Local Procurement
May 2018
Introduction

The advocates of local procurement suggest that governments should use their buying power to support local businesses in the hope that this will grow the local economy. This model has received increasing interest in the UK recently, with experiments taking place in Preston, Greater Manchester and Doncaster.

This briefing covers the theory behind local procurement and considers the available evaluation evidence for it as a tool for local growth.

What are the arguments for local procurement?

There is a simple and attractive rationale at the heart of the argument for local procurement. Local governments in England spend a great deal of money — over £45bn was spent across all forms of procurement in 2013. Advocates for increasing local procurement argue that spending more of this money in an authority’s own economy will benefit local businesses and protect local jobs. They will in turn spend more money in the area, and the local economy will grow.

Using Preston as an example, the argument goes that if the council employs a Preston construction firm for a local building project, that firm is more likely to source supplies from neighbouring businesses, and their staff will provide more business for local cafes and shops. If a firm from outside Preston wins the contract — let’s say one based in Sheffield — more of their supply chain spending and salaries will be in Sheffield. The economy there will benefit instead.

What evidence do we have?

There is no evaluation evidence that considers whether local procurement strategies generate local economic growth. We were not able to find any robust evaluations of a local procurement scheme which met our standards for evidence: www.whatworksgrowth.org/resources/scoring-guide.

We were able to source two evaluations on the use of procurement preferences with a different objective: to support firms owned by minority groups in the United States. One study found small positive benefits (a 5% rise in contracts going to minority groups in a California study). The other less robust study found negative effects (the success rate of bids by black and Hispanic-owned business fell under a New Jersey set-aside programme).
Although this evidence is mixed, it does suggest that, at the most basic level, using procurement preferences to increase the flow of funding to targeted businesses may work in some cases. The degree to which these limited findings are applicable to local procurement is unclear, but if they carry through it suggests that targeting procurement policies to favour local businesses could increase the amount of spending in the local economy in some cases.

However, this does not answer the question of whether favouring local businesses when making procurement decisions is a cost-effective way of growing the local economy. The opportunity cost of paying more for goods and services, as well as the unintended consequences of geographical preferences, have not been the subject of robust evaluation.

In the absence of evaluation evidence, the rest of this briefing digs deeper into the conventional wisdom that underpins local procurement schemes and provides a more complete picture of the likely effects. To do this, it draws on available empirical evidence and economic theory.

**Legal Considerations**

Research on local preference procurement has been complicated by European and British law on procurement restricting the ability of local authorities to discriminate on the basis of place, and also the difficulties in identifying such discrimination. For instance, while 46% of EU businesses who replied to an EU commission survey stated that local preferences were highly influential in the outcome of public procurement, none were able to provide any concrete evidence.

In the UK, interest in local preference procurement has increased since the Social Value Act 2012, which opens up a broader usage of the word ‘value’ for local authorities to consider during the procurement process.

The definition of ‘value’ in the Social Value Act – allows consideration of how procurement might ‘improve the economic, social and environmental well-being of the relevant area’. This is not necessarily incompatible with a ‘most economically advantageous’ (MEAT) approach to procurement. The cheapest contract will not always provide the best economic value, and factors such as life-cycle costs, the environment, and the quality of public services should be considered.

However, in practice defining “local value” might be more difficult than it first seems. In addition, legally, it is not clear at what point social value might come into conflict with MEAT. Local authorities that pursue a strong preference for social value over MEAT may risk opening themselves up to legal challenge on the basis of discrimination.

Post-Brexit, our procurement regime may change, although we will likely enter into an arrangement similar to the Agreement on Government Procurement (GPA). The GPA will, like European law, still limit the legal ability of local government to discriminate based on location.

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Implications

There are a number of issues which should be taken account of when considering this type of policy:

• **Higher procurement costs**

As public sector procurement is generally bound to accept the lowest bid (see box on legal), giving preference to local companies will mean higher costs (if local companies were offering the best prices they would not need preferential treatment). Councils should consider whether this money would be better spent on other, more direct forms of economic development policy to achieve growth.

• **Local procurement reduces competition and may further raise procurement costs**

‘Non-local’ firms may exit the market for local procurement if they are less likely to win a contract due to local procurement rules. This reduces competition in the procurement process. With less competition, innovation and value for the taxpayer from the public spend are likely to decline.

In extreme circumstances, a preference for local firms may emerge as a symptom and cause of corruption and capture by local politicians. In evaluating the impact of Italian municipal reforms, researchers found evidence of a relationship between the length of tenure of local mayors, more local firms winning contracts, fewer bidders per auction, and higher procurement costs.5

• **‘Local’ is difficult to define and potentially misleading**

Across the UK, 47% of people in work commute across local authority boundaries to get to their job. These employees may be hurt by local procurement practices if their employer is not considered ‘local’ enough to qualify for contracts.

In addition, the devil is in the details of defining what constitutes a local firm. Does an outsider-owned firm based locally count as local? Does a locally-owned firm with operations outside the local area score as local? Economic relationships are complex, and attempts to delineate them based on political boundaries is likely to be problematic.

• **Local procurement is not scalable**

If a local authority implements a local procurement policy, the surrounding area will necessarily lose out as their firms have less access to contracts in that authority. In response, these surrounding local authorities may decide to retaliate and impose their own local procurement strategy.

In other words, if one locality manages to reduce the amount of money “leaking” from procurement to non-local firms, that results in other localities experiencing a reduction in the amount of money flowing into their community. In cases where these places losing out are in the UK, local procurement preference amounts to a zero-sum game.

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Evidence on solutions

While local procurement may prove problematic, there are alternative ways that local policy makers can improve the performance of local businesses in the local procurement process.

Improving SME participation in procurement bids would go partway to accomplishing some of the proposed goals of local preference participation, without the associated costs to economic growth and welfare. SMEs report facing multiple barriers to winning government contracts, including poor knowledge about the opportunities available, uncertainty about how to apply, and the expense of the bidding process. There are more direct approaches to helping SMEs overcome these barriers and it would be good to see a number of these piloted and tested in the UK.

More generally, improving performance of local SMEs will also improve their competitiveness in the local procurement process. The evidence base for business support policies is much more advanced than that for local procurement, and is available on our website.

Conclusion

Although there has been heightened interest in local procurement, the evidence base for the viability of these policies remains poor. In particular, the risk that local procurement may hurt the income of local residents employed by non-local firms, the higher costs to local authorities, and the inability of the policy to scale due to retaliation all urge considerable caution on the ability of such policies to deliver local economic growth.

Cities and local authorities can and should consider elements outside the traditional cost-benefit analysis such as the environment, skills, and innovation when engaged in local procurement, but it is not clear that the location of the firm should be one of them. Local authorities interested in piloting and testing alternative approaches to facilitating SME participation in local procurement processes are encouraged to get in touch.

Annex: Evidence on Local Procurement Policies

We looked for evidence on the impact of local procurement policies on wages or employment.

We found no evaluations on the impact of local procurement policies that meet our minimum standards. We found two evaluations on the use of procurement preferences with a different objective: to support firms owned by minority groups in the United States. One study finds small positive benefits (a 5% rise in contracts going to minority groups in a California study) – and one less robust study finds negative effects (the success rate of bids by black and Hispanic-owned business fell under a New Jersey set-aside programme).

Study 1 (SMS 4) analyses the effectiveness of affirmative action in highway procurement at increasing purchases from disadvantaged business enterprises (DBEs are for-profit small business concerns where socially and economically disadvantaged individuals own at least a 51% interest and also control management and daily business operations). Using project-level data with information on highway construction auctions conducted by the California Department of Transportation between 1996 and 2002, the study exploits the variation in projects’ DBE goals using an instrument constructed from the average goal during the same year but for other projects in distant parts of the state. This study finds that raising the affirmative action goal on a project by 10 percentage points increases the fraction of the contract value subcontracted to DBEs by 5.4 percentage points.
Study 2 (SMS 1) analyses the award of public procurement and construction contracts to women-owned and minority-owned business before and after the imposition of a state minority set-aside programme introduced by the state of New Jersey in 1990. A survey was conducted among business and the data used to compare differences between characteristics of the businesses and relevant outcomes for minorities vs. non-minorities. The study finds that the programme did not reduce the original discrimination, nor did it benefit minority businesses. In fact, the success rate of bids by black and Hispanic-owned business fell under the set-aside programme.

References

