

Bailouts and Subsidies: the Economics of Assisting the Automotive Sector in Canada

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I. Assisting the automotive sector: 2004 – present

“Bailout” of GM and Chrysler 2009

- Total \$14.4 billion
- GM \$10.6 billion (\$US 9.5 billion)
- Chrysler \$3.8 billion
- Federal share 2/3, Ontario share 1/3
- Net cost: \$9.5 billion → \$4.9 billion liability to Ontario’s Pension Benefit Guarantee Fund

I. Assisting the automotive sector: 2004 – present

Project-based subsidies 2004 – present

- Total \$1.4 billion
- federal share 45 %, Ontario share 55 %
- Recipients: Ford, GM, Chrysler, Toyota, Honda, Navistar, Linamar, Valiant, NemaK, Toyota Boshoku, Toyotetsu, AGS Automotive/Tiercon, Denso
- loans vs. grants
- production facilities vs. R&D

II. Economic Perspective on Subsidies

Justifications for investment subsidies:

- External benefits of investment
(e.g. clusters, technology spillovers, etc.)
- Avoiding social costs of adjustment
(unemployment, reduced tax revenues)
- Attracting high productivity industries

II. Economic Perspective on Subsidies

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 - GST/HST ~ \$1.11

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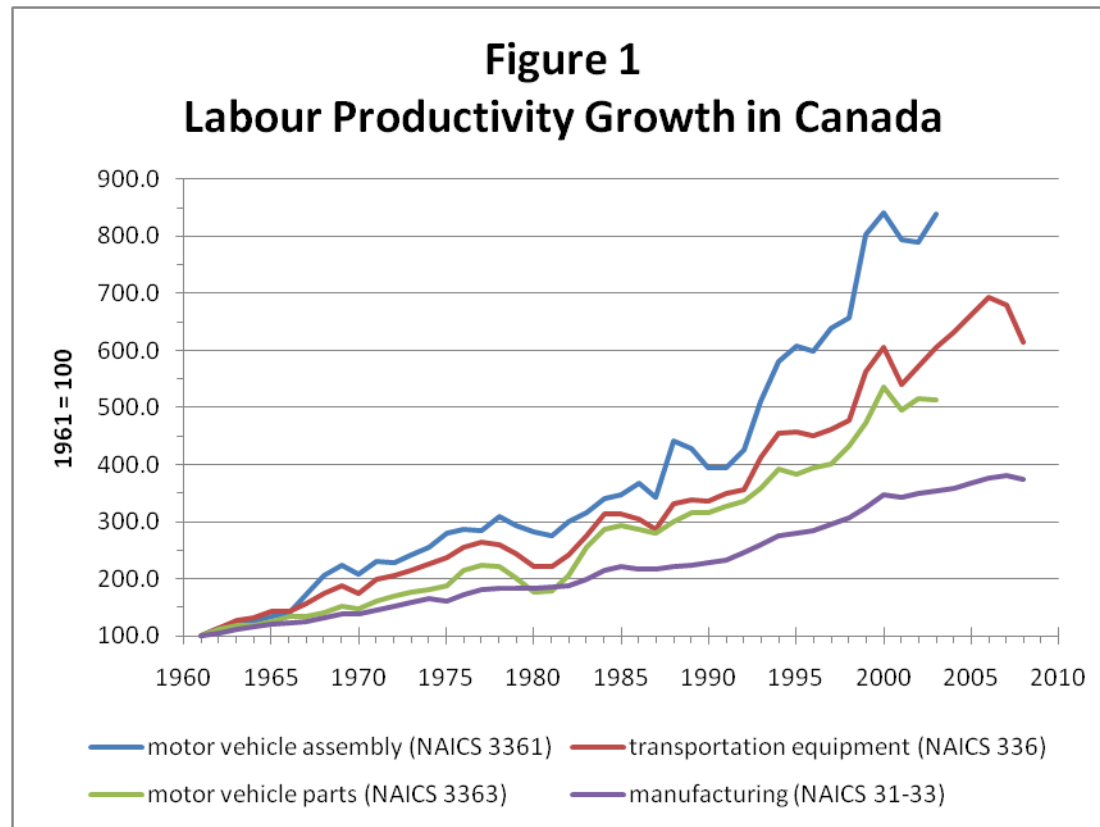
- How much benefit can be extracted from high productivity industries?

III. High Productivity Industries: How Much Can Be Extracted?

Consider the Canadian automotive industry:

- High labour productivity growth
- Superior pay

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Source: Statistics Canada, Industry KLEMS Productivity Database.

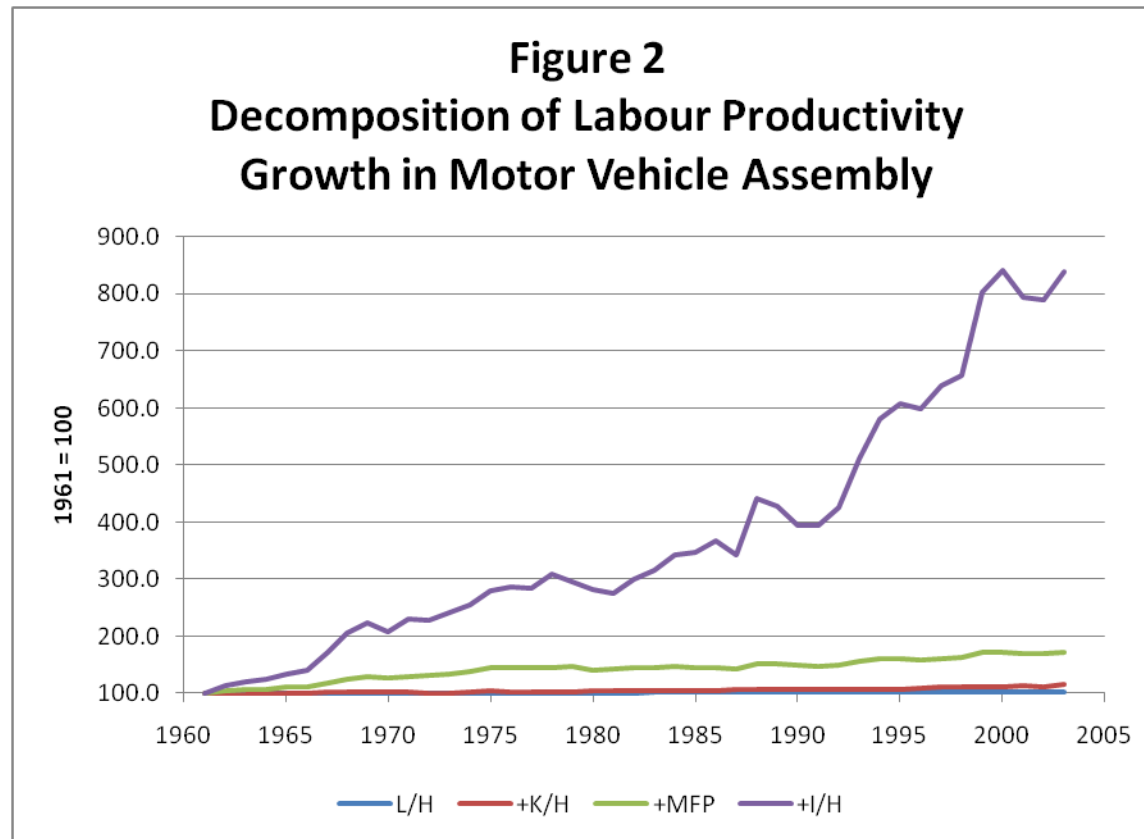
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**Average Hourly Earnings (2007)
Excluding Overtime, Employees Paid by the Hour**

Canadian Motor Vehicle Assembly	\$31.83
Canadian Motor Vehicle Parts Manufacturing	\$24.13
Ontario Manufacturing	\$21.90

Source: Statistics Canada, CANSIM v1809188, v1809189, v1809131, v1809789.

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- International competition
→ pay level not sustainable unless supported by subsidies

IV. Cost-Benefit Analysis of the Bailout of GM and Chrysler 2009

Macroeconomic performance evaluated with the Provincial Economic Modeling System of The Centre for Spatial Economics (C₄SE)

Assumptions:

- Analysis based on information available to policy makers in spring 2009
- US was going ahead with bailouts anyway
- No Canadian bailout →
 - Canadian operations close, move to another jurisdiction
 - No increase in sales for Ford, Toyota, Honda, etc.
 - Claim of approx. \$4.9 billion on Ontario's Pension Benefit Guarantee Fund

IV. Cost-Benefit Analysis of the Bailout of GM and Chrysler 2009

Three scenarios:

- Successful bailout
 - continued viability of GM and Chrysler but with gradual reduction in market share and employment
 - with and without pay back

- No bailout

- Bailout resulting in closure – temporary reprieve, companies close in 2015

IV. Cost-Benefit Analysis of the Bailout of GM and Chrysler 2009

All bailout scenarios were preferable to no bailout

Ex. Successful bailout – nothing paid back

- net cost of the bailout - \$9.5 billion
- GDP losses avoided in 2009: **\$23.1 billion**
- Job losses avoided in 2009: **~ 100,000**
- Government finances yield a positive return by 2015

V. Cost-Benefit Analysis – Project-Based Subsidies, 2004-2011

\$1.4 billion total: \$782 million from Ontario, \$645 million federal

Conclusion: Like the bailouts, project-based subsidies also were preferable to losing the investment.

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- Subsidies must be financed by distortionary taxation → there is additional cost over and above the transfer to workers

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- Therefore, it would be more efficient for workers to provide the investment incentive through concessions
- How much could automotive workers provide?

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Example: Ford Centennial Project (2004)

- Convert Oakville assembly plant into a flex facility
- Ontario's grant of \$100 million
- 3,900 direct jobs secured
- Equivalent pay concession of 79 cents per hour

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- Concession of the \$10 premium earned by automotive assembly workers \times 18,400 workers \rightarrow capitalized value of \$6 billion.
- Compare with \$9.5 billion net cost of the bailout / \$14.4 gross cost

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- Average annual market income of Canadians aged 25-64 (2007):
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- Redistribution of income upward rather than downward →
not compelling

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Cooperative strategy reflecting the competitive level of pay?

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Investment inducements based on workers' concessions are superior to subsidies in terms of efficiency, equity, and sustainability.

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Policy recommendations:

- External benefits of investment projects should be identified, quantified and debated before a subsidy is granted.
- Governments should require competitive labour compensation as a precondition for subsidies.

Thank You!