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Volkswagen Emissions Scandal Could Affect Production at Plant in Puebla

by Carlos Navarro

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A recent scandal involving German automaker Volkswagen threatens to cause economic damage to the company's operations in Puebla, which rely extensively on exports to the US. The company also operates a smaller plant in Silao, Guanajuato state, which produces gasoline engines. In mid-September, Volkswagen admitted to a plan to manipulate 11 million vehicles with software to cheat diesel emissions tests in the US and Europe. The German automaker's admission followed the release of a report from the US Environmental Protection Agency (EPA), which indicated that the nearly half million vehicles sold by Volkswagen in the US since 2008 contained software that provided false information on emissions from its four-cylinder diesel-power vehicles. The scheme affected some of the company's most popular models including Jetta, Jetta Sportwagen, Beetle, Beetle Convertible, Audi A3, Golf, Golf Sportwagen, and Passat.

The company apparently decided to implement the scheme a decade ago after it was unable to meet US emissions standards. After introducing the altered software on its engines, the company boasted of using new technology that produced "clean diesels." However, the engines actually produced as much as 40 times the legal limit of emissions allowed in the US.

Because of the scandal, Volkswagen was forced to halt the marketing of its automobiles temporarily, affecting operations at the company's plant in Puebla in the short term and raising questions about potential long-term implications for that facility. The Puebla plant began operations in 1964. In 2014, the facility produced more than 475,000 vehicles, almost 15% of Mexico's total output of 3.2 million for the year. The Asociación Mexicana de la Industria Automotriz (AMIA) said production at the Puebla plant through August of this year stood at slightly more than 324,000 units, of which 281,000 were exported to the US market, including the Jetta, Beetle, and Golf models. Of this total, some 41,000 vehicles were equipped with the questionable diesel engines. Each of the vehicles had a value of about US\$23,000 on average, said AMIA.

The Volkswagen decision also affects marketing of vehicles produced by its subsidiary Audi, which has a plant in the community of San José Chiapa in Puebla. Some Audi models were equipped with the four-cylinder diesel engines containing the altered software.

Even though the company projects that the scandal could reduce the value of exports from the Puebla plant to the US by about US\$2.6 million daily, Volkswagen had not announced any reductions in production a week after the scandal broke.

A suspension of production at the Puebla plant could affect more than 15,000 employees who work directly for Volkswagen in Puebla and 3,800 employed by Audi in San José Chiapa. In addition, another 30,000 to 35,000 workers employed by companies that supply parts to the German company would also be affected by a suspension of production, said the Cámara Nacional de la Industria de la Transformación (CANAINTRA).

Guanajuato Gov. Miguel Márquez said he was hopeful that the scandal would generally not affect the plant in Silao because the facility produces 330,000 gasoline engines annually for the Puebla plant and its facility in Chattanooga, Tennessee. However, any reduction in overall demand for Volkswagen vehicles in Mexico could limit output at the plant, so there is some uncertainty about the future for the 700 employees at the facility. "This is information that only the company knows," Márquez told the daily business newspaper *El Economista*.

The union that represents workers at the Puebla plant (Sindicato Independiente de Trabajadores de la Industria Automotriz Volkswagen, SITIAVW) already anticipates a 4% decline in the number of units produced at the facility this year relative to 2014.

The reduction in operations would also affect 95 manufacturers of auto parts that supply the plant in Puebla, said René Sánchez Juárez, secretary-general of the Federación Revolucionaria de Obreros y Campesinos (FROC), the union that represents workers at those facilities.

Volkswagen accounts for 25% of GDP in Puebla state

A study by BBVA Bancomer found that roughly 25% of the GDP of the state of Puebla is linked directly to Volkswagen and another 15% to the auto-parts industry that supplies the company. "This means that four of every 10 pesos generated in the state come from the automotive sector," said the daily newspaper *El Financiero*.

"Evidently, a situation of this nature will have an impact in the short term on sales, the capacity to export, and ultimately production," Puebla Gov. Rafael Moreno Valle told reporters. "We recognize that there certainly will be an economic impact on the state."

Still, only a percentage of the vehicles assembled in Puebla is equipped with diesel engines, which means that the plant will continue to operate in a significant capacity in the long term. The picture might not be as rosy for some of the auto-parts manufacturers, which could reduce capacity by about 50%, at least in the short term, said Constantino Sánchez, secretary-general of the Confederación Sindical Republicana. Sánchez said management might keep factories idle for some days in October and November to prevent layoffs.

The potential decline in sales and production comes just a few months after the company announced plans to invest about US\$1 billion in the Puebla plant to expand its vehicle assembly capacity for production of the new Tiguan compact crossover sport utility vehicle. Company officials had expected to begin production of the new model in late 2016 and bring the vehicles to market sometime in 2017. The recent scandal has not changed this plan, said Moreno Valle.

The Puebla governor said executives at the German headquarters did not inform executives at the Volkswagen plant in Puebla of the software manipulation, and all the questionable engines used in the Mexican assembly operations were manufactured in Germany. "There was no situation where we could ascribe direct responsibility to any official or contractor working with the Puebla plant," said Moreno Valle.

The governor said that his economic team plans to consult with Volkswagen officials to determine their projections for the Puebla facility in the aftermath of the scandal and to determine what plans will be set in motion.

Since he took office in 2010, Moreno Valle has made it a priority to support the Volkswagen plant in Puebla. "In past years, Moreno Valle has supported the plant when it faced problems resulting from

a decline in sales to the European market, including a temporary scheme to assume some of the pay and benefits for the workers, who nevertheless were still laid off," said the weekly news magazine *Proceso*.

Moreno Valle also noted that the Audi plant in Puebla would not be affected in a significant way by the Volkswagen problems, as demand is expected to remain strong north of the border. "You have to understand that this situation will not affect Audi," said the governor. "This brand of vehicles is among the most popular in the US, and, even though they are manufactured by the same corporation, the two brands are distinct."

Questionable vehicles also sold in Mexico

In addition to concerns about exports to the US and Europe, the Volkswagen plant in Puebla might face some difficulties at home. The company has sold 40,000 of the vehicles in question in the Mexican domestic market since 2009, but authorities are uncertain how many of these units have the manipulated software. The Secretaría de Medio Ambiente y Recursos Naturales (SEMARNAT) said those cars represent about 7% of Volkswagen's total sales in the Mexican market.

Officials said the consumer protection agency (Procuraduría Federal del Consumidor, PROFECO) is looking into the possibility of filing a class action lawsuit against Volkswagen de Mexico if some of the cars sold in Mexico are proven to have the manipulated software.

The Volkswagen scandal has affected the company in other ways, including the loss of value of the company's stock in the global markets. Volkswagen stock experienced losses of 18% and 15% in the two days following the release of the news that the company had manipulated emissions-measuring software. The loss the first day was equivalent to 20 million euros (US\$22 million).

Some analysts estimate that the scandal could ultimately cost the company about 18 billion euros (US\$20 billion) in fines, plus several billion euros in lost sales in the US market, plus the cost to pay damages to clients who were defrauded.

The scandal initially also had repercussions for the global auto industry. In the wake of the Volkswagen cheating scheme, US regulators announced plans to conduct random tests on software used by other automakers. Additionally, during the first week after the scandal broke, stock values declined for other automakers in global markets. For example, French automaker Peugeot experienced a decline of about 19% in the week following the scandal.

While other automakers might be able to recover from the Volkswagen scandal, analysts say the same might not be true for the German company, which led the global market during the first quarter of the year with more than 5 million vehicles sold.

"Perhaps the worst consequence is the loss of confidence among consumers," columnist Enrique Quintana wrote in *El Financiero*. "The company should have invested money to reduce contamination. Instead, it opted for fraud. The cost cannot be measured, and a recovery is uncertain."

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