

WHITE PAPER – BENEFITS OF LOCAL SPENDING

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Introduction

The bedrock of modern public procurement has always been to obtain the lowest price possible for the desired goods or services through an open and free competitive process. This has served as the procurement mantra in a perfect world with a thriving economy and sufficient business to satisfy the needs of the local business community.

A challenging economy will always change or attempt to change the business climate. One change is the use of Local Business Enterprises. Any good business will search for whatever opportunities they can find. One opportunity they seek is government spending. Typically, governments do not reduce spending as significantly as consumers and other businesses. An example of this is the current federal American Recovery and Reinvestment Act (ARRA), better known as the stimulus package. The federal government is pumping billions of dollars into the US economy hoping to spur spending by other businesses. While local governments do not have the ability to increase spending solely to spur the economy, they can evaluate how the funds they do have are spent. It is possible to use existing funding to stimulate the local economy.

The public procurement profession has been experiencing a paradigm shift in the method used for basis of award. Over the years the method has shifted from a strict “lowest price wins” to a more transformational “best value” determination. Best value determination includes factors when selecting a vendor for award. Factors such as return on investment (ROI), total cost of ownership, available options and value added services are only a few. The actual factors considered in determining a ‘best value’ will differ for each type of procurement. Generally, “Best Value” can be defined as the tradeoff between price and performance that provides the greatest overall benefit under the specified selection criteria. In simpler words, “Which one provides the most bang for our buck.”

Local governments can reevaluate their spending to insure they are receiving the best value. Best value does not only apply to what is purchased but also from whom and how goods and services are purchased.

Locale Based Preference

Discussions of local vendor preference typically form two sides. On one side are elected officials representing their constituents and the best interest of the local community using local government spending to support and improve the economy. On the other side procurement professionals citing open and fair competition proposing no one vendor should have an advantage over another.

These are two conflicting goals when interpreted in their strictest sense. The one wants to restrict or favor spending to local business and the other strives to open up spending opportunities to the world. Both goals are admirable and have their place. The challenge is to find a balance between providing stimulus to the local economy and maintain a sound procurement process.

This is where the “best value” determination can be used. There is no difference in not awarding the purchase of a piece of equipment to the low bidder because the 3rd low bidder is providing a life

time warranty versus a 3 year warranty. The higher cost of the equipment with a life time warranty could be the better value.

The best value approach would ask, “Does spending dollars locally provide more of a benefit to the citizens than purchasing goods and services from outside the area?” The answer is obviously yes, but how can the response be supported with evidence and not just gut instinct? Following is information and case study examples that detail what the benefit of spending locally could be.

It is important to understand the potential negative effects of a local vendor preference. Offering too much of a preference to local businesses will discourage interest from non-local businesses. This effect may not exist during challenging economic times. However, history tells us it will become an issue when the economy improves. Non-local businesses will seek more lucrative business opportunities resulting in reduced interest, less competition and higher prices. This downside must be kept in mind when creating a local vendor preference policy.

Effect of Local Vendor Preference

Within the last 4 years studies have been released providing information on the effects of local spending. Not all of the reports focused strictly on “The effect of government spending locally.” They do however provide information on money flow in the local economy.

Staff used several studies and reports released in both the United States and United Kingdom in preparing this paper. The United Kingdom reports contain very useful information on the principles of spending money locally. While their monetary system is different, the principals are still applicable to local governments within the United States. The studies and reports referenced are listed in the bibliography. The full text of the reports will be provided upon request.

Study 1 – Office Product Suppliers

In the Procurement Matters study prepared by Civic Economics, the economic impact of a local Phoenix, AZ office product retailer is compared to the impact of national retailer Office Max. In the study, the firm evaluated four factors that drive the enhanced economic impact of locally owned firms. Those factors are:

1. Labor costs, which directly inject money into the local economy through payments of wages and benefits to local residents;
2. Profits, which remain in the community in proportion to local ownership;
3. Procurement of local goods and services for resale and operations; and
4. Charitable giving, when local firms contribute a greater share of revenue to local causes.

This study focused strictly on office products. Studies on other goods and services and between different businesses have found local firms to re-circulate substantially larger amounts in all four categories. The preliminary findings revealed the local retailer reintroduces 18.96% of their revenue in the local economy. National retailer Office Max provided only 11.56% of revenues to the local economy. The local retailer produces 64% greater local economic impact per dollar of revenue than Office Max. (Bib. 1 – p7)

These contributions to the local economy are even greater if the linkages to local businesses by the local retailer are included. The amount spent locally by the local retailer is re-spent by those businesses in their supply chain. Adding the enhanced economic impact, 33.4% of the local retailers’ revenue remains in the local economy. The amount by Office Max remains at 11.56%. (Bib.

1 – p8) The importance of linkages and the ability of local business to re-spend their revenue locally are discussed later.

Applying this example to spending by local government would yield \$.33 of every \$1.00 dollar remaining in the local economy. The Big Box Retail study completed by Dan Houston of Civic Economics supports this finding. The Austin study reveals, “. . . \$45 of every \$100 spent at a locally owned store stays in the community vs. only \$14 for every \$100 spent at a national retailer.” (Bib. 2 – p28)

The premise behind the greater local contribution is that the local retailer will re-spend more of their revenue with other local businesses and employees than the national retailer. The local retailer will spend money locally on advertising, attorneys, accounting, IT services and more local staff as employees. Large national retailers will consolidate these services and provide them to branch stores from their national headquarters. Next to no local spending on the support services are made.

Effects of Re-spending

Local spending has the potential for significant impact on the local economy. The impact can be even greater than the 33.4% stated in the previous example. The 33.4% only looks at a single round of re-spending. The dollars introduced to the local economy are spent, and re-spent, and re-spent, and hopefully re-spent some more.

The New Economics Foundation (NEF) in the United Kingdom (UK) has completed significant research in the area of re-spending. Their research has resulted in a report titled *Public Spending for Public Benefit, How the public sector can use its purchasing power to deliver local economic development.* This report focuses on many topics related to public sector spending and the extent it can benefit the local economy.



NEF uses the analogy of a leaky bucket to represent the effects of local spending. The bucket represents the local economy. The level of the water inside the bucket is the amount of money in or the health of that economy. The leaks represent money leaving the local economy through spending outside the local area. The goal is to keep the bucket full for a healthy economy. There are two options to keep the bucket full. One, you can ignore the leaks and keep pouring more water into the bucket. If the water were money, as in real life, this would not be a desirable option. The money will undoubtedly run out at some point. The better option is to plug the leaks preventing the water from flowing out. Keeping the bucket full is much easier and efficient when there are fewer leaks. (Bib. 3 – pp26-27)

The leaky bucket is a great visual representation of how money flows into the local economy and either stays or leaks out. The NEF organization has developed an economic analyses tool known as the Local Multiplier 3 (LM3). This tool can be used to perform a spend analyses calculating through three spending rounds how much of the money stays local. The result of the analyses is an index number. The index provides an indication of the effectiveness of the local spend.

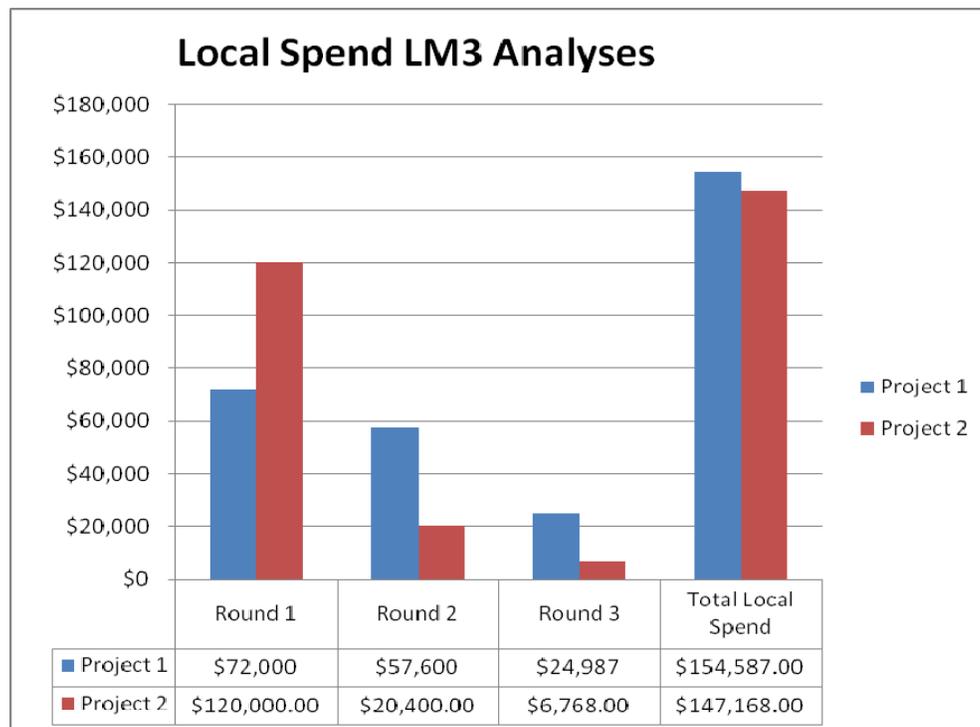
Case Study 2 – Construction Projects

The report by NEF provides results of an actual case study. The study looked at two construction projects. Each project involved comparable concrete work. The projects required very little specialized labor or materials, it was possible for both contractors to use local labor and suppliers for the respective projects. The table shown here summarizes the results of the case study.

Spending Round	Project 1	Project 2
Round 1	\$72,000	\$120,000
Round 2	\$57,600	\$20,400
Round 3	\$24,987	\$6,768
Total Spend	\$154,587	\$147,168
LM3 Index	2.15	1.23

In this comparison, round one represents the payment to the prime contractor. Rounds 2-3 represent the distribution or re-spending of the round one money by the prime contractor. The LM3 index is calculated by dividing the total spend by the round one amount. The index tells how much total spend was generated by the initial spend.

The LM3 indexes in this comparison tell us that Project 1 generated an additional \$1.15 dollars for every dollar spent in round one. Project 2 generated significantly less, \$.23 for every dollar in round one. It is important to note that Project 1 cost significantly less than Project 2, \$72,000 versus \$120,000. The lower costing Project 1 had a much larger impact on the local economy. This is presented graphically in the bar graph. As NEF cites “. . . it is not the quantity of money thrown at the local economy but *how* the money then circulates in the local economy after it is spent.”



These results are not typical of every project and every dollar spent. The LM3 analyses tool is intended to be used on individual projects. An analyses of how the money flows is required in order to get an accurate measurement of a projects effect on the local economy. In response to this, NEF has issued a document titled “The Money Trail – Measuring your impact on the local economy using LM3”. The document details how to use the LM3 tool and apply the tool to your own projects, the result being an LM3 index for the project.

To keep the local economy full and minimize the leaks requires two things. Providing adequate local services so businesses can spend their money locally with other businesses. For construction, this would mean having sufficient local material suppliers and subcontractors to support the activities of prime contractors. It could also mean having enough local professional services to serve other businesses such as legal, accounting and consulting.

Multi-Purpose Spending

Another way to add additional economic benefit with local spending is by spending to support multiple goals. Spending or routine budgeted funds could serve two purposes by supporting social enterprises. For larger government agencies, funding social programs is a significant part of their budget. Smaller local governments do not have as large a role in funding social programs. However, that does not mean local governments cannot use their spending to assist what are called social enterprises.

A social enterprise is defined as, “. . . a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profits for shareholders and owners.” (Bib. 5 – p5) Good examples of social enterprises would be Goodwill Industries, PRIDE (Prison Industry) and RESPECT of Florida.

If a local social enterprise can provide goods and services required by local government the economic benefits of that local spending are enhanced. The money spent in the local economy accomplishes a secondary goal of supporting the goals of the social enterprise. This may also mean reduced expenses or request for services in other areas such as public safety.

An example provided by NEF is an agency that had the need for construction services. The agency also funded job training for long-term unemployed people. Both needs are funded with the same money by providing the training on the construction projects for the agency. This could have been a social enterprise created solely for the specific projects, or vendors hired for the construction projects were encouraged to work with local social enterprises that could provide construction labor. (Bib. 3 – p27)

This type of spending would require additional administrative work but the benefits received from the money spent would be much greater than spending directly with contractors or businesses with no consideration of assisting social enterprises.

Definition of Local

The benefits associated with local spending have been provided. The key element is the re-spending of the money locally. To be truly beneficial it must be determined what ‘local’ is. Within what geographic area must the money be spent in order to provide the ‘best value’ and the greatest benefit.

The City’s current policy defines local as any business with a permanent storefront within a 20-mile radius of city hall. This criteria was adopted from its’ use with police officer residency. This requirement for police officer residency is intended to maintain a reasonable response time in cases of emergency. The economic benefit to Leesburg was not a factor when establishing this residency requirement.

Looking at the 20-mile radius on the map raises several questions as to the economic benefit provided to the Leesburg economy. Keeping in mind the goal of a local vendor preference program is to provide economic benefit to the community. To the north, the boundary extends into Marion County. To the west, it extends across all of Sumter County and into Citrus County. The southern boundary includes Groveland and Mascotte. Apopka and a corner of Orange County are included in the easterly boundary.

The established boundary, a 20-mile radius, is easy to define and verify. Nevertheless, do all areas within this boundary really benefit Leesburg? How many vendors or businesses in Apopka, for example, will re-spend their money in Leesburg? It would seem they would be more likely to go to Altamonte, Longwood, Orlando and other points east.

Vendors and businesses in Wildwood, Bushnell and other rural areas would be more likely to re-spend in Leesburg. Leesburg can offer products and services they may need that are not available in their immediate community. One of the key elements to the benefits of local spending is the re-spending within the local community.

Summary

The information and data obtained from these reports is adequate to support the benefits of local spending. When it comes to establishing percentages there are no standard percentages that fit each situation for all municipalities. The appropriate percentage should be based on the needs and requirements of the specific community. Additionally, any changes in the preference percentages should be made with consideration given to maintaining the interest of vendors outside the local area and the affect of any changes on department budgets.

The table provided here lists what some other agencies within Florida are using.

Municipality	Local Vendor Preference Percentage
City of Tallahassee	2%, 3% or 5% based upon actual cost
City of Osceola	3%
Citrus County	3% or 5% based upon actual cost
City of Tallahassee	5%
Sumter County	2%
City of Sarasota	5%
Osceola County	2%, 3%, 4%, or 5% based upon actual cost
City of Palm Beach	5%, 7.5% or 10% based upon business classification
City of Gainesville	5%
Polk County	5%, 2%, 1% or .5% based upon actual cost
City of Ocala	5%

Source: Marion County Board of County Commissioners Procurement Services

The current City policy employs a unique preference method for construction projects exceeding \$25,000. All contractors are able to qualify as a Local Business Enterprise by using at least 51% local material suppliers or sub-contractors. In the case of construction projects, the appropriate percentage would be the amount (percentage preference) given to attract at least 51% of the project cost to the local economy. Two tables listing the percentage values are included at the end of this report for your reference.

The commission may consider designating certain goods and services to be procured only from local businesses. The selected commodities should be available from several local vendors that can provide a competitive process. It could also be commodities where the savings realized from purchase outside the area are less than the total benefit received from spending the money locally, applying the best value principal. On a purchase-by-purchase basis, ordering on-line from a company in Texas may be cheaper than purchasing the items locally. This does not consider the economic benefit of making the purchase locally at a reasonably higher cost.

The geographical area defined as local should be revised to include those areas that present a real possibility of any re-spending would take place within the Leesburg community. The information provided here stresses the importance of businesses re-spending money locally. It is important to keep the water in the bucket by minimizing the number of leaks. Increasing the geographical area makes possible the occurrence of many more leaks.

There is definitely an economic benefit in governments spending locally. The real benefit comes in the subsequent rounds or re-spending with other local business. In order for local spending by government to generate the most benefit local business must spend with other local businesses. The full economic benefits of local government spending will not be realized without assistance from the local business community. Businesses that receive government spending must commit to re-spend as much of that money locally.

Bibliography

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