Bail-out for SAA ‘the wrong message’

The Financial and Fiscal Commission says government guarantees should not be taken for granted, despite R10bn being provided to SAA in 2017-18

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Pull quote: SAA continued to make losses despite numerous interventions, with the commission noting that the interventions seem to be superficial and do not address underlying core reasons for the airlines woes.

The Financial and Fiscal Commission has warned that the government’s decision to bailout the struggling South African Airways (SAA) could send the wrong message to the airline and other state-owned entities, which could create perverse incentives that undermine basic principles of fiscal responsibility.

On Tuesday, the commission briefed Parliament’s standing committee on appropriations on SAA’s debt relief and recapitalisation plan. This was ahead of the airline’s appearance before the committee next week.

The commission has the responsibility to advise and make recommendations to Parliament, provincial legislatures, local government and other organs of state on financial and fiscal matters. It said in its submission that guarantees should not be viewed as an easy option, as now appears to be the case: "Guarantees should not be taken for granted and become a default response position."

Finance Minister Malusi Gigaba said in his medium-term budget policy statement (MTBPS) in October that the recapitalisation of SAA and the South African Post Office (Sapo) put the expenditure ceiling at risk of a R3.9bn breach.

Total recapitalisation of R10bn will be provided to SAA in 2017-18. An amount of R5.2bn has already been provided, with the remaining R4.8bn to be transferred by March 31 2018.

SAA and Sapo have both been in the throes of a serious financial crisis in recent years, which has posed a serious risk to the fiscus. Eskom, which has the largest government guarantee at R350bn, has also been facing financial turbulence because of weak governance.

The commission said the SAA bailout will likely increase the budget deficit and further push back fiscal consolidation over the medium term. However, should the government follow through on plans to dispose of state assets, including a part of its shares in Telkom, to offset expenditure incurred, this will have a neutral impact on the budget, but government’s balance sheet will still be negatively affected.

Gigaba said in October that details on the disposal of state assets will be announced at the beginning of 2018. Their sale is a once-off cash injection and cannot be called on again to balance off future expenditure needs, the commission said.

The most successful businesses seek to minimise interest expense and optimise the mix of debt instruments within their total portfolio, the commission said, and, as such, the government's repayment of SAA's debt and injecting equity into the company was a step towards managing the airline's debt and minimising its interest expense.

"However, the commission is concerned that this bailout will create the perception that SAA and other public entities can count on government to support it when faced with financial troubles. This may create perverse incentives that undermine the basic principles of fiscal [responsibility]."

Furthermore, given SAA's existing loan commitments, the equity injection into the airline may not be sufficient to secure its long term viability. "Given that guarantees are not exposed to the same level of scrutiny in the budget process as regular spending, the commission advises that oversight mechanisms of guarantees be strengthened to reduce the risk of unintended consequences from materialising, particularly at national treasury, macro-risk oversight division."

Treasury deputy director-general Ismail Momoniat told MPs that it was frustrating that SAA kept coming back for government assistance.

"It is extremely frustrating when an entity keeps coming back again and again and the issue is not resolved … Hard questions have to be asked. Why have those entities failed?" said Momoniat. "Those guarantees are coming to haunt us and there is recklessness taking place as we see with Eskom … It is painful to come here and ask for appropriations for these entities ... I don't think we can fully account for their failures."

The commission also noted that SAA's ongoing financial woes occur in stark contrast to thriving domestic and international competitors. Reasons for SAA's underlying losses included tough competition, poor fleet fit for purpose, operational inefficiencies and managerial issues. SAA continued to make losses despite numerous interventions, with the commission noting that the interventions seem to be superficial and do not address underlying core reasons for the airlines woes.

For SAA to return to profitability, the commission proposed that, among other interventions, it renegotiate contracts, including network arrangements, leases and fleet structure; sell off non-strategic assets such as the Airlink stake, which undercut SA Express; halt operations on non-performing routes; and diversify income away from ticket sales to also focus on catering, lounges and technical services.

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