August 2018

STREAM 1, POLICY BRIEF 1

PROCUREMENT

Policy brief prepared for the Labour Caucus in the Jobs Summit Economic Sector Interventions working group by the Institute for Economic Justice (IEJ).

Stream: Economic Sector Interventions Stream, Brief 1

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1. NATURE OF THE PROBLEM

The South African economy has faced a slowdown since the end of the metals boom in 2011, combined with difficulties in reducing the deficit after the stimulus in 2008 and a decline in tax revenues in 2017/8. In these circumstances, it is crucial to increase aggregate demand through a stronger emphasis on local procurement by all spheres and institutions of the state as well as by large private enterprise.

The obstacles to local procurement include the following:

1. Local producers often require more time to gear up to produce a product; may require higher prices because of smaller scale or limited experience in producing a good; and may not be aware of tenders. In addition, departments often include unnecessary specifications that are repeated from earlier tenders or copied from international examples, for instance around the materials for school desks, that effectively exclude local suppliers for no reason.
2. The budget process does not require that institutions in government and major companies track and report on the share of imports in their total consumption. Outside of a few major products, they often purchase goods through intermediaries and therefore do not know if they are imported. This problem is aggravated by the fact that there is no agreed-on label to distinguish imports of final products from products assembled in South Africa using imported parts, from products where most of the value add is generated in South Africa.
3. The BBBEE requirements on supplier development have had a positive impact in encouraging procurement from smaller local suppliers, but they also have substantial weaknesses. Reporting on BBBEE is based on "measured procurement spend," which is defined to exclude imports if they are capital goods or, in the case of intermediate inputs, the company argues they cannot easily be purchased locally with the desired brand name. As a result, virtually all companies, including SOCs, generate a figure for BBBEE procurement that is close to 100%, even though they are importing substantial capital equipment and inputs. Since 2013, a prerequisite for BBBEE certification is 25% local value add (excluding labour costs) for all white-owned companies and for medium and large companies of all kinds. Black-owned small and micro enterprises are however effectively exempt from local procurement requirements. If a company procures from a small or micro trading company that is black owned, it can evade the local procurement requirements altogether. Furthermore, some imports can be excluded from the calculation, as noted above, which makes it difficult to evaluate the actual level of local procurement. Finally, it appears that this requirement may be ignored by a substantial share of companies, but more research is required to see if that is the case. Certification companies do not appear to monitor closely whether imports should be excluded from calculated procurement spend or not. In part, this reflects the fact that there are very limited quality controls on the certification companies, which are private and paid for by the companies they evaluate.
4. The budget process in the public sector poses additional regulatory obstacles to local procurement. The budget process does not require that agencies enable local producers to at least match prices for imports after they have lost a tender based on their initial bid. This procedure is permissible but not

required under current procurement regulations. Where it has been used, in some cases local companies were able to compete with imports. If local procurement will cost more than imports, especially in the short run where producers may be introducing new products, the cost is left entirely to the procuring department. That often runs contrary to their core mandate. For instance, in some cases the Department of Health must choose between a lower supply of medicines and local procurement. Addressing this problem requires a dedicated, separate fund run by the dti, which is responsible for industrialisation, to determine whether an excess cost is justified and cover the expense for the department concerned. To justify investment in local production of new goods and services often requires a commitment to long-term procurement of substantial amounts. The budget process generally makes this kind of commitment impossible. That is why, for instance, Aspen Pharmaceuticals has shifted its business model to production of niche products for the global market rather than large-scale generic production for domestic use: the public sector simply would not provide any guarantee of consistent demand.

2. PREVIOUS AGREEMENTS

The Local Procurement Accord was signed in 2013. As with the other accords, it lacked a high-level unblocking and oversight system, which meant that it has been honoured mostly in the breach. A particular problem was that many commitments had many caveats, and in the absence of a joint unblocking mechanism to address obstacles there was little incentive to implement them.

3. PROPOSALS

Core proposals would be:

1. **Both large private companies and public agencies must record the share of all imports in local procurement**, distinguishing initially between goods that are imported as final products either directly or through an intermediary from other products. Over time, more sophisticated reporting can be introduced around the level of local value add, but making that a precondition for any reporting has thus far meant that nothing is done because the technical obstacles become insuperable. Critically, the BBBEE requirements should not apply to reporting on local procurement – that is, the calculations should include capital goods and branded inputs. Unions and other stakeholders can then challenge whether or not the reporting is accurate.
2. **In the public sector, the budget process should be reformed:**
    a. To require that where imports are procured, local producers have the option of matching the procurement price;
    b. To ensure an open budget process where, for tenders over R50 million, agencies must publish the reasons for selecting a particular supplier as well as the unit price (this system has been piloted in Gauteng already);
    c. To establish a fund at the dti to review major tenders and, where justified in terms of industrial deepening or job creation/retention, cover the difference between local and imported products;
    d. To require departments to inform the dti at least two months in advance of any tender worth over R50 million, so that the dti can ensure that specifications are not unnecessarily exclusionary and identify potential local suppliers.
3. The BBBEE codes should be amended to apply to all enterprises, irrespective of size and ownership and to require a report of the share of imports in total procurement, including branded and capital goods, even if BBBEE spend is still measured only excluding these products.

4. FINANCING AND SOURCES OF FUNDING

- **The budget would have to allocate funds to the dti:** To review tenders and identify potential local suppliers, and To make up the difference in cost between local and imported products where that would contribute to industrial deepening and job creation in the medium term.

5. SEQUENCING AND TIMEFRAMES

It will take at least six months to negotiate changes to the BBBEE Codes and to change budget regulations. The fund for the dti could only be provided in the next budget.