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The National Shipbuilding Procurement Strategy and the ‘Ambition-Capability Gap’

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The decision of the Harper government to ‘push the reset button’ on the fighter replacement program did much to temporarily anesthetize, or, at least, to divert, media, public, and political attention from the travails of Canadian defence procurement. The debate over the most credible successor to the CF-18 will, in due course, be rejoined, but in the meantime—and possibly long after the fighter dust settles—the spotlight has shifted to naval procurement. Much of this attention has focused upon specific projects within the broader National Shipbuilding Procurement Strategy (NSPS), including the Joint Support Ship (itself “reset” on multiple occasions over the years), and, most notably, our old friend, the Arctic/Offshore Patrol Ship (AOPS). A not-unimportant initiative, given the growing geo-strategic and economic significance of the Arctic and the RCN’s lamentably limited ability to operate in the region, AOPS has nevertheless been derided by more than a few critics as an ill-conceived ‘slushbreaker’ of decidedly modest utility. Recent media accusations of wildly inflated design costs have further damaged its reputation. Criticisms of AOPS and JSS are not new, but it is noteworthy that the National Shipbuilding Procurement Strategy, which, for the most part, generated rave reviews when it was unveiled in June of 2010 (Jeffrey Simpson of the *Globe and Mail*, for example, posited that the Harper government had broken with Canadian shipbuilding tradition—“50 per cent engineering, 50 per cent politics”—in “exemplary fashion”), is now receiving deeper and not always

positive analysis. Further attention to the NSPS as a whole is neither inappropriate or unwelcome—it does, after all, embrace the rebuilding, at considerable cost, of almost the entirety of the RCN—but an even broader debate about ambitions, capabilities, and Canadian maritime strategy is arguably in order.

A representative sampling of the recent literature includes an audit of the NSPS in the Fall 2013 Report of the Auditor General of Canada (followed shortly thereafter by additional responses from Public Works and Government Services Canada), and a blunt December 2013 critique of the NSPS by Michael Byers and Stewart Webb (Canadian Centre for Policy Alternatives and the Rideau Institute, *Blank Cheque: National Shipbuilding Procurement Strategy Puts Canadians at Risk*). The latter was quickly followed by a no-less-blunt response from Seaspan ULC and Irving Shipbuilding Inc.

More technical, narrowly focused contributions to the debate have included two reports from the Parliamentary Budget Office: *Labour Sensitivity Analysis for the Acquisition of Two Joint Support Ships* (11 December 2013), and *Feasibility of Budget for Acquisition of Two Joint Support Ships* (28 February 2013). The latter drew considerable media attention with its assertion that “the cost of replacing the current [*Protecteur Class*] AORs with two analogous ships built according to Government procurement rules in Canada” would cost significantly more than the DND estimate. The PBO report also concluded, not surprisingly, that “producing a [third



Rendering of a concept design of the Arctic Offshore Patrol Ship (AOPS).

AOR] does not significantly add to program costs, as most of the costs are incurred during the development phase.”

Generally positive, the Auditor General’s appraisal of the NSPS concluded that “National Defence, Public Works and Government Services Canada (PWGSC), Industry Canada, and Fisheries and Oceans Canada have designed and are managing the [NSPS] in a way that should help sustain Canadian shipbuilding capacity and capability. In addition, the NSPS should help the government to procure federal ships in a timely, affordable manner, consistent with the build-in-Canada shipbuilding policy.” On the naval front specifically, the OAG concluded: “National Defence and PWGSC—in consultation with the Treasury Board of Canada Secretariat—are, to date, managing the acquisition of military ships in a timely and affordable manner following the National Shipbuilding Procurement Strategy.” The report also observed that the earlier “competitive process for selecting two shipyards that was led by PWGSC resulted in a successful and efficient process, independent of political influence, carried out in an open and transparent manner.”

The OAG’s report advanced three recommendations. First, that PWGSC “should review the [NSPS] request for proposal process, including the negotiations with the successful bidders, to ensure that lessons learned are captured, examined and considered for application in future complex procurements and strategic sourcing arrangements.” Second, that PWGSC, “...supported by Industry

Canada, National Defence, and Fisheries and Oceans Canada, should regularly monitor the productivity of the shipyards in terms of competitiveness, cost-effectiveness, and efficiency, including measuring progress against the target state.” And, third, that DND and PWGSC, “...working with the Treasury Board of Canada Secretariat, should ensure information to Treasury Board ministers includes updated information on changes to costs, capabilities, and schedules and should request additional authorities, as required.” All three recommendations were accepted by the relevant departments. Indeed, the recommendations and findings from the OAG were cited with considerable frequency in PWGSC’s 26 November 2013 response to a series of Frequently Asked Questions, as well as in the Seapan-Irving response to the Byers-Webb report.

Although the OAG’s report necessarily examines a wide variety of issues, its most fundamental point—certainly from a wider maritime strategy and defence policy perspective—quite correctly centres upon what could be deemed the ‘ambition-capability gap’. Noting that “complex developmental projects,” such as naval vessels, “require years to design and build,” the report stresses: “...[that] it is important that any gap between the government’s level of ambition and the Royal Canadian Navy’s capability is regularly measured and minimized. Canada’s last general policy statement on its expected level of ambition was in 2008, through the Canadian First Defence Strategy (CFDS). While the CFDS did outline the expected number of Navy ships and the core missions for the Canadian [Armed] Forces, it did not define the specific naval

capabilities required to fulfill the government's level of ambition." In the opinion of the OAG, "...a gap appears to be developing between the CFDS level of ambition, the evolving naval capabilities, and the budgets. National Defence should continue to monitor the extent to which it will or will not meet the government's expectations for future military needs, and continue to report to ministers on expected capability gaps, allowing the government to make adjustments to expectations and capabilities." The report also observes: "[that] because budget caps were established early in the planning process, National Defence has reduced the expected number of military ships or their capabilities to remain within budget. As a result, cost/capability trade-offs need to be monitored and revisions made to project budgets, if necessary, to make sure that Canada gets the military ships it needs to protect Canadian interests and sovereignty." The manner in which the 'ambition-capability gap' is bridged will shape the RCN and Canadian maritime strategy for decades to come.

The report of the OAG also takes note of government declarations dating back to 2001 that Canada "would continue to procure, repair, and refit ships in Canada." It consequently focuses its attention upon whether relevant departments "...have designed and are managing the NSPS to procure federal ships in a timely and affordable manner, in a way that will help sustain Canadian shipbuilding capacity and capability," and does not explicitly enter the debate over domestic versus offshore sourcing. The PWGSC document of 26 November 2013, however, provided a staunch defence of domestic sourcing, arguing that the NSPS "...will bring predictability to federal ship building and eliminate cycles of boom and bust in the shipbuilding and marine industries," and generate "...good long-term jobs in all regions of the country. In addition to ship construction, parts, sub-assemblies, equipment and specialized services will be required to develop long-term sustainable supply chains, creating significant opportunities for Canadian companies of all sizes. It is estimated that the [NSPS] will create 15,000 jobs and generate over \$2 billion in annual economic activity." Building in Canada, "... provides protection

against risks, including through-life cost increases, availability of engineering information (for support/refit/upgrade work] and assured access to and security of future supply (sovereignty capability)." These are valid points. Indeed, the list could be buttressed by the assertion that offshore sourcing and the concomitant loss of Canadian employment would erode public support for defence spending and the retention of a credible navy. That said, recent foreign moves, such as the United Kingdom's decision to build four BMT-designed *Aegir* Type replenishment vessels in South Korea, at an attractive price with prompt delivery, have drawn attention to the potential merits of offshore construction for naval vessels of some types. Norway has taken a similar route for its forthcoming replenishment vessel. The production locale of the two *Queenston* Class Joint Support Ships is now effectively moot, but as the NSPS progresses, one should anticipate ongoing (and important) debate over the quantity and quality of the Canadian employment opportunities generated, directly or indirectly, by systems integration, the production of electronic systems, subsystems, and components, and the production of the myriad other components of a modern naval vessel.

In *Blank Cheque*, for example, Byers and Webb acknowledge that the stated goal of the NSPS to "provide long-term certainty" for Canada's shipbuilding industry "might well occur, but only at a much greater cost than is necessary." For the Harper government made a serious mistake by confining the only truly competitive portion of the NSPS to the choice of shipyards, which are both, effectively, also in the position of position of 'prime contractors' now. "As prime contractors, Irving and Seaspan will be free to select the 'system integrators' which coordinate various aspects of the procurement, including the selection and acquisition of communication, sensor, and weapon systems." "[The] shipyards, together with tier appointed system integrators, will also select the various sub-contractors who design and equip the vessels. The only restriction on these selections will be that the designs and equipment must meet the requirements of the RCN and CCG—



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Another perspective of the Thyssen/Krupp JSS submission.



Rendering of a concept design of the Canadian Surface Combatant Ship.

requirements that in most cases have yet to be set. The selection of a sub-contractor need not be made on the basis of best value, but may instead be determined by other factors such as the shipyard's 'familiarity' with a particular company. And those decisions, made by the shipyard, will have significant impacts on the ultimate cost of the ships. In essence, this means that the Harper government has issued blank cheques to Irving and Seaspan."

In response, Seaspan and Irving Shipbuilding labeled the study "grossly inaccurate" and "misleading," and pointed to "23 specific factual errors." Further, the OAG "... concluded that, through the NSPS, the Government is managing the acquisition of military ships in a timely, affordable, efficient, and transparent manner that will support the shipbuilding industry for years to come. All of our contracts and agreements with Canada include performance and capability improvements milestones based on independently validated benchmarking; specific value proposition commitments that will benefit the Canadian Marine Industry; as well as a genuine commitment to open-book accounting." Moreover, "detailed estimates for vessels are submitted to the Government, who then validate the information using third party expertise. Ships are fully designed before final quotes are determined so the greatest certainty is known in the costing. Fully designing the ship before start of production also reduces errors and rework, which reduces the overall vessel cost. We were well aware going into NSPS that if we don't perform on-time and on-budget, Canada has no commitment to give us further contracts. This is a significant way for Canada to de-risk the project..."

At this comparatively early juncture, it would be imprudent to offer more than a preliminary assessment of the massive undertaking that is the National Shipbuilding Procurement Strategy. The

reviews to date—in large measure anchored by the findings of the Office of the Auditor General—have been commendably solid and encouraging but, as the reservations registered by such analysts as Byers and Webb remind us, the breathtakingly stellar reviews that greeted the launch of the NSPS in 2010 were never destined to last forever. Nor is it less true for being obvious that countless challenges remain...and will endure over a protracted period of time. Should noteworthy issues, for example, develop with private sector contractors, their practices or their performance, or should future OAG reports identify noteworthy issues with NSPS management and governance at the bureaucratic level, the result could only be a serious, perhaps profound, loss of public, media and political confidence and support. If doubts should grow with respect to the quantity and quality of NSPS-generated employment in Canada, or about the level of technology transfer to Canada—particularly at a time when our broader manufacturing sector has already absorbed heavy blows—confidence in NSPS (and, in a broader sense, naval modernization) would again be eroded. Above all, we should take particular heed of the OAG's references to a perceived 'ambition-capability gap'. If credible measures are not taken to address that gap—and if the powers that be fail to convince the broader public of the merit and the need for those measures—the RCN surface fleet of the future could be confined to a handful of AOPS, two more-or-less standard AORs and a rump of Canadian Surface Combatants.

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