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- Policy management, governance and poverty alleviation in the Western Cape
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- Culture, language and identity



# Municipal procurement and the poor

A case study of three municipalities in the Western Cape Province

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Amiena Bayat,  
Zunaid Moolla*

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Project: Policy Management, Governance and Poverty Alleviation in the Western Cape

This new research programme focuses on the three key areas of government activity in housing, health and employment, through:

1. policy reviews, which entail analysis of policy documents prepared by each level of the governing hierarchy to assess their appropriateness and to determine the coherence of policy between different levels of government, and interviews with key informants at all three levels of government;
2. process studies, which are informed by the findings of the policy reviews. As well as assessing the policy framework, the process studies entail interviews with officials at different levels of the administrative hierarchy in both provincial and local governments;
3. a skills audit, aimed at comparing skills in health departments with the requisite skills for optimal health care delivery (in terms of financial management, strategic management, technical skills etc) and entailing a review of departmental organograms, of the skills and qualifications of key staff and of the quantity and quality of human resources training available to staff, as well as interviews with both management and workers; and
4. analysing the interface between the state and civil society, aimed at establishing how ordinary citizens perceive the services delivered to them and ascertaining what they believe to be their entitlements and obligations as citizens.

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2005

## Introduction

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Since 1994, the South African government has placed great emphasis on service delivery and improving the social and economic condition of the poor. However, despite progressive legislation and massive investment in infrastructure, poverty and inequality remain key features of the South African economy. Budlender (2001:93) suggests that both poverty and inequality may have increased between 1994 and 1998, a finding supported by a recent official publication using the results of the 2000 income and expenditure survey (Stats SA, 2001). In addition to this, income inequality within race groups has increased, particularly among the black population with upper and lower quintiles showing the widest disparity. Terreblanche (2003) sees this as part of a deliberate policy to encourage the creation of a Black middle class, while Bond (2004) attributes this to the neo-liberal philosophy that has underpinned both fiscal and monetary policy. Other analysts argue that this is an expected outcome when a clearly articulated poverty alleviation strategy is not in place at the national level (Parker, 2002). What is cited as evidence is the following: the average income of black households fell by 19% between 1995 and 2000, while average white household incomes rose by 15% after adjusting for inflation. This increased the income inequality ratio between white and black households from four times in 1994, to six times in 2000 (De Swart, 2003). So while economic growth in the Western Cape was higher than the national average, those benefiting most from this growth were people in the upper income categories. Ebrahim Rasool, Premier of the Western Cape, commented on this in his Budget Speech in 2003,<sup>1</sup> pointing out that the tertiary sectors experienced the highest growth in the provincial economy, particularly financial services, business processing and real estate. These sectors rely mostly on higher skills levels. Since the African and Coloured populations are relatively less skilled than their White counterparts, the large major-

ity of historically disadvantaged groups did not feel the benefits of this growth. Secondary and primary sectors, where African and Coloured labourers pre-dominate, were both net shedders of jobs particularly in manufacturing, mining and construction, while agriculture, fishing and energy made some net gains in employment.

In the absence of sufficient foreign direct investment and domestic inward investment to drive growth across sectors, national government is being pressurised to introduce incentives for investment in specific sectors in the form of prescribed assets or similar instruments. Along this line of thinking, a frequently asked question is whether government, particularly at the provincial and local levels, can exert a more pronounced influence on investment patterns through its own budgets and expenditure items.

This paper explores ways in which government can leverage its resources to draw disadvantaged communities into local economic development. The option that is considered, in particular, is the use of procurement policies and budgets of local governments. This will, of course, require municipalities to modify their procurement policies to include poverty alleviation as a major objective. Thereafter procurement activities would have to be placed under intense scrutiny to ensure that these objectives are achieved. The two most important changes that would be required for this would be, firstly, a greater emphasis on poverty alleviation as a core objective of policy and secondly, the continuous setting of targets to reflect the needs for local economic development (LED).

The first part of this paper maps the regulatory framework to examine if there is sufficient room for the poor to benefit from legislation. The second part of the paper looks at the implementation of the procurement policies in three local municipalities in the Western Cape Province and its consequences for the poor. In the analysis of the impact of procurement on local economic development, the multiplier effect is used to illustrate the potential poverty alleviation effects of involving

the poor within a community. Lastly, conclusions are drawn and recommendations offered with a view to illustrating the potential of a preferential procurement policy if carefully crafted to create opportunities for Black Economic Empowerment (BEE) in order to address the pressing issue of poverty alleviation. In the conclusion, it is found that procurement within the three municipalities is only widening the income gap between the rich and poor since only a small percentage of procurement budgets are going to historically disadvantaged institutions (HDI) and BEE companies.

## Current regulatory framework

In the developing world the question of regulatory reform has become an essential part of the discourse on local economic development and anti-poverty programmes. It is recognised that the regulatory framework is established by both central and local governments and is designed to apply nationally and locally. Essentially, the regulatory framework sets the parameters for development in general but more specifically for the local/municipal environment. The regulatory framework comprises a wide range of laws, including local government laws, ordinances, legislation and regulations related to town planning, public health, building and land development and procurement (Vanderschueren et al., 1996). There are several aspects of the South African regulatory context that deal specifically with procurement. They include the *Preferential Procurement Policy Framework Act* (PPPFA), its regulations, the *Municipal Financial Management Act* (MFMA), and the *Broad-Based Black Empowerment Act* (BBBEA) as well as other Acts that deal indirectly with it, such as the *Skills Development Act* and the *Employment Equity Act*.

Procurement reforms in government started in 1995 and were directed at two broad focus areas, namely the promotion of principles of good governance and the introduction of a preference system to address certain socio-economic objectives. The procurement reform proc-

esses were supported by the introduction of a number of legislative measures, including the adoption of the *Public Finance Management Act* (PFMA) and the PPPFA.

The procurement reform initiatives were given further impetus when, in November 2000, the “Report on Opportunities for Reform of Government Procurement in South Africa” was presented to Cabinet. Cabinet endorsed the thrust of the report and directed that the Minister of Finance, in consultation with other relevant ministers, address the details where necessary. As the procurement reform measures in the national sphere of government were adopted by the other organs of state, very divergent interpretations of government’s procurement objectives and strategies became evident. To assist the National Treasury in guiding a more uniform implementation approach, a Joint Country Procurement Assessment Review (CPAR) was conducted during 2001/02 with the World Bank. The CPAR revealed a number of deficiencies that needed to be addressed. Some of the main difficulties highlighted then, which continue to pose a problem, are:

- there is inadequate provision for capacity building for disadvantaged enterprises to successfully compete for government contracts; and
- preferential procurement policies are not clearly formulated and targets are not set for the introduction of sunset and graduation provisions once targets had been achieved.

The above recommendations, among other factors, led to the promulgation of the Preferential Procurement Policy Regulations and the introduction of the *Municipal Finance Act* (MPA). The following is a brief overview of the various Acts and regulations that make up the regulatory framework with regard to procurement.

## Preferential Procurement Policy Framework Act

The PPPFA (Act 5 of 2000) and its regulations are applicable to state organs. The Act provides that all state organs implement a preference system in the allocation of contracts for categories of service providers to advance the interest of disadvantaged persons. According to the PPPFA, the specific goals and objectives of a preferential procurement policy *may* include provisions to encourage and support:

- increased participation of HDIs in provincial procurement opportunities;
- increased participation by small and medium enterprises (SMEs);
- the promotion of local labour;
- the promotion of joint ventures and partnerships;
- linkages between small and large enterprises;
- the promotion of skills transfer and training of the historically disadvantaged;
- the creation of employment;
- the promotion of a uniform procurement approach in all provincial procurement substructures.

The PPPFA provides the enabling legislation and framework for all organs of state to develop policies to address their specific requirements. In essence, the enabling legislation provides for procurement preferences to be based on a variety of factors, such as race, gender, disability, the factor-intensity of the industry, training programmes, labour conditions, environmental impact, firm size, location, intra-industry links and economic multiplier effects. In this context it should be noted that this policy needs to conform to all legislation on preferential procurement as promulgated by the National Treasury.

The PPPFA makes provision for a points system for awarding contracts that is based on either an 80/20 or a 90/10 calculation. Where the estimated tender value is equal to, or below, R500 000, up to a maxi-

imum of 80 points are awarded on the basis of functionality and price. Where the tender value is estimated above R500 000, a maximum of 90 points are awarded on the basis of functionality and price. The remaining 20 and 10 points, respectively, are allocated to HDI criteria or any other specific goals that a particular municipality may prescribe. The 80/20 and 90/10 policy is aimed at getting the lowest cost and functionality and combining it with preferential procurement goals.

A procurement policy may ignore the points formula if it has local economic goals that can only be achieved by doing so. Thus pro-poor objectives may be pursued within the points allocation framework or even in spite of it if local economic goals dictate this. The Act thus allows municipalities and other state organs to develop pro-poor procurement policies if they deem it necessary.

### Preferential Procurement Regulations

The PPPFA has a set of accompanying regulations and goals for tendering conditions. The tendering conditions may stipulate specific goals. Those specific to pro-poor, local economic development and poverty reduction/alleviation are listed below:

- the promotion of enterprises located in a specific province for work to be done or services to be rendered in that province, region or municipal area;
- the promotion of enterprises located in rural areas;
- the empowerment of the work force by standardising the level of skill and knowledge of workers; and
- the upliftment of communities through, but not limited to, housing, transport, schools, infrastructure donations and charity organisations.

These pro-poor local economic goals within the preferential procurement policy framework regulations are not mandatory. However,

they can be incorporated within the 80/20 and 90/10 point system, which is mandatory. This means that the Act and its regulations allow for municipalities to incorporate pro-poor policies if they deem it necessary.

## The Municipal Finance Management Act (MFMA)

The MFMA, as a further extension of the PFMA, aims to assist municipalities to maximise their capacity to deliver services. The Act is clear on measures for combating fraud, corruption, favouritism and unfair and irregular practices and seeks to promote the ethical behaviour of officials and other role-players involved.

Each municipality and each municipal entity must have and implement a supply chain management policy that gives effect to the provisions of the supply chain management provisions within the Act. The supply chain management policy must be fair, equitable, transparent, competitive and cost-effective. The Act places considerable emphasis on efficiency in the provision of services and achieving financial value for money and seeks to buttress this with a strong code of conduct for municipal officials in order to combat corruption. Supply chain management is an integral part of the MFMA, which intends to introduce international best practice to the procurement process. It seeks to breach the gap between traditional methods of procuring goods and services and the balance of the supply chain and at the same time addressing procurement-related matters that are of strategic importance.

A possible interpretation of the MFMA gives local municipalities the opportunity to develop policies that are pro-poor and incorporate them into the ambit of procurement. Thus the procurement policy function is to provide institutional support that would bring the poor into the procurement loop in order to make the MFMA pro-poor.

Among the responsibilities of supply chain management is for the municipality to maintain a database to support monitoring the extent

to which government's procurement reform objectives are met, the manner in which policy is implemented in respect of government's procurement reform objectives, the manner in which targets are set and attained, as well as delivery mechanisms and whether value for money is obtained. This performance review provision can be used for enabling and monitoring the pro-poor effects of a procurement policy. This performance review could be used to identify and evaluate issues around the effects of the procurement policy on the poor and how the policy may be adapted to benefit the poor in the long run.

## The Broad-Based Black Economic Empowerment Act

The BBBEEA expands the framework provided for procurement policies in the PPPFA to take into account and apply codes of good practice for BEE. It provides for the use of qualification criteria for the issuing of licenses, the sale of state-owned assets and the entering into of public/private partnerships. The Act envisages the strengthening of government's legislative and other policy instruments towards achieving its BEE objectives. This includes the PPPFA and its associated regulations.

During the past several years, government has initiated a number of strategies over a broad area to bring about structural change in the economy. In all government programmes the extent to which black people benefit is a fundamental criterion of operation and success. Consequently, actions and policies that will have the effect of bringing about black economic empowerment will have an impact on many spheres of society and the economy. In this context, government's procurement policies have a major role to play as a collective instrument of policy.

The Act states that government will use a 'balanced scorecard' to measure progress made in achieving BEE by enterprises and sectors. The use of a common scorecard by different stakeholders provides a basic framework against which to benchmark the BEE process in differ-

ent enterprises and sectors. The scorecard will measure three core elements of BEE:

1. direct empowerment through ownership and control of enterprises and assets;
2. human resource development and employment equity; and
3. indirect empowerment through preferential procurement and enterprise development.

Unfortunately there is no specific reference made to address poverty. Nevertheless, poverty alleviation can also benefit from the BBBEE initiatives via the promotion of small, medium and micro enterprise (SMME) development and subcontracting arrangements. This can include pro-poor procurement policies as part of a broad poverty alleviation strategy. It is not enough to only advance established BEE companies but other HDIs should also be drawn into the procurement loop, since among the BBBEE Act's specific objectives is the promotion of economic transformation and the empowerment of local and rural communities.

## Procurement in the municipal context

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Within the PPPFA and its regulations each municipality develops its own procurement policy. Municipalities employ different institutional arrangements when procuring goods and services. This section provides an overview of the extent to which procurement has achieved its targets as envisaged in the targeted procurement policies of three municipalities, namely the City of Cape Town (CoCT), Drakenstein and Bitou municipalities. For each municipality we discuss the following:

- demographics;
- budget for procurement;
- staff employed;
- targets set and met;

- institutional arrangements; and
- procurement policies of the municipalities

The municipalities were chosen on the basis of their size and the institutional arrangements that govern procurement. The CoCT is by far the largest of the three chosen and of all municipalities in the Western Cape Province (WCP). The municipality serves roughly three million people (64% of the total population of the WCP) and has a good track record in terms of service delivery. The municipality has a centralised procurement office that undertakes all procurement activities. Drakenstein is a smaller, local municipality comprising approximately 209 674 people or 7% of the WCP (Department of Social Services and Poverty Alleviation: 2002). It is in the process of reviewing its procurement policy and has started with a review of the institutional arrangements that govern procurement. Bitou is a small municipality comprising approximately 30 000 people. It was one of the first municipalities in the Western Cape to draw up a procurement policy with provisions for LED and poverty alleviation. The practices in Bitou, Drakenstein and the CoCT are reflective of what is happening in other municipalities in the WCP.

The targeted procurement policies of the three municipalities are committed to the following planned objectives:

- to have preference for employment and economic empowerment;
- to include priority groups that have not benefited from the implementation of procurement policy;
- to have a significant contribution towards job creation, poverty alleviation and economic growth;
- to have a procurement policy that is linked with the Integrated Development Plan (IDP) of the municipality.

Although municipalities have recognised the importance of linking their procurement policy to pro-poor concerns (as illustrated in their objective of including priority groups such as blacks as beneficiaries of

preferential procurement policy framework), thus far, their procurement policies and practices have not been sufficiently refined to bring meaningful local economic involvement for HDIs and the poor.

## The City of Cape Town

In the CoCT procurement is a centralised function that is located in a special procurement section at its offices in Wale Street, Cape Town. The CoCT employs a special procurement manager for its municipal procurement. The procurement manager is in charge of:

- the tender section;
- procurement;
- warehouses and stores; and
- accounts payable.

The limited external buying offices report directly to the procurement directorate. A total of 330 employees work in the procurement directorate. It has 27 buyers who process approximately 800 orders per day. The annual procurement budget amounts to R4.5 billion. A key objective of the CoCT is to bring its procurement policy in line with national criteria. At present approximately 20% of the total procurement budget goes to BEE and HDI companies. If there is no BEE or HDI company in a specialised service, then a contract or tender is given to an advantaged supplier on condition that at least 30% is shared with a BEE or HDI company. This is done by means of a joint venture or consortium. In order to have better control over this process the CoCT oversees all joint ventures. The 20% target is half of the CoCT's short-term target of 40%. Among the reasons for the target not being met is the fact that many BEE and HDI companies have not registered on the CoCT's supplier database. All preferred and potential suppliers must be registered on the database to be considered for procurement but only a small percentage of black businesses are registered, since many do not have access to fax or email. No specific efforts are made by the

procurement section to further encourage the participation of the poor except through the HDI points system.

According to the procurement manager, large tenders can be broken down into smaller tenders/contracts. This enables SMMEs to bid on contracts that were only available to larger companies in the past.

## Bitou Municipality

Bitou Municipality was one of the forerunners of the idea of using procurement as an instrument for HDI advancement and local economic development and drew up a procurement policy with clauses related to poverty alleviation, LED and BEE. Despite this progressive procurement policy, there is general consensus among the municipal staff that HDI and BEE representation is low. The municipality has not managed to use procurement as an instrument for poverty alleviation either. Municipal officials are keen to involve SMMEs but state that the municipality has neither the capacity nor the infrastructure to do so.

What makes things worse is that procurement operations are decentralised since there is no procurement manager, office or department that takes overall responsibility for procurement within the municipality. Goods and services are procured by the various heads of departments (HoDs) who report to the Head of Administration. Even though the municipality has a policy to have a centralised procurement function in place the implementation falls short of the objectives. This is attributed to a lack of institutional capacity.

In order to make procurement more accessible, the municipality advertises in three languages. The municipality also encourages the use of local labour through encouraging joint ventures between SMMEs and previously advantaged companies. The municipality pays smaller companies on a regular basis to keep them from running into cash-flow problems.

Strategic targeting is also used for projects worth less than R5 million. The municipality identifies projects within its budget that it wants to pursue to enhance SMME participation, particularly in the construction industry. Here the municipality waives securities for SMMEs.

All procurement contracts are conducted using the closed tendering system where quotes are submitted in a closed envelope to ensure fairness and due diligence and not to compromise the procurement process. Thus buyers cannot divulge inside information to their friends and acquaintances. This system is meant to reduce any possible kickbacks to role players.

The respondents indicated that even though there is no gift register, staff members involved in procurement are required to sign declarations of interest.

## Drakenstein Municipality

Drakenstein Municipality (DM) has been engaged in several initiatives over the past two years to bring about the social and economic transformation of its community. Foremost among these initiatives is the attempt to reduce poverty and unemployment. To this end, the Council has commissioned an IDP, of which the LED is a central plank. Council, in close collaboration with the Mayoral Committee, has also identified several initiatives to restructure the internal organisation of its departments as part of the broader effort to create developmental local government. The Procurement Office is one part of the internal reorganisation exercise that aims to link the procurement of goods and services to local economic development while stimulating the formation of SMMEs among previously disadvantaged communities and thereby contributing to local black economic empowerment.

Only 2-3% of the monetary value of procurement contracts is currently awarded to HDIs. Much of the procurement budget is aimed at

high cost capital-intensive projects, which makes it difficult to benefit the poor directly in the procurement process. Efforts are currently underway to identify the most appropriate goods and services required by the municipality that can be supplied by HDIs and the poor.

Departments that procure goods and services in DM currently undertake all their own buying since each department has its own budget. Not all departments are familiar with the details of the procurement policy and in the absence of a centralised monitoring system, officials use their own evaluation system to decide on which service provider to use. There are concerns that this practice may not achieve the objectives of the procurement policy. Buyers that are under the Head of Expenditure merely process the orders since supervisors obtain all quotes. This system leaves a lot of room for bribery and corruption. The following observations on the institutional role of the procurement manager were also made:

- the procurement manager is not part of the process of evaluating all tenders;
- he only signs off projects for processing;
- there is no clarity on the roles and responsibilities of the procurement manager; and
- the institutional arrangements under which the procurement manager works are not appropriate for achieving the aims of preferential procurement.

## Current problems with procurement at the municipal level

In virtually all the municipalities investigated the following problems were identified:

- Municipalities generally do not keep track of the goods and services that are being procured and have inadequate information on the status of companies in terms of PPPFA requirements.

- Where institutional capacity is poor, accountability for targets also seems to suffer. If targets are set there is no monitoring mechanism in place to assess performance management or the indices for supply chain performance to map the progress towards the PPPFA objectives.
- No infrastructural arrangements to accommodate the special needs of HDIs have been put in place.
- The procurement and provisioning procedures in government are overly rule-driven, where value for money is almost always equated to the lowest price tendered. The emphasis is almost exclusively focused on the monitoring of inputs, with little or no regard to the outcomes of procurement and provisioning processes.
- The PPPFA policies are not properly formulated and national targets are not set in respect of important policy objectives such as the promotion of HDIs and SMMEs.

The above issues affect almost all municipalities. This means that there are serious issues that need to be addressed, such as the focus and the implementation of procurement policies. Other issues identified in the municipalities are discussed below.

## Fronting

The use of black directors in predominantly white companies to score points on a tender is generally called fronting. Among the factors that distinguish fronting companies from genuine empowerment firms are the following:

- the black directors have no significant decision-making powers;
- they are not involved directly in the operational side of the company in question;
- they do not occupy executive positions in the company; and
- a significant share of the company's equity is not held by HDIs.

## Fraudulent practices in procurement

Governments at every level have a special responsibility to prevent fraud and corruption as far as public funds are concerned. The procurement process is often fraught with the danger of corruption and fraud, either through kickbacks, nepotism (favouring friends, relatives, or companies in which an official has an interest) or privately negotiated *quid pro quo* agreements with suppliers. The regulatory framework sets out a clear code of conduct that applies to all the parties concerned but there is reason to believe that the code is not always observed and that the controls and/or enforcement are weak.

## Impact of procurement expenditure on the local economy

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The impact of procurement expenditure on the local economy can best be assessed by analysing the information that was made available by officials of several departments in the municipalities investigated. The total expenditure on procurement of goods and services for the different municipalities represents a healthy injection of capital into the local economy. What distinguishes procurement expenditure from other private investment, however, is that it is guided by policies aimed at achieving a range of social and economic objectives in the course of providing goods and services. In assessing the present procurement practice it will be necessary to see to what extent these policy objectives have been achieved. The analysis reveals that only a small fraction of procurement expenditure went to companies with significant black ownership. The effect of such a pattern of procurement expenditure is that it perpetuates the flow of income to established businesses, which, by and large, are owned by the more privileged sections of the population. This only exacerbates the already large disparities evident in income

inequality and has severe consequences for social development. If poverty is to be alleviated, municipalities would have to ensure that a larger share of financial resources is directed towards low-income areas so as to stimulate local economic activity. The logic here is that every additional rand that circulates in a given community induces demand for goods and services, some of which can be provided directly by locally based entrepreneurs or micro-enterprises. This is known as the 'multiplier effect'. The multiplier effect is used to show what the effects will be for the local economy if the budget (or a large proportion of it) is spent locally within the municipalities. In this way we are building a case for involving the poor in the procurement process since the benefits will flow back into the local economy and not outside of it, as is the case when big companies do work on behalf of the municipalities.

## Calculating multipliers of particular categories of goods and services for a given community

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This is generally done by figuring out the impact that can be expected from a given expenditure or economic activity. The economic activity could be the production of goods that are sold to a business in another area (an export) or it could be a public works programme (building roads, bridges, etc.) or a housing construction project. Whatever the source, an injection of a sum of money into a local economy stimulates spin-off activities, which generate either jobs or incomes for the local population. The total effect of the original economic activity and the spin-offs is what the multiplier measures. We can illustrate the multiplier with the following example:

Company A, a textile company in Drakenstein, gets an order for upholstery cloth from Company B, a large furniture company in Johannesburg, for R1 million. After payment is received Company A spends about 40c of every Rand received for goods and services in the

local community. The households or businesses who receive these 40c spend 16c within the community. Of the 16c another 6c is spent on local goods and services, followed by another 3c and finally, 1c. The expenditure of R1 in the local community generated a total income of R1.66 for other firms and residents. The multiplier therefore is 1.66.

If we assume that we target the procurement budget in such a way that for every R1 that is spent in the local economy, companies spend R0.60 in the local economy, through the multiplier the total economic impact of the procurement budget is substantial.

As things currently stand, however, this money circulates (generally) among the upper quintiles of the WCP's population, which may partially explain the worsening of income distribution. There is also a strong possibility that a proportion of this money leaves the local economy as dictated by the diverse investment and consumption interests of high-income groups and their more mobile lifestyles.

If, however, this money were to flow into the income stream of low- to middle-income groups, there is a strong likelihood of the beginning of a virtuous cycle wherein basic goods and services are demanded which, in turn, leads to more job creation leading to even more goods and services.

The re-allocation of fiscal resources in this way may at first appear to be making one part of society worse off in order to make another part better off. Viewed in a wider context, however, the outcomes from such re-allocation show that the benefits to society as a whole are substantial. An easy way to understand this is to look at the levels of expenditure and saving of a given community. Where the marginal propensity of consumption of a community (the amount people are inclined to spend of their income) is greater than the marginal propensity to save (the amount of their income they are inclined save), then the expenditure multiplier is higher. In simple terms, for every additional Rand that people spend of their income rather than save, expenditure will multiply by a factor of X. The multiplier means that every time a

Rand turns over, a portion of it goes towards additional demand for goods and services, which increases income to someone else in the economy and which, theoretically, should result in the creation of more jobs. This was one of the important contributions made by John Maynard Keynes, when he demonstrated the effect of increased government expenditure as a way of stimulating the economy. In the WCP, as in South Africa at large, the challenge is to not only increase government expenditure but also to target it in ways that raise per capita incomes of the poorest sections of the population because this has been shown to raise the rate of growth of the economy.

## Recommendations

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Conflict between policy objectives and market principles needs to be avoided by creating win-win situations for policy implementation and market efficiency. There is a need to build and strengthen the capacity of authorities to strike a healthy balance between developmental pro-poor needs and concerns and to formulate procurement procedures aimed at achieving the goal of sustainability.

### Some detailed measures for bridging the divide

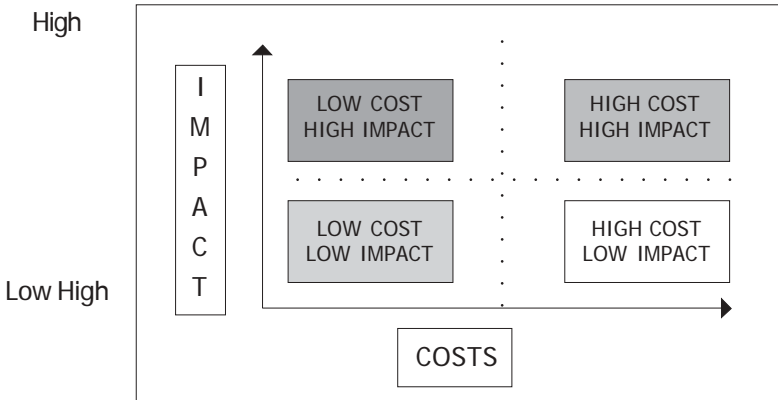
The low HDI share of procurement can be attributed mainly to the paucity of skills in South Africa's previously disadvantaged communities, which thus limits their ability to take advantage of procurement contracts directed at HDIs. Other limiting factors are lack of access to finance, literacy levels, management and organisational skills and networking. The challenge lies within the supply chain management office of municipalities to incorporate institutional mechanisms to draw in more HDIs as well as spreading the pie among the poor. These institutional arrangements include the development of linkages between SMMEs and skills development through the SETAS. Internally it means that a

help desk needs to be set up to provide information and to assist HDIs to form linkages, joint ventures and sub-contract with major companies as a means of knowledge and skills transfer. However, since the poor have mostly labour and basic skills at their disposal, the supply chain management office needs to identify low cost/high impact contracts within the budget and assign this area for HDIs and poverty alleviation aspects. This idea of segmenting the procurement pie to identify the portion that can be directed to the poor, namely low cost/high impact goods and services, is illustrated in table 1.

The first step in allocating procurement to HDI and poverty alleviation would be to have a comprehensive list of the main goods and services required by a municipality as well as a database of local businesses/companies/individuals that are able to provide these services. A matrix of the goods and services can then be developed to calculate their cost and impact (job creation, poverty alleviation effect and equity), and thereby give the municipality a basis for selecting service providers to ensure maximum impact on the local economy.

The following diagram illustrates how this would work:

**Figure 1: Impact versus cost matrix**



Examples of the goods and services that fall into the four designated categories illustrated in Figure 1 are given in the table below:

**Table 1: Description of goods and services according to their cost and impact**

<b>Low cost/low impact</b>	<b>High cost/low impact</b>
<ul style="list-style-type: none"> <li>• Supplier is able to offer the goods at the best possible price.</li> <li>• Relatively low expenditure by the municipality but minimal impact as far as job/income creation is concerned.</li> <li>• Amount injected into local economy is too small to have any effect as a multiplier.</li> <li>• Getting poor communities to produce the goods is not feasible because capital costs may be too high.</li> <li>• Spin-offs may not be extensive because of the nature of the industry.</li> </ul> <p>Possible example: toilet paper, nuts and bolts, nails and screws</p>	<ul style="list-style-type: none"> <li>• Goods/services are essential and costs are high.</li> <li>• There may only be a few providers or suppliers.</li> <li>• Industry is capital intensive with high- to semi-skilled employees.</li> <li>• Expenditure may be high but few spin-offs.</li> </ul> <p>Possible example: IT companies (software specialists, programmers, analysts) and consultants</p>
<b>Low cost/high impact</b>	<b>High cost/high impact</b>
<ul style="list-style-type: none"> <li>• Generally service-oriented projects.</li> <li>• Labour rather than capital intensive.</li> <li>• Overhead costs are low.</li> <li>• Needs low- to semi-skilled workers.</li> <li>• Spin-offs can be high if other measures are put in place.</li> </ul> <p>Possible examples: Public works projects (light construction, beautification/environmental clean up) and light manufacturing (overalls for municipal staff)</p>	<ul style="list-style-type: none"> <li>• Goods and services are essential to growth of local economies.</li> <li>• Both labour and capital intensive.</li> <li>• Requires full range of skills, from unskilled to professional.</li> <li>• Spin-offs are high because of multiplier.</li> </ul> <p>Possible examples: Infrastructure projects, housing construction</p>

The next step is to target the low cost/high impact goods and services and develop specific pro-poor measures to get the poor to participate in the provision of these goods and services.

Through the 80/20 and 90/10 points system, municipalities have a way of encouraging the use of local enterprises and local labour by the weight it assigns to these criteria. The stimulation of expenditure in the local economy in this way should see a progressive increase in the multiplier. This could be significantly strengthened, however, if municipalities developed a comprehensive list of products that need to be procured and then applied the principles of impact and cost to each category of goods/services. An ever-increasing proportion of goods and services that are procured according to low cost/high impact criteria would raise the multiplier by a considerable margin and thus cause a larger volume of money to circulate in poor communities.

## Further recommendations

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### Break-out procurement

When contracts are large there may be the possibility of dividing the work into smaller contracts and thereby spreading the provision of goods and services among several SMMEs. This is referred to as break-out procurement or unbundling. The primary rationale behind it is to create opportunities for several smaller companies who would otherwise not be able to tender because they lack the human and financial resources that would be required. While this objective certainly gives effect to the central aims of procurement, care must be taken to ensure that quality, time, cost and value for money are not compromised. The municipal manager and the procurement manager should encourage HoDs to apply their minds to determining the unbundling of contracts

where feasible and without compromising quality and value for money. It is recommended that municipalities implement unbundling where it is possible.

## Targeting

Targeting refers to the use of the tendering system to ensure that progressively larger proportions of the procurement budget are awarded to persons previously disadvantaged by unfair discrimination. This usually entails setting specific goals that stipulate the number of SMMEs owned by HDIs that should be recipients of contracts or awarding more points to companies in which a portion of the equity is held by previously disadvantaged persons, women or the disabled. There have to be rewards and penalties for achievement of targets. Targets have to be tied to the contracts of senior staff so that greater effect can be given to the targets rather than leaving it up to their discretion.

## The location and organisational structure of the procurement office

The organisational structure of the municipality can, and often does, affect the way in which decisions are made and work is processed. For example, because of the absence of a procurement manager until fairly recently, the Drakenstein Municipality has not yet had the opportunity to rationalise the location of government departments to implement its procurement policy and to give effect to the vision of the municipality for its social and economic development.

## Mentorship policy

Consideration should be given to joint ventures with poor individuals and communities with the aim of mentorship and capacity develop-

ment. The procurement policy should provide incentives for companies that establish joint ventures with HDIs, particularly in labour-intensive contracts.

### Improving access to information

It is recommended that a tender advice desk be established with the specific role of holding tender advice briefing sessions in the various wards, particularly in wards where literacy levels are low. The tender advice desk should also be mandated to make the annual procurement plan and all tender advertisements of the municipality available to all communities (via libraries, clinics, community centres, etc.). Ward committees can also play an important role in disseminating information about procurement in the different wards

## Conclusions and recommendations

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Although the regulatory framework has gone through significant changes, the results in the three municipalities researched provide evidence that the situation has not improved much. The research has shown that this has not translated into tangible, material differences in the lives of the poor and that certain steps need to be undertaken to make procurement more pro-poor. This may largely relate to problems with implementation, but also reveals that the provisions of the PPPFA and the procurement policies of the municipalities need to make pro-poor goals *mandatory*. The regulatory framework demonstrated in the targeted procurement policies of a few local municipalities has the potential to be pro-poor. Now effective implementation, by means of monitoring and setting achievable targets, needs to be set up and followed through. During our research we discovered some areas where the procurement regulatory framework counteracts the needs of the poor. These include the following:

- the system is designed for cost effectiveness for the municipality;
- a small percentage of only 20% or 10% is considered for designated categories;
- its design does not encourage pro-poor activities since most of the pro-poor regulations are not mandatory; and
- even those BEE companies that do get contracts are not sufficiently supported to ensure their sustainability.

Procurement, as it now functions within the three municipalities, is only helping to widen the income gap since only a small percentage of procurement budgets are going to BEE. To address these inadequacies those specific pro-poor goals stipulated in the Preferential Procurement Regulations, 2001 should be made mandatory. Furthermore, the regulatory framework has to put some emphasis on the targets for BEE and the socio-economic effects that ought to be achieved. The regulation has to go beyond prescription and towards enforcement since South Africa has one of the highest Gini-coefficients in the world, with half its population living below the poverty line (Terreblanche, 2003).

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## Notes

- 1 While he was MEC for Finance.