicar plant. *Toronto Star*. 19 May, p A1.
Daw, J. (1986). Talks to resume with Japanese on auto curbs. *Toronto Star*. 31 July, p C3.

[256] Daw, J (1986). Hopes fading for Suzuki's Ontario plant. *Toronto Star*. 22 July, p D1.

[257] Toronto Star. (1986). GM, Suzuki risk millions on car plant. *Toronto Star*. 12 August, p G1.

had been unrelenting, fuelled in large part by the market's move toward smaller cars, particularly following the second oil shock of 1979. Legislators became convinced that stemming the flow of foreign made automobiles could provide breathing space for an embattled and important industry. Significant pressure was heaped on policy makers to reduce the level of Japanese imports. The process started in the US and spread quickly to Canada.

It has been proposed that the imposition of controls on Japanese built automobiles in Canada was not without significant economic and political risk. Driven by western Canadian commodity exports, Canada-Japan trade was in relative balance in 1980. Focusing exclusively on automobiles had the potential to initiate a trade war, and this chapter has sought to demonstrate how politicians navigated through these turbulent waters. When the US reached an agreement on automotive imports from Japan, Canada quickly followed its own process to strike a similar accord despite the limited impact import restraints would have on Canadian production, the less severe downturn in Canada vis-à-vis the US, and the significant risk of retaliatory measures being imposed by Japan.

Clearly, governments in North America were under considerable pressure to halt the decline in automotive production and became convinced that restricting Japanese imports would pacify the affected constituencies. However, close examination of the data reveals that restricting trade was not a cure-all for the ills of the Canadian industry. It has been shown that even though relationships existed in Canada between automotive profits and sales and automotive profits and new capital investment, there was no relationship between import market share and automotive profits nor was there one between import market share and new capital investment. So while it is true that the industry did bounce back after 1981, the recovery was not a direct consequence of limiting imports. That does not mean VERs did not have an impact. Indeed, it was shown that the imposition of VERs caused offshore manufacturers to enter markets that had traditionally been the preserve of the North American based producers. Additionally, it was demonstrated that VERs served as an early and important prompt for offshore-based firms to make manufacturing investments in

North America, effectively the starting point for a thoroughgoing transformation of the industry that continues to the present. It is for that reason that the introduction of VERs is of enduring interest. Other policy measures will be discussed in subsequent chapters, however, understanding the role of VERs provides a starting point for the second key research question this thesis poses: "What role did governments play to facilitate the process of encouraging inward FDI during the 1980s?"