

**CAPC Innovation Working Group (IWG)**  
**Status Report**  
**January 31, 2008**

Recognizing the continued need for strong innovation in Canada's automotive manufacturing sector, especially in light of developments such as the appreciation of the Canadian dollar and the entrance of new players in the automotive business scene, the CAPC Innovation Working Group has met several times since the last CAPC meeting in May 2007.

Among the major initiatives and developments are the following:

1. The IWG has begun meeting jointly with the Innovation Committee of the APMA to help streamline our work and ensure that the messaging is agreeable to all stakeholders.
2. The private sector members of the IWG collaborated on the creation of a submission to the SR&ED Review Process (attached hereto).
3. Many members of the IWG took part in the two Automotive Expert roundtables that were organized by Industry Canada ATIB in the December/07 – January/08 period.
4. The AUTO21 Network of Centres of Excellence was renewed for a second 7-year funding cycle from 2008-2015.
5. A status report on the priorities which was created in March-April/07 at the request of Chairman Don Walker (see below).

**STATUS REPORT – from the April-May 2007 Priorities Document**

**1. Establish Supports for Industry-based Innovation Activities**

The IWG continues to call for the establishment of new government supports (Federal and Provincial) focused on accelerating private company based research and development activities in advancing the innovation of products and manufacturing processes/productivity in both vehicle and auto parts companies. Furthermore, governments must recognize that companies do not have all the needed innovation resources to respond effectively/profitably to broad range of new government environmental policies.

**2. Continuing & Expanded Support for Effective Existing Innovation Support Programs**

The list of initiatives formulated by the IWG is below along with some comments related to those which have experienced a major development since the last CAPC meeting.

**a) Ontario Automotive Investment Strategy (OAIS)**

The Ontario government has announced that they are developing a replacement to be called the Next Generation Jobs Fund but details are not yet available.

**b) AUTO 21 Network of Centres of Excellence**

Most of the member companies represented on the IWG and a very large number (over 290 in fact) of other bodies from research institutions to the municipalities of the Automotive Mayors Group supported the renewal of AUTO21 for a second 7-year funding cycle.

The group was pleased to note that AUTO21 was renewed until 2015, but suggests that the continuation of funding at the same level as in the first 7 cycle (2001-2008) represents a decrease in the financial resources over the coming period due to inflation. The group continues to call for increased resources for AUTO21.

**c) NSERC's Research Partnership Programs**

This set of program continues to the generate good outcomes for a number of industry partners with several new Industrial Research Chairs, CRD's and other initiatives.

**d) Ontario Research Fund (ORF)**

A major ORF investment in Waterloo and McMaster universities is expected to be announced within the next few months.

**e) Ontario Centres of Excellence (OCE)**

The Ontario Centres of Excellence programs have funded a number of automotive-related research projects in the province's universities in the past year.

**f) Effective and accessible replacement for the Federal TPC program**

The IWG continues to call for a replacement for the Federal TPC program that addresses auto industry priorities, timeframes and practices.

**g) Canada Foundation for Innovation (CFI)**

**h) CANMET's move of the Materials Technology Laboratory from Ottawa to Hamilton**

**i) SR&ED tax credit system**

The submission of the IWG to the SR&ED Review Process is attached below.

**3) Lightweight Materials Development and Support**

A number of excellent lightweight materials projects have been undertaken by Canadian industry as university collaboration activities and the output of these projects are now ready to enter the advanced technology development phase in the private sector. However, the lack of a Canadian support mechanism for this type of industry research and development initiative makes it unlikely that these new technologies will be implemented here.

Another key lightweight materials research program is the tri-national (Canada-China-US) magnesium intensive front-end R&D program (MFERD) which seeks to decrease vehicle weight while enhancing safety through the increased use of magnesium in vehicle structures and components. The decrease in vehicle weight will help to bring about GHG emission reductions and enhanced fuel economy. It is important that Canada support this activity to ensure a place for Canadian parts suppliers' in the future automotive magnesium parts business.

**4) Climate Change / Fuel Economy**

The announced regulatory changes in the new advanced fuel economy regulations in the US have led the American government to announce significant auto industry financial support for R&D and re-tooling that will be necessary to achieve these dramatic improvements in fuel economy.

The IWG strongly urges Canada to make similar provisions for supporting our automotive industry in deploying these advanced technologies.

If similar support measures are not made available to Canadian operations, the business case for maintaining production mandates in our country will become that much less attractive as US facilities gain this additional competitive advantage.

## **Summary – CAPC Fiscal, Investment and Innovation Working Group Presentations to the CAPC Meeting 5 February 2008, Ottawa**

The presentation was supported by the attached updated CAPC Fiscal Investment Working Group (WG) Score Card. The Innovation Working Group has submitted a separate and more detailed update as well.

### **Industry Investment and Competitiveness Challenges - Update**

The challenges to Canadian industry's ability to attract the large scale mandates and related investments which anchor the Canadian automotive industry and supply chain continue to increase. While most attention is rightly focused on the competitive challenges posed by the sharply lower US dollar (and relative cost pressures in Canada) the Canadian competitiveness challenge continues to also be driven by other factors with direct public policy implications.

**1) Competitive Incentives** - Competing jurisdictions in the US and elsewhere continue to provide investment incentives (or tax offsets) ranging from 15% - 30% or more of total investment or reinvestment costs. As outlined in the CAPC KPMG study these jurisdictions are focused on retaining the strong social and economic benefits derived from large local automotive supply chains. A further CAPC study has indicated these government investments "pay themselves back" in taxation and related benefits in 4-6 years.

**2) Green Retooling Supports** - Added to this competitive challenge is concern in facing the massive investment implications of the new US Energy Bill which mandates a 40% fleet fuel economy improvement by 2020 – (approximately 2 product cycles). NHTSA conservative cost estimates for this change by US industry exceed \$100 billion. Accordingly, the US Energy Bill provides for green retooling incentives for US auto plants to assist them to adapt to this challenge – with estimates for this support in the range of \$10-\$20 billion in loan guarantees and related supports. Program specifics are yet to be determined. While Canada has proposed to follow the US 40% fuel economy requirement, it has not indicated whether it will support the necessary investments to achieve this extraordinary technological and investment challenge in Canadian operations.

**3) Currency Impacts** – The rapid move to currency parity with the US dollar has significantly increased the relative cost (and therefore competitiveness) of Canadian-purchased goods and services including energy, raw materials, parts, labour and related benefits and pension costs. While companies are aggressively moving to reduce costs, hedge their currency exposure and move to higher added value activities, the speed of the adjustment has been punishing.

## **Responding to the Competitiveness Challenge**

While Canadian automotive companies move quickly to reduce costs and further enhance their existing productivity and quality leadership in North America, public policy also plays a critical role in our industry's ability to meet the competitiveness challenge outlined above.

The CAPC Fiscal and Investment Working Group continues to monitor progress in its areas of recommended action through the Score Card process. The WG's recommendations for Action come in 3 key broad areas:

- Competitive incentives
- Competitive tax policy
- Competitive innovation and R&D support

Several important developments have been noted in these areas since the last CAPC meeting. Overall, however, Canada lacks the competitive fiscal and innovation policy framework needed to meet short re-investment challenges and the transformative innovation changes that will be required to address new environmental standards and ongoing competitive pressures from within North America and beyond. The Fiscal and Innovation Working Group believes these challenges can be met with coordinated and urgent policy action.

### **Score Card Update – Key Highlights**

#### **A) Competitive Investment Incentives**

The most significant and welcome change was Ontario's announcement in June 2007 of a \$650 incentive fund as part of its Next Generation Jobs strategy. Criteria are still being finalized but various proposed investments are under discussion.

The former federal TPC fund is no longer applicable to the auto sector and has transformed into a fund which supports Aerospace investments in Canada. The federal announcement of a \$1 billion community support fund (with \$350 million earmarked for Ontario) is welcome. However questions remain as to whether the fund will be accessible by the auto sector which notably has many "one industry towns" across Ontario.

As noted above, Canada has indicated it will follow the new US 40% Fuel Economy improvement requirement. Consultation has begun on new Canadian fuel economy regulations but there are no indications as to whether supports for advanced environmental innovation retooling will be provided as in the US.

The Fiscal and Investment WG continues to mark as its highest priority the need for targeted investment partnership funds or similar mechanisms at both the

provincial and federal level. This approach has already proven to be an effective policy tool to secure key investments, enhance competitiveness and assist in transforming the industry.

As federal and provincial governments consider new incentive supports, it is essential that these be made timely in their application, sustained, directly accessible to businesses and qualification should be founded in a broad range of accepted policy priorities: i.e. support for investments that increase skills capability, apply advanced flexible manufacturing systems, enhance energy or environmental efficiency, engineer, develop and commercialize new technologies and enable Canadian automotive companies and their suppliers to develop and export these advances.

## **B) Competitive Taxation Policy**

Another highly significant and welcome tax policy development since the last CAPC meeting has been the federal Government's announcement that it will reduce the general corporate rate to 15% by 2012 starting with a 1% reduction in 2008 beyond the already scheduled reductions. The GST has also been reduced 1% which benefits new vehicle sales. Similar reductions have not followed in Ontario or Quebec. The WG also supports sales tax harmonization between the provincial and federal levels.

Both Canada and Ontario, with its 2007 Fall Economic Statement, have now eliminated Capital taxes applied in the manufacturing sector and Quebec will do so by 2011 – Capital taxes are the most directly punitive to new investment so this step is also very significant.

The federal government has increased the capital cost allowance rate to 50% until March 2009 and Quebec allows new machinery purchases to reduce Capital taxes. While this step is positive (and Ontario is encouraged to follow), the WG joins other industry groups in strongly recommending that such assistances be extended. Additionally, the WG continues to pursue refundable investment tax credits to ensure that the many automotive companies not in a taxable position be able to benefit and utilize this advantage for new investments.

The WG has provided additional tax-policy based recommendations to respond to the need for improved fiscal competitiveness including the elimination of the federal "feebate" program and its unwelcome \$50 million tax on auto companies as well as tax policy changes that would extend the loss carry-back period to 10 years to allow Canadian automotive companies in a loss position to monetize their tax loss carry forwards to fund much needed investments. It is noted that Canada may need to exceed the tax provisions provided in other jurisdictions to regain and overall competitive position.

While important recent tax changes are welcomed, the WG has noted that many Canadian automotive companies are not in a position to benefit from tax-based assistance at this critical time. Many are not in a position write down taxes as a result of the impact of dollar appreciation on profitability as well as many related factors beyond their immediate control.

A mix of policy actions is therefore required.

### **C) Competitive Innovation and R&D Policy**

Key recommendations of the Innovation working Group were also presented in this session as these are particularly important in light of the government mandated fuel economy / environmental technology challenges that are expected to transform the North American industry over the coming decade.

CAPC seeks to establish a Canadian Automotive Advantage based on higher value added skills, processes and technologies that will be competitive and required by the automotive industry worldwide. Canada's Innovation, Science and Technology policies and supports can have a critical role in assisting with the transformation of Canada's Auto industry.

Several recent positive developments were noted including renewed funding for Auto 21 to 2015, the CANMET move to Hamilton and several university-based auto R&D projects with particular note of light weight materials advanced research and capability in Quebec. Industry Canada's consultation in the area of Science and Technology policy has been well received and the WG hopes this will lead in the very near term to new policy directions to help enhance the competitive policy environment for Canada's Auto sector.

Highest priority recommendations in this area are for policy changes to make Canada's generous R&D and innovation funding supports more directly accessible to Canada's automotive companies. It is noted that these companies are usually the prime drivers of the commercialization of R&D in the auto sector. It is also stressed that the fuel economy challenge of the coming decade will require massive innovation and investment in the Canadian automotive supply chain.

It is recommended that:

- SR& ED credits be broadened to apply to manufacturing-related innovation and be made fully refundable.
- New and direct innovation supports also be made available to assist Canadian-based automotive companies investing in higher level skills, innovation, R&D and retooling to meet the environmental challenge of the next decade and build a Canadian Automotive Innovation Advantage.