



## In-state Preferences

### Introduction

Each year vendors are faced with a political reality, public procurement being used as a policy tool<sup>1</sup>: state legislators considering legislation that give in-state preferences in response to local businesses lobbying for preferences in contract awards.

During these difficult economic times, state governments are often pressured to do more to assist their local suppliers. This assistance can include giving local suppliers special consideration in the procurement process. Historically, government procurement laws and policies existed for the purpose of providing a legal, ethical and predictable framework which balances the government's desire to get the best value for its dollars while ensuring that the process is fair and open to the maximum number of participants. Given the importance of transparency, fairness and competition in public procurement, and the volume of purchases public agencies bring to the economy, the issue of in-state preferences is an important, highly scrutinized topic, embraced by the citizens and others who are seeking to aid our local suppliers, but who may not understand the public procurement process and the importance of fair, open and transparent competition in the marketplace.

### What is an In-State Preference?

An in-state (local) preference is an advantage given to bidders/proposers in response to a solicitation for products or services<sup>2</sup> which may be granted based on pre-established criteria. The criteria can include any one or more of the following: supplier's geographic location; residency requirements; or origination of the product or service.

The first question that arises when creating or implementing a local preference law is defining the criterion (or criteria) to

be used. In other words, one must define what an in-state or local business is? How will the entity determine the origin of the product or service? There are many definitions for these terms throughout the states, but no common definition or best practice. For example, one consideration may be where the principal place of business is located, and another might be the economic impact of the company by the taxes it pays within the state. State contractors (whether in-state or out-of state) may employ state residents to state sub-contractors or may purchase goods or services from in-state businesses in connection with a state contract.<sup>3</sup>

After settling on the specific terms or definitions of the preference, (remembering that the definitions vary from state-to-state) one must exercise caution in implementation. Implementation of in-state preferences can lead to unintended consequences, adverse results and other unexpected impacts on the governmental entity's procurement process and your state's vendor community.

### Implications

Local preference laws invite reciprocity. There has been an increase in retaliatory legislation when a local preference is implemented. In many states, the purchasing authority is prohibited from doing business with any firm located in a state that has local-preference laws or policies.

The costs of goods or services are increased for all taxpayers when a percentage differential is allowed; meaning that the state will not get the same value for the dollars spent. This increases the percentage of the entity's budget spent on procurement. This practice discourages firms that don't meet the preference from participating in the procurement process. These end up creating a much smaller market competing for the state's business. Experience has shown that when restricting a market, or implementing a preference, prices increase. Also, reciprocal preferences can crowd out

1 Qiao, Y, Thai, K. & Cummings, G. (2009) State and Local Procurement Preferences: A Survey. *Journal of Public Procurement*, 9 (3&4): 371-410

2 NASPO State and Local Government Procurement: A Practical Guide. (2008). Lexington, KY: Author

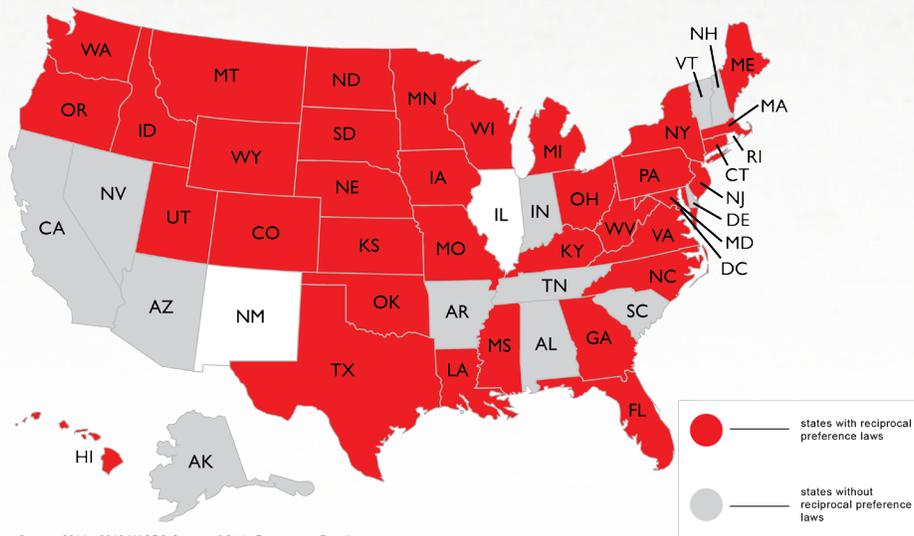
3 Report on In-State Preference Policy in State Procurement, Connecticut Department of Administrative Services January 1, 2012

small and minority businesses from competing for state government contracts outside their home state.

Arguments have been made to favor local preferences. State tax dollars are recycled into the state economy for the benefit of the taxpayer. Small local businesses may get opportunities that enable growth and stability.

**Current Statistics**

A 2011-2012 Survey of State Procurement Practices by the National Association of State Procurement Officials (NASPO) found that the majority of states have some type of local preference or reciprocal preference language in their statutes or Procurement Codes. Out of forty-eight states responding to the survey, thirty-five states have reciprocal preference laws as shown in the figure below:



preferences adopted by legislatures “to achieve some social goal through public procurement run counter to that commitment”.<sup>4</sup>

One state procurement official responding to a 2005 NASPO Survey noted that while preferences for certain business classifications “provide some measure of competition” they are inhibitors to the “best value” solution. Others referred to preference laws as protectionist legislation, as the “political powers continue to be concerned with the economy inside their borders” and mentioned anecdotally that there is significant political pressure in some states to give business to in-state vendors, even when the state does not have such in-state preference other than for tie bids.

Historically NASPO has opposed preference purchasing policies, whether they are in-state preferences, “Buy American” preferences or similar state laws and passed resolu-

According to the 2011-2012 survey twenty-five states provide a legal preference for in-state bidders or products, separate and apart from preferences for MWBEs, sheltered workshops and correctional industries. Table 1 shows the states with vendor-based price preferences and the type of preference provided.

**Discussion**

It is a common practice in some states to provide a preference for vendors and products manufactured within their borders, however many procurement officials oppose preference legislation and policies. The 2008 NASPO Practical Guide stresses the commitment of state procurement professionals to “maintaining the openness of the competitive process” and notes that socioeconomic programs such as

tions to that effect, with the most recent one being dated in 1992.

The National Institute of Governmental Purchasing, Inc. (NIGP) has also opposed all types of preference law and practices and views them “as impediments to the cost effective procurement of goods, services and construction in a free enterprise system”. Two NIGP Resolutions state that the practice of preference laws or regulations results in reduced competition and increased prices.

In summary, there are both critics and supporters of preference laws. This briefing paper is intended to shed a light on them and make procurement decision makers and legislators aware of the need to weigh both arguments when making a decision. Table 2 summarizes both advantages and disadvantages of local preferences to guide your decision.

<sup>4</sup> NASPO State and Local Government Procurement: A Practical Guide. (2008). Lexington, KY: Author

NASPO believes that more research and cost-benefit analysis studies are warranted to gauge success rates and gains, if any, or failures of preference programs and policies, including whether any state has realized any direct or indirect cost benefit or loss as a result due to a specific preference.

**Table 1. States that have vendor-based price preferences (not product-based such as environmental preferences) or set-asides.**

Vendor-based price preference	State Count	Responding States
Women-owned business enterprise	4	FL,IA,MN,OR
Minority-owned business enterprise	6	FL,IA,MN,OH,OR,WI
Small business enterprise	11	AZ,CA,DC,HI,IA,IN,MA,MD,MN,OR,VA
Disabled-owned business enterprise	6	AK,DE,FL,IA,MN,OR
Sheltered workshop	18	AR,DE,GA,HI,IA,KS,LA,MA,ME,MI,MN,OH,OK,SD,TN,UT,VA,WI
Veteran-owned business enterprise	6	AK,AZ,DC,IA,MN,OR
Service-disabled veteran owned business	6	AK,CA,FL,IA,MI,NV
Correctional industries	17	AZ,FL,GA,HI,IA,KS,LA,MA,NE,OH,OR,SC,TN,UT,VA,WA,WI
HUBZone	1	OH
Other	5	DC,MD,MI,MN,ND

Source: 2011-2012 NASPO Survey of State Procurement Practices

**Table 2. Advantages and Disadvantages of Local Preferences**

Arguments in favor of Local Preferences/Advantages	Arguments against Local Preferences/Disadvantages
+ The extra cost to the preference is outweighed by the commitment to support local business and the gain to the local community	- Violate the open competition principle of free market
+ Additional dollars spent locally may generate economic activity in the form of additional sales, jobs and income beyond the value of the initial contract, even when assuming that the local contract implies higher costs (by a maximum of 5%) to the city <sup>5</sup>	- States retaliate by enacting reciprocal preference laws that will limit businesses ability to compete in other states
+ State tax dollars are recycled into the state economy for the benefit of the taxpayer.	- Reduced competition by favoring vendors within a defined geographical area only
+ Local vendors activity may produce an overall indirect positive impact through the recycling of local spending <sup>6</sup> .	- Lead to higher prices paid by governments
+ Short term increases in costs to state and local agencies may be offset by increases in tax revenue and possible decrease in unemployment costs from hiring locals for public works projects. <sup>7</sup>	- Higher costs to administer preference programs. Makes the purchaser's job more difficult.
	- Requires systems to determine eligibility for the preference programs for the implementation of such programs (by state-prescribed definitions or criteria, certification by the state or self-certification)
	- Defining a local business for the purpose of local preferences is difficult in terms of geographical location and ownership and management of the business.

5 Avalos, A & Birdyshaw, E. Assessing the Economic Impact of a Local Preference Ordinance in the City of Fresno. (2007) Center for Economic Research and Education of Central California Research Working Paper No. 2007-02. Retrieved from: <http://www.csufresno.edu/cerecc/documents/CERECC-2007-02.pdf>

6 The Economic Impacts of Buying Locally: SCF Arizona Case Study. (2010). Applied Economics. This is an economic benefit analysis of the operations of SCF Arizona, the largest provider of worker's compensation insurance in Arizona.

7 Fiscal Impact Report on Senate Bill 1, prepared by the Legislative Finance Committee for Standing Finance Committee of the New Mexico Legislature. Retrieved from <http://www.nmlegis.gov/Sessions/11%20Special/firs/SB0001.pdf>