

# The Dangers of Procurement Protectionism

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Around the world, governments constitute the largest single consumer of private goods and services.<sup>1</sup> Among OECD countries, total expenditures on public procurement represented 12.9% of GDP in 2021. For Canada, that figure was slightly higher, at 13.4%<sup>2</sup> (see Figure 1). Because it represents such a substantial share of the tax burden shouldered by taxpayers, vulnerabilities within the procurement process, well-known to economists, can lead to substantial fiscal costs.

Over the past decade, the idea of restricting foreign firms from participating in public procurement has gained in popularity in high-income countries. Up until the recent trade tensions with the United States, Canada had engaged more sparingly in this practice.<sup>3</sup> Unfortunately, the federal and provincial governments have now moved toward adopting “buy national” rules for public procurement. This procurement protectionism could end up being quite costly for taxpayers.

### TYPES OF “BUY NATIONAL” MEASURES

There are multiple kinds of tools that can be used to engage in procurement protectionism. The most extreme is an outright ban on foreign participation. However, these do not appear to be



very common, especially among high-income countries such as Canada.

Less extreme measures include bid preferences in favour of domestic firms (or sometimes types of firms such as small businesses), which do not prohibit foreign actors outright. Often, a scaling factor is defined that helps the targeted type of firm compete.<sup>4</sup> Thus, other firms might end up losing despite having the lowest bids.

Similarly, foreign firms must often satisfy additional requirements. These are meant to drive up their costs in order to give an edge to domestic firms. This could include, for example, mandating the use of inputs from the country awarding the contract.

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These two latter types of procurement protectionism can sometimes be circumvented via a process known as “tariff jumping.” This refers to foreign firms avoiding tariffs by establishing a nominal local presence. It applies analogously to public procurement, with foreign firms creating a local subsidiary or entering into a joint venture to qualify as “domestic” and gain access to the bidding process.<sup>5</sup>

The federal government’s Buy Canadian Policy, which came into effect in December 2025, relies heavily on the latter two types of procurement protectionism. This policy “mandates the use of Canadian-produced materials (e.g., steel, wood products, and aluminum) in federal construction and defense procurements” and proposes a form of bid preference whereby Canadian suppliers are treated as being cheaper “for the purpose of evaluating their bids.” There are also mandatory set-asides to help Canadian small businesses compete.<sup>6</sup>

Moreover, this federal policy creates tighter controls to avoid tariff jumping. For example, to be an eligible Canadian supplier, firms must be registered to file taxes in Canada, maintain headquarters in

Canada, and not rely on sub-contracting to non-Canadian suppliers that results in “minimal value-added activities being performed in Canada.”<sup>7</sup> Provincial governments have engaged in similar types of procurement protectionism.<sup>8</sup>

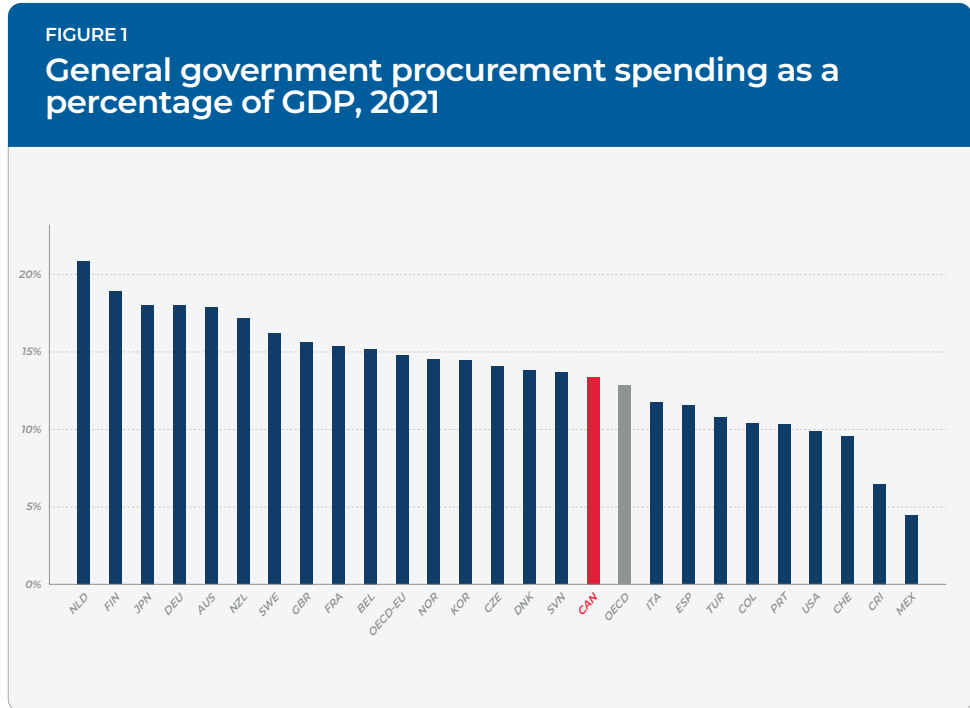
### THE PITFALLS OF PUBLIC PROCUREMENT

To understand the potential costs of this procurement protectionism, we must start with the usual problems related to public procurement: incomplete contracting, the potential for corruption, collusion between firms in the bidding process, and the shift in emphasis to political considerations.<sup>9</sup>

The first issue, incomplete contracting, is a common one related to monitoring the terms of a contract. For example, a public tender for running a prison is difficult to contract because the service has multiple dimensions (recidivism, cost, quality, the rights of prisoners, and so on) that are difficult to define. Competition between firms over time can help reveal imperfections in contract design and facilitate improvements.

Moreover, when contracts have termination dates with options not to renew, firms may exercise greater care in cost control and service quality, faced with the prospect of being replaced once the contract expires. This creates incentives for self-discipline that mitigate the size of the problem. Procurement protectionism has little direct connection to the problem of incomplete contracting, but it does relate to it indirectly by reducing the level of competition.

The second problem, corruption, emerges when firms bribe government officials and politicians to obtain a contract despite not being the best candidate. This is particularly relevant for countries with dictatorial regimes or limited state capacities. Opening public procurement up to foreign bidders reduces both costs and corruption. “Buy national” policies, in contrast, by creating larger payoffs for domestic firms facing fewer competitors, can incentivize them to bribe gov-



Source: OECD, Topics, Public Procurement, consulted February 11, 2026.

ernment officials of all types to obtain contracts. The result is that firms with lower costs but without the means to bribe must scale back their activities, and taxpayers are left with higher tax burdens.

**The federal government’s Buy Canadian Policy mandates the use of Canadian-produced materials and proposes a form of bid preference.**

The third problem emerges when firms collude to rig auctions in their favour.<sup>10</sup> However, because firms differ in their cost structures (for instance, some might be better at small projects but cannot scale up, and vice-versa), constraints (such as distance), or project-specific characteristics (favouring complicated or simpler projects, for example), the detection of collusion is difficult. For example, the usual gauge of collusion, stable market share, is problematic if such stability only illustrates natural market segmentation. Economists describe this as “asymmetric bidding”

because the firms are just naturally quite different.<sup>11</sup> The asymmetry makes collusion less likely because it is difficult to effectively police members of a cartel, though it also, as noted, makes it more difficult to detect.

This is why “buy national” policies may create significant collusion problems. While the asymmetries remain, the bid preferences reduce the number of active bidders and eliminate the threat of entry by foreign firms that may understand market conditions better than regulators. As a result, the remaining firms become more homogeneous and face less competitive pressure, making collusion easier to sustain between a smaller group of members while remaining sufficiently difficult to detect by bureaucrats, policymakers, and voters.

Finally, in the presence of some political discretion by political actors, the temptation to reallocate contracts to politically convenient players becomes significant. This aligns well with findings that political donations and political connections matter to the probability of successfully winning a procurement bid, and adversely affect the quality of services rendered.<sup>12</sup> This does not necessarily amount to corruption in the process, whereby politicians are receiving formal payoffs. Yet, in designing procurement protectionism, politicians are essentially exerting discretion by shaping the rules in ways that offer political rewards to domestic firms.

### INCREASED COST, REDUCED QUALITY

The empirical literature fuels serious concerns about the consequences of procurement protectionism. First, it is clear that *more* competition (from more bidders) in an auction has a positive effect on outcomes. An analysis of more than 1.3 million procurement auctions in Brazil between 2015 and 2018 found a strong association between the number of participants in an auction and the efficiency of delivery.<sup>13</sup> A similar analysis of the departments of transportation in the fifty American states showed that competition in bidding on government construction contracts lowered project costs significantly, with each additional bidder on a project reducing project costs by 8.3%.<sup>14</sup>

In yet another study, the World Trade Organization’s Government Procurement Agreement, which mandates that foreign suppliers be treated

no less favourably than domestic suppliers, was found to have significantly increased foreign competition and led to more cost-effective procurement.<sup>15</sup> These studies strongly suggest that procurement protectionism by Canadian governments will most likely increase costs and reduce quality.

There is also a large battery of key empirical results regarding the mechanisms by which procurement costs may be driven up. One study found that while there was a positive correlation between sales to government and indicators of firm performance, this correlation was stronger in countries that were more open to foreign participation. The implication is that foreign competition in tendering forces local firms to level up their game in order to remain viable candidates.<sup>16</sup> The presence of potential entrants into the procurement market thus forces local firms to be more innovative in cutting costs to remain competitive. Reducing competition will thus have the dynamic effect of relaxing the incentives firms face to control costs.

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With respect to bid preferences, California created a program for state-funded projects in which resident small businesses were offered a 5% bid preference over non-resident firms. This ultimately increased total procurement costs on these projects by 3.6% as large firms that were more competitive left the market.<sup>17</sup> A later study applied a different approach to the same program and found a smaller but still non-negligible 1.4% increase in costs.<sup>18</sup> For purposes of illustration, adopting a California-like program for all procurement spending in Canada in 2021 would have increased costs per Canadian by between \$124 and \$320<sup>19</sup> (see Figure 2).

Another study concerning Buy American provisions on U.S. federal government procurement found that the policies did generate more activity for American businesses at the expense of foreign ones. However, the net cost was between

\$111,500 and \$137,700 per job, far in excess of the average income of Americans.<sup>20</sup>

There is also evidence that large corporations with politically connected board members are more likely to be rewarded in public procurement—or punished if they support the opposing party.<sup>21</sup> A study examining Lithuania’s ban on corporate donations to electoral campaigns found that after the ban, firms that had previously donated experienced a 5-percentage-point decline in their probability of winning public procurement auctions relative to firms that had not donated.<sup>22</sup>

This is consistent with notions of political favouritism and discretion in contracting, which raise costs for taxpayers. Procurement protectionism may end up having a similar effect, creating rules that systematically favour a select group of firms whose economic support, employment base, or political alignment offers indirect rewards to politicians with extra burdens for taxpayers.

Finally, there is evidence regarding the possibility of corruption, even for low-corruption countries like Canada. Using data from Sweden, another low-corruption country, one study looked at the size of city councils to identify the effect of the number of politicians on corruption.<sup>23</sup> The underlying mechanism is straightforward: as governments grow larger, individual accountability weakens, responsibility becomes more diffuse, and coordination among monitors deteriorates,

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FIGURE 2

### Projected increase in procurement costs per Canadian, 2021, with California-like bid preferences



**Sources:** Author’s calculations. Justin Marion, “Are bid preferences benign? The effect of small business subsidies in highway procurement auctions,” *Journal of Public Economics*, Vol. 91, Nos. 7-8, August 2007, p. 1620; Elena Krasnokutskaya and Katja Seim, “Bid Preference Programs and Participation in Highway Procurement Auctions,” *American Economic Review*, Vol. 101, No. 6, October 2011, p. 2656. Statistics Canada, Table 17-10-0005-01: Population estimates on July 1, by age and gender, September 24, 2025; Statistics Canada, Table 36-10-0222-01: Gross domestic product, expenditure-based, provincial and territorial, annual (x 1,000,000), November 6, 2025.

all of which increases the scope for corrupt behaviour. This study found that larger governments tend to be vulnerable to corruption and concluded that Sweden had “non-trivial” corruption problems.

**Procurement protectionism ends up reducing competition for bids, leading to costlier projects and less efficient results.**

Procurement protectionism exacerbates this problem, as less competition means larger possible rents for winning firms, which can in turn offer to share some of the spoils with politicians and bureaucrats. A second study found that more corrupt areas of Sweden tended to engage in undisclosed bid preferences in favour of local firms by rigging the bidding process, and thus had higher procurement costs.<sup>24</sup>

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## CONCLUSION

Procurement protectionism ends up reducing competition for bids, leading to costlier projects and less efficient results. In the end, taxpayers and service consumers are left worse off. Canada should instead follow the generally shared suggestion in the empirical literature, which is that it is preferable to make procurement rules more open, with lower entry costs, a more transparent bidding process, and efforts to invite more firms to participate in the process.<sup>25</sup>

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