SAKELIGA

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TOWARD RESPONSIBLE AND INDEPENDENT PROCUREMENT

How state entities in South Africa can legally end BEE, local content rules, and other harmful preferential procurement policies, and forge a better path

November 2022

SUMMARY

How can municipalities in South Africa preserve a flourishing constitutional order, despite attempts to convert them, at public expense, into mere instruments of national government objectives fundamentally at odds with constitutionalism?

This report reconfirms municipalities' apparently forgotten but constitutionally mandated discretion and independence in procurement.

A proper interpretation of the legislative framework for public procurement indicates that municipalities and other state entities should distinguish between normal value-for-money procurement under section 217(1) of the Constitution, and preferential procurement under section 217(2) of the Constitution. State entities are obliged to do the former, but not the latter.

In the wake of the Zondo Commission's report, this report now paves the way for significant cost savings in government procurement and greater value for money for the public.

In part 1 of its report, the Zondo Commission asks about preferential procurement: "Is it the primary intention of the Constitution to procure goods at least cost or ... to prioritize the transformative potential identified in section 217(2) [of the Constitution]?" The Commission answers as follows: "Ultimately in the view of the Commission the primary national interest is best served when the government derives the maximum value-for-money in the procurement process and procurement officials should be so advised."

In stressing the discretion of municipalities regarding procurement, our report reminds them of their responsibility to maintain independent procurement policies and processes in service of their communities. While the report focuses on municipalities, where wide-spread service delivery failures highlight the public harms of procurement that diverts resources to satisfy B-BBEE and local content requirements, it applies to all organs of state and public entities.

Acronyms used

BEE	**:**	**Black Economic Empowerment**
B-BBEE Act	**:**	**Broad-Based Black Economic Empowerment Act 53 of 2003**
GATT	**:**	**General Agreements on Trade and Tarrifs**
MFMA	**:**	**Municipal Finance Management Act 56 of 2003**
PPPFA	**:**	**Preferential Procurement Policy Framework Act 5 of 2000**
SCA	**:**	**Supreme Court of Appeal**
SCM	**:**	**Supply Chain Management**
TRIMs	**:**	**Agreement on Trade-Related Investment Measures**
WTO	**:**	**World Trade Organization**

Acknowledgements

This report has been drafted by Sakeliga's internal legal and research teams, with generous input from external legal experts and jurists. We extend our appreciation to those who assisted us. Responsibility for the final version of the report remains ours.

THE FORGOTTEN LEGAL DISCRETION OF STATE ENTITIES TO APPLY PREFERENTIAL PROCUREMENT POLICIES

Constitutionalism under threat

Public authorities have a constitutional duty, first and foremost, to act in the public interest. This means, in the context of public procurement, that public funds should be employed to contract for the highest possible quality of goods and services at the lowest possible price. This principle accords with the requirements of section 217(1) of the Constitution. This provision requires all organs of state to contract for goods and services in accordance with five principles, identified as fairness, equitability, transparency, competitiveness, and cost-effectiveness.

Corruption in public procurement constitutes the most obvious negation of these principles. Corrupt procurement processes all but guarantee that the best possible service and infrastructure will not be rendered at the lowest possible cost. While corruption is criminalised and commonly denounced, state organs have also deviated from the aforementioned principles through ostensibly lawful routes, to the same effect of deprioritising serving the public with the best possible service and infrastructure at the lowest possible cost.

Such deviations have taken several forms. One is to force organs of state to, *inter alia,* curate exclusive pools of tenderers with which organs of state may contract based on local content and BEE requirements. This has been justified – erroneously – on the basis of section 217(2) of the Constitution. Such policies continue to favour *tenderpreneurship* at the expense of the broader public.

Horizontal (or secondary) procurement objectives[1] that do not relate to functional criteria but rather to policy considerations, have been part of public procurement for many decades.

[1] "Horizontal" or "secondary" policies in procurement encompass social, environmental and wealth redistributive goals, in contrast with the primary objective of a procurement of obtaining goods, works or services at the best value for money and according to functional criteria.

In the recent times, promoting black economic empowerment has become the prevailing policy consideration embedded in public procurement legislation. The inclusion of BEE policies in public procurement has been driven, however, not by Acts of Parliament, but by secondary legislation – regulations and so-called codes of good practice adopted by cabinet ministers over the years.

As a framework for purportedly measuring disadvantage, the B-BBEE Act plays a role. However, organs of state and municipalities' perceived obligation to implement BEE policies when contracting for goods and services did not originate in Parliament. Rather, members of the executive have used – and abused – regulation-making powers to impose BEE on various sectors of the economy and indeed on the SCM policies of municipalities. In some cases, organisations of civil society have had to approach the courts to have such regulations set aside.

Sakeliga's important Constitutional Court victory

Most recently, the Constitutional Court in a matter between the *Minister of Finance* and *Sakeliga*[2] confirmed an order of the SCA declaring *ultra vires* and invalid the 2017 PPPFA Regulations of the Minister of Finance.

The Minister of Finance had unlawfully availed for himself law-making powers when he made regulations purporting to let organs of state outright disqualify tender bids based on the BEE status of the tenderer. The 2017 regulations also imposed local content requirements on organs of state when it came to tendering, regarding products from various industries earmarked by the government. The *judgment* in *Minister of Finance v Afribusiness* is important. However, given the established nature of BEE and local content requirements, one court ruling alone should not be expected to prevent future attempts by the national executive to introduce BEE and local content requirements on the SCM policies of organs of state and local governments. The question is therefore not whether there will be further attempts to force perhaps even more stringent preferential procurement requirements upon local governments, but rather how local governments should respond to these infringements on their discretion to respond to the needs of their local communities.

It must be noted that local governments can heed the demands of constitutionalism, while at the same time being in contravention of executive decrees by national ministers and other measures

[2] *Minister of Finance v Afribusiness NPC* [2022] ZACC 4 ('Minister of Finance v Afribusiness').

of the executive branch of national government. Where such a tension arises, constitutionalism should prevail.

In fact, regulations such as the 2017 PPPFA regulations violate fundamental tenets of constitutionalism, such as the legality principle and the doctrine of separation of powers. Such regulations stand to be set aside purely on the basis that they are inimical to the constitutional order.

Municipalities are organised forms of authority in their own right and operate in close vicinity of actual people and their actual needs. The question of how local governments will respond to future attempts to have their SCM policies infused with more BEE and preferential procurement, can perhaps be phrased even more specifically:

How can municipalities in South Africa preserve a flourishing constitutional order, despite attempts to convert them, at public expense, into instruments to achieve national government objectives fundamentally at odds with constitutionalism?

This report assists in developing answers to this question in respect of public procurement regulations.

Statutory framework for public procurement in municipalities

Section 217 of the Constitution theoretically sets the scene for all procurements by organs of state in South Africa. It is generally accepted that public procurements include the acquiring of goods and services, hiring or letting of goods and services, and the sale or lease of government property. All exercises of public procurement, in most cases referred to as "tendering", must adhere to the principles laid down in section 217(1) of the Constitution, namely fairness, equitability, transparency, competitiveness and cost effectiveness.

> **Fairness** and **equitability** refer to conducting procurement processes that are procedurally fair, with all bidders enjoying access to the same information so that all bidders tender with the same knowledge and specifications at hand, along with the same opportunities to pursue the tender.
>
> **Transparency** requires openness and accountability, specifically that all procurement information, including how certain outcomes have been reached, is generally available. This principle is in theory aimed at preventing corruption and favouritism in procurement.

Cost-effectiveness refers to achieving the best possible outcome, considering all relevant costs and benefits over the procurement cycle. Achieving cost effectiveness is reliant on competitiveness.

Competitiveness seeks to maximise quality and minimise cost to the public of the goods and services procured. A competitive procurement process is invariably one in which the widest possible group of bidders can participate.

The five principles broadly have the interests of the public in mind. Apart from aiming to ensure administrative fairness, clarity and predictability for bidders, constitutional procurement processes are meant to ensure that the public receive the best possible public services and efficient development and maintenance of public infrastructure. The specific financial management and procurement legislation that has been enacted for municipalities and municipal entities, namely the MFMA, requires, in step with section 217(1) of the Constitution, that municipalities and municipal entities implement an SCM policy that is fair, equitable, transparent, competitive, and cost-effective.[3]

The principles in section 217(1), as embedded in the MFMA, are clearly paramount and imperative for the SCM policies of municipalities. The matter does not end here, however. Section 217(2) of the Constitution provides that the principles in section 217(1) do not prevent organs of state, when contracting for goods and services, from implementing a policy providing for categories of preferences that protect or advance those previously disadvantaged by unfair discrimination. This non-prevention clause has given rise to what is known as preferential procurement policies in South Africa.

The PPPFA was enacted explicitly as legislation in terms of section 217(3)[4] of the Constitution to provide a framework to organs of state for implementing a preferential procurement policy contemplated in section 217(2) of the Constitution. The PPPFA framework expressly applies to local governments.[5] Consequently, while local governments are inextricably bound to the five principles in section 217(1), they are not prevented when contracting for goods and services from implementing policies, albeit in accordance with the framework in the PPPFA, providing for categories of preferences that protect or advance those previously disadvantaged by unfair discrimination.

[3] Section 112 of the MFMA.

[4] Section 217(3) provides that preferential procurement policies must be implemented within a framework for this purpose, provided for in national legislation.

[5] Section 1 of the PPPFA.

Immediately, an apparent tension arises between the principles in section 217(1), as embedded in section 112 of the MFMA on the one hand, and the authorisation to implement preferential procurement policies on the other hand.

Preferential procurement policies, indeed, do not relate directly to the functional reasons for procuring goods and services. Constitutionally speaking, they serve to "protect or advance those previously disadvantaged by unfair discrimination." In practice, their scope kept expanding and today often entail promoting socio-economic (commonly referred to as "transformational") objectives such as wealth redistribution, to even out what is considered uneven racial and other patterns of ownership. Nevertheless, both in its original constrained understanding and the later transformationalist understanding, such ancillary objectives may directly contradict, for instance, the imperative to provide cost-effective goods and services to the public at the lowest possible price.

This tension, however, is resolvable because of two specific legislative realities:

1. Firstly, that a preferential procurement policy may not be inconsistent with the five principles in section 217(1) of the Constitution, as embedded in section 112 of the MFMA.
2. Secondly, that municipalities do in fact have discretion whether to – and when to – create and apply preferential procurement policies when contracting for goods and services.

The legislative requirement that even preferential procurement policies (envisaged by section 217(2)) must have as their objective the requirements of section 217(1) of the Constitution, has been animated by the SCA in the context of pre-disqualification provisions in procurement regulations. Pre-disqualification provisions are an extreme type of preferential procurement policy which purported to permit organs of state to disqualify outright tenderers based on, *inter alia,* a lack of black ownership. The SCA held in *Afribusiness*[6] that the advancement of the requirements in section 217(1) of the Constitution are paramount, even where preferential procurement policies are applied:

> *"Any pre-qualification requirement which is sought to be imposed must have as its objective the advancement of the requirements of s 217(1) of the Constitution."*[7]

It is common cause, however, that it may not always be possible to set as the objective for preferential procurement policies, the advancement of constitutional requirements such as cost-

[6] *Afribusiness NPC v Minister of Finance* 2021 (1) SA 325 (SCA) ('Afribusiness').
[7] *Afribusiness* para 38.

effectiveness and quality. Indeed, preferential procurement points are derived not from factors such as price and quality, but often in spite of low scores for such factors.[8] The SCA's reasoning in *Afribusiness* thus would amount to impractical wishful thinking, if regard is not had to municipalities' discretion to decide for themselves whether and when it would be constitutionally permissible to apply preferential procurement policies to a specific tender.

Despite the prevailing common presupposition that municipalities are *bound to* invariably implement preferential procurement policies when advertising, adjudicating and awarding a tender, neither the Constitution nor the PPPFA imposes such a requirement. The apparent "requirement," in other words, is a political, not a legal one.

The PPPFA

In terms of section 2(1) of the PPPFA, a municipality "must determine its preferential procurement policy and implement it within the following framework."[9] On the framing of the Act, it seems as if a municipality cannot opt-out of its application. It is not only obligated to create a preferential procurement policy but must implement it in terms of the Act if it chooses to apply it. However, this does not by implication mean that a municipality does not have discretionary powers in relation to the contents of its procurement policies and when preferential procurement will be applied. Such an interpretation would bring section 2(1) of the PPPFA in direct friction with section 112 of the MFMA.

Even though it is not expressly stated, section 2 of the PPPFA seems to imply a two-stage process.

1. The first stage is the so-called **threshold stage,** which sets the specifications and conditions of the tender.
2. The second stage is the so-called **evaluation stage**, in which the relevant price criteria and preference criteria of a preferential procurement policy may be applied once a tender has met the minimum acceptable quality and functionality requirements of the tender invitation.

The evaluation stage will weigh the price competitiveness of the various tenders received. Preference points for so-called *specific goals*, may be applied in terms of section 2(1) of the PPPFA, during the evaluation stage. A municipality can only award preference points to tenders that meet so-called *specific goals* determined within the framework of the PPPFA point scoring system. A

[8] Preference points do not take into account price and quality.
[9] Section 2 of the PPPFA.

tender *"must be awarded to the tenderer who scores the highest points, unless objective criteria in addition to those contemplated in [section 2 (1)] (d) and (e) justify the award to another tenderer."*[10]

The PPPFA seems to provide some discretion to municipalities in defining its specific goals, which "may include- (i) contracting of persons, or categories of persons, historically disadvantaged by unfair discrimination on the basis of race, gender or disability." [11]

Unless a municipality's council has, in drafting its procurement policy, limited its own discretion to determine which and when specific goals will be applied to a specific tender invitation, such goals may be determined on a case-by-case basis in response to its service delivery needs. If the "specific goal for which a point may be awarded" is specified in the tender invitation, the decision of the specific goal or goals to be incorporated in a tender invitation and what weight it will carry at the evaluation stage clearly lies with the municipality.

It is necessary at this stage to revisit sections 2(1)(b)(i) and (ii). They read:

> *"(i) for contracts with a Rand value above a prescribed amount a maximum of 10* ***points may be allocated for specific goals*** *as contemplated in paragraph (d) provided that the lowest acceptable tender scores 90 points for price;*
>
> *(ii) for contracts with a Rand value equal to or below a prescribed amount a maximum of 20* ***points may be allocated for specific goals*** *as contemplated in paragraph (d) provided that the lowest acceptable tender scores 80 points for price;"* [Own emphases]

On reading sections 2(1)(b)(i) and (ii), it seems that the allocation of preferential points for specific goals is not necessarily a requirement for every tender invitation.

The use of the words "may be allocated" instead of "must be allocated" or "shall be allocated" is material to the interpretation of the section.

[10] Section 2(1)(f) of the PPPFA. In *Trencon Construction (Pty) Limited v Industrial Development Corporation of South Africa Limited and Another* [2015] ZACC 22, the Constitutional Court emphasised the mandatory nature of the requirement of objective criteria or justifiable reasons for not awarding the tender to the bidder who scored the highest points.

[11] Section 2(1)(d)(i) of the PPPFA.

Notwithstanding PPPFA regulations that may from time-to-time be promulgated and/or amended,[12] organs of state *may* allocate a prescribed maximum number of points (10 or 20, whatever the case may be) for *specific* (preferential) *goals*. The 'may' is a permissive, not a peremptory provision, in the sense that the text seems to provide discretion to an organ of state whether to include specific goals in a tender invitation.[13]

The interpretation exercise does not end here. The courts in South Africa have repeatedly stressed the importance of the language and words used in a legal document or contract. The interpretation exercise starts at section 39 (2) of the Constitution, which requires that all legislation be interpreted "to promote the spirit, purport and objects of the Bill of Rights." The Court in *Cool Ideas*[14] confirmed that while words in a statute must be given their ordinary grammatical meaning, unless to do so would result in an absurdity, statutory provisions should also always be interpreted purposively, they must be properly contextualised, and all statutes must be construed to as far as possible preserve their constitutional validity. In the current context, the following considerations are relevant:

- Section 217(1) and (2) of the Constitution places the locus of decision-making in respect of a decision to apply specific goals at the feet of the **specific organ of state responsible for the procurement of goods and services**.
- Organs of state have a duty to adopt a procurement policy **if they wish to apply specific goals** in terms of section 217(2).
- As far as provision is made for national legislation, **Parliament clearly only has the authority to prescribe a framework for preferential procurement**. The *ultra vires* doctrine dictates that **Parliament cannot usurp a power** (which includes a discretion) which has been allocated to a different branch of government or a specific organ of state.
- The use of the words 'must do so' in section 217(1) emphasizes the imperative of fair, equitable, transparent, competitive, and cost-effective procurement systems. **Section**

[12] The framing used in subordinate legislation such as ministerial regulations is of no help in interpreting the empowering legislation. See *Marshall NO and Others v Commissioner, South African Revenue Service* 2019 (6) SA 246 (CC) at para 10.

[13] It can also be read to mean that an organ of state has discretion regarding the number of points it can award a tenderer during the evaluation stage in respect of specific goals. However, a court might also interpret the clauses as merely predictive of the possibility that an organ might include many specific goals, resulting in a range of different point combinations being afforded to a tenderer, or that the final point awarded might differ from tenderer to tenderer.

[14] *Cool Ideas 1186 CC v Hubbard and Another* 2014 (4) SA 474 (CC).

217(2) cannot be interpreted at the expense of section 217(1), particularly not when the framing provision is peremptory and the one that follows it is permissive.

- Furthermore, the use of the words 'does not prevent' in section 217(2) instead of 'must' or 'shall', also supports the view that **the Constitution does not obligate an organ of state to apply specific goals to every procurement activity**.
- The basic values and principles of public administration as set out in section 195 of the Constitution, and the requirement for economical, responsive, and publicly orientated administration, also supports the **requirement for decentralised discretionary procurement powers at the hands of organs of state**.

It follows that as far as legal requirements go, municipalities have a ***constitutionally mandated* discretion** as to whether and when to apply preferential procurement principles to tenders within a legislative framework such as the PPPFA. This discretion should be applied carefully so as to ensure that a municipality always abides by the peremptory requirements of section 217(1) of the Constitution, to remain economical, publicly orientated, and responsive to the needs of communities.

The B-BBEE Act

The introduction of the B-BBEE Act has politicised the tension between cost-effective procurement and achieving *specific goals*. BEE is not a single policy, but an array of legislation, codes, and polices aimed at achieving uniformity of standards and measurement for the implementation of policies designed to promote the state's definition of black economic empowerment. The bulk of BEE manifests in so-called codes of good practice and transformation charters that ministers publish in terms of the B-BBEE Act to promote BEE in general and also on an industry-specific basis.[15] Leveraging the commercial need for and expediency of being able to do business with the state, the codes provide for generic and industry-specific scoring mechanisms through which private entities can attain a BEE score (thus becoming a "measured entity") and therewith obtain a proverbial license to do business with the state (i.e., through public procurement contracts).

[15] See for instance the Financial Sector Code for Black Economic Empowerment, 2012 GN 997 in GG 35914 of 26-11-2012. As a further example, the amended Competition Act 89 of 1989 now ostensibly allows the Competition Commission to in effect dispossess and redistribute property by requiring that corporate mergers and acquisitions promote goals related to "historically disadvantaged" ownership of a target company.

It has become long standing practice for PPPFA regulations to peg a bidding entity's score for achieving preferential goals directly to a bidding entity's BEE score, as determined by the BEE scoring frameworks in the B-BBEE Act and its regulations and codes.[16] The "ownership" component of the BEE codes broadly measures the make-up of "black" individuals in which ownership rights of the measured entity vest,[17] while management control broadly measures the make-up of "black" individuals exercising management control at the various management levels of an entity.[18] Similarly, other criteria beyond ownership and management control that contribute to a measured entity's BEE score, focus on advancing the economic interests of "black people". These include a gauging of a measured entity's contributions to skills development,[19] enterprise and supplier development,[20] and socio-economic development[21] in relation to "black people." Measured entities must verify their contributions to these BEE components and obtain a B-BBEE certificate from a verified B-BEE verification agency.

The B-BBEE Act and its codes thus provide for the "official" measurement criteria for those private entities seeking to obtain a B-BBEE score. Section 10(1)(c) of the B-BBEE Act, on a proper interpretation of the Act as a whole, then gives structure to how specific criteria focusing on 'historically disadvantaged' persons should be qualified and measured in a procurement policy of an organ of state. It is clear from the heading of the B-BBEE Act, that the Act only intended to "establish a legislative ***framework*** for the promotion of black economic empowerment" [own emphasis].

It is not the intention of the Act to override the discretion or authority of any institution as to when and under what circumstances it would be appropriate to apply special policy considerations to a tender – as, it must be remembered, this discretion is a constitutionalised institution that can only

[16] Section 9 of the B-BBEE Act allows for the publication of codes of good practice by the Minister of Trade and Industry, which may include "qualification criteria for preferential purposes for procurement and other economic activities". See also *Airports Company South Africa SOC Ltd v Imperial Group Ltd & Others* [2020] ZASCA 02 par 47 (separate concurring judgment).

[17] See Paragraph 2 of Statement 100: The General Principles for Measuring Ownership, 2013 GN 1019 in GG 26928 of 11-10-2013.

[18] A "measured entity" is usually an entity in the private sector seeking to obtain a B-BBEE score. See Paragraph 2 of Statement 100: The General Principles for Measuring Ownership, 2013 GN 1019 in GG 26928 of 11-10-2013.

[19] See Paragraph 2 of Statement 300: The General Principles for Measuring Skills Development, 2013 GN 1019 in GG 26928 of 11-10-2013.

[20] See Statement 400: The General Principles for Measuring Enterprise and Supplier Development, 2013 GN 1019 in GG 26928 of 11-10-2013, as amended.

[21] See Statement 500: The General Principles for Measuring the Socio-Economic Development Element, 2013 GN 1019 in GG 26928 of 11-10-2013, as amended.

be varied pursuant to a constitutional amendment. The Act can only set the framework to measure 'historical disadvantage.'

Notwithstanding the purpose and intention of the B-BBEE Act, it is possible that the courts may in the future overemphasise the burden of egalitarian jurisprudence, such as found in the *Van Heerden*[22] judgment of the Constitutional Court. It can happen that a court, in order to 'resolve' any apparent tension between the sections, employs an interpretative approach which favours 1) centralisation of decision-making in favour of leading transformation policies, and 2) pays mere lip-service to the more essential ideals relating to governing to the benefit of and in response to the needs of the public.

Given, however, the unprecedented hardships faced by local communities in the wake of unabated municipal decay and failing service delivery in general, the jurisprudential pendulum should be more likely to swing in the direction of maximum value-for money in the procurement process. Notably, the Judicial Commission of Inquiry into State Capture ("Zondo Commission") may have prefaced the manner in which the tension in public procurement between transformation policies on the one hand and value for money on the other hand, will be approached. The Commission summarised the disharmony as follows:

> *"This uncoordinated approach leaves a critical question unanswered:* ***is it the primary intention of the Constitution to procure goods at least cost or is the procurement system to prioritise the transformative potential identified in section 217(2)?*** *There is an inevitable tension when a single process is simultaneously to achieve different aspirational objectives."*[23]

The Commission answered its own question as follows:

> *"In the view of the Commission the failure to identify the primary intention of the Constitution is unhelpful and it has negative repercussions when this delicate and complex choice has to be made, by default, by the procuring official."*[36]*"Ultimately in the view of the Commission* ***the primary national interest is best served when the government derives the maximum value-for-money in the procurement process*** *and procurement officials should be so advised."*[24]

[22] *Minister of Finance and Other v Van Heerden* 2004 (6) SA 121 (CC).
[23] Zondo Commission Report: Part I: Vol 1 (2022) at para 529 [own emphases added].
[24] Zondo Commission Report: Part I: Vol 1 (2022) at para 532 [own emphases added].

In our view, while the Commission's emphasis on the primary national interest vesting in maximum value-for-money in the procurement process is welcome and appropriate, there exists no real tension between section 217(1) and (2) of the Constitution.

The Constitution clearly distinguishes between the *requirements* of section 217(1), and the *optional* nature of section 217(2). For this reason, whenever there is a tension in practice between a section 217(1) consideration and a section 217(2) consideration, the former must enjoy precedence. Where this is not done, that tender and the process leading to it would not only be unlawful, but unconstitutional, pursuant to section 2 of the Constitution, as it would amount to conduct that is inconsistent with the Constitution and therefore invalid.

The Commission's findings were foreshadowed by warnings expressed by the Eastern Cape Division of the High Court as far back as 1997, in the context of RDP factors – the predecessor of the current PPPFA and B-BBEE preferential procurement framework. In *Cash Paymaster*, the court reasoned:

> *"If tenders are to be awarded indiscriminately on the basis of RDP factors without due consideration for the cost to the country, the inevitable result will be an impoverishment of the economy to such an extent that the very people that the RDP factor is intended to develop and empower will suffer the most and be impoverished even more at the end of the day."*[25]

Local content requirements

Since 2011, local content and production requirements[26] have become embedded in preferential procurement regulations.[27] Under PPPFA regulations since 2011, the government designated certain sectors in which all suppliers must meet the set minimum local content requirements if they are tendering for goods, works, and service contracts within the public sector. The regulations[28]

[25] *Cash Paymaster Services (Pty) Ltd v The Province of the Eastern Cape* [1997] 4 All SA 363 (Ck) para 386.

[26] Although there is no consensual international definition of "local" or "content", "local content" policies typically require a certain percentage of factors of production in a production process to be sourced within the borders of a jurisdiction. These factors may include labour, intermediate goods, services, knowledge, and technology.

[27] See section 9(1) of the 2011 PPPFA Regulations. Notably, following *Minister of Finance v Afribusiness*, there is at the time of writing no lawful regulations providing for local content requirements in public procurement. New PPPFA regulations promulgated on 4 November 2022 will enter into force on 16 January 2023 void of any local content or B-BBEE requirements.

[28] The 2011 Regulations have been repealed by the 2017 Regulations, and the 2017 Regulations have been declared unconstitutional and unlawful in 2021.

purported to require all organs of state to buy only locally produced services, works, or goods in the designated sectors. Those sectors or products that have been designated for local procurement have stipulated minimum thresholds of local content that must be sourced when organs of state tender for goods and services in respect of such products or sectors.

No apparent legal basis

Notwithstanding their prevalence, all mandatory impositions of local content requirements or incentives or disincentives for procurement from local producers in public procurement is, on a proper reading of the constitution, in our view entirely unconstitutional and unlawful.

While section 217(2) of the Constitution authorises, subject to adherence to section 217(1), the use of categories of preference when contracting for goods and services, the employment of such categories of preference must protect or advance those previously disadvantaged by unfair discrimination. In step with this requirement, the PPPFA stipulates that *specific goals* may include contracting with persons, or categories of persons, historically disadvantaged by unfair discrimination on the basis of race, gender, or disability.

Local content requirements are geographical in nature and focus on whether goods or services have been manufactured within the borders of South Africa. This is unrelated to *unfair discrimination on the basis of race, gender, or disability*. It follows that neither section 217 of the Constitution nor the PPPFA authorise mandatory categories of preference based on whether manufacturing of goods take place within the borders of South Africa.

Local content requirements can also come into direct conflict with the principles in section 217(1) of the Constitution.

Consequently, any PPPFA regulations or other legislation purporting to oblige or authorise organs of state to implement categories of preference for local content, are and would most probably be found *ultra vires* the Constitution and the PPPFA. This position is strengthened if regard is had to international trade agreements that South Africa has assented to.

International Trade Agreements

International trade agreements add a further dimension to considerations of preferential procurement with regard to local content requirements. The matter is not elaborated on here, but since local content requirements are but a geographic version of the same general procurement-

based restriction on trade of which BEE is a racial version, the arguments could be expected to apply to BEE *mutatis mutandis*.

It is not uncommon for developing countries to maintain a discretion when it comes to enforcing discriminatory local trade policies. The difficulty for the South African government is, however, that it has entered into a variety of bilateral, multilateral and plurilateral international trade agreements that prohibit local content laws in both the public and private sector. While these agreements need to be enforced by a contracting party, i.e., another state, local content laws or incentives may be vulnerable to legal challenge locally on lawfulness grounds by non-state parties.

The law in South Africa has been developed to such an extent that lawfulness is equated to reasonableness even in the context of the principle of legality. The government has a duty, when it makes decisions, to consider all principles of law and fact. If they do not, then they might be acting irrationally and therefore unreasonably in the circumstances. Where South Africa is bound by the terms of WTO agreements, the government has a legal duty to consider the obligations that are imposed under those agreements, and to ensure that South Africa's laws comply with them. This is not because international law automatically applies at a domestic level in South Africa, but because the alternative (that the government does not have a legal duty to heed the trade agreements) would suggest that South Africa can whimsically become a party to international treaties and then subsequently not incur any legal consequences at domestic level. The principle of legality dictates that the government must consider international trade treaties when enforcing local content requirements in both the public and private sectors.[29]

Relevant international trade obligations in the context of preferential procurement are summarised in Annexure A.

While some local content laws in South Africa might be inconsistent with international trade agreements such as the GATT and TRIMs, the difficulty for the public is that such agreements can only be enforced by contracting parties to those agreements. Local companies, members of the public and civil society organisations cannot approach the WTO dispute settlement panels to enforce WTO agreements, for instance.

However, members of the public and businesses can indirectly enforce the WTO agreements by challenging the validity of government conduct and laws that seek to enforce local content

[29] Local content enforcement by the government is considered a state action. Regardless of whether such policies apply to private companies or to local government entities, they would be subject to the non-discrimination obligations under the GATT.

requirements on the private and public sector, without due consideration for the trade agreements to which the government have themselves assented to.

In addition, it could be argued that organs of state other than national government, such as local government entities, could be required by considerations of prudence to only implement procurement requirements consistent with international trade agreements that South Africa is party to. This might require refraining from implementing local content requirements in public procurement.[30]

As noted earlier, municipalities have a discretion, within a national framework, to determine where and when they want to implement preferential procurement policies, and to a large extent they can determine such policies. That sound procurement policies tend to be consistent with the expectations of long-established international trade agreements strengthens the rationale for procurement reforms within organs of state and municipalities.

Note on the Public Procurement Bill

We take notice of the Public Procurement Bill that has been published by the National Treasury. The Bill seeks to repeal and replace *inter alia* the PPPFA and significantly enhance the powers of cabinet ministers to determine public procurement frameworks and rules uniformly for all organs of state. We also note that owing to pressure from *inter alia* the Black Business Council and "developmental" interests in the DTIC, a primary focus of the Bill is to enhance BEE and local content coercion at organ of state level. For a combination of all the reasons mentioned in this report the Bill, if passed in its current form, will be unconstitutional. Organs of state have a discretion when it comes to implementing preferential procurement policies, and this discretion may not be usurped.

[30] Such an approach could foreseeably give rise to intergovernmental disputes between local governments and the National Treasury. Any dispute arising between different spheres of government in this regard, could be resolved in terms of section 40 of the Intergovernmental Relations Framework Act 13 of 2005. All organs of state must make every reasonable effort to settle intergovernmental disputes without resorting to judicial proceedings.

INTERNATIONAL TRADE AGREEMENTS IN THE CONTEXT OF PREFERENTIAL PROCUREMENT

General Agreement on Tariffs and Trade

Article III of the General Agreement on Tariffs and Trade, to which South Africa is a contracting party, requires contracting parties to recognize that laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation or distribution or use of products should not be applied to imported or domestic products so as to afford protection to domestic production. This does not apply however to products purchased for governmental purposes or without a view to commercial resale. However, many goods purchased by the government are procured with a view of commercial resale or for use in the production of goods for commercial sale. A local content procurement policy for government procurement of products used to produce and sell electricity for instance, appears to be in direct conflict with article 3 of GATT.

Article XI:1 of the GATT also requires:

> *No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences* ***or other measures****, shall be instituted or maintained by any contracting party* ***on the importation of any product*** *of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party. [Own emphases]*

With regard to the provisions of Article XI:1, a report of a dispute settlement panel adopted on 4 May 1998 in the matter of *Japan – Trade in Semi-Conductors* noted that the wording of Article X1: 1 "was comprehensive" in that it applies to "...**all measures** instituted or maintained by a contracting party prohibiting or restricting the **importation**, exportation or sale for export of products..." [31]

The panel further noted that Article XI: 1, unlike other provisions of the GATT, covers any measure, irrespective of the legal status of the measure. The panel noted that even non-mandatory requests by contracting parties are prohibited "measures" within the meaning of Article XI:1.[32] Any incentives or dis-incentives created by the government through regulations, directives,

[31] Para 104 [own emphases added].
[32] Para 108 [own emphases added].

administrative guidance, consultations, or any other form of government involvement to the effect of restricting imports, would constitute a contravention of Article XI of the GATT.

Regulations, practice notes, directives or any other government involvement in South Africa incentivising companies or local governments to restrict imports in favour of procuring locally or dis-incentivising companies or local governments from doing same, would in our view constitute "measures" under Article XI:1 of the GATT.

Local governments should refrain from contravening South Africa's obligations under the GATT.

Agreement on Trade-Related Investment Measures (TRIMs)

The TRIMs prohibition against quantitative restrictions[33] is phrased quite broadly. TRIMS significantly expands, in a trade-related investment context, the application of the prohibition against quantitative restrictions and the national treatment principle. An illustrative list annexed to the TRIMs, for instance, provides that requirements under law to purchase or use products of a domestic origin, whether specified in terms of particular products, volume or value of products, or in terms of a proportion of volume or value of its local production, would be inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994.

Requirements to this effect would also be inconsistent with Article III:4 of GATT if compliance with requirements by enterprises is necessary to gain an advantage. In a public procurement context, this means in our view that legal prescripts requiring of private enterprises to reach a higher proportion of local content production in order for them to gain an advantage in a government tendering process, are inconsistent with the TRIMs and GATT. Similarly, requirements imposed on local governments to purchase or use products of a domestic origin, seem to be at odds with the TRIMs and GATT. Such legal requirements and incentives violate the national treatment principle in the GATT, which expects of countries not to discriminate between 'like products' from local industries and imports.

WTO Government Procurement Agreement

While South Africa is not a party to the WTO's Government Procurement Agreement (GAP), it is noteworthy that Article IV of the GPA specifically prohibits the use of offsets that encourage the use of local content requirements. Signatory countries to the GPA also need to ensure in legislation

[33] Quantitative restrictions are specific limits on the quantity or value of goods that can be imported (or exported) during a specific time period.

that procuring entities accord to foreign goods, services and suppliers no less favourable treatment than domestic goods, services and suppliers.

THE ECONOMIC AND SOCIAL HARM OF PREFERENTIAL PROCUREMENT POLICIES

Preferential procurement policy has come to focus on giving preference to suppliers based on race (BEE scores) and political geography (local content requirements). Preferential procurement is intended (ostensibly) to promote domestic, and particularly black domestic, industrial development by directing the enormous buying power of state institutions to purchasing goods and services from qualifying firms who would otherwise likely not have been able to obtain contracts on the basis of price and quality.

It is claimed that such procurement policies promote domestic investment, business formation, and employment opportunities while speeding up the acquisition of asset ownership and wealth among those defined by the state as previously disadvantaged. The Department of Trade, Industry and Competition (DTIC) promotes this view extensively, which forms the basis of its Industrial Policy Action Plan (IPAP) framework.[34]

From value creation to favoured firms

To the extent that preferential procurement has overridden the primary principles of sound public procurement as required in section 217(1) of the Constitution, they can be said to have ***reprioritised the goal of public procurement from efficiently providing valued services to promoting the establishment and growth of preferred firms.***

Preferred firms do indeed benefit directly from such procurement policies since they receive revenue for their services from reprioritised spending. Some other firms benefit, in turn, by being preferred suppliers to these direct beneficiary firms because their own BEE or local content scores enhance the preferred status of the procurer firms. Some other firms benefit similarly further along

[34] Department of Trade and Industry *Industrial Policy Action Plan - Economic sectors, employment and infrastructure development cluster 2018/19 - 2020/21* (2018).

the supply chain. Moreover, some proportion of preferred firms may not have been formed at all, or been as financially successful, without preferential procurement.

Unfortunately, the promotion of certain firms does not translate into economic benefits for society as a whole. Rather, done ever more to the exclusion of efficiency considerations, it does immense economic harm.

Unsound procurement causes social and economic harm

In the first instance, shifting procurement expenditure *to* certain firms necessitates moving it *away* from others. This is reallocation rather than growth in business activity. If spending is reallocated from more efficient offshore to less efficient domestic firms, the higher costs incurred necessitate a reduction in spending on other locally produced goods and services.

Indeed, where preferential procurement reallocates spending, it implies buying more expensive or lower quality goods and services, or some combination of both. This, in turn, means fewer goods and services and a lower quality of goods and services provided to the public. The public – comprising chiefly of households, firms, institutions of civil society, and state institutions – relies on a host of important state services for personal wellbeing, meeting basic needs, and providing critical inputs into productive activities. As such, a reduction in the quantity and quality of state services harms domestic industrial development.

A table produced by the Supply Chain Management Office for 2006/07 financial year shows significant premiums paid for implementing preferential procurement. This premium excludes the problem of inevitable instances of lower quality goods and services provided. Moreover, the intensity and scope of preferential procurement has escalated significantly since 2007. Cost overruns and incomplete or substandard work is now commonplace in the public sector. For example, the new Eskom power plants, Medupi and Kusile, were initially started in 2007 and meant to be completed by 2014. They are not yet fully completed and now are planned to be completed by 2024, 10 years late. Various analysts estimate cost overruns to be in the order of 200%, amounting to as much as R300 billion in overruns.[35]

[35] See the following press reports: Yelland, C. (2021) Falling short: Medupi and Kusile an Eskom plan designed to fail, BizNews.com (https://www.biznews.com/thought-leaders/2021/03/17/eskom-medupi-kusile-yelland); Illidge, M. (2022) Medupi and Kusile — eight years late and R300 billion over budget, MyBroadband (https://mybroadband.co.za/news/energy/443784-medupi-and-kusile-eight-years-late-and-r300-billion-over-budget.html).

Table: Financial cost paid by departments for effecting preferential procurement

Department	Contract Value	Premium Paid	Premium Paid %
Transport (NW 052/05)	13,504,402	3,611,003	26,74%
Agriculture (DPW/05)	284,943	80,259	28,16%
Education (EDU15/06)	11,700,000	1,093,150	9,34%
Public Works (DPW 264/05)	274,885	77,243	28,10%
Sports, Arts & Culture (SAC1/06)	665,567	411,273	61,79%

Source: Supply Chain Management Office, National Treasury, Date Range 01/04/2006 to 31/03/2007

Poorly serviced households must spend more money, time, and energy meeting certain needs. This pulls spending power away from other goods and services and reduces the time and energy available to spend on both productive work as well as healthy rest.

Poorly serviced firms are beset by costlier and less productive inputs, lowering their productivity and earnings. They, in turn, will have to reduce investment spending, slow the pace of hiring or lay off staff, and reduce the quantity or quality of their products and services provided to other firms, institutions, and households. This sparks further rounds of cost escalations and productivity declines with negative knock-on effects on business formation and hiring.

Key state services *themselves* rely on critical state services. For example, for a state electricity utility to function effectively, it must have access to good quality, abundant basic municipal services. State roads must be maintained. Municipal wholesale buyers of electricity must be able to pay their bills and manage final-mile infrastructure. Electricity production and distribution assets require protection by state security services, there needs to be accessible, affordable, and fair commercial and labour dispute resolution in courts, and so on. Without efficient state services, other state services become inefficient or begin to fail as shortages emerge, and further negative consequences spill over to households, firms, and civil society organisations.

It should be clear, therefore, that economically critical state services – where alternative services are statutorily prohibited, inhibited, or have not yet adequately emerged in response to state service failure – must have profoundly harmful economic consequences when they become inefficient, scarce, prohibitively expensive, and of poor quality. When the state fails to provide such services at all – as in the case of totally failed municipalities or where national or regional water or electricity provision ceases – the consequences are economically and socially catastrophic. Moreover, where less economically important state services absorb too much budget due to inefficient procurement

and poor management, they reduce budget for more economically critical services, with consequent negative impact on industrial and social development.

Preferential state procurement and BEE

The state has a very large influence on revenues in South Africa. We estimate that state procurement is roughly one-seventh the size of all business turnover in South Africa.[36] In some regions or towns, state sector procurement may be proportionately higher than this and a dominant local economic force. Moreover, the state's regulatory authority over, and its procurement from very large firms, allows it to cement and expand the criteria of preferential procurement, especially BEE and local content requirements.

In turn, large firms pressure smaller suppliers and service providers to prioritise racial and geographical criteria over quality and efficiency, with knock-on effects to their suppliers, and so on. Likewise, in local districts, preferential buying power from state institutions has the capacity to entrench and spread adherence to BEE and local content among suppliers to the state.

In this way, state preferential procurement policy is the key driver of BEE, with negative economic consequences beyond merely providing poor state services.

With the infusion of BEE in the private sector also comes a degradation in private services. BEE results in capital misallocation and capital consumption. This process reduces the productive capacity of the economy and slows the rate of creation of valued goods and services.[37] BEE's far reach into the economy, and its scope for resource waste and political corruption make it a prime candidate for explaining a significant portion of South Africa's weak economic performance of the past 15 years.

BEE forces productive members from all cultural communities to subsidise connected political opportunists. BEE, therefore, leads to a greater emphasis on getting ahead using coercive means and a lower emphasis on responding to the needs of customers and firms through voluntary trade. Instead of spending precious time focused on serving the needs of others using resources efficiently, much time and effort is spent securing political favour, jostling for political positions,

[36] Based on our analysis of GDP data (Stats SA), Quarterly Financial Statistics (Stats SA), and the budget documents (National Treasury).

[37] Lamberti, R. and van Onselen, G. (2019) South Africa's race-based socialism, Mises Institute (https://mises.org/wire/south-africas-race-based-socialism).

deemphasising the needs of customers relative to those of compliance officers, and having a lower regard for economising resources and the formation of productive capital.

The net effect is wealth destruction and the perpetuation of economic and social dissatisfaction.

CONCLUSION

State institutions can have profound influence on social and economic life through their procurement policies and execution of their duties to provide key public services. Municipalities have a social and economic responsibility to efficiently allocate public resources in order to provide the best services possible to households, firms, civil society organisations, and other state entities. This aids in the productivity and flourishing of society.

Despite the prevailing common presupposition that municipalities are bound to invariably implement preferential procurement policies when advertising, adjudicating, and awarding a tender, neither the Constitution nor the PPPFA imposes such a requirement. The apparent "requirement," in other words, is a political, not a legal one.

Where state preferential procurement has overridden the primary principles of sound public procurement as required in section 217(1) of the Constitution, the state entity risks causing severe economic and social harm for which they must be held constitutionally responsible.

By adhering to sound public procurement principles and focusing on delivering effective services rather than promoting favoured firms, municipal supply chain managers and procurement officials fulfil their constitutional responsibilities, act in a sound and prudential manner, and promote broad-based economic and social development (or at least avoid causing considerable economic harm). They should apply their constitutionally mandated discretion when deciding whether or not, when, and how to apply preferential procurement, rather than standard procurement. Failure to do this is a dereliction of duty and unconstitutional.