South African Institute of Race Relations NPO

Submission to the National Treasury,
regarding the draft
Preferential Procurement Regulations, 2022
Johannesburg,
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1 Introduction

The National Treasury (the Treasury) has invited public comment, by 11th April 2022, on the draft Preferential Procurement Regulations of 2022 (the draft Regulations). These draft Regulations were published in the *Government Gazette* on 10th March 2022, under the powers conferred on the Treasury by the Preferential Procurement Policy Framework Act of 2000 (the Act).

This submission is made by the South African Institute of Race Relations (IRR), a non-profit organisation formed in 1929 to oppose racial discrimination and promote racial goodwill. Its current objects are to promote democracy, human rights, development, and reconciliation between the peoples of South Africa.

2 The urgent need to increase opportunities for the disadvantaged

Some 28 years after the political transition in 1994, it remains vitally important to increase opportunities for the poor and unemployed: the truly disadvantaged in the country. This cannot be done without overcoming key barriers to upward mobility, which include:

- a meagre annual economic growth rate, averaging some 1.3% of gross domestic product (GDP) over the past 12 years, instead of the 5% or more required;
- one of the worst public education systems in the world, despite the massive tax revenues allocated to it;
- stubbornly high unemployment rates on a broad definition (46,2% among South Africans in general and 77% among young people aged 15 to 24), made worse by labour laws that encourage violent strikes, deter job creation, and price the unskilled out of work;
- pervasive family breakdown, as a result of which some 70% of black children grow up without the support and guidance of both parents;
- electricity shortages and costs, compounded by general government inefficiency in the management and maintenance of vital economic and social infrastructure;
- a limited and struggling small business sector, unable to thrive in an environment of low growth, poor skills, and suffocating red tape; and
- a mistaken reliance on race-based affirmative action measures, which (like similar policies all around the world) generally benefit a relative elite while bypassing the poor.

Constantly ratcheting up black economic empowerment (BEE) and other 'transformation' policies, as the African National Congress (ANC) has been doing in recent years, will not help to overcome these problems. On the contrary, the continued erosion of business autonomy and business confidence will raise these barriers still higher. So too will the persistent exclusion of many of the most competitive businesses from the state's procurement of vital goods and services.

3 The negative impact of preferential procurement rules

BEE preferential procurement in state tenders has often made for enormous wastefulness. This core problem was summed up by journalist Jovial Rantao back in 2007, well before Jacob Zuma came to power and Gupta-linked 'state capture' began.

The government's declared BEE aim, wrote Mr Rantao, was to 'spend billions of rands' on delivering much needed goods and services while simultaneously empowering black business. But what many suppliers did was to 'pocket the millions' they received, buy better houses and 'the biggest and flashiest 4x4 by far' – and then use what little was left over to deliver on their contracts with the state.[1]

Inflated pricing often compounds defective delivery, as finance minister Pravin Gordhan lamented in 2010, when he said that the government was paying more for everything, from

[1] *Business Report* 23 September 2011

pencils to building materials, than a private business would: 'R40 million for a school that should have cost R15m, R26 for a loaf of bread that should have cost R7.'[2]

In 2012 Gwede Mantashe, secretary general of the ANC, voiced a similar concern, saying that BEE companies must 'stop using the state as their cash cow by providing poor quality goods at inflated prices'. He also criticised officials for 'prioritising the enrichment of BEE companies through public contracts at the expense of…quality services at affordable prices'.[3]

Later the same year, Mr Mantashe warned that the state would be ill advised to continue putting preferential procurement before service delivery. Said the ANC secretary general: 'This thing of having a bottle of water that you can get for R7 procured by the government for R27 because you want to create a middle-class person who must have a business is not on. It must stop.'[4]

One of the factors making for persistent BEE price escalation was explained in 2012 by an unnamed BEE contractor, who told *The Star* that BEE businessmen seeking state contracts had little choice but to charge inflated prices to 'recoup the costs of paying mandatory kickbacks' to corrupt officials and 'regularly donating huge sums' to the ANC and its allies.[5]

Said the businessman: 'You pay to be introduced to the political principals, you pay to get a tender, you pay to be paid [for completed work], and you must also "grease the machinery". From time to time, you are called to make donations to the ANC. There are also donations to the youth league, the women's league, and the SACP.' Those who failed to make the necessary payments either in cash or 'in kind' – by giving sub-contracts to the relatives of public servants and politicians – would find themselves excluded from state contracts worth many millions of rands.[6]

Though few other businessmen have admitted to making payments of this kind, the comment is consistent with the persistent inflated pricing that both Mr Gordhan and Mr Mantashe have lamented. It also seems to provide insight into a wider pattern of corruption estimated to be costing the state between 30% and 50% of an annual procurement budget of around R1 trillion a year.

These figures come from the Treasury itself. In October 2016 Kenneth Brown, then the chief procurement officer at the Treasury, warned that between 30% and 40% of the state's R600bn annual procurement budget was effectively being lost to 'fraud and inflated prices'.[7]

[2] *Business Day* 18, *Sunday Times* 20 September 2009
[3] *The Sta*r 22 August 2012
[4] *Business Da*y 22 August 2012
[5] T*he Star* 22 August 2012
[6] *The Star* 22 August 2012
[7] businesstech.co.za, 6 October 2016

The problem has since grown worse, for in August 2018 the Treasury's acting chief procurement officer, Willie Mathebula, told the Zondo commission of inquiry into state capture that 'the government's procurement system is deliberately not followed in at least 50% of all tenders'. This had a huge impact on service delivery, Mr Mathebula went on, because the government was 'the biggest procurer of goods and services, spending an estimated R800bn a year'. Moreover, once the usual tendering rules had been suspended, often for spurious reasons, 'a contract which started at R4m was soon sitting at R200m'.[8]

The state's current annual procurement bill is considerably larger than R800bn. According to the first part of the Zondo commission's report, published in January 2022, state procurement amounted to R967bn by 2017.[9] It is now almost R1 trillion a year.[10]

The Preferential Procurement Policy Framework Act of 2000 (the Act) is supposed to limit BEE price inflation to a maximum of 10% (on bigger contracts) or 20% (on smaller ones), as described below. In practice, however, these maximum authorised BEE weightings of 10% or 20% have signally failed to prevent the much higher price escalations highlighted by Messrs Gordhan, Mantashe, Brown, and Mathebula.

4 Relevant constitutional provisions

Section 217(1) requires that organs of state, in contracting for goods and services, must do so 'in accordance with a system which is fair, equitable, transparent, competitive and cost-effective'.[11]

Section 217(2) goes on to say that this obligation 'does not prevent the organ 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'.[12]

Section 217(3) adds that 'national legislation must prescribe a framework within which the policy referred to in subsection (2) may be implemented'.[13] The Act is, of course, the legislation that has been enacted for this purpose.

5 Key provisions of the Act

The Act lays down a mandatory 'preference point system' under which, 'for contracts with a rand value above a prescribed amount, a maximum of 10 points may be allocated' for BEE

[8] News24.com, 21 August 2018
[9] Judicial Commission of Inquiry into State Capture, Part 1, para 327 (Zondo Report) https://www.bowmanslaw.com/insights/government-contracting-and-public-sector-procurement/south-africa-public-procurement-cast-into-uncertainty-by-constitutional-court-judgment/
[10] https://www.bowmanslaw.com/insights/government-contracting-and-public-sector-procurement/south-africa-public-procurement-cast-into-uncertainty-by-constitutional-court-judgment/
[11] Section 217(1), Constitution of the Republic of South Africa, 1996]
[12] Section 217(2), 1996 Constitution
[13] Section 217(3), 1996 Constitution

status (and other specific goals), 'provided that the lowest acceptable tender scores 90 points for price'.[14]

For contracts with a rand value below the prescribed amount, up to 20 points may be allocated for BEE status (and other specific goals), provided the lowest acceptable tender scores 80 points for price.[15]

According to the Act, 'acceptable tenders which are higher in price must score fewer points on a pro rata basis'. Once this scoring exercise has been completed, the contract must be awarded to 'the tenderer who scores the highest points'.[16]

The 'specific goals' to which the Act refers include 'contracting with persons, or categories of persons, historically disadvantaged by unfair discrimination on the basis of race, gender and disability'.[17] Another specific goal is to implement the programmes of the Reconstruction and Development Programme (RDP) of 1994. In practice, however, this latter aim has fallen away, along with the RDP itself.

6 Rationale for the draft Regulations

The draft Regulations are intended to replace 2017 ones which were struck down by the Constitutional Court in February 2022.

The main problem with the 2017 regulations, according to the Constitutional Court, was that they introduced mandatory BEE pre-qualification (and sub-contracting) requirements which the Act does not authorise – and which were therefore 'invalid for being *ultra vires* the enabling section'.[18]

The Constitutional Court judgment striking down the 2017 regulations has created uncertainty as to how organs of state should comply with Section 217(2) of the Constitution. The draft Regulations are intended to fill this gap.

7 Content of the draft Regulations

7.1 General

The draft Regulations are careful to avoid the pre-qualification criteria struck down by the Constitutional Court as *ultra vires* the Act. However, some of the clauses in the draft Regulations are also *ultra vires*, albeit for different reasons.

7.2 The preference point system in procurement contracts

[14] Section 2(1)(a), Act
[15] Section 2(1)(b), Act
[16] Section 2(1)(f), Act
[17] Section 1(d)(i), Act
[18] *Minister of Finance* v *AfriBusiness NPO* [2022] ZACC 4; https://www.saflii.org/za/cases/ZACC/2022/4.pdf, paras 114-116, 118-119, at para 118

Clause 4 of the draft Regulations obliges organs of state to follow a 10/90 formula for contracts worth more than R50m. According to this formula, 10 points are awarded for BEE status and 90 points for price. Under Clause 5, essentially the same formula must be applied to contracts valued at R50m or less, where 20 points are allocated to BEE status and 80 to price.[19]

The Act is silent as to what the prescribed amount should be, but the draft Regulations peg this at R50m, as did the 2017 ones. When the amount of R50m was introduced in the 2017 regulations, it marked an extraordinarily high – almost 5 000% –increase on the R1m amount which had initially been set and which had remained in place for many years.

This enormous increase greatly expanded the extent to which cost-effectiveness and competitiveness could be subordinated to BEE status for the benefit of a small black elite – and to the detriment of the great majority of black South Africans.

Since the Act itself is silent as to what this threshold or 'prescribed amount' should be, the draft Regulations should at minimum return to the R1m level that earlier prevailed. Ideally, the Regulations should reduce this even further (say, to R500 000) to ensure better value for money and reduce the harm being done to the black majority.

7.3 Tenders to generate income or dispose of or lease assets

Clauses 6 and 7 of the draft Regulations deal with the disposal or leasing of assets by organs of state as well as state initiatives to 'generate income'.[20] These clauses are *ultra vires* the Act, which deals solely with procurement or the purchasing of goods and services by state entities. Procurement is fundamentally different from the disposal (or leasing) of assets owned by the state and also from state activities aimed at generating income.

In addition, Clauses 6 and 7 emphasise the need for the state to accept the 'highest acceptable tender' in these instances.[21] This wording conflicts with the Act which – since it deals with procurement, and not with disposal – expressly requires that acceptable tenders with higher prices be ranked below acceptable tenders with lower ones.[22]

Clauses 6 and 7 are entirely at odds with the Act and must be excised from the draft Regulations.

7.4 Criteria for breaking any deadlock in scoring

Under Clause 8 of the draft Regulations, 'if two or more tenderers score an equal number of points, the contract must be awarded to the tenderer that scored the highest points for specific goals'.[23]

[19] Clauses 3 to 5, draft Regulations
[20] Clauses 6, 7, draft Regulations
[21] Clauses 6, 7, draft Regulations
[22] Section 2(1)(c), Act]
[23] Clause 8(1), draft Regulations

Since RDP-related specific goals have fallen away, what the draft Regulations envisage is that any tie between competing tenders should be resolved by awarding the contract to the tenderer with the most BEE points. However, this clause is *ultra vires* the Act, which makes no provision for breaking deadlocks in this way.

An automatic preference for BEE status in these circumstances is also contrary to Section 217 of the Constitution, as earlier described. There is nothing in the wording of Section 217(2) that automatically allows BEE considerations to trump the need for 'fair', 'competitive', and 'cost-effective' procurement, as set out in Section 217(1). On the contrary, Section 217(2) makes it clear that preferential procurement is optional, not obligatory.

According to Section 217(2), the emphasis on cost-effectiveness in Section 217(1) 'does not prevent' organs of state from implementing procurement policies with constitutionally permitted 'categories of preference' The 'does-not-prevent' wording used in Section 217(2) is clearly permissive. It does not make preferential procurement compulsory, let alone give it the capacity to trump the need for cost-effectiveness, as stressed in Section 217(1). The Act – which is generally in line with the Constitution in this regard – also does not attempt to give BEE a trumping status. Clearly, thus, the Regulations cannot include a trumping clause that neither the Act nor the Constitution allow.

In addition, the trumping provision in Clause 8 is at odds with Judge Raymond Zondo's interpretation of what Section 217 requires, as set out in the first part of his commission's report into corruption and state capture, published in January 2022.

According to Judge Zondo, the wording of Section 217 '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)?'[24]

This is the wrong question to ask, however, as the 'does-not-prevent' wording used in Section 217(2) cannot give preferential procurement priority over the 'least cost' procurement emphasised in Section 217(1). Judge Zondo also errs in assuming – given all the problems of fraud and inflated pricing earlier described – that tender awards generally 'satisfy both objectives of the Constitution'.[25]

However, Judge Zondo is correct in noting that there is likely to be confusion at times within state entities as to which objective is to prevail. In this situation, says Judge Zondo, 'the primary national interest is best served when the government derives the maximum value-for-money in the procurement process'.[26] In other words, it is Section 217(1) which must prevail

[24] Zondo report, para 529
[25] Ibid, para 530
[26] para 532

– and procurement officers in all spheres of government 'should be so advised', he concludes.[27]

The commission's identification of 'value-for-money' as the overarching national priority in public procurement is an important one. It should not have been overlooked by the Treasury in drawing up the draft Regulations. Clause 8 is thus inconsistent with the Constitution as well as *ultra vires* the Act, and it must be excised.

8 Ramifications of the draft Regulations

When the ANC urged the introduction of BEE in 1994, it said this was aimed at 'removing all the obstacles to the development of black entrepreneurial capacity' and 'unleashing the full potential of all South Africans to contribute to wealth creation'. But BEE requirements have in fact eroded black entrepreneurship, while constraining growth and fostering dependency.

Richard Maponya, a veteran black businessman who started out as a clothing salesman in Soweto in the 1950s and established his own dairy business in the 1970s, warned in 2012 that BEE was significantly harming black business. He urged that all BEE requirements be scrapped – and particularly the preferential procurement system. Said Mr Maponya: 'In my day there was nothing like a tender turning people into billionaires overnight. It's a terrible system that has created corruption from top to bottom, and it's a system which should be done away with.'[28]

Professor William Gumede, Associate Professor at the Wits University School of Governance, agrees, saying that BEE has created 'a select group of political fixers' who pretend to be 'genuine entrepreneurs' but are nothing more than middlemen with 'access to government contracts'. The government should have focused on helping 'the five million real black entrepreneurs who have been running their own micro-, small- and medium-sized businesses since the apartheid era', whether in the form of 'taverns, spaza shops, butcheries, or taxi companies'. This group already has 'business experience and skills' but needs more access to finance to 'transition up the value chain'. But these businesspeople are 'not connected to the ANC' and are thus excluded both from policy formulation and the state assistance supposed to be available to black South Africans.[29]

Adds Professor Gumede: 'By focusing on empowering political capitalists, BEE has killed off legitimate black and white small and medium-sized businesses; and discouraged existing and potentially black entrepreneurship. BEE…is wasteful, unfair, and actually disadvantages both capable white and black people. It does nothing to address the structural issues which prevent capital accumulation and wealth building in the black community. [These include] issues around education, [thanks to which] almost all black children do not graduate from high school and are functionally illiterate and innumerate.'[30]

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[27] para 532
[28] *Financial Mail*, 16 November 2012
[29] https://www.wits.ac.za/news/latest-news/opinion/2020/2020-11/how-real-bee-can-help-ordinary-folk.html
[30] Ibid

BEE is a key part of the reason South Africa's real economic growth rate – at 1.3% of GDP on average since 2010 – has lagged so far behind those of its emerging market peers. Had it not been for this damaging policy (and a host of other ill-advised interventions), South Africa could have matched the growth rates notched up by other emerging markets and sub-Saharan African countries between 2010 and 2017. If it had succeeded in doing so, said the Bureau for Economic Research (BER) at the University of Stellenbosch in an October 2018 report, 'the South African economy could have been up to 30% or R1-trillion larger, and created 2.5 million more jobs', while tax receipts would have risen by around R1 trillion too.[31]

As the BER's research underscores, what business most needs for increased success is not the race-based preference system envisaged in the draft Regulations but a much faster rate of economic growth. Ideally, growth should rise to at least 5% of GDP a year, which would see the economy doubling in size every 14 years. This would vastly expand economic opportunities while generating millions more jobs and greatly increasing domestic consumer demand.

At the same time, the quality of schooling must be greatly improved. Some 80% of public schools are dysfunctional, while almost half the pupils who start in Grade 1 leave school without reaching Grade 12 or passing their matric examinations. Mainly because their schooling leaves most students poorly prepared, completion rates at universities are dismal too, averaging a mere 17% for undergraduate degrees in 2019.[32]

The country's defective public education system, coupled with its unemployment crisis, puts the most vulnerable people at a particular disadvantage. As research by the FinMark Trust has shown, the people most likely to succeed in business are those who come from stable two-parent families, have the benefit of solid schooling, obtain university degrees, work for several years in existing firms, have a strong entrepreneurial spirit – and branch out on their own when they already developed significant skills and experience on which to draw. If such entrepreneurs are to build up their businesses, they must also have the benefit of a rapidly expanding economy with low unemployment rates and growing consumer markets.

This is a proven formula for success. In South Africa, however, only 30% of black youngsters grow up in two-parent homes, while the great majority attend dysfunctional public schools which often fail to equip them with even the most basic skills. Not surprisingly, many then battle to find jobs. This is partly because South Africa's growth rate has long been too low. Also relevant, however, are minimum wage and other labour laws which raise entry level salaries so high as to price the inexperienced and poorly skilled right out of the jobs market.

These factors – coupled with a crippling burden of red tape, high crime rates, often poor infrastructure, and limited access to venture capital – combine to put black entrepreneurs at a

[31] John Endres, 'Growth & Recovery: A Strategy to #GetSAWorking', IRR, August 2020, p4
[32] Centre for Risk Analysis, 'SA's Education and Skills Mismatch', Macro Review, March 2022, p17

severe disadvantage. These fundamental obstacles to their success cannot be overcome through a simplistic reliance on preferential state procurement.

9 Unconstitutionality of the draft Regulations

The draft Regulations do not comply with any of the three *Van Heerden* tests laid down by the Constitutional Court in 2004 and are therefore unconstitutional too.

The *Van Heerden* dispute dealt with the validity of differing pension rules for pre- and post-1994 MPs under Section 9 of the Constitution (the equality clause). According to the Constitutional Court's judgment in this case, race-based affirmative action measures cannot be presumed to be unfair – notwithstanding the Constitution's prohibition of unfair racial discrimination – because they are 'authorised remedial measures'. Instead, their validity depends on the three-fold test of whether (1) they target the disadvantaged, (2) are designed to 'advance' them, and (3) promote 'the achievement of equality'.[33]

Since these tests are conjunctive, all three must be met. In addition, though the tests were laid down in the context of the equality clause, they are equally applicable to Section 217(2) which seeks to bring about the 'advancement' of those 'disadvantaged' by unfair discrimination and so prevent what the Constitutional Court described in the *AfriSake* case as 'the widening of the gap'.[34] In fact, however, the draft Regulations fail all the *Van Heerden* tests.

9.1 The first test: targeting 'the disadvantaged'

As regards the first *Van Heerden* test, most beneficiaries of the draft Regulations will not be 'the disadvantaged'. Rather, they will the most advantaged group within the black population: the roughly 15% with the best skills and/or political connections.

Like similar affirmative action interventions all around the world, the draft Regulations will help only a relatively small elite within the previously disadvantaged group, or what India calls 'the creamy layer'.[35]

By contrast, the 11.2 million black people[36] who are currently unemployed on the expanded definition – and often lack a matric, pertinent skills, relevant business experience, and strong links to the ruling party – will have little or no realistic prospect of ever being awarded state procurement contracts under the draft Regulations.

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[33] *Minister of Finance and Other* v *Van Heerden* [2004] SACC 3, para 37; De Vos and Freedman, *South African Constitutional Law in Context*, p536;Dave Steward, 'Tightening the screws: the true significance of the Employment Equity Amendment Bill', *Politicsweb.co.za*, 14 December 2018

[34] AfriBusiness, op cit, para 98

[35] *Business Day* 7 May 2010, 21, 30 September 2010

[36] http://www.statssa.gov.za/publications/P0211/P02114thQuarter2021.pdf , p43

9.2 The second test: 'advancing' the disadvantaged

Under the second *Van Heerden* test, an affirmative action measure is valid if it is 'designed to advance' the disadvantaged. The draft Regulations fail this test too, for they have little capacity to 'advance' the great majority of black people – and will hurt them instead.

BEE preferential procurement has greatly facilitated corruption and is the main reason why the prices paid by the state for goods and services are often so absurdly high: R40m for a school that should have cost R15m, as Pravin Gordhan said in 2009, R27 for a bottle of water that should have cost R7, as Gwede Mantashe added in 2012 – and a staggering R238 000 for a wooden mop, as Eskom reported in 2021.[37]

These are not isolated instances, moreover. Rather, as Mr Mathebula told the Zondo commission in 2018, Treasury procurement rules intended to ensure cost-effectiveness are deliberately not followed in at least half of all state contracts. And once some excuse has been found to bypass normal procurement requirements, 'a contract which starts at R4m is soon sitting at R200m', as Mr Mathebula warned.

Inflated pricing wastes scarce tax revenues, adds to public debt, pushes up debt servicing costs, and reduces the money left over for the delivery of vital goods and services. Often, too, what is delivered is partial and deficient, adding to the wastage. The people who bear the brunt of this defective delivery are the majority of black South Africans, who cannot afford to buy from the private sector and are compelled to rely on the government for such core needs as education, housing, healthcare, sanitation, and water.

In addition, BEE rules have long been so unduly onerous – and so constantly in flux – as to deter fresh investment, encourage disinvestment, and hobble the economic growth and expanding employment vital to upward mobility. The people who suffer the most from this economic malaise are again the majority of black South Africans.

9.3 The third test: promoting the achievement of equality

According to the third *Van Heerden* test, an affirmative action measure is valid only if it 'promotes the achievement of equality'. The draft Regulations fail this test as well.

If BEE preferential procurement was able to promote the achievement of equality for the great majority of black people, this would have become apparent in the 22 years since the Act took effect. Instead, income inequality, as measured on the Gini coefficient, has increased significantly. This is largely because BEE, including its procurement element, has widened inequality within the black majority by helping a small and often politically connected group to forge ahead, even as some 11.2 million black South Africans have remained jobless and mired in destitution.

[37] *Business Day* 22 August 2012

Growing inequality within the black majority is particularly severe, as the South African Communist Party (SACP) has pointed out. Intra-black inequality is far higher than inter-racial inequality and is the main reason – given the size of the black population – why South Africa is currently an even more unequal country than it was in 1994. Then its Gini co-efficient was 59. Now it stands at 67, making South Africa the most unequal nation among the 164 countries the World Bank measures.[38]

Official figures on changes in South Africa's income distribution further confirm that preferential procurement has not helped achieve equality for the poorest black people. In 2015, according to Statistics South Africa, the bottom 40% among black South Africans obtained a mere 3.7% of national income. This small share of national income was almost identical to the meagre 3.4% this group had gained in 2006.[39]

By contrast, the top 10% among blacks gained 26% of national income in 2015, up from 19% in 2006, while the remaining 50% of blacks obtained 22% of the total (up from 16% in 2006). If so-called 'coloureds' and Indians are counted too, the top 10% among black South Africans obtained 32% of national income in 2015. By contrast, the top 10% among whites gained 11% (down from 18% in 2006) – or three times less.[40]

This decline among the white top 10% is generally ignored by the government as it contradicts its preferred narrative of unbroken white economic power and privilege since 1994. The ANC has also declined to acknowledge that BEE's preferential procurement and other requirements have clearly not worked for the bottom 40% of black South Africans – whose share of national income has stagnated even as BEE rules have been ever more stringently applied.[41]

Since the draft Regulations fail all three of the *Van Heerden* tests, they are unconstitutional and cannot lawfully be adopted.

10 No SEIA reports made available

Since September 2015 all legislation and regulation in South Africa must be subjected to a 'socio-economic impact assessment' before it is adopted. This must be done in terms of the Guidelines for the Socio-Economic Impact Assessment System (SEIAS), developed by the Department of Planning, Monitoring, and Evaluation in May 2015. The aim of this system is to ensure that 'the full costs of regulations and especially the impact on the economy' are fully understood before new rules are introduced.[42]

[38] Editorial, *The African Communist*, 1st Q 2017, Issue 116, February 2017; Steward, 'Tightening the screws', 14 December 2018; https://www.businesslive.co.za/bd/opinion/editorials/2022-03-15-editorial-give-serious-thought-to-the-world-banks-recommendations-on-inequality-and-policy-failures/
[39] Gabriel Crouse, 'Why race is not a proxy for disadvantage', *The Daily Friend*, 12 November 2020
[40] Ibid
[41] Ibid
[42] SEIAS Guidelines, p3, May 2015

According to the Guidelines, the SEIA system must be applied at various stages in the policy process. Once new regulations (or other rules) have been proposed, 'an initial assessment' must be conducted to identify different 'options for addressing the problem' and making 'a rough evaluation' of their respective costs and benefits. Thereafter, 'appropriate consultation' is needed, along with 'a continual review of the impact assessment as the proposals evolve'.[43]

A 'final impact assessment' must then be developed that 'provides a detailed evaluation of the likely effects of the [regulation] in terms of implementation and compliance costs as well as the anticipated outcome'. When the regulation is published 'for public comment and consultation with stakeholders', the final assessment must be attached to it.[44]

The Guidelines stress that the SEIA system must be applied not only to legislation, but also to 'significant regulations' and any 'major amendments of existing regulations…that have country coverage with high impacts'. In addition, where 'legislation provides an enabling framework for more detailed regulations', as the Act does, then 'the subordinate regulations should be the main subject of the assessment process'.[45]

However, no SEIA reports on the draft Regulations have been made available, as the Guidelines require. This has undermined necessary public consultation and made it more difficult for the public to know about the issues raised or to have an adequate say on the rules that are to govern them.

11 A better and constitutional alternative

Instead of adopting the draft Regulations (and otherwise ratcheting up BEE requirements), the country needs to embrace a new system of 'economic empowerment for the disadvantaged' or 'EED'.

EED differs from BEE in two key ways. First, it no longer uses race as a proxy for disadvantage. Instead, it cuts to the heart of the matter by focusing directly on disadvantage and using income and other indicators of socio-economic status to identify those most in need of help. This allows racial classification and racial preferencing to fall away, thereby helping South Africa to uphold the founding value of 'non-racialism' embedded in the Constitution.

Second, EED focuses on providing the inputs necessary to empower poor people. Far from overlooking the key barriers to upward mobility, it seeks to overcome these by focusing on all the right "**E**s". In essence, it aims at rapid **e**conomic growth, excellent **e**ducation, very much more **e**mployment, and the promotion of vibrant and successful **e**ntrepreneurship.

[43] Guidelines, p7
[44] Guidelines, p7
[45] Guidelines, p8

EED policies aimed at achieving these crucial objectives should be accompanied by a new EED scorecard, to replace the current BEE one. Under this revised scorecard, businesses would earn EED points for such contributions as:

- making direct investments in the country;
- maintaining and, in particular, expanding jobs;
- contributing to tax revenues and R&D spending;
- helping to generate export earnings; and
- topping up the tax-funded vouchers provided to low-income families to enable them to purchase the sound education, healthcare, and housing of their choice.

The voucher element in EED is particularly important because it reaches right down to the grassroots to equip poor households with the sound schooling, housing, and healthcare they need to help them get ahead.

According to the National Treasury's *Budget Review 2022*, some R790bn has been budgeted for basic schooling, healthcare, and housing/community development in the 2022/23 financial year.[46] But the state's centralised and top-down delivery system is so inefficient and mismanaged – often because racial targets are given precedence over workplace skills and cost-effective procurement – that outcomes are generally extraordinarily poor.

As regards education, 'most primary and secondary schooling is, by some metrics, even worse than it was previously', in the apartheid era.[47] Hence, even those who pass their matric examinations are often functionally illiterate and innumerate. They thus lack a sound foundation either for on-the-job training – for those lucky enough to find employment – or for success in tertiary studies.

In the housing sphere, the state's 'free' RDP homes are tiny and often badly built, while delivery has flagged to the point where the housing backlog (at 2.2 million units) is bigger than it was in 1994 (1.5 million). In public health care, most hospitals and clinics are so badly managed that only about 15% adequately meet minimum standards on such essentials as infection control and the availability of medicines.[48]

EED recognises that state spending is already high and cannot be increased. Hence, the key need is rather to get far more bang for every tax buck. This can be achieved by redirecting much of the revenue now being badly spent by bureaucrats to tax-funded vouchers for schooling, housing, and healthcare for the poor. Low-income households empowered in this way would have real choices available to them. Schools and other entities would have to compete for their custom, which would help to hold costs down and push quality up.

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[46] http://www.treasury.gov.za/documents/national%20budget/2022/review/FullBR.pdf, p iv

[47] David Benatar, The Fall of the University of Cape Town: Africa's leading university in decline', https://www.amazon.com/Fall-University-Cape-Town-university/dp/3982236428

[48] *Business Day* 6 December 2017, *Sunday Times* 6, 14 January 2018, *The Citizen* 19 September 2018; IRR, *2019 South Africa Survey*, p761; *Financial Mail* 19 July 2018; Office of Health Standards Compliance, *Annual Inspection Report 2016/17*, p31

In the schooling sphere, dysfunctional public schools would have to up their game, while many more independent schools would be established to help meet burgeoning demand. In the housing arena, people could stop waiting endlessly on the state to provide and start building or upgrading their own homes. In the healthcare sphere, people could join low-cost medical schemes or take out primary health insurance policies, giving them access to sound private care.[49]

Unlike BEE, these vouchers would truly empower the poor – as ordinary South Africans seem well aware. In December 2020, for example, some 75% of black respondents in an IRR opinion poll supported the idea of schooling, health care and housing vouchers. In addition, 74% of black respondents said these vouchers would be more effective than BEE in helping them to get ahead. [50]

After two decades of damaging preferential procurement and other BEE policies, it is time to call a halt. South Africa cannot hope to expand opportunities for the disadvantaged unless it raises the annual growth rate to 5% of GDP or more. A shift to EED will help achieve this. By contrast, the draft Regulations (especially when combined with other transformation policies) will keep the economy mired in its current low- or no-growth path.

12 The way forward

Three of the key clauses in the draft Regulations (Clauses 6, 7 and 8) are *ultra vires* the Act for the reasons earlier outlined. The key remaining clauses (Clauses 4 and 5) are in keeping with the Act but fail the three *Van Heerden* tests and are therefore unconstitutional.

Under the principle of subsidiarity, the Act is currently the legislative lens through which the provisions of Section 217(2) must be interpreted. New regulations in keeping with the Act should therefore be adopted and kept in place until such time as an EED statute is enacted to revitalise the economy and give real substance to empowerment.

The new regulations under the current Act should focus on limiting the damage being done to the great majority of South Africans by preferential procurement requirements. The 'prescribed amount' referred to in Section 2(1) of the Act should thus be set at R500 000, rather than R50m, so as to confine the larger 20% BEE preference to state procurement contracts below this value.

Also important is Section 3 of the Act, which allows the finance minister, on request, to exempt organs of state from all the provisions of the Act if this is 'in the public interest'.[51] Limiting the enormous damage being done by preferential procurement is clearly 'in the public interest'. The new regulations should therefore instruct all organs of state with

[49] Anthea Jeffery, 'EED is for real empowerment, whereas BEE has failed', *@Liberty*, IRR, Issue 31, April 2017, pp5-8
[50] IRR, *2020 Race Relations Survey*
[51] Section 3(c), Act

procurement budgets exceeding R5m to request exemption in the public interest. They should also instruct the minister to grant all these exemptions.

This is the quickest way to restore a necessary emphasis on 'value for money' in state procurement – as Section 217 of the Constitution requires and Judge Zondo has urged. These new rules would help enormously to protect the poor black majority from the fraud, inflated pricing, and defective delivery that plague so much of state procurement. Together with the speedy adoption of EED, they offer the best mechanism to empower the truly disadvantaged, help bring about their 'advancement' – and start narrowing the gap between the 15% of black people who benefit from BEE and the 85% of black South Africans who are greatly harmed by it instead.

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