



The Jimmy Reid
Foundation

Using Our Buying Power to Benefit Scotland

- the case for change



REPORT SUMMARY

The Aim

The Scottish Government introduces its Sustainable Procurement Bill later this year. This can play a major part in promoting economic and social development in Scotland and reform a procurement system which is not working effectively.

The potential wins are enormous – hundreds of millions of pounds and very possibly more could be injected into the Scottish economy and targeted at supporting Scottish businesses (and in particular SMEs), expanding training, encouraging research and development, strengthening the Scottish supply chain and enacting national economic policy.

Instead, a twin approach of favouring big business and a micro approach which concentrates too much on cost saving and project delivery without considering wider economic and social implications has in fact harmed the Scottish economy.

The solutions to this problem are straightforward, mostly within the powers of the Scottish Parliament and the legal constraints of the EU Procurement Directive and largely shown to work elsewhere (*main report 7.1 - 7.9*).

But if Scotland is to gain this boost to its economy and wider society, everyone involved must accept that there are clear failures, and accept that they can be resolved. At the moment it is far from clear that Government Ministers and policymakers are getting a balanced and representative picture (*6.5 - 6.10*).

This report from the Jimmy Reid Foundation (authored by Jim and Margaret Cuthbert) is the most detailed and in-depth independent study of procurement to be produced in Scotland. The findings are clear and, while it would be a mistake to conclude that all aspects of procurement in Scotland are failing or that there are no examples of good practice (*5.17*), the conclusions are unambiguous. In many cases, the effects of the present procurement system are working against, rather than for, the economic and social development of Scotland: and the monitoring system which should be alerting us to what is going on is painting a partial and unduly rosy picture.

The Scottish economy is under an unprecedented assault from the global crisis of corporate capitalism. The tenets of corporate capitalism – that policy should focus on micro issues and leave the free market to ‘do the rest’ and that the interests of big business and the wider population are synonymous – still hold sway in too many parts of public procurement in Scotland, and must not be allowed to scupper this chance to provide a valuable lifeline to the Scottish economy.

What is required is real reform: the appearance of reform which leaves business-as-usual intact would be to let down Scottish businesses, Scottish workers, Scottish society and in the end, Scottish taxpayers.

What could be achieved

The Scottish public sector spends more than £9 billion per year on procurement (*1.1 - 1.3*). Too much of this money is allowed to leave the Scottish economy with the cost to jobs and the business base this implies. Meanwhile, the money which does remain in our economy is almost wholly detached from wider economic development policies.

It does not need to be this way. Some simple reforms to procurement rules and practices could make a major difference:

Economy

- Simply by designing procurement in a way that (within EU rules) gives Scottish business the best possible chance of winning contracts would be the equivalent of a major inward investment coup, year on year.
- This money need not be 'policy-neutral'. It can be used to encourage better business and better businesses, for example by encouraging more training and staff development, by identifying and remedying weaknesses in the Scottish supply chain and by maintaining research and development activity domestically.
- And if there is real vision in using procurement contracts as an economic development tool, the public sector should be planning ahead to identify gaps in the Scottish domestic supply chain or need for improvement and innovation in the Scottish domestic supply chain and should be helping Scottish companies to adapt and prepare now to meet those challenges when they arrive and in so doing achieve a competitive advantage in the market, domestically and beyond.

Society

- Procurement policy can make sure that businesses act as 'good citizens', ensuring they meet their obligations to pay fair tax, treat workers fairly (and pay them fairly), abide by proper health and safety standards, play a positive role in protecting the environment and more.
- The interests of the users of Scottish public services can be championed if the development of contracts would put their interests first, ensuring that projects are specified for long-term benefit and not short-term expedience.
- Imaginative use of conditions applied to contracts can achieve many social, environmental and economic benefits such as providing jobs for vulnerable groups, requiring community interaction or that best environmental technologies be used.

What's the problem?

When we look at the facts on the ground we find that what is actually happening in the procurement system belies the claims made for it. The report's findings are symptomatic of the following features of the system (*8.2 - 8.4*):

- There are pressures to make contracts so large that Scottish companies, and in particular, smaller Scottish companies, find it difficult to compete.
- There appears to be such a narrow focus on cost savings that focus is drawn away from achieving an acceptable balance between saving money and achieving economic and social benefits for Scotland.
- There seems to be an assumption in several strategic parts of the public sector that best outcome will be partner arrangements with large corporations. In many cases, Scottish companies are too small to undertake this role, so the private sector partners end up being consortia of large firms from outside Scotland. It also tends to place too much control in the hands of the corporate partner.

These conclusions are derived from a very wide survey of actual outcomes. The following are a number of indicative key findings. They show that Scottish companies are regularly paying the price of 'efficient procurement' and they also show that in many cases corporate interests appear to have dominated the public interest.

- **Locking Scottish companies out – for years.** A framework agreement is a long-term contract which ties the public sector into buying named goods and services from named companies for periods of up to four years. The report shows that the large majority of companies on these lists are not headquartered in Scotland. For example, the central government purchasing agency Procurement Scotland created 49 agreements of which 28 contain no Scottish companies at all (5.3). There is also very low penetration by Scottish companies in several of the framework agreements set up for the local authority sector (5.2).
- **Expediency over Scottish interests.** Framework agreements do not need to be negotiated in Scotland – they can be 'picked off the shelf' from UK-wide bodies or even from bodies that do not operate in Scotland. The Scottish central purchasing agency Advanced Procurement for Universities and Colleges operates over 130 framework agreements. Fewer than half were negotiated in Scotland and 28 per cent were negotiated by organisations that don't even operate in Scotland. This is a problem because when an agreement is set up by a non-Scottish organisation penetration by Scottish companies is very small: for example, there were only five Scottish companies in total out of the 152 successful tenderers for the group of framework agreements set up by organisations which do not operate in Scotland (6.2 - 6.4).
- **Sizing out competition.** Private Finance Initiative contracts have been so big that there is often little competition: a study of the 37 schools PFI projects commissioned in Scotland indicates that there were on average just two bids at the final selection stage, and these bids involved just 22 groups of firm (5.7).
- **Failing to protect R&D.** Scottish Water has contracted out the delivery of a large part of its £500 million annual investment programme (which includes a substantial R&D element) to a private sector partner which, while Scottish sounding ('Thistle') is a French, English and Californian consortia. For that part of its investment programme not covered by Thistle, Scottish Water has appointed what are called construction delivery partners: of the 16 partners appointed only three are Scottish companies (5.8 - 5.9).
- **Creating monopoly access.** The Scottish Futures Trust has divided Scotland into five hubs to deliver public sector infrastructure such as schools, libraries, swimming pools,

health centres etc. Each hub involves a single private sector partner, appointed on extraordinarily long contracts of 20 to 30 years duration and with a remarkable level of control (from specifying the projects to financing them, building them and operating them). Three out of four private sector partners appointed so far are consortia with no Scottish partners. These hub arrangements are very similar to the establishment of a single supplier framework agreement and under the EU Procurement Directive, framework agreements are limited to a life of no more than four years. So not only does this procurement practice appear to be of doubtful wisdom, but also of questionable legality. The legality of the hub 20 to 30 year contracts therefore should be tested against the Directive (5.11 - 5.13).

- **Squeezing out diversity.** Some products procured by the public sector are very diverse (for example books) but procurement bodies still tend to specify requirements in terms of large contracts covering a wide range of aggregate supply. This penalises small scale specialist suppliers (who might often be Scottish firms) in favour of large wholesale-type suppliers (who are almost all headquartered outside Scotland). Claims have been made that aggregate contract can actually cost more than a number of smaller contracts (5.15 - 5.16).
- **Giving a misleading picture.** The Scottish Government has claimed, as evidence of the success of its procurement policies in helping the development of the economy, that 73 per cent of the contracts awarded through the Public Contracts Scotland portal are awarded to SMEs. The report shows that the monitoring system upon which this claim is based is so flawed that this figure is potentially highly misleading. For example, the threshold used for defining an SME is so large that it covers 99 per cent of firms in Scotland; the size of firm is self reported by the firm and is not validated – so branch plants or depots of large firms may be recorded as SMEs; there is nothing to say the firms in question are actually based in Scotland; purchases made through framework agreements are not recorded; and the establishment of framework agreements which may be utilised in Scotland, but which actually originate elsewhere in the UK, are not recorded (6.5 - 6.10).

This evidence shows the system failing Scotland by actually costing Scottish jobs and undermining Scottish companies. But there is one telling fact which must make us ask serious questions about the approach being taken: no-one involved in the expenditure of £9 billion of Scottish money is able to tell what value of contracts went to Scottish businesses (6.10). The system is set up in such a manner that Scottish economic development is so inconsequential to its aims and goals that it doesn't even bother to measure it. This is clearly a problem.

Why is it going wrong?

There are three simple problems embedded into the approach to procurement from which spring most of the problems identified above.

The UK policy towards procurement was developed in Whitehall under intense corporate lobbying and appear to have been designed with the interests of big business put ahead of almost all other interests (4.1 - 4.3). Where businesses could have been required to promise to act in accordance with the laws of the land, Whitehall chose to make this optional. Where proper monitoring of practices such as subcontracting could have made sure businesses

were acting appropriately, Whitehall made this optional. Where EU rules made clear that opt-outs and additional social or environmental criteria could be used, Whitehall did all it could to downplay these possibilities. Scotland adopted the UK approach almost in its entirety. This tied the hands of the Scottish public sector from the outset.

This was exacerbated by the policy approach taken by John McClelland in his defining report on procurement (4.4 - 4.9). This report took a 'corporate' view of procurement, identifying it as a 'micro' issue almost entirely unlinked to the 'macro' issue of the wider economy. The McClelland report (which barely mentions economic development at all) failed to see any link between £9 billion of public sector expenditure and any economic development role, instead adopting a narrow and short-sighted definition of the purpose of procurement as a process of cost-savings. It recommended more and more centralisation, removing procurement further and further from its policy environment. In failing to realise that running a country is not the same as running a business, the McClelland report again tied the hands of the Scottish public sector from the outset.

Having set out a policy context on the basis of these two approaches, procurement in Scotland was set out on the wrong course from the beginning. It is true that the Scottish Government has subsequently taken a number of worthwhile initiatives, which are recorded in the report (4.11 - 4.12). But the overall momentum of the system is such that these initiatives have not been able to prevent the system, super-tanker like, continuing to head off in a wrong direction. And there are still fundamentally mistaken attitudes in parts of the system, like the preference for large contracts, and long term arrangements with large public sector partners, which need to be countered. Moreover, any chance of correcting that course was then greatly diminished by a process of monitoring which was unlikely ever to give an accurate picture of progress. Insufficient data is collected, and much of the data which is collected is not validated (most of it being self reported by businesses). And thus we have a situation where no-one can tell what share of the £9 billion being spent by Scotland is spent in Scotland.

The biggest and most problematic outcomes of all of this are the bundling of contracts together into one giant tender which is easy to manage, easy for big business to tender for but almost impossible for smaller and domestic businesses to win and the routine use of Framework Agreements which favour big suppliers and then freeze out all other suppliers for up to four years. The problems above show that the impact of these approaches are very real. This problem is one of mindset. Many people in the procurement community would like to take a more visionary approach, but again and again they are directed away from this and constrained by the narrow definitions of what procurement is for.

Some of this would be challenged by those responsible. Some would argue that Scotland has not adopted a restrictive definition of EU rules; this report shows that argument is difficult to sustain when we look at what other EU countries have done (7.1 - 7.9). Some would argue that cost-saving remains the primary function of procurement and that progress has been made. Certainly some cost savings have been achieved, but it is not clear that they offset the harm done in the process, or that they could not have been achieved with an approach designed to boost the Scottish economy. And lately there has been a new focus on longer-term macro-thinking on procurement, but this not yet being backed up with necessary reform of the process.

The causes of the problems are clear and while they might be challenged by those responsible, public policy must follow the evidence. The evidence makes a clear case for reform.

Can it be fixed?

There is nothing stopping major reform of procurement:

- There is very clear scope within the EU directive to take a different approach to procurement. There is a substantial list of ways that procurement laws can be interpreted flexibly. The list is too long to summarise here but for example you do not need to put projects with substantial R&D elements out to tender at all, you can protect projects where a training need or employment of vulnerable groups requires to be protected, there is substantial leeway in applying social or environmental criteria to contracts and so on. But above all, there is absolutely no requirement to create giant amalgamated contracts which cut out Scottish businesses and put far too much power in the hands of the big businesses who win these contracts (4.1 - 4.3).
- The McClelland approach is one entered into voluntarily by the Scottish public sector and can be reversed immediately. Instead of centralising functions into large agencies those agencies could instead act to help procurement professionals much closer to the ground achieve cost savings and policy goals. Instead of building large contracts, contracts could be disaggregated to the level best able to give Scottish businesses a chance to win them. Rather than passively advertising for suppliers, a 'forward procurement' process could see the roles of economic development, public sector procurement requirements and business support brought together with procurement to work towards common goals. The EU Directive does nothing to discourage any of these approaches.
- The problem can be fixed; the EU rules do indeed act as some degree of impediment to certain approaches Scotland might wish to take and there should be continuing lobbying to change this. But those impediments do not prevent any of the recommendations below being enacted. Above all there are two reasons to be absolutely confident that more can be done. The first is that many other EU countries already demonstrate better practice. The second is that there are already examples of good practice in procurement in Scotland right now. Denying that better performance is possible should be dismissed.

Procurement can be done better – indeed in cases like the Clyde and Hebrides ferry tender it was, and initiatives such as a training requirement in the draft Scottish Budget and work on community benefit show that the Scottish Government is already making some progress (5.17). Across the Scottish Government and the public sector there is a desire to improve and that must be supported with action.

What must be done?

There are simple, clear actions which can transform procurement in Scotland from being a narrow tool which causes the perverse range of problems identified in the report to being an effective tool for economic and social development (*full version of these recommendations in main report 8.5*):

- A. Make it the norm to split contracts into relatively small blocks – and consider a law to make this mandatory

- B. Exploit to the maximum extent the existing potential to use exemptions from the EU Directive to assist the local economy and social well-being in areas like research and development and skills training
- C. Ensure all contracts contain adequate safeguards on pay, terms and conditions and pensions by making it mandatory for firms to confirm compliance with relevant obligations on tax, environmental protection, employment protection provisions and working conditions
- D. Identify gaps in the supply chain and potential innovative products for which there could be a public procurement demand and then help Scottish enterprises to exploit these opportunities – ‘forward procurement’ uses public procurement to help Scottish companies develop a market advantage in innovative products
- E. Review the wisdom and legality of the Scottish Futures Trust hub arrangements
- F. Do not adopt framework agreements which have been negotiated by regional purchasing bodies elsewhere in the UK
- G. Develop the role of centralised procurement agencies in assisting their members and clients to be better at producing – and winning - contracts
- H. Exploit the potential of Scottish Enterprise and other economic development bodies, for example, to facilitate the formation of SMEs into consortia capable of winning framework agreements and individual contracts
- I. Ensure that all industry advisory groups for key sectors are working with the Scottish Government’s procurement directorate to develop plans for their sectors
- J. Develop the capacity of the small business sector to respond to opportunities in public procurement
- K. Carry out a research exercise to establish how well the information on firms winning contracts corresponds to their actual size, location and ownership status
- L. Continue to improve the current arrangements for monitoring the operation of public procurement in Scotland
- M. Continue to lobby the EU to broaden the definition of value for money in the EU Procurement Directive so that it is easier to include support for local and economic well-being as a criterion

Conclusion

In one process of reform Scotland can gain a major tool to address economic and social development while escaping the widespread failings of the current badly-designed system. Above all, it must be recognised that governments always work at the macro level and can never justify disregarding the impact on the economy and society when they design processes for themselves. If these processes had been designed to strengthen Scotland and not just save a bit of money they would look very different. The opportunity to fix this is in front of us, the potential benefits are numerous and the scope for doing it is clear. Action should be taken immediately.



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