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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

PUBLIC PURCHASING POLICY

Memorandum by the Chancellor of the Exchequer  
and the Secretary of State for Industry

1. We were invited by the Prime Minister on 10 September 1979 to review public sector purchasing policy with particular reference to ways in which it might be adapted to assist British industry. This review is now complete and a report is attached for the Committee's consideration.
2. The Committee is invited to take note with approval of the recommendations at paragraph 15 of the attached report.

G.H.

K.J.

HM Treasury  
Department of Industry  
13 February 1980

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PUBLIC PURCHASING POLICY

Note by the Treasury and the Department of Industry

1. The public sector, taken as a whole, is British industry's biggest single customer. Its purchases run at over 15% of GDP, and in some sectors public purchasers are the predominant or sole customer. This paper reviews the scale of public purchasing, the policies at present followed, and the industrial considerations; considers possible steps to improve the effect of public purchasing in British industry; and makes recommendations.

Scale

2. Public purchasing includes procurement by central Government, local authorities and nationalised industries. In 1977/78, Government Departments and the National Health Service placed contracts worth almost £4,500m for supplies and £650m for works. Annex A shows the costs of the supplies ordered by major purchasing departments from firms in the UK, whether for UK or foreign goods, and from abroad. These figures do not reflect the import content of goods provided as part of contracts for works. Leaving aside some of the purchases, eg food, which are governed by special factors, departments placed orders abroad for 11% of non-defence and about 8% of defence supplies. Nationalised industry purchases are much larger than the departmental purchases. In 1974/75 (the latest year for which complete figures are available) the nationalised industries spent almost £7,000m on supplies equal to say £10,000m in 1977/78 values. Local authorities purchasing probably ran at about £2,000m in 1977/78. Available data indicate that local authorities and nationalised industries placed much the same overall proportion of their orders with British firms as Departments. Direct purchases abroad are generally believed to have been made either because there was no suitable equivalent manufactured in this country, or because they represented better value for money.

Present policies

3. The common element in all public purchasing is that it involves an outlay of public funds and thus requires that the best value for money be obtained in all the circumstances. In the case of Government Departments this objective is pursued by the use of competitive tendering where practicable, although a large proportion particularly of Ministry of Defence procurement (about £2,000m) has to be obtained non-competitively. Value for money in this latter category is sought under special arrangements agreed with the CBI, and monitored by the independent Review Board for Government Contracts. The value for money aspect overall is carefully watched over by E & AD and the Public Accounts Committee.

- 1 -

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4. The purchasing decisions of local authorities and the nationalised industries are not subject to direct Government influence, but naturally these bodies seek to buy cost-effectively. For nationalised industries commercial considerations are paramount.

5. There are one or two examples of preferences given by Departments for industrial or social policy reasons. It has been Government policy since the early 1970s to place contracts for large computers with ICL, subject to suitability. This preference will lapse in January 1981 when international rules on non-discrimination on grounds of nationality start to apply to computers. A limited preference is also given to firms in development areas and to sheltered workshops for the handicapped and prison workshops.

6. It is of great importance that the general principle of best value for money be maintained. It is a safeguard for the taxpayer against wasteful expenditure; it reduces the risk of corruption; and it maintains confidence among suppliers in the fairness of the Government's commercial practices. As a general consideration, it also fosters competition and hence provides a strong incentive to industry to become more efficient. It is also consistent with the Government's present and prospective international obligations (see note at Annex B). Although, as noted in the Annex, our existing obligations have had little effect on procurement patterns so far, it is expected that the EEC Supplies Directive in particular will have an increasing impact over time.

#### Industrial Implications

7. The question is how far "value for money", in the widest sense, should take account of the interests of the suppliers, and particularly British suppliers:-

(i) Any large purchaser, taking a large share of the output of an industrial sector, will need to consider what he can do to promote the competitive performance of firms within it, in his own long-term interest. A good example of this approach is the purchasing policy of Marks and Spencers, which has given firms an assured market, raised their efficiency and improved their products by close co-operation between producer and buyer. Public purchasers should have at least the same interest in the health of their suppliers, and normally look first to firms in the UK as partners in this kind of close relationship, for a number of reasons, notably to ensure security of supply.

(ii) Beyond this "enlightened self-interest", it can be argued that public purchasing policy should go out of its way to promote the competitive efficiency of the British supplying industry, in the overall national interest. It can help to develop products to specifications which will sell abroad, and ensure long enough production runs to promote new investment and product design. This is different from merely paying high prices for the output of a declining UK sector which is failing to keep up with international competition; in the absence of constructive co-operation to improve competitive performance, such a policy could lead to much wasteful expenditure as against

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buying from abroad. But if a firm or sector can be maintained and enabled to compete successfully, this is arguably worth some additional short-term cost and management effort in the national interest.

Whether either of these arguments applies to particular purchases, and to what extent, will vary from case to case. They are more likely to apply where the product is less uniform, with a higher technological content. It should be noted that competitive tendering can tend in some circumstances to place undue emphasis on more immediate value for money, and to lead to inadequate consideration of longer-term aspects.

8. Successive Governments have seen the importance of using public purchasing as a tool for promoting improved industrial performance in suitable cases. A 1967 White Paper (Cmd 3291) laid down a number of goals for public purchasers. These included the encouragement of innovation and economy in production, standardisation, promotion of quality assurance and centralisation of purchasing to obtain economies of scale. Much work has been done in these directions, in particular in devising specifications which both meet the buyer's requirements and enable the supplier to produce goods acceptable in export markets.

9. There have been a number of reports suggesting that public purchasing could be used to support Industry's performance. The Corfield Report (January 1979) stressed that public purchases could do much to improve product and design. The Warner report on Standards and Specifications in the Engineering Industries (February 1977) emphasised the same point. The Advisory Council for Applied Research and Development (ACARD) Report (August 1978) recommended that the Government should require nationalised industries and the major purchasing agencies to support the international competitiveness of their suppliers when designing and ordering new equipment and have returned to this theme in a report on "R & D in support of public purchasing" which they have just completed. Several sector working parties have recently emphasised much the same themes. These do not represent special pleadings for assistance to bolster up failing UK firms; they are calls for the constructive use of the power of public purchasing to "pull through" improvements in UK industry.

10. In response to a continued search for ways of making sure that British companies have full opportunity to bid for Government business, a number of administrative measures have been taken (noted in Annex C). It is not yet sure that all these are likely to prove productive. Ways are being considered of encouraging small businesses to tender for Government business by providing them with better information on how to set about the process.

11. From the international point of view, there is ample anecdotal evidence to support the conclusion that public purchasing is used effectively as a non-tariff barrier. This may diminish as international obligations start to bite, but there will always exist a bias in favour of domestic suppliers. This is not necessarily a

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reason for giving more protection to UK suppliers, though it should be noted that a similar bias has always existed in the United Kingdom, and this is one explanation for the relatively low proportion of supplies purchased abroad. This bias has its roots not just in the knowledge purchasing officers have that Departments are as likely to be criticised for buying abroad as for failing to accept the lowest tender, but in the undoubted convenience of dealing with local suppliers. Hitherto, however, Departments and other public sector purchasers have not always seen it as part of their responsibilities to be on the lookout for situations in which public purchasing can be used strategically to promote the competitiveness of British industry. There is evidence that the governments of many other developed countries, eg the US, Germany, Japan and France, use public purchasing systematically to help launch new products and technologies.

12. In considering what more should be done, a balance has to be struck between using public purchasing in carefully selected cases to strengthen the international competitiveness of existing or new companies and the need for the public sector to procure its requirements at minimum cost. These objectives are not necessarily in conflict, but the balance between them cannot be struck by laying down a detailed policy, because the problem is one of specific cases. Effective action depends on purchasing officers' or boards' ability to identify cases - which may be of a relatively insignificant value in the first place - where measures of the sort discussed in paragraphs 8-10 above would be cost effective.

13. Department of Industry's own observation indicates that the purchasing practices of public sector organisations have varied considerably. Some have used their purchasing leverage particularly constructively to help improve the products, processes or productivity of their British suppliers. The National Coal Board for mining machinery, the Ministry of Defence for electronic capital goods and the Post Office for telecommunications provide good examples of what can be done. At the other extreme, there have been criticisms of standards and specifications laid down by some public bodies (eg CEEGB) which are said to limit export potential of the products involved. There may therefore be scope for a dialogue with the nationalised industries to seek improvements. But it is important that any Government initiative in this area should not conflict with the steps being taken in other contexts to strengthen the framework of financial discipline within which the industries operate and to eliminate unnecessary Government interference in their commercial activities.

14. None of the foregoing is intended to imply that action should be one-sided. There is, naturally, a tendency on the part of industry to blame public sector purchasing for giving insufficient support when the causes of missed orders or unhelpful specifications lie within industry itself. The main effort to improve its performance must come from industry itself.

Benefits, both to themselves and to suppliers, of improving the competitiveness of UK suppliers and contractors.

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(ii) To this end, close links should be established and maintained between purchasers, suppliers, and sponsor Departments where this is not already the practice. These links should cover inter alia, product and process developments, productivity, future requirements, specifications of requirements, and the development of home and export markets. Initially it may be necessary to concentrate on a few areas, especially those involving growth technologies or innovation.

(iii) Ministers should discuss the impact of public purchasing on the supplying industries with the Chairmen of nationalised industries and should seek to gain their co-operation to a positive attitude towards UK suppliers. This should include:-

- The possibility of providing support under existing schemes for pre-production orders of advanced equipment; and reviewing the arrangements that exist at all levels for consulting suppliers on the standards and purchasing specifications which should be used. Nationalised industries should be asked to indicate regularly progress in aligning specifications to support the efforts of their suppliers, notably to facilitate their export competitiveness;
- the scope for improved "early warning" arrangements so that suppliers and sponsor Departments can be informed of important prospective developments, especially those incorporating technological advance.

The Chairmen might be invited to produce early specific proposals for improving the situation.

(iv) Similarly, purchasing Departments should be reminded of the desirability of fostering British industry in the light of the considerations in this paper and of the importance of the administrative measures taken (Annex C), and any extensions thereof that might be appropriate. Department of Industry and other sponsoring departments should seek to identify specific areas within which, by determined effort, the benefits of a closer supplier/customer relationship could be realised.

(v) The co-operation of local authorities, using their associations as appropriate, in similar work to that described above, should be sought.

(vi) The co-operation of other important bodies that rely on public funds should also be sought, where appropriate, in the selected product areas.

HM Treasury  
Department of Industry  
13 February 1980

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ANNEX A

ESTIMATED VALUE OF SUPPLIES CONTRACTS PLACED  
BY MAJOR PURCHASING DEPARTMENTS, 1977/78

Departments	Purchases		£M
	UK	Overseas	
Agriculture and Fisheries for Scotland	2	-	2
Civil Service	48	16	64
Ministry of Defence	3,000	370*	3,370
Transport	2	-	2
Property Services Agency	264	4	268
Health and Social Security	108	22	130
Home Office (including Metropolitan Police)	34	2	36
Royal Mint	28	4	32
Scottish Home and Health	9	2	11
HM Stationery Office	96	20	116
	3,591	440	4,031

\* This figure includes certain contracts placed under collaborative agreements with other countries. Under such agreements work is also placed by those countries in the UK.

13 February 1980

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ANNEX B

INTERNATIONAL OBLIGATIONS IN THE PUBLIC PURCHASING FIELD

Article 7 of the Treaty of Rome forbids discrimination on grounds of nationality. Article 30 prohibits measures having the effect of quantitative restrictions on imports. The EEC Supplies Directive lays down detailed rules on the advertising of supplies contracts worth £130,000 or more and the fair award of such contracts. It applies to Government Departments (including the NHS) and local authorities. Certain specified types of contract are exempted from these procedures; for example, most defence contracts.

2. From 1981 the GATT Government Procurement Code will extend the principle of non-discrimination in the award of supply contracts outside the EEC to all signatory countries including the USA and Japan. It will apply to government departments and the NHS but not to local authorities or nationalised industries (except the postal business of the Post Office).

3. The Supplies Directive has not so far produced any significant diversion of trade to our disadvantage. The value of public contracts caught by the advertising requirement to date seems to have been much smaller than expected; in the first six months of advertising (the only period for which figures are available) only about £50m worth of government contracts was advertised. So far as is known no supply contracts advertised have gone abroad that would not have done so in any case (eg food supplies for BAOR). Some British companies have, however, won business on the Continent as a result of it. There is no evidence that, apart from Italy which has not yet passed the necessary legislation to enable it to comply with the Directive, other Member States are not meeting their obligations under it.

4. A similar EEC Directive governs the advertising and award of works contracts. The UK has complied with it since accession and, since 1973, has advertised more than 5,000 contracts. Of these, the Orwell Bridge (the contract for which was recently awarded to a Dutch Company) was the first to go to a foreign firm. All other Member States are complying with this Directive.

5. A close watch will be maintained on the operation of both Directives which have the support in principle of the CBI, and of the GATT Code when it comes into effect. Failure to comply with the Directives would risk a confrontation with the Commission and other Member States which might result in heavy pressure on the UK to enact legislation to enforce them.

6. The GATT Code is due to be reviewed within three years. We are likely to come under heavy pressure at that time from the US (and perhaps from some other Members of the EEC) to extend the Code to nationalised industries.

13 February 1980

CONFIDENTIAL



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ANNEX C

ADMINISTRATIVE MEASURES

Government departments are required to notify the Department of Industry of impending significant foreign purchases in specific product areas, eg office equipment, cars and commercial vehicles, printing machinery, textiles and clothing. This is to enable DOI to ensure that British competitors are fully considered before a decision is made to buy abroad and to draw attention to areas where purchasers and suppliers need to get together at an early stage in the development of the next generation of equipment.

2. The DOI has established "product groups" in four areas: electronic capital goods; scientific instruments; X-ray film; and machine tools. These bring together the DOI and purchasing departments to examine possibilities for matching the latter's requirements with suppliers' capabilities.

3. In addition to its participation in the above arrangements, the Ministry of Defence has for some years been operating procedures to ensure that its contracts generally are placed as far as practicable with UK industry and in such a way as to promote the continuing availability of adequate and economic design, development and production capacity to meet the need of its equipment programmes. These procedures have full regard for the aims and objectives set out in the paper.

4. Nationalised industries have been asked to consult their sponsoring departments on any prospective foreign purchase likely to be controversial and to prepare annual reports on other foreign purchases. Further proposals are being studied inter-departmentally.

5. A number of other proposals are in the pipeline, eg NEDC is having discussions with the representatives of local authorities about purchasing overseas.

13 February 1980

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