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

Leslie Shiell
Department of Economics
University of Ottawa

Robin Somerville
Director,
The Centre for Spatial Economics

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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

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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

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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

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  - federal corporate income tax ~ $1.71
  - GST/HST ~ $1.11

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

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

Consider the Canadian automotive industry:

- High labour productivity growth
- Superior pay

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

Figure 1
Labour Productivity Growth in Canada

Source: Statistics Canada, Industry KLEMS Productivity Database.
III. High Productivity Industries: How Much Can Be Extracted?

<table>
<thead>
<tr>
<th>Industry</th>
<th>Average Hourly Earnings (2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canadian Motor Vehicle Assembly</td>
<td>$31.83</td>
</tr>
<tr>
<td>Canadian Motor Vehicle Parts Manufacturing</td>
<td>$24.13</td>
</tr>
<tr>
<td>Ontario Manufacturing</td>
<td>$21.90</td>
</tr>
</tbody>
</table>

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Figure 2
Decomposition of Labour Productivity Growth in Motor Vehicle Assembly

Source: Statistics Canada, Industry KLEMS Productivity Database

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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
$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.
VI. Good Policy … Better Policy … Best Policy
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Efficiency analysis:

➢ Average mfg wage is the “opportunity cost” of auto workers
  ➞ $10 wage premium  ➞ there is room for concessions

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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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How much could automotive workers provide?
VI. Good Policy … Better Policy … Best Policy


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

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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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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!