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**PROCUREMENT POLICY IN CANADA  
EVOLUTION AND IMPACTS – DOMESTIC POLICY, TRADE, AND  
INFORMATION TECHNOLOGY**

by

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A thesis submitted to the Faculty of Graduate Studies and Research  
in partial fulfillment of  
the requirement for the degree of

Doctor of Philosophy

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## ABSTRACT

This dissertation explores Canadian procurement policy and seeks to account for its evolution through three time periods, coinciding with the rise of regional-industrial policy, the growing trade agenda, and information technology.

Recent events underscore the volatile nature of procurement policy. Procurement policy and the institutions of procurement suffer from a lack of legitimacy in the eyes of the public and even from within government itself, due to the association of spending and contracting with corruption and constant 'bending of the rules.' Contracting is the vehicle by which procurement policy is implemented. In a public policy perspective, the political, economic, legal, and social aspects of why and how government is purchasing goods and services are critical to understand.

Empirically this research covers three overlapping periods of the evolution of procurement policy, the broad post World War II period to about 1990, the 1980s-1990s trade policy period, and the 1990s to the present. Three chapters tell the empirical story. Chapter Three examines the larger multiple policy purposes of procurement before the trade and information technology variables took hold, which are subsequently analyzed in chapters Four and Five.

The study argues that the focus of procurement has shifted from an interventionist orientation to a free-market perspective, and secondly that procurement is a multi-purpose tool of government over which the government has increasingly less discretion. These arguments are explored conceptually by drawing the empirical results through a neo-institutional framework, integrating historical, economic, and organizational institutionalism. Neo-institutional theory helps to account for why institutions, both formal and informal, form the parameters through which change and evolution of policy occurs.

This thesis contributes to public policy literature by examining an important subject area in which there is little published. It illuminates the dynamics of procurement policy over three time periods. This thesis extends the use of neo-institutional theory in a useful way to help account for change as well as continuity in public policy. Finally, it demonstrates to the academic and general policy community that procurement is indeed a policy field requiring more attention and deeper understanding.

## ACKNOWLEDGEMENTS

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My family (especially Alanna my sister and ‘rock’) and friends have been most supportive and without them ‘thesis-life’ would have been grim. Thank you all so much.

This thesis and my Ph.D. is dedicated to my father. Dad would see going to RMC, doing an MBA, completing a Ph.D., and embracing an academic life as a fitting destiny for his youngest. I remember that ill-fated moment when I said to him, “Dad, I’ll probably be a student forever.” What you did not get to do in your far-too-short life, I have done for you. *Per ardua ad astra.*

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## **PART ONE: PROCUREMENT POLICY AND THE RESEARCH FRAMEWORK**

### **INTRODUCTION**

#### **PURPOSE**

The purpose of this research is to explore the nature of Canadian federal government procurement policy and how that has changed over three eras.

Procurement policy is oft mentioned but little understood and rarely examined. It is the hidden story behind much of Canadian public policy given that government functions through its purchase of goods and services. Procurement policy is the embodiment of the ideas and functions of purchasing in a political environment – the assertion of values that guides the actions of government. This political environment distinguishes public sector procurement from private sector procurement. Public sector procurement involves an enormous range of goods and services, everything from pens to helicopters, people to paperclips. One third of Canadian federal discretionary spending is directed towards the purchase of goods and services each year. Government activity depends to a large extent on how and what it buys and its relationships with the sectors that provide these goods and services.

Thus, there is both an important empirical and conceptual story to be told.

Recent events such as the Gomery inquiry underscore the volatile nature of procurement policy. The day-to-day procurement of goods and services by the government does not elicit much interest or concern but when problems with contracts reach the public light, the media attention is severe and implications potentially substantial. Procurement policy and the institutions of procurement suffer from a lack of legitimacy in the eyes of the public and even from within government itself, due to the frequent association of spending and contracting with corruption and constant ‘bending of the rules.’

However, procurement is about more than contracting; contracting is the vehicle by which procurement policy is implemented. The political, economic, legal, and social aspects of why and how government is purchasing goods and services are critical to understand.

The chronological history of federal procurement is a complex one. Hence the chronology unfolds in three ways. First, as we see below, each of the three empirical chapters covers three overlapping periods of change. Second, in Chapter Three an overall chronology is presented diagrammatically (see page 111) with links to the neo-institutional approaches used in the thesis overall. Chapter Three also contains a more detailed chronology for the policy events/changes of the period covered in that Chapter. Chapter Four provides a similar more detailed chronology for the various trade agreements and their procurement components. Chapter Five does not have a chronology

per se. This is because the changes inherent in the IT Agenda and procurement are driven by inherent technological change in the last decade.

Empirically, this research covers three periods in the evolution of procurement policy; the post World War II period to about 1990; the 1980s-1990s trade policy period; and the 1990s to the present where information technology is an important factor. There are overlaps between the periods that the analysis will point out but overall this thesis analyzes the factors that caused the changes and relative shifts in three basic periods.

Three chapters tell this empirical story – first, Chapter Three deals with the larger multiple policy purposes of procurement before the trade and information technology variables took hold. This post war period to approximately 1980 (with brief reference to earlier periods for context) involved the adjustment to cold-war realities in terms of defence and a shift in procurement policy focus from defence to regionalism – with the political nature of procurement policy becoming particularly problematic. This period is critical in that procurement emerged as an important policy field as reflected through regional and industrial policy, and during this time the foundations were laid for the change that was about to come during the second period of concern here, one of broadened horizons and growing international trade characterized by the busy 1980s trade agenda. In the 1980s the foundations were laid for the Free Trade Agreement(FTA), the North American Free Trade Agreement(NAFTA), the World Trade Organization Agreement on Government Procurement(WTO-AGP), and the Agreement

on Internal Trade(AIT). Their impacts and effects continue to the present day. The decade is important empirically as a time period in which the key changes to procurement policy vis-à-vis trade were put in place.

In the 1990s, new forces emerged. Central here is the growth of Information Technology(IT) and its permeation in industry and government and the larger socio-economic space. This discussion is framed at three levels. First, E-Government is the policy level concept defined as the values and behaviour associated with IT, made explicit and asserted through guidelines, norms, laws, and regulations. Government-online is the second order concept involving application of the decisions made at the policy level in a policy instrument framework. Finally, Electronic Procurement is an operational mechanism of E-government that has considerable implications for procurement policy. While IT was certainly used in government prior to 1990, from approximately 1990 onwards the requirement to implement, integrate, and understand IT became not just a mechanical issue but also a critical part of the government's policy agenda. With the creation of the federal Chief Information Officer position in 1995 the visibility of the IT agenda accelerated. IT and its relationship to procurement make this period an important one to explore.

Conceptually, the thesis utilizes neo-institutional schools of thought in order to provide a foundation for the empirical analysis in the three chapters. Each school of neo-institutional literature provides a partial account of the forces at work in a given situation,

and captures different dimensions of human action and institutional impact.<sup>1</sup>

Synthesized, the insights from each of the analytic approaches provide a foundation to help uncover the particular dynamics of procurement policy. The integrated approaches form a prism with which to view procurement policy in a macro sense over time. Whilst the schools of thought developed rather independently from one another, and there has been a paucity of interchange among them, there is much to be gained from a comprehensive approach when dealing with a subject matter such as procurement in a public policy framework. The thesis captures a large time frame and examines a number of interrelated issues that speak to the change in the nature of procurement policy over that time.

## **CONTRIBUTION**

This thesis is one of the first pieces of academic research in the field of politics, public administration, policy and governance in Canada to explore procurement policy. The history of procurement in Canada has not garnered much attention. Perceived as a specialty largely associated with Defence, its importance has been overlooked as a critical element of the activities associated with government and changing notions of nation building. Even with the negotiation of major trade agreements and substantial change in the socio-economic environment, it continues to receive scant attention in

---

<sup>1</sup> Peter A. Hall and Rosemary C.R. Taylor, "Political Science and the Three New Institutionalisms", *Political Studies*(1996), XLIV, 955.

academia. There is no readily accessible, comprehensive discussion of how the role of procurement figures in the fulfillment of national objectives.

The economic literature assesses efficiency in procurement – for example optimal bidding, contracting mechanisms, preferential and discriminatory procurement, and auctions. There is much less work associated with the contextual and policy issues of public purchasing. In Canada, there are only a few researchers who have investigated procurement policy and process issues, largely associated with Defence and/or industrial development, and most of this work is now dated. There are very few books, articles or studies on procurement policy in Canada outside of government reports and publications.

In a broader sense, this thesis contributes further insights into how trade agreements and information technology are affecting procurement policy evolution. Because the use of information technology in a strategic sense is still quite new (referring to widespread use of IT in government beyond basic email) and is evolving relatively rapidly, there has not been much time to consider and evaluate its impact on governmental institutions and government policy. Likewise, the series of trade agreements negotiated since the late 1980s have added complexity to the procurement environment, and consequently to the way in which the government fulfills objectives through spending.

This thesis provides much needed documentation and analysis of procurement in Canada. It reviews procurement policy and the implementation of that policy, in policy

statements; legislation, guidelines and statutes both before and after the Free Trade Agreement and the North American Free Trade Agreement were implemented. An analysis of the effects of the role of trade agreements and the information technology revolution on procurement contributes to the knowledge being accumulated concerning how new forces are affecting policy development.

This thesis contributes to the academic and the larger community concerned with public policy in four ways. First it contributes to the public policy literature by examining an important subject area in which there is little published. Second, it illuminates the dynamics of procurement policy over three time periods, and in doing so provides a greater global understanding of both procurement in Canada and the field more generally. Third, this thesis extends the use of neo-institutional theory in a useful and important way to help account for change in public policy. Finally, it indicates to the policy community how procurement is indeed a policy field requiring more attention and deeper understanding than ever before.

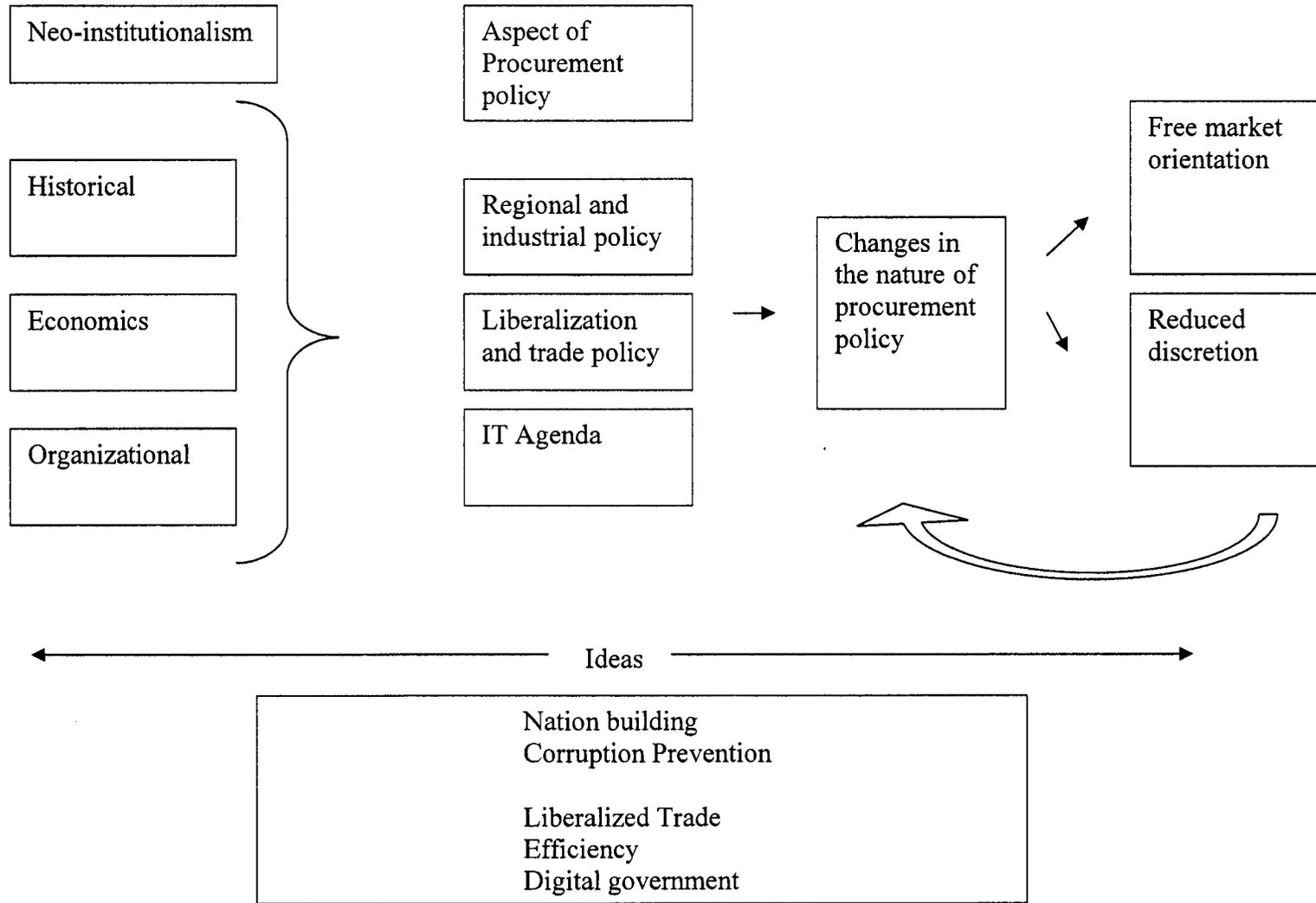
## **LINES OF ARGUMENT AND METHODOLOGY**

This investigation is grounded in two main research questions:

1. What are the key changes in procurement policy in the post-war period?
2. How has domestic post-war policy, free trade and information technology influenced change in procurement policy?

Two related overall arguments underpin the research framework. First, it is argued that procurement policy has shifted from an inward, interventionist orientation with respect to procurement activities governed by national laws and norms, to a free-market orientation due to complex rules and regulations stemming from an altered international and business-government environment. Secondly, procurement policy is a multi-purpose tool of government over which the government has increasingly less discretion. The following table depicts how these lines of argument can be visually conceptualized in the thesis in an initial way.

Figure 1: Conceptual framework



The research methods for the study centre on three key sources of information: statements and academic literature, policy statements and government reports and studies, and selected confidential interviews with a questionnaire approved by the Carleton University Research Ethics Committee. Confidentiality and anonymity were assured the participants as requested and approved by the Ethics Committee. Confidentiality was important due to the nature of the topic – federal purchasing is at times a very sensitive issue. Within the last fifteen months, procurement has become extremely public and mired in political controversy, now centered on the Gomery Inquiry. It was felt that interviewees would be more forthcoming if provided confidentiality and anonymity. A consistent approach was taken with all the interviews even if the individual was not concerned with anonymity. The purpose of the interviews as a third source was threefold: first, early interviews helped to develop the hypotheses and themes of the research, second the interviews were crucial to understanding key developments in greater depth, and third the interviews provided the researcher a better understanding of the institutional dynamics.

## **LITERATURE STREAMS**

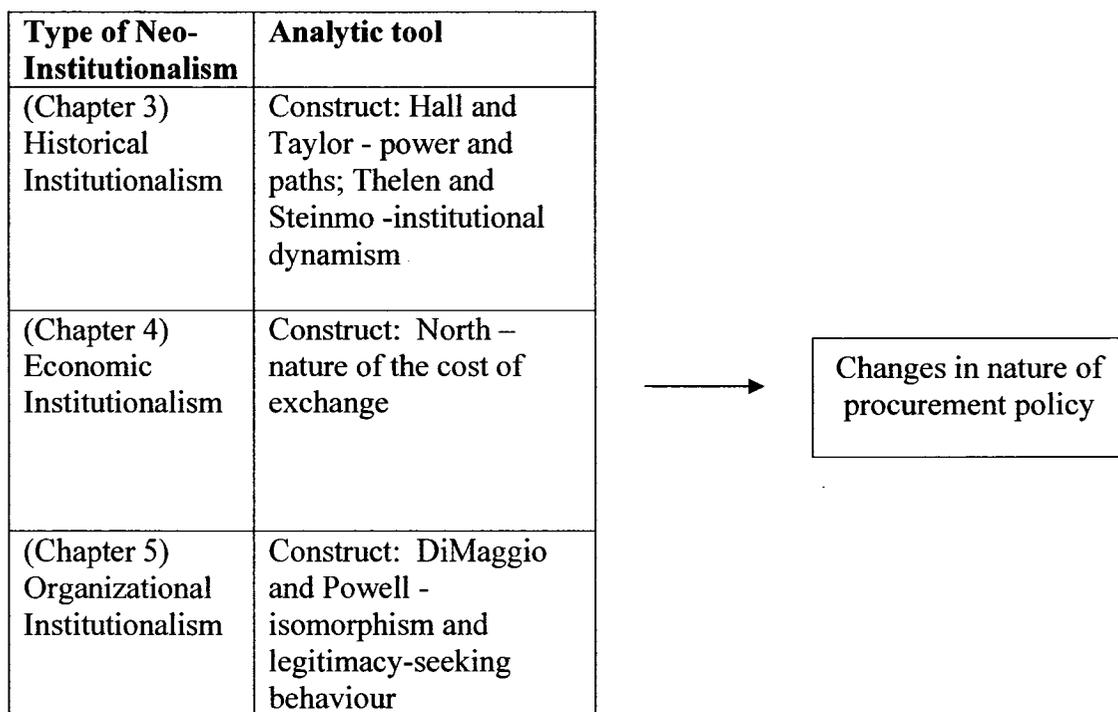
This thesis is anchored in politics-institutions literature reviewed in Chapter One and Chapter Two. Public policy literature also grounds the thesis. Neo-institutionalism is the central conceptual lens. It has many variants, three of which are helpful in accounting for

particular dynamics that have emerged in procurement, but each of which on their own lack the capacity to provide a comprehensive foundation for all the aspects of procurement being considered. The thesis focuses on specific aspects of each school of thought, using one construct from within each stream, namely power, path dependence and institutional dynamism from historical institutionalism, transactions costs from institutionalism and economics, and isomorphism as legitimacy-seeking behaviour, from organizational institutionalism. Additionally, other literature has been considered in this work, drawing from various fields including law and management. The field of law and international trade law provides a background for analyzing how new international trade agreements came into existence and interpretation of case law emerging from modern experiences with these agreements. The management literature – especially supply chain management and associated work in terms of how electronic procurement has become a strategic business driver – is essential when looking at the last period in which information technology looms large.

## PREVIEW OF FRAMEWORK

The analytical framework utilizes the foundations of neo-institutionalism.

**Figure 2: Neo-institutional streams**



The conceptual and empirical aspects of this thesis are linked in this outline of the main framework. Each of the strands of institutional literature correspond to a piece of empirical research. Each of the chosen constructs help to pinpoint events or relationships that show how procurement policy has changed or been slowed and how the new

relationships have affected the conditions for policy making. The neo-institutionalism streams and the operationalized constructs provide a comprehensive way in which to assess procurement activities of the chosen time period. For example, by looking at the events and activities of the post-war period up to 1990 through the historical institutional constructs of power asymmetry and path dependence, the dynamics of policy making in that period are partially illuminated. Similarly, by drawing on the notion of the nature of exchange in economic institutionalism, the thesis draws out the impacts of the trade agreements on procurement and the changes in policy making in this realm. Finally, the importance of gaining legitimacy for procurement policies with respect to Information Technology is examined by looking at organizational pressures characterized in isomorphic processes defined as legitimacy-seeking behaviour.

Completing the framework are the 'ideas' that underpin each time period and associated conceptual tools. Ideas are inherently a part of neo-institutionalism, and through their discussion normative terms are synthesized into public policy objectives, pursued in and through institutions. Ideas form the backdrop against which the nature of public policy is understood.

The overall framework helps capture how procurement has shifted to an outward focus, with far less discretion available for politicians and officials to use it for socio-economic objectives.

## **OVERVIEW OF CHAPTERS**

The dissertation is organized in three sections. The first section is comprised of the Introduction, Chapter One and Chapter Two, and outlines the study and introduces the lines of argument – the research questions and hypotheses. The second section formulates the empirical and related conceptual analysis in Chapters Three, Four, and Five, with overall conclusions presented in Chapter Six.

The literature review is found in both Chapter One and Chapter Two. Chapter One explains where work on procurement generally is found - in the policy, management, law and administration literature. In Chapter Two, the conceptual literature coming from both neo-institutional theory and procurement literature is explored.

Chapter One begins by locating procurement in public policy, explaining how procurement emerges in terms of policy, as an instrument, and as an activity and process. Second, this chapter explores the literature of procurement as seen in the supply chain management field, in the literature of politics and accountability, and trade. A basic taxonomy is used to illustrate the nexus of policy and politics as seen through the lens of procurement. The chapter then looks at the evolution of procurement reform, and where in the public policy realm procurement has become an important field of concern.

Chapter Two explains the idea of the ‘institution’ and the way in which the thesis approaches neo-institutional analysis. The purpose of the chapter is to outline the conceptual neo-institutional literature being related to procurement and to present a framework based on neo-institutional concepts for the understanding of public procurement.

Chapter Three marks the beginning of the empirical journey. This chapter explores the evolution of procurement policy in Canada up to approximately 1990, focusing on how traditional domestic policy fields utilized procurement as a tool for socio-economic objectives. Corruption in procurement is also addressed as one of the characteristics emerging from the manipulation of purchasing and the varied socio-economic objectives of procurement policy. This chapter will place the analysis within historical institutionalism, using two constructs (drawn from Hall and Taylor and Thelen and Steinmo) as a way to illuminate the drive for continuity and the emerging changes in the nature of procurement policy in this time period.

Chapter Four outlines the free trade period with an examination of the fundamentals of the key trade agreements with respect to their procurement elements. It also explores the impacts of the Canadian International Trade Tribunal on policy evolution. The use of a framework drawn from institutionalism and economics is developed, specifically the work of Douglass North. Through North’s work the nature of exchange is examined

with respect to procurement. The chapter helps account for some of the impacts of the trade agreements on the nature of procurement seen as an economic exchange.

Chapter Five examines the impact of Information Technology on procurement from both a procedural and contextual perspective. The chapter also looks at IT as a variable impacting directly inside organizations and fundamentally on the relationships between organizations. Through the use of isomorphism (legitimacy seeking behaviour) as a construct drawn from organizational institutionalism, the analysis accounts for how and why the drive for legitimacy is a constraint imposed on policy making associated with information technology.

Finally Chapter Six revisits the analysis and draws the conceptual framework together in order to discuss the main findings. This chapter also looks at a research agenda that can be built on from this thesis.

# **CHAPTER ONE**

## **THE NATURE OF PROCUREMENT POLICY**

### **INTRODUCTION**

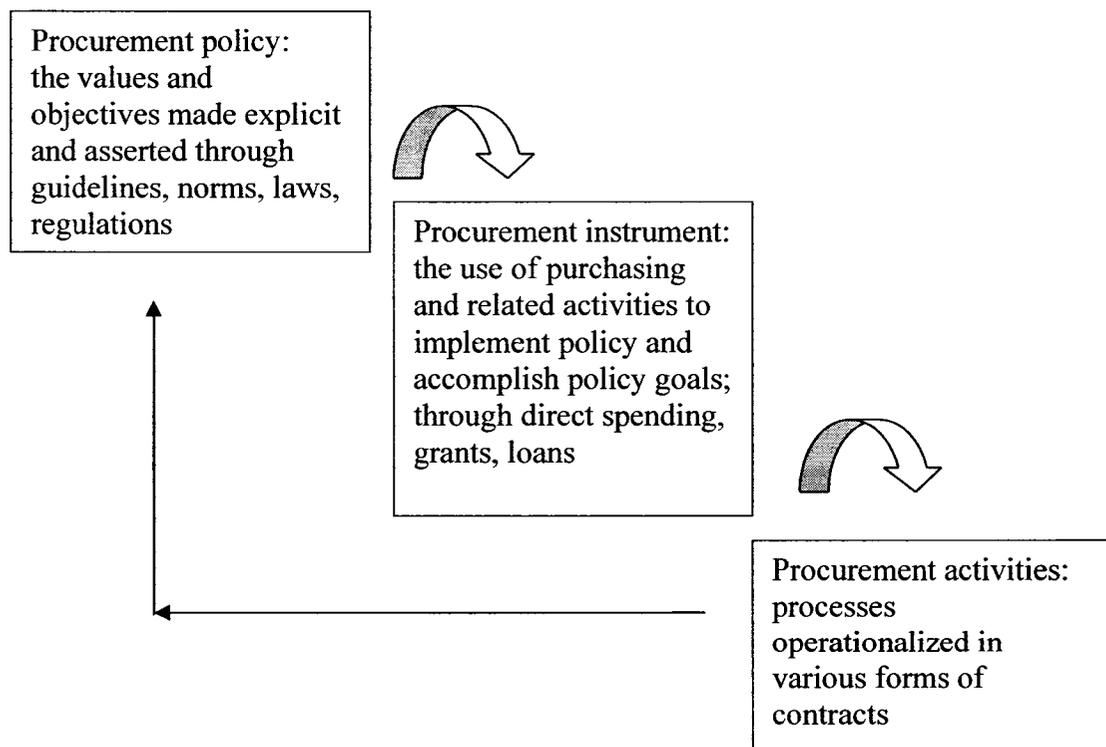
Public sector purchasing involves everything from pens to helicopters, and people to paperclips. A great deal of what government does depends on how and what it buys and on its relationships with the sectors that provide these goods and services. The policy context of procurement is complex as it crosses numerous policy fields and subject areas.

Procurement has been studied in association with spending generally, regional and industrial policy, defence policy, and more recently trade policy. However, it has not been theoretically grounded in any discipline or methodological approach. This chapter begins by locating procurement in public policy, discussing how the term 'procurement' is used and outlining the key areas in which procurement appears as a policy vehicle, an instrument or a process. Following this discussion is a critical review of the literature in which procurement has appeared, covering a range of subject areas and fields. Next, the chapter looks at the connection between politics and procurement and how procurement is often associated with political corruption. Finally the chapter looks at how procurement is connected to the trade agenda, the IT agenda and also at how procurement has been the subject of numerous attempts at reform.

## LOCATING PROCUREMENT IN PUBLIC POLICY

This section defines procurement policy, procurement as an instrument and process, and procurement activities generally. These terms are used often and interchangeably in government and in academic circles. While there are various ways to use these terms they are made more concrete here for the purposes of this study. The following figure depicts the categories, the arrows indicating their overlapping nature and conceptual connection with each other.

**Figure 3: Procurement terms - relationships**



## **Procurement as Policy**

This research approaches procurement from a broad perspective by inquiring into the normative content of policy and the process of implementing policy through the activities of purchasing both goods and services.

Government procurement policy expresses the fundamental values and legislative and regulatory frameworks underpinning the activity of purchasing. Values are the beliefs and positions of the government formed over time as a result of government interpretation and the shaping of what it believes to be the needs and wants of citizens. The policy objective of the Treasury Board of Canada Secretariat Contracting Policy states that, “The objective of government procurement contracting is to acquire goods and services and to carry out construction in a manner that enhances access, competition and fairness and results in best value or, if appropriate, the optimal balance of overall benefits to the Crown and the Canadian people.”<sup>2</sup>

The policy indicates that the values of competitive contracting, fairness, best value, and balance, are all important to the government. The use of ‘value’ language in the policy statement disguises as much as it clarifies. Concepts such as ‘fairness’ and ‘balance’ are inherently subjective, providing much potential for political manipulation. The

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<sup>2</sup> Treasury Board of Canada Secretariat, Contracting Policy, < [http://www.tbs-sct.gc.ca/pubs\\_pol/dcgpubs/Contracting/contractingpol\\_e.asp](http://www.tbs-sct.gc.ca/pubs_pol/dcgpubs/Contracting/contractingpol_e.asp)>, 07/02/05.

juxtaposition of ‘competition’ and ‘best value’ with ‘balance of ‘benefits’ may conflict enough such that the policy framework can be bent as to its purposes or for the convenience of users.

All governments purchase products as inputs into the provision of public goods and services – for example education, defence, utilities, infrastructure, public safety and health. Central government purchases of goods and services (depending on the economic system of a nation) typically account for 10 percent of gross domestic product. This figure may be much higher if the purchases of public corporations, regulated monopolies, and other levels of government are included. It would seem that the larger the role of the state, the more important is the efficiency of the public purchasing process.<sup>3</sup>

Many objectives of government are pursued explicitly or implicitly through the procurement of goods and services, some of which include: lowering the tax burden by economical purchasing; amelioration of regional unemployment by purchasing from industries in those areas, stabilization of effective demand, technological advancement, and protection of specified domestic industries.<sup>4</sup> The avoidance of corruption is also a goal embodied in procurement policy statements. Because economy in purchasing must

---

<sup>3</sup> Bernard M. Hoekman, ‘Introduction and Overview’ in eds, *Law and Policy in Public Purchasing* (Ann Arbor: The University of Michigan Press, 1997), 1.

<sup>4</sup> Klaus Stegeman and Keith Acheson, “Canadian Government Purchasing Policy”, *Journal of World Trade Law* 6, No.4 (July-August 1972): 442.

be sacrificed to make a contribution to achieving any of the others, the government's decisions in terms of this sacrifice result in a variable and complex procurement policy.

Where and how the government articulates its procurement policy, and how it has come to be a vehicle for multiple objectives is an essential element of Canadian public policy per se. Government purchasing policy is embodied in legislation and regulation, but the interpretation of that policy is reflected through a number of other policy areas.

That policy is also reflected through the changing dominant ideas that underpin the evolution of procurement policy over the chosen period of time. Doern and Phidd propose that ideas have a normative force of their own and may be combined or used to embody a particular normative preference in a particular policy field. The central ideas with respect to procurement policy both indicate its complexity and its conflicting objectives. How and why do some ideas gain acceptance and remain government priorities while others do not emerge at all?<sup>5</sup> In terms of the importance of government purchasing to the overall economy, the ideas underpinning procurement indicate a changing perspective and view of how procurement fits in the larger policy environment. The emerging focus on the international pressures on purchasing and reduced discretion for both politicians and bureaucrats indicate a number of new dynamics that will affect a government's choices.

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<sup>5</sup> G. Bruce Doern and Richard W. Phidd, *Canadian Public Policy – Ideas, Structure and Process* (Toronto: Methuen Publications, 1983), 51.

### **Procurement as an Instrument**

Procurement is used as an instrument to implement policy, the means through which to achieve the ends of political goals. However, instruments cannot only be viewed in terms of techniques for they are partly ends in themselves.<sup>6</sup> This is because instruments are fundamental objects of political dispute and inherently suggest values and ideas that are always in contention. This is certainly an issue in the procurement environment. For example, questions over whether the best value in a bid is in fact the lowest bid have spawned entire professions (such as the ‘bid evaluator’). Issues such as whether Canadian companies should have preferential access to government business, and the subsequent rules that would govern this type of restriction, have been central to procurement policy debate.

It will be useful to define what is meant by a “tool” or “instrument” of public action. A tool or instrument of public action is an identifiable method through which collective action is structured to address a public problem.<sup>7</sup> There are three notable features to address. First, each tool has common features that make it identifiable. Second, tools structure action such that relationships that tools foster are institutionalized.<sup>8</sup> And finally

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<sup>6</sup> Doern and Phidd, *Canadian Public Policy*, 111.

<sup>7</sup> Lester M. Salamon ed., and O.V. Elliot, *The Tools of Government - A Guide to the New Governance* (New York: Oxford University Press, 2002), 19.

<sup>8</sup> Salamon points out that tools are “institutions” in the sense of new institutionalism (i.e. they are regularized patterns of interaction among individuals or organizations) – they

the action structured by tools is ‘collective action’ aimed at responding to public problems.<sup>9</sup>

The lack of the term ‘procurement’ in some of the better-known instrument classification literature raises the question as to why it has not been included as such. In their effort to develop an approach to building theory on instrument choice and policy design Linder and Peters outline some of the difficulties associated with defining an instrument. They note that only in rare cases will an instrument serve only one function or objective at a time. Its explicit functions and its implicit functions may be difficult to identify, or they may be clearly stated.<sup>10</sup> The appearance of an instrument matters, but the uncovering of the implicit functions served by a given instrument also tells us why they matter.<sup>11</sup>

Procurement is a sub-category of the meta-level ‘spending’ instrument operationalized in the ‘contract’.

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define who is involved in the operation of public programs, what their roles are, and how they relate to each other. Thus, they importantly shape the set of considerations that effectively come to bear in the all-important implementation phase of policy. Salamon, *Tools of Government*, 20.

<sup>9</sup> Entities beyond government are also often involved in the action structured by tools of public action.

<sup>10</sup> S. Linder and B. G. Peters, “Instruments of Government: Perceptions and Contexts”, *Journal of Public Policy*, 9(1), 1989, 43.

<sup>11</sup> Procurement in Defence serves as a particularly good example of explicit and implicit functions. Explicitly, acquiring a new piece of equipment serves the operational needs of the Forces; having a Canadian company develop and/or supply the equipment may demonstrate the implicit function of the development of a defence industry, or even serve the political needs of the politician in whose riding the equipment is being made. The ‘development of industry’ as a goal may be explicitly stated by the government but the political ends are never as formally articulated of course.

The original focus of this body of work was focused on individual instruments and their attributes. Since the seminal 1982 study *The Choice of Governing Instrument* interest has moved towards how the choice of instrument is made as well as in the mix of instruments.<sup>12</sup> More recent work has focused on how procedural policy instruments are aimed at managing policy processes in order to assure general support for government aims and initiatives.<sup>13</sup>

Salamon, in *The Tools of Government* suggests that a proliferation of the tools of public action, the instruments or means used to address public problems has occurred.<sup>14</sup>

Substantial pressure on traditional government structures and processes has emerged from trade liberalization and associated impacts from globalization, as well as more domestic concerns such as the pressure to downsize government structures and budgets.

The effective governance of networks thus has become a critical capacity of organizations, in the face of multi-lateral agreements and multi-player arrangements.

Where once government activity was largely restricted to the purchase and delivery of goods and services by government bureaucrats, it now involves a huge array of loans,

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<sup>12</sup> Trebilcock, M. J., D. G. Hartle, et al., *The Choice of Governing Instrument - the Calculus of Decision* (Ottawa: Minister of Supply and Services Canada, 1982) and Policy Research Initiative – *Conference on Instrument Choice and Global Democracies*, Faculty of Law, McGill University, Montreal, September 26-27 2002, <<http://policyresearch.gc.ca>>, 1/09/04.

<sup>13</sup> M. Howlett, “Complex Network Management and the Paradox of Modern Governance: A Taxonomy and Model of Procedural Policy Instrument Choice”, *Paper Presented to the Annual Meeting of the Canadian Political Science Association*, University of Sherbrooke, Sherbrooke, P.Q., June 6, 1999, 2.

<sup>14</sup> Salamon, *Tools of Government*, 2.

loan guarantees, grants, contracts, social regulation, economic regulation, insurance, tax expenditures, vouchers, and various forms of collaborative relationships and outsourcing arrangements.<sup>15</sup> Government uses its broad range of policy instruments to guide or regulate economic activity. This is particularly significant because each instrument set has its own operating procedures, skill requirements and delivery mechanism - its own “political economy.”<sup>16</sup> A tool imparts its own twist on government operations; loan guarantees for example involve commercial banks and various forms of government corporations and thus become implementing agents of government lending programs. Programs operated by private lenders likely produce programs that look much different than they might have been from direct government lending.<sup>17</sup>

Newer tools are also highly indirect and involve a wide assortment of “third parties”, such as universities, private medical services, social service agencies and industrial corporations to deliver publicly financed services and pursue publicly authorized purposes. Crucial elements of public authority are now shared with a host of outside government organizations; an elaborate system of third-party government exists.<sup>18</sup>

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<sup>15</sup> Salamon, *Tools of Government*, 2.

<sup>16</sup> *Ibid.*, 2.

<sup>17</sup> Salamon points out that tools are “institutions” in the sense of new institutionalism (i.e. they are regularized patterns of interaction among individuals or organizations) – they define who is involved in the operation of public programs, what their roles are, and how they relate to each other. Thus, they importantly shape the set of considerations that effectively come to bear in the all-important implementation phase of policy. Salamon, *The Tools of Government*, 20.

<sup>18</sup> *Ibid.*, 2.

The theory associated with policy instruments is useful in linking procurement policy with the activities and implementation of procurement at an operational level.

### **Procurement as Process and as an Activity**

For the purposes of this study the procurement process is defined as the manner by which the federal government projects, plans, and secures goods and services through its primary purchasing agency, Public Works and Government Services Canada.

For greater clarity the procurement process includes:

1. The determination of what to buy, the physical and performance specifications of the goods or services to be bought and the quantity to be obtained.
2. The identification and selection of potential sources of supply.
3. The qualification of sources and of the products they will supply.
4. The design of the Request for Proposals and the solicitation of bids.
5. The negotiation of prices, terms, and conditions with selected vendors and the allocation of purchase amounts among them.
6. The monitoring of supplier performance and the conduct of ongoing supplier relations including:
  - the management of technical interchange activities
  - delivery schedules and transportation arrangements for incoming shipments
  - audits of vendor costs

- accounting for equipment and materials owned by the buyers and located on the vendor's premises
  - feedback on vendor performance
  - the resolution of delivery, product quality, and service problems
  - the handling of any claims against the vendor for failure to perform
7. The establishment of procurement strategies, control systems, and performance-measurement systems.
8. Sometimes the management of inventories of purchased parts, materials and supplies.
9. Often the disposal of waste and scrap materials.<sup>19</sup>

The process of procuring goods is not fundamentally different from the process of procuring services. A requirement is defined. A method for selecting the successful bid is established. A solicitation is tendered. Bids are received and evaluated and a winner(s) is selected for the contract award. At this level, the same could be said for the procurement of construction, software, building leases and intellectual property. At the macro level of policy and process, the competitive procurement of any two 'things' has much more in common than not.<sup>20</sup> In practice there are specific differences with respect to how requirements are specified and how the contracts are managed.<sup>21</sup>

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<sup>19</sup> Adapted from E. Raymond Corey, *Procurement Management - Strategy, Organization, and Decision-Making* (Boston: CBI Publishing Company Inc., 1978), xvi.

<sup>20</sup> Interview I6, 3 September, 2004.

<sup>21</sup> With respect to procurement of goods versus services, differences arise in how requirements are defined in the Request for Proposal (Statement of Work/Statement of Requirements), how the winner of the resulting contract is selected (i.e. the evaluation

First, there is a spectrum to consider for both, which is related to size and monetary value. Second there is a spectrum of specificity, for example the procurement of goods is easier to specify, with objective standards, whereas services have a greater qualitative judgmental mix.<sup>22</sup> Trade agreements address particular aspects of contracting for goods or services and large outsourcing arrangements are also addressed with their own regulations in the Public Works and Government Services Supply Manual.

The question here is less one of whether the procurement is of goods and/or services (most complex acquisitions involve both) but more one of the specificity of the goods or services. For example, a particular procurement may involve the articulation of every piece of technology required and every service and service level down to the minute detail. On the other hand, a procurement may involve the statement of a need and

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and selection methodology) and how the resulting contract is managed based on varying commodities such as software, professional services, non-professional services, off-the-shelf goods, build-to-order goods, construction, etc. There are further differences depending on the type of contract one is trying to establish (itself influenced by a variety of unique factors). For instance, a multi-year standing offer with multiple firms would typically involve a somewhat different strategy than a one-off contract, winner take-all. Further, the subtle application of varying techniques and strategies with respect to requirements definition and evaluation/selection can have profound effects on the competitive process, the proposal writing strategies of bidders, allegiances between competitors, the substance and nature of bid challenges, contract management issues, the potential for contract disputes and a range of other very real and tangible measures/outcomes. Interview I6 3 September, 2004.

<sup>22</sup> G. Bruce Doern and M. MacDonald, *Free Trade Federalism: Negotiating the Canadian Agreement on Internal Trade* (Toronto: University of Toronto Press, 1999), 84.

capacity requirement, but not the specification of the actual good or service to fulfill the requirement.<sup>23</sup>

The activities of ‘purchasing’, ‘acquisition’, ‘supply management’, and ‘supply chain’ all have an important place in the procurement literature and are often used interchangeably. More often than not, the terms used lack clarity in their application. Here purchasing is one element of a procurement process. The term ‘acquisition’ is used primarily in relation to defence goods and services most frequently in the United States. ‘Acquisition’ is used interchangeably with ‘procurement’ but the term will not be used in this thesis other than when referring to American procurement literature.

## **LITERATURE ASSOCIATED WITH PROCUREMENT**

The literature on procurement comes from many different fields, including economics, management and law and each of these generally focuses on a different aspect of purchasing. The economic literature is naturally concerned with issues of efficiency and there is substantial literature on topics including optimal bidding and contracting

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<sup>23</sup> This refers to the trend towards new types of procurement processes and relationships, such as Benefits Driven Procurement (federal) and Common Purpose Procurement (provincial – Ontario) which aim to fulfill a need by defining the nature of the goods or services required but not the specifics of those goods or services or the process by which they are put in place. It is hoped that in so doing, a collaborative relationship is developed with the supplier and a reduction of ex-post contractual problems is achieved. The problem of velocity of change is one of particular importance when dealing with the procurement of information technology products and related services.

mechanisms (Laffont and Tirole 1993; McAfee, Preston and McMillan 1986) as well as agency problems and efficiency issues in terms of Defense procurement (Rogerson 1999; De Fraja and Hartley 1996). In recent years there has been substantial focus on the efficiency aspects of electronic procurement, notably auctions and reverse auctions (Bajari, McMillan and Tadelis 2003).<sup>24</sup>

By far most of the writing and research done on procurement falls in the management literature category. Early procurement management literature falls into three categories:

(a) books that describe the role of purchasing and the techniques of doing the work of buying and procurement management;<sup>25</sup>

(b) work that focuses on the behavioural aspects of the buyer's job and considers the nature of the influences at work in shaping individual as opposed to corporate buyer behaviour;<sup>26</sup> and

(c) work that treats the negotiating process specifically, considering the bargaining processes through which prices and terms are set.<sup>27</sup>

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<sup>24</sup> The economic literature associated with procurement and contracting is expanding, the authors noted represent just a sample.

<sup>25</sup> See for example, *Purchasing Management, Materials in Motion* by Westing, Fine, and Zenz(1976) which describes the objective of purchasing as buying "materials of the right quality, in the right quantity, at the right time, at the right price from the right source with delivery at the right place." The authors give particular attention to procedural aspects of purchasing and the materials management concept that would position purchasing in close organizational proximity to production functions at the plant level. See also Wilbur B. England and Michael R. Leenders, in *Purchasing and Materials Management*(1975) and Ammer's *Materials Management*(1974).

<sup>26</sup> See Webster and Wind's *Organizational Buying Behaviour* (1972).

<sup>27</sup> See Chester Karrass in *The Negotiating Game*(1970) and *Give and Take*(1974).

The term “materials management” came into common usage and practice in business during the 1960s. The term highlighted the fact that there were economies to be gained by coordinating the related activities of production planning and scheduling, purchasing, shipping, storing, handling, and controlling of materials put into the manufacturing process.

Thus the literature on procurement from the late 1960's and 1970's ranges in focus from purchasing techniques, to negotiating skills to broad descriptions of buying behaviour – forming the foundations for the Operations Management discipline. At one level, it deals with the tasks, tools, and techniques of line purchasing and at another, it focuses on procurement as an organizational process and describes it in the language of the behavioural sciences.

Supply Chain Management(SCM) evolved from the Operations Management discipline – a natural evolution that occurred to fill the academic gap of the externalization of Operations Management. This was driven by rapid changes in information technology that enabled more effective communication among businesses in the new globalised environment.<sup>28</sup> Supply chains have always existed in industries and organizations, but

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<sup>28</sup> Mihalis Giannakis and Simon Croom, “The Intellectual Structure of Supply Chain Management: An Application of the Social Network Analysis and Citation Analysis to SCM Related Journals”, *The 10<sup>th</sup> International Annual International Purchasing and Supply Education and Research Association Conference*, Jonkoping, Sweden, 2001, 418.

the term SCM was introduced in 1982 as a consulting solution and it grew in business circles as a new competitive way of forming companies' strategic approach to markets. The nature of SCM research has been examined by many scholars (see for example Harland 1994,1996; Giannakis and Croom 2000; Ellram 1991; Saunders 1995; Croom et al. 2000) and is described as a multivariate discipline encompassing a large number of different literatures and research areas.<sup>29</sup>

Purchasing and procurement are seen as major elements of Supply Chain Management from the perspective of the SCM literature. 'Sourcing' is seen as an integrative concept that is related to all activities necessary for linking external resources to a company.<sup>30</sup>

The Supply Chain Management literature has been criticized for lacking clear theoretical and conceptual schema to delimit its boundaries. It overlaps competing disciplines, but there are a substantial number of excellent journals, both theoretical and less so, from which to glean relatively organized research.<sup>31</sup>

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<sup>29</sup> Giannakis and Croom, "The Intellectual Structure of Supply Chain Management", 418.

<sup>30</sup> Ulli Arnold and E.E. Scheuing, Supply Chain Management – Integrating E-Purchasing and Retailing Concepts, <<http://www.ism.ws/ResourceArticles/Proceedings/2002/ArnoldFD.pdf>>, 18/11/03.

<sup>31</sup> Giannakis and Croom (2001) condensed a network of journals in the field of SCM through Citation and Social Network Analysis. They include the European Journal of Purchasing and Supply Management, International Journal of Logistics Management, International Journal of Operations and Production Management, Journal of Business Logistics, International Journal of Purchasing and Materials Management.

In terms of procurement per se, and the concern here with public procurement, there is no such defined field from which to draw.<sup>32</sup> In the SCM literature it is one of the areas in which articles appear from time to time, but the public nature of purchasing is seen as a niche area from the business perspective. This is one of the reasons why the strategic nature of public purchasing was not recognized for a long time. While business dealt with the public sector on a regular basis, and in many locales, the public sector forms a major part of the private sector's business, it was still not treated in concert with problems within industry. Information technology has impacted on research in supply chain management and its many variations, as well as public procurement – radically influencing the topics and questions addressed as seen in the conference publications and work of the International Purchasing and Supply Management Education Research Association (IPSERA) and the European Journal of Purchasing and Supply Management.

Most writing on public sector procurement has been focused on defence procurement. There is substantial cross-pollination between defence management literature and defence policy literature. The United States is a particularly strong contributor of defence procurement publications, notably the Acquisition Review Quarterly coming from the Defense Acquisition University. In the United Kingdom strong work on defence procurement has emerged from the Centre for Defence Economics at the University of York. In terms of law, the specialty journal Public Procurement Law Review leads the

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<sup>32</sup> Procurement is either a very narrow or very broad field depending on the perspective taken. From a supply chain management perspective, it would be seen as more narrow.

way and the Public Procurement Research Group in the Faculty of Law at the University of Nottingham is an important center of research in the field. The harmonization of public procurement rules has been a focus of the European Union and consequently there has been a fair amount of research emerging in this area.

Much less work looks at the contextual and policy issues, although there is some cross-over with supply management journals. The odd article involves public sector issues and how they interrelate with private sector supply management problems.<sup>33</sup> The aforementioned IPSERA organization has a small but active group who examine public sector procurement issues – largely European academics. The Centre for Research in Strategic Purchasing and Supply (CRiSPS) at the University of Bath School of Management undertook an International Research Study of Public Procurement in 2003. The collaborative research developed case studies in public procurement from thirteen countries and the results are being analyzed and published. A relatively new and notable journal is the Journal of Public Procurement in the United States. In Canada, there are only a few researchers who have investigated procurement policy and process issues (Byers 1985; Edgar & Haglund 1995; Tupper 1982), largely associated with Defence and/or industrial development, and much of this work is quite dated. There are very few books, articles or studies on procurement policy in Canada outside of government reports and publications. There appears to be no academic research in Canada related to

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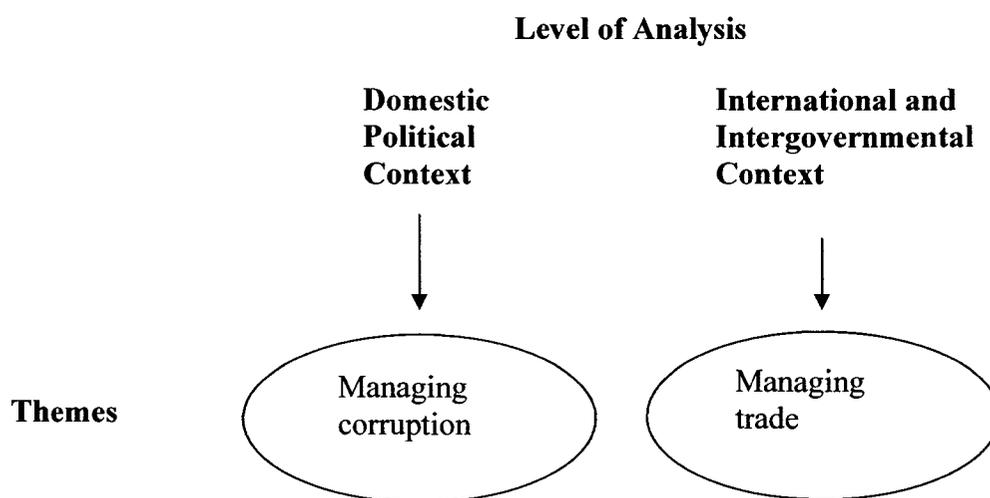
<sup>33</sup> See P.F. Johnson, M.R. Leenders, and C. McCue, “A Comparison of Purchasing’s Organizational Roles and Responsibilities in the Public and Private Sector”, *Journal of Public Procurement*, 2003, Vol.3, Issue 1, 57-74.

understanding procurement as a critical function of public policy and its importance in terms of the operations and organization of government.

## THE POLITICS OF PROCUREMENT

Despite the lack of academic material grounding public procurement, its political aspects emerge as important elements of complex activities in Canadian public policy. In this section a framework is presented for grouping the higher order political goals where procurement figures prominently.

**Figure 4: The Politics of Procurement**



The question as to what separates corruption from the manipulation of procurement in the context of regional policy is a complex one and is not resolved here. Regional and

industrial policy are characterized in Chapter Three as part of a ‘regional policy paradigm’, largely as distributive politics separate from the issue of corruption. This paradigm encapsulates how procurement has been used in the context of regionalism and industrial support.

### **The Domestic Political Context**

First, the key theme that arises in the domestic political framework is the management of corruption. Arguably, very public political scandals connected to federal procurement such as the awarding of the CF-18 maintenance contract, the EH-101 helicopter bid and the Sponsorship affair<sup>34</sup> make procurement a subject worthy of much more careful attention and study. While these modern-day ‘scandals’ are what come to mind for most with respect to questionable political decisions associated with contracting and

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<sup>34</sup> For example, a panel of seventy-five government experts analyzed bids for the CF-18 maintenance contract from a Halifax consortium, Bristol Aerospace of Winnipeg, and Canadair of Montreal. The Halifax bid was deemed to be technically inadequate, they awarded Bristol 926 points out of a possible 1,000 points for technical merit, compared with only 843 for Canadair. For “systems engineering”, the core element of the contract, Bristol’s bid was thirteen per cent lower, and three per cent lower over all in the first three and half years of the contract. Despite Bristol’s obvious superiority and the verdict from the experts, the prime minister and other Quebec ministers steered the contract to Canadair, using a rationale about technology transfer that was clearly a purely political decision. Jeffrey Simpson, *Spoils of Power – The Politics of Patronage* (Toronto: Harper & Collins, 1988), 375. The EH-101 saga began in the late 1970’s and continues to this day. The ‘Sponsorship Scandal’ is being investigated in the form of the Gomery Inquiry, due to report at the end of 2005. It has already been the subject of great controversy.

procurement, there are numerous documented events reaching back to Confederation.<sup>35</sup> An assortment of cases of political corruption is documented in newspapers, committee reports and history books. A few analyses of corruption and related problems have appeared in popular magazines, and one can follow the attempts at cures proposed for various levels of government by the governments themselves or occasionally by interested observers.<sup>36</sup> The greatest attention has come from the practical demands placed on politicians and bureaucrats, from which the evolution of Canadian law and regulation on corruption has emerged in the form of Conflict of Interest Codes and Lobbyists Registration regulations.

The notion of political corruption strikes at the very heart of a government system. Its presence as a malevolent activity in politics makes it a driving force behind procurement policy. Political corruption is a very comprehensive concept covering a wide range of

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<sup>35</sup> Attempts to discredit the government-of-the-day have more often than not alluded to the existence of political corruption. Sir R.L. Borden's conservative opposition put together a fascinating little report in 1906 outlining all the questionable 'expenditures' of the Laurier government for the preceding ten years, see "A Session's Disclosures – Some Transactions of the Laurier Administration Exposed in the Session of 1906", twenty-five detailed descriptions of land deals, construction contracts, and problematic elections, accusing both individuals and groups of various forms of corruption.

<sup>36</sup> There are still few academic sources available on political corruption in the Canadian context. There is a journalist tradition certainly, Richard Gwyn's *The Shape of Scandal* (1965), relates the details of a particular case; Jeffrey Simpson and Peter Newman would qualify as journalists/historians who have dealt with Canadian political corruption in their work. The most comprehensive book outside of this tradition remains *Political Corruption in Canada: Cases, Causes and Cures* (1976). In the preface, Kenneth M. Gibbons and Donald C. Rowat briefly review the availability of good, now somewhat dated sources on this topic.

activities.<sup>37</sup> Kenneth Gibbons deals with the thorny issue of defining political corruption in the Introduction to Gibbons and Rowat's work and notes that most definitions are either implicit or very narrow. Gibbons' very reasonable definition focuses on the importance of private gains being made at public expense - "political corruption is the use of a public office in a way that forsakes the public interest, measured in terms of mass opinion, elite opinion or both, in order that some form of personal advantage may be achieved at the expense of that public interest."<sup>38</sup> There are numerous problems with trying to define political corruption, but ultimately it is impossible to know whether corruption has taken place unless the cost of such behaviour – the need for personal advantage to be gained at the expense of the public interest – is ascertainable in some way, even in a theoretical sense.<sup>39</sup>

Gibbons identifies six dimensions that can be employed in analyzing and identifying the various types of political corruption: the number and type of actors involved; the role of the political actor in any corrupt activity; his or her status as an official or combatant in the electoral process; the kind of reward involved; the degree to which rewards can be

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<sup>37</sup> K.M. Gibbons, "The Study of Political Corruption", in K.M. Gibbons and D. C. Rowat, eds., *The Political Culture of Corruption. Political Corruption in Canada: Cases, Causes and Cures* (Toronto: McClelland and Stewart Limited, 1976), 6.

<sup>38</sup> Gibbons, "The Study of Political Corruption", 5.

<sup>39</sup> Some important international organizations are dedicated to reducing corruption. "Transparency International is the leading global non-governmental organization devoted to combating corruption. Its mission is to *create change* towards a world free of corruption." <<http://transparency.org>>, 21/02/05. The companion site of Corruption Online Research and Information System includes a fair amount of research on the subject. Corruption is defined here as "the abuse of entrusted power for private gain." <<http://www.corisweb.org>>, 21/02/05.

meted out to individuals selectively or only as invisible rewards; and the location of the act in either the electoral or administrative spheres of government.<sup>40</sup> He further divides the concept of political corruption into several types of activities that can be distinguished from one another by means of the aforementioned dimensions. These include patronage, vote-buying, pork-barreling, bribery, graft, conflict of interest, corrupt campaign financing and influence peddling. Criminal corruption, any improper conduct on the part of political actors which involves criminals as the second actor may involve other activities defined under political corruption but in this case criminality is determined by the second actors engaging in alleged illegal activities.<sup>41</sup>

The question then arises of how one distinguishes politically motivated corruption from normal politics as far as procurement is concerned. There is of course, considerable potential for and temptation to, abuse the procurement power by officials both for personal and political reasons. Indeed the influence of these considerations may prejudice the legitimate objectives of the procurement instrument.<sup>42</sup>

As explained by the Glassco Commission:

At all levels of government there is pressure to influence purchasing for the personal advantage of individuals, for electoral advantages in constituencies, and for partisan advantage. This is a special and common hazard in government procurement procedures. In addition, government

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<sup>40</sup> Gibbons, "The Study of Political Corruption", 6.

<sup>41</sup> Ibid., 13.

<sup>42</sup> Sue Arrowsmith, *Government Procurement and Judicial Review* (Toronto: Carswell, 1988), 31.

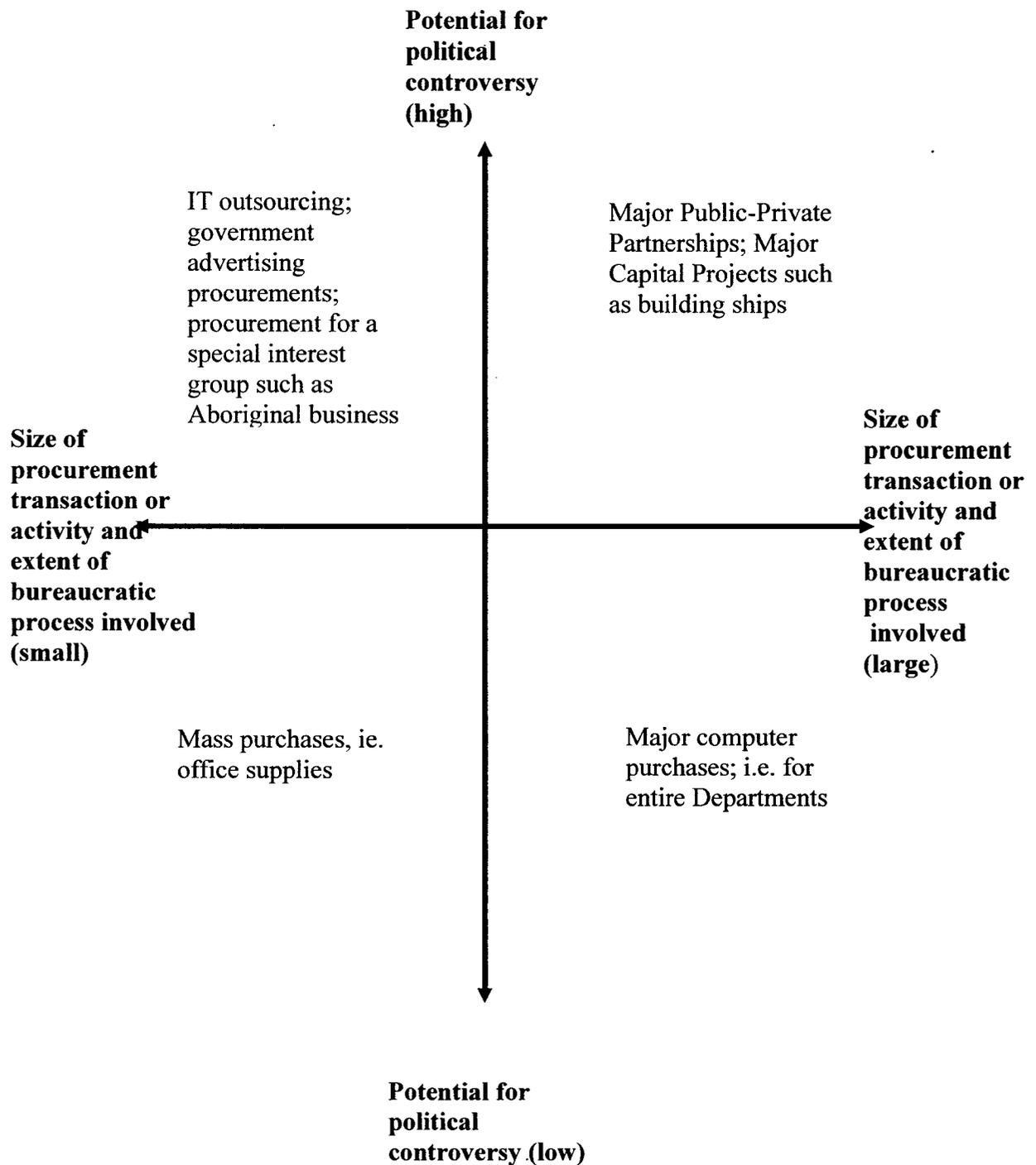
shares with private organizations the constant hazard that officials may make decisions for their own advantage or that of friends and associates. An effective procurement system for the public service must be on guard against these hazards without exacting an unnecessarily high price in terms of cumbersome procedures, costly delays or undue rigidity.<sup>43</sup>

Procurement is itself a political process because the use of taxpayer money directed towards government objectives is a question of choices; choices made by politicians and implemented by officials. Politically motivated corruption is distinguished from the normal politics of procurement by the attempt to make personal gains at the expense of the public interest. The matrix below depicts the political nature of procurement as it relates to the nature of the procurement activity.

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<sup>43</sup> Canada, Royal Commission on Government Organization (Chairman J.G. Glassco), Report (1962-63), Vol.2, Report 10, pgs. 80-81, as quoted in Arrowsmith, *Government Procurement*, 31.

**Figure 5: Depiction of political nature of procurement as it relates to nature of activity**



The potential for political controversy increases as both the sheer size and dollar value of a contract increases and the bureaucratic complexity increases. There is a large amount of activity that is not overtly 'political' on a day-to-day basis. The supply of goods and services to government and the associated buying process is governed by a series of on-going standing contracts that provides for the necessities of continuous government activity. One can think of simple goods in this case; paper, pens, computers, uniforms, food; goods and services found in quadrant one (beginning in lower left hand quadrant and moving clockwise).

When these activities are aggregated or combined into contracts of a changing nature, the opportunity for conflict emerges (moving from quadrant one to two). The procurement process is arranged to handle the daily operation of continuing supplier-buyer relationships, and also to manage the complexity of the relationships between the marketplace and government in the purchase of goods and services. Large procurements may not garner much political focus – they may be of an ongoing nature such as the large-scale replacement of desktop computers, expensive but relatively straightforward in terms of process. Certainly as the size of the procurement increases, the potential for problems increases stemming from the increasing visibility of the process, the increased requirement for bureaucratic approvals, the level of interest from the private sector and the ensuing private-public sector relationship that must be managed.

Procurement policy has been driven in part by the need to control political corruption and there is certainly room for differences of opinion in terms of how well the Canadian polity has done.<sup>44</sup> Whether the norms and procedures that have developed over time are adequate is debatable. Statutory provisions contained in *The Conflict of Interest and Post Employment Code for Public Office Holders*, *The Lobbyist Registration Act*, and *The Conflict of Interest Code for Members of the House of Commons* have evolved to increasingly enhance public confidence in the integrity of public office holders and the decision-making process in government.<sup>45</sup> For over ten years the question of how to institutionalize the role of an ‘ethics watchdog’ was debated and now takes the form of the Ethics Commissioner as an officer of Parliament.

Concern with accountability in government and most recently the Sponsorship Scandal moved procurement policy and associated procurement activities into the spotlight.

Where there are decisions made by individuals with respect to contracting, there will always be the potential for corruption despite legislation, regulation and ethics review.

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<sup>44</sup> A deterrent to corruption is provided in some cases by criminal sanctions. Broadly speaking, these may apply where a bribe is offered to obtain a contract, whether in the form of a benefit to an official or his family, or in the case of Crown contracts, in the form of political contribution. With Crown contracts the relevant provision outlining criminal sanctions is section 110 of the Criminal Code. In Arrowsmith (1988), 101.

<sup>45</sup> Conflict of Interest Code and Post-Employment Code for Public Office holders, <<http://strategis.ic.gc.ca/epic/internet/inoec-bce.nsf/en/oe01422e.html>>, 12/01/05. It was most recently revised in October of 2004 to reflect changes since the first independent Ethics Commissioner assumed office in May of 2004. The Commissioner replaces the Ethics Counsellor, with more power and more independence from government. The Commissioner reports to Parliament whereas the Counsellor reported to the Prime Minister’s Office.

At the same time, effective implementation of the procurement process is a means by which government can demonstrate its probity, efficiency and fairness. Transparent and competitive procedures provide an important deterrent to corruption. The more objective the selection criteria, the more difficult it will be for improper motives to be concealed.<sup>46</sup> Availability of information about government and increased access to the activities and available contracting opportunities of government through information technology has resulted in a more transparent and open procurement environment. The strategic use of IT involves both administrative centralizing and decentralizing pressures that impact on accountability and political and managerial responsibility.

New Public Management approaches were applauded as a modern, business-like way of organizing government and revitalizing its mechanisms of accountability and responsibility. The NPM doctrines began to dominate the bureaucratic reform agenda in the OECD during the 1990s. Private sector management principles for evaluating the public sector included: a move away from bureaucratic styles to more flexibility; competition and rivalry as the key to lower costs and better standards; disaggregated units and use of the franchise arrangement in or outside of the public sector; hands-on professional management; explicit standards and measures of performance; output controls and performance linked to results rather than process; and a constant focus on

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<sup>46</sup> Arrowsmith, *Government Procurement*, 102.

cost cutting.<sup>47</sup> In Canada, this was reflected in Public Service 2000, a policy prescription for how NPM principles were to work across the whole of the bureaucracy. It had two main components. The first was an institutional change in arrangements within the public service aimed at “deregulating” and “empowering” line managers, and the second was an attempt to articulate a new set of core values for the public service.<sup>48</sup> Roberts suggests that the fear of the impacts of decentralized processes and decision-making on the part of ‘the control lobby’ (a loosely organized community that included the federal Office of the Auditor General, many legislators, public-service unions, the media, some industry associations, and perhaps auditors and financial administrators within the public service) constrained the path of reform. The reform was to involve Bill C-26 (deregulation of personnel management practice). Bill C-52 (designed to provide new legislative foundation for PWGSC); also contained sections that confirmed the right of common service organizations within the department to contract for work with “any government, body, or person in Canada or elsewhere” and gave the department the right to set its own fees for services, and an expanded role for common services organizations. The effort to potentially ‘manage’ corruption through the limitation of the effect of NPM (essentially the effect of the ‘control lobby’) put parameters around how much decentralization could actually take place. These tensions would arise dramatically when

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<sup>47</sup> Rannveig Roste, “Studies of Innovation in the Public Sector, a literature review”, PUBLiN – Innovation in the Public Sector, March 2004.  
<<http://www.step.no/publin/reports/d8-litterature-survey-march2004.pdf>>, 12/05/05.

<sup>48</sup> Alasdair Roberts, “Worrying about misconduct: the control lobby and the PS 2000 reforms”, *Canadian Public Administration*, 1996, Volume 39, No.4, 490.

information technology demonstrated the potential once again to alter management and how the bureaucracy functioned.

### **The International and Intergovernmental Context**

Now we turn to the second level of analysis in this section, the International and Intergovernmental Context. The key theme is the ascendancy of managing trade as a focal point in politics. The increasing profile of trade issues intersects with procurement in a number of ways. Decisions about what elements will be included or excluded in trade agreements by the government are shaped by intergovernmental politics as well as the country's role in international relationships. At an international level, procurement can be viewed as part of a 'regime'; a network of rules that affect and shape behaviour in the economic sphere.<sup>49</sup> Increasingly world and international level trade agreements have dealt with procurement rules through negative and positive integration frameworks, which leave less capacity for states to retain domestic preference policies.

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<sup>49</sup> A very commonly used definition of regimes is that of Stephen Krasner. Regimes are "set of explicit or implicit principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given [issue-area]." Keohane and Nye state that "[regimes are] sets of governing arrangements [that include] networks of rules, norms and procedures that regularize behaviour and control its effects." Stephen D. Krasner, ed., *International Regimes*, Cambridge, Mass, Cornell University Press, 1983, 2. Keohane and Nye in *Regime Theory and International Relations*, V. Rittberger, ed., Oxford, Oxford University Press, 1993, 2.

As an increasingly important part of the liberalizing trade agenda, procurement is a traditionally 'domestically' managed issue both at the political and bureaucratic levels. Politicians were (and are) reluctant to put the domestic policy area of procurement into the realm of international negotiations where powers could be reduced for states and the potential for conflict with the provinces could increase. Indeed, international agreements where procurement was a focal issue, namely NAFTA, GATT, WTO, and the AIT brought the issue of dispute settlement to the forefront. Disputes between parties would now be played out through the Canadian International Trade Tribunal (CITT) mechanism, a robust but controversial mechanism based in the NAFTA legislation.

The CITT has played a key role in bringing focus to the issue of fairness in contracting. Established in 1988, it replaced the Canadian Import Tribunal, the Tariff Board and the Textile and Clothing Board. The Tribunal acts as the bid challenge authority under NAFTA, the Agreement on Internal Trade and the World Trade Organization Agreement on Government Procurement. Following implementation of NAFTA in 1994, the Tribunal also became Canada's bid challenge authority with respect to federal government procurement, replacing the Procurement Review Board of Canada.<sup>50</sup> Legal challenges to contract awards have been increasing and currently eighty percent of the disputes before the CITT come from Canadian based procurements.

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<sup>50</sup> Catherine Morrison, "That's not fair! Or is it?", *Summit- Canada's Magazine on Public Sector Purchasing*, June 2001, 11.

Since twenty to thirty percent of major contracts are challenged in the courts or CITT, there is a significant institutional impact. Projects are delayed, such as the case of the switch to privately supplied services to the CFB Goose Bay, Labrador in 1997, which was held up for 135 days by a challenge lodged with the CITT.<sup>51</sup> Challenges, delays, and disputes in the procurement process translate into considerable costs for the government, the taxpayer, and possibly for the private sector company as well. On the other hand, this mechanism may provide an opportunity for unfairly awarded contracts to be overturned, and fairness and transparency increased. Increased decentralization in procurement authority and pressure from departments to control their own procurements coupled with the important influence of the CITT has altered the nature of the role of state structures in procurement policy.

Although modest in its success in expanding market opportunities for suppliers of goods to federal governments within North America, the North American Free Trade Agreement did increase the amount of procurement open for competition between Canadian and US suppliers in each other's market. More significant however, were the improvements to the process (beyond dispute settlement) in regard to transparency such as bid-challenge procedures.<sup>52</sup> Some of these procedures will be examined with a view to understanding the process of procurement implementation.

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<sup>51</sup> Morrison, "That's not fair", 11.

<sup>52</sup> Michael Hart and Pierre Sauve, "Does Size Matter? Canadian Perspectives on the Development of Government Procurement Disciplines in North America", in eds., B.M. Hoekman and P.C. Mavroidis, *Law and Policy in Public Purchasing – The WTO*

The WTO Agreement on Government Procurement (AGP) is one of the agreements negotiated during the Uruguay Round(1986-1994). The AGP went into effect January 1, 1996. Twenty-six countries (including Canada, the US, European Union, Japan and others, mainly developed countries) are now Parties to this agreement. The agreement covers somewhere in excess of \$250 billion of public procurement expenditures. The AGP is currently being reviewed with the mandate to simplify the agreement, which may potentially involve more procurement as well as the removal of ‘discriminatory measures’ or exceptions to the coverage.

All countries to the Agreement except Canada made commitments to permit suppliers from the other Parties to bid on an equal footing with domestic suppliers for certain procurement of federal departments, sub-central (provincial, state, municipal etc.) government departments and crown corporations. The United States has been reluctant to eliminate its exception for Small Business Set Asides and expand coverage. Canada limited its coverage under this agreement to federal departments and agencies in light of constraints on the federal government to exercise power in areas of provincial jurisdiction. Thus Canadian provincial, municipal or regional governments are not included and Canada as a result does not have access to the procurement of the sub-

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*Agreement on Government Procurement* (Ann Arbor: The University of Michigan Press, 1997), 216.

central entities of other Parties to the agreement.<sup>53</sup> Improved access to foreign government procurement under this agreement for Canada will require the participation of the provincial governments.<sup>54</sup>

An important change involves the use of offsets. Offsets are defined by the WTO as measures to encourage local development or improve the balance-of-payments accounts by means of domestic content, licensing of technology, investment requirements, counter-trade or similar requirements. The use of offsets is prohibited explicitly in the Agreement on Government Procurement. Offsets attached to large procurement contracts have been used in Canada as an important element of industrial and regional development. This is an example of a change resulting from an international agreement with important political and economic consequences in Canada.

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<sup>53</sup> Canada's position on the inclusion of sub-national governments in the procurement process is historically based in the Labour Conventions of 1937 which established that provinces are independent, sovereign actors in areas within their own jurisdictions that cannot be bound in international agreements to which they do not explicitly assent. The Judicial Committee of the Privy Council held as far back as the 1880s that the inter-provincial trade clause of the Constitution Act 1867 (BNA Act) does not have the same function of overriding sub-national governments' internal economic jurisdiction as does the "Commerce Clause" in the U.S. Constitution. Nevertheless, reciprocal access to procurement opportunities by sub-national U.S. state government is normally dependent on formal accession of state governments to such agreements. In 2005, the Republicans are facing serious opposition to the Central American Free Trade Agreement, such that an increasing number of states are backing away from their commitments to open up state contracts to foreign competition in free-trade deals. Jeffrey Sparshott, "Wary States resist free-trade deals", The Washington Times, April 4, 2005.

<sup>54</sup> World Trade Organization Agreement on Government Procurement, <<http://www.dfait-maeci.gc.ca/tna-nac/discussion/govproc-en.asp#WTO>>, 22/12/04.

Turning to the intergovernmental context, Canada's Agreement on Internal Trade has significant implications for the procurement process, particularly as related to the CITT. The Agreement on Internal Trade (AIT) is an intergovernmental agreement signed by the First Ministers of Canada. It came into force in 1995 to increase the profile of internal trade by addressing obstacles such as labour mobility and discriminatory procurement practices that are faced by Canadian companies. It represents a broadened trade focus, responding to freer international trade and recent advancements to transportation and telecommunication systems, and illuminates inconsistencies that result in trade barriers.

The AIT focuses on reducing trade barriers within eleven sectoral chapters, one of which is procurement. It is intended to eliminate local price preferences, biased technical specifications, unfair registration requirements and other discriminatory practices for non-resident suppliers to ensure equal access to procurement for all interested Canadian suppliers. Since the Agreement came into effect the Parties have continued negotiations to reduce the exclusions of both government entities and services. A service provider was contracted to develop and implement a common electronic tendering system. The Parties also approved the procurement provisions that apply to the MASH (municipalities, municipal organizations, school boards and publicly-funded academic, health and social service entities) Annex to the Agreement implemented in July 1999 for all provinces and territories except British Columbia and the Yukon. There have been

numerous disputes involving procurement practices handled by the CITT with respect to the federal government allegedly acting contrary to the provisions of the AIT.<sup>55</sup>

The AIT itself is subject to substantial criticism. A study recently published by the Certified General Accountants Association of Canada (CGAAC), *Canada's Agreement on Internal Trade: It Can Work If We Want It To* concludes that the AIT has a serious credibility problem, and that intergovernmental discussions about the agreement must be re-instated. The CGAAC recommendation for a CITT-like organization at the provincial level is an attempt to enhance public confidence in provincial procurement and the credibility of the purchasing profession.<sup>56</sup>

The extent to which the WTO agreements, NAFTA, and the AIT affect procurement in the Canadian context is critical to understanding how trade mechanisms have impacted federal government procurement processes. Government officials and industry players struggle to understand the changes in regulation and adapt to the ever evolving and rapidly changing environment. The economic liberalization process highlighted by these

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<sup>55</sup> For example, from 1995 to 2000, eighty-four dispute-settlement cases were disposed or pending. The majority (62/84) of disputes have been procurement cases under Chapter 5 the AIT and most of these have been with respect to federal policies. Eugene Beaulieu, Jim Gaisford and Jim Higginson, "Interprovincial Trade Barriers in Canada: How Far Have We Come? Where Should We Go?", Department of Economics, University of Calgary, A Report Prepared for the Van Horne Institute, 2003, 33.

<sup>56</sup> Paul M. Lalonde, "A Case for provincial trade tribunals", in *Summit – Canada's Magazine on Public Sector Purchasing*, September 2001, 29.

trade agreements deeply affects, and is deeply affected by, the domestic political context in Canada.

Elucidating the relevant elements of trade agreements in chapter four of the study sheds light on their impact on the procurement process and the mediating role of the institutionalization of trade agreements. The regional policy paradigm and the liberalization paradigm become intertwined as we examine the evolution of procurement policy.

## **PROCUREMENT EVOLUTION AND REFORM**

This section provides a brief review of some of the efforts that have been made with respect to procurement reform, and suggests how these efforts are related to the themes examined earlier in the Chapter. As well, we preview the broader policy and institutional issues that arise in the empirical chapters.

Procurement seems to be always undergoing 'reform'. Government studies on procurement, dating back to 1962 include: The Royal Commission on Government Organization (the Glassco Commission), The Lambert Commission, The Neilson Task Force on Program Review, Increased Ministerial Authority and Accountability, the Renewal of the Public Service in Canada, DND/PWGSC Procurement Reform, Supply Business Process Renewal, and the most recent Parliamentary Secretary's Task Force

Government-Wide Review of Procurement. Nestled in these reform programs are institutional agendas that have included procurement in their plans to make change. At various times, Treasury Board has had a broad program of government-wide reform and a specifically targeted IT procurement reform. PWGSC created an Electronic Supply Chain project intended to allow suppliers to electronically submit bids, receive orders, submit invoices and receive payments across a wide variety of activities. Defence has worked closely with PWGSC to harmonize its procurement activities, and numerous industry groups such as the Information Technology Association of Canada and the Aerospace Industries Association of Canada have worked in conjunction with government to overhaul the procurement system, as well as lobby for change.

The most comprehensive reform effort has certainly been the most recent program begun in December 2003, whereby the Prime Minister named the Honourable Walt Lastewka, P.C., M.P. as Parliamentary Secretary to the Minister of Public Works and Government Services with special emphasis on procurement review. An interdepartmental task force examined the existing procurement environment, under the broad context of the Government's declared need to review and renew the government's direction across a wide spectrum of expenditure and other critical control areas.<sup>57</sup> While the sponsorship

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<sup>57</sup> The Deputy Minister of PWGSC and the Assistant Deputy Minister of PWGSC's Acquisitions Branch established a Task Force to support Mr. Lastewka in his mandate. The Task Force was further supported by an interdepartmental committee of Directors General, Members from PWGSC, Department of Justice, DND, and TBS and a private sector consultant. The pan-government nature of the Task Force was reinforced by recognizing the work of the Task Force as one of the nine pillars of the TBS-led

affair sparked opposition and public outcry directly at issues in procurement, problems with contracting are not new and they are intricately linked with expenditure management in all departments and at all levels.

A core set of institutional relationships has developed over time, forming the context in which the procurement process takes place. These involve the roles of, and interactions among the Treasury Board, Public Works and Government Services Canada (PWGSC), and the Departments and organizations responsible for program implementation. Above the working level is an interaction of organizations that make the major spending decisions and work to define and guide the procurement activities of the government, namely the PCO, and the Department of Finance. The difficulties with maintaining accountability and legitimacy while attempting to integrate new management philosophies and incentive structures have plagued the procurement process.

Partnerships and networks, increasingly with the private sector, call for different forms of organization and the willingness to innovate.

Major capital equipment purchases such as ships differ from small, one-time procurements or on-going standing offers in terms of complexity and time frames - but the fundamental principles underpinning the procurement system remain the same.

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Expenditure Review Committee(ERC) process. Parliamentary Secretary's Task Force – Government-Wide Review of Procurement, Concepts for Discussion Report September 24, 2004, <[http://www.pwgsc.ca/prtf/text/concept\\_doc-e.html](http://www.pwgsc.ca/prtf/text/concept_doc-e.html)> 5/10/04 and Final Report January 2005.

Ensuring the competitiveness of the government marketplace and the probity and transparency of the process is critical to the integrity of the system.

The 'politics of procurement' is supported by an institutional environment in which institutions play a role as actors and also as a framework of norms. Values and processes are embedded in interrelated organizations, which never stray far from the political context. For example, the evolution of the government's primary purchasing agency, Public Works and Government Services Canada as well as the emergence of the Canadian International Trade Tribunal have a significant impact on the relationship of the political process to the bureaucratic decision making capacity.

Government procurement based on complicated regulated processes to ensure a fair competitive 'playing-field' as well as the acquisition of services and goods based on lowest cost have evolved to protect the public interest and increasingly to promote the development of open markets. These procurement processes have been designed to function in a relatively static environment without the cost and human-resource based imperatives of outsourcing. The Defence environment has been the most studied in terms of procurement research due its involvement with the outsourcing of large capital equipment requirements, as well as the sheer dollar values involved. These programs have been managed under tight control through complex and rigid hierarchical procurement regimes, most of which have gone over-budget, over-time and with often claimed questionable results.

Much has been learned from difficult military procurements, made more complex by the inherently political choices associated with regional and industrial development. Defence is an important case with its cyclical major capital equipment purchases and procurement relationships with PWGSC. One cannot divorce the political and institutional factors from the study of procurement. The acquisition of goods and services in a multi-billion dollar spending envelope across government is itself a political process. In fact, above all else, political sensitivity is a key strategic dimension in understanding procurement in Canada. The fact that economic interests can be much more salient for political elites than any single departmental issue is always something that has to be factored in.<sup>58</sup> This will be explored in Chapters Three and Four.

In the 1990s, information technology became an important variable through which policies and strategies associated with procurement became increasingly reflected. The policies, strategies, and activities of the IT agenda have shaped procurement at both the structural and broader institutional level as well as at the internal organizational level.

The tensions between political and bureaucratic centralization and decentralization are problematic with respect to information technology. For example, PWGSC retains the central contract administration function for the government, with policy and direction

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<sup>58</sup> James Fergusson, "Beyond the Dollar Crisis: Defence Strategy and Procurement in Canada" in eds., David G. Haglund and S. Neil MacFarlane, *Strategy and the Global Economics of Defence Production* (Montreal & Kingston: McGill-Queen's University Press, 1999), 100.

from Treasury Board - but the increasing complexity of managing the on-line environment with pressures to expand and complete the on-line contracting function, challenges the organization and has departments looking for increased autonomy to take care of their own contracting activities.<sup>59</sup> The fundamental institutional pressure has its root in a central issue: the strategic use of information technologies involves both centralizing and decentralizing pressures. The ability for a central organization to combine and organize the needs of diverse departments, especially for similar requirements with on-line tools is astounding. In the face of resource shortages, both technological and human, and an old procedural morass not yet evolved to deal with the speed potentialities of the 'wired' world, it is certainly understandable why varied government organizations would want to take on their own purchasing functions and test the boundaries of spending thresholds and procedural standards (the Advance Contract Award Notice process is an example of this).

A government bureaucrat working on the IT Procurement reform agenda suggested that "the issues of procurement 'for many purposes' are most reflected in the IT environment, where things just can't happen fast enough." He commented "the use of procurement as a lever is archaic."<sup>60</sup> Indeed, there is conflict here amongst officials and in business.

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<sup>59</sup> The Parliamentary Secretary's Task Force Government-Wide Review of Procurement Final Report recommended a corporate approach to procurement across the whole of government. This represents a centralization of policy and processes, such that commodity management and evaluation efforts will be focused through PWGSC with increasingly fewer contracting decisions left in the hands of departments and individuals.

<sup>60</sup> Interview B4, 28 October 2000.

Some wish it was more rule-bound, purely competitive and involved less discretion, while others (i.e. emerging industries or special interest groups) see discretion on the part of government officials and in the rules as important to their ability to develop their product and find a market in which to sell it. On-going consultations between the Government and the Information Technology Association of Canada with respect to the limitation of liability in procurement contracts reflect the conflict that arises when the Government uses its position as contractor to direct how money is spent in the private sector.

Information technology was initially simply a way to deal with information-based discrete transactions in a faster way. Keeping track of invoices and summarizing information was a key benefit. Very quickly after the initial uses of IT became commonplace, IT came to the forefront as the real potential for faster communications made the procurement of computers and associated equipment a new area of concern. As well, the potential for using IT in procurement beyond transaction-based functions was growing. IT was starting to be recognized as a strategic element in policy, and operationally becoming as critical to the procurement function in the public sector as it was for supply chain management in the private sector. It was already central to process performance and competitiveness in the private sector,<sup>61</sup> and becoming no less important to effective activity and program management in the public sector.

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<sup>61</sup> Mark E. Nissen, “SPS and Beyond: Innovating Acquisition Through Intelligent Electronic Contracting”, *Acquisition Reform – A Revolution in Business Affairs*,

The emergence of IT and its integration into the supplier-buyer process was beginning to fundamentally alter the operations of government. This required new skills and new mind-sets about relationships and contracting. However, shifting culture in the public sector is exceedingly difficult. The growing technological capacity for on-line procurement activities challenges the government's organizational and managerial capacity, which tends to evolve very slowly. The Electronic Supply Chain project in PWGSC (which now is the Government of Canada Marketplace, under development) and the MERX service (an on-line repository of bid opportunities and documents available to the private sector from across the country) were early attempts to integrate internet technologies with traditional procurement processes, with varying degrees of success.

The increasingly internet-enabled world of procurement raised the possibility of problems with accountability. Devolution of departmental spending and the operational spending with automated credit cards led to rising concerns that officials would have too much discretion. Enabled by information technology, operational units can directly purchase on-line some of the goods and services required, when and where they are needed. With the evolution of MERX, the on-line availability of government contracts available for bid, as well as the bid documents themselves, not only speeds the process but means that information is far more available in real-time than ever before. However, moving from

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Proceedings of the 1999 Acquisition Research Symposium, Sponsored by the Deputy Under Secretary of Defense for Acquisition Reform, Co-hosted by Defense Management College and the National Contract Management Association, Washington D.C., 468.

an 'automated' information management environment to a dynamic integrated supplier-purchaser environment requires some fundamental changes in governance mechanisms and operating mentalities. Canadian federal institutions operating in a traditional accountability framework have not yet developed the structural and procedural capacity to handle the multiplying pressures on their resources and frameworks.

The traditional hierarchical institutional relationships continue while requirements to communicate and operate in a much more horizontal and networked fashion put pressure on reporting relationships. Financial reporting and accountability arrangements have come under increasing scrutiny as a result of the Sponsorship affair and problems with information technology procurement.

The limited research dealing with these issues in the Canadian public sector is rooted in the traditional forms of contracting and procurement.<sup>62</sup> While we cannot say the traditions of government are no longer relevant, there is a requirement to better understand the procurement environment, where the pressures of moving to the strategic use of information technologies necessarily changes the frame in which we view government processes. The shift towards a new order of "e-governance" (penetrating political, commercial and social spheres) involves using information technology as an enabler of better government services and even more effective democracies. The role of

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<sup>62</sup> S. Globerman and A.R. Vining, "A Framework for Evaluating the Contracting-Out Decision with an Application to Information Technology", *Public Administration Review* 56(6), 1996, 577.

information technology in procurement relationships such as public-private partnerships requires thinking about new dynamics that are very far from traditional public sector processes for procuring and contracting.<sup>63</sup>

The commonly used generic cure for procurement management inadequacies has been reorganization. The reform efforts described earlier show there has been no lack of reorganizational efforts in Canada to this end. Reorganization however provides no benefit unless it is accompanied by fundamental changes in management philosophies.<sup>64</sup> The joint forces of increasing world-wide economic interactivity and the strategic use of information technology for organizing, managing and delivering public services, is necessitating a significant shift in public sector management philosophy manifested in institutions that have yet to be realized. The shift to much more horizontal forms of governing where multiple accountabilities are managed in a legitimized framework is occurring.

## CONCLUSIONS

Chapter One examines how and where procurement emerges in the discussion of public policy. The purchasing of goods and services by government is a critical activity, one

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<sup>63</sup> J.Papows, *Enterprise.com: Market leadership in the information age* (Reading: Perseus Books, 1998), and Stephen H. Linder and Pauline V. Rosenau, "Mapping the Terrain of the Public Private Policy Partnership", in ed. Pauline V. Rosenau, *Public-Private Policy Partnerships* (Cambridge: The MIT Press, 2000), 1-18.

<sup>64</sup> Rodney D. Stewart and Ann L. Stewart, *Managing Millions: An Inside Look at High-Tech and Government Spending* (New York: John Wiley & Sons, 1988), 7.

that crosses over numerous policy fields, regional and industrial policy, defence policy, trade policy and IT policy. Procurement policy embodies the values and objectives made explicit through guidelines, norms, laws and regulation. It is used as an instrument to accomplish policy goals and operationalized in its most important mechanism - contracting.

The literature on procurement examined here (as well as in Chapter Two), has involved research in economics, management (supply chain management), political science, and law. Two key themes of managing corruption and managing trade have been explored through a simple framework depicting the domestic political context and the intergovernmental/international context. The connection between procurement and political corruption has been examined. Procurement policy has been in many ways a response to the association of purchasing and politics with the latter viewed in a variety of forms. In the last section of the chapter the discussion turned to procurement reform efforts, and how information technology emerges as an important variable in the exploration of procurement policy. These discussions will be extended substantially in Chapters Three and Four and Five.

## **CHAPTER TWO**

### **RESEARCH FRAMEWORK AND METHODOLOGY**

#### **INTRODUCTION**

The purpose of this chapter is to define the way in which the term 'institution' is used, to describe how institutional analysis will be used in this research, and to outline three streams of neo-institutional literature and three specific constructs therein. The chapter presents the conceptual framework and describes the methodology used for the thesis. In keeping with the questions and hypotheses of this thesis, neo-institutionalism will enable the examination of change in the nature of procurement policy over three time periods. The specific constructs facilitate the analysis of the hypotheses in a conceptual way. The broad framework helps to account for the many different elements of the procurement field and provides issues for analysis where the nexus of forces impacting procurement collide.

#### **INSTITUTIONS AND INSTITUTIONAL ANALYSIS**

Institutional analysis has in the past played an important role in policy studies although it has experienced a re-invigoration in recent years - with the realization that process

models often lacked in their capacity to account for multiple environmental influences and a complex, changing context. What appears in the new approach to institutionalism is the blending of the recognition of the importance of institutions and their operating procedures with the methodologies and direct concern with theory construction that have appeared in the process-oriented approaches to public policy.<sup>65</sup> This neo-institutionalism is an approach that systematically accounts for how structures and their characteristics influence policy and decision-making in a social context.

Michael Atkinson explains that in Canada, with some notable exceptions, the connection between institutions and public policy has not been drawn very tightly.<sup>66</sup> This is quite true in the case of procurement. There is no coherent narrative explaining how the various attempts at using procurement as a tool through institutions are related over time. Political institutions have been studied for their own sake or for what they can tell us about our political character. Atkinson points out too that we study institutions to see what might be. Institutions have an important influence on our capacity to solve problems of collective action and thus we must be open to and looking for alternative institutional designs. Institutions are a means of imposing some modicum of control over how society operates; they shape us but we also shape them.<sup>67</sup>

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<sup>65</sup> B.Guy Peters, 'The Policy Process: an institutionalist perspective', *Canadian Public Administration* 1992, 35(2), 162.

<sup>66</sup> Michael Atkinson, *Governing Canada – Institutions and Public Policy* (Toronto: Harcourt Brace & Company, 1993), 21.

<sup>67</sup> Atkinson, *Governing Canada*, 21.

With respect to the notion of the institution, Lowndes's analysis of institutionalism works from a baseline definition that involves three elements. First an institution is a meso-level concept. Institutions are both created by individuals while also constraining their action. They are part of a broad social fabric but are also the medium through which decisions are made and actions taken. They impose constraints on action, but also provide opportunities. This suggests that institutions are much more than bricks and mortar - they are conglomerations of structural elements as well as groupings of people who have differing values and ideas. Second, institutions have formal and informal aspects. Rules and laws are formal elements, but there are also informal norms and customs. Informal institutions may arise from habitual action and also relate to processes - the way things are done. Third, Lowndes suggests that institutions have legitimacy, derived from stability over time. They become valued in themselves, not simply for their immediate purposes.<sup>68</sup> Institutions are conceived to be central actors, if not *the* central actors in the policy-making process.<sup>69</sup> In terms of the evolution of procurement policy, there is evident a structured pattern of interaction where institutions play the key roles. At a normative level, the appropriateness of institutions and their values in making public policy is the key concern. "Institutions not only are structures, they are the holders and propagators of social values. The values that any one institution advocates may be more or less desirable as rules of action for society, so that policy can be seen as an explicit

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<sup>68</sup> Vivien Lowndes, 'Varieties of New Institutionalism: A Critical Appraisal', *Public Administration*, Vol. 74, Summer 1996, 182.

<sup>69</sup> Peters, "The Policy Process", 176.

contest among alternative sets of institutional values.”<sup>70</sup> Institutional values and the ideas upon which they are based is a barometer in terms of how procurement policy is evolving in the face of such forces as emerging information technology and new management techniques. Lowndes’s definition of institution takes the idea beyond the notion of the institution as simply a structure. She includes the concept of the institution as ‘organization’, whereby people impact the structure by virtue of their values and approaches.

Hall and Taylor propose that institutions are “the formal or informal procedures, routines, norms and conventions embedded in the organizational structure of the polity or political economy. They can range from the rules of a constitutional order or the standard operating procedures of a bureaucracy to the conventions governing trade union behavior or bank-firm relations.”<sup>71</sup> This is a slightly different perspective on the notion of the institution, somewhat disassociating the structure itself from the behaviors of the actors within the institution. North, in a similar vein, proposes, “Institutions are the rules of the game of a society composed of the formal rules (constitutions, statute and common law, regulations) the informal constraints (norms, conventions and internally devised codes of conduct) and the enforcement characteristics of each”.<sup>72</sup> North separates the notions of

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<sup>70</sup> Peters, “The Policy Process”, 176.

<sup>71</sup> Peter A. Hall, and Rosemary C. R. Taylor, “Political Science and the Three New Institutionalisms,” *Political Studies*, 1996, XLIV: 938.

<sup>72</sup> Douglass C. North, “The Process of Economic Change”, Washington University, for the UNU World Institute for Development Economics Research (Helsinki) project on

institution and organization from one another - organizations are the firms, households, schools, and political parties vying for scarce resources. Institutions provide the incentive structure that dictate how the organizations will interact.<sup>73</sup>

Drawing on the different approaches to the idea of an institution, this thesis uses an integrative definition that enables the use of the three strands of neo-institutionalism.<sup>74</sup>

First, institutions are the central actors in the political process, the formal and informal structures through which policy is developed as well as filtered and changed. At another level of abstraction, institutions are the formal and informal rules and norms embedded in the organizational structure but evolving as the constraints in a particular context change.

The essays by Alston and Eggertson in Empirical Studies in Institutional Change (1996) emphasize that the study of institutions involves layers of analysis, and different layers often require different theoretical approaches and tools.<sup>75</sup> In order to examine the

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New Models of Public Goods Provisions and Financing in Developing Countries (St.Louis, 1997), 2.

<sup>73</sup> North, "The Process of Economic Change", *iv*.

<sup>74</sup> Scholars working in the neo-institutional tradition, are increasingly seeing the value in interchange amongst the schools of thought, emphasizing that the 'old' and 'new' institutionalisms should not be counterposed too sharply and a standardized definition of 'institution' is not desirable. See E. Immergut (1998) in Jonathon S. Davies, "Conjuncture or Disjuncture? An Institutionalist Analysis of Local Regeneration Partnerships in the UK", *International Journal of Urban and Regional Research*, Vol. 28.3, September 2004, 572.

<sup>75</sup> Lee J. Alston, Thrainn Eggertsson and Douglass C. North, eds., "Introduction" in *Empirical Studies in Institutional Change* (Cambridge: Cambridge University Press, 1996), 2.

changing nature of procurement policy over time, we filter that policy through a layered analysis built on neo-institutional constructs.

Simon Reich, using Theodore J. Lowi's work as a starting point, challenges the claim that any one form of institutionalism is most suited to developing a general theory.<sup>76</sup> Reich asserts that the character of a policy arena or domain is most influential in determining the most appropriate form of institutional analysis. Areas of policy or government activity form arenas of power, which in turn tend to develop their own characteristic political structure, political process, elites and group relations.<sup>77</sup> Lowi's three policy domains were: distributive, redistributive and regulatory policy, to which he later added 'constitutive' policy. Reich re-worked Lowi's categories, in the face of more modern pressures and called his policy domains redistribution, regulation, democratization/modernization, and liberalization.

Reich suggested that there are four major approaches to the study of institutions: historical institutionalism, new economic institutionalism, institutions as cognitive frameworks, and institutions as actors. He suggested each is best suited to analysis in one particular policy domain. The key to this suitability is the nature of politics in each

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<sup>76</sup> S. Reich, "The Four Faces of Institutionalism: Public Policy and a Pluralist Perspective", *Governance: An International Journal of Policy and Administration*, Vol. 13, No.4, 501.

<sup>77</sup> See Lowi (1971), 689-690 in Reich, "The Four Faces", 502.

approach, the underlying assumptions of the form of institutionalism itself, and the definition, purpose, and nature of institutions.

**Table 1: Institutionalism and Policy Domains**

Type of institutionalism	Policy Domain <sup>78</sup>
Historical institutionalism	Nature of the debates in re-distributive policy domain; the politics over scarce resources
New economic	Regulation – actors seeking to gain greater efficiency through cooperation; often deals with market failure or ‘collective action’ problems; leads to adoption of new structures reflecting assumptions of New Economic Institutionalism
Institutions as cognitive frameworks	Modernization – focuses on debates regarding democratization; value laden, cognitive in tone; Katzenstein – institutions as a normative context
Institutions as actors	Liberalization – institutions with greater agency i.e. International financial organizations demand states reform policies; or transnational corporations that punish

If we can relax the most extreme assumptions of each school’s theoretical position, there is common analytical ground on which the insights of one approach might be used to supplement or strengthen those of another.<sup>79</sup> They posit that both the ‘calculus’ and ‘culture’ approaches to the relationship between institutions and action observe that institutions affect action by structuring expectations about what others will do, even if they model the sources of those expectations slightly differently. Reich’s analysis

<sup>78</sup> Reich, “The Four Faces”, 511-517.

<sup>79</sup> Hall and Taylor, “Three New Institutionalisms”, 955.

suggests that the perspectives in neo-institutionalism can be matched analytically to help examine problems in particular policy areas. Hall and Taylor posit that each of the literatures reveal different and genuine dimensions of behaviour and the effects of institutions on behaviour – each providing a partial account of the forces at work in a given situation or capturing different dimensions of the institutional impact present there.<sup>80</sup>

By drawing on historical institutionalism, economics in institutionalism, and institutionalism in organizational analysis, we will use the insights that each approach provides to explain how procurement policy has evolved to its current state.

## **LOCATING PROCUREMENT IN NEO-INSTITUTIONALISM**

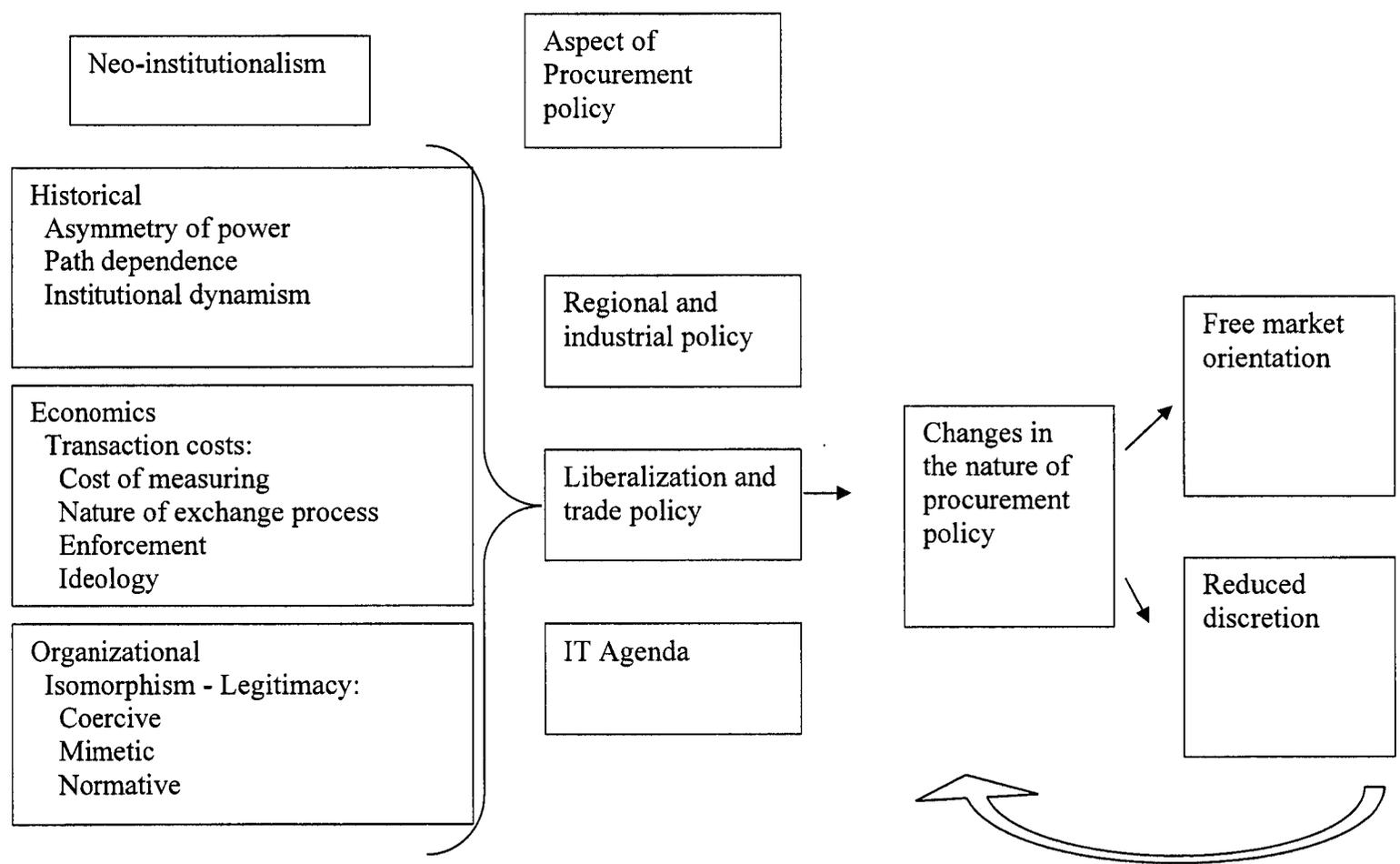
Empirically this study examines procurement over three overlapping periods.

Conceptually, this thesis is utilizing neo-institutional theory in the three empirical chapters. Neo-institutional theory helps to show how institutions, both formal and informal, structure the parameters through which change and evolution of policy occurs. The figure below is an analytical framework to provide a master conceptual basis for the theoretical aspects of this dissertation.

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<sup>80</sup> Hall and Taylor, “Three New Institutionalisms”, 955.

**Figure 6: Expanded conceptual framework**



In order to examine changes in the nature of procurement policy we look at the evolution of events and activities within three time periods and procurement policy as it appears in different forms over time. The dimensions drawn from each neo-institutional stream provide focus for the dynamics of the time period, and allow us to draw on the most important elements that point to change in procurement policy.

The next three sections of this chapter look selectively at the work located within the three new institutional streams, and from these streams specific constructs are chosen that will be used analytically to illuminate the nature of procurement policy and changes therein.

## **HISTORICAL INSTITUTIONALISM**

Historical institutionalism is most useful in helping to account for change, as well as continuity, over a long period of time. This thesis tells some of the ‘story’ of procurement policy in Canada – which is bound up in various forms of domestic policy and which is closely related to the process of nation-building.<sup>81</sup> The values underpinning

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<sup>81</sup> In general, historical institutionalists work with a definition of institutions that includes both formal organizations and informal rules and procedures that structure conduct. Sven Steinmo, Kathleen Thelen, and Frank Longstreth, eds., *Structuring Politics – Historical Institutionalism in Comparative Analysis* (Cambridge: Cambridge University Press, 1992), 2.

procurement policy were embodied in the implementation of regional and industrial policy, through distributive and re-distributive mechanisms.

Hall and Taylor suggest that the best of historical institutional analyses demonstrate some integration across the approaches, by showing how historical actors select new institutions for instrumental purposes; “much as rational choice analysis would predict, but draw them from a menu of alternatives that is made historically available through the mechanisms specified by sociological institutionalism.”<sup>82</sup> Consequently, historical institutionalism itself is an integrative mechanism that is not theoretically restrictive. This has both advantages and disadvantages – it is quite flexible and relatively easily used as a general conceptual framework for looking at policy change over long periods of time, but it is also less robust in terms of its explanatory power. For the purposes of this thesis that seeks to account for change in procurement policy over a long period of time, it is useful for the first empirical period.

Historical institutionalists tend to conceptualize the relationship between institutions and individual behavior in relatively broad terms. It represents an attempt to illuminate how political struggles are mediated by the institutional settings and organizational contexts in which they take place.<sup>83</sup> Key to the analyses of such authors as Peter Hall, Stephen

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<sup>82</sup> Hall and Taylor, “Three New Institutionalisms”, 957.

<sup>83</sup> G. John Ikenberry (1998), “Conclusion: An Institutional Approach to American Foreign Economic Policy” in Steinmo, Thelen, and Longstreth, *Structuring Politics*, 2.

Skowronek and John Ikenberry is the notion that institutional factors can shape both the objectives of political actors and the distribution of power among them in a given polity.<sup>84</sup> Historically-based analysis is important in that it tells the story of what the goals of political actors are, and why political actors are emphasizing certain goals over others (preference formation is endogenous).<sup>85</sup>

There are four distinctive features of historical institutionalists that will be drawn upon in chapter three:

- 1) They emphasize the asymmetries of power associated with the operation and development of institutions.
- 2) They tend to have a view of institutional development that emphasizes path dependence and unintended consequences.
- 3) They are especially concerned to integrate institutional analysis with the contribution that other kinds of factors, such as ideas, can make to political outcomes.<sup>86</sup>

Analyses based in historical institutionalism have been adept at examining the interaction of institutions and political processes over time. There are two aspects to this – first how institutions mediate and filter politics and second how the impact of institutions is

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<sup>84</sup> Steinmo, Thelen and Longstreth, *Structuring Politics*, 6.

<sup>85</sup> *Ibid.*, 6.

<sup>86</sup> Hall and Taylor, “Three New Institutionalisms”, 938.

mediated by the broader political context. Thelen and Steinmo's compilation of articles explore the political conditions under which particular institutions have specific consequences.<sup>87</sup>

Thelen and Steinmo identify four distinct sources of institutional dynamism – situations in which there is variability in the impact of institutions over time.

- (1) Broad changes in the socioeconomic or political context can produce a situation in which previously latent institutions suddenly become salient, with implications for political outcomes.
- (2) Changes in the socioeconomic context or political balance of power can produce a situation in which old institutions are put in the service of different ends, as new actors come into play that pursue their (new) goals through existing institutions.
- (3) Exogenous changes can produce a shift in the goals or strategies being pursued within existing institutions – that is, changes in outcomes as old actors adopt new goals within the old institutions.<sup>88</sup>
- (4) When political actors adjust their strategies to accommodate changes in the institutions themselves.

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<sup>87</sup> Steinmo, Thelen and Longstreth, *Structuring Politics*, 16.

<sup>88</sup> These first three sources describe situations in which the very same institutions can produce different outcomes over time.

Moments of dramatic change such as institutional breakdown or institutional formation may illustrate this institutional dynamism, but piecemeal change is more common, resulting from specific political battles or ongoing strategic maneuvering within institutional constraints.

Returning to the framework, historical institutionalism provides the conceptual foundation for a period that stretches from early nation building construction through the First and Second World War time periods, and the early (1950-1970) and later post war periods (1970 to present). The associated ideas are ever-present and they indicate underlying values and institutional contexts. Critical in the formulation of procurement policy has been its use as an instrument of distribution. Here it involves the provision of money or resources (i.e. grants and support to the aerospace industry) to a particular area or industry in the country for a specific purpose, such as the protection of an industry employing thousands of Canadians. The pursuit of equity through distribution results in distributive politics, in which we see both big “P” politics (partisan political behavior favoring party supporters or sympathizers through contracts for lobbying firms, PR firms or law firms known to be sympathetic to the governing party) and small “p” politics (normal non-partisan decisions where discretion is simply exercised such that some people, groups, industries, or regions win or gain favor from ministerial or government decisions and others lose or are not chosen). The institutionalization of ‘distribution’ in the economic realm resulted in various forms of ‘distributive policy’, known as Industrial

Regional Benefits policy (IRBs), offsets, regional-industrial policy and the creation of a host of institutions - various agencies and departments to administer this activity. The historical analysis of procurement policy's various forms in Chapter Three will show how the relationships of political actors and institutions were changing the nature of that procurement policy.

### **ECONOMICS AND INSTITUTIONALISM**

The particular events surrounding the implementation of trade agreements in the 1980s requires a second construct to explain how procurement policy was increasingly affected by the quest for market efficiency and the slowly constricting discretion politicians and officials came to face in government operations.

Work in the tradition of the economic approach to the analysis of institutions is characterized by three elements: a contractual perspective on organizational relationships, a focus on hierarchical command, and formal analysis via principal-agent models. The origins and basic themes of the economics in institutionalism were put in place by early dissenters from the neoclassical theory of the firm, such as Ronald Coase, Herbert Simon, and Armen Alchian.<sup>89</sup> Coase contended an understanding of economic

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<sup>89</sup> T.M. Moe, "The New Economics of Organizations", *American Journal of Political Science*, 1984, 28(3-4), 742.

activity required systematic inquiry into the institutional context in which such activity takes place.<sup>90</sup>

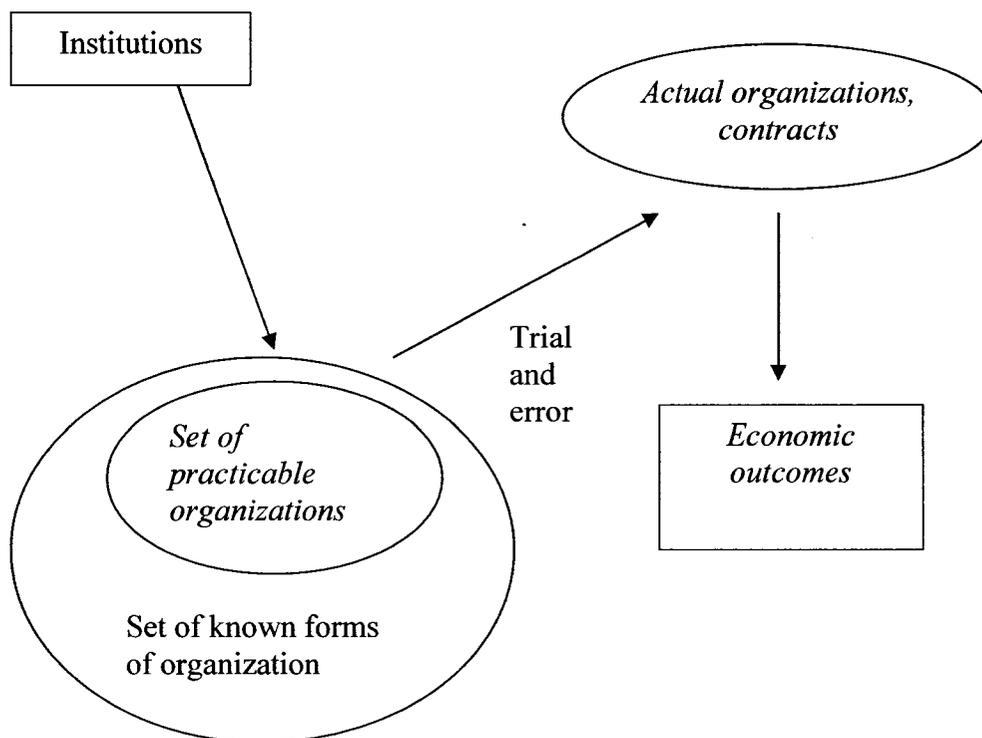
Present day 'economic institutionalism' evolved from its focus in the 1980s on the behavioural tradition to its more current concern with the contractual paradigm. From this perspective procurement is a nexus of contracts, between organizations, within organizations (such as government departments) and between and within firms. Eggertson uses broad frameworks to illustrate how research in the economics of institutions can be segmented into analytical levels depending on which variables are endogenous. His first level of analysis attempts to explain how variations in institutional arrangements affect economic outcomes or wealth; here he treats institutions, organizations, and contractual arrangements as exogenous variables. At the second analytical level, the framework attempts to explain how the institutional framework affects the structure of economic organizations and contractual arrangements. As illustrated below, the institutional framework defines and limits the set of practicable forms of economic organization available to economic actors.<sup>91</sup>

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<sup>90</sup> Moe, "The New Economics of Organizations", 742.

<sup>91</sup> T. Eggertson, "A note on the economics of institutions" in Alston, Eggertson and North, eds., *Empirical Studies in Institutional Change* (Cambridge: Cambridge University Press, 1996), Figure 2, 11.

**Figure 7: Institutions and Organizations**



Economics in institutionalism has been quite successful in finding ways to explain changes in formal rules. Decision processes and structures of political organization that produce formal rules must be understood. Positive political theory has applied and extended the rational choice model with information and transaction costs.<sup>92</sup>

Usually, economic policy involves modifying formal institutions. Eggertson explains that informal institutions are not usually available policy instruments. He points out that a

<sup>92</sup> Eggertson, "A note", in Alston, Eggertson and North, eds., *Empirical Studies*, 11.

better understanding of informal institutions (norms, conventions and informal codes of conduct) as an exogenous phenomenon is of vital importance for policy. Importantly, he notes that formal and informal institutions are complementary in creating specific economic outcomes, and the design of efficient formal rules must take into consideration the interaction between new formal rules and existing informal ones. “A better understanding of informal rules could help us understand when the introduction of particular formal rules is futile – when they do not match the system of informal rules and therefore will not be enforced... Conversely, a better understanding of the role of informal institutions could be of help in designing formal rules that take advantage of existing informal rules to rely extensively on self-enforcement, leaving only pathological cases for the formal enforcement mechanism, the policy and the courts.”<sup>93</sup>

Agency theory and transaction-cost economics (TCE) perspectives are mainly complementary, working out of substantially identical behavioural assumptions. Both inform our understanding of economic organization – and with respect to this thesis, they both have applicability.<sup>94</sup> The agency problem can be interpreted as the problem of

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<sup>93</sup> Eggertson, “A note”, in Alston, Eggertson and North, eds., *Empirical Studies*, 22. Eggertson, his footnote: “The desirability of governments adding the power to control norms and other informal institutions to their arsenal of policy instruments is a question left with the reader.”

<sup>94</sup> Oliver E. Williamson, “Corporate Finance and Corporate Governance”, *The Journal of Finance*, Volume 43, Issue 3, *Papers and Proceedings of the Forty-Seventh Annual Meeting of the American Finance Association*, Chicago, Illinois, December 28-30, 1987, 568.

preventing corruption in the context of procurement policy.<sup>95</sup> TCE regards the transaction as the basic unit of analysis. In agency theory the individual agent is the unit of analysis. This thesis looks to the nature of the transactions (and the ex post structure) to show the change in procurement policy, as opposed to the ex ante alignment in contractual focus. Agency theory is little concerned with dispute resolution (lack of concern is characteristic of all ex ante approaches to contract). Dispute avoidance and the machinery for processing disputes are central to TCE.<sup>96</sup>

Where there are positive transaction costs and limited rationality the manner of organization matters. Two distinct types of activities should be recognized, the setting up of organizations (which involves acts of collective choice) and the use of organizations by individuals (which represents matters of individual choice). The economic analysis of institutions suggests that there should be a tendency for decision makers to adopt the most efficacious institutional arrangement to deal with any problem. Furubotn and Richter posit then that we might expect the “best” institutional framework to be chosen on the constitutional or legal level and, within this given framework, to observe the operation of the “least-wasteful” type of voluntary contracts. Of course, transaction costs

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<sup>95</sup> The ‘agency problem’ is also linked to structures and processes for performance and accountability. While this thesis does not use ‘agency’ theory to analyze procurement reform, it is a topic to be investigated in another paper by the author looking at the impact of the Parliamentary Secretary’s Task Force Government-Wide Review of Procurement.

<sup>96</sup> “How are gaps to be filled, contractual errors to be corrected, and disputes to be settled when the contract drifts out of alignment? Assessing the comparative efficacy of alternative governance structures for harmonizing ex post contractual relations is the distinctive focus and contribution of TCE.” Williamson, “Corporate Finance”, 573.

make the monitoring and enforcement of all legal and contractual obligations an ever-present problem.<sup>97</sup>

Measurement of the separable dimensions of a good or service is the crux of transaction costs. Neoclassical theory implied a market characterized by instantaneous exchange of claims over a one dimensional good or service. In the theoretical model there were clearly defined inputs and outputs, and price and quantity were the determinants of decision-making. The model was very far from an approximation to reality, but it still permitted neoclassical theory to develop some powerful insights into the operation of markets. The new technology of the second economic revolution North argues changes the characteristics of both the inputs and the outputs so as to radically alter the costs of measuring the dimensions of the goods or services exchanged.<sup>98</sup>

The results of the revolution are evident in the complex contractual arrangements that govern exchange in the western world. The objective of detailing contractual specifications is to define the multiple dimensions of a good or service in exchange so as

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<sup>97</sup> E.G. Furubotn and R. Richter, *Institutions and Economic Theory - The Contribution of the New Institutional Economics* (Ann Arbor: The University of Michigan Press, 1998), 122.

<sup>98</sup> North uses the term 'economic revolution' to indicate two structural attributes in a changing economic system, a fundamental change in the productivity of a society, and an equally basic change in organization to allow for that productivity. The first economic revolution created agriculture and civilization; the second built economic growth into the system with the integration of science and technology. D.C. North, "Structure and Performance - The Task of Economic History", *Journal of Economic Literature* XVI(3), 1978, 963-978.

to minimize the waste from the dissipation of nonexclusive income of some unpriced margin and to raise the costs of opportunistic behavior (cheating, shirking) by the parties in exchange. But because contracts are themselves costly to devise and enforce, frequently the gains from complete specification would be exceeded by the cost.<sup>99</sup>

North's transaction cost construct along with the cost of specifying property rights are useful in the examination of how the institutionalization of trade agreements and associated repercussions have impacted procurement policy.<sup>100</sup> He outlines what he believes to be the four major variables involved in the cost of exchange.

The first variable is the cost of measuring – measuring the valuable attributes of the goods and services being exchanged or measuring the performance of agents. This is essential to the specification and enforcement of property rights and underlies all the costs of contracting. The nature of the exchange process is the second variable. In the absence of constraints on behaviour like personal loyalty, impersonal exchange results in

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<sup>99</sup> North, "Structure and Performance", 972.

<sup>100</sup> North defines the transaction cost as: "the costs of specifying and enforcing the contracts that underlie exchange. They include all the costs involved in capturing the gains from trade. Whether exchange occurs across markets or as part of the production process inside firms, the resources devoted to the organization and integration of the production and marketing of goods and services are a large – and growing – share of the total costs of goods and services." He further explains that: "underlying these strictly economic costs are the costs of specifying and enforcing the body of property rights (as well as the costs of attempting to alter the property rights), which are a large share of the costs of government." D.C. North, "Government and the Cost of Exchange in History", *The Journal of Economic History*, 44(No.2), 1984, 255-264.

parties taking advantage of one another if they can gain by doing so. Consequently contracts need to be as precise as possible and complex arrangements of safeguards developed to enforce compliance.<sup>101</sup>

North's third variable is enforcement. Perfect enforcement cannot exist because the costliness of measurement makes it difficult to determine whether a contract has been violated and by whom. For complex contracting (in a world of specialization and impersonal exchange) an impersonal body of law, courts, and the coercive power to enforce judgments are fundamental. These three variables determining the costs of exchange are a consequence of an environment in which individuals maximize at every margin. The neoclassical assumption does not go far enough given that social organization would be impossible if everyone were to cheat whenever profitable. The costs of measuring would be too high. Preferences or tastes matter – but they are most certainly not constant.

This is how North draws in his fourth variable, ideology. Its strength is measured by the premium people are willing to incur rather than 'free ride'. "Specialization and division of labour produce divergent perceptions of reality and hence contrasting and conflicting views of the fairness and justice of institutional arrangements. In such a world the cost of

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<sup>101</sup> North, "Government and the Cost of Exchange", 257.

contracting, *ceteris paribus*, increases because one cannot rely on common perceptions of fairness to enforce compliance of agreements.”<sup>102</sup>

The cost of contracting is a combination of the resources devoted to specifying, enforcing, and altering property rights and resources devoted to economic organization.<sup>103</sup> As North points out, the proportion of society’s resources devoted to exchange has been increasing. There are three reasons for the growth of the transaction sector. First, growing specialization and division of labor means an ever-increasing number of exchanges, each requiring specification and enforcement. Second, the cost per exchange tends to rise as impersonal exchange replaces personal exchange. Third, government’s increasing control over property rights enables groups that acquire influence over decision-making governmental bodies to raise the cost of transacting to other parties to exchange and thereby redistribute to themselves.<sup>104</sup>

Counteracting factors to the costs of transactions are relevant in terms of procurement in the context of this theory. As Williamson suggests, the innovation of organizational forms may reduce the cost of transacting (the focus of Williamson’s study of the corporation in 1981 and much of economists transaction cost literature). Second, the substitution of capital for labor may occur to reduce the opportunity for shirking, stealing,

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<sup>102</sup> North, “Government and the Cost of Exchange”, 258.

<sup>103</sup> Ibid., 262.

<sup>104</sup> Ibid., 263.

and opportunistic behavior and to reduce quality variance. Much technological change has had this objective. The role of government has not been simply a gigantic mechanism for income redistribution raising the costs of transacting. North has argued that the role of government as an impersonal third party to specify and enforce contracts has been an essential part of the story.<sup>105</sup> Finally, the role of government is fundamentally conditioned by an ideological conviction about the value of rules that does constrain the participants (however imperfectly). Ideology plays an important role in the stability and change in institutions.<sup>106</sup>

## **ORGANIZATIONAL INSTITUTIONALISM**

Historical institutionalism provides the context for procurement policy and process in Canada over the timeframe of the post-war period to approximately 1980. The economics of institutions, specifically North's transaction costs approach, helps account for the impacts of the trade agreements over the second period. The dynamics of procuring in terms of the nature of exchange are altered by the requirements of the trade agreements such as increasingly transparent competitive bidding. There is a resultant restrictive effect on contracting and on policy itself.

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<sup>105</sup> North, "Government and the Cost of Exchange", 264.

<sup>106</sup> Ibid., 264.

Different issues and contexts require an examination beyond historical and economic institutionalism. Information technology, including the Internet, is a different sort of pressure that political actors did not have to consider prior to 1990. As Chapter Five shows, IT was used prior to 1990 but it was only in the 1990s and beyond that IT came into its own as a factor and policy agenda of its own. Organizations face more than a functional challenge from IT; they face it as a political force and an agenda searching for legitimacy in a policy and institutional context. With respect to procurement, IT was embraced as a way to enhance the efficiency of purchasing mechanisms, but also as a way to raise its profile and recognition in the midst of the competition for political power and institutional legitimacy. Isomorphic processes – defined as legitimacy-seeking behaviour, result in the copying of organizational structures as a way of securing legitimacy in political life.<sup>107</sup> Legitimacy makes it easier for organizations to transact with other organizations, to attract career-minded staff, to be acknowledged as appropriate and reputable, and to fit into administrative categories that define eligibility for public and private grants and contracts.<sup>108</sup>

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<sup>107</sup> Claudio M. Radaelli, “Policy Transfer in the European Union: Institutional Isomorphism as a Source of Legitimacy”, *Governance: An International Journal of Policy and Administration*, Vol.13, No.1, January 2000, 27.

<sup>108</sup> P.J. DiMaggio and W.W. Powell, “The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organization Fields”, in eds., W.W. Powell and P.J. DiMaggio, *The New Institutionalism in Organizational Analysis* (Chicago: The University of Chicago Press, 1991), 73.

In an organizational frame, the institution is fundamentally an organized, established, procedure. These special procedures are often represented as the constituent rules of society (the “rules of the game”).<sup>109</sup> *Institution* represents a social order or pattern that has attained a certain state or property. *Institutionalization* denotes the process of such attainment. An institution may reveal a particular reproduction process. The pattern is institutionalized when a deviation from the pattern is counteracted in a regulated way by some set of rewards and sanctions.<sup>110</sup> In most cases, routine reproductive procedures support and sustain the pattern, furthering its reproduction – unless collective action blocks, or an environmental shock disrupts, the reproductive process.<sup>111</sup>

This is relevant because many procurement activities form a set of routine, reproductive processes sustaining a pattern in which individuals function in a particular way cultivating a similar mindset. One such case is demonstrated by the large bureaucratic structure that is Public Works and Government Services. Patterns have been established over time that continue to be reproduced. For example the management of contracts is done in much the same way as it was thirty years ago, despite a very different environment.

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<sup>109</sup> R.L. Jepperson, “Institutions, Institutional Effect, and Institutionalism”, in Powell and DiMaggio, *The New Institutionalism*, 143.

<sup>110</sup> Jepperson, “Institutions, Institutional Effect”, 145.

<sup>111</sup> *Ibid.*, 145.

The notion of institutionalization pertains to the way in which change in the procurement environment and change in the processes become entrenched in the ways people work and in the ways institutions function. Jepperson points to three primary carriers of institutionalization: formal organization, regimes and culture. The latter two carriers are characterized as informally organized institutionalization: regimes and culture. The first, *regimes*, refers to institutionalization in some central authority system, in explicitly codified rules and sanctions, without primary embodiment in a formal organizational apparatus (legal or constitutional system can operate as a regime in this sense, so can a profession). With regimes, expectations focus upon monitoring and sanctioning by some form of a differentiated, collective, “center”.<sup>112</sup> The procurement ‘profession’ by example has not until recently had any formal organizational status but there were certainly rules and sanctions by which officials operated.

Institutionalization can also be carried by “culture”: simply those norms, procedures, and goals without primary representation in formal organization, and without monitoring and sanctioning by some “central” authority. These rules are customary or conventional in character. Institutionalizing in culture produces expectations about the properties, orientations, and behavior of individuals, as constraining “others” in the social

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<sup>112</sup> Jepperson, “Institutions, Institutional Effect”, 150.

environment.<sup>113</sup> Many refer to a strongly institutionalized ‘culture’ of procurement reflected in the organizational relationships and contracting processes.

One of the major issues with respect to procurement and particularly salient for this thesis is the contrast of environments between the private sector (especially regarding information technology broadly defined) and the public sector. In organizational analysis terms this would be referred to as institutional environments as distinguished from technical environments.

In procurement there is a confluence of these environments: “technical sectors are those within which a product or service is exchanged in a market such that organizations are rewarded for effective and efficient control of the work process.”<sup>114</sup> By contrast, “institutional sectors are characterized by the elaboration of rules and requirements to which individual organizations must conform if they are to receive support and legitimacy from the environment”.<sup>115</sup> There is constant tension between process-driven organizations and sub-organizations (for example most parts of PWGSC, at least traditionally) and outcome-based organizations (for example service delivery organizations such as social services).

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<sup>113</sup> Jepperson, “Institutions, Institutional Effect”, 151.

<sup>114</sup> Scott and Meyer, 1983, as quoted in W. Richard Scott, “Unpacking Institutional Arguments”, in Powell and DiMaggio, *The New Institutionalism*, 167.

<sup>115</sup> Scott and Meyer, “Unpacking Institutional Arguments”, 167.

In distinguishing technological from bureaucratic cognitive styles it can be seen that technological consciousness separates means and ends. Bureaucracy suggests the non-separability of means and ends. In bureaucracy the means are typically as important, or nearly so, as the ends. It is not just a question of providing passport services, but of using the proper means. A positive moral value is assigned to the proper means and procedures, and in some cases it is assumed that even if the legitimate end is obtained by illegitimate means, the damage done by this to the bureaucratic agency far outweighs any positive benefit from the action.<sup>116</sup> DiMaggio and Powell contend that bureaucratization and other forms of organizational change occur as the result of processes that make organizations more similar without necessarily making them more efficient.

Bureaucratization and other forms of homogenization emerge out of the structuration of organizational fields.<sup>117</sup> Highly structured organizational fields provide a context in which individual efforts to deal rationally with uncertainty and constraint often lead in the aggregate, to homogeneity in structure, culture, and output.

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<sup>116</sup> Berger, Berger, and Kellner (1973) as quoted by Scott, "Unpacking Institutional Arguments", in Powell and DiMaggio *The New Institutionalism*, 168. Note that in the recent Sponsorship Scandal, it may be that the illegitimate means used in the sponsorship situation seemed to be far outweighing what the politicians and some of the officials believed to be legitimate ends.

<sup>117</sup> DiMaggio and Powell, "The Iron Cage Revisited", 65. Fields only exist to the extent that they are institutionally defined. The process of institutional definition, or "structuration", consists of four parts: an increase in the extent of interaction among organizations in the field; the emergence of sharply defined interorganizational structures of domination and patterns of coalition; an increase in the information load with which organizations in a field must contend; and the development of a mutual awareness among participants in a set of organizations that they are involved in a common enterprise.

In the long run, organizational actors making rational decisions construct around themselves an environment that constrains their ability to change further in later years.<sup>118</sup> Early adopters of organizational innovations are commonly driven by a desire to improve performance. New practices become infused with value beyond the technical requirements of the task at hand. As an innovation spreads, a threshold is reached beyond which adoption provides legitimacy rather than improves performance. Strategies that are rational for individual organizations may not be if adopted by large numbers. The fact that they are normatively sanctioned increases the likelihood of their adoption. Thus organizations may try to change constantly; but after a certain point in the structuration of an organizational field, the aggregate effect of individual change is to lessen the extent of diversity within the field. Organizations in a structured field, respond to an environment that consists of other organizations responding to their environment, which consists of organizations responding to an environment of organizations' responses.<sup>119</sup>

A concept that captures the process of homogenization in political science and public policy terms is isomorphism, here defined as legitimacy-seeking behaviour, and described in the literature as a constraining process that forces organizations and actors in

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<sup>118</sup> DiMaggio and Powell, "The Iron Cage Revisited", 65.

<sup>119</sup> Ibid., 65.

a sector to resemble other units that face the same set of environmental conditions.<sup>120</sup> In terms of procurement policy, isomorphism or legitimacy-seeking behaviour constrains how actors and organizations respond to changing circumstances. Isomorphism can result because non-optimal forms of structures or relationships are selected in response to new pressures or because organizational decision makers learn appropriate responses and adjust their behaviour accordingly. This notion of isomorphism provides a frame for thinking about how the challenge of integrating information technology into the procurement process and how the institutional framework presents constraints on the effective evolution of procurement policy.

There are three mechanisms through which institutional isomorphic change occurs, coercive isomorphism – stemming from political influence and the problem of credibility; mimetic isomorphism resulting from standard responses to uncertainty; and normative isomorphism, associated with professionalization.<sup>121</sup>

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<sup>120</sup> A reviewer of Claudio M. Radaelli's work, 'Policy Transfer in the European Union: Institutional Isomorphism as a Source of Legitimacy', *Governance: An International Journal of Policy and Administration*, Vol.13, No.1, January 2000, pp.25-43, suggested that since isomorphism refers to the relationship between two mathematical structures, political scientists should use other terms such as similarity and homogenization. Radaelli notes however that isomorphism has now gained good currency in organizational theory where it describes the mechanisms leading one unit in a population to resemble other units facing the same set of environmental conditions (DiMaggio and Power 1991; Hannan and Freeman 1977; Meyer 1983.) Radaelli, Note 4, p.40.

<sup>121</sup> DiMaggio and Powell, "The Iron Cage Revisited", 67. Note, an analytic typology not always empirically distinct.

First, *coercive* isomorphism results from both formal and informal pressures exerted on organizations by other organizations upon which they are dependent and by cultural expectations in the society within which organizations function. Pressures may be felt as force, as persuasion, or as invitations to join in collusion. The existence of a common legal environment affects many aspects of an organization's behavior and structure. Organizations faced with unmanageable interdependence seek to use the greater power of the larger social system and its government to eliminate difficulties or provide for needs. Politically constructed environments have two characteristic features: political decision makers often do not experience directly the consequences of their actions; and political decisions are applied across the board to entire classes of organizations, making decisions less adaptive and flexible.<sup>122</sup>

Secondly, *mimetic* isomorphism describes the force of uncertainty that encourages imitation.<sup>123</sup> When organizational technologies are poorly understood, when goals are ambiguous, or when the environment creates symbolic uncertainty, organizations may model themselves on other organizations.<sup>124</sup> Mimetic behaviour could be advantageous in some cases. For example when an organization faces a problem with ambiguous causes or unclear solutions. There may be little expense in copying the structure or

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<sup>122</sup> DiMaggio and Powell, "The Iron Cage Revisited", 68.

<sup>123</sup> Ibid., 69.

<sup>124</sup> March and Olsen (1976), in DiMaggio and Powell, "The Iron Cage Revisited", 69.

process of another organization or network, despite the fact that the solution may be ill suited to the context at hand.

Much homogeneity in organizational structures results from the inability to find or create variation in arrangements or relationships. There may seem to be relatively little variation to be selected from. New organizations are modeled upon old ones throughout the economy. Organizations tend to model themselves after similar organizations in their field that they perceive to be more legitimate or successful. The ubiquity of certain kinds of structural arrangements can more likely be credited to the universality of mimetic processes than to any concrete evidence that the adopted models enhance efficiency.<sup>125</sup>

The third source of isomorphism in organizations is *normative* and stems primarily from professionalization – the collective struggle of members of an occupation to define the conditions and methods of their work, the control “the production of producers”<sup>126</sup> and to establish a cognitive base and legitimation for their occupational autonomy.

Each of these aspects of isomorphism contributes to illuminating how the environment of procurement has changed, and how the nature of discretion on procurement choices is constrained by the institutional context. The isomorphic processes or legitimacy-seeking behaviours are important to help explain this institutional context – IT in government and

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<sup>125</sup> DiMaggio and Powell, “The Iron Cage Revisited”, 70.

<sup>126</sup> Larson (1977), in DiMaggio and Powell, “The Iron Cage Revisited”, 70.

procurement activities, and the cultural shift associated with IT are bound by the efforts to gain recognition and acceptance.

## **METHODOLOGY**

This study undertakes qualitative research with an approach that seeks to understand phenomena in context-specific settings – real-world settings without the manipulation of the phenomenon of interest.<sup>127</sup> The quality concept in research has the primary purpose of generating understanding. Dependability in qualitative research closely corresponds to the notion of reliability in quantitative research. Reliability in this case is primarily obtained through the examination of trustworthiness. The development of a theoretical framework is focused on providing a way to think about procurement that illuminates and elevates understanding.

The methodology is focused on four aspects of qualitative research, relevance, plausibility, confirmability, and credibility. Reliability and validity are conceptualized as trustworthiness, rigor and quality in the qualitative paradigm.<sup>128</sup> Relevance is accomplished by linking historical analysis and descriptive research about procurement that has not been done before with current-state issues and challenges in procurement

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<sup>127</sup> Nahid Golafshani, “Understanding Reliability and Validity in Qualitative Research;,” *The Qualitative Report*, Volume 8, Number 4, December 2003, 597-607, <http://www.nova.edu/ssw/QR/QR8-4/golafshani.pdf>, 15/10/04, 600.

<sup>128</sup> Golafshani, “Understanding Reliability and Validity in Qualitative Research”, 604.

policy. Procurement is an issue under study and debate as of the end of the writing of this thesis, and is under the microscope in government – both in public administration and political terms. The study is plausible in that it does not seek to irrefutably prove untested hypotheses, but suggests lines of argument that are suitably investigated and considered. The research can be confirmed by similar investigation such that sources are available and it is highly credible due to the qualifications and knowledge of the researcher, the long period of time over which the research was done, and the rigor with which the research was pursued.

The researcher has been a keen observer of events and developments with respect to procurement for many years. There is a possibility of researcher bias having some effect in this process. As a military officer for ten years early in her career, the researcher gained substantial knowledge about the procurement field and observed the process in various roles. However, this has more advantages than disadvantages because it provided the author with a sound background in a difficult field that few have both been involved with directly, and studied academically. The author has been involved with government procurement institutions in recent years as an observer only. Academically, the study breaches new ground, thus the ability of the researcher to draw together information from a variety of sources and understand that material provides credibility and dependability to the study.

The sources of information and data for this study include primary and secondary research material with respect to a long period of Canadian public policy development. It primarily focuses on the post World War Two period, referring briefly to some key aspects of procurement in the early development of the country. The aims were to make the research systematic, intelligent, important, and dependable.

Sources for this work are ranked as follows: first, policy statements, second, reports and agreements, and third interviews as useful context as approved by the Carleton University Graduate Studies Research Ethics Committee. Policy statements are key, but reports, government documents, and archival material also all provide documented work on historical events and current policy that are of significance. In some cases these sources discuss procurement directly but more often than not these sources provide a policy and historical context for events and institutions that are indirectly associated with purchasing in Canada. Because there are very few works actually exploring procurement from a public policy approach, the examination of a substantial number of sources from various fields was essential in terms of laying a foundation for the study and to aid in framing the field of procurement.

The tertiary research source consisted of 30 semi-structured interviews with key persons from the public sector and private sector. These interviews were carried out between April 2000 and June 2004, with a large percentage conducted over the winter of 2004.

The objective of this interview process was to obtain information, opinions and analysis from as many perspectives as possible regarding procurement policy and the procurement process. The individuals were chosen with the aim of gaining information and understanding about procurement broadly speaking, and then broken down into the two sections defined as procurement and trade agreements and procurement and information technology. Some interviewees were able to comment both on policy per se, and the aforementioned key areas.

All the interviews were confidential, anonymous, and not-for-direct attribution. This approach was chosen because many of those involved in this field were less willing to share openly their experiences if they knew that their name would be published along with various comments. This was discovered early in the process (thesis proposal stage) in informal discussions with practitioners and officials. Procurement has at times, been highly criticized in the media, and in many situations, officials do not want to be seen to be criticizing government policy or individuals themselves. Some interviewees told the author they did not mind attribution of their comments, but the choice has been to remain consistent and not use any attribution.

The researcher spoke with public officials from the executive to the administrative level, both past and present, politicians past and present, academics, private sector business-people and lawyers. Despite the confidentiality assured the interviewees, at times their

comments were tempered by reluctance to divulge or share information, due to the political constraints or the personal feelings of the individual. The author attempted to draw out the difficult points without pressuring the interviewee beyond their comfort level.

Interviews lasted between 45 minutes and 90 minutes, with many individuals providing much more time than that over various discussions and interactions. A few interviewees were most helpful at various junctures of this work in terms of being available for further information or verification.

All interviewees were provided with information about the author ahead of time, an abstract of the work, and a list of questions to be discussed. In some cases the interviews followed the questions closely, at other times due to the nature of the individual's particular expertise the interview was a more informal discussion of government policy and the individual's experiences. The author relied on referrals from known individuals for interviews, as well as contacts made through conferences and meetings associated with other work. Interviews used information from previous interviews to encourage participants to supply further information on particular events or themes; in many cases this raised the discussion level and allowed the interviewer to obtain deeper insights into events and evolutionary issues in procurement.

The interview questions were divided into three categories: general questions on procurement and policy; questions related to trade agreements; and questions related to information technology. In all cases a series of fairly general questions were asked, followed by more detailed questions in their area, which may have involved trade agreements exclusively, IT exclusively or some combination of both. In some cases, it was important to establish that the researcher was quite well versed in the subject matter, at which point the interview could become more nuanced and useful. In many cases, a pre-discussion of some type occurred (such as an email exchange) which allowed the actual interview to proceed in more detail thus enhancing its effectiveness.

A selection of interview questions asked in interviews is provided in Appendix 1 to the chapter.

## **CONCLUSIONS**

This chapter defined the way in which the term 'institution' is used, described how institutional analysis is used in this research, and outlined three streams of neo-institutional literature and three specific constructs therein. The chapter then presented the conceptual framework and described the methodology used for the thesis. The broad framework will help to account for the many different elements of the procurement field and provide a number of insertion points at which the nexus of forces impacting

procurement collide. The next part of the thesis begins the empirical and conceptual analysis.

## **APPENDIX 1: SELECTION OF INTERVIEW QUESTIONS**

### **Procurement – General**

What is your understanding/explanation of the federal/provincial government's procurement policy? Has there been any change in the nature of procurement policy?

What do you think have been the key problems/issues with respect to procurement in Canada in recent years?

Has the procurement process become more fair or less in recent years? (Describe what you mean by 'fair'). Has it become more transparent, or less?

### **Procurement and Trade Agreements**

What are your relationships with, and how have your relationships with the public sector evolved? Are these relationships friendly? Competitive? Conflictual? Mutually beneficial?

What are your opinions on the ongoing attempts to remove ‘discriminatory measures’ from the Agreement on Government Procurement ?

Have you had any interaction with the Canadian International Trade Tribunal? In what way and how did the process affect your business?

How does the evolution of international trade agreements affect the Canadian procurement process?

### **Procurement and Information Technology**

What are the particular problems your business (and business generally) encounters in terms of procurement?

Have you seen any change or evolution in terms of the issues you encounter?

Do you believe electronic procurement is in fact here to stay despite its slow evolution?

How far do you think e-procurement can be implemented in the federal government?

Has there been an impact on traditional procurement by e-procurement? If so, what do you believe has the impact been?

What have been the barriers to implementing e-procurement in the federal environment?

To what extent then, can/does e-procurement become an instrument of the government?

This methodology involving the use of interviews to expand and enhance primary sources provided a credible instrument with which to examine the real world of procurement policy.

## **PART TWO – EMPIRICAL AND CONCEPTUAL ANALYSIS**

## **CHAPTER THREE**

### **PROCUREMENT POLICY DEVELOPMENT – DOMESTIC POLICY AND SOCIO-ECONOMIC OBJECTIVES**

#### **INTRODUCTION**

This chapter begins the empirical analysis of Part Two. It explores the evolution of procurement policy in Canada up to 1990 with a focus on how procurement policy embodied domestic regional pressures and became articulated in regional policy and associated institutions. Through regional policy, industrial policy, and defence policy procurement was used as a tool for socio-economic objectives. The symbiosis and interdependence of these policy areas is reflected throughout the discussion. This chapter places this analysis in historical institutionalism as a way to identify the key impacts and effects on procurement policy over time. The historical institutional concepts of path dependency, power asymmetry, and institutional dynamism will be used to analytically explore the interaction of institutions and policy reflected in the nature of procurement policy and processes.

In this Chapter we examine in particular the paradigm that emerged in the form of regionalism. The traditional regions of Canada increasingly clamored for their 'fair share' of government dollars in the 1970s and 1980s. This force was endemic in the

Canadian struggle with its particular form of federalism and of political power flowing through the oscillation between political centralization and decentralization.

Finding the balance between supporting and developing industry through government spending (characterizing regional policy with the direction of grants and loans for example), and the pursuit of economic efficiency and market competition (liberalization and removal of interventions) through policy objectives involves political choice. The way in which these choices are made, and the decision about what type of instrument to use at what time, says much about a government's philosophical stance. Significant tensions arose in Canada between these competing ideas.

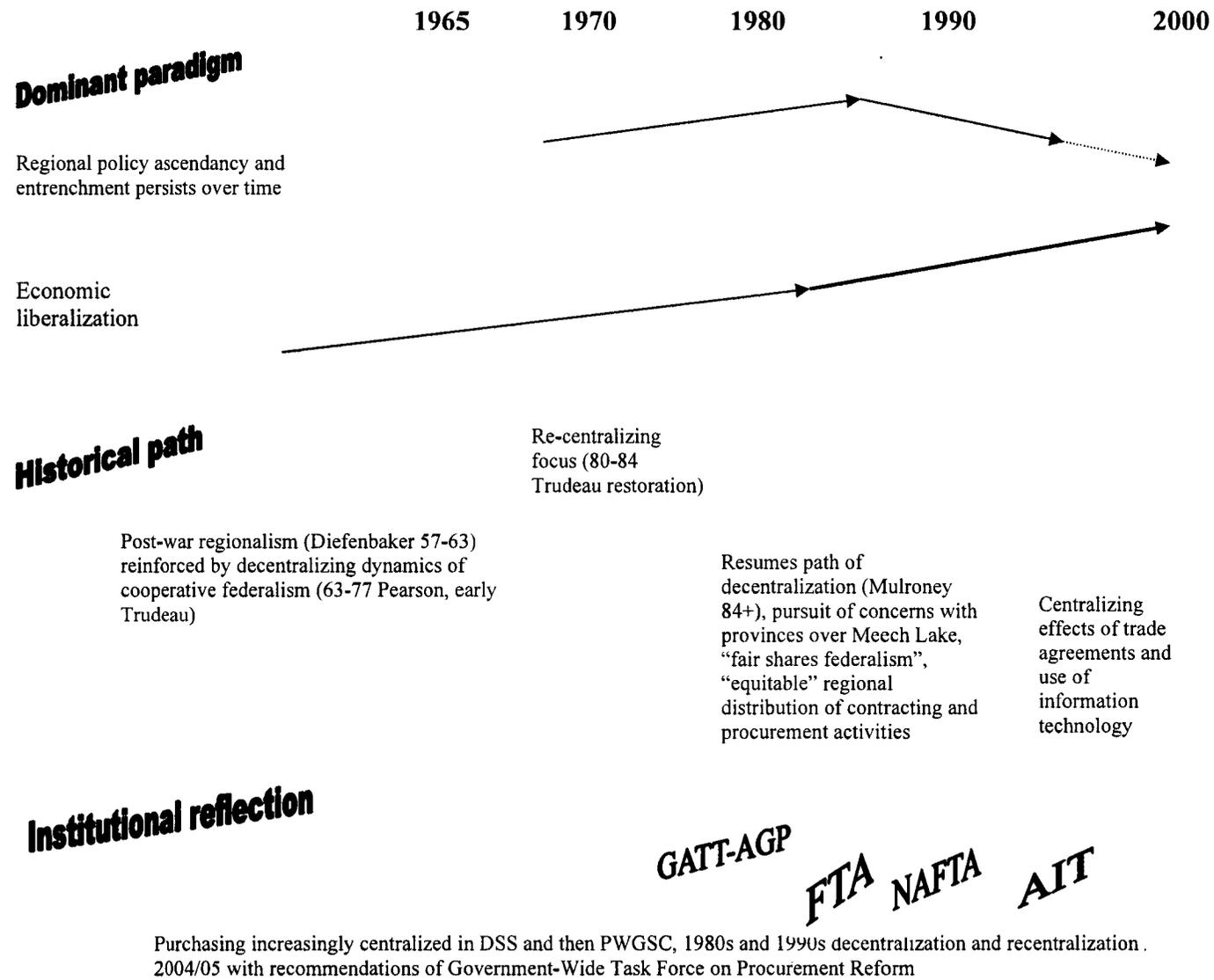
The territory of government spending through procurement was inwardly focused and politically charged in terms of regional development issues, from the early Trudeau years to the late 1980s and early 1990s, at which point the expansion of national and international trade agreements began a relative shift in domestic policy. While not all regional policy is about procurement in that it also involves grants and contributions and straight transfers of funds, purchasing goods and services mainly by contract did play a central role in the development of regionalism in Canada. Purchasing for defence was also critical with respect to how procurement policy developed in the time frame at issue in this chapter. Documents, reports, and conference proceedings from the time period demonstrate the government's efforts to come to terms with a new confluence of factors.

The procurement policy environment was highly complex and confusing. There were indications of change in the form of attempts to simplify and streamline policy but these were very incremental.

Defence, industrial, and regional policy are all traditional fields where the foundations of current policy vis-à-vis procurement have important visibility. For example, the federal government directed significant amounts of money through the instruments of grants and contributions. Through the creation of an Industrial-Regional Benefits (IRB) policy the government also tried to ensure Canadian companies would not be immobilized in the face of greater competitiveness and openness. Various incarnations of departments and organizations whose role it was to direct money to regions and industries became the institutional filters through which procurement policy was managed.

The figure below gives a visual sense of the key policy trends and institutional developments impacting procurement and explored both in this chapter and in the following two chapters.

**Figure 8: Historical and political context at a glance**



In this chapter we will focus on the rise of the regional policy paradigm and the role of procurement in this journey. The historical path highlighted by key events important in the evolution of procurement policy for this chapter is given in more detail in the chronology outlined below.

**Table 2: Chronology of Trends and Procurement Policy Development, 1867 to late 1980s**

1867 – 1960s	Purchasing on a ‘grand scale’ – nation building Railways, Great Lakes-St.Lawrence Seaway, Pipelines, Highways
1940 - 45	Organizing and purchasing for WWII Department of Munitions and Supply established
1950s, 1960s	Explosion of government activity, domestic economic and social development  Defence Production Act of 1951 establishes Department of Defence Production  Fair Wages Policy of 1954 – favoring domestic firms and labour in procurement policy, preference to Canadian manufacturers in sourcing  Defence Industry Productivity Program (DIPP), Canada United States Defence Production Sharing Agreement (DPSA) 1959  Emergence of ‘regional policy’ 1965 Shipbuilding Procurement policy in support of regional economic development
1970s	Evidence of strengthening of regional industrial policy General Development Agreements (GDAs) implemented through Department of Regional Economic Expansion (DREE)

Defence budget frozen at 1.8 Billion, percentage of federal budget spent on defence reduced from 18 % in 1967-68 to 13 % in 1971-72

Government adopts a policy providing for the designation of sole source supplier to maintain an industrial defence capability

Profit policy for negotiated contracts is amended to include an additional incentive to reduce regional disparities

Approval of the Procurement Review Mechanism to identify regional and industrial opportunities in contracts above \$2 Million

1981 Entry into force of the GATT Procurement Code opening up to international competition a portion of the government procurement needs

1983 Formal introduction of the Canadian Content Policy allowing for a 10% premium in favor of Canadian content

Spending in Defence rises to \$3 Billion by 1987

1986 Government approves an Industrial Regional Benefits Policy establishing long term IRBs as primary objectives for major procurements

Announcement of the Atlantic Canada Opportunities Program establishing a target of \$600 Million for increased federal contracting in Atlantic Canada

1987 Government decides to hold the first FPT Conference on Procurement to discuss issues related to the geographical distribution of contracts

Spending in Defence rises to \$3 Billion

1988 Ministers approved the Canadian Annual Procurement Strategy (CAPS) aimed at improving the achievement of national objectives through systematic ministerial review of Major Crown contracts

Continued institutionalization of regional policy -

- Ministers approved the participation of the Western and Atlantic regional agencies in the Procurement Review mechanisms

- Ministers approved a series of initiatives under the Access Small Business program, aimed at assisting small business through procurement
- Ministers approved an objective of \$600 Million in added procurement expenditures in Western Canada
- Ministers approved a “best effort commitment” to set-aside Major Crown projects for Western Canada
- Ministers approved the Atlantic Canada Supplier Development Program to increase the number of competitive suppliers in Atlantic Canada
- Ministers directed the development of plans involving the enhancement and integration of technology and R&D in procurement
- Ministers announced a special procurement initiative to assist Northern Ontario suppliers
- Federal and Provincial Trade Ministers approved an intergovernmental agreement on the reduction of procurement trade barriers in Canada
- Ministers announced the development of a new procurement initiative to encourage the purchasing of products classified and labeled as environmentally friendly

1989

Further FPT conferences on Procurement

## **POLICY USES OF PROCUREMENT - THE PURSUIT OF SOCIO-ECONOMIC OBJECTIVES**

Procurement in the public sector has two connected objectives which often conflict with one another – to obtain goods and services for government getting the best value for the least money and secondly to use the purchasing power to achieve wider policy objectives.

Both objectives leave wide room for interpretation.

While it is generally known that government uses its purchasing power to support various objectives, the policies themselves are not very well understood. There seems to be genuine surprise from Canadian taxpayers and even from politicians and officials within the system (feigned or not), when a questionable contract (at least in terms of value-for-money) is made public.

Contracting with the private sector is one of the most important, if conflict-ridden foundations of procurement policy throughout Canada's history. Choices made for political reasons seem to override choices that would be made in line with good purchasing practices. For all kinds of reasons to be discussed throughout this work, one could say that the Canadian government is willing to make a substantial sacrifice in terms of tax funds by not generally procuring its material needs from the lowest-price sources.<sup>129</sup>

The building of the nation involved procurement on a grand scale. Construction of major transportation systems involved varied forms of purchasing, often private ventures benefiting from favourable government regulations. The railways, pipelines, and the St. Lawrence Seaway are three examples among a host of others that demonstrate how purchasing in order to create transportation links played a critical role in the political

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<sup>129</sup> Stegeman and Acheson, "Canadian Government Purchasing Policy", 465-466.

union of a country of such vast geography as Canada.<sup>130</sup> The relationship of the government to the private sector and to American interests emerges as a key characteristic, central throughout the history of purchasing in Canada.

Buying goods and services generally and construction on a major scale was not formal 'policy' *per se* in the early years of the building of Canada as a nation, but purchasing was certainly used explicitly as an incentive to bring provinces into the union. For example British Columbia agreed to become a part of the Dominion of Canada based on the agreement that the Government would build and extend the Canadian Pacific Railway to its borders. There was substantial concern that this enterprise would over-burden the government and result in a tax increase for citizens. The only way the Government could secure an agreement was to promise that private business would build the railway, although of course this would be possible by the use of Government land grants and subsidies.<sup>131</sup> The disparity between political union and the economic development

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<sup>130</sup> The government subsidized or contracted for the building of three national transcontinental railways between 1871 and 1913. In fact, the construction of the CPR and the National Transcontinental/Grand Trunk systems involved unique arrangements in that the government built part of each line directly, and provided concessionary financing terms and regulatory support to private firms that would ultimately take ownership of the line. Such arrangements in today's terms would be called Public-Private Partnerships.

<sup>131</sup> "The House of Commons was by no means unanimous in the support of the terms of union. Despite the constant and well-directed assurance of the Government that "it was not the intention of the Government to construct the road, but it would be undertaken by companies to be assisted mainly by land grants. (Hear, hear.) It was not the intention of the Government to burden the exchequer much to obtain this railway." (Hear, hear.) Speech of the Hon. Sir Geo. E. Cartier, House of Commons Debates, 1871, vol.II, p.662),

necessary for fulfillment of its essential terms was immediately reflected in the controversial character of the debates, leading to acceptance of the terms by the Canadian Parliament, which insisted upon safeguards against excessive taxation.

The building of the railways also demonstrated a growing interdependence with the United States, which would be a continuing characteristic of purchasing related policy in the years to come.<sup>132</sup> Canadian industrial (and defence and regional policy) would often be inextricably connected to American interests, naturally due to geography but also due to the economic dependencies of a smaller population on a larger one. In light of the

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an amendment “that the further consideration of the question be postponed for the present session of Parliament”....

To make its position even more secure in the House of Commons, the Government adopted a resolution specifically stating, “That the railway should be constructed and worked by private enterprise and not by the Dominion Government; and that the public aid to be given to secure the undertaking should consist of such liberal grants of land and such subsidy in money or other aid not increasing the present rate of taxation, as the Parliament of Canada shall hereafter determine” (Journals of the House of Commons, Canada, 1871, p.266) This attitude was apparently understood to some extent by British Columbia. “Ten years was not put into the terms of union as an absolute limit but simply as a bona fides that the Government would commence the road and carry it on to completion as quickly as could be without injury to the interests of the country” (speech of Mr. Carrall, one of the delegates from British Columbia appointed to arrange the terms of union. Senate Debates, 1876, p. 153).” Harold A. Innis, *A History of the Canadian Pacific Railway* (London: P.S. King & Son Ltd., 1923), 75-77.

<sup>132</sup> “Additional evidence of disparity was found in the energetic and successful efforts of the Government to secure an imperially guaranteed loan, and in the appearance of a clause permitting the possibility of private enterprise sharing in the coveted traffic of the western states, and consequently ensuring the attractiveness and success of the policy. The policy in the face of a task which involved the construction of a railroad through barriers, the magnitude of which was only beginning to be known, to unite the sparsely settled districts of British Columbia and Red River to Canada, necessitated dependence upon American traffic and American interests.” Innis, *A History*, 75-77.

growing economic dependencies, the thrust of Canadian industrial policies between the late 1870s and early 1930s was to reduce this dependence on the larger market by fostering domestic markets within Canada.<sup>133</sup>

Negotiations with the Americans with respect to the development of the Great Lakes-St. Lawrence waterway took place between 1871 (Canada granted free navigation of the St. Lawrence to the United States) and 1954 when construction was finally begun. The interdependence with the United States resulting from a joint waterway, the major shared resource of the continent, was critical to opening up Canada to a larger international market.<sup>134</sup> This was an important venture in the history of the relationship between the two countries because of the value of the resource and the size of the financial outlay required.<sup>135</sup> An indigenous steel and pipe-making industry emerged with regionally-based companies such as the Interprovincial Steel Corporation (IPSCO Inc.) integrating with, and serving as, a regional supply base for the West's burgeoning pipeline sector.<sup>136</sup>

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<sup>133</sup> There was a lack of willingness on the part of the Americans to negotiate the general liberalization of trade barriers in the early part of the century (notably 1911). The policy to reduce dependence on the U.S. actually resulted in *increased* dependence due to the need for U.S. investment capital for the development of Canadian industries.

<sup>134</sup> Industry Canada Collections, [http://collections.ic.gc.ca/stlauren/hist/hi\\_international.htm](http://collections.ic.gc.ca/stlauren/hist/hi_international.htm), 01/07/05.

<sup>135</sup> Jennifer Sussman, *The St. Lawrence Seaway - Canada-U.S. Prospects*, A series sponsored by C.D. Howe Research Institute (Canada) and the National Planning Association (U.S.A), (November 1978), 1.

<sup>136</sup> In the 1950s, IPSCO was a small regional upstart that was created as a mixed public-private enterprise. It proved to be extremely successful becoming a top-tier profitable North American mini-mill. Peter Clancy, *Micro-Politics & Canadian Business: Paper, Steel, and the Airlines* (Peterborough: Broadview Press, 2004), 162-168.

Indigenous industry and the building of major transportation networks involved important purchasing partnerships, both geographically and inter-governmentally. For example, the Trans-Canada pipeline was one of the most controversial construction projects of modern times in Canada, but demonstrated the important role of government in setting the conditions for economic development as well in financing the economic development itself. Increasing interdependence with the United States during the 1950s and 1960s would challenge growing Canadian economic nationalism.<sup>137</sup>

In Canada transportation has been used as a direct instrument of national economic policy. Transportation incentives to reduce economic disparities between regions and to provide a framework for communication were part of the basic agreements under which the British North America colonies agreed to Confederation. There was little concern for efficiency and value-for-money. There were few suppliers and few to no rules about how to buy for government. Those given the responsibility for procuring were given the leeway to get what they needed. With multiple policy tools including engaging private business to build some systems while government built others directly, government was undertaking to build transportation links across vast expanses of territory in the name of the broader policy of nation building.

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<sup>137</sup> William Kilbourn, *Pipeline – TransCanada and the Great Debate, A History of Business and Politics* (Toronto: Clarke, Irwin & Company Limited, 1970), 188.

### **Growing Scope and Complexity**

What began to change in the 1950s, accelerating in the 1960s and 1970s, was the level of government activity – it had exploded. Battles over expenditure dollars became increasingly political and when combined with persistent deficit financing, there was a massive increase in the political temptation to spend vast sums of public money. Of course this temptation had always been central to the Canadian political experience.<sup>138</sup>

Simpson points out that all that changed in the modern era was the scale and scope of government spending, but the change represented a quantum leap from what had gone on before. Although programs carried the prerequisite regulations and bureaucratic norms, by either adjusting these norms or simply overriding them with an act of political discretion, politicians could try to turn these programs to their political advantage. Parties in power differed little in this aspect.<sup>139</sup>

Politically advantageous state intervention became the rule, not the exception.

Purchasing policy, industrial subsidies and grants, government financial services were referred to as ‘contemporary policy arsenal’ and ‘discretionary policy weapons’.

Governments were increasingly relying on these instruments, reflecting various political and economic trends. Tupper refers to the:

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<sup>138</sup> J. Simpson, *Spoils of Power - The Politics of Patronage* (Toronto: Harper & Collins, 1988), 374.

<sup>139</sup> Simpson, *The Politics of Patronage*, 374.

- (a) Lesser role played by tariffs in post-war years and related rise of non-tariff barriers, including various forms of industrial assistance;
- (b) Emergence and increasing importance of such policy goals as balanced regional economic development, the maintenance of employment in particular firms and industries, and the preservation and extension of national ownership and control in important economic sector.
- (c) The apparent necessity for governments to extend (non-tariff) protection to domestic firms comparable to that offered by other states.<sup>140</sup>

Abraham Rotstein, in his introduction to Forced Growth, said that governments must assume full responsibility for strategies of regional development, given that the private sector conscience was different than that of governments and that “normal commercial ventures imply a quite different economic setting and different rules of the game from development ventures sponsored by the government.” Thus, most policy prescriptions of this period stipulate that the government “must” or “should” do so-and-so. A legitimate criticism of government is the propensity to change direction before any single policy prescription has had a chance to work.<sup>141</sup>

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<sup>140</sup> A. Tupper, *Public Money in the Private Sector - Industrial Assistance Policy and Canadian Federalism* (Kingston: The Institute of Intergovernmental Relations, Queen's University, 1982), 2.

<sup>141</sup> R.H. McGee, *Getting it Right - Regional Development in Canada* (Montreal and Kingston: McGill-Queen's University Press, 1992), 6.

The effort towards regional balance did not play a major part in national economic policy until after the Second World War. Although the Rowell-Sirois Commission recommended a strengthening of the federal government's economic powers and a series of national grants to the poorer provinces (so that they could offer public services broadly equivalent to those in the richer provinces), it was only in 1957 the federal government set up the fiscal equalization program. This program was intended to reduce disparities between regions, to achieve a national standard in public services, and at the same time to equalize provincial-government revenues.<sup>142</sup> Increasingly the goal seemed less to grow the national pie, but to divide it through a decentralized framework oriented to the circumstances of the regions. The regionalization of federal procurement policies was analogous to the notion of equalization; there was a growing dedication by the provinces to see federal procurement of goods and services evenly distributed between the regions.<sup>143</sup>

The confusion over the role of purchasing policy is evident in Tupper's findings as he described the procurement environment and the growing importance of purchasing with regional or other industrial objectives:

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<sup>142</sup> B. Higgins and D. J. Savoie, *Regional development theories & their application* (New Brunswick, New Jersey: Transaction Publishers, 1995), 276-277.

<sup>143</sup> D.J. Savoie, *Regional Economic Development: Canada's search for solutions* (Toronto: University of Toronto Press, 1992), 161.

- 1) Canada has no statutory equivalent to the “Buy America Act”, but the federal government has eschewed least-cost purchasing and substituted instead a complex protectionist policy. As well as granting Canadian suppliers an outright premium of 10 percent, Ottawa has also devised a host of administrative procedures that favor Canadian suppliers.
- 2) It remains unclear to most observers, and perhaps even to policy makers, precisely which economic and political objectives are being pursued. DSS says for example, that purchasing policy is used to promote a “healthy economic climate” in Canada, while analysts conclude that purchasing policy is indeed multi-purpose, being employed for such diverse ends as the sustenance of a defence production industry, the protection of Canadian firms from import competition, and the encouragement of Canadian-based, high technology industries.
- 3) Finally the administration of federal purchasing policy features considerable government discretion. While elaborate administrative procedures do exist, most commentators point to their flexibility and the resulting scope for tailoring procurement policy to the needs of particular firms and industries. Such extensive discretion perhaps accounts for the problem of discerning clear policy patterns and the high degree of political conflict involved.<sup>144</sup>

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<sup>144</sup> Tupper, *Public Money*, 21.

With this confusion came an inability to assess the costs of these policies and purchasing decisions. Pursuing numerous objectives through purchasing makes it difficult to undertake an independent evaluation of public procurement decisions, namely their efficiency.<sup>145</sup> The task of quantifying the impact of procurement used to support government objectives is a difficult if not impossible one, there have been no studies or reports effectively doing so.

Secondary objectives of procurement are sometimes embodied in legislation, but generally these policies are drawn up within the administration without any legislative base. Within the federal and Ontario governments individual policies have normally, although not invariably, been endorsed at Cabinet level.<sup>146</sup>

Successive governments recognized the problematic nature of the objectives of procurement and various attempts were made to reconcile them and create frameworks for managing the complexity. In a discussion paper entitled "Rationalization of the Impact of National Objectives on Procurement" dated September 26<sup>th</sup>, 1989, a major review of the socio-economic objectives associated with procurement was undertaken. Acting Director General of the Supply Program Management Directorate, B. Lipsett describes the situation in a cover letter:

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<sup>145</sup> Arrowsmith and Hartley, *Public Procurement*, 7.

<sup>146</sup> S. Arrowsmith, *Government Procurement and Judicial Review* (Toronto: Carswell, 1988), 82.

“... there is an array of initiatives arising from national objectives that SSC must take into account in day-to-day procurement – accumulated over time through a number of decisions, usually made by Cabinet on various national objectives. As a result, procurement is a complex maze with no road map. There has been no overall review of national objectives and how they impact procurement done since 1979.”<sup>147</sup>

This study reviewed 250 Cabinet decisions for which the achievement of national objectives through procurement was a key consideration. Twenty-seven individual initiatives were derived, organized under six broad categories: industrial development, regional development, international competition, social programs, science and technology, and national security. The objectives of this study were to identify how best to integrate or rationalize national objectives in the procurement process and how to make them more visible to suppliers, procurement staff and the public. The national objectives were reviewed against the CAPS procurement policy framework approved by Cabinet in June 1988.<sup>148</sup>

The rationalized procurement process documents show a somewhat reduced list of considerations to be made in the Program Planning/Requirements Definition. While evidence of the paring down of the number of objectives in the policy framework is

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<sup>147</sup> Public Archives of Canada, Hon Paul Dick fonds, R-3391, Volume 58, File 2, with permission from Paul Dick. Letter, B. Lipsett, Acting Director General of the Supply Program Management Directorate.

<sup>148</sup> Letter from Acting Director General of the Supply Program Management Directorate, B. Lipsett, September 26, 1989. Public Archives of Canada, Hon Paul Dick fonds, R-3391, Volume 58, File 2, with permission from Paul Dick.

apparent, new priorities emerged that had to be reflected in procurement policy at various levels.

While this chapter focuses on overall developments up to the late 1980s it is important to note the increasing importance of the Aboriginal agenda. It saw a consequent coupling of the improvement of the socio-economic status of Aboriginals with the use of procurement as an instrument to promote this objective. In April 1996, the federal government launched the Procurement Strategy for Aboriginal Business (PSAB) to increase the number of Aboriginal suppliers bidding for and winning federal contracts. All departments that come under the Financial Administration Act must implement the procurement strategy within their departments as part of their regular contracting process. Substantial conflict exists over the fairness of the program (and indeed over what constitutes success), especially since the program is essentially excluded from the trade agreements.<sup>149</sup>

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<sup>149</sup> T. Osborne, "Aboriginal Procurement Strategy - Working, and here to stay", *Summit: Canada's Magazine on Public Sector Purchasing*, Vol. 6, No. 5 (Ottawa: Summit: The Business of Public Sector Procurement Inc., 2003), November: 12; and Department of Indian Affairs and Northern Development Corporate Services, *Evaluation of the Procurement Strategy for Aboriginal Business*, Project 00/06, August 2002, Prepared by Departmental Audit and Evaluation Branch with the Collaboration of Prairie Research Associates (PRA) Inc.

Protecting the environment through ‘green’ procurement has also emerged as policy objective in procurement, even to the point of including ‘environmental friendliness’ as an important evaluated element upon which bids are assessed.<sup>150</sup>

Pursuing industrial development through procurement is more currently reflected in the call for its use as an instrument of innovation and technological development. As early as 1984 a new association with the more modern notion of technology appeared in the Wright Report on programs for technology development. It pronounced that procurement is one of the most effective means by which government can promote technology development.<sup>151</sup> In the European Union, there is a well-supported effort to enhance the use of public technology procurement as an instrument of innovation policy, although in harmonization efforts the EU regime has rejected in principle the instrumental use of

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<sup>150</sup> Green procurement is the procurement of products and services that have a lesser or reduced effect on human health and the environment when compared with competing products or services that serve the same purpose. In *A Guide to Green Government*, procurement is included the sustainable development agenda – increasingly viewed as an essential goal of public policy. The report points out that, as a ‘best practice’, the government should procure “consistent with Canada’s international trade obligations, purchase products and services that meet environmental specifications wherever these are available, and consider life-cycle costs. In some cases, this could involve a small price differential.” Minister of Supply and Services 1995, p. 31. Studies such as this became the building blocks for new policy, which evolved into strong policy statements. For example, more recent policy emphasizes “that where available and cost effective, green products and services, including construction, that are of equal or better performance and quality, will be purchased.” Treasury Board Advisory Committee on Contracts, Working Group on Green Procurement, Proposed Green Procurement Policy, January 2003. <http://www.pwgsc.ca/sd-env/sds2003/green-procurement-e.html>, 22/01/04. See also Green Procurement Reporting Framework, [http://www.tbs-sct.gc.ca/cmp/green-vert/grnproc\\_e.asp](http://www.tbs-sct.gc.ca/cmp/green-vert/grnproc_e.asp), 7/01/05.

<sup>151</sup> Canada, Task Force on Federal Policies and programs for Technology Development, Chairman D. Wright, Report (1984) in Arrowsmith, *Government Procurement*, 83.

public procurement. The limitation or suspension of competition, in practice remains characteristic of many sectors in the EU.<sup>152</sup>

The Canadian Advanced Technology Association (CATA) released a consultation paper in February of 2003, *Government On-Line (GOL): By, For and About Canadian Innovation*. CATA calls on the federal government to commit itself to innovation in IT, based on its dominant position as the largest consumer of goods and services in the country. The paper calls on Ottawa to become a model user, a first customer, and to create a procurement system that is fast and fair and forward looking. CATA President John Reid encouraged the government to make GOL an agent for prompting, pioneering and presenting Canadian innovation. The group wants the process to make government buying a real catalyst for innovation in Canada and a critical sale that can turn a bright idea into a hot commodity.<sup>153</sup> While generally supportive of these ideas, the government is not keen on overtly framing its technological agenda in terms of the use of government buying to stimulate IT innovation (see Chapter Five).

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<sup>152</sup> Charles Edquist, Leif Hommen and Lena Tsipouri, eds., *Public Technology Procurement and Innovation*, (Boston: Kluwer Academic Publishers, 2000), 8-9.

<sup>153</sup> R. Bray, "IT Procurement still under fire", *Summit: Canada's Magazine on Public Sector Purchasing*, Vol. 6, No. 3, (Ottawa: Summit: The Business of Public Sector Procurement Inc., 2003), June, 6.

## THE CONTEXT OF REGIONAL-INDUSTRIAL POLICY IN CANADA

Canada is one of the most highly regionalized economies amongst the United Nations 'industrialized market economies'. Working from the theory that uniform macroeconomic policies may not ensure the prosperity of each area given that the operation of the free market bears varying results regionally, governments in Canada have adopted an interventionist approach to manipulating economic outcomes. Over time, national economic policies have been regionalized to some extent with regional variations in unemployment insurance, freight rates, and revenue sharing. The balancing of regional economies is a consistent struggle for governments especially since it is a field of government expenditure where vast sums of public money are committed but little is really known about the success of the policy.<sup>154</sup>

Regional policy and industrial policy are interdependent and overlap. The terms are often even used interchangeably.<sup>155</sup> The connection of regional policy to procurement is both direct and indirect. Regional policy can refer to policies and programs overtly designated as such – where a given spatial region (sub-national, sub-provincial, city or rural area) is accorded special incentives by the state in order to reduce economic disparities or

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<sup>154</sup> Savoie, *Regional Economic Development*, 3-4.

<sup>155</sup> "Distributive equity" in the context of regional/industrial policy is a parallel and complementary factor in the domestic politics of procurement. The regional policy paradigm involves the idea of a changing concept of equity - a more individualized or firm-level concept of equity symbolized by the political firestorm over the CF-18 contract discussed in Chapter One (FN 34) and influenced by the rising liberalization agenda.

inequalities.<sup>156</sup> In this case procurement may be one part of a framework of incentives.<sup>157</sup>

Alternatively, regional economic development policy may be viewed more generally, whereby nations can simply favor internal spatial areas through an array of policies whose effect is favorable to a given area but the intent of which is not regional *per se*. In international trade terms, regional policy became bound up in debates about subsidies.<sup>158</sup>

No single economic theory explains regional disparities and there is no consensus on the right theoretical approach. From growth-pole theory<sup>159</sup> (which has evolved and taken on new implications as ‘cluster theory’), to Harold Innis’s staples theory to the development approach<sup>160</sup> to trade theory<sup>161</sup>, various attempts have been made to understand and explain why regional disparities occur and how they are to be managed.

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<sup>156</sup> Doern and MacDonald, *Free Trade Federalism*, 84.

<sup>157</sup> *Ibid.*, 84.

<sup>158</sup> *Ibid.*, 84.

<sup>159</sup> French economist Francois Perroux argued that economic activity tends to concentrate around certain focus points. Growth reveals itself in certain points or poles, with different degrees of intensity and spreads through diverse channels. By strengthening focal points in slow-growth regions a process of self-sustaining economic growth may emerge. Strengthening may include incentives of various forms to businesses or groups of people for example. In Savoie, *Regional Economic Development*, 6.

<sup>160</sup> The development approach posits that the market causes regional disparities and that government intervention is essential. Economic failure breeds other failures and a region cannot attract new economic activities unless it can break this cycle. Governments should intervene by supporting demand through transfer payments and fiscal equalization.

The linkage in the Canadian political economy to industrial policy further complicates this analysis. The federal government's continuing need for ships, railroad rolling stock, and specialized defence materials provides it with an important capacity for nourishing particular firms and industries.<sup>162</sup> The procurement of weapon systems blurs the parameters of economic, political, and strategic concerns. Governments use their buying power to determine the size, structure and performance of national defence industries.<sup>163</sup> It may do so less in Canada as compared to the United States or the United Kingdom, but defence purchasing remains a conflict-ridden field of policy even in this country.

Debates have ebbed and flowed with regards to the effectiveness of state purchasing power as an instrument for promoting industrial development. There is a rather forceful economic argument that activist purchasing policies exert an unhealthy economic influence. Indeed free traders have long loathed protectionist procurement practices and insidious perversions of international trading accords.<sup>164</sup> Traditionally, defence procurement has been excluded from international trade agreements, both because of its economic importance and sensitivity and because of the difficulty of accommodating national security concerns in such agreements.<sup>165</sup>

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<sup>161</sup> Trade theory has been adopted to explain the movement between regions within the same nation – a region will maximize its economic potential by concentrating its efforts on its economic strengths.

<sup>162</sup> Tupper, *Public Money*, 21.

<sup>163</sup> Arrowsmith and Hartley, *Public Procurement*, 13.

<sup>164</sup> Tupper, *Public Money*, 19.

<sup>165</sup> Arrowsmith and Hartley, *Public Procurement*, 12.

Industrial, Science and Defence Associations have always been in the forefront of arguing for interventionist government purchasing. Organizations such as the Science Council of Canada argued that an interventionist government purchasing code is vital to the development of indigenous, high technology industries. John Shepherd, the vice-chairman of the Council in 1979, argued that major aircraft procurements, both for the Canadian Armed Forces and Air Canada, must be used to bolster the Canadian aerospace industry. Speaking in 1979, Shepherd said, "In these times of economic uncertainty, procurements of such magnitude must serve our long term technological interest. If they do not, they must be deferred until that condition is met."<sup>166</sup>

On the one hand, it is reasoned that Canada's industrial structure is distorted in the name of regional development. People from economically disadvantaged regions argue that national economic policies are largely responsible for the economic underdevelopment of their respective regions and much more must be done.<sup>167</sup> On the other hand, direct interventions by the federal government in regional development consistently have been anathema to those interested in a highly decentralized structure. Regional development discussions have in more recent years appeared in the context of federal provincial relations – as most regional programs are devised as some sort of cooperative endeavor between levels of government. Effective horizontal and integrated policy making

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<sup>166</sup> Tupper, *Public Money*, 20.

<sup>167</sup> Savoie, *Regional Economic Development*, 4.

however, is as yet quite elusive for the federal government. Considering the political conflict involved, for example, striking an appropriate regional balance in economic development has been seen as a key ingredient to the national unity agenda – there is no doubt that it requires an extremely skilled leader to navigate the issue. This has been enormously problematic for prime ministers as using the purchasing system for wide objectives inevitably results in choices made for reasons other than good value.

### **INSTITUTIONALIZATION OF REGIONAL POLICY**

The story of regional policy as a formal element in federal economic policies really begins in the 1960s. Post-war economic development and Canadian industry was largely shaped by a strong central government, expansionist policies, resource development and large federally funded infrastructure projects such as the Trans-Canada highway, telecommunications and airport construction. This type of procurement became central to regional policy.<sup>168</sup> Many efforts in the form of stimulating development were directed towards lessening the impact of the 1956 recession, but there was as yet no evidence of a multi-dimensional approach to regional development.<sup>169</sup> Various attempts to deal with regional disparity emerged in the 1960s and slowly the belief grew that a consistent horizontal focus (area perspective) on the problem needed to be created.<sup>170</sup>

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<sup>168</sup> Procurement certainly became a central tenet of regional policy, whilst grants, contributions and transfers of funds were also elements of this type of policy.

<sup>169</sup> McGee, *Getting it Right*, xxiv.

<sup>170</sup> *Ibid.*, xxv.

For example, the 1960 budget permitted firms to obtain double the normal rate of capital-cost allowances on most of the assets they acquired to produce new products – if they located in designated regions (with high unemployment and slow economic growth).<sup>171</sup>

There were a series of development initiatives put in place through enactment in legislation and institutionalized in a Board or Agency; such as the Agriculture Rehabilitation and Development Act (ARDA) (1961), the Fund for Rural Economic Development (FRED) (1966), and the Atlantic Development Board (1962). Measures such as the Area Development Incentives Act (ADIA) and the Area Development Agency (ADA) were designed to encourage the private sector to stimulate growth in economically depressed regions.

Federal regional development policy based on creating economic opportunity started to take shape in the late years of the decade.<sup>172</sup> The establishment of a new department with specific responsibilities for regional development, the Department of Regional Economic Expansion (DREE) in 1969 was a major step in the evolution of Canadian policies of regional development and its associated institutions.<sup>173</sup>

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<sup>171</sup> Higgins and Savoie, *Regional Development*, 278.

<sup>172</sup> McGee, *Getting it Right*, xxv.

<sup>173</sup> Higgins and Savoie, *Regional Development*, 279.

The Trudeau government placed a much stronger emphasis on regional development policy, linking it to the threat to national unity. Trudeau suggested the problem of regional development was as threatening to national unity as the language issue and English-French relations. He saw the two as interwoven: regions that were predominantly francophone were also economically underdeveloped.<sup>174</sup> High unemployment in rural Quebec and Atlantic Canada meant that regional development was important as both an economic and political issue. Most seats in Atlantic Canada went to the Conservatives in the 1968 election making regional development a tool to with which to gain support.

Underlying DREE's establishment was the need to bring a variety of programs, policies, and institutions under the direction of one Ministry rather than several, the hope being to thereby enable a more coordinated approach to regional problems. A measure of decentralization was created with officials posted to various regions to permit a greater degree of flexibility in operation and awareness of the specific problems confronting such regions.<sup>175</sup>

The growth-pole concept was fully espoused. Also evident at this point is a specific link between the modern notion of regional policy and that of industrial policy through a

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<sup>174</sup> Higgins and Savoie, *Regional Development*, 279.

<sup>175</sup> N.H. Lithwick, *Regional Economic Policy: The Canadian Experience* (Toronto: McGraw-Hill Ryerson Limited, 1978), 279.

program for “regional industrial incentives” and another for “special areas”. Through grants and loan guarantees to companies the idea was to encourage manufacturing and processing industries in selected communities within slow-growth regions having growth potential.<sup>176</sup> By 1972 DREE had not successfully reduced regional disparities in any evident way. In the election that year the Liberals lost heavily in western Canada so Trudeau proceeded to remove the focus of DREE from eastern Canada.

Unhappiness on the part of the provincial governments with the way in which federal-provincial relations were undertaken by the federal government (a “take-it-or-leave-it” approach in the area of regional development) led to the decentralization of DREE and the rise of the General Development Agreements (GDAs) throughout the 1970’s.<sup>177</sup> Popular with provincial governments due their flexibility and lack of restrictions, the GDAs became problematic for federal politicians. GDAs were seen as an instrument financed with federal funds but favoring the political profile of provincial governments.<sup>178</sup> It appeared to federal politicians that central control was being eroded – in this era not a favorable development. Thus a second major review of regional development policy was undertaken.

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<sup>176</sup> Higgins and Savoie, *Regional Development*, 279.

<sup>177</sup> GDAs were broad enabling documents that permitted the federal government and individual provincial governments to sponsor a variety of projects under individually negotiated subsidiary agreements. These subsidiary agreements could be province wide in scope, concentrate solely on a specific sub-provincial area, an economic sector, or even a single industry. *Ibid.*, 280.

<sup>178</sup> *Ibid.*, 281 .

A re-centralization occurred such that DREE was disbanded in 1982 and the GDA mechanism was replaced by new federal-provincial agreements designed to allow the federal government to deliver projects directly. DREE was seen to have been incapable of launching a sustained effort at promoting regional development. McGee noted that organized regional development in Canada reached its zenith in the 1970s with DREE. DREE gave way in 1982 to a series of experiments that McGee believed had yet to match the innovativeness or successes of the previous institutional arrangements.<sup>179</sup>

After a sweeping victory in the 1984 election, Conservative Prime Minister, Brian Mulroney, was intent on showing he had a new political agenda based on four policy fronts: national reconciliation, economic renewal, social justice, and constructive internationalism.<sup>180</sup> Regional development underpinned two of these themes, national reconciliation and economic renewal. The idea was to look to the provinces for solutions to regional development rather than impose centrally designed policies and programs – seemingly a shift away from the center once again.<sup>181</sup>

The Conservatives altered the institutional mechanisms initially put in place by the Liberals and then dismantled; DREE was followed by DRIE (Department of Regional

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<sup>179</sup> McGee, *Getting it Right*, xix.

<sup>180</sup> Savoie, *Regional Economic Development*, 98.

<sup>181</sup> *Ibid.*, 98.

Industrial Expansion). This new line department would deliver regional and industrial development programs. In addition a new central agency was created, the Ministry of State for Economic and Regional Development (MSERD) to ensure a ‘government-wide’ focus on regional development – in line with a system of ministers of state for various smaller portfolios. The Government created new regional development agencies, one for Atlantic Canada, one for Western Canada and another for Northern Ontario. Quebec was given a large regional development budget through the Department of Industry, Science and Technology.

With the initial intention of shifting responsibility for much of its Industrial Regional Development Program (IDRP) to the provinces, the Conservative government soon feared the loss of visibility and began to retrench itself in doling out the incentives to the private sector itself. ERDAs (Economic Regional Development Agreements) were eventually signed by all the provincial governments. In fact, the federal government ended up delivering the initiatives directly that had been previously delivered by provincial governments under the GDAs.

McGee writes that the uniqueness of the regional development approach of the 1980’s was founded on a premise that the federal and provincial governments could work together as partners in the absence of political interference in the implementation of

government policy.<sup>182</sup> However, the premise was unrealistic. Regional policy *is* about purchasing for political purposes and political direction has always been part and parcel of how regionalism contributed to nation building.

The 1988 Policy Manual for “An Agenda for Continued Prosperity” given to PC candidates shows the unabashed intent of the government to use procurement directly to support the regions.

“The PC government believes that government procurement can be a useful tool for economic development in the regions. That is why we have instituted:

- The Atlantic Canada Opportunities Program to increase the share of government procurement in this region – this program has already met its target of \$600 million;
- The Western Procurement Initiative will increase federal government procurement from the West by \$600 million over the next four years, an increase of 16%;
- Regional procurement opportunities for Northern Ontario will be enhanced through the Fed-Nor Procurement Initiative;
- The Access Small Business Program will, through new sub-contracting and supplier development features for large firms bidding for government contracts, ensure that small businesses in the regions begin to receive a larger portion of the benefits of government procurement;
- New administrative measures including bid rotation and regional supplier fairs, have meant increased opportunities for local small businesses to bid for government contracts.

The PC government believes that economic development in the regions flourishes best through cooperation and shared commitment, which is why we have signed economic and regional development agreements with every province since 1984 totaling over \$4.3 billion.”<sup>183</sup>

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<sup>182</sup>McGee, *Getting it Right*, xviii.

<sup>183</sup> 1988 Policy Manual for Progressive Conservative candidates on “An Agenda for Continued Prosperity,” was to assist the candidate to portray accurately the direction in which a PC government will take the government over the next four years. It focuses on

The government's intentions to make economic prosperity a pillar of its agenda thus further institutionalized the use of purchasing, even at the risk of looking more interventionist than market-oriented ideologically.

### **THE RISING PROFILE OF PROCUREMENT**

The Mulroney government was directing large sums on supporting this regional development agenda. Having established the Atlantic Opportunities program in 1986, they were looking for a total value of \$2.2 billion worth of federal contracts sourced in Atlantic Canada over the four-year period of the program – representing a \$600 million increase from 1984-85 levels of sourcing in the region.<sup>184</sup>

It was rarely possible however to see clearly the impact of new procurement on regional firms and economic development. For example, automobiles could be purchased from a dealer in Atlantic Canada, with all of the industrial benefits still going to the automobile industry located in southern Ontario. Officials reported that some such practices did

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major national issues as well as regional concerns and was intended as a reference source. This part appears in Section 3, Principles and Practices, Sub-section 2, paragraph 8 – Regional Development(p.55). Public Archives of Canada, Hon Paul Dick fonds, R-3391, Volume 8, File 1.

<sup>184</sup> The extra \$600 million was to be made up of a \$200 million increase in purchasing to meet the ongoing requirements of federal departments and agencies and \$400 million in procurement related and industrial-benefits opportunities associated with major procurement projects. The federal government reported on 31 March 1990 that it had exceeded both targets, having secured over \$900 million in new contracts. Savoie, *Regional Economic Development*, 172.

occur to inflate the numbers, notably the purchase of large new oil shipments from the Atlantic Canada dealers. They also readily admitted the weakness of the manufacturing base in Atlantic Canada and that 'leakage of contract dollars out of the region continues to be a problem'.<sup>185</sup>

Officials knew the crux of the real problem - politicians and the media give too much attention to the 'numbers game' and not enough to building up the long-term capacity in the slow-growth regions 'to the development of a more competitive supplier base in these regions.' Government procurement as a tool of regional development was viewed largely inside government as 'an accounting exercise rather than a program to strengthen the manufacturing and productive capacity' of slow-growth regions,<sup>186</sup> despite the rhetoric (as in the aforementioned Policy Manual).

Underlying these issues was a change in the machinery of intergovernmental relations that had evolved over the Trudeau era. The shift from administrative and cooperative federalism to more confrontational executive federalism occurred as federal and provincial governments vied for control of new and/or expanded areas of jurisdiction.<sup>187</sup> Tensions between the two levels of government had been on the rise throughout the

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<sup>185</sup> Savoie, *Regional Economic Development*, 173.

<sup>186</sup> *Ibid.*, 172.

<sup>187</sup> Kathy L. Brock, "The End of Executive Federalism", in eds., François Rocher and Miriam Smith, *New Trends in Canadian Federalism* (Peterborough: Broadview Press, 1995), 97.

1960s and 1970s, as demands for more services and programs came up against the opposing need to restrain fiscal deficits. Executive federalism took shape in increasing numbers of First Ministers Conferences, fully institutionalized in several layers into the federal bureaucracy by the mid 1970's. The pendulum shifted somewhat back to a collaborative approach to federalism as the number of agreements and arrangements between levels of government increased. By 1985, outside of major fiscal transfers, there were ninety-nine cost-sharing agreements, fifty intergovernmental agreements for transfers, ninety-three joint activities and over sixty-six other arrangements.<sup>188</sup> The Mulroney government upon its return from the 'political wilderness' was cultivating the 'coalition of outs'; efforts of the Mulroney government to consolidate a Quebec and Western coalition and garner provincial support for Meech Lake and the Free Trade Agreement.

Procurement as part of a number of agendas associated with economic prosperity and fiscal matters thus became the subject matter for a set of intergovernmental meetings.<sup>189</sup> The provincial premiers held a First Ministers conference in Vancouver on November 20-21, 1986 and the decision to hold a conference for federal, provincial and territorial Ministers Responsible for Procurement in the coming year was made. Consequently a series of conferences began, the first held in Ottawa on May 20, 1987 and the second in

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<sup>188</sup> Brock, *End of Executive Federalism*, 98.

<sup>189</sup> There were 353 ministerial meetings in 1985, compared to the average of eighty-two per year from 1980-84, and seventy-two deputy minister meetings compared to the 1980-84 annual average of forty-five. *Ibid.*, 99.

Kananaskis, Alberta was held on October 6, 1987, to consider how to improve public sector procurement practices.

As Michel Cote, the Minister of Supply and Services wrote in his letter in the final report to the Prime Minister Brian Mulroney, “The decisions of these two conferences, the first ever involving Ministers with procurement responsibility, are described in this report. The implementation of these decisions is evidence of the commitment of all Ministers to make real progress towards shared regional development goals. We have also laid firm foundations for further cooperation in the future.”<sup>190</sup>

The first meeting approved three continuing Federal-Provincial-Territorial task forces studying ways of improving current practices to bring about a better distribution of public sector procurement: The Task Force on Improving Access to Government Procurement, The Task Force on Canadian Source Development, and the Task Force on Public Sector Procurement Data.

At the second meeting on October 6, 1987, they received the Task Force report and reached a number of decisions largely with respect to improving access to government procurement and Canadian source development. A statement of principles around

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<sup>190</sup> Government of Canada, Report, Annual Conference of First Ministers – Toronto, Ontario November 26-27, 1987, *Report on Public Sector Procurement Initiatives*, Letter from Minister of Supply and Services Michel Coté to Brian Mulroney, Prime Minister of Canada.

‘geographic neutrality’ was crafted.<sup>191</sup> The loophole for regional development remained wide open in a statement ‘complementing’ these principles, namely, “The conditions under which government entities could adopt policies or practices which do not meet the principles of geographic neutrality are: . . . for regional development purposes, when restricted competition is used by the contracting authority with the specific objective of enhancing economic or industrial development.”<sup>192</sup>

On the one hand participants in these processes were recognizing, and attempting to codify more open and transparent procurement practices (for example the initial attempts to start standardizing coding and quality across provinces were made here). Yet the attempts to intervene in the market process by designing programs for the development of suppliers and directing officials to source standing offers regionally showed a growing

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<sup>191</sup> This notion of geographic neutrality was given special emphasis, never before had Ministers been so adamant about ensuring that all jurisdictions operate on the same basic principles. These principles were: (1) Access: All qualified firms that are interested in becoming government suppliers shall be given equitable access to the contract opportunities of their governments. (2) Competition: Government contracting authorities shall meet their goods and services requirements through a fair acquisition process based on the highest degree of competition consistent with an efficient and cost-effective procurement system. (3) Policies: Government contracting policies and practices shall not impose conditions which are counter to the principles of geographic neutrality. For example, any prescribed time-limit for the submission of tenders must be adequate to permit all interested and qualified suppliers to respond, wherever they may be located; and (4) Transparency: Governments may wish to establish specific policies or procurement practices which are exception to the principles of geographic neutrality, but such policies and practices must be identified, made known and clearly identified as such. Government of Canada, Report, Annual Conference of First Ministers – Toronto, Ontario November 26-27, 1987, *Report on Public Sector Procurement Initiatives*, Appendix A, p. 5.

<sup>192</sup> Government of Canada, *Report on Public Sector Procurement Initiatives*, Appendix A, p. 5.

contradiction between the principles of competitive procurement and the actual policies governments were promoting.

Two further FPT Conferences on Procurement were held, in June 1989 in St. Andrews-by-the-Sea and July 1989 in Quebec City. The arrangement of working groups under a 'Strategic Information Task Force' and a 'Canadian Source Development/Access Task Force', showed a continuing concern with regional supplier development but also the emergence of new concerns – a focus on the development of a National Software Conference and a Procurement Data group, as well for the first time a working group on Environmentally Friendly Products. The impact of ongoing provincial dissension was apparent in Otto Jelinek's comments as the Minister of Supply and Services Canada, when he pledged to Ottawa to buy more goods and services from outside central Canada after "20 years of unfair procurement."<sup>193</sup>

There were efforts in the procurement discussions to accommodate those clamoring for regional benefits within Mulroney's caucus (notably 50-plus PC MPs from Quebec) in late 1989 and 1990. Georgina Wyman, Deputy Minister of Supply and Services Canada wrote about the problems identified by the Federal Provincial Working Group on the Participation of Quebec Suppliers in Federal Government Procurement, in a

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<sup>193</sup> Otto Jelinek, Minister of Supply and Services Canada, in comments to the Canadian press, July 8<sup>th</sup> 1989, Federal Provincial Conference, July 1989 in Quebec City. Public Archives of Canada, Hon Paul Dick fonds, R-3391, Volume 69, Clippings.

Memorandum to the Minister. The intergovernmental group had looked for ways to deal with problems such as:

- The poor participation and limited success of active small business in Quebec;
- The concentration of federal purchasing and S&T expenditures in the National Capital Region;
- The high percentage of sole source contracts;
- Quebec's poor results in certain sectors, mainly in the informatics, commercial services and consulting services sectors;
- The language barrier;
- The low level of interaction between federal buyers and Quebec companies, and
- The ability or willingness of Quebec companies to comply with national and international standards.

A number of solutions were suggested aimed at assuaging these elements but the Deputy Minister was wary of the implications of directing solutions at Quebec and warned the Minister of the problematic nature of singling out Quebec in terms of procurement and 'fair share' issues.<sup>194</sup> She noted that this would be poor timing to undertake any form of activity that could be considered contrary to open bidding with the negotiations for the Agreement on Internal Trade underway.<sup>195</sup>

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<sup>194</sup> Memorandum to the Minister, May 15 1990, from Georgina Wyman, Deputy Minister SSC, Public Archives of Canada, Hon Paul Dick fonds, R-3391, Volume 120, File 9.

<sup>195</sup> "You may wish to take this opportunity to inform your colleagues that any SSC participation in a Quebec procurement initiative must be consistent with the principles of access, fairness and competition and that recent departmental initiatives such as open

What is clear as the AIT negotiations became a new element (although frequently taking a back seat to more pressing priorities) in federal-provincial relations, is that the 'regional' paradigm and its various incarnations addressing and reducing regional disparity was being challenged from different sources of pressure and argument.<sup>196</sup>

National economic development policies associated with procurement were increasingly based on open and competitive bidding practices, making the traditional use of directed procurements (with political guidance) less acceptable. Politicians were aware of these important changes afoot, and indeed at the helm of decisions surrounding the changes in the economy, but a true understanding of the constraining nature of these changes was not yet recognized. At this point pressure for change was consistently balanced by the federal government's historical commitment to regional support institutionalized politically and in federal structures.

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bidding, the use of electronic bulletin boards, Government Business Opportunities and the Supplier Promotion Program will provide improved access to all suppliers from all regions of Canada. In this context you might want to point out that: Any attempt to direct or allocate contracts, including R&D contracts, to Quebec or any other region would be considered as contrary to open bidding; any special treatment in support of Quebec "fair share" issue would trigger similar demands from other regions or from regional development agencies; and ISTC statistics show that with respect to the purchase of goods and services, Quebec seems neither favored nor disadvantaged in comparison with other provinces." Memorandum to the Minister, May 15 1990, from Georgina Wyman, Deputy Minister SSC, Public Archives of Canada, Paul Dick fonds Volume 120, File 9. This pressured Deputy Minister might have been invoking the new forces of market-based decentralization as a way to try and discipline politically-motivated demands inconsistent with greater efficiency and administrative discipline in the management of procurement policies.

<sup>196</sup> Doern and MacDonald, *Free Trade Federalism*, 19.

## PROCUREMENT POLICY AND DEFENCE

The nature of procurement policy as it relates to Defence is also an important part of the story in this period. Procurement for defence capacity and the protection of Canadian interests contributed greatly to overall industrial development. Rapid decision-making due to the nature of defence and national sovereignty-related emergencies is often the justification for procurement spending without 'competition' or consideration of 'best-value'. At the same time, effective long-range planning for the purchase of major equipment systems requires sophisticated procurement processes that must be based in both competitive processes and complex partnerships. The evolution of defence procurement is evident in three phases that overlap and demonstrate the use of procurement as an instrument and embedded historical policy uses of purchasing.

First, procurement is a critical tool for national defence preparedness. In organizing for war, many institutions were created in order to handle the growing demand for products by the Government and the varied forms of production that ensued.<sup>197</sup> The Department of Munitions and Supply was established in 1940 to take over the increasing duties of the War Supply Board. In the wartime environment, orders and contracts were issued with great rapidity and in some cases plants were actually constructed and production undertaken before legal contracts had been signed. Typical of the beginning of every

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<sup>197</sup> In this section we deal with World War Two and forward. Procurement is always critical to equipping national forces; for the purposes of this thesis the institution-building period of the post-war period is of most interest.

war, a gap between demand and supply of war materials occurs resulting in the issuance of hundreds of contracts, often poorly conceived and constructed.<sup>198</sup> In terms of structural arrangements, the Canadian government decided it could finance the massive construction and production needed more cheaply than private industrialists and a mixture of government owned and privately owned industries and machinery emerged. The wartime industrial program demanded huge numbers of skilled and semi-skilled workers.<sup>199</sup> The organizing of the Canadian economy for war involved the diminishing dependence on the ordinary peacetime mechanisms of prices and profits and the increasing dependence on a mixture of compulsion and voluntary cooperation.<sup>200</sup> Purchasing for war became highly institutionalized although ultimately the emergency nature of the situation shaped the decision-making and meant that value-for-money was less important than obtaining the goods and services in a timely manner.

Post-war, the country had benefited from wartime organization efforts in terms of a solid institutional backdrop. Other reasons for purchasing later emerged. The Fair Wages Policy of 1954 empowered the federal government to favor domestic firms and domestic

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<sup>198</sup> Phung Nguyen, Book Review, *A History of Government Contracting*, *Journal of Public Procurement*, Volume 3, Issue 3, 417.

<sup>199</sup> The Inter-Departmental Committee on Labour Coordination predicted in 1940 that 100,000 skilled and semi-skilled workers would be required by industry and the armed forces during 1941. J.F. Parkinson, ed., *Canadian War Economics* (Toronto: The University of Toronto Press, 1941), 13.

<sup>200</sup> Parkinson, *War Economics*, 8-15.

labor in its procurement policy.<sup>201</sup> The use of procurement for other purposes beyond cost-effective acquisition was justified in terms of employment, technology, balance of payments and security of supply objectives. Awarding contracts to firms in high unemployment areas began to emerge in a form of regional policy with both economic and social objectives.<sup>202</sup> By awarding government contracts to firms in marginal constituencies, purchasing came to be seen as a way to support a re-election bid. Gibbons and Rowat explain how this idea of 'nation building' through manipulation of purchasing was associated with political corruption. Many of the early cases they cite became motivation for implementing more rules concerning conflict of interest for public office holders.<sup>203</sup>

The second and third phases in the evolution of defence procurement involve the use of procurement to develop strong defence capacity in the Cold War period based on institutional links with the United States, and the use of procurement as a tool for regional development during the subsequent atrophy of defense capabilities. Regional-industrial

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<sup>201</sup> Stegeman and Acheson, "Canadian Government Purchasing Policy", 448-450.

<sup>202</sup> Sue Arrowsmith and Keith Hartley, "Introduction" in Sue Arrowsmith and Keith Hartley, eds., *Public Procurement - Volume 1 and Volume 2*, The International Library of Critical Writings in Economics (Cheltenham: Edward Elgar Publishing Limited, 2002), 7.

<sup>203</sup> See cases cited in Kenneth M. Gibbons and Donald C. Rowat, eds., *Political Corruption in Canada: Cases, Causes and Cures* (Toronto: McClelland and Stewart, 1976). Some examples include: 'The Pacific Railway Scandal' (Pierre Berton), 'Early Corruption in Newfoundland' (S.J.R. Noel), 'The Beauharnois Power Scandal' (S.J. Donovan and R.B. Winmill), and 'Corruption Under Duplessis' (Herbert F. Quinn).

policy has a close association with elements of defence policy due to the importance of the development of defence products in a national industrial structure.

Fergusson points to two key factors that structured the evolution of Canada's domestic defence industrial base. The first was recognition that the Canadian market was insufficient to maintain a fully integrated independent defence industrial capacity. The second was the obtaining of privileged access to the American defence market through the negotiation of the Defence Production Sharing Arrangement (DPSA). Canadian firms were to be treated, with some exceptions, as American firms in Department of Defense (DoD) procurement competitions.<sup>204</sup>

In comparison to many western developed countries, Canada's defence industrial base is weak and dependent – largely due to the increased integration of the Canadian and American economies, and indeed, to the small size of the Canadian Armed Forces. It is dependent upon, and structured to serve the American market as a second-tier subsystem and component suppliers to DoD and American defence prime contractors.<sup>205</sup>

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<sup>204</sup> J. Fergusson, "Beyond the Dollar Crisis: Defence Strategy and Procurement in Canada", in eds., David G. Haglund and S. Neil MacFarlane, *Security, Strategy and the Global Economics of Defence Production* (Montreal & Kingston: McGill-Queen's University Press, 1999), 101.

<sup>205</sup> Fergusson, "Beyond the Dollar Crisis", 101.

In the early post-war years, procurement policy was inextricably linked to defence policy – it had not yet been separated legislatively or administratively. The Defence Production Act of 1951 established the Department of Defence Production “with the exclusive authority to buy or otherwise acquire defence supplies and construct defence projects required by the Department of National Defence”.<sup>206</sup>

After the cancellation of the CF105 Arrow Program in 1959, there was a greater reliance placed on the Canada/United States Defence Production Sharing Arrangement (DPSA) and the Defence Development Sharing Agreement (DDSA) to maintain a defence industrial capacity. The Defence Industry Productivity Program (DIPP) was introduced in the 1960s to support the development and production of products aimed at the defence export market, primarily the US.

Stegeman and Acheson note that statements of purchasing policy made by the Honourable C.M. Drury in the House of Commons on July 29<sup>th</sup>, 1964 were the most explicit to that time. Drury spoke directly of using Canadian labor, parts, and materials in defence construction work, and that a premium would be paid for higher Canadian content. At the time, the authority for preferential treatment of domestic sources was derived from the Defence Production Act exclusively. The separation of responsibility

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<sup>206</sup> Stegeman and Acheson, “Canadian Government Purchasing Policy”, 445.

for efficient and economical purchasing and the development of a viable Canadian defence industry was given lip-service but by no means was it reality.

The Trudeau Government's choices in the 1970s regarding defence and foreign policy had a profound effect on the nature of the industrial structure supporting defence, and accelerated the decline of Canada's military strength. In 1972 the defence budget was frozen at \$1.8 billion and the percentage of the federal budget devoted to defence catapulted downward from 18 per cent in 1967-68 to 13 per cent four years later. The percentage of gross domestic product spent on the military similarly declined from 2.5 to 2 percent.<sup>207</sup> Defence issues were not a priority – thus industry pressed for a way in which to benefit from what little production and contracting existed. Canadian defence capability atrophied considerably throughout the 1970s and the choices of this time period would leave a legacy of weakened defence for many years to come.

The Mulroney Conservatives promised to re-invigorate and rebuild the Canadian Forces, making many promises with respect to defence spending before the realization of the seriousness of the fiscal situation set in. Capital spending in the DND budget had reached 28 per cent in 1985 with a dollar amount nearing \$3 billion by 1987. This involved significant stakes for Canadian business, including mega-projects such as the CF-18 program and the associated maintenance contract, new patrol frigates and the

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<sup>207</sup> J.L. Granatstein, *Who Killed the Canadian Military?* (Toronto: HarperCollins Publishers Ltd., 2004), 117.

possibility of nuclear powered submarines which inevitably involved major regional and industrial considerations.<sup>208</sup> Smaller attractive capital projects (expected at the time in space research) garnered the attention of many high-tech companies as well. The re-equipment program talked about for years gained momentum, a wave of defence contract letting and procurement decisions were made – unprecedented since the Korean War.<sup>209</sup>

However, the military industrial environment was changing rapidly. The ever-increasing technological sophistication of weapons systems meant long lead times and budgeting uncertainties. As well, the international security context was fundamentally shifting. Meanwhile in Canada defence procurement was growing ever more politicized and non-strategic reasons were becoming more significant in the selection and location of production.<sup>210</sup>

In 1986 Cabinet approved a new policy of industrial benefits in federal procurement. This coincided with the creation of regional economic development agencies, such that there were now specific interests in regional industrial benefits. The offset program labeled Industrial and Regional Benefits (IRBs) was designed to ensure defence dollars would be spent inside Canada. IRBs were to be a vehicle for developing Canadian industry to serve Canadian defence requirements and to make it competitive

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<sup>208</sup> E.J. Dosman, “The Department of National Defence: The Steady Drummer”, in ed. K. A. Graham, *How Ottawa Spends - The Conservatives Heading Into the Stretch 1988/89* (Ottawa: Carleton University Press), 180.

<sup>209</sup> Dosman, “The Steady Drummer”, 180.

<sup>210</sup> *Ibid.*, 183.

internationally. However, distinctions between three Major Crown Projects that best illustrate IRB policy between the period of 1975 to 1985, the Leopard I Main Battle Tank (MBT), the P-3 Aurora Long Range Patrol Aircraft, and the CF-18 Hornet – imply the absence of any clear consistent set of offset policies relative to military requirements.<sup>211</sup>

The program was also meant to be an enticement to American firms to set up production facilities in Canada and develop relationships with Canadian firms. Canada sought defence offsets as a means to enhance Canada's industrial capability through foreign investment and technology transfer. American firms were enticed through the offset program to set up production facilities in Canada and develop relationships with Canadian firms.<sup>212</sup>

In 1988 the Canadian Annual Procurement Strategy enunciated a hierarchy of principles for using procurement to promote national objectives. The primary objective was to meet operational needs at the least cost. The regional component, the IRB policy, was confirmed as a lever to achieve and develop objectives by focusing on long-term benefits of industrial and regional development. It would facilitate the distribution of limited defence dollars across the country.<sup>213</sup> While this was the objective, IRBs structured the Canadian defence industry and its procurement policy, constraining it and even dictating

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<sup>211</sup> J. Fergusson, "In Search of a Strategy: The Evolution of Canadian Defence Industrial and Regional Benefits Policy", in ed. Stephen Martin, *The Economics of Offsets – Defence Procurement and Countertrade* (Amsterdam: Harwood Academic Publishers, Amsterdam, 1996), 115.

<sup>212</sup> Fergusson, "In Search of a Strategy", 127.

<sup>213</sup> *Ibid.*, 127.

acquisition choices. Defence requirements have been structured to meet industrial needs; thus non-strategic reasons became increasingly significant in the selection and location of any production.

Dosman argues that the failure to create a consistent procurement policy (both in the Trudeau and Mulroney years) has been costly. Premiums were added to defence production because of bargaining for industrial offsets and job creation in depressed areas. A 'buy Canadian' approach (when much cheaper equipment was available internationally off-the-shelf) resulted in policy based not on long-term planning, but based on political choices.<sup>214</sup>

The issue of regional jobs kept several military bases open despite the disappearance of operational needs they ostensibly were designed to meet. Regional development implications from shipbuilding and repair, and aircraft and parts industries heavily dependent on defence spending (54.9 per cent and 22.3 per cent),<sup>215</sup> involved federal-provincial bargaining over contracts, and ultimately purely political choices, most notably exemplified in Mulroney's politically motivated award of the CF-18 maintenance contract to Canadair of Montreal over Bristol Aerospace of Winnipeg. Pat Carney, Minister of International Trade in Mulroney's Cabinet described the CF-18 decision as one that, "in my view, changed Canadian history by hardening western alienation,

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<sup>214</sup> Dosman, "The Steady Drummer", 182.

<sup>215</sup> Ibid., 182.

breathing life into the Reform movement, and bringing on the slow death of the Progressive Conservative Party.”<sup>216</sup> This was undoubtedly an example of big “P” politics – wherein a particular group was being rewarded for and influenced by their political affiliation. Although Mulroney was repeatedly accused of political corruption there was no conclusive evidence of personal gain.<sup>217</sup>

Program Review and the slashing of military spending in the mid 1990s coincided with a rapidly changing international context. The negotiation of trade agreements meant that Canada’s domestic policies on regional and industrial development would be increasingly challenged as being anti-competitive and restrictive. The Department of Industry and the Department of Foreign Affairs were on the ascendancy in terms of profile and power, as their agendas were being shifted to deal with this growing outward focus and the rise in importance of information technology and associated businesses. The 1960s and 1970s institutional context had been responding to the socio-economic pressures of those times; but the international situation had changed.

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<sup>216</sup> P. Carney, *Trade Secrets - A Memoir* (Toronto: Key Porter Books, 2000), 263.

<sup>217</sup> Mulroney subsequently sued the Government of Canada due to corruption allegations made by Chrétien and Justice Minister Rock. At the Examination for Discovery pre trial phase, RCMP investigators were cross examined and it was revealed that the only evidence the RCMP found after five years of investigation was Stevie Cameron’s book *On the Take* (1994), which was based on innuendo and no evidence. Justice Canada lawyers urged Chrétien to settle as it had no credible defence, and the anticipated highly negative Court decision would bind and restrict future governments. Thus, at the 11<sup>th</sup> hour, the government lawyers settled and paid \$2 million to Mulroney with a promise to apologize.

## **HISTORICAL INSTITUTIONALISM AS A FRAME FOR CHANGE AND CONTINUITY IN PROCUREMENT**

The story of procurement policy up to the end of the 1980s is found in the dynamics of how socio-economic objectives were pursued in and through regional, industrial and defence policy. Procurement was used primarily as a distributive instrument in this era because it served the goals of the political actors to gain favor by re-allocating funds to particular areas (and ensure the continuity of funding and programs), a very strong lever with which to direct and implement economic and social ideas and plans. A broad historical institutional frame captures the context of the policy environment. The political struggles over spending were reflected in regional-industrial policy and defence policy. While the day-to-day purchasing of government certainly continued (i.e. the government buying the many goods and services needed with bids and lowest cost procurement goals and purposes) at the policy level there is a shift in focus and recognition to regional and industrial concerns. The first shift took place between 1960 and 1982 with the creation of DRIE; the second involved efforts at recentralization between 1982 and 1984; and the third shift between 1985 and 1989 revealed an intensified pattern of regionalized procurement while trying to negotiate the FTA and the eventual AIT (see Chapter Four).

The institutions associated with procurement (i.e. DREE, its many variations, First Minister Conferences on procurement) that were created between 1960 and 1989

structured the battles over regional and industrial policy and in so doing influenced political and economic outcomes. The legacy of post-war institution building largely through defense spending, created expectations and a strong sense of popular entitlement among beneficiaries of government contracts. The question as to whether some of the choices to spend in particular regions or industries crossed into the realm of political corruption is highly debatable. No credible evidence ever indicated Trudeau or Mulroney made 'personal gain' from political choices. Gibbons links political culture with the types and nature of corruption in Canada. He finds that the most important aspect in Canada is regionalism.<sup>218</sup> The focus on regionalism raised the possibility that choices of the Trudeau and Mulroney governments would be deemed corrupt, as they rode the line between normal politics and corrupt practices. The political controversies of this period ensured that the motivation to prevent corruption would grow as a driving force behind procurement policy. Chrétien would come to power largely on the 'anything but Brian' tide of anger, and promises to clean up government through greater transparency and accountability were made. The promise of reform (such as the movement towards having a federal Ethics Commissioner) was to prove symbolic only. The freedom in the contracting function for politicians and officials to pick their firms of choice according a subjective view of the importance of the issue eventually resulted in the current 'Sponsorship Scandal'.<sup>219</sup>

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<sup>218</sup> Gibbons, "The Political Culture of Corruption", 247.

<sup>219</sup> Interestingly, the Chrétien government (term used broadly here since has not yet been established whether the direction came from the top) clearly felt that promoting the

Governments expanded the use of procurement policy to serve their regional interests in this period. Increasingly that was reflected in the evolution and growth of the institutions related to purchasing in the regions. Returning to Hall and Taylor's ideas on the relationship between institutions and behavior, their three key themes hold salience for how procurement evolved over this period: First, the existence of an asymmetry of power in the Canadian federal system, accentuated by geography and population and only further emphasized by the focus and recognition given to regional concerns helps to account for why purchasing by the federal government came to be entwined with the ascendancy of regional-industrial policy. The political battleground was characterized by the constant pull by the federal government (entrenched in strong centralization) juxtaposed to the growing pull by the provinces and regional concerns of MPs.<sup>220</sup> The asymmetries of power that exist between the provinces, between economic regions (which may be provinces or other types of clusters) and between levels of government had to be handled in such a way as to allow for somewhat equal economic and social development across the country. While officials at the center emphasized that making purchasing choices based on regional concerns, as opposed to best value, were not the

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federal government in the wake of the 1995 referendum constituted a socio-economic objective important enough to override the proper procurement process.

<sup>220</sup> The dual focus on Quebec (a powerful economic and political player) and on the Atlantic region (economically deprived but with strong political patrons) was Mulroney's (and federal bureaucrats') attempt to deal with the system asymmetry as it had manifested at that time. This asymmetry oscillates between more power at the centre and less with the provinces, and the reverse.

most cost-effective, this was the price to pay for getting and holding on to political power and institutional recognition.

Second, procurement policy was ‘path dependent’: once programs and institutions were developed to account for the regional asymmetries it became extremely difficult to change, shut down, or end any particular policy direction. The institutionalization of regional development organizations and policies continued even after their relevance was questionable (and performance nearly impossible to measure), and the creation of industries dependent on procurement policies became difficult to manage. The structures and vested interests of regional and industrial policy (and associated costs) meant that change would be difficult. Certainly these costs were only to add to the problems of the Canadian economy in the 1980s.<sup>221</sup>

Third, the way in which ideas about a policy area become entrenched certainly contribute to political outcomes, and this is quite evident in the realm of public procurement.

Interventionist and discretionary purchasing underscored by the regional paradigm, as opposed to more market oriented purchasing policy characterizes the conflict of this

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<sup>221</sup> If we think about this issue in terms of transactions costs and the framework of Chapter Four (North), numerous issues arise. The value and impact of procurement transactions in the forms of regional distribution and the support of the associated institutions are very difficult to measure; any discrimination based on ‘region’ is essentially inefficient (in an economic sense); there is substantial political discretion involved in spending based on regionalism and thus no real institutional enforcement of effective purchasing practices; and an ideology of unaccountable purchasing underscores these dynamics.

period under examination. This type of purchasing created a strong sense of entitlement among beneficiaries which reinforces the path dependence of procurement policies and institutions.

The second construct to account for change in procurement over this period is drawn from Thelen and Steinmo's sources of institutional dynamism, and the variability in impact of institutions over time. In tracing the use of procurement through regional-industrial policy, it is apparent that the formulation and continuing re-formulation of Departments and agencies for the promotion of economic and social development through particular regions ensures the saliency of institutions that are not successful in their aims or have become irrelevant. Regional policy became a foundation for Canadian public policy because the institutions were in place and difficult to change. Entire bureaucracies built up around the articulation and implementation of regional policy – despite the fact that its success was questionable and uncertain in terms of how much money was spent. Indeed these institutions remained, changing slightly in form and name (for example DREE to DRIE), as the ends and reasons for their existence shifted. As the central institutions gave way to a more de-centralized arrangement with Atlantic, Northern and Western organizations responsible for ensuring regional development, they began to serve different and more political ends. Regional ministers adopted geographically based economic and social agendas and they were able to promote these increasingly through the decentralized institutions. The institutions built up around

executive federalism even came to be an avenue through which the implementation of purchasing policies was used in political frameworks.

Thelen and Steinmo also point to how exogenous changes produce a shift in goals or strategies being pursued in existing institutions. Socio-economic changes, both domestically and internationally over these years began to impact what institutions were eminent in terms of the control of purchasing and the distribution of funds.

Purchasing as a tool of industrial and defense policy had been a feature since wartime, but as Canada reduced its military the opportunity for economic development through defense purchasing waned. It was as yet not clear how the international environment was changing, other than a move towards international trade agreements and a general ideological shift towards liberal markets. In order to preserve some sort of domestic capacity in defense and technology, the Industrial-Regional Benefits policy became a direct way to ensure that purchasing would protect and enhance Canadian industry. It came however, at a time when interventionism and protectionism was beginning to be assessed as anti competitive and discriminatory with respect to a country's commitment to international trade agreements. These exogenous changes meant that institutional development and policy shifts would have to be directed towards other goals that would hopefully be successful in producing the same results. With the Department of Industry taking on more of a role in industrial and technological development, the emergence of innovation and the IT agendas meant a change in how these policies would be articulated.

Politicians needed to adjust their strategies in order to continue promoting regional development and socio-economic progression. For example the Aboriginal agenda was growing in importance, but it had to be written carefully into overall policy goals and appear less discriminatory.

## **CONCLUSIONS**

This chapter explored how procurement policy was implemented through the dominant policy approaches of the time period – regional and industrial policy as well as defence policy. Although procurement was a critical activity of government from its earliest existence in Canada, it was only as the scope of economic activity of government increased dramatically that it became entrenched in particular policy areas outside of, and including defence. The complexity of the various objectives pursued through procurement, such as industrial support, regional development generally, and efficient purchasing resulted in a confusing array of socio-economic objectives for government purchasing. Procurement was a means to an end in terms of purchasing with political overtones and the goal of funding continuity. It also became an end in itself, obtaining a ‘fair share’ of the government spending represented power within the federation and legitimacy for institutions associated with regional spending, as well as continued existence for companies that would otherwise no longer be in business. The tendency towards path dependence for procurement policy and the associated institutions meant

that by 1990 a vast assortment of domestic socio-economic objectives was being pursued through numerous institutions. Substantial spending was being directed at a host of programs and organizations (with largely unknown costs) in the effort to sustain the continuity of power bases built up around regional interests. The analysis suggests that path dependence resulted in strong institutionalization of decentralized organizations based on a regional paradigm. The institutional entrenchment in regional and industrial policy and the expectations of beneficiaries hampered procurement policy development. In fact change would only emerge under dire fiscal circumstances and a rapidly evolving international environment.

While regional policy, regional-industrial policy, and defence policy have been studied quite extensively on their own, the convergence of these areas is essential to creating a comprehensive perspective on how and where procurement emerges as a policy area and how the ideas that underscore it changed. Empirically, this period demonstrates a wide use of the notion of purchasing as a means for attaining government's ends through each of these policy areas. The inward interventionist position is quite evident over time, implicitly if not explicitly in policy per se. A battery of evolving institutions associated with regional policy, swinging from centralist to decentralist and back again, demonstrates ideological positions of the governments of the time, but also a reaction to the economics of the period and the strategies of the political actors. Entrenched policy expectations, manifested in different organizational forms, persisted even when faced

with growing dysfunctions and challenged by competing policy paradigms.

Conceptually, the variability of the impact of these institutions over time in terms of procurement policy shows how procurement continued to be an important, if ill-managed, instrument for government.

The next two chapters explore the coming changes that were to impact on procurement policy. The trade agenda began to shift the way in which procurement was viewed and indeed could be used, and the rise of information technology demanded new perspectives on its organization as well as in the type of contracting government undertook.

## CHAPTER FOUR

### FREE TRADE ERA POLICY DEVELOPMENT

#### INTRODUCTION

This portion of the study deals with liberalization and the key post-war trade agreements as an important variable impacting on procurement policy. The chapter advances the empirical story of the thesis by exploring the events of the 1980s and early 1990s in terms of trade and liberalization, and how this is related to procurement policy. The paradigm of economic liberalization (as per Figure 8 in Chapter Three) expanded and there arose tensions with the socio-economic trade-offs and the regional policy paradigm that had been dominant in the analysis in Chapter Three. Drawing on the economics of institutions and transactions costs theory, the conceptual story line is advanced by looking at how the constraints on procurement shifted, and how the focus shifted from an inward interventionist orientation to an outward free market orientation. This section does not deal specifically with two elements; namely the details of the negotiations of the agreements, and secondly, the intricate details of the texts themselves. There are many books and articles describing and analyzing these events, although few truly integrate the political and economic issues in a comprehensive manner.<sup>222</sup>

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<sup>222</sup> For a notable exception, see G. Bruce Doern and Brian W. Tomlin, *The Free Trade Story - Faith and Fear* (Toronto: Stoddart Publishing Co. Limited, 1991).

The purpose of this chapter is threefold. First, the fundamentals of the key trade agreements are laid out with the focus on their procurement elements. Second, the impacts of the Canadian International Trade Tribunal with respect to procurement are examined. Finally, through the use of economics in neo-institutionalism, specifically North's four variables in the cost of exchange (cost of measuring, nature of the exchange process, enforcement, and ideology), a model is framed for developing a greater understanding of the impacts of the agreements on procurement.

While Chapter Three explored post-war procurement policy as it was implemented through regional and industrial policy, in this chapter, the focus turns to examining how procurement policy is impacted vis-à-vis trade policy. We look at the changes that the agreements brought to procurement, and the implications this has for procurement policy and the associated institutions. In the time period being examined here, primarily the 1980s and early 1990s, the domestic economic environment changed – Canada underwent two recessions and experienced the results of over-spending through deficit financing and the accumulation of debt.<sup>223</sup> The entrenchment and institutionalization of regional policy was one of several factors that weakened the federal government's capacity for fiscal recovery. The international environment shifted significantly as well

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<sup>223</sup> Tim Lewis provides an excellent analysis of fiscal politics in Canada in the 1990s. He discusses how the entrenchment of ideas in policy paradigms continues to affect decisions long after the reason for their initial introduction has expired. *In the Long Run We are All Dead* (Vancouver: UBC Press, 2003).

with a changed political environment, increasing economic integration, and the effects of instantaneous communication achieved through growing use of information technology.

The trade agreements discussed here build on one another and reflect similar principles and frameworks. A rules-based regime emerged, one which some officials and practitioners say challenges the ability of government to effectively manage the procurement system. Others purport that finally the system is somewhat improved, whereby proper principles of procurement management have been constructed integrating principles of procurement management which should have always been there.<sup>224</sup>

The post-war period preceding the Canada-United States Free Trade Agreement (hereafter referred to as the FTA) is discussed briefly in order to outline why procurement was not a part of the trade agenda *per se*. In the 1980s trade policy was ascending as a focus for government policy and Canada entered a dynamic period wherein the opening of markets was featured as a driving force behind adjustment domestically to international pressures.

The FTA opened up modest amounts of government purchases of goods to greater bilateral competition, followed by the North American Free Trade Agreement (NAFTA) and its inaugural foray into the opening of the government purchases of services market.

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<sup>224</sup> Interview A7, 1 March 2004, Interview A8, 3 March 2004.

The World Trade Organization (WTO) and the Agreement on Government Procurement, held over from GATT, broadened the extent to which procurement was a critical agenda item. It was viewed increasingly as more than a purely technical issue and one of the means by which further liberalization would occur. The Canadian Agreement on Internal Trade, treated as a separate item here, is still highly contested as to whether it has had lasting impacts or not. The question remains as to whether it ushered in another new era of open trade domestically, with impacts internationally or whether it remains an agreement with no teeth. Each agreement was built on a previous agreement or set of negotiations, and resulted from many years of dynamic tension and change within each country and between the countries involved, in terms of business evolution, shifts in government management techniques, and the nature of relations between industrial sectors.

The offspring of NAFTA, the Canadian International Trade Tribunal, is the most important modern institution in terms of procurement, and it is treated here as the central feature impacting on procurement in the past seven years. Through its interpretation of NAFTA, WTO, and AIT guidelines in the dispute resolution process, the CITT has shaped procurement in a number of ways.<sup>225</sup>

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<sup>225</sup> For example, one author, P.M. Close, now the Vice-Chair of the CITT and lecturer at NPSIA, refers to the impacts as 'domestic spin-offs', highlighting the unintended consequence of the dispute resolution system being primarily used by Canadian suppliers, as opposed to foreign suppliers. This third-party tribunal has become a new instrument of government by virtue of the implications of its determinations. In fact, government

From the economics of neo-institutionalism perspective, North's seminal work linking transaction costs and the operation of government organizations (1984) identifies four variables in the cost of exchange. They will be used to help account for the impact of the trade agreements on procurement and the ensuing dynamics that resulted in this period. We explore the extent to which trade agreements are shaping the conditions for domestic public policy and how the trade agreements and the CITT have narrowed the discretion that allows procurement to be used as a policy instrument.

In economic terms, there is a social welfare loss – a sacrifice, when purchasing is associated with the pursuit of objectives other than best value. Until recent years, it was implicitly accepted that the Canadian government would trade off this loss against the gain it believed to be getting from pursuing regional or industrial development through the manipulation of purchasing.

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officials have found that dealing with the implications of the decisions of the CITT has made their jobs so difficult, there is an effort (this seems to be both explicit and implicit in the way in which recommendations for change are being made in the official review, as well as somewhat 'underground' in the efforts of officials to retain power and discretion in how contractors are chosen) underway to alter its design and power, the current Government-Wide Procurement Reform Review is in fact looking at altering the terms under which the CITT operates. P.M. Close, "An Unintended Consequence: the Canadian Domestic Spin-off of Government Procurement Trade Agreements", *Canadian Foreign Policy* 10(Number 3): 117-140.

Economic and financial pressures on government coincided with the recognition that there were gains to be made for business, and money to be saved by government, by altering the procurement environment. In the past five years, procurement as a strategic approach to managing government resources has taken a much higher profile in the Canadian government.<sup>226</sup> It is with this mind that we explore how the trade agreements are altering the conditions for procurement policy-making and how the government is (or is not) responding. This chapter first looks at the evolution of the trade agreements with special attention to procurement, and then using a transaction cost economics framework examines the influences that liberalization and the results of the trade agreements have had.

## **THE MAJOR TRADE AGREEMENTS AND PROCUREMENT**

This section looks at the relationship of procurement to trade policy. What does trade policy have to say about procurement rules *per se*? First, in trade terms, elements of procurement policy can be viewed as a form of protection that violates the principles of

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<sup>226</sup> In watching the evolution and talking to numerous officials and observers, there is no doubt that the profile of procurement has changed in the 2004-2005 period. The unprecedented appointment of a Parliamentary Secretary for Procurement on the political side and a business-oriented Deputy Minister at PWGSC on the bureaucratic side shows that procurement has got the attention of Cabinet. Media reports and government scandal are certainly part of the reason for this, but the momentum behind the need for attention in procurement has been building for some time. Also note, "It Matters to You – Material Management Institute takes front row center", *Summit – Canada's Magazine on Public Sector Purchasing*, June 2004, 12.

trade policy, which are often focused on allowing for, and promoting, the full play of comparative advantage as well as seeking efficiency in exchange (cost reductions).<sup>227</sup>

Procurement is typically inefficient and laden with problems associated with political influence, directly or indirectly.

Secondly, procurement policies reflect a unique combination of public policy elements that traditionally have had few rules, especially in the Canadian environment. The same policy objective in two countries may be pursued using very different instruments, and procurement systems have evolved in distinct ways across countries and continents.

Even the concept of procurement varies significantly. In Canada for example it has even been argued that our procurement system is a part of our cultural endowment.<sup>228</sup>

Consequently, in tracing the nexus of procurement and the liberalization agenda we come face-to-face with an environment in flux, especially during the period in which the trade agreements were being negotiated and implemented, and then the period following in which the CITT entered a very active phase in interpreting how the rules affected Canadian procurement processes and policy. The following table outlines the key

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<sup>227</sup> Interview A15, May 13, 2004. This interviewee refers to neo-liberal approaches to trade policy. Generally however, it has not been true of Canadian trade policies through Canada's history. Procurement is a form of protection when government policies related to it provide substantial formal or informal discretion for its use to this end, either as a matter of law or bureaucratic and political culture.

<sup>228</sup> Interview A15, May 13, 2004.

features of the trade agreements and the aspects of the agreement that are relevant for exploring their impact on procurement.<sup>229</sup>

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<sup>229</sup> NAFTA, the AIT, and the WTO-AGP require the signatories to maintain an independent bid challenge authority. Parliament has implemented these agreements into Canadian legislation to ensure that the procurements covered by these agreements are conducted in an open, fair and transparent manner and where possible in a way that maximizes competitiveness. Although not dealt with specifically here, the Canada-Korea Agreement on Procurement of Telecommunication Equipment has the same requirements. More than one trade agreement may apply to any given procurement, and the “procurement rules” differ between the four trade agreements. As parties do not know with certainty which trade agreement or agreements apply to a given procurement until after the CITT renders its decision, procuring entities do not know which procurement rules apply to a procurement until after the Tribunal renders its decision. Consequently this uncertainty undermines the existence of objective, transparent and predictable procurement rules of universal application. From David Attwater, *Procurement Review: A Practitioner’s Guide* (Toronto: Carswell A Thomson Company, 2002), 1.2.5.

**Table 3: Trade Agreements and Procurement Issues**

<b>Institution</b>	<b>Key activity in terms of procurement</b>	<b>Critical issue</b>	<b>Key political constraints</b>	<b>Future issue</b>
Early OECD and GATT,	Formulation of principles, inventory of barriers	Not a priority to governments	Laws and regulations requiring government to buy from domestic suppliers	Slow movement to reduction of non-tariff barriers
FTA	Thresholds lowered although modest	Connection to trade remedy laws, US unwilling to be bound by new rules	Protection of domestic markets of concern to both countries	Greater access to American market
NAFTA	National Treatment principle included; services and construction included for first time	Many types and number of exclusions, taken into domestic law for first time; creation of challenge authority -CITT	Approach to negotiating, positive list; entity-cum-threshold very restricting in terms of possible progress	Further opening of market
AIT	Removal of barriers across the provinces, principles spelled out	Many exemptions remain, no real dispute resolution system	Discretion increasingly disappearing as defence procurements subject to AIT	Intense disputes likely, no teeth
WTO/AGP Uruguay Round	1996 GPA extended coverage to sub-national levels but higher thresholds than NAFTA	Signing of World Trade Agreement symbolically important	Many exemptions and approach restricted progress	Developing countries may be at a disadvantage due to lack of access to markets

### **The Long Road to Liberalization – the OECD to the Canada-United States Free Trade Agreement**

With the signing of the General Agreement on Tariffs and Trade (GATT) in 1947 by 23 countries, the post-war economic order under the auspices of the proposed International Trade Organization (ITO) was framed. The inclusion of procurement in the GATT was rejected for two main reasons. First, it would require significant changes to domestic laws, regulations and policies which required government to buy from domestic suppliers. Governments were not yet prepared to do this. Secondly, it was a highly charged political instrument, whose inclusion in any agreement would have to have a long list of exceptions to it to exclude buy-local programs, domestically sensitive regions and industries, and other preferential [discriminatory] procurement practices, thereby making an agreement exceedingly cumbersome and nearly irrelevant.<sup>230</sup>

Consequently, the relationship of government procurement to broader trade policies was not the subject of much national attention or international negotiation until the issue was taken up by the Organization for Economic Cooperation and Development (OECD) in the

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<sup>230</sup> Annet Blank, and Gabrielle Marceau, “The History of the Government Procurement Negotiations Since 1945”, *Public Procurement Law Review*, 5, 1996, 77 and Blank and Marceau, “A History of Multilateral Negotiations on Procurement: From ITO to WTO”, *Law and Policy in Public Purchasing: The WTO Agreement on Government Procurement*, eds. B. M. Hoekman. a. P. C. Mavroidis (Ann Arbor: The University of Michigan Press, 1997), 51. Also, see Alton, Sabrina, *Understanding Government Procurement Liberalization in Canada and its Implications for the Federal Procurement Process*, 2004, Thesis for Master of Arts, Faculty of Graduate Studies and Research, Institute of Political Economy, Carleton University, Ottawa.

mid 1960s. Bilateral trade in North America took place within the Canada-United States Defence Production Sharing Agreement, which made provision for mutual access to the defence procurement markets.<sup>231</sup> In Europe, the European Free Trade Association held some negotiations with respect to integrating procurement regimes.

Of concern to economic policy makers and OECD officials were the steady deterioration in world economic conditions and the consequent rise in protectionist pressures.<sup>232</sup> Many nations demonstrated growing interest in the impact of non-tariff barriers as tariff barriers themselves were lowered, particularly after the Kennedy Round.<sup>233</sup> Indeed the OECD launched negotiations on government procurement restrictions that proceeded in tandem with the Tokyo Round negotiations until they were folded into the GATT negotiations in 1976.<sup>234</sup> A pre-condition to moving forward in trade negotiations was that the ‘veil of secrecy’ be lifted, and that the existing practices of GATT members be documented.<sup>235</sup>

The early work that was done in the GATT group involved creating an inventory of 800 non-tariff barriers and then the cataloguing of these into about 30 distinct types organized

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<sup>231</sup> A.L.C. de Mestral, “The Impact of the GATT Agreement on Government Procurement in Canada”, in *Non-Tariff Barriers After the Tokyo Round - Proceedings of a conference sponsored by The Canada-United States Law Institute*, eds., J. Quinn and P. Slayton (London, Ontario: The Institute for Research on Public Policy, 1982), 173.

<sup>232</sup> Michael Hart, *A Trading Nation - Canadian Trade Policy from Colonialism to Globalization* (Vancouver: The UBC Press, 2002), 315.

<sup>233</sup> de Mestral, “The Impact of the GATT Agreement on Government Procurement”, 173.

<sup>234</sup> Hart, *A Trading Nation*, 314.

<sup>235</sup> Stegeman and Acheson, “Canadian Government Purchasing Policy”, 442.

by six broad categories.<sup>236</sup> This was important work that was to pave the way for future breakthroughs, but it was not work that attracted much political or public attention. In the government procurement group there arose a history of frustrating specific cases of Canadian firms trying to sell goods to US federal, state, and local government agencies.<sup>237</sup>

In Canada, the issue was the subject of industry and government consultation in 1970, as a result of which the government of Canada determined to give it higher priority in international negotiations. In the European Community, largely for internal reasons, barriers to government procurement markets became a matter of concern at about the same time and it was determined at the Paris Summit of October 1972 to take action to open up public and semi-public procurement.<sup>238</sup>

During this period many of the basic problems were debated and draft guidelines prepared. The basic issues that emerged, and would be the focus of all further negotiations, were those of (a) “transparency”, that is, the degree of publicity to be given to interested parties as to the process of awarding government contracts and the nature of

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<sup>236</sup> Group 1 of the GATT illustrative list of nontariff measures: Government participation in trade included countervailing duties, export subsidies, government procurement, state trading in market economy countries, trade diverting aids and other restrictive practices. Group 2 was Customs and administrative entry procedures, Group 3 Standards, Group 4 Specific limitation on trade, and Group 5 Charges on imports. Hart, *A Trading Nation*, 313.

<sup>237</sup> *Ibid.*, 314.

<sup>238</sup> de Mestral, “The Impact of the GATT Agreement on Government Procurement”, 173.

the decision in respect of individual contracts; (b) coverage, both in terms of the goods and services in question and the institutions whose contracts should be subject to new rules; and (c) dispute settlement in the event of unsatisfactory procedures or decisions by institutions covered by the new rules.<sup>239</sup>

Technology intensive industries and service industries emerged as priority areas in the 1980s and the procurement aspects became substantial challenges in the negotiations. Up to this time period, the U.S. had been unable to successfully pursue multilateralism on these “new” issues. The focus on tariffs was no longer entirely appropriate. New export opportunities were more dependent on rules about foreign direct investment, trade in services and intellectual property protection than on further reductions in tariffs. The U.S. wanted to show to its other trading partners that it was prepared to negotiate on a bilateral basis on these new issues. There was a lot of sense in undertaking a demonstration-type agreement with Canada, but it did not want to set any unhelpful precedents.<sup>240</sup>

Pursuing bilateral arrangements was a risk for both Canada and the United States. The U.S. did not want to bind itself in any arrangements it could not later excuse itself from, nor did it relish ‘free riders’. Exercising power in an ad hoc manner was characteristic of

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<sup>239</sup> de Mestral, “The Impact of the GATT Agreement on Government Procurement”, 173.

<sup>240</sup> M. Hart and P. Sauvé, “Does Size Matter? Canadian Perspectives on the Development of Government Procurement Disciplines in North America”, in eds., Hoekman and Mavroidis, *Law and Policy in Public Purchasing*, 204.

U.S. foreign policy and rules-based bilateral regimes could reduce the freedom to act.

For Canada, multilateralism has always been an efficient way to offset US power.

Canada has more often than not, tried *not* to choose between partners and pursued special status with both US and UK markets.<sup>241</sup>

The 1985 decision to pursue bilateral free trade by Prime Minister Mulroney, was the product of a confluence of political reasoning, fortuitous events, and personal influences.

Doern and Tomlin point to the very important role of individuals in the eventual agreement and implementation of the FTA: “The damaging recession early in the decade and the specter of U.S. protectionism that haunted important segments of the Canadian business community created the necessary preconditions for the free trade decision, but these were not in themselves sufficient to ensure its eventual emergence on the Conservative policy agenda.”<sup>242</sup>

The Canadian negotiators linked their desire for a comprehensive agreement by associating procurement and the trade remedy agenda. If national treatment were extended to Canada, Canada would be exempt from important elements of U.S. trade remedy law. Security of access was a key tenet of the Canadian position, and the principal threat to this objective was the trade remedy laws. However, from the U.S. point of view, to avoid the application of countervailing duties against its products, then

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<sup>241</sup> Hart and P. Sauvé, “Does Size Matter?”, 204.

<sup>242</sup> Doern and Tomlin, *The Free Trade Story*, 276.

all government subsidies should be ended.<sup>243</sup> Canada was certainly not prepared to deal on all forms of subsidy despite its position on negotiating a comprehensive agreement.

The Americans initially seemed interested and talked through the middle of the process as though a major comprehensive deal were possible, answering Canada's call for a detailed far-reaching deal. For Canada, the prospect of access to the \$750 billion dollar market in procurement was partly the basis upon which these motivations rested. The Americans recognized, with especially strong pressure from individual States, that procurement provided the U.S. with effective instruments of protection. Procurement issues would have involved potentially difficult matters of federal versus state jurisdiction. Procurement is interwoven into the dynamics of congressional patronage. Politicians jealously protect their ability to bring money to their constituencies, and this is a well-understood *modus operandi*. U.S. negotiators did not want to wade into this minefield. Even so, if the Americans had wished to go further, the Canadians would have faced serious problems with provincial jurisdiction and regional development policy.<sup>244</sup>

For example, the Buy America Act of 1933 is the best known and most restrictive of domestic preference policies in the US. While the original motivations for 'Buy America' were associated with encouraging domestic economic activity to bring the U.S. out of the Depression, it persisted as a way in which to protect American companies from

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<sup>243</sup> Doern and Tomlin, *The Free Trade Story*, 154.

<sup>244</sup> *Ibid.*, 84.

foreign competition. Canada introduced the “Buy Canadian Policy” dating back to 1951 and a federal Cabinet decision that was intended to promote and stimulate local industry and to provide employment. The economic argument in most cases finds that such restrictions have had little if any positive effect. In fact many of the provisions have had the negative effect of eroding incentives to modernize and compete, also increasing the time required for procurements, offending trading partners and inviting retaliatory protectionism.<sup>245</sup>

The government procurement provisions in the FTA were modest compared with what might have been achieved.<sup>246</sup> The thresholds set in the GATT code were lowered from about \$171,000 U.S. to \$25,000 for purchases by code-covered entities of covered goods. Coverage in terms of entities and goods was the same as in the GATT Procurement Code. Above this threshold, purchases must be competitive unless falling under special provisions for small business or national security. Besides the thresholds, the other major change was the introduction of a bid challenge mechanism for aggrieved suppliers – in the form of a new institution called the Procurement Review Board.

Generally, the government procurement chapter was a disappointment and the objectives were only partially achieved. Discriminatory procurement had blocked access to the

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<sup>245</sup> A. Reich, “Government Procurement and Bid Challenging in Canada After the Free Trade Agreement,” *The Canadian Business Law Journal* 18, 1991, 198-199.

<sup>246</sup> Doern and Tomlin, *The Free Trade Story*, 84.

large U.S. government market for Canadian manufacturers of steel and transportation, power generating, and telecommunications equipment. Marginal improvements had occurred but much was left to negotiate. The amount of actual trade governed by the rules was still small.<sup>247</sup> Nevertheless, rules governing procurement improved and a commitment was reached on future negotiations. Transparency had been increased, and redress for suppliers now existed.

### **The North American Free Trade Agreement**

In terms of coverage, while NAFTA did not result in Canada's objectives being fulfilled entirely, the procurement chapter broke new ground by including services and construction-related procurement for the first time.<sup>248</sup> The general rule of Chapter Ten, set out in Article 1003, is that the three governments must treat goods and services from another NAFTA country — and suppliers of such goods and services — "no less favorably" than domestic goods, services, and suppliers with respect to purchases by

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<sup>247</sup> Michael Hart, with Bill Dymond and Colin Robertson, *Decision at Midnight: Inside the Canada-US Free-Trade Negotiations* (Vancouver: UBC Press, 1994), 379.

<sup>248</sup> The NAFTA procurement chapter begins by listing the government entities and enterprises covered by its provisions which apply to contracts for certain types of goods, services and construction work that exceed threshold values: for federal government entities, US\$50,000 for contracts for goods, services or any combination thereof, and US\$4.5(now 6.5) million for contracts for construction services; for government enterprises, US\$250,000 for goods, services or any combination thereof, and US\$8.0 million for contracts for construction services; and for state and provincial government entities, the applicable threshold, as set out in the Annexes.

covered government entities.<sup>249</sup> In terms of trade rules, procurement had typically been in violation of this ‘national treatment’ principle. It was written into the rules that countries could engage in this exception. Thus, this was an important change.<sup>250</sup>

Procurement is defined broadly to include procurement by such methods as purchase, lease or rental, with or without an option to buy. It specifically does not include non-contractual agreements or any form of government assistance, including cooperative agreements, grants, loans, equity infusions, guarantees, fiscal incentives, and government provision of goods and services to persons or state, provincial and regional governments (Article 1001(5)).

What is not included in the procurement clauses seems to leave some room and protect the ability of the federal government to promote regional development within Canada through purchasing broadly defined. Grants, loans, and other instruments are not considered part of the procurement package in terms of the NAFTA chapter. However, one has to look more carefully at where these instruments fall and their relationship to the procurement function. As rules in the specific procurement chapter of NAFTA squeezed the discretion that still existed in terms of using procurement for socio-economic development, efforts to promote regional industry were funneled in other directions. Even so, these came under international scrutiny. For example, Technology Partnerships

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<sup>249</sup> U.S. Department of Commerce International Trade Administration, Office of NAFTA and Inter-American Affairs, <[http://www.mac.doc.gov/nafta/gov\\_proc.html](http://www.mac.doc.gov/nafta/gov_proc.html)>, 12/05/04.

<sup>250</sup> Interview A15, 13 May 2004.

Canada came under attack as an unfair and anti-competitive program supporting the aircraft industry.<sup>251</sup>

The many exceptions negotiated leave a confusing array of covered/not covered entities and services. There are notable exceptions in negative lists including shipbuilding, urban rail and transport equipment and communications equipment. All three parties are exempt many types of goods purchased by the military.

Services-related procurement has many exceptions as well including transportation, services relating to research and development, financial and related services, utilities and for Canada only, education, health, and social services.<sup>252</sup>

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<sup>251</sup> Technology Partnerships Canada (TPC) was a technology investment fund established in 1996 to contribute to the achievement of Canada's objectives of increasing economic growth, creating jobs, and supporting sustainable development. TPC supported government initiatives by investing strategically in research, development and innovation in order to encourage private sector investment, and so maintain and grow the technology base and technological capabilities of Canadian industry. TPC was theoretically intended to encourage the development of small and medium sized enterprises (SMEs) in all regions of Canada. Peter Hadekel in *Silent Partners: Taxpayers and the Bankrolling of Bombardier* (2004) noted that the government had to camouflage its support of aerospace by allowing other sectors to come in, like biotechnology and environmental science, although two-thirds of the funding was set aside for aerospace. (p.167) On August 2, 1999, the Appellate Body of the World Trade Organization confirmed an earlier ruling that found the way TPC was administered in support of five projects relating to the regional aircraft industry was inconsistent with WTO rules. Under the ruling, Canada was obliged to make adjustments to the administration of TPC support for the Canadian regional aircraft industry. TPC Contribution Agreements for the Canadian regional aircraft industry were amended in order to terminate all obligations to disburse funds effective November 18, 1999. As a result, some \$16.4 million of funding pursuant to those agreements was cancelled.

<sup>252</sup> Hart and Sauvé, "Does Size Matter?", 213.

Although NAFTA quadrupled the value of government markets open to competitive bidding in North America, it actually represented less than a tenth of the total civilian public procurement market.<sup>253</sup>

In terms of procedure, NAFTA replicates much of what is found in the GPA and the FTA in regards to transparency and procedural obligations.<sup>254</sup> Procedures for awarding contracts covered by the agreement were improved significantly. More flexibility was built in to help avoid lengthy procedures when they are shown to impede the efficiency of government. By limiting the criteria used to assess bids, governments are forced to focus on issues of technical specifications, instead of on perceived benefits such as local content.

NAFTA marked the first time an international agreement has been taken into domestic law in Canada. In a civil law country, international agreements become part of the law-of-the-land through codification and statute. In common law countries, domestic law generally interprets international law and it may or may not apply. English common law

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<sup>253</sup> Hart and Sauvé, “Does Size Matter?”, 213.

<sup>254</sup> Important provisions guard against practices such as splitting a contract into smaller components to avoid exceeding the threshold value; forbid parties to evaluate bids on the basis of offsetting factors such as local content, technology licensing, or investment; forbid parties to require technical specifications or seek technical advice with the purpose of creating obstacles to trade; require entities to specify their needs in terms of performance criteria rather than particular designs or trademarks (Hart and Sauvé, “Does Size Matter?”, 214). Guidelines to ensure non-discrimination or otherwise preclude competition include those details involved in tendering of contracts. Limited tendering still may be used in some circumstances such as extreme urgency, exceptionally advantageous purchasing conditions or the requirement for consulting services of a confidential nature (Ibid., 220).

concepts are based in legal organizational methods that give a pre-eminent position to case law as opposed to legislation. The CITT was a new and special case. It was created as a quasi-judicial body with considerable powers.<sup>255</sup> Its jurisdiction over disputes arising from international obligations has put it at the center of much government-business conflict.

NAFTA Chapter 10 was the sleeper chapter that was to have more real world impact on procurement than any other.<sup>256</sup> Suppliers now believe there are real recourses, and that there are teeth to the recourse mechanisms when a procurement bid is anti-competitive in some manner. The game became more open and more suppliers started participating; the hidden side to this trend was that many suppliers, who were not well qualified or extensively experienced, began bidding on contracts. As one interviewee emphasized, in the immediate years following the implementation of the agreements many bids were very badly written.<sup>257</sup>

Hart and Sauvé point to four problems that were complicating factors in the efforts towards further procurement liberalization. First, the type of approach used through the many years of GATT negotiations, had set a precedent. The positive list, entity-cum threshold approach suited to GATT's mercantilist bargaining techniques would prove

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<sup>255</sup> Interview A15, 13 May 2004, and A7, 10 March 2004.

<sup>256</sup> Interview A7, 10 March 2004.

<sup>257</sup> Interview A15, 13 May 2004, and A7, 10 March 2004.

difficult to break and make future progress slow and incremental. Canada wanted to put government procurement on a fully competitive basis in terms of North American suppliers, but reciprocal treatment from the U.S. would include provincial procurement markets, government-owned enterprises and funded programs, and an end to the practice of offsets involved in major purchases. Compensating benefits to the U.S. would have to include far more than full access to Canada's marketplace. The political advantages of its protectionist programs were too great to lose without some major compensation.<sup>258</sup>

Related to this observation, the asymmetry in size of the two economies was problematic. The U.S. procurement market was more than 10 times the size of the Canadian market. Canadian companies had competitive access to less than 5 per cent of the U.S. market but were confident they could compete for more. For the Americans, more access to the Canadian market was desirable, but equal access was seriously problematic in terms of congressional politics.<sup>259</sup>

Second, the forms of discrimination used were different in the two countries. In Canada, both the federal (for contracts not covered by the GPA) and provincial governments excluded foreign bidders if there were sufficient domestic suppliers; and for major purchases, Canada negotiated industrial or other offsets from foreign suppliers. The U.S. welcomed foreign bidders for many contracts but established price or local content

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<sup>258</sup> Hart and Sauvé, "Does Size Matter?", 208.

<sup>259</sup> *Ibid.*, 208.

premiums favoring domestic products or suppliers, and certain contracts were set aside for particular classes of domestic suppliers.<sup>260</sup>

Third, the U.S. economy is a big internal market and is much more diverse and comprehensive than the Canadian economy, which meant that fewer goods and services purchased by the U.S. government had to be imported. Canada already purchased a larger proportion from abroad, eroding the perceived benefit to the U.S.<sup>261</sup> The final problem that Hart and Sauvé cite centers on the institutional and constitutional structure of Canada. A truly open bilateral market for government procurement would mean that all sub-national governments would have to be a part of the agreement (as in the U.S.). Canada's constitutional limitations (the federal government is unable to negotiate on behalf of the provinces), means that major purchasers of internationally traded goods and services are not party to the deal and can continue to discriminate against out of province goods.<sup>262</sup>

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<sup>260</sup> Hart and Sauvé, "Does Size Matter?", 208.

<sup>261</sup> The other economic argument here is important, that the size of the U.S. economy, and the typically larger number of potential suppliers of many goods and services to government, tends to afford Americans a relatively greater capacity to tolerate and absorb the welfare costs associated with preferential procurement practices. Ibid., 209.

<sup>262</sup> Ibid., 209.

### **The World Trade Organization – Agreement on Government Procurement**

The Tokyo Round Agreement on Government Procurement (or GATT Procurement Code), concluded in 1979, was the first international trade agreement on government procurement with twenty-one signatory countries. Its basic premise was to remove discrimination and to improve transparency – although offsets were still allowed and there were some general exceptions. Canada wanted to retain the ability to use offsets; they were an important for local and industrial development. Canada was interested in a low threshold level so Canadian suppliers could gain greater access to foreign markets. The GATT procurement Code was reasonably successful in this objective, covering goods purchased by entities of the central governments for contracts above \$C 238,000.

The Tokyo Round opened up fewer opportunities than expected. The 1979 Government Procurement Agreement opened \$500 million in Canada and about \$25 billion in the US in 1984.<sup>263</sup> The agreement did not cover all federal procurement and excluded all purchasing at the sub-national level, federally funded programs, set-asides for small minority businesses, government-owned enterprises as well as R&D related activities.

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<sup>263</sup> Hart and Sauvé, “Does Size Matter?”, 207.

Prior to the GATT code, where there were enough Canadian suppliers, foreign suppliers were being effectively excluded from any participation in government tenders. Between 80 and 85% of all DSS procurement was completely closed to any foreign competition.<sup>264</sup> In fact, until April 1, 1990, maintaining source lists as opposed to advertised notices of procurement was the common procurement practice.<sup>265</sup>

In parallel with the Uruguay Round negotiations initiated in 1986, parties to the AGP held negotiations to extend the scope and coverage of the agreement. Consequently, the Agreement on Government Procurement (1994)(GPA) was signed in April of 1994 at the same time as the Agreement establishing the WTO, coming into force in January of 1996.<sup>266</sup> The Uruguay Round was seen to be another opportunity to further open the North American procurement market. However, once again the precedent of the

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<sup>264</sup> A. Reich, "Government Procurement and Bid Challenging", 201.

<sup>265</sup> Domestic preferences were implemented mainly through two policies – the Canadian Sourcing Policy and the Canadian Content Premium Policy. The highlights of Canadian sourcing policy as follows:

- DSS will invite bids only from a limited number of firms, the names of which are drawn from source lists maintained in DSS central computer system
- All potential suppliers are categorized into groups that are listed in order of priority, based upon whether they manufacture the required product in Canada or a foreign country, and on their ability to provide after sales service
- The invitations to bid will be sent only to local firms in the first priority group, provided there is a sufficient level of competition between them
- The list of potential sources can be expanded to Groups 2,3, and 4, but only if there are fewer than 3 sources available in the first group(s)
- Whenever there is a need, (due to insufficient domestic capability) to invite a foreign based manufacturer or agent (group 4) to bid, special approval must be obtained from the director of the applicable DSS branch. Ibid., 199-201.

<sup>266</sup> World Trade Organization, Overview of the Agreement on Government Procurement, <[http://www.wto.org/english/tratop\\_e/gproc\\_e/over\\_e.htm](http://www.wto.org/english/tratop_e/gproc_e/over_e.htm)>, 1/31/01.

reciprocity-based, entities-cum-threshold approach adopted at the Tokyo Round meant that wrangling over the inclusion of key sectors would hamper the efforts to further expand the coverage of the GPA. Telecommunications and energy-related equipment were problematic areas, where a concession-swapping approach meant slow progress indeed. An important evolution was the explicit prohibition of the use of offsets.

The 1996 GPA extends the procurement coverage to sub-national purchasing and services but higher thresholds than those applying in the NAFTA, the large number of activities exempted and the fact that Mexico did not sign the GPA meant very modest movement forward.<sup>267</sup>

Measuring procurement ratios broken down by government levels is helpful for appreciating the expanded coverage of the WTO GPA Agreement to sub-central government entities since 1996. The OECD study indicates that the shares of total government procurement accounted for by central government and sub-central governments (including provinces and MASH sector) are 35% and 65% respectively. Thus, the expanded coverage of the WTO GPA, which includes sub-central entities, is about three times larger than that of the GATT code. By extrapolating the estimated shares of total public procurement accounted for by public utilities (EC work), the

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<sup>267</sup> Hart and Sauv , "Does Size Matter?", 217.

coverage of the GPA is increased by a quarter to reach four times that of the GATT code.<sup>268</sup>

### **The Canadian Agreement on Internal Trade**

In conjunction with the international agreements being negotiated, it was recognized that the barriers within Canada were even more discriminatory towards effective trade than some of the international ones. Over time regional discriminatory policies had been disciplined to some extent through international agreements, but provincial and regional barriers were difficult to dismantle.<sup>269</sup> The first forays into negotiating an agreement took place in the 1980s.

The Maritime Provinces and the Western Provinces each signed agreements to reduce barriers to trade in government goods procurement within their respective regions in 1992. Also in 1992, the Provinces, the federal government and the Yukon and Northwest Territories signed the Intergovernmental Agreement on Government Procurement (IAGP). The IAGP was quite limited in its coverage and obligations.

In 1993, Quebec and New Brunswick signed a bilateral agreement that improved upon the IAGP coverage, transparency and open tendering procedures. Shortly thereafter,

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<sup>268</sup> The Size of Government Procurement Markets. OECD Journal on Budgeting Vol. 1, No.4, 2000, < <http://www1.oecd.org/publications/e-book/2202011E.PDF>>, 15/06/05.

<sup>269</sup> Doern and MacDonald, *Free Trade Federalism*, 85.

Quebec and Ontario signed an agreement to open access to construction procurement opportunities, and agreed to undertake further negotiations to open government procurement of other goods and services. Bilateral negotiations between Ontario and Quebec on labor mobility and construction were very active. One participant pointed out that in his opinion, the Ontario-Quebec work was in effect the real groundwork leading to the final AIT.<sup>270</sup> The Committee of Ministers on Internal Trade launched comprehensive negotiations in July 1993, leading to the AIT, which came into effect in July of 1995. Chapter Five of the AIT is the most comprehensive chapter of the agreement. Article 501 states that the purpose of the chapter is the establishment of a framework that will ensure equal access to procurement for all Canadian suppliers. Overall the agreement is intended to contribute to a reduction in purchasing costs and to the development of a strong economy in a context of transparency and efficiency.<sup>271</sup> The list of public entities exempted from the procurement provisions by many provinces is (distressingly) long, although at the time implementation was subject to further negotiations.<sup>272</sup>

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<sup>270</sup> Interview A9, 3 March, 2004.

<sup>271</sup> M.J. Trebilcock, and R. Behboodi, "The Canadian Agreement on Internal Trade: Retrospect and Prospects", in eds. M.J. Trebilcock and D. Schwanen, *Getting There: An Assessment of the Agreement on Internal Trade*, Policy Study 26 (Toronto: C.D. Howe Institute, 1995), 47.

<sup>272</sup> Organizations listed in Annexes 502.2A and 502.2B are excluded from the chapter, those branches of government entities that are not accountable to the executive branches of governments of the parties, whose objective is national security, businesses of a commercial nature that are in competition with the private sector and state monopolies involved in the transformation and distribution of goods. Parties agreed however, not to direct them to discriminate against the goods, services, and suppliers of goods and services of any party. Trebilcock and Behboodi, "The Canadian Agreement on Internal Trade", 48.

The chapter applies in the case of goods acquired where the estimated value of the procurement is \$25,000 or more; in the case of services (except those excluded in Annex 5012.1B), where the value of the procurement is \$100,000 or more and in the case of construction where the value of the procurement is \$100,000 or more.<sup>273</sup> The MASH annex - municipalities, academic institutions, hospitals, and school boards - took effect July 1, 1999, and extended coverage of the AIT to include these sectors of all provinces and territories except those of B.C. and the Yukon Territory.

Each party must adhere to the concept of nondiscrimination; treatment no less favorable than the best treatment that it accords to its own goods and services and its own suppliers of such goods and services. Transparency is key: no party may impose, in the evaluation of bids or the award of contracts, local content or other economic benefits criteria designed to favor goods or services from any particular province, region, or territory.<sup>274</sup>

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<sup>273</sup> Some of the services excluded include those provided by licensed professionals such as medical doctors, engineers, chartered accountants, and lawyers, certain transportation services, the organization of sporting events, services provided by financial analysts and investment managers, the management of the financial assets of governments, health and social services, and advertising and public relations services.

<sup>274</sup> Inconsistent principles include: the imposition of conditions on the invitation to tender based on the location of a supplier's place of business; the biasing of technical specifications in favor of or against certain goods and services or the suppliers of such goods and services for the purpose of circumventing the chapter; the timing of contract opening and closing so as to prevent qualified suppliers from submitting bids; the specification of quantities and delivery schedules of a scale or frequency that may reasonably be judged to be deliberately designed to prevent qualified suppliers from meeting requirements; the division of required quantities or diversion of budgetary funds to subsidiary agencies in a way designed to circumvent the obligations of the chapter; the use of price discounts or preferential margins to favor particular suppliers; the

Local content or other economic benefits criteria may not be imposed in the evaluation of bids or the award of contracts to favor goods or services from any particular province, region or territory.

A party may derogate from some obligations (Article 507) in a number of narrowly defined, exceptional cases. More significant is that fact that under exceptional circumstances, a party may exclude a procurement from the application of the agreement for economic and regional development purposes, provided that all such exceptions are reported prior to commencement of tendering procedures to the other parties with an explanation of the circumstances that justified the decision.<sup>275</sup>

There are widely different opinions on the success and impact of the Agreement on Internal Trade. Legal observers comment consistently that it is an agreement with no

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unjustifiable exclusion of a qualified supplier from tendering. Trebilcock and Behboodi, "The Canadian Agreement on Internal Trade", 49.

<sup>275</sup> In the case of a dispute relating to a procurement excluded from the provisions of the chapter, Article 508(2) sets out a number of factors to be taken into account in the dispute resolution process. For example, the frequency of the use by the Party of such exclusions for its procurements; the extent to which the use by the Party of the exclusion for the particular procurement may contribute to economic development objectives or to the reduction of economic disparities; whether the use of the exclusions for the particular procurement was applied in a manner to minimize the discrimination among bidders; and the extent to which the use by the Party of the exclusion affects the development of competitive Canadian companies. A party may continue transitional nonconforming procurement policies and programs designed to reduce economic disparities in place as of the day of the coming into force of the agreement. Such policies will be identified in writing for other parties and may be continued subject to a review of those programs by 1998. Trebilcock and Behboodi, "The Canadian Agreement on Internal Trade", 49-50.

teeth, the dispute resolution system lacks any way to enforce the decisions made, and they are calling for the AIT to be included in the CITT's jurisdiction. By contrast, one procurement official emphasized that in fact the AIT has had the most impact of all the agreements, since all procurements now are subject to the AIT. The only exception remaining is something that can be qualified under Essential/National Security, and even this is hard to justify within the Defence Department.<sup>276</sup>

Certainly not all parties were pleased with the expanded coverage of the AIT. The inclusion of defence procurement was of great concern to "the Gordie Howe of lobby groups"<sup>277</sup>, the Aerospace Industries Association of Canada(AIAC). The AIAC aptly describes the concerns over the AIT with respect to the broad coverage of nearly all forms and types of procurement falling under trade agreements in its response to a DND Efficiency Review:

Consistent with the need to use defence procurement to achieve desired industrial and economic outcomes, the Review underscores concerns previously raised by the AIAC over the constraining impacts of the Agreement on Internal Trade(AIT). At the urging of the Provinces, Canada made its defence procurement subject to the AIT, intending to ensure that firms in all regions have an equal opportunity to compete on price and technical merit. However, the AIT as currently drafted has had two unintended impacts. First, the AIT creates a globally unique requirement in Canada to open all defence competitions to bids from foreign-based suppliers with nothing more in Canada than a mailing

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<sup>276</sup> Interview A13, 18 March, 2004.

<sup>277</sup> Peter Hadekel, *Silent Partner*, 159.

address, even when there exist firms (whether Canadian or foreign-owned) with an acceptable domestic supply capability. As a result, the operational readiness of the Canadian Forces is compromised by unnecessary reliance on sources that are distinct and that may in times of emergency give priority to meeting the needs of their own defence force. Accordingly, the AIAC believes that removing defence procurement from AIT coverage, or at least clarifying the AIT so that it achieves its original intent of free and fair trade within the national common market, would be a very positive step.<sup>278</sup>

Despite this call for a narrowing of the coverage of the AIT, consultations and meetings about internal trade have continued the trend towards opening procurement even further. Provincial and Territorial Ministers responsible for Internal Trade completed a major initiative on April 28, 2004 when they agreed on how to include procurement by Provincial/Territorial Crown Corporations under the Procurement Chapter of the AIT. This is to be achieved by January 1, 2005. Ministers have re-committed to energizing the AIT, and have discussed ways to address concerns about the decision-making process.<sup>279</sup>

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<sup>278</sup> Aerospace Industries Association of Canada, Position on DND Efficiency Review, <[www.aiac.ca](http://www.aiac.ca)>, 16/06/04.

<sup>279</sup> News Release – Provincial-Territorial Committee of Ministers on Internal Trade, Toronto, Ontario, April 28, 2004. “Council of the Federation Workplan on Internal Trade”, <[http://www.scics.gc.ca/cinfo04/860479004\\_e.html](http://www.scics.gc.ca/cinfo04/860479004_e.html)>, 17/06/04.

## **ECONOMICS IN INSTITUTIONALISM AS A FRAME FOR CHANGE IN PROCUREMENT – TRADE AGREEMENTS AND REPERCUSSIONS**

This section will account for the impact of these agreements on procurement and the ensuing dynamics with the public policy environment. The theoretical constructs of economics and institutionalism, based on extending the neoclassical assumptions and including the cost incurred when any form of exchange takes place are highly applicable to procurement in a policy context. Procurement activities are ‘exchanges’ or ‘transactions’ in their most basic format. This exchange is one of the primary activities of all organizations, obtaining goods and services to engage in buying, selling, or providing services. The analysis in this section proceeds from the view that efficiency in procurement is a worthy objective – and in the public sector environment this objective is complicated by other goals as discussed in Chapter Three.

Over time, governments have recognized that there is a cost associated with procuring goods and services, over and above the actual cost of the good or service itself. If choices are made based on any other objective besides obtaining the best possible goods and services in an efficient and cost-effective manner, the cost of exchange increases. Due to factors of uncertainty and lack of proximity and/or familiarity for both purchasers and suppliers, and lack of information, exchange involving not-from Canada players raises the prospect of increasing the cost of transactions. In trade terms, any tariff or non-tariff barrier, either within countries or amongst them, raises the cost of transacting.

This section looks at government's contractual relationship, in which it exchanges funds for goods or services. This 'transaction' has a cost associated with it, the idea being to keep the cost of the exchange as low as possible in keeping with the nature of the goods or service and the agreed-to nature of the exchange. In some cases, as previously discussed, the government will be willing to trade off some cost to engage in the exchange.

New institutions and their evolution, in this case trade agreements, have had a substantial impact on procurement and its characteristics of exchange. As laid out in Chapter Two, North(1984) identifies four variables in the cost of exchange. This is used as a frame for examining how the trade agreements impact procurement.

### **The Cost of Measuring**

The cost of measuring involves measuring the valuable attributes of the goods and services being exchanged or measuring the performance of agents. This is essential to the specification and enforcement of property rights and underlies all the costs of contracting. In terms of the procurement function, knowledge about the characteristics of the goods or services and the performance of agents is particularly problematic given that effective contracts are established based on the disclosure of information. That same information may be what provides a supplier an advantage over another. When tariffs or other non-tariff barriers exist, there is increasing complexity in obtaining information and

added administration. The performance of agents is increasingly difficult to measure when in addition to the economic objectives the procurement is used for social objectives.

An interesting conundrum emerges. While barriers to open competition may increase the cost of measuring attributes and performance, at the same time this 'need to know' may drive procuring organizations towards domestic suppliers and products. De Mestral notes that even in a vast country like Canada, domestic suppliers are likely to know the needs of their government departments and to be more able to supply these needs with acceptable products. In the same way, government buyers are more likely to turn to the domestic enterprises they know best. Assurances of delivery, control of quality, lack of transportation difficulties, and certainty as to legal recourse in the event of difficulties are contributing factors of some importance.<sup>280</sup> Helliwell points out that the issue for the nation-state is whether the grouping of a high proportion of transactions within national markets is justified in terms of lower transaction costs provided by the ability to operate within commonly understood procedures and within trusted and well-understood channels of distribution.<sup>281</sup> In an increasingly integrated and interconnected business environment, the transaction costs of trading in cross-border markets should be reduced. Thus there is less of a need to rely on domestic markets.

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<sup>280</sup> de Mestral, "The Impact of the GATT Agreement on Government Procurement", 172.

<sup>281</sup> John F. Helliwell, *How Much Do National Borders Matter?* (Washington, D.C.: Brookings Institution Press, 1998), 121.

Measuring the performance of agents becomes an issue once a procurement bid is challenged under the auspices of the Canadian International Trade Tribunal. This is an ex ante measurement, as it is the conduct or questionable motives that often are challenged. “On occasion, a potential supplier may have reason to believe that a contract has been or is about to be awarded improperly or illegally. Similarly, a potential supplier may have reason to believe that in some way it was wrongfully denied a contract or an opportunity to compete for a contract.”<sup>282</sup> As soon as the specter of a challenge is raised the cost of the procurement transaction goes up. It is very difficult to tell by how much as the variables involved will be different each time.

Competitive bidding is intended to select the lowest cost bidder, prevent corruption and favoritism that are opposed to efficiency. It offers a clear yardstick with which to compare offers. Theoretically, the more competitive bidding that the government is engaged in the more efficient its purchasing should be, and the capacity to actually measure the efficiency is also increased.<sup>283</sup>

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<sup>282</sup> Attwater, *Procurement Review*, 1-1.

<sup>283</sup> Note however, that at some point, competitive bidding for each and every small volume contract no longer is efficient. Grouping of small volumes takes advantage of economies of scale.

### The Nature of the Exchange Process

This element of North's construct asks, "what is the nature of the exchange process." We extend this to ask what, with respect to procurement, are the impediments or accelerators of the exchange that may translate into increased or decreased costs of exchange.

The most important characteristic of the procurement exchange process as it has evolved in Canada and many other countries is its foundation in highly discriminatory practices. As tariffs and quotas were slowly being negotiated out of the trade process, governments found new and creative ways to protect their control over the exchange process. The emergence of state intervention through subsidies, government procurement preferences, and the application of trade remedy laws had all but replaced tariffs and quotas as powerful and discriminatory instruments of protection.<sup>284</sup> The GATT and its subsidiary agreements constituted valiant attempts to discipline the application of state intervention and trade remedy law, but all these instruments of intervention or protection are inherently discriminatory in some sense.

Subsidies and procurement preferences expressly favor domestic over imported products and seek to overcome lack of comparative advantage. Trade remedy laws—providing for

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<sup>284</sup> Hart, Dymond and Robertson, *Decision at Midnight*, 27.

the application of anti-dumping and countervailing duties and similar measures are equally discriminatory.<sup>285</sup>

Stegeman and Acheson noted that if the contracting parties of GATT were seriously interested in negotiating a reduction in these barriers, then an incentive existed for participating countries to make their policies more objective and visible so that they could be used as a counter in the negotiations. Unfortunately, future negotiations also provided an incentive for contracting countries to make their policies more restrictive in the interim in order to strengthen their bargaining power.<sup>286</sup>

North notes that absent the factors of kinship ties, friendship, personal loyalty, repeat dealing and personal knowledge, the exchange process becomes more costly. "In impersonal exchange there is nothing to constrain the parties from taking advantage of each other if they can gain by doing so." North would say that this is why contracts must be specified as precisely as possible and elaborate safeguards developed to enforce compliance.<sup>287</sup>

Theoretically then, the use of foreign suppliers (those in other provinces or states can be included in the absence of internal trade agreements) would result in parties being more

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<sup>285</sup> Hart, Dymond and Robertson, *Decision at Midnight*, 27 .

<sup>286</sup> Stegeman and Acheson, "Canadian Government Purchasing Policy", 442.

<sup>287</sup> North, "Government and the Cost of Exchange", 257.

likely to take advantage of one another and thus incur more costly exchange. The principles underlying the opening of more procurement attempt to deal with this feature.

*Most-favored nation* and *national treatment* are essential features of liberalization based on reciprocal trade negotiations. At the post-war conferences that established the GATT, agreement on most-favored nation and national treatment enabled the first round of tariff cutting to succeed. These principles provided assurance that the expanded trade opportunities resulting from the reduction of trade barriers would not be denied through measures of external or internal discrimination. Without such assurance, the reduction of trade barriers would have been foolhardy and investment to exploit comparative advantage and pursue specialization based on larger markets a huge gamble.<sup>288</sup>

Despite these attempts to base the emerging exchange process on principles that would remove some of the discriminatory aspects, the difficulty with moving procurement away from its other socio-economic uses was evident. By the mid 1980s, there had also developed an epidemic of voluntary restraints and orderly marketing arrangements which denied most-favoured-nation treatment in all but name; *degrees* of most-favoured nation treatment had been established.<sup>289</sup>

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<sup>288</sup> Hart, Dymond and Robertson, *Decision at Midnight*, 26.

<sup>289</sup> *Ibid.*, 26.

## Enforcement

As a variable in the cost of exchange, enforcement has become increasingly relevant due to its inclusion in the clauses of the trade agreements and the challenges made under these laws. The more open trade becomes, the more important the enforcement mechanisms become.

In a world of perfect enforcement there would be a neutral third party impartially evaluating disputes and awarding compensation to the party injured as a result of contract violation as in domestic legal systems (assuming equality of legal status among contracting parties). In such a world, opportunism, shirking, and cheating would never pay. This situation does not exist because the costliness of measurement (or the lack of transparency in the design of contract specifications) frequently makes it difficult to determine whether a contract has been violated (and by whom). Nevertheless, an impersonal body of law, courts, and the coercive power to enforce judgments are fundamental factors in permitting the complex contracting essential to a world of specialization and impersonal exchange.<sup>290</sup>

Procurement involves a variety of types of contracts, broadly categorized as complete contracts and incomplete contracts. With incomplete contracts, even if the parties to a transaction are symmetrically informed about the terms of the transaction and can

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<sup>290</sup> North, "Government and the Cost of Exchange", 258.

monitor each other at zero cost, the contract by virtue of its incompleteness, cannot be monitored by a third party and is therefore unenforceable by such a party. Consequently there exists a large body of procurement relationships (known as public-private partnerships, relational contracts, benefits-driven procurement, common purpose procurement, and many others) that do not seem to fall under the trade agreements in terms of their enforceability. In relational contracting most transactions are embedded in an ongoing relationship and interactions are mediated by a balance of cooperation and coercion, communication and strategy.<sup>291</sup>

Breton says that if the goods and services (i.e. partnership-type contracts) that have important non-verifiable characteristics, are not excluded from the AIT agreement, their presence will lead to an unraveling of the whole chapter on procurement. After the endorsement of more open and transparent procurement in numerous GATT rounds, EC directives and court rulings, countries still pursue discriminatory protectionist procurement policies. “What would we have to say if it turned out that these policies were a response to incomplete contracts and were, therefore, not protectionist? We would have to say that if governments abided by the agreements they had signed, they would be worsening the allocation of resources and reducing growth and wealth.”<sup>292</sup>

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<sup>291</sup> Furubotn and Richter, *Institutions and Economic Theory*, 158-159.

<sup>292</sup> If public-private partnership-type contracts are ‘incomplete contracts’ with non-verifiable characteristics, and cannot be enforced because they are not included in the agreements, there is potential both for officials to purposefully design more contracts like this (to avoid any CITT challenges) and include discriminatory measures. This does not,

Arrowsmith notes that the full importance of measures designed to achieve free trade in public markets have been felt only recently due to the fact that their impact on secondary policies has now been the subject of judicial decisions; and also because it is only in the last few years that serious attempts have been made to enforce the rules. The freedom to use procurement as a tool of national policy has been reined in by restrictions in European Community law and the GATT Agreement on Government Procurement(GPA) also imposes limitations in this field.<sup>293</sup>

In Canada, suppliers may challenge federal government procurement decisions that they believe have not been made in accordance with the requirements of Chapter Ten of NAFTA, Chapter Five of the AIT, the AGP, or the Canada Agreement on the Procurement of Telecommunications Equipment. The bid challenge portions of these agreements came into force on January 1, 1994, July 1, 1995, January 1, 1996, and September 1, 2001, respectively.<sup>294</sup>

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at least not yet, seem to be occurring – partnership agreements are exceedingly complicated and costly to negotiate and manage. A. Breton, “A Comment”, in eds. Trebilcock and Schwanen, *Getting There*, 93.

<sup>293</sup> S. Arrowsmith, “Public Procurement as an Instrument of Policy and the Impact of Market Liberalisation,” *Law Quarterly Review* 111(April 1995), 235.

<sup>294</sup> Government of Canada, Canadian International Trade Tribunal, Annual Report for the Fiscal Year Ending March 31, 2003, <[http://www.citt-tcce.gc.ca/doc/english/Publicat/ar2d\\_e.pdf](http://www.citt-tcce.gc.ca/doc/english/Publicat/ar2d_e.pdf)>, 19/06/04.

The Procurement Review Board was created to fulfill an obligation of the Free Trade Agreement (Article 1305(3)) and was subsequently subsumed and renamed the Canadian International Trade Tribunal. It was responsible for receiving, investigating and making determinations on complaints by suppliers with respect to trade-covered procurement. In making a determination, the PRB could recommend that bids be re-evaluated, that the procurement be re-tendered or that the contract be terminated. It could also issue recommendations to contracting authorities regarding changes to procurement procedures. Its powers were expanded under the CITT Act in parallel with the expanded scope of the FTA-NAFTA.

The procurement review mechanism constitutes an instrument of domestic socio-economic policy and the CITT has become the most important institution with regards to procurement in a policy context. It has been focused on taking the discretion out of procurement decisions and discipline processes where possible. The foundation is the use of trade policy to reduce and eliminate discretion, bring greater certainty to the marketplace, and encourage the free flow of comparative advantage. Indeed, in its role as reviewer of challenges to the trade agreement, it has by default, a pro-liberalization bias. For those in government charged with continuing programs that utilize procurement outside of the trade objectives, it has become a thorn. Interviewees in government implicitly, if not explicitly, spoke of their frustration of being at the mercy of what the

CITT will decide next. There is thus substantial tension created in the spectrum of activities between government and its suppliers, which has yet to be worked out.<sup>295</sup>

Bid protest procedures under the AIT are quite different from those of the international agreements.<sup>296</sup> The process, which reflects a strong anti-litigation bias, places emphasis clearly on negotiation and consensual solutions by governments.<sup>297</sup> On the one hand it may have had substantial impact in practical terms on suppliers and government, having opened nearly all procurement to pan-national trade; on the other hand, due to the nature of its enforcement mechanisms, it lacks credibility and legitimacy in the eyes of many in the private sector.

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<sup>295</sup> A different structure for the CITT might render different decisions as well.

<sup>296</sup> If the supplier in one jurisdiction considers that it has been prejudiced by the actions of a government or its entities in another jurisdiction, and it has failed to resolve the matter directly with the party responsible for the procurement, the supplier may approach the contact person in its own jurisdiction, who would then approach the contact person in the procuring government's jurisdiction and seek to resolve the complaint. If the two contact persons cannot resolve the complaint, a review panel must be struck at the request of the government of the jurisdiction where the aggrieved supplier is located. The composition of the panel is to be determined by the two official points of contact and is to comprise three members, one from each of the two jurisdictions affected and a neutral chairperson, all drawn from a standing roster of panelists to be maintained by each party. A panel reports its findings and recommendations to the procuring organization and the supplier's government. In the case of challenges regarding procurement by the federal government, where a supplier does not achieve a successful resolution of its complaint with the procuring entity, it may bring the matter to the attention of a reviewing authority with no substantial interest in the outcome of the procurement. Trebilcock and Behboodi 1995, "The Canadian Agreement on Internal Trade", 50.

<sup>297</sup> I. Miller, "Dispute Resolution: An Interprovincial Approach", in eds. M.J. Trebilcock and D. Schwanen, *Getting There: An Assessment of the Agreement on Internal Trade*, Policy Study 26 (Toronto: C.D. Howe Institute, 1995), 169.

Trebilcock and Behboodi say that the provisions on government procurement in the AIT can be seen as negative integration measures. They prohibit both explicit discriminatory government procurement policies and government procurement policies or practices that may appear neutral but have an impact on out-of-jurisdiction suppliers, are incompatible with a least-trade-restrictive means test, and suggest in many cases colorable or disguised forms of discrimination. “The unresolved debate among the parties about the extent to which government procurement can be used as a legitimate instrument for the pursuit of regional development goals, even where this would explicitly or implicitly entail discrimination against out-of-jurisdiction suppliers, raises the larger issue of subsidies that have the potential to distort trade.”<sup>298</sup>

The “cost-efficiency” and “better-service” models of managing suppliers seem to yield valuable commercial results for governments in the short term; but, in the longer terms, this model may limit opportunities to enhance national economic performance. The increasing strength of trade blocs, such as NAFTA, APEC, and the EU, suggests that many nations covertly feel that global free trade is risky and that greater economic security may be found within the more limited, free-trade boundaries of a formal trade group that extends national boundaries without creating a global market place.<sup>299</sup>

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<sup>298</sup> Trebilcock and Behboodi, “The Canadian Agreement on Internal Trade”, 51.

<sup>299</sup> G. Callender and Darin Matthews, “The Economic Context of Government Procurement: New Challenges and New Opportunities,” *Journal of Public Procurement*, 2002, 2(2): 224.

### **The Canadian International Trade Tribunal and its Impact on Procurement Policy**

We have spoken broadly about the impact of the CITT on procurement and policy implications. In this section we expand upon these issues and make some comments about the nature of the CITT as an institution with mediating influence on procurement policy.

Many now speak of the ‘legalization’ of procurement in Canada. It arises from the fact that procurement and contracting has traditionally received little attention, and in the past 10 years it has emerged as an important policy area in the legal field largely due to the interest in the decisions made by the CITT.

In some jurisdictions, there is a considerable body of law and legal writing concerned specifically with the contracting of government.<sup>300</sup> In the United States, although there exists no conceptually distinct concept of the “administrative contract” and the agreements of public bodies are, like Canada’s, governed in principle by the private law,

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<sup>300</sup> In France, a distinct legal category of *contrats administratifs* is recognized, into which fall many of the government’s contracts of procurement. These are governed by a conceptually distinct “law of administrative contracts” developed and administered by special administrative courts. Although many of the rules of this “public law” are similar to those governing French civil (private) law transactions, there are also important differences. S. Arrowsmith, (1988), Government Procurement and Judicial Review. Agincourt: Carswell Co., Ltd., p.4.

there is a large body of special rules, both legislative and judicially created, which apply to the contracts of government. In the U.S. and other similar systems, government contracting has been a distinct area of study with a substantial body of literature on the subject.<sup>301</sup>

In Commonwealth jurisdictions, there was growth in the latter half of the century in the literature on government contracting, arising from attention to a particular issue: the potential for conflict between contractual obligations of public authorities and the need for effective government – that is, for the government to be able to exercise its discretionary powers in the manner most conducive to the public interest at any time.<sup>302</sup> The dispute resolution mechanisms adopted under the Canada-U.S. Free Trade Agreement and subsequently NAFTA are innovative in that they resort to the domestic courts and administrative agencies of the parties, international commercial arbitration and traditional international dispute resolution mechanisms. The procedural and substantive rules employ both domestic and international law. As a result, depending on the particular chapter, to a greater or lesser extent, panels established under the agreements attempt to reconcile different domestic laws, international trade law and general principles of international law. This raises the question of what effect these dispute

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<sup>301</sup> Arrowsmith, *Government Procurement*, 5.

<sup>302</sup> See Arrowsmith, *Government Procurement*, pages 4-7, for details on this literature.

resolution mechanisms will have on domestic administrative agencies, courts, particularly the Federal Court of Canada, and domestic law.<sup>303</sup>

The body of work is now significant in Canada, owing to the existence of the CITT and its decisions. The chart below summarizes the significant procurement cases in the past five years and identifies their importance in terms of procurement per se and their larger public policy impact.

**Table 4: CITT Procurement cases and Public Policy Impact**

<b>Key issue</b>	<b>Case or example</b>	<b>Impact on Procurement</b>	<b>Larger public policy impact</b>
Incumbency, conversion, trade mark technology exceedingly problematic, also problem of allowing alternative/substitute product	Corel 1999, other Telecom cases such as Bell Canada, Telus, AT&T Canada, Telesat, Accutel Conferencing, Systems Inc., Foundry Networks	Government must respect legislative scheme, non-compliance to be very exceptional, CITT must balance legitimate transition cost and compatibility concerns versus unfair incumbent advantage, tender documents must be very clear, specs must be generic	Corel case received much public attention; first real situation making procurement officials worried about loss of discretion, balance extremely difficult for PWGSC
CITT used as domestic complaint mechanism, not	National Airmotive Corporation, June 1999	Anything not falling under CITT jurisdiction – no	Lack of understanding of role/power of CITT,

<sup>303</sup> Denis Lemieux and Ana Stuhec, *Review of Administrative Action under NAFTA* (Scarborough: Carswell - Thomson Professional Publishing, 1999), 1.

<b>Key issue</b>	<b>Case or example</b>	<b>Impact on Procurement</b>	<b>Larger public policy impact</b>
foreign		recourse for suppliers in Canada	foreign suppliers may not realize this translates into further discrimination
Non-implementation of CITT recommendations	Wang Ltd. V. Canada and Attorney General of Canada V. Symtron Systems Inc.	Federal Court said Tribunal recommendations are to be followed, imposed costs of court proceedings on the department	Rigorous respect of legislative scheme required, giving 'teeth' to the CITT
Emphasis that competitive process should be the norm	Wescam	Government bears burden to prove why it should derogate from normal tendering procedures	Positive and compelling evidence to prove non-competitive process legitimate, risk good faith called into question
Ease of launching complaint	various	CITT begun to make compensation awards for aggravated damages, punitive damages	Discussion on-going with respect to government's right to sole-source vs. principle of competition
When is a contract a contract	MIL Fleetway	CITT approach seems to be – the award of the right to be called upon by task requisition or the call-up itself	Power of postponement, point is very early in process
Access to information	Western Star Trucks	Government requires some flexibility but must be wary of perceived discrimination	Intent of motives very hard to prove, must have compelling evidence
Politicization	EH-101	Using CITT process as a tool to slow procurement down	Not beneficial to effective and timely program

<b>Key issue</b>	<b>Case or example</b>	<b>Impact on Procurement</b>	<b>Larger public policy impact</b>
		in supplier's interest	implementation
Amendment clauses allow contract extension	Tendering Publications Limited April 2002	CITT says amendment clauses permit extension during term but not the extension of the contract	Closing back door on discretion to extend contracts if needed and avoid competitive process

The impact of these cases has been to in effect make the CITT into a 'policy shaping', if not 'policy making' institution with respect to procurement policy.

### **Ideology**

North's fourth variable in the cost of exchange is ideology.<sup>304</sup> This seems particularly relevant in the case of procurement due to the importance of whether procurement is viewed strictly as a mechanism for cost-effective purchasing, or an instrument for socio-economic objectives. Underlying this is the question of fairness – are we 'fair' by following disciplined trade rules ensuring the least cost/best value solution is chosen no matter where the supplier is located – or, is it more 'fair' to view the purchasing of goods and services in a domestic context where suppliers can be chosen because they are part of the government's objectives to support industry in a particular region or other such

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<sup>304</sup> For North ideology seems to refer to beliefs, convictions and attitudes, especially towards justice and rules about how society functions.

programs? The cost of contracting increases because we do not have a common view of fairness in all situations.

The neoclassical assumption that behavior is only constrained by rules and the effectiveness of their enforcement is clearly incomplete; honesty, integrity and living up to the spirit as well as the letter of the law do matter. But North asks, how much? If the amount were constant over time we could stick with the neoclassical assumption that preferences or tastes matter but are held constant. But ideological attitudes, the fourth variable, are not constant.<sup>305</sup>

Until the 1970s, access to government purchasing as an issue was hardly open to discussion and debate in Canada, “Governments held it as an article of faith that they should, whenever possible, return tax revenues to their own economies by reserving the bulk of their purchasing to their domestic suppliers; for this reason governments have

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<sup>305</sup> “The strength of ideology can be measured by the premium people are willing to incur rather than “free ride.” Such a premium is the cost of one’s convictions. Not only does the premium vary according to one’s beliefs about the justice of the rules and the contractual arrangements of the society, but it can be influenced by education, propaganda, and symbols. Appeals to justice and fairness do matter, otherwise we would be at a loss to explain a good deal of schooling as well as the immense investments made by politicians, employers, labor leaders, and others trying to convince participants of the fairness or unfairness of a contractual arrangement. Our understanding of ideology is still sketchy, but one more point is significant. Specialization and division of labor produce divergent perceptions of reality and hence contrasting and conflicting views of the fairness and justice of institutional arrangements. In such a world the cost of contracting, *ceteris paribus*, increases because one cannot rely on common perceptions of fairness to enforce compliance of agreements”. North, “Government and the Cost of Exchange”, 258.

been slow to criticize others for adopting a similar course. Despite the fact that this practice must in at least some cases increase the tax burden through increased costs, there has been in the past and even today there is little or no public criticism of this government policy.”<sup>306</sup> Governments perceived themselves as being highly vulnerable to the criticisms of ‘neglecting national interests’, ‘exporting jobs’, and ‘failing to protect domestic industry’ when they are in a position to do so.<sup>307</sup> This represents the prevailing ideological attitude towards procurement for the post-war period.

Interestingly the decisions to go bravely down the free trade road were not a product of ideological enthusiasm. Mulroney was not so much following the ideological waves of conservatism demonstrated by Reagan and Thatcher at the time, though he undoubtedly favored liberalized markets, as he was making an intuitive political judgment that this was “a policy whose time had come” in that it was needed to ensure Canadian access to U.S. markets when protectionist pressures there were in the ascendancy.<sup>308</sup>

While specific decisions about free trade may not have been ideologically based, there can be no doubt that Canadians struggle with the notion of economic integration because it challenges our regional identities and consequently feeds into our larger questions about the Canadian identity. Albert Breton in “A Comment” to Trebilcock and

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<sup>306</sup> de Mestral, “The Impact of the GATT Agreement on Government Procurement”, 172.

<sup>307</sup> Ibid., 172.

<sup>308</sup> Doern and Tomlin, *The Free Trade Story*, 273.

Behboodi's article, considers the underlying economic ideological reasoning behind moving further towards economic union, though stressing that it is one of the most difficult problems to wrestle with and one which encourages extreme positions. He notes that 'harmonization' and 'integration' have joined 'cooperation' and 'globalization' as motherhood sacred icons, and they seem nearly impossible to be against. He asserts that it is not possible to provide a rationale for, or a defense of, federal states that do not give pride of place to differences in the preferences of citizens, thus there is genuine tradeoff between the requirements of economic integration and those of federalism.<sup>309</sup>

The economic reasoning that would dominate government decisions underlying the FTA and the AIT was largely the result of The Royal Commission on the Economic Union and Development Prospects for Canada (the MacDonald Commission) that reported in September 1985. The Commission urged the Canadian government to raise long-term productivity by opening up the Canadian market to more competition. Consultations were dominated by large business interests and traditional neo-classical economists making it difficult to reconcile the imperatives of neo-classical economics, distributive justice and pareto optimality while compensating beneficiaries such as the provinces and manufacturers for the loss of institutionalized entitlements. The MacDonald Commission concluded, "Our proposals ... to enter into a free trade agreement with the United States reflect our general preference for market forces over state intervention as the appropriate

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<sup>309</sup> Breton, "A Comment", 91.

means through which to generate incentives in the economy, from which growth will follow.”<sup>310</sup>

There were difficult contradictions to be managed through the negotiations of the trade agreements. The contradictions were based in the tensions between satisfying the path dependent, regional policy dominated federalism of the 1970s and 1980s and the powerful ideology of market forces encouraged by the MacDonald Commission that meant the removal of discretionary policies of benefit to regions and sectors.

Breton comments that there was almost a complete absence of economic theory from the debates and negotiations leading to the AIT for example, except for the largely ideological premise that negative and positive integration mean more economic growth and more wealth. In reality, the ideological foundations were already strongly in place. The tensions between retaining some form of domestic protection and further market liberalization now took the form of the extent to which positive or negative integration would be embraced.

Negative and positive integration are two different approaches to reconciling the tensions of inter-jurisdictional agreements and federalism (and continental economic integration at

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<sup>310</sup>Canada. (1985). *Royal Commission on the Economic Union and Development Prospects of Canada* (Vol. 1). Ottawa: Minister of Supply and Services Canada in Edward Connor, *The Department of Communications under the Free Trade Regime*, Canadian Journal of Communications, Volume 16 No.2, 1991.  
<<http://info.wlu.ca/~wwwpress/jrls/cjc/BackIssues/16.2/comor.html>>, 03/07/05.

another level).<sup>311</sup> Positive integration can be described as the removal of internal barriers to trade combined with shared rules imposed by a central authority. Negative integration is a framework of rules that prohibits certain forms of behaviour by participating governments while accommodating varying levels of policy differences within the different elements of that framework.<sup>312</sup> Negative integration was a conceptual framework that could help to balance domestic and international pressures arising from federalism and the entrenched regional policy paradigm. Sub-national governments persisted in looking to retain and expand their sovereignty in face of pressure to accede to both international trade agreements and the AIT. By negotiating exclusions from the AIT, at least in the initial stages, provinces and other stakeholders could see the possibility for retaining some measure of ‘special access’ to contracts which they had traditionally counted on in terms of regional and industrial development (such as the original MASH sector exclusion). In the face of increasingly economic integration, both domestically and internationally, provinces would not as a rule, be able to accept a

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<sup>311</sup> In terms of the actual mechanisms of positive and negative integration in trade agreements, positive integration is a bottom-up process whereby a good or service has to be explicitly listed in order for the agreement to cover it. Goods or services that are covered, are then subject to exceptions listed in Annexes and listed entities that are covered must exceed specified thresholds. Negative integration is top-down, generally all goods and services are covered and then the agreement proceeds with lists of exclusions.

<sup>312</sup> Mark R. MacDonald, “The Agreement on Internal Trade: Trade-offs for Economic Union and Federalism”, in *Canadian Federalism: Performance, Effectiveness and Legitimacy*, ed. Herman Bakvis and Grace Skogstad (Toronto: Oxford University Press) and Geoffrey E. Hale, “Adapting to North American Integration: Challenges for Canadian Federalism”, Policy Research Initiative, Horizons, Volume 6, Number 3, 44.

federal government agenda that could, in some circumstances, tend to suppress federalism.<sup>313</sup>

The AIT has many opinionated observers. Armand de Mestral in “A Comment” in Getting There, is very concerned that the AIT is not consistent with the principles and institutions of Canadian federalism which involve a very high degree of economic integration. Instead the provinces modeled the AIT on the international law of the GATT, and have not even committed to the extent of the Uruguay Round negotiations. It’s ‘no law, bad law, and the wrong kind of law’.<sup>314</sup>

De Mestral strongly asserts that it is a political text not grounded in any legal system, be it federal, provincial, international or Canadian constitutional law. The dispute settlement system has no guidance as to the law in which in the agreement is based. There is very little commitment by the parties, and the right of provinces to pursue their own policy goals appears often. Because the text is drafted similarly to GATT or NAFTA, the

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<sup>313</sup> Breton, “A Comment”, 91. For an interesting discussion of the effect of globalization on regional autonomy and assertiveness see Pieter Van Houten, “Globalization and Demands for Regional Autonomy in Europe” in M.Kahler and D.A. Lake, eds., *Governance in a Global Economy – Political Authority in Transition* (Princeton: Princeton University Press, 2003), 110-135. Van Houten’s evidence suggests that political institutions are as important in determining regional assertiveness as any of the effects of globalization. Regions then are unlikely to be weaker in their role with respect to changes imposed from international trade agreements and will continue to press for ‘exceptions’ such as those captured by negative integration processes.

<sup>314</sup> deMestral, A. “A Comment” to Trebilcock and Behboodi, “The Canadian Agreement on Internal Trade”, 95.

impression is that the provinces are independent sovereign actors capable of making concessions comparable to those made by governments in NAFTA. But inter-provincial trade falls under federal, not provincial jurisdiction. Thus there is a confusing underlying, potentially unconstitutional series of provisions relating to inter-provincial trade.<sup>315</sup>

Indeed, the backdrop for inter-provincial trade is changing. Provinces and regions are highly integrated north-south, and since they are distinct industrially from other east-west provinces/regions, there will be a tendency for them to enact policies that will enhance their ability to compete in North American economic space.<sup>316</sup> Courchene believes that this is the emergence of North American economic region states and likely this will result

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<sup>315</sup> deMestral, "A Comment", 95.

<sup>316</sup> There is considerable tension in Canada between the pressures toward policy convergence with the United States versus the benefits of policy independence and thus divergence. The policy convergence approach holds that greater integration creates incentives for policy convergence between countries. The second is associated with 'competitive federalism' where governments are assumed to compete with each other for mobile factors of production by choosing the policies most likely to attract incremental investment and jobs in light of the policies chosen by other governments. Richard G. Harris, ed. *North American Linkages: Opportunities and Challenges for Canada*, The Industry Canada Research Series, University of Calgary Press, 7. Hale notes the emergence of 'complementary federalism', an approach to shared or overlapping government jurisdictions in which federal and provincial governments carry out related, but operationally independent functions that recognize areas of common and discrete jurisdiction. The concept is a by-product of government efforts to set priorities, balance budgets, and increase political and fiscal discretion in responding to challenges arising from globalization and continental economic integration. See G. Hale, "Adapting to North American Integration", 43-44. These arrangements enable some degree of symmetry between national policy regimes addressed in NAFTA and evolving federal-provincial arrangements.

in an enhanced degree of decentralization, and therefore greater asymmetry.<sup>317</sup> It is possible, as Courchene argues, that the focus on symmetry as a philosophical goal of federalism has been trumped by the provincial/regional realities of North American trade integration.<sup>318</sup>

## CONCLUSIONS

The purpose of this chapter was to outline the fundamentals of the key trade agreements in terms of their procurement elements, to look at the impacts of the Canadian International Trade Tribunal with respect to procurement, and through the use of North's transaction cost framework in the economics of institutionalism, to examine the impact and effect of liberalization and trade on procurement policy.

The initial amount of trade that was opened up under the series of trade agreements was not extensive and there were many exceptions that allowed Canada to continue using procurement to protect industry and to promote development programs. This demonstrated the continuing existence of the strong regional policy paradigm and the

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<sup>317</sup> Ontario is by far the most deeply integrated province with Quebec a close second. For example, as a 'percent of goods exports shipped to the US', Ontario has 93.1% and Quebec 84.6%, whereas Saskatchewan is at 57.8%. Hale, "Adapting to North American Integration", 42.

<sup>318</sup> T.J. Courchene, "Broadening, Deepening and Re-Territorializing Federalisms: NAFTA and KBE Perspectives: Preliminary Background Bullets for the Closing Panel "Implications for the Federation and Intergovernmental Relations", *Quebec and Canada in the New Century: New Dynamics - New Opportunities*, Institute of Intergovernmental Relations, School of Policy Studies, Queen's University, 2003, 6.

desire for stakeholders to continue receiving the benefits to which they had become accustomed. 'Negative integration' approaches to economic liberalization held more promise (than 'positive integration') for politicians to protect traditionally subsidized industries and regions. But, over time, the exceptions and set-asides were increasingly reduced. For example, two important extensions to the AIT increased its impact. First, the expanded coverage to the municipalities, schools and hospitals sector (MASH) reduced inter-provincial barriers to access of procurement contracts. Second, the extension of coverage to defence reduced the extent to which exceptions could be made for anything but highly scrutinized 'security' issues.

Thus there was a significant shift in the capacity for the government to use procurement as a tool for economic development, socio-economic policy, defence industry protection, and directed spending generally. The rules-based regime stemming from the legalistic context in which procurement now functioned changed the way the procurement officers had to approach all processes around the bid system. Trade agreements had to be considered first, along with lessons learned from CITT decisions including now the consideration of probable biases and the body of case law already in place. The liberalization process and the direct association of trade policy with procurement (now as included directly in the trade agreements) means that procurement choices are now shaped with externally imposed constraints at the forefront.

In the economic institutional framework developed, the cost of exchange, and how this relates to procurement as a transaction is broken down into four categories. Each of these has an impact on the nature of procurement and in turn has altered the conditions for policy making. The new dynamics include the use of competitive bidding as the yardstick due to the difficulty in obtaining sufficient information otherwise, adherence to non-discriminatory principles as way to govern exchange between parties, enforcement mechanisms based in the growing body decisions of the CITT, and the growing ideological foundation of procurement in 'fairness' in a liberal trade sense (not a domestic regional policy sense).

The cost of measuring any procurement exchange increases if the mechanism for obtaining goods and services is not competitive bidding. In a competitive bidding situation, the objective is clear (although having only two bids in a given situation may not be considered very competitive, i.e. the EH-101 helicopter bid) and any discretion exercised around who is allowed to bid introduces inefficiency. Corruption, difficult to identify and measure, is consequently inefficient and contrary to competitive bidding practices. In the context of procurement policy, success is measured by the number of CITT challenges (low is better); this seems to hold some potential as a yardstick for effective procurement in government.<sup>319</sup> The increasing emphasis on competitive

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<sup>319</sup> While it is reasonable to expect a spike in the number of cases heard by any administrative tribunal following its creation or the expansion of its jurisdiction to clarify the case law and establish its effective authority, the number of these cases judged in

bidding reduces the capacity for political and bureaucratic discretion, and for better or worse is required with respect to compliance with international trade agreements.

The nature of procurement exchange, the rules under which contracting proceeds, is now governed by principles of ‘most-favored nation’ and ‘national treatment’. Despite the continuing existence of categories of goods and services that do not fall under the trade agreements, increasingly these exceptions are being reduced, and thus discretion is removed from officials in contracting and mechanisms for contracting.

The enforcement of procurement exchange looks far different from twenty years ago; there is little choice on the part of procurement officials with respect to how bids are developed and published, and the way in which bids must be evaluated. The CITT case history now presents a formidable series of judgments (although the CITT is not bound by its own case law and has been criticized for inconsistency in the way it addresses issues) that officials must know and understand in order to avoid being challenged by the potential suppliers. The CITT has become a policy-making institution, by essentially controlling the conduct of procurement by much of the federal government.<sup>320</sup> It is slowly constricting the discretion of procurement officials by the nature of its decisions and choices as to how procurement contracts will be solicited, managed, and enforced.

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context over time is important variable in the examination of the evolving procurement environment.

<sup>320</sup> Attwater, *Procurement Review*, 2.5.3.1.

The traditional institutions of procurement, Public Works and Government Services Canada (and its earlier incarnations), Treasury Board, Industry Canada (and earlier forms), now operate in a policy context where the CITT is a fundamental force. In light of the CITT process, effective procurement results to a certain extent through a process of trial and error, whereby these institutions interact and the traditional government organizations shift and react in the pursuit of the best outcomes possible. This environment, as it changes and alters, defines and limits the practicable forms of organization available.<sup>321</sup> Fundamentally, the CITT is now an institution that will limit the practicable organizations and arrangements that can emerge in the procurement field.

While the ideology underlying procurement policy retains the preference for regionalism and de-centralized decision-making, the sheer cost of de-centralized institutions and choices based on promoting 'inefficient' objectives have moved Canadian procurement policy more towards values of competitiveness and rules-based decision-making. The 'ideology' of economic liberalization is attractive in many ways (to a federal government and possibly provinces and large companies), promising more efficient procurement and larger markets. If less 'regionalism' is not acceptable the Canadian government will continue to pay a premium for subsidization both in terms of transactions costs and in terms of the difficulty of being competitive in the liberalized trade environment. The regional paradigm continues to exert pressure but the federal government is far less

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<sup>321</sup> This reflects Eggertson's framework, see page 75, Chapter Two.

interventionist and more market-oriented than before the key trade agreements discussed here were in place. In Chapter Five we turn to the role information technology plays in this evolving environment.

## **CHAPTER FIVE**

### **PROCUREMENT POLICY AND INFORMATION TECHNOLOGY**

#### **INTRODUCTION**

The chapter examines the connections between procurement and information technology. It builds a typology for looking at procurement through the lens of the information technology agenda comprised of Electronic Government and Electronic Governance, Government On-Line, and Electronic procurement. Through an application of organizational institutionalism, we explore the way in which constraints on institutions and the behaviour of actors affect the evolution of procurement policy.

This chapter takes the perspective that information technology is an important variable through which policies and strategies associated with procurement have increasingly been reflected. The policies, strategies, and activities of the IT agenda are shaping procurement at both the structural and broader institutional level as well as at the internal organizational level. As discussed in Chapters Three and Four, socio-economic trade-offs and regional policy, and economic liberalization reflect enduring paradigms and the slowly evolving nature of procurement in the context of these paradigms. The IT Agenda introduces a third variable, the transformative effect and impact of information technology on policy and strategy with respect to procurement.

After depicting the IT agenda and the institutional environment this Chapter examines the contextual and structural dichotomy of the public and private sector as it relates to procurement.<sup>322</sup> This dichotomy is a critical determinant of how procurement takes place in government.

Next the analysis examines the neo-institutional idea of organizational isomorphism, defined as legitimacy-seeking actions at the institutional and structural level and legitimacy-seeking behaviour at the organizational level. The coercive, mimetic, and normative aspects of this idea help to account for why, despite change and innovation in institutions, procurement evolution at the policy and activity level is constrained.

Legitimacy is important because the policies, institutions, and ideas involving IT and procurement are adapting to this new element (IT as a mechanism, and as policy) and are not as yet entrenched either as an 'idea' nor as a new paradigm.<sup>323</sup> Political institutions and actors require legitimacy because from this flows power and funding. Legitimacy tends to be achieved by following established trends and mimicking behaviour that is deemed 'authoritative'. In the chapter we look at the mechanisms through which institutional isomorphism occurs: first, *coercive isomorphism* which stems from political

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<sup>322</sup> 'IT industry' in this chapter is the same thing as the 'ICT industry', the Information and Communications Technology industry. The Information and Communications aspects cannot be separated from one another as the technologies are now well-integrated concepts and technologies.

<sup>323</sup> One could say that the 'new economy' represents a new paradigm. How public procurement and the 'new economy' are related is an interesting idea to be explored in further work.

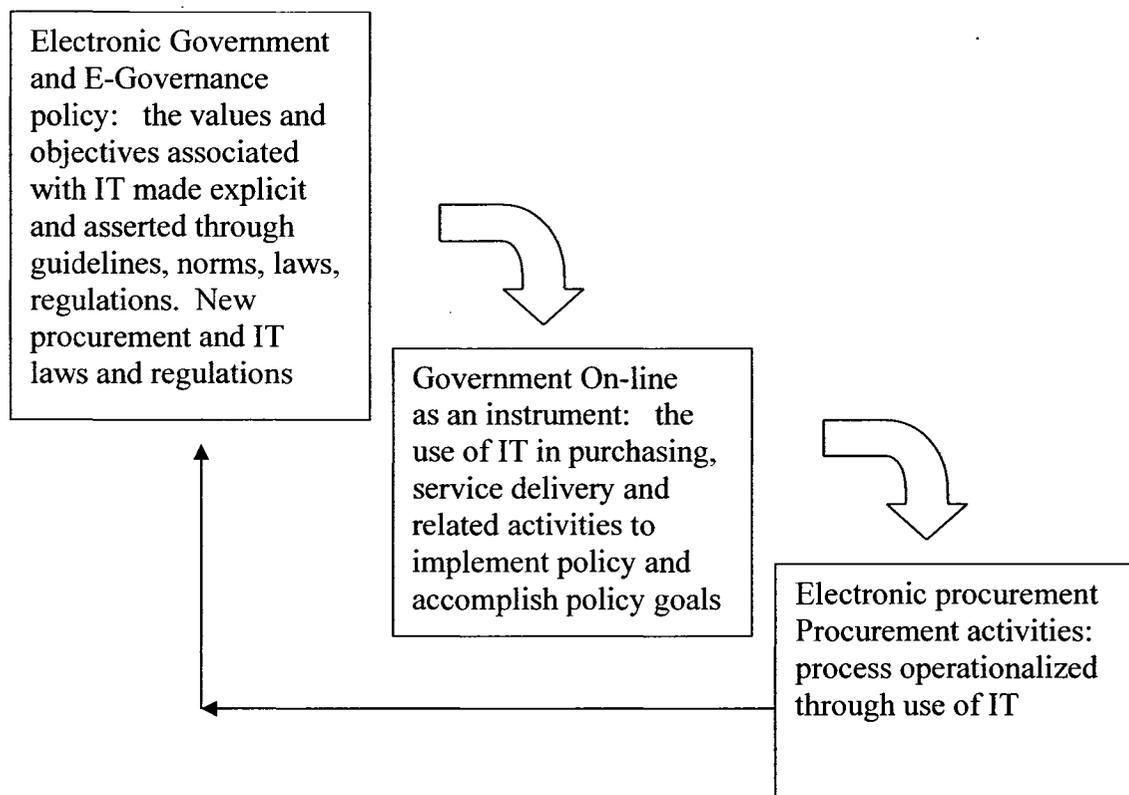
influence and the problem of appropriateness; second *mimetic isomorphism* which results from standard responses to uncertainty; and third *normative isomorphism* which points to the problems associated with professionalization. The Chapter then proceeds to examine these issues through a typology that aids in reducing the complexity of procurement as it relates to IT, by examining procurement *of* IT, procurement *for* IT, and procurement *with* IT. The constrained behaviour resulting from isomorphic pressures impacts on the complex policy and institutional interactions that arise from having to simultaneously manage the “of IT”, “for IT”, and “with IT” dimensions. It is through these dimensions that procurement and IT reflects the higher order political goals of accountability, efficiency, administrative integrity, and value for money.

#### **FRAMING THE IT AGENDA: ELECTRONIC GOVERNMENT, GOVERNMENT ON-LINE, AND ELECTRONIC PROCUREMENT**

In order to bring together the policy and practices of procurement and the scope of information technology this section lays out a simple framework for capturing the concepts. The concepts are presented in a parallel way to the three-level depiction of procurement in Chapter One. For the purposes of this Chapter, this framework represents the IT agenda; the integration of information technology into the policies, strategies,

structures and resources of government and the choices that are made as to how IT is used as it relates to procurement.<sup>324</sup>

**Figure 9: The IT Agenda**



<sup>324</sup> The IT agenda may also be viewed as a political and bureaucratic mission to make information technology a key and critical policy area. IT becomes an 'agenda' when political actors and the bureaucracy associate power and legitimacy with funding and institutional creation (and continuity) over time. They then associate their success and future success with institutional and individual authority. Increasingly, this 'agenda' is linked to how IT can spur and support innovation and international competitiveness. In some ways this is the modern and shifted version of 'regional policy', a way in which stakeholders can gain from government choices around funding.

Within the scope of the IT agenda this Chapter explores these concepts at three levels. First E-government is an overarching concept at the policy level. It reflects the values and behaviours desired by government and made explicit in laws and guidelines and regulations regarding the use of IT in government. Policies on procurement as they relate to IT have emerged as part of E-government. Included in this definition of E-government is E-governance, which involves the use of IT to create networks, manage partnerships, and foster individual and community engagement with the democratic process through the use of technology. E-governance is often directed towards the improvement and evolution of communities through widespread and public access to the Internet.<sup>325</sup> The shift towards 'E-government' may present the possibility of new governance capacities through the broadening and transformation of partnerships with private sector providers.

The second level of this model presents the concept of Government On-line as an instrument of E-government policy, and connects the use of IT in government to service delivery. Over the past ten years, the use of IT has moved from a focus on its capacity for data storage and as a method of information input to being viewed as a technology with 'transformative' potential. Richard Lipsey argues how every once in a while a new General Purpose Technology (GPT) emerges that causes deep structural adjustments and massive changes in our way of life as well as rejuvenating the growth process by

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<sup>325</sup> In some cases E-governance is viewed as a higher order concept that would encapsulate E-government. This thesis does not explore E-governance in depth and defines it as one aspect of E-government.

presenting a whole new research program for finding improvements in and new applications for the new basic technology.<sup>326</sup> In this vein, IT represents an opportunity to significantly shift how, where and when people work as well as productive processes themselves. The GOL instrument is the way in which the Canadian government has chosen to manage these ideas and transformative capacities of IT.

In the late 1990s, the emphasis for GOL was on increasing the use of the Internet for government, business, and individuals. The Canadian government boasted that by 2003 Canada would be the most connected government in the world. Indeed Canada placed first in Accenture studies of 'most connected governments'.<sup>327</sup> However, increasingly it was understood by officials, and to a lesser extent politicians, that simply using the Internet did not make government necessarily better or more efficient. The reality was that it was more important how the Internet would be used. Thus through 2003 and 2004 the Government shifted its attention to leveraging the electronic channel to support service

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<sup>326</sup> Richard G. Lipsey, "Economic Growth, Technological Change, and Canadian Economic Policy", C.D. Howe Institute Benefactors Lecture, Vancouver, November 6, 1996, Sponsored by Hongkong Bank of Canada, p. 15.

<sup>327</sup> Several research groups, consulting firms and government organizations have undertaken surveys to rank worldwide electronic government service delivery and related areas. The most recent results from 2004 have Canada placed as follows: Accenture(First); Brown University (Fourth); World Economic Forum (Sixth); United Nations (Sixth); TNS Inc. (Sixth); and The Economist Intelligence Unit (Ninth). The disparity in rankings is primarily due to different assessment strategies and indicators employed in these surveys.

[http://www.pwgsc.gc.ca/onlineconsultation/text/publications/E-Government\\_Rankings\\_2004-e.html](http://www.pwgsc.gc.ca/onlineconsultation/text/publications/E-Government_Rankings_2004-e.html), 24/05/05.

transformation and more efficient operations.<sup>328</sup> One of the fundamental institutional pressures in federal political systems emerged starkly. The strategic use of information technologies involved and enhanced centralizing and decentralizing pressures.

The third level of this framework presents E-procurement as the use of technology to accomplish procurement activities, from the automation of transactional information to complex contracting with the use of IT, such as e-auctions, e-bidding and e-contracting. E-procurement is an internal procedural manifestation of E-government. Since it presents a new way to obtain and deliver services, it consequently puts pressure both on individuals and organizations to adjust their behaviour.

With respect to the IT agenda, E-procurement laws and regulations have evolved to protect the security of information and individuals and suppliers in the online environment, as well as to increasingly enable on-line purchasing and contracting activities. Full use of electronic procurement would mean electronically providing the end-to-end competing, negotiating, awarding, and management of contractual arrangements.<sup>329</sup> The technological capacity for expanding on-line procurement activities exists, but the government organizational and managerial capacity is evolving at a much slower rate. The rapid states of flux induced by the IT agenda in an environment of evolving trade law and domestic policy make it difficult to 'catch up' to this potential.

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<sup>328</sup> Treasury Board of Canada Secretariat, "Serving Canadians Better: Moving Forward with Service Transformation at the Enterprise Level", Canada Country Report, September 2004. <http://www.cio-dpi.gc.ca>, 12/04/05.

## CONTEXT AND INSTITUTIONAL ENVIRONMENT

There are a number of complicating factors with respect to the introduction of new IT systems and related process innovations such as: technology, regulatory changes, legislative changes, e-business, cultural changes, public attitudes, and inter-governmental cooperation.<sup>330</sup>

The rapid and ongoing change in the technology means that government must make substantial financial outlays each year for IT products. A large and important industry emerged around information and communication technologies. The government is not only now dependent for infrastructure on the IT industry but also the government must play a role in the development of that industry, either by shaping the market environment or more directly by support to individual companies and sub-industries. As a result of the factors discussed in the previous two Chapters, governments are holding on to reducing amounts of discretionary power often now directed at the information technology sector.

Regulatory changes generally flow from legislative changes or are altered within the current legislative framework. With respect to e-business where GOL and E-procurement figure prominently, there is provincial and territorial legislation in all of

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<sup>330</sup> David Wyld, "The Auction Model: How the Public Sector Can Leverage the Power of E-Commerce through Dynamic Pricing", eds., Mark A. Abramson and Grady E. Means, *E-Government 2001*, The PriceWaterhouseCoopers Endowment for the Business of Government, Lanham: Rowman & Littlefield Publishers Inc., 123.

Canada except for Quebec, and there is federal legislation filling in the gaps in provincial laws. The provincial Electronic Commerce Acts are all quite similar and are based upon the United Nations' Model Law on Electronic Commerce. They create a legal framework for e-commerce.<sup>331</sup> A series of nine reviews of government operations resulted in the President of the Treasury Board's plan for "Smart Regulation"; involving substantial changes in the regulation of procurement and expected reallocations of \$2.5 Billion over a number of years.<sup>332</sup> As discussed in earlier chapters, NAFTA and the AIT as well as other international agreements have had substantial impact on procurement.

There can be no doubt that information technology has driven cultural change. However, cultural change takes place as a result of many factors, and this in turn affects the attitudes towards the integration of information technology in public and private lives. Statistics show that individuals are increasingly using the Internet.<sup>333</sup>

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<sup>331</sup> Robert C. Worthington, "E-Commerce Legislation, Canada Gets Its Acts Together", July 2003, <<http://www.purchasinglaw.com/articlejuly2003.htm>>, 24/05/05.

<sup>332</sup> Speech by Reg Alcock, President of the Treasury Board, Launch the Government of Canada's Implementation Plan for Smart Regulation, March 24, 2005, National Press Club, Ottawa, Ontario. [http://www.tbs-sct.gc.ca/media/ps-dp/2005/0324\\_e.asp](http://www.tbs-sct.gc.ca/media/ps-dp/2005/0324_e.asp), 20/05/05.

<sup>333</sup> Public Works and Government Services Canada, Online Consultation Technologies, Centre of Expertise, <http://www.pwgsc.gc.ca/onlineconsultation/text/index-e.html>, 19/05/05.

**Figure 10: Canadian Citizens and On-line Government Services**

- 59.1% of Canadians used the Internet from home to access government information in 2003
- 56.7% in 2002
- 52.5% in 2001
- 47.1% in 2000
- 44.1% in 1999

The Household Internet Use Survey, Statistics Canada 2004

Businesses are increasingly using the Internet as well at least in a basic fashion.

**Table 5: Business and government use of information and communication technology(1)**

<b>Business and government use of information and communication technology<sup>334</sup></b>					
	<b>Enterprises that use email(%)</b>				
Year	2000	2001	2002	2003	2004
Private sector	60.46	66.03	71.22	73.89	76.60
Public sector	98.98	99.71	99.60	99.81	99.89
	<b>Enterprises that use the internet(%)</b>				
Private sector	63.40	70.84	75.67	78.27	81.62
Public sector	99.16	99.71	99.59	100.00	99.89

<sup>334</sup> Statistics Canada Survey of Electronic Commerce and Technology – sample of 21,000 enterprises using Business Register list and other administrative listings for the public sector, <http://www40.statcan.ca/101/cst01/econ146d.htm>, 21/05/05.

Individuals who now communicate with government over the Internet and who use email regularly come to expect more rapid service delivery and instantaneous problem solving. Communicating with the public and business drives these groups increasingly on-line and puts increasing pressure on government to deliver more and more services on-line.

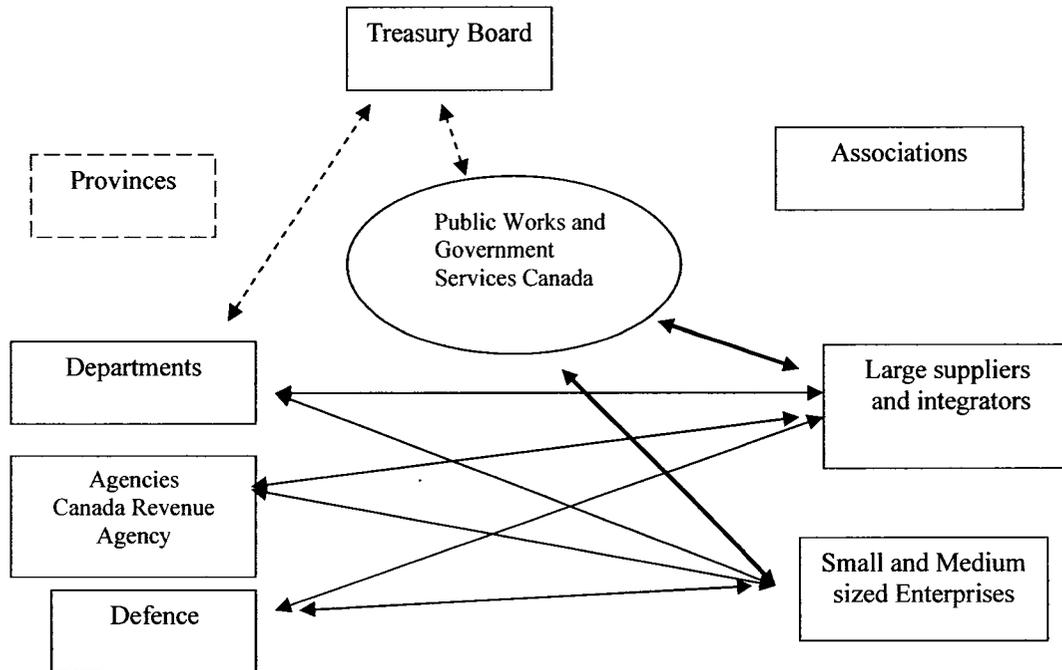
Inter-governmental cooperation is both driven by IT and encourages its further development. Electronic tendering requirements were negotiated into the Agreement on Internal Trade in 1995. Provincial governments are important players in public-private partnerships that are driving infrastructure development at the city level.

The institutional environment in which these issues evolve is depicted below.<sup>335</sup> The way in which the procurement relationships develop is a function of the authority that PWGSC holds.

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<sup>335</sup> Note that this is a selection of the interacting institutions representing the key policy and implementing institutions important for this discussion from the public sector and private sector. A different or extended diagram could show the Office of the Auditor General and Parliament as institutions of oversight and financial accountability.

**Figure 11: Institutions and procurement relationships**



Note: Solid arrows represent key IT procurement relationships; dotted arrows represent financial reporting relationships

Treasury Board sets the overarching policy for procurement and contracting activities and has the oversight role in terms of gathering expenditure plans and coordinating budgets. Public Works and Government Services Canada evolved in various forms as the central purchasing organization for the Federal Government. The arrows represent the key procurement relationships as they relate to IT between private sector organizations, PWGSC, and Departments and Agencies. The Canada Revenue Agency and the Department of National Defence are highlighted because of their unique and singularly important procurement relationships with both PWGSC and the private sector businesses. The CRA has more control over its spending authority in procurement due to its agency

status and arms-length relationship with Treasury Board with respect to managing and reporting.<sup>336</sup> The Department of National Defence deals with the largest and most complicated projects in the Canadian public sector, both IT related and otherwise (Major Crown projects for equipment for example) and has special arrangements with PWGSC for managing these programs. Large and small suppliers have direct contact with Departments and Agencies for particular devolved contracts that involve standing orders and small amounts. In other situations, PWGSC holds the power and responsibility to manage contracting to the private sector.

The Associations such as the Information Technology Association of Canada (ITAC), the Canadian Advanced Technology Alliance (CATA), and the Canadian Information Processing Society (CIPS) represent various combinations of the companies in the information technology and communication sector. The Associations are an important group of organizations that allow smaller businesses to communicate with government when they might not otherwise have the capacity or influence. This was well demonstrated in the Government-Wide Procurement Reform Project consultations.

There have been some important changes in this environment as relates to the IT agenda.

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<sup>336</sup> CRA's Payroll Modernization Program involved designing a fair and transparent bid that would not be preferential to contractors with 'prior knowledge' already working in CRA. In the fall of 2004, PWGSC bureaucrats were watching the CRA process carefully, expecting that similar issues would soon arise with the full government payroll modernization program (Author's experience with CRA and PWGSC 2004).

The call to appoint Chief Information Officers (CIO) for government departments, including a Federal Chief CIO housed in Treasury Board in the mid 1990s seemed to be recognition, manifested in an institutional change, that IT was a major issue and influence on government. There was continuing disagreement over which organization and who should control the Government On-line agenda. On December 12, 2003, the responsibility for GOL was transferred to the Information Technology Services Branch at PWGSC. PWGSC is increasingly the centralized authority for procurement activity with expanding responsibility for the IT agenda. In the wake of the Task Force report PWGSC is in state of transformation as individuals are shifted from one group to another, and more new structural adjustments are made.

### **THE UNDERLYING DICHOTOMY**

This institutional context has implications at the policy, strategy, and structural levels. Information technology is now as critical to the procurement function in the public sector as it is for supply chain management in the private sector. It is central to process performance and competitiveness in the private sector, and no less important to effective activity and program management in the public sector.<sup>337</sup> The pervasiveness of IT is evident in its growing use since 2000.

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<sup>337</sup> M.E. Nissen, "SPS and Beyond: Innovating Acquisition Through Intelligent Electronic Contracting", Acquisition Reform - A Revolution in Business Affairs, Proceedings of the 1999 Acquisition Research Symposium, Sponsored by the Deputy

The Government of Canada has created policies (i.e. Common Look & Feel for the Internet, Management of Information Technology Policy, Policy for Public Key Infrastructure Management in the Public Service, Alternative Service Delivery Guidelines) and institutions (i.e. Chief Information Officer Branch) to organize and manage IT as well as deliver a large number of services through the use of IT.<sup>338</sup> Equipping public servants with computers and telecommunications equipment, and maintaining them is of itself a massive task. Procuring for this IT involves both fairly standard processes of ordering and contracting for the supply of these resources but on a larger scale, when IT operations are outsourced, the relationships become more complex. The public-private sector relationships have been described at various times as ‘wicked’ problems<sup>339</sup>, the sometimes conflict-ridden and ever precarious state of the relationships between the private sector and the public sector that come into play in order to manage and procure this IT. These relationships are shaped by the institutional context as described earlier, and also impact on how policy is developed.

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Under Secretary of Defense for Acquisition Reform. Co-hosted by the Defense Systems Management College and the National Contract Management Association, Washington D. C, 468.

<sup>338</sup> All of the Government of Canada’s most commonly used services – 135 in total – are at least partly on-line. This involves an enormous infrastructure of IT and procurement activity. <http://www.cio-dpi.gc.ca>, 12/05/05.

<sup>339</sup> The notion of policy and process as ‘wicked problems’ is drawn from G. Paquet, “Tackling Wicked Problems”, *Governance Through Social Learning*, (Ottawa: University of Ottawa Press, 1999), 41, and T.J. Courchene and A.E. Stewart, eds, *Essays on Canadian Public Policy* (Kingston: Queen’s University School of Policy Studies, 1991), 171-186.

The chart below outlines the contrasting environments of the sectors and the important aspects as they relate to procurement. These characteristics hold true for procurement generally, but become accentuated in the complex environment of IT procurement. Much of the difficulty associated with procurement and information technology arises from the nature of these differences between the private and the public sector.<sup>340</sup>

**Table 6: Public vs. Private Sector Procurement Environment<sup>341</sup>**

<b>Public Sector</b>	<b>Private Sector</b>
Unsuccessful projects or poor decisions profiled in media with negative consequences for politicians. This contributes to risk averse behaviour by public servants.	Bad decisions written off. Only if major in nature would they be reported or highlighted even in annual reports. Consequences mainly financial, responsible persons may be fired.
Fiduciary and statutory rules bind choices; responsibilities for source selection reflect public policy interests and public trust.	Rules are established by administrative choices and audit processes based on principles of good business management. Historical or strategic relationships usually define procurement models; suppliers usually limited to select few; unsolicited proposals are readily accepted.
Traditional arm's length separation between purchaser and vendor/service provider. (typically PWGSC is purchaser and	Strategic working relationships through negotiation and multi-player consortia, close ownership relationships, market alliances – personal networks important

<sup>340</sup> In a supply management framework, Johnson, Leenders, and McCue compared the roles and responsibilities of purchasing organizations in the private and public sectors. They found significant areas of difference in five areas examined, organizational structure, supply chain responsibilities, the reporting line, teaming and involvement in major organizational activities. P.F. Johnson, M.R. Leenders, and C. McCue, "A Comparison of Purchasing's Organizational Roles and Responsibilities in the Public and Private Sector", *Journal of Public Procurement*, 2003, Vol.3, Issue 1, 57-74.

<sup>341</sup> Adapted from "Public vs. Private Sector – Partnering and Procurement Frameworks", <<http://www.partnering.ca/Procurement%20Frameworks.htm>>, 16/06/04.

<b>Public Sector</b>	<b>Private Sector</b>
sometimes Departments)	and encouraged.
Trade agreements and sanctions may apply to procurements; priority in process.	Trade treaties generally not of consequence, trade sanctions may affect multi-national activities.
Equal opportunity must be provided to supplier community in public process.	Practices centered on inter-dependence, development of strategic alliances, collaboration.
Practices must be based on openness, fairness and transparency defensible to public audit or challenges to tendering process.	No public disclosure required, publicly traded companies may have some requirements but limited.
Procurements under alternative service delivery arrangements require broader vendor/public communications and consultation than is the case for commodity purchases.	These distinctions would not attract any particular attention in private sector procurement activities.
Contract periods fixed with requirements to re-tender at the end of a contract period.	No tendering requirements; working relationships often open-ended and flexible. Extensions arranged through negotiation.
Subjective evaluation criteria kept to a minimum if best practices observed. Not always applicable in contracting for services.	Subjective evaluation criteria often form a large part of the evaluation.
Public procurement requires extended time lines to ensure all interested vendors/suppliers have fair and adequate time to respond.	Process can be limited to invited tenders from a select list of suppliers/vendors who have demonstrated experience and who can respond quickly. Not subject to challenge from the vendor/supplier community.
Multiple approvals required according to statutory, fiduciary and administrative requirements governing expenditures; alternative service delivery initiatives may be multi-ministry based over many years.	Generally fewer levels of management approvals, with authority vested with individual managers to quickly adapt to or facilitate changes in negotiations or contracting conditions.
Bound by strict conflict of interest rules with severe penalties for non-compliance.	Few rules beyond fiduciary requirements for publicly traded companies, close working relationships viewed as collaborative or strategic.
Political sensitivities and their embodiment	Emphasis on financial risk management,

<b>Public Sector</b>	<b>Private Sector</b>
in policy directions affect engagements in ASD; build around socio-political interests and long-term socio-economic goals.	frameworks build around commercial interests, short-term goals and financial returns on investment.
Loss of public employee jobs through outsourcing or ASD usually a sensitive political issue.	Employee adjustment through outsourcing is a matter of achieving internal operating efficiency.
Price sensitive, traditional bias toward low-cost compliance overrides qualitative or strategic concerns in most cases.	Qualitative or strategic concerns will override low cost bias often.

It is in the context of business-government relationships where the complexities of actually contracting for IT goods and services become a public policy issue. Large public IT projects pose many challenges. Budgets are exceeded, deadlines are over-run and often the quality of the new system is far below the standard agreed upon when the project was undertaken. The company IT Cortex brought together results from five major studies of the failure of IT projects (The Robbins-Gioia Survey 2001, The Conference Board Survey 2001, The KPMG Canada Survey 2001, The Chaos Report 1995 and The OASIG Survey 1995) and concluded that an IT project is more likely to be unsuccessful than successful, about one out of five IT projects is likely to bring full satisfaction, and the larger the project the more likely the failure.<sup>342</sup> The Standish Group that produced the Chaos Report in 1995 also estimated that only 28% of all IT projects in 2000 in the US in both government and industry were successful with regard to budget, functionality, and timeliness. Twenty-three per cent were cancelled and they succeeded only partially, failing on at least one of the three counts.

<sup>342</sup> IT Cortex, "Failure Rate – Statistics over IT Failure Rate", < [http://www.it-cortex.com/Stat\\_Failure\\_Rate.htm](http://www.it-cortex.com/Stat_Failure_Rate.htm)>, 03/05/05.

The hierarchical command and control systems of governance that dominate in the public sector suffer from three fundamental failings in terms of how government is able to organize for and around IT. First, the concentration of power can corrupt both people and organizational performance. Second, the “contrary” characteristics in people that are nature’s checks and balances are suppressed. And third, information overload, biases and errors often frustrate effective management.<sup>343</sup> In an environment where change is accelerated because the IT systems are continuously replaced and upgraded, new ways to organize and manage are developed faster than the speed at which people can adapt.

This public-private sector dichotomy manifests itself in complex relationships when dealing with procurement *of* IT, procurement *for* IT and procurement *with* IT. IT creates both pressures and opportunities for new partnerships, both on the service delivery side with and respect to the operational functioning of government. Theoretically, IT can foster new horizontal opportunities by shifting away from traditional bureaucratic structures toward flatter organizational structures and different kinds of service delivery arrangements. Organizationally, these trends mean IT forces are both dispersing creating more flexibility across government, and centralizing thereby fostering integrative action.

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<sup>343</sup> Shann Turnbull, “A New Way to Govern – Organisations and society after Enron”, The New Economics Foundation, London, 2002, 6.

The rise of E-government with its pressures for a variety of initiatives introducing alternative models of decision-making and service delivery implies sharing accountability for outcomes.<sup>344</sup> According to some, new governance arrangements threaten to undermine key institutions and practices of democratic accountability. One element of these new governance arrangements is the contracting-out (this is referred to here as outsourcing) of entire IT operations and resources (this may or may not include the actual people).<sup>345</sup> In theory, from a public sector perspective, contracting out should be used when society is made better off by doing so. This objective is not necessarily the same thing as minimizing governmental costs.<sup>346</sup> While new forms of arrangements (such as Benefits Driven Procurement) emerge to deal with the growing trend to outsource, in Canada there is reluctance to engage in partnerships largely because of this question as to whether partnership arrangements fundamentally challenge accountability mechanisms or can be absorbed in traditional models of decision making.<sup>347</sup>

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<sup>344</sup> B.A. Allen, L. Juillet, G. Paquet, and J. Roy, "E-Governance & government on-line in Canada: Partnerships, people & prospects." *Government Information Quarterly*, 2001, 18, 98.

<sup>345</sup> Contracting out can imply a procurement function and/or the devolution of authority to another governmental, private sector or non-governmental organization. There may be more or less explicit conditions for accountability and performance. Typically this is where problems arise. It is very difficult to predict how performance and the management of the arrangement will play out over what may be years.

<sup>346</sup> S. Globerman and A.R. Vining, "A framework for evaluating the government contracting-out decision with an application to information technology", *Public Administration Review*, 1996, 56(6), 578.

<sup>347</sup> There is no reference to, or use of the word 'partnerships' in the Parliamentary Secretary's Task Force Government-Wide Review of Procurement Final Report. Bureaucrats in PWGSC are careful not to use the term 'partnership'.

An alternative view is that collaborative arrangements can make government more accountable.<sup>348</sup> The proponents of collaborative arrangements insist that involving external stakeholders strengthens accountability to citizens by virtue of the addition of partners, and in particular with private sector partners the pressure for accountability to customers or clients is increased.

The risk associated with collaborative arrangements in information technology projects comes in many forms – political, economic, and bureaucratic and organizational risk. There is risk associated with the natural friction and stress in the buyer/seller relationship based on the inherent nature of the acquisition process.<sup>349</sup> Certainly the economic waste is evident in terms of the failure of IT projects, less evident is the time and human resource capacity wasted on designing and implementing systems that do not work, as well as the time invested in developing public-private sector relationship management. Accounting for risk aids in reducing the likelihood of failure, or at least can alert officials to the potential problems that may emerge in large projects.

#### **ORGANIZATIONAL INSTITUTIONALISM AS A FRAME FOR CHANGE AND CONTINUITY IN PROCUREMENT AND IT**

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<sup>348</sup> J. Armstrong, “Some thoughts on alternative service delivery”, in *Optimum online*, Volume 28, Issue 1, March 1998, 7, <http://www.optimumonline.ca>, 11/02/05.

<sup>349</sup> V. Pooler and D. Pooler, *Purchasing and Supply Management*, 122.

The dynamic of dealing with IT in the public sector is like changing an engine in a car that is moving. Altering some of the fundamental mechanisms and the way that they work together is likely to cause disruption and contradictions both at the organizational and behavioural level.

Organizational institutionalism is used to shed light on each of these aspects and how they impact on the evolving nature of procurement policy as it relates to IT.<sup>350</sup> The push and pull tendencies in the supplier-buyer relationship and the institutional centralizing-decentralizing forces in government exert pressure on structures and human resources. The IT agenda reflects these issues in procurement policy and practice in a new way.

The concept of isomorphism is defined here as legitimacy-seeking actions at the institutional and structural level and legitimacy-seeking behaviour at the organizational level. Isomorphism is derived from the idea of homogenization, a constraining process that forces organizations and actors in a sector to resemble other units that face the same set of environmental conditions. Isomorphism can result because non-optimal forms are

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<sup>350</sup> The study of IT and procurement has not been well explored in terms of theory. The purchasing and supply management field has done some work on one aspect of this field; e-procurement in both private sector and public sector environments. Typically studies have been focused on inductive explanations of practice, with qualitative and descriptive studies resulting in a collection of practical experiences aimed at understanding what has happened. Jan Telgen, Introduction to the Conference Themes, *11<sup>th</sup> Annual Conference, International Purchasing and Supply Education Research Association (IPSERA)*, 2002. At the most recent IPSERA conference, 2005, there were a number of Ph.D. students presenting developmental papers on theory for e-procurement which signals advancement in the field.

selected or designed out of a set of organizations or because organizational decision makers learn appropriate responses and adjust their behaviour accordingly. The concept of institutional isomorphism is a useful tool for understanding the politics and ceremony that pervade much modern organizational life and has been used in political science to better understand the dynamics within and between organizations.<sup>351</sup>

Political institutions and actors are searching for legitimacy for their organizations, for themselves, and for the policy area they are working on, with this flows power and funding. The mechanisms through which institutional isomorphic change occurs are first, *coercive isomorphism* which stems from political influence and the problem of appropriateness; second *mimetic isomorphism* which results from standard responses to uncertainty; and third *normative isomorphism* which points to the problems associated with professionalization.<sup>352</sup> This is an analytic typology. The three types are not always empirically distinct. The following chart elaborates on how these isomorphic pressures impact on procurement policy. A typology of procurement is used to organize the different levels of procurement activity: procurement *of* IT, procurement *for* IT, and procurement *with* IT. The categories are not intended to be empirically distinct from one another and there are necessarily many areas of overlap.

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<sup>351</sup> P.J. DiMaggio and W.W. Powell, "The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organization Fields", in eds., W.W. Powell and P.J. DiMaggio, *The New Institutionalism in Organizational Analysis* (Chicago: The University of Chicago Press, 1991), 66.

<sup>352</sup> DiMaggio and Powell, "The Iron Cage", 67.

**Table7: Organizational Institutionalism and Procurement Dynamic in IT**

<b>Dynamic</b>	<b>Procurement of IT</b>	<b>Procurement for IT</b>	<b>Procurement with IT</b>
<p><b>Coercive isomorphism</b> -formal and informal pressures exerted on organizations by other organizations upon which they are dependent and by cultural expectations -force or persuasion, may be direct response to environment, regulations, legal and technical requirements of the state</p>	<p>Outsourcing and partnerships</p> <p>Realm of contracting; cost and control</p> <p>Accountability potentially problematic</p> <p>Scope, transparency, and unions</p>	<p>Development of the industry</p> <p>Subject to federal and provincial establishment of support similar to and competing with other industries</p> <p>Results of Task Force</p> <p>Decentralization would benefit SMEs but centralization increasingly the choice by government</p>	<p>Financial accountability driving centralized solutions</p> <p>Centralization can improve financial control and accountability</p>
<p><b>Mimetic isomorphism</b> -uncertainty powerful force driving imitation - organizational technologies poorly understood, goals ambiguous, symbolic uncertainty</p>	<p>Many unknowns in outsourcing, trust and collaboration required in uncertain environment</p>	<p>Efforts to build IT into recognized 'sector'</p> <p>Closer work with vendor community</p> <p>Through industry organizations try to have symbolic strength</p>	<p>Centralizing and decentralizing pressures</p> <p>Human behaviour may not match requirements of elaborate procurement systems</p>
<p><b>Normative isomorphism</b> -professionalization, filtering of individuals, recognition of legitimacy gained from developing profession, those 'in' and 'out'</p>	<p>Leverage competencies of specialists; pressure on and from unions</p>	<p>Professional norms being driven by new programs, Material Management Institute, Treasury Board</p>	<p>Sophistication of e-procurement and specialized financial systems leads to outside professionalization</p>

## **PROCUREMENT OF IT**

Procuring IT involves a number of activities that can be placed on a continuum from fairly simple ‘order-pay-receive-install’ activity to arranging the much more complex activity of outsourcing an IT department in order to place this function outside of the organization. IT outsourcing is now one of the main ways in which government procures for the resources it requires to function. The procurement of IT has shifted somewhat at least in rhetoric, towards the language of ‘partnerships’ implying shared accountability and ‘new governance arrangements’.<sup>353</sup>

In the case of outsourcing public sector IT operations, public-private sector tensions form the parameters around which new ties are being formed between governments and the vendors of IT systems and solutions. IT solutions demand close collaboration between private sector suppliers and public sector clients. The complexity and sophistication of such solutions produce many strategic choices for government about how to deploy IT both in and across public sector operations.

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<sup>353</sup> With respect to the federal government, to some extent this shift to new arrangements is still rhetoric. The Parliamentary Secretary’s Task Force, Government-Wide Review of Procurement Final Report only goes so far as to talk about ‘strategic relationships’ with suppliers. Bureaucrats in PWGSC do not use the terminology ‘partnerships’ although they are involved in many partnership-type arrangements. This is due to the fact that ‘partnerships’ does indeed introduce the potential for questions of accountability; an area that bureaucrats are understandably sensitive about. Provinces and municipalities work in the language of partnerships and some such as British Columbia and Ontario actively pursue public-private partnerships as a means of obtaining the needed resources for building infrastructure.

Any move towards IT outsourcing, meaning a reliance on external service providers, is likely to be controversial for government from a human resources perspective. The advantages of outsourcing IT and its management to external parties are derived from the opportunity to leverage the competencies of specialists. The disadvantages are rooted in concerns about control and performance measurement, while underlying questions of cost often become the resulting sources of friction.

The main challenge in increasingly complex forms of IT outsourcing and partnerships is that despite recognition of the need to work together in new ways, more organizational processes and most people reside within the realm of contracting, with its traditional emphasis on cost and control. This is particularly relevant for the public sector with its extra burden of transparency and fairness, the basis of traditional assurances of public accountability. Contracting for professional services in IT has become pervasive in terms of the way in which large federal government units engage private sector businesses to operate IT infrastructure. In some cases, all of the operations, project management, and implementation are done by a private sector organization, over long periods of time and for millions of dollars. The accountability for these arrangements becomes complex and traditional frameworks do not necessarily work effectively. The following examples in

Table 8 vary in the extent to which all or some of the organization's IT infrastructure and human resource requirements are outsourced.<sup>354</sup>

**Table 8: Canadian IT Outsourcing Deals From 1996 to June 2003**

Client	Vendor	Year Signed/Closed	Term (in Years)	Dollar Value \$Cdn
Alberta Human Resources and Employment Ministry	CGI Group Inc.	July 2002	4	\$12M
Alberta Municipal Affairs	SHL	1996	7	US\$800M
Alberta Ministry of Health and Wellness	CGI Group Inc.	January 2001	5	\$25M
Canada Department of National Defence	IT Net Ottawa Inc.	July 2002	1	US1.6M
Canada Department of National Defence	Calian Technologies Ltd.	July 2002	3	US\$7.8M
Canadian Federal Treasury Board	CGI Group Inc.	May 2001	5	\$7M
Department of Indian and Northern Affairs Canada	Sierra Systems Group Inc.	July 2002	2	\$15M
Elections Canada	OnX Enterprise Solutions Inc.	August 2002	3	\$2.4M
Government of Canada	CGI Group & BDP Business Data Services Limited	July 2002	<1 (up to 15 years)	\$36M
Ministère du Revenu du Québec	CGI Group Inc.	August 2002	5	\$35M
Natural Resources Canada	Calian Technologies Ltd.	July 2002	2	US\$1.5M
Ontario Ministry of Transportation	Serco Group plc	February 2003	10	N/A
Provincial Health Services Authority of B.C.	Crothall services Group	May 2003	N/A	N/A
Public Works and Government Services Canada	Computer Sciences Corporation	March 2003	7	\$60M
Saskatchewan Health Ministry	CGI Group Inc.	2001	N/A	\$6M
Secrétariat du Conseil du Trésor du Québec	CGI Group Inc.	February 2003	5	\$18.9M

<sup>354</sup> George J. Atis compiled a list of 149 Canadian IT and Business Process Outsourcing Deals between 1996 and 2003. The table highlights 16 of the public sector deals.

In the United States, at the State and City government level there have been a number of high profile cases. The State of Connecticut spent millions of dollars and over three years negotiating one of the most ambitious outsourcing deals of a government ever, only to see the deal collapse before completion. Both parties, the government and the primary vendor, provide amicable, though contrasting explanations for the deal's demise. While no single factor is evident, it is fair to conclude that the requisite mix of political acceptability and profitability could not be achieved in an adequate fashion, due in part to a tremendous emphasis on contracting specifications, objectives, terms and conditions – a process fundamentally at odds with the trust and collaboration required to partner on such a massive scale.<sup>355</sup>

Public sector outsourcing poses some unique challenges, any one of which could kill a deal. First, the scope of work: IT investments have been spotty at best in most organizations. The equipment is old, the networks are patched together, and the information silos are unbreached. Political turf is fiercely protected. One example often referred to is a major outsourcing project by the County of San Diego. Even though both sides undertook due diligence before signing, the county never really knew what it had for IT assets – much less what shape they were in. No amount of preparation prepared the partner Computer Science Corporation's Pennant Alliance<sup>356</sup> for the amount of work

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<sup>355</sup> Allen, Juillet, et al. "*E-governance*", 99.

<sup>356</sup> The Pennant Alliance is a consortium of companies led by Computer Science Corporation. They were chosen in 1999 to create a virtual government for the County of

that needed to be done just to get the ancient infrastructure ready for upgrading.

Complicating matters was the fact that all the work had to be done while maintaining high levels of public service.<sup>357</sup>

The second challenge is the transparency required in the public sector. Even though most private sector outsourcing deals are conducted between publicly held companies, the negotiations are still held in private. In government, by contrast, every bid is a public document. The Government officials are used to the requirement for transparency, although they may dislike it, but the vendors are often not accustomed to it. For a vendor, even if the company loses the contract, suddenly its pricing structure may become public knowledge.

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San Diego that would provide its citizens greater accessibility to county services. The contract was valued at \$644 million over seven years and had three additional year option periods. At the time, this represented the largest information technology outsourcing project carried out by a local government agency in the United States. By 2002 the program was on the verge of collapse. The county claimed that prime contractor Computer Sciences Corp. was not meeting numerous service-level agreements stipulated in the seven-year contract. CSC countered that San Diego County officials had set the bar too high on the performance standards. At issue were ambiguities in the contract language outlining the dozens of requirements in the performance-based contract. The companies did not go to court, instead resolving their differences by defining more clearly the responsibilities of the contractor and the county. Since then, the county has been satisfied with CSC's performance on the IT infrastructure portion of the contract. San Diego County intends to remove every possible ambiguity from the contract as it prepares to re-compete the contract due to expire in December 2006. Interestingly, CSC has not expressed interest in bidding for the project.

<http://www.csc.com/newsandevents/news/657.shtml>, 10/05/05 and

<http://washingtontechnology.com>, 10/05/05.

<sup>357</sup> Tom Field, "You can't outsource City Hall", CIO Magazine, June 15, 2002, <<http://www.cio.com/archive/061502/govt.html?printversion=yes>> 29/07/04.

Thirdly, unions pose an important challenge. In government the unions are still powerful enough to kill an outsourcing project. In the Connecticut situation, two employee unions that controlled his IT staff and lobbied hard against his plans outgunned the CIO. With respect to San Diego fewer staffers were union members but after the deal was done, the union kept the county busy with requests for sensitive documents and even audits. “We want them to do an internal audit [of the outsourcing initiative] and prove they’re good managers.... This politicking is commonplace in the public sector but the vendors find the constant tug-of-war taxing.”<sup>358</sup> In Canada the University Health Network, a teaching hospital, has been outsourcing for ten years and gone through three major contracts with providers like HP and Digital Equipment. The director of risk management and controller struck a deal with outsourcing vendors that they seek permission before hiring the hospital’s staff hoping to ward off surprises in employee relations.

At the crux of the labour-management dispute regarding contracting-out is the difficulty in reconciling interests. The employer tries through outsourcing to obtain greater organizational flexibility on issues such as costs, skills, and size of labour force. This quest for flexibility often collides with union preoccupation with the jobs and working conditions of its members.<sup>359</sup> Jalette and Warran discussed overall trends in contracting-

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<sup>358</sup> Field, “You can’t outsource City Hall”.

<sup>359</sup> Patrice Jalette and Peter Warran, “Who Let the Contract Out? A Comparison of Public Sector and Private Sector Contracting-Out Provisions in Canadian Collective Agreements”, Paper Presented at the IIRA/CIRA Joint Conference, Toronto, Canada, June 27<sup>th</sup>, 2002, 4.

out provisions in the Canadian economy over the last two decades. The key finding was the important rise of contracting-out provisions, and of employees covered by them, in the public sector between 1986 and 1998.<sup>360</sup>

Nevertheless, the ‘tug-of-war’ may in fact represent one of the best ways to obtain effective IT in an outsourcing situation. A recent case in California was a 95 to 126 million dollar no-bid contract that was awarded by California’s Department of Information Technology to Oracle for the long-term purchase of software database licenses. In a series of articles in the *San Jose Mercury News* by Noam Levey, it was suggested that Oracle, through a number of contributions and lobbying efforts, had influenced the decision in Oracle’s favour, and that *ex post* the contract was not considered an attractive deal to the state of California. More recently, the award of “rebuilding Iraq” to Bechtel has also raised concern about the transparency of awarding a huge contract (up to \$680 million) through a process other than competitive bidding,

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<sup>360</sup> In the public sector as a whole (including federal, provincial and local administrations, health and education) the number of provisions increased by 20% from 27.5 to 47.2 and the number of employees covered doubled from 29.4 to 58.9%. Generally unions will not try to pursue, nor will they achieve, a complete ban on contracting-out. They will instead seek restrictions regarding the type of work that can or cannot be contracted out; how a contract can or cannot be contracted out and what are the impacts of contracting out. The most important condition is the “no-layoff” provision. This type of provision generally specifies that contracting-out is allowed unless it causes layoffs of bargaining unit members. Jalette and Warrian, “Who Let the Contract Out?”, 6, 9.

concerns that were exacerbated due to Bechtel's connection with the Republican administration.<sup>361</sup>

IT outsourcing is particularly problematic in the public sector. The characteristics of the public sector environment presented in Table 6 bring to light the coercive and rule-bound nature surrounding any form of activity associated with procurement. Multi-year, multi-player arrangements will require numerous approvals and are bound by the contracting rules as set by the governing institutions. Given the challenges posed by the scope of IT contracting, the transparency required and the issue of unions, outsourcing by government is understandably shaped by the structural and behavioural implications of moving public sector activity outside the public realm. At the central level of Canadian government where increasing authority is being placed in PWGSC the tendency to risk aversion due to strict financial controls and regulation as well as media attention grows stronger. This will draw organizations to embrace outsourcing models that have been successful and pose the least amount of financial and political risk.

Mimetic isomorphism results from the uncertainty associated with moving work outside the public sector and dealing with private sector organizations. Trust and collaboration must be developed when designing an outsourcing arrangement, even if the contract is

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<sup>361</sup> There are scores of articles written on Bechtel's associations with the Republican party; however there are also articles indicating the Bechtel develops deep ties to government by recruiting former senior people from both parties.

prescriptive. In IT there is a chance that the requirements will change and a certain amount of willingness to renegotiate needs to be built in to a contract. It is exceedingly difficult for the public sector to break out of long-standing institutional patterns and form the type of network arrangements across government as well as with private sector consortiums required to manage large IT projects. The scope of work, political turf, publicity, and possible union involvement all raise the risk of attempting new and unusual arrangements. Mimetic forces encourage imitation with past processes and structures, despite the recognition that often the same ideas and approaches are not working. The failures of projects and risk aversion of public officials when it comes to outsourcing arrangements speaks to this powerful attraction to finding certainty in past processes and structures (and perhaps the misplaced hope that 'this' time, 'our' IT project will work). Public sector organizations will understandably use the same providers over and over in an effort to reduce the uncertainty and hopefully build on previous relationships. This reduces the potential however for new organizations to introduce different methods and possibly better deals. A company such as CGI with its many public sector IT contracts will become entrenched and take on a symbolic role of 'trusted provider' if previous contracts have gone well. This symbolic element has a normative constraint associated with it. Especially at the federal level, particular companies such as CGI (others would be IBM and possibly Oracle) become holders of the know-how and the 'professionals' who over time come to understand government IT processes better than many individuals actually working for the government. These 'few' companies define the field of IT

outsourcing with professionals who move amongst them as technology experts. This in turn puts constraints on government as well-known groups and incumbents have advantage in bidding for contracts.

A dichotomy exists between organizational commitment and professional allegiance especially among IT workers that are involved in outsourcing arrangements (working directly for a private sector organization but within the government). Professional power is assigned by the state as much as it is created by the activities of the professions – professionals are subject to the same coercive and mimetic pressures as organizations.<sup>362</sup> This professionalization is defined as the collective struggle of members of an occupation to define the conditions and methods of their work, to control “the production of producers”<sup>363</sup> and to establish a cognitive base and legitimation for their occupational autonomy.<sup>364</sup> How the norms of the procurement profession will affect the relationships between the institutions of the public and private sectors remains to be seen.

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<sup>362</sup> DiMaggio and Powell, “The Iron Cage”, 71.

<sup>363</sup> M.S. Larson, *The Rise of Professionalism: A Sociological Analysis* (Berkeley: University of California Press, 1977), 49-52.

<sup>364</sup> Two aspects of professionalization are important sources of isomorphism. One is the resting of formal education and of legitimation in a cognitive base produced by university specialists; the second is the growth and elaboration of professional networks that span organizations and across which new models diffuse rapidly.

## **PROCUREMENT FOR IT**

Procurement for IT means the use of procurement and procurement policies to aid in the development of the IT industry broadly defined to include information technology products, manufacturing, telecommunications and the service industry associated with IT. The IT industry has been growing in importance. The Information and Communications Technologies (ICT) sector contributed \$58.1 billion to Canada's GDP (\$1997) in 2001, representing 6.2% of the total economy.<sup>365</sup> After a slowdown in 2002 and 2003, the ICT sector's contribution to the Canadian GDP continued to increase; by 2004 there was a significant rise of 4.1% from 2003 compared to 3.1% for the overall Canadian GDP. In 2004, for the first time since 2000, the growth of the ICT sector exceeded the growth of the overall economy.<sup>366</sup> The growth of the sector became critical in terms of employment for Canadians. During the 1990s, employment growth in Canada was fuelled by job gains in the technology sector. One out of every six jobs created during the decade was in the ICT sector. In Canada's largest cities, ICT industries accounted for 4 out of every 10 new jobs.<sup>367</sup>

Bernard Courtois, the President and CEO of the Information Technology Association of Canada (ITAC) recently spoke of the link between productivity and the ICT Industry. In

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<sup>365</sup> Government of Canada. Innovation in Canada.

<http://www.innovation.gc.ca/gol/innovation/site.nsf/en/in02579.html>, 21/05/05.

<sup>366</sup> Industry Canada, ICT Sector Gross Domestic Product, April 2005, <[http://strategis.ic.gc.ca/epic/internet/inict-tic.nsf/en/h\\_it05864e.html](http://strategis.ic.gc.ca/epic/internet/inict-tic.nsf/en/h_it05864e.html)>, 25/05/05

<sup>367</sup> Statistics Canada, The Daily, Thursday July 31 2003, <http://www.statcan.ca/Daily/English/030731/d030731b.htm>, 20/04/05.

a speech to the *Standing Senate Committee on Banking, Trade and Commerce* he cites an Industry Canada study of four economic sectors, which found that the importance of ICT as an enabler has surpassed that of ICT as an economic sector in its own right. He points to numerous studies that show that firms that implement ICT and organizational changes have a higher incidence of productivity and process innovation. As CEO of ITAC, Courtois is expressing concern for the slow uptake of ICTs for small firms that employ the majority of Canadians (firms under 500 people). Advanced e-business applications such as e-procurement, supply chain management, finance and human resource management are not being used. ITAC decided to create an 'e-Team' which will address this issue and help to demonstrate the value for SMEs in adopting the new business models. Adoption of advanced applications is viewed as critical to growth and competitiveness. ITAC as an industry association is naturally lobbying government to increase spending and support of the ICT sector.<sup>368</sup>

This example of ITAC's efforts to promote SMEs stresses the fact that governments not only deal with organizational and financial management issues, governments must operate in ways that advance various other policy objectives, such as supporting SMEs.<sup>369</sup>

As a major purchaser a government can provide enormous incentive for suppliers to

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<sup>368</sup> Information Technology Association of Canada, Notes for Bernard Courtois, President and CEO ITAC, to the Standing Senate Committee on Banking, Trade and Commerce, May 11 2005. [www.itac.ca](http://www.itac.ca), 27/05/05.

<sup>369</sup> Darryl Coulthard and Tanya Castleman, "Electronic Procurement in Government: More Complicated than just Good Business", Global Co-operation in the New Millennium, The 9<sup>th</sup> European Conference on Information Systems, Bled, Slovenia, June 27-29, 2001, 1002.

become web-enabled.<sup>370</sup> For some SMEs, the implications may be negative as they may be unable to afford the IT infrastructure, but in principle e-procurement should bring greater access to tendering opportunities with governments through the development of electronic markets. On the one hand, governments may be stimulating more efficient, sophisticated business processes and opening to a wide range of potential vendors. On the other hand it may be shutting out some small and medium sized businesses who do not have the resources, either human or financial, to become fully internet-enabled.<sup>371</sup>

By encouraging more rapid and more effective uptake of e-commerce, governments are using this as a technique of securing competitive advantage. Offering inducements and support for e-commerce adoption are not nearly as powerful as requiring businesses to operate on-line if they want to do business with government.<sup>372</sup> In light of the rules of the trade agreements that are increasingly preventing subsidization and directed support of sectors and regions, the 'enhancing competitiveness' approach may be the only way that the government can help businesses and other potential beneficiaries.

From another perspective with respect to service delivery, governments are both competing with one another and with the private sector in some cases for business and citizen support. The underlying concept is based in the idea that as increasing numbers of consumers become used to the quality of service offered by the best web retailers and

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<sup>370</sup> Neef, *e-Procurement*, 110.

<sup>371</sup> Coulthard and Castleman, "Electronic Procurement in Government", 1000.

<sup>372</sup> *Ibid.*, 1001.

service providers, their willingness to tolerate sub-standard service in the public sector comes under strain. If the same 24-hour, seven-days-a-week availability and convenience, fast delivery, customer focus and personalization became the norm in the public sector, it would not just make life easier, it would fundamentally change the way that people view government itself.<sup>373</sup>

Recently, the Government-Wide Review of Procurement Task Force made new rules about the use of standing offers and the consolidation of purchases. In the consultation period, industry associations voiced their concerns that this would have a negative effect on small business.<sup>374</sup> PWGSC's efforts to respond to these concerns are summarized below.<sup>375</sup>

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<sup>373</sup> Matthew Symonds, "Government and the Internet: The next revolution", *The Economist*, June 24, 2000, S3.

<sup>374</sup> Author attended consultations with IT sector industry associations in October 2004.

<sup>375</sup> Public Works and Government Services Canada, Budget 2005, The Way Forward, Buying Smarter, <[http://www.pwgsc.gc.ca/b2k5/text/public/staging\\_pp/fs-2-e.html](http://www.pwgsc.gc.ca/b2k5/text/public/staging_pp/fs-2-e.html)>, 15/05/05.

**Figure 12: Excerpt from Public Works and Government Services Canada Budget 2005 – The Way Forward Buying Smarter**

- Combining the purchasing power of departments doesn't mean using only one supplier. For instance we will require, where appropriate, that small and medium sized businesses be included in major contracts. And for some industries, the suppliers will likely all be from the small and medium sized business community.
- We will make it easier, simpler and faster to do business with the government. We have already eliminated the fees to access federal government tenders. And we are simplifying our contracts, by removing complex language and making them shorter.
- We are setting up an office of small business as an entry point into how to do business with the government. It will also assist in understanding niche markets, oversee all procurement plans over \$10 million to ensure that small business needs are taken into consideration, and advise procurement staff on subcontracting plans.
- Through our Contracts Canada office, we continue to meet with and inform suppliers across Canada about how to do business with the government.
- We have in the past and will continue to use tools such as Regional Standing Offers to ensure that businesses right across the country can have access to government business.
- We are also creating commodity councils for each of the commodity groups that are being coordinated with industry representatives and other stakeholders at the table. The councils will determine the right balance in our purchasing decisions among factors such as efficiency, effectiveness and the effects on small and regionally based businesses. The councils may also recommend other measures to ensure the interests of small businesses continue to be supported.

Of considerable importance as well is the establishment of the Information Technology Services Branch (ITSB) in 2003. The ITSB was created as a shared services agency to manage the federal government's technology infrastructure and to provide technology support to government administrative services (including in the areas of financial and human resources management as well as information and technology management).<sup>376</sup>

The ITSB recognized that the vendor community would have a vital role to play at every stage of the process of migrating to a shared service enterprise environment. There is a patchwork of contractual agreements with individual departments and units within departments, with clusters of departments and with PWGSC.

With the evolution of the ITSB shared service initiative, along with the recommendations from the Task Force, there will be some contract and service consolidation and some remaining supply arrangements will stay with the departments in a more fully integrated government-wide framework.<sup>377</sup> This type of extensive vendor consultation demonstrates a concern for the development of the supplier community, and recognition of the difficulties of ensuring that the vendors will actually be able to provide the government with the type of integrated technologies needed, and equally importantly have the capacity to communicate with government in the development of shared services. In this consultation process there was a very strong message of the importance of full

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<sup>376</sup> Public Policy Forum, Vendor Engagement Strategy Consultation, Final Report, March 21, 2005, <http://www.ppforum.ca>, 20/05/05, 2.

<sup>377</sup> Public Policy Forum, Vendor Engagement Strategy Consultation, 5.

involvement of SMEs in the shared systems project. This point had also been made in the procurement reform consultations and led to the announcement of the establishment of an SME office in PWGSC. Smaller firms and associations are concerned that due to their more limited infrastructure and their capacity to participate in consultation about shared services strategy that their involvement in its implementation could be limited.<sup>378</sup>

The federal government has not legislated that SMEs operate on-line in order to do with business with government. Nevertheless if an SME wants to bid on government tenders, there is really no option but to find a way to do so. The speed with which competitors who do operate on-line are able to obtain information both about bid opportunities themselves, and also information on their competitors ensures that web-enabled companies are best positioned to win the business. While 'basic' access to federal opportunities is free, more comprehensive information is not free. The environment of doing business with government is such that the technical requirements of being competitive essentially coerce businesses to move to web-enabled processes. The SME environment is increasingly being shaped by such policies at federal level of government.<sup>379</sup>

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<sup>378</sup> Public Policy Forum, Vendor Engagement Strategy Consultation, 15.

<sup>379</sup> It is likely that fewer and fewer SMEs will choose to do business with the federal government. The aggregation of large contracts that suits big companies means it will be difficult for SMEs to 'get a piece of the pie' despite PWGSC requiring that smaller contractors be included in major contracts. The Canadian Advanced Technology Alliance expects that the new procurement processes involving closed standards with selected suppliers will lock out many technology companies from government

The mimetic pressures arising from the uncertainty of operating without Internet capability will drive businesses on-line or out of the provision-to-government market. As well, belonging to industry associations is an important way for SMEs to navigate the environment when they feel they may not have all the information they require to make good decisions.

Alongside developing the institutions comes the need to develop human resources capacity and individual skills. At the normative level, the professionalization of procurement officers and administrators is an issue of critical concern currently in the government. There is an underlying problem that has been vaguely identified if not addressed directly – how does government proceed with the professionalization of procurement officers (and subsequent professional allegiance) given that commitment to the organization (government department, largely PWGSC) defines how procurement officers act and is at least in an unwritten sense, seen as more important than the development of a ‘profession’ per se. This is connected to the ability of government to direct procurement as an instrument of public policy. This professionalization will ultimately result in a much clearer range of action (and likely reduced) under which procurement officials must function. Treasury Board, in conjunction with the Canada School of Public Service, has fought to retain the training of such professionals, as opposed to it being done by an outside organization such as the Material Management

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procurement. CATA Alliance Advocacy Issues 2005, Budget 2005, January 18 2005, <http://www.cata.ca/files/PDF/CATAAdvo2005.pdf>, 22/05/05.

Institute. There is essentially no university education available with respect to public procurement and this is seen as a problem in terms of gaining legitimacy for the profession. The legitimization of the procurement profession is an important element in the current reform of government procurement. The normative pressures from within the organization will be constraining and defining in terms of what the profession will look like in the future.

### **PROCUREMENT *WITH* IT**

Procurement *with* IT is focused on E-procurement. E-procurement has both enabled e-commerce as well as evolved along with the nature of the business environment.

In a public sector context, E-procurement is about using IT systems in a comprehensive and systemic manner to establish agreements for the acquisition of products and services (contracting) or purchasing products and services in exchange for payment (purchasing).

E-procurement achieves these ends through various means, such as electronic ordering; purchasing cards, reverse auctions, and automatic accounting systems, among others.<sup>380</sup>

Like with any new technology, proving why an organization should spend substantial sums on new systems is a challenge. When first introduced, E-procurement needed to show 'real value' in the form of reduced costs and the capacity to procure more

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<sup>380</sup> M. Jae Moon, "State Government E-Procurement in the Information Age - Issues, Practices, and Trends", September issue of the *PriceWaterhouseCoopers Endowment for the Business of Government*, 2002, 7.

effectively. The Canadian public sector made very conservative estimates of potential savings; officials were careful to underestimate their numbers stating that saving 4% in transactions costs was realistic over time and still worthwhile.<sup>381</sup>

Reports coming out of the United States declared that E-procurement reduced the cost of transactions from US\$120 to around \$20 and reduced delay from around 40 days to less than 5 days. The Australian Government expected that the ratio of processing costs for cheque versus electronic payments ranged between 10:1 and 5:1.<sup>382</sup> Undoubtedly there is substantial potential for E-procurement given the size of government procurement markets. According the OECD's study on Government Procurement the total expenditure (consumption and investment) in Canada as a percentage of GDP was 25.83%.<sup>383</sup> In the United States the combined federal and state government procurement costs each year for materials and services purchased from private firms is estimated to be almost \$1 trillion. Given the substantial level of participation of government in all areas of life, and considering the combined European Union government procurement spending was \$778 billion in 2000, the potential impact of E-procurement could be even more

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<sup>381</sup> Interview A1, February 4, 2003.

<sup>382</sup> A.C. Church, *Electronic Commerce and the Procurement Process*, Office of Electronic Commerce, USA, 1998, <http://ec.fed.gov/IIBT98/sld001.htm>, 03/02/04 and Darryl Coulthard and Tanya Castleman, "Electronic Procurement in Government: More Complicated than Just Good Business", *Global Co-Operation in the New Millennium*, The 9<sup>th</sup> European Conference on Information Systems, Bled, Slovenia, June 27-29, 2001, 1000.

<sup>383</sup> OECD, *The Size of Government Markets*, 11 February 2002, [www.oecd.org](http://www.oecd.org), 02/04/05.

profound.<sup>384</sup> However, the exact proportion of this market that could be undertaken with E-procurement methods is unknown. The extent to which this is possible will depend on the capability of E-procurement systems and whether governments are prepared to develop effective systems of financial accountability.

Although not acknowledged as a major driver for the development of e-procurement, it can be a powerful tool for shaping and controlling government activity. This kind of aim, or even as a consequence is significant because it goes beyond the processes involved in purchasing to the nature of public administration and the role of government. In order to take full advantage of E-procurement, its processes can be embedded in the strategic management of government but it must relate to the multiple agendas that all governments manage.<sup>385</sup>

Table 9 below provides a summary of the evolution of IT and E-procurement as it relates to procurement in the public sector environment.

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<sup>384</sup> Dale Neef, *e-Procurement: From Strategy to Implementation* (Upper Saddle River: Financial Times - Prentice Hall, 2001), 109.

<sup>385</sup> Coulthard and Castleman, "Electronic Procurement in Government", 1001.

**Table 9: Evolution of IT and e-procurement**

<b>Phase of evolution</b>	<b>Characteristics/Context</b>	<b>Key challenges</b>
First use of computers in government	Simple data storage, first inter-organizational e-mail-type communications	Space requirements for equipment, few with new skills
Integration and expansion	EDI – Electronic Data Interchange, transfer larger amounts of data, faster computer speeds, inter-organizational data exchange, electronic transfer of invoices	Smaller organizations unable to afford investment in large hardware storage systems, not enough people with computer skills
Use of the internet expands, web sites used for information	Nearly instantaneous access to large amounts of information, previously unobtainable, suppliers know more about competitors and government, as does the public	No one knows how much information to share, what information to share, not integrated with policy or fully with legislation yet
Contracting capability on-line, widespread implementation of Enterprise Resource Programs (ERP)	Bidding documents available on-line, capacity for and initial uses of auctions, massive outsourcing arrangements	Accountability comes under question as does the capacity of government to manage both internal and external partnerships
Electronic marketplace	Requires increasingly sophisticated technology with rising costs	Organizations see the potential for cost savings and want to design their own systems
Virtual real-time procurements	Buy-in not yet achieved, technology updates required, supplier base may not be capable	Policy and human resources capacity not yet developed

These stages can be grouped into four phases. Both the public and private sectors in technologically advanced countries are at stage three or four, although SMEs lag behind

in advanced uptake of e-procurement. In the first phase, e-procurement involved the provision of information associated with purchasing on-line; the second phase involved selective interactive procurement services. E-procurement in phase three shows the beginnings of interactive capacity, government-consumer-business commercial transactions, including initial tender info. Finally phase four involves integrated tendering info, solicitation of RFPs and response to RFPs, qualification of bidders, and an on-line review process.

A survey of procurement officers in 2001 showed that on-line procurement in Canada was only 5% of total procurement. It was expected to increase to 14% in 2002 and reach 35% by 2005.<sup>386</sup> This survey showed that 94% of procurement officers used the Internet to identify potential suppliers, while 90% used the Internet to communicate with suppliers and 89% used it to view electronic catalogues. The statistics below seem to show that the prediction for use of the Internet for procurement was correct, at least on the purchasing side.

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<sup>386</sup> Survey of procurement officers conducted by Purchasing Management Association of Canada (PMAC), Industry Canada, and the Conference Board of Canada - to profile organizational participation in e-commerce activities. Survey participants selected from PMAC's membership were drawn from relatively large organizations with mean annual revenues of \$530 million and mean annual procurements of \$169 million. Almost half the organizations employ more than 500 people. As reported in *Summit – Canada's Magazine on Public Sector Purchasing*, June 2002.

**Table 10: Business and government use of information and communication technology(2)**

<b>Business and government use of information and communication technology(2)<sup>387</sup></b>					
<b>Enterprises that purchase goods/services over the Internet (%)</b>					
Year	2000	2001	2002	2003	2004
Private Sector	18.09	22.51	31.86	37.27	42.45
Public Sector	49.32	56.72	65.14	68.48	77.36
<b>Enterprises that sell goods and services over the Internet (%)</b>					
Private sector	6.53	6.43	7.60	7.12	7.43
Public sector	8.54	12.22	15.10	16.77	14.04

As shown, the purchase of goods and services over the Internet has grown quite substantially especially for the public sector. Interestingly the numbers of enterprises actually selling goods and services over the Internet are not large although they have increased since 2000. The lower percentages for selling as compared to the numbers for purchasing may be due to the fact that only large suppliers and aggregators of goods and services find this worthwhile activity.

As these E-procurement phases evolve, at the E-government policy level changes are taking place in the legislative, policy and operational imperatives of the government. E-procurement requires new legislation (security), new policy (auctions and

<sup>387</sup> Statistics Canada Survey of Electronic Commerce and Technology – sample of 21,000 enterprises using Business Register list and other administrative listings for the public sector, <http://www40.statcan.ca/101/cst01/econ146d.htm>, 19/05/05.

competitiveness regulation) new operational imperatives (getting departments equipped for E-procurement functions).<sup>388</sup> It also requires a capacity to conform to the principles and processes of financial control prevalent within the federal government. Much of the difficulty in expanding the use of electronic procurement generally through the use of increasingly sophisticated Enterprise Resource Programs stems from the challenge of effectively gathering and organizing the multiple financial reporting systems.

In a similar vein, small policy changes can require large changes in IT infrastructures, budgets and governance arrangements. Time is of critical importance in both directions, waiting for legislative change can result in the need for adjustment in the predicted IT systems, and once in place the IT systems are often not technologically what was originally required.

Mark Trepanier, a senior government official described the situation quite clearly:

Federal e-procurement is not simply getting the best price electronically - which is still important - but so is respecting all of the social, economic, trade and legal backdrop. E-procurement is doable and there is a reward.

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<sup>388</sup> Interesting issues have arisen with the Electronic Commerce Acts. The three hardest parts of the Acts will be the issues of: 1) consent to e-contracting; 2) when electronic messages are deemed received (when an electronic message becomes capable of being retrieved, not when the recipient becomes aware of the message); and 3) the requirements for proving an electronically stored document is an acceptable document to the Crown. Whether an Owner issuing an electronic Invitation or Request can require e-bidding only is still an open question; especially in public tendering where they may be an implied obligation to allow the “public” to bid. Robert C. Worthington, “E-Commerce Legislation, Canada Gets Its Acts Together”, July 2003, <<http://www.purchasinglaw.com/articlejuly2003.htm>>, 24/05/05.

When we succeed, all that context will be in place, but in the background. The complexity will be transparent. The user will be able to procure electronically with full confidence, within the legislation framework and still point, click, order, and receive.<sup>389</sup>

Building the capacity to deal with the ‘social, economic, trade and legal backdrop’ so that the technological interface with the citizen or business is seamless, is a complicated set of tasks that needs to progress through the aforementioned phases.

Early attempts at E-procurement involving some or much of the purchasing function took the form of Electronic Data Interchange (EDI), the precursor to more complex forms of vendor-purchaser connections. Companies reluctant to move to the new formats found themselves being ‘pulled’ into e-procurement systems, where increasing numbers of commodities and services were available through very basic electronic market spaces more readily than through traditional forms of ordering. Simple processes such as purchasing on-line have paved the way for next-generation sophisticated forms of internet-enabled contracting using intelligent agents to investigate availability, perform contracting functions, and complete both purchasing and evaluation functions with minimal human direction.

In the late 1990s states and cities in the United States were launching websites as rapidly as they sent out tax notices. Governments at all levels in Canada were experimenting

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<sup>389</sup> Mark Trepanier, “The Question – What does e-procurement mean to you”, *Summit – Canada’s Magazine on Public Sector Purchasing*, June 2001, 4.

with putting information on web sites, with little to no standardization making navigation frustrating and difficult. For-profit *dot-coms* emerged in the United States to design the Internet connections essential to modernizing government. This made possible license renewals, court filings and building permits on-line. Governments in Canada began to experiment with on-line service provision, although the actual provision of services was not very effective at the outset. There was much less opportunity for business to profit from bringing government services to citizens in Canada. The emerging auction economy brought about by the Internet was taken up quickly and early in the United States, moving quickly from the private sector to the public.<sup>390</sup>

'Freemarkets' in the United States was one of the early examples of online marketplace development, but as with all the early adopters, this company found that they needed to develop beyond hosting a portal to supplier solutions, and the actual market space functionality was taken in-house by supplier companies seeing they could save the percentage charged for the exchange by developing the relationships online themselves. E-Mall in the State of Massachusetts was one of the first on-line procurement systems that pooled multi-state government needs. In Canada, 'Procuron' was the chosen horizontal marketplace product of the federal government in 2000, but although the product worked, the company was unable to extract any value for itself.<sup>391</sup>

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<sup>390</sup> Jeffrey H. Birnbaum, "Death to bureaucrats, good news for the rest of us", *Fortune*, New York, June 26, 2000, 1.

<sup>391</sup> Interview A1, February 4, 2003.

The Canadian provinces were equally or even more active in E-procurement initiatives than the federal level of government. Many had plans for elaborate E-procurement sites with e-auctions and reverse auctions as part of the functionality. What resulted as the hype of the early part of this decade settled was a series of excellent information-based provincial websites that were designed to help organizations do business with government. E-Futures is the province of Alberta's e-business development site and SourceCan is one of the federal government's service-centered websites.

The development of MERX, a service that makes government opportunities available to bidders online, is a fascinating example of the evolution of E-procurement at the federal level and the pressures resulting from the nature of the federal system.

It was mandatory for the government to put opportunities on-line through MERX beginning in 1997. The original agreement with the Bank of Montreal, MERX's first owner, was for three years and allowed for an extension of two years. At the end of the first three years, the federal government found itself in a difficult position. It had failed to plan properly for the end of the contract period and hastily negotiated a further extension of the contract. This was challenged in the Canadian International Trade Tribunal as being anti-competitive and was one of the main reasons why the provinces began to develop their own alternatives to MERX. This has highlighted one of the key barriers to the implementation of E-procurement in the Canadian public sector context. As Jacques LaFrance, Assistant Deputy Minister of the Treasury Board Secretariat notes,

“It’s not a problem of Merx; it’s a problem of the provinces and the federal government agreeing to have one system”.<sup>392</sup>

To date, despite provinces choosing other alternatives, the federal government has favoured just one centralized bid solicitation solution; the idea being that there is one stop where everyone knows where to go, small business need only to look at one site to see all potential business opportunities with government. MERX, also known as GETS (Government Electronic Tendering System), has indeed had a front-line role to play in establishing e-procurement in the government marketplace.

However, rather than one massive centralized bid-solicitation and tendering system, there are many different ways to distribute bid information that could still fit the business requirements of the governments in Canada. Hart North, owner of BIDS, a company based in Fredericton New Brunswick, envisions MERX being replaced by a variety of services that custom-tailor bid information for paying customers. Many feel that tender information and distribution should be a non-exclusive arrangement, whereby many companies could distribute both public and private tenders (information) on a subscription basis.

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<sup>392</sup> Shane Schick, “Provinces plan own e-tendering sites”, *Technology in Government*, 10, March 2003, 1.

Michael Asner, a frequent Canadian contributor to journals on procurement issues, asks whether it is in the public interest to restrict the distribution of procurement data or should the data be more readily available and should other organizations be allowed to repackage it to better meet industry's needs.<sup>393</sup> In Canada, the federal government owns the copyright on federal procurement data and consequently MERX in its contract has a monopoly on the data. Only the federal government can publish, distribute or sell it.<sup>394</sup> By contrast in the United States, where public procurement information can be repackaged and sold, suppliers can subscribe to the bid tendering service that best meets their needs. Asner believes that this system requires change. He believes that MERX's monopoly must end both at the federal and provincial level so that all procurement information and documents are readily available and usable by everyone. On the technology side, electronic tendering systems must have the functionality to frequently

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<sup>393</sup> Michael Asner, "Free the data - Make procurement data available for repackaging", *Summit – Canada's Magazine on Public Sector Purchasing*, March 2002, 8.

<sup>394</sup> The federal government does own all that they post on a website via copyright law. But, they have a vested interest in having the information get the widest possible distribution, in order to get the most bids and to comply with Canada's internal and international trade agreement obligations. There may also be some question in copyright law as to whether by releasing it on the web they may have allowed the information to fall into the public domain, meaning anyone can use it. Our federal government is not known for enforcing its copyright unless it is very serious theft. Until recently, MERX was charging for its information. Other websites charge for the information and MERX is starting to get annoyed, partially because the federal government promised them exclusive listings. These other sites are taking the information off of MERX and then posting it without asking whether they can do so. Demand letters are starting to be exchanged but no lawsuits are on the horizon. Email exchange, Barbara Ann Allen and Bob Worthington ([www.purchasinglaw.com](http://www.purchasinglaw.com)), 11 July 2005.

search the Web for new procurement opportunities and automatically update the database.

At the outset, MERX was free for suppliers to look at and obtain bid documents. The enormous cost of operating the system influenced the government then to begin charging a fee for suppliers to register as well as to obtain bid documents. The Task Force recently reported that MERX would once again be a free service after concluding that the fees were a disincentive for small suppliers to utilize E-procurement at all. The extent to which MERX has been integrated with other provincial E-procurement systems has varied. Now being run as a subsidiary of Mediagrif Interactive Technologies, MERX is responsible for the development and operations of the e-tendering services offered by the federal government and the Provinces of Ontario and Manitoba, Saskatchewan, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador and Nunavut. Quebec, Alberta, and British Columbia have chosen to establish their own E-procurement systems. Quebec government tenders can be found at Systeme électronique d'appel d'offre, ([www.seao.ca](http://www.seao.ca)), Alberta tenders at the Alberta Purchasing Connection ([www.purchasingconnection.ca](http://www.purchasingconnection.ca)) and British Columbia at BCBid ([www.bcbid.ca](http://www.bcbid.ca)). There is now quite an array of both free and fee-based bid opportunity websites.

In 2004 MERX announced some new features and servicing including reduced subscription fees, three service packages designed to meet the different needs of various

suppliers, expanded functionality for members, value added services available for suppliers who want to access opportunities in multiple jurisdictions/regions, choose to receive the amendments automatically or want to have additional match profiles set up, and as an enhanced service it offers the reproduction and delivery of the hard copy of tender documents.<sup>395</sup> MERX has been improving in terms of user-friendliness as well; the communication of information, once deeply buried and difficult to find, is much more accessible and understandable and the graphical representation of jurisdictions aids in the communication of information. As a result of the Government-Wide Review of Procurement, PWGSC announced that for basic MERX services, suppliers would not be charged a fee, although any expanded service does still require a subscription fee.

Besides MERX, the other major federal government E-procurement initiative is the Electronic Supply Chain (ESC) Initiative. The ESC Program is now focused on developing the Government of Canada Marketplace (GoCM), which is intended to be an end-to-end purchasing service that will allow participating departments and agencies to shop for, buy and report on their purchases. It will also support the payment, settlement and assets management requirements of participating departments and agencies. It enables the Government of Canada supply chain business processes (i.e. procurement,

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<sup>395</sup> “In the News Archive” – Summit Connects - [http://www.summitconnects.com/In\\_the\\_News/Archive/2004\\_07.htm](http://www.summitconnects.com/In_the_News/Archive/2004_07.htm), 10/09/04.

purchasing and payment) to work in a secure electronic environment.<sup>396</sup> This also includes the support services for these business processes (i.e. user management, information collection and management, and information exchanges with related processes). The overall aim is to develop a solution that enables the participation in the Electronic Supply Chain (ESC) of all stakeholders involved in the acquisition of goods and services for the Government.<sup>397</sup> Its three main objectives are: to provide an efficient electronic environment for the procurement and purchase of goods and services; to meet legislative, policy and operational imperatives of the Government; and to reinforce Parliament's vision of developing Canada as a world leader in electronic commerce.<sup>398</sup> It is expected to generate savings by delivering volume price discounts, consolidating procurement instruments such as standing offers, allowing for increased credit-card rebates, and improving and simplifying procurement processes.<sup>399</sup>

The ESC project phases involve 4 major milestones with 5 stages: from e-Purchasing (some of which is in place now), Electronic Supply Chain, the Government of Canada Marketplace, and the Canada Marketplace. The stages involve transition, enhancement,

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<sup>396</sup> Public Works and Government Services Canada, 2004-2005 Estimates, Section 5 – Annexes, Annex B – Horizontal and Major Initiatives, Government of Canada Marketplace, [http://www.pwgsc.gc.ca/reports/text/rpp\\_2004-2005\\_annexB\\_c-e.html](http://www.pwgsc.gc.ca/reports/text/rpp_2004-2005_annexB_c-e.html), 24/05/05.

<sup>397</sup> Canada, Public Works and Government Services Canada, Request for Proposal, Electronic Supply Chain Project, November 9<sup>th</sup>, 2001.

<sup>398</sup> Canada, Public Works and Government Services Canada, Electronic Supply Chain (ESC), 2001 Banking Colloquium, April 12, 2001.

<sup>399</sup> PWGSC, 2004-2005 Estimates.

replacement, refinement, and expansion beyond 2004. The ESC team has spent the last year and a half working on the main challenges of getting the government's business requirements right; finding and capturing the needs of the twenty-one departments working with the project; and secondly creating Public Works and Government Services e-purchasing website.<sup>400</sup> Allocations and spending are publicized for 2004-2005, beyond this it is unclear how it will be financed.

Isomorphic pressures constrain how procurement *with* IT is evolving in the Canadian government. A key issue for governments in the design of E-procurement concerns the extent to which purchasing decisions are devolved rather than centralized and the level at which they are devolved. The issue is not whether E-procurement necessarily leads to centralization (there will be a complex mixture of centralized and devolved processes) but how the government designs, implements and manages an E-procurement system to

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<sup>400</sup> The GoC will make use of the recent trends in supply chain services to enhance existing programs while maintaining appropriate levels of management and control. The GoC will position itself to participate in and benefit from commercially available e-business methods and the ability to exchange information between organizations to streamline processes and minimize timeframes.

- The ESC Project will address the core elements of the supply chain process – procurement, purchasing, payment and support functions. Other supply chain functions (e.g. asset management, disposal, logistics, etc.) may be incorporated into the ESC Project after successful implementation of the Core Business Solution.
- The ESC Project will consider vendor proposals for a broad range of implementation and ownership options, including in-house ownership, packaged solutions, purchasing outsourced supply chain services or combinations of these options.

Public Works and Government Services Canada, Request for Proposal, Electronic Supply Chain Project, November 9<sup>th</sup>, 2001.

balance its competing goals.<sup>401</sup> Centralization could imply greater coerciveness, although a devolved system with strict controls could be equally constraining.

In Canada there is the structural issue as to how bid opportunities are made available. The federal MERX system has evolved as only one of the solutions, sharing the market with other provincial web-sites and private sector options. Provincial governments would certainly argue that central government should not have monopoly on bidding opportunities for business.

There is some question as to whether the government needs to undertake the E-procurement activity itself. The challenges in finding financial resources to develop E-procurement systems led American state governments to rely on the participation of private companies, which would later recoup their costs by charging fees. Accordingly, many E-procurement systems are developed, provided, and maintained by vendors and Alternative Service Providers (ASPs), which leads to the potential problem of private business interests overruling public interests. An E-procurement system driven by private businesses could be corrupted when those private interests lack appropriate accountability mechanisms. Canadian governments have a difficult time surrendering typical public sector functions to the private sector even when it meets the needs of the government and is more cost effective because the requirements for fairness and accountability are not always met adequately.

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<sup>401</sup> Coulthard and Castleman, "Electronic Procurement in Government", 1001.

As well, within the levels of government themselves the option exists for departments and agencies to run their own E-procurement systems. Steinar Vagstad asks whether the different levels of government should design and run procurement functions for their different departments and agencies or let them do so on their own. Centralization, it is argued, allows the government to retain control over important decisions. Departments and agencies both at the federal and provincial levels would like to have some control over the management of bidding opportunities for their suppliers. In a very centralized system, to utilize this local [specialized] information the government must either elicit it or delegate decision-making.<sup>402</sup>

Effective use of the technology to link the E-procurement functionality with the public financial management requirements is the critical issue. An integrated financial management system (IFMS)<sup>403</sup> has the potential to provide the accountability required for effective E-procurement systems. IFMS can provide automated identification of exceptions to normal operations, patterns of suspicious activity, cross reference asset

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<sup>402</sup> S. Vagstad, "Centralized vs. decentralized procurement: Does dispersed information call for decentralized decision-making?", *International Journal of Industrial Organization* 18 (2000), 949.

<sup>403</sup> An integrated financial management system consists of several sub-systems which plan, process, and report public financial resources. The basic sub-systems normally include accounting, budgeting, cash management, debt management and related core treasury systems. Non-core sub-systems may be further integrated such as revenue collection, asset management, and human resource and payroll systems. "Integrated Financial Management System: An important but limited anti-corruption tool", World Bank E-Transparency Conference, <[www1.worldbank.org/publicsector/egov/AntiCorEgovSeminar/](http://www1.worldbank.org/publicsector/egov/AntiCorEgovSeminar/)>, 22/05/05.

inventories with equipment purchases to detect theft, and automate and strengthen cash disbursement rules to minimize risk of theft of public funds.<sup>404</sup> The problem with these IFMS arrangements (there are numerous industry names for this such as Enterprise Resource Planning systems) is that they are often not integrated with work routines, are often informal, and thus result in incomplete, inaccurate, untimely data. These systems are only as good as the data that is entered; the human systems underlying and surrounding the technology are more important. New technologies and working routines create uncertainty and thus mimetic pressures come into play. Individual behaviours will fall back on the regularized routines. Increased information from the technologically powerful financial systems raises the potential for greater transparency and potentially higher probability of detection of any attempt to thwart the system. This can create a perception that public servants face a higher risk and this may lead to changes in behaviour. These new systems are rarely integrated to their potential and are only a partial way to capture all the needed information. In a similar way to procurement *for* IT, the procurement *with* IT normative pressure stems from the need for outside expertise to fully integrate E-procurement systems, and the legitimacy that is derived from sophisticated knowledge.

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<sup>404</sup> World Bank, “Integrated Financial Management System: An important but limited anti-corruption tool”, 3.

## CONCLUSIONS

This chapter has discussed the nexus of procurement and information technology. It builds a typology of the IT agenda comprised of Electronic Government and Electronic Governance, Government On-Line, and Electronic procurement. The IT agenda forms an important variable through which policies and strategies associated with procurement have increasingly been reflected. This chapter has explored how the policies, strategies, and activities of the IT agenda are shaping procurement at both the structural and broader institutional level as well as at the internal organizational level.

The emergence of IT as a strategic element in policy and its integration into the supplier-buyer process is altering the operations of government. The dynamic of dealing with IT in the public sector is like changing an engine in a car that is moving. Information technology has actually brought about reasonably rapid change (in government terms) – but the effective reaction to it and ability to integrate it is fundamentally shaped by institutional constraints. Partnering and outsourcing require multiple players at multiple levels, all of which are exceedingly difficult to manage such that legislation and regulation is put in place to control the structural pressures. PWGSC is the centre for the new internet-enabled procurement processes; MERX, an on-line repository of bid opportunities and documents available to the private sector from across the country, and the Government of Canada Marketplace. The technological capacity for expanding on-

line procurement activities exists, but the Government organizational and managerial capacity is evolving at a much slower rate.<sup>405</sup>

The issue of constrained behaviour is linked to the complex policy and institutional interactions that arise from having to simultaneously manage the *of* IT, *for* IT and *with* IT dimensions. The change in the operations of government and the cultural shift (new ways of working and, most importantly, thinking) is constrained by isomorphic processes and the constant drive for legitimacy.

From an organizational institutional perspective, coercive, mimetic, and normative pressures constrain and form parameters around the rate at which change can take place, especially the rate at which behaviour and culture can adapt to new processes and relationships. The effects of coercive isomorphism can be seen in the nature of outsourcing (large firms integrated into government environment makes government dependent on them), and the environment for SMEs such that increased centralization calls for larger and standardized contracts as well as sophisticated IT systems to improve accountability. Uncertainty arises in conjunction with the unknowns of outsourcing and the lack of entrenched processes around support for the IT sector.

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<sup>405</sup> E-Procurement for Government Conference, Jan 23/24 2002, Ottawa.

Mimetic forces drive companies to join industry associations and look for support in traditional ways (like other sectors and regions). Normative isomorphism has had the effect of driving professionalization in procurement and enhancing the effect of outside 'professions' on government procurement. Thus the institutions and actors seeking legitimacy in the realm of procurement and IT garner authority and power by adopting and adapting to these pressures. The pressures from IT generally, coupled with the rise of liberalization as an underlying paradigm, require a very market-oriented perspective where competition is pervasive and government no longer can operate with an inwardly focused approach. Consequently, IT agenda is a considerable influence on change in the nature of procurement policy and has contributed to the new environment of outwardly focused, less discretionary policy making. This contributes to the thesis' overall argument that procurement policy is increasingly rule-bound and susceptible to problems underlying the business-government environment with a resulting loss of discretion in decision-making.

## **CHAPTER SIX**

### **CONCLUSIONS**

#### **INTRODUCTION**

The purpose of this research has been to explore the nature of Canadian federal government procurement policy and how it has changed over three partially overlapping eras.

The three eras were the post World War II period to approximately 1990, the 1980s-1990s trade policy period, and the 1990s to the present where information technology is an important factor. The periods overlap since the factors at issue do not start and stop at a specific date but continue to shift and change.

The empirical elements and factors at play have been analyzed through a neo-institutional framework, drawing on specific constructs from within three schools of thought – path dependence and institutional dynamism from historical institutionalism, the nature of transactions costs from the economics of institution, and isomorphism as legitimacy-seeking behaviour from organizational institutionalism. This analysis has helped to provide evidence to support two main arguments. The first is that procurement policy has shifted from an inward, interventionist orientation with respect to procurement activities governed by national laws and norms, to a free-market orientation due to

complex rules and regulations stemming from an altered international and business-government environment. The second argument is that procurement policy is a multi-purpose tool of government over which the government has increasingly less discretion. The thesis has examined changes in the nature of procurement policy as reflected through regional and industrial policy, liberalization and trade policy, and policy emerging in the IT Agenda - E-Government, Government On-line and E-procurement.

This thesis contributes to academic research and to the larger community concerned with public policy by examining an important subject area in which there is little published, particularly in the disciplines of policy, politics and public institutions. It illuminates the dynamics of procurement policy over three time periods and extends the use of neo-institutional theory in a useful way to help account for change as well as continuity in public policy. It draws attention to the fact that procurement is indeed a policy field requiring more attention and deeper understanding than ever before.

## **MAIN FINDINGS**

Chapter Three explored how procurement policy was implemented through the dominant policy approaches of the time – regional and industrial policy and to a lesser extent defence policy, increasingly bound up in regional and industrial concerns, and inward-looking socio-economic trade-offs. Whilst regional policy is also about grants,

contributions, and straight transfers of funds, procurement is one of its central elements. As the scope of government activity increased in the 1960s, 1970s and 1980s the use of procurement was entrenched in regional and industrial policy. The potential for political corruption was ever-present since many aspects of procurement policy, including regional policy, involved discretionary choices and purchasing for objectives other than least cost. The institutions of these policy fields mediated and became the filter through which decisions about procurement were made, directing and shaping how and which decisions would be made. The drive for de-centralization through regionalism, and reflected in multiple institutional arrangements made balancing the objectives of procurement policy increasingly complicated. Despite the continuing re-shaping of the institutions of regionalism, industrial policy and defence policy, the power of discretionary purchasing was understood in the context of asymmetrical federal institutions.

Procurement policy followed a path dependent course with growing regionalism and the creation of institutions to promote this approach becoming ends in themselves. While complex objectives left room for discretionary choices, the strong institutionalization of de-centralized organizations and policies constrained how Canadian politicians and officials were able to negotiate trade agreements in the ensuing years. Choices about procurement, often directed at maintaining continuity of organizations and funding, were constrained by the institutional mix that had been designed around procurement policy.

It eventually proved to be very difficult to protect any discretionary power at all in the negotiations of the trade agreements. But regional policy during this first period was entrenched as a policy paradigm. Its staying power affected how the economic liberalization process would unfold. Expectations about discretionary purchasing and subsidization would affect trade negotiations and the nature of the trade agreements themselves.

Chapter Four outlined the key aspects of the many trade agreements of the 1980s and 1990s in terms of their procurement elements. It also examined the Canadian International Trade Tribunal and its impact on procurement policy. During this period, as we have seen, there was a slow, but increasing inclusion of procurement clauses in major trade agreements, which were eventually extended to services and opened up trade to most sectors of the economy. Negative integration (detailing exceptions from broadly based goods and services coverage) became a way in which the federal government could continue to protect particular sectors, albeit in a small and limited way.

The case law emerging from decisions of the CITT have substantially shaped how procurement officials deal with suppliers while promoting competitiveness and non-discrimination. The analysis has shown how this new focus on legal decisions emanating from an institutional creation of NAFTA, most definitely constrains the actions of government and reduces the discretion of politicians in terms of directing purchasing

decisions. Local content or other economic benefits criteria designed to favor goods and services from any particular province, region or territory, is forbidden in most cases. And where there are limited exceptions the CITT has not generally been supportive of the government in any effort to take advantage of the exceptions.

The CITT has had an impact on officials' behavior in that each and every bid development must be evaluated in terms of the likelihood of a challenge from a supplier. There is little room for 'creative' contracting, and at least with respect to the requirements of the trade agreements, wide discretion is a thing of the past. Each of the elements of North's transactions cost construct indicates that efficiency is gained by competitive bidding but they also raise questions about the extent to which the CITT is an efficiency-enhancing institution. Understanding and reducing the transactions costs associated with procurement choices shifts procurement policy further and further into a market-based orientation based on competitiveness and rules.

Chapter Five examined the effect of the IT Agenda on procurement policy essentially from 1990 to the present. The technological capacity for expanding on-line procurement exists but institutional barriers, both formal and informal, make this a slow and arduous process. The capacity to formalize procurement rules through electronic mechanisms reduces the discretion officials have in contracting. While Internet technologies are transforming procurement in the business realm, the public sector lags behind. To a

certain extent this can be explained by isomorphic processes and the behaviour associated with gaining credibility and legitimacy. The need for legitimacy in terms of the information technology agenda results in officials and politicians making choices about institutions that replicate accepted ways of organizing activity – often based on decentralized approaches. IT and e-procurement is best managed centrally, but the Canadian federal system is very contradictory in this sense. The struggle over MERX characterizes the battle over centralization versus decentralization, certainly a reflection of the new way that pressures on the federal structures are emerging. On the one hand, centralized processes and institutions are often more efficient but they do not respond to the cultural and political norms of the system. Change is at best slow and incremental. A high level of uncertainty in terms of how IT is best managed means that procurement policy as reflected through E-government is still evolving. The effort to professionalize the procurement field is another aspect of the need to legitimize procurement policy as the Canadian polity moves further into a free market orientation. Information technology has proven to be a force that is not effectively managed within the traditional institutional arrangement. Yet, the risks arising from changing the institutions, such as new departments or organizations, seem too daunting in a structure not designed for rapid innovation or massive shifts in culture.

Thus there remains a fundamental contradiction between the new forces of liberalization and information technology, making centralization a logical approach to dealing with

procurement issues, and the traditional modes of emphasis on de-centralization, regionalism and discretion. Purchasing not covered by trade agreements or institutional rules around accountability is constrained by behaviour motivated towards gaining legitimacy for IT-associated activities and institutions. Procurement policy, now operating through these new forces and articulated in trade policy and the IT Agenda, retains little discretionary room. It is in this realm of discretionary choices however, that political controversy in procurement continues to arise. In terms of political and economic paradigms, regional policy is descending and economic liberalization is in ascendancy and growing in strength. Liberalization through trade agreements is a threat to domestic control of policy-making but this is the larger reality of the current period. The current Parliamentary Secretary's Task Force on Government Wide Procurement reform is right to look to business models based on competitive practices for different ways of operating, but the public sector environment will always be different, with other reasons for choices beyond least cost and the bottom-line.

#### **FURTHER AREAS FOR RESEARCH**

This is one of the first major pieces of research focusing on procurement policy in Canada. As such, it is a starting point for a possible far-reaching research agenda that could constitute more in-depth analysis of each of the empirical chapters in this dissertation. Other avenues for further research might include comparative explorations

of Canadian and American procurement regimes, Canadian-European procurement, and other developed and developing countries. Related to Chapter Four, but utilizing the legal academic work available, the harmonization of European procurement policy could be addressed with a view to examining how Canadian and North American harmonization will evolve. From a regulatory perspective, procurement could be addressed with respect to how it functions with other regulatory regimes in Canada.

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