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Policy Update

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The announcement of Canada's new Defence Procurement Strategy (DPS) has received mixed feedback. While industry understandably applauds this large-scale reform project for its ambition to streamline the procurement process and developing a defence industrial strategy, others have been more hesitant to join the choir, perhaps for good reasons. Finding the right formulae to harness the most military and economic benefits from defence spending has been a declared goal of most states with a sizable domestic defence industrial base since the end of the Cold War. For the most part, the results have not been particularly encouraging. Therefore, to assess the potential merits and pitfalls of Canada's new defence procurement and industry support strategy, it might be useful to start off by looking at a case where very similar objectives have been pursued.

Dissatisfied with continuous overspending and project delays, the UK Government adopted the 'Smart Procurement Initiative' in 1998, refined as 'Smart Acquisition' in 2000, and a Defence Industrial Policy and Strategy in 2002 and 2005 respectively. Then UK Secretary of State for Defence, Geoff Hoon, summarized the objectives of this agenda as follows:

The Government is committed to a strong and globally competitive UK defence industry. We all benefit from its high-value, technology skill base. Our new policy demonstrates our drive to provide high quality equipment for the Armed Forces whilst promoting the interests of British industry and maximising the economic benefit to the UK from our defence expenditure. It has been drawn up in consultation with industry, and will maintain this close dialogue as we take this policy forward.

If you recall recent statements by Canada's Minister of Public Works and Government Services, Diane Finley, introducing the new procurement strategy, you probably realize the congruency of ambitions here. Thus, knowing how the UK has fared with its reform programme can provide valuable insights. Broadly speaking, the British experience shows us that radical swings of the policy pendulum toward or away from industry interests do seldomly result in sharp reductions of cost-overruns, significant fewer delays for larger weapons systems or the generation of sustainable employment and economic growth. The reason for this is that such swings go hand-in-hand with policy steps that often contradict one another. Second, effectively targeted industrial policies to build and maintain a competitive defence industrial base require predictable and sizable funding commitments, i.e. steady orders and stable budgets, a factor that has proven to be particularly difficult given budgetary constraints in the face of economic downturns, rising equipment and in-service costs, as well as quickly changing defence and security requirements.

Of course, being the result of four years of intensive consultation with industry, Canada's new defence procurement strategy reflects a comparably more holistic approach to defence acquisition reform. Yet, with the UK experience in mind, the declared objectives of the DPS require serious pondering. Even though industry and the Armed Forces are supposed to be continuously engaged and listened to in order to calibrate the DPS toward the greatest benefits for both, intensive consultation is, *eo ipso*, no guarantee that the envisioned transformation will indeed 'avoid the law of unintended consequences', as a senior representative of PWGSC put it at a recent Townhall Information Session in Vancouver.

Let's look at two cornerstones of the new DPS to show how individually persuasive reform steps can amalgamate into a complex set of incentives that may not complement one another: First, developing close and supportive relationships with industry while retaining a sincere



commitment to competition and market forces, and, second, streamlining procurement while increasing preferential complexity with more stakeholders getting involved in the development, implementation, monitoring, and adjustment of the process.

Certainly, developing long-term relations with industry is a laudable move given the poor guidance it has received over the past two decades. Planning uncertainty has been one of the core challenges for Canadian defence firms. Therefore, information as to where to allocate resources and intensify R&D, e.g. through determination of key industrial capabilities and the annual acquisition guide, will relieve industry of some of this uncertainty.

At the same time, engaging industry early and providing long-term procurement priorities with an explicit preference for Canadian bidders, comes with the risk of putting government at the will of industrial priorities and profit expectations. If the government is serious about maintaining its commitment to competitive acquisition, the actual cost savings on procurements become questionable. It is very difficult to demand maximum cost-efficiency in terms of value-for-money for both taxpayers' and the Canadian Forces, while maintaining close and highly supportive relations with industry.

For industry to be able and willing to allocate resources to meet government preferences regarding essential capabilities and value propositions of economic relevance, it requires and probably will call on the government for a steady pattern of orders. Such commitment can become very costly and unsustainable, not only because of the boom and bust nature of defence budgets. What also needs to be taken into account here are the premiums paid for domestic over foreign supply. These are barely ever seriously accounted for through a sincere look at actual economic, industrial and employment impact versus opportunity costs. While uncertainty and foreign competition are, of course, a tough call on industry, experience from the UK has shown that these can lead to considerable savings of up to 10-15% in procurement and overall life-cycle costs.

A similar argument can be made for the ambition to tackle the frustration with offset agreements. Leveraging procurements from foreign bidders to generate targeted and quality industrial and regional benefits sounds reasonable and desirable. Yet foreign suppliers that are not particularly reliant on the Canadian market will probably be unwilling to deliver quality work to potential Canadian competitors. And those companies that do have a vested interest in selling military equipment, technology or services to Canada, will charge an implicit, or less likely, an explicit premium to meet the 'quality' offset requirements. 'Smart procurement' requires effective negotiations and sound contracting (e.g. performance-based rather than outcome-based) to assure actual delivery of the desired offsets. However, the government's track record of penalizing contractors for not realizing agreed upon direct and indirect offsets as well as its stated unwillingness to introduce a gated procurement process is a not very promising indicator on this front.

Therefore, we should be doubtful that closer relations with industry and demanding quality offset agreements from foreign contractors will balance off the premiums to be paid with taxpayers' money when stricter adherence to competition and market forces to ensure cost-efficiency is compromised.

Another core pillar of the new procurement strategy is the streamlining of the acquisition process. This part of the DPS has been designed in accordance with the approach used for Canada's Naval Shipbuilding and Procurement Strategy (NSPS). At its heart, the reform is



intended to concentrate expertise and decision-making authority in the yet to be created Defence Procurement Secretariat, foremost to reduce the Department of National Defence's influence on procurement decisions and to create a single point of accountability. Internal and external monitoring capacity will be expanded through the creation of the inter-departmental Permanent Work Group of Ministers, its mirror committee, the Deputy Minister Governance Committee, and the Defence Analytics Institute, an independent, external 'watchdog' of the DPS' progress and future source of recommendation for improvement.

On the interaction level, streamlining shall improve the communication between stakeholders, enable more and better political oversight, and allow sufficient flexibility to adjust the strategy along the way to reflect changing operational, industrial and financial conditions. At first glance, institutionalizing accountability and designing mechanisms to avoid gridlock among stakeholders are certainly commendable goals.

However, it is somewhat perplexing that streamlining the process and increasing accountability translates into increasing the number of stakeholders involved, with several departments, committees, the Secretariat and the Defence Analytics Institute having to coordinate, cross-monitor, co-evaluate and at times, co-decide. Rather than abolishing the dual, and technically poly-departmental, governance of defence procurement, unique to Canada, the DPS will increase the complexity of interaction and institutionalization.

Streamlining does not have to mean 'simplifying' the process. Yet, it should also not mean 'complicating' it. The central concern of streamlining acquisition processes is to alter the institutional setting to adapt to and mitigate the complexity and diversity of stakeholders' preferences to ensure that the cost, performance and delivery time projections of acquisitions can be realized.

How persuasive is the reference to the NSPS with its concept of 'shared accountability' to justify the strength of the committee and secretariat approach in the DPS? So far, not very compelling.

Briefly summarized, several reports and inquiries revealed already that ordered vessels will reach initial operational capability far later than expected and that costing estimates were wrong, so that either more funding or a reduction in the number of orders will be required. The gains in terms of performance have also been shown to be questionable with vessels being too slow, too lightly armed and providing too little capability to adequately perform their core duties. Overall, the NSPS model seems not to have been the grand leap and shared accountability not been able to avoid the typical pitfalls of large-scale acquisition programs.

Admittedly, Canada does not have a comprehensive defence industrial base, so targeted procurements and investments in infrastructure, technical expertise and continuous capability development opportunities should allow for a steep learning curve and will benefit industry. However, looking at the rather modest results in the UK and the potential difficulties inherent to the new DPS discussed above, it has also become clear that there remains good reason to not simply join the choir praising the DPS as the magic formulae for greatly improved outcomes on all the economic, industrial, and military fronts. The political rhetoric surrounding the reforms appears to downplay the persistent struggles characteristic to defence procurement systems and to overestimate the benefits that reforms as well as a defence industrial strategy can actually achieve.

► **About the Author**

Tommi Rebien is a doctoral candidate (ABD) at the University of British Columbia's Political Science Department as well as the Defence Industry and Public Procurement Associate at Blue Force Global. His doctoral research focuses on defence industrial governance strategies in European and East Asian advanced economies, in particular marketization and export promotion policies. He has also conducted research on defence procurement systems in Scandinavia as a Foreign Research Fellow with the Swedish Defence Research Agency and on maritime security and naval modernization in the Asia-Pacific with the Liu Institute for Global Issues.



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