Eskom Appropriation Bills

Presentation to Select Committee on Appropriations

23 June 2015

Parliamentary Budget Office

PARLIAMENT

Input from the PBO

- Role of the PBO: Provide independent, objective and professional advice and analysis to the finance and appropriations committees on money Bills, the Budget and related matters (Money Bills Act, 2009)
- Recently completed a report on financing of state-owned enterprises (SOEs) - requested by the Standing Committee on Finance, based on proposals in the 2014 MTBPS
- Today's presentation
  1. Background to SOE financing
  2. Considerations particularly relevant to Eskom
  3. Analysis of tabled Bills
  4. Key issues for consideration
  5. Overview of public hearings on the 19th of June

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- The core mandate of the Parliamentary Budget Office, as laid out in the Money Bills Amendment Procedure and Related Matters Act (2009), is to "provide independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money Bills". Under this mandate, the presentation seeks to provide the appropriations committees with a brief, independent analysis of the Eskom Bills.

- The PBO recently completed a report on SOE financing for the Standing Committee on Finance, which was provided to the appropriations committees last week. That report was based on a number of policy proposals in the 2014 MTBPS related to SOE financing. The report considers: the role of SOEs in a developmental state; the separation of commercial and non-commercial mandates; approaches to funding SOEs and related challenges; and, the sale of non-core assets to finance equity injections.

- Today's presentation has four components: First, we provide some generic background to the issue of SOE financing, drawing on the PBO report; Second, we mention some issues relating to financing that are particularly important in the Eskom case; Third, we explain and analyse the tabled Bills; Fourth, we highlight

some issues for the committees arising from the preceding analysis.

- An important point is that the PBO has not conducted a detailed analysis of Eskom's financial situation; further work can be conducted on request. Eskom's financial situation is relevant to the appropriations committees because of requests such as those before us today, but also relevant to the finance committees because of the large guarantees Eskom holds and the implications of financing arrangements for the fiscal framework and the economy.

- In addition to the above, the PBO was asked to provide a summary of the issues raised by presenters in the public hearings on the two Bills that took place on the 19th of June. We do this at the end of our presentation.

Why fund SOEs?

- SOEs are established at 'arms length', which has advantages but also creates a number of challenges
- As commercial entities, SOEs earn revenue and can borrow from financial markets: why fund them?
- Three main reasons:

1. Capitalisation by the shareholder (government)
2. Non-commercial mandates
3. Reducing (public) borrowing costs

- Other reasons: economic shocks; SOE not entirely self-sufficient; recapitalisation for infrastructure projects; etc

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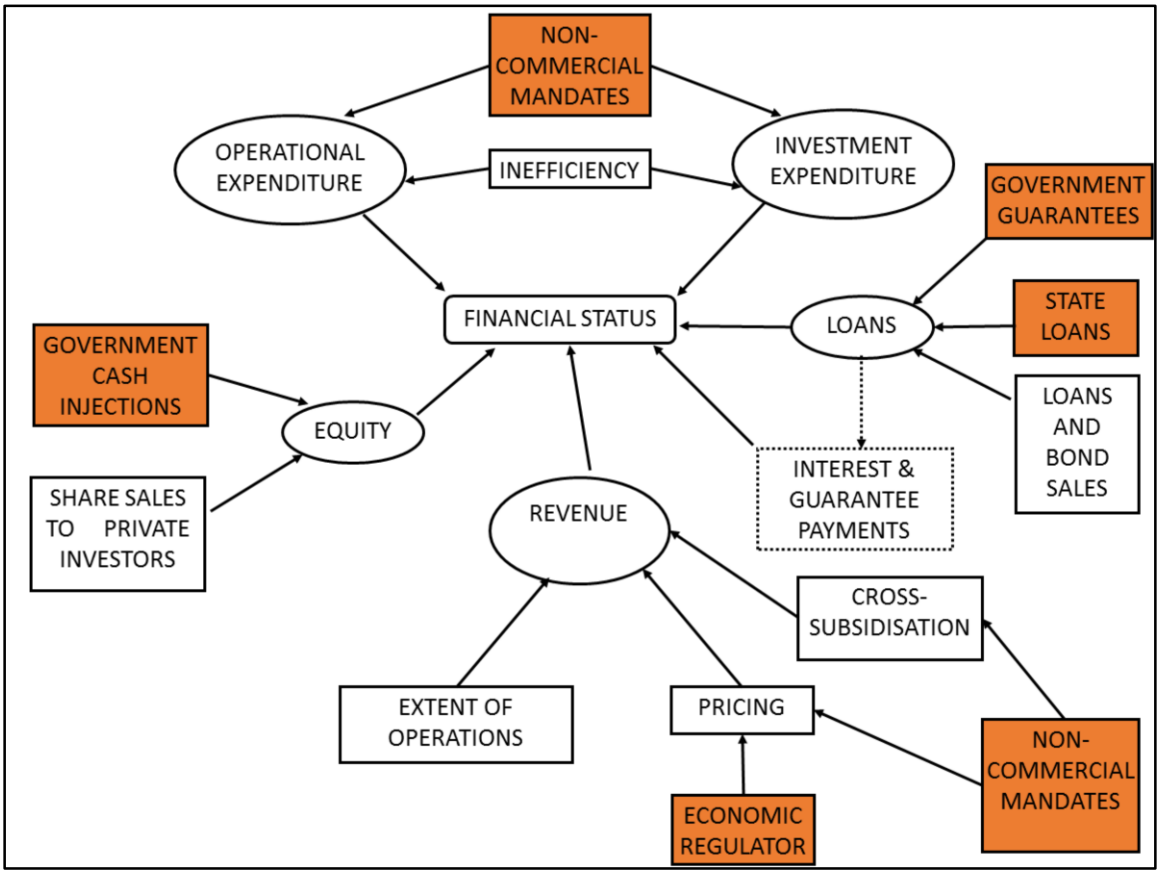
- State-owned enterprises in South Africa, as in other countries, are established at 'arms length' from government. This has the advantage of allowing them to focus on a specific mandate and manage their operations and finances in the same way as a private sector company. However, it creates the challenge of ensuring/monitoring delivery on the SOE's mandate and return on the state's investment without having direct control.
- Given that SOEs can raise revenue and borrow from capital markets, an obvious question is: when/why should the State fund an SOE?
- There are three main reasons: the enterprise needs capital to begin operating, or expand its operations; SOEs are often expected to fulfil non-commercial mandates and it is increasingly considered good practice to compensate them for these; in some cases SOEs are temporarily unable to borrow enough, or borrow at a low enough rate, so it is desirable for government to provide financial support in order to either reduce the SOE's costs or substitute for private debt financing.
- There are a variety of other reasons as well, including cases where due to the nature of the SOE's mandate it cannot be entirely self-sustaining.



❑It is useful to consider the standard factors contributing to a private sector enterprise's financial status, supplemented by the factors that (positively and negatively) affect the finances of *state-owned* enterprises.

❑ Failures in any one factor (e.g. high costs due to inefficiency, inadequate *or* excessive tariffs, excessive non-commercial mandates, etc) will have consequences for other factors.

❑This is an important point because when an enterprise finds itself in financial difficulties it is important for oversight and accountability that we know *why* this has happened. If government support is needed, why is that the case? E.g. high costs from inefficient operations, inadequately funded non-commercial mandates, inadequate tariffs from the regulator, etc.

Funding conditions and fungibility

- When the State does provide funding, one approach to accountability and oversight is to stipulate conditions on funding (cash transfers or loans)
- A problem with this is the issue of *fungibility*:

money used for the purpose stipulated by the conditions might just mean the SOE shifts funds it would have spent on that to something else

- Different example: giving financial assistance to an authoritarian government experiencing a natural disaster
- Implication: such conditions on the use of financing are hard, if not impossible, to enforce
- Monitoring, and transparency, of expenditure and outcomes is fundamental

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- In providing public funds to an SOE a concern is that these funds may not be used to resolve the problems that led to the request for funding. As a result, one approach is to attach conditions to the use of funds.
- A problem with this is that money is 'fungible': it can be shifted around. As a result it is hard, and in some cases impossible, to actually say that funds are spent on one particular expenditure rather than others.
- For example, imagine an authoritarian country has a natural disaster and appeals for international assistance. R10billion in emergency aid is provided on the condition that the funds only be spent on disaster relief and not other things such as weaponry. But the recipient country takes R5billion of its own budget *it was going to spend on disaster relief* and spends that on weaponry. Strictly speaking it has honoured the agreement but not in the way that was intended by those providing assistance.
- The lesson from this is simply that placing conditions on what funds are used for may not be as effective an accountability mechanism as it seems. Detailed monitoring of SOE expenditure and the achievement of mandated outcomes remain, therefore, fundamental to oversight of the use of public finances in this way.

Broad policy background

The State, as owner should ensure [state-owned entities] access to adequate funding... The Government should adopt appropriate funding principles and models...Government should address the issue of non-financially viable commercial SOEs (Presidential Review Committee on State-owned Entities, 2012)

Given fiscal constraints over the next two years, capitalisation will only be funded by the sale of non-strategic state assets, and will not be drawn from tax revenue or added to the debt of national government. Government policy remains that state-owned companies should operate on the strength of their balance sheets.

(National Treasury, 2014 MTBPS)

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- The PBO's report on the financing of state-owned enterprises drew on the broader Presidential Review Committee report on state-owned *entities*. That report makes clear the role of the State in overseeing the financial stability of SOEs through appropriate funding principles and models.
- In the 2014 Medium-Term Budget Policy Statement the National Treasury linked balance sheet support to SOEs to the sale of state assets.

Public finance oversight

	Finance Committees	Appropriation Committees
Relevant areas for oversight	▪Government contingent liabilities ▪Fiscal framework ▪Macroeconomic impact	▪Appropriation of funds ▪Oversight of expenditure ▪Monitoring of loan appropriations
Current situation	▪R350bn in guarantees, R144.5bn have been used (64% of total guarantees from government) ▪NT estimate 0.5-1% reduction in real GDP growth due to loadshedding ▪Impact of tariff increases	▪R60bn loan disbursed from 2008 to 2011 ▪Request for loan conversion ▪Request for R23bn cash injection

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❑Eskom's financial situation is relevant to all four of the committees tasked with direct oversight of public finances and there is a somewhat artificial separation based on the nature of Bills and documents tabled before Parliament. The table provides a rough indication of the roles of the different committees as envisaged in the Money Bills Act (2009). (The Standing Committee on Finance also has oversight responsibilities relating to National Treasury, which also informs the table). In addition, oversight of relevant policy and Eskom's operations is more regularly carried out by the Committees on Public Enterprises and Energy.

❑(Note that before the Money Bills Act was passed (2008) the appropriation for the loan was overseen by the Committee on Finance)

❑The table indicates some of the main responsibilities/concerns of the appropriations versus the finance committees. However, since all these are interrelated it is important that issues not be dealt with in isolation.

Background to current Bills

- The two Bills tabled are intended to assist Eskom with the financial challenges it currently faces
- Among the reasons for Eskom's financial situation:
  - Massive infrastructure programme running over schedule: cost increases *and* revenue reduction
  - Historically low tariffs
  - Supply challenges lead to: loss of revenue (loadshedding and demand reduction measures) plus the cost of running diesel and gas turbines
  - Other possible factors: delayed maintenance, supply chain costs, municipal non-payment

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- As noted in the presentations last week by Eskom and the Department of Public Enterprises, the SOE finds itself in a difficult financial situation. This is reflected in, and compounded by, downgrades of its credit rating by major ratings agencies.
- There are a number of factors that have led to this situation. Arguably the three most important are:

1. Historical tariffs that were too low to finance future or current investment (as discussed by Eskom last week)
2. The increases in costs and loss of forecasted revenue due to overruns in the new build programme
3. Inability to meet demand, which leads to revenue losses, costly use of gas and diesel turbines and higher maintenance costs

- Some of these are due to problems within Eskom and others due to external factors
- The net result is a 'hole' in Eskom's finances that has led to cash flow problems and worsening balance sheet indicators, leading to increased difficulty borrowing accompanied by higher borrowing costs

Meeting demand

- Massive build and refurbishment programme began in 2007; arguably should have started earlier
- Since 2008 Eskom has had intermittent problems meeting demand, leading to loadshedding
- International norm is for a 10-25% 'reserve margin'
  - Not enough to have installed capacity > peak demand
  - Ensures that 'random' factors - mentioned by Eskom last week - do not lead to supply disruptions
  - Eskom had 20-22% margin in 2013-2014 but 'operating reserve margin' is negative when gas turbines are excluded

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- In 2007 Eskom began to build new generation capacity after 15 years in which no new capacity had been added to the system. It has been acknowledged that this process should have started earlier.
- Partly as a result of this delayed response to increasing demand, Eskom has at various points in time since 2008 been unable to meet peak demand. The result has been loadshedding to protect the integrity of the system.
- It is important to note that to avoid loadshedding it is not enough to have installed capacity that is greater than peak demand. Like in any other 'fleet', there will always be breakdowns and 'unexpected events'. For this reason, the international norm is for a reserve margin of 10-25%, depending on the types of generation capacity and other factors.
- In rough: to avoid loadshedding under normal situations we need 10-25% more capacity than peak demand. But with a maintenance backlog we probably need an even greater margin to allow maintenance to be caught-up without random occurrences reducing supply below demand.
- In recent presentation (Feb 2015, to SARB) Eskom noted a 20-22% reserve margin in 2013-2014 but an 'operating reserve margin' that was negative when (costly) gas turbines are removed from the calculation [Operating reserve margin is defined by one source as: "The amount of unused available capability that can be applied to the system within ten minutes at peakload for a utility system, expressed as a percentage of total capability". Other definitions are used, though the basic principle is the same.]
- Eskom's reserve margin has been a concern for some time – see report for DPE "Review

of Security of Supply in South Africa" (2006) for historical details

Electricity tariffs

- Tariffs are regulated by the National Energy Regulator (NERSA)
  - NERSA governed by the 2008 Energy Pricing Policy (EPP)
  - The EPP emphasises that electricity tariffs need to allow for investment and must be cost-reflective
- Widespread view that NERSA decisions have not allowed adequate tariff increases
- Important for *State* to consider additional issues:
  - Intergenerational equity
  - Overall balance of financing

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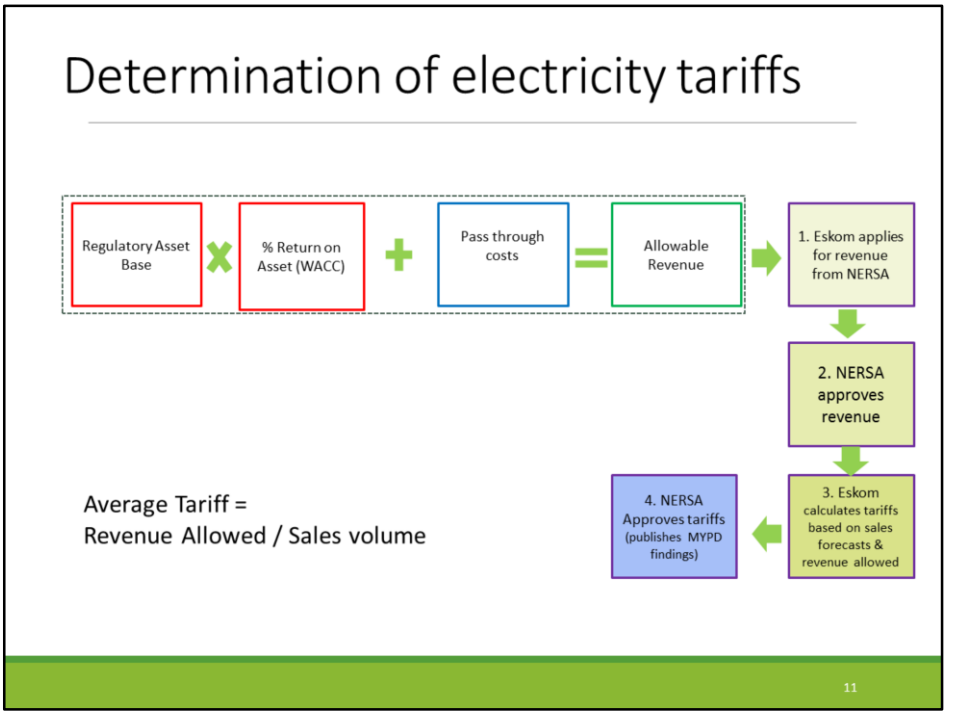
❑As with other enterprises, tariff levels are an important contributor to Eskom's financial status and are determined by an independent economic regulator.
❑The Eskom situation is a challenging case for regulation because of historically low tariffs and the large new build programme, but there is a widespread view that the increases NERSA allowed were inadequate
❑The regulator itself has a fairly narrow mandate. From the State's perspective, there are two other issues to consider:

1. What is an equitable contribution for *current* consumers to make to infrastructure costs given that *past* consumers clearly underpaid and future consumers will also benefit?
2. If it is not equitable for current consumers to shoulder the full burden of the shortfall, where else should the funds come from? (This links to the general point made earlier: shortfalls in one source of financing will have to be compensated for by others in order to keep an enterprise afloat)



1. Revenue applications has 2 main components
    1. Return on asset base
    2. Pass through costs
2. Obvious area for potential improvement in efficiency is in 'pass through costs', but there may also be scope for improvement in capital expenditure

Eskom Special Appropriation Bill

- Part of the 2014 Cabinet-approved support package for Eskom
- Purpose – to provide operating cash flow
- 2014 MTBPS and 2015 Budget signalled government's intention to allocate R23 billion to Eskom in the 2015/16 financial year
- Funds raised through sale of "non-strategic government assets"
- Funds to be appropriated in three tranches
  1) R10 billion in June 2015
  2) R10 billion in December 2015
  3) R3 billion in 2016/17

..Implications

Is it useful to think about separate financials for Eskom and government?

Eskom	Government
❑ Balance sheet temporarily improves	❑ Balance sheet weakens
❑ Since cash injection used to fund interest payments on debt	❑ Latest in a series of capital injections
❑ Cash used to maintain Eskom's *going concern* status	❑ Sale of asset may worsen budget deficit through foregone dividend/interest/rent

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Assuming the separation of Eskom and Government's financials

Eskom

Balance sheet temporarily improves as the company records the cash as an asset which increases its equity position.

This will however reverse throughout the course of the financial year as the cash is used to pay for either the principal or interest payments due to Eskom's debt holders.

The cash is, therefore, used to maintain Eskom's *going concern* status – a business that is operating and making a profit – as at present, its revenues are insufficient to cover it's normal operating expenses as well as its debt obligations which have arisen as a result of its build-programme.

This latest equity injection effectively fulfils the role played by the R60 billion loan granted to Eskom in 2008/09 which has been used.

Government

Government sells asset and transfers proceeds to Eskom. Assuming the separation in financials, government's balance sheet is weakened as its asset base is reduced.

Equity injection is the latest in a procession granted by government to Eskom. This instance differs in that there is an attempt to ensure that the equity injection is budget neutral.

Should the asset sold be a financial asset (bonds or shares) or property, government foregoes the income that would have been earned on those assets.

Interest, rent and dividends form part of the main budget revenue of government.

The sale is therefore likely to worsen the budget deficit.

For example:

Should government sell its stake in publicly listed company A.

Assuming that government held only ordinary shares and that the companies annual dividend yield (annual dividend paid by the company divided by the price of its shares) is 5.59%, the sale of R23 billion in shares would result in government foregoing the equivalent of about R1.36 billion in dividends (in today's money) every year.

Summary

Impact on public finances. If we assume a separation of financials:

Eskom

Balance Sheet – equity increases as shareholder increases paid in capital. This is temporary as cash is injection is used to pay for either operational expenses or interest.

Income Statement – unchanged. Cash injection is considered a financing decision and is recorded in shareholder's equity.

Cash flow Statement – the main benefit of the cash injection is capture here. Cash flow from financing activities increases due to capital injection. This helps to pay for the principal on Eskom's debt as well as its cash interest expense (which falls under operating cash flow).

Government

Balance Sheet – weakens

Loss in asset whilst cash received is transferred.

Income Statement – decrease in revenue: future dividend/interest/rent payments foregone.

Eskom Subordinated Loan Special Appropriation Amendment Bill

- Part of cabinet's 2014 support package for Eskom
- Purpose – to strengthen the balance sheet of Eskom
- Converts the "subordinated loan" of R60 billion granted to Eskom in 2008/09 to equity
- Priority of claims:

Senior debt → Junior debt → **Subordinated debt** → Shareholders

- Funds appropriated in three tranches
  1) R10 billion in 2008/09
  2) R30 billion in 2009/10
  3) R20 billion in 2010/11
- Loan was actually in part a cash injection

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The conversion of the full value of the subordinated loan to equity is in effect only a partial conversion as more than half the loan served as a cash injection upon issuance.

The subordinated loan of R60 billion issued over 2008/09 and 2009/10 was made up of ten smaller loans of between R5 billion and R7.5 billion.

Payment of interest on these loans was waived for the first ten years. Interest payments in contingent on two of Eskom's credit ratios, namely their interest coverage ratio – operational profit divided by their interest expense – and their leverage ratio – long-term debt to capitalisation (Long-term debt + minority interest + equity) – meeting certain levels.

Specifically, the interest coverage ratio would need to be at least 2.5x and the leverage ratio could not be higher than 12.5%.

Under the terms of the loan, if in a given year, Eskom's credit ratios did not meet the minimum standards, Eskom would not have to pay interest on the loan. This "missed payment" would never need to be repaid in the future, so it would represent foregone revenue for government.

The value of the loan recorded on the balance sheet of both government (where it is an asset) and Eskom (where it is a liability) depends on the expected future cash flows emanating from the loan. So if an interest payment is not made, the value of the loan to government (the asset) decreases as does the value of the loan to Eskom (the liability).

So in order to accurately work out the value of the loan today, Eskom provided government with a projection of when it anticipated that it would satisfy the credit ratios and hence begin to pay interest.

Eskom Subordinated Loan Special Appropriation Amendment Bill

Eskom balance sheet 2008-2009

Assets (cash) R60bn ↑

Liabilities (loan) R29.5bn ↑

Equity (paid-in capital) R30.5bn ↑

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At the issuance of the loan, it was clear that Eskom would not meet the minimum credit ratio standards in the near future and would, therefore, not be expected to pay interest. Thus, while Eskom was theoretically given a "loan" of R60 billion by government, the full R60 billion was never recorded as a liability on Eskom's balance sheet. Only a portion of the loan (R29.5 billion) was recorded as a liability while the remainder (R30.5 billion – representing the foregone interest payments) would be recorded as a straight equity injection.

Eskom's recent financial statements suggest that the initial credit ratio projections have since been pushed back. This can be seen by looking at the amount of the loan recorded as equity versus the amount recorded as a liability. The equity portion has increased since 2008/09 from R30.5 billion to R35.6 billion at present. Hence, only R24.4 billion of the loan initially granted is being converted to equity as a result of the Eskom Subordinated Loan Special Appropriation Amendment Bill.

..Implications

Eskom	Government
❑ Balance sheet improves	❑ Balance sheet weakens
❑ No longer an obligation to pay back loan or interest on loan	❑ Give up option to ask for repayment on loan after ten years
❑ Dividend payments subject to dividend policy – no incentive to pay	❑ Potentially forego approximately R82.6 billion in interest payments
	❑ No dividend receipts envisaged

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Eskom

Balance sheet improves – signals improved creditworthiness to capital markets and credit rating agencies.

Interest coverage ratio (operating profit/finance costs) remains unchanged at 1.57x as Eskom pays no interest on the subordinated loan (It is worth noting that Eskom capitalises the interest it pays on money borrowed for capital expenditure. If the interest coverage ratio was adjusted to account for this, the interest coverage ratio would be lower than the figure reported here. Eskom's financial statements do not specify the exact amount of interest on capital expenditure that is capitalised, hence the adjustment could not be made).

Financial leverage ratio (total assets/equity) improves from 4.16x to 3.34x as Eskom converts 24.4 billion remaining debt to equity.

Leverage ratio (long-term debt/(long-term debt + minority interest + equity)) improves from 65% to 58%.

Debt to equity ratio decreases from 2.063 (67.35% of assets funded by debt) to

1.574 (61.15% of assets funded by debt) as debt decreases by R24.4 billion and Equity increases by the same amount. Changes capital structure of Eskom. Does this move Eskom close to its target capital structure so as to minimise its cost of capital (debt plus equity).

Interest coverage ratio improves over the long-term since interest payments in the future, pending adequate credit ratios, would now no longer feature as part of interest expense.

Better off in the long run given that the obligation to pay back the principal or the interest on the loan should credit ratios improve has been removed.

No obligation to pay dividend to the state and no obvious incentive to do so.

Government

In contrast, government's balance sheet will be weakened by a deterioration in the quality of the assets held with respect to Eskom. This raises the risk of government's financials.

While essentially they swap one asset for another (from loan receivable to ownership of shares), their new position means that they are now lower down on the priority of claims ladder. In other words, government would be the last-in-line to receive a payout should Eskom's assets be liquidated.

In addition, the ten year call option on the loans will become null and void – the call option on the loans gave government the right to ask for their money back after ten years. This would be particularly beneficial to government if interest rates increase significantly by 2018/19.

Government revenue is also likely to be affected.

Interest, rent and dividends form part of the main budget revenue of government.

The conversion means that government will forego any potential interest payments by Eskom in the future. DPE reported that this figure amounts to R82.6 billion over the life of the loan. [See slide 8 of DPE presentation]

This wouldn't be as much of a problem if the equity position were likely to yield a dividend.

Eskom has not, however, paid a dividend for many years. There is no expectation of a dividend payment in the future according to the Director's report for the end of the 2014 financial year. The report states that "no dividend was declared during the current and prior year, and none is proposed after taking into account the resource impact of the capacity expansion programme and the current capital structure."

There is no clear incentive for Eskom to pay a dividend in the future.

Summary

Impact on public finances. If we assume a separation of financials:

Eskom

Balance Sheet – decrease in debt increase in equity: improves credit ratios

Income Statement – unchanged

Government

Balance Sheet – unchanged

Straight conversion of present value of loan to equity. No advantage, however, of call option. New asset (shares) is riskier.

Income Statement – decrease in revenue: potential future interest payments foregone, dividend unlikely. No obligation for Eskom to pay a dividend.

Issues to note/for consideration

- Various factors suggest that it is necessary and desirable to provide Eskom with financial support
- The causes of Eskom's financial situation, and the extent to which they matter, are important for oversight
- Conditions attached to how a cash transfer is spent may be difficult to enforce: accountability requires detailed understanding of the composition of costs and revenue
- Loan provisions that allow for interest not to be paid can turn a loan into a partial cash transfer
- Conversion of the subordinated loan potentially reduces return to the State from Eskom's future activities
- Sale of state assets *could* have some impact on the fiscal framework if those assets would have yielded a return

Overview of public submissions

1. Tobias Bischof-Niemz (CSIR)
2. Hilton Trollip (Energy Research Centre, UCT)
3. Phillip Lloyd (CPUT) and Rob Jeffrey (Econometrix)

1. Bischof-Niemz

- Argued that renewable energy sources are making an important contribution to the energy system and are cost competitive
- Noted that building new generation infrastructure always increases the average costs of providing electricity, so if tariffs are cost-reflective then tariffs will also rise
- Some independent power producer agreements are not covered under next Eskom-NERSA pricing agreement, which could present Eskom with some liquidity problems
- Proposed appropriations will assist Eskom with current liquidity problems and potentially reduce tariff increase required
- Maintenance of, and investment in, transmission is also important

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The PBO was asked to provide an overview of the submissions made to the public hearings on the two Bills that took place on the 19th of June. These are summarised briefly in the following slides.

Overview of public submissions

2. Hilton Trollip

- Emphasised the importance of cost-reflective tariffs and argued that current financing shortfall is a result of past tariff decisions being inadequate
  - And that current tariff levels are distortionary
- Argues, therefore, that while current appropriations are necessary they should not happen again; rather ensure tariffs are adequate
  - Poor can be protected through compensating measures
- Raised concerns regarding the conversion of the original loan and whether the terms of the loan agreement in the Act were not misleading given absence of interest payments, etc

Overview of public submissions

3. Lloyd and Jeffrey

- Emphasise the importance of increasing power supply for a growing economy
- Argue current shortages are due to various poor decisions, including: late start of construction; low tariffs; municipal debt; supply chain costs; renewable energy programme
- Concerned that current Eskom structure makes it hard to determine specific costs (e.g. connection costs for renewable projects)
- Recommend restructuring Eskom into 3 components: generation, transmission and distribution
  - Restructuring regulation (NERSA) accordingly
  - Partially privatise generation and distribution
  - Main objective should be to reduce cost of doing business in SA

Thank you

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Any errors or omissions are the responsibility of the authors

Additional slides

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The following slides are largely drawn from the PBO's work on state-owned enterprises for the Standing Committee on Finance. They are provided here as additional information for Members. The final slide provides a link to Eskom's month-ahead forecasts of demand and supply (and hence also expected shortages) – this links to the earlier discussion of reserve capacity.

SOE debt and debt guarantees

- NT definition of *contingent liability*: "A government obligation, such as a guarantee, that will only result in expenditure upon the occurrence of a specific event"
- SADC countries agreed a threshold of 60% for net debt *and* contingent liabilities, which is also what IMF recommends for SA. In the past NT has indicated preference for self-imposed target of 50%.
- Main form of contingent liabilities are debt guarantees to state-owned entities (SOEs), particularly state-owned companies
- IMF Article IV consultation 2014:

A contingent liability shock where 75 percent of the government's guarantee commitments— estimated at 14 percent of GDP in FY2013/14—is realized would increase debt to 72 percent of GDP, slightly above the high risk threshold

- Asset sales and debt guarantees resolve different problems - as discussed further in PBO report on SOE funding

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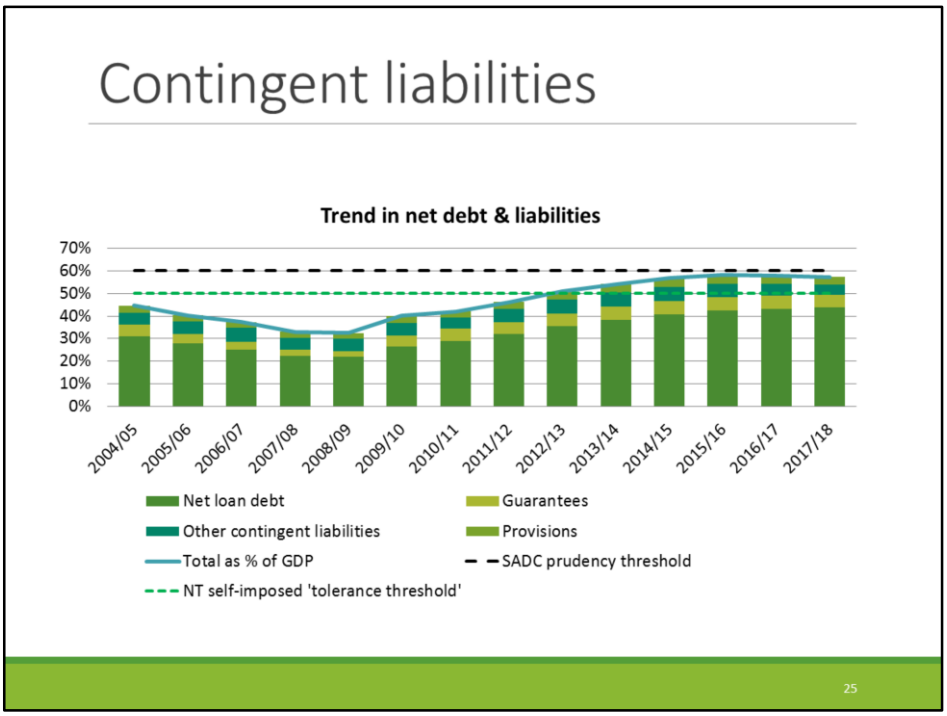
As noted, National Treasury is aiming to stabilise net government debt at just above 40% of GDP. A separate issue is the combination of net debt and 'contingent liabilities'.
A contingent liability is something that may lead to government expenditure in the future, but this is uncertain. (If it was certain it would simply be a liability, but it is 'contingent' on some future event).
SADC countries have agreed on a target threshold of 60% for net debt, provisions and contingent liabilities. National Treasury has elsewhere indicated that an appropriate 'prudency' or 'tolerance' threshold for South Africa would be 50%.
The main component of contingent liabilities are debt guarantees to SOEs.
In its recent Article IV consultation the IMF conducted a (standard) debt sustainability analysis. Part of this was modelling the outcomes of a 'shock' in which 75% of government's guarantees were called upon. The IMF found that the effects on debt would place the country in a 'high risk' zone.
However, the IMF does acknowledge that its modelled scenario is 'extreme'.
It is important to note that the question of asset sales resolves a different problem. Asset sales are a way of obtaining funds to provide *direct* support to SOEs (in this case, Eskom) whereas guarantees are designed to retain the funding burden in SOEs themselves with support of government.
There has been little detail on asset sales in Budget 2015 and Parliament has limited oversight over these decisions. Nevertheless, the PBO report on SOE funding discusses the issue in greater detail.



The graph shows the change in net debt and contingent liabilities, and the composition of this (as % of GDP), over the last decade and the forecast for the MTEF period.

As already mentioned, net loan debt has grown rapidly due to slower economic growth and government's counter-cyclical policy. Provisions, guarantees and other contingent liabilities have also grown in absolute terms, but have actually *decreased in relative terms.* In other words, net debt is a higher proportion of the total than it has been in the past.

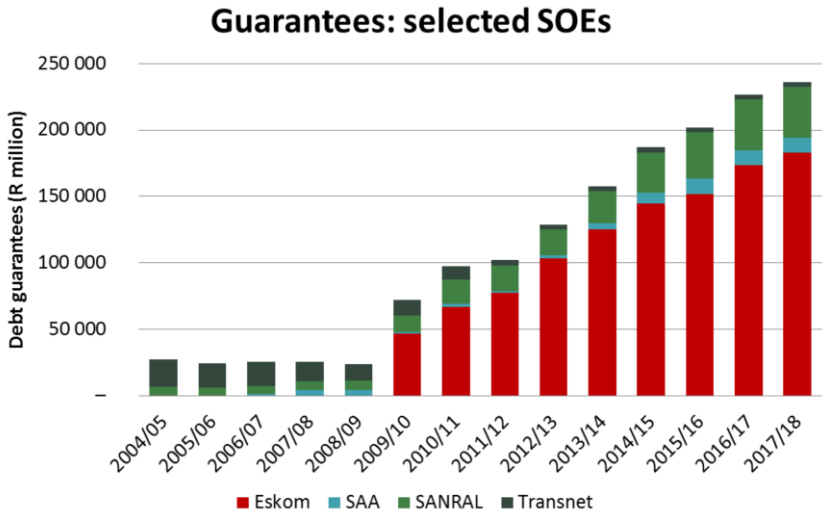
Note in relation to statements in the Budget, that the Road Accident Fund comprised 40% of 'other contingent liabilities' (at R98bil), almost double its percentage a decade earlier.

There are therefore three key points:

1. Total liabilities have already (in 2012/13) exceeded the self-imposed threshold. The planned fiscal consolidation over the MTEF will prevent the total exceeding the SADC threshold of 60%.
2. However, this is *primarily* due to growth in net loan debt, rather than debt

guarantees to SOEs.

3. The contingent liabilities shown here do not include guarantees to SOEs that have not been used as a basis for borrowing. E.g. Eskom has guarantees of R350billion but has only borrowed against R144.5 billion [see Table 8.5 in the Budget Review].


Guarantees: selected SOEs
Debt guarantees (R million)
250 000
200 000
150 000
100 000
50 000
–
2004/05
2005/06
2006/07
2007/08
2008/09
2009/10
2010/11
2011/12
2012/13
2013/14
2014/15
2015/16
2016/17
2017/18
Eskom
SAA
SANRAL
Transnet

Competitive neutrality

- Literature on SOE financing produced by IFIs increasingly focuses on 'competitive neutrality'
  - The idea that state support to SOEs should not benefit those enterprises relative to actual or potential private sector competitors
- In SA:
  - Incremental adoption of some principles (e.g. debt guarantee fees, market-related interest on loans, etc)
  - Recent PRC recommendations relating to economic regulation
- Unclear how/whether this principle is compatible with developmental state orientation
- With regard to current Appropriation Bills, Eskom has not actually paid interest or guarantee fees
  - Important question then: what mechanism is ensuring accountability for public funds?

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- Rationale for competitive neutrality is that allowing SOEs advantages over private firms dull the effect of competition ('market discipline') and thereby allows inefficiencies, reduces social welfare, etc
- Not clear that such considerations are necessary the primary concern in developing countries or, specifically, developmental states
- In context of the two Eskom Appropriation Bills, the important point is that while the original Act stipulated interest payments under certain conditions those conditions have not arisen. In the absence of such financial disciplining devices, detailed oversight of expenditure arguably becomes more important.

Eskom forecasts of supply status

- Eskom has useful website providing information on monthly forecasted supply, demand and expected shortfalls:

http://www.eskom.co.za/Whatweredoing/SupplyStatus/Pages/Supply_Status2.aspx