

The Parliament of the Commonwealth of Australia

## **Australian Government Purchasing Policies:**

### *Buying our Future*

### **First Report**

Report by the House of Representatives  
Standing Committee on Industry,  
Science and Technology

March 1994

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## PREFACE

The House of Representatives Standing Committee on Industry, Science and Technology is one of eight general purpose standing committees established pursuant to Standing Order 28B of the House of Representatives. Each of the general purpose standing committees corresponds in its area of interest with a Federal Government department or group of departments. In the case of the Industry, Science and Technology Committee those departments are: Industry, Technology and Regional Development; Science and Small Business; Primary Industries and Energy; Resources; Industrial Relations and Tourism.

Under the Standing Orders the Committee is empowered to inquire into and report on any matters referred to it by either House or a Minister, including any pre-legislation proposal, bill, motion, petition, vote or expenditure, other financial matter, report or paper. In addition, annual reports of government departments and statutory authorities stand referred automatically to the relevant Committee for any inquiry the Committee wishes to make.

On 20 August 1992 the then Minister for Administrative Services, Senator the Hon Nick Bolkus, requested the Industry, Science and Technology Committee in the 36th Parliament to inquire into and report on the efficiency and effectiveness of Commonwealth Government procurement policies.

The inquiry lapsed with the dissolution of Parliament on 8 February 1993. Following the re-appointment of the Committee in the 37th Parliament the Minister for the Arts and Administrative Services, Senator the Hon Bob McMullan, referred the inquiry to the Committee on 27 May 1993. The inquiry was readvertised on 6 June 1993, with interested organisations being invited to provide further submissions to the Committee. The terms of reference of the inquiry are set out immediately following the *Table of Contents*.

The manner in which Commonwealth agencies purchase goods and services has undergone fundamental change since Commonwealth Government purchasing policies and practices were reformed in 1989.

Two of the key reforms introduced were the decentralisation of the purchasing function from the Department of Administrative Services to individual agencies, and the abolition of the 20% preference margin for Australian and New Zealand suppliers. Within agencies there has been, as well, a devolution of purchasing responsibility to a much larger number of people.

The Committee wished to ascertain, among other things, whether the Commonwealth Government had programs in place to ensure the maximum involvement of Australian suppliers in its acquisition of goods and services.

After examining the evidence, the Committee holds serious concerns about the way aspects of purchasing policies are expressed in the Commonwealth Procurement Guidelines, and the manner in which policy is implemented and monitored. The impact of decentralisation and devolution of the purchasing function means that Departments with no experience in managing purchasing have become responsible for devising and implementing purchasing procedures and practices. This, in the Committee's view, has led to a breakdown in the administrative controls over purchasing.

The Committee does not consider that the policies aimed at maximising competitive opportunities for Australian and New Zealand suppliers are being implemented effectively by Government agencies.

In the Committee's view a radical change in the development and implementation of purchasing policy and programs needs to occur to remedy the effects of decentralisation and devolution in purchasing.

The Committee received 154 submissions and 227 exhibits in the course of the inquiry. Thirteen public hearings were held in Canberra, Sydney, Melbourne and Brisbane. Ninety-five witnesses appeared before the Committee, recording over 1100 pages of evidence.

This is the first report of the inquiry into Government purchasing policies. Having presented this report to Parliament, the Committee will now pursue a number of issues that arose during the course of the inquiry, and may hold further public hearings in relation to these matters. The Committee will welcome any public comments in response to this Report.

I wish to thank all those who gave their time and effort to contribute to the inquiry.

Arch Bevis, MP  
Chair  
March 1994

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## TERMS OF REFERENCE OF THE INQUIRY

The House of Representatives Standing Committee on Industry, Science and Technology is undertaking an inquiry into Government purchasing policies, with particular reference to:

- . the efficiency and effectiveness of Commonwealth Government procurement policies to maximise commercial opportunities for Australian suppliers:
  - selling to Commonwealth Government Departments, Agencies and Government Business Enterprises, and
  - participating in major development projects;
- . the application of those policies by Departments, Agencies and Government Business Enterprises;
- . measures adopted by Departments, Agencies and Government Business Enterprises to develop their supply bases in Australia;
- . the regulation of "Made in Australia" labelling;
- . Commonwealth Government efforts to promote the use of Australian Made goods and services;
- . agreements and co-operative arrangements with State and Territory Governments and the New Zealand Government; and
- . the contribution that industry support programs make to the use of Australian and New Zealand goods and services.

# MEMBERSHIP OF THE COMMITTEE

## 37th PARLIAMENT

Chairman: Mr A R Bevis MP

Deputy Chairman: Hon N B Reid MP

Members:  
Mr R E Charles MP  
Mr P R Cleary MP  
Mr M R Cobb MP  
Mr B T Cunningham MP  
Mrs M Easson MP  
Mr L D Ferguson MP  
Mr R H Horne MP  
Hon L S Lieberman MP  
Mr A A Morris MP  
Mr G M O'Connor MP

Secretary: Mr P McMahon  
Research Officer: Mr R Cavanagh

Other staff who assisted the Committee in the course of the inquiry:

Ms M Brooks  
Mr B Egan  
Ms M Fisher  
Ms H Fyfe  
Mr M Ridgway  
Ms F Wilson

## MEMBERSHIP OF THE COMMITTEE

### 36TH PARLIAMENT

Chairman: Mr M J Lee MP

Deputy Chairman: Mr F S McArthur MP

Members:  
Mr G Campbell MP  
Mr M R Cobb MP  
Mr L D Ferguson MP  
Mr F A Ford MP  
Mr E L Grace MP  
Mr H A Jenkins MP  
Hon B O Jones MP  
Mr P E Nugent MP  
Hon N B Reid MP  
Mr L J Scott MP

## ACRONYMS/ABBREVIATIONS

ACTRAC	Australian Committee for Training Curriculum
ACTU	Australian Council of Trade Unions
AEEMA	Australian Electrical and Electronic Manufacturers' Association
AGCC	Australian Government Credit Card
AII	Australian Industry Involvement
AIIA	Australian Information Industry Association
ANAO	Australian National Audit Office
ANZ	Australian and New Zealand
AOTC	Australian Overseas Telecommunications Corporation
APPM	Australian Pulp and Paper Manufacturers Pty Ltd
APS	Australian Public Service
BIE	Bureau of Industry Economics
CALS	Computer aided Acquisition and Logistics Support
CEPA	Commonwealth Environment Protection Agency
CETG	Commonwealth Electronic Trading Gateway
CIF	Cost Insurance and Freight
CPAC	Commonwealth Procurement Advisory Committee
CPGs	Commonwealth Procurement Guidelines
CUCs	Common Use Contracts
DAS	Department of Administrative Services
DEET	Department of Employment, Education and Training
DITARD	Department of Industry, Technology and Regional Development
DoF	Department of Finance
EDI	Electronic Data Interchange
EFT	Electronic Funds Transfer
ESU	Efficiency Scrutiny Unit
FIS	Free Into Store
FMIP	Financial Management Improvement Program
FTA	Fixed Term Agreement
GBE	Government Business Enterprise
GDP	Gross Domestic Product
GITC	Government Information Technology Conditions
GOPAC	Government Offsets and Procurement Advisory Committee
GOSIP	Government Open Systems Integration Profile
IP	Intellectual Property
IPSM	Institute of Purchasing and Supply Management
ISO	Industrial Supplies Office
IT	Information Technology
JAPSTC	Joint Australian Public Service Training Council
MSF	Merchant Service Fee
MTIA	Metal Trades Industries Association
NPPD	National Procurement Development Program
NSG	National Supply Group
NZISO	New Zealand Industrial Supplies Office

**ACRONYMS/ABBREVIATIONS (Contd)**

OECD	Organisation of Economic Co-operation and Development
OSI	Office Structures Implementation
PDC	Purchasing Development Centre
PFID	Partnership For Development
QSI	Queensland Systems Integration
SCIP	Standing Committee on Industry and Procurement
SMEs	Small to Medium Enterprises
SPIRAC	State Preference and Industry Restructuring Advisory Committee
TAAATS	The Australian Advanced Air Traffic System
UN	United Nations

## SUMMARY

1. This is a first report from the Committee concerning its inquiry into Australian Government Purchasing Policies and the promotion of Australian made goods and services. Many important issues have emerged during the inquiry which the Committee has not had time to explore to the extent warranted. The inquiry will therefore be left open so that the Committee's investigations can continue.
2. The Committee has made 45 recommendations, including major changes in the structure by which purchasing policy is developed and by which its implementation is monitored. The recommendations are listed immediately after this Summary in the order in which they appear in the report.

### MAJOR FINDINGS

#### Maximising benefits for the Australian economy

3. The Federal Government is a major consumer of goods and services. Its annual procurement budget has been estimated variously at between \$8 billion and \$12 billion. Government procurement, if directed more towards Australian suppliers, has substantial potential to benefit Australian suppliers and the economy as whole, through employment generation and import substitution.
4. The Committee is concerned that the opportunities which Commonwealth procurement ought to provide for Australian industry development are not being fully grasped. This results not only from the manner in which government procurement is conducted but also from the way in which government policy is expressed in the procurement guidelines.
5. The Committee was surprised to find that little evidence was available, or had been sought by government policy organisations on the investment and employment multipliers associated with increasing local procurement. Calculation of the benefits which would flow to the Australian economy from making greater use of Australian suppliers has been seen by government agencies as too difficult - or more difficult than calculating the costs. It has therefore not been attempted. This is an appalling failure of policy administration.
6. The Committee received evidence that government purchasing can play an important role in industry development, as demonstrated by the contributions of Telecom and Defence towards developing competitive Australian industry. The examples of Telecom and Defence are examined in Chapter 3.
7. The available evidence indicates that most other developed nations extract considerable leverage from Government procurement. ANZ suppliers' share of

Australian government procurement is therefore considerably lower than that of competing OECD nations. This is a cause of great alarm to the Committee. (See recommendations 7, 8, 9, & 10.)

8. Recognition of the importance of small to medium enterprises (SMEs) to a healthy industrial base is being increasingly reflected in industry development policy. Government purchasing leverage is often used in other countries for small business development. The USA, for example, has adopted specific measures to assist SMEs in securing government sales.

9. The implementation of the 1989 reforms has not enhanced the opportunities for small businesses to participate in the government market. Government purchasing policy needs to compensate for the fact that the barriers to entering the government market have a disproportionate effect on small to medium enterprises. An entry barrier that is a hurdle to a large firm is often an insurmountable obstacle to a small firm.

10. The Committee has recommended a number of measures to help overcome the problems SMEs suffer in gaining access to government procurement, including requiring agencies to provide justification where purchases under \$10 000 are not made from SMEs. (See recommendation 13.)

#### **Decentralisation and Devolution**

11. Decentralisation and devolution of responsibility for purchasing has led to an explosion in numbers of people involved in buying for government. Since the purchasing reforms of 1989, the number of staff involved in purchasing has increased from approximately 3500 full time and 10 000 part-time to an estimated 30 000 to 40 000 full and part-time in 1993.

12. Research commissioned in 1992 by Purchasing Australia indicates that officers involved in purchasing have a poor understanding of the Commonwealth's Procurement Guidelines.

13. Decentralisation and devolution has also led to totally inadequate monitoring of expenditure. The lack of adequate information about the nature and composition of expenditure raises serious concerns about accountability and makes it extremely difficult to properly assess whether any stated policy objectives are being achieved.

14. Departments with no experience in managing purchasing became responsible for devising and implementing purchasing procedures and practices, while the expert purchasing administrative department relinquished regulatory control of purchasing and adopted the role of advisory body. The Committee received the impression that decentralisation/devolution has allowed those who should be monitoring the efficiency and effectiveness of government procurement to take comfortable refuge from their responsibilities.

15. While the intent of the 1989 reforms was to enable Government buyers to have the flexibility and authority to purchase efficiently, the application of the principles of value for money and open and effective competition can require fairly complex analysis. Purchasing officers are often insufficiently trained to carry out such analysis.

16. The Committee does not consider that all purchasing should be recentralised within agencies. Low value purchasing can be done more efficiently by purchasing officers at a more devolved level. Purchasing above a threshold limit should be conducted by a central purchasing unit within agencies. (See recommendation 18.)

### **Attitudinal problems**

17. There is a large amount of anecdotal evidence that there is an attitudinal problem among government purchasers which results in a reluctance to purchase from Australian suppliers or in a lack of knowledge concerning the capabilities of Australian suppliers.

18. The most effective method for removing bias or discrimination favouring foreign suppliers is to require the maximisation of competitive local content. In other words, where ANZ suppliers are price and quality competitive, government agencies should be required to purchase from ANZ suppliers. (See recommendation 6.)

19. The development of a purchasing culture which automatically looks to justify why ANZ goods and services are not being purchased is crucial to obtaining maximum benefit for Australia. Other countries seem to have such an attitude.

20. There should also be a greater use made of the services of the Industrial Supplies Office to help raise awareness of the capability of Australian suppliers. The Industrial Supplies Office (ISO) is an initiative funded by the Commonwealth and State governments which focuses primarily on promoting import replacement and retention of manufacturing opportunities in Australia. Its role is to maximise the local content in Government and industry purchases by identifying local industry capabilities. The ISO provides its services free of charge.

21. The New Zealand ISO network provides a positive example of how the performance of the Australian ISO network could be improved. The NZISO, unlike the Australian ISO, is directly supported by the NZ industry department, the Ministry of Commerce. It plays a much closer role in matching local suppliers with government buyers.

22. The Committee's recommendations include the provision of Commonwealth funding to the ISO for the development of an Australian industry capability data base; and discussions aimed at achieving government department representation on the national management board of the ISO. (See recommendation 12.)

### **Training and Career structure**

23. Substantial anecdotal evidence was received that training in purchasing is inadequate through all levels of the public service, from people making small purchases on credit cards to buyers involved in major contracts and major projects. This was supported by various surveys carried out in 1992 and 1993. The Auditor-General has found a similar lack of formal training among holders of the Australian Government Credit Card.

24. The large number of people involved in purchasing because of devolution makes the possibility of providing adequate training an almost impossible task. It remains imperative, however, that those involved in purchasing be adequately trained. The Purchasing Review Task Force has proposed that staff performing purchasing functions be required to undergo mandatory training. The Committee agrees with this proposal. (See recommendation 26 & 28.)

25. Devolution has had the effect of dispersing purchasing expertise within departments, isolating purchasing officers from each other while increasing their responsibilities without improving their status. This has had the unintended outcome of decreasing the emphasis placed on purchasing as a career in itself. A career structure for purchasing staff should be implemented without delay. (See recommendation 29.)

### **Purchasing statistics**

26. The Committee encountered problems caused by the lack of purchasing statistics when attempting to determine the level of local content in Government purchasing. Purchasing Australia informed the Committee that, as with overall purchasing statistics, no statistics have been kept on contracts entered into concerning Commonwealth purchases from ANZ suppliers.

27. The lack of data on Government purchasing is not a new issue. A number of committees of inquiry into Government purchasing have pointed to the lack of data as a major impediment to their investigation of purchasing activity. The lack of data also hinders the making of confident decisions concerning purchasing policy.

28. Commonwealth Procurement Guideline No. 12 states that buyers should actively seek out potential Australian and New Zealand suppliers, and communicate and build relationships with these suppliers. The lack of data concerning Government purchasing makes it difficult for any evaluation of the extent to which this aspect of the policy is being implemented.

29. The lack of purchasing data contravenes the Commonwealth Procurement Framework which requires DAS to collect and analyse purchasing statistics to assist the Government in determining the effectiveness of purchasing policies and practices. Despite numerous recommendations from committees of inquiry, the lack of an adequate purchasing database is an issue that DAS has not adequately addressed.

30. The Committee has recommended that the National Procurement Board (see later in this summary for detail concerning the Board) establish a data collection unit and ensure that the electronic commerce system be designed to allow the production of necessary data. (See recommendation 42.)

### **The Commonwealth Procurement Guidelines**

31. The Commonwealth's purchasing guidelines encompass three principal aims: value for money (Commonwealth Procurement Guideline No. 1), open and effective competition (CPG No. 2) and maximisation of opportunities for Australian and New Zealand industry to compete for Commonwealth Government business (CPG No. 12). It is clear that the dominant aims are those dealing with value for money and open and effective competition, with industry development occurring largely as an incidental function of the first two.

#### *Value for money*

32. The Committee has received a substantial body of evidence from suppliers, industry associations and purchasing institutes supporting the view that Government buyers, when applying the value for money guideline, still usually interpret it as meaning buying the cheapest product.

33. The inability of some government purchasers to properly apply whole of life costing to procurement is largely a function of devolved purchasing with poorly trained or untrained officers often having purchasing authority. The requirement takes the form of exhortation with no systematic auditing or effective pressure to ensure its application. Whole of life costing, including appropriate cost and benefit identification, is often a complex and resource intensive process. Where the organisation or purchasing officer involved in procurement has low levels of skills in whole of life costing techniques, the interests of efficiency would often be better served by involvement of specialised expertise in these evaluations. (See recommendation 14.)

#### *Open and effective competition*

34. The application of the guideline concerning open and effective competition also requires a complex and detailed knowledge of the product and industry. The most serious barrier to open and effective competition, identified in many submissions and public hearings, was an attitudinal bias, a 'cultural cringe', against domestic suppliers. This attitudinal bias ranges from discriminatory tender specifications and other barriers to entry discussed in Chapter 8, to lack of knowledge of the local ANZ product by the devolved purchaser.

35. Furthermore, the policy only encourages rather than requires the purchasing officer to consider the advantages of procurement through ANZ suppliers. There is no

effective monitoring of this 'encouragement' to consider ANZ suppliers by the Purchase Australian Office.

36. The Australian policy and its implementation differ markedly from that of the New Zealand Government which pursues both efficiency and opportunity for local suppliers in its purchasing policy. New Zealand has a positive approach to ensuring that open and effective competition does not discriminate against local suppliers. (See recommendation 17.)

### *Maximising Opportunities for ANZ suppliers*

37. The overwhelming weight of evidence taken by the Committee supports the view that the industry development guideline, concerned with maximising opportunities for ANZ suppliers, is the least understood and least implemented in the purchasing process. Poor application of Guideline No. 12 was identified in evidence from a number of companies, indicating that the objective of *maximising opportunities for Australian and New Zealand suppliers to compete on the basis of value for money* is not being met.

38. In the devolved purchasing world the value judgements, depth of knowledge required of local industry and resources to conduct local industry capability search practices often lie outside the skills of the individual purchasing officer.

39. The failure of some purchasing officers to fully explore local industry capability, coupled with deficiencies in the application of the value for money and the open and effective competition criteria often result in industry development running a poor third (if considered at all) in the general procurement process. This poor position is reinforced by the priority of the value for money guideline as a mandatory Department of Finance guideline.

40. The procurement guideline specifically states that, although the aim is to maximise opportunities for ANZ suppliers, it is not the aim to maximise ANZ content of purchases. The wording seems almost to guarantee that, in any particular purchasing decision, consideration of the possible long-term economic benefits to Australia will be pushed very much into the background. This is a fundamental flaw in the guidelines.

41. It is the Committee's view that the Guideline's statement regarding the non-maximisation of ANZ content is inappropriate and has no place in purchasing policy. (See recommendation 6.)

### **Australian Government Credit Card (AGCC)**

42. There has recently been considerable controversy about the use of the AGCC. The Auditor-General conducted an efficiency audit on the AGCC in 1993 and found that it was considerably more expensive to the Commonwealth than alternative

payment methods such as cheque, Electronic Funds Transfer (EFT) and Electronic Data Interchange (EDI).

43. The Auditor-General also found that from the original intention of the scheme for the AGCC to be used primarily for paying minor claims the system had evolved to the extent that most of the AGCC expenditure was made by transactions in excess of \$1000 with some card holders having limits of \$2m per month. Of 16 000 AGCC users the Auditor-General estimates that only 35% have received any training.

44. The Committee also investigated the use of the AGCC, writing to all Government departments on two occasions. The Committee was concerned that some of the information provided in the responses was either inaccurate or lacking in detail to an extent which indicated that the monitoring of AGCC use was inadequate.

45. The Auditor-General advised that information given to the Committee by some departments on the level of AGCC credit limits was inaccurate. These discrepancies appear to be a result of the lack of accurate management information systems within departments.

46. The Auditor-General also expressed concern at the lack of risk management strategy, fraud control and accountability. The Committee has similar concerns.

47. The current AGCC system operates at a high cost to the Commonwealth and with a lack of control. Having evaluated the Auditor-General's findings and following its own investigations the Committee has identified four particular areas of concern:

- . lack of training (See recommendation 30);
- . the large number of card users (See recommendation 31);
- . the need for more information on AGCC purchases (See recommendation 32); and
- . the use of the AGCC for large capital purchases and high monthly card limits (See recommendation 33).

48. The extent of training given to card holders and other officers involved in the AGCC system is not sufficient. While some departments provide extensive training others provide very little significant training beyond basic half day courses. The number of card holders attending these courses is often a very small percentage of total departmental card holders.

49. The Department of Finance is encouraging the use of a system which is uncontrolled and for which there is unsatisfactory training. It is clear that the emphasis placed on AGCC use through the Finance Directions has not been followed up with a proper monitoring of the system. This is because the Department of Finance has taken the view that the reforms of the public service accompanying devolution have placed the responsibility for monitoring AGCC purchasing with departments. Unfortunately, the findings of the Auditor-General and evidence given to the Committee point to the failure of departments to undertake this role. As the Department charged with responsibility for the "administration of the Public

Account," the Department of Finance is displaying a very relaxed attitude to the expenditure of public funds.

50. The number of card holders could be reduced significantly without any detrimental effect on the scheme as a whole. A change in emphasis is needed in the Finance Directions to discourage AGCC issue to staff without an ongoing purchasing role. Ongoing monitoring of efficient usage data should be used to reduce the number of card holders. It could reasonably be expected that this approach would reduce the number of AGCC holders by at least half. With the implementation of an electronic commerce system the Committee would expect the number of AGCC holders to be reduced far more.

51. One issue which is of great concern is the lack of information available from departments on AGCC usage. The Auditor-General was forced to undertake its own surveys and rely on data from Westpac and the Reserve Bank to obtain enough reliable information to base its findings on. Purchasing policy cannot be effectively implemented without proper information about what is being purchased.

52. While the responsibility for monitoring card use rests with departments, a uniform purchasing policy approach will be very difficult to achieve. The day to day management of the AGCC system can be left to departments, but information needs to be collated and evaluated by a central body to provide the Government with the ability to assess the effectiveness of the system in meeting its purchasing policy goals. This role should be performed by the proposed National Procurement Board.

53. The use of the AGCC for large capital purchases is inconsistent with the often stated aim of value for money in Government procurement. The simplest means of preventing large capital purchases by AGCC is by reducing the maximum limit available to a level which effectively only allows the card to be used for small purchases.

54. There should also be a reduction in the maximum allowable monthly AGCC limit. There can be no justification for any AGCC holder having a limit of more than \$100 000 under the arrangements proposed by the Auditor-General and in this report. No officer should be issued with more than one card.

55. The implementation of the AGCC scheme has seen it move in a direction which was never intended by the Efficiency Scrutiny Unit. Instead of credit cards being used primarily for minor purchases, the opposite has become the case. The fact that this has been allowed to occur without any major review until 1993, six years after the scheme's introduction, is a serious lapse by the Department of Finance. This Department ultimately must accept that its responsibility under the Administrative Arrangements Order for "governmental financial administration and accounts, including administration of the Public Account" does not dissolve with devolution.

## The National Procurement Board

56. There is a culture within the bureaucracy, and a sentiment within current policy, which both need major alteration. The creation of a new National Procurement Board would help bring about that change in attitude and policy focus. It would result in much better consideration of how government purchasing expenditure can be used to promote the development of Australian industry and to maximise economic benefits for Australia.

57. The current administrative arrangements are not capable of delivering the attitudinal changes, efficiencies and industry development benefits which are desirable. A high level group with public, private sector and union participation needs to be created to advise the government on the implementation and operation of changes to the government purchasing system. An injection of outside expertise at a senior level is necessary to ensure the required attitudinal changes.

58. The Committee recommends the establishment of a National Procurement Board which would be responsible for:

- providing advice to ministers on government purchasing policies and procedures and related industry development policies;
- auditing/monitoring the efficiency and effectiveness of government purchasing;
- overseeing the development and implementation of a whole of government electronic purchasing system, including generation of appropriate statistics; and
- investigating complaints by ANZ suppliers concerning full and fair access to opportunities to compete. (See recommendation 2.)

59. The Board should report to the Minister for Administrative Services and provide advice to the Minister for Industry, Technology and Regional Development and other Ministers as appropriate.

60. The Board should have no more than eight or nine members to allow internal efficiency of operation. The membership should be appointed by the Minister for Administrative Services, in consultation with the Minister for Industry, Technology and Regional Development and should include a part-time Chair from outside the public sector, and representation from:

- the Department of Administrative Services;
- the Department of Industry, Technology and Regional Development;
- a senior management level officer from a major purchasing department;
- a senior industry representative from an industry closely involved in government procurement; and
- a trade union representative. (See recommendation 4.)

61. These major structural changes the Committee considers essential in the way purchasing policy is developed and administered are set out in Chapter 2.

## Electronic Commerce

62. Electronic commerce by Commonwealth agencies has potential benefits for both suppliers and buyers in reducing paperwork and administrative lead times and allowing agencies to adopt more efficient purchasing practices.

63. Electronic commerce has the capability of significantly boosting the ability of departmental purchasing managers to monitor and audit both departmental purchasing and the procedures used by full and part time purchasing staff to conduct purchasing.

64. To ensure the benefits of electronic commerce are fully realised it is important that products purchased using CUCs be traded electronically. Electronic commerce for purchases from Common Use Contracts would also enable a large number of suppliers to be included in the network from its initiation, providing an incentive for both buyers and suppliers to trade on the system. (See recommendation 19.)

65. The adoption of an electronic commerce environment will present major administrative challenges for Commonwealth agencies. Coordinated management of electronic commerce will be critical to its successful implementation. This function should be carried out by a project team comprised of key buying agencies, Purchasing Australia and DITARD. (See recommendation 20.)

66. The National Procurement Board should appoint a strategic partner, with responsibility for developing and implementing specific technological infrastructure solutions for each department, to work with the project team. This will have the benefit of ensuring that uniform standards are adopted across the whole of the Australian Public Service, while having the flexibility to meet the individual needs of each Department.

67. In order to facilitate the introduction of the system the Government should agree to meet the initial costs, and provide adequate resources for the project team and the strategic partner. (See recommendation 21.)

68. Appropriate auditing of electronic commerce will be required not only to ensure probity, but to measure the cost of implementation and the savings from improvements in administrative efficiency.

## Common Use Contracts

69. Common Use Contracts (CUCs) are standing offer arrangements negotiated by DAS to procure goods and services commonly used by Commonwealth departments. Annual purchasing expenditure on CUCs is about \$250 million. Under these arrangements goods and services are evaluated by DAS and a preferred list of suppliers are selected.

70. The Auditor-General reviewed the use of CUCs in 1992 and found that this system of purchasing can effectively harness the collective purchasing power of the Commonwealth to achieve major cost savings. The Audit Report concluded that CUCs constitute an effective channel whereby Australian suppliers can access the Commonwealth market.
71. The Audit Report also found that CUC suppliers had been adversely affected by devolution and the 1989 purchasing reforms, with the costs involved in selling to Government having increased by up to 10%.
72. Evidence from suppliers indicated that some Government buyers are using CUCs to establish benchmark prices, and negotiating further reductions in price from non-CUC suppliers. The Committee was unable to determine the extent to which Government buyers are buying off contract, but evidence indicates that in some areas, such as stationery, it could be extensive. The Committee is concerned over this 'leakage' away from CUCs by Government buyers.
73. CUCs negotiated by qualified and trained staff at a central or regional purchasing level, are more likely to reflect national purchasing policy directives and guidelines. Government buyers, in seeking alternative sources of supply, or engaging in further negotiations with suppliers for products on CUCs, are not treating CUC suppliers fairly.
74. By circumventing CUC arrangements, buyers are undermining the value of the system to suppliers, and duplicating efforts already made by Purchasing Australia to evaluate products and suppliers to determine a fair price. (See recommendation 23.)
75. The Committee recommends that CUCs be subsumed within a wider approved suppliers list to broaden the efficiency gains and provide a mechanism for implementing improvements. An approved suppliers list would consist of suppliers that have undergone some form of pre-qualification, the criteria for which would include value for money, quality and industry commitment. (See recommendation 22.)
76. Purchasing from approved suppliers (including CUCs) should be mandatory. Under current purchasing policy, buyers are required to purchase through CUCs, but it is widely acknowledged that this policy is not being adhered to at present. To reinforce this policy, the mandatory requirement should be incorporated in the Finance Regulations covering the conduct of purchasing. (See recommendation 23.)
77. Purchasing staff should undergo training in the CUC system in order to achieve the maximum efficiencies that CUCs are capable of delivering. Buyers should undergo this training before being authorised to carry out purchasing functions. (See recommendation 26.)
78. An area of concern to suppliers is the imposition since mid-1989 of an administrative charge on CUCs. DAS is required to collect a commission ranging from 1% to 4% from the suppliers under CUCs and pay this into consolidated revenue.

79. Departments are reluctant to pay the commission, placing pressure on suppliers who are required to pay the fee to DAS. Suppliers see the imposition of the fee as placing them at a price disadvantage compared with their competitors without CUC arrangements.

80. The commission has, in practice, operated as a disincentive to use CUCs. Agencies are effectively 'rewarded' by purchasing from non-CUC sources. Where purchases are made from CUCs the commission is, in the end, passed on either directly or indirectly to the consumer. The commission does not fulfil a useful role and should be abolished. (See recommendation 27.)

## RECOMMENDATIONS

### Recommendation 1

The Committee recommends that the Minister for Administrative Services consult with State Ministers responsible for purchasing, industry and small business concerning issues identified in this report. (para 2.14)

### Recommendation 2

The Committee recommends that a National Procurement Board be created to:

- . provide advice to ministers on government purchasing policies and procedures and related industry development policies;
- . audit/monitor the efficiency and effectiveness of government purchasing;
- . oversee the development and implementation of a whole-of-Government electronic purchasing system, including generation of appropriate statistics; and
- . investigate complaints by ANZ suppliers concerning full and fair access to opportunities to compete. (para 2.22)

### Recommendation 3

The Committee recommends that the National Procurement Board be empowered to establish working groups covering strategic industry sectors in which government purchasing has, or may have, significant impacts, and that such working groups be established with a two year 'sunset' clause. (para 2.23)

### Recommendation 4

The Committee recommends that the membership of the National Procurement Board:

- . be appointed by the Minister for Administrative Services in consultation with the Minister for Industry, Technology and Regional Development;
- . be no more than eight or nine persons;

- . be headed by a part-time chair from outside the public sector; and
- . include representation from the following:
  - the Department of Administrative Services,
  - the Department of Industry, Technology and Regional Development,
  - a major purchasing department,
  - a senior representative from an industry closely involved in government procurement, and
  - a trade union representative. (para 2.24)

#### **Recommendation 5**

The Committee recommends that:

- . the Secretariat of the National Procurement Board be resourced from the Department of Administrative Services;
- . the position of Secretary to the Board be classified at Senior Executive Service level;
- . the Secretariat structure include purchasing and industry policy positions as well as purchasing program implementation elements; and
- . the Secretariat should include at least one officer seconded from a broad based industry association at the Commonwealth's expense. (para 2.25)

#### **Recommendation 6**

The Committee recommends current industry development guidelines, concerning 'maximisation of opportunities for ANZ suppliers to compete', be amended to require purchasing officers to maximise the level of competitive ANZ content of purchases. (para 3.47)

### **Recommendation 7**

The Committee recommends for Commonwealth funded projects that:

- . all projects valued at \$1 million or over be required to have an industry development criterion in the tender assessment;
- . all projects over \$5 million also have comprehensive pre-tender ANZ supplier briefing procedures;
- . industry impact statements also be prepared by all non-exempted agencies for projects valued at \$30 million or over;
- . industry development undertakings of successful tenderers be reflected in contracts as performance clauses subject to meaningful enforcement, including measures such as awarding of damages, termination or revision of contract; and
- . the Department of Industry, Technology and Regional Development assess the industry impact statements and audit industry development performance clauses. (para 3.77)

### **Recommendation 8**

The Committee recommends that purchasing guidelines be amended to require local involvement of ANZ design suppliers wherever possible. (para 3.81)

### **Recommendation 9**

The Committee recommends that for Commonwealth funded projects:

- . all IT projects valued at \$1 million or over be required to have an industry development criterion in the tender assessment;
- . industry development undertakings of successful tenderers be reflected in contracts as performance clauses subject to meaningful enforcement, including measures such as awarding of damages or termination of contract;
- . the Partnerships for Development and Fixed Term Arrangements programs be accommodated within a wider approved supplier scheme that has access for small and medium IT firms;

- . where approved supplier commitments (including PfDs or FTAs in transition) form the basis or part of the industry development bid of the successful tenderer, the undertakings of the programs be reflected in each individual contract as a performance clause;
- . the Department of Industry, Technology and Regional Development be responsible for:
  - vetting industry development contract criteria and industry development plans, and
  - implementation and policy administration of the approved supplier scheme (including entry and performance validation); and
- . the National Procurement Board provide advice to the Minister for Industry, Technology and Regional Development on the performance of these industry development arrangements. (para 3.98)

#### **Recommendation 10**

The Committee recommends that:

- . industry development undertakings, including definition of role and share of non-panellist IT firms, given by successful SI tenderers be reflected in contracts as performance clauses subject to meaningful enforcement, including measures such as awarding of damages and revision or termination of contract;
- . systems integration carried out by panellists in any one contract be limited to a major portion of the value of the systems integration (around 70%);
- . establishment of a second tier SI category to pre-qualify smaller systems integrators and IT firms for consortium formation with panellists;
- . where a systems integrator proposes using proprietary software or hardware to a value exceeding a small proportion of the contract value (around 10%), the value attributed to the proprietary product be identified in a second offer process to competing firms;
- . establishment of a specialist panel category for highly specialised SI firms such as security systems firms;
- . the Department of Industry, Technology and Regional Development be responsible for vetting and monitoring industry development undertakings of panellists in contracts; and

- . the National Procurement Board provide advice to the Minister for Industry, Technology and Regional Development on the performance of the SI Panel. (para 3.110)

#### Recommendation 11

The Committee recommends that:

- . the Commonwealth resource a concerted marketing effort for the National Procurement Development Program; and
- . the National Procurement Board advise the Minister for Industry, Technology and Regional Development on the effectiveness of the scheme and further extension. (para 3.118)

#### Recommendation 12

The Committee recommends that:

- . the National Procurement Board co-ordinate with agencies and the ISO the identification and monitoring of Australian industry capability including advice on the need to increase resourcing of the ISO network for expansion of activities;
- . discussions be held with the ISO with a view to having representatives of appropriate government departments appointed to the management board of the proposed national ISO corporate structure;
- . the Commonwealth provide funding to the ISO for the development of an Australian industry capability data-base; and
- . the use of the ISO by agencies to inform ANZ suppliers of opportunities to access Commonwealth funded procurement be monitored by the National Procurement Board. (para 3.126)

#### Recommendation 13

The Committee recommends that:

- . 10% of government procurement be set aside for small to medium enterprises (SMEs) in a similar fashion to the US system;
- . agencies be required to provide justification for purchases under \$10,000 that are not made from SMEs;

- . Australian Government purchasing guidelines contain a requirement that contracts greater than \$5 million include a 'small business participation plan' and that this plan be regarded in evaluation of a tender. Advertisements calling for tenders should include this statement;
- . all industry impact statements include a SME impact consideration;
- . Australian Government purchasing officers be required to consider smaller specialised firms in issuing large contracts and, where *competitive SME capability exists, divide large contracts into smaller components*;
- . SMEs be identified on a regional basis in electronic purchasing system databases, approved supplier lists and industry capability databases; and
- . regional buyers be encouraged to purchase from local approved SMEs. (para 3.137)

#### **Recommendation 14**

The Committee recommends that:

- . the Purchasing Guidelines be re-written and re-numbered, with the industry development guideline becoming guideline number 1;
- . the application of whole of life costing across agencies be examined by the National Procurement Board with the institution of an appropriate rolling audit sample program by the Australian National Audit Office; and
- . a specialised whole of life costing cell be established within the Department of Administrative Services to assist agencies experiencing difficulty in this area. (para 3.147)

#### **Recommendation 15**

The Committee recommends that the Minister for Finance request an appropriate Parliamentary Committee, such as the Banking, Finance and Public Administration Committee or the Public Accounts Committee, to conduct a review of the efficiency and flexibility of annual budget carry-over arrangements for agencies. (para 3.150)

**Recommendation 16**

The Committee recommends that purchasing guidelines be amended to:

- . place the onus on agencies to determine whether predatory pricing (including tender dumping) exists in procurement bids; and
- . require agencies to exclude vendors where predatory pricing is identified in their bids. (para 3.156)

**Recommendation 17**

The Committee recommends that:

- . Australian Government funded organisations be required to demonstrate that, where contracts are not awarded locally, ANZ suppliers have had full and fair opportunity to compete for procurement; and
- . the National Procurement Board investigate claims by local suppliers of unfair treatment and pursue non-conformance revealed by monitoring. (para 3.165)

**Recommendation 18**

The Committee recommends that:

- . the National Procurement Board appoint a project team to assist in the creation (or modification) of purchasing units within all Commonwealth agencies;
- . any purchases over the value of say \$100,000 be managed by these accredited purchasing units;
- . the project team work with individual agencies to develop purchasing administrative structures suitable for the needs of each agency; and
- . the project team report periodically to the National Procurement Board on progress in the implementation of this recommendation. (para 4.31)

**Recommendation 19**

The Committee recommends that:

- . the Government implement whole-of-Government electronic commerce for purchasing by December 1997;
- . the design of the electronic commerce system allow for the identification of the source of goods and services purchased (including the proportion of Australian value added); and
- . all purchasing using Common Use Contracts be conducted via electronic commerce by December 1997. (para 5.18)

**Recommendation 20**

The Committee recommends that:

- . a project team consisting of key buying agencies, Purchasing Australia and the Department of Industry, Technology and Regional Development be established under the National Procurement Board to plan and implement electronic commerce in Government agencies;
- . the National Procurement Board appoint a strategic partner from the private sector to work with the project team to assist individual agencies to develop and implement electronic commerce arrangements;
- . the project team report periodically to the National Procurement Board; and
- . each Commonwealth agency form a unit with the specific purpose of implementing electronic commerce. (para 5.23)

**Recommendation 21**

The Committee recommends that the project team and strategic partner be given adequate funding and resources to implement electronic commerce across the Australian Public Service. (para 5.26)

**Recommendation 22**

The Committee recommends that:

- . the Common Use Contract system be absorbed into a wider approved suppliers scheme; and

. the National Procurement Board monitor and advise on the effectiveness of such an approved suppliers scheme to ensure that it reflects government purchasing policy. (para 5.44)

### **Recommendation 23**

The Committee recommends that:

- . purchasing goods and services from suppliers who have approved supplier arrangements such as Common Use Contracts with Purchasing Australia be mandatory (with the possibility of exemptions for remote area buyers if authorised by an agency's chief purchasing officer in individual instances);
- . the Finance Regulations be amended in line with this recommendation; and
- . Purchasing Australia conduct an information and awareness campaign among suppliers and buyers informing them of the mandatory requirement to purchase from Common Use Contracts. (para 5.46)

### **Recommendation 24**

The Committee recommends that approved supplier arrangements (including Common Use Contracts) which contain prices that are used as ceiling prices be renegotiated to incorporate prices that reflect best value for money for Government buyers. (para 5.51)

### **Recommendation 25**

The Committee recommends that a 'one-stop-shop' be established for firms wishing to sell to government to minimise the complexity and delays in product/supplier evaluation. (para 5.54)

### **Recommendation 26**

The Committee recommends that training in the use of approved supplier schemes (including Common Use Contracts) be made compulsory before authority to conduct purchasing is delegated to Government buyers. (para 5.56)

**Recommendation 27**

The Committee recommends that the commission levied on all sales made under Common Use Contracts be abolished. (para 5.62)

**Recommendation 28**

The Committee recommends that:

Option 4, Part 6, Section 3 of the Purchasing Review Task Force Report be adopted, namely the introduction of:

- compulsory procurement awareness training based on the Commonwealth Procurement Competency Standards for entry level, middle management and executive level staff in all Commonwealth agencies, and
- compulsory procurement awareness training based on the Commonwealth Procurement Competency Standards for non procurement staff involved in key aspects of the purchasing process (e.g. project managers and engineers);

training based on the Commonwealth Procurement Competency Standards be mandatory for all APS staff performing procurement functions;

a computer based training course be developed to supplement off-the-job training for basic level purchasing;

all courses and the course providers be subject to approval by the National Procurement Board; and

the National Procurement Board develop and maintain a list of approved purchasing courses and course providers for distribution to departments and Commonwealth agencies. (para 6.31)

**Recommendation 29**

The Committee recommends that the Department of Industrial Relations and the Department of Administrative Services review the career structure proposed by the Department of Administrative Services in the light of other recommendations in this report with a view to establishing an appropriate career structure for purchasing staff. (para 6.41)

**Recommendation 30**

The Committee recommends that:

- . all training courses for AGCC holders be approved by the proposed National Procurement Board;
- . all new AGCC holders attend a training course approved by the National Procurement Board when they receive an AGCC;
- . all AGCC holders with a purchasing function attend approved training courses on purchasing and that this training involve instruction in Government procurement policy;
- . all managers responsible for approving AGCC expenditure attend approved training courses;
- . all Settlement Account Administrators or alternatively, those finance section staff working at unit level who are responsible for arranging payment on behalf of AGCC holders, attend an approved training course, at least every two years;
- . existing AGCC holders spending in excess of \$50,000 p.a. be targeted and required to attend an approved course;
- . all training be provided at a regional level and be free to users; and
- . the National Procurement Board evaluate the feedback received from training courses as part of its ongoing process of improving arrangements for the AGCC. (para 7.17)

**Recommendation 31**

The Committee recommends that:

- . Finance Direction 30A be removed and the following direction be inserted: "Departmental Secretaries must ensure that the Australian Government Credit Card is only issued to officers with an ongoing purchasing role."; and
- . ongoing monitoring based on AGCC usage statistics be conducted to reduce the number of card holders. (para 7.22)

**Recommendation 32**

The Committee recommends that:

- . the Government investigate the development of a US style procurement card which provides greater information on purchases and allows for more control over card use; and
- . the proposed National Procurement Board be given responsibility for collating and evaluating information on AGCC use and that the Board advise the Government on the performance of the AGCC system in relation to purchasing policy. (para 7.29)

**Recommendation 33**

The Committee recommends that:

- . the maximum AGCC purchase limit be reduced to \$2000; and
- . that monthly AGCC limits should be restricted to below \$100,000 and that only one card be allowed per officer. (para 7.39)

**Recommendation 34**

The Committee recommends that the National Procurement Board, in conjunction with the Attorney-General's Department:

- . review the liability provisions of Commonwealth contracts with a view to capping the liability of suppliers; and
- . review the GITC with the objective of incorporating limited liability provisions into information technology contracts. (para 8.14)

**Recommendation 35**

The Committee recommends that:

- . the National Procurement Board examine the costs associated with tendering and provide Commonwealth agencies with guidelines which will minimise costs;
- . individual purchasing cells within Commonwealth agencies regularly review the cost of tendering as part of their financial management of purchasing; and

the National Procurement Board review every 5 years the costs associated with the preparation of Requests for Tenders, preparation of tenders by suppliers and tender evaluation. (para 8.21)

### **Recommendation 36**

The Committee recommends that:

- the National Procurement Board examine prequalification/registration of suppliers as a means of reducing evaluation costs;
- standard evaluation periods be applied for less significant purchases; and
- Commonwealth agencies consider, on a case by case basis, meeting reasonable costs incurred by those tenderers invited to retender. (para 8.24)

### **Recommendation 37**

The Committee recommends that the National Procurement Board engage appropriate consultants to assist in a review of Commonwealth purchasing documentation to reduce the overall number, variety and complexity of documentation. (para 8.30)

### **Recommendation 38**

The Committee recommends that:

- quality assurance accreditation be included as one of the criteria when evaluating tenders; and
- where available quality accredited suppliers are not selected, justification be incorporated in the decision documentation. (para 8.42)

### **Recommendation 39**

The Committee recommends that:

- ownership of intellectual property be referred to a Parliamentary Committee for inquiry; and
- until that inquiry is completed, the question of ownership of intellectual property be addressed on a case by case basis. (para 8.49)

**Recommendation 40**

The Committee recommends that all Commonwealth contracts include automatic penalties for late payment. (para 8.53)

**Recommendation 41**

The Committee recommends that:

- agencies be required to demonstrate that their purchasing practices identify and separate embedded/ancillary goods and services in imports;
- agencies be required to demonstrate that ANZ industry capability has been properly considered in the acquisition process; and
- where freight and insurance services on imports have not been acquired on a Free on Board basis, the agency demonstrate that local freight and insurance suppliers have had an opportunity to tender and that the local suppliers' bids were not competitive. (para 8.59)

**Recommendation 42**

The Committee recommends that:

- the National Procurement Board establish a unit for data collection and review existing procedures and capabilities to implement Government-wide data collection on a cost effective basis;
- the electronic commerce system be designed to allow the production of necessary data; and
- this data be made available publicly through AGPS. (para 8.87)

**Recommendation 43**

The Committee recommends that:

- the Finance Regulations be amended to require agencies to notify, in the Purchasing and Disposals Gazette, payments made on goods and services;
- the Minister for Administrative Services write to all departmental secretaries informing them of the reporting responsibilities of departments under Finance Regulation 43B;

- . the \$10 per entry charge on entries for the Purchasing and Disposals Gazette be abolished;
- . Commonwealth agencies be required to include in Gazette notifications of purchases the Australian Company Number, or the Australian Registered Body Number of the supplier; and
- . the Product and Service Code, currently used in the Purchasing and Disposals Gazette, be replaced by a more useful commodity classification system. (para 8.88)

#### **Recommendation 44**

The Committee recommends that:

- . the labelling scheme proposed by the Working Groups on Country of Origin Labelling of Consumer Products be adopted; and
- . the descriptors used in this labelling scheme be used as the basis for a definition of local content for the purposes of purchasing data collection. (para 8.97)

#### **Recommendation 45**

The Committee recommends that:

- . in principle, social policies that apply to local firms should, wherever possible, apply to overseas firms; and
- . where the Australian Government imposes identifiable net cost disadvantages on local suppliers through imposition of environmental standards, the extent of that net cost disadvantage be taken into consideration in price and access terms in Government purchasing and tender evaluations. (para 8.107)



## CHAPTER 1

### INTRODUCTION

#### PURCHASING BY THE COMMONWEALTH GOVERNMENT

1.1 The Federal Government is a major consumer of goods and services. Its annual procurement budget has been estimated variously at between \$8 billion and \$12 billion.<sup>1</sup> The combined purchasing budget of Federal, State and local governments is approximately \$30 billion.<sup>2</sup> Government purchasing policies and procedures can have a significant impact on particular industries and the domestic economy.

1.2 The Department of Defence is the largest single procurement agency, spending approximately \$4 billion annually.<sup>3</sup> Telecom is the second largest buyer, spending \$3.2 billion in 1991-92.<sup>4</sup> Other Federal Government departments and agencies have relatively modest budgets. For example, the Department of Employment, Education and Training estimates its annual purchasing budget as \$219 million<sup>5</sup>, and the Department of Primary Industries and Energy spent \$69.8 million in 1991-92.<sup>6</sup>

1.3 Total purchases of goods and services by Budget dependant Commonwealth agencies amount to approximately 3% of GDP.<sup>7</sup> The main areas of spending by these agencies are:

- . \$3.8 billion on Department of Defence equipment and stores;
- . \$1.6 billion on buildings and accommodation (including Department of Defence facilities and housing);
- . \$1.5 billion on information technology hardware, software and services; and
- . \$550 million on non-information technology collective purchasing arrangements for items such as vehicles, fuel, paper, tyres and furniture.<sup>8</sup>

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1 Speech by Senator N Bolkus, Minister for Administrative Services, Brisbane, 26 August 1992; Senator B McMullan, Minister for the Arts and Administrative Services: Senate Hansard, 27 October 1993 p 2599

2 Speech by Senator N Bolkus, Minister for Administrative Services, 1 May 1992 p 3

3 Industry Commission: *Defence Procurement*: Exhibit 130 p 3

4 Telecom Australia: Submission 90 p 6

5 DEET: Submission 32.2

6 Department of Primary Industries and Energy: Submission 109 p 1

7 DAS: *Purchasing Review Task Force Report*: Exhibit 182 p 5

8 *ibid.*

## CURRENT PURCHASING POLICY

1.4 Current purchasing policy is based on enabling purchasing staff to 'manage for results' by encouraging and allowing greater management flexibility, initiative and judgement, decentralising responsibility for purchasing functions to individual Departments and reducing central regulatory control over purchasing to a minimum.<sup>9</sup>

1.5 This policy was adopted following a review of purchasing policies and procedures conducted in 1987 by the Department of Administrative Services (DAS) under the Financial Management Improvement Program (FMIP). The Review found that, in relation to the purchasing system then in use:

- operating procedures were excessively regulatory, leaving little scope for flexibility and innovation;
- rules and regulations governing purchasing had grown piecemeal, and were confusing for purchasing staff; and
- the prescribed procedures produced a culture of risk avoidance.<sup>10</sup>

1.6 Further findings of the Review were:

- purchasing staff in some areas had only rudimentary training and many did not have the required professional skills;
- the single-stage public tendering process was too inflexible and costly for both the Commonwealth and its suppliers;
- tender requirements were often over specified;
- the purchasing system discouraged the use of superior technology and innovative solutions to supply problems; and
- the purchasing system precluded post-offer negotiations.<sup>11</sup>

1.7 Following the Review, reforms were implemented to change the focus of Government purchasing from a prescribed administrative process to one that was to be "results orientated and concerned with performance" and relieved of the bulk of regulatory prescription.<sup>12</sup>

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9 Purchasing Reform Group: *The Human Element in Procurement: Volume 1: The Report*. Exhibit 115 p 37

10 Purchasing Reform Group: *The Human Element in Procurement: Executive Report*. Exhibit 114 pp 2-3

11 The Auditor-General: *Audit Report No.3 1991-92: Project Audit - Implementation of Purchasing Reforms in the Australian Public Service*, AGPS, Canberra 1991 p 1

12 *ibid.*, p 4; *Industry interface drives contracting function*, Defence Industry and Aerospace Report, Vol 11(13), 31 July 1992 p 3

1.8 The key elements of the purchasing reforms were to:

- develop strategies to improve performance through a professional approach involving better purchasing practices and techniques and well trained staff;
- recognise value for money as the prime purchasing objective;
- adoption of the principle of open and effective competition as a guide in determining purchasing methods;
- remove central regulatory control of detailed purchasing processes and procedures, leaving them to be decided by Departmental managers; and
- provide a centrally determined policy framework and development and distribution of best practice guidelines.<sup>13</sup>

1.9 The purchasing reforms were primarily administrative mechanisms designed to streamline the purchasing process. The overall prime objective of Government purchasing policy remained. This objective was to support Government programs by obtaining value for money in the acquisition of supplies.<sup>14</sup>

1.10 To achieve value for money in procurement, buyers are encouraged to consider all of the price and non price factors that are significant in any individual procurement. Such factors include fitness for purpose, whole of life costs, fair market prices, timely delivery, post delivery support and effective warranties. In policy guidelines buyers are advised that they do not have to choose the lowest price option if there are sound reasons to do otherwise.<sup>15</sup> This is in contrast to the Finance Regulation which requires, rather than encourages, that:

“a person must not enter a commitment requiring the expenditure of moneys ... unless the person who enters into the commitment is satisfied, after making such inquiries as are reasonable, that when the commitment is entered into ... the Commonwealth is unable to obtain better value for the expenditure in all the circumstances”.<sup>16</sup>

1.11 The mechanism to achieve value for money is open and effective competition in the procurement process. Openness in the procurement process is achieved by providing information to the public and potential suppliers via the Commonwealth Purchasing and Disposals Gazette for purchases over \$2000.<sup>17</sup>

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13 *ibid.*, pp 37-8

14 DAS: *Purchasing Review Task Force Report*: Exhibit 182 p 6

15 DAS: *Commonwealth Procurement Guideline No 1: Getting Value for Money*, AGPS, Canberra 1989

16 Finance Regulation 44B

17 DAS: *Commonwealth Procurement Guideline No 2: Open and Effective Competition and Gazette of Purchasing Information*, AGPS, Canberra 1989

1.12 Effective competition is achieved by:

- . the provision of adequate information to all prospective suppliers;
- . providing enough time for potential suppliers to prepare tenders;
- . the availability of alternative choices;
- . absence of bias in:
  - specifications,
  - invitations for offers,
  - evaluation of offers,
  - selection of suppliers, and
  - implementation and administration of contracts; and
- . reducing barriers for new suppliers or potential suppliers.<sup>18</sup>

### **PURCHASING POLICY AND AUSTRALIAN INDUSTRY**

1.13 At the time of the FMIP review of purchasing policy and practices in 1987, the Bureau of Industry Economics (BIE) examined the operation of the 20% preference margin for Australian and New Zealand (ANZ) suppliers. The BIE concluded that “there was little evidence that the preference policy had been effective in assisting the development of internationally competitive industries”, and the compliance costs associated with the preference margin policy outweighed the benefits. Following the BIE review, the preference margin was abolished.<sup>19</sup>

1.14 The focus of purchasing policy as it related to ANZ suppliers was directed instead towards preventing discrimination in purchasing and the debriefing for unsuccessful tenderers. The Purchase Australian Office was established within DAS to organise public sector education campaigns to promote the advantages of dealing with ANZ suppliers, and to investigate complaints of discrimination against local suppliers.<sup>20</sup>

1.15 The current aim of the ANZ suppliers' policy is to “maximise opportunities for ANZ suppliers to compete for Commonwealth business on the basis of value for money.” This is to be achieved by:

- . an open and transparent procurement process;
- . requiring buyers not to overlook suitable ANZ suppliers in the purchasing process;
- . encouraging competitive ANZ suppliers to bid;
- . enabling competitive ANZ suppliers to increase their share of the Commonwealth market; and

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18 *ibid.*

19 Bureau of Industry Economics: *Program Evaluation Report 6: The Commonwealth Purchasing Preference Margin as an Industry Development Mechanism*, AGPS, Canberra 1988 pp 43,47; DAS: *Purchasing Review Task Force Report: Exhibit 182* p 6

20 DAS: Submission 50 p 10

being consistent with the requirement to buy according to value for money.<sup>21</sup>

1.16 While the stated aim is to maximise the competitive opportunities for ANZ suppliers, the guidelines instruct buyers that the policy **does not mean**:

- . buying everything possible from ANZ suppliers;
- . discrimination on the basis of ownership of a supplier;
- . discrimination against foreign suppliers; and
- . **aiming to maximise ANZ content of purchases.**<sup>22</sup>

1.17 DAS considers that, taken with the other purchasing reforms implemented in 1989, the operation of this policy would not adversely affect local suppliers. The application of the principles of 'value for money' and 'open and effective competition' in purchasing would mean that all suppliers and potential suppliers would be treated equally, regardless of place of origin. In theory at least, competitive ANZ suppliers would be selected on merit without the need for a protectionist policy.<sup>23</sup>

#### ADMINISTRATION OF PURCHASING POLICY

1.18 The key purchasing reform introduced in 1989 was the decentralisation of the purchasing function to individual Government departments. Decentralisation followed amendments to the *Audit Act 1901* and *Finance Regulations* which provided a legal basis for this initiative.<sup>24</sup>

1.19 Each Department and agency is responsible for determining its own purchasing procedures, controls and strategies. In developing these strategies, Departments are assisted by DAS in the form of Commonwealth Procurement Guidelines (CPGs) which provide advice on best purchasing practice for Government buyers.<sup>25</sup>

1.20 With the decentralisation of the purchasing function, DAS relinquished its regulatory role over purchasing operations by Departments. DAS is responsible for:

- . administering Common Use Contract arrangements;
- . pre-qualification for information technology suppliers seeking to sell to the Commonwealth;

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21 *ibid.*

22 DAS: *Commonwealth Procurement Guideline No 12: Australian and New Zealand Supplies*, AGPS, Canberra 1990

23 *Proposals for Reform of Commonwealth Government Purchasing Arising from Government Review under the Financial Management Improvement Program*: Exhibit 171 pp 21, 23-4

24 DAS: *Purchasing Reform Plans: Guidelines for Departments*, Purchasing Reform Group, Canberra, October 1989 p A2

25 DAS: Submission 50 p 46

- . participating in IT Acquisition Councils;
- . providing general agency purchasing and disposal policy;
- . promoting and coordinating purchasing training arrangements for Government agencies;
- . administering Commonwealth purchasing and disposal policy; and
- . collecting and analysing appropriate statistics relating to purchasing to assist the government in determining the effectiveness of purchasing policies and practices in general.<sup>26</sup>

1.21 Other departments which have a role in the overall administration of Government purchasing are:

- . the Attorney-General's Department (responsible, through the Australian Government Solicitor, for the preparation of all agreements and contracts for the purchase of goods and services by Commonwealth agencies);
- . the Department of Finance (responsible for the administration of the *Audit Act 1901* and *Finance Regulations*); and
- . the Department of Industry, Technology and Regional Development (responsible for the development of industry policy and industry development programs which impact on Government purchasing).<sup>27</sup>

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26 *ibid.*, pp 29, 46

27 *ibid.*, pp 46-8

## CHAPTER 2

### CHANGING THE SYSTEM

2.1 The Committee has received a considerable body of evidence concerning the current policies for Commonwealth Government procurement and the implementation of those policies. Analysis of that evidence leads the Committee to hold serious concerns about the way aspects of the policies are described in the Commonwealth's procurement guidelines. The Committee has major concerns about the manner in which purchasing policy is implemented and monitored.

2.2 Specific areas of concern are described in detail in the body of this report. However, in particular, the Committee is concerned about the fact that the opportunities which Commonwealth procurement ought to provide for Australian industry development are not being fully grasped. This results not only from the manner in which government procurement is conducted but also from the way in which government policy is expressed in the procurement guidelines.

2.3 Calculation of the benefits which would flow to the Australian economy from making greater use of Australian suppliers has been seen by government agencies as too difficult - or more difficult than calculating the costs. It has therefore not been attempted. The Committee considers this to be an appalling failure of policy administration.

2.4 Another area of great concern to the Committee is that decentralisation and devolution of purchasing responsibility has led to totally inadequate monitoring of expenditure. The lack of adequate information about the nature and composition of expenditure raises serious concerns about accountability and makes it extremely difficult to properly assess whether any stated policy objectives are being achieved.

2.5 Decentralisation and devolution have sidelined Purchasing Australia, which has given the Committee the impression of having taken comfortable refuge in that situation. The Committee considers that the current administrative arrangements are not capable of delivering the attitudinal changes, efficiencies and industry development benefits which are desirable.

2.6 In view of these findings and the importance of government procurement to some Australian industry sectors, the Committee believes that a high level group with public, private sector and union participation needs to be created to advise the government on the implementation and operation of changes to the government purchasing system.

2.7 In considering the creation of a new tripartite group the Committee was mindful of previous structures and the comments of the Purchasing Review Task Force.

2.8 The Committee notes the view of the DAS Purchasing Review Task Force that a high level committee should be established to perform the role of overseeing and reviewing purchasing, and that the recently formed Commonwealth Procurement Advisory Committee (CPAC) could perform this role.<sup>1</sup>

2.9 The Committee notes that CPAC is composed of Senior Executive Service officers from various agencies who have long had responsibility for applying current purchasing guidelines. The Committee believes that this group, who are essentially responsible for the current purchasing situation, will not have the necessary independence in evaluating their own purchasing practices or the capability for change management, particularly in relation to giving a higher priority to industry development.

2.10 The Committee notes the comments of the DAS Purchasing Review Task Force in relation to their option of establishing a consultative Committee of Commonwealth/State/union/industry representatives:

“In considering this option it should be noted that the Joint Council approach has already been trialled through the former SPIRAC [State Preference and Industry Restructuring Advisory Committee] and GOPAC [Government Offsets and Procurement Advisory Committee] and has only recently been abandoned as ineffectual. The existing structures - NSG [National Supply Group] and SCIP [Standing Committee on Industry and Procurement] - provide a useful vehicle to pursue selected topics and to exchange information. To abolish these ... would be opposed by a number of States and could be difficult to achieve.”<sup>2</sup>

2.11 The examples of SPIRAC and GOPAC do not provide justification for rejecting the tripartite approach. Both bodies were largely concerned with the reduction of State preferences and the removal of Commonwealth preferences. In this regard, particularly in the case of GOPAC, much of the work program had been completed before they were disbanded. Given this completion, and that SPIRAC was the predecessor of GOPAC, the Committee is uncertain as to the full meaning of the Purchasing Review Task Force's statement that they “had been abandoned as ineffectual”.

2.12 The Committee, however, accepts that large advisory committees can be unwieldy in operation and notes the large membership of CPAC. The Committee also notes the Task Force opinion that the NSG and SCIP provide useful vehicles to pursue selected topics and exchange information with State and Territory governments. The Committee does not propose the abolition of these Commonwealth/State/Territory consultative mechanisms. The Committee is firmly of the view that the attitudinal changes require an injection of outside expertise at a senior level.

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1 DAS: *Purchasing Review Task Force Report*: Exhibit 182 pp 55 & 56.

2 *ibid.*, p 29

2.13 The Committee received a number of submissions concerning the purchasing practices and procedures used by State governments. State purchasing policies , however, are outside the terms of reference of the Committee's inquiry. Nonetheless, these issues require more detailed examination by the relevant governments.

### ***Recommendation 1***

**2.14 The Committee recommends that the Minister for Administrative Services consult with State Ministers responsible for purchasing, industry and small business concerning issues identified in this report.**

### **THE NATIONAL PROCUREMENT BOARD**

2.15 The high level advisory group created to oversee and review purchasing should be a streamlined body with the expertise to provide balanced advice to Ministers on efficiency and industry development.

2.16 The Committee recommends the establishment of a National Procurement Board as shown at Diagram 1. Board membership should be no more than eight or nine members to allow internal efficiency of operation. Tripartite representation (Government/industry/trade union) is essential to ensure that the opportunities for competitive Australian industry development are not limited.

2.17 The Board should report to the Minister for Administrative Services and provide advice to the Minister for Industry, Technology and Regional Development and other Ministers as appropriate.

2.18 To provide the focus and balance missing from current purchasing arrangements the Board membership should include:

- . a part-time Chair from outside the public sector, appointed by the Minister; and representation from:
  - . the Department of Administrative Services,
  - . the Department of Industry, Technology and Regional Development,
  - . a senior management level officer from a major purchasing department,
  - . a senior industry representative from an industry closely involved in government procurement, and

a trade union representative.

2.19 The Board should be responsible for:

- providing advice to ministers on government purchasing policies and procedures and related industry development policies;
- auditing/monitoring the efficiency and effectiveness of government purchasing;
- overseeing the development and implementation of a whole of government electronic purchasing system, including generation of appropriate statistics; and
- including investigation of complaints by ANZ suppliers concerning full and fair access to opportunities to compete.

2.20 The Board should be empowered to establish working groups covering strategic industry sectors affected by government purchasing. The working groups should report to the Board concerning changes in Government purchasing policy and practices that might improve the efficiency of government purchasing and aid in the development of those industries. These working groups should have a two year 'sunset' clause to provide a focus for reporting within a reasonable timeframe. Areas in which the *Committee believes Working Groups might be established include* telecommunications, information technology and paper production.

2.21 The Board should be supported by a Secretariat located within the Department of Administrative Services. The staff of the Secretariat should include officers with demonstrated purchasing and industry policy skills, and should be headed by a Senior Executive Service officer. The Committee considers that at least one of the Secretariat officers should be seconded at the Commonwealth's expense with relevant broad based industry experience to provide a focus for industry liaison with the Secretariat.

***Recommendation 2***

**2.22 The Committee recommends that a National Procurement Board be created to:**

- provide advice to ministers on government purchasing policies and procedures and related industry development policies;**
- audit/monitor the efficiency and effectiveness of government purchasing;**
- oversee the development and implementation of a whole-of-Government electronic purchasing system, including generation of appropriate statistics; and**
- investigate complaints by ANZ suppliers concerning full and fair access to opportunities to compete.**

***Recommendation 3***

**2.23 The Committee recommends that the National Procurement Board be empowered to establish working groups covering strategic industry sectors in which government purchasing has, or may have, significant impacts, and that such working groups be established with a two year 'sunset' clause.**

**Recommendation 4**

**2.24 The Committee recommends that the membership of the National Procurement Board:**

- . be appointed by the Minister for Administrative Services in consultation with the Minister for Industry, Technology and Regional Development;
- . be no more than eight or nine persons;
- . be headed by a part-time chair from outside the public sector; and
- . include representation from the following:
  - the Department of Administrative Services,
  - the Department of Industry, Technology and Regional Development,
  - a major purchasing department,
  - a senior representative from an industry closely involved in government procurement, and
  - a trade union representative.

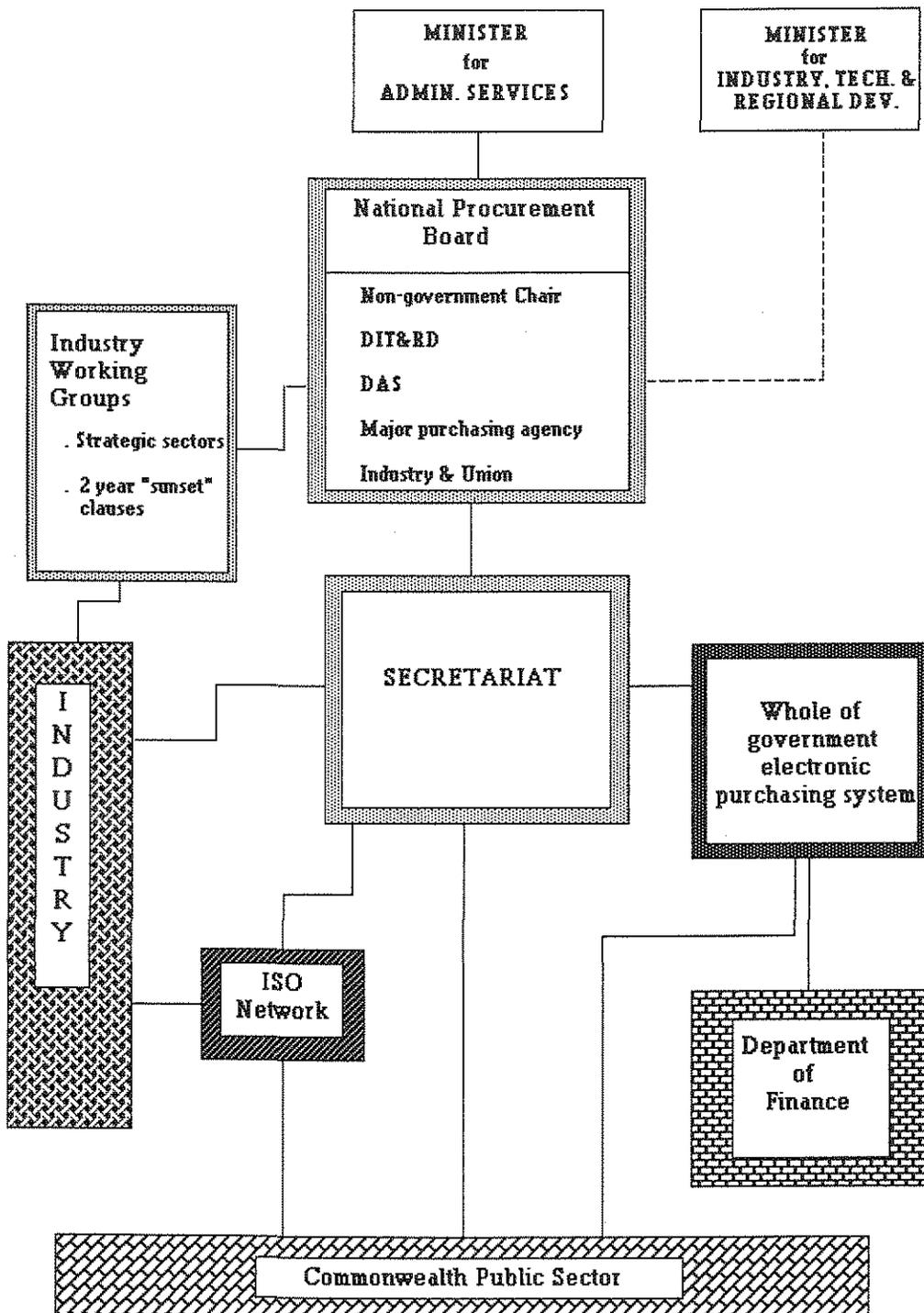
**Recommendation 5**

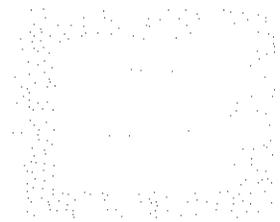
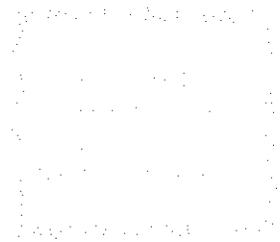
**2.25 The Committee recommends that:**

- . the Secretariat of the National Procurement Board be resourced from the Department of Administrative Services;
- . the position of Secretary to the Board be classified at Senior Executive Service level;
- . the Secretariat structure include purchasing and industry policy positions as well as purchasing program implementation elements; and
- . the Secretariat should include at least one officer seconded from a broad based industry association at the Commonwealth's expense.

DIAGRAM 1.

# NATIONAL PROCUREMENT BOARD





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## CHAPTER 3

### THE ROLE OF PURCHASING POLICY IN ENHANCING INDUSTRY DEVELOPMENT

#### MAXIMISING DOMESTIC ECONOMIC BENEFITS FROM GOVERNMENT PROCUREMENT

3.1 The central term of reference for the inquiry is the examination of the efficiency and effectiveness of Commonwealth Government procurement to maximise commercial opportunities for Australian suppliers. This examination requires an assessment of the benefits and costs of local participation in Government procurement, which would be expected to differ from industry to industry.

3.2 Treasury has commented that information on costs and benefits is extremely difficult to find.<sup>1</sup> Indeed, the Department of Finance replied to the Committee after an eleven week consideration that:

“Our search has not yielded any information of direct relevance.”<sup>2</sup>

3.3 Information that was available was not, in most cases, presented to the Committee in quantifiable form, despite the Committee spending some time seeking such information. The debate and evaluation of the current purchasing regime appears to have been largely undertaken within the theoretical framework of neoclassical or perfect market theory.<sup>3</sup> Such a theoretical approach emphasises the potential costs, largely ignoring potential benefits since these are difficult to quantify. The emphasis is on local suppliers meeting international competition in bidding for individual contracts largely on the basis of cost price.

3.4 The neo-classical approach has been challenged by a number of commentators.<sup>4</sup> Many successful and growing national economies have benefited from Government policies which have played a positive role in building new industries and helping old ones restructure. Government purchasing leverage is just one of the tools which have been used elsewhere with apparent success.<sup>5</sup>

3.5 Treasury submitted that increasing local content in Government procurement will lead to increased demand for local industry product, thus increasing employment and

1 The Treasury: Supplementary Submission 62.1 Part C p 2, 3

2 Department of Finance: Submission 61.1 Attachment A

3 The Treasury: Supplementary Submission 62.1 Part C p 2, 3

4 See for example: Stewart, J, *The APEC dilemmas of a trade gadfly*, The Australian, 8 December 1993, p 11; Stewart, J: *The Lie of the Level Playing Field: Industry Policy and Australia's future*, Text Publishing, Melbourne, 1994

5 World Bank Research Report: *The East Asian Economic Miracle* Oxford Uni Press 1993.

profitability for that product. There will also be effects on downstream input industries that will be needed to boost production and employment to meet the additional demand. Treasury acknowledges that channelling Government procurement to local firms over the medium to long term will create pressure for additional investment by those firms, creating further employment opportunities (depending on the type and sourcing of the investment).<sup>6</sup>

3.6 On the cost side, the principal arguments against increasing Australian content are the opportunity cost argument (where there is no price differential between local and overseas suppliers) and a resource misallocation argument (where preferential treatment for local suppliers is proposed).

3.7 The Committee notes Treasury's point that Government purchasing is small in relation to GDP and output in most sectors.<sup>7</sup> It should equally follow that opportunity costs related to Balance of Payment effects and overheating would be correspondingly small.

3.8 Where local suppliers are comparable to overseas suppliers in terms of cost and quality, Treasury considers that the 'opportunity' cost of resources may be a factor against encouraging increased local content.<sup>8</sup> The argument advanced is that increased industry activity in the sectors benefiting from Government procurement may create diversion of resources from more productive activity in other sectors of the economy.

3.9 Where switching to local content involves paying more for a local product, either directly or indirectly through a preference margin or quota, this can lead to the misallocation of resources across industry sectors and the potential development of uncompetitive local suppliers. These resource misallocation costs need to be outweighed by benefits to justify preference intervention on behalf of local suppliers.

3.10 The Committee was surprised to find that little evidence was available, or had been sought by government policy organisations on the investment and employment multipliers associated with increasing local procurement. One estimation was that submitted by the Industrial Supplies Office which commissioned a study by Professor R C Jensen, Department of Economics, University of Queensland, to examine the multiplier effects of activity in the manufacturing sector on the domestic economy.

3.11 The study was to take into account the adjustments required to previously developed multipliers from:

- . industrial restructuring in the economy;
- . improvements in firm efficiency (reflected primarily in labour productivity gains);

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6     *ibid.*

7     *ibid.*

8     *ibid.*

- . changes in the level of welfare support; and
- . changes in the profiles of government fiscal operations.

3.12 The study (produced in August 1992) estimated that, with respect to the year 1991/92, each million dollars of new or retained manufacturing activity could be expected to produce:

- . approximately 29.5 person/years of employment (direct and indirect)
- . \$280,000 in taxes and charges to all levels of government;
- . \$255,000 in direct consumer expenditure; and
- . \$231,000 in welfare savings to governments.<sup>9</sup>

3.13 Professor Jensen stated that the study involved the calculation of an average across all manufacturing industries. New investment or investment arising from import substitution would affect the figures. It should be noted that Professor Jensen commented to the Committee that he considered his study to be only "a fairly rough measure", dealing with the manufacturing sector as an aggregated whole, where as "each part of the manufacturing sector will have different effects and impacts on the economy".<sup>10</sup> However, while the particular study was narrow, the results provide an illustration of the type of benefits accruing from switching activity to the Australian manufacturing sector.

3.14 Australian Economic Analysis Pty Ltd estimated that a 10% shift in Commonwealth government procurement towards Australian made goods and services would result in the creation of 132,000 new jobs over a five year period.<sup>11</sup>

3.15 A report in November 1992 to the Minister for Defence from the Hon Roger Price, MP, concluded that the Department of Defence was unable to determine the impact of defence spending on industry, and recommended that a study be undertaken to find the best method to achieve such an understanding.<sup>12</sup> The Committee awaits with interest the outcome of the current inquiry into defence procurement being carried out by the Industry Commission. The terms of reference for that inquiry include an examination of "the impact, including regional effects and industry development aspects, of defence procurement programs and institutional arrangements on particular industries such as shipbuilding, aerospace, electronics and engineering".<sup>13</sup> The Industry Commission plans to produce a draft report in May 1994.

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9 Jensen, R: Exhibit 59 p 8

10 Jensen, R: Transcript pp 784 - 785

11 Australian Economic Analysis Pty Ltd: Exhibit 103

12 Price, R: *Defence Policy and Industry: Report to the Minister for Defence prepared under the direction of the Parliamentary Secretary to the Minister for Defence the Hon Roger Price, MP*, AGPS, Canberra, November 1992 p 12

13 Industry Commission: *Defence Procurement, Issues Paper*: Exhibit 130

3.16 The Committee received evidence that government purchasing can play an important role in industry development. The contributions of Telecom and Defence towards developing competitive Australian industry are illustrated in the next section. Government purchasing involves the expenditure of taxpayers' dollars. The Committee views with concern the general failure of the current purchasing system to maximise the return to taxpayers of the money they invest in government.

3.17 The Committee does not accept that current government purchasing from local suppliers is at an optimal level and that the application of current purchasing policy provides the most efficient use of Commonwealth funding in the medium to long term. The Committee rejects the theoretical argument that, where Australian suppliers are comparable with overseas suppliers in terms of cost and quality, increasing the local content of Government purchasing will result in a large diversion of resources from more productive industry sectors.

3.18 The Committee notes Treasury's further point that the opportunity costs arising from such a diversion of resources will be more pronounced in an economy experiencing full employment.<sup>14</sup> Regrettably, current projections indicate that full employment is unlikely to be achieved in Australia in the short to medium term.

3.19 The opportunity cost argument regarding losses created by a drift of skilled labour from other competitive Australian industries has also not been quantified in any useable manner. The argument is that, even with relatively high levels of unemployment, increasing purchasing from local suppliers drags skilled labour from other sectors. No evidence to support the existence of this type of opportunity cost in Australia was presented.

3.20 Government procurement is a permanent feature of the Australian market. Any increase in the demand for skilled labour, resulting from an increase in the role of efficient local suppliers servicing the Government sector, should be provided for in the longer term by the skills training system.

3.21 Moreover, the potential benefits to Australian industry, employment and balance of payments arising from increased levels of government purchasing from competitive ANZ suppliers are, in the Committee's view, substantial.

3.22 There has been little evidence presented that the wider benefits of local sourcing are being included in cost/benefit assessments in a systematic manner. The devolved nature of current Government purchasing practices makes it difficult to evaluate the efficiency and probity of a large proportion of Government purchasing, let alone the extent to which such purchases might benefit the Australian economy. There is an absence of reliable data on the totality of Government procurement, the composition of that expenditure or the amount of local sourcing.

## LEVEL OF GOVERNMENT PROCUREMENT LEVERAGE

3.23 The amount of leverage provided in the domestic economy by the current system of Government procurement is difficult to assess given the absence of reliable data and the large degree of decentralisation of purchasing responsibility to Departments and agencies and devolution within those bodies.

3.24 The Committee sought detailed data on the composition of government expenditure and the local industry share which was not forthcoming. As a result the Committee commissioned a report by the Christopher Company on the Australian information technology sector (refer Appendix VII). The report estimated that the ANZ value added share of Commonwealth procurement in the information technology and telecommunications sectors in 1992/93 was 12.1% (down from 14%). DAS provided comments (received as the Committee's Report was being finalised) on the Christopher Company Report regarding the estimation of ANZ content:

“Whilst it is undoubtedly true that many small Australian owned companies are importers, it is also true that many are not. Yet because TCC [The Christopher Company] did not have the resources to determine otherwise they implicitly assumed 0%. There is no basis for this assumption and hence no basis on which to accept the final TCC results.”<sup>15</sup>

3.25 Notwithstanding those comments, it is not in dispute that ANZ content in government purchasing is at a level that the Committee considers unacceptably low. Concerns about methodology are clearly matters to be taken up by the National Procurement Board.

3.26 Information from the Department of Finance and Treasury accorded with the Christopher Company Report's estimates of low levels of local participation. The Department of Finance estimated that the Australian made share of their IT purchasing was 15%.<sup>16</sup> Treasury estimated that 12.43% of the Australian Taxation Office's IT/Telecommunications purchases had a local content range of 30% or more. The estimate of product purchase with 40% or more local content was 5.18%.<sup>17</sup> The Australian Taxation Office subsequently estimated that of its total purchases, including services, Australian content in 1991/92 was 15% and in 1992/93 it was 14%.<sup>18</sup> These low levels constitute a deplorable state of affairs in such a strategic industry sector as IT/Telecommunications.

3.27 These proportions cannot be applied across the whole of Government procurement, but give rise to concerns over the ANZ suppliers share of Australian Government procurement.

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15 DAS: Supplementary Submission 50.11

16 Department of Finance: Submission 61.1 Attachment B

17 Department of the Treasury: Submission 62.1 Attachment B p 2

18 Commissioner of Taxation: Submission 144 p 3

3.28 The Auditor-General's report on the efficiency of Common Use Contracts has relied on a DAS estimate of local content for a narrow band of items on Common Use Contracts such as fuel, freight, paper, office furniture, photocopiers and stationery.<sup>19</sup> The total value of the items is some \$250 million against estimates of Commonwealth purchasing that range from \$10 billion to \$12 billion. Fuel was the dominant item, accounting for 41% of the \$250 million. IT purchases under CUCs were excluded.

3.29 DAS estimated that 86% of items purchased on CUCs have high local content.<sup>20</sup> However, this figure cannot be used as a proxy for local content in government purchasing. It does not mean that local content was 86%, just that 86% of non-IT CUC purchasing involved high local content. A definition of high local content was not provided. The exclusion of IT, with its high imported content, from the DAS calculations further artificially boosts the high local content estimate. Thus the statement by the Auditor General, based on the DAS estimates, that "by value 80% of goods and services provided through CUCs were sourced in Australia and New Zealand," which has been frequently used in the government purchasing debate, needs to be treated with caution.

3.30 The purchase of fine paper illustrates this point. DAS estimates the purchase of fine paper (photocopy and laser printer) through CUCs at around \$5 million of local product<sup>21</sup>. While this may be the case, evidence of local paper producers that the bulk (an estimated \$95 million out of \$160 million) of fine paper purchased by the Commonwealth was produced off-shore presents a much more accurate picture of local content.<sup>22</sup> The simple fact is that purchases from CUCs represent only a small proportion of total government procurement.

3.31 Direct international comparisons are difficult given the paucity of Australian data and the usual methodology variations. However, the available evidence indicates that most other developed nations extract considerable leverage from Government procurement. Examination of the purchasing of some of the signatories to the GATT Government Procurement Code, designed to reduce practices which favour domestic suppliers, provides a relevant illustration.

3.32 In the United States of America, domestic suppliers account for around \$22 billion of about \$24 billion of code-covered procurement (over 90%). In Germany, EC suppliers account for all but about \$10 million of around \$1 billion of code covered procurement (99%), while in the United Kingdom EC suppliers account for

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19 The Auditor-General: *Audit Report No. 7 1992-93, Efficiency Audit - Saving Time and Money with Common-use Contracts*, AGPS, Canberra 1992 p xii

20 *ibid.*, p 66

21 *ibid.*

22 Mr O'Shannessy, Consultant to APPM: Transcript p 520

all but around \$4 million of approximately \$1 billion of code-covered procurement (99.6%).<sup>23</sup>

3.33 These proportions are unlikely to be significantly lower in procurement areas that are not covered by the GATT Government Procurement Code. The above proportions apply to areas that are already considered to be liberalised by inclusion in the Code.

3.34 It was announced in December 1993 that there will be "a new agreement on Government Procurement which will open up to international competition government purchases worth several hundred billion dollars per year."<sup>24</sup> It will be a matter of some interest to see if the current high local content levels persist after the expansion of the Code.

3.35 Other international practices related to government procurement leverage are detailed at Appendix V. ANZ suppliers' share of Australian government procurement is therefore considerably lower than that of competing OECD nations. This is a cause of great alarm to the Committee.

#### **INDUSTRY DEVELOPMENT: MAXIMISATION OF COMPETITIVE OPPORTUNITIES FOR ANZ SUPPLIERS**

3.36 General ANZ industry development policies are set out in Commonwealth Procurement Guideline No. 12. Much of the language is supportive of ANZ suppliers, exhorting Commonwealth buyers to actively seek out ANZ suppliers, build relationships, inform the market early enough to allow ANZ suppliers to bid and eliminate practices which may favour foreign suppliers over ANZ suppliers. However, the submission to the Committee by DITARD states that industry development is the least understood and least implemented criterion in the purchasing process.<sup>25</sup> This view accords with the overwhelming weight of evidence taken by the Committee.

3.37 Poor application of Guideline No. 12 has been identified in evidence from a number of companies indicating that the objective of maximising opportunities for Australian and New Zealand suppliers to compete on the basis of value for money is not being met. The Chamber of Manufactures of NSW stated that:

"there appears to be, with some exceptions, significant problems with the implementation of that policy by Departments and other agencies ... Attitudes and practices of purchasing officers would appear to be little influenced by the new philosophy ..."<sup>26</sup>

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23 Hird, J, Director, GATT Projects, Department of Foreign Affairs and Trade: *Insight*, 15 March 1993 p 9

24 GATT: Press Release GATT/1603, 15 December 1993

25 DITARD: Submission 71 p 7

26 Chamber of Manufactures of New South Wales: Submission 51 p 10

3.38 Emphasis is on non-discrimination against foreign suppliers and subsequently assisting ANZ suppliers to develop through a competitive government market built on pursuance of the value for money concept:

“The policy does not:

- . mean buying everything possible from ANZ suppliers;
- . discriminate on the basis of ownership of a supplier - there is no preference for ANZ equity in itself;
- . discriminate against foreign suppliers; and
- . aim to maximise ANZ content of purchases - it does not reward suppliers simply because their products are of ANZ origin.”<sup>27</sup>

3.39 The central message of the Guideline (and indeed of purchasing policy) is adherence to value for money:

“buy supplies on the basis of value for money after considering all relevant factors and evaluating offers against requirements”<sup>28</sup>

**3.40 In particular it is the Committee's view that the Guideline's statement regarding the non-maximisation of ANZ content is inappropriate and has no place in purchasing policy.**

3.41 In the devolved purchasing world the value judgements, depth of knowledge required of local industry and resources to conduct local industry capability search practices often lie outside the skills of the individual purchasing officer. While the guideline mentions the State-based Industrial Supplies Office (ISO) network as particularly useful in identifying the capabilities and capacities of Australian suppliers, the network reports little increase in its services since the inception of the current purchasing arrangements:

“As there is no ‘Buy Australian’ policy, the Purchase Australian Office has developed and implemented programs directed at encouraging buyers to consider Australian products and services, interfacing with ISO to enhance their activities. Yet ISO has not seen any significant increased use of its services as a consequence of these initiatives.”<sup>29</sup>

3.42 The failure of some purchasing officers to fully explore local industry capability, coupled with deficiencies in the application of the value for money and the open and

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27 DAS: *Commonwealth Procurement Guideline No. 12: Australian and New Zealand Supplies*, December 1990 p 5

28 *ibid.*, p 2

29 ISO: Submission 15 p 3

effective competition criteria often result in industry development running a poor third (if considered at all) in the general procurement process. This poor position is reinforced by the priority of the value for money guideline as a mandatory Department of Finance guideline. The policy in practice has been correctly paraphrased as seeking to assist ANZ suppliers to get to the starting blocks but not caring about whether they reach the finish line.

3.43 The New Zealand approach is concerned with how ANZ suppliers fare in the procurement 'race'. In maximising full and fair opportunity for domestic suppliers, agencies are requested to:

- “ ensure that potential New Zealand/Australian producers for all or part of the goods and services required are not overlooked;
- communicate with potential producers so that they understand the buyers' needs and the buyers understand the suppliers capabilities, capacities, strengths and needs;
- plan procurement and inform the market in a timely manner so that all potential suppliers have the opportunity to meet the buyers' requirements or the requirements of prime contractors;
- eliminate any bias or discrimination favouring foreign suppliers over New Zealand/Australian producers at any stage of procurement and encourage agents, such as supply brokers and consultants, to do the same;
- be prepared to debrief suppliers, including local suppliers.”<sup>30</sup>

3.44 The most effective method for removing bias or discrimination favouring foreign suppliers is to require the maximisation of competitive local content. In other words, where ANZ suppliers are price and quality competitive, government agencies should be required to purchase from ANZ suppliers.

3.45 The development of a purchasing culture which automatically looks to justify why ANZ goods and services are not being purchased is crucial to obtaining maximum benefit for Australia. Other countries seem to have such an attitude.

3.46 Purchasing guidelines should require the buyer to take account of Australian industry at all times unless there are disadvantages in price, supply, quality, servicing and delivery arrangements in using local sources.

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30 Ministry of Commerce: *Suppliers' Guide to Government Purchasing in New Zealand*, May 1992 p 9

**Recommendation 6**

**3.47 The Committee recommends that current industry development guidelines, concerning 'maximisation of opportunities for ANZ suppliers to compete', be amended to require purchasing officers to maximise the level of competitive ANZ content of purchases.**

**STRATEGIC USE OF PURCHASING FOR INDUSTRY DEVELOPMENT**

3.48 Despite the general picture of quite limited Australian government procurement from Australian suppliers in some areas, there are individual organisations and projects using government funds which achieve significant levels of sourcing from local suppliers through a strategic approach to procurement. This approach tends to exist predominantly outside the general Purchasing Australia framework. The Department of Defence's Australian Submarine and ANZAAC Ship Projects and Telecom's purchasing practices are examples of locally focused strategic supply arrangements.

3.49 While the Committee has received evidence of some problems in purchasing in regard to the Department of Defence and Telecom, it is clear that their purchasing culture and practices are far more supportive of competitive ANZ industry.

3.50 Telecom claims that it sources in excess of 98% of its requirements from Australian based suppliers with some 70% of the price of its telecommunications equipment representing ANZ content.<sup>31</sup> The ANZAAC Ship Project is currently achieving over an 80% ANZ content level (70% originally required) on a \$10 billion project.

3.51 Efficiency and increased local sourcing are compatible in the examples of the ANZAAC Ship Project and Telecom. The fixed price for the ANZAAC Ship Project was only 4% over the fully imported price. This small margin is estimated to be rapidly overcome, translating into significant cost savings over the life of the project as a direct result of designing and engineering the project to suit Australian circumstances without departing from international standards.<sup>32</sup> This project has the potential to combine increased efficiency with high levels of local content.

3.52 The factor that starkly differentiates these projects from the operation of more general purchasing policy arrangements administered by Purchasing Australia is the determination of the Department of Defence and Telecom to combine maximisation of local sourcing with the building of an internationally competitive local industry supply base.

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31 Telecom Australia: Submission 90 p 1

32 Transfield Shipbuilding Pty Ltd: Exhibit 37 p 6

### **Telecom and Industry Development**

3.53 The Telecom Industry Development Plan is focused on creating a local supplier base capable of producing world class internationally competitive goods and services coupled with the establishment of high value added internationally competitive design and development activities.<sup>33</sup>

3.54 Telecom's preferred supplier approach and its ability to provide significant local participation is based on the organisation's understanding that procurement decisions should not simply be based on lowest purchase price. Telecom considers that local suppliers can often deliver efficient outcomes through goods and services that have the lower whole of life product cost because of advantages such as: designs based specifically on Australian conditions; superior security of supply; and better product support.<sup>34</sup>

3.55 Telecom's purchasing policies have played a prominent role in developing the telecommunications manufacturing industry in Australia. Telecom's long term attitude to this development is illustrated in its submission:

“Following the Second World War, Telecom supported the development of Australian industry through the use of long term purchasing agreements and by insisting on the transfer of technology to Australia and for the local manufacture of major items such as exchange switching equipment and cable. These long term purchasing agreements enabled companies to establish local manufacturing and support facilities. This in turn allowed them to expand their range of products and facilitated the establishment of smaller support companies.

In essence the Australian telecommunications supply industry has been built by Telecom's purchasing policy.”<sup>35</sup>

3.56 The Australian Electrical and Electronic Manufacturers' Association (AEEMA) Ltd made similar comments:

“Telecom's policy of purchasing its major telecommunication equipment requirements locally helped establish the only integrated manufacturing sector of the Information Industries (computer and telecommunications hardware and software) in which Australia has a significant presence.”<sup>36</sup>

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33 Telecom Australia, op cit., p 1  
 34 ibid.  
 35 ibid.  
 36 AEEMA: Submission 55 pp 7-8

3.57 AEEMA further commented that directing government purchasing to Australian-based companies helps enhance their manufacturing capabilities and stimulates their ability to export.<sup>37</sup>

3.58 Telecom continues to rely on a competitive local telecommunications industry producing leading edge technology at competitive prices, and anticipates purchasing \$10 billion of equipment from local industry in the next five years.<sup>38</sup>

3.59 Telecom plans to continue the development of its local supply base. In the Telecom Industry Development Plan, Telecom has undertaken to:

- ensure that local industry generates world class value;
- make available world-class products and services in Australia on competitive terms and conditions; and
- establish in Australia high value added, internationally competitive design and development activities.<sup>39</sup>

3.60 Alcatel supported Telecom's view that public sector purchasing policies are critical to the development of the telecommunications industry, claiming that support for local manufacturing industries through Government purchasing policies works well in that industry, assisting in the development of world class R&D and manufacturing facilities. Alcatel stated:

“Telecommunications equipment provides a good example of how the strength of public infrastructure demand, combined with a close developmental relationship between a GBE and industry on standards development and R&D can create an internationally competitive local supply industry.”<sup>40</sup>

### **Defence Purchasing and Industry Development**

3.61 The Department of Defence is a major Government purchasing agent, with an annual purchasing budget of approximately \$4 billion. In addition to achieving value for money in its purchasing, Defence also has strategic considerations (including local sourcing) which overlay its procurement strategies.

3.62 Defence procurement can contribute significantly to industry development as demonstrated in the ANZAAC Ships Project and the Collins Class Submarine Project.

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37 *ibid.*, p 2

38 Telecom Australia, *op cit.*, p 2

39 *ibid.*, pp 1-2

40 Alcatel Australia: Submission 37 pp 9

3.63 In 1992, the Allen Consulting Group surveyed Australian defence industries and commented that:

“the response from the companies suggests that, for a particular group of companies, the submarine project has resulted in a considerable increase in industrial capability in areas such as design, quality control, management systems and manufacturing processes.

A second group of companies felt that the project has been particularly important in expanding production or providing a base workload.

The overall response suggests that there is a core of companies which are experiencing considerable benefits from the submarine and frigate projects.”<sup>41</sup>

3.64 The projects have assisted in the establishment of ‘spin-off’ industry capability and activities from the core project which are now self sustaining. This capability did not exist before the projects, and would have been unlikely to exist had the Government not made the decision to build such highly specialised equipment in Australia.

3.65 Dr J White, Chief Executive, Transfield Shipbuilding Ltd, identified the benefits to the Australian economy of these projects as:

- . development of internationally competitive engineering based industries;
- . improved balance of payments figures;
- . employment generation; and
- . broadening of the taxation base.<sup>42</sup>

3.66 Dr White further identified the success of Telecom and the ANZAAC project in bringing to their respective industries:

- . modern industrial engineering techniques;
- . the introduction of new industrial arrangements which encourage broad based skilling and skill enhancement, and the abolition of inefficient demarcation arrangements;
- . increased utilisation of available resources both within the industries and in related industries by subcontracting; and
- . the formation of large industrial groupings which can efficiently integrate and apply resources on a nationwide basis.<sup>43</sup>

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41 The Allen Consulting Group Pty Ltd: *Defence and Australian Industry: Description and Economic Analysis*, AGPS, Canberra, October 1992 pp 48-9

42 J D White, N Apple, G Haselgrove, R Dowe, D H Clyde: *Creating wealth through manufacturing - the role of Government in developing an internationally competitive design and engineering capability in Australia: Exhibit 37*

43 *ibid.*

3.67 For strategic reasons, Defence strongly supports the establishment of a strong internationally competitive local industry base, favouring sound pro-active measures to provide ANZ suppliers with every reasonable opportunity to compete for government business.<sup>44</sup> In major capital equipment projects the principle measure is the requirement for a specific Australian Industry Involvement (AII) plan, a requirement that Defence considers can be used outside the department:

“In general, Defence is not aware of any impediments to the successful use of its Australian Industry Involvement (AII) policy by other government agencies though it is most suitable in the area of major acquisitions. It should be noted that the Australian content requirement should be set with a view to the capacity of Australian industry to provide competitive inputs to the project, up to the specified level, and not set arbitrarily at what may be unrealistic levels.

Defence usually leaves establishment of local content and Defence Offset levels to the competitive tendering process, encouraging high levels through inclusion of these in tender evaluation criteria. Where the level is specified before tendering, this is based on project definition studies which include examination of Australian industry capacity. Experience has shown that the achievement of Australian content objectives is assisted by the use of local prime contractors which is also a Defence policy.”<sup>45</sup>

3.68 The operation of Defence procurement is not without flaws, particularly in relation to smaller scale ANZ suppliers and the separation of embedded goods and services.<sup>46</sup> Despite these flaws, the pro-active approach of Defence to maximising ANZ content in competitive tendering and the requirement for AII proposals in major tenders is a sensible and effective approach that should be emulated more widely in government procurement.

## **EXTENDING INDUSTRY DEVELOPMENT IN GOVERNMENT PURCHASING**

3.69 Given the success of organisations like Telecom and Defence in pursuing local content and international competitiveness, the failure of much of the current government purchasing system to do the same is not defensible.

3.70 Part of this failure stems from the lack of clear purpose, authority and understanding of purchasing responsibilities in the Commonwealth Government structure since the combined decentralisation and devolution of purchasing in 1989. The implementation of the reforms, conducted with a ‘laissez faire’ (literally ‘let things be’) mentality, has resulted in a government purchasing system with significant shortcomings in efficiency and industry development.

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44 Department of Defence: Supplementary Submission No. 59.4 p 7

45 *ibid.*, p 12

46 Fliway-AFA International Pty Ltd: Exhibit 2

3.71 Organisations such as Telecom and Defence which have resisted this mentality have combined long term experience in procurement and internal centralised/specialised purchasing cells with an understanding of strategic long term industry development issues.

3.72 The Committee is particularly concerned that the benefits to the Australian economy of industry development are often not included in major tender assessment, are often not understood by purchasing officers, or are not accepted. This results in distorted value for money evaluations. Where Commonwealth funded procurement can be used to satisfy agency objectives and create internationally competitive local industry development, the evaluation of value for money should not be limited to individual cost consideration. The value for money consideration must include the overall value to Australia of committing expenditure.

3.73 DITARD noted the importance of maximising these overall benefits:

“Strategic use of its purchasing power provides government with the ability to exert significant leverage on suppliers to contribute to achieving its industry policy objectives. This leverage is important particularly in view of the small Australian market, the consequent difficulty firms experience in reaching the critical mass to penetrate international markets, and the poor linkages between leading edge customers, the research sector and industry. Notwithstanding this, protective government purchasing policies are not the path to international competitiveness. Rather, government purchasing leverage must be used constructively as an instrument for industry development and economic growth.”<sup>47</sup>

3.74 The Committee endorses this view. This constructive approach to industry development was a factor in the recent re-calling for tenders for The Australian Advanced Air Traffic System (TAAATS) where the successful bid included a strong commitment to local procurement and export prospects. It was chosen over a lower price bid,<sup>48</sup> reflecting the greater value of the successful bid to the Commonwealth.

3.75 In December 1992, the Government requested Commonwealth Government Business Enterprises (GBEs) to include industry development objectives in their corporate plans. Before inviting tenders for projects for \$30 million or over, GBEs are requested to prepare industry impact statements to ensure that opportunities are available to competitive local firms. Exemptions are allowed for individual GBEs like

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47 DITARD: Submission 71 p 1

48 Financial Review: *Safer Skies Ahead*, January 17 1994

AOTC which already have industry development plans in place. Portfolio Ministers are to regularly review the performance of GBE's against their corporate plan in conjunction with the Minister for Industry, Technology and Regional Development.<sup>49</sup>

3.76 The Committee endorses this greater emphasis on evaluating the contribution of industry development and considers that the approach should be applied more widely in medium to large project tender assessment and not be limited to GBEs.

### *Recommendation 7*

**3.77 The Committee recommends for Commonwealth funded projects that:**

- all projects valued at \$1 million or over be required to have an industry development criterion in the tender assessment;**
- all projects over \$5 million also have comprehensive pre-tender ANZ supplier briefing procedures;**
- industry impact statements also be prepared by all non-exempted agencies for projects valued at \$30 million or over;**
- industry development undertakings of successful tenderers be reflected in contracts as performance clauses subject to meaningful enforcement, including measures such as awarding of damages, termination or revision of contract; and**
- the Department of Industry, Technology and Regional Development assess the industry impact statements and audit industry development performance clauses.**

3.78 Evaluation of industry development criteria for purchases under \$1 million by individual agencies is probably not an efficient use of agency resources, particularly in regard to irregular purchases of small value items. However, while small purchases may have limited industry development impact individually, the aggregation of these smaller purchases across the public sector can result in a scale of purchases which can have significant industry development ramifications. An appropriate approved supplier scheme for capturing these industry development benefits is described at Paragraph 5.40.

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49 Button, J and Bolkus, N: *Government Promotes Opportunity for Local Firms*, Joint Press Release, Minister for Industry, Technology and Commerce and Minister for Administrative Services, 17 December 1992 pp 1-2

3.79 Local participation in design is often important in maximising opportunities for ANZ suppliers:

“Likewise, the importance of design, engineering and management in major Australian projects, not only to the cost effectiveness, but also to the overall control and support of such projects, cannot be overstressed. It is at the design and engineering stage that specifications are written and when cost, quality and technology are built into the final product. Experience has shown that the engineers carrying out these tasks tend to specify goods and services that they are familiar with. There is therefore a correlation between these factors and the ability for Australia to ultimately retain cost effective control over a project's operation and support.

The direct correlation between these elements was shown in a recent study of aid funded projects managed by Japan, where the projects were internationally bid after the design and engineering had been carried out in Japan. The study showed that, regardless of international bidding for plant and equipment in this project, Japanese companies were successful in winning all but three per cent of these contracts”<sup>50</sup>.

3.80 Telecom and Defence have also identified the importance of local design in building a long term competitive domestic supply base.<sup>51</sup> Local design also improves the likelihood of locally based through life support, often creating significant lower support costs and increased convenience.

### **Recommendation 8**

**3.81 The Committee recommends that purchasing guidelines be amended to require local involvement of ANZ design suppliers wherever possible.**

### **CURRENT INDUSTRY DEVELOPMENT PROGRAMS**

3.82 Many of the Government's industry development programs use government purchasing for leverage. These programs, in general, have a positive effect on Australian industry development. Some of these programs are interpreted by industry, and in some cases used by suppliers in marketing, as conferring an approved supplier status. Such programs include the Partnerships for Development program, the System Integrators Panel and the Telecommunications Carriers Industry Plans. Other programs which involve government purchasing leverage include the National

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50 J D White, N Apple, G Haselgrove, R Dowe, D H Clyde, op cit., p 5

51 Telecom: Submission 90; Department of Defence Submission 59

Procurement Development Program and the pharmaceutical industry development program, Factor (f).

3.83 A formalised approved supplier system, encompassing relevant existing industry development programs, would provide the dual benefits of a more coherent whole of government approach and optimisation of benefits to the Commonwealth for the commitment of its expenditure dollar.

### **Information Industries Strategy**

3.84 The Government's Information Industries Strategy is designed to enhance the development of the Australian information technology sector (including computers, software, communications equipment and information and communication services) and assist the industry to gain access to the global market. The basis of the strategy is to provide opportunities for Australian companies to piggy-back on overseas corporations to find international niche markets.<sup>52</sup> Major IT suppliers are encouraged to enter long term strategic development and investment agreements with domestic industry.

3.85 An important role government IT purchasing can play in developing local software capability is to facilitate access to and participation in the global trading networks of international software developers. The Committee understands that the information industries strategy is targeted at developing such opportunities, but would point out that maximisation of such opportunities is dependent on the **performance** of transnational IT firms in fulfilling their voluntary undertakings under the strategy.

3.86 The programs under which these agreements are administered are the Partnerships for Development (Pfd) program and the Fixed Term Arrangements (FTA) program. International firms with annual IT sales to government over \$40 million are requested to sign a Pfd agreement. Firms with annual government IT sales between \$10 million and \$40 million are requested to enter four year FTAs. FTAs provide a transition to the Pfd Program as the international company's Australian government IT business grows. There are no industry development requirements for firms with annual government IT sales of less than \$10 million per annum.

3.87 IBM Australia acknowledged that the information technology industry had grown since the inception of the Pfd program. However, they pointed out that there is no direct linkage between participation in the program and access to public sector business and, in IBM's view, this hinders investment in industry development and exports by companies involved in the program.<sup>53</sup>

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52 Stewart, R, Department of Government and Public Administration, University of Sydney: Exhibit 1 p 21

53 IBM Australia Ltd: Submission 33 p 6

3.88 AEEMA also had some criticism of the PfD program.

“the Partnerships [for Development] program ... has not always recognised the competitive manufacturing structure of the Australian high technology industries and the considerable investment undertaken in advanced manufacturing facilities. ... Nor is the Association convinced that changes to the Partnership program have been taken with any strategic consideration towards ensuring that investment occurs in those areas of competitive advantage, such as telecommunications. Rather changes seem to have been made for administrative reasons that could be overcome via better management. The lack of consistency and firmness in administration has reduced opportunities to enhance industrial capabilities.”<sup>54</sup>

3.89 The PfD and FTA programs are voluntary agreements between suppliers and the Government, represented by the Minister for Industry, Technology and Regional Development. The agreements, as such, are not linked directly to Commonwealth IT contracts, but tend to be used as a proxy for industry development assessment in major IT contracts.

3.90 The formal mechanism by which industry development is evaluated for major IT projects is the Acquisition Council process. IT Acquisition Councils are formed on a project by project basis for IT projects of \$5 million and over, or where projects under that value are identified as involving sensitive issues or high risks. In regard to Australian industry development, Acquisition Councils will evaluate:

- . potential opportunities for Australian industry development arising from the proposal;
- . the extent that the proposal has taken account of the Government's IT policies such as outsourcing, plans to vendor independent open systems environments including implementation of GOSIP; and
- . the use of the restricted panel of systems integrators.<sup>55</sup>

3.91 DITARD has a role in the industry development evaluation:

- “7.3 DITARD has the option of membership on all Councils and is to be invited to participate in the Council process.
- 7.4 the DITARD representative will be operating in both a consulting and evaluative mode, and will be primarily concerned with ensuring that the Council takes account of the Government's Australian IT industry

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54 AEEMA: Submission 55 pp 7-8

55 Department of Finance: *Guidelines for the Operation of IT Acquisition Councils*, December 1991 p 19

development policies and will be a source of advice within Council on these matters.”<sup>56</sup>

3.92 DAS, however, also has an industry development role as it is responsible for the evaluation of the three main principles of purchasing:

“8.3 The DAS representative on the Council will be operating in both a consultative and evaluative mode, however the officer will be primarily responsible for ensuring that the proposal accords with IT policy and the three main principles governing Commonwealth purchasing. These are:

- . value for money;
- . open and effective competition; and
- . support for local industry.”<sup>57</sup>

3.93 The Committee is therefore sympathetic to IBM's view that the linkage between its long term industry development program and access to Government business is too indirect, particularly where there is no requirement to include its commitment to the PfD program in tender evaluations. The Committee does not however, consider that companies in the PfD program should be guaranteed shares of procurement on the basis of industry development. Industry development undertakings such as PfDs and FTAs need to be more directly linked into IT project evaluation through the provision of an industry development criterion in IT project contracts.

3.94 The Committee is aware of the success of both programs in boosting Australian IT exports and research and development in a post offsets policy framework. The goals of increased domestic and export capability in the sectors of information technology and telecommunications are important to the strategic development of a competitive Australian industry base.

3.95 However, the Committee has received a large amount of evidence from Australian IT firms that the PfD and FTA schemes create access barriers in domestic and export markets. These barriers arise from the scale of activity needed to reach the sales threshold of the schemes and the subsequent focus on large scale IT suppliers to government. Evidence has been presented to the Committee that smaller Australian IT companies have faced problems in markets where a track record in government sourcing is viewed as valuable. Asian markets in particular view a government track record in this way. The ability of large transnationals involved in the PfD and FTA to market themselves as ‘partners’ of the Australian government gives these companies a significant advantage in these markets.

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56 *ibid.*, p 29

57 *ibid.*, p 30

3.96 The Committee therefore recommends that PfDs and FTAs be subsumed within a wider approved supplier scheme that allows access for smaller Australian IT companies to both the benefits of government imprimatur and the obligations of industry development. The approved supplier scheme would need to have levels or stages of commitment regarding employment, investment, export and R&D targets related to the scale of government business. Approved supplier status could be considered as meeting the industry development criterion in major contracts. Firms outside the approved supplier system would still be able to compete on an industry development basis in these tender assessment processes.

3.97 The Committee recognises that current PfD/FTA agreements can be long term in nature. In transition, such agreements should run their term and, if undertakings are fulfilled, be accorded approved supplier status in the interest of providing certainty to industry.

**Recommendation 9**

3.98 The Committee recommends that for Commonwealth funded projects:

- all IT projects valued at \$1 million or over be required to have an industry development criterion in the tender assessment;
- industry development undertakings of successful tenderers be reflected in contracts as performance clauses subject to meaningful enforcement, including measures such as awarding of damages or termination of contract;
- the Partnerships for Development and Fixed Term Arrangements programs be accommodated within a wider approved supplier scheme that has access for small and medium IT firms;
- where approved supplier commitments (including PfdDs or FTAs in transition) form the basis or part of the industry development bid of the successful tenderer, the undertakings of the programs be reflected in each individual contract as a performance clause;
- the Department of Industry, Technology and Regional Development be responsible for:
  - vetting industry development contract criteria and industry development plans, and
  - implementation and policy administration of the approved supplier scheme (including entry and performance validation); and
- the National Procurement Board provide advice to the Minister for Industry, Technology and Regional Development on the performance of these industry development arrangements.

**Systems Integration Panel**

3.99 The Government announced in March 1991 the proposed formation of a restricted panel of systems integrators (SI Panel) to assist in the development of the Australian software and services industry:

“The Systems Integration Panel (SIP) is aimed at providing opportunities for the development of innovative and cost effective IT solutions and at increasing the prospects of world competitive Australian IT service companies. The SIP

was established in June 1992 and agencies undertaking IT acquisitions must comply with the SIP guidelines where appropriate.”<sup>58</sup>

3.100 As previously mentioned, and unlike the PfD program, the SIP is referred to in Acquisition Council guidelines. The effectiveness of an Acquisition Council guideline that agencies should use SI Panel guidelines where appropriate, in regard to Australian IT industry development, is difficult to determine owing to the short amount of time the Panel has been in existence. The Committee notes that the SI Panel is currently under review by the Department of Finance, DAS and DITARD concerning how effectively the Panel has met its policy objectives.<sup>59</sup>

3.101 The members of the SI Panel are expected to ‘pull through’ other local suppliers in return for being part of a restricted group:

“3.7 Panellists are expected wherever possible to use the services, skills and products of Australian companies in their SIP activities, consistent with other purchasing principles. Panellists should be aware of other companies with specialist expertise and with whom they wished to form alliances for particular bids. The Help Line ... provides a source of information on other companies bids.

3.8 Sub-contracting to other suppliers is a valuable way of encouraging the growth of the IT industry and widens the options open to agencies. It maximises the number of companies benefiting from public sector business.”<sup>60</sup>

3.102 A number of submissions were critical of the industry policy effectiveness of the SI Panel, claiming that it restricts the opportunities for the development of an indigenous information technology industry. These views were summed up by the statement:

“the SI Panel concept collected the reins of IT purchasing together and handed them to transnationals and pseudo-Australian companies ... Probably the only reason that the SI panel has not totally destroyed Australian IT is that it was established at a time when IT business in Canberra was so low that there were insufficient funds to lock the transnationals in.”<sup>61</sup>

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58 Information Exchange Steering Committee: *Guidelines for the Operation of the Restricted Panel of Systems Integrators*, December 1992

59 DAS: *Purchasing Review Task Force Report*: Exhibit 182 p 99

60 Information Exchange Steering Committee, op cit., p 13

61 pTizan Computer Services Pty Ltd: Submission 99 p 7

3.103 The SI Panel was considered by some to affect the IT industry in two ways:

- effectively reserving the future government IT market to the 16 panellists; and
- causing adverse market reaction to non-panellists.

3.104 The Committee was informed that a large IT company based in Australia was told by an Asian government that its non-membership of the SI panel created the impression that it might be non-viable and unprofessional.<sup>62</sup>

3.105 The Australian Information Industries Association (AIIA) questioned whether the SI Panel is the best means of encouraging local industry development.<sup>63</sup> Two suggestions made to the Committee to improve the local industry development aspects of the Panel were to:

- partner Panellists with local companies and require a percentage of the revenue of a contract to be derived from the sale of Australian developed software; and
- appointment of Australian specialist panellists to the SI Panel.<sup>64</sup>

3.106 The Committee is of the view that the current guidelines do not provide an effective basis for the development of IT firms owing to the guideline approach and notes that:

“It cannot be guaranteed that individual panel members will be awarded contracts to perform SI services. Contracts will be awarded by agencies using standard Commonwealth purchasing practices based mainly on value for money.”<sup>65</sup>

3.107 The SI Panel is a new mechanism which is undergoing its first review. However, evidence to the Committee indicates a serious failure of the panellists to ‘pull-through’ non-panellist firms in tendering practices to date.

3.108 The Committee's overall opinion is that the SI Panel is not effectively achieving its objectives. However, as there is a review in progress, the Committee is not in this Report making any finding on the continued existence of the SI Panel.

3.109 The Committee intends returning to the issue of the effectiveness of the SI Panel in achieving the objective of industry development after the Departmental

62 AIIA: Submission 40 p 11

63 *ibid.*

64 Executive Computing Pty Ltd: Submission 72 p 1; pTizan Computer Services Pty Ltd: Submission 99 p 7

65 Information Exchange Steering Committee, *op cit.*, p 14

review is completed. For the time being, however, the Committee's recommendation assumes the continuation of the SI Panel.

### ***Recommendation 10***

#### **3.110 The Committee recommends that:**

- . industry development undertakings, including definition of role and share of non-panellist IT firms, given by successful SI tenderers be reflected in contracts as performance clauses subject to meaningful enforcement, including measures such as awarding of damages and revision or termination of contract;**
- . systems integration carried out by panellists in any one contract be limited to a major portion of the value of the systems integration (around 70%);**
- . establishment of a second tier SI category to pre-qualify smaller systems integrators and IT firms for consortium formation with panellists;**
- . where a systems integrator proposes using proprietary software or hardware to a value exceeding a small proportion of the contract value (around 10%), the value attributed to the proprietary product be identified in a second offer process to competing firms;**
- . establishment of a specialist panel category for highly specialised SI firms such as security systems firms;**
- . the Department of Industry, Technology and Regional Development be responsible for vetting and monitoring industry development undertakings of panellists in contracts; and**
- . the National Procurement Board provide advice to the Minister for Industry, Technology and Regional Development on the performance of the SI Panel.**

### National Procurement Development Program

3.111 Another program by which the Government uses its purchasing power to help promote the development of Australian industry is the National Procurement Development Program (NPDP). The NPDP was established in 1987 as a government-funded selective assistance scheme. The aim of the program is to stimulate a greater level of collaboration between government and industry in the development of innovative Australian products to meet future government requirements.

3.112 Under the NPDP, grants are provided for up to 50% of eligible project expenditure (including salaries, prototypes, trialing pilot plant and materials). The NPDP differs from other R&D assistance schemes by providing help at the latter stages of product development. Since its inception, 107 grants totalling \$35 million have been approved. Grants have been approved for product development in the following industries:

- . computer software;
- . medical technology;
- . communications technology; and
- . scientific instrumentation.

3.113 Only a small number of submissions from industry associations commented on the NPDP, but those which did viewed the Program favourably. The Australian Electrical and Electronic Manufacturers' Association (AEEMA) supported the role of the NPDP in supporting emerging Australian companies, and pointed to exports being achieved as a result of the Program. The Institute of Purchasing and Supply Management considered the program to be worthwhile, but noted that it had a very low profile with Government buyers and suppliers.<sup>66</sup>

3.114 The ACTU also supported the NPDP, calling for its expansion to assist emerging manufacturers to develop innovative products and compete against better established international firms.<sup>67</sup>

3.115 The policy approach to industry development incorporated in the NPDP is consistent with the principles outlined by Professor Michael Porter in *The Competitive Advantage of Nations*. Professor Porter saw Government purchasing as one of the few interventionist approaches which can have a positive influence in upgrading competitive advantage.

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66 AEEMA: Submission 55 p 16; IPSM: Submission 22 p 16

67 ACTU: Submission 98 p 7

3.116 Porter argued that Government procurement can be a positive influence in upgrading national competitive advantage when procurement strategies seek to incorporate:

- . early demand for advanced new products or services;
- . stringent product specifications and the requirement to identify sophisticated product varieties;
- . product specifications reflecting international needs;
- . procurement processes that facilitate innovation; and
- . competition among suppliers.<sup>68</sup>

3.117 The NPDP can play a valuable role in most of the above factors. The Committee is concerned that the existence and role of the NPDP has a low profile in industry. A concerted marketing effort is needed.

### ***Recommendation 11***

**3.118 The Committee recommends that:**

- . **the Commonwealth resource a concerted marketing effort for the National Procurement Development Program; and**
- . **the National Procurement Board advise the Minister for Industry, Technology and Regional Development on the effectiveness of the scheme and further extension.**

### **ROLE OF THE ISO**

3.119 The Industrial Supplies Office (ISO) is an initiative funded by the Commonwealth and State governments which focuses primarily on promoting import replacement and retention of manufacturing opportunities in Australia. Its role is to maximise the local content in Government and industry purchases by identifying local industry capabilities. The ISO provides its services free of charge.<sup>69</sup>

3.120 The success of the ISO flows largely from the fact that it is staffed by people with appropriate technical skills. ISO officers are likely to be aware not only of what

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68 DAS: Submission 50 pp 4-5

69 ISO: Submission 15 p 1

is currently manufactured, but also general industry capability to produce a new or modified good or service.

3.121 The Committee received a number of submissions advocating an increased role for the ISO in Government purchasing.<sup>70</sup> The ACTU recommended that the ISO network be upgraded, and become a central link between Australian industries and public sector buyers.<sup>71</sup>

3.122 To date Government buyers have not used the ISO to a great extent. ISO figures show that less than 5% of its activities represent Government buyers using ISO services.<sup>72</sup> In order to increase the utilisation of the ISOs services by Government buyers, Cabinet decided in January 1993 to integrate the ISO into departmental purchasing procedures.

3.123 The Cabinet decision requires each Commonwealth Department and agency to develop and incorporate into purchasing procedures a Memorandum of Understanding with the ISO network, setting out how the ISOs services would be used, taking into account the particular circumstances of each Department.<sup>73</sup>

3.124 The New Zealand ISO network provides a positive example of how the performance of The Australian ISO network can be improved:

“The New Zealand Industrial Supplies Office (NZISO) was established to give practical support to the Government's purchasing policy by facilitating contracts and exchange of information between public sector bodies and suppliers about purchasing requirements and domestic industry capabilities. The NZISO is a unit within the Ministry of Commerce. A Management Committee, which includes representatives of government purchasing agencies and New Zealand industry, provides strategic guidance to industry.”<sup>74</sup>

3.125 Thus the NZISO, unlike the Australian ISO, is directly supported by the Ministry of Commerce, the NZ Government's industry department. It plays a much closer role in matching local suppliers with government buyers. Unlike NZ, Australia does not have any group which combines government purchasing agencies and industry as in the NZISO Management Committee. This lack of industry input into strategic direction is a major factor in the drift of the current Australian purchasing system from accountability in industry development terms.

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70 Champion Compressors Ltd: Submission 76 p 1; Australian Chamber of Manufactures: Submission 49 p 15; MTIA: Submission 47.1 p 10

71 ACTU: Submission 98 p 10

72 Box, J, Chairman, ISO: Transcript p 202

73 DAS: Supplementary Submission 50.2 p 1

74 New Zealand High Commission: Supplementary Submission No. 46.1 Attachment p 2

### *Recommendation 12*

3.126 The Committee recommends that:

- . the National Procurement Board co-ordinate with agencies and the ISO the identification and monitoring of Australian industry capability including advice on the need to increase resourcing of the ISO network for expansion of activities;
- . discussions be held with the ISO with a view to having representatives of appropriate government departments appointed to the management board of the proposed national ISO corporate structure;
- . the Commonwealth provide funding to the ISO for the development of an Australian industry capability data-base; and
- . the use of the ISO by agencies to inform ANZ suppliers of opportunities to access Commonwealth funded procurement be monitored by the National Procurement Board.

### **SMALL TO MEDIUM SIZE ENTERPRISES**

3.127 Recognition of the importance of small to medium enterprises (SMEs) to a healthy industrial base is being increasingly reflected in industry development policy. Government purchasing leverage is often used in other countries for small business development. The USA, for example, has adopted specific measures to assist SMEs in securing government sales.

3.128 The Committee has considered this issue before during its inquiry into the problems of small business in Australia. In its report titled *Small Business in Australia: Challenges, Problems and Opportunities*, released in January 1990, the Committee noted that Australia lagged behind other countries in the initiatives offered to encourage greater participation by small to medium enterprises in Government purchasing.<sup>75</sup>

3.129 The Committee recommended in that report that:

- “. the [then] Department of Industry, Technology and Commerce, in conjunction with the Purchase Australian Office, Industrial Supplies Office and small business organisations, investigate appropriate

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75 House of Representatives Standing Committee on Industry, Science and Technology: *Small Business In Australia: Challenges, Problems and Opportunities*, AGPS, Canberra 1990 pp 255-6

mechanisms for small businesses to participate more fully in Australian Government purchasing opportunities. These mechanisms could include a register of interested firms and means of evaluating firms as approved goods and service providers. Criteria for approval could include meeting quality assurance standards;

- consideration be given to encouraging the establishment of small business cooperatives to increase opportunities for small business to subcontract to large suppliers of goods and services or to contract directly with government;
- Australian Government purchasing guidelines contain a statement to the effect that, for larger contracts (say greater than \$5m) where a tenderer does not manufacture the complete product (or provide the complete service) itself, inclusion of a 'small business participator plan' and the ability to employ sub-contractors will be regarded in evaluation of a tender. Advertisements calling for tenders should include this statement; and
- Australian Government purchasing officers be required to consider smaller specialised firms in issuing large contracts and where possible break large contracts into small lots ...".<sup>76</sup>

3.130 In responding to this report, the Government stated that:

"the institution of formalised small business plans ... is not consistent with the objectives of recent purchasing arrangements. Nevertheless the Government is confident that the reforms will meet the intent of the Committee's recommendation by enhancing opportunities for small businesses to successfully tender for Government contracts."<sup>77</sup>

3.131 This confidence in the application of current purchasing policy was sadly misplaced. The implementation of the reforms has not enhanced the opportunities for small businesses to participate in the government market. Government purchasing policy needs to compensate for the fact that the many and various barriers to entering the government market have a disproportionate effect on small to medium enterprises. An entry barrier that is a hurdle to a large firm is often an insurmountable obstacle to a small firm. Small to medium enterprises have little capacity to market effectively to 30,000 to 40,000 public sector officers involved in government purchasing.

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76 *ibid.*, pp 256-7

77 *Government Response to the House of Representatives Standing Committee on Industry, Science and Technology Small Business in Australia: Challenges, Problems and Opportunities*, AGPS, Canberra 1990 p 36

3.132 The benefits of greater SME access to government purchasing are not confined to the domestic economy. The role of government purchasing in assisting the growth of emerging exporters was examined in 1993 in the McKinsey Report: *Emerging Exporters: Australia's High Value-Added Manufacturing Exporters*.

3.133 In identifying the impediments to emerging exporters, McKinsey found that SMEs often have the capability to enter export markets, but lack credibility. Winning Government procurement contracts can enable SMEs to develop production expertise and credibility prior to launching into export markets.<sup>78</sup>

3.134 McKinsey's conclusion concerning the effectiveness of the purchasing policy reforms accords with that of the Committee:

“Initiatives to use procurement policy to the advantage of smaller firms are fragmented and do not appear to be very effective. Despite a range of attempts to upgrade policy ... the area should be re-examined.

In the interim, relevant Government agencies need to be more aware of the capabilities of SMEs, and they also need to improve the collation and dissemination of purchasing statistics that relate to SMEs.”<sup>79</sup>

3.135 The US Government takes a more active stance to assist small businesses in gaining access to Government contracts. Under the *Small Business Act 1958* large public and private sector corporations are required to increase participation by SMEs in their procurement processes.<sup>80</sup> Canada has identified US law as requiring:

- “ 20 per cent of prime contract awards be made to US small business;
- all contracts worth less than \$25,000 are limited to small business;
- all contracts above \$25,000 be set aside if the contracting officer can reasonably expect two or more bids from small business; and
- if only one bid from a small business is received, the small business be given a 12 per cent price advantage in evaluation.”<sup>81</sup>

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78 McKinsey and Company: *Emerging Exporters: Australia's High Value-added Manufacturing Exporters*, Australian Manufacturing Council, Melbourne, June 1993 pp 58-9

79 *ibid.*, p 62

80 House of Representatives Standing Committee on Industry, Science and Technology, *op cit.*, p 254

81 External Affairs and International Trade Canada: *Register of United States Barriers to Trade*, 1993 p 10

3.136 Canada considers the effect of these set-asides to be far-reaching, totalling some \$31 billion in 1991:

“In 1991, a total of \$189.6 billion was awarded in contracts worth more than \$25,000. Of those large contracts, \$6.9 billion was set-aside for small business, \$3.8 billion was awarded through the 8(a) program and \$21.1 billion was awarded in contracts worth less than \$25,000.”<sup>82</sup>

### *Recommendation 13*

3.137 The Committee recommends that:

- . 10% of government procurement be set aside for small to medium enterprises (SMEs) in a similar fashion to the US system;
- . agencies be required to provide justification for purchases under \$10,000 that are not made from SMEs;
- . Australian Government purchasing guidelines contain a requirement that contracts greater than \$5 million include a ‘small business participation plan’ and that this plan be regarded in evaluation of a tender. Advertisements calling for tenders should include this statement;
- . all industry impact statements include a SME impact consideration;
- . Australian Government purchasing officers be required to consider smaller specialised firms in issuing large contracts and, where competitive SME capability exists, divide large contracts into smaller components;
- . SMEs be identified on a regional basis in electronic purchasing system databases, approved supplier lists and industry capability databases; and
- . regional buyers be encouraged to purchase from local approved SMEs.

## PURCHASING CRITERIA AND INDUSTRY DEVELOPMENT

3.138 Current Commonwealth Procurement Guidelines encompass three principal aims: value for money (CPG No. 1), open and effective competition (CPG No. 2) and maximisation of opportunities for Australian and New Zealand industry to compete for Commonwealth Government business (CPG No. 12). Earlier in this chapter, under the heading "Industry Development: Maximisation of Competitive Opportunities for ANZ Suppliers," the wording and application of CPG No. 12 was considered. It is clear that the dominant aims are those dealing with value for money and open and effective competition, with industry development occurring largely as an incidental function of the first two.

### Value for Money

3.139 Value for money is the dominant criterion and is defined as:

"ensuring that benefits are commensurate with costs. The least-cost choice should not be followed automatically if there is clear and reasoned justification for not doing so. The pursuit of value for money requires that purchasing processes be efficient so that inappropriate or unnecessary costs and delays are minimised or eliminated."<sup>83</sup>

3.140 Value for money is the only purchasing criterion paraphrased in Department of Finance regulations and is therefore the only one to which purchasers must adhere:

#### **"Conditions for approval of proposals to spend public moneys**

44A. (1) A person is not to approve a proposal to spend public moneys unless satisfied that:

- (a) the proposal is in accordance with the policies of the Commonwealth; and
- (b) the proposed expenditure will make efficient and effective use of the public moneys available for the Commonwealth programs implementing those policies."<sup>84</sup>

3.141 As well as assessing the costs and benefits CPG No. 1 states that buyers should:

- . plan their purchases;
- . research industry capabilities;
- . not over-specify their needs;
- . make effective use of competition in the marketplace;

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83 DAS: *Commonwealth Procurement Guideline No. 1*

84 Department of Finance: *Finance Regulations Part IIA*

- . negotiate with suppliers;
- . develop alternate choices in suppliers to encourage competition;
- . develop relationships with suppliers;
- . evaluate the transactions over their operating life; and
- . reconsider supply arrangements where they no longer offer value for money.<sup>85</sup>

3.142 The value for money criterion requires the individual purchasing officer to have a developed understanding of the product, alternative supply chains and substitutable products, through life costing and industry capability, a high level of purchasing expertise and product knowledge for each type of purchase made. It is hardly surprising that, in a devolved purchasing world, the purchasing officer (for whom purchasing may be only a small proportion of function) will often take the lowest acquisition price as a relatively safe and easy substitute for a proper value for money evaluation.

3.143 The Committee has received a substantial body of evidence from suppliers, industry associations and purchasing institutes supporting the view that Government buyers, when applying the value for money guideline, still usually interpret it as meaning buying the cheapest product. Suppliers were particularly critical of buyers not applying whole of life costing principles to the evaluation of products.<sup>86</sup>

3.144 The inability of some government purchasers to properly apply whole of life costing to procurement is largely a function of devolved purchasing with poorly trained or untrained officers often having purchasing authority. While current policy requires whole of life costing, with in some cases specific guidelines on cost-benefit analysis,<sup>87</sup> the requirement takes the form of exhortation with no systematic auditing or effective pressure to ensure its application. Whole of life costing, including appropriate cost and benefit identification, is often a complex and resource intensive process. Where the organisation or purchasing officer involved in procurement has low levels of skills in whole of life costing techniques, the interests of efficiency would often be better served by involvement of specialised expertise in these evaluations.

3.145 The order in which the three guidelines is presented may influence the importance which purchasers attach to them. Value for money and open and effective competition are prominent as the first and second purchasing guidelines. The guideline concerning maximisation of opportunities for ANZ suppliers to compete is effectively buried as the twelfth in order. This placement is highly inappropriate.

3.146 The guidelines need to be re-written to reflect the Committee's recommendations.

85 DAS: *Commonwealth Procurement Guideline No.1*

86 For example *see* NIASS Educational Systems: Submission 80; Krone (Australia) Technique Pty Ltd: Submission 81; Style Engineering: Submission 87

87 Department of Finance: *Value For Your IT Dollar, Guidelines For Cost-Benefit Analysis Of Information Technology Proposals*, 1993

**Recommendation 14**

3.147 The Committee recommends that:

- the Purchasing Guidelines be re-written and re-numbered, with the industry development guideline becoming guideline number 1;
- the application of whole of life costing across agencies be examined by the National Procurement Board with the institution of an appropriate rolling audit sample program by the Australian National Audit Office; and
- a specialised whole of life costing cell be established within the Department of Administrative Services to assist agencies experiencing difficulty in this area.

3.148 Furthermore, the ISO pointed out in its submission to the Committee that annual budget processes mitigate against the proper application of the value for money guideline. The annual allocation of funds for purchasing places pressure on buyers to seek out the lowest cost item within an annual expenditure framework, without due regard to a whole of life costing approach that extends over a number of years.<sup>88</sup> David Osborne and Ted Gaebler in *Re-inventing Government* identify the rigidity of annual government budget cycles in the United States of America as a factor that creates inefficiency:

“smart public managers spend every penny of every line item, whether they need it or not. This explains why public organisations get so bloated: our budget systems actually encourage every public manager to waste money.”<sup>89</sup>

3.149 The Committee notes that many suppliers still talk informally, despite improvements in the ability of agencies to roll-over funds, of end of year ‘splurging’ by agencies to meet annual expenditure allocations, often viewed as targets.

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88 ISO: Submission 15 p 2

89 David Osborne and Ted Gaebler: *Re-inventing Government* 1992 p 119

*Recommendation 15*

**3.150 The Committee recommends that the Minister for Finance request an appropriate Parliamentary Committee, such as the Banking, Finance and Public Administration Committee or the Public Accounts Committee, to conduct a review of the efficiency and flexibility of annual budget carry-over arrangements for agencies.**

3.151 Another disturbing aspect of the tendency for purchasing officers to seek the lowest price is the practice of unquestioning acceptance of that price as a market or competitive price. This is particularly a problem when imported products are purchased as the market or competitive nature of that price can be difficult to obtain. The current purchasing framework does not seek to identify levels of subsidy or protection embedded in imported product or other anti-competitive elements such as dumping and predatory pricing resulting in prices under the market level.

3.152 The price of the import is often assumed by the purchaser and purchasing system to reflect a competitive cost structure in its formation. The purchasing system does not explore in any useful way distorted cost factors which may be prevalent in the overseas country of manufacture. However, some organisations adopt a more analytical approach to consideration of prices.

3.153 Telecom indicated in meetings that it would not purchase product offered at what it considered was a non-sustainable or predatory price. Telecom stated that its focus is a competitive long term supply network. It considered that accepting predatory or 'spot' prices on a random basis to the detriment of competitive long term suppliers to be a false economy.

3.154 The question of spot pricing was raised in submissions and hearings. A large group of DAS officers asserted that they had never come across a single instance of spot pricing. DITARD, Telecom and other participants in the inquiry were familiar with the concept of spot pricing. They considered that spot or predatory pricing did exist to the extent that purchasing officers needed to be aware of this anti-competitive practice in procurement:

“Additionally, too many companies have raised the issue of spot pricing in government purchasing decisions to simply ignore the matter. Irrespective of this, no company has been prepared to provide written documentation because of the potential liabilities.”<sup>90</sup>

3.155 The related practice of tender dumping proved more difficult to identify. The Committee considers, in regard to government purchasing, there is a duty to ensure

long term viable competition resulting in benefits to both purchasing agencies and industry.

### ***Recommendation 16***

**3.156 The Committee recommends that purchasing guidelines be amended to:**

- place the onus on agencies to determine whether predatory pricing (including tender dumping) exists in procurement bids; and**
- require agencies to exclude vendors where predatory pricing is identified in their bids.**

### **Open and Effective Competition**

3.157 The application of the second criterion, open and effective competition, also requires a complex and detailed knowledge of the product and industry. The most serious barrier to open and effective competition, identified in many submissions and public hearings, was an attitudinal bias, a 'cultural cringe', against domestic suppliers. This attitudinal bias ranges from discriminatory tender specifications and other barriers to entry discussed in Chapter 8, to lack of knowledge of the local ANZ product by the devolved purchaser.

3.158 The weakness of current purchasing policy in combating this bias is illustrated by correspondence from the Purchase Australian Office to the Australian Customs Service dated 18 June 1991:

"I notice that ANZ content has been included as an evaluation criterion. While you may have reasons for this there is no longer a requirement to consider levels of ANZ content when making purchasing decisions. The Government's Australian and New Zealand (ANZ) Supplies policy, amongst other things, encourages Commonwealth buyers to consider the advantages which ANZ suppliers can offer over their offshore counterparts. The underlying rationale for the policy is to encourage suppliers who can compete effectively on a value-for-money basis with imported products."<sup>91</sup>

3.159 If the Purchase Australian Office, as the policy administrator, believes that there is no need to consider ANZ content as a criterion, then the need of the purchasing officer to identify local suppliers to ensure access to the government market is lessened. Indeed, if any arm of the bureaucracy could be expected to promote ANZ purchases, it is the Purchase Australian Office. The fact that it has provided advice of

this sort to purchasing agencies highlights the problem of developing an attitudinal change within the current structure.

3.160 Furthermore, the policy only encourages rather than requires the purchasing officer to consider the advantages of procurement through ANZ suppliers. There is no effective monitoring of this 'encouragement' to consider ANZ suppliers by the Purchase Australian Office.

3.161 The Australian policy and its implementation differ markedly from that of the New Zealand Government which pursues both efficiency and opportunity for local suppliers in its purchasing policy. New Zealand has a positive approach to ensuring that open and effective competition does not discriminate against local suppliers.

3.162 The New Zealand Tariff Policy and Industry Issues Group of the Ministry of Commerce has a specific policy advice and monitoring/investigating role to ensure that ANZ industry has full and fair opportunity to compete on its merits in an open and competitive market. The Group investigates specific complaints by domestic producers of lack of full and fair opportunities and conducts periodic, flexible and selective surveys of government agencies, public funded institutions and state owned agencies to determine the level of understanding and implementation of its purchasing policies.<sup>92</sup>

3.163 The Group investigates complaints in consultation with the agency concerned:

"The purchasing agency is expected to cooperate fully in such investigations and be able to show that purchasing decisions are consistent with the policy and the Government's purchasing guidelines. In other words, where contracts are not awarded locally, the onus is on the purchasing agency to show that the capability of local industry was considered fully and that there was no unfair discrimination against local firms in term of tender specification or the manner in which tenders were let."<sup>93</sup>

3.164 This emphasis on requiring validation of opportunities for ANZ suppliers to compete is likely to be significantly more effective than current Australian purchasing policy.

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92 New Zealand High Commission: Supplementary Submission 46.1 Attachment p 1

93 *ibid.*, p 2

***Recommendation 17*****3.165 The Committee recommends that:**

- . **Australian Government funded organisations be required to demonstrate that, where contracts are not awarded locally, ANZ suppliers have had full and fair opportunity to compete for procurement; and**
- . **the National Procurement Board investigate claims by local suppliers of unfair treatment and pursue non-conformance revealed by monitoring.**



## CHAPTER 4

### DEVOLUTION

#### DEVOLUTION AND GOVERNMENT PURCHASING

4.1 As discussed in Chapter 1, the review of purchasing conducted in 1987-88 found that the then existing purchasing practices and procedures were incompatible with the Financial Management Improvement Program (FMIP) focus on devolution, flexibility and management for results<sup>1</sup>.

4.2 Consistent with the FMIP, the “overriding theme of the ... reforms ... [arising from the review was to improve procurement practices] through a reduction in regulation and a focus on outcomes”. This was to be achieved in “an environment in which purchasing officers decide the most appropriate method of procurement ... [and] ... Agencies ... find innovative solutions to requirements.”<sup>2</sup>

4.3 The review concluded that “there was scope for considerable savings ... by providing the opportunity to use simple processes where appropriate”, and by reducing the number of steps needed to authorise, approve and spend funds. While the review did not quantify the savings, they were expected to be significant, particularly in the low value, high volume area of purchasing:

“the benefits are ... believed to be significant in terms of administrative efficiencies through streamlining and simplification; improved effectiveness through greater opportunity for innovative and quality solutions; better prices through negotiation and less imposition on industry; and less cost to the Commonwealth and industry through better planning.”<sup>3</sup>

4.4 There was recognition at the time the reforms were introduced that “cultural and attitudinal changes were necessary if maximum benefits were to be realised.”<sup>4</sup>

“The successful introduction of the reforms requires effective communication of objectives, increased skills, appreciation of staff viewpoints and effective utilisation of key personnel to effect the changes. The implementation of the purchasing reforms also depends on the use of management information

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1 The Auditor-General, *Audit Report No. 3 1991-92: Project Audit: Implementation of Purchasing Reforms in the Australian Public Service*. Exhibit 19 p 1  
2 *ibid.*, pp 3  
3 *ibid.*, pp 1-2  
4 *ibid.*

systems which assist management in decision making and to assess results, in particular the analysis of procurement information.”<sup>5</sup>

4.5 Implementation of the reforms was the responsibility of individual departments. Departments were required to develop Purchasing Plans for the approval of their Ministers, detailing how they would implement and manage their purchasing arrangements in the reformed environment.

4.6 However, the purchasing reforms were introduced at the same time as a number of other changes to the public service, including:

- . amalgamations of departments under the 1987 Machinery of Government reforms;
- . Office Structures Implementation (OSI) (introduction of restructured office practices and procedures based on participative workplace design as agreed between APS managers and unions);
- . program budgeting; and
- . devolution of some departmental functions other than purchasing.

4.7 These and other reforms had an impact on the way in which Government departments approached their new purchasing responsibilities.<sup>6</sup> Consequently, many of the operating structures which governed the conduct of purchasing by organisations altered considerably from those envisaged when the reforms were introduced.

4.8 In 1990 the Purchasing Reform Group commissioned Touche Ross and Associates to examine the training needs of, and career development opportunities for, purchasing staff. The report, entitled *The Human Element In Procurement*, identified the complexity of the procurement function and the diversity of staff involved in it:

“In the purchasing function, one needs to include users, who initiate the process, specify the need and select the successful bidder, and middle level managers who supervise users or purchasing officers, or have *financial management responsibilities for purchasing*. The aggregate of all these varied groups of people is obviously a very large number of Commonwealth officers. The structures within which they operate vary considerably.

**With the major changes taking place in the APS (Australian Public Service), no department or agency is able to specify accurately without major effort the number and location of purchasing staff, and the percentage of time each spends on purchasing.**<sup>7</sup> The operating structures are continuing to change. ... Not only do people engaged full-

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5     ibid.

6     Purchasing Reform Group, *The Human Element in Procurement: A Consultancy Report on Training Needs and Career Development: Volume 1, The Report*: Exhibit 115 p 185

7     Emphasis added

time in purchasing operate differently from those for whom purchasing is a part-time activity, but arrangements vary within the organisation from one work unit to another ... such differences reflect the diversity of purchasing situations in the APS and, particularly with devolution, are likely to remain a permanent feature of Commonwealth purchasing.”<sup>8</sup>

4.9 The report found that a lack of appreciation of the skills involved in purchasing led to the establishment of inappropriate structures in some departments which integrated purchasing with other departmental functions. For example at least one department disbanded its central purchasing group and distributed the purchasing staff across various program areas<sup>9</sup>.

4.10 In some cases relatively junior officers were expected to assume responsibility for a whole range of purchasing requirements and few out-posted purchasing officers had the necessary range of skills or experience to cope with the new situation. Without a core group of purchasing officers, out-posted officers had little assistance to draw on with unfamiliar or difficult aspects of purchasing<sup>10</sup>.

4.11 The result was that the purchasing function was spread throughout departments, becoming an additional duty for a large number of officers, rather than the specialised function of an expert few. The number of staff involved in purchasing has increased from approximately 3500 full time and 10,000 part-time in 1989<sup>11</sup> to an estimated 30,000 to 40,000 full and part-time in 1993.<sup>12</sup> In the long term purchasing expertise would be eroded and there would be little opportunity for professional development for purchasing officers<sup>13</sup>.

4.12 The problems experienced by purchasing officers are compounded by indifference to purchasing shown by senior officers. The Touche Ross report found that **communication between purchasing staff and executive management had “largely broken down, with management unaware of the complexity of the purchasing function or the range of skills and experience required for effective purchasing.”**<sup>14</sup> There was a perception by purchasing staff that purchasing managers “did not support or encourage staff to take up training or professional development opportunities.”<sup>15</sup>

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8 Purchasing Reform Group: *The Human Element in Procurement: A Consultancy Report on Training Needs and Career Development: Volume 1, The Report*: Exhibit 115 p 186

9 Purchasing Reform Group: *The Human Element in Procurement: A Consultancy Report on Training Needs and Career Development: Executive Report*: Exhibit 114 p 8

10 *ibid.*, p 8

11 Purchasing Reform Group: *The Human Element in Procurement: A Consultancy Report on Training Needs and Career Development: Volume 1, The Report*: Exhibit 115 p 186

12 Butler, A., General Manager, Purchasing Australia: Transcript p 129

13 *ibid.*, p 8

14 Emphasis added; *ibid.*, p 6

15 *ibid.*

4.13 A critical finding of the report was that, with communication links between executive management and purchasing officers in “disarray”, information concerning the purchasing reforms and departmental reform implementation programs was not available for purchasing officers.<sup>16</sup> Consequently purchasing officers, on whom the success of the purchasing reform process relies, were found to have only a rudimentary knowledge of the reforms.

4.14 This situation had not changed in 1992. Further research commissioned by Purchasing Australia to evaluate the attitudes of purchasing staff towards procurement policy and practices found that although three quarters of the buyers surveyed claimed to be familiar with the reforms and 94% identified value for money as the key purchasing objective, only 18% mentioned open and effective competition and 13% mentioned ethics and fair dealing as the other key purchasing principles.<sup>17</sup>

4.15 Follow up questioning of purchasing staff revealed that, while obtaining value for money was recognised as the prime objective of purchasing, relatively few buyers understood how to achieve this.<sup>18</sup>

4.16 Anecdotal evidence from the IPSM supports these findings. In his evidence before the Committee Mr Alan Jones, council member of the IPSM stated:

“I have talked to people in [the Department of] Defence ... and they said they have got over 20,000 maybe 30,000 people actually buying. Many of these people are using credit cards. It is just impossible for the message to get around, and when you have a credit card it is so easy to go to the local shops and buy without having surveyed the market ... the point is that people who are doing purchasing as one of a number of functions which they perform are therefore not necessarily aware of the 12 or 13 [Commonwealth Procurement Guidelines] and of the correct ways of going about things, nor do they have the tools like the details of the common use contracts handy to them ... because of devolution, purchasing is in the hands of a lot of people who do not necessarily know the principles which DAS correctly have devised over the last two or three years in the reforms ... the lack of knowledge of the people who were actually at the coalface is staggering”.<sup>19</sup>

#### DEVOLUTION AND ADMINISTRATIVE DEFICIENCIES

4.17 The administration of purchasing policy has been impeded by the decentralisation of the purchasing function to individual departments. Departments with no experience in managing purchasing became responsible for devising and implementing purchasing

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16 *ibid.*

17 Minter Research: *The Minter Report on Government Purchasing* Exhibit 87 pp 8-9

18 *ibid.*, p 8

19 Jones, A, Councillor, Institute of Purchasing and Supply Management: Transcript pp 401-2

in managing purchasing became responsible for devising and implementing purchasing procedures and practices, while the expert purchasing administrative department relinquished regulatory control of purchasing and adopted the role of advisory body.

4.18 An outcome of the devolution of the purchasing function has been the breakdown in administrative controls over purchasing. In examining the impact of devolution on purchasing, the consultant's report *The Human Element in Procurement* found that departmental managers had a generally poor understanding of the Commonwealth purchasing system, and there was only limited understanding of probity, accountability, fair and open competition and value for money.<sup>20</sup>

4.19 In 1991-92 the Australian National Audit Office (ANAO) in reviewing the implementation of the purchasing reforms found a wide divergence between departments in the extent to which they had:

- reviewed organisational structures in purchasing areas;
- revised existing procedures and instructions;
- monitored and reviewed mechanisms; and
- improved procurement skills through training.<sup>21</sup>

4.20 **The ANAO found that agencies had not implemented "appropriate mechanisms to monitor fully their purchasing function", and further, that the level of documentation maintained by agencies in relation to key decisions was often "inadequate".**<sup>22</sup>

4.21 It is clear that devolution has fragmented Government purchasing to such an extent that it is now difficult for any coordinated national procurement policy to be effective.

4.22 The devolution of purchasing within Commonwealth agencies stands in contrast to the purchasing system used by the second largest public sector purchasing agency, Telecom.

4.23 To achieve economies of scale in purchasing, maximum involvement of Australian industry and the achievement of Telecom's Industry Development Plan, Telecom purchases major items centrally. These items are generally Telecom specific, such as switching, transmission, cable, telephones and installation material. Of Telecom's total annual procurement budget of \$3.2 billion, approximately \$2.6 billion, or 81%, is purchased centrally and controlled by a staff of 100.<sup>23</sup>

20 Purchasing Reform Group: *The Human Element in Procurement: A Consultancy Report on Training Needs and Career Development: Volume 1, The Report*. Exhibit 115 p 164

21 The Auditor-General, *Audit Report No. 3 1991-92: Project Audit: Implementation of Purchasing Reforms in the Australian Public Service*. Exhibit 19 pp 5, 6 & 7

22 Emphasis added; The Auditor-General, *Audit Report No.3 1991-92*, op cit., pp 17, 19

23 Telecom: Submission 90 p 4; Smith, L: General Manager, Supply, Telecom Australia: Transcript p 275

4.24 Telecom currently has 20 material management groups ranging in size from 12 people down to 2-4 for smaller business units. Approximately 150 staff work on regional material management functions. These regional groups include qualified purchasing officers who undertake procurement of items for which ANZ industry development considerations are not a crucial factor.<sup>24</sup>

4.25 In response to a question concerning devolution and Commonwealth purchasing, Mr Les Smith, General Manager, Supply, Telecom stated: "Fragmenting the purchasing weakens your position and you can do very little when you have got thousands of little buyers everywhere, right throughout Australia, trying to handle it. It will not work."<sup>25</sup>

4.26 The Committee considers that the decentralisation of the purchasing function to Commonwealth agencies and devolution of purchasing within these agencies has not achieved the administrative efficiencies that were expected as an outcome of the reforms.

4.27 While the intent of the reforms was to enable Government buyers to have the flexibility and authority to purchase efficiently, the application of the principles of value for money and open and effective competition can require fairly complex analysis. Purchasing officers are often insufficiently trained to carry out such analysis.

4.28 The adverse impact of devolution on purchasing was recognised by the Purchasing Review Task Force. It identified the key problems as being:

- a lack of adequate training, education and career development infrastructure at the time of devolution;
- a lag time between devolution and training during a period of widespread and rapid reform;
- dissipation of skills and expertise arising from the abolition or downsizing of central procurement cells or the distribution of their responsibilities to program management; and
- management of complex projects by staff not previously exposed to the risks which accompany projects.<sup>26</sup>

4.29 Devolution of purchasing within agencies must be limited to prevent these problems from worsening.

4.30 The Committee does not consider that all purchasing should be recentralised within agencies. Low value purchasing can be done more efficiently by purchasing officers at a more devolved level. Purchasing above a threshold limit should be

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24 *ibid.*; Smith, L: General Manager, Supply, Telecom Australia: Transcript p 274-5; Correspondence from Mr M P Orwin, National Manager Supply, Telecom Australia, dated 15 February 1994

25 Smith, L: General Manager, Supply, Telecom Australia: Transcript p 272

26 DAS: *Purchasing Review Task Force Report*: Exhibit 182 p 59

conducted by a central purchasing unit within agencies. The Committee agrees with the broad thrust of the Purchasing Review Task Force Report - Section 3, Part 2, Option No. 4.<sup>27</sup>

***Recommendation 18***

**4.31 The Committee recommends that:**

- . the National Procurement Board appoint a project team to assist in the creation (or modification) of purchasing units within all Commonwealth agencies;**
- . any purchases over the value of say \$100,000 be managed by these accredited purchasing units;**
- . the project team work with individual agencies to develop purchasing administrative structures suitable for the needs of each agency; and**
- . the project team report periodically to the National Procurement Board on progress in the implementation of this recommendation.**

