

Intelligence MEMOS



From: G. Kent Fellows

To: Concerned Canadians

Date: June 1, 2023

Re: **NEW AUTOMAKER SUBSIDIES ARE UNWISE AND INFLATIONARY**

Following the federal Government's announcement of \$700 million in construction subsidies and up to \$14 billion in production subsidies to attract a Volkswagen battery plant to Ontario, automaker Stellantis has demanded a similar deal.

Stellantis had already begun building a \$5-billion battery plant in Windsor, but said earlier this month that the Canadian and Ontario governments were not delivering on promised financial support for the project and halted construction. Ottawa and Queen's Park have been scrambling ever since to find more money to keep Stellantis, the latest corporate incarnation of Chrysler, in Canada.

It is easy to see what Volkswagen and Stellantis get out of these deals. Subsidies clearly improve their returns on investments enough to attract these plants away from the US or Europe. It is harder to see what the Canadian and Ontario governments get in return. They won't get a stake in profits. These are subsidies, not investments. Federal and provincial governments won't own a portion of the plants and they will not share in the financial returns. Governments may capture some corporate income tax revenues, but as production subsidies get more generous it's hard to see how the resulting tax revenues will offset the subsidies.

Reviewing government statements on both deals, the two elements that come up most often are references to jobs and economic impacts. The federal Government has claimed that the Volkswagen plant in St. Thomas, Ontario, will create 3,000 direct jobs and 30,000 indirect jobs. While I've not seen a number for the indirect jobs created by the Stellantis plant, I suspect the government is of the opinion that it will also carry a significant job creation "impact." I'll discuss whether we should trust this number (we shouldn't), but first it's worth discussing whether we want a government that uses subsidies to create jobs.

As of November 2022, Canada's unemployment to job vacancy ratio was at a near historic low. There are fewer Canadians looking for jobs (relative to the jobs available) than at any point in recent history. This is conventionally referred to as a labour shortage. Nearly half the firms active in both construction and manufacturing [report difficulties](#) in attracting skilled labour as an obstacle to continued operations.

This labour shortage is a major contributing factor to recent inflationary pressures, which in turn have led the Bank of Canada to raise interest rates faster than at any point since 1995.

Subsidizing job creation at this stage of a business cycle doesn't mean that more Canadians will have jobs, it means shuffling the deck; some businesses will lose workers so that those workers can move to newly created jobs in government subsidized plants.

Had these agreements been made at the bottom of a recession, they would be responsible and welcome. Right now, this is irresponsible and inflationary spending.

This also means (as indicated above) we should not trust the extraordinary claims about indirect job creation. The federal government has not released any formal economic modelling or any of the calculations used to support its claim of 30,000 indirect jobs related to the Volkswagen plant. This makes these numbers hard to criticize beyond simply asking how the government arrived at these figures.

The Volkswagen deal and mostly likely also the Stellantis deal have been prompted in part by the US *Inflation Reduction Act*, which includes blanket agreements for generous production subsidies for clean energy projects (like electric vehicle batteries). The new reality is that if we want to compete with the US to attract manufacturing plants like this, we now have to offer competitive subsidies. But, Canada cannot win a subsidy war with the US. It has a substantially larger economy with a larger tax base and (through sheer force of size) the US economy is also more diverse than ours. As an aside, this is precisely why the negotiation of NAFTA (and its CUSMA successor) is so critical to Canada: Both countries benefit from open trade. Protectionism and mercantilism (including a subsidy war) will only hurt us.

That's not to say we should abandon any and all attempts to attract investment. But it does mean we need to be strategic. Governments need to have clear guidelines for the use of public funds on industrial subsidies. Industrial policy is a very powerful tool but it needs to be used very carefully and in limited capacity to ensure that taxpayer funds are going towards worthwhile strategic uses and are not simply padding a return on investment or leading to costly reallocation of labour from already productive uses.

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A version of this Memo first [appeared](#) in The Globe and Mail.