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TOPIC:

LOCAL PREFERENCE IN PUBLIC PROCUREMENT

The Importance of Best Value Analysis When Government has Adopted Local Procurement Preferences

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LOCAL PREFERENCE IN PUBLIC PROCUREMENT

A position paper from NIGP: The Institute for Public Procurement
On the Importance of Applying a Best Value Analysis When Government Has Adopted Local Procurement Preferences

INTRODUCTION

There is a long-standing history of implementing various socioeconomic preference programs in government on the federal, state and local level. Such selective purchasing, in the case of local preference, is a decision by the government to direct purchases to certain companies based on location. The local preference program is one such program that has generated interest for its impact on the public procurement process. Local preference programs have been established and promoted to benefit the local economy. Upheld by federal and state laws when established to achieve the state interest, the use of such local preference programs present advantages and disadvantages for governments in their quest for quality, savings, fairness, and efficiency in the procurement of goods and services.

In general, local preference programs may include, but are not limited to, preferences applied as described below. These preferences are highlighted as vehicles to improving socioeconomic levels in, and adding benefits to, local economies.

- Tie-bids - when the bid of a local bidder is the same amount of that of a non-local bid;
- Percentage bids - when the local bidder's bid falls within a certain percentage of that of the lowest bid by a non-local bidder;
- Reciprocal bids - when the local bidder's bid is reciprocal to that of a bid of non-local bidder; and
- Absolute bids - where the bid is awarded to the local bidder even if it is not lowest bid.

Any profession, when establishing its ideals, begins the process by considering the perfect situation and identifying the fundamental tenets that will contribute to achievement of *the perfect situation*. For procurement professionals, that situation is evidenced by a well-developed market of many buyers and sellers; perfect knowledge of the goods or services required; and sufficient lead time to conduct a fair procurement. In reality, the principles guiding public procurement's best practices must often consider social, political, and economic realities.

Adequately reconciling local preference policies with public procurement's guiding principles of fostering full and open competition, best value, equity, and impartiality has historically proved challenging. Through this paper, NIGP takes on that historic challenge to articulate a position that is at once principled and practical.

POSITION

NIGP: The Institute for Public Procurement maintains the position that preference policies, including local preferences, conflict with the fundamental public procurement principles of impartiality and full and open competition. Therefore, NIGP *does not support the use of preference policies.*

Conversely, NIGP does support economic, social, and sustainable communities as part of the Institute's values and guiding principles. Acknowledging that governments may in fact adopt local preferences as a tool for improving local economies, *NIGP recommends that any local procurement preferences be implemented only as one of several criteria in a 'best value' evaluation and award process*. Best value means the most advantageous balance of price, quality, and performance identified through competitive procurement methods in accordance with stated selection criteria. There is no uniform statutory or regulatory definition, but it generally refers to a source selection based upon a cost/benefit analysis. The application of best value procurement to local purchasing preferences extends the concept of considering non-cost items in the evaluation process, and thereby provides the rational basis for including a geography-based criteria.

WHAT IS LOCAL PURCHASING?

Local purchasing is a bid preference which may be given to suppliers doing business in the purchasing jurisdiction (NIGP, 2009). Local purchasing is often promoted as a means of benefiting the local economy.

ADVANTAGES AND DISADVANTAGES OF LOCAL PREFERENCE PROGRAMS

Local preference programs have been met with qualified acceptance in the procurement community. Communities implementing preference programs have identified both advantages and disadvantages of such programs. Proponents claim advantages that include the following: (1) achieving local social policy goals to assist the local economy, and (2) improving and protecting the local economy. While procurement expenditures may rise in response to a local preference program, governments believe the additional costs are outweighed by the support for the development, enrichment, growth, expansion and the retention of the local business community, thereby keeping any tax dollars spent on contracts in the area.

Conversely, critics have been vocal about the disadvantages of such programs, such as: (1) increased cost to the local taxpayers and government to implement such a program; (2) limiting supplier competition; (3) reducing the incentive for local businesses to provide the best value for the dollar for the purchased goods/services; (4) affecting, complicating and potentially burdening the procurement administrative processes; (5) defining a defendable fair process to determine the definition of a local business including, but not limited to, geographic location requirements, management and ownership control, if necessary, and (6) lacking equal opportunity or reciprocity with other jurisdictions.

Literature Review

Research by Glenn Cummings (2009) published in the *Journal of Public Procurement* surveyed state and local procurement preferences. The survey documented the range of geographic preferences practiced by state and local governments, usage patterns and trends, and analyzed their impact on the recipients and on the public procurement process. The preference laws were enacted in the belief that social and political benefits from these programs exceed the cost arising from restricted competition. Furthermore, a 2009 study by the National Association of State Purchasing Officials (NASPO) reported that 27 states gave preference to resident bidders for government contracts.

Academic research studying the impact of local procurement preference laws is not extensive. However, there is consistent evidence that the economic impact sought through preference laws can be achieved. The 2008 study, *Local Preference in Municipal Audit Markets*, conducted by the Owen Graduate School of Management at Vanderbilt University concluded that a local preference law can serve its purpose, in that it always increases the likelihood that the local firm wins (Shor, July 2008). The model used by the author "demonstrates that insiders benefit from a local preference at a cost to the outsider through a lower chance of winning and a cost to the municipality through higher average prices" (Shor, 2008).

An honors thesis presented to the Department of Economics at the University of Oregon reviewed several scenarios examining the impact of local procurement preferences on the local economy as well as the market impact. Based on the study models, the authors identify an increase in employment in the local economy. The positive effects stemming from local preferences could, however, come with associated costs. Depending on cost differentials between local and non-local firms, the policy creates the potential for higher consumer prices, decreased demand, reduced spending, and job loss (Lorelli, June 2003).

Bid preferences were studied by the University of Pennsylvania, Department of Economics and the Wharton School. The study authors found that preference programs result in high-cost companies performing a larger share of work and increased procurement costs. However, these programs also provide incentives to non-favored firms to bid more aggressively, offsetting the upward price pressures (Seim, April 2009).

The use of local preferences in North Carolina was studied in 2011; a year after the Governor had signed an executive order for such preferences. A survey of localities indicated that local preferences were awarded equally among informal purchases for services, goods, or small construction. Survey respondents indicated that goals of preference policy were understood to be promotion of local businesses, job creation, increased tax base, sustainability and wealth creation (Jensen, 2011).

The Government Finance Review (June 2012) conducted a comprehensive review of local preference policy outcomes in both cities and counties. In cities, the preference given to local businesses ranged from 1 to 5 percent, with 5 percent being the most frequent. Counties tended to afford higher percentage preferences to local businesses, 5 to 10 percent. Not surprisingly, cities that maintain local preference policies identified 'local businesses' as those with city business licenses and locations within city limits. Correspondingly, counties that established local preference policies applied the same standards for licensing and locations. One of the main differences between city and county preference policies is that a greater number of counties have reciprocal arrangements with other counties.

Extensive research was conducted in Europe, where progressive integration of social objectives with traditional procurement practices is more readily accepted. The New Economics Foundation (NEF), an independent think tank that promotes innovative solutions in economic, environmental and social issues, released a report on local procurement preferences in 2005. The NEF established an economic case for promoting revitalization through public spending. The revitalization benefited the community through poverty reduction, increased social inclusion, and governmental savings through local procurement preferences. NEF findings indicate that local preference laws kept money circulating in the local economy by fostering local economic linkages and raising the capacity and expertise of local residents and suppliers (NEF, 2005).

Anecdotal or paid consultant studies depict a consistent perspective on the issue. Civic Economics, an economic analysis and strategic planning consultancy focused on developing healthy, sustainable economies, has conducted research on behalf of Arizona and other communities. The reports produced by Civic Economics supported the use of local suppliers as they generate greater economic activity than chain suppliers (Civic Economics, 2007). The applicability of the report is limited as it studies a single retailer, not a statistically valid sample. A Special Report prepared by the Florida TaxWatch (2009) estimated one local job loss for every $100,000 worth of online shopping from other states and countries.

Interestingly, the most staunch opposition to local preference policies comes from procurement professionals. NIGP issued Resolution 1016 in 1987, re-affirmed in 1995, that stated the Institute is, “opposed to all types of preference law and practice and views it as an impediment to cost effective procurement of goods, services and construction in a free enterprise system.” (NIGP, 1987) NASPO, likewise “believes that public procurements should be made under conditions that do not restrain markets and that foster adequate competition in the market for the item or service purchased” (NASPO, 2010).

Multiplier Effect

The economic benefit of keeping local dollars in the local economy is known as the ‘multiplier effect.’ The concept was developed by John Maynard Keynes in collaboration with other economists in the early twentieth century and is used as a means of measuring the economic impact of laws, trade, etc. Simply put, it is a way the government’s spending ripples through the economy. The Keynesian model was developed for a national economy. The NEF adapated the model for use at the local level (local multiplier LM3). The ‘3’ represents three ‘rounds’ of spending. Round one is the orginal source of the funds or the budget, round two is the public body expenditure, and round three captures how the recipients spend the money within the local area. As local tax dollars are spent in a local economy, more jobs are maintained or created and income is generated for residents.

Legal Foundation for Local Preference Laws

Under the federal constitution, local preferences in public procurement typically implicate the commerce clause of Article 1, §8 and the equal protection and due process clauses of the Fourteenth Amendment. The courts have found that states violate the commerce clause when they act to regulate commerce to benefit in-state economic interests. However, in situations when the state acts as a market participant, similar to private actors in the market, it is immune from attack. To survive an equal protection challenge, a state must produce credible evidence at trial that the classification created by the local preference scheme is rationally related to such legitimate state interests. The courts, as they have reviewed the equal protection and due process clauses have applied the “rational basis” legal test. Under this test, “legislation is presumed to be valid and will be sustained if the classification drawn by the statute is rationally related to a legitimate state interest” (City of Cleburne, Texas v. Cleburne Living Center, 105 S.Ct. 3249, 3254 (1985)).

24 CFR[1] PART 85, Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments, identifies a number of procurement standards that apply to the expenditure of federal grant funds. Of note is the prohibition of using “statutorily or administratively imposed in-State or local geographical preferences in the evaluation of bid or proposals, except in those cases where applicable Federal statutes expressly mandate or encourage geographic preference.” Consequently, state and local grantees may not use valid local preference laws when the procurement is funded by the federal government.

The Arizona Superior Court, Pima County, ruled on the legality of local preferences in November 2014. The Court analyzed the constitutional challenges to the Tucson procurement code that provided a

[1] “CFR” is the Code of Federal Regulations.

preference for certain bidders of goods and services purchased by the city. The Court found that the preference law violated the Gift Clause of the Arizona Constitution, the Equal Privileges and Immunities clause of the Arizona Constitution, the Federal Equal Protection Clause and the Privileges and Immunities Clause of the United States Constitution. The basis of the finding was that the law was not reasonably related to furthering a legitimate state purpose, discriminated among bidders for government work/services and granted a direct taxpayer subsidy to certain preferred bidders and the City received no direct consideration in return.

CONCLUSION

Upon review of the issue, NIGP maintains the position that local preference policies are in conflict with the fundamental public procurement principles of impartiality and full and open competition and, therefore, *does not support the use of local preference policies as an appropriate tool for improving local economies*.

However, acknowledging that governments may, in fact, adopt local preferences as a tool for improving local economies unless otherwise prohibited by federal court preferences, *NIGP recommends that local procurement preferences are reflected as one of many criteria in a 'best value' evaluation and award process*. Best value means the most advantageous balance of price, quality, and performance identified through competitive procurement methods in accordance with stated selection criteria. There is no uniform statutory or regulatory definition, but it generally refers to a source selection based upon a cost/benefit analysis. The application of best value procurement to local purchasing preferences extends the concept of considering non-cost items in the evaluation process, and thereby provides the rational basis for including a geography-based criteria.

APPENDIX A

DEFINITIONS

A **local preference** occurs when a local firm is favored in a procurement over non-local firms for reasons unrelated to the procurement itself, typically to support the local economy.

Preference policy is a mandate by policy or ordinance that imposes legislative requirements in the public bidding process to award contracts to local suppliers.

Selective purchasing is a decision by the government to avoid buying from certain companies based on their political, social, environmental, or in this case, geographical attributes.

A **multiplier effect** is created when local economic activity is enhanced by a change in government spending. This relationship is recognized as a multiplier effect in that an initial incremental amount of spending can lead to increased consumption spending, increasing income further and hence further increasing consumption, etc., resulting in an overall increase in local economic activity greater than the initial incremental amount of spending. Certain types of government spending crowd out private investment or consumer spending that would have otherwise taken place. This crowding out can occur because the initial increase in spending may cause an increase in interest rates or in the price level. Effectiveness is based on economic linkages that cause funds to be retained in the local economy – not 'leaked' out to other districts.

TYPES OF LOCAL PREFERENCE PROGRAMS

- "Second chance" bidding for local firms
- Bidding or value "credits" that augment a local firms' actual bid for the purpose of bid comparisons, such as percentage preferences (typically 1.5% to 10%)
- Tie bid – allowing local firms to trump in a tie bid situation
- Reciprocal – jurisdiction 'matches' the type and scope of preference enacted in locality where the bidder is based
- Absolute **-** requires jurisdiction to purchase certain commodities within designated area

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