



PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

Briefing on the 2022 draft Preferential Procurement Regulations-

Following the Constitutional Courts ruling on the Minister of Finance vs Afribusines NCP CCT279/20- 16 February 2022

Parliamentary

Budget
Office

The Parliamentary Budget Office (PBO) has been established in terms of the Money Bills Amendment Procedure and Related Matters Act (Act 9 of 2009). The PBO provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money Bills. The PBO supports the implementation of the Act by undertaking research and analysis for the Finance and Appropriations Committees.

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1. Purpose of this brief

The purpose of this brief is to provide the PBOs analysis of the draft Preferential Procurement Regulations that the National Treasury (NT) has requested public comments on following the Constitutional Courts ruling on the Minister of Finance vs Afribusines NCP CCT279/20.

The purpose of this brief is also to express the PBO's assessment of changes to the practice of state procurement that would affect the redistributive and developmental role of fiscal policy that could affect achieving the state's developmental objectives such as the deep level of disadvantage in society due to unfair discrimination and achieving other goals of the Reconstruction and Development Programme, including support for economic transformation, industrial policy and support for small, medium and microenterprises.¹

2. Background

The government Economic Reconstruction and Recovery Plan (ERRP) has places emphasis on industrialisation through localization. The programme to drive industrialisation through localisation, as stipulated in the ERRP, seek to achieve various strategic objectives including; reduce proportion of imported intermediate and finished-goods, improve the efficiencies of local producers, and develop export competitive sectors that can expand the sale of South African made products on the continent and beyond. According to Department of Trade, Industry and Competition (DTIC), the government purchasing power through public procurement contributes between 15 per cent and 25 per cent to gross domestic products.

The State Owned Corporations (SOCs) and other public entities have made commitment that, they will deliver sustainable supplier development, localisation and industrialisation by leveraging on their procurement spend. They further committed to a targeted at enterprises and supplier development initiatives that support localisation and industrialisation, and provide opportunities for black people, youth women, small businesses, people with disabilities and people living in rural communities'.

The approach to preferences in government procurement has its roots in the Constitution of the Republic of South Africa (1996), which required a framework for preferential procurement that was legislated in the form of the Preferential Procurement Policy Framework (PPPFA) Act (2000). The PPPFA states that the right to develop preferential procurement policy vests with *organs of the state* and that the Minister of Finance may make regulation deemed necessary for achieving the objects of the PPPFA. In this regard, the 2017 Preferential Procurement Regulations were challenged by Afribusines. The discussion in this brief refers to the Constitutional Courts ruling handed down on 16 February 2022 and the new draft Preferential Procurement Regulations gazetted by the NT in March 2022 for public comments in response to this ruling.

2.1. The Constitution

Section 217(1) of the Constitution (1996) has the requirement that:

When an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do

¹White Paper On Reconstruction and Development: Government Gazette No. 16085, 23 November 1994

so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.

Section 217(2) then adds that a procurement policy by an organ of state may have categories of reference. It says:

Subsection (1) does not prevent the organs of state or institutions referred to in that subsection 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.

It then requires national legislation to provide a framework for implementing preferences in contracting.

Section 217 (3): National legislation must prescribe a framework within which the policy referred to in subsection (2) must be implemented.

2.2. The PPPFA provides the framework

The PPPFA provides the framework for implementing preferential procurement policies. Section 2(1) states that “*The right to determine the preferential procurement policy vests with the organ of state*”.

Section 2(d) adds that:

the specific goals may include

(i) contracting with persons, or categories of persons, historically disadvantaged by unfair discrimination on the basis of race, gender or disability;

(ii) implementing the programmes of the Reconstruction and Development Programme as published in Government Gazette No. 16085 dated 23 November 1994;

Section 5 of the PPPFA deals with regulation, it states:

5(1): The Minister may make regulations regarding any matter that may be necessary or expedient to prescribe in order to achieve the objects of this Act.

5(2) Draft regulations must be published for public comment in the Government Gazette and every Provincial Gazette before promulgation.

2.3. The 16 February 2022 Constitutional Court (CC) ruling

On 16 February 2022, the Constitutional Court handed down a judgement in the case *Minister of Finance v Afribusines NCP CCT279/20*, which was an application by the Minister of Finance (Minister) for leave to appeal against a judgment and order of the Supreme Court of Appeal. This application was brought by the Minister against Afribusines NPC about the validity of the Preferential Procurement Regulations, 2017 (Procurement Regulations), which the Minister promulgated on 20 January 2017 in terms of section 5 of the Preferential Procurement Policy Framework Act (PPPFA).

The minority judgment in the CC ruling stated that the Minister of Finance did not act beyond the powers conferred on him by the PPPFA when he promulgated the regulations because the Minister under section 5(1) of the PPPFA has the power to make any regulations regarding any matter that may be “necessary or expedient” to achieve the objects of the PPPFA. However, the majority judgment had a contrary interpretation of the words “necessary or expedient” (in section 5(1) of the PPPFA). The majority judgement said that rather than giving

the Minister power to make regulation to achieve the objectives of the PPPFA, the words “necessary and expedient” in fact limit the power of the Minister to make the referred to regulations. The majority judgement argued that since section 2(1) of the PPPFA states that an *organ of state* must determine its preferential procurement policy it cannot be in the power of the Minister to make regulations on the same matter.

The majority judgment comes to this conclusion by reading the words “necessary or expedient” with section 2(1) of the Procurement Act, which provides that an organ of state must determine its preferential procurement policy. Since each organ of state is empowered to determine its own preferential procurement policy, it cannot also lie with the Minister to make regulations that cover the same field. Ultimately, the majority judgment holds that it can neither be necessary nor expedient for the Minister to make regulations that seek to achieve that which can already be achieved in terms of section 2(1).

3. The NT's draft Procurement Regulations for public comment of 23 March 2022

In response to the majority judgement of the Constitutional Court, the NT has drafted Preferential Procurement Regulations (draft PPR 2022) and requested public comments on the draft.² The PBO is concerned that there is a lack of evidence that, NT had , discussed or agreed with other government departments before the drafted PPR 2022 being publicly released for comment.

The PBO is further concerned that the NT's draft PPR 2022 is based mainly on their interpretation of the judgement handed down by the Constitutional Court on 16 February 2022. In that the NT' main concern seems to be to ensure that the regulations suggested by the Minister of Finance cannot be challenged on the basis that the Minister is “overreaching” his power in cases where organs of state have the right to develop policies with regard to preferential procurement.

The NT explains in their document “Rationale for the Draft Preferential Procurement Regulations, 2022” (Rationale document) that:

Those matters regulated in the Preferential Procurement Regulations, 2017 (2017 Regulations) which are to be contained in the procurement policies determined by organs of state have been omitted from the draft Regulations.

Therefore, the NT chose to omit certain regulations from the draft Regulations;

4.1. Broad-based black economic empowerment status

The Rationale document explains that they have omitted regulations that refer to B-BBEE status as a specified goal when allocation preferential points because

The application of the B-BBEE Act by organs of state coupled with the limitation it poses on organs of state in determining their own specific goals for each tender suggests that B-BBEE as it was applied in the 2011 and 2017 Regulations would be an overreach, if included in the regulations.

4.2. Local production and content

The NT has also chosen to omit regulations that provide for local production and content (i.e., Regulation 8 of the 2017 Regulations) also because they interpret these rules to be “outside of

² Government Gazette No 46026 of 10 March 2022: Draft Preferential Procurement Regulations Comment for Public Comment

the Ministers regulation-making authority" and worry that they could be successfully challenged in court. The NT's Rationale document states:

The framework, in section 2(1) of the Act, does not provide for local production and content per se, but refers to implementing the programmes of the RDP and provides for points to be awarded for specific goals. It does not provide for local production and content to be used as a disqualification criterion.

4.3. Other regulations omitted from the Draft Regulations

The NT has also chosen to remove several other regulations because they are not provided for in terms of section 2(1) of the PPPFA or because they are deemed not in line with section 2(1) of the PPPFA and "do not fall under preferential procurement and are therefore outside the scope of the Act". These omitted regulations are:

- Provisions for functionality;³
- Subcontracting after the award of a tender;³
- Cancellation of orders;³
- Prequalification for preferential procurement;⁴
- Subcontracting as a condition of tender;⁴ and
- Issuance of circulars and guidelines⁵

5. Analysis and discussion

The National Treasury has been developing regulations taking into account section 5 (3) of the PPPFA in line with Sn 217(3) of the Constitution, which requires that national legislation must prescribe framework for organs of state to implement preferential procurement policies. It seems that the situation was one where the regulations tabled by the Minister of Finance were the secondary sources of legislation intended to support and give guidance to the primary legislation, the PPPFA. The Minister of Finance, in an effort to maintain this situation, appealed the judgment and order of the Supreme Court of Appeal on the validity of the 2017 Preferential Procurement Regulations. However, the Constitution Court delivered a finding in the Minister of Finance vs Afribusines NPC (CCT 279 of 2020) [2022] that declared regulations issued under the Preferential Procurement Policy Framework Act of 2000 unconstitutional and invalid. The majority finding of the court was that the 2017 regulations, such as black economic empowerment considerations and pre-qualification requirements for those seeking to tender for public contracts, were ultra vires because they exceeded the authority granted by the (PPPFA). The response of the NT to the ruling has been to propose new regulations that omit previous regulation that they interpret could be challenged as Ministerial overreach that impacts on the right powers of organs of state to formulate preferential procurement policy.

³The NT interprets the Constitutional court judgement to say that this function:

... must be left to the organs of state to determine and should not form part of the regulations prescribed by the Minister. Alternatively, it may be prescribed through an Instruction in terms of section 76 of the Public Finance Management Act (PFMA), or by amending the Municipal Supply Chain Management Regulations under the MFMA, where required, or by adopting in the SCM policies of the municipalities, where permissible (i.e. the broader SCM prescripts).

⁴NT says these regulations "have been omitted since the Constitutional Court considered these provisions to be not necessary or expedient to be prescribed by the Minister as it should have been left to the organs of state to determine in their preferential procurement policies."

⁵This regulation was omitted because NT interprets the Constitutional Court ruling to be that there is a requirement for organs of state to determine their own preferential procurement policy. The NT states that "if deemed necessary for guidelines or circulars to be issued, they may be issued without being provided for in regulations, since they are not binding in nature and are merely issued to provide guidance to organs of state."

a) The Constitution requires national legislation to prescribe a framework for organs of states to implement preferential procurement

The Constitution when talking about procurement in section 217 (1) says that when an organ of state contracts it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective. The PPPFA section 2(1) says that an organ of state must determine its preferential procurement policy. It seems that the interpretation of the Constitutional requirement for procurement by all organs of the state led to a certain type of wording in the PPPFA that all organs of state have a right to determine their own preferential procurement policy. The formulation that talks about "any organ of state", therefore, has created problems where attempts by a Minister of the National Government to put in place preferential procurement regulations to provide guidance for organs of state has been ruled *ultra vires* because organs of state have the right to develop their own procurement policies. Therefore, the question of whether the Constitution's reference to "any organ of state" would be incompatible with a national policy on preferential and nations regulations. The Constitutional requirement that national legislation must prescribe a framework for organs of state to implement preferential procurement policies could be interpreted to support a national policy.

b) Fragmented Preferential Procurement Framework will delay realisation of Nationally coordinated policies like, BBEE, Industrial Policy and other development policies

An argument in favour of each organ of state developing its own procurement policy is that an organ of state would be more familiar with its own specific situation and, therefore, be able to develop a procurement policy that best serves it and its stakeholders. However, an effective response to this argument would be that policies such as B-BBEE, industrial policy and policies aimed at supporting and incentivising SMMEs have important and often dominant national dimensions. If the approach to preferential procurement is left too fragmented, then the alignment with these policies that have strong national dimensions may not be adequately effective. The realities of the South African economy require that there be a strong national approach to preferential procurement.

The South African economy is a highly concentrated economy where most markets are dominated by a few large corporations (Bosiu et al, 2017).⁶ South Africa is also the most unequal country in the world where because of the historical legacy of colonialism and apartheid there is a very strong racial dimension to inequality – both asset and income inequality. This level of concentration and inequality means that SMMEs and firms owned by black people, women and people with disabilities would generally be at a large disadvantage when bidding to supply goods or services to an organ of state in the absence of preferential procurement policies and regulations. The unfairness of the situation was recognised in paragraph 5 of the judgement in the Minister vs Afribusines case:

This matter has its genesis in complaints received by the National Treasury from members of the public relating to the efficacy of the 2011 Preferential Procurement Regulations⁵ (2011 Procurement Regulations), the precursor to the 2017 Procurement

⁶For an overview of the extreme level of concentration in South Africa see for example Competition Commission (2009), *Unleashing Rivalry: Ten years of enforcement by the South African competition authorities, 1999 – 2009*, Competition Commission and Competition Tribunal, Pretoria and the more recent paper by Bosiu, T. N. Nhundu, A. Paelo, M.O. Thosago and T. Vilakazi (2017), "Research Project on Large Firms and System for Regular Tracking of their Strategies and Decisions: Top 50 firms on the Johannesburg Stock Exchange (JSE)," Industrial Development Research Programme, Working Paper 17/2007, Centre for Competition, Regulation and Economic Development, University of Johannesburg.

Regulations. State-owned enterprises also raised complaints that the 2011 Procurement Regulations created a competitive advantage for white persons as they would consistently win on price, and no corresponding emphasis was placed on the achievement of economic redress for previously disadvantaged persons. This led to the establishment of the Preferential Procurement Policy Framework Act Review Task Team (Task Team)⁶ to address these concerns.

After the task team was established the Minister promulgated the 2017 Procurement Regulations, which enabled organ of state to apply prequalification criteria. This prequalification criterion was an important element of the challenge to the regulations by Afribusiness.

c) Due to lack of capacity and capabilities organs of state always relied on the preferential procurement system prescribed by the Minister of Finance

Another practical consideration that points to the need for a strong national approach to preferential procurement is the extent to which organs of state have not developed their own procurement policies. According to Magagula (2022), "organs of state have always relied on the preferential procurement system prescribed by the Minister in the 2017 Procurement Regulations instead of establishing their own preferential procurement policies."⁷ Therefore, the question of capacity and capability of thousands of organs of state to develop and implement their own procurement policies is a crucial question to consider when developing a policy framework for preferential procurement for the public sector.

The Association of Black B-BBEE Professionals and the Black Business Council also raise concerns about capacity across organs of the state. They worry that the omission of regulations with regard to functional it will mean that there will not be proper guidance to organs of state about how to measure functionality. They express the concern that "this is going to create untold havoc because there are different capacities within these organs of state." They assert that "if these organs of state individually must determine their own objective criteria to measure functionality, it's going to create problems."⁸

d) Requesting each organ of state to have own approach to preferential procurement is divergence from international norms

Prof. Thuli Madonsela also expressed concern about "the court decisions for each organ of state to have its own approach to preferential procurement, she observed that this approach diverges from international norms. She also expressed concern that this fragmented approach to preferential procurement would lead to a "chaotic environment that will make auditing by the Auditor General difficult in addition to fostering an uneven environment for advancing equality and related constitutional compliance."⁹

⁷Sithelo Magagula (2022). "It is high time that the organs of state implement their own preferential procurement policies" in De Rebus 2022, 26. Pretoria: Law Society of South Africa. Downloaded from <https://www.derebus.org.za/it-is-high-time-that-the-organs-of-state-implement-their-own-preferential-procurement-policies/>

⁸The Association of Black B-BBEE Professionals and the Black Business Council were part of a round table convened by Prof. Thuli Madonsela. Their comments are reported in Prof. Thuli Madonsela's submission as the Law Trust Chair in Social Justice at Stellenbosch University in collaboration with participants who attended a roundtable convened as a Social Justice Think Tank on 04 April 2022, to review and respond to draft Treasury Regulations on Preferential Procurement.

⁹From Prof. Thuli Madonsela's submission on the draft Treasury Regulations on Preferential Procurement (see footnote 8 for the full reference)

e) The omission of Local procurement and content in the 2022 draft PPPFA have far reaching implication for industrial policy (Industrialisation) in South Africa

The Department of Trade, Industry and Competition (the DTIC) as well as several industry organisations and manufacturing firms have expressed concern about the omission of local procurement and content from NT's draft regulations. The impact on industrial policy goals is potentially large. The DTIC argues that the full extent of the economic costs (and not just the price implications) should be taken into account when considering the omission of local content from the preferential procurement regulations. They argue that many domestic producers will face hardship and possibly bankruptcy if imports replace domestically produced goods procured by the state. They warn of the loss of domestic capabilities and capacity.

f) Foreign and domestic investors have invested and created jobs in South Africa because of government's preferential procurement regulations

They also infer that the changes in the regulations create not just uncertainty for business but also unhappiness and distrust. Both foreign and domestic investors have invested and created jobs in South Africa because of government's preferential procurement regulations. The omission of these regulations and the possibility that new versions of preferential procurement legislation may not give preference to local content would cause economic hardship for firms who had already invested to take advantage of local content preference regulations and also for their employees and other firms in their value chains. The uncertainty about the regulations will also deter new investment and employment, particularly in sectors and for firms where the state is an important customer.

g) Omitting local content may lead to organs of state procuring imported goods instead of domestically produced goods

Another possible negative economic implication associated with omitting local content preferences from preferential procurement regulations that lead to organs of state procuring imported goods instead of domestically produced good are increased imports that could lead to changes in the trade balance and have a negative impact on the balance of payments. Taken together, there exists the potential for macroeconomic problems associated with the withdrawal of foreign investors who invested within South Africa to be able to benefit from state procurement local content preferences and potential negative trade balance effects. Economies of scale are important in the manufacturing sector and the reduction in demand by organs of state from domestic producers could therefore have a larger than expected impact on domestic output and over time on domestic production capacity. There could also be disruptions in local and regional value chains if domestic firms close down or have to reduce production. The South African economy has already suffered relatively large levels of deindustrialisation since the 1980s; the potential loss of demand from organs of state could exacerbate this problem and further impede structural transformation of the economy, which has been a goal of the South African government's policies since the release of the RDP White Paper on 1994.

The DTIC is of the view that since section 2(1)(d)(ii) of the PPPFA refers to the goals of the Reconstruction and Development Programme (RDP) it can be used to argue against local content provisions being ultra vires and to support the national government's local content policy through preferential procurement regulations.

6. Conclusion

The impact of the Constitutional Court judgement and the NT's draft Preferential Procurement Regulations is uncertain. However, we expect that the impact on South African society will not be inconsequential. The Constitution recognized the need for organs of state to utilise preferential procurement regulations in order to address past injustices and protection of people who are unfairly disadvantaged. South Africa remains an economy where unemployment, poverty and inequality place a very large proportion of the population in a situation where they are disadvantaged and the legacies of racial and gender discrimination still loom large. Expenditure by the state is a large percentage of GDP¹⁰ and has the ability to make a significant contribution to structural economic transformation, including growth of more enterprises owned by black people and women as well as deepening and diversifying the industrial base of the economy. The PBO is concerned that the ruling handed down by the Constitutional Court on 16 February 2022 and the draft Preferential Procurement Regulation put out for public comment by the NT could lead to fragmentation and weakening of preferential procurement by organs of the state.

¹⁰Bowmans the law firm in a briefing on public procurement in March 2022 says that state procurement in South Africa is almost R1 trillion a year. <https://www.bowmanslaw.com/insights/government-contracting-and-public-sector-procurement/south-africa-public-procurement-cast-into-uncertainty-by-constitutional-court-judgment/>