

THE USE OF PROCUREMENT AS AN INSTRUMENT OF LOCAL ECONOMIC DEVELOPMENT

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SUMMARY

Local government has a duty to promote social and economic development. The creation and maintenance of public assets and the provision of municipal services is within the direct control of a local authority and as such can form the first part of a phased approach to local economic development. The use of procurement as an instrument of local economic development can be used to achieve certain policy objectives. This paper sets out the objectives of a local economic policy in the creation and maintenance of assets and presents the achievements of the Midrand Metropolitan Local Council during the 1998/99 financial year in its application of targeted procurement as an instrument of Local Economic Development.

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BACKGROUND

One of the objects of local government, in terms of the constitution of South Africa, is to promote social and economic development. Local government, in terms of this developmental duty, is required to structure and manage its administration and budgeting and planning processes to give priority to the basic needs of the community, and to promote the social and economic development of the communities which they serve. Metropolitan councils and local councils have, in terms of the Local Government Transitional Act, powers and duties, *inter alia*, to promote within the principles of co-operative government, “integrated economic development so as to ensure that imbalances that may exist, are addressed”. (Strategic Procurement Systems, 1998).

Local economic development in the current South African context generally entails the addressing of the imbalances of the past; empowering previously disadvantaged communities; income generation; education of the illiterate and provision of basic shelter for the homeless. The key elements of local economic development within the boundaries of a local authority include :

- the creation of employment and business opportunities for persons living within a defined geographical area.
- the mobilising of resources to promote skills development, sustainable employment creation, entrepreneurship and small scale enterprises within a predetermined geographical area.
- the development and support of small scale enterprises within the local authority’s area of jurisdiction.
- the improvement of a local authority’s capacity to provide services.
- the enhancement and broadening of the local tax / economic (financial) base.

- the provision of a safe and healthy environment where communities can work, live and raise their children.
- the development of a stable economy which is investor friendly.
- focussed and appropriate local government budgeting and expenditure.
- a process of planned social change designed to promote the well being of the population as a whole in conjunction with a dynamic process of economic development.

Infrastructure investment; payment of rates, user charges and fees; marketing; investment attraction; entrepreneurship and small business support; training and labour market support including capacity building; procurement; partnerships (both public and private); public safety and security; health; social development; finance; the regulatory environment; commercial developments and tourism all have a significant economic development dimension.

Many of the abovementioned factors have forward and backward linkages, and in some instances are highly dependent upon each other. They also encompass many disciplines. Consequently, it is desirable to have a phased approach to policy development and the implementation of local economic development. The first phase of policy development should focus on what can be achieved within relatively short time frames. Accordingly, the first phase should focus on that which is within the direct control of a local authority, viz., the creation and maintenance of public assets and the provision of municipal services.

THE EMPLOYMENT POTENTIAL OF PROJECTS INVOLVING THE CREATION AND MAINTENANCE OF ASSETS

There are a number of ways in which employment opportunities in the creation and maintenance of public assets can be maximised. These relate to forms of construction; construction methods and manufacturing methods. The choice of technology has a marked influence on the number and location of employment. The choice of construction method can, particularly in the case of civil engineering projects, significantly influence the total number of manhours of employment generated. The choice of manufacturing method of

construction components can also significantly affect the number of employment opportunities generated. (Watermeyer *et al*, 1995).

Research has indicated that, provided there is little or no cost premium associated with employment intensive practices, the overall increase in employment opportunities for a given project over conventional plant-based practices may reach a factor of 2 in urban infrastructure and 3 in rural road construction; increases which are nevertheless extremely valuable. (Watermeyer, 1997).

Small businesses have a major role to play in the South African economy in terms of employment creation, income generation and output growth. Small, medium and micro enterprises (SMMEs) account for approximately 60% of all employment in the economy and 40% of output. They are also often the vehicle by which the lowest-income people in society gain access to economic opportunities - at a time that distribution of income and wealth in South Africa is amongst the most unequal in the world. (Strategic Procurement Systems, 1998).

THE OBJECTIVES OF A LOCAL ECONOMIC DEVELOPMENT POLICY IN THE CREATION AND MAINTENANCE OF ASSETS AND THE PROVISION OF SERVICES

The potential for local economic development through the creation and maintenance of public assets and the provision of municipal services, at any point in time, is the product of past and current policy, resources and external influences of various sorts. All these factors, over time, collectively lead to the determination of a particular structure of a local economy, which in turn determines a local community's economic and social quality of life.

Local government can influence the direction and structure of the local economy through its expenditure on assets and the provision of services particularly in so far as employment and business opportunities are concerned. Inappropriate policy can be detrimental to the local economy and result in fewer business and employment opportunities and a lower

standard of living. It is therefore important that such policy be holistic in nature and that it takes cognisance of all possible consequences, both positive and unintended. (Strategic Procurement Systems, 1998).

A suitable and comprehensive set of socio-economic objectives for a policy on the realisation of socio-economic deliverables through the creation and maintenance of public assets and the provision of municipal services includes :

- To stimulate and develop local economic growth in a targeted and focussed manner.
- To create employment and business opportunities for previously disadvantaged persons within a local authority's area of jurisdiction in order to reduce inequalities in income distribution.
- To improve living standards of residents in a sustainable way.
- To promote the competitiveness of local businesses.

This can be achieved by encouraging the substitution of labour for capital; promoting the use of "labour friendly" technologies; stimulating and developing small scale local enterprises; targeting of local resources; and promoting social development.

POLICY CONSIDERATIONS

The policy for the creation and maintenance of public assets and the provision of services in areas under the jurisdiction of a local authority should focus, in the first instance, on the structuring of economic activity to create business and/or employment opportunities for its constituents in a targeted manner, and thereafter should shift to ensure that any opportunities which are created thereby can be realised and sustained.

Economic activity can be initiated by communities, the public sector, or the private sector. The Council, in rendering services to its constituents, can either utilise its own personnel (direct employment) or procure service providers to do so (out-source). The policy pertaining to economic activity should accordingly be divided into four sections : direct labour, procurement by Council, private sector initiatives and community based initiatives

and should be based on the premise that its implementation insofar as the creation of opportunities is concerned, will (Strategic Procurement Systems, 1998) :

- Not require extraordinary Council budgetary expenditure since any cost premium, even though modest, may result in a reduction in services.
- Require only modest funding to enable its implementation in the private sector; and
- Require grant funding for its implementation by communities.

The use of procurement as an instrument of policy can ensure that a significant proportion of those who benefit from the business and employment opportunities generated by economic activity within a local authority's area of jurisdiction are those who are targeted in a local economic development policy. This is true, irrespective of who initiated such economic activity. Procurement can be used to enable the beneficiaries of a local economic development policy to gain access to markets. Supply side interventions are, however, required to provide the necessary institutional arrangements, access to credit and skills which targeted businesses may require to realise the opportunities presented through the procurement arrangements and to grow their businesses. Accordingly, a local economic policy should also address aspects such as small business programmes, financing of supply side measures, support centres, training and technical issues including technology choices.

THE USE OF PROCUREMENT AS AN INSTRUMENT OF POLICY

The use of public sector procurement as an instrument of government policy to achieve certain socio-economic objectives can have significant outcomes in a variety of areas ranging from the protection and development of national industry, to social policy goals such as the promotion of equal opportunity. Likewise, the use of procurement as a regulatory tool to enforce existing legal obligations, or to encourage standards of behaviour beyond those required by the law, has the potential to make a substantial impact. (Watermeyer *et al*, 1998).

The use of procurement as an instrument of policy has, however, been frustrated in the absence of a suitable model which satisfies public sector requirements. A procurement system from a public sector point of view should not :

- overtax the administrative capacity of public bodies;
- create unfair competition within sectors of the economy;
- abuse or lower labour standards;
- expose public bodies to unacceptable risks;
- compromise value for money;
- compromise the efficiency and effectiveness of the public sector in their ability to deliver.

Recently a system of Procurement which meets the aforementioned requirements has been developed in South Africa. This system which is known as Targeted Procurement enables procurement to be readily used as an instrument of social policy, by public bodies both on a large scale and in a focussed manner. Aspects of Targeted Procurement can also be used to measure, quantify, verify and audit any socio-economic targets that are to be met.

Targeted Procurement, enables procurement to be used as an instrument of policy as it provides employment and business opportunities for marginalised individuals and communities. It furthermore enables socio-economic deliverables to be linked to procurement in a fair, transparent, equitable, competitive and cost effective manner. Targeted Procurement also permits these social objectives to be defined, quantified, measured, verified and audited both at a project and programme level. Targeted Procurement was developed by the Procurement Task Team in South Africa to enable various organs of state to link social deliverables articulated in the Reconstruction and Development Programme to procurement in a manner which satisfies the constitutional provisions of the South African Constitution.

Targeted Procurement rests on three pillars, viz., the classification of contracts, the use of resource specifications and the awarding of contracts in terms of a development objective /

price mechanism. The classification of contracts enables contracts to be packaged (unbundled) in a manner which facilitates the engagement of a range of targeted groups or structured in a manner, which permits targeted groups to participate as prime contractors. Resource specification are used to define socio-economic deliverables, to set out the methods by which deliverables can be attained, audited and verified and to provide the means by which progress toward the attainment of the deliverables can be measured and quantified during the execution of the contract. A development objective / price mechanism is a points scoring system in terms of which tenderers are awarded, in the first instance, points for their financial offers and, in the second instance, points for their offers to deliver socio-economic objectives, measured in terms of resource specifications or, in the case of low value contracts, for their current enterprise status.

In terms of the Targeted Procurement procedure, contractors are penalised financially should they fail to achieve their contracted socio-economic deliverables in the performance of the contract.

THE MIDRAND CASE STUDY

The Midrand Metropolitan Local Council, adopted a local economic policy in June 1998 in order to realise socio-economic deliverables through the creation and maintenance of public assets and the provision of municipal services. The Council used the system of Targeted Procurement to implement the policy.

Council, in order to achieve some of its Local Economic Policy objectives, limited the number of standard targeting strategies which were adopted in engineering and construction works contracts to the following :

- Prime (Major) where use is made of either TP4(APP4) (Targeting of Local Resources) or TP5(APP5) (Engagement of Targeted Labour) specification.
- Prime (Minor)
- Prime (Micro)
- Structured Joint Ventures where use is made of the TP3(APP3) (Targeted Partners)
- Development Contracts

The following area bound definitions were approved by the Council.

Targeted Labour / Local Labour : South African citizens who permanently reside within the boundaries of the Midrand Metropolitan Local Council and earn wages and allowances amounting to less than 1,5 times the statutory minimum hourly wage.

Local Enterprises / Targeted Joint Venture Partners : Affirmable Business Enterprises (small business which are owned, managed and controlled by previously disadvantaged persons see www.pwdprocure.co.za) who have their sole office or head office located within the Midrand Metropolitan Local Council area.

The policy was applied in the 1998 / 1999 financial year to engineering and construction works contracts only. 29 engineering and construction works contracts were awarded during the period 1 July to 1 May 1999. One multiple award contract was excluded from the study. The procurement arrangements and work categories for the capital expenditure during the 1998 / 1999 financial year are as set out in Tables 1 and 2 respectively. An analysis of tenders received is provided in Table 3.

The financial premium associated with the attainment of socio-economic objectives through the use of procurement as an instrument of social policy, has direct and indirect cost components. The direct cost component relates to the increased tender amount to accommodate socio-economic objectives. The indirect cost component relates to costs not included in the tendered amounts such as increased administration requirements, internal staff training, financial premiums associated with the embracement of a policy, etc., if any. The direct financial premium, where tenders are adjudicated in accordance with a development objective/price mechanism, can be calculated by expressing the difference between the prices of the awarded tenders and the lowest responsive tenders as a percentage of the sum of all responsive tenders.

The direct financial premium where use is made of a 90/10 development objective / price mechanism, is best reported on in terms of the ranges tabulated in Table 4. The maximum direct financial premium payable where a 90/10 development objective / price formulation is utilised is 11,1%.

Key performance indicators, as defined in Table 5, are tabulated in Table 6.

TABLE 1 : PROCUREMENT ARRANGEMENTS FOR MIDRAND METROPOLITAN LOCAL COUNCIL'S CAPITAL WORKS (1998 / 1999 FINANCIAL YEAR)

| PROCUREMENT ARRANGEMENT | CONTRACT PARTICULARS | | | |
|-------------------------------|----------------------|--------------|-------------------|--------------|
| | NUMBER | | VALUE | |
| | NO | % | RAND | % |
| Targeted procurement not used | 1 | 3,6 | R394 982 | 1,4 |
| Prime (Minor) contracts | 3 | 10,7 | R847 495 | 3,1 |
| Prime (Major) contracts | 19 | 67,9 | R18 229 176 | 65,6 |
| Structured Joint Ventures | 5 | 17,8 | R8 318 698 | 29,9 |
| TOTAL | 28 | 100,0 | R2 779 035 | 100,0 |

TABLE 2 : WORK CATEGORIES FOR MIDRAND METROPOLITAN LOCAL COUNCIL'S CAPITAL WORKS (1998 / 1999 FINANCIAL YEAR)

| WORK CATEGORY | NUMBER OF CONTRACTS | | VALUE OF CONTRACTS | |
|--------------------|---------------------|--------------|--------------------|--------------|
| | NO | % | RAND | % |
| Water (general) | 4 | 14,8 | R1 377 207 | 5,0 |
| Sewer | 7 | 26,0 | R9 101 992 | 33,2 |
| Stormwater | 3 | 11,1 | R2 055 311 | 7,5 |
| Resealing of roads | 1 | 3,7 | R1 114 687 | 4,1 |
| Roads | 4 | 14,6 | R4 206 222 | 15,4 |
| Earthworks | 3 | 11,1 | R1 435 558 | 5,2 |
| Building | 2 | 7,4 | R6 458 388 | 23,6 |
| Paving | 2 | 7,4 | R1 059 207 | 3,9 |
| Concrete Works | 1 | 3,7 | R586 797 | 2,1 |
| TOTAL | 27 | 100,0 | R27 395 369 | 100,0 |

TABLE 3 : ANALYSIS OF TENDERS RECEIVED

| NUMBER OF CONTRACTS | TENDER VALUE | RESOURCE GOALS (%) | | |
|--|--------------|--|------------------|---------------------------------|
| | | AVERAGE MINIMUM PROVIDED FOR IN THE TENDER | AVERAGE TENDERED | AVERAGE FOR SUCCESSFUL TENDERER |
| PRIME (MAJOR) contracts where use is made of the TP4(APP4) specification (Targeting of Local Resources) | | | | |
| 14 | R15 479 580 | 18,1 | 33,3 | 45,5 |
| PRIME (MAJOR) contracts where use is made of the TP5(APP5) specification (Engagement of Targeted Labour) | | | | |
| 5 | R2 749 596 | 15,4 | 16,8 | 25,0 |
| Structured Joint Venture contracts where use is made of the TP3(APP3) specification (Targeted Partners) | | | | |
| 5 | R8 318 698 | 10,7 | 27,8 | 37,4 |

TABLE 4 : DIRECT FINANCIAL PREMIUM RANGES

| DESCRIPTION FOR DIRECT FINANCIAL PREMIUM | PERCENTAGE FINANCIAL PREMIUM (%) ASSOCIATED WITH : | |
|--|--|---|
| | TARGETED LABOUR INDEX | TARGETED ENTERPRISES, AND EMPOWERMENT INDICES |
| Nominal | 0 – 2,22 | 0 – 1,0 |
| Very low | 2,23 – 4,44 | 1,01 – 2,40 |
| Low | 4,45 – 6,67 | 2,41 – 4,20 |
| Moderate | 6,68 – 8,89 | 4,21 – 7,40 |
| High | > 8,9% | < 7,4% |

TABLE 5 : TARGETED PROCUREMENT INDICES

| INDICATOR | DEFINITION | TARGETING STRATEGIES CONTRIBUTING TO THE INDEX |
|------------------------------|--|---|
| Targeted Enterprises Index : | The estimated total value of work undertaken by Targeted Enterprises expressed as a percentage of the total value of relevant contracts awarded where Targeted Enterprises are targeted. | <ul style="list-style-type: none"> • Prime (Minor) and Prime (Micro) contracts. • Prime (Major) contracts where use is made of the TP1(APP1), TP4(APP4) or other specifications which target enterprises. • Structured Joint Ventures where use is made of the TP2(APP2), TP3(APP3) or other specifications which require joint venture formation. • Development Contracts. |
| Targeted Labour Index : | The estimated total value of work undertaken by Targeted Labour expressed as a percentage of the total value of relevant contracts awarded where Targeted Labour is targeted. | <ul style="list-style-type: none"> • Prime (Major) contracts where use is made of the TP4(APP4) and TP5(APP5) specifications. |
| Empowerment Index : | The total value of work undertaken by Targeted Enterprises and Targeted Labour expressed as a percentage of the total value of contracts awarded where Targeted Procurement is used. | <ul style="list-style-type: none"> • Prime (Minor) and Prime (Micro) contracts. • Prime (Major) contracts where use is made of TP1(APP1), TP4(APP4), TP5(APP5) or other specifications. • Structured Joint Venture where use is made of the TP2(APP2), TP3(APP3) or other specifications. |

TABLE 6 : KEY PERFORMANCE INDICATORS FOR THE MIDRAND METROPOLITAN LOCAL COUNCIL'S CAPITAL WORK PROGRAMME (1998 / 1999 FINANCIAL YEAR)

| INDEX | VALUE OF INDEX | DESCRIPTION FOR DIRECT FINANCIAL PREMIUM ASSOCIATED WITH THE INDEX |
|---------------------------|----------------|--|
| Targeted Enterprise Index | 33,0 | Nominal (< 1,0%) |
| Targeted Labour Index | 23,1 | Nominal (< 1,0%) |
| Empowerment Index | 37,3 | Nominal (< 1,0%) |

CONCLUSION

Targeted Procurement can be used as an effective tool to implement aspects of a local economic development policy.

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