**3. REPORT OF THE STANDING COMMITTEE ON APPROPRIATIONS ON THE SPECIAL APPROPRIATIONS BILL [B36-2018] (NATIONAL ASSEMBLY – SECTION 77), DATED 27 NOVEMBER 2018**

Having considered the ***Special Appropriations Bill [B36 – 2018],*** referred to in terms of Section 13 of the Money Bills Amendment Procedure and Related Matters, Act No. 9 of 2009, the Standing Committee on Appropriations reports as follows:

1. **Introduction**

In the 2018 Medium Term Budget Policy Statement (MTBPS), the Minister of Finance announced that Government would allocate R5 billion of funding to the South African Airways (SOC) Limited (SAA) to settle debt redeeming between October 2018 and March 2019. This allocation would help prevent a call on SAA’s outstanding debt of R16.7 billion, which was guaranteed by Government. The Special Appropriation Bill (B36-2018) was therefore tabled by the Minister of Finance on 24 October 2018 along with the 2018 MTBPS.

Section 213(2) of the Constitution of the Republic of South Africa, provides that money may be withdrawn from the National Revenue Fund only in terms of an appropriation by an Act of Parliament. The Appropriation Act sets out to appropriate money from the National Revenue Fund for the requirements of the State and to prescribe conditions for the spending of funds withdrawn. In executing this mandate, the Standing Committee on Appropriations, hereinafter referred to as the Committee, was established in terms of section 4(3) of the Money Bills Amendment Procedure and Related Matters Act, No. 9 of 2009, and herein referred to as the Act.

In line with Section 13 (2) of the Act, the Committee has a responsibility to hold public hearings on any money bills and and report thereon to the National Assembly. To this end, advertisements were published in national and regional newspapers from 2 to 9 November 2018 inviting general public inputs and the submissions were received from the following individuals and organisations:

* Mr DW Nott
* Dr Sean Muller; and
* Congress of Trade Unions of South Africa (COSATU).

Public Hearings on the Bill were held in Parliament on 23 November 2018. In addition to the National Treasury which briefed the Committee on the Bill in its entirety, the following stakeholders were requested to provide written or oral submissions:

* Department of Public Enterprises;
* South African Airways (SOC) Limited;
* Parliamentary Budget Office; and
* Financial and Fiscal Commission.

1. **Provisions of the 2018 Special Appropriation Bill**

Clause 1(1) provides that the appropriation of R5 billion is for the requirements of the Department of Public Enterprises in the 2018/19 financial year in order to settle debts due by SAA.

In terms of Clause 1(2)(a), and subject to the Public Finance Management Act, 1999, the Accounting Officer of the Department of Public Enterprises must transfer the amount to SAA, referred to in clause 1(1), in the portions and on such dates determined by the Minister of Finance, taking into account the financial position of SAA as verified by National Treasury.

Clause 1(2)(b) provides that for the purpose of promoting transparency and the effective management of the R5 billion, the Minister of Finance must, in writing:

1. Impose conditions to be met by the SAA before any part of the amount is transferred;
2. Impose conditions to be met by the SAA after the transfer of any part of the amount; and
3. Stop the use of the amount in respect of which conditions have been imposed in terms of subparagraph (ii), until such conditions are met.

Clause 1(2)(c) of the Bill requires National Treasury to disclose the stoppage of an allocation in terms of paragraph (b) (iii) in its next quarterly report to the Standing and Select Committees on Finance.

Clause 1(2)(d) provides that any part of the amount referred to in subsection (1) not transferred to the SAA by 31 March 2019, reverts back to the National Revenue Fund.

Clause 2 of the Bill contains the short title.

1. **Submissions from stakeholders on the Bill**
   1. **National Treasury**

National Treasury gave a background to the historic financial performance of SAA and stated that the entity has incurred losses in 8 of the last 11 financial years since its unbundling out of the Transnet Group in 2007. Table 1 below provides overview of the historic performance of SAA over the last 11 financial years.

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Year** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** |
| Revenue | 20,652 | 22,511 | 26,888 | 22,263 | 22,824 | 23,861 | 27,098 | 30,266 | 30,492 | 30,716 | 30,742 |
| Operating costs (including depreciation and impairments | 21,174 | 23,629 | 24,582 | 20,805 | 21,815 | 25,114 | 28,089 | 32,653 | 34,509 | 31,084 | 36,005 |
| Net profit/Loss | (883) | (1,085) | 370 | 417 | 750 | (843) | (1,204) | (2,590) | (6,142) | (1,478) | (5,569) |

National Treasury further submitted that the several years of significant losses has led to the deterioration of SAA’s financial position which increased the entity’s reliance on government support. It was also reported that SAA will not be able to repay its maturing R5 billion government guaranteed debt during the 2018/19 financial year without recapitalisation. Furthermore, failure by SAA to meet its guaranteed obligations would result in a call by the airline’s lenders on the entire obligation totalling R16.7 billion. National Treasury further submitted that options being explored with the private sector include joint ventures and strategic equity partnerships.

* 1. **Department of Public Enterprise**

The Department of Public Enterprises (the Department) provided remarks highlighting the initiatives forming part of the turnaround strategy as well as actual improvement in performance due to implementation of the strategy. Reference was made to the Minister of Public Enterprises engagement with the SAA employees as well as efforts to clean up SAA and apply consequences for misconduct. It was reported that 14 employees at SAA were in the process of being disciplined in relation to procurement transgressions. The Department indicated a need for more funds to be injected into SAA in order to stabilise its finances and that efforts were currently underway to find a strategic equity partner for SAA.

* 1. **South African Airways**

In its submission, South African Airways SOC Limited (SAA) indicated that SAA has developed a long term turnaround strategy in 2013 which has since been revised due to limited success. In terms of the revised 2019-20123 corporate plan which was approved in 2017, SAA would break even by 2021 and would incur financial losses of R5.2 billion and R1.9 billion for the 2018/19 and 2019/20 financial years respectively. SAA reported a net loss of R5.7 billion for the 2017/18 financial year due to exposure to significant environmental and execution risk, driven, amongst others, by a lack of critical skills, a weak balance sheet, liquidity challenges and escalating oil prices.

SAA reported on its progress to date on the implementation of its long-term turnaround strategy. The strategy focuses on revenue stimulation and network optimisation, supply chain transformation and organisation design. Key achievements to date include the following:

* Route optimisation : reduction of domestic capacity leading to 3 out of 4 routes being profitable at the domestic level, reduction of London route frequency which has led to profit in the second quarter, the ceasing of Central Africa route to arrest losses, and optimisation of Low Cost Carrier Market through partnership with Mango Airlines ;
* Procurement interventions: implementation of new procurement policy to control spending, the cleaning up of supply chain organisation which ended up in some suspensions, and total savings of R400 million of the target of R1.6 billion.
* Organisational design: reduction of excess cabin crew and flight deck crew through sabbaticals, early retirement and release on contract.

More initiatives being implemented as part of the strategy include:

* increased aircraft utilisation, review of alternate routes to optimise asset use, and the conclusion of current fleet review and re-negotiation of leases;
* completion of procurement contract review and establishment of contract database to highlight spending categories, and the establishment of cross functional teams to focus on cost reduction and revenue leakages;
* completion of definition of new operating model; organisational design process is underway with final project plan being drafted and ongoing engagement with labour workgroups; and
* SAA Technical business transformation to address turnaround times for returning aircraft to operations, organisational and operational challenges and inefficiencies.

SAA provided an analysis of the potential risks to the successful implementation of the strategy along with the potential impact on SAA’s performance as well as mitigation measures. The keys risks identified by SAA pertain to funding and liquidity, oil price volatility, SAA technical organisational and operational issues, skills and capacity, and supply chain constraints. In terms of the Supply Chain Management constraints, SAA highlighted limitations as a result of the Public Finance Management Act and Treasury Instruction Notes. SAA requested that certain exemptions and concessions be granted to ensure the achievement of turnaround timelines, the reduction in cash burn and improvement of cash flow positions, and to focus management’s efforts on major cultural issues which impacted on the airline’s service and competitiveness. SAA alluded to the possible inability of attaining the R2.8 billion savings target within three years as well as its breakeven point if no exemptions or concessions were granted.

* 1. **Parliamentary Budget Office**

In its submission, the PBO provided an analysis on the Bill first by giving a background on SAA in the South African economic context. The PBO submitted that while some state-owned companies such as SAA received funding in 2018/19, their poor financial position could burden the public finances over the medium term. The PBO further submitted that government will however maintain the main budget expenditure ceiling, avoid increases in major tax instruments, and retain the compensation ceilings of national departments.

The PBO reported that government guarantees to SAA have extended by more than 13 times in the last five financial years with SAA using most of the guarantees. SAA had a R19.1 billion government guarantee facility from which R14.5 billion has been used. In general, the PBO suggested that SAA will not generate sufficient cash to repay its total debt and will have to negotiate with lenders to refinance of extend maturity dates.

The PBO also submitted that government’s support to SAA has often been accompanied and contingent on new turnaround strategies and changes to the executive and board. However, the effect of these changes remained unclear specifically relating to the financial position and sustainability of SAA. The said interventions were limited by the effect of cross-default requirements on government’s SOE debt. The PBO put forward that government will not allow any of its SOEs to default on debt, irrespective of the degree to which the SOE has implemented turnaround strategies.

The PBO raised concerns about the fact that SAA was not reflected in the budget as an entity of the Department of Public Enterprises as well the said department’s oversight role in terms of non-financial performance. The PBO also expressed concerns about the drawing-down of the contingency reserve to allow SAA to meet its debt obligations and was of the view that this could result in a reduced ability by government to respond to emergencies. It also suggested that government should be aware of breaching the self-identified expenditure ceiling as the Bill has placed upward pressure on the said ceiling. The PBO submitted that rating agencies may take a negative view towards breaching the said expenditure ceiling.

* 1. **Financial and Fiscal Commission**

In its submission, the Financial and Fiscal Commission (FFC) assessed the Bill within the context of the current economic climate of South Africa. The FFC submitted that, in general, SAA was not generating sufficient cash to repay its total debt and will have to negotiate with lenders to refinance or extend maturity dates. There was limited fiscal space for government to recapitalise SAA, and inefficiencies have translated into higher costs for consumers thus warranting private sector participation. The FFC further submitted that there was a great need for regulation to be clarified, costs optimised, and procurement contracts to be reviewed and for SAA to be commercially run. The FFC also made an analysis of the SAA’s profitability and sustainability focusing on both external and internal causes of decline.

The FFC made the following comments and recommendations with regard to the Bill:

|  |  |
| --- | --- |
| **Improving Performance and Profitability** | 1. Improve the organisational structure to capture fairer share of the value of SAA. This will require following:    * A clear long-term visionshared by both the airline and policymakers within its main shareholder – Government. Crucially, the foundation for such a long-term vision must be based on whether SAA is viewed as a strategic asset or simply a business    * Ensuring that the operations of the airline is carried out within the strict principles of non-interference from politicians. In accordance with good governance practices, there is a need to commit to ensuring that ownership and management of the airline are completely separate.    * Ensuring frugality by removing the soft-budget constraint that has become a feature of frequent intervention initiatives by the main stakeholder. Fiscal interventions by Government needs to be benchmarked against comprehensive assessment of the utilisation of bailout funds within the context of key performance indicators. 2. Be attractive to multiple stakeholders by doing the following:    * increase value for other stakeholders whose support is required in performance improvement;    * better customer service and satisfaction;    * simpler pricing for consumers;    * reduced costs of fragmentation;    * reduced congestion, delay, environmental impact; and    * more predictable wages, benefits and incentives for workers. |
| **Improving Capacity** | 1. The FFC recommends the review of government subsidies and guarantees for SAA and their ability to engage in excessive and destructive capacity expansion based on public funding. In addition, there is a need to modify labour policies that impose extra costs as well as limitation of excessive power by labour unions to disrupt key operations. |
| **Improving Customer Satisfaction to Enhance Revenues** | 1. Develop a shared understanding of the current organisational operation structure. Complete understanding of the full economic costs of the current organisational operation structure by all employees and the consequences of for customer satisfaction, service, and environmental impact. 2. Set pricing and capacity decisions based on longer-term profitability, reducing the tendency for competition to be focused on price at the expense of service, brand, and other dimensions. 3. Contract with suppliers in a way that reduces fixed costs or shares the demand risk, to enable more rational choices about capacity and pricing. 4. Simplify the pricing model to better link price and service quality, and discriminate less among customers receiving a similar service. 5. Explore a broader range of service and business models to encourage competition to occur on many different dimensions, not just pricing. |

* 1. **Congress of South African Trade Unions**

The Congress of South African Trade Unions (COSATU) submitted that, whilst it did not support endless bailouts to SOEs, it supports the R5 billion additional funding provided to SAA. This was due to the risk that SAA would not be able to service its debts which could provoke other lenders to SOEs to call in their loans and thus threaten not only the survival of SAA but also the state as a whole given the size of the SOE debt burden. COSATU further submitted that it supports the SAA’s turnaround plan which was beginning to show some results coupled with the new management team showing commitments to changing the current situation.

COSATU further submitted that it was equally concerned at some wasteful expenditure on management salaries and perks and was of the view that it could not expect workers to tighten their belts whilst those on top earned exorbitant salaries. The stakeholder further suggested that the turnaround plan needed to include comprehensive forensic audits, more modern and fuel-efficient planes, further cost cutting efforts, route re-evaluations, better coordination and integration with Mango and SA Express as well as partner airlines.

* 1. **Submission from Mr DW Nott**

Mr DW Nott submitted that no further money should be spent on government-owned airlines. He suggested that the government-owned airlines be privatised as there was no possible justification for government to maintain these when privately owned airlines ran competitively at no cost to the state. He also stated that these privately-owned airlines contributed to the state’s revenue in tax on profits.

* 1. **Submission by Mr SM Muller – Senior Lecturer at the School of Economics, University of Johannesburg**

Dr SM Muller submitted that the Bill was a simple document however it raised important and complex issues that have already been mentioned in various reports. He was also of the view that although the rationale behind the cash injection to SAA could be understood, the problem was that it was recurring and should as such not be considered in isolation.

He made reference to the various social and economic challenges facing South Africa and questioned whether bailing out a perpetually loss-making airline was more urgent than, for instance, addressing the consequences of gender-based violence. He submitted that SAA has received numerous cash injections in the past along with other SOEs. He also made reference to the current low economic growth, lowered expenditure ceilings and fiscal consolidation. He emphasized the need for avoiding the urgency of SOE bailouts and alluded to the need to address the institutional and financial structures within these entities.

He submitted that an argument, besides manufacturing an urgency, for providing cash injections was non-commercial/strategic importance of some SOEs for example it is argued that SAA is crucial to tourism and Denel is argued to be important for national security. He submitted that these arguments were hardly adequately interrogated and therefore tend to serve as a ‘get out of jail free card’ that is applied in terms of requests for funds. He questioned whether SAA had any non-commercial mandates that it is currently serving, or whether there were any such mandates that justify persistent fiscal support.

Mr Muller further suggested that shareholder compacts were at the core of SOE accountability to the Executive as well as the legislature and recommended that these be made available, assessed for suitability, and checked for adherence. He further submitted that short and long term funding needed to be consistent with shareholder compacts.

1. **Committee Findings and Observations**

Having considered all the submissions made by the above stakeholders on the 2018 Special Appropriation Bill, the Standing Committee on Appropriations made the following findings and observations:

* 1. The Committee takes note of the financial challenges being experienced by South African Airways (SAA) which necessitates the recapitalisation of R5 billion in order to repay a government guaranteed debt facility maturing on 30 November 2018. The Committee notes that if SAA were to default on this government guaranteed debt this would trigger SAA lenders to call the entire government guaranteed obligations totalling R16.7 billion which would have serious negative implications for the fiscus.
  2. The Committee welcomes the improvements that have already been realised by SAA in the implementation of its turnaround strategy. Key improvements relate to revenue stimulation through route optimisation, procurement interventions which have resulted in savings of   
     R400 million and the reduction of excess crew through offers of sabbaticals and early retirement.
  3. The Committee notes that the Department of Public Enterprises and South African Airways are engaged in efforts to find a strategic equity partner for SAA in the future. SAA envisages a strategic equity partner in the form of an airline that would bring on board innovation, skills, synergies as well as operational leverage.
  4. The Committee views continuity in terms of the management of SAA as essential in ensuring long-term sustainability and the yielding of significant successes in the implementation of the turnaround strategy.
  5. The Committee notes that although SAA has operated at a loss since 2012, it projects to break-even by 2021 based on key assumptions holding true. The Committee also notes risks that may impact on the implementation of the turnaround strategy which pertain to funding and liquidity, oil price volatility, SAA technical organisational and operational issues, skills and capacity, and supply chain management (SCM) constraints.
  6. The Committee notes that SAA has highlighted SCM constraints as a risk due to some limitations of the Public Finance Management Act and Treasury Instruction Notes. SAA requested certain exemptions and concessions to ensure the achievement of turnaround timelines, the reduction in cash burn and improvement of cash flow positions, and to focus management’s efforts on major cultural issues which impacted on the airline’s service and competitiveness.
  7. The Committee views the requirements and stipulations of the Public Finance Management Act and Treasury Instruction Notes as critical for accountability, transparency and ensuring value for money in the procurement of goods, works and services. Whilst the Committee does not condone failure to adhere to supply chain management regulations, it does however, note that the above-mentioned legislative instruments do allow for certain exemptions and deviations on approval by National Treasury. The Committee is of the view that entities like SAA should within the parameters of these legislative instruments balance accountability and transparency with profitability and the competitive edge.
  8. The Committee supports provisions in the 2018 Special Appropriation Bill which enable the Minister of Finance to impose conditions on any part of the R5 billion appropriation. The aim of these conditions must be to promote and enforce transparency and efficient management in respect of revenue, expenditure, assets and liabilities of public entities as required by section 6(1)(g) of the PFMA.
  9. The Committee welcomes submissions from the FFC, PBO, COSATU and Dr Sean Muller on ways to address challenges confronting SAA. Key recommendations by stakeholders relate to:
* the improvement of performance and profitability, capacity, and customer satisfaction in order to enhance revenue;
* the benchmarking of fiscal interventions by Government against comprehensive assessment of the utilisation of bailout funds within the context of key performance indicators;
* the implementation of comprehensive forensic audits; utilisation of fuel-efficient aircrafts, and better co-ordination and integration with other airlines; and
* the review of shareholder compacts as a core for SOE accountability.

1. **Recommendations**

The Standing Committee on Appropriations, having considered the briefings and comments by invited stakeholders on the 2018 Special Appropriation Bill, recommends as follows:

* 1. That the Minister of Public Enterprises should ensure the following:
     1. That the requisite support is provided to South African Airways to ensure continuity and the maintenance of the relevant skills and institutional knowledge in the entity’s efforts towards long-term sustainability.
     2. That South African Airways engages with National Treasury (the Office of the Chief Procurement Officer) on supply chain management exemptions and concessions that are within the legislative parameters in order to mitigate risks towards the attainment of its targets.
     3. That the conditions imposed by the Minister of Finance to the allocation for South African Airways are strictly complied to.
  2. That the Minister of Finance should ensure the following:
     1. That the following conditions are implemented:

1. Impose conditions to be met by the SAA before any part of the amount is transferred;
2. Impose conditions to be met by the SAA after the transfer of any part of the amount; and
3. Stop the use of the amount in respect of which conditions have been imposed in terms of subparagraph (ii), until such conditions are met.
   * 1. That the framework of the conditions referred to in 5.2.1 above be provided to the Committee.
     2. That any future considerations for recapitalisation of SAA and other entities are benchmarked against comprehensive assessment of the utilisation of bailout funds within the context of key performance indicators.
     3. That National Treasury in its review of the Supply Chain Management Reforms considers the extent to which laws and regulations enable profitability and competitive edge for state owned entities.
4. **Committee Recommendation on the Bill**

Notwithstanding the recommendations in section 5 above, the Standing Committee on Appropriations recommends that the National Assembly adopts the Special Appropriation Bill [B36-2018], without amendments.

**Conclusion**

The responses to the recommendations as set out in section 5 above by the relevant Executive Authorities must be sent to Parliament within 60 days of the adoption of this report by the National Assembly.

Report to be considered.