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# PUBLIC PROCUREMENT AND REGIONAL DEVELOPMENT LITERARY REVIEW

## SUMMARY OF KEY THEMES

### REGIONAL RESEARCH CONNECTIONS



## ABOUT REGIONAL RESEARCH CONNECTIONS

Regional Research Connections (RRC) is a partnership with Universities that provides new capacity for regional policy research in Australia. Four Universities have joined with the Regional Australia Institute (RAI) in 2018 to form RRC – University of South Australia, RMIT University, Southern Cross University and Charles Darwin University. RRC supports RAI's Intergovernmental Shared Inquiry Program.

## ABOUT THE REGIONAL AUSTRALIA INSTITUTE

Independent and informed by both research and ongoing dialogue with the community, the Regional Australia Institute develops policy and advocates for change to build a stronger economy and better quality of life in regional Australia – for the benefit of all Australians. The RAI was established with support from the Australian Government.

## ABOUT THIS WORK

This summary paper is a synthesis of a larger, wide-ranging literature review about the role of public procurement in helping government's achieve policy objectives such as regional economic development. This literature review was undertaken by leading academics at Charles Darwin University in 2018. It extensively surveyed academic and grey literature regarding public procurement and its role in regional economic development. What follows is a summary of the key themes and findings of that review.

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## REFERENCE

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## ABOUT THIS REPORT

This paper provides an overview of the key themes and findings from the literature review undertaken by leading academics at Charles Darwin University in 2018. The review extensively surveyed academic and grey literature regarding public procurement and its role in regional economic development.

The review was is one of two key inputs into the Regional Australia Institute's (RAI) [Public Procurement and Regional Development: Briefing Note](#). It gave us a powerful insight into the fragmented nature of the evidence base but also an insight into the ways that procurement processes have been used to achieve a variety of policy objectives, sometimes with little success. The review also gives us an understanding of the contested nature of public procurement itself.

However, one of the limitations of any academic work is that there is always a time-lag between the design, implementation and review of programs on the ground and their appearance in academic studies. This lag exists across academia and is inherent in the nature of peer-review research. For this project, it has meant that many contemporary policy efforts have not yet made their way into the academic literature. Because we wanted to get a sense of the whole picture where we understand **both** what has happened in the past and what is also happening now, we collected and analysed a series of contemporary procurement policies and programs from around Australia. This analysis was the second key input into our [Briefing Note](#), giving us a sense of how governments and communities were using procurement to bring about regional development.

## HOW TO READ THIS PAPER

This summary paper should be read as a synthesis of a larger, extensive literature review about the role of public procurement in helping government's achieve policy objectives such as regional economic development, which itself helped inform the [Public Procurement and Regional Development: Briefing Note](#).

# CONCLUSION OF THE REVIEW ON PUBLIC PROCUREMENT AS A POLICY INSTRUMENT: KEY ISSUES AND CHOICE SEQUENCE

Chapters 2 to 7 summarized the most valuable literature we managed to uncover, following the rules and methodological principles we set and described in chapter 1. Prior to extracting findings to inform future decisions about public procurement, we make a number of generic observations about current the state of public procurement knowledge from a policy perspective (not an operational one).

## THE STATE OF KNOWLEDGE ABOUT PUBLIC PROCUREMENT

There are many, fragmented ‘public procurement’ research worlds, and our review showed that these worlds have never been integrated to address systematic contradictions that appear to arise when overviewing them. To that extent the literature currently provides limited guidance to solve practical problems, although our review identifies key issues that require attention and appear critical across procurement systems, places, and jurisdiction levels.

The writings (research, policy, advocacy, etc.) about public procurement we’ve uncovered belong broadly to two domains that do not appear to inform one another:

- a. The academic literature which has been emphasized in this review, which attempts to focus on whether public procurement as a policy mechanism (in given places and time) is informed by coherent objectives or rationale, and whether evidence has been produced (directly or indirectly) that can inform on what has been effective and economical when addressing those original intentions. Research work and empirical sources themselves arise from a large variety of disciplines; they do not appear to be ‘owned’ by any discipline and have never really been purposely integrated;
- b. A grey literature found mainly on the web originating from wide-ranging sources which combine government sources describing their priorities, beliefs and intentions (which we have mapped across Australian jurisdictions in an appendix) as well as advocacy bodies (NGOs, some regions or local governments, various interest groups, etc.) which usually feature enthusiastic statements about the ‘procurement opportunity’, elusive support for wide-ranging political agendas. Government documents therefore emphasize policy aspirations and sometimes their developing implementation plans. The advocacy contributions can include sketchy case studies, tools and templates with various degrees of believability.

Despite recent eagerness by various advocacy platforms to make public procurement a new foundation for economic or social action (across jurisdiction scales or government levels) and redesign it as a ‘policy opportunity’, it remains controversial in the academic literature. The views of following leading thinkers from a more than a decade ago have not changed with McCrudden (2006) describing public procurement as ‘an extraordinarily adaptable tool’ while Schapper, Malta, & Gilbert (2006, p. 2) claimed that ‘[p]ublic Procurement is one of the least understood and most vulnerable areas of public

administration' and that procurement 'as well as its reform, still faces lack of consensus about its scope, nature and strategic value'. In our judgment informed mainly by the academic contributions, these remain a fair assessment of what that disjointed literature says about the field to this day, in large part due to limited progress in the field's ability to evaluate and to produce convincing evidence of progress

It is important to reaffirm that while the vast majority of the worthy procurement knowledge and evidence we found applied to national or state scales (irrespective of domains covered in our various chapters) and only a few instances could be found that addressed intentionally the regional or local procurement contexts, the principles extracted below are expected to apply equally across levels.

This view is informed by some research which has considered whether the nature of specific key issues (trade and protectionism for instance) applied equally to 'In-State' trade and strategic considerations. The main differences across jurisdiction levels (from the national to the state to the regional and local) have to do with the range of capabilities found at each level, in terms of competencies available to design policy instruments, to extend policy scope, to evaluate and produce credible evidence frameworks as well as the existence of legal institutions and compliance mechanisms not necessarily accessible for lower jurisdiction levels.

## DEFINING THE PUBLIC PROCUREMENT 'PROBLEM' REMAINS PROBLEMATIC

Procurement as a public management function has existed for a long time, and never been fully impartial (being a government administrative process), never been fully transparent (for sound reasons as it sits at the interface between the public and private sector domains), and has always been somehow juxtaposed to other policy instruments capable of fulfilling a similar role, although perhaps entailing different costs, scrutiny and risks to governments.

Much of the research on public procurement reviewed intends to make judgments about whether it constitutes an 'effective' way of solving social, political and economic development problems. While this would be a fair and straightforward enunciation of the focus of research, the 'problem' with public procurement is really in agreeing on the dimensions of effectiveness. Does it refer to the acquisition of goods X, Y, Z at a decent price? Does it refer to employing locals in the process? Does it refer to using certain types of enterprises or certain types of workers? Does it mean managing or fulfilling a target number of contracts per months? Does it mean streamlining and reducing the costs of procurement?

In government media communications, in public agency planning documents, and in annual reports, the term effective (applied to policies or interventions) can be quite hollow, unless it is precisely framed and backed by evidence. The same applies to research insofar as our research has found that interpretations of 'effectiveness' vary considerably across procurement domains, across disciplinary perspectives and across policy agendas. It is indispensable to further the agenda of public procurement research to circumvent definitional inconsistencies and instead highlight the diverse perspectives on effectiveness for the sake of advancing a dialogue based on a more cohesive analytical framework capable of providing practitioners and policymakers with endorsed principles that can adjust to the varying scope of diverse procurement dilemmas.

To do this, it is useful to initially adopt a simple representation and definition of the problem encountered when assessing the desirability of various policy channels, which is one take on the meaning of what is 'effective'. When probing public procurement as a policy instrument, we start from the minimal possible scope of government purchases. It is established that any government, on behalf of the public, must acquire some goods and services (or even purchase entire major concepts and projects), which are to be supplied by the private sector. Those acquisitions are legitimate and been supported by the electorate through a variety of political processes and institutions which are not questioned here. The need for these goods and services has been formulated, endorsed and shaped or designed by the bureaucracy, and it has been decided that they will be acquired from the private sector (in some cases it could be produced by the public sector or in a joint venture). The procurement process starts there, with the administration of that acquisition; and everything decided prior is taken for granted. To consider more subtle questions relating to effectiveness, we must establish a hierarchy of functions, whereby we distinguish between primary and secondary objectives of public procurement.

Alternative goals	Description
<b>Primary function: Related to the acquisition (of goods and services) or delivery (of an infrastructure project)</b>	<ul style="list-style-type: none"> <li>• Delivery of a government commitment that involves choosing, purchasing and sometimes assembling input ingredients (office stationery, a road, housing construction services, school materials, police or health services, a submarine, etc.)</li> <li>• Based on notional 'public interest' principles that would dictate that it should maximize the output (with multiple attributes such as quality, timing, reliability, etc.) per cost unit</li> <li>• Decision process considered to be fair, upright, transparent and cheap</li> </ul>
<b>Secondary functions: Related to objectives either subsidiary or extraneous to the primary object</b>	<ul style="list-style-type: none"> <li>• Favouring suppliers believed to help boosting the local economy</li> <li>• Favouring types of businesses/groups deserving more help (i.e. SMEs)</li> <li>• Favouring groups otherwise disadvantaged (women, minorities, homeless, Aboriginal, etc.)</li> <li>• Supporting worthy social causes</li> </ul>

Subtle questions arise about choices that need to be made within the primary and secondary functions, as well as the tensions and resulting trade-offs between them, which will be discussed below. What is clear from our review is that the research literature has not been able to disentangle those issues, let alone provide simple methods to tackle them at a practical level. Future research will need to formulate frameworks addressing these three different but related questions in a coherent manner. Yet, we can identify in this conclusion chapter several generic tensions that need to be considered, and choices that need to be made when trying to determine whether public procurement constitutes a suitable instrument to address social and economic problems.

When looking at a policy menu, the notion of 'public interest' can easily be manipulated to justify a course of actions or defend public expenditures, often by reducing it to one aspect without considering impacts or distortions arising around that aspect. The importance of the distinction between primary and secondary functions stems from the need to consider how they affect each other (when integrated within the public procurement mechanism), and their joint impact on the public purse. Many of the basic

difficulties encountered when embarking in (and designing) public procurement instruments arise from the inherent tension between short-term goals and long-term ones, the latter usually being aspirational (and influential when a policy direction is proposed) but rarely pursued to its full logic nor evaluated, for obvious political and administrative reasons.

Throughout the review, short-run and long-run trade-offs were identified, which in fact provide a useful way of characterizing many of the tensions found in public procurement:

- Favouring local suppliers is the most widespread, almost universal, secondary objective pursued by jurisdictions of all levels and sizes. In the short run, it always appears desirable for a region to prioritise procurement from 'local' suppliers (assuming that local capabilities exist) because attention is only given to short-term gains, political and economic. In the longer run, one must consider the possibility that neighbouring regions are likely to retaliate, or simply mirror such behaviour. This leads to jointly inferior outcomes in the long-run as trade based on both private and government markets deteriorates. Chapter 3 has shown that the neediest jurisdictions (either dealing with economic decline or structurally remote) are the most vulnerable to losing out from any trade degeneration.
- Governments favouring local industry through the procurement process (whether they do so explicitly or not) often call upon simplistic arguments such as those articulated around income recirculation and multiplier effects. These can be quite misleading if they do not entail reliable counterfactual scenarios based on credible evidence and attempts to measure the benefits arising to both government and community (there are always winners and losers). The reality is that governments wish to allocate contracts to locals because of reasons that have little to do with 'public interest' overall. The combination of 'populism' (the impact on their chances of being re-elected), 'parochialism' (the unquestioning trust governments and community have in the superiority of local knowledge and the loyalty of local businesses to that community), and 'protectionism' (the belief that if you can get away with favouring locals without being detected by neighbouring localities, this will create a win-win situation) all explain this excessive with short-term gains. They surely do not contribute to the ability of a locality or region to methodically assess its long-term competitive advantage and the determination of the best arrangement of institutions and policies to support future aspirations.

The key points being made here is that defining public interest is messy, cannot be based solely on short-run consequences of interventions, and that governments will likely favour simplistic narratives to manipulate that agenda. Our review has uncovered much evidence (see chapters 3 and that even when governments allegedly reciprocally agree on cooperative trade measures, their rationale, and the means to pursue them (incorporating public procurement components), the majority will systematically cheat against the agreements they support, if they can get away with it. This is important because it shows that any assessments of the pros and cons of using public procurement to address various policy agendas (combining primary and secondary functions in the way illustrated above) must take into account realistic traits and behaviours of industry, government officials and public authorities. This applies equally to the propensity to be involved in corrupt behaviour and to the tendency to promise evaluations and evidence which are very rarely fulfilled, some researchers suggest perhaps deliberately. The need to manage those behaviours imposes considerable costs which must be taken into account when deciding on the scope and design of public procurement instruments.

# MEASURES OF PERFORMANCE AND SUCCESS IN PUBLIC PROCUREMENT CONTEXTS

The themes of ‘performance’ (of a policy instrument) and ‘success’ (of an intervention or policy) are often confused because closely linked. To the extent that degrees of involvement in procurement differ between jurisdictions, demonstrating that using public procurement is an effective way of dealing with a complex problem usually requires

- a. ability of the mechanism to ‘solve successfully’ the problem be demonstrated (usually through sound evaluation procedures backed by credible evidence) and
- b. that the net benefits (including full system costs) to the public of this policy approach be contrasted with the next best alternative approach, including the possibility of not intervening.

The latter is complex and academic research has not attempted to model these fully, yet thinking in terms of decisions regarding trade-offs between types of costs and likelihood of positive impact should guide decisions to engage in extended public procurement policies, irrespective of jurisdictional level. We propose below a categorisation of ‘measures’ relevant to that question, and the next section will suggest a sequence of ‘decision’ that need to be considered.

	Typical outputs	Typical outcomes
<b>Primary function:</b> <b>Good or service delivery focused</b>	<ul style="list-style-type: none"> <li>• Output delivery (to target)</li> <li>• Cost per unit of output</li> <li>• Quality of output</li> <li>• Some weighted scope (such as the MEAT discussed in chapter 5)</li> </ul>	<ul style="list-style-type: none"> <li>• Transparency of process (public satisfaction)</li> <li>• Supplier satisfaction with process outcomes (industry winners and losers)</li> <li>• Indicators such as complaints about process, public perceptions of corruption or unfairness</li> <li>• compliance effectiveness or legal costs to the public</li> </ul>
<b>Secondary function:</b> <b>Additional economic or social objectives</b>	Demonstration that the ‘preferred’ group has been advantaged, i.e. more bids and success (can be relative to a target or other comparison group)	Demonstration that the preferred group is: <ul style="list-style-type: none"> <li>• better off overall (no distortions or backlash)</li> <li>• less disadvantaged than before statistically</li> <li>• in a better position to participate in procurement in the future (without assistance)</li> </ul>

Those familiar with the distinction made between outputs and outcomes in the context of evaluation studies will recognise that in some ways it parallels the tension between short-run (what actions or what has been done or produced by the intervention) and the long-run (what impacts can be demonstrated that constitute meaningful changes attributable to those actions). We use that distinction loosely but extend it to account for procurement situations where two (or more) distinct functions are often combined, which is the central problem that much of the research literature has been struggling with. This categorisation is essential because the presentation of public procurement as a loose array of disparate benefits, that would not distinguish between functions and between outputs and outcomes, is

clearly inadequate to understand how primary and secondary goals affect each other, and how short-term and long-term outcomes and costs are likely to materialise.

The table above is easy to understand through an example. If public procurement to produce stationary goods utilised in schools (the primary function) also aspires to advantage women workers or SMEs (a common secondary function in the US), the metrics required to ascertain whether the policy is effective must consider firstly if the public is getting value for money with respect to the production and delivery of stationary (primary function), and whether this is leading to a greater participation of women SMEs. Clearly tensions will arise between them if the policy is procuring from SMEs that were not necessarily the best (in a cost-value sense) but favoured to achieve the secondary objective (a notional disadvantage must have existed otherwise the secondary function was absolutely unnecessary). Furthermore outputs and outcomes applicable to both the primary and the secondary functions matter.

In terms of its primary function, the procurement intervention must not only deliver value for money (the output) but also retain the integrity of the procurement system (the outcome) and not generate new system costs (red tape, compliance, legal, etc.) that would ultimately be borne by the public. In terms of its secondary function, the intervention might temporarily and artificially increase the number of bids by women-led SMEs, but in fact change little in their future ability to compete in procurement markets, but even negatively affect some of them (often those most competitive), lead to backlash and create other distortions costly to the public and the government (especially if full transparency and integrity become questioned).

While this level of thinking about public procurement issues might appear complicated, it really is a simplification of the complex interactions at play within that system. Of course, much conventional public procurement did not entail explicit secondary objectives, and even then the tensions between delivery 'value for money' and maintaining an economical procurement system abound (see chapter 2). Yet, the literature shows that discrimination towards local suppliers has historically been quasi- universal (for reasons detailed in chapters 3 and 4) and almost always creates trade-off between the public interest related to the goods procured and that related to perceived local benefits from spending inside the jurisdiction. The balancing act required to assess those claims requires that primary and secondary goals be differentiated.

Given the increasing number of startling claims made about the benefits of using public procurement to pursue even more diverse policy agendas, the dependability and suitability of success measures needs to be commensurate to those claims purporting high levels of effectiveness and great value for money. Our findings suggest that such claims, for lack of appropriate categories and frameworks, usually side-step many of the most important cost or benefit questions and rarely provide any evidence of effectiveness or outcomes. In fact, the often so-called 'opportunity' to add secondary objectives must be considered carefully, and always in the light of the next best alternative, remembering that many policy instruments could be used to achieve those goals. This applies even to local preferencing where the risks of corruption, trade retaliation, increased red tape, compliance and legal costs (opaque procurement decisions can be challenged in courts by businesses) mean that those aspects must be weighed and set side-by-side against the anticipated benefits.

Any government considering adding a secondary function (or more) to the public procurement process will eventually be asked to demonstrate that this was a good idea, and will need to be able to provide evidence with respect to:

- Its ability to effectively address the secondary aspiration beyond simple outputs?
- The extent to which the inclusion of the secondary function or goal did not compromise or affect negatively the delivery of the primary objective?
- The relative cost-effectiveness of using public procurement (relative to other policy mechanisms) to address those secondary objectives?

The latter point is most demanding yet critical decision to make, and our review showed that many jurisdictions and government authorities rush optimistically towards public procurement as a policy instrument without an appreciation of the implications of those questions and without contrasting it with alternatives. While our review did not uncover any simple best practice or templates that regions can adopt, we suggest below a sequence of questions to be considered and taken seriously when embarking on the multi-function procurement pathway, that should apply to most cases and contexts. Developing the ability to consider those issues systematically before embarking in complex procurement designs and setting up suitable evaluation frameworks.

## LESSONS FROM THE LITERATURE ON PUBLIC PROCUREMENT: MAPPING SEQUENTIAL SOME KEY CHOICES

The literature review revealed an overwhelming gap between the claims made about the possibilities that public procurement offers, and the presence of:

- a. any coherently constructed logic capable of informing policy choices about public procurement scope, design and implementation
- b. any historical or recent evidence that those choices were effective in some way compatible with their own stated goals, and
- c. the cost-effectiveness of that approach.

In fact, the ability (and perhaps genuine willingness) to even evaluate public procurement policies is so limited that proper evaluations could not be found in the public domain, and the entire review was based on attempts by researchers to indirectly assess procurement policy effectiveness using datasets and stakeholder surveys in a large number of contexts. These rigorous inferences demonstrate in general that procurement aspirations incorporating secondary functions despite being common, are very rarely realised, most of the evidence on impacts being either negative or inconclusive, that success with outputs is usually obvious and trivial (in many cases of limited interest to practitioners because they were based on false conjectures) and the cost-effectiveness of using public procurement was never seriously considered, as various governments across levels lack the capabilities to address those questions.

Questions such as ‘which is the best method to support the local economy’ or ‘assist small enterprises’ or ‘aid disadvantaged minorities’ through interventions in the procurement process cannot be readily

answered from what the review has revealed. There is no integrated and coherent body of knowledge allowing to answer such fundamental interrogations.

In fact, it is likely that such a question cannot be answered from an abstract calculation. Our review showed that many context-specific elements contribute to an array of fundamental choices that need to be made explicitly when choosing a procurement direction. Those choices can be interpreted as a map of the basic ingredients that need to be considered when selecting a public procurement approach (in terms of its scope, design, transparency, rigidity, administration, etc.) that is useful to most governments, yet will be answered differently across different jurisdictional levels, community aspirations and government mandates, taking into account dissimilar resources and capabilities. These choices reflect specific public procurement trade-offs revealed in the various sections of the report:

1. Considering the trade-off between 'efficient delivery' and procurement system accountability
2. Considering the tension between long-run benefits from open/free trade competition and the short-run compulsion to advantage locals
3. The choice between intervening to back 'buy-local' or adopting a neutral procurement approach
4. Addressing perceived barriers to accessing government procurement markets: The choice between remedial preferencing and tackling barriers directly
5. The choice of preferencing method
6. The choice to link public procurement delivery to extraneous social objectives
7. The decision to invest in capabilities required to effectively and transparently administer the procurement process, to undertake monitoring and to implement credible evaluations

They reflect fundamental tensions between priorities and beliefs about what the procurement process offers and what its legitimate uses should be, and whether distinct procurement agencies are both capable and willing to identify needs, risks, and issues to learn from their mistakes. We offer this sequence of choices (reflecting tensions or trade-offs applicable to most policy settings) as a pathway to building more effective and adaptive public procurement processes reflecting the best choices for distinct conditions. This is done because we believe that any distinct ideal mix will ultimately result from social, political and economic aspirations, emerge as a context-specific compromise between functions (featuring various net benefits and costs), the validation of which will require further investments in trustworthy evidence-informed policy frameworks.

## **1. CONSIDERING THE TRADE-OFF BETWEEN 'EFFICIENT DELIVERY' AND PROCUREMENT SYSTEM ACCOUNTABILITY**

At the heart of conventional public procurement features the design of procedures to ensure that procurement decisions are fair, reflect the public interest, and do not lead to excessive amounts of red tape and administration costs (extending into compliance work), uphold community expectations with respect to transparency, minimise corruption (a very real and recurring source of disruption) or objectionable behaviour (both within the bureaucracy and private sectors), and do not lead to distortions affecting other trade and commerce including transaction costs (in and outside government procurement). Major international organisations discuss those aspects at length (see chapter 2) and note that high-level tensions arise (even in the context of only single function procurement) which cannot be

'digested from a procurement training manual'. That part of the review shows ongoing tensions between the instrumental purpose of procurement (getting the job [of building the bridge, acquiring equipment, etc.] done) and the government's policy mandate regarding fair and efficient coordination, transparency and accountability mechanisms within the procurement system.

Among the considerations that smaller regions need to consider carefully, the role played by 'institutions capable of conveying credible threats' to ensure compliance, and avoid fraud and mismanagement are critical. If they don't already exist, they could pose significant costs (if they need to be established) or their absence could result in local and regional governments having limited powers to control and exercise authority when winning bids and suppliers do not deliver the promised products or project as understood or in the conditions negotiated (cheating on derivative conditions, social and environmental is common and creates costs, either legal or to the public purse). When legal mechanisms are weak, then the potential red tape associated with monitoring is considerable.

Another key aspect is the transparency of the decision process (with respect to the formulation of criteria, their communication to the public, the invitation and selection of bids, the decision mechanism, etc.). A key principle emphasized in the literature is that those mechanisms should result in the same final decisions irrespective of whom is involved, and that no individual or role should have much discretion on the final outcomes. It is possible that such dimensions are more murky at the local and regional levels, where individual interference is possible, where opportunities for corruption arise due to small numbers, lesser institutional scrutiny (real or perceived) and weaker auditing processes. The review has revealed that dealing with the aftermath of poorly conceived procurement implementation is likely to constitute one of the largest sources of administration costs, and that risks of fraudulent behaviour increases with the number of objectives and their complexity.

## **2. CONSIDERING THE TENSION BETWEEN LONG-RUN BENEFITS FROM OPEN/FREE TRADE COMPETITION AND THE SHORT-RUN COMPULSION TO ADVANTAGE LOCALS**

Popular references to a trade-off between 'the size of the pie' (whereby stable and open competition lead to a greater economic output) and one's 'share of the pie' (which can be augmented in the short-run by advantaging locals at the expense of external competitors) need to be considered when making choices favouring locals. The long-term consequences of those decisions can easily be overlooked by smaller jurisdictions taking for granted that their impact on overall economic activity is either too small to be noticed or to lead to retaliation. Chapter 3 has shown that those principles apply at all scales; and that regions overly focus on popular short-term employment gains without appraising the snowballing impact of reduced trade between regions when appraising the 'public interest'.

Other costs arising from favouring locals need are discussed below (in choice #3), but the reduction in competition arising when external firms operate in a locality or regions must be considered; for instance, the greater innovation, the competitive pressures forcing locals to increase their productivity (potentially making them less dependent on government markets), the lower prices for local consumers, etc. While some traditional reasons evoked by governments to bypass open and fair-trade

harmonization can be found to be reasonable when specifying precise policy objectives, they generally could be dealt with directly, rather than through public procurement interference.

Several authors discussed in chapter 3 have claimed that the reason governments interfere with public procurement to achieve macroeconomic, regional development or restructuring agendas is precisely because as it is perceived as a policy channel to offer flexible and suitably opaque to trade partners, which is desirable to avoid having to justify actions condemned by trade agreements or more critically trigger trade retaliation. This is how governments can support the general principles of fair and open competition while creating opaque barriers to trade (using the procurement market) so often contravening the principles they claim to embrace.

In that context, several authors emphasize the ‘international disciplines’ benefits arising from adherence to open trade not only for the greater worth extracted (the primary function output) but also in its ability to deter bribery and corruption. That logic applies to the regional level. The inclusion of bids from external businesses provide a necessary benchmark to ascertain whether local bids are genuinely on par with industry expectations, and any enlargement of the pool of bidders puts downward pressures on prices that serves the public interest, but also provides an indicator about bids that are too low to be credible. In all cases, it means that delivery undertakings can be dealt with if a supplier is in difficulty as a large pool of alternatives can be found. Similarly, choice and comparability keep a check on corruption, and play a critical role in maintaining necessary transparency.

### **CASE STUDIES: INDIRECT COSTS RESULTING FROM TRADE BREAKDOWN**

Trade researchers have long established that absurdly high proportions of government contracts go to local suppliers. When interviewed confidentially in research surveys conducted by Rickard & Kono (2014) in Europe, national procurement authorities and specialists confirmed that contracts are systematically awarded to domestic firms. The proportions were particularly high for local governments. Ninety-nine percent of all local authority contracts in European Union countries are, in fact, awarded to domestic firms (according to Martin, Hartley, & Cox, 1999) despite established principles that no anti-competitive interference should occur.

The connection between unethical or corrupt behaviour and local support has been demonstrated, through large data sets documenting US State governments decisions to join the optional but federally endorsed General Procurement Agreement (GPA). Kim (2009) conjectured that the government as a political actor will be more inclined to support protectionist measures when under higher political pressure, and will then be more open to political support, lobbying and illegal bribes. When such political pressure is less manifest, he conjectures that state governments will have a greater incentive to join GPA as this brings in benefits for consumers, due to both better prices and lesser likelihood of corruption.

He builds a measure of ‘political competition’ (while accounting for other possible protectionist pressures such as foreign employment, union strength, economic insecurity) and finds strong support for his ‘political competition hypothesis’, whereby the existence of strong party rivalry creates induces the propensity for governments to favour short-run political gains at the expense of consumers and in a manner that undermines long-run distributed economic growth and welfare.

Even when discrimination in procurement markets is concealed ('de facto'), major costs to the public might result. Significant challenges have been brought to court in the US by companies arguing that they had made largely superior bids and were excluded from specific state procurements contracts, the states themselves arguing that they were pursuing 'legitimate state interest'. Of course, their ability to legally demonstrate that they were acting in the public's interest depends again on the clarity of those objectives, the evidence they have that decisions were made with integrity (based on evidence, not political discretion), the logic of which applies equally to regions and to States (Abutabenjeh et al., 2017; McCrudden, 2007; Qiao et al., 2009).

### 3. THE CHOICE BETWEEN INTERVENING TO BACK 'BUY-LOCAL' OR ADOPT A NEUTRAL PROCUREMENT APPROACH

This dilemma follows directly from the one above, although it is useful to restate (without references to trade) to the dangerous and potentially costly connections between favouritism and corruption. Several researchers reviewed in chapter 4 suggest that preferential procurement programs have serious negative consequences on the public interest, and on the administration of public affairs; that need to be considered when embarking on that journey. Both concerns result from the lack of realism characterising assumptions made about both the ability of public officials and bureaucrats to define public interest and their propensity to actually pursue it. Researchers often refer to the celebrated 'capture theory' to suggest that the vast majority of agendas and beliefs about the benefits of preferencing local businesses or workers rarely emanate from legitimate analysis or credible evidence, and are almost universally driven and subsequently 'captured' by interest groups. Choices and decisions about policy system designs require that realistic assumptions be considered regarding opportunism, agency capabilities (ability to map the net benefits, potential distortions and consequences of policy decisions), agenda flexibility (ability to admit mistake and change course), impacts on public confidence, etc.

#### CASE STUDY: MOTIVATIONS BEHIND LOCAL PREFERENCING: PRIVATE INTERESTS OR DEMONSTRATED OUTCOMES?

In the US, Qiao et al. (2009) have stressed the need for empirical studies of preferential procurement programs and their impact, even when actions are poorly documented, and their rationale is ambiguous. He mentions a number of surveys conducted with procurement officers (the experts in that field) to seek their opinions about the legitimacy of various preferencing policies. The National Association of State Purchasing Officials (NASPO 1999) has commented that it is unacceptable that "there is no substantial body of data" to suggest the gain for the preferential group is worth the cost incurred by taxpayers, including the losses due to restricted competition.

They note that in contrast to other controversial measures and policy domains that cost so much to the public, the dearth of evidence is inconceivable; arguing that one would expect advocates for or against such significant policies to typically produce major empirical studies supporting their respective positions, and that similar issues usually attract several U.S. federally-sponsored investigations and research reports. They wonder why this is not the case with research on public procurement policies, suggesting that it is perhaps in the interest of those capturing to maintain such unsubstantiated beliefs.

In choosing which option to follow, other costs (arising from favouring locals) must be reiterated:

- It is expected that the value (in cost-quality-delivery terms) of the good or service produced will be compromised (otherwise no favouritism would be necessary), and this ought to be evaluated;
- It is possible that uneconomical bids will be made if inferior 'local firms' are used to fill targets, and this might result in compliance or legal costs when the latter are found to seek support from outsiders, thereby breaching their 'local' status;
- The possibility that excluding external players might result in lesser regional innovation (and diminution in regional competitiveness), reduced competition between locals resulting in higher prices for local consumers, increased dependency of local firms on government procurement markets, etc. are all possibilities that require proper modelling and evidence.

One angle that can become very problematic for local, regional or smaller jurisdictions has to do with first 'defining' and subsequently managing the understanding of 'local'. Disagreements surrounding those interpretations have generated much controversy and operational definitions might clash with public sentiment. When explicitly discriminating, public procurement design and policies must not only be crystal clear about every single aspect of what 'local' entails (as every opportunity to exploit weaknesses will be tested), but also prepare for the most likely reactions to policy design, and anticipate endeavours to circumvent them such as those involving changing business addresses or opening subsidiaries and shopfronts to be legally protected and administratively fulfilling bid conditions. Not only this can generate important distortions (especially when regional, state and national agendas are not perfectly compatible), but also can result in considerable red tape, compliance and legal ex post deliberations.

### **CASE STUDIES: LOCAL PREFERENCING, LOCAL CAPABILITIES, AND LOCAL INTERESTS**

The observation of recurring practices deemed unethical (for instance opening shopfronts in locations to access procurement markets without commensurate economic activity), weak institutional compliance and quasi-universal absence of evidence on economic development impacts suggest that these issues are linked. In fact the unsuitability (or complete absence in many cases) of definitions of 'local' prevent researchers to articulate what local public interest might be, and inhibit all attempts to evaluate the effectiveness of specific public procurement policies; in the same way they undermine compliance efficacy. Such deficiencies associated with the public procurement process have caused Grandia & Meehan (2017) to argue that this field lacks strategic maturity, as those weaknesses prevent both proponents or detractors from being able to debate how to define success, and when to support its use (as a policy instrument) and when not.

Closer to home, the Western Australian Auditor General reported (2017) on the effectiveness of government procurement initiatives in delivering local content and employment for the sake of stimulating sustained local business activity, and reported on consistency issues surrounding that topic. It found that lack of clarity and guidance about the terminology made it impossible to blame those implementing (in compliance terms) but obviously lead to mistakes and inconsistencies. The definition of local was deemed so broad that 'companies can qualify as local despite being geographically distant', little monitoring occurred (or was deemed possible given the vagueness of the definition) and 'no

effective consequences for, companies failing to meet their local content tender commitments' (Western Australian Auditor General, 2017).

The implications are of course that leaves excessive discretion to procurement officials, which opens the door to corruption. The report comments at length on the inadequacies of data, monitoring and reporting to confirm that outputs can be demonstrated (showing that local businesses 'win' tenders as they are favoured) but no reliable analysis of content, or value for money, or competitive advantage (the potential outcomes) is ever performed. A last reason why evaluation is impossible is that compliance itself is unfeasible, by virtue of the above. Firms located across the State make plans to use local subcontractors to pass the procurement line, and neither proper monitoring nor compliance mechanisms (such as penalties) ensue to guarantee that the policy is enforced. From our literature review, this appears to pretty much describe a universal situation.

The report notes some distortions (although difficult to evaluate in monetary terms) that were most probably unexpected. These result from the policy attempting to support business located and operating in small communities which might have impeded on larger metropolitan businesses' ability to compete even at home (in WA) against interstate and international contenders due to constitutional protections (and some trade agreements) preventing the State from excluding other firms.

Other distortions can arise in regional contexts due to policy agendas conflicts and definitional clashes involving groups that governments are trying favour (from Anonymous NT government sources). Not only is determining who is 'local' creating political turmoil, but also leads to headaches for procurement decision-makers whose authority is being challenged. In jurisdictions and regions with high population turnovers, the notion of being 'local' is sensitive. Furthermore, new and established service suppliers with significant government contracts that have made decisions to open shop in those regions or localities which had led them to instigate repeated, and undue pressures on local governments to 'obtain a return of their investments'.

#### **4. ADDRESSING PERCEIVED BARRIERS TO ACCESSING GOVERNMENT PROCUREMENT MARKETS: THE CHOICE BETWEEN REMEDIAL PREFERENCING AND TACKLING BARRIERS DIRECTLY**

Some types of preferencing aims at correcting pre-existing access barriers (perceived or real), usually based on statistically documented differentials in the propensity to lodge procurement bids and by extension to win any. Preferencing small or medium businesses (SMEs) is common in many countries including Australia and typically predicated on that sort of rationale, although sometimes confusingly intertwined with 'buy-local' arguments. Our review identified authors having considered those issues in details who established that in the US, and they claim that the main rationale to support SMEs is based on notional fairness and perceptions that big business is unduly advantaged by policy. This explains why no specific outcomes are usually articulated nor policy impacts, as the simple result of seeing more SMEs involve in government markets satisfies those premises, and in a sense will endure as long as the perception continues, since no structural impact is pursued.

Critiques have argued that if specific barriers affecting SMEs more than large businesses, they should be addressed through policy rather than undertaking an purposeless procurement transfer to that sector, a process which might be deemed cumbersome and costly to the public, and rarely evaluated as such (due to the absence of identified outcomes). Some also argue that those measures might be built on a fallacy as their surveys of SME entrepreneurs have suggested good structural (and often sector-specific) reasons for not considering public procurement attractive as growth strategies. If this is true, much costly efforts might be encouraging SMES to engage with government procurement markets despite their better judgments. As discussed through multiple examples in chapter 5, such attempt to interfere with the rules of the procurement system can backfire and create perverse outcomes or unexpected distortions as illustrated in the box below; and these should be considered only when specific outcomes (that can be evaluated and evidenced) are formulated.

### CASE STUDY: ON THE WISDOM OF PREFERENCING

An approach contemplated in the European Community to make procurement more accessible to SMES involves replacing conventional criteria to select bids (involving lowest price and a measure of administrative burden) with a weighed formula to measure 'most economically advantageous tender' (MEAT) focusing on overall bid 'quality' and by dividing procurement in more than one contract, i.e. bite size, a typical approach to address size-related barriers for public services). While this creates additional administrative and transaction costs, it aims at allowing SMEs to bid for sub- components (they can fulfil and is therefore presumed to result in higher frequency of bids, and higher frequency of contract awards going to SMEs. Once again, either because support for SMEs rests on unproven suppositions about barriers, or larger firms are so advanced in their adaptiveness and quality, results went completely contrarily to the intuition behind those policies. Stake (2016, p. 1145) submits that 'including quality in the evaluation increases participation by large firms, while there are no significant results for micro, small or medium-sized enterprises'. Stake (2016) further warns that MEAT-type processes based on evaluating 'quality' (entailing greater amounts of subjectivity) can open the process up to corruption, as procuring agents are in a position to exercise more discretion in the selection process.

In a number of cases discussed in chapter 5 (for instance Reis and Cabral 2015), empirical evidence suggest that another type of distortion can occur even when procurement interventions (such as SME targets) are put in place and result in greater SME participation and being awarded contracts, they can have the perverse effect of leading to large number of contract terminations due to poor performance at time of delivery. This not only creates further social costs, but additionally undermines the integrity of the procurement system, creates a loss of public confidence and suggests that those business which were encouraged to participate in procurement market by the policy (the secondary function) were ill-equipped to do so.

Pickernell et al. (2011) observe that assisting SMEs is frequently proposed among a range of economic policies aimed at promoting the competitive advantage of remote or declining localities or regions; whereby public procurement preferencing SMEs is perceived as an engine for regional growth. as a way for governments to assist them. They disagree and argue that public procurement as a policy instrument seems unlikely to promote higher economic growth via SMEs, given that no significant link between procurement and small firm growth has ever been empirically documented. They suggest instead that focusing on small local firms can in fact entrench decline and prevent local authorities from

reaching for more sophisticated procurement demands (sometimes inescapably requiring services centralisation that attract younger workforce in towns) that could have transformative impacts on those economies. The simplistic connection made between SMEs, buy- local and retention of young people might actually cause a clash between objectives and deliver ambiguous results.

Parallel findings have recently been documented in northern Australia around declining regions (following mine closures) where attempts to preference local Aboriginal staff with unequal skills and capabilities has had a negative impact on those that were competent, and have decided to leave towns where government work (usually dominant in such places) was attributed on the basis of criteria other than merit, also signalling a basic clash between the objectives of facilitating local population access to procurement markets, and retaining or growing the population (anonymous NT government sources).

## 5. THE CHOICE OF PREFERENCING METHOD

Despite the numerous warnings above about the ability of policy solutions to generate desired outcomes, it appears inevitable that political expediency and populism will continue to result in the use of procurement regimes attempting to favour certain suppliers at the expense of others. A number of procedures used differ from each other with respect to their degree of transparency, the discretion they confer to procurers (and the risks of corruption that ensues), the level of compliance and legal institutional backup required to support them, and the capabilities needed within the procurement authority.

### GENERIC PREFERENCING METHODS FOUND IN THE US (BASED ON ABUTABENJEH, GORDON, & MENGISTU, 2017)

- One approach is a tie-bid preference ‘law’ that gives preference to in-jurisdiction bidders only if their bids are identically priced with the other non-local bidders and they are found in all the states and local governments in the US.
- Second, a percentage preference can apply a fixed percentage of the bid price to the out-of-jurisdiction firm’s bid price; the in-jurisdiction bidder is then considered the low bid if the adjusted bid is less than the actual bid price of the out-of-jurisdiction bidder. How these percentages are chosen, and whether they are adapted to suit specific objectives is not clear.
- Third, an absolute preference policy requires the purchasing office of the jurisdiction “to buy certain goods or services from vendors [located] within a designated area”; how they choose how to supply within the in-state bidder cohort (and those from outside the state) and how they ensure that no illicit trading takes place between them is not specified. It is likely especially at the local level that the procurement authority and its officers have considerable discretion, which opens the door to potential exploitation. Some absolute preference laws stipulate that government must buy certain goods or services within a designated area. Historically in the US, printing has been the most common “protected” commodity, followed by coal nationally. Other choices are State-specific such as lumber and paper products for New York State and milk products in South Dakota.
- Fourth, a general preference law gives a wide range of preference to serve the interest of the jurisdiction, some of which might refer to indirect supply chain attributes, such as when a preference is to be accorded based on the origins of an input (worker type, raw material, etc.).

- Lastly, reciprocal preference laws give preference to residents whose state does not themselves have preference laws, by adding a percentage to the out-of-jurisdiction vendors when their own jurisdiction impose preferences on the out-of-jurisdiction vendors. More than half of the states have this type of preference laws.

As noted earlier, procurement objectives are in many cases so vague (true for the majority of policies reported in the literature), that the objectives of ensuring public interest, favouring locals, supporting economic growth, assisting regional competitive advantage are often inter-mingled and bundled incoherently as if tantamount. Interested private sector suppliers will attempt to exploit any such imprecisions allowing them to qualify for specific government contracts, and will do so in increasingly innovative ways (shell companies, illegitimate joint ventures, so-called black cladding in the context of Aboriginal procurement are to be expected). This further undermines both the outcomes of those policies, open the door to policy capture and corruption, and will threaten public confidence. We repeat those observations to suggest that the choice between methods and their precise design should attempt to be based on definitional clarity, simple straightforward objectives (the least the better) and a strategy to assess success.

## 6. THE CHOICE TO LINK PUBLIC PROCUREMENT DELIVERY TO EXTRANEIOUS SOCIAL OBJECTIVES

While highly praiseworthy from an aspirational viewpoint, the addition of social goals to public procurement processes is neither inconsequential (in terms of effectiveness of the primary function) nor cheap in procurement system terms. Chapter 6 shows that there has been a strong recent interest in supporting disadvantaged groups (socially or economically). It also indicates that there are many reasons to be concerned about the impact of such a purpose on the effectiveness of delivery, especially when the capacity of government agencies (especially local or regional ones) to ascertain what is 'worthy' and document how to transform social circumstances appear so inadequate. In making the critical decision to attempt to address social causes (themselves not directly connected to the primary procurement mandate), it is incumbent on that decision to establish:

- Whether the linking between mandates creates substantive costs to the public (lower cost-effectiveness in the primary delivery) and costly bureaucratic expansion;
- Whether the government has a clear mandate to support any specific agenda (research reviewed has demonstrated that legitimacy is central to effective implementation by procurement authorities, and that inappropriate behaviour by procurement managers is significantly correlated with their perceptions that a government is pursuing agendas they were not elected to carry);
- If the linking process is actually generating the desired outcomes; that is can be supported by proper evaluation procedures, themselves based on a clear impact logic mapping and substantiated by credible and independent evidence;
- That intervening to support disadvantaged community members through a public procurement policy intervention is superior (either more effective or cheaper) to other conceivable interventions or policy instruments.

It is important to face the fact that the capabilities required to address complex social problems are considerable, and that their amalgamation with, and deployment through, private suppliers' production activities appears hazardous. This appears to be particularly likely to be the case when political and social sensitivities prevent political clarity of objectives (as discussed chapter 7 case studies of Aboriginal procurement), and the contexts of local and regional development exacerbate the impact of limited capabilities and the lack of strategic maturity characterising the field of public procurement.

### **CASE STUDIES: AFFIRMATIVE ACTIONS FOR WOMEN THROUGH PUBLIC PROCUREMENT IN THE US**

Because of the relatively long history of those policies, several rigorous empirical studies (sometimes quite complex) have been conducted to establish their impact and effectiveness.

- Orser, Riding, and Weeks (2018) combine statistical modelling and stakeholders' interviews to examine the efficacy of gender-based federal procurement policies in the United States, which aimed at redressing discrimination and economic exclusion applying to women, and for which the United States government has targeted 23% of its annual half-trillion dollar spend to SMEs and 5% of its spend to women-owned businesses. Their findings indicate that none of the various certifications increased either bid frequency or bid success by women. After arguing that so-called pre-existing statistical gaps in accessing public procurement markets by male- and female-led SMEs were misinterpreted by policy advocates, they conclude these public procurement targets are wasted as policies. They also note that repeated claims of success made by the agencies themselves endorsing their own policies are never backed by evidence. They call for critical program reviews and increased reporting and transparency, given that the actual gap between rhetoric and program promotion serve political ambitions without using consistent theory or data. They further note that the fact that the US government itself has over many decades failed to describe a convincing theory of what changes were required and in the form of a program logic, has failed to implement a data-based evidence strategy to allow ongoing evaluation, while making fervent claims based on poor output indicators rather than actual outcomes, provides a sobering lesson indication the extent and limitations that local or regional jurisdictions would face if embarking in conducting such ambitious transformative interventions.
- Marion (2009) considers the useful question "How does affirmative action affect the cost of government contracting?" and estimates the efficiency loss discrimination policies by comparing (after adjustments) road construction project costs. He finds that a road construction project costs the government 5.6% less to complete after the elimination of the affirmative action program in California, a larger difference than expected, which corresponds to savings of around \$64 million in two years. Marion explains that this is not due to differences in productivity between genders (or discriminated and non-discriminated businesses), but to the impact discrimination had on reducing the total number of bidders allowing for larger concentration of bids (verified empirically) pushing for higher bid costs.

## **7. THE DECISION TO INVEST IN CAPABILITIES REQUIRED TO EFFECTIVELY AND TRANSPARENTLY ADMINISTER THE PROCUREMENT PROCESS, TO UNDERTAKE MONITORING AND TO IMPLEMENT CREDIBLE EVALUATIONS**

The choice of level of investment in procurement capabilities extending to the demonstration of effectiveness applicable to both primary and secondary functions is critical. It should be central to the efforts of any procurement authority (or local-regional jurisdiction) attempting to justify their rationale to use procurement instruments to pursue policy objectives, and convince the public as well as probing treasury departments that they are embarking on a sensible course of action when choosing the scope of those procurement activities. Given the fact that the most important determinant of success (and indirectly of costs arising from those undertaking) will be the ability to learn and adapt to new challenges, changing community aspirations and shifting competitive contexts, the effectiveness of public procurement policy-making will depend crucially on the design of, and resources dedicated towards those specific evaluation capabilities. Demonstrating an ability to systematically consider the choices and trade-offs discussed above (and assess realistically the capabilities required to document outputs and outcomes for primary and secondary functions using the 2X2 matrix) should be considered a prerequisite to extending the role of public procurement.

In fact, we would argue that adding secondary functions to public procurement should not be contemplated at all unless evaluation competencies are expanded to the point where they can inform the public and industry directly about policy outcomes and worth. Given the assortment of cases reviewed that featured inadequate theories of change (and accompanying surprises or distortions arising), we can assess those capabilities as deficient generally and espouse the view that less interferences with the procurement process is, unless validated convincingly, the best policy.

Case after case reviewed promised evaluations and pledged future evidence-gathering efforts that were abandoned and never really explained (see chapter 7 cases for instance). This has resulted in some researchers and commentators alleging that perhaps public procurement has become popular for its ability to avoid scrutiny and legitimate processes. For these reasons, the onus of the proof regarding policy effectiveness should reside with the proponents of public procurement scope expansion, and public authorities should exercise extreme caution with the sudden popularity of that policy instrument.

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