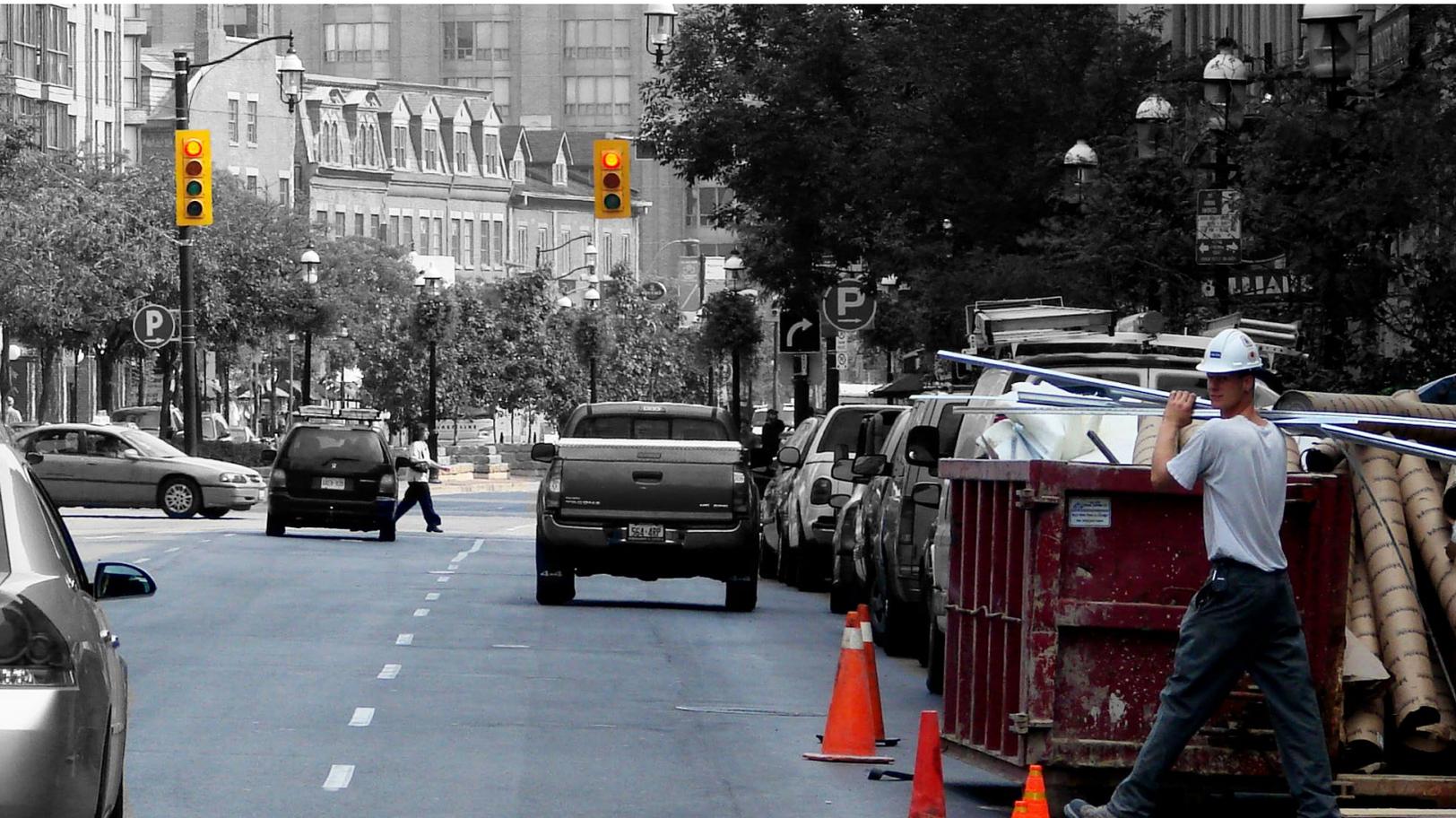


TUNING UP ONTARIO'S ECONOMIC ENGINE: Competitive Construction in the City of Toronto



A CARDUS CONSTRUCTION COMPETITIVENESS MONITOR BRIEF

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April 9, 2015

CARDUS

PROJECT LEAD

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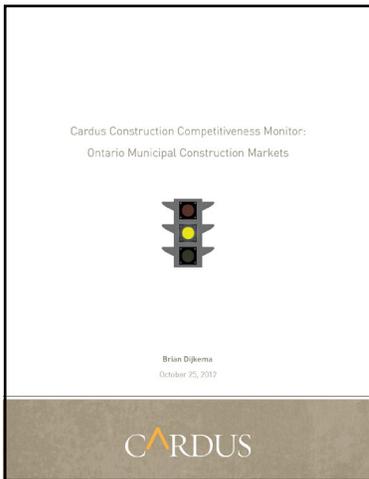


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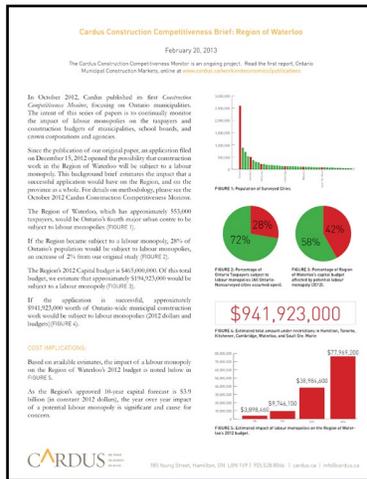
Toronto rightly calls itself the economic engine of Ontario. But Toronto's performance is hampered by legislation which prevents it from getting the best value for its construction projects. Cardus papers have noted that Toronto is paying anywhere from 20% to 30% more for its construction projects than it would in a truly competitive market. Yet the City of Toronto has not played a major role in calling for more competition in its construction markets. Why is this?

One of the reasons can be found in a 2008 staff report which studied the cost implications of closed-tendering in Toronto. This paper **reviews that staff report and finds significant methodological problems with it that lead to faulty conclusions.** Particularly, the report failed to account for the variety of ways in which competition works. Instead, it focused on one small segment of competition: labour costs. The fact that the City's fair wage policy specifically restricts competition on labour costs makes the report's conclusion misleading. Further, the report focuses too heavily on the unionization or non-unionization of firms, rather than examining a wider range of variables which would affect competition and cost.

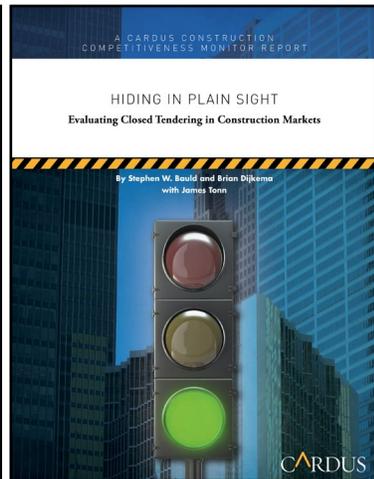
We suggest that these factors should compel Toronto to revisit its construction procurement practices with a view to providing a clear signal to the market that it is open for business. One way to do this would be to commission an independent review by leading competition experts to evaluate the competitiveness of Toronto's construction procurement market. Another would be to join other leading municipal organizations like the Association of Municipalities of Ontario and the Large Urban Mayors Caucus in supporting a fair, open, and transparent procurement regime.



Cardus Construction Competitiveness Monitor 2012



Cardus Construction Competitiveness Brief 2013



Hiding in Plain Sight: Evaluating Closed Tendering in Construction Markets 2014



INTRODUCTION:

Cardus has produced a series of papers that examine the issue of restricting qualified contractors from bidding on public construction projects. These papers were produced as a series under the heading “Cardus Construction Competitiveness Monitor.” The monitor proceeds from the assumption that public contracts should not be restricted to a subset of private companies because of the choices of their workers; rather, all qualified contractors, regardless of the private affiliations of their workers, should be allowed and encouraged to bid on public projects.

The first of these papers, *Ontario Municipal Construction Markets*, described how Ontario construction labour law has effectively created statutory oligopolies in vast swaths of its public construction markets. These statutory oligopolies exist in a variety of public construction markets, which include municipal construction markets, but also other public markets like school boards, other crown agencies, and corporations.

This paper surveyed the number of municipal taxpayers affected by restricted bidding, provided estimates on the amount of public monies affected by these restrictions, and surveyed the available estimates provided by a variety of stakeholders on the overall impact of these restrictions on the public purse. The cost estimates were spread over a wide range from a minimum estimate of 1.7% in additional costs (from a City of Toronto report) to a maximum estimate of 40% additional costs (from consultants hired by the City of Hamilton).

A number of other iterations of this paper were published in response to developments in Ontario, particularly the restriction of bidding in the Region of Waterloo, and to provide estimates to the way in which restrictive bidding affects other jurisdictions, including Manitoba, British Columbia, and the Government of Canada.

An open, competitive bidding environment in which all qualified companies can bid is more likely to achieve best value for public money than an environment marked by restrictions.

Last year, Cardus produced a paper entitled *Hiding in Plain Sight: Evaluating Closed Tendering in Construction Markets*, which focused particularly on the policy frameworks in Ontario, Canada, and the around the world that support maximizing competition in public procurement systems. The intent of this paper was to show that there is virtually unanimous consensus from economists and governments around the world that competitive bidding environments provide the best value for taxpayers and that reducing competition leads to distortions in public procurement processes that not only increase costs but tend towards more corrupt environments. A variety of papers – both empirical and theoretical across a wide array of sectors – suggest that shrinking the bidding pool in ways similar to that of Ontario’s largest municipalities results in cost increases ranging from 20% to 30%.

This consensus is backed up by government policies and directives that are structured to reap the benefits of fair and open competition on publicly funded projects. And it is supported by a federal bureau, the sole purpose of which is to ensure that markets are not distorted by monopolies, collusion, bid-rigging, or other negative market behaviours.

In short, there is general consensus that maintaining an open, competitive bidding environment in which all qualified companies can bid is more likely to achieve best value for public money than an environment marked by restrictions.

But there continues to be some disagreement on the extent to which closed tendering increases costs in construction.

Competitive markets are better for those purchasing goods and services.

CITY OF TORONTO – HOW DOES COMPETITION CREATE VALUE?

One source of the lack of consensus on the cost implications in Toronto is a report entitled *Labour and Training Costs in Construction Procurement* and produced by the city in 2008. This report suggested that closed tendering for Toronto led to cost increase of 1.7%.

This report's primary flaw derives from its baseline assumption that the only, or primary, cost savings on construction procurement come as a result of wage differentials between competitors.

This assumption is shown in the methodology by which the report calculates the cost implications of closed tendering. These are outlined on page 14 of the City's report:

Roughly half of the work on a typical project will relate to work and expenses that fall outside of the jurisdiction of the City's nine unions. This percentage fluctuates from project to project based on the work that is to be performed. As approximately 33.5% of projects relate to labour costs, a typical project will result in approximately 17% of total cost being attributable to the payment of wages to union workers in the nine unions. If one could assume that all of the remaining wages paid on such projects would be paid at the Fair Wage rate (approximately 10% less than unionized rate), as opposed to the collective agreement union rates, and assume that these savings would be passed on to the City in the form of lower bid prices, it is possible that there might be a savings of approximately 1.7% of the total project costs. However, as the construction industry is highly unionized (as the experience in the non-ICI sectors demonstrates), it is unlikely that all the work would be performed by non-union forces. As a result, the savings to be realized by the City may be significantly lower.

For clarity, the City's assumptions are as follows:

- a) Labour costs in construction = 33.5% of total project costs.
- b) 50% of the work on a particular ICI project is i) open to competitive tendering and ii) will attract bids from non-union companies.
- c) The wages on the portion of work which is open to competitive tendering are 10% less than those paid to unionized workers.

The City's report assumes that a modest cost increase of 1.7% is as simple as ABC.

PRECISION ≠ ACCURACY

The trouble is that the effects of competition on price are not that simple. The result is that the City's 2008 report suffers from precision bias; that is, the belief that because the figures are precise they are also accurate. They are not, and the reason this report does not provide an accurate picture of the costs associated with closed-tendering can be found in assumptions that are made but not clearly articulated in the City's report.

The City's report assumes:

- a) That labour costs are the only, or primary, means by which firms compete when bidding on public construction projects.
- b) That closed tendering can be boiled down to union vs. non-union discussion.
- c) That the complexity of placing bids which involve the simultaneous management of multiple labour pools has no negative affect on attracting bids on City work.
- d) That policy signals have no effect on market participants.

These assumptions are incorrect, and should cause City officials to revisit the report and its conclusions. Here we address each of these assumptions in turn.

COMPETING ON LABOUR COSTS IN A MANDATED WAGE ENVIRONMENT?

The City's 2008 report notes that "there are a large number of factors which go into bid prices received by the City for construction work."¹ It goes on to list four of these factors:

1. The overall state of the economy
2. The state of the construction industry specifically
3. The amount of competition between firms
4. The ability to negotiate on access to and prices for
 - a. Equipment
 - b. Materials
 - c. Labour

¹ City Manager's Report to City of Toronto. *Labour and Training Costs in Construction Procurement*. September 23, 2008. p. 15 <http://www.toronto.ca/legdocs/mmis/2008/ex/bgrd/backgroundfile-15927.pdf> Accessed March 19, 2015

Closed tendering forces an unnecessary reduction of qualified firms that can compete for public works. In doing so it unnecessarily eliminates firms which would otherwise bring a competitive edge on cost, quality, time, and innovation to Toronto's construction market.

Further, the City goes on to report that “a particular interest for the City is to ensure there is a sufficient degree of competition amongst companies bidding for City work.”²

Yet while all of these factors have implications for the price the City pays for its construction, the report does not address any of these factors in its report. It assumes equality between all bidding firms on everything other than labour costs. This is a significant gap, especially in an environment like Toronto whose fair wage policy attempts to reduce or eliminate competition on labour costs by mandating the wages that firms pay to employees. In short, the City focused on the one area that was least likely to have an impact on the price of bids and created an entire report around that factor. It's generally accepted that firms compete on many factors beyond cost and that competing on cost involves a wide variety of factors other than labour. As noted by Kale and Arditi:

The construction industry calls upon construction companies to adopt an approach that attaches great emphasis to the combined effect of four modes of competition—cost, quality, time, and innovation. It is this simultaneous emphasis on exploiting the current competencies for being efficient in transforming inputs into outputs and exploring new ways of competing that makes the difference among competitors' offerings significant, which in turn promotes competitive success.³

As we note in previous Construction Competitiveness Monitor papers,⁴ closed tendering forces an unnecessary reduction of qualified firms that can compete for public works. In doing so it unnecessarily eliminates firms which would otherwise bring a competitive edge on cost, quality, time, and innovation to Toronto's construction market. This reduction of firms prevents the City from taking advantage of the competitive positioning of the firms that are disallowed from participating in the market.

2 Ibid.

3 Kale, Serdar and Arditi, David. “Competitive Positioning in the United States Construction Industry.” *Journal of Construction Engineering and Management*, Vol. 128, No. 3, June 1, 2002. p. 241

4 Those papers are available at: <http://www.cardus.ca/research/workandeconomics/publications/>

COMPETITIVE TENDERING IS NOT A UNION V. NON-UNION ISSUE

The City's 2008 report breaks down the value of contracts that have gone to union and non-union firms, and notes that even in the ICI sector (the sector most affected by "construction employer status") non-union firms are able to win work.

It also notes the number of unionized firms in the GTA and Ontario and draws two conclusions:

1. "That there are a significant number of companies for general contractors to choose from, which would appear to suggest that there is a competitive marketplace."⁵
2. "[That the City] cannot be certain [...] whether further competition would in turn have the effect of lowering prices by general contractors."⁶

While there may be a significant number of unionized companies this does not imply that the market is efficient, or that it is likely to produce the public value that comes from healthy competition. After all, even a duopoly can be competitive. The issue is not whether the Toronto public construction market meets a minimal definition of competitiveness among unionized firms, but whether it has a competitive marketplace that brings best value for public dollars spent on construction projects.

The City would have done a better job of advising its government if it were to provide a comparison of qualified unionized firms as a proportion of *all* qualified firms in the market, regardless of their union affiliation. Without that it is difficult to gauge the extent to which their market is truly competitive.

5 City Manager's Report, 2008, 14.

6 Ibid.

The issue is not whether the Toronto public construction market meets a minimal definition of competitiveness among unionized firms, but whether it has a competitive marketplace that brings best value for public dollars spent on construction projects.

The City's 2008 report does not provide any data on:

1. The number of firms competing for public projects.
2. The number of bids its receives on projects.
3. The range of those bids, and a comparison of that range to the market as a whole.
4. The proximity of the bids it does receive to its estimates.
5. The relation of its own estimates to other municipalities in the province.
6. How these data points compare to other Canadian and international jurisdictions.

This type of granular data is what is needed to provide an accurate empirical picture of the exact cost implications of closed-tendering on Toronto.

The defining question is whether or not qualified contractors, regardless of their union affiliation, are able to bring their respective competitive advantages to the market place to compete for work that is paid for by the public.

And, as we show in *Hiding in Plain Sight*, Canada, Ontario, and Toronto have a robust series of laws and regulations which are in place to ensure competition because there is near universal consensus that competitive markets are better for those purchasing goods and services, including construction.⁷ This is borne out both by theoretical economic models, empirical studies, and the recent experience of Ontario municipalities such as the City of Hamilton.⁸ And, likewise, there is a high degree of consensus that government regulation that prevents qualified contractors from entry into markets is likely to increase prices.⁹

7 Dijkema, Bauld, Tonn. "*Hiding in Plain Sight: Evaluating Closed Tendering in Construction Markets*." *Cardus*. September 9, 2014. Available here: <https://www.cardus.ca/store/4290/>

8 See, for instance: <http://hamilton.siretechnologies.com/sirepub/cache/2/poredhdjdb5tzh5u40i22h-pf/5755704012015115022144.PDF> Accessed January 20, 2015

9 Dijkema, Bauld, Tonn. "*Hiding in Plain Sight*"

One of the urgent challenges for Toronto, and indeed our cash and infrastructure-strapped province as a whole, is to communicate that it is open to business

COMPLEXITY MATTERS

A less noticeable assumption made in the City's 2008 report is that companies will not be deterred by the complexity involved in managing multiple labour pools when bidding on public projects. The City's report assumes that companies will not change their prices even if it means having to alter their business model and labour structure to meet the City's labour obligations.

However, the complexity of bidding does affect the price that companies place on their services. As noted by Clive Thurston, president of the OGCA, last year,

The majority of my members don't like to bid the city, and those that do have learned how to play the game so they charge a premium,[...] Throw in another 10% to 15% [...] I call it the aggravation factor.¹⁰

The City report's assumption that requiring firms to alter the organization of their workforce because the City is designated as a construction employer will not increase the bid price for is highly unlikely. This is one reason why Cardus's estimates of the work affected by closed tendering are higher than the City's.¹¹ The City's numbers only account for the portions of work that are required to be subcontracted to unionized firms, and they assume that there will be no effect on how general contractors submit their bids. However, as noted by the OGCA and other actors, many firms will either not bid on such work or will add a premium to account for the extra effort in managing multiple labour pools.

10 Moloney, "Paul. *Red Tape Costing City Taxpayers, Contractors Say.*" *Toronto Star*. June 4, 2014. Accessed: March 19, 2015 http://www.thestar.com/news/city_hall/2014/06/04/red_tape_costing_city_taxpayers_contractors_say.html

11 Dijkema, Brian. "*Cardus Construction Competitiveness Monitor: Ontario Municipal Construction Markets.*" *Cardus*. October 25, 2012 Available here: <https://www.cardus.ca/store/3647/>

One of the best ways to signal that you are open to business is to remove any barriers that stand in the way of healthy competition.

RECOMMENDATIONS: TIME FOR TORONTO TO SIGNAL THAT IT'S OPEN FOR BUSINESS

There is no doubt that Toronto suffers from a number of significant challenges in its procurement of construction projects. One of the urgent challenges for Toronto, and indeed our cash and infrastructure-strapped province, is to communicate that it is open for business. And one of the best ways to signal that you are open to business is to remove any barriers that stand in the way of healthy competition. Strategically it makes sense to remove barriers that are obvious, that can be changed easily, and that have a direct effect on the price for services that would enhance the competitive environment.

Closed tendering is one of these barriers. It not only adds costs to cities and the province, but it stands in the way of securing the removal of another of Ontario's competitive barriers: its infrastructure deficit.¹²

To move forward, Toronto could undertake two small steps that, even in the absence of a just law on competitive tendering in the province, will signal their commitment to an open, fair, and transparent procurement process.

1. Toronto should support the Association of Municipalities of Ontario, and the Large Urban Mayor's Caucus of Ontario's call for competitive bidding in the province.
2. Toronto should commission an independent report by leading competition experts to review the current competitive environment in Toronto.

It's time for Ontario's leading City to remove the road-blocks and get itself and our province running again.

12 See: "Making Sense of Public Dollars: Ontario Government Revenue, Spending, and Debt." Working Paper 16. [Institute for Competitiveness and Prosperity](#). May 2013.



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