

October 22, 2008

Mr. Ken Lewenza
President
CAW - Canada
205 Placer Court
Toronto, Ontario
M2H 3H9

Dear Mr. Lewenza:

Re: Buy Canadian - Build Communities Resolution

You have asked for our opinion about the compatibility of “Buy Canadian” purchasing policies with the procurement rules of both international and domestic trade agreements.

In order to foster such policies, the CAW is proposing that municipal councils adopt a *Buy Canadian – Build Communities* Resolution that would have them i) adopt “Buy Canadian” purchasing policies, and ii) call for federal and provincial legislative initiatives that would implement such policies.

Procurement policies are used by many nations as a critical tool for fostering economic development and employment, and from time to time Canadian governments have done so as well. However Canada’s approach has been *ad hoc*, and public purchasing has often favoured foreign goods and services even during times of economic downturn. Moreover, unlike many nations, including the United States which has enacted two federal statutes to implement “Buy American” policies, the Canadian federal government has declined to legislate to ensure that public spending is used to favour Canadian goods and services.

Recently, some governments have raised concerns that Buy Canadian procurement policies may offend international or domestic trade rules. The following opinion addresses this concern.

Short Answer:

For reasons that are set out below, neither international nor domestic trade agreements prevent municipal governments from adopting procurement policies that favour Canadian goods and services. Their prerogatives to do so include the right to specify Canadian content and final assembly requirements for public transit vehicles.



Provincial governments also have the same latitude to adopt procurement policies that foster economic development and employment in Canada because international procurement agreements do not apply to either provincial or municipal governments. While provinces and municipalities are bound by the procurement rules of the *Agreement on Internal Trade*, these rules explicitly permit Buy Canadian procurement policies and practices. The provinces are also free to legislate for the purpose of implementing Buy Canadian policies for both direct purchases and as a condition of provincial funding to municipalities and other bodies.

The options of the federal government to favour Canadian goods and services in public purchasing are more constrained because of the commitments federal officials have made under various international trade agreements. However, these agreements include important exceptions, including for urban rail and transportation equipment and related services, and more importantly for federal funding support for provincial and municipal projects and spending. These trade reservations and carve-outs permit significant scope for a federal Buy Canadian statute along the lines called for by the CAW Resolution.

The Facts:

Our understanding of the facts of this matter is as follows.

Many nations have developed and implemented procurement policies that favour local goods and service providers. For example, rules for public transit vehicles often establish local content requirements or restrict purchasing to local suppliers.¹ Canada's most important trading partner, the United States, has in fact legislated for this purpose. Thus under the *Buy America Act* federal funding may only be used to procure buses, rail cars, ferries and other rolling stock where 60% of components by cost are of U.S. origin, final assembly is in the U.S. and pre- and post-award audit requirements are in place.

Notwithstanding this common international practice, no similar requirements have been established in Canada, and the federal government has declined to use its spending or legislative authority to encourage or require that public spending on transit favour Canadian goods and services. The result has been the extensive use of public funding to acquire goods and services from outside the country notwithstanding the presence of competitive Canadian suppliers.²

The absence of Buy Canadian procurement preferences is particularly hard-felt when the manufacturing economy is suffering. As we know, over the past two years Canadian

¹ The European Union has established a 50% EU content rule, but member nations may have more stringent requirements. In China, 70% local content is required, and in Japan the market is closed to outside bids.

² For example, in past three years: Ottawa light-rail transit equipment was purchased from Europe, Toronto subway equipment from China; York Region buses from Belgium; B.C. Ferries purchased ships from Germany; the Vancouver "Canada-line" was acquired from Korea and the federal government purchased buses from German – "Made in Canada Matters," presentation by Bill Murnighan of the CAW Research Department to the Columbia Institute of Civic Governance, Huntsville, Ontario, May 10, 2008.

manufacturing has experienced one of its steepest downturns, with job losses in this sector exceeding 200,000 since the beginning of 2006. Moreover, if Canada experiences a recession, Canadian governments may well respond by boosting spending on public infrastructure projects to sustain economic activity at a reasonable level.

The urgent need for significantly increased infrastructure spending at the municipal level was highlighted by a 2007 report of the Federation of Canadian Municipalities which identified a deficit of \$123 billion in the maintenance of existing infrastructure. The report also identified the need for an additional \$115 billion in new municipal infrastructure spending to meet the future needs of our communities.³

These circumstances underscore the importance of Canada playing catch-up with other jurisdictions that have acted to ensure that procurement play in central role sustaining and building local economies.

The CAW adopted a *Buy Canadian – Build Communities* Resolution (referred to herein as the “CAW Resolution”), at the meeting of the CAW Council in March, 2008. That resolution was subsequently endorsed by the Canadian Labour Congress at its national convention. It proposes that municipal councils adopt the following resolution:

THEREFORE, BE IT RESOLVED that (Municipal Councils) will work to keep good jobs in our communities by:

1. Adopting a “Buy Canadian” policy for municipal purchases which includes:
 - requiring a minimum of 50% Canadian content and domestic final assembly in the purchase of public transit vehicles;
 - requiring the purchase of goods and services with the highest possible level of Canadian content;
 - requiring potential vendors to identify the source of goods and services, and the overall level of Canadian content, as part of the tendering process;
 - reporting annually to Council on the level of Canadian content in municipal purchases; and
 - identifying opportunities to enhance the level of Canadian content in future purchases.

³ *Danger Ahead: The Coming Collapse of Canada’s Municipal Infrastructure*, Dr. Saeed Mirza, for the Canadian Federation of Municipalities, November, 2007

2. Calling on the federal, provincial and territorial governments to immediately enact “Buy Canadian” legislation applying to direct public purchases, and to grants and other funding provided to municipal governments.

The CAW Resolution has now been presented to several municipalities. While some municipal governments have adopted the resolution, others have been advised by their staff that international and/or provincial trade agreements prohibit such policies. For the reasons set out below, Buy Canadian policies are clearly permitted under both international and domestic procurement regimes, and advice to the contrary is clearly in error.

PART I: MUNICIPAL MEASURES

International Procurement

Public purchasing policies are subject to various international trade rules and agreements. Of these the most important are set out in the Procurement, Investment and Services provisions of the North American Free Trade Agreement (NAFTA) and various agreements established under the auspices of the World Trade Organization (WTO). If these rules were to apply to municipal procurement, they would generally prohibit the Buy Canadian policies called for by the CAW Resolution⁴ Fortunately, while the application of these international rules to municipal governments is contemplated by these regimes, the federal government has yet to make any such commitments.⁵

In short, international rules that might otherwise constrain Buy Canadian procurement policies do not apply to municipal governments.

⁴ For example, the obligation to provide *National Treatment* to foreign suppliers would preclude policies that favour those from Canada. See for example NAFTA Procurement rules which are set out in Chapter 10 of that Treaty. Article 1003: *National Treatment and Non-Discrimination* provides in part:

With respect to measures covered by this Chapter, each Party shall accord to goods of another Party, to the suppliers of such goods and to service suppliers of another Party, treatment no less favorable than the most favorable treatment that the Party accords to:

1. its own goods and suppliers; and
2. goods and suppliers of another Party.

⁵ For an explanation of the current state of such commitments go to the website of the Department of International Trade <http://www.international.gc.ca/trade-agreements-accords-commerciaux/fo/gp-faqs.aspx?lang=en#4Federal>

The Agreement on Internal Trade

While Canada has steered clear of compromising the procurement options of municipal governments under international trade agreements, provincial governments have made such commitments under an agreement with other provinces and the federal government – *The Agreement on Internal Trade* (the AIT).⁶ Chapter 5 of that Agreement sets out detailed rules and procedures for municipal governments to follow in purchasing goods and services. For reasons that follow, while these rules generally prohibit discrimination among Canadian suppliers, they do not prohibit policies that favour Canadian goods and suppliers over those from outside the country.

Because of their importance to municipal procurement, the key provisions of AIT procurement rules are worth reciting.

Article 502:4 of the AIT provides:

Annex 502.4 establishes the provisions to cover procurement by municipalities, municipal organizations, school boards and publicly-funded academic, health and social service entities (MASH entities). ...

Thus Annex 502.4 sets out detailed rules for this purpose, which is described to be as follows:

This Annex establishes the provisions required to extend coverage of Chapter Five (Procurement) to municipalities, municipal organizations, school boards and publicly-funded academic, health and social service entities.

The Annex sets out rules of general application to municipal procurement, including those relating to specifications relating to Canadian Content and Regional Economic Development. The following considers these in turn.

To be subject to the Annex, procurement values must exceed \$100,000 in the case of goods and services, or \$250,000 in the case of construction.

Section D of the Annex establishes general rules which prohibit procurement policies or practices that “differentiate between suppliers, or goods or services on the basis of geographic location in Canada”; or that discriminate on the basis of “the province of origin of goods, services, construction materials or the suppliers of such goods...” We have added emphasis to highlight the fact that while AIT rules prohibit discriminatory treatment of suppliers or goods from other Canadian jurisdictions, as noted it imposes no similar constraint on policies that favour Canadian over foreign suppliers.

⁶ *Agreement on Internal Trade, Consolidated Version, 2007*, http://www.ic.gc.ca/epic/site/ait-aci.nsf/en/h_il00054e.html

This right to discriminate in favour of Canadian goods and services is made explicit by section J: *Canadian Content* of the Annex, which provides:

1. Entities covered by this Annex may accord a **preference for Canadian value-added**, provided that the preference is no greater than 10 percent.
2. An entity covered by this Annex may limit its tendering to **Canadian goods or suppliers**, provided the procuring entity is satisfied that there is sufficient competition among Canadian suppliers and the requirement for Canadian content is no greater than necessary to qualify the procured good as a Canadian good.
[emphasis added]

Thus, under subparagraph 2, and subject to the noted qualifications, municipalities may entirely exclude foreign goods and services from tendering or other procurement processes. As we know, the CAW Resolution proposes a more modest goal:

- requiring a minimum of 50% Canadian content and domestic final assembly in the purchase of public transit vehicles;

To begin with under section J:1, municipalities are entitled to accord a preference for Canadian value-added, provided that be no greater than ten percent. In this regard, the ten percent figure refers to the premium that may be awarded during the evaluation of bids for Canadian value-added, not the required level of Canadian content which municipalities would be free to determine.⁷ “Canadian value-added” is a defined term under the AIT and in relation to services means the proportion of contracted services performed by Canadian residents. In relation to goods, value-added means, *inter-alia*, the value added to imported goods by manufacturers and distributors. Pursuant to these provisions, municipalities are clearly authorized to use price preferences to achieve both 50% or better Canadian content, as well as the final assembly requirements that are specified by the Resolution.

The other question that arises here is whether municipalities can, apart from price preferences, establish threshold requirements for all tenders for public transit vehicles to require these to meet the 50% Canadian content and domestic final assembly standards. The answer to this question, in our view, is yes, for the following reasons.

First, if municipalities may entirely limit tendering to Canadian goods or suppliers, which they are clearly entitled to do under section J:2, it would be inconsistent with the trade liberalization policies and objectives of the AIT to preclude more modest Buy Canadian targets.

⁷ See AIT Article 518 which defines Canadian Value-added and includes the following stipulation. The preference for Canadian value-added, as used in Article 504(5)(a), means the premium that may be awarded by a Party during the evaluation of bids for Canadian value-added, not the required level of Canadian content. Section J:1 traces Article 504(5)(a).

Second, the stipulation that “the requirement for Canadian content is no greater than necessary to qualify the procured good as a Canadian good” requires municipalities to moderate policies that would otherwise entirely exclude goods and services from outside the country.

Third, “Canadian good” is defined by Article 518 to mean a good that is: i) produced exclusively from domestic materials, ii) manufactured in Canada or iii) a good which if exported outside of Canada would qualify as a good of Canada under appropriate rules of origin. The drafting of this provision and its relationship with section J:2 is ambiguous, and the term “manufactured in Canada” is not defined. Nevertheless, there is no obligation for a municipality to adopt the least restrictive of these tests, and no constraint on promulgating procurement rules that would engage more than one of the criteria for determining whether a good is a Canadian good. Stipulating a 50% Canadian content threshold and domestic assembly requirement would accord with such an approach.

Finally, the requirement for there to be sufficient competition among Canadian suppliers also reinforces the notion that municipalities can adjust procurement policies for this purpose, such as by specifying a variable 50%-or-better Canadian content requirement.

Turning to the second bullet point under section 1 of the Resolution, which advocates a policy of requiring the “highest possible level of Canadian content” in goods and services purchased, we note that this proviso would extend to all such procurements, not simply those concerning public transit vehicles and services. Once again, section J:1 clearly authorizes the use of price preferences to achieve this objective. The option of paying a premium for Canadian content allows municipalities a critical tool for achieving Buy Canadian goals, and underscores the scope for such policies that are specifically authorized under the AIT.

We can see no impediments whatsoever to the other two requirements of Part I of the Resolution, namely that potential vendors identify the source and Canadian content of the goods and services they proffer, and that Municipalities report annually to Council on the level of Canadian content in municipal purchases.

Another proviso of Annex 502.4 which adds yet further scope for Buy Canadian municipal procurement is set out by section *K. Regional Economic Development* which provides as follows:

A Province may, under exceptional circumstances, exclude a procurement of an entity covered by this Annex from the application of this Annex for economic development purposes provided that all such exclusions are reported, prior to the commencement of any procedure leading to the award of a contract, to the other Provinces with an explanation of the reasons justifying the decision. A Province invoking this provision will seek to minimize the discriminatory effects of the exclusion on the suppliers of the other Provinces.

No definition is provided for the term “exceptional circumstances” which indicates that the term is self-defining for a province seeking to invoke it. In our view a recessionary economy, such as the one that may be looming for Canada, would provide ample justification for invoking this provision. However, for the reasons set out above, it would not be necessary to invoke this provision for implementing the Buy Canadian policies called for by the Resolution. Rather the rule appears to be tailored to permit procurement policies that favour local or in-province goods or suppliers.

In sum: in our opinion, section 1 of the CAW resolution is clearly consistent with both the letter and spirit of AIT procurement rules.

PART II: PROVINCIAL AND FEDERAL “BUY CANADIAN” LEGISLATION

The second element of the CAW Resolution proposes that municipalities call upon federal, provincial and territorial governments to enact Buy Canadian legislation that would apply to direct public purchases, and to grants and other funding provided to municipal governments. The circumstances of provincial and federal governments are quite distinct in this regard, and we consider them in turn.

Provincial Legislation

The procurement prerogatives of provincial governments are very similar to those of municipalities. Therefore provinces and territories have similar options for implementing the Buy Canadian policies contemplated by the CAW Resolution.

The exemption from international trade rules relating to procurement applies equally to all sub-national governments and institutions, whether provincial or municipal. The provisions of the AIT that apply to municipal procurement essentially replicate AIT rules that apply to provincial governments. The latter are set out in Article 504.⁸

Article 504:6 adds an additional proviso to those set out in section J:2 of Annex 502.4 which may be read to limit the use by provincial governments of non-price preference domestic content requirements. There appears to have been only case that has considered this provision, which appears to limit the use of non-price preferences to require that certain servicing work be carried out in Canada. That case, which was decided by the Canadian International Trade Tribunal, involved a sole-source procurement by the federal government and offers only the

⁸ Article 504:6 adds an additional proviso to those set out in section J:2 of Annex 502.4 which may be read to limit the use by provincial governments of non-price preference domestic content requirements. For this reason the prudent course would be to always frame Buy Canadian procurement policies to take advantage of the allowance for price preferences in addition to any non-price related Canadian content requirements.

most perfunctory consideration of Article 504:6.⁹ In our view the case offers little guidance about how this provision might be interpreted in other circumstances.

Nevertheless, the prudent course would be for provincial governments to frame Buy Canadian procurement policies to always take advantage of the allowance for price preferences in addition to any non-price related Canadian content requirements.

Finally, with respect to provincial initiatives we believe it makes good practical sense for a province to establish legislative parameters that would establish a consistent and transparent approach to Buy Canadian objectives that would not only bind provincial and municipal procurement, but would also apply to Crown corporations, such as Ontario Power Generation and other public bodies operating in the province. These rules could provide a consistent methodology for dealing with a variety of issues that must be addressed in order to give effect to Buy Canadian policy goals, including rules for ascertaining Canadian content, defining the circumstances in which sufficient competition will be deemed to exist among Canadian suppliers, and for delineating the reporting obligations of the procurement authority.

In sum, provincial governments are largely unconstrained by either international or domestic trade agreements from adopting Buy Canadian procurement policies for direct procurement or as a condition of funding for municipal procurements. Among the measures a province may adopt for this purpose is legislation that would establish such rules as binding obligations to be observed by government ministries, Crown corporations, municipalities and other publicly funded bodies.

Federal Legislation

Unfortunately, federal Buy Canadian options are more constrained because of the commitments made by Canada to international procurement rules under the WTO, NAFTA and other international trade agreements.¹⁰ As a general proposition, international procurement rules effectively preclude federal Buy Canadian policies where they apply.

While Canada has made substantial commitments to comply with international procurement rules, it has established certain exceptions under these regimes that would allow it to enact a *Buy Canadian Act* for certain purposes. Thus notwithstanding Canada's international obligations, such a federal statute could accomplish key objectives of the CAW Resolution, including:

⁹ *Rolls-Royce Industries Canada Inc. V. Canada*, CITT File No.: PR-99-053, http://search.citt-tcce.gc.ca/search?q=rolls-royce&site=All-Tout&btnG=+Search+&entqr=0&output=xml_no_dtd&sort=date%3AD%3AL%3Ad1&entsp=0&lr=lang_en&client=frontend_e&ud=1&oe=UTF-8&ie=UTF-8&proxystylesheet=frontend_e

¹⁰ Canada has obligated more than 80 federal departments and agencies to comply with WTO procurement rules, and notwithstanding the reservation for National Security, has committed imposed similar obligations on the Department of National Defence with respect to the acquisition of over 70 products, including railway equipment and motor vehicles, see Appendix 1, General Comments http://www.wto.org/english/tratop_e/gproc_e/appendices_e.htm

- Buy Canadian standards that would attach to federal transfers to the provinces; and
- Buy Canadian requirements for all purchases by the federal government and Crown corporations in areas where no international commitments have been made.

With respect to adding Buy Canadian conditionality to federal transfers, while it is beyond the scope of this opinion to assess the constitutional parameters of federal procurement authority, it is well established that the federal government is entitled to rely on its spending power to impose conditions on the use of federal funding by provinces, including in areas of provincial constitutional authority such as health care.

For present purposes, the more important point is that federal transfers to the provinces are not subject to international procurement rules. For example: NAFTA Article 1001:5 exempts:

“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.” [emphasis added]¹¹

In other words, international procurement rules do not apply to federal funding or transfers to the provinces, including those that will subsequently be used to achieve Buy Canadian goals.

As for direct procurement by the federal government, several exceptions allow such purchases to favour Canadian goods and services, including for:

- ship building and repair;
- urban rail and transportation components, materials, iron, steel and equipment;
- transportation services that are part of, or incidental to, a procurement contract; and
- procurement for national security purposes.¹²

While federal officials have abandoned many of Canada’s prerogatives to favour Canadian goods and services, it has i) preserved the right of provincial and municipal governments to adopt such policies, ii) reserved its own right to adopt such policies for a short list of goods and services; and iii) most importantly, maintained the option of attaching conditions to federal transfers that would require Buy Canadian procurement practices by funding recipients.

¹¹ The same exception is set out Canada’s reservations under the WTO General Agreement on Procurement, see Appendix 1, General Comments http://www.wto.org/english/tratop_e/gproc_e/appendices_e.htm

¹² See NAFTA Annex 1001.2b, General Notes, Schedule of Canada; and see Annex 1 to the WTO General Agreement on Procurement which sets out identical reservations. http://www.wto.org/english/tratop_e/gproc_e/appendices_e.htm

These policies might readily be entrenched in a federal *Buy Canada Act* that would establish such obligations as legally binding and enforceable. It might, in crafting such a statute, wish to consider US federal legislation - the *Buy America Act* and the *Buy American Act* – which establish such preferences for US goods and services.

CONCLUSION

As the preceding analysis describes, municipal and provincial governments have relatively unfettered authority to establish and maintain procurement preferences that would implement the policies set out by the CAW Resolution. While the options of the federal government are constrained by commitments it has made under international trade agreements, it has preserved its options to favour certain goods and suppliers in direct purchases, and most importantly has maintained the option of requiring that federal transfers to the provinces and territories be used in this manner. Both the federal and provincial governments are free to incorporate such requirements to legislation that would establish such preferences as binding legal obligations.

Sincerely,

Steven Shrybman

SS:lr

cope 343

F:\DOC\CAW\08-1910\00177740.DOC