CHAIRPERSON: Can the witness confirm that he is still under oath?

MR DONALDSON: I do.

MS RAMAGAGA: Thank you Chair. Before I proceed with the evidence of Mr Donaldson I'd like to bring it to the attention of the Commissioner that the documents "AD1" and "AD2" have been retrieved from the possession of the Lawyers for Human Rights, "AD9" and "AD10" I beg your pardon. We have discussed and we have also furnished them with copies of the bundle that does not have the two documents. It has been explained to the Lawyers for Human Rights that the departments, the relevant department will undertake proper recognised declassification of the concerned documents where after the documents would then be furnished to them, that is the declassified documents.

CHAIRPERSON: I'm sorry, are we talking about (indistinct) or is it only "AD9"?

MS RAMAGAGA: It is only "AD9" and "AD10" Chair.

CHAIRPERSON: "AD9" and "AD10"?

MS RAMAGAGA: Yes, only "AD9" and "AD10".

CHAIRPERSON: Just before we start do you want to say something?

ADV SNYMAN: Thank you Chairperson. I confirm (indistinct) this morning a complete file of this bundle except for Annexures "AD9" and "AD10".

CHAIRPERSON: Thank you. You may then proceed.

MS RAMAGAGA: Thank you Chair. Mr Donaldson when we adjourned we had, you had completed leading evidence in respect of paragraph 55 of your statement and we were just about to start with paragraph 56 which appears on page 28 of the witness's statement. Now paragraph 56 deals with the criticisms that is out there about the role that was played by the Department of Finance with respect to the Affordability Report and in actual fact the criticism is about the effect and the impact of the Affordability Report. Would you proceed to testify about that?

MR DONALDSON: Thank you Chairperson. The Arms Procurement has been the subject of considerable public interest and comments and publications and I don't intend to try to comment in detail on the criticism of the procurement but just to point out three important aspects of the financial implications of the procurement, it has sometimes been argued that the costs of the procurement initially announced at R30bn was underestimated because the effects of inflation were not taken into account and I merely point out here that it is common practice in respect of long term procurements or major projects that take place over a considerable period of time for the prices to be stated in constant price terms, in real price terms at the start and for contract price escalation clauses to be included in the agreements to take account of the effect of inflation and that is exactly the reason why the initial R30bn expenditure in 1999 prices translates into a cash or nominal expenditure over the subsequent 14 years or so that adds up to just over R40bn, or approximately R46.5bn.

And then secondly there has been arguments that the costs of the SDPP were underestimated because the risks of Rand depreciation were not sufficiently taken into account and it's sometimes been suggested that the Affordability Report did not pay sufficient attention to this but as we've already seen in fact the Affordability Report deals in some detail with exchange rate risk and in fact presented it to Cabinet prior to the final decision being taken, a cost estimate and that is the R36bn cost estimate that I referred to, or to earlier, that explicitly takes into account the risk of a real depreciation of the Rand over time, and so the Ministers' Committee and Cabinet were fully alive to this concern and the associated risks were dealt with in detail in the Affordability Report.

And I make an economic point here which is that when a company's currency depreciates in its balance of payments the effects of that depreciation are seen both in the inflows and outflows both in export values and in import values and indeed a substantial depreciation translates over time into higher earnings of the export industries which in turn contribute through tax revenue to higher Government revenue, so properly understood as paragraph 56.2 concludes depreciation risks are partially mitigated by offsetting balance of payments and fiscal adjustments. And then thirdly it's sometimes been argued that the costs of the SDPP, of the Procurement Programme were underestimated because the interest in debt repayments were excluded, and here we just simply need to distinguish between the cost of the goods or goods and services that were purchased, just when one buys a motor vehicle the cost of the motor vehicle is a R100 000 or R200 000, the cost of the motor vehicle doesn't change if you pay cash for it or if you borrow money from a bank from it, or indeed if you sell your house in order to buy it, the price of the motor vehicle is what it is, but it is the price of debt that is relevant to the financing arrangements and governments manage the debt and their, and the costs of servicing that debt on a consolidated basis, in other words what is of interest is the overall debt of government and not just the debt or loans that may be associated with one particular procurement. So, those are three broad aspects that have come under criticism where I think it is helpful to offer that clarification. Thank you.

MS RAMAGAGA: Right, thank you. Then in paragraph 57 you mention that based on the information that was placed before the Ministers' Committee, which information came from the three divisions that were advising the Ministers' Committee a decision was then made that the procurement should be done, is that correct?

MR DONALDSON: That's correct Chairperson.

MS RAMAGAGA: And evidence has already been led about the fact that the decision to procure included procurement in tranches. Now I will take you to the next paragraph, the one that deals with the procurement decision and its costs to budget. In paragraph 58 you are talking about the initial projected costs of the Arms Acquisition Programme. Will you take the Commission through that evidence.

MR DONALDSON: Chairperson, what I wish to emphasise here is that in our budget documents tabled in Parliament first in 1998 and then with more detail in 1999 and subsequent years there has always been disclosure of the procurement and its future financial implications, and so in paragraph 58 we refer to the statement in the 1998, February 1998 National Expenditure Survey which is tabled in Parliament at the time of the budget about the Cabinet decision of November 1998 and then the following year the National Expenditure Survey at the time of the budget indicated that the procurement would extend over about 15 years, that the expenditure would be accommodated within the Defence Budget and so we indicated right at that stage that the actual outlays, whether for the local production components or the imported components would be shown on the Defence Budget and it was indicated that negotiations were in process to finalise the terms and conditions of these acquisitions.

MS RAMAGAGA: Right. The National Expenditure Survey referred to in this paragraph, in paragraph 59 "AD14" does appear in page 438 of the bundle, the document itself is explanatory and as a result it will not be necessary for you to highlight any portion of the document. The next evidence that you are dealing with in your statement is the Procurement Decision. This evidence actually gives a breakdown relating to the Procurement Decision and the evidence has already been, similar evidence has already been presented before the Commission. The same applies with paragraph 61, that information is already with the Commission by evidence that has been presented by other witnesses that testified before you.

The same applies with, let me see, ... Okay, will you just briefly talk about paragraph 62 of your statement, it appears on page 32 Commissioners.

MR DONALDSON: Yes Commissioners. In paragraph 62 I refer to the announcements that was made by Cabinet after that September decision and the public statement that was made that dealt with the costs of the procurement and so it was indicated and publicly stated at the time that the first tranche, the part of the procurement that was committed to in 1999 would amount to R21.3bn over eight years in 1999 prices and to be clear about what those prices refer to at a fixed exchange rate of R6.25 to the Dollar or the equivalent rates to other currencies, and it was indicated that taking into account prevailing forward foreign exchange rates the cost would be somewhat higher in real terms or R23.1bn, so there was an indication publicly at the time of a recognition of the foreign exchange cost risks or the possibility of a higher real cost of the programme associated with exchange rate movements and it was indicated that if the second and third aircraft tranches were included the overall cost would amount to R30bn over a longer time period of 12 years, again at the fixed exchange rate of R6.25 to the Dollar, or to approximately R35bn taking into account forward foreign exchange rates, and so there was an indication right at that time of the, of the higher costs associated with possible future Rand depreciation.

MS RAMAGAGA: Thank you. And in paragraph 63 you were dealing with the contract, actually you mentioned that the contract cost excludes the price escalation associated to the inflation and that evidence has already been presented to the Commission, and turning the page over to page 33 at paragraph 64 you refer to the Cabinet's announcements on its decisions on the SDPP's and the documents that you refer to are "AD15" and "AD16" respectively. Is there anything that you would like to highlight on the two press releases?

MR DONALDSON: Chairperson no, I think they are self-explanatory and merely wants to emphasise that there was public disclosure at this time of the projected costs, perhaps

Chairperson I can add that in the next paragraph these were elaborated in the published Medium Term Budget Policy statement which was tabled in Parliament in October, so the following month in October of 1999 and the statement that is quoted in that paragraph recognises this is a procurement programme intended to strengthen Government's capacity to contribute for example to the resolution of conflict on our continent and to allow the Defence Force to upgrade obsolete Defence equipment and thereby contribute to our broader security and peacekeeping responsibilities. And again in the Medium Term Budget Statement the cost in 1999 prices, in 1999 Rand was set out.

MS RAMAGAGA: Right, then shall you proceed to page 34 of your statement, "The Cost to Budget of the Procurement Decision". Now can you just briefly talk about the contents of paragraph 67, 68 and 69, bearing in mind that you have already dealt to an extent in detail with similar information.

MR DONALDSON: Thank you Chairperson. Beginning in 2000, 2001 which was the first year of actual expenditure on the SDPP its annual costs were provided for on the Defence Appropriation Vote, so in the Appropriation Bill submitted to Parliament at the time of the budget these were, these would have been, these costs were included in the Defence Vote and in the published three year estimates of national expenditure, because of the importance and because of the significance of this very large future commitment, not just the three year estimates but also the projections available at the time of the full costs of the procurement were published, and if I may Chairperson I'll deal with this whole section jointly because the important thing that is illustrated here is that each year as the Rand, and in particular as a consequence of the movement of the Rand relative to other countries the published projections of the overall costs of the programme changed.

These estimates were done jointly between the Treasury and ARMSCOR, we jointly maintained a very detailed spreadsheet-based model of all of the commitments and drawdowns on each of the components of the programme broken down by the local procurements and associated local management costs, the imported contents set out in its various exchange rates for each of the relevant exchange rates the associated drawdowns on export credit facilities, so a full set of the financial implications, a full model of the financial implications of the procurement was maintained in a spreadsheet that was updated regularly jointly by ARMSCOR and ourselves in the National Treasury and based on that so-called Warburg Dillon and Read Model, because the initial design of that model was done by consultants from the Warburg Dillon and Read company. Based on that model we published projections each year in the budget documents of the overall cost.

And in paragraph 73 I just indicate the overall cost and how it changes in those estimates from year to year, and if I may draw attention to 73.2 in 2002, following the very steep depreciation of the Rand in 2001, we set out a projection of the overall costs of the programme that added up to R52.7bn, and it was only in the course of 2003 and 2004 with the recovery of the value of the Rand that the projected expenditure estimate came down somewhat and so in paragraph 73.4 the total estimated projection in 2004 amounted to R48.7bn and in subsequent years R45.6bn, R44.8bn and then finally by 2008/2009 as the programme was reaching its end the overall cost stabilises at about R47.4bn, in fact we now are in a position to indicate the overall costs of the programme at somewhat less than that of R46.6bn as has already been indicated.

So, this is a recognition that the costs of a programme like this are uncertain, they do depend on inflation and exchange rate trends which cannot be firmly stated but for transparency and disclosure purposes, and obviously in order to contribute to our own budgeting responsibilities full account is taken over time of changes in exchange rate and inflation as they impact on the procurement. Thank you.

MS RAMAGAGA: Thank you. And in paragraph 74 you state that:

"With effect from 2009, these detailed tables have

not been published in the annual budget documents, ...".

Why is that so?

MR DONALDSON: Yes Chairperson, we referred in our earlier evidence to the agreement between the Treasury, the Finance Department initially and Defence that as the baseline budget allocation of Defence could not accommodate the full costs of the programme supplementary allocations would be made. These fell away after 2009 and by then most of the expenditure had already been incurred and the baseline, in other words the ongoing budgets of Defence was able to accommodate the balance of spending that was required and so we no longer published the detailed table although in 2013 in the interests of disclosing the final outcome or at that stage very near final outcome of the expenditure programme the table was set out, which is reproduced in Table 3 which ... Sorry, I shouldn't say it's reproduced in Table 3, which is referred to or used for the purposes of Table 3 but is set out in "AD21" in which the full procurement programme over time is summarised.

MS RAMAGAGA: Right, and you have already informed the Commission about the total expenditure being about R46.6 million [sic]. Shall you then proceed to paragraph 77 of your statement.

MR DONALDSON: Chairperson if I may just say a little about Table 3 which shows total defence spending alongside the spending on the Arms Procurement Programme, the SDPP expenditure row adds up to the R46.6bn, but what is also shown to put this spending in perspective is the, the share that it takes of total defence spending in each of those years, and you can see how in the early years of the procurement programme 2002/3, 2003/4 this was a very substantial share of defence spending, up to 1/3 of defence spending in 2002/3, but by 2008/9 it had fallen to about 10% or so of defence spending.

And I also indicate here that over the duration of the spending programme including the Special Arms Procurement Programme, defence spending in all years except one was 1.5% of GDP or less, and so the outcome of the Defence Procurement Programme as it turned out was that that 1.5% threshold for defence spending indicated in the 1997 Defence Review was not exceeded.

In paragraph 77 I provide an estimate of the real terms expenditure and this is an arithmetic exercise for the purposes of indicating, of comparing with the original R30bn estimate and so what is done here is that the R46.7bn, R46.666bn expenditure over the full duration of the programme is discounted by the GDP Deflator Index.

The GDP Deflator is a measure of overall inflation in the economy, so if GDP increases by 8% or 9% in a year, 2% or 3% of that might be real GDP increase, that's the real growth rate of the economy that is often referred to, and the difference, the 6% or 7% difference between nominal GDP growth in a year and the real 2.5% or 3% or 4% growth in GDP is referred to as the GDP Deflator, a measure of the overall price increases, the overall rate of inflation in the economy as a whole.

By discounting the R46.7bn expenditure over 14 years by the GDP Deflator we get a measure of its expenditure, of that expenditure in 1999 price terms and it comes to approximately R30.8bn, so slightly higher than the R30bn cost estimates at the time in 1999 prices, and the reason for that 3% or so real increase in the cost of the programme is essentially that in 2002/3 particularly when the Rand was weak we were spending rather more in real terms on the imported components of the programme.

MS RAMAGAGA: Right, in paragraph 78 you are dealing with the comparisons between the expenditure on the SDPP as against the expenditure relating to the Social and Development Departments which the general public believed that they were supposed to be prioritised and because of the SDPP's they were actually to some extent left behind and the Defence was prioritised.

MR DONALDSON: Commissioners, this is the "guns or butter" paragraph, and I'm really reflecting here on the, the criticism one sometimes sees that spending R30bn or spending R46bn on an arms procurement is very large relative to the other social and developmental challenges we face, but it is important to remember that that R46.7bn was spent over 14 years and if you make the comparison on a one year-by-year basis then by taking the highest year of defence arms procurement expenditure which was 2002/3 in which R6.3bn was spent on this procurement, then the guns and butter, guns or butter comparison needs to be made with the levels of spending on other services in that year.

And in 2002/3 overall Government expenditure on education amounted to R62.bn, on health services R34.9bn, on social security and welfare and social assistance R42bn or so, housing, transport and police services are also indicated in this paragraph. There's no value judgement in these numbers, it's merely for the purposes of perspective the size of arms procurement spending in that year of R6.3bn needs to be compared with the spending on other services in that year which is set out in this table.

CHAIRPERSON: I'm sorry Ms Ramagaga, I suppose there seems to be a typographical error because in my document it appears as millions and he says billions. Can you ask him just to confirm that so the record can properly reflect the figure that is supposed to be the correct figure?

MS RAMAGAGA: Thank you Chair. Mr Donaldson in your evidence you referred to billions and it would appear, in fact on the document you refer to the millions, is it a typo error?

MR DONALDSON: Chairperson thank you, the document is in millions and so I should more correctly have used the millions' numbers, R62 757 million is the expenditure in education which is of course equivalent to R62.7bn and similarly for the related numbers.

MS RAMAGAGA: Right, thank you. And shall you then deal with paragraph 79, in 79 actually you are just mentioning that incremental budget for the Social and Education Department. Shall you then proceed to paragraph 80 on page 39 and speak to Table number 4 that appears on that page?

MR DONALDSON: Thank you Chairperson. Here we're seeking to clarify the contribution of this Procurement Programme to Government debt and in response to the criticism that has sometimes been levelled at the procurement that it brought us into a state of perhaps unsustainable or irresponsible levels of debt and so in assessing that kind of criticism one has to look at the Procurement Programme relative to overall Government debt and the annual overall budget balance, and so the table sets out in the first column arms procurement expenditure in each year, R2.9bn, R4.2bn up to that peak in 2002/3 of R6.3bn, and shows the budget balance, the budget deficit in years when there is deficit and then a few years surplus.

In the first year of the programme the budget balance, the budget deficit of R17 657 million or R17.6bn was equivalent to 1.9% of GDP and in the next year the deficit was 1.2% of GDP, and in both of those years you can see the Arms Procurement Expenditure amounted to in the first year approximately 15% or so of the budget balance, in the next year perhaps 30% of the budget deficit. The year of the highest level of spending on the Arms Programme, 2002/3 its expenditure of R6.3bn was equivalent to about half of the total deficit for that year, half of the deficit for Government as a whole.

But in all of these years the budget balance, the budget deficits, the amounts that was in effect being added to debt was comfortably below prudent limits, we sometimes think of about 3% of GDP as a prudent maximum level of the deficit or of nett borrowing in any particular year although even that limit sometimes needs to be exceeded for fiscal policy purposes.

By 2006/7, the end of the first half of the table the budget was in surplus and so we were no longer running a deficit at all and it’s important to recognise there that although we were still drawing down on the Arms Deal loans, there was no overall increase in Government debt in those, nett debt in those years and so in effect the drawdowns on the Arms Deal loans were offset by reductions in debt elsewhere in the Government’s debt management arrangements.

Also shown in this table is the cumulative debt on the Arms Procurement Programme, cumulative debt on the Arms Procurement Programme relative to gross loan debt, so gross loan debt is the total value of all debt obligations of Government, which has increased substantially over the period in question, it had increased from just under R400bn, R399 551 million to in the most recent year 2013/14 R1.5 trillion, R1 586 437 million, so that's a very substantial increase in debt, but of course the economy has grown and so this has to be compared with the overall growth of the economy over this period.

The debt associated with the Arms Procurement loans, the Export Credit facilities which were drawn on for the purposes of this Procurement Programme has over the full period been a small fraction of overall debt and so you can see initially cumulative debt on the Arms Procurement Programme growing from R2.2bn to R7.8bn, R10bn, R23 554 million or R23.5bn in 2006/7 and a peak in 2007/8 of R30 802 million or R30.8bn.

But even in that year of the highest level of Arms Deal debt, that debt amounted to just 5.3% of gross loan debt, of the total debt of Government, and so again here seen in perspective the Arms Procurement Programme has contributed a significant amount, but nonetheless a comparatively small fraction of Government's overall debt and indeed in the entire period in question Government's debt has remained reasonable relative to GDP and debt service costs have remained moderate relative to Government spending and other, and national income.

MS RAMAGAGA: Right, then in paragraph 83 you are pointing out as to what should be looked at in assessing the overall cost of the budget of the SDPP. Will you take the Commission through that evidence?

MR DONALDSON: Chairperson, in summary in paragraph 83 we are submitting that while the total nominal or cash outlays on the Procurement Programme of some R46.7bn was a substantially larger number than the original contract price of R30bn, the difference is explained by inflation related price escalation and exchange rate movements and not by increases in real costs or increases in supply specifications, so this was not a significant real increase in spending, the R46bn is a consequence of inflation and exchange rate movements.

And then secondly recognising that the Special Defence Procurement Programme was a substantial procurement programme which did raise affordability concerns at the time that it was negotiated, it was spread over a 14 year period and it has not resulted in a material increase in overall defence expenditure as a percentage of GDP which has remained low and indeed now is significantly below 1.5% of GDP and during the years of substantial Special Defence Procurement expenditure the overall budget balance half removing into unsustainable deficit in fact moved into surplus.

And then in 83.3 we point out that the loan facilities associated with the foreign currency denominated expenditure in the SDPP formed part of Government's overall loan debt, they are part of the published debt numbers and cumulative arms procurement loan debt peaked at about R30.8bn in 2007/8, equivalent to 5.3% of gross loan debt and has subsequently declined as we've already repaid substantial parts of these loans as at the end of March 2014 to approximately 1.1% of Government's current gross debt.

MS RAMAGAGA: Right, in paragraph 84 you are dealing with the "Loan Debt Allocation" and indicating as to where the loan budget is ... Actually, it's where the loan facility's debt are allocated, which budget in particular, please proceed to lead evidence on that.

MR DONALDSON: Thank you Chairperson. As we've indicated already the expenditure itself on the Arms Procurement is accounted for in the appropriation of accounts of the Department of Defence, so that's where to go to find the records and find the audited statements of expenditure on the programme, a total of R46.7bn as of the end of 2013/14. The loan facilities, however, a part of debt, they are in the accounting records of the National Treasury and they are not for the Department of Defence's accounts, they form part of the financing activities of Government and the remaining sections of this statement set out in further detail the specific loan agreements that have been managed by the National Treasury along with all other sovereign debt obligations, and along with other debt obligations, servicing and repayment of these loans are a first charge against the National Revenue Fund.

MS RAMAGAGA: Okay, will you then proceed to lead evidence on the loan agreements with foreign banks, the overview of the loan agreements first?

MR DONALDSON: Chairperson for the sake of completeness in the statement we have summarised each of the loan agreements for each of the main components of the Arms Procurement Programme, the opening paragraphs just summarise these. The loan agreements were concluded on the 25th of January 2000 in formal agreements signed between the Minister of Finance and several foreign banks. They were signed in terms of the Exchequer Act but they have been managed, drawn on, repaid and interest paid on them in terms of the Public Finance Management Act once that came into effect.

And on paragraph 86 we provide a summary table of the value of these loans, a US$2 500 million or US$2.5bn loan with, negotiated with Barclays Capital in London, a €611.9 million loan facility with Commerze Bank and a second Commerze Bank loan facility of €846 188 000 facility with Société Générale, and Medio Credito Centrale, an Italian bank, US$199.8 facility, so these agreements, these loans backed by export credit agreements with the export credit agencies are the facilities that have provided not for the full costs of the Arms Procurement Programme but for the imported components of the programme.

MS RAMAGAGA: Right, thank you. And the further particulars of information relating to the agreements in respect of each of the mentioned banks appear on pages 42 to 45 of your statement. Now I'd like you to then turn to page 46 for further evidence. In page 46 you are dealing with the management of the Supply Terms and loan agreements, will you also just deal with this information in a summary form.

MR DONALDSON: Thank you Chairperson. These agreements are managed by the Asset and Liability Management Division of the Treasury, so they are managed by the same team within the Treasury who are responsible for all of Government's debt, and the loan agreements have several aspects to them, the initial contract price, there are some fees associated with the agreements and the Export Credits Agency Services. There are specific drawdowns or tranches identified in the agreements which, and these correspond with the deliverables or the drawdowns that would be specified in the supply agreements between the Department of Defence and ARMSCOR and suppliers, they specify the foreign currency that applies, interest rate and there is some variation in the various interests, fixed or floating interest rates applicable, repayment dates and several other conditions. So, these are loan agreements with considerable detail in them and they are managed by our Debt Management Team very strictly in terms of those agreements. And there is in the paragraphs 100 and 101 a clarification of the respective issues, respective components of the loan agreements and the supply agreements and the relationship between them in page ..., in paragraph 102 we repeat that the supply agreements were managed by Defence and ARMSCOR, the loan agreements by National Treasury, but by agreement between National Treasury and ARMSCOR drawdowns on the loans are triggered by delivery or compliance with suppliers with the specified supply commitments in each of the Arms Supply Agreements, so there is a protocol of communication established between ARMSCOR and National Treasury through which drawdowns on the loans are linked to the payments that are due to suppliers in terms of the supply agreements. Thank you.

MS RAMAGAGA: Now the process followed to draw from the loans and pay the suppliers is actually what you have just summarily also dealt with to say the process of drawing down would be triggered by information that would have been received from ARMSCOR, is that correct? Right.

MR DONALDSON: That’s correct Chairperson.

MS RAMAGAGA: And this is dealt in detail in paragraphs

104 and 105. Now shall you then proceed to page 49 of the statement. May I just indicate to the Commission before we deal with the next topic the process followed to make interest and redemption payments. Just indicate, I would just like to indicate to the Commissioners that that document "AD23" appears in pages 519 to 528 of the bundle. Now Sir, I'd like you to then present evidence in relation to the process followed to make interest on redemption payments.

MR DONALDSON: Thank you Chairperson. As is common in agreements of this kind interests payments are made semi-annually, so there are two interest payments a year typically and the redemption of these loans, the repayments of these loans also is structured to occur typically in 20 equal instalments over a 10 year period. There are some options for variation in that, but these agreements typically have that structure and as is indicated in paragraph 107 and a 108 and a 109 there is an established procedure between the Asset and Liability Management Division of Treasury and the banks in question and the South African Reserve Bank which actually manages the cash or oversees, serves as a banker of Government and handles the conversion of Rand into foreign currency for the purposes of making foreign currency payments, and these protocols are well established and standard procedures and have been followed for the purposes of these loans.

The subsequent section Chairperson which deals with the interest rate and exchange rate risks is about the options available to the Treasury on certain of these loans and is one of the mechanisms, it refers to the mechanisms through which the costs of these loan agreements have been kept moderate and reasonable relative to other sources of finance to Government.

MS RAMAGAGA: Right, thank you. Now I'd like you to turn to page 52 and interpret the table, table number 7 that appears on that page to the Commission. That table should be actually read with paragraph 118 of your statement. You may proceed.

MR DONALDSON: Thank you Chairperson. The Table 7 summarises the overall position on these loans as at 31st of March, so with effect from the end of 2013/14 now that the drawdowns on loans are complete the Arms Procurement itself has reached the end of its time but there are still some loans that are not yet fully repaid and so there is a summary for each of the loans in question of the total approved amount and then the amount that is actually drawn and so Commissioners you can see how in each case in practice the loans have not been fully drawn down and so partly as a consequence of somewhat lower costs anticipated but also simply to reflect that the loan agreements themselves take into account possible price escalation that may not have materialised or take into account the highest full, the highest possible drawdowns on loans and in each case, in practice the amounts drawn down have been somewhat lower.

In the case of the loan for the Light Utility Helicopters which is the last row of the table the Mediocredito Centrale Bank in fact only about half of the loan was drawn and it has been fully repaid already, and this was a decision taken and an option available to us in terms of that loan, a decision taken by comparison with the costs and relative merits of this loan facility as against other sources of finance available to Government, and so one of the advantages of these agreements is precisely that they have provided that kind of early repayment option when it had been sensible to do so.

In all of these cases a substantial part of the loan has already been drawn down and the amounts in the third column are now in Rand, so of the amounts drawn of €566 million in the case of the first loan agreement R5.6bn has been repaid. If I can jump to the second last column there is a small amount still outstanding on this loan of a R146 million and so the sum of the loan repaid and the capital still to be paid is the total Rand equivalent of the Euro amount that is in the column headed "Amounts Drawn", or if I take another example perhaps of the largest of these loans, the Barclays British Pound loan an amount drawn of £665 million translates into a Rand equivalent of R6.4bn that has already been repaid and a balance still to be repaid of about R540 million.

Also shown in this column is the Rand value of interest paid and of interest still to be paid and so if I can turn to the column at the bottom of the table loans repaid already approximately R26bn, capital still to be paid approximately R12bn and so a total Rand value of these loans, both repaid and still to be paid, a sum of those two columns, approximately R38bn. Interest paid amount already, amounts to R10.2bn, interest still to be paid is estimated here at about R2.6bn, so a total interest on these loans will come to just under R13bn, and the paragraphs that follow summarise these amounts.

MS RAMAGAGA: Right, thank you. Will you then proceed to page 53, in “Conclusion”. Your “Conclusion” is actually supported by the evidence that you have already presented before the Commission but for the completeness of the record I would like to invite you to place that conclusion on record.

MR DONALDSON: Thank you Chairperson. So, in paragraph 121 we summarise the overall Rand value costs of these loans, approximately R38.2bn, or R38 203 000 in capital and approximately R12 838 000 in interest. There are also fees over and above those interest costs that amount to approximately R211 million. A more useful measure of course of the costs of these loans or the costs of debt is the effective all-in interest cost of the debt and in earlier paragraphs from paragraph 104 through to paragraph 116 and a 117 we summarise for each of the loans the terms of the loans and give an indication of the interest costs. I can say in sum that these foreign currency loans have cost between 5% and 7.5% as an overall interest rate over the duration of the loans, which is a very reasonable rate of interest for foreign denominated loans and compares favourably with other sources of finance in Government’s debt portfolio.

MS RAMAGAGA: Right, thank you. Is there anything else that you would like to say?

MR DONALDSON: Chairperson, in the concluding sections we refer once again to the various roles that the National Treasury has played and I don’t need to repeat that. We conclude by indicating that with respect to the cost of the Special Defence Procurement Programme it’s important to distinguish between the estimated total cost in 1998 of R29.773bn, or R29 773 000 In 1998 prices distinguished between that and the prices indicated in paragraph 123.2 of the commitments actually entered into in September 1999 which amounted to a total cost of R29 992 000 in 1999 prices.

These amounts are in constant prices and are therefore different from the total nominal or cash outlay on the Defence Vote of R46 666 000 which is our most recent estimate of the total cost of actual expenditure between 2000, 2001 and 2013, 2014. The main reason for the difference is inflation and the depreciation of the Rand over the duration of the procurement.

And then in paragraph 123.5 is summarised again the real cost discounted by the GDP Deflator which I referred to earlier. And then finally the financing of these Special Defence Procurement Programme has been undertaken through loan agreements. These facilities associated with the foreign currency denominated expenditure in the procurement programme form part of Government's loan debt and are accounted for as such by the National Treasury and not part of the costs on the Defence Vote of the procurement itself, cumulative loan debt associated with the programme peaked at R30.8bn at the end of 2007/8 at which point it was approximately 5.3% of gross Government loan debt. Much of the debt has already been repaid and at the end of 2013/14 the outstanding debt on these loans amounts to approximately R16.9bn or 1.1% of the gross loan debt of Government. Thank you.

MS RAMAGAGA: Right, thank you. Mr Donaldson, one of the considerations that the Commission should make and recommend would be a question as to whether the contracts should be cancelled or not, the loan agreements in particular. Now what do you think would be the effect, and impact of the cancellation should the Commission advise in favour of the cancellation?

MR DONALDSON: Chairperson, the possible cancellation of the loan debts which was the subject of an extended court action several years ago, certainly at that time the Treasury's view as articulated in those proceedings was that there would be very substantial negative consequences of a cancellation of debt and if I may summarise what those consequences would be, governments which do not meet their debt obligations not only find themselves out of favour with the lenders who may have lent those particular amounts of money, they find themselves out of favour with all lenders and so governments which do not honour their debt obligations find that their access to capital is affected right across the financial markets and so the consequence of not honouring even comparatively small debts are very serious and that's why our Constitution and our financial legislation gives priority to debt repayments, treat debt repayments and debt obligations as a first charge on the National Revenue Fund.

But of course the reputation of governments are not just determined by their adherence to financial obligations, adhering to contractual commitments to suppliers are also critically important and so in addition to the reputation risk associated with non-repayment of debt the implicit non-compliance with purchase agreements or procurement agreements which would be associated with any interference with these loan agreements would also be damaging not just in financial markets but also to Government's relationship with its suppliers and Government's broader relationship with its suppliers, whether these are for large procurements, major projects, large construction works, or whether these are supply agreements with small businesses who make a living out of supplying Government adherence to and compliance with the obligations to pay what is due to those who have made supplies to Government contributes to the reputation of Government, to the cost of doing business and indeed to the relationships of trust on which an economy rests and the relationship between governments and its society rests.

So, the damage to trust and the damage to reputation associated with a reversal of, or cancellation of the loan agreements or the supply agreements would be very considerable indeed.

MS RAMAGAGA: Thank you. That concludes the evidence of Mr Donaldson.

CHAIRPERSON: Is there any person who wants to cross-examine Mr Donaldson?

ADV SNYMAN: Thank you Chairperson, we do not wish to cross-examine Mr Donaldson.

CHAIRPERSON: Thank you Mr Donaldson, you are excused. Thank you. I'm sorry, any re-examination?

ADV MASILO: Thank you Chairperson, just one point that I want to clarify with Mr Donaldson.

CROSS-EXAMINATION:

ADV MASILO: Mr Donaldson is it correct that ... Mr

Donaldson is it correct that the cancellation of the loan ...

CHAIRPERSON: I'm sorry Sir, can you just introduce yourself?

ADV MASILO: Thank you Chairperson. Chairperson my name is (indistinct) Masilo, I'm the legal representative for ARMSCOR, I'm one of the counsels who is being led by Advocate Solomon on behalf of ARMSCOR.

CHAIRPERSON: So you are not re-examining, this is not your client.

ADV MASILO: That's correct Chair.

CHAIRPERSON: Oh okay.

ADV MASILO: Mr Donaldson, is it correct that the cancellation of the loan is the (indistinct) recommend that the loan is cancelled that would affect the (indistinct) credit rating in terms of lending?

MR DONALDSON: Yes Chairperson, we would expect a negative impact on credit ratings to follow from a cancellation of debts.

ADV MASILO: Now furthermore is it also correct that in order to finance (indistinct) National Treasury in order to finance South Africa's credit deficit it requires a good credit rating and a good loan credit record?

MR DONALDSON: Yes Chairperson, the role that credit ratings play is to give assurance to lenders and that assurance contributes to a lower cost of debt, a lower cost of borrowing.

Government of course is not primarily responsible for trade finance but there is indeed a link between the costs to Government of its borrowing and the costs that the business people may face in raising debt in Rand in capital markets.

ADV MASILO: Thank you Chairperson, that's all.

CHAIRPERSON: Thank you. Any re-examination?

SPEAKER: None. None Chairperson.

CHAIRPERSON: Thank you Mr Donaldson, you are excused. Thank you.

MR DONALDSON: Thank you Chairperson, thank you Commissioner.

MS RAMAGAGA: Chair, that concludes the proceedings for the day and a programme of the next witness to be called will be published. As far as we are aware the Commission will resume, it's sitting sometime to come tomorrow? But in terms of the programme the next witness that will be called to the, to take the stand is Mr Esterhuyse from ARMSCOR. The team that should lead Mr Esterhuyse is not here today, but Mr Masilo who is the counsel for ARMSCOR is here, I do not know as to whether he can confirm that Mr Esterhuyse will be the next witness to take the stand.

ADV MASILO: Thank you Chairperson. Chairperson I can confirm that as in terms of the programme (indistinct) 22nd day of April (indistinct) as well as the ARMSCOR legal team are at work to ensure that that takes place.

CHAIRPERSON: Thank you. Then in that case we are going to adjourn until the 22nd of April and Mr Masilo, can you please make sure that a summary of the evidence of Mr Esterhuyze is on our website at least three days before the 22nd?

ADV MASILO: Thank you Chairperson, we shall endeavour to communicate it to the Evidence Leaders as well as the (indistinct).

CHAIRPERSON: Thank you. We will adjourn.

(COMMISSION ADJOURNS)