

## Competition can raise value for public money

The public purse is used to purchase approximately \$30 billion dollars of goods and services per year.<sup>1</sup> Now more than ever, the fiscal situation demands central and local government departments spend wisely. One very effective way to ensure value for money in procurement processes is for government departments to use their purchasing power to leverage off competition among suppliers.

Overseas evidence suggests that improvements in procurement processes could deliver savings of up to 40%.<sup>2</sup> In New Zealand, even a 1% improvement in the value for money of government spending could lead to annual savings of \$300 million of taxpayers' money.

### Funding pressures will put public purse to the test

In the current climate government spending has come under the spotlight as part of the overall requirement for government departments to improve performance and reduce spending. Treasury in its long-term fiscal statement stressed that if government spending followed historic trends, budget deficits would last beyond 2050, resulting in net public debt reaching more than 220% of GDP midway through the century.<sup>3</sup> This is unsustainable, and the Minister of Finance has told government departments to think hard about how to live with little or no extra funding for the next three to five years.

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<sup>1</sup> [http://www.med.govt.nz/templates/Page\\_41694.aspx](http://www.med.govt.nz/templates/Page_41694.aspx).

<sup>2</sup> Ibid.

<sup>3</sup> Challenges and choices: NZ's long term fiscal statement. The Treasury. October 2009.

## Achieving value for money...

Government departments will have to make every dollar count. But what does value for money mean? It is not just about quick short-term financial savings. Value for money essentially means adopting the option that meets your long-term needs at the desired quality level and within a given budget. The Auditor-General defines the concept of value for money as follows:<sup>4</sup>

*Public entities should use resources effectively, economically, and without waste, with due regard for the total costs and benefits of an arrangement, and its contribution to the outcomes the entity is trying to achieve. Where practical, this may involve considering the costs of alternative supply arrangements.*

## ...through greater competition

Value for money can be achieved by promoting public procurement processes to take full advantage of competition among providers. More intense competition can deliver lower prices, better quality products and services and innovation. However, sometimes competition is not always considered in procurement processes as the administration costs of procurements are more visible than the cost savings from more intense competition, or there is a reluctance to switch to new unknown suppliers.

## Government departments can promote competition

As big spenders, government departments have the ability to enhance competition in procurement processes, for example, by maintaining a competitive market structure through deliberately sourcing from a number of suppliers, by providing the right incentives to suppliers to invest and innovate, or by helping firms to overcome barriers to entry.

## Room for improvement

The Auditor-General found that more than half of the procurement policies it looked at in its annual audits fell well short of good practice standards.<sup>5</sup>

In the past the Commerce Commission (Commission) has also had some concerns with the ability of government departments to promote competition and use their purchasing power to the full extent or for long-term considerations. For example, in a bus merger, the Commission found that Environment Canterbury, as a single purchaser, had greater scope to exercise the full extent of its purchasing power to negotiate better deals with bus operators in the Canterbury region.<sup>6</sup> In the supply of pathology services, the Commission found that in the short-term, the District Health Boards (DHB) would have benefited financially from a merger between two providers, under the bulk funded single-provider model. However, post-merger, in the long-term the DHB's purchasing

<sup>4</sup> Public sector purchases, grants, and gifts: Managing funding arrangements with external parties, Office of the Controller and Auditor-General, 2008. Part 2.

<sup>5</sup> Central government: Results of the 2006/07 audits, part 4, "Procurement, grants, and other funding arrangements". Office of the Controller and Auditor-General.

<sup>6</sup> Commerce Commission Decision No. 551 Red Bus and Leopard Coachlines.

model would have left it with one supplier dampening their purchasing power.<sup>7</sup> As a result, the proposed merger was declined.

### Following best practice

While there are a number of guidelines available to assist central and local governments in designing their procurement processes, these guidelines are not always followed. Some of the guidelines are too long and more importantly not all government departments are requiring their staff to use them or training staff on how to use them. Following best practice can help promote competition and achieve value for money. But this requires inexperienced government departments to seek expert advice on how to follow best practice.

### New approach to Government supplies

The Government has announced the introduction of Centres of Expertise (CoE) which will lead a new “all-of-government” contract to purchase common items, like stationery and computers directly from approved suppliers.<sup>8</sup> The new approach is designed to streamline the purchasing process for government departments and eliminate the need for suppliers to respond to multiple tenders. The four-year contract can achieve value for money if it:

- designs the tender so as to encourage bidders to participate. Restrictive selection criteria can rule out credible suppliers
- defines its requirements clearly, making it easier for potential suppliers to understand the “all-of-government’s” needs and submit a bid
- monitors and benchmarks the performance of successful suppliers to allow it to reward good performance and incentivise suppliers to deliver on their promises
- makes the CoEs accountable for their procurement decisions.

### Risks with the new approach

There are a number of real risks with centralised purchasing that need to be managed, if it is to deliver value for money in the long-term. One of these risks is that bundling contracts for common supplies could destroy competition in the long-run, for example, by making it difficult for firms that only provide one part of the bundle to compete. This could reduce the participation of bidders in the long-run and remove the ability to benchmark performance. Another and related issue is that it could also make it difficult for government departments to switch providers if they became too expensive or quality levels started to drop. As a result government departments may become over-reliant on existing suppliers over a long period of time.

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<sup>7</sup> Commerce Commission merger Decision No.559: New Zealand Diagnostic Group Limited and Sonic Healthcare (New Zealand) Ltd.

<sup>8</sup> <http://news.business.govt.nz/news/strategic/article/9654>.

## Guidance on competition matters

Government can deliver greater value for money by promoting competition in public procurement processes. However, every procurement process is different as it depends on the nature of the public goods and services required. NZIER can provide guidance on the possible competition effects of public procurement processes. By applying best practice and drawing on our experience with advising clients on the economic aspects of competition law, we can help with conducting a total cost benefit analysis of procurement arrangements and provide any other related advice on achieving value for money. Examples of our previous work in public procurement is shown below.

### **Public Procurement**

NZIER considered a framework for assessing whether a government agency should purchase health equipment jointly with another agency. At the time, we found the market structure already achieved the economies of scale needed to lower costs and so greater clarity was required on the objectives of joint purchasing.

Recently, NZIER provided economic advice on a change in a procurement strategy for transport services. We conducted a scenario analysis and assessed whether the proposed purchasing arrangement delivered value for money and if it did not what could be done to achieve it. We recommended a long-term procurement strategy to enhance competition between suppliers, as well as designing procurement contracts with appropriate incentives and sanctions.

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