PRESENTATION TO STANDING COMMITTEE ON PUBLIC ACCOUNTS

Briefing on State-Owned Company (SOC) bailouts and government guarantees

PRESENTED BY:

Asset and Liability Division

Date: 14 March 2023

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

STAY SAFE
VACCINATE TO SAVE SOUTH AFRICA

State-Owned Company (SOC) Challenges

- The 2012 Presidential Review Commission (PRC) on State-Owned Companies (SOCs) highlighted several challenges facing these entities: multiple and conflicting objectives, inadequate financing policies and framework, lack of adequate oversight and accountability, severe weaknesses in board composition and functioning, and lack of transparency and accountability.

- Over the last decade there has been a significant decline in the performance of major SOCs as operational costs have increased, net profits have fallen, and debt levels have become increasingly unsustainable.

- Customers have also complained about the increasingly poor levels of service delivery. Compensation costs in general have far outpaced the growth of these businesses and have become a key factor in declining net profit or losses.

- The multiple bailouts for Eskom, SAA, SABC, Post Office and others have become a fiscal burden, and the high debt levels have increased fiscal risk to unacceptable levels and crowded out important social and other expenditure.

Government guarantees – context

CONSTITUTION

- Section 218(1) of the Constitution stipulates that “The national government, a provincial government or a municipality may guarantee a loan only if the guarantee complies with any conditions set out in national legislation”.
- Section 218(3) stipulates that “Each year, every government department must publish a report on the guarantees it has granted”.

PUBLIC FINANCE MANAGEMENT ACT

- The Public Finance Management Act 1999, Act No 1 of 1999 (PFMA) gives effect to Section 218(1) of the Constitution.
- Section 66 of the PFMA prescribes the powers of Government and the public entities to borrow money, issue guarantees, indemnities and or securities that may bind the National Revenue Fund.
- Section 70 of the PFMA stipulates the responsibility of Cabinet members for the issuance of guarantees, indemnities and or securities as well as duties of the responsible Cabinet Member. It also stipulates that the Minister of Finance has to concur with the issuance of such guarantees, indemnities and or securities.
- Section 70(3) of the PFMA stipulates that “A Cabinet member who seeks the Minister’s concurrence for the issue of a guarantee, indemnity or security, must provide the Minister with all relevant information as the Minister may require regarding the issue of such a guarantee, indemnity or security and the relevant financial commitment.”

Government guarantees – policy framework

- A government guarantee is a contractual obligation to cover the beneficiaries in meeting their financial obligations such as on loans/bonds repayments and/or interest payments under specific circumstances.

- The obligation is triggered by the inability of a beneficiary to service those guarantees obligations.

- Guarantees were intended to be issued based on the following 1996 Cabinet approved guidelines:
  - Limiting the issuance of guarantees to reduce the gross contingent liability obligation;
  - Allow public entities to borrow on the strength of their balance sheets using guarantees;
  - Using guarantees, in exceptional cases to support restructuring objectives and to meet international agreement obligations; and
  - Levying guarantee fees to equalise benefits on borrowing cost margins of public entities borrowing with a guarantee and those borrowing without a guarantee.

Government guarantees – as at March 2023

R billion	2020/21		2021/22		2022/23	
	Guarantee	Exposure[2]	Guarantee	Exposure[2]	Guarantee	Exposure[2]
Public institutions	**581,6**	**384,7**	**559,9**	**395,3**	**478,5**	**396,1**
of which:						
Eskom	*350,0*	*298,3*	*350,0*	*313,0*	*350,0*	*337,8*
SANRAL	*37,9*	*37,4*	*37,9*	*42,0*	*37,9*	*28,6*
Trans-Caledon Tunnel Authority	*43,0*	*13,2*	*25,0*	*9,6*	*25,0*	*8,7*
South African Airways	*19,1*	*6,7*	*19,1*	*2,8*	*19,1*	*0,3*
Land and Agricultural Bank of South Africa	*9,6*	*2,4*	*9,6*	*1,9*	*8,1*	*0,4*
Development Bank of Southern Africa	*10,0*	*4,9*	*9,9*	*5,2*	*9,9*	*5,5*
Transnet	*3,5*	*3,8*	*3,5*	*3,8*	*3,5*	*3,8*
Denel	*6,9*	*3,4*	*3,4*	*3,5*	*3,4*	*0,3*
South African Express	*0,2*	*0,0*	*0,0*	*0,0*	*0,0*	*0,0*
Industrial Development Corporation	*0,5*	*0,1*	*0,5*	*0,1*	*0,5*	*0,1*
South African Reserve Bank[3]	*100,0*	*13,7*	*100,0*	*12,8*	*20,0*	*10,0*
Independent power producers	**200,2**	**176,7**	**200,2**	**165,7**	**208,5**	**187,1**
Public-private partnerships[4]	**8,0**	**8,0**	**7,9**	**7,9**	**7,1**	**7,1**

1. A full list of guarantees is given in Table 11 of the statistical annexure in the Budget Review

2. Total amount of borrowing, adjustments to inflation-linked bonds as a result of inflation rate changes and accrued interest

3. In April 2022, the Minister approved the reduction of the loan guarantee scheme to R20 billion

4. These amounts only include national and provincial PPP agreements

Source: National Treasury

- Government's exposure to contingent liabilities emanating from guarantees issued to public entities, (representing utilised guarantees) is expected to reach R396.1 billion in from R384.7 billion as at 31 March 2021.
- The total issued guarantees declined from R581.6 billion in 2020/21 to a projected R478.5 billion as at 31 March 2023.
- Exposure to Eskom comprises 85.3 per cent of the total.

Government guarantees – minimum criteria 1

- The Fiscal Liabilities Committee (FLC) is a structure within the National Treasury that advises the Minister of Finance on all guarantee requests received.
- To improve the quality of requests submitted to FLC and Minister of Finance, an Instruction Note outlining minimum criteria to be met before guarantees are considered was issued by the Minister of Finance in December 2020.
- Minimum criteria includes:
  a) There should be a demonstrable need for government to accept the risk (i.e. the underlying transaction must be necessary in the fulfilment of the applicant's mandate in accordance with government's overall strategy);
  b) The applicant must demonstrate adequately that it will generate sufficient cash flows during the term of the underlying transaction (e.g. debt obligation) that will enable it to settle its obligation in line with the terms of the transaction timeously;
  c) The guarantee, security, indemnity, borrowing limit, or transaction for which an approval is being applied for, should be offered by government and should be in line with all applicable legislation;

Government guarantees – minimum criteria 2

d) The type of project that the underlying financing is needed for should be in line with the applicant's mandate;

e) Sufficient evidence that, a clear assessment of the underlying project viability or lending activity in the case of a development finance institution (DFI), has been conducted by the relevant Ministry should be submitted as part of the application. Where it is determined that the underlying project will yield social benefits without generating enough revenue and returns that will enable the public entities to service the required debt, then the project or lending activity should be funded through the budget appropriation process; and

f) Public entities that have previously not adhered to guarantee conditions should not submit applications for new guarantees.

- Requests that do not meet the criteria are not considered by the FLC.

Historical SOC Bailouts

- Government has granted R331.2 billion in recapitalisations over the period 2013/14 to 2022/23, of which Eskom accounts for 55% of the total recapitalisations.
- Recapitalisations were granted for the implementation of turnaround plans, to repay debt/government guarantees, improve liquidity and for capital expenditure.

SOC Recapitalisations											
R'mil	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**Total**
Eskom	-	-	23 000	-	-	-	49 000	56 000	31 693	21 857	**181 550**
SAA	-	-	-	10 000	-	10 500	20 800	4 300	1 800	1 000	**48 400**
SANRAL	-	-	-	-	-	-	-	-	-	23 736	**23 736**
Sasria	-	-	-	-	-	-	-	-	22 000	-	**22 000**
Land Bank	300	500	-	-	-	-	-	3 000	4 563	5 200	**13 563**
SAPO	205	-	174	650	3 700	3 263	-	-	-	2 400	**10 392**
Denel	-	-	-	-	-	-	1 800	576	3 036	3 583	**8 994**
DBSA	2 400	2 500	3 000	-	-	-	12	-	-	-	**7 912**
Transnet	-	-	-	-	-	-	-	-	-	5 837	**5 837**
SA Express	-	-	-	-	-	1 249	300	164	-	1 583	**3 296**
SABC	-	-	-	-	-	-	3 200	-	-	-	**3 200**
ACSA	-	-	-	-	-	-	-	2 325	-	-	**2 325**
	2 905	**3 000**	**26 174**	**10 650**	**3 700**	**15 012**	**75 112**	**66 365**	**63 091**	**65 196**	**331 206**

Eskom 1

- In 2008, Parliament approved that funding totalling R60 billion be provided in the form of a subordinated loan to Eskom to support its capital expenditure programme. The money was appropriated as follows: R10 billion in 2008/09; R30 billion in 2009/10 and R20 billion in 2010/11 through the budget of the NT.
- To strengthen Eskom's balance sheet, Cabinet approved the provision of a support package in September 2014, which included the conversion of the existing R60 billion subordinated loan to equity. The conversion of the subordinated loan did not have direct cash flow impact either for Eskom or Government.
- The support package also included an allocation of R23 billion to Eskom which was to be funded through the sale of non-strategic assets.
- Over the period 2015/16 to 2022/23, Eskom received bailouts to the value of R181.55 billion excluding the conversion of the subordinated loan.
- In the February 2019 Budget Speech, the Minister of Finance announced that Government has set aside R23 billion per year for the ten years to financially support Eskom, with the accumulated fiscal support amounting to R230 billion.

Eskom 2

- However, due to a decline in Eskom's financial position, a Special Appropriation Bill was tabled on an urgent basis to allocate a significant portion of the R230 billion fiscal support earlier than initially planned.
- Of the R230 billion government support package, Government has provided R158.6 (R49 billion, R56 billion, R31.7 billion and R21.9 billion for 2019/20, 2020/21, 2021/22 and 2022/23 respectively). Of R21.9 billion in equity allocated for the 2023 financial year, R11 billion was received by 31 December 2022, with the remaining balance received in January 2023.
- In the 2023 Budget, the Minister of Finance proposed a total debt-relief arrangement for Eskom of R 254 billion.
- This consists of two components. One is R184 billion. This represents Eskom's full debt settlement requirement in three tranches over the medium term. Second is a direct take-over of up to R70 billion of Eskom's loan portfolio in 2025/26.
- Because of the structure of the debt relief, Eskom will not need further borrowing during the relief period.
- Government will finance the arrangement through the R66 billion baseline provision announced in the 2019 Budget, and R118 billion in additional borrowings over the next three years.

South African Airways (SAA)

- The total direct recapitalisation amount for SAA since 2007 until the airline was placed into business rescue in December 2019, amounts to R22.8 billion.
- An additional R16.4 billion was allocated over the 2020 Medium Term Expenditure Framework (MTEF) period for the repayment of government guaranteed debt.
- An additional R10.5 billion was also made available to SAA in 2020/21 for the implementation of the business rescue plan following the 2020 Medium Term Budget Policy Statement (MTBPS).
- The Minister of Finance has also announced an additional allocation of R1 billion in the February 2023 budget speech for SAA for the settlement of outstanding business rescue process obligations.
- Therefore, when the 2023 Appropriation Bill is assented into law, SAA will have received a total of R50.7 billion in direct government funding from 2007 to 2022, of which R48.4 billion will have been received in the past 10 years.

Airports Company South Africa (ACSA)

- The COVID-19 pandemic and the subsequent travel restrictions negatively affected the operations of ACSA. ACSA recorded a 92% decline in traffic volumes in the first six months of 2020/21 when compared with 2019/20.
- Traffic volumes were not expected to return to the pre-covid 19 levels in the medium-term, leading to shortfalls in available funds to meet ACSA's operational requirements.
- To mitigate against the impact of the pandemic, ACSA engaged with its shareholders, including Government, on possible shareholder support.
- As a result, Government allocated R2.3 billion to ACSA in the 2020 Medium-Term Budget Policy Statement (MTBPS) for the purchase of redeemable preference shares to cover the shortfall resulting from the reduced traffic volumes.

TRANSNET

- The Special Appropriation Act (2022) provided Transnet with R2.9 billion to accelerate locomotive repair and maintenance.
- The Adjustments Appropriation Act (2022) provided an additional R2.9 billion to Transnet to restore infrastructure damage caused during the April 2022 floods in KwaZulu-Natal

SANRAL

- SANRAL was allocated R23.7bn to settle maturing debt and debt-related obligationsincluding debt obligations related to Gauteng Freeway Improvement Project, through a Special Appropriation Bill in 2022.

SABC

- In 2019, the SABC was experiencing severe liquidity constraints threatening its going concern status due to a decline in audience share resulting in low revenue.
- This resulted in government allocating R3.2 billion to the South African Broadcasting Corporation (SABC) through the contingency reserve in 2019/20. The funds were intended to help the SABC pay its bills, acquire new content and conduct maintenance required in line with its turnaround plan. The SABC was required to meet a set of pre-conditions before any funding was disbursed.

South African Post Office (SAPO)

- SAPO's financial position deteriorated drastically after the cessation of the (universal service obligation (USO) subsidy in 2013.
- The unfunded USO mandate coupled with its outdated business model resulted in SAPO relying on loan funding for its working capital requirements.
- As SAPO could not repay these loans, SAPO required R7.9 billion in recapitalizations over the period 2014 to 2019 to repay outstanding debt as well as to implement its turnaround plan and invest in capital expenditure.
- Despite SAPO, receiving recapitalisations and its USO funding being reinstated in 2019, SAPO still could not improve its financial position due to its outdated business model relying on traditional mail which is declining globally.
- SAPO's decline was exacerbated by the Covid-19 pandemic, resulting in government approving a recapitalization of R2.4 billion in 2023 to assist SAPO in implementing its new turnaround plan.

DENEL

- Denel has been experiencing liquidity and solvency challenges that emanated from, amongst others, weak governance structures, poor programme execution, poor working capital management, a high cost base with declining revenues, poor contracting resulting in the entity taking on unprofitable projects etc.
- Due to Denel's ailing financial position, the entity has not been able to meet its financial obligations i.e. guarantee obligations, supplier and salary payments, tax obligations etc.
- Therefore, in 2019/20 and 2020/21 Denel was recapitalised with R1.8 billion and R576 million, respectively. These funds were provided in support of the entity's turnaround plan.
- An additional, R3.4 billion has been allocated in 2022/23 to assist the entity with the completion of its turnaround plan. These funds will only be disbursed to the entity following adherence to the conditions attached thereto.
- In 2021/22 and 2022/23, Denel was provided with funds amounting R3.035 billion and R204.7 million respectively. These funds assisted the entity to meet obligations under its Domestic Medium Term Note Programme i.e. payment of maturing bonds and associated interest payments.

SASRIA

- Following the July 2021 unrest, Sasria received claims that were higher than anticipated and this significantly deteriorated Sasria's financial position.
- Thus, in 2021/22, Government recapitalised Sasria with R22 billion.
- The funds enabled the entity to settle valid claims and assist the entity to recover its solvency cover ratio in line with the regulatory (Prudential Authority) requirements.

Land Bank

- Over the period 2013/14 to 2022/23 the Land Bank has received bailouts to the value of R13.6 billion.
- From 2010 to 2013 the Land Bank was provided R3.5 billion to support it from the financial loses it experienced over the last years and support it liquidity challenges.
- In the Budget 2021, R7 billion was allocated to the Land Bank to (a) cure the default position; and (b) re-establish the development and transformation mandate of the Land Bank of which R5.2 billion will flow in 2022/23 with the remainder to flow over the MTEF period. Any consideration for additional funding will be provided to the Land Bank upon completion of a new business case, subject to government Budget process.
- Since 2011 the Land Bank also received government guarantees totaling R5,2 billon for both development lending, to address liquidity shortfalls and to boost the deteriorating capital position.

The Development Bank of Southern Africa

- In 2014 to 2016 the DBSA received a total injection of R7,9 billion to support its turn around strategy and restructuring, to supplement the DBSA's capital and to support their development mandate.