



**Canadian  
Manufacturers &  
Exporters**

Canada's Leading  
Business Network

**Manufacturiers et  
Exportateurs du  
Canada**

Le réseau d'affaires  
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# **RENEWING CANADA'S INFRASTRUCTURE: AN OPPORTUNITY TO INVEST IN OUR FUTURE**

**CME Position Paper**

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## **SUMMARY**

The economic situation of Canadian manufacturing and exporting companies has grown considerably more difficult in recent years. The rise of the dollar, ever-greater competition and the accelerating pace of technological innovation are some of the factors which explain the whirlwind of change in which the Canadian industry finds itself.

In this context, it more imperative than ever for governments to make sure that domestic manufacturing and exporting companies benefit from a globally competitive business environment. Moreover, businesses expect their governments to create policies which support their competitiveness, establish rules and regulations which provide them with equal footing, and apply these rules in an even and systematic way.

Government funding, specifically in the case of infrastructure and mass transit projects, is one of the tools that governments have at their disposal to foster domestic economic development. This approach is well-established and desirable for any economy which endeavours to support the development of a strong and dynamic domestic industry. This is why many countries use this approach.

This is especially true of the United States, Canada's premier trading partner and the world's leading economic power. Highway, road, airport facilities and mass transit infrastructure projects are governed by laws, bylaws and policies which maximize economic benefits for U.S. domestic companies and, by the same token, support the development of the local manufacturing industry while allowing competition that is based on fair rules for all vendors.

Many might be surprised by this reality, because a free-trade agreement exists between Canada and the U.S., one chapter of which deals specifically with government procurement and provides a framework for such policies. However, this does not mean that Canadian exporters automatically have access to infrastructure and mass transit projects which are funded by the U.S. government. Even though Canadian exporters take part in certain projects which are funded by governments in the U.S., several contracts or sub-contracts are reserved for companies which are in the U.S.

In spite of NAFTA and the WTO's Agreement on Government Procurement, which provide fair treatment to signatory nations when granting certain contracts, the U.S. government succeeds in promoting manufacturing on U.S. soil while respecting these agreements. For example, restrictions exist regarding a manufacturing presence in the U.S. for all projects funded by the U.S. government in the sectors of mass transit, airports or road construction. These policies help meet economic development goals by striving to maximize the impact of government funds on U.S. industry.

However, Canadian companies do not benefit from the same support from their own governments, even though Canada has economic development goals which are similar to those of its main trading partner, and even though it is important for Canadian companies to have support that is similar to the one obtained by foreign companies from their governments in order to be competitive on a global scale. Too often, international agreements to which Canada is a signatory have been estimated to be restrictive regarding the actions it can take, to the point where it is powerless. However, Canada does have a scope of concern that it does not use, to the detriment of companies that choose to design and manufacture their products here.

Provinces and states are not subject to NAFTA. Several U.S. states use government procurement to maximize domestic economic benefits. In Canada, because of the Agreement on Internal Trade



(AIT), provinces cannot do the same; they must give free access to their government procurement for all Canadian companies. They can therefore use government procurement to support Canada's economic development, but not of their province specifically.

In order to maximize Canadian domestic economic benefits of government procurement and offer Canadian manufacturers and exporters a business environment that is competitive with the one their competitors benefit from in their domestic markets, Canadian Manufacturers and Exporters recommends the following:

1. that the Federal government and the provinces implement every measure possible when funding projects to stimulate economic development, in accordance with standards imposed by the international agreements to which Canada is a signatory;
2. that the Government of Canada apply rules and regulations favouring Canadian content when it funds infrastructure and mass transit projects under its authority, or under the authority of provinces and municipalities;
3. that provincial governments also use funds invested to develop and renew infrastructures as economic development levers.



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## 1. INTRODUCTION

Canada's largest trade and industry association, Canadian Manufacturers and Exporters (CME) represents a sector of economic activity that is responsible for over 15% of Canada's GDP and 2 million direct jobs.

The indirect economic contribution of manufacturing and exporting companies to the Canadian economy is significant. It has been estimated that every dollar of value added by manufacturers results in \$3.05 of economic activity in Canada – the most significant multiplying factor of any Canadian economic sector. One out of every three jobs in Canada depends on our capacity to export our products abroad. Manufacturing businesses are responsible for two-thirds of goods and services exports, and three-quarters of all the private-sector research and development done in Canada.

It is important not to lose sight of the importance of these two key sectors of the Canadian economy, because every manufacturing and exporting company is currently facing challenges which will considerably change the nature of its activities, and therefore have an impact on the capacity of the Canadian economy to create wealth. We are entering a phase of profound restructuring which will affect every sector of the North American economy. This restructuring will occur over the next five to ten years, and will be driven by five factors:

1. The intensification of competitive pressures from countries with lower-production costs, such as China, Brazil, India and South Korea, from economies which are rapidly becoming new industrial powers and which aim to export a significant portion of their production to North America, Europe and Japan. Let us note that, in this respect, Canada's share of American exports has already shrunk by 14% in the past five years – the impact of this loss totals some \$48 billion for 2006.
2. A decrease in profits caused by the intense pressure on product prices (for which the effect is actually exacerbated in Canada by the rise of the Canadian dollar, which is akin to a decrease in prices of more than 60% on export sales) and the rapid increase in operating costs, including energy, labour and raw material costs, in addition to other costs such as fiscal expenses and the costs of complying with regulations.
3. The continuing globalization of companies, with manufacturers and exporters outsourcing some of their operations, products, services, technologies, skills and knowledge throughout the world, all the while asking that their vendors be more and more competitive on a global scale, as regards cost, value, quality, design, engineering and service delivery aspects.
4. Demographic changes which, during the next decade, will result in the retirement of a large proportion of qualified employees. This will exacerbate qualified workers shortages, which are already limiting Canada's economic growth.
5. The competitive returns on investment which can be obtained in certain jurisdictions. Fiscal structures are very important in this respect. In spite of federal and provincial government promises to lessen the fiscal burden, real marginal tax rates paid by Canadian businesses on every dollar invested are among the highest in the world.



Bearing in mind the economic importance of the manufacturing sector for Canada's economy, it is crucial that this industry and its partners succeed in meeting these challenges. Up to now, companies in this sector have answered these challenges by reducing their operating costs, which accounts for a significant portion of the 340,000 jobs lost since 2002. They also decreased or outsourced their production, increased the operational productivity, consolidated their operations and took advantage of new market opportunities. Over the longer term, manufacturing and exporting companies will work to introduce innovative products, services and processes, improve worker skills and competencies and invest in the modernization of their operations.

Challenges facing them remain considerable, however. In 2004-05, the CME launched the Manufacturing 20/20 Campaign and organized more than 100 meetings with more than 3,000 manufacturers and their partners throughout the country to define the future of manufacturing in Canada, and identify what must be done to ensure the competitiveness of the industry. Manufacturers are taking a leadership role in modernizing their operations, competing for market share, growing their businesses and adapting their business models to the new business environment. However, they need a world-class business environment that will give them an equal or better opportunity to succeed over their competitors. To remain world-class companies, manufacturers will also need governments to rethink their way of doing things, adopt a strategic approach when developing public policies, implement a competitive fiscal and regulatory framework, and invest in the improvement and development of public infrastructure.

Massive investments in public infrastructure and mass transit projects are some of the tools which are available to our governments to help local companies become or remain world-class players. Considering that most jurisdictions competing with Canada use their funding capacity in a wise and strategic manner to support the development of their domestic industry, it is essential for companies choosing to design and build their products in Canada to benefit from the same competitive environment.

The objective of this document is to shed new light on this situation, and to suggest possibilities for improvements to governments, so that they use their procurement and funding powers to their full potential. Section 2 reviews some recent commitments made by the federal and provincial governments regarding the funding of infrastructure and mass transit projects.

Section 3 asks if Canada will seize the opportunity that has arisen to support economic development in Canada, considering the scope of infrastructure and mass transit projects which will be implemented in the near future.

Section 4 examines the positive role that governments can play in domestic economic development, by maximizing the positive benefits linked to funding infrastructure and mass transit projects.



Section 5 examines current practices in force with some of our trading partners, specifically the U.S., and examines the situation of two specific sectors, i.e. steel girders and transportation equipment.

Section 6 reviews two major international agreements to which Canada is a signatory and which deal with government procurement and project funding: the World Trade Organization Agreement on Government Procurement (WTO-AGP) and Chapter 10 of the North American Free Trade Agreement (NAFTA).

Section 7 contains the Association's three recommendations for governments and Section 8 summarizes who is CME.



## 2. A UNIQUE OPPORTUNITY

Governments in Canada have committed themselves to making major investments in infrastructure and public mass transit projects in the near future. This is not surprising, considering the growing need for modern infrastructures and the necessity to undertake major repair projects on aging infrastructures. Large allocations of funds will therefore be invested in the building, repair and modernization of roads, bridges, waterworks systems and public transportation systems, without taking into account the investments made to modernize border infrastructures and port installations.

In fact, the Government of Canada stated in the last Federal Budget that it plans to invest \$33 billion over the next seven years in public infrastructure projects. These funds have been set aside specifically to build and renew roads and highways, fund the development of public transit and increase the production of certain types of renewable energy sources.

These investments include an annual transfer to municipalities of \$2 billion per year (by extending the Gas Tax Fund transfer) for highways, urban transit, sewage treatment and flood mitigation, \$8 billion for the new Building Canada Fund announced in the last budget, as well as a total investment of \$2.3 billion over seven years for trade-related infrastructure, such as gateways, roads, highways and other transportation facilities.<sup>1</sup>

The provinces have also planned major investments to renew their infrastructures. In 2005, Ontario launched *ReNew Ontario*, a plan to invest more than \$30 billion in the repair, revitalization and expansion of Ontario's public infrastructure by 2010. These investments will be made in public infrastructure such as schools, hospitals, water and wastewater systems and transportation infrastructure, including public transit, highways, roads, bridges and border crossings. Ontario's government is planning to build an additional 194 kilometres of highway and 118 bridges, and repair 3,600 kilometres of highway and 400 bridges.<sup>2</sup> Moreover, last June the government launched *MoveOntario 2020*, a multi-year \$17.5 billion rapid transit action plan to deliver 52 rapid transit projects, including the extension of a subway line in Toronto and the construction of two rapid transit lines across Hamilton.<sup>3</sup>

In Quebec, the government plans on investing \$30 billion over five years to develop and restore schools, hospitals, roads and public transit equipment. Two-thirds of amounts

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<sup>1</sup> Department of Finance Canada, Budget 2007, *Chapter 5 – A Stronger Canada Through a Stronger Economy: Infrastructure Advantage*, March 19, 2007, available online at: <http://www.budget.gc.ca/2007/bp/bpc5be.html>.

<sup>2</sup> Ontario Ministry of Finance, 2007 Ontario Budget, *Expanding Prosperity Through Ontario's Infrastructure*, March 22, 2007, document available online at <http://www.ontariobudget.ca/english/bk8.html>.

<sup>3</sup> Premier of Ontario, *McGuinty Government Action Plan For Rapid Transit Will Move The Economy Forward*, News Release, June 15, 2007, available online at: <http://www.premier.gov.on.ca/news/Product.asp?ProductID=1383&Lang=EN>.



invested will be used to maintain assets and correct the maintenance deficit of the previous decades.<sup>4</sup>

In Alberta, the provincial government plans to invest \$18.2 billion dollars in infrastructure projects between 2007 and 2010. Close to half of these funds will be directed towards municipal infrastructure and roads.<sup>5</sup>

In British Columbia, the government plans to invest \$2.4 billion in the transportation infrastructure, as well as \$1.1 billion in joint investments with the Federal Government within the framework of partnerships with private companies, local governments and other agencies.<sup>6</sup> The six other Canadian provinces also plan on making major investments in infrastructures, specifically road and highway infrastructures and those of municipalities, such as waterworks and mass transit systems.

In short, it is clear that the Federal government, the provinces and municipal governments plan on partnering to make substantial investments in developing and restoring our infrastructure. In addition to restoring the infrastructures upon which our society depends to ensure its development, these investments can make significantly contributions to the Canada's economy. Will we seize this opportunity and maximize the positive effects of these investments for Canada's economy?

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<sup>4</sup> Ministère des Finances du Québec, *Budget 2007-2008 – The Budget at a Glance*, available online at: <http://www.budget.finances.gouv.qc.ca/budget/2007-2008a/en/bref/renovations.asp>.

<sup>5</sup> Ministry of Finance, Alberta, Budget 2007 – Managing our Growth, Capital Plan 2007-2010, April 19, 2007, available online at: <http://www.finance.gov.ab.ca/publications/budget/budget2007/capplan.html>.

<sup>6</sup> Ministry of Finance, British Columbia, Budget and Fiscal Plan 2007/2008 – 2009/2010, February 20, 2007, available online at: <http://www.bcbudget.gov.bc.ca/2007/bfp/default.html#3>.



### 3. WILL CANADA SEIZE THIS OPPORTUNITY?

Many Canadian manufacturers are well-positioned to benefit from major investments to develop and restore infrastructures, specifically manufacturers of:

- cement and concrete;
- metallic products;
- electrical equipment, devices and components;
- rubber and plastic products;
- transportation equipment;
- furniture and related products;
- medical equipment.

Several other sectors of Canada's economy are also likely to benefit from these investments, specifically consulting engineering firms, companies in the construction sector as well as every products and services vendor that are part of the value chain of companies in the above-mentioned sectors.

While the size of investments to be made by governments to develop and restore infrastructures is known, this is not the case regarding their benefits for Canadian manufacturers. As we will see later on, most of our trading partners use their investments to leverage economic development when funding the construction or repair of roads, bridges and public transit systems, by making sure that a significant part of the equipment purchased is manufactured domestically, thereby ensuring maximal domestic benefits, within a context of open and transparent competition.

We cannot be certain that the Canadian economy will fully benefit from the above-mentioned investments, unless Canada also views these infrastructure investments as economic development tools and enacts a clear policy to make sure that Canadian manufacturers benefit economically.

Unfortunately, a company currently has a better chance of supplying the North American market from the U.S. rather than from Canada.

Because of restrictions based on U.S. content (for example, the *Buy America Act*), and the absence of such rules in Canada, Canadian manufacturers in the construction products and public transit equipment manufacturers sector have a vested interest in moving their production activities to the U.S. This explains, among others, the large presence of Canadian manufacturing companies in the Northern part of the U.S.

While foreign governments implemented a long time ago provisions which maximize the benefits of infrastructure investments, Canadian policies are quite different. This situation places Canadian manufacturers at a disadvantage. However, the Government of Canada can make a difference by making sure that Canadian industry benefits from a business



environment that is globally competitive, and that the rules of the game are the same for Canadian manufacturers and their competitors.

In the next section, we will see the advantages for Canada to adopt a policy favouring Canadian content in infrastructure procurement projects. Moreover, we will look at the practices of our main trading partners and compare them to the situation in Canada.



## 4. INFRASTRUCTURES AND ECONOMIC POLICIES

Using government procurement and infrastructure project funding for socioeconomic purposes is not a new practice, as we will see later on for the United States.<sup>7</sup> Governments are asked to find ways to use project funding to leverage economic development.

This strategy, which maximizes the economic impact of sums invested and granted by governments, has four main benefits.

First, by favouring domestic companies, governments use public funds to stimulate the local creation of quality jobs.

Second, these measures reinforce the supply chains of national companies, especially small and medium-sized businesses in two ways. When governments require that a certain percentage of a given finished product's components be made domestically, it facilitates the entry of locally-based small and medium-sized manufacturers into the supply chains of major suppliers in charge of the project. These companies tend to be large, internationally-renowned companies, and constitute an excellent base on which to build on for a small or medium-sized manufacturer.

Third, these measures favour the attraction and retention of private investment. This is perfectly understandable, considering the fact that domestic companies use local employees, pay taxes to the government which funds the infrastructure project and generate benefits for the country's economy. It is therefore normal for governments to favour companies which have decided to invest domestically when choosing partners. The example of transportation equipment in New York State that we will examine later on is an excellent example of this.

Fourth, these measures help reach a high level of transparency in governmental tendering processes, while ensuring competition that is based on fair rules for the various vendors.

Some may be tempted to put a policy favouring local content under a negative heading because their enactment results in higher costs for governments. However, this argument does not take into account the important local economic benefits for jobs and investments stemming from these measures. Considering the current state of Canada's manufacturing sector, if well conceived, such rules and regulations would, in the end, have more positive effects than negative ones in comparison with other measures that are based on company grants and subsidies.

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<sup>7</sup> By "government procurement", we intend the overall purchases made directly by government.



## 5. THE UNITED STATES, CANADA, AND THE CASE OF TWO SPECIFIC SECTORS

### The United States

Since the 1930s, the United States have adopted a relatively systematic approach which consists in favouring the purchase of products that have been partly built domestically. Furthermore, similar limits have been imposed on companies selling services or performing work within the framework of contracts that have been awarded by public, federal or state organizations. These companies must have operations in the U.S. to be eligible for tenders.

Several federal laws and bylaws govern governmental procurement and the awarding of grants and subsidies to states in order to realize infrastructure projects, specifically:

- *the Buy American Act* of 1933;
- *the Small Business Act* of 1953;
- *the Defense Federal Acquisition Regulations Supplement* (DFARS);
- National Security Exceptions (NAFTA, Chapter 10, Section D, Article 1018);
- The Berry Amendment (fabrics, food and clothing from foreign sources);
- Amendment Byrnes-Tollefson (vessels from foreign sources);
- *Buy America* – public transportation (*Federal Transit Administration* grants, an agency which is not regulated by NAFTA as the U.S. did not include it in Annex 1 of Chapter 10 of the Agreement);
- *Buy America* – road construction (*Federal Highway Administration* grants, also not regulated by NAFTA );
- *Buy America* - airports (*Federal Aviation Administration* grants)
- Support programs for *Disadvantaged Business Enterprises* or *DBE*.

These laws and regulations obviously have direct consequences for companies which do not have facilities in the U.S. and which want to do business with the Federal Government or state governments. Several obstacles stand in their way: the U.S. government openly introduces measures favouring companies that generate economic activity in the U.S. or, more specifically, companies operating in the U.S., hiring U.S. residents (taxpayers and generally voters), and subcontracting some manufacturing or other activities to other companies located in the U.S. The table on the following page, taken from the website of the Department of Foreign Affairs and International Trade Canada, summarizes these measures.

This table allows us to establish that “*Made in USA*” or “*Made by certain categories of businesses*” content requirements are present in the procurement of goods, services or work that is funded in whole or in part by the U.S. Federal Government. Similar and even more restrictive requirements also exist in several states. The U.S. Federal Government dictates strict rules for U.S. content when, for example, a public transit contract is awarded and federal funds are invested in it. This means that 60% of components used to



manufacture the equipment must come from the U.S. and that final assembly must be done entirely in the U.S.

In addition to these market requirements for federal funds, the states regularly choose to include additional and often stricter "state" requirements when they wholly fund a project or a tendering process. Not only must the components be made in the U.S., but part of these must be made in one specific state. U.S. content can then be extended to the obligation of fly with U.S. airlines when making business trips related to a given contract, as well as having the equipment shipped with U.S. companies.

Contrary to popular belief, having free trade agreements in place that deal with part of this issue does not mean that, in practice, these markets are totally open. There are many real examples which prove this belief to be erroneous. It is important to understand that free trade does not mean that companies located in Canada automatically have access to contracts awarded by U.S. agencies, governments or departments (federal or state). This subject will be covered in greater detail when we examine the case of two specific sectors.



## U.S. Federal Grants – Measures Supporting U.S. Manufacturing<sup>8</sup>

Law / Regs	U.S. Mfg	U.S. Content	Definitions, Waiver Provisions, and Work-Arounds
<b>BUYER: U.S. state / local government - transportation authority is buyer; U.S. Federal Government provides grants and related limitations</b>			
<b>BARRIER: <u><a href="#">Buy America - Transit</a></u> (grants provided by the Federal Transit Administration) - no barriers on prime contracts under US\$100,000</b>			
Rolling stock: <u><a href="#">49 C.F.R. Part 661.11</a></u>	Final assembly of rolling stock	60% of cost of components of rolling stock	Waivers based on quality, quantity, price, public interest at: <u><a href="#">49 C.F.R. Part 661.9 and 661.12</a></u> . Teaming is common.
Other than rolling stock: <u><a href="#">49 C.F.R. Part 661.6</a></u>	100%	100%	Waivers based on quality, quantity, price, public interest at: <u><a href="#">49 C.F.R. Part 661.7</a></u> . Teaming not usually a solution
<b>BARRIER: <u><a href="#">Buy America - Highways</a></u> (grants from the Federal Highway Administration) - largely prohibits permanently incorporated products made of iron or steel. Canadian firms can compete for highways on federal land.</b>			
<u><a href="#">23 C.F.R. Part 635.410</a></u>	100%	100%	Waivers at: <u><a href="#">23 C.F.R. Part 635.410 (c)</a></u>
<b>BARRIER: <u><a href="#">Buy American - Airports</a></u> (grants from the Federal Aviation Administration)</b>			
<u><a href="#">Aviation Investment and Reform Act for the 21<sup>st</sup> Century (AIR-21)</a></u>	final assembly in U.S.	60% (manufactured products)	Waivers based on quality, quantity, price, public interest. Teaming can be a solution.
<b>BUYER: State Government, and no federal grants are involved</b>			
<b>BARRIER: <u><a href="#">Restrictions vary by state</a></u></b>			
<u><a href="#">NAFTA Chapter 10</a></u> does not cover state or local government purchases.			

<sup>8</sup> Department of Foreign Affairs and International Trade Canada: <http://geo.international.gc.ca/can-am/sell2/sell2usgov/barriersguide-en.asp>, as of 2007 – 1- - 01.



## Canada

In Canada, there are no clear policies akin to those existing for our main trading partner. When the Federal Government takes part in the funding of infrastructure or transportation projects, this funding is not dependent on conditions which ensure minimum local economic benefits, contrary to the U.S. which has laws, bylaws and policies which support economic development and favour local industry.

Up to now, the Canadian position has consisted in applying pressure on the U.S. so that it eliminates the negative impacts that their policies have on Canadian companies. In its open markets action priorities, the Government of Canada stated that it will continue taking action to change U.S. approaches in order to eliminate negative consequences for Canadian businesses. In the document detailing the priorities of the Department of Foreign Affairs and International Trade Canada, it is stated that: "Canada will continue to press the United States to further open its procurement markets to Canadian suppliers".

The Canadian Government declared that it was concerned about the effects of U.S. laws in force:

*"Currently, U.S. government exceptions under NAFTA Chapter 10 and the WTO Agreement on Government Procurement prevent Canadian suppliers from bidding on a broad range of government contracts in sectors of key importance. (...) The need for progress in both assuring and improving access for Canadian suppliers at the U.S. federal, state and local levels remains a key issue for provincial governments as they consider whether to offer to open Canadian provincial procurement markets".<sup>9</sup>*

The Canadian Federal Government's will to act regarding U.S. government procurement consists in mainly trying to eliminate discriminations against companies located in Canada. And yet, U.S. practices are not diminishing; quite the opposite, in fact.

It would be relevant to review the Canadian strategy, as its chances for success are at best low. Moreover, Canada is criticizing policies that are completely understandable in economic terms. As seen previously, U.S. policies result in job creation in the U.S., simplify access of U.S. companies to global supply chains, attract investments and provide a globally competitive business environment to companies located in the U.S.

Not only is the Canadian strategy unsuccessful, but actions can be taken that support the competitiveness of some Canadian companies, thanks to Canadian infrastructure projects. As we will see further on, in spite of international agreements to which Canada is a signatory, there remains room to manoeuvre for the Federal Government nonetheless (specifically under NAFTA's Paragraph 5(a) of Article 1001 in Chapter 10). Moreover, NAFTA does not limit provincial spheres of activity.

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<sup>9</sup> International Trade Canada (2005), *Opening Doors to the World – Canada's International Market Access Priorities 2005*, Section on Government Procurement. Available at: [http://www.international.gc.ca/tna-nac/2005/5\\_05-en.asp](http://www.international.gc.ca/tna-nac/2005/5_05-en.asp) modified on 2005-04-13.



Without resorting to protectionism, an approach that would not be advantageous for the Canadian economy, its companies and its workers, it is easy to reconcile the potential offered by these infrastructure projects with Canadian economic policy goals. This issue should be viewed as one of reciprocity rather than protectionism.

Two industries specifically illustrate the difficulties that Canadian manufacturers face when selling their products to the United States because of the restrictions previously listed, and when competing with foreign companies in the Canadian market, because there are no provisions favouring local production. It is important to note here that even though these two industries are among those which are the most affected by this situation, they are not the only ones to suffer from its consequences.

### **The Case of Steel Girders**

In a note written by the Canadian government for Canadian companies that want to sell their products within the framework of U.S. government procurement, the following is specified: "it is very important to realize that free trade does not mean that Canadian products can be used automatically in every U.S. government project".<sup>10</sup>

When a government procurement contract is awarded, Canadian companies are faced with quite a list of restrictions. Regarding equipment manufacturers of steel girders or any other material used for work, the restrictions can be summarized as follows:

- If the U.S. Government or one of its agencies awards a contract, then Canadian companies can bid on an equal footing only if the value of the contract awarded by the contract awardee is greater than \$8,422,165. Otherwise, the equipment purchased must be manufactured 100% in the U.S., and more than 50% of the value of its components must be from the U.S.;
- it is possible for a Canadian company to be part of the process, if its bid is 6% lower than the bid of the U.S. company;
- however, the U.S. Government can reserve contracts for small U.S. companies under Article 19 of the *Federal Acquisition Regulations*, and this regardless of the value of the contract. This exemption was negotiated by the U.S. through NAFTA, and these contracts are exempt from NAFTA's Chapter 10, and do not guarantee equal access to Canadian companies. The definition of a small company varies according to its sector of activity. Generally speaking, manufacturing companies are considered to be small if they have fewer than 500 employees;<sup>11</sup>

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<sup>10</sup> Department of Foreign Affairs and International Trade Canada. Buy American Act and Construction Projects: A Guide for Canadian Companies. Available at: [http://geo.international.gc.ca/can-am/sell2/sell2usgov/baaconstruction-en.asp?lang\\_update=1](http://geo.international.gc.ca/can-am/sell2/sell2usgov/baaconstruction-en.asp?lang_update=1)

<sup>11</sup> The Small Business Administration provides details on its website at: <http://www.sba.gov/services/contractingopportunities/sizestandardtopics/summarywhatis/index.html>. The complete list of sectors by NAICS code (North American Industry Classification System) is available at: <http://www.sba.gov/services/contractingopportunities/sizestandardtopics/tableofsize/index.html>.



- Other *Buy American* provisions can also apply if the project concerns a public transit system, an airport, a road, a bridge, a ferry or other types of transportations. These contracts always include national preference rules and regulations, require certificates and the fulfilment of other conditions;
- Finally, if the project is funded by a state or local government, then they can impose their own conditions.<sup>12</sup>

Conversely, U.S. companies that want to sell to the Government of Canada face no such obstacles. Only provinces may impose local content restrictions if they wish to do so. More often than not, however, provinces do not use government procurement to favour Canadian industry or industry from their province. They choose the lowest bidder.

### Steel Girders – Some Examples

The city of Port Angeles in Washington State held a request for tenders in 2005 to replace two bridges. The project's value was estimated to be between \$15M to \$20M US. A Canadian company believed, according to information obtained, that it could offer a very competitive price (the exchange rate at that time was 81 cents) and was interested in bidding on the project. However, after learning that the *Buy America* provision applied to this project would penalize them by 25% compared to their U.S. competitors, the company decided not to make any bids, knowing full well that its price would not be competitive. This contract represented the equivalent in production of more than 3,000 tons of steel girders, which represented some 35,000 plant work hours.

More recently, the access ramp for the Lily Pond Avenue leading to the Verrazano-Narrows Bridge linking Staten Island to Brooklyn in New York City had to be rehabilitated. A Canadian company had the best price, but wasn't awarded the contract because its price was increased by 6% under a *Buy American* provision. At that time, the exchange rate was 92 cents and this had already heavily penalized the company. With an exchange rate of one or two years ago, the Canadian company would probably had been awarded this contract, which represented more than 500 tons of steel girders, and 7,500 plant work hours.

Conversely, Canadian steel girder manufacturers are having more and more difficulty in retaining their market shares in Canada. The rise of the Canadian dollar renders U.S. company prices much more competitive. Moreover, while Canadian companies must put up a fight to be able to sell their products in the U.S., U.S. manufacturers don't have to face a myriad of rules and regulations which put them at a disadvantage.

The contract for the Deo Cho Bridge over the Mackenzie River in the Northwest Territories is one example. This project represents more than 8,000 tons of steel. Canadian and U.S.

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<sup>12</sup> Information provided by the Canadian Department of Foreign Affairs and International Trade, <http://www.dfait-maeci.gc.ca/sell2usgov/buyconstructionreport-fr.asp#Requesting%20Waivers%20and%20Exceptions%20to%20the%20BAA> as well as <http://www.dfait-maeci.gc.ca/sell2usgov/buyact-fr.asp>.



companies have bid on this project and are fighting on an equal footing, with no advantage being given to Canadian companies. This is also true for other projects which are currently holding requests for tenders, be it for the Simon Fraser Bridge in British Columbia, the Kicking Horse Canyon Bridge funded by the federal and provincial governments and the Highway 25 project linking Montreal to Laval.<sup>13</sup>

## Transportation Equipment

When the U.S. Government provides funding for projects related to public transit, be it for trains or buses, federal aid is given on condition that part of the funds awarded are earmarked for the purchase of products which are made in the U.S.. With respect to rolling stock, final assembly must be made 100% in the U.S., and 60% of the component costs must be from the U.S. For equipment other than rolling stock that is nonetheless related to public transit, final assembly and all components must be done in the U.S.<sup>14</sup> As more than 80% of public transit projects benefit from grants awarded by at least one federal agency, the State or local government that is making the request for tenders must make sure that companies carrying out the contract conform with provisions concerning the national contribution. It is important to remember that the U.S. is able to circumvent NAFTA provisions because the Federal Government funds its projects through the *Federal Transit Administration*. This federal agency is not in Annex 1 of Chapter 10 of NAFTA, and therefore its purchases are exempt from this agreement. As we will see in the next section, federal transfers to states and municipalities are considered as grants, and grants are excluded from NAFTA.<sup>15</sup> Every single one of the 50 states is free to impose additional restrictions to foster economic benefit, be it in the U.S., inside their state specifically or even in certain counties or municipalities.<sup>16</sup>

Moreover, New York State already used this approach in a request for tenders for the *Long Island Railroad* (LIRR) commuter train some years ago. In this particular case, 30% of the rolling stock value had to be manufactured in New York State (two large train assembly companies have plants there).

U.S. regulations partly explain why Canadian companies such as Bombardier Transportation (rail car manufacturer), Multina (manufacturer of interior and exterior vehicle finishings for trains and buses) and New Flyer (bus manufacturer), companies which have succeeded in carving out an enviable part of their respective markets, have chosen to open plants in the U.S. as part of their development strategy. In the case of Bombardier Transportation and Multina, which are based in Quebec (at La Pocatière and St-Bruno for

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<sup>13</sup> These examples are taken from privileged information obtained by the Canadian Manufacturers and Exporters.

<sup>14</sup> Information provided by the Department of Foreign Affairs and International Trade Canada, Awarding of U.S. Government Procurement: Reference Guide to Common Barriers, available at: <http://geo.international.gc.ca/can-am/sell2/sell2usgov/barriersguide-en.asp>.

<sup>15</sup> Department of Foreign Affairs and International Trade Canada, Buy America Act and Transit Projects: Guide For Canadian Companies, available at: <http://geo.international.gc.ca/can-am/sell2/sell2usgov/baatransit-en.asp>

<sup>16</sup> It is important to note here that states can include provisions favouring manufacturing in their State only if they do not obtain federal funding.



Bombardier and in the Centre-du-Québec region for Multina), their facilities employ several thousand workers in Northern New York, at Plattsburgh. As for New Flyer, which is based in Winnipeg, Manitoba, it now has operations in St. Cloud and Crookston, in Minnesota, which employ collectively more than 800 workers. These three companies are but some of the examples of the leverage effect obtained by the U.S. government on the economic development of the country. Each of these companies has several dozen vendors, and it goes without saying that when realizing projects, they must maximize U.S. domestic economic benefits.

Other examples can also be given: companies with facilities in the Plattsburgh region in New York State (only some kilometres from the Canadian border) around the Bombardier Transportation plant such as CEIT (equipment manufacturer), Multina USA (seats and interiors), PCS Technologies (subsidiary of Axion which manufactures communication systems), Railtech Composites (interior devices and components), TransEd, Wadbec (brakes, air conditioning and electronic equipment). Because major contract awarders such as Bombardier Transportation, Alstom and Mitsubishi must make sure that 60% of the value of their components comes from the U.S., several Canadian vendors have decided, of course, to set up operations in New York State, close to their main clients, thereby creating a major manufacturing cluster. This of course has helped them qualify for U.S. contracts, but also encourages them over the long term to supply the Canadian market from their U.S. facilities.

We must admit that the *Buy America Act* has, for the transportation equipment industry, attracted investments to the U.S., specifically in New York State, where three assembly companies are present, Bombardier at Plattsburgh, Alstom at Hornell and Kawasaki at Yonkers, as well as several of their Canadian and European vendors. This state has a real transportation equipment cluster, and this sector has become an engine for jobs and the economic development of the northern part of this state.

### **Transportation Equipment Elsewhere in the World**

U.S. practices in this respect are the rule rather than the exception. In the case of rail equipment, let us note that:

- The European Union has enacted a guideline for “special sectors” requiring member countries to reject bids from companies not located in one of the member countries or a country with which the European Union does not have a reciprocity agreement when they cannot guarantee that a minimum of 50% of the product’s value will be manufactured in the European Union. Moreover, a 3% price difference is applied to bids which are not made by European companies. Since 2000, no rail car sold in Europe has been built in North America.
  - In theory, European Union member states must practice reciprocity among themselves. However, the European Commission cannot force member states to apply this policy, so much so that most European Union countries give priority to domestic companies. This explains why the major



manufacturers all have facilities and vendors in every European Union country (except Denmark). Consequently, since 2000:

- Ninety-eight percent of metro cars ordered in Germany were built in Germany;
- All metro cars ordered by France were built in France by Bombardier or Alstom as Siemens has no plant there;
- Seventy-three percent of metro cars ordered by the United Kingdom were built there in one of Bombardier's two plants;
- Ninety-one percent of metro cars ordered in Belgium were built in Belgium.
- Japan closes its market to foreign companies, only Kawasaki has access to it; this advantage benefits Japanese manufacturers which fund the development of new technologies thanks to contracts from the Japanese government;
- The Mexican Federal Government gives local manufacturers a 10% price advantage; in addition, advantages are granted to companies when more than 50% of a project is realized by companies located in Mexico. Bombardier, Alstom and Siemens have plants there;
- China requires that 70% of public transit equipment be made in China, and a technology transfer agreement must be in place if the company is owned by foreigners. Siemens and Bombardier have three plants in the country, and Alstom has two;
- Germany has not imported metro cars since at least the year 2000;

## The Case of Transportation Equipment in Canada

Contrary to the U.S., where the Federal Government imposes conditions consistently when funding public transit projects, Canada has no such policies. The approach used, rather, is on a case by case basis, according to the preferences of the provincial or municipal government awarding the contract.

In some cases, contracts have been awarded with Canadian content specifications. For example, certain contracts such as the more recent ones awarded by the Société de transport de Montréal and the Toronto Transit Commission specified a certain percent of the contract value which had to be done in Canada.<sup>17</sup> However, during recent tenders by Calgary Transit and the Edmonton Transit System, contracts were awarded without tenders and without any specification as to Canadian content.<sup>18</sup> In the case of the new Canada

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<sup>17</sup> As for Montreal, the Agence métropolitaine de transport specified that 30% of the contract's value had to be done in Canada in order to bid on the project. Moreover, additional points were awarded to vendors in accordance with the percentage of the contract value that originated from Canada. It is important to not confuse this issue with the highly publicized event of Bombardier being awarded a contract without a tendering process. It is possible for a transportation agency to specify that a certain percent of a contract's value be made in Canada while going through an open tendering process.

<sup>18</sup> These trains will be built by Siemens at their plant in Sacramento, California. Go to: [http://www.transportation.siemens.com/ts/en/pub/newslines/newslines/presse\\_2004/2004/22\\_12\\_2004.htm](http://www.transportation.siemens.com/ts/en/pub/newslines/newslines/presse_2004/2004/22_12_2004.htm) for Calgary and [http://www.siemens.cz/siemjet/en/home/press/releases/all/Main\\$pageletManager\\$PressList\\$AssetGrid-gotItem/29407.jet](http://www.siemens.cz/siemjet/en/home/press/releases/all/Main$pageletManager$PressList$AssetGrid-gotItem/29407.jet) for Edmonton.



Line / Richmond Airport-Vancouver (RAV), in British Columbia, to be built for the 2010 Olympic Games, the contract was awarded through a tendering process, but without Canadian content requirements. The Korean company ROTAM was awarded the contract, and these conditions also apply for the light rail transit planned for Vancouver for 2011.

As we have ascertained, the Canadian content policy is not institutionalized and generalized in Canada as it is in the U.S. Public transit systems will require major investments during the next decade because of aging infrastructures. Our governments have a vested interest in maximizing economic benefits for Canada and using their government procurement as an economic development lever. The uncertainty of knowing if these contracts will be given to the lowest bidder without regard to the location where the design and the components will be made, and where final assembly will take place, begs the following questions: Why should companies choose to invest in their Canadian facilities, or set up operations in Canada? Why should they have Canadian facilities if it is possible to supply the entire North American market from the U.S.? Why should companies have facilities in Canada if this limits their access to the U.S. market? For companies which already have operations in Canada, and which have the choice to invest in Canada or the U.S., why should they choose to invest in Canada? Furthermore, what impact does the absence of buy Canadian policies striving to develop local industry have on the fabric of small and medium-sized companies?

It is also important to note that U.S. States have the power to maximize the economic benefits of their purchases for their local industry. In Canada, internal trade agreements block provinces from favouring their province to the detriment of others.



## 6. INTERNATIONAL TRADE AGREEMENTS

Generally speaking, and this result is expected, the various international frameworks regulating government procurement promote greater competitiveness in government procurement of products, services and works through policies and the practice of transparent and non-discriminatory tendering processes. Two agreements are relevant within the scope of this brief: the World Trade Organization Agreement on Government Procurement (WTO-AGP) and Chapter 10 of the North American Free Trade Agreement (NAFTA).

The WTO-AGP, a multilateral agreement negotiated during the Tokyo Round which came into force on January 1, 1981, applies to most federal departments. It is a multilateral agreement that increases international competition in government procurement. The WTO-AGP covers goods and services markets whose value is equal to or greater than \$245,000, and also applies to construction work markets of the Canadian Federal Government whose value is greater than \$9.4M.<sup>19</sup> However, a number of markets are excluded from the coverage of this agreement.

Canada, the United States and Mexico chose to go one step further in opening their government procurements within the scope of NAFTA. The AGP was deemed too thin by many stakeholders. According to Szandra Bereczky, then student at the McGill Law Faculty and winner of a prize from the Department of Foreign Affairs and International Trade Canada for an essay submitted within the context of celebrations surrounding the 10<sup>th</sup> anniversary of NAFTA:

“The limited coverage of the Procurement Code left many Canadian and American firms still subject to a variety of protectionist measures of each other’s governments. In the U.S., these measures were part of the *Buy American Act*, which required that only domestic suppliers be considered for public procurement. Similar circumstances were present in Canada, where the *Canadian Content Premium Policy* favoured goods with high Canadian content and authorized a procurement review mechanism that favoured the awarding of any contract to Canadian corporations”.<sup>20</sup>

The AGP and NAFTA’S Chapter 10 grant reciprocity when dealing with partners that are signatory to the agreement, and this reciprocity is obviously reinforced for NAFTA partners among themselves within the scope of Chapter 10. In other words, in principle, a Canadian

<sup>19</sup> For more information, go to the Business Access Canada website at: <http://contractscanada.gc.ca/en/trade-e.htm#30>.

<sup>20</sup> Szandra Bereczky (2004), “NAFTA Chapter 10: Enhancing Trust in the Canadian Business Community”, available on the Department website: <http://www.dfait-maeci.gc.ca/nafta-alena/bereczky-en.asp>



company is to be treated like a U.S. company when it bids on government procurement tenders in the U.S., and reciprocally for a U.S. company.

However, and this is where the principle is showing its inadequacies, NAFTA's Chapter 10 only applies to federal and state entities listed in Annex to this Chapter. If the entity is not part of this list, or if the bid subject corresponds to an exception which has been already specified in the Agreement or the Chapter, the provisions of Chapter 10 do not apply to the government procurement of this entity. It can then discriminate and give preferential treatment to companies that operate in the U.S. Some federal agencies, such as the Federal Highway Administration and the Federal Transit Administration, are not covered by this agreement. Moreover, like in Canada, the U.S. does not subject its subordinate governments (the States in the U.S., and the provinces in Canada) to NAFTA's Chapter 10 as they are not listed in the Annex.

Moreover, the provisions of the *Buy America Act* which regulate the U.S. Federal Government also seem to be exempt from NAFTA because of Paragraph 5a) in Article 1001 of Chapter 10, which states:

*"Procurement includes procurement by such methods as purchase, lease or rental, with or without an option to buy. Procurement does not include:*

*(a) 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**;"*

Therefore, when the U.S. Government provides financial assistance to states for roads, bridges or public transit systems, these funds are not subject to NAFTA.

Paragraph 5(a) therefore provides Canada with sufficient room to manoeuvre to define a more vigorous policy which uses infrastructure projects to support Canadian economic development. Thanks to this Article, the Government of Canada can link conditions with the funding it provides to provinces and municipalities when it funds projects carried out by these governments.



## **7. RECOMMENDATIONS**

### **Recommendation 1 – Economic Stimulus**

Beyond any specific measure proposed in the recommendations herein, CME asks federal and provincial governments, as well as municipalities, to use every aspect of federal funding awarded to infrastructure and public transit projects to stimulate domestic economic development and job creation, within the guidelines imposed by international agreements to which the Canadian Government is a signatory, and the Agreement on Internal Trade.

CME expects Canadian governments to be innovative when awarding government procurement contracts. CME want to eliminate the existing reflex of hiding behind international agreements instead of identifying business opportunities to legally use government procurement to foster economic development and reinforce the Canadian entrepreneurial fabric.

The Government of Canada must recognize how little success it has had with its pressure tactics on the U.S. Government to improve access to the U.S. market for Canadian companies. In an ideal world, every government infrastructure and transportation project would be completely open to all Canadian companies (and vice versa); we must recognize that it is normal and legitimate for governments to use government procurement to foster domestic economic development and job creation. Our pressure tactics on our trading partners has not produced the results expected, and furthermore it could harm relations with our main trading partner.

### **Recommendation 2 – Federal Funding and Canadian Content**

In order to use government procurement as an economic development lever and make the rules of the game fair for all Canadian companies, CME recommends that the Government of Canada make its funding for projects realized by provinces, municipalities and agencies under their responsibility, conditional to the application of rules and regulations favouring Canadian content by:

- introducing a weighting in the assessment of proposals which gives preference to those with greater Canadian content;
- including in the analysis criteria of proposals the proportion of content manufactured or realized in Canada. Also, a positive weighting should be given to products whose final assembly, design and engineering is done in Canada. The same should hold true for proposals where a significant proportion of components and subcomponents are made in Canada. These elements regarding Canadian content should count for a minimum of 10% of the total assessment of proposals to have sufficiently significant importance.



### **Recommendation 3 – A Common Strategy for the Provinces**

CME encourages provincial and municipal governments to acknowledge that their support is essential in making the rules of the game fair for Canadian companies. As the provinces are not subject to Chapter 10 of NAFTA, they benefit from greater room to manoeuvre when managing their government procurement. Considering the considerable scope of their purchasing power, they should always strive to use this manoeuvring room to support economic development in Canada when it is economically viable to do so. Recommendation 1 asks the Federal Government to use its funding of public infrastructure and mass transit projects to make sure it benefits companies with domestic operations. This recommendation instead asks the provinces, when they fund projects without federal participation, to make sure that they ensure maximal economic benefits for Canada.

CME therefore asks the provincial governments to unite, and collectively use their government procurement as an economic development lever. Joint action is important in this respect because one province alone cannot favour the industry of its province to the detriment of others, because of the agreements on internal trade. The temptation for provinces is therefore to always award contracts to the lowest bidders because there are no guarantees that these contracts will be awarded to a company from its province. Unfortunately, if every province follows this logic, then collectively everyone loses. This is why it is important for provinces to enact legislative measures which will force them to use their government procurement to foster economic development. This may prove to be a little more expensive for public finances when awarding some contracts, but collectively governments will win out because of the domestic economic activity generated.

This is why CME believes that provinces must develop a common strategy (this could be done through the Council of the Federation) by taking inspiration from recommendations 2 and 3.



## **8. ABOUT THE CANADIAN MANUFACTURERS AND EXPORTERS**

Canadian Manufacturers and Exporters (CME) is Canada's main trade and industry association. Known as the Alliance of Manufacturers and Exporters of Canada until October, 2000, the CME was formed through the 1996 merger of the Canadian Manufacturers Association (CMA) and the Canadian Exporters Association (CEA). Our history dates back to than 135 years.

Our mission is to stimulate the competitiveness of Canada's industry and the growth of its exports. To this end, we provide:

- Policy solutions to federal and provincial governments that will improve the business environment for manufacturers & exporters in Canada.
- Access to best practices, networks, business solutions and intelligence that improve bottom line performance by saving time and money for our members.
- Access to new business opportunities in Canada and around the world.

CME members include Canada's leading businesses engaged in manufacturing and exporting goods and services. Together, CME's membership accounts for an estimated 75% of total manufacturing production and 90% of Canada's exports. While our membership includes Canada's largest players, 80% of our members are considered small and mid-sized companies. CME's membership is drawn from all sectors of Canada's manufacturing and exporting community and from every province across the country.

The manufacturing sector represents Canada's largest sector of economic activity. It is responsible for 15% of Canada's GDP and has yearly shipments which total more than \$600 billion in Canada and throughout more than 180 countries. Considering every sector of activity, manufacturing is the one which has the most significant multiplying effect: every industrial production dollar generates \$3.05 of total economic activity. Manufacturers directly employ more than 2 million Canadians and pay wages which are 22% higher than the national average. This sector is also responsible for two-thirds of exports and private R&D. Since 1990, Canadian manufactures have reduced their greenhouse gas emissions by more than 7%.

For more information, visit our website at: [www.cme-mec.ca](http://www.cme-mec.ca).