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Reciprocal but not optimal

Federal procurement reform should focus on maximizing public benefit, not penalizing Canada's trade partners

A submission from the Canadian Centre for Policy Alternatives to Global Affairs Canada's Reciprocal Procurement Consultation

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General comments on reciprocal procurement

Global Affairs Canada is seeking advice on the development of a reciprocal procurement policy that would “reduce access to Canadian federal procurement opportunities for foreign suppliers, goods, and services from countries that do not provide a comparable level of access to Canadian suppliers.”¹ The consultation document frames the policy as a means of ensuring fairness and mutual benefit in Canada's international trade relationships.

The CCPA is generally supportive of the idea of reciprocal procurement. However, we question both the practicality and cost-benefit of some of the proposals in the Global Affairs Canada consultation document. Fundamentally, government procurement policy—at the federal, provincial/territorial, and municipal levels—needs to be updated so that public purchasing is focused on maximizing public benefits, not penalizing Canada's trading partners.



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Therefore, the CCPA recommends that a reciprocal procurement policy should be tied to a broader procurement reform agenda, with a focus on the following five elements:

- Preferences for domestic goods and services in federal procurement where allowable under Canada’s trade obligations and where there are clear benefits for workers, the public, the environment, and government.
- “Buy Canadian” conditions on federal transfers to provincial, territorial, and municipal governments for major projects, again where these are still permitted under Canada’s extensive procurement-related trade commitments.
- Sustainability criteria on direct federal procurement of, and federal transfers for, goods and services used in large infrastructure projects such as highways, urban transit, hospitals, universities, and public water and waste-water systems.
- Set-asides (e.g., as a fixed target of total contracts in a year or as a proportion of the value of annual public spending) for small and medium-sized businesses (SMEs), women-owned businesses, Indigenous-owned businesses, community-based not-for-profits, and businesses owned by racialized or so-called marginalized groups.
- Modifications to Canada’s procurement commitments in the Canada–EU Comprehensive Economic and Trade Agreement (CETA), as allowed for in Article 19.18 of the agreement.

As a final, overarching point, the CCPA recommends shifting federal procurement policy from a lowest-cost to a more mission-oriented model, as proposed by Mariana Mazzucato, professor and founding director of the University College London’s Institute for Innovation and Public Purpose, in a recent policy report commissioned by the B.C. government. Mission-oriented procurement recognizes the power of public spending to shape economic outcomes, speed the rollout of innovative goods and services, and contribute to social well-being. As such, it is potentially much more socially beneficial than either lowest-cost or performance-based procurement, which relies on the private sector to solve limited governmental problems.

These practical and achievable reforms would all provide greater benefit to government, business, and the public than tit-for-tat restrictions on foreign companies. The fact is, Canadian governments will always have more control over how *they* spend public money than on how other countries do—even when those countries have made similar trade-based procurement commitments to Canada. A poorly planned reciprocal procurement policy risks simply aggravating Canada’s trading partners without significantly benefiting Canadian suppliers.

Comments on the government's three proposals for procurement reform

The consultation document on reciprocal procurement sets out three potential, though not mutually exclusive, approaches that are being considered by the government. The CCPA is generally supportive of all the approaches, but focusing solely on reciprocity will be complex, disruptive, and ineffective compared to a focus on maximizing public benefits. We offer the following assessments of the three general approaches and related policy options in the consultation document.

1. Applying reciprocity to federal procurements on the basis of Canada's international trade obligations

This option may appear simple at first glance, but depending on how it is implemented, the complexities may not be worth the effort. The CCPA is also concerned that this approach to reciprocal procurement will come across as sour grapes, or even as a provocation, to Canada's trading partners that have chosen to use public procurement strategically to support domestic jobs and innovation.

Nothing is currently stopping Canada from more strictly applying its procurement-related trade obligations. Doing so would favour bidders based in Canada, in country signatories to the World Trade Organization (WTO) Agreement on Government Procurement (GPA), and in countries with which Canada has made additional procurement commitments (e.g., European Union member states via the Comprehensive Economic and Trade Agreement, or CETA). This is exactly how these trade agreements are intended to operate.

But as the consultation document notes, Canada, Australia, and the United Kingdom are international outliers in generally offering *all* foreign suppliers preferential access to government contracts regardless of whether their home jurisdiction is part of one or more of these agreements. In contrast, other countries (e.g., the United States) that more strictly apply their GPA commitments by restricting access to government purchases may appear to be free riding on the generosity of more "open" procurement markets.

Though Canada gave up far too much procurement policy space in the GPA and especially CETA, there is a simple rationality and administrative efficiency to applying standard rules to bidders from any country. And so, while the federal government is within its rights to offer bonus points to firms from GPA and CETA countries or to exclude bids from companies outside of those jurisdictions, the question is whether the public benefit is significantly enhanced by such a policy.

On the one hand, Canada should be seeking ways to support the domestic production of high-quality and sustainable local goods and services when tendering for public contracts, as discussed in more detail below. It makes less sense to rule out or penalize a high-qualifying, beneficial bid from a foreign supplier simply because that firm's home country maintains some domestic preferences in its own procurement policies.

The reality is that Canada's federal procurement market is quite small compared to the United States and China—the presumed targets of the proposed reciprocal procurement strategy. An antagonistic procurement policy is more likely to produce a backlash in these potentially lucrative markets for Canadian bidders than to convince their governments to treat Canadian bids as equivalent to domestic ones.

2. Placing conditions on foreign suppliers' participation in federally funded infrastructure projects undertaken by provinces and territories

The CCPA is very supportive of “buy local” conditions on federal transfers to provincial, territorial, and municipal levels of government. In combination with sustainability criteria (e.g., bonus points for low-carbon construction materials), decent-wage conditions, and inclusivity targets (e.g., requirements to hire workers with disabilities or workers from marginalized groups), domestic content requirements can be especially beneficial on large-scale construction, infrastructure, and public services projects.

As the reciprocal procurement consultation document notes, Canada is quite limited in where it can apply preferences for domestic goods and services by our extensive GPA and CETA commitments. The Canada–EU trade deal dramatically expanded these procurement restrictions to municipal and other MASH sector agencies, such as school boards and hospitals, far beyond what most of Canada's trading partners have agreed to. However, where “buy local” conditions are permitted, as they are for federally funded urban rail and highway construction (at least under the GPA), they should be actively pursued.

It makes less policy sense to apply conditions to federal transfers that would favour content from any jurisdictions with reciprocal commitments covering infrastructure projects, for the same reasons described above. How is public welfare enhanced by favouring a high-qualifying European or South Korean bid over a high-qualifying Mexican or Vietnamese bid simply because the former two countries are GPA signatories? Such an outcome may reinforce global (i.e., North–South) imbalances in trade and economic development without any significant benefits to Canadians. It might also antagonize Canada's trading partners rather than level the playing field for Canadian suppliers bidding on foreign contracts.

Unfortunately, CETA is the fly in the ointment with respect to federal transfers. Of all the provinces, only Quebec retained the right under CETA's procurement limits to insist that final assembly of mass transit vehicles take place in Canada. And in Ontario, CETA provides European bidders with many ways of meeting local content quotas without actually purchasing Canadian-made vehicles (e.g., by claiming the equipment will be maintained by local technicians, etc.).²

Importantly for this discussion on reciprocal procurement, the federal government gave up its GPA right in CETA to apply domestic preferences on highway and urban transit projects, which presumably applies to federal transfers for these projects as well. Only Prince Edward Island carved out highway construction from its CETA procurement commitments, meaning it can still apply Canadian preferences on materials and other goods and services.

What this means in practice is that Canada can still attach minimum Canadian content requirements to funding for provincial, territorial, and municipal mass transit and highway projects. However, European Union-based firms would be able to challenge these requirements as contravening the CETA procurement chapter. Article 19.4.2 of the CETA states (emphasis added):

With respect to any measure regarding covered procurement, a Party, including its procuring entities, shall not:

- a) treat a locally established supplier less favourably than another locally established supplier on the basis of the degree of foreign affiliation or ownership; or
- b) discriminate against a locally established supplier on the basis that the goods or services offered by that supplier for a particular procurement are goods or services of the other Party.*

The federal government could proceed with “buy local” conditions on federal infrastructure projects and federal transfers, and deal with any potential disputes down the road. Or, to avoid such challenges, the government could try to modify its CETA procurement coverage with the EU, as outlined in Article 19.18 of the agreement. By contrast, the clear advantage of applying sustainability criteria to federal transfers is that they can be designed to be non-discriminatory while delivering significant public benefits, including meeting Canada's greenhouse gas emissions-reduction targets.

3. Creating a federal set-aside program for Canadian small businesses

Setting aside a portion of total contracts each year, or a portion of the value of all contracts, for small and medium-sized businesses (SMEs) is a good idea. In the United States, every federal government purchase between US\$10,000 and US\$250,000

is set aside for small businesses as long as at least two companies can provide the good or service at a fair price.³ On top of this, the U.S. government tries to set aside at least 5% of contracts for women-owned businesses, 5% for small, disadvantaged businesses, and 3% for service-disabled veterans, among other set-aside programs.⁴

Canada preserved the right to develop similar, U.S.-style set-aside programs at the federal and provincial/territorial level in its GPA commitments.⁵ However, only an Indigenous business set-aside program was in place when Canada negotiated its comprehensive trade agreement with the EU and only that program was protected in CETA. All other procurement set-asides—for SMEs, women-owned businesses, etc.—are, therefore, CETA-incompatible and will need to be developed carefully.⁶

The simplest way to bring a SME set-aside policy in line with CETA would be to treat EU-based SMEs as if they were Canadian SMEs. However, this might undermine the main goal of a set-aside program, which is to support *domestic* small or women-owned businesses, for example. It is also possible that larger EU firms would be able to dispute the policy as a breach of CETA's procurement rules. Allowing large EU firms to bid on and win contracts set aside for small Canadian businesses would defeat the purpose of a set-aside policy altogether.

Canada could create more certainty with respect to set-aside programs for SMEs, women-owned businesses, community-based not-for-profits, and businesses owned by so-called marginalized groups (including racialized people or people with disabilities) by notifying the EU of its intention to modify its CETA procurement commitments. This may require “appropriate compensatory adjustments” (Article 19.18.2b) to the EU's own procurement commitments to Canadian businesses, unless the effect of Canada's adjustment is negligible, which it might be depending on how the set-aside programs are structured.

From lowest-cost to mission-based procurement

The reciprocal procurement consultation document invites comments on other approaches that the government could consider. The CCPA encourages the federal government to think about the bigger-picture role that public spending can play to “tilt economic development in a desired direction,” as proposed by Mariana Mazzucato in a recent policy report for the B.C. government.⁷ While some small tenders (e.g., for stationery) may be simply a means to secure goods or services at the highest value and lowest cost, other large and small tenders alike “can also be used as a strategic tool to foster bottom-up innovation and the creation of new markets to help achieve well-defined missions,” she writes.⁸

The federal government and Canadian provinces are beginning to consider how public procurement can foster inclusive and sustainable growth by increasing supplier diversity and lowering Canada's carbon footprint, for example. The B.C. government builds many of Mazzucato's recommendations into its 2022 economic plan.⁹ Also this year, the Ontario government announced a new policy of favouring local firms in all government purchases under GPA, CETA, and Canadian Free Trade Agreement (CFTA) procurement thresholds and promised to "incorporate the evaluation of criteria such as social and economic considerations" on all public contracts going forward.¹⁰

We are also encouraged by the federal government's Greening Government Strategy¹¹ and the commitment, in the 2022 budget, to "use [the government's] significant buying power to accelerate the transition to a net-zero economy."¹² Such sustainability criteria are permitted under all of Canada's procurement commitments and will often provide local benefits that are equivalent to outright domestic preferences. For instance, Canadian steel, concrete, and aluminum are among the least carbon-intensive in the world, according to Clean Energy Canada.¹³ Canada's plan to reduce the embodied carbon of the materials used in major construction projects by 30% (starting in 2025) should naturally favour Canadian inputs of building materials.¹⁴

While such policies need to be carefully designed to be fully non-discriminatory, unsuccessful bidders from jurisdictions with which Canada does not have reciprocal procurement commitments should be barred from challenging them (e.g., at the Canadian International Trade Tribunal or through provincial procurement dispute processes) as alleged violations of international trade agreements. Indeed, excluding non-GPA countries from the bid dispute system may be a simple way of bringing Canadian procurement policy more strictly in line with its trade commitments.

A mission-based procurement strategy would also entail thinking beyond lowering emissions and diversifying the supplier base and workforce, as critical as these two priorities are for the Canadian economy and environment. Mazzucato envisions a greater role for "pre-commercial procurement," or the collaborative brainstorming of innovative solutions to problems facing the public sector. A functional versus product-oriented (lowest-cost) approach to procurement would describe the outcome or mission the government is hoping to achieve in the hope of stimulating bottom-up solutions and rewards for "actors willing to take risks and experiment."¹⁵

One example, offered by Mazzucato, of mission-based procurement is the U.S. Small Business Innovation Fund (SBIF), another of the many U.S. set-asides described above. Under the program, all federal agencies with R&D expenditures over US\$100 million are required to spend 3.2% of their budget on socially and economically disadvantaged businesses that would not otherwise be able to bring their technological innovations to market. Agencies develop "themes," or technological needs, every two years; small businesses that can pass a feasibility test for a novel technology

are funded through the development phase and, if the solution works, receive non-competitive funds to commercialize the project.¹⁶

The Innovative Solutions Canada Program serves a similar purpose to the SBIF, in that the government funds and provides testing grounds for innovative new Canadian products and services. As an R&D measure, Innovative Solutions Canada tenders are also exempt from Canada's procurement commitments, including those in CETA. But the program's value to small Canadian firms is lowered by the absence of a guarantee that a successful innovation (e.g., solar-energy-generating windows¹⁷) will be purchased and used by the government. Companies can be left high and dry, without a solid proving ground for their goods or services.

Ideally, mission-based procurement strategies would bring together multiple steps and goals—such as the assessment of public needs through R&D, innovation, and the application of inclusivity and sustainability criteria—in the determination of procurement needs. The approach is similar to, but more ambitious than, “outcomes-based” procurement, where the private sector is relied upon to solve limited governmental problems.¹⁸ In Mazzucato's vision, public sector needs play a vital role in determining what kinds of innovation public spending should be fostering. “Rather than asking what gap or failure public goods are filling and fixing, we should ask what are the outcomes that society desires and how can we make these happen,” she writes.¹⁹

Conclusion

Jurisdictions like Canada and the EU, whose procurement commitments at the WTO and in bilateral trade agreements are far more extensive than most countries, may reasonably feel they are being taken advantage of by countries that have preserved the right to favour domestic suppliers in public tendering. Recent “Buy American” and “Buy America” policy updates in the United States, for example, will likely reduce procurement market opportunities for non-U.S. firms, as those policies intend. But they are completely in line with U.S. procurement commitments at the WTO.

The inescapable reality for Canada is that domestic preferences in government spending are the norm, not the exception, in most of the world—and there is little sign of this changing. While the EU may have enough market clout to convince some countries to offer EU firms national treatment at home to avoid their companies being discriminated against in the EU, Canada has relatively much less bargaining leverage. Governments in Canada can do more to help Canadian firms win bids in other countries through innovative and competitiveness-enhancing green industrial strategies and procurement policies at home.

While the CCPA supports the idea of reciprocal procurement and many of the suggestions put forward in the government’s consultation document, ultimately, there are better ways to ensure maximum public benefit from federal, provincial/territorial, and municipal spending. As outlined above, these include domestic preferences attached to direct federal purchasing and transfers to provincial and local governments wherever allowable under Canada’s trade agreements; setting aside a portion of contracts for SMEs, diverse and community-based not-for-profit suppliers; expediting binding sustainable procurement policies that will incidentally favour many Canadian suppliers, especially of critical inputs and construction materials; and, importantly, shifting from lowest-cost, product-based procurement to a more functional or mission-oriented approach.

Notes

- 1 Global Affairs Canada, “Share your views: Consultations on reciprocal procurement policies in Canada”: <https://www.international.gc.ca/trade-commerce/consultations/RP-AR/index.aspx?lang=eng>.
- 2 The Notes to Canada’s Annex 19-4 specify that the application of Canada’s exceptions in CETA for procurement of goods, including the exceptions related to mass transit in Quebec and Ontario, will be revisited five years after the entry into force of the agreement, or as early as September 2022. Canada could take this opportunity to expand federal and provincial exceptions for mass transit and highway products, in line with Canada’s GPA commitments.
- 3 U.S. General Services Administration, “Set-Asides and Special Interest Groups”: <https://www.gsa.gov/small-business/register-your-business/explore-business-models/setasides-and-special-interest-groups>.
- 4 U.S. Small Business Administration, “Types of contracts”: <https://www.sba.gov/federal-contracting/contracting-guide/types-contracts>.
- 5 Canada–General Notes–Annex 7, Agreement on Government Procurement: <https://e-gpa.wto.org/en/Annex/Details?Agreement=GPA113&Party=Canada&AnnexNo=7&ContentCulture=en>.
- 6 See Annex 19-7—General notes (2a) of the CETA procurement chapter: <https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/text-texte/19-A.aspx?lang=eng#a>.
- 7 Mariana Mazzucato, “Inclusive and sustainable British Columbia: A mission-oriented approach to a renewed economy,” Institute for Innovation and Public Purpose, March 2022, p. 47: https://www.ucl.ac.uk/bartlett/public-purpose/sites/bartlett_public Purpose/files/ucl-iipp-british-columbia-report-2022_.pdf.
- 8 Ibid.
- 9 Government of British Columbia, “Minister’s statement on Inclusive and Sustainable British Columbia report,” March 31, 2022: <https://news.gov.bc.ca/releases/2022JER10013-000465>.
- 10 Government of Ontario, “Building Ontario Business Initiative: Backgrounder,” March 9, 2022: <https://news.ontario.ca/en/backgrounder/1001730/building-ontario-businesses-initiative>.
- 11 Treasury Board of Canada, “Greening Government Strategy: A Government of Canada Directive”: <https://www.canada.ca/en/treasury-board-secretariat/services/innovation/greening-government/strategy.html>.

12 Department of Finance Canada, Budget 2022, Chapter 3: Clean Air and a Strong Economy: <https://budget.gc.ca/2022/report-rapport/chap3-en.html>.

13 Clean Energy Canada, “A ‘Buy Clean’ Roadmap for Canada,” p. 6: https://cleanenergycanada.org/wp-content/uploads/2021/07/CEC-Buy-Clean-Roadmap_FINAL.pdf.

14 Ibid., p. 5.

15 Mazzucato, p. 54.

16 Ibid., p. 56.

17 See <https://tenders.globaldatabase.com/tender/energy-producing-window-coverings-en578-20isc3-48-74ba1e89ba5b7d8e0577932aa3a44981>.

18 Tom Lukiwski (chair), “Modernizing Federal Procurement for Small and Medium Enterprises, Women-owned and Indigenous Businesses,” Report of the Standing Committee on Government Operations and Estimates, June 2018: <https://www.ourcommons.ca/Content/Committee/421/OGG0/Reports/RP9996115/oggorp15/oggorp15-e.pdf>.

19 Mazzucato, p. 61.



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