Dr. Dave, Can state and local governments favor local and in-state businesses when purchasing products and services?

A. Yes. Many already do, although the types and levels of preferences vary dramatically. A survey by the National Association of State Purchasing Officials (NASPO), found that 39 states use the location of a firm as a tiebreaker if all other aspects of the bid are equal (e.g. price, performance). Some 15 allow in-state bidders to ask for a higher price (usually 5 percent but as high as 15 percent) and still receive the contract.

Several dozen cities favor local businesses and products in government purchasing. (See Local Purchasing Preferences for examples and links to procurement ordinances). Some, like San Francisco, have several levels of preference. It allows higher bids from in-city vendors (5 percent), and an additional price 5 percent price preference for women or minority owned businesses, if local.[1] Many cities have a cap on the size of a contract that don't have to be awarded to the lowest bidder. Others reduce the bid differential allowed as the contract size increases.[2]

A number of legal limitations restrict the right of cities and counties to favor local businesses.

First, local preference is not allowed if state law prohibits it.

Second, city councils cannot enact local preference ordinances if the city charter requires that all contracts be awarded to the lowest bidder.

Third, federal statutes often prohibit in-state and local preferences if federal funds are involved.

Fourth, international trade agreements may limit the ability of states and localities to favor local businesses. For example, the World Trade Organization (WTO) Agreement on Government Procurement (GPA) requires national governments to purchase goods and services based only on price and performance criteria. Every two years the U.S. government updates the threshold levels at which local, state and federal contracts are affected by this provision.[3]

Given the increasing reach of international trade agreements, it is not inconceivable that someday soon we might be in a situation where a city like San Diego could favor local firms over those in San Francisco or Salt Lake City, but not over those located in Japan or Germany.

Some 35 states have enacted "reciprocal laws". These require public contracting agencies, in determining the lowest responsible bidder, to add a percent increase to each out-of-state bidder´s bid price equal to the percent of preference given to local bidders in the bidder´s home state. Thus, if the low bidder is from a state that grants a 10 percent preference to its own in-state bidders, the procurement agency must add 10 percent to that bidder´s price when evaluating the bid.[4]

There has been a great deal of litigation about the constitutionality of state and/or local governments favoring local businesses in their procurement practices. Out-of-state companies argue that such favoritism conflicts with the Commerce Clause of the Constitution (Article 1, §8), as well as the equal protection and due process clauses of the l4th Amendment.

One analysis done for the Virginia legislature discusses the governing case in that region, Setzer & Sons v. South Carolina Procurement Review Panel.[5] The case involved a South Carolina ordinance that allowed in-state firms to be awarded a contract even if their bid price was 5 percent higher. Smith Setzer & Sons headquartered in North Carolina and manufactured reinforced concrete pipes at plants outside South Carolina. It was the lowest bidder on many contracts that were awarded to in-state companies because of the in-state preference statute. The company sued.

The Fourth Circuit Court of Appeals concluded that states could discriminate in favor of local or in-state firms when they act as "market participants", that is, when they themselves were the customers. In this case, in reviewing the statute the "legislation is presumed to be valid and will be sustained if the classification drawn by the statute is rationally related to a legitimate state interest". The Court went on to note, "rules stating a preference that such (tax) monies (generated from the citizens of the state) be recycled within the local economy, either through the purchase of locally-produced products or through purchases from local vendors, rather than funneled out of state, reflect legitimate state concerns". And it pointed to an econometric study done by the state showing that although South Carolina could save $50,000 by

purchasing Smith Seltzer's product, the state's economy would suffer an overall economic loss (in terms of lost jobs, tax revenue, etc.) of $2.1 million if it did so.[6]

Thus it appears that, barring a local, state or national law prohibiting such arrangements, courts will support local preference statutes. This is especially true if the state or city can make a reasonable case that the statutes will achieve a legitimate state or local interest (i.e. expanding the local economy).

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[1] In-state and local purchasing preferences, by state and large city.

[2] For example, Phoenix allows for a 5 percent price differential for contracts with an annual value up to $250,000 and 2 1/2 percent for contracts with annual value between $250,000 and $500,000. Detroit provides for a preference of 10 percent for purchases up to $10,000, 8 percent up to $100,000, 6 percent up to $500,000, 4 percent up to $1 million, and 1 percent for purchases over $1 million.

[3] The most recent threshold chart can be found here.

[4] To see a complete list of those states with reciprocal laws and details click here.

[5] Diane E. Horvath, In-State Preferences in Public Procurement: How Far Can Virginia Go? *Virginia Legislative Issue Brief*. Number 16. July 15, 1996. The Setzer & Sons case can be found at 20 F. 3d 1311(1994)

[6] Frank L. Hefner, State Procurement Preferences: Evaluating their Economic Benefit . Spectrum: *The Journal of State Government*. 69(no. 1): 33-38.