AN EMPIRICAL EXAMINATION OF THE ECONOMIC IMPACT OF STATE PROCURMENT PREFERENCE POLICIES

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ABSTRACT. The purpose of this research is to examine empirically the economic impact of the state procurement preference policy. The overarching research questions that this study attempts to answer are: *What is the impact of implementing the in-state procurement preference policies on the economy of the state of South Carolina? What would be the economic loss to the state of South Carolina if procurement preference policies were not used?* To answer these questions, this research draws on procurement literature and applies an econometric model. The Regional Economic Model (REMI) Policy Insight software for structural forecasting and policy analysis will be utilized to conduct the empirical investigation. This paper consists of seven sections: background, purpose of the research, the research questions, the importance of the research, prior research that has investigated this problem, the contribution of the research, and methodology†.

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† Note: this paper is work in progress; this is a small part of my dissertation proposal.

BACKGROUND

Public procurement is an essential function at all levels of government and involves a staggering amount of expenditures. One study shows that the combined federal, state, and local government spending on procurement runs between $1.4 trillion and $1.6 trillion annually (Thai, 2001). Another study reported even much higher expenditures by state and local governments alone; for example, (McCue, Buffington, & Howell, 2003) noted that state and local governments spend 50% to 75% of their budget on purchasing which is estimated to be from $1.598 trillion to $2.396 trillion.

While public procurement represents a significant outlay at all levels of government, studies show that the types and purposes of procurement policies vary among the federal, state, and local governments. In general, governments spend a significant portion of their budgets on procurement to achieve public goals including serving economic, political, and social purposes. To achieve the previous goals, governments adopt different types of procurement policies such as procurement preference policies that target specific classes of people or businesses. Studies reveal that procurement preference policies and programs are designed “to give a competitive advantage to a class or type of vendor and/or a class or type of product” (Buffum, 1997, p.1). For example, the federal government has given preferential treatment to small businesses, disadvantaged businesses, women-owned businesses and others.

Studies further indicate that states and local governments adopt some of the federal programs, and each level of government enacts a variety of procurement preference policies with the aim of promoting specific economic, political, and social goals. In general, however, state procurement preference policies are designed to “... give preference to bidders for state contracts based on local content and local vendor criteria” (Hefner, 1996, p.33). Focusing at the state level, this research thus seeks to empirically examine the extent to which in-state procurement preference policies have been effective in achieving the stated/desired economic goals.

A review of procurement literature and research reveals that twenty-seven states have adopted various forms of procurement preferences (NASPO, 2009). The four main types are: 1) the tie bid preference, 2) percentage preference, 3) absolute preference law, and 4) the reciprocal preference law (Qiao, Thai, & Cummings, 2009). Each of these preference types serves specific purposes. Hence, the tie bid preference gives preference to local bidders only if their bids are identically priced with the other non-local bidders. Percentage preference refers to a policy that requires adding a fixed percentage of the bid price to the non-local firm's bid price; the local bidder is then considered the low bid if their prices are less than the bid of the non-local including the preference percentage. The absolute preference policy requires government "... to buy certain goods or services within a designated area" (Qiao, Thai, & Cummings, 2009, p.374). The reciprocal preference laws require preference to residents whose state does not have preference laws.

The rationales for adopting procurement preference polices are many and varied, but the most common reason cited in the literature is a state's desire to increase competition in a specific industry and to engage local, small, minority, and disadvantaged businesses in the market place (Krasnokutskaya & Seim 2008; Qiao, Thai, & Cummings, 2009). Also another important rationale offered pertaining to economic development is to encourage local businesses to stay in their home state so that they will be able to create more jobs, keep the current jobs in the economy, and increase local tax returns (Hefner 1996; McCrudden 2007; Krasnokutskaya & Seim 2008; Qiao, Thai, & Cummings, 2009). While supporters provide rationales that appear to have some merits, the preferential procurement policy has nonetheless generated controversies in government and business circles as well as in academia.

Critics invariably argue that preferential treatment "...violate[s] the basic principles of public purchasing, equity, impartiality, open competition, and the least cost to the taxpayers" (Qiao, Thai, & Cummings, 2009, p. 379). In view of these deficiencies, preferential treatment policy runs contrary to the free market principle and undermines competition in the market place. For example, the National Institute of Governmental Purchasing (NIGP) vigorously opposes procurement preference policies saying that all types of preference laws and practices are inconsistent with the free enterprise system and impedes competition in the market place (Strayer, 1996).

In a similar vein, the National Association of State Procurement Officials (NASPO) opposes procurement preference policy arguing that businesses and special interest groups are likely to exercise undue influence in the promotion of preference laws. The NASPO stated "… preference provisions and practices should be eliminated from public purchasing. Government bodies and legislatures must recognize that preference is promoted by business and special interest groups, that the net effect is costly, and that efforts to establish or maintain preference need to be resisted" (as citied in Qiao, Thai, & Cummings, 2009, p. 379).

Critics further contend that preference policies that constrain/discourage competition and protect local vendors are likely to lead to higher taxes, higher product prices, and reduced efficiencies (Hefner, 1996). This is so because local vendors are protected from competition and there is no motivation to enhance labor productivity and to develop cost saving strategies Therefore, the existence of opposing views raises concerns regarding the appropriateness of procurement preference policies that some states pursue vigorously (Krasnokutskaya & Seim, 2008). In light of the unresolved claims and counter claims about the benefits of procurement preference policies, it is perhaps proper to examine empirically if states are indeed gaining any economic benefits by using procurement preference policies or losing any economic benefits by not using procurement preference policies.

The PURPOSE OF THE RESEARCH

The purpose of this research is to help document empirically the economic impact of the in-state procurement preference policies that the state of South Carolina has adopted. As indicated in the preceding section, both supporters and opponents of procurement preference policies make contradictory claims. Yet there is a lack of empirical studies to support the claims one-way or the other. This lack of empirical investigation to determine the economic benefit (or lack of) of in-state procurement preference policies creates an important gap in the literature. This study attempts to fill this gap in the literature by investigating and documenting the benefits from adopting procurement preference policies or the losses from not adopting these polices.

THE RESEARCH QUESTIONS

Research shows that states adopt procurement preference policies to promote important social and economic goals that include helping minority and disadvantaged businesses, protecting local vendors, creating more jobs, and increasing tax revenues for the state (McCrudden 2007; Krasnokutskaya and Seim 2008). This research focuses on two main points: first, the economic goals that state government could achieve by implementing procurement preference policies. Specifically, the research question this study seeks to answer is: *What is the impact of implementing the in-state procurement preference policies on the economy of the state of South Carolina?* Second, the economic losses that state government could lose by implementing procurement preference policies. The research question this study seeks to answer is: *What would be the economic loss to the state of South Carolina if procurement preference policies were not used?* To answer the research questions, this research will utilize the Regional Economic Model (REMI) Policy Insight software for investigating the economic gains that states would be able to achieve as a result of adopting a specific preferential policy.

THE IMPORTANCE OF THE RESEARCH

Literature reveals that procurement preference programs have been "... a very important and controversial issue" (Qiao, Thai, and Cummings, 2009), but there is a lack of "...a substantial body of data" (NASPO, 1999, P.94) and few empirical studies have been conducted to document the benefits of implementing procurement preference policies for the taxpayers. Addressing this gap in the literature is certainly the significance of this study. The empirical study proposed in this research will be significant in many respects; by empirically investigating and documenting the economic impact of preference policy, this research can add to our knowledge base about the theory of procurement in general as well as to our understanding of the motives that underlie government preferential treatments that target specific classes of people and businesses. Also, as Qiao, Thai, and Cummings (2009) asserted "...procurement has always been and will continue to be used as an important policy tool for a wide range of socioeconomic and political purposes" (p. 398). In view of this assertion, empirical evidence can enhance the knowledge base of policymakers and influence their perspectives or decisions on policy issues that pertain to preferential policies.

Furthermore, the findings of this research will have practical policy implications. The empirical documentation of procurement preference policies could help policy makers and public administrators to decide if procurement preference policies have been used as an effective tool to achieve economic and social goals such as bringing local jobs, bringing income (taxes money), and engaging the disadvantaged businesses in the local economy. If the empirical results show that procurement preference policies contribute to the previous goals, policy makers and public administrators should continue implementing these policies. However, if the empirical results show that procurement preference policies are not achieving the potential goals, formulating and implementing procurement preference policies should be reconsidered. Therefore, producing and documenting empirical evidence about procurement preference programs is a significant contribution of this study.

PRIOR RESEARCH THAT HAS INVESTIGATED THIS PROBLEM

This research is different from previous works because it focuses on the economic impact of procurement preference on the state's economy. Previous studies have investigated some dimensions/ aspects of procurement preference policies in the context of different disciplines and fields such as international trade, economics, and public administration. Researchers have applied economic impact studies to a wide range of activities such as implementing new policies or modifying existing policies, planning construction projects, closing or opening a military base and expanding businesses. For example, economists studied the economic impact of recycling policies (Hefner & Blackwell, 2006) analyzed the economic impacts that would result from the purchase and operation of transportation projects (Lynch, 2000). They also assessed the economic impacts of 9/11 on the air industry and the overall economy of New York City and the surrounding region (Treyz & Leung, 2009) and estimated the economic impact of the allocation of tradable emission allowances and the recycling of revenues (Rose, Wei, & Prager, 2010).

Scholars have also studied the impact of procurement preference policies on government procurement costs and on the bidding behavior and participation decisions of vendors (Baldwin & Richardson, 1972; McAfee and McMillan, 1989; Trionfetti, 2000, Marion, 2006; Krasnok and Seim, 2008; De Silva et al, 2011). The benefits that businesses achieve from the procurement preference programs have also been investigated (Bates, 1985). Nevertheless, there is little empirical investigation that attempts to document the relationship between procurement preference policies and economic benefits at the state level. This researcher was able to identify only one study conducted in 1996 by economist Hefner that sought to measure the economic impact of not applying procurement preference to concrete pipes in the state of South Carolina. This paucity of empirical investigation thus warrants further investigation of the economic impact of procurement policies.

THE CONTRIBUTION OF THIS RESEARCH

The procurement preference policy has spawned controversies on theoretical and empirical grounds. Both opponents and proponents of preferential policies make sound theoretical arguments, but neither group was able to produce empirical support for their respective claims. This lack of empirical documentation constitutes an important gap in the literature that this research seeks to fill; in so doing, this research attempts to contribute to our knowledge of procurement theory and practice by investigating and documenting the impact of preferential policies on the economy of the state.

METHODOLGY

This research employs the REMI Policy Insight model. This model is constructed by REMI Inc. and it has been used for structural forecasting and policy analysis. REMI Policy Insight can be customized for the specific geographic area (s). It integrates input-output, computable general equilibrium, econometric and economic geography methodologies. Also, the model simulations in REMI Policy Insight "…estimate comprehensive economic and demographic effects in wide-ranging initiatives such as: economic impact analysis; policies and programs for economic development, infrastructure, environment, energy and natural resources; and state and local tax changes" (REMI Policy Insight User Guide, 2007).

REMI Policy Insight answers the question "What if…?" any change in a policy would affect the regional and local economies and adjust to those changes which will occur on a year-by-year basis (REMI Policy Insight User Guide, 2001). The model has been used many times by scholars, researchers, practitioners and professionals from different private, public and nonprofit organizations. The findings and results of theses research are published in variety of journals such as the American Economic Review, The Review of Economic Statistics, the Journal of Regional Science, and the International Regional Science Review (REMI Policy Insight User Guide, 2007).

To employ the REMI policy model, data from the Bureau of Economic Analysis, the Bureau of Labor Statistics, the Department of

Energy, and the Census Bureau will be used. Also, data from the procurement contracts that have been awarded by implementing in-state preferecne policies in the state of South Carolina will be collected. By utilizing REMI Policy Insight, this research attempts to find out if impelmnitng procurement in-state prefercen policies would bring more jobs, state tax revenues, personal income…etc.

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