Research for new economic policies

# Public Procurement Policy: Real Value for Money

## Introduction

The global recession caused by a failure of financial markets, excessive leverage and risk taking has, perversely lead to reduction in public expenditure across most western economies. This seriously flawed policy has furthered economic distress and limited the power of state investment as a vehicle for economic renewal and sustainability. While this paper rejects the theory of expansionary fiscal contraction, it is very clear that there has never been a more important time to get value for money from public expenditure. “Value for Money” is a term often abused in public finance and the definition is frequently limited to the theory of cost minimisation rather than benefit maximisation. While much of state spending is used on government services provided directly by public and civil servants, an increasing amount is spent by the government buying in external services and products, known collectively as public procurement. A cursory glance at the figures surrounding public procurement shows that the power of state spending is not only felt in the “public sector” but in the private sector too. Governments often account for the largest consumers of certain products and services in the economy, the NHS as the largest purchaser of medical equipment in the UK for example. With this vast spending power, government has the ability to affect the economy by how it chooses to spend its money.

If we expand on the definition of “value for money”, we can explore many ways in which the government can create positive developments in the private sector by broadening the selection criteria for the tendering process. Government tendering processes have become a complex area of public policy in recent years as states attempted to contain spending and avoid corruption. Unfortunately this has lead in many cases to contracts being awarded to the lowest bidders as those assessing the contract were forced to disregard any broader considerations for fear of favouritism. While it is right and proper that tendering processes should be entirely transparent and fair, we need to widen the selection criteria beyond purely cost considerations.

Contracts should be able to value the effect that various bids would have on local employment, indigenous industry or environmental concerns. Contracts would still seek to minimise cost to the exchequer, but this aim would be placed in context with broader measures of the economy. In recent years much of public procurement has come to be dominated by large multinational firms who compete for government contracts worldwide. While this has achieved a modest decrease in cost for governments, it has come at a price. In particular small firms and indigenous firms have become unable to compete against multinationals that operate with significant economies of scale. Many contracts between the state and large multinationals have been characterised by low pay and significantly deficient security of employment for workers (the social care sector is one area). Issues like low pay and the tax arrangements of large multi-national corporations have contributed to the economic difficulties that many governments find themselves dealing with at present. Reforming public procurement could give governments an opportunity to boost the economy in the short term and long term whilst at the same time reversing some of the more harmful by-products of multinational domination which have characterized public procurement to date.

Concerns about the legality of such policies, particularly relating to the European single market are over played. Recently European institutions have come to favour a more holistic approach to public procurement and this will be discussed in full in the following sections.

## Wider Benefits – Tackling Social Disadvantage

As mentioned above, value for money can be achieved through benefit maximisation not just cost minimisation. Benefits that can arise from procurement spending include but are not limited to; reducing unemployment, reducing economic inactivity, up skilling the workforce, expanding apprenticeships and vocational education, building up SME's and supply chain companies and keeping money in the domestic economy. All of these are goals of economic policy for most governments, however most governments do not see public procurement as a route to achieving these.

Wider benefits or community benefits as they have become known are not a completely new policy proposal. Social clauses have been built into contracts for large scale government expenditures, particularly capital projects for many years. The difficulty has been that these social clauses were often token gestures or optional extras negotiated after the contract had been awarded. They were not used to evaluate competing tenders. The second major flaw was that social clauses only became associated with large capital projects, governments failed to see the opportunity to embed community benefits into all areas of government expenditure in the private sector.

All areas of government expenditure can be subjected to evaluation under the community benefits criteria. Areas like the provision of food for school meals or stationary for the civil service, the tendering process should account for the effect that awarding the contract will have on the local economy. There are many ways to construct a contract to place value on these aspects and European law, far from forbidding it, actually encourages this process.

### Helping SME's

A policy that has been under consideration for some time is the process of dividing up public procurement contracts into a number of smaller contracts. This process has two main benefits. Firstly dividing contracts into smaller lots allows small firms to bid for more modest contracts as opposed to large tenders which could only reasonably be contested by large firms. Secondly it allows the state to avoid domination by one provider by limiting the amount or number of lots that any one provider can contest. This has the benefit of extending opportunities to small firms shut out before while at the same time ensuring healthy competition.

The European Union, as mentioned earlier, directly encourage this policy and they outline this in the 2011 Directive of the European parliament and of the council on public procurement

*"Allowing contracting authorities to broaden their supplier base, with positive effects of higher competition for public contracts. In order to make public contracts as accessible as possible to SMEs……Contracting authorities will be invited to divide public contracts into —homogeneous or heterogeneous — lots to make them more accessible"*

## Building supply chain industries

Contracts can also be designed to mandate that all successful bidders must firstly advertise for suppliers and subcontractors within the domestic market. This policy can go further by setting up events for local suppliers and contractors to meet with successful bidders and procurement officials to build up local networks for future projects. The benefit of this policy is that small firms could see significant growth in production through procurement deals which may enable them to scale up and move into new product or export markets. It also may draw in firms that never considered public contracts as potential growth areas for their businesses.

## Recognizing that public services are different

Much of public procurement spending these days is in outsourced spending within public services. Key areas of public service provision are now contracted out as if they were homogenous services that any bidder could provide. However public services are more often than not unique to the welfare settlement that exists within particular countries and cannot be quite so easily auctioned off to the highest bidder. Health service call centres for example cannot be as quickly outsourced to massive centres in Asia or beyond in the same way that they could be for a phone company. Local knowledge is important and this can be hard to reflect in contracts. Many argue that local favouritism would breach the law of the European single market; however European authorities have been keen to highlight the unique nature of public services and the limited scope for any "cross-border dimension". The 2011 directive states

*"Social, health and education services have specific characteristics which make them inappropriate for the application of the regular procedures for the award of public service contracts……The services have, by their very nature, only a very limited cross border dimension. Member States should therefore have large discretion to organise the choice of service providers"*

## Eradicating a "two-tier workforce"

Over the last three decades we have seen large scale privatisation of state assets and companies across most western economies. In more recent years we have seen a trend toward "outsourcing" of government functions, where services normally provided by government are tendered to outside providers. This outsourcing now accounts for a large majority of public procurement.

These programmes have been justified on the grounds that workers paid by private sector employers are automatically more productive than when they are paid by public sector employers. It is often justified on the basis that private companies can secure better terms of finance for investment than sovereign governments, and it is justified on the basis that services provided by the private sector will provide better value for money for the tax payer. However one views the accuracy or the efficacy of these arguments, at no point have any of these programmes been justified on the basis that they would ensure reduced pay and conditions for the employees involved.

Any reform of public procurement should ensure that our domestic economy is not further damaged by reducing the pay of thousands of employees under the guise of value for money. Reform of public procurement should reinstate "two tier workforce" directive which was abandoned by the United Kingdom government in 2010 and which is still extant in Wales.

## Boosting local employment

One of the main community benefits that can be drawn from public procurement is through employment initiatives. These can range from employment opportunities for people in the local area, to employment opportunities for the unemployed or people who have become economically inactive. These contracts can also include training opportunities for the long term unemployed and those furthest from the labour market. The 2011 directive says,

"*Contract performance may, in particular, be intended to favour on-site vocational training, the employment of people experiencing particular difficulty in achieving integration, the fight against unemployment*"

Providing training positions is important, but it should not be confused with providing apprenticeships, which is a separate but complementary aspect of skills training. Furthermore, apprenticeships provided through public procurement should be at level 3 on the NVQ scale or above to ensure that skills and experience gained are of an objectively high standard.

These measures can also be targeted at the most vulnerable groups of potential workers including those with disabilities or those re-entering society after incarceration. Equality and social mobility considerations can also be built into contracts

"*The production process or the favouring of social integration of disadvantaged persons or members of vulnerable groups amongst the persons assigned to performing the contract, including accessibility for persons with disabilities.*"

### *Sample contract – Conditions for local employment initiatives*

The Contractor shall implement in full its Community Benefits Plan which is attached at Schedule ( ) to this Agreement, within the agreed timescales set out in XXXX subject to the availability of any persons whom it intends to employ in accordance with the Community Benefits Plan.

The Contractor shall not cause any current employee of the Contractor or any current employee of any of its sub-contractors **(of any tier)** to become unemployed as a result of implementing the Community Benefits Plan.

The Contractor shall keep the Community Benefits Plan under review throughout the Contract and modify it as appropriate in order to achieve the community benefits described in the Community Benefits Plan. Proposed modifications of the Community Benefits Plan shall be discussed with the Employer and are subject to the Employer's approval. The Employer will consider reasonable requests for modifications in light of current circumstances and the commitments set out in the Community Benefits Plan, but reserve the right to reject any proposed modifications which it regards as unreasonable.

The Contractor shall advertise any sub-contracts which arise as a result of the Contract on www.sell2wales.co.uk. The Contractor shall pay sub-contractors within 30 days of receipt of a valid invoice save that the Contractor may withhold or delay payment where it has reasonable grounds to do so and must communicate those grounds to the sub-contractor within 10 days of receipt of the disputed invoice.

## Protecting Workers

Contracts can also favour bidders who have a good record on protection of workers, their health and safety and commitment to fair pay and a minimum wage. Most importantly contracts can exclude completely, bidders who have been shown to or are suspected of breaching workers' rights in their previous contracts,

"A contracting authority can exclude economic operators from the procedure, if it identifies infringements of obligations established by Union legislation in the field of social, labour or environmental law or of international."

"Public contracts should not be awarded to economic operators that have participated in a criminal organisation or have been found guilty of corruption, fraud to the detriment of the Union's financial interests or money laundering"

This is a significant measure to enforce against repeat offenders who have abused rules and regulations surrounding workers' rights and workers safety in other regions and with other contracts.

Finally we can also reform the public procurement process, demystify it and allow it to be opened up to firms and companies who felt shut out by the complexity and regulatory stringency of previous contracts. This paper will outline how this was achieved in Wales, a region of the UK which has taken this new vision of public procurement to heart in its framework

# Wales

The Welsh government has led the way in reforming its use of public procurement to maximise the benefit for the local economy. When the proposals were introduced, Welsh Minister for Finance Jane Hutt AM was asked if she was wasting tax payer's money, she responded

"*Certainly not. We are trying to regenerate our economy here with a procurement policy which puts community benefits first.*"[1]

Wales made several changes to existing procurement policy, and refocused contracts to cover the stated goals of the Welsh Government

[1] http://www.bbc.co.uk/news/business-17381440

- Retention &Training for the Existing Workforce
- Supply Chain Initiatives
- Training and recruitment opportunities for the economically inactive
- Promotion of Social Enterprises &Supported Businesses
- Contributions to Education
- Community Initiatives- Resources- Consultation

Now in Wales, 20% of the weighting for awarding the contract is awarded on the basis of lowest cost, 80% weighting is given to how tenders meet the above standards. Contracts can be designed in two ways, core and non-core. Non-core is where the community benefits are not defined within the initial contract, but are agreed with the successful bidder after the contract has been agreed. However the contract cannot be awarded on the basis of community benefits, the contract can only specify a commitment to community benefits from the successful bidder.
Core contracts can specify key community benefits that must be fulfilled by the successful bid, contracting authorities are allowed to take this into consideration when awarding the contract. While not all projects would be suitable for a Core contract arrangement, it is clearly the most effective contract for achieving community benefits.

In addition to reforming its contracts the Welsh government committed to significant institutional change, in particular they

- Established “Sell2Wales” an online system designed to encourage SME’s into public procurement
- Established the Supplier Qualification Information Database (SQuID) to make it easier for small businesses to tender for public sector contracts.
- Established XchangeWales to help the Welsh public sector transition from paper to electronic procurement
- Established National Procurement Service to implement policy across all sectors
- Established “Home-grown” talent programme to train people in new procurement practices

The Welsh Government has achieved considerable success including the following

- Applied to all government Welsh branches of public procurement, Assembly government, local government and NHS
- Since use of SQUID in construction 2/3 of contracts or places on frameworks went to suppliers with Welsh HQ (compared to 1/3 in previous years)
- Applied to £4bn of contracts. 80 projects underway. 14 complete – £229m – 79% spent in Wales.
- 224 disadvantaged people given over 11,000 weeks training.
- 71 apprentices employed
- Collaborative Procurement – delivered £130m savings over 5 years
- Xchangewales programme – delivered £70m efficiencies over 4.5 years – with 78% adoption of e-trading hub

## Northern Ireland

It should be a key aim of the Executive in Northern Ireland to replicate the success of the Welsh government. This should be possible as the government in Cardiff operates under the same strictures within the UK and EU frameworks.

The most recent figures for Northern Ireland, made available by the Central Procurement Directorate in the Department of Finance and Personnel, outline the extent of procurement spending by government departments, Agencies, Non Departmental Public Bodies and Public Corporations. Total procurement spending for these groups amounted to £2.6 billion in the years 2011-2012, including £926 million spent on construction and maintenance services. These figures do not include spending by local government, nor do they include spending by housing associations – a key driver of infrastructural development. This highlights one of the main features of the Welsh model, that all procurement spending by any arm of government or state spending should be treated as potentially useful. For example councils across the UK have begun to implement a living wage campaign and so far of the 400 councils in England and Wales 82 and all 32 Scottish councils are now living wage employers. As far back as 2009 the European Commission confirmed that EU procurement rules do not constrain councils or any arm of government from specifying a living wage for all employees in public procurement contracts. Mr McCreevy for the EU Commission in response to a question in the European Parliament:

*The first question of the Honourable Member concerns the possibility of including living-wage conditions in the procurement processes. Living-wage conditions may be included in the contract performance clauses of a public procurement contract 'provided they are not directly or indirectly discriminatory and are indicated in the contract notice or in the contract documents'.*[2]

Looking at these figures we can examine the degree to which Northern Ireland is already successful in using procurement to optimise economic growth. The figure initially provided by the CPD show that 76% of all procurement spending goes to Northern Ireland firms. While this may seem impressive at first, firms are counted as "Northern Ireland firms" if their bidding address is located within Northern Ireland. There is no guarantee that workers or profits remain within Northern Ireland, under this definition. Large multinational corporations can set up office within Northern Ireland whilst using labour and supply services from outside. The reforms that are proposed here do not seek to exclude firms from outside; it seeks to give advantage to those firms who would maximise local employment and local supply. A Northern Ireland postcode guarantees neither of these.

As Northern Ireland is an economy based on small and medium sized enterprises there needs to be an emphasis on the size of the company to which contracts are awarded to. This is why dividing contracts into lots is such an imperative piece of the reform programme. Rather than introducing a bias against large companies, the contracts can be broken to reflect the make-up of enterprise within Northern Ireland and therefore provide a level playing field.

[2] http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=P-2009-0922&language=EN

The policy ambition for Northern Ireland must be to reach beyond large providers and engage the SME sector both in public contracts and the consequent supply chains. A further important aim should be to ensure that employment provided through public procurement guarantees good employment practices, safe conditions and fair compensation. Public procurement can also lead the way in excluding firms that have abused government contracts in the past, by failing to fulfil their contracts or failing to provide a safe and secure work environment.