

A CARDUS CONSTRUCTION
COMPETITIVENESS MONITOR REPORT

HIDING IN PLAIN SIGHT

Evaluating Closed Tendering in Construction Markets



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with James Tonn



CARDUS

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ABOUT CARDUS

Cardus (root: cardo) is a think tank dedicated to the renewal of North American social architecture. Drawing on more than 2000 years of Christian social thought, we work to enrich and challenge public debate through research, events, and publications, for the common good.



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EVALUATING CLOSED TENDERING IN CONSTRUCTION MARKETS

The Need for Fairness and Fiscal Responsibility in Construction Procurement

EXECUTIVE SUMMARY

Ontario is faced with huge deficits and a debt that will hamper the province's long-term economic prospects. In the face of this dire situation, Ontario's government is turning over stones to find savings for the provincial budget. While many will focus on the need to make cuts in order to achieve this goal, there is a way to achieve significant savings in Ontario hiding in plain sight: *opening up public construction procurement to competitive bidding*.

In 2012 Cardus released its *Construction Competitiveness Monitor*. That paper notes that the pool of eligible bidders on construction projects in three major Ontario municipalities (Toronto, Hamilton, Sault Ste. Marie) was shrunk significantly by a little known piece of Ontario labour law: the "construction employer" provision of the *Ontario Labour Relations Act*. We noted that these restrictions affected almost three quarters of a billion dollars of work per year. Since that paper was written, another major municipality (the Region of Waterloo) is in danger—indeed is all but assured—of having its pool of bidders shrunk. The combined effect of this has left Ontario's citizens with an environment where over three quarters of potential bidders are simply forbidden from bidding on public works worth just under a billion dollars per year.

At the time the monitor was confined to surveying the estimates of the cost-impact of these restrictions. These estimates ranged from 2% to 40%.

This iteration of the *Cardus Construction Competitiveness Monitor* offers an analysis of the restrictions from the perspective of one of Canada's leading procurement experts. It asks the following questions: Does union affiliation serve as an objective basis for shrinking the pool of bidders in public procurement? Does it serve the public interest? What are the implications of shrinking the pool of bidders on public construction projects?

A survey of the legislative framework and theory behind public procurement, as well as an analysis of empirical studies, show that limiting public procurement by union affiliation does not promote the public interest. In fact, the vast preponderance of evidence and practice suggests that restricting public bidding in this way is not only far outside of the norm, but can have significant and deleterious consequences for the public interest. Studies show that likely cost increases are on the higher end of the estimates offered by Cardus in our original publication in 2012 (most studies suggest the increases are in the 20-30% range). Perhaps more importantly, such restrictions serve as a petri dish for corruption in public procurement.

The results of this paper should cause politicians, regardless of their partisan affiliation, to find cause to remove the "construction employer status" obstacle from public bodies' bidding practices. The result will be a more open, fair, and transparent bidding environment in Ontario—and one which will help the government achieve its difficult objective of balancing the budget.



Read the 2012 Cardus Construction Competitiveness Monitor report on **Ontario Municipal Construction Markets**

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INTRODUCTION

When it comes to public procurement, there is one simple truth: public procurement is intended to serve the public interest. And while many might contest the term “public interest,” its definition is equally simple: “the good of the general public, as contrasted with the particular individuals or firms involved in a decision.”¹

And yet there are cases where government or industry—intentionally or otherwise—creates sets of criteria that restrict the number of bidders, and/or create structures which make the bidding process less transparent. Yet how do we evaluate such restrictions? And what should we know about the immediate and long-term effects of such a precedent that would help us make that decision?

Debates on important public issues—especially complicated public issues like closed tendering—often suffer from a lack of clarity over the terms of the debate. In the hurly-burly of public debate, in legislatures and in the press, the content of a debate can be obscured, exaggerated, or simply misunderstood.

The purpose of this paper is to clarify these terms around the issue of construction tendering and procurement practices on projects owned by municipalities and other public bodies. The paper will evaluate such practices according to the standards of the industry most directly affected by closed tendering: public procurement. By evaluating common procurement practices and providing a clear set of criteria by which we can evaluate the impact on the public interest in instances where tendering is restricted, we can move the debate beyond the partisan divide and help public officials clearly see the impact on the public interest of one particular restriction, that of closed bidding based on the union affiliation of a company’s workers.

1. Black, John. *Oxford Dictionary of Economics*, 2nd edition. Oxford University Press. Oxford. 2003. Pg. 379

BASIC TENETS OF PUBLIC PROCUREMENT: FAIR, OPEN, AND TRANSPARENT

Openness, fairness, and transparency are the basic principles of public procurement. These are the three watchdogs that guard the public purse. They are enshrined in the policies, legislation, and agreements that guide procurement for public bodies at all levels of government in Canada. Furthermore, these principles permeate Canadian jurisprudence, or judge-made law, on public procurement. Our courts impose legal obligations on public bodies to conduct fair competitions in which all bidders are treated equally in the assessment of bids, and relevant information is disclosed equally to all bidders.

“Openness, fairness, and transparency are the basic principles of public procurement. These are the three watchdogs that guard the public purse.”

The difference between open and closed tendering rests on whether all members of the public are provided with an equal opportunity to compete for public contracts. In the public procurement process, contracts for publicly funded projects are generally open for all qualified members of the public to bid on. For instance, when a public road needs to be paved, public notice of the opportunity is given and the details of that opportunity are made accessible to the general public so that qualified contractors can make a bid for the contract. In open tendering, any contractor that submits a bid is given an opportunity to demonstrate it is qualified to complete the work. Closed tendering, on the other hand, arises when the ability of contractors to bid on a contract is categorically restricted, such as when the procurement process includes prequalifying criteria that excludes or disqualifies contractors who would otherwise be qualified and competent to complete the work. There are a variety of ways in which a public tender can create a closed tendering environment. Oftentimes it may occur unintentionally, but it may also come as a result of public policy or law. Regardless of intention, however, reducing the number of bidders inevitably results in less competition among the bids received by the public body. But, before we discuss the distinctions between legitimate and illegitimate restrictions on bidding, it's important to establish why the principle of openness is so important for equitable procurement practices.

OPENNESS AS BASIS FOR SOUND PUBLIC PROCUREMENT

As we have noted,

The justification for openness and transparency in public administration arises from the fact that public finance and procurement, and the public services and projects to which both of them relate, are inherently matters of public concern...Without an open and transparent system of procurement, the rights of the citizens to review public administration and hold government to account for maladministration are compromised. Thus transparency and openness in public procurement provide an important economic foundation for democratic accountability and the rule of law.²

“Granting one person exclusive access to government business excludes other citizens whom the municipality is required by law to serve, and it violates the municipality’s responsibility to treat all persons equally.”

Transparency and openness in public procurement are ensured both by the legal structures guiding public procurement and by the financial incentives provided to public bodies and through open bidding.

2. McGuinness, Bauld, Johnson. *Municipal Procurement Handbook*. Butterworths, pg. 17

STRUCTURES SUPPORTING PUBLIC BIDDING

As noted above, open bidding is enshrined in policies, legislation, agreements that guide procurement for public bodies, as well as standards documents for procurement professionals. This section of the paper will provide a glimpse of examples of specific policies and legislation which demonstrate that open, fair, and transparent bidding are integral to the Canadian public procurement field.

Public entities such as municipalities are legally obligated to act in the public interest as they conduct business, including the procuring of goods and services. The definition of “public interest” offered by Black above, that “the good of the general public, as contrasted with the particular individuals or firms involved in a decision,” is the driving force behind public procurement and can be seen most clearly in section 18 of the *Ontario Municipal Act*, 2001. It states that “A municipality shall not confer on any person the exclusive right of carrying on any business, trade or occupation unless specifically authorized to do so under any Act. 2001, c. 25, s. 18.”³

There is a twofold rationale for why the municipal act forbids the conferring of monopolies. First, conferring an exclusive right of carrying on business is just that: exclusionary. Granting one person exclusive access to government business excludes other citizens whom the municipality is required by law to serve, and it violates the municipality’s responsibility to treat all persons equally. Second, granting monopolies violates a second government responsibility: to ensure greatest public value for public tax dollars.

While a completely open tendering (i.e. no restrictions of any sort on entry to bidding on public work) of government work is rare, it is universally acknowledged in our economic structures in Canada that monopolies, or oligopolies, are detrimental to the goal of acquiring the best value. Where such monopolies are in place, they negatively affect the economy. It is for this reason that a competitive bidding environment is to be preferred.

As noted in the federal *Competition Act*, competition

Promote[s] the efficiency and adaptability of the Canadian economy, [...] expand[s] opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, ensure[s] that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and [...] provide[s] consumers with competitive prices and product choices.⁴

The importance of competition is not only found in legislation that promotes it, nor in a significant government bureaucracy intended to promote and enforce it; rather, the importance of competition is present in the procurement guidelines of almost every government and government agency.

The Broader Public Sector Procurement Directive, issued by the management board of the Cabinet in Ontario, for instance, places competitive procurement as its *de facto* preferred means of procurement. It notes that “Organizations must conduct an open competitive procurement process where the estimated value of procurement of goods or services is \$100,000 or more.”⁵ And, even in situations where the value of goods or services is below that threshold, it nonetheless recommends a competitive process. To make the bias towards competition clear, the directive notes that “Organizations must not reduce the overall value of procurement (e.g. dividing a single procurement into multiple procurements) in order to circumvent competitive procurement thresholds.”⁶ Likewise, the government’s guidelines suggest that “organizations should use competitive procurement processes to get maximum value for money.”⁷

This preference for competitive bidding is not unique to municipalities, to Ontario, or even to Canada. It is integral to the public procurement practices of all major developed economies. To take one example, the Office of Fair Trading in the UK notes that

3. *Ontario Municipal Act*, 2001 Sec. 18

4. *Competition Act*, 1985 <http://laws-lois.justice.gc.ca/eng/acts/C-34/page-1.html#h-3>

5. Management Board of Cabinet. “Broader Public Sector Procurement Directive.” Government of Ontario, n.d. [https://www.doingbusiness.mgs.gov.on.ca/mbs/psb/psb.nsf/Attachments/BPSProcDir-pdf-eng/\\$FILE/bps_procurement_directive-eng.pdf](https://www.doingbusiness.mgs.gov.on.ca/mbs/psb/psb.nsf/Attachments/BPSProcDir-pdf-eng/$FILE/bps_procurement_directive-eng.pdf).

6. Ibid.

7. “Procurement Guideline for Publicly Funded Organizations in Ontario.” Government of Ontario, n.d. [https://www.doingbusiness.mgs.gov.on.ca/mbs/psb/psb.nsf/Attachments/BPSProc-Guideline-pdf-eng/\\$FILE/bps_procurement_guideline-eng.pdf](https://www.doingbusiness.mgs.gov.on.ca/mbs/psb/psb.nsf/Attachments/BPSProc-Guideline-pdf-eng/$FILE/bps_procurement_guideline-eng.pdf).

Procurement is usually carried out through competitive bidding or tendering. This process should enable Government to identify the most efficient supplier, thereby ensuring the highest value for the tax payers' money. The Julius Review indicated that cost savings from competitive tendering were typically between 10 per cent and 30 per cent.⁸

There can be no doubt that while the exact nature of the competitive playing field differs depending on the type of government tender, there is a universal preference for an open competitive bidding environment rather than one where competition is restricted without a compelling interest directed from the tendering body itself. While in practice there might be aberrations, the structures and legislation related to public procurement all point in favour of fair, open, and competitive tendering.

FINANCIAL RATIONALE SUPPORTING OPEN COMPETITIVE BIDDING

The economic foundation for this body of rules is intended to ensure that public bodies receive greatest value for public monies spent. In the case of public construction this value is determined by the balance between quality and price. Why does the industry work so hard to ensure that procurement is open? In short, it is because both economic theory and historical case studies show that a greater number of bidders (within limits, which we will discuss below) is more likely to lead to greater value for the purchaser; a government is more likely to receive better quality construction for a lower price as the number of bidders increase.⁹

“There is a universal preference for an open competitive bidding environment rather than one where competition is restricted.”

Put simply, reducing competition increases price. By definition, the more concentrated a market becomes, the less competitive it is. Generally, economists assess market concentration by measuring the total output that is produced in an industry by a given number of firms within the industry. The most basic concentration ratios are the CR4 and the CR8. The CR4 concentration ratio measures the total market share of the four largest firms in an industry while the CR8 measures the total market share of the 8 largest firms in an industry. The concentration ratio is the percentage of market share held by the largest firms in an industry.

Increase in the market concentration of suppliers inexorably leads to higher pricing. Many studies have shown that constraints upon the number of bidders on tenders—or on the number who voluntarily participate in tenders—can have the same type of effect on prices as actual market concentration.¹⁰

One author notes that

Virtually all tender market theories point to higher buying prices and lower selling prices as the number of bidders grow. The theory is supported by empirical studies in municipal bond underwriting, bidding for offshore oil, and bidding for national forest timber. Other concentration price studies have been made in such diverse industries as life insurance, newspaper and television advertising, gasoline retailing, prescription drugs, cement, and microfilm. All of these studies found a positive relationship between market concentration and prices.¹¹

8. Office of Fair Trading. “Government in Markets: Why Competition Matters -- a Guide for Policy Makers.” Government of the United Kingdom, Crown copyright, n.d. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284451/OFT1113.pdf

9. Parts of this section draw from: Bauld, Stephen. Price Implications of Government Contracting Practices in the GTHA. An Independent Study Commissioned by the Residential and Civil Construction Alliance of Ontario. September 2010. http://www.rccao.com/news/files/RCCAO_SEPT10_REPORT_LOWRES.pdf

10. Lawrence White, “Economics, Economists & Antitrust: A Tale of Growing Influence,” in J.J. Siegfried (ed.) *Better Living Through Economics*, (Cambridge: Harvard Univ. Press, 2010) at p. 230

11. Willard F. Mueller “The New Attack on Antitrust,” in A.A. Heggestad (ed.), *Public Policy Towards Corporations*, (Gainesville: Univ. Presses of Florida, 1988) at p. 64.

And the reverse of this is also true. A recent study on waste collection suggested that the introduction of competition in two highly concentrated markets in Ontario—Toronto and Hamilton—resulted in waste collection budget savings of 24% and 22% respectively.¹²

Concentration ratios can be developed in terms of a market area in which the buyers actually compete (or can compete) and estimation of the statistical relationships between those concentration ratios or other measures of concentration and factors such as captive supplies, pricing pattern, and the level and variability of prices will be very revealing in relation to construction tenders.

A market is considered to be relatively competitive when the four largest firms in the market own less than 40% of the market. Medium concentration is considered to exist where the four largest firms control 50% to 80% of the market. An industry in this range is likely an oligopoly, meaning that customers are paying above the market price. The more concentrated, the more likely it is that they are paying well above the market price. A highly concentrated market will have a CR4 equal to or greater than 80%. The higher the concentration, the higher the price to those dealing with the concentrated market power. The critical level beyond which the use of market power can be expected to emerge in a dramatic way is 60%.¹³ Even so, a CR4 equal to or less than 40% can still have adverse implications. For instance, in the American meatpacking industry, dealing in markets having a CR4 of just slightly more than 25% have been found to suffer price distortions of as much as 3%.¹⁴ At a CR4 of 70%, the price distortion has been found to be in the range of 12%.¹⁵ These studies offer a sufficient reason for exercising caution before introducing artificial restrictions on closed tendering practices on competition for government construction projects.

A recent joint study between the Texas Department of Transportation and scholars from Texas A&M notes that “the larger the number of bidders for a project, the lower is the winning bid.”¹⁶ Using a calibrated simulation model, they found that “the lowest bid when eight bidders are present would be predicted to be approximately 25 percent lower than the lowest bid with only two bidders present, all other things being equal.”¹⁷ One of the key recommendations of that paper was the elimination of limitations that constrain the number of bidders on state road construction projects.

Generally, the construction market in Canada has a CR4 of 5%. However, this low ratio is misleading since it includes the large number of construction firms active in the residential home and home repair market. Within certain submarkets, the Canadian construction CR4 is much higher, partly because many construction firms operate only locally,¹⁸ and partly because only a relatively small number of firms are able to secure the bonding coverage and lines of credit necessary to undertake larger contracts. As one moves towards industrial and institutional construction, the CR4 rises dramatically. In the public sector, many governments find that they are effectively offering their construction work to a closed list of bidders, which rarely exceeds two or three firms. Also, the size of some government mega-projects works against efficient procurement. The naturally high concentration in these environments, and the increased costs that are associated with such concentrations amplifies the need to ensure that the widest possible pool of qualified bidders is in place, in order to ensure the greatest value for public dollars.

Perhaps more important than the actual number of bids received is the number of bids that bidders anticipate. Construction contractors tend to base their prices on the anticipated intensity of competition. One measure of the intensity of competition is the number of contractors bidding in open competition. A major study which compared a variety of

12. Dachis, Benjamin. “Picking up Savings: The Benefits of Competition in Municipal Waste Services.” *C.D. Howe Institute Commentary*, Urban Issues, no. 308 (n.d.). http://www.cdhowe.org/pdf/commentary_308.pdf.

13. Wayne D. Purcell, *Pricing And Coordination In Consolidated Livestock Markets Captive Supplies, Market Power, IRS Hedging Policy*, (Blacksburg, Virginia: Research Institute on Livestock Pricing, 1992) at p. 14

14. C.E. Ward, “A Review of Causes for and Consequences of Economic Concentration in the U.S. Meatpacking Industry,” [2002] *Current Agriculture, Food & Resource Issues* (No. 3) 1

15. G.W. Brewster, D. Musick, “The Effect of Market Concentration on Lamb Marketing Margins,” (1995), 27 *J. Agr. & Applied Economics* 172 at p. 180

16. Ivan Damnjanovic, Stuart Anderson, Andrew Wimsatt, Kenneth F., and Reinschmidt, and Devanshu Pandit. “Evaluation of Ways and Procedures to Reduce Construction Cost and Increase Competition.” Texas Transportation Institute, The Texas A&M University System, n.d. <http://d2dt5nnpfr0r.cloudfront.net/tti.tamu.edu/documents/0-6011-1.pdf>

17. *ibid*

18. See, for instance, Barbara Wake Carroll, “Market Concentration in a Geographically Segmented Market: House-building in Ontario, 1978-1984,” (1998), 14 *Canadian Public Policy* (No. 3) 295

studies and published data sets from around the world—including public works projects in the USA, London England, Singapore, Belgium—found that there was a decrease over a range of 20% to 25% in the number of bidders as a result of closed tendering.¹⁹

While Ontario municipalities do not publish a broad database of the number of bids and the varying prices offered in those bids, it is difficult to conceive how the reduction of the number of bidders would produce results that differ from these studies. It is notable, though, that these studies are consistent with the estimates provided by municipalities in Ontario.²⁰

For these reasons, a party conducting a tender process is well advised to structure it in a way that attracts the maximum number of bidders. The price secured through the tender process is optimized for the following reasons. First, as the number of bidders increases, each participant in the process has an incentive to offer a better price because it becomes harder for the bidders participating in the process to anticipate each other's behaviour. Second, a higher number of bids can increase the chance of receiving a bid from a party who will place a high value on securing the contract. Such a party is likely to offer the most competitive price. Third, an increase in the number of bids makes it more difficult for the bidders to organize on a collusive basis.²¹

19. R.M. Skitmore, "Raftery curve construction for tender price forecasts," (2002), 20 *Construction Management and Economics* (Part 1) 83. See particularly, Fig. 4.

20. For a compilation of these estimates, see *Cardus Construction Competitiveness Monitor: Ontario Municipal Construction Markets*. Download at www.cardus.ca/store/3647.

21. See, generally, Joseph T. L. Ooi, Geoffrey K. Turnbull, C.F. Sirmans, "Price Formation under Small Numbers Competition: Evidence from Land Auctions in Singapore," (2006), 34 *Real Estate Economics* (No. 1) p. 51. This particular study looks at tender sales, but the conclusions are readily applied in the tender purchase context.

CLOSED TENDERING CAN SUPPORT CORRUPTION AND COLLUSION

With the media attention that Quebec's Charbonneau Commission has garnered over the past two years, the potential for corruption and collusion to taint the public procurement process is now an issue with which Canadians are intimately familiar. From a global perspective, the difficulties Quebec has faced in maintaining the integrity of its management of public contracts are nothing unusual. According to research by the World Bank, every year an estimated \$200 billion USD is spent worldwide on bribery for public procurement, comprising 3.5% of global procurement spending.²² The Organization for Economic Co-operation and Development (OECD) also recognizes public procurement is "the government activity most vulnerable to waste, fraud and corruption due to its complexity, the size of the financial flows it generates, and the close interaction between the public and private sectors."²³ Collusion and corruption usually go hand in hand with public procurement, and have a mutually reinforcing effect.²⁴ To combat these issues, public bodies need to look to the principles of openness, fairness, and transparency in terms of ensuring that their procurement process is subject to robust and healthy competition.²⁵ A closed tendering environment with restricted competition, on the other hand, will be particularly vulnerable to these forms of anti-competitive and market distorting activities.

"Virtually all tender market theories point to higher buying prices and lower selling prices as the number of bidders grow."

Collusion in public procurement occurs when bidders agree between themselves to remove the element of competition from the tendering process. Typically this occurs through bid-rigging where several contractors determine between themselves which of them should be successful in the tender process, then the co-conspiring contractors each arrange their own bids to ensure one is selected as the most competitive. The Charbonneau Commission has heard testimony as to how the funding from Canada's Economic Action Plan was allegedly targeted in this way, with eight companies in Quebec City setting up a system between themselves to agree on a minimum price for work and to take turns winning public tenders.

In Canada, the exact nature of bid-rigging in construction is unknown. However, the data we have suggests that bid-rigging affects work worth significant amounts of money. In fact, one study from 2008 suggests that bid-rigging affected over 1.4 billion dollars of construction work.²⁶ Evidence from the UK suggests that, the tendency of the construction to be affected by anti-competitive collusion is an industry problem, rather than a country specific one. In an investigation from 2009, the UK's Office of Fair Trading noted that "cover pricing was a widespread and endemic practice in the construction industry."²⁷ The OECD draws a very clear line between the number of bidders and corruption, bluntly noting that "the fewer the number of sellers, the easier it is for them to reach an agreement on how to rig bids."²⁸

Although the stakes are high for engaging in this type of potentially criminal activity in Canada, the Charbonneau Commission has served as a sober reminder that corruption may be a reality in some corners of our construction industry.

From the initial needs assessment stage to the execution of an awarded contract, corruption can occur at all stages of the public procurement process. Where competition is weak, corrupt public officials can create artificial demand for contracts that advantage a particular contractor or design the tender specifications to ensure this contractor's bid is suc-

22. Emmanuelle Auriol, "Corruption in procurement and public purchase", 24 *International Journal of Industrial Organization* 5, September 2006, citing the World Bank: Six Questions on the Cost of Corruption with World Bank Institute Global Governance Director Daniel Kaufmann – <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20190295-menuPK:34457-pagePK:34370-piPK:34424-theSitePK:4607,00.html>

23. Organisation for Economic Co-operation and Development: Fighting corruption in the public sector – <http://www.oecd.org/gov/ethics/integrityin-publicprocurement.htm>

24. Organisation for Economic Co-operation and Development, Policy Roundtables: Collusion and Corruption in Public Procurement, 2010 – www.oecd.org/competition/cartels/46235884.pdf

25. For example, see Transparency International: Corruption and Public Procurement (Talking Paper #05/2010) – http://www.transparency.org/whatwedo/pub/working_paper_05_2010_corruption_and_public_procurement

26. "Mid-Term Evaluation of the Competition Bureau's Anti Bid-Rigging Activities." Industry Canada, April 25, 2008. https://www.ic.gc.ca/eic/site/ae-ve.nsf/eng/02945.html#p_3.1

27. http://www.oft.gov.uk/shared_of/business_leaflets/general/Information-Note2.pdf

28. "Guidelines for Fighting Bid Rigging in Public Procurement: Helping Governments to Obtain Best Value for Money." OECD, n.d. <http://www.oecd.org/competition/cartels/42851044.pdf>.

cessful. However, if the public procurement process is designed to ensure open and fair competition within a transparent process, the ability of a public official to manipulate the process in favour of any one contractor becomes substantially reduced.

The Charbonneau Commission highlights the relationship between corruption, collusion, and closed markets. The construction industry in the City of Montreal lies at the centre of the controversies surrounding that public inquiry. In November of 2012 the City of Montreal released a 2004 study which indicated that the City was aware it had been overpaying for its construction projects by as much as 30% due to the low number of competitors for these tenders, and public contracts were being awarded to the same handful of companies over and over again.²⁹ The report suggested that a more competitive bidding process could save Montreal between 20% to 30% on its construction contracts. The testimony coming out of the Charbonneau Commission strongly suggests that rather than acting on these recommendations, Montreal continued to operate as a “closed market” with strong relationships between these privileged construction firms and corrupt municipal officials, in addition to members of organized crime.

A closed tendering environment that significantly reduces the number of bidders makes it easier for these types of illicit relationships between public officials and various bidders to arise over time. While this is certainly not to suggest that corruption is present in Ontario’s system nor in areas where closed bidding currently exists, it suggests that the structural framework for bidding on major municipal projects in Ontario is analogous to those which were present in Quebec that all parties suggest led to the culture of corruption traced in the Charbonneau report.³⁰

Most importantly, the costs associated with collusion and corruption are borne primarily by the public. Not only do taxpayers absorb the extra costs that result from issues such as uncompetitive bid prices and the creation of unnecessary contracts, but members of the public also face safety risks that can result when fair competition is eliminated from the tender process. For example, corruption with respect to the construction of public buildings in China, Haiti, India, and Turkey has been partly blamed for the high death tolls associated with earthquakes in those countries.³¹ Furthermore, allegations of corruption and collusion significantly undermine the integrity of the public procurement system and lead to market uncertainty that discourages investment and the entry of new competitors.

Since collusion requires consensus between bidders, maintaining a competitive procurement process with open entry and as many bidders as possible creates a strong deterrent against this form of anti-competitive activity. Reduced competition and restricting potential bidders to contractors associated with a particular union, on the other hand, creates an environment for close relationships to develop between competitors, which can give way to bid-rigging or at least tacit collusion. Indeed, the introduction of greater competition is the remedy prescribed by the report from city staff in Montreal in 2004, by the Office of Fair Trading in the UK,³² by the OECD,³³ and by Australian Competition and Consumer Commission.³⁴

To conclude:

- a. There is a preponderance of evidence and almost universal agreement that restricting competition raises prices.
- b. Particular markets – especially public construction markets – are structurally prone to limited competition. Limiting these markets further exacerbates the risk to the public interest.
- c. Closed tendering has been shown to increase the likelihood of corruption in the construction industry.

29. CTV News: Montreal warned years ago about ‘closed’ construction market – <http://www.ctvnews.ca/canada/montreal-warned-years-ago-about-closed-construction-market-1.1035503>

30. France Charbonneau, Roderick A. Macdonald, Renaud Lachance. “Rapport D’étape de La Commission D’enquête Sur L’octroi et La Gestion Des Contrats Publics Dans L’industrie de La Construction.” Government of Quebec, January 13, 2014.

31. Transparency International: Corruption and Public Procurement (Talking Paper #05/2010) – http://www.transparency.org/whatwedo/pub/working_paper_05_2010_corruption_and_public_procurement

32. *ibid*

33. “Guidelines for Fighting Bid Rigging in Public Procurement: Helping Governments to Obtain Best Value for Money.” OECD, n.d. <http://www.oecd.org/competition/cartels/42851044.pdf>.

34. “Cartels: Deterrence and Detection - a Guide for Government Procurement Officers.” Australian Competition and Consumer Commission, 2011. <http://www.accc.gov.au/system/files/Cartels%20deterrence%20and%20detection%20-%20and%20checklist.pdf>.

A COMPELLING PUBLIC INTEREST FOR CLOSED MUNICIPAL BIDDING?

We noted above the rarity of an entirely “open” tender where there are no restrictions on who can bid on a project. Put differently, there are many instances when the pool of bidders on a given tender will be limited. This section of the paper will examine and evaluate a variety of potential rationales for limiting bidding.

For construction projects, public bodies generally tender out work. This means that the contract will be awarded to the lowest compliant bidder. Yet in order for this system to function, specifications as to what is required to complete the contract need to be defined precisely so that the price quoted by a bidder can be fairly treated as determinative.

When purchasing goods, the tendering process can assure fairness to all bidders by specifying an identifiable industry standard that must be met by the goods sought. If the public body requires any successful bidder to meet precise standards, then the price quoted by each bidder will generally provide a fair basis to assess competing bids. On the other hand, if there is no objective way to specify the quality of the product sought, a lower bid price may also imply a lower quality product, and fair assessment of competing bids becomes far more complicated.

“A closed tendering environment with restricted competition will be particularly vulnerable to these forms of anti-competitive and market distorting activities.”

Similarly, when public bodies require services rather than goods, it may be difficult to identify appropriate benchmarks so that the qualifications of competing eligible contractors can be objectively assessed. Benchmarks must remain consistent with the fundamental principles underlying public procurement; namely, these benchmarks must be *open* to an appropriate level of competition, *fair* in terms of creating a level playing field for all bidders and *transparent* in how they communicate their compliance standards.

Public bodies are also frequently faced with tight time constraints in which procurement must be completed, whereas the assessment of qualifications can add a number of weeks (if not months) to the procurement process. In order to address these competing needs, public bodies typically conduct a separate prequalification process prior to tendering. This allows procurement to be completed much more quickly and efficiently as specific needs and opportunities arise. Prequalification still requires benchmarks to be set, however.

What are the criteria typically used by public bodies in prequalifying bidders on construction tenders? It is generally understood that past experience, the ability to acquire appropriate levels of bonding, and other “experiential” factors are all considered. These “competency” criteria tend to focus on the likelihood of a company to fulfill the work on time and on budget. However, other types of criteria which draw upon factors other than competency are sometimes offered as legitimate (rather than arbitrary) means of prequalifying bidders. We evaluate those in the following:

Licensed Professionals

So how can public bodies set benchmarks when seeking bids for professional services through a fair, open, and transparent process? When seeking the services of professional consultants, a public body may have objective industry standards upon which they can rely for prequalification. For example, if a public body is seeking the services of someone from a regulated profession, such as a lawyer, architect, accountant or engineer, it can objectively require all bidders to hold current membership in good standing with the relevant regulatory body. This ensures that all bidders meet the high standards of ethics, education, and training for their profession. Some regulatory bodies even certify the specialties of their members, providing further objective criteria for a public body to identify in its tender. In construction, on the other hand, finding an appropriate benchmark is far more challenging. There are many areas where no industry requirements for licensing or certification exist. In fact, in some trades only a minority of individuals hold any form of certification, and in other trades there may be a variety of certifications that can be difficult to compare objectively. In the construction industry, however, these criteria are common for all companies, and are enforced through means other than through the bidding process.

Trade Associations

One of the functions of trade associations is to provide their memberships with an objective standard of qualifications similar to those held by regulated professions. Although many of these trade associations are successful in this regard, using membership in these organizations as criteria for public procurement may still be problematic. First of all, many trade associations are localized to a certain geographical area. If a public body relies on membership in a geographically limited organization, they will inadvertently exclude eligible and competent bidders from areas outside the reach of that association. In this way trade associations differ greatly from the provincially regulated professions that often have standards for qualifications set at a national level and must provide a certain level of interprovincial mobility for their members. A public body can look to national or international trade associations to avoid the problem of geographically limited organizations; however, it will still be necessary to provide a strong rationale for why an association membership has been set as a *mandatory* prequalification criterion. Regulated professions like lawyers and engineers have specific professional services that legally only their members can provide in order to protect the public interest in competent professional services. Trade associations, on the other hand, are simply in place to further the interests of their membership in having a standard qualification; membership is typically not an industry requirement nor does it restrict the ability of non-members to perform the same work as members do. A primary obligation in public procurement is the maintenance of fair competition. That is, the onus will always fall on a public body to provide an extensive rationale for the restrictions it places on the competitiveness of the procurement process. It is notable that Trade Associations are addressed specifically by the Competition Bureau, and many of the practices singled out as practices that should be avoided have been offered as defences by various labour associations as a rationale for closed-tendering. These include “creating a false impression that lower prices [...] are indicators of lower quality of service.”³⁵

“Local Preference” and “Geographic Discrimination”?

Over the last 10 years, public sector procurement professionals have been under increasing pressure from their elected officials to show “local preference” to contractors who primarily operate within city limits and contribute to the local tax base. While the desire of elected officials to spur local business is admirable, seeking to do so through the creation of benchmarks for bids on public contracts may not be appropriate. While some jurisdictions give preference to local contractors, and may be legally entitled to do so in certain circumstances, the use of “local preference” to disadvantage outside bidders has been officially deemed “geographic discrimination” in Ontario and has been the subject of much debate in procurement circles throughout North America. For example, Paul Emanuelli, a leading Canadian lawyer specializing in public sector procurement law, argues strenuously against “local preference” in his extensive white paper on the subject.³⁶ Emanuelli points out that applying “local preference” as a criterion for public procurement can potentially be illegal by breaching Chapter 5 of the Agreement on Internal Trade (AIT), as well as violating legislated and common law requirements for public tenders. Emanuelli further criticizes this form of geographic restriction for undermining the integrity of the public procurement process, again referring to the tenets of openness, fairness, and transparency, and for allowing procurement to become politicized to the detriment of healthy competition.

Union Affiliation as a Prequalification Factor in Construction Bidding

In Ontario, but also in other jurisdictions across Canada, affiliation with a particular trade union has inadvertently become a factor in prequalifying for public construction projects. As outlined by Cardus in its Construction Competitiveness Monitor, some of Ontario’s largest municipalities are required by law to restrict their construction tenders to companies affiliated with particular trade unions.

And while these restrictions are transparent they fail on the other two criteria for sound public procurement. They are neither fair nor open.

35. “Trade Associations and the Competition Act - Competition Bureau.” Accessed June 1, 2014. <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03691.html>.

36. Local Preference in Public Purchasing: Risks and Recommendations. A White Paper by Paul Emanuelli - <https://www.opba.ca/chapters/nigp-opba/files/LocalPreferenceWhitePaperFinal.pdf>

Membership in a particular trade union does not provide an objective criterion for the purposes of public procurement. Trade union membership is a function of the choices of particular members and does not signify that any objective standard of qualifications has been met by union members. In this way, union membership cannot be relied upon as an industry standard in the same way as membership in a regulated profession or even in a trade association can. Furthermore, union membership is often localized to certain geographic areas. To restrict potential bids in a public procurement process to members of such an organization would mean eliminating a great deal of potential competition on the basis of geography alone. And, as we noted above, restricting competition leads to higher prices.

The resulting competitive environment is one where the “construction employer status” considers public entities on the same plane as private companies. For instance, the City of Toronto, from a labour relations perspective, is considered, the equivalent of any private company affiliated with the unions which have deemed Toronto a construction employer. And yet, as we noted above, cities rarely, if ever, perform major construction projects on their own, choosing instead to tender such work to private companies. The net result of this is a chimerical procurement environment in which private sector profit, companies, and their labour unions are shielded from normal marketplace competition and yet are not restrained by the fiduciary responsibility to act in the public interest.

It is sometimes suggested that placing restrictions on bidding to companies affiliated with unions will increase safety on public construction procurement projects. True, it is important to recognize that we no longer rely on the efforts of private organizations alone to ensure rigorous health and safety standards for Canadian workers. Indeed, every province and territory in Canada has general legislation in place to secure the protection of occupational health and safety for workers across the country, as well as specialized legislation protecting those whose employment involves unique risks, such as commercial diving or working with hazardous materials. However, construction companies in Canada will be subject to rigorous occupational health and safety standards regardless of whether or not they are affiliated with any particular union. Even if safety standards were an objective criteria, the restriction should be placed on that level alone, regardless of union affiliation.

Similarly, there is no basis for assuming that union-affiliated contractors will provide safer infrastructure. Again, the objective criterion is not the affiliation of a company’s workforce, but a company’s ability to construct safe infrastructure based on engineering or other standards which are present regardless of union affiliation.

The purpose of a trade union is to provide protection for its members, not as a barrier to exclude other workers. Companies affiliated with trade unions of all sorts have, in a variety of areas, shown that they can compete based on value. To prevent competition for publicly funded projects for reasons of trade union affiliation runs counter to the very purposes of the union.

The safety standards for construction projects built in Canada will be governed in each jurisdiction by a complex regime of building codes and regulations that apply regardless of the affiliations of any given contractor. As already noted above with respect to benchmarking for tenders, union membership cannot be relied upon as an industry standard for the skills of a union’s members.

Indeed, the purpose of a trade union is to provide protection for its members, not as a barrier to exclude other workers. Companies affiliated with trade unions of all sorts have, in a variety of areas, shown that they can compete based on value. To prevent competition for publicly funded projects for reasons of trade union affiliation runs counter to the very purposes of the union.

WHAT ARE THE POTENTIAL IMPACTS OF CLOSED TENDERING ON THE PUBLIC INTEREST?

There is one unifying goal that guides the public procurement process and gives rise to the strict requirements for fairness, openness, and transparency imposed on it: upholding the public interest. Public bodies are by definition institutions that are funded by the tax-paying public and that exist to serve the interests of the public. Laws, policies, and trade agreements across Canada all favour healthy competition for public procurement processes because it is in the public interest to obtain the best value possible when spending taxpayer money. Likewise, public procurement in Canada strongly favours healthy competition because the bidders who compete for public contracts are also members of the public, and they deserve an opportunity to compete for these contracts based on merit rather than their private affiliations or memberships.

Membership in a particular trade union does not provide an objective criterion for the purposes of public procurement.

Closed tendering for public procurement acts contrary to the public interest in several important ways: it reduces the vitality of our federal, provincial and local economies; it impacts the integrity of the public procurement process; it reduces the quality and quantity of infrastructure received for every taxpayer dollar spent on public projects; it reduces the vitality of the private sector marketplace; and it reduces the vitality of the construction industry.

The debate on closed tendering versus open tendering should not be mischaracterized as a tussle between unionized and non-unionized industry members; the real issue is how public bodies can ensure fair and transparent benchmarking so as to get the best value possible for public dollars.

The competitive principles of fairness, openness, and transparency should not only guide the way in which public contracts are awarded, but also how these contracts are completed. When contractors fail to execute public contracts efficiently, open and fair competition allows a public body to hold them accountable without singling them out from other bidders. Where a tender is adequately specified, robust competition for a renewal of that public contract should ensure that inefficient contractors either lose the contract to more efficient competitors or they tighten their belt significantly to meet the higher standard set through competition. When robust competition is eliminated through closed tendering, on the other hand, there are far fewer incentives for contractors to reduce inefficiencies and fewer mechanisms for public bodies to police the efficient use of taxpayer monies on these contracts.

The Toronto District School Board recently learned this valuable lesson when PricewaterhouseCoopers LLC provided them with a report reviewing the Board's resource allocation in November of 2012. This report noted that the Board's unionized maintenance staff were operating well below capacity with their productive "wrench time" making up only a small portion of the time for which they were paid overall. The report further highlighted issues with excessive travel time and expensive overtime hours being spent on routine, non-critical work orders.³⁷ The report also identified the need to consider the impact of the Board being deemed a "construction employer" under Ontario's Labour Relations Act (OLRA) in addressing these concerns. An investigation by the *Toronto Star* earlier in 2012 came to similar conclusions regarding the inefficient use of the Board's resources for maintenance work, with allegations that 76 hours were billed for the installation of an electrical outlet that actually took 4 hours to complete, and the installation of a pencil sharpener costing the Board \$143.³⁸ The *Toronto Star* later noted that in spite of the findings and the recommendations of the PricewaterhouseCoopers report, the Board renewed its contract with the very same construction group.³⁹ With the closed tendering environment that the Board's designation as a construction employer under the *LRA* has ensured, it should come as no surprise that the status quo for this public contract continued uninterrupted. It is worth considering whether the Board would have come to the same conclusion on renewal of the contract had that contract been subject to rigorous open competition regardless of union affiliation.

37. PricewaterhouseCoopers LLP: Toronto District School Board, Resource Allocation Review, Final Report – http://www.tdsb.on.ca/Portals/0/AboutUs/docs/TDSBResourceAllocationReviewReport-FINAL_NOV_27_2012.pdf

38. *Toronto Star*: Toronto schools pay high prices for small jobs – http://www.thestar.com/news/gta/2012/06/21/toronto_schools_pay_high_prices_for_small_jobs.html

39. *Toronto Star*: Province renews TDSB contract with expensive maintenance and trades workers – http://www.thestar.com/news/canada/2013/01/04/province_renews_tdsb_contract_with_expensive_maintenance_and_trades_workers.html

CONCLUSION

In summary, there are many reasons why Canadians should be concerned when restrictions on access to public contracts have the effect of excluding certain contractors on the basis of their union-affiliation alone. Numerous studies have shown that these closed tendering arrangements lead to significantly higher costs for taxpayers without providing any clear benefits in return. Likewise, restricting competition can encourage collusion and corruption and prevent inefficient contractors from being held accountable. Closed tendering can also undermine workers' rights to choose what organizations they associate with and restrict their ability to work on the public contracts that their own tax dollars fund. Public bodies must always bear in mind the public interest in the conduct of their procurement activities, and the public interest will generally only be met when the foundational principles of openness, fairness, and transparency are respected.