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GOVERNMENT PROCUREMENT AS A POLICY TOOL IN SOUTH AFRICA

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ABSTRACT. Prior to 1994, the government procurement system in South Africa favoured large and established businesses and it was very difficult for newly established business to enter the procurement system. In 1994, however, government procurement was granted constitutional status, and was recognised as a means of addressing past discriminatory policies and practices. This paper critically analyses the way in which provision has been made in legislation for the use of procurement as a policy tool. It is argued that the use of procurement as a policy tool in South Africa is justified. On the whole, the primary legislation dealing with the use of procurement as a policy tool offers an adequate effect to the constitutionally prescribed use of procurement as a policy tool.

INTRODUCTION

The size and volume of government procurement contracts facilitates the government's decisions with regarding when and whom it contracts with, and these decisions affect a number of issues. Aside from government procurement being "business," i.e., the acquisition of goods and services on the best possible terms, it also has broader social, economic and political implications (Labuschagne, 1985; Morris, 1998; Turpin, 1972). Government procurement is and has, for example, often been used to promote aims which are, arguably, secondary to the primary aim of procurement. Examples include using procurement to promote social, industrial or environmental policies (Arrowsmith, Linarelli & Wallace, 2000; Cane, 2004; Turpin, 1989). It is in this regard that government procurement is of particular significance to South Africa. Due to the discriminatory and unfair practices of the past, a number of

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groups in South Africa were prevented from accessing government contracts. Prior to 1994, the government procurement system was geared towards large and established contractors. Thus new contractors found it very difficult to participate in government procurement procedures (Minister of Finance, 1997). The aim of this paper is to evaluate the way in which the South African government has made provision for the use of procurement as a means to address past imbalances.

The paper will begin with an overview of the policy objectives underlying the use of procurement as a policy tool. Attention will then be given to two constitutional principles that directly impact on the use of procurement as a policy tool, i.e., the right to equality and the attainment of value for money. Next, attention will be given to the constitutional framework of preferential procurement in South Africa. Specific attention will be given to section 217 of the Constitution of the Republic of South Africa (108 of 1996) which makes provision for the use of procurement as a policy tool and the legislation that has been enacted to give effect to section 217, i.e. the Preferential Procurement Policy Framework Act (5 of 2000) – hereafter the Procurement Act. Reference will be made to other legislation that prescribes the use of procurement as a policy tool, for example, the Public Finance Management Act (1 of 1999, as amended by Act 29 of 1999) – hereafter the PFMA, the Broad-Based Black Economic Empowerment Act (53 of 2003) – hereafter the BBBEEA, the Local Government: Municipal Finance Management Act (56 of 2003) – hereafter the MFMA and the Local Government: Municipal Systems Act (32 of 2000, as amended by Act 44 of 2003) – hereafter the Municipal Systems Act. The primary focus, however, will be on the Procurement Act and the Regulations thereto (Preferential Procurement Regulations, Government Notice R725, *Government Gazette* No. 22549, 10 August 2001) which were enacted to give effect to section 217(3) of the Constitution.[1] The Procurement Act and Regulations will be critically analysed and attention will be given to the way in which the courts have interpreted and applied the Act and Regulations.

OVERVIEW OF POLICY OBJECTIVES

Using procurement as a policy tool can also be referred to as "wealth redistribution" – using procurement to channel funds to discrete categories of economic actors (e.g., previously disadvantaged groups in

South Africa). The freedom of governments to use procurement as a policy tool has, however, to a large extent been restrained in recent years due to the implementation of measures aimed at achieving free trade in public markets. These measures most notably include the World Trade Organisation Government Procurement Agreement (WTO GPA) and the trade restrictions in place under European Community law. This does not detract from the fact that procurement has often been, and at times still is, used by governments as a tool to implement secondary policies (Arrowsmith, 2005; Cane, 2004; Craig, 2003; McCrudden, 1999; Reich, 1999; Seddon, 2004; Sparke, 1996; Turpin, 1989). A study undertaken for the European Community in 1995 (Watermeyer, 2000) indicates that procurement has been used by governments to: stimulate economic activity; protect national industry against foreign competition; improve the competitiveness of certain industrial sectors; and remedy regional disparities. It has also been employed to achieve certain more direct social policy objectives such as to: foster the creation of jobs; promote fair labour conditions; promote the use of local labour as a means to prevent discrimination against minority groups; protect the environment; encourage equality of opportunity between men and women; and promote the increased utilisation of the disabled in employment.

There are numerous arguments that can be raised in favour of the use of procurement as a policy tool. One such argument is that "where properly employed, procurement may prove a useful and effective instrument" (Arrowsmith, 1995). The use of procurement is "a valid and valuable tool for the implementation of social policies; and one which should not be denied to government[s] without convincing justification" (Arrowsmith, 1995, pp. 247-248). Provided that the use of procurement as a policy tool has measurable targets; the processes used are verifiable, auditable, and transparent; and the use of procurement as a policy tool takes place within a competitive environment, procurement can to a large extent contribute to the development of growing enterprises that are able to participate equitably in the global economy (Shezi, 1998; Watermeyer, 2000). It is therefore appropriate for the use of procurement as a policy tool to be regulated, but it should not be assumed that such use is "presumptively illegitimate" (McCrudden, 1999, p. 11). Contracts made by organs of state should "not be viewed solely as commercial bargains. The very power to grant contracts should be able to be utilized to advance socially desirable objectives, precisely because [organs of state]

cannot be and should not be politically neutral towards such matters" (Craig, 2003, p. 141).

Preferential procurement policies can also offer advantages over more direct methods of assistance because "it does not raise public spending directly…is less likely to be channeled into the purse of organized crime…[and is] more efficient than tax-financed State aid which barely reaches recipients" (Martin & Stehmann, 1991, p. 238). Procurement can furthermore be used to achieve anti-discrimination objectives in workplaces. Contracts can be denied to employers who make use of discriminatory practices. This, in turn, fosters fair competition because contracts are awarded on merit and not to contractors who violate anti-discrimination laws. In South Africa, for example, suppliers, service providers and contractors, in so far as their labour is concerned, are bound by various statutes: the Labour Relations Act (66 of 1995), the Basic Conditions of Employment Act (75 of 1997), the Employment Equity Act (55 of 1998) – hereafter the EEA, and the Occupational Health and Safety Act (85 of 1996). The non-observance of these statutes, usually to maximize profits, inevitably gives rise to unfair competitive advantages in the tendering process. It is, therefore, important to ensure that those who participate in public sector procurement adhere to labour standards. Section 53(1) of the EEA aims to ensure this and provides that "[e]very employer that makes an offer to conclude an agreement with an organ of state for the furnishing of supplies or services to that organ of state or for the hiring or letting of anything (a) must (i) if it is a designated employer, comply with [the chapters on the prohibition against unfair discrimination and affirmative action in the Act]; or (ii) if it is not a designated employer, comply with [the chapter on the prohibition against unfair discrimination]."

Failure by an employer to comply with the relevant chapters may, in terms of section 53(4) of the EEA, serve as a ground for the rejection of its offer or the cancellation of the agreement. There is, of course, also the moral justification that governments should not support contractors who practice discrimination in their workplaces. Ultimately, "[p]rocurement is an important item of public expenditure with far reaching social, economic and political implications. To argue…that public procurement is a sacred cow which should be "outside the political arena" is restrictive and unwarranted. Purchasing policies pursued by public authorities should be open to modification in the light of pressing social or economic problems – even if this does require procurement decisions

not to be guided exclusively by commercial criteria" (Morris, 1998, pp. 87-88).

There are two constitutional principles that directly impact on the use of procurement as a policy tool in South Africa: the right to equality and the attainment of value for money. The impact of these principles will be examined in the ensuing paragraphs.

POLICY PROMOTION AND EQUALITY

The equality debate in the context of government procurement is not a new phenomenon. In the South African context, the equality debate has surfaced particularly in view of the fact that the Constitution guarantees the right to equal treatment. Section 9 provides that:

(1) Everyone is equal before the law and has the right to equal protection and benefit of the law.

(2) Equality includes the full and equal enjoyment of all rights and freedoms. To promote the achievement of equality, legislative and other measures designed to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination may be taken.

(3) The state may not unfairly discriminate directly or indirectly against anyone on one or more grounds including race, gender, sex, pregnancy, marital status, ethnic or social origin, colour, sexual orientation, age, disability, religion, conscience, belief, culture, language and birth.

(4) No person may unfairly discriminate directly or indirectly against anyone on one or more grounds in terms of subsection (3). National legislation must be enacted to prevent or prohibit unfair discrimination.

(5) Discrimination on one or more of the grounds listed in subsection (3) is unfair unless it is established that the discrimination is fair.

On a formal view of equality, it may be argued that using procurement as a policy tool, i.e., affording preferential treatment to certain sections of the South African community when awarding government contracts, is unconstitutional based on sections 9(1) and 9(3) of the Constitution. The Constitutional Court has, however, held that the

right to equality in the 1993 and 1996 Constitutions refers to a "substantive" conception of equality as opposed to a "formal" conception of equality (*President of the Republic of South Africa and Another v Hugo* 1997 (6) BCLR 708 (CC); *Harksen v Lane NO and Others* 1997 (11) BCLR 1489 (CC); *National Coalition for Gay and Lesbian Equality and Another v Minister of Justice and Others* 1998 (12) BCLR 1517 (CC); *Bato Star Fishing (Pty) Ltd v The Minister of Environmental Affairs and Others* 2004 (4) SA 490 (CC)). The actual economic and social circumstances of individuals should be taken into account when reading section 9 of the Constitution. The section should be interpreted as "[encompassing] the need to remedy inequality as well as to remove discrimination, to give in the present that which was unjustly withheld in the past, and to restore in the present what was wrongly taken in the past" (Albertyn & Kentridge, 1994, p. 152). A substantive conception of equality therefore means that affording preferential treatment in the award of government contracts is not unconstitutional because affirmative action, and thus affirmative procurement, has been integrated into the right to equality – it is not a departure therefrom. Section 9(2) of the Constitution also provides that "[t]o promote the achievement of equality, legislative and other measures designed to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination may be taken".

Thus, in terms of a substantive conception of equality, it cannot be presupposed, as is the case in terms of a formal conception of equality, that all persons in South Africa are equal bearers of rights and that the inequalities of the past can be eliminated by simply extending the same rights and entitlements to all in accordance with the same "neutral" norms or standards. The actual social and economic disparities between groups and individuals in South Africa cannot be ignored. Due to South Africa's history of discrimination, unfair practices and marginalisation of people, various groups in society were denied the privilege of being economically active within the government procurement system. Affording preferences to previously disadvantaged groups in the award of government contracts therefore does not infringe on the right to equality. As pointed out by Albertyn and Kentridge (1994, p. 178), "the right to equality acknowledges and accommodates group differences and encompasses the right to *reparation* for past inequality. Only if it is understood in this way is equality equal to the task of reconstruction and reconciliation" (emphasis added).

It is furthermore important for the right to equality to be read in light of the underlying values of the Constitution and in light of the task which the Constitution sets out to accomplish, i.e., to:

- Heal the divisions of the past and establish a society based on democratic values, social justice and fundamental human rights;
- Lay the foundations for a democratic and open society in which government is based on the will of the people and every citizen is equally protected by law;
- Improve the quality of life of all citizens and free the potential of each person; and
- Build a united and democratic South Africa able to take its rightful place as a sovereign state in the family of nations (Preamble of the 1996 Constitution).

The reality, unfortunately, is that even though much progress has been made since 1994, racial inequality and both conscious and unconscious racial discrimination still persist in South Africa. This is evident in places of work, different areas and neighborhoods, and also the marketplace. Applicants for employment may have similar qualifications but still experience different treatment depending on their race. Black people looking for housing face discriminatory treatment by landlords and real estate agents, and white and black consumers still encounter different deals. This kind of bias, whether conscious or unconscious, reflects conventional and unexamined habits of thinking and serves as obstacles to equal opportunity and non-discrimination. It is therefore submitted that, within the South African context, the use of affirmative procurement is justified.

POLICY PROMOTION AND COST-EFFECTIVENESS

The relationship between policy promotion and the attainment of value for money is a bone of contention. Section 217(1) of the Constitution requires that when organs of state contract for goods or services, they must do so in accordance with a system which is, *inter alia*, "cost-effective". In other words, the aim is to procure goods or services from a contractor on the best possible terms. The question that arises therefore is the following: how and to what extent does policy promotion impact on the principle of cost-effectiveness?

It cannot be argued that there are no costs involved in using procurement as a policy tool. Costs may flow from, *inter alia*, the following: longer tendering periods to secure participation by the relevant groups (target groups); the training of emerging businesses; and the administrative costs associated with the enforcement of policies (Watermeyer, 2000). The problem, however, is that it is often difficult to accurately estimate, on the one hand, the costs involved in policy promotion and, on the other hand, the benefits that may be achieved thereby (Arrowsmith, 1995). Studies have shown that the current lack of data collection and records by organs of state prevents the effective monitoring of targeted procurement. It not only prevents the assessment of the degree to which "small businesses" are successfully being targeted, but also negatively impacts on the transparency of the tendering process (Sharp, Mashigo & Burton, 1999, p. 26). The extent to which procurement can be used to implement national policies is therefore difficult to determine. The question also arises as to who should bear the costs of implementing and enforcing procurement policy.[2]

There are, however, studies that confirm that progress has been made since the implementation of affirmative procurement in South Africa. Gounden's findings (Gounden, 2000), for example, show that the financial premiums born by the state in adopting affirmative procurement policy in the construction industry, in particular, have proved to be nominal compared with the initial projected outcomes and the overall benefits. Watermeyer (2000), also points out "major changes" that have taken place in South Africa since the implementation of affirmative procurement policies. According to him, targeted procurement has been effectively used to direct capital flows into underdeveloped and disadvantaged rural communities by means of conventional construction projects. He references a number of projects that have been successfully implemented. Of particular significance is the Malmesbury prison complex[3] which Watermeyer points out is "the project which gave birth to Targeted Procurement in South Africa in 1996". Sodurland and Schutte's review of the Malmesbury Prison Complex and Associated Housing Estate prepared for the National Department of Public Works in September 1998 also shows that the Malmesbury Prison Contract "proved to be more efficient at channeling money into communities than some focused poverty alleviation programmes in South Africa involving the construction of community buildings" (Watermeyer, 2000, p. 247).

It is submitted that even though there may be time and cost premiums attached to the use of procurement as a policy tool, this premium should be regarded as an integral part of a country's growth and transformation. Increasing the participation of small, medium and micro enterprises (SMMEs) in the government procurement system, in particular, has many advantages:

> SMME's [*sic*] tend to be more labour intensive and by definition less reliant on large amounts of capital and highly advanced technology and equipment. Being more flexible and less constrained by capital and technology-driven intensive factors of production, they are able to increase output, and hence employment, at faster rates than the formal, capital intensive firms. A fast growing SMME sector accordingly has enormous potential to reduce unemployment, increase average household incomes, reduce the poverty gap, and increase the tax base of the economy, which in turn provides the basis for further, sustainable long term growth in the economy (Mkhize, 2004, p. 12).

In the case of South Africa, therefore, the question is not whether it can afford to use procurement as a policy tool but rather, whether it can afford not to. The South African government has chosen to embark upon the use of procurement as an instrument/tool to correct the imbalances of the past. The way in which this has been done will be examined in the ensuing paragraphs.

CONSTITUTIONAL FRAMEWORK OF PREFERENTIAL PROCUREMENT

Overview

Prior to 1994, price was the overriding criterion for the procurement of goods and services by the government. Tenders were awarded strictly based on price and the tenderer who submitted the lowest tender (in terms of price) was only overlooked "when there [was] clear evidence that he [did] not have the necessary experience or capacity to undertake the work or [was] financially unsound" (Ministry of Finance and Public Works, 1997, clause 3.4.1). In other words, only if there was a high risk that the lowest tenderer would not complete the contract, was the tender awarded to another tenderer.

With the coming into effect of the 1993 and 1996 Constitutions, the practice of awarding tenders strictly based on price has to a large extent changed. Even though price is still a very important criterion for the procurement of goods and services (*Cash Paymaster Services (Pty) Ltd v Eastern Cape Province and Others* 1999 (1) SA 324 (Ck) 351G-H; *South African Post Office Ltd v Chairperson, Western Cape Provincial Tender Board, and Others* 2001 (2) SA 675 (C) para 13), it is no longer the decisive criterion. The practice of accepting the lowest tenderer in terms of price only was described in clause 3.4.4 of the Green Paper on Public Sector Procurement Reform (discussed in greater detail below) as "inflexible" in the sense that it "restrict[s] the degree to which the smaller enterprises can access the process". The specification of unnecessarily high standards in tender advertisements for goods or services is also recognised at local government level (not at national and provincial government level though) as possibly having the effect of discouraging or excluding small firms from tendering (Regulation 27(2)(e) of the Local Government: Municipal Finance Management Act, 2003: Municipal Supply Chain Management Regulations, *Government Gazette* No. 27636, 30 May 2005). Government procurement has, in other words, been recognised as a tool to correct South Africa's history of unfair discriminatory policies and practices. When procuring goods and services, organs of state are today required to take account of a number of factors when awarding contracts. It is particularly the notion of "empowerment" that plays an important role in determining whether or not a contract is awarded to a particular contractor. A contractor's ranking in respect of its achievement of socio-economic objectives therefore plays a significant role in the selection process.

First, the way in which the Constitution makes provision for the use of procurement as a policy tool will be examined. Next, policy initiatives prior to the drafting and enactment of the national legislation dealing with procurement as a policy tool (the Procurement Act) will be investigated. The eventual enactment of the Procurement Act will then be given a more detailed analysis. The Regulations that were promulgated to give substance to the Act will also be examined. The PFMA, the BBBEEA, the MFMA and the Municipal Systems Act also make provision for the use of procurement as a policy tool. The primary focus, however, will be on the Procurement Act and Regulations.

Section 217

Even though both the 1993 Constitution (in section 187) and the 1996 Constitution (in section 217) recognise government procurement as a constitutional principle, it is only the 1996 Constitution that makes express provision for the use of procurement as a policy tool. This (making express provision for the use of procurement as a policy tool in a country's constitution) is not common practice. The fact that it has been done in South Africa's Constitution serves to illustrate the importance attached to the use of procurement as a tool to correct past imbalances and to uplift vulnerable groups in society.

The most important provision in the Constitution that deals with government procurement and specifically its use as a policy tool is section 217. Subsection (1) provides that when organs of state contract for goods or services, they must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective. Subsection (2) provides that "[s]ubsection (1) does not prevent [organs of state] from implementing a procurement policy providing for (a) categories of preference in the allocation of contracts; and (b) the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination". Subsection (3) then provides that "[n]ational legislation must prescribe a framework within which the policy referred to in subsection (2) *must* be implemented" (emphasis added).

Broadly speaking therefore, section 217 makes provision for the use of procurement as a policy tool. It reflects the broader notion of equality in South Africa, i.e. a substantive conception of equality as provided for in section 9 of the Constitution (see the discussion on "substantive equality" supra). Section 217 allows organs of state to make use of "affirmative procurement", "preferential procurement" or "targeted procurement" when awarding contracts.

Obligation to Use Procurement as a Policy Tool

Section 217(2) of the Constitution does not place organs of state under an obligation to implement a preferential procurement policy. Section 217(2) simply provides that organs of state are not "prevented" from using procurement as a policy tool. This should not be cause for concern. The Constitution is meant to govern the country in the long term and procurement is not intended to be used as a policy tool indefinitely. The aim, in South Africa, is (simply) to use procurement as

a means to address *past* discriminatory policies and practices. The use of procurement is, in other words, an interim measure. There is, accordingly, no need for the Constitution to make the use of procurement as a policy tool obligatory for organs of state. This should, instead, be left to legislation – examined in greater detail below.

After the recent amendment of section 217(3), organs of state who implement a preferential procurement policy are also obliged to do so *in accordance with* the national legislation referred to in section 217(3), i.e. the Procurement Act. This is because section 217(3) has been amended by the Constitution of the Republic of South Africa Second Amendment Act (61 of 2001) and the word "must" has been substituted for the word "may". Before proceeding to examine the precise nature and content of the Procurement Act, a brief overview will be given of policy initiatives that preceded the enactment of the Procurement Act.

POLICY INITIATIVES PRIOR TO THE PROCUREMENT ACT

Ten-Point Plan

To give effect to the new policy role of government procurement in South Africa, the government embarked upon a reform process of the government procurement system which started with a ten-point plan in November 1995 (Ministries of Finance and Public Works, 1995). The aim of the plan was to provide interim or temporary procurement strategies until the enactment of national legislation (the Procurement Act) that were in line with existing legislation but at the same time accommodated the objectives of the Reconstruction and Development Programme (RDP). The plan included the following measures:

- the improvement of access to tendering information;
- the development of tender advice centers;
- the broadening of a participation base for small contracts (less than R7 500);
- the waiving of security/sureties on construction contracts with a value less than R100 000;
- the unbundling or unpacking of large projects into smaller projects;
- the promotion of early payment cycles by government;

- the development of a preference system for SMMEs owned by historically disadvantaged individuals (HDIs);
- the simplification of tender submission requirements;
- the appointment of a procurement ombudsman; and
- the classification of building and engineering contracts.

The above measures were thus aimed at increasing the participation of SMMEs with the emphasis on the disadvantaged and marginalised sectors of society and the unemployed.

Green Paper on Public Sector Procurement Reform

In April 1997 the Green Paper on Public Sector Procurement Reform was released and contained all the principles of the ten-point plan. Some of its main principles and proposals included easier access to tendering information; the simplification of tender documents; breakout procurement (unbundling or the use of smaller contracts); and the award of tenders in terms of a development objective. A further proposal included the drafting of an affirmative procurement policy with its essential characteristics being the use of targeted procurement to achieve socio-economic objectives and the specific targeting of groups in accordance with national policy objectives. Further suggestions included consistent and uniform definitions, strategies, monitoring and reporting mechanisms to realize policy objectives. In February 2000, effect was finally given to section 217(3) of the Constitution with the promulgation of the Procurement Act.

THE PROCUREMENT ACT AND REGULATIONS

The purpose of the Procurement Act is "[t]o give effect to section 217(3) of the Constitution by providing a framework for the implementation of the procurement policy contemplated in section 217(2) of the Constitution; and to provide for matters connected therewith" (Preamble to the Procurement Act). The aim of the Act is, therefore, to enhance the participation of HDIs and SMMEs in the public sector procurement system. Section 5(1) of the Act further provides that "[t]he Minister [of Finance] may make regulations regarding any matter that may be necessary or expedient to prescribe in order to achieve the objects of this Act". The Regulations to the Procurement Act have been promulgated though they are, at present, in the process of being

redrafted. The aim is to bring the Regulations more in line with the BBBEEA. In the ensuing paragraphs, a broad overview will be given of the implementation of preferential procurement policies; the use of a preference point system; the specific goals to be achieved by organs of state when awarding contracts; the award of preference points for "equity ownership" and "RDP" goals; and the imposition of penalties.

Implementation of Preferential Procurement Policies

Obligatory or Discretionary

Section 2(1) of the Procurement Act makes it obligatory for organs of state to implement a preferential procurement policy – "[a]n organ of state *must* determine its preferential procurement policy and implement it within [the framework provided for in the Act]" (emphasis added). The compulsory nature of section 2(1) can be commended. True reform of the South African government procurement system can only take place if organs of state have little (if any) discretion on whether or not to implement a preferential procurement policy. The EEA (in Chapter III) also makes it compulsory for organs of state as "designated employers" to implement affirmative action measures in their workplaces. Recent constitutional jurisprudence dealing with affirmative action measures further serves to illustrate that the implementation of preferential procurement policies should not be left to the discretion of organs of state (*Bato Star Fishing (Pty) Ltd v The Minister of Environmental Affairs and Others* 2004 (4) SA 490 (CC) para 74).

Thus, based on constitutional jurisprudence, the use of the word "must" in section 2(1) of the Procurement Act, and in view of Chapter III of the EEA which obliges organs of state (as employers) to implement affirmative action measures, all organs of state (as contracting entities) should be and are correctly obligated to use procurement as a policy tool.[4]

Entitlement to Preferential Treatment

It is only logical that contractors from target groups should not be entitled to be awarded government contracts simply because they fall within a specific target group. Section 217(1) of the Constitution lays down five principles that must be complied with when organs of state procure goods or services: fairness, equity, transparency, competitiveness and cost-effectiveness. Even though the principle of equity, in particular,

cannot be ignored when organs of state procure, the principle (of equity) is only one of the five principles. It must be balanced with the other principles and the weight afforded to it will be determined by the facts and circumstances of the particular case. Also, as explained below, insofar as selecting a winning contractor is concerned, equity only accounts for a maximum of 10 or 20 points (out of 100) in the actual award of contracts. Whether or not a particular contractor will be awarded a contract is therefore determined by the number of points awarded to it out of 100, the notion of equity only accounting for a maximum of 10 or 20 points depending on the value of the contract. Contractors who fall within a specific target group are thus not entitled to be awarded government contracts simply because they fall within a specific target group.

Obligation to use Framework in Procurement Act

The Procurement Act provides in section 2(1) that an organ of state must determine its preferential procurement policy and implement it "within" the framework provided for in the Act (A similar provision is contained in Regulation 2(2)). This may give rise to controversy because an organ of state cannot use a system that is "more generous to HDIs than that established by the [Procurement Act] and Regulations" or that is "different but equivalent" to the framework provided for in the Act and Regulations. It has therefore been argued that Regulation 2(2), in particular, is "fairly restrictive" (Penfold & Reyburn 2003).

It is submitted that section 2(1) of the Procurement Act and Regulation 2(2) serves to illustrate the importance attached to the attainment of value for money in the procurement process. Even though price is no longer the only criterion for the award of government contracts, it remains, and should remain, the most important criteria. The court in *Cash Paymaster Services (Pty) Ltd v Eastern Cape Province and Others* 1999 (1) SA 324 (Ck) emphasised this notion. The tender board awarded a contract to a tenderer who quoted approximately R200 million more than other tenderers and justified the award on the ground of factors related to the RDP. The court held that using procurement as a policy tool is vital but its use should not be elevated to such a degree that it goes further than even that which the government intended it to be (p. 351D-E). It is unsound to award a contract to a tenderer who quotes approximately R200 million more than other tenderers and to justify this on ideological grounds. The use of procurement as a policy tool does not

supersede other considerations such as fairness and competitiveness. The court set aside the award of the tender and ordered that new tenders be called for.

There may, admittedly, be organs of state that "are eager to promote the implementation of social and economic objectives (through the award of contracts to HDIs) to a greater extent than is allowable by the preference points system provided for in the [Procurement Act]" (Penfold and Reyburn, 2003, p. 25-20). The contrary may, however, also be true. There may be organs of state that would prefer to afford less (if any) preferential treatment than that prescribed by the Procurement Act and Regulations. The "restrictive" nature of section 2(1) and Regulation 2(2), to a large extent, serves to ensure uniformity in the use of procurement as a policy tool in South Africa which, in turn, goes towards the integrity and openness of the government procurement system.

The Preference Point System

To address past discriminatory policies and practices, the Procurement Act establishes a preference point system for the award of contracts. Since price, however, is and always will be an important criterion in the selection of contractors, the point system created by the Act is "dual-scale" depending on the value of a specific contract. The total number of points that may be awarded to contractors is 100, and to ensure that organs of state still obtain the best price for goods and services, more preference points are awarded for lower value contracts and less preference points for higher value contracts. For contracts between R30 000 and R500 000, a maximum of 20 preference points may be awarded for the achievement of "specific goals". Thus, 80 points must be awarded for price and a maximum of 20 points may be awarded for the achievement of "specific goals" (Regulation 5). For contracts above R500 000, only a maximum of 10 preference points may be awarded for the achievement of "specific goals". Thus, 90 points must be awarded for price and a maximum of 10 points may be awarded for the achievement of "specific goals" (Regulation 4 and s 2(1)(*a*) read with s 2(1)(*b*) of the Procurement Act).

The 80/20 Point System

Regulation 3(1) provides a formula that must be used to calculate the points to be awarded for price out of 80. The points awarded for price

must then be added to the points awarded out of 20 to a tenderer "for being an HDI and/or subcontracting with an HDI and/or achieving any of the specified goals stipulated in regulation 17" (Regulation 3(2) read with Regulation 3(3)). The formula for the 80/20 preference point system is as follows:

Ps = 80 (1 – (Pt – P min) ÷ P min))
Where:
Ps = the points scored for price for the tender under consideration,
Pt = the rand value of the tender under consideration, and
Pmin = the rand value of the lowest acceptable tender.

The following example can be used to demonstrate the application of the above formula. The Education Department invites tenders for the provision of computer software. A, an empowerment company, offers the software for R350 000. B, which has no empowerment component, offers the software for R250 000. Since the contract is worth more than R30 000 but less than R500 000, the 80/20 preference point system applies and the points awarded to A and B must be calculated as follows:

B's tender

Price	= 80
Preference	= 0
Total points	= 80

A's tender

Price	= 80 (1 – (Pt – P min) ÷ P min))
	= 80 (1 – (R350 000 – R250 000) ÷ R250 000))
	= 80 (1 – (R100 000 ÷ R250 000))
	= 80 (1 – (0.4)
	= 80 (0.6)
	= 48
Preference	= 20 (this is on the assumption that 20 points are awarded – it need not necessarily be 20, it could be less)
Total points	= 68

The tender will be awarded to B because it scored the most points. If the facts and figures provided were different and A and B ended up with the same total number of points for price, A (and not B) would be awarded the tender because the award of preference points would be the

determining factor – B has no empowerment component. On the other hand, if both A and B had empowerment components and both were equal in all respects (the same points for price and preferences) the contract would have to be awarded by the drawing of lots (Regulation 12(8)).

The 90/10 Point System

Regulation 4(1) provides the formula that must be used for contracts above R500 000: 90 points must be awarded for price and a maximum of 10 points may be awarded to a tenderer "for being an HDI and/or subcontracting with an HDI and/or achieving any of the specified goals stipulated in regulation 17" (Regulation 4(2)). Aside from the fact that only a maximum of 10 preference points (as opposed to 20) may be awarded to a tenderer, the application of the 90/10 preference point system is principally the same as the application of the 80/20 preference point system. Further examination of the 90/10 point system is thus unnecessary.

The Attainment of "specific goals"

Section 2(1)(*d*) of the Procurement Act provides that an organ of state may, in its procurement policy, aim for specific goals which may include:

- contracting with persons, or categories of persons, historically disadvantaged by unfair discrimination on the basis of race, gender or disability; and
- implementing the programmes of the [RDP] as published in *Government Gazette* No. 16085 dated November 23, 1994.

A "historically disadvantaged individual" (HDI) is defined in Regulation 1(h) as a South African citizen "(1) who, due to the apartheid policy that had been in place, had no franchise in national elections prior to the introduction of the Constitution of the Republic of South Africa, 1983 (Act No 110 of 1983) or the Constitution of the Republic of South Africa, 1993 (Act No 200 of 1993) ("the Interim Constitution"); and/or (2) who is a female; and/or (3) who has a disability, provided that a person who obtained South African citizenship on or after the coming effect of the Interim Constitution, is deemed not to be an HDI."

Two potential problems of the above definition have been correctly noted (Penfold & Reyburn, 2003). The first is that the definition is framed in terms of individuals rather than groups: Regulation 1(h) specifically refers to "a South African citizen". A woman born prior to 1980 may therefore fall outside the definition because the reason for her exclusion would have been age (she was too young to vote in 1994) and not apartheid. The second potential problem is that some of the qualifications contained in the definition may have "unintended consequences". A black Nigerian woman who has been disabled from birth and became a South African citizen on May 1, 1994 will not, for example, qualify as an HDI whereas a white South African man disabled in 2002 would qualify as such.

Points for "equity ownership" and "RDP" Goals

Regulation 13(1) provides for the allocation of preference points for equity ownership by HDIs and states that "[p]reference points stipulated in respect of a tender *must* include preference points for equity ownership by HDIs" (emphasis added). The provision is thus cast in mandatory terms, meaning that preference points may not, for example, be allocated only for the attainment of RDP goals. On the other hand, however, it would appear that preference points may be awarded only for equity ownership by HDIs. This is because Regulation 17(3) is cast in directory terms: it provides that "[o]ver and above the awarding of preference points in favour of HDIs, the following activities *may* be regarded as a contribution towards achieving the goals of the RDP" (emphasis added).

The mandatory nature of Regulation 13(1) serves to illustrate that South Africa's current use of procurement as a policy tool is more directed at *persons* who were disadvantaged by previous discriminatory policies and practices. Even though "RDP" goals are recognised as worthy of preference in the award of government contracts, organs of state are not compelled to take account thereof when awarding preference points.[5] An organ of state *may* furthermore, in terms of Regulation 12(1), award preference points for the procurement of "locally manufactured products" provided that the intention to do so is communicated to potential tenderers in the call for tenders.

Penalties

Regulation 15 sets out a number of penalties that an organ of state "must" apply upon detecting that (1) a preference under the Procurement Act or Regulations was obtained on a fraudulent basis, or (2) any of the specified goals in the Procurement Act and Regulations are not attained in the performance of a contract. Penalties include, *inter alia*, the recovery of all costs, losses or damages incurred (Regulation 15(2)(a)); cancellation of the contract including damages suffered due to such cancellation (Regulation 15(2)(b)); financial penalties (Regulation 15(2)(c)); and debarment for a period not exceeding ten years (Regulation 15(2)(d)).

It is particularly in the context of fronting or "window dressing" that the penalties provided for in the Procurement Act and Regulations will find application. Broadly, fronting refers to the practice of black people being signed up as fictitious shareholders in essentially "white" companies. A common example of fronting, it has been noted (Derby, 2004), is where companies start a new black economic empowerment (BEE) company which does precisely the same as the existing company but all the work is channeled through the BEE vehicle. The turnover and the work is still done by the existing "non-BEE company" and most of the profits are taken by the company. Another example is where a company is black-owned (50%+) but the shares are allocated on an earn-out basis or are deferred ordinary shares. Thus, when dividends are paid, the black-owned company which is a shareholder, only gets a small percentage of the profit.

It is currently (March 13, 2006) the role of rating agencies such as Empowerdex, EmpowerLogic and Tradeworld to make sure that when a company is rated, BEE is meaningful and tangible and in accordance with the BBBEEA. The Department of Trade and Industry is also in the process of drafting codes of good practice on empowerment which will assist to combat fronting practices (Code 000: Framework for the Measurement of Broad Based Black Economic Empowerment, Statement 001: Fronting Practices and Other Misrepresentation of BEE Status – available at http://www.dti.gov.za/bee/2NDPHASE.htm). Only companies that comply with the codes will be awarded contracts whereas companies that resort to fronting to secure contracts will be guilty of fraud which will render invalid the contract awarded to it. Thus, even

though fronting serves as a barrier to the efficient use of procurement as a policy tool, pre-emptive measures are being put in place.

CONCLUSION

The use of government procurement as an instrument of policy is not without controversy. On the whole, however, particularly in the South African context, procurement as a policy tool can be said to be justified. Even though there are time and cost premiums attached to the use of procurement as an empowerment tool, the costs incurred are, to a large extent, outweighed by the fact that it is not only the owners of affirmative businesses that benefit but also their workforce. This, in turn, leads to job creation and economic development. Affirmative procurement also does not amount to an infringement of the right to equality in section 9 of the Constitution. The Constitutional Court has held that section 9 refers to a substantive conception of equality as opposed to a formal conception of equality. The right to equality "acknowledges and accommodates group differences and encompasses the right to *reparation* for past inequality" (Albertyn & Kentridge, 1994, p. 178; emphasis added). Affording preferences to previously disadvantaged groups in the award of government contracts therefore does not infringe on the right to equality or the principle of fairness in section 217(1) of the Constitution.

The primary legislation that deals with the use of procurement as a policy tool in South Africa is the Procurement Act and the Regulations thereto. On the whole, effect is given to the constitutionally prescribed use of procurement as a policy instrument. The preference point systems created by the Act illustrate the importance that is still attached to the attainment of value for money when the state procures goods or services. The allocation of preference points is determined by the value of contracts – the higher the value of contracts, the fewer preference points may be allocated. Contractors that belong to target groups also do not have an entitlement to preferential treatment simply because they fall within a specific target group. All the principles in section 217(1) of the Constitution find application when organs of state contract for goods or services and the principle of equity is only one of those principles. All the principles must be afforded weight in a given set of circumstances to ensure overall compliance with section 217.

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NOTES

1. The Procurement Regulations are currently (13 March 2006) in the process of being redrafted (Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000): Draft Preferential Procurement Regulations, *Government Gazette* No. 26863, 4 October 2004).

2. Usually, the costs involved in policy promotion are covered by the relevant organ of state's allocated budget. In Canada, however, it appears that in practice, "the assessment of additional costs and their allocation to the appropriate budget is frequently considered not to warrant the administrative effort involved [in using procurement as a policy tool]" (Arrowsmith, 1988, p. 96).

3. Malmesbury is a small rural town approximately 70 km from Cape Town, South Africa.

4. See also the Parliamentary Monitoring Group Minutes of the Joint Meetings of the Finance Portfolio Committee and the Finance Select Committee on 12 and 18 January 2000 at which the Procurement Bill was considered (available at www.pmg.org.za - click on "The PMG Archives: July 1999 to mid-2000" – confirmed access: 28 October 2005). The intention appears to have been that "every" organ of state "must" implement a preferential procurement policy. The same intention appears to flow from the opinion provided by the Principal State Law Advisor and the opinion on behalf of the Ministry of Finance (drafted by Halton Cheadle, Nicholas Haysom and Mandy Taylor) at the meeting of 18 January 2000.

5. RDP goals, in terms of Regulation 17(3)(a)-(k), include the following: the promotion of South African owned enterprises; the promotion of export orientated production to create jobs; the

promotion of SMMEs; the creation of new jobs or the intensification of labour absorption; the promotion of enterprises located in a specific province, region, municipality or rural areas; the empowerment of the workforce by standardising the level of skill and knowledge of workers; the development of human resources; and the upliftment of communities. Regulation 17(3) does not, however, appear to lay down a closed list of activities which may be recognised for the purposes of preferences points. It simply states that the activities mentioned "may" be regarded as a contribution towards achieving the goals of the RDP.

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