

“Public Procurement – Quantifying Economic Value in the North East”

Final Report to ONE North East

www.beyondprofit.org/procurement

May 2007

Adam Wilkinson and Associates

Gable End
1 Sanderson Road
Whitley Bay
Tyne and Wear
NE26 3PF

07811160822

Email: adam@adamwilkinson.com



Executive Summary

“Public Procurement – Quantifying Economic Value in the North East”

www.beyondprofit.org/procurement

May 2007

Adam Wilkinson and Associates

Gable End
1 Sanderson Road
Whitley Bay
Tyne and Wear
NE26 3PF

07811160822

Email: adam@adamwilkinson.com



EXECUTIVE SUMMARY

This report has been commissioned by One NorthEast to support the development of the North East Procurement Agreement. The aim of the report is to produce an improved evidence base to demonstrate the importance of the public sector and in particular procurement to the regional economy of the North East.

This summary considers:

- The objectives of the project,
- The current impacts identified,
- The economic potential identified, and
- Key findings relevant to One NorthEast.

OBJECTIVES

1. Quantify total public procurement expenditure in the North East and broad inward/outward investment patterns.
2. Analyse current economic impact of this expenditure on participation levels, productivity levels, and regional Gross Value-Added (GVA), and model a baseline trend to 2016.
3. Develop a modelling profile to evaluate the potential economic impact of this expenditure to 2016.
4. Carry out a gap analysis to identify the potential economic contribution of public procurement expenditure to achievement of the overall 2016 Regional Economic Strategy (RES) targets.

Methodology

The project methodology reconciled data available from three sources, these were:

1. Durham Business School Input-Output (DBS) model,
2. North East LM3 project, and
3. Intensive desk-based research.

A triangulation approach that enabled cross-checking was adopted to produce a consistent and reliable result in an area that has not previously been so intensively investigated. It is inevitable that certain assumptions still have to be made, wherever this is the case the assumptions have been highlighted and explained with footnotes. A web-based version of the methodology was also produced to allow online scenarios to be produced and downloaded – www.beyondprofit.org/procurement

The public sector was defined as central government, local government and public corporations, along with universities and further education (FE) colleges.

The results have been calculated based on constant productivity, which is predicted to increase at differential rates for each sector of the economy. The impact of this variation and changing patterns of demand is likely to reduce the actual number of jobs created¹.

¹ Labour productivity is projected to grow in the period to 2016 and the number of FTE workers required to produce a given level of output or gross values added will fall. The implication of this is to overstate the FTE workers required to fulfil the future demands that public sector procurement may place on the region. While modelling changes in regional productivity is beyond the scope of this research, the National Institute of Economic and Social Research forecasts that productivity will grow by 2.2% per annum over the long-term

CURRENT IMPACTS

This report examines how money is spent within the regional economy through a series of transactions within the supply chain.

1. Budget spend by the public sector (initial impact),
2. Impact of that spending with suppliers (direct impact), and respending of those suppliers (other impact).

INITIAL IMPACT OF PROCUREMENT SPEND

The annual budget of the public sector in the North East is currently estimated at £10.4 billion per annum. The public sector spends approximately £3.45 billion per annum on procurement and **spends approximately £1.57 billion, or 45%, of this initial spend within the North East.**

Total GVA² in the North East was £34.4 billion in 2004. Public sector expenditure directly accounts for £8.4 billion or 24.4% of the region's total. On a pro rata basis³, this indicates that **procurement activity resulting from initial spending accounts for £2.77 billion of GVA.**

The public sector currently directly employs 261,000 people, and this represents 23.7% of the workforce within the North East. On a pro-rata basis, this indicates that **public sector procurement activity accounts for 86,000 Full-Time Equivalent (FTE) jobs.**

DIRECT AND OTHER IMPACT OF PROCUREMENT SPEND

As a result of direct and other respond in supply chains, **a further £1,16 billion GVA and approximately 35,600 FTE jobs in the North East are dependent upon regional public procurement spend.**

²

GVA at regional level is calculated using the "income method", which is based on compensation of employees (salaries etc) and the profits earned by businesses. For the public sector this is almost entirely based on compensation of employees (public corporations will earn profits and some public sector agencies/departments may earn rental income, but other than that GVA for the public sector is made of salary costs) To demonstrate the importance of the public sector the regional economy we need to use a sector breakdown of GVA. Whilst there is no properly defined definition of the public sector based on SICs, for GVA the sector is generally represented by three broad industrial groups: public admin & defence, health and social work and education. Whilst this has to come with a health warning, as there are elements of the latter two groups that fall within to the private sector, this is the best fit available at a regional level. The source for this data is Regional Gross Value Added 2005, ONS (Dec 2006).

³ The pro rata calculation is necessary as it is not possible to divide data below the Regional Gross Value source data cited. Calculation is as follows Public Sector budget = 10.4b Procurement accounts for 3.45 b or 33%. Total public GVA is 8.4b X 33% = 2.77 b. The same method is used for FTE however in this case more of a caveat is needed and a labour market survey would produce a more accurate figure.

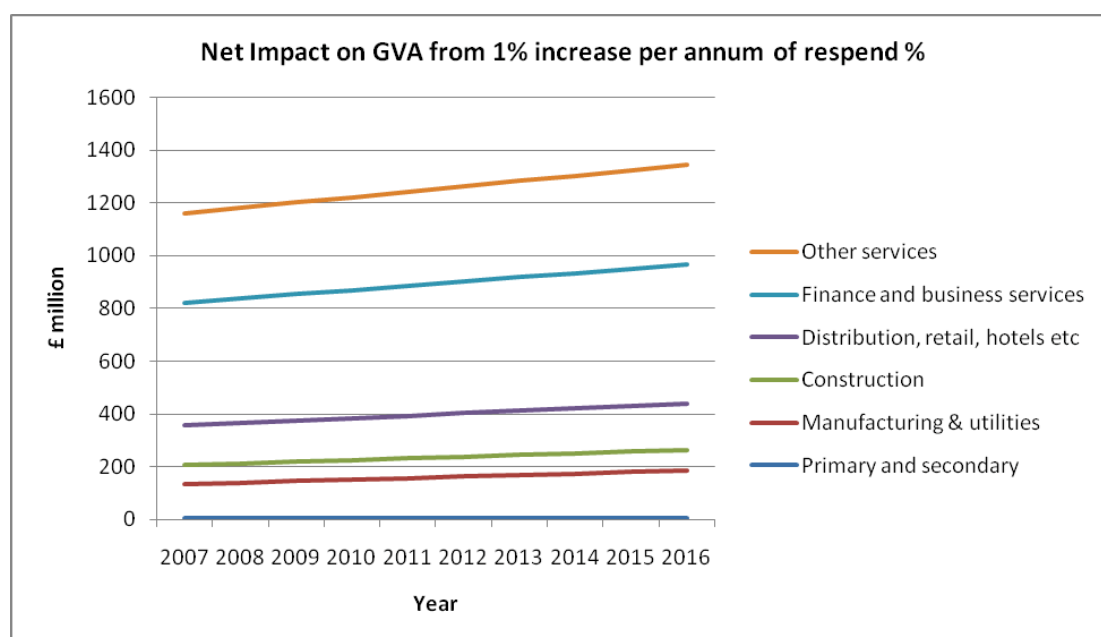
ECONOMIC POTENTIAL OF SMARTER PROCUREMENT

INCREASING THE PROPORTION OF REGIONAL PUBLIC PROCUREMENT SPEND BY 1%

There is significant potential to improve the economic impact of this procurement expenditure simply by changing the way it is spent, without expecting any change in the procurement budget itself.

The graphs below show the impact on GVA and FTE that a shift in spending of 1% has on the regional economy; this is a shift of existing spending from non-regional to regional suppliers, maintaining the current procurement budget at £3.4 billion per annum.

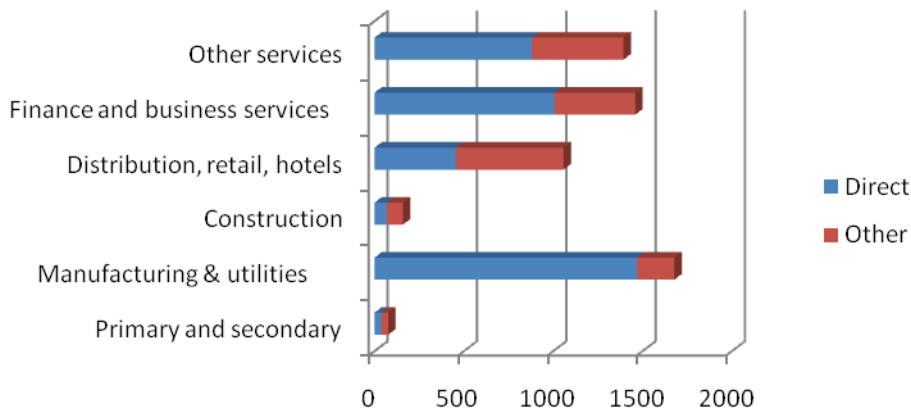
As a result of this change, GVA would increase from £1,160 to £1,346 million per annum by 2016.



The spending shift increases the FTE number or jobs within the region by 5,830, or nearly 10% of the region's target for the period. ⁴

⁴ All of the impacts in this report assume a constant labour productivity within the regional economy. This implies that scenarios should be interpreted as the possible effects of changes (in the level of procurement spend etc) that could occur given current production methods/techniques/technology. Over time productivity will rise implying that the number of FTE workers required to produce a given level of output or gross values added will fall. The implication of this is to overstate the FTE workers required to fulfil the future demands that public sector procurement may place on the region. Modelling changes in regional productivity is beyond the scope of this research, however the following should be a reasonable first approximation. The National Institute of Economic and Social research forecasts that while economy productivity will grow by 2.2% per annum over the long-term. If this occurs in the North East then applying a 'static' productivity adjustment will imply that any 2016 FTE estimates will need to be lowered by 18.1%.

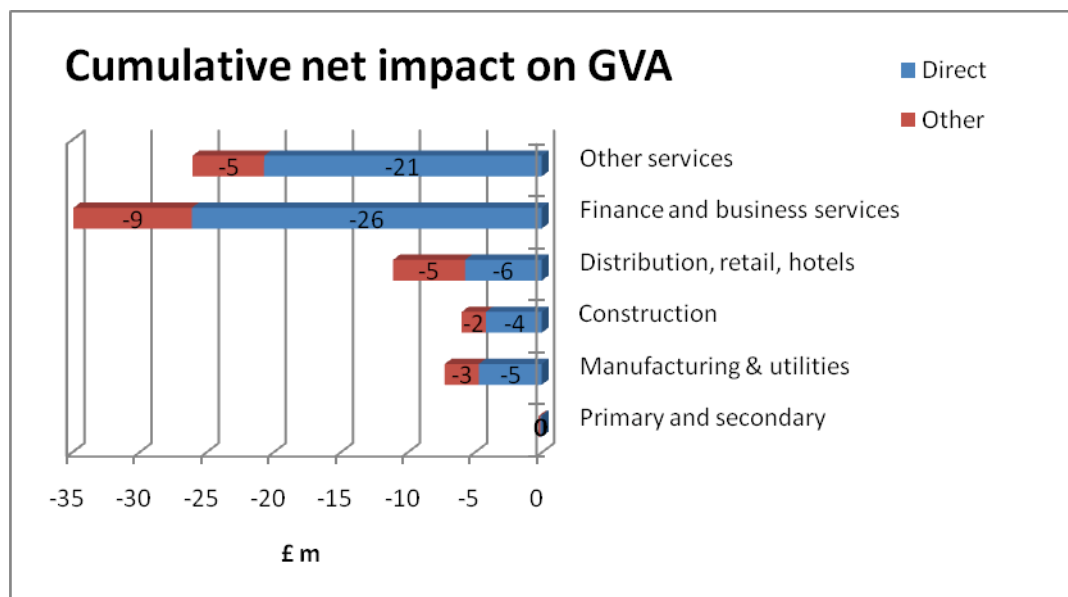
Net Impact FTE 2007-16 1% increase regional spend



RISKS AND CHALLENGES

The impact of efficiency savings on the regional economy

Further modelling was also undertaken considering the impact of a 3% decline of procurement budgets for the next three years and nil change until 2016. In this scenario, shown below there is a negative impact on the economy, and this represents a risk to the viability of some smaller regional suppliers. In summary, there would be a cumulative net loss to the regional economy of 1,700 FTE jobs and a cumulative decline in GVA of £56 million.

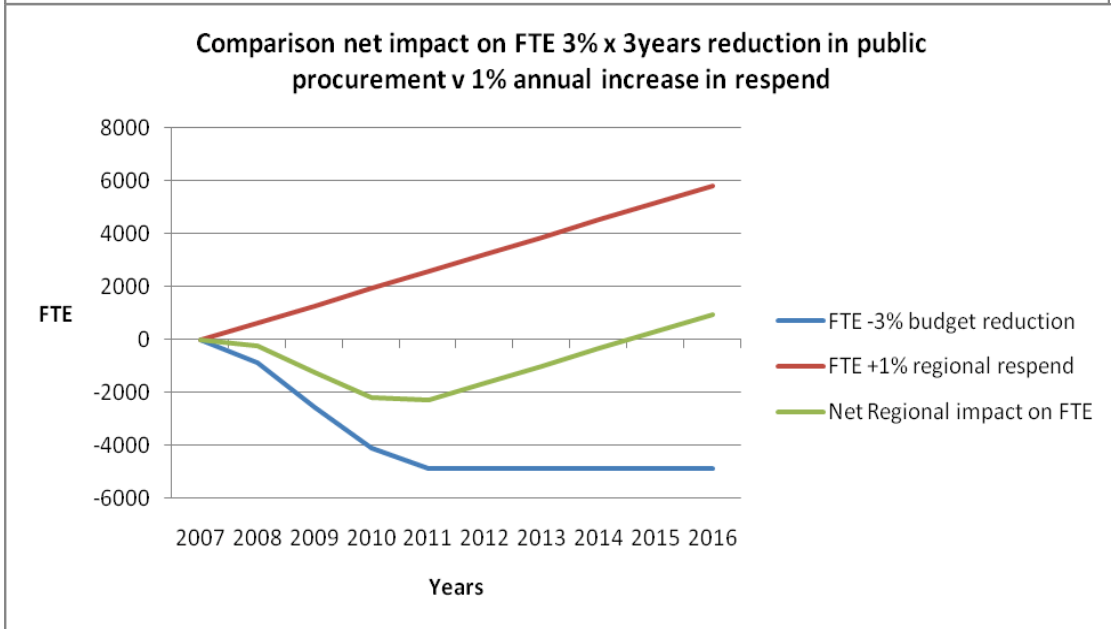
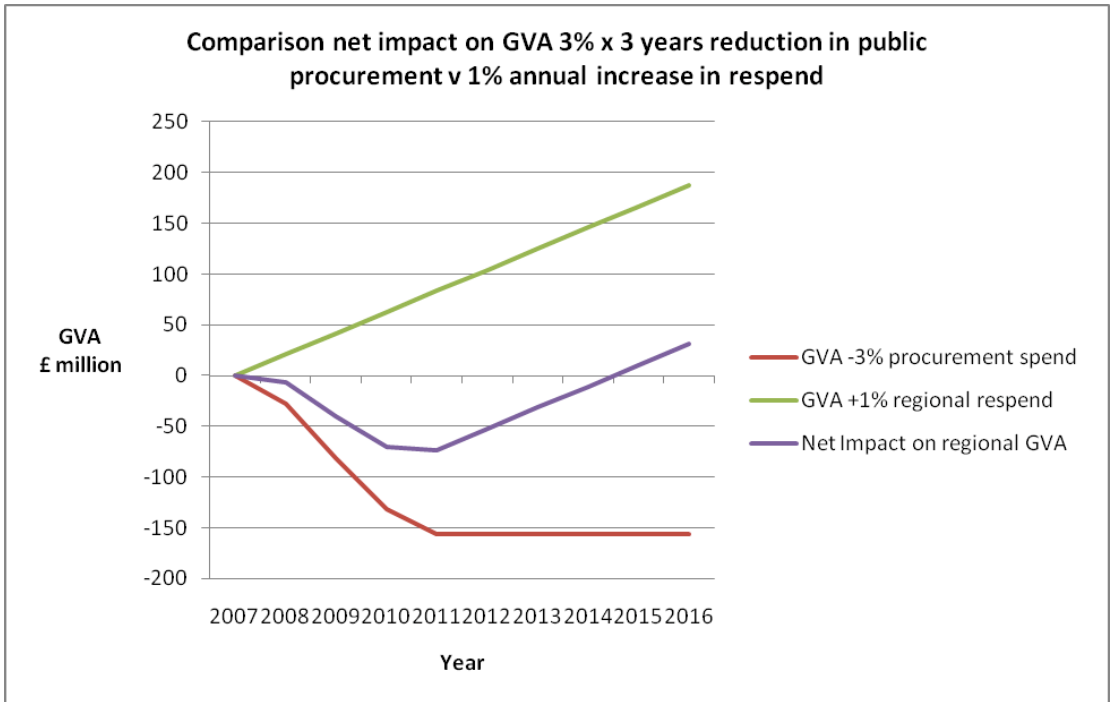


This demonstrates clearly the impact on the economy of a 'do nothing' approach to public procurement in the region between 2007 and 2016.

Mitigating the impact of efficiency savings on the regional economy.

The graphs below combine these scenarios and indicate the cumulative net impact on the economy for both GVA and employment. In particular, the graphs demonstrate that the impact of changing policy and practice to generate an additional annual increase of 1% in North East procurement more than offsets the impact of cashable efficiency savings reducing the actual budget expenditure.

In summary, there would be a cumulative net increase to the region's economy of around 1,000 jobs and £34 million of GVA over the period to 2016.



This scenario demonstrates a realistic and achievable policy response, ensuring current economic performance can be maintained, alongside efficiency and productivity gains.

KEY FINDINGS

THE IMPORTANCE OF PUBLIC SECTOR PROCUREMENT TO THE REGIONAL ECONOMY

This project has broken new ground in a number of areas. It has looked for the first time at the economic role of public sector procurement, using a combination of Input-Output and LM3 research to develop and demonstrate the potential impacts on the regional economy as a whole. The key findings are:

- The public sector spends £3.4 billion per annum on procurement and £1.57 billion or 45% of this amount within the North East.
- This re-spending rate of 45% results in a contribution to the region of a further £1,160 million GVA and 35,600 FTE jobs.

- Data regarding the FTE occupations shows that changes in employment would focus on professional and managerial types.
- A likely baseline scenario demonstrates a net reduction in GVA of £56 million by 2016, with the vast majority of this reduction being born by the construction and service sectors. This includes 'Other Services' and is important as most of this category relates to workers spending incomes. The reduction in FTE was projected to be approximately 1,700 jobs within the region.
- Mitigation of these consequences can be achieved by increasing the propensity to re-spend public budgets regionally. An annual 1% increase in the regional re-spend rate from 2007 to 2016 is projected to offset the impact of cashable efficiencies.
- Evidence from desk-based research has demonstrated that the increasing national control over procurement contracts means that North East businesses will need to be capable of competing nationally in the future; this represents both a threat and an opportunity for the region.
- A 'market intelligence' system could develop a strategically targeted delivery mechanism, which would be able to draw together public, private, and regional agendas around creating an efficient use of resources and growing the regional economy. This would be driven by 'smarter' procurement – forward procurement opportunities, shifting policy to invest in regional economic impact and targeted supply chain development where opportunities exist. This place-making approach would also strengthen the region's businesses to compete for national and European public sector procurement contracts.

A 'market intelligence' system

The broad theme arising from this report's analysis is the opportunity for ONE to support the development and delivery of a 'market intelligence' system for public service delivery. Such a mechanism would serve to:

- Build on existing investment by ONE and others in understanding public procurement behaviour and acting on the results,
- Offer a cohesive regional approach to delivering on both public procurement and regional economic development targets, and
- Grow regional businesses based on actual, rather than anticipated, opportunities.
- Enables a rationale into which 'smarter procurement' directs the demand side of the system

This system would sit well within the scope of the Regional Procurement Forum and could become the flagship for that partnership. A fuller explanation of this approach is set out in the recommendations section of the main report.