



RECAPITALIZING THE CANADIAN FORCES' MAJOR FLEETS: ASSESSING LINGERING CONTROVERSIES AND CHALLENGES

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EXECUTIVE SUMMARY

Canada's Conservative government is committed to recapitalizing the Canadian military's major fleets—at least in principle. Unfortunately, the replacement of the military's major fleets has not gone as well as hoped. The sheer size and complexity of recapitalizing the military, as well as the burdens placed on the defence department's limited procurement staff, slowed the process from the beginning. These difficulties were exacerbated by delays associated with improper cost-estimates and budgeting, inflated specifications, and ill-fated attempts to game procurement processes in favour of a particular platform or pursue questionable sole-sourced acquisitions. Whether these problems are surmounted or not, the Conservative government and DND/CF are facing a still larger challenge: plans to replace the military's major fleets were not properly costed, were probably not affordable when first announced, and are clearly not realistic in light of the government's 2012 budget. Consequently, unless new money is invested into the CF's recapitalization efforts, the military will likely have to make do with fewer platforms or less capable equipment.

This study examines the delays and controversies that have surrounded the recapitalization of the Canadian military's major fleets, as well as the challenges that the defence department and military will confront in the coming years as they attempt to bring their procurement programs into line with a tighter defence budget. The study concludes that while the problems that have surrounded defence procurement since 2006 might be overcome, the future of the CF's recapitalization is far from certain owing to budgetary constraints.

SOMMAIRE

Le gouvernement conservateur du Canada s'est engagé à recapitaliser les flottes majeures des forces armées canadiennes—en principe, du moins. Malheureusement, le remplacement des flottes militaires majeures ne s'est pas aussi bien passé qu'on l'espérait. La seule taille et la complexité de la recapitalisation militaire, ainsi que le fardeau placé sur le personnel d'acquisition limité du ministère de la Défense, ont ralenti le processus depuis ses tout débuts. Ces difficultés ont été exacerbées par les délais associés à de mauvaises estimations et budgétisation de coûts, à des spécifications gonflées et à des tentatives vouées à l'échec de détourner les processus d'acquisition en faveur d'une plateforme particulière ou de poursuivre des acquisitions à source unique douteuses. Que ces problèmes soient surmontés ou non, le gouvernement conservateur et le MDN, et les FC, font encore face à une difficulté encore plus grande : les plans visant au remplacement des flottes majeures des forces militaires n'ont pas été proprement traduits en coûts, ils n'étaient probablement pas à la hauteur de nos moyens quand on les a d'abord annoncés et ils ne sont clairement pas réalistes à la lumière du budget de 2012 du gouvernement. En conséquence, à moins que de l'argent neuf soit investi dans les efforts de recapitalisation des FC, les militaires vont probablement devoir se contenter de moins de plateformes ou d'équipement de moindre capacité.

Cette étude examine les délais et les controverses qui ont entouré la recapitalisation des flottes majeures des forces armées canadiennes, ainsi que les difficultés auxquelles seront confrontés le ministère de la Défense et les forces militaires au cours des prochaines années dans leurs tentatives de ramener leurs programmes d'acquisition dans l'alignement d'un budget de la défense plus serré. L'étude conclut que, même si les problèmes qui ont entouré les acquisitions de la défense depuis 2006 pouvaient être surmontés, l'avenir de la recapitalisation des FC est loin d'être certain à cause des contraintes budgétaires.

INTRODUCTION

Canada's Conservative government is committed to recapitalizing the Canadian military's major fleets—at least in principle. Since coming to power in 2006, Prime Minister Stephen Harper's Conservatives have pledged that they will revive the Canadian Forces (CF) and equip them for the variety of missions that they will likely undertake in the coming decades. During their first years in power, it appeared that the recapitalizing program was going well. A number of high profile procurements were completed, while others were announced in the government's 2008 defence strategy. For the first time in two decades, it seemed that a Canadian government was prepared to invest the money required to rejuvenate the military and retain the CF's core capabilities.

Troubles with the recapitalization appeared soon after it began, however. Unless these problems are addressed, the CF's recapitalization will continue to be plagued by controversy and delay. Even if these issues are resolved, reductions in defence spending mean that the original plan to replace all of the CF's major fleets is unaffordable. This is the larger challenge facing Canadian defence procurement today. The question the government and CF must confront is what will have to be sacrificed to make means and ends meet in the military capital acquisition program.

This paper examines the delays and controversies that have surrounded the recapitalization of the CF's major fleets to date, as well as the challenges that the defence department and military will confront in the coming years as they attempt to bring their procurement programs into line with a tighter defence budget. The paper concludes that while the problems that have surrounded defence procurement since 2006 might be overcome, the future of the CF's recapitalization is far from certain owing to budgetary constraints.

CANADIAN DEFENCE PROCUREMENT, 1994–2006

Few major equipment procurement projects were initiated after the large-scale cuts to the Canadian defence budget that were announced in 1994. Although some equipment would be replaced or modernized over the next decade, the recapitalization of most of the military's major fleets was delayed. This led to two worrying consequences as the years wore on. First, it meant that several equipment fleets would need to be replaced simultaneously and in a short period of time to preserve the CF's existing set of capabilities.¹ Second, it markedly reduced the number of experienced procurement program managers within the defence department, atrophying the materiel group at the Department of National Defence (DND). This problem was compounded by the practice of rotating officers in and out of positions at National Defence Headquarters. Stated simply, DND/CF was left with a growing list of urgent procurements and relatively few experienced people to manage them.²

During Paul Martin's brief period as prime minister, steps were taken to replace certain key platforms.³ Yet these programs were barely underway by the time Stephen Harper's Conservatives defeated the Martin Liberals and formed a government in February 2006. Whereas the Martin government had been cautious about how much the CF's existing capabilities could be replaced in the short-term, the Conservatives were determined to fully re-equip and modernize the Canadian military. It was an ambitious objective considering the state of DND's materiel group and how many procurements would need to be managed, yet the new government was determined to see it through. To that end, the Conservatives preserved their predecessor's policy of increasing military expenditures by \$12 billion, added an additional \$5 billion, and introduced steady defence budget increases of two percent over twenty years. The new government also began working with DND/CF to prepare a comprehensive procurement plan and timetable. Together, these funding increases and acquisition projects would serve as the foundation of the Conservatives' 2008 *Canada First Defence Strategy* (CFDS).

1 Brian MacDonald, "The Capital and Future Force Crisis," in Douglas L. Bland, ed. *Canada Without Armed Forces?* (Kingston: School of Policy Studies, Queen's University, 2004).

2 As noted on page 28 of the *Report on Transformation 2011*, although the materiel group's spending increased by approximately 70% from 2003/2004 to 2009/2010, it only saw a 5% increase in personnel. As the Report noted, "ADM(Mat) gained very few people but experienced one of the largest increases in overall expenditures."

3 The Martin government re-capitalization priorities were outlined in its 2005 *Defence Policy Statement*.

PROCUREMENT SUCCESSES AND CONTROVERSIES, 2006–2012

During the Conservatives' first years in power, notable procurements were quickly completed. Four C-17 strategic-lift aircraft were bought and delivered in 2007. A contract to buy seventeen C-130J tactical-lift aircraft was signed in 2008, with delivery slated for 2010–2012. Main battle tanks and helicopters were leased for CF operations in Afghanistan and contracts to buy used Leopard tanks and new Chinook helicopters were signed. Two shipyards were selected to build new fleets for the navy and coast guard. Conservative ministers also announced a slew of smaller projects and planned procurements in these first years, further cementing the impression that the recapitalization of the military was moving forward steadily.

Yet the rapid acquisition of certain platforms and regular announcement of forthcoming expenditures masked problems that were emerging with the recapitalization effort. The C-17s and C-130Js aircraft were 'off-the-shelf' platforms bought without a competitive process, which explains the ease and speed with which they were required.⁴ The Chinooks were also bought through a sole-sourced process, but as the Office of the Auditor General (OAG) noted, their cost inflated as the supposedly 'off-the-shelf' equipment was tailored to fit additional specifications set by the Royal Canadian Air Force (RCAF).⁵ A similar problem affected the navy's joint support ships (JSSs) and two army vehicle programs. The procurement of the JSSs was delayed in 2008 when industry determined that specifications set by the military could not be met within the budget allocated.⁶ The project has been stalled ever since, as planners have tried to bring the ships' capabilities into line with the money earmarked for the acquisition. This tendency has not yet been effectively curtailed by the summer of 2012, when Public Works and Government Services Canada (PWGCS) cancelled a request for proposals for the army's medium-sized logistics trucks because the platforms could not be bought within budget.⁷ Similar problems have delayed acquisitions of new close combat vehicles for the army since 2009.⁸

What contributed to these delays and cases of 'specification-creep'? Three likely factors were at play. First, it is probable that overburdened and relatively inexperienced project managers did not realize to what degree the specifications they set would affect the procurement costs or the ability of industry to meet the requirements.⁹ Second, given the CFDS' broad missions and the sense that money was being provided to supply the CF with the best possible equipment, those involved in setting the specifications may not have felt it necessary to be overly concerned with cost-effectiveness. Stated differently, the government's pledge that the CF would be recapitalized may have made budget envelopes seem less constraining or important. Thirdly, as hinted at by the OAG, those charged with overseeing the specification setting process appear to have neglected their responsibilities.¹⁰ In making this observation, though, it is equally important to recognize that the defence department's materiel group has been asked to manage a sizable number of complex procurements in a short period of time without an increase in experienced staff. Put bluntly, the veritable influx of procurement projects that were initiated since 2005 may have overstretched those tasked with ensuring that programs are effectively managed and not undermined by overloaded specifications.

While 'specification creep' may not appear to be a particularly serious problem, other procurements have been derailed by more disconcerting practices. In 2005, the Martin government initiated a replacement of the RCAF's fixed-wing search and rescue (FWSAR) aircraft. The RCAF's preferred FWSAR platform was the Alenia C-27J. To ensure that Alenia would win the contract, the statement of requirements for the FWSAR procurement was written to favour the C-27J.¹¹ In the years that followed, the procurement faced a series of delays as Alenia's competitors worked to make the process fairer. When it became apparent that the procurement

4 The sole-sourced acquisition, it should further be noted, may have left Canadian industry at a disadvantage in terms of industrial and regional benefits, and there is no guarantee that the procurements provided the best value for money.

5 Office of the Auditor General of Canada, *2010 Fall Report of the Auditor General of Canada*, chapter 6, sections 6.47–6.65.

6 Canadian Forces, Chief of Review Services, *Internal Audit of the Joint Support Ship Project* (November 2011), 1.

7 "Military truck purchase cancelled due to cost concerns," *Canadian Press*, 11 July 2012.

8 David Pugliese, "Close Combat Vehicle Back to Square One?" *Ottawa Citizen Defence Watch* blog, 19 April 2012.

9 *ibid.*

10 OAG, 2010 Fall Report, sections 6.47–6.65.

11 David Pugliese, "Getting a laugh about a \$3 billion Canadian Forces search and rescue aircraft project," *Ottawa Citizen Defence Watch* blog, 15 April 2010.

was at an impasse, the National Research Council was asked to conduct a review of the FWSAR statement of requirements.¹² A revised statement of requirements was then produced in December 2010 in light of the Council's report. Two years later, it was finally announced that request for proposals would be issued before the end of 2012, seven years after the procurement was initiated.¹³

The replacement of Canada's CF-18s fighter aircraft has been surrounded by significant controversy as well. In the summer of 2010, defence minister Peter MacKay announced that Canada would be acquiring 65 F-35 Joint Strike Fighters to replace the CF-18s. According to the RCAF, the F-35 was the only fighter that met the military's high level specifications. For its part, the government incorrectly stated that a contract to buy the aircraft had already been signed.¹⁴ Over the next two years, both the Parliamentary Budget Office (PBO) and the OAG identified problems with the way the CF-18 replacement had been conducted to date. The PBO noted that DND had provided inadequate information about the CF-18 replacement program and underestimated the total cost of the F-35,¹⁵ while the OAG reported that the decision to move forward with a sole-sourced acquisition had not been properly justified and that due diligence had been lacking throughout the process, including when the RCAF had determined that only the F-35 met its requirements.¹⁶ In response to the OAG report, the Harper government initiated a review of the procurement in the summer of 2012. Most recently, the government has announced that the National Fighter Procurement Secretariat established in the aftermath of the OAG report will conduct a new options analysis that will not be bound by the military's original statement of requirements.

Considering these various procurement delays and controversies, it is evident that efforts should be made to address the difficulties and questionable practices that have hurt the CF recapitalization effort up to this point. Above all, the government must examine whether the materiel group has the staff and resources required to effectively manage so many projects. If not, it may be necessary to accept that the recapitalization will need to take longer than originally planned. Particular attention must also be devoted to avoiding additional cases of 'specification creep'; in fact, the shipbuilding strategy that has been widely lauded thus far could easily be undermined by inflated requirements. Further attempts by DND/CF to skew competitions or push through sole-source acquisitions must be curtailed as well; however well-intentioned they may be, this behaviour has helped derail two procurements that would likely have gone more smoothly had fair competitions been held. Indeed, if the platforms sought by the military were truly best for the CF, this would have been validated by a transparent, unbiased competitive process. The government, meanwhile, should recognize that whatever short-term gains are made by distorting or withholding information related to defence procurements, the long-term price is quite high, both for DND/CF and the party in power.

CF RECAPITALIZATION AND THE 2012 BUDGET

Ideally, the Canadian government will succeed in correcting the troubles and behaviours that have complicated the recapitalization up to now. The establishment of several procurement 'secretariats' suggest that Cabinet appreciates the importance of doing so. Yet whether these procedural problems are overcome or not, a larger obstacle lies ahead: the mismatch between the cost of the CFDS capital program and the money available to fund it.

12 "Purchase of search-and-rescue planes delayed again," *Canadian Press*, 9 March 2012.

13 David Pugliese, "Fixed wing search and rescue project secretariat to meet industry in October, draft RFP expected by end of year," *Ottawa Citizen Defence Watch* blog, 24 July 2012.

14 For an overview of the controversy surrounding the F-35, see Philippe Lagassé, "Lessons learned from the F-35 acquisition debacle," *Macleans.ca*, 3 April 2012, available at: <http://www2.macleans.ca/2012/04/03/lessons-learned-from-the-f-35-acquisition-debacle/> and Philippe Lagassé, "The opposition must ask better questions about the F-35," *Macleans.ca*, 2 May 2012, available at: <http://www2.macleans.ca/2012/05/02/the-opposition-must-learn-to-ask-better-questions-about-the-f-35>.

15 Office of the Parliamentary Budget Officer, *An Estimate of the Fiscal Impact of Canada's Proposed Acquisition of the F-35 Lightning Joint Strike Fighter*, Ottawa, 10 March 2011.

16 Office of the Auditor General of Canada, *2012 Spring Report of the Auditor General of Canada*, chapter 2.

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Critics were skeptical about the CFDS capital program costing from the moment the document was released. They questioned whether the *Strategy's* drafters had been overly optimistic about the projected cost of replacing the CF's major fleets, particularly if the process did not progress well.¹⁷ In the absence of clearer information about how various projects had been costed and devised, however, these assessments were merely speculative.

As the number of delayed projects grew and reports emerged that program budgets were proving insufficient to acquire the capabilities sought by the CF, it became apparent that the skeptics had been correct: the CFDS capital program was underfunded.¹⁸ As long as the Conservative government was publicly committed to recapitalizing the military, however, there was reason to believe that individual procurement budgets could be augmented, or defence spending sufficiently increased, to ensure that all the CF's major fleets could be replaced.

This hope was dealt a blow in 2010, when the federal budget slowed the increases in defence spending announced as part of the CFDS.¹⁹ Two years later, the federal budget announced an additional seven percent cut in defence operating expenditures, as well as further delays to projected capital program spending.²⁰ According to David Perry of Carleton University, when combined with a government-wide strategic review requiring all departments and agencies to return a percentage of their budgets, DND/CF will be facing a total budget reduction of up to eleven percent.²¹ In light of these reductions, the Harper government quietly acknowledged that the CFDS would need to be revised. According to Perry, DND/CF is planning on reducing readiness to absorb the budgetary reductions.²² However, even if readiness cuts do account for most of the expected reductions, he further notes that the delayed capital program spending will mean that the purchasing power of DND/CF's equipment budget will be eroded by defence-specific inflation.²³ Although the government has refused to acknowledge it, the CFDS capital program is no longer affordable, if it ever really was.

One of two consequences will necessarily flow from this state of affairs: the CF will either acquire less capable equipment than they had hoped, or they will be forced to make due with fewer platforms than expected. Thus far, it appears that both the Conservatives and DND/CF favour the latter option. For instance, the government has stated that it will only spend \$9 billion on the initial procurement costs of the CF-18 replacement, meaning that the RCAF might be forced to settle for fewer aircraft than it deems necessary, particularly if the F-35 is ultimately chosen as Canada's next fighter.²⁴ A similar approach may be followed for naval procurements.²⁵ The procurement budget for the navy's new combat vessels has been set at \$25 billion. This amount was meant to fund the construction of eight Arctic Offshore Patrol Ships and fifteen surface combatants. If the budget proves insufficient to acquire all twenty-three ships with the capabilities that the navy considers essential, however, it appears that the defence department is preparing to build fewer ships rather than sacrifice the capabilities of individual vessels. Notably, DND/CF's shipbuilding procurement website is now remarkably silent about how many naval combat ships will actually be built.

Is it wise for DND/CF to accept fewer platforms in order to maintain higher end capabilities? Or should the defence department and military aim to retain a greater number of platforms, albeit with fewer capabilities? Perhaps the answer should be different depending on which service or platform is at issue. In the end, these are decisions that should be guided by a clear defence policy, one that attempts to match capital expenditures with the CF's future missions and roles.²⁶ Indeed, unless the Conservative government is planning to invest large

17 Memorandum 'Transforming the Canadian Forces: The Spirit is Willing...' from Scott Bellard, American Embassy in Ottawa to US State Department, Washington, February 2010, Wikileaks cable 100ttawa49; Philippe Lagassé and Paul Robinson, *Reviving Realism in the Canadian Defence Debate*, Martello Paper No. 43 (Kingston: Queen's Centre for International Relations, 2008), chapter 4.

18 Lee Berthiaume, 'Tories knew last year shopping list of military equipment was 'unaffordable', documents show,' *National Post*, 4 June 2012.

19 Canada, Department of Finance, *Budget 2010: Leading the Way on Jobs and Growth*, 4 March 2012, 158-159.

20 Canada, Department of Finance, *Budget 2012: Jobs, Growth and Long-Term Prosperity*, 29 March 2012, 213, 223.

21 David Perry, 'DND will be doing less with less,' *iPolitics*, 4 April 2012.

22 Murray Brewster, 'Budget cuts mar carve \$2.5B from DND,' *Canadian Press*, 1 October 2012.

23 Email exchange with David Perry of Carleton University, 12 October 2012.

24 Colin Horgan, 'F-35: The \$9 billion message problem,' *iPolitics*, 21 March 2012.

25 The Royal Canadian Navy's director of maritime force development, Commodore Dan Sing, noted as much at the Naval Association of Canada conference in Ottawa on 1 June 2012.

26 Senator Roméo Dallaire, 'With new budget, new challenges, it's time for a Defence White Paper,' *Hill Times*, 28 May 2012.

sums in DND/CF once the deficit has been eliminated, the absence of such guidance will undermine the CF's recapitalization efforts. Instead of making well thought out decisions about the trade-offs between platform numbers and capabilities, or between the different needs of the three services, DND/CF's default position will prevail: higher capability platforms will be bought in fewer numbers based on the assumption that DND/CF will eventually be given additional capital funding to make up for any quantitative shortfalls.²⁷ Unfortunately, that assumption may prove to be unfounded, leaving the CF with riskily shrunken equipment fleets.

CONCLUSION

The Conservative government's recapitalization of the military's major fleets has not gone as well as hoped. Structural problems, such as the sheer size and complexity of the endeavour and the burdens placed on DND's short-staffed materiel group, created significant obstacles at the outset. These were exacerbated by delays associated with improper cost-estimates and budgeting, specification inflation, and ill-fated attempts to game procurement processes in favour of a particular platform or pursue unjustified sole-sourced acquisitions. Better efforts to address these problems will need to avoid further procurement delays and controversies.

Whether these problems are surmounted or not, the Conservative government and DND/CF are facing a still larger challenge: the recapitalization scheme outlined in CFDS was not properly costed, was probably not affordable at the outset, and is clearly not realistic in light of the government 2012 budget. As a result, the ambition of the CFDS capital program will need to be reined in. Either the CF will have to make do with fewer platforms, less capable equipment, or some combination of the two, based on a reevaluation of the military's expected future requirements and missions. Early indications are that the government and DND/CF are prepared to accept fewer platforms with greater capabilities. The logic or policy guiding this decision have yet to be articulated, however, which suggests that the approach has not been carefully considered. If this is the case, it does not bode well for the government's already trouble-ridden attempt to replace the CF's major fleets.

²⁷ For a detailed discussion of this issue, see Peter Jones and Philippe Lagassé, "Rhetoric v. Reality: Canadian defence planning in a time of austerity," *Defense & Security Analysis* 28/2 (2012): 141–152.

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