DEMOCRACY REPORT

By Rowland Brown and Cheryl Emvula

Special Briefing Report No. 23

APRIL 2018

THE NATIONAL BUDGET 2018-19: WALKING THE FISCAL TIGHTROPE

Macroeconomic Environment

Namibia's national budget 2018/19 was tabled during what is unquestionably the most challenging economic time experienced in the country's independent history. The economy continued to deteriorate through 2017, with the first three quarters of the year showing a 1.6% contraction, in inflation adjusted terms, when compared to the same period of 2016. This contraction stemmed from a number of sectors, but was most noticeably the result of large contractions in the construction and wholesale and retail trade sectors. During the three-quarter period, the amount of construction value addition activity in the country fell by 43 percent when compared to the first three months of 2016, while wholesale and retail trade activity fell by nearly 7%. Smaller contractions were seen in public administration (government activity) and fishing.

The causes of the contractions and general economic slowdown were multi-fold, including external conditions affecting Namibian exports, climate conditions affecting local agriculture and manufacturing, and domestic policy affecting domestic demand, particularly from households.

Following the contractions seen in all of the first three quarters of the year, and provided no major revisions are seen, fourth quarter growth will have to be approximately 5% in real terms if the country is to avoid a contraction for the year. As a result, Namibia will likely end up posting its lowest growth in more than two decades in 2017.

For the upcoming year, however, signs of recovery are slowly emerging, driven primarily by improving external conditions, particularly the positive political developments in the region, coupled with improving global tailwinds. This filters through to the domestic economy, with a number of primary-sector industries expected to post reasonable growth in 2018. These include agriculture and mining particularly, with the latter driven by growth in diamond, gold and copper output. In the secondary industries, some recovery is expected in manufacturing output, largely driven by base effects, as well as water and electricity production as a result of recent investments.

However, despite the increasing list of positive developments, a number of major weaknesses remain, which are likely to dampen the growth outlook, at least to some degree. Namibian households remain under severe pressure, which is likely

Democracy Report is a regular publication featuring analysis and commentary relating to the legislative agenda of the Parliament of the Republic of Namibia. It is produced by the Institute for Public Policy Research (IPPR), PO Box 6566, Windhoek, Namibia. Tel: +264 61 240514, Fax: +264 61 240516,info@ippr.org.na. The publication is also available as a PDF download from http://www.ippr.org.na Democracy Report is funded by the Embassy of Finland

Embassy of Finland Windhoek

to remain for the foreseeable future. This is driven by a number of factors, largely as a result of the general economic slowdown. Households remain highly indebted, with household debt levels approaching 100% of household disposable incomes, meaning that your average Namibian household has all but spent next year's income already. Added to this, disposable incomes are on the decline in inflation-adjusted terms, as both unemployment levels increase, and wage settlements are stagnating at levels around inflation at best.

Similarly, the expectations for 2018 are that while some respite has been seen on government finances, public spending will remain constrained, and will thus not be a key driver of growth for the year. This is despite largely failed efforts to bring public expenditure under control over recent years and is largely driven by constraints with regards to government's ability to grow revenue. However, due to these largely failed attempts to reduce expenditure and grow revenue, large budget deficits have seen Namibia downgraded to "junk" status, and the Ministry of Finance has now turned to tax increases in the current budget in an effort to bring the budget deficit under control. Some of these tax measures are likely to further dampen the already sub-optimal investment environment in the country, most notably the dividend tax to be introduced, and to have a particularly negative impact on small businesses if not carefully enacted.

The result of the aforementioned is that neither households nor government spending can be expected to drive growth through 2018. More positive, however, is the outlook for net-exports, with a stronger Rand and weak household consumption expected to reduce imports through the year. Exports, too, are expected to fall in value terms, particularly in the mining space, as a stronger Rand will reduce hard-currency revenues for local mining entities. Particularly at risk in this regard is the local uranium industry, which has been teetering on a knife-edge for a number of years. On the other hand, diamond, gold, zinc and copper output will likely remain relatively resilient.

As a result, the primary hope for growth through 2018 will be investment, largely driven by local pension funds, African Development Bank loans and infrastructure project development. However, as positive as the regional tailwinds may be for the southern African region as a whole, the increasingly attractive neighbouring jurisdictions, namely Angola, Zimbabwe and South Africa, mean that Namibia will have to improve her own investment environment in order to attract foreign investment for further growth. To date, however, initiatives from policy makers have fallen far short of the mark, highlighted by what can only be described as a futile cabinet reshuffle, and renewed efforts to push through policies and legislation that may deter investment if not carefully adjusted, such as the New Equitable Empowerment Framework and the Namibia Investment Promotion Act. Contrary to their titles, the former will cause poverty and inequality to rise if implemented in its current form, while the latter will continue to deter investment if not dramatically altered to encourage foreign participation in the economy.

The outcome of the above is that growth for 2018 will remain subdued, unlikely to exceed 2%. Thereafter, growth will hinge on whether government is able to reform policy to create a more positive long-term investment environment in the country. If not, growth will at best improve to around 3% by 2020.

Inflation

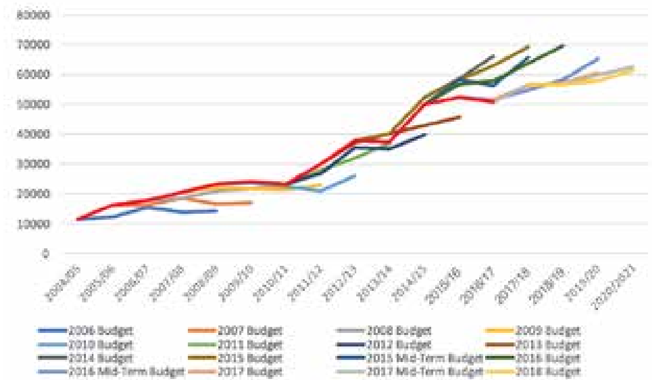
On the inflation front, 2018 will be a relatively low inflation year, currently forecast to average 4.3%, as both food and housing prices remain subdued, the former due to a stronger Rand and improved regional cereal harvests, and the latter due to the subdued local economy. Transport inflation, the third largest component of the NCPI basket will, however, pull the average up, as oil price increases have exceeded the rate of Rand strengthening over recent months, resulting in higher oil prices in Rand than was the case a year ago. Beyond 2018, inflation is expected to return to long-term levels of approximately 6% for 2019 and 2020.

Interest Rates

Interest rates are unlikely to be increased through 2018, with the most likely scenario being rates kept on hold at current levels through the year. There is a possibility of interest rate cuts in the second and third quarters of the year, off the back of a similar move from South Africa.

Revenue

Graph 1: Revenue (N$ Million)



For the upcoming financial year (2018/19), revenue figures have remained largely unchanged, both when compared to the previous period (down 0.1%) and when compared to previous forecasts (up 0.1%). As such, revenue for 2018/19 is expected to be N$56.7 billion, down from N$56.8 billion in the previous period. The stabilising of revenue forecasts is viewed as a substantial positive, as it is indicative of improved forecasting and a stabilising economic environment. This improvement in accuracy follows the large downward revisions experienced in the 2015/16 financial year with revenue overestimations amounting to over N$7 billion (12% of then revenue). Nevertheless, the current forecast, while likely

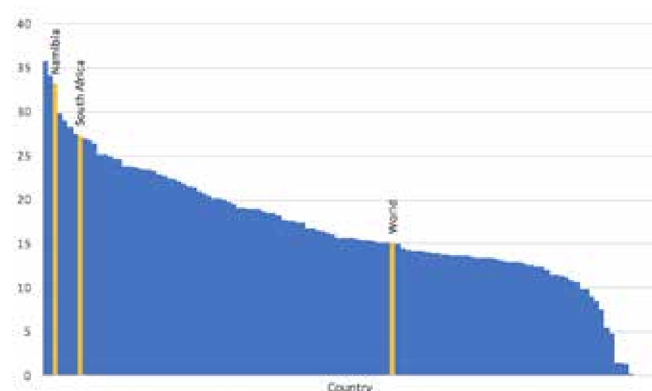
to be more accurate, still reflects a substantial revenue decrease on the previous period in real terms, with zero growth in revenue in nominal terms when compared to the previous financial year and average inflation over the past calendar year of 6.2%.

Overall, total revenue receipts for FY2017/18 have been revised up a mere N$38 million and by N$79 million for the FY2018/19. These upward revisions can be associated with an improvement in the current and forecasted economic situations experienced around the country. Over the remaining two years of the forecast period, however, revenue has been revised down, by N$2 billion in 2019/20 and N$1.2bn in 2020/21, when compared to the 2017 mid-term budget forecasts.

Another reason for the increase in revenue during the previous period is the efficiencies achieved in capturing outstanding amounts within the existing tax base. This administration efficiency is a useful method to broaden the tax base without having to introduce new legislation to increase revenue capture.

Overall, Namibian tax revenue is extremely high by global standards when compared to GDP. According to the World Bank, in 2014 Namibia collected the fourth highest tax revenues when compared to GDP in a sample of 141 countries, and was the third highest in 2015 among a sample of 119 countries. This is third only to Denmark (2nd) and Timor-Leste (1st).

Graph 2: Tax Revenue (% GDP)



Breakdown

Graph 3: Revenue Breakdown (%)

The aforementioned efficiency to gather tax revenue is also further reiterated when you deconstruct revenue streams. Over the last decade, the majority of revenue that has been gathered by the government has been in the form of taxes. In FY2017/18, non-tax revenue only accounted for 6.89% (N$3.9 billion) of total revenue. This contribution to total income is estimated to decrease in the upcoming financial years, reaching a low of 5.5% (N$3.2 billion) in FY2019/20 before returning to 6% by 2020/21. This therefore averages to a contribution of 6.1% to revenue under the considered period.

The future increase is justified by future royalties from mining companies, with a significant rise in other mineral royalties. This period corresponds to the period when the new Husab Mine will move into full production, though scepticisms around this production capacity being reached remain, due to battered uranium spot prices.

The remainder of revenue, 93.1% or N$53.5 billion, is drawn from a myriad of taxes. The largest component of tax revenue comes from the Southern African Customs Union (SACU) receipts. For the financial years between 2017 and 2021, the receipts will, on average, represent 30.2% of revenue captured by the government, with Value Added Tax (VAT) and company taxes contributing 23.6% and 22.2%, respectively. Another significant contributor to tax revenue is the taxes imposed on company profits. For the FY2017/18, these taxes contributed 13.4% to total revenue, due in part to the troubling economic conditions in the country, but are set to play a more sizable role in revenue capture over the medium term, averaging at a contribution of 15.1% over the period.

The remainder of taxes and grants amounted to 2.8% of revenue in FY2017/18 and will average the same amount over the three-year forecast period. A list of these taxes include:

- Non-Resident Shareholders Tax
- Tax on Royalty
- Annual Levy on Gambling Income
- Withholding tax on companies and individuals
- Withholding Tax on Services
- Levy on Fuel
- Fishing Quota Levies
- Gambling License (Business)
- Other Taxes on goods and services
- Environment levies and Carbon Emission Taxes

SACU

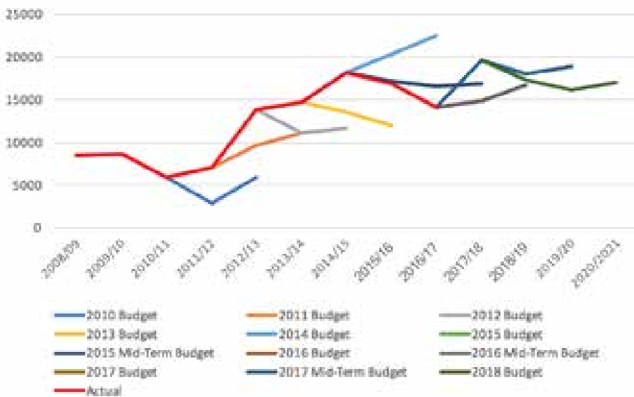
SACU transfers have been consistently amended since the FY2008/09, which clearly illustrates the complexity and inconsistencies of the revenue pool calculation. This inconsistency, however, can have and has had detrimental effects on our economy, with exceptionally low transfers in FY2016/17 aiding to the economic slowdown experienced in the country. However, the revenue obtained from SACU still accounts for

31% of total revenue received by the Namibian government, therefore making it the largest contributor to FY2018/19 revenue. Following a bumper year for SACU receipts in 2017/18, revenue transfers for the 2018/19 are to be N$2.2 billion less than previously received, amounting to N$17.4 billion.

It is important to consider that the lowest receipt from SACU in the past 8 years in FY2016/17, was first forecast at N$22.6 billion for the economy. However, it only generated N$14 billion, 62% of initial estimates. Moreover, as the single largest revenue line, this excessive forecast resulted in a material undershoot in total revenue.

Going forward, receipts are estimated to decline in the following financial period before showing positive growth in FY2020/21. These estimates are on the conservative side, however, and upward revisions are a possibility should regional growth recover off the back of new leadership in South Africa.

Graph 4: SACU Transfers N$ Million



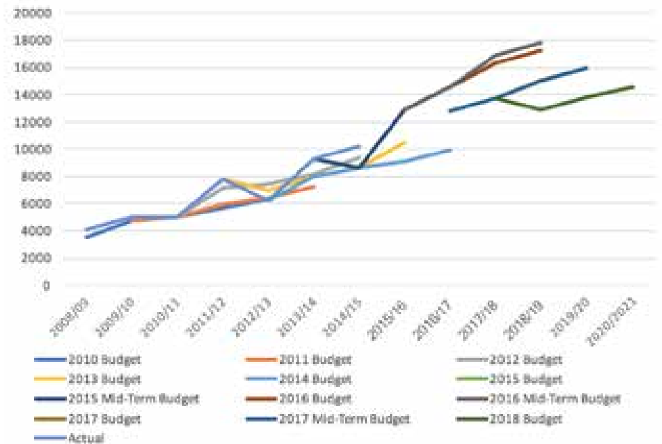
Value Added Tax (VAT)

Contributing to the overall downward revisions experienced in total revenue, VAT is also estimated to generate less revenue than was forecast in previous budgets. This correlates with lower expenditure in the economy by both the government and consumers; therefore, VAT collection is being adversely affected. Nonetheless, VAT contribution to revenue still amounts to 22% of the total revenue capture and will remain around this figure for the foreseeable future.

VAT for the 2017/18 period had been accurately estimated at N$13.7 billion, however forecasted values are now expected to be lower than previously anticipated. VAT collection for FY2018/19 is estimated to generate just under N$13 billion, nearly N$800 million less than the previous period. This is the first anticipated decrease in VAT collections since FY2013/14.

Further to this, the VAT collection forecasts for the 2018/19 year have been revised down by more than N$2.1 billion when compared to the annual budget forecasts of 2017. Going forward, VAT collection forecasts suggest that from the lower base in 2018/19, VAT will grow over the remainder of the forecast period, to N$14.6 billion by 2020/21.

Graph 5: VAT (N$ Million)



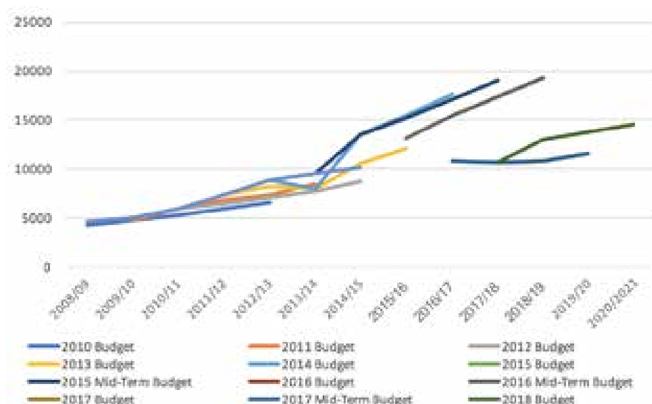
Personal Taxes

As with overall downward revenue revisions, income tax on individuals has been on a downward trajectory compared to prior estimates over the past few years. In the current budget, however, we see substantial upward revisions once again. The initial downward revisions correlated with increases in unemployment experienced in the economy between 2014 and 2016, with the unemployment rate spiking to 34% in 2016, up from 27.9% in 2014.

First estimates for personal income tax for the FY2017/18, in the 2015 budget report amounted to N$19 billion but had been relentlessly revised down to an amount of N$10.7 billion in the most recent budget – nearly half the initial estimate.

However, collections for personal income tax for the FY2018/19 have been revised up N$2 billion to N$13 billion, since the tabling of the November mid-term budget in 2017. This increase has been justified by a more efficient tax collection process and the forecast economic recovery over coming years. These collections are expected to contribute N$2.2 billion more than was received in the prior financial year, but are highly ambitious given the current state of the local economy. With rising unemployment and below inflation wage adjustments planned for the civil service and many others, the only plausible explanation for the over 20% increase in personal income tax in 2018/19 when compared to 2017/18, is an adjustment in the base, implying that the 2017/18 figures may be understated.

Graph 6: Income Tax on Individuals



Proposed taxes

The Minister of Finance proposed a myriad of new taxes in an effort to reduce inefficiencies in the preferential tax rates, which will be experienced by various players in the economy. Moreover, he stressed the importance of these taxes not eroding the existing tax base and enhancing progressivity of tax policy for individual income tax. With the introduction of these taxes, the government anticipates that it will generate an additional N$500 million a year in revenue. However the substantiation of this number is currently lacking. The details of the proposals are:

• Manufacturers
Phasing out of preferential tax treatment available to certain existing manufacturing

• Exports Processing Zone Act
Repealing the Export Processing Zone Act and introducing Special Economic Zones

• Individuals
Reduce the lower bracket tax rate from 18% to 17%
New tax rates of 39% and 40% for individuals earning over N$1.5 million and N$2.5 million respectively

• Dividend Tax
10% dividends tax for dividends paid to residents

• Trusts
Abolish the current practice of a conduit (flow through) principle in the taxation of trusts

• Tax Exempt Entities
Income derived from commercial activities by charitable, religious, educational and other types of institutions that are exempt will be subject to tax

• Foreign Income
Taxing all income earned from foreign sources by Namibian residents

• Betting and Gambling Entities
Explore a profit tax of 37% on betting and gaming entities

• VAT
Introduce VAT on income of listed asset managers
Introduce VAT on proceeds on sale of shares or membership in a company owning commercial immovable property

• Excise Taxes
Increase fuel levy by 25 cent per litre and expand overage of export levy to include other specific agricultural, forestry and game products and other mining products currently not covered. Introduce additional 5% national "sin tax" on alcohol and tobacco products.

Assessment

The overall expectation of lower revenue is consistent with the current challenging economic environment in the country. However, revisions to total revenue have been modest over the last two budgets (full year and mid-term) as opposed to the large downward revisions experienced in previous periods. Therefore, current estimates seem reasonable and revisions moving forward will not have the same magnitude as previous ones. This is a testament to improved forecasting by the MoF, as well as improved collection methods.

The concentration of exposure to SACU receipts and the unpredictability of such, continues to create uncertainty around total revenue, and there remains a risk of large downward revisions in receipts should the regional economic recovery not proceed as currently predicted. In this regard, the "Ramaphoria" experienced by current and potential investors in South Africa has been somewhat short-lived, as questions around land reform and property rights have once again put investment on hold and dampened the short-lived improvement in growth outlook.

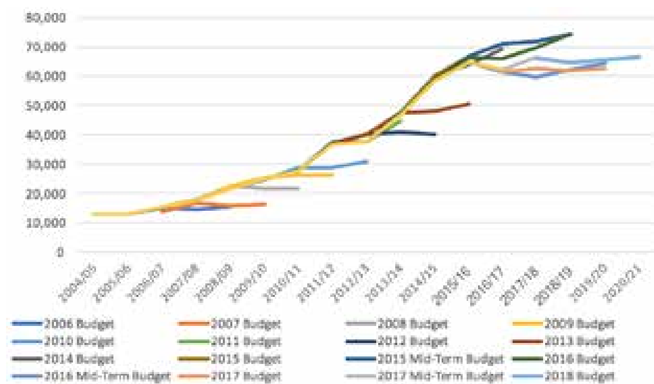
As well as SACU volatility, red flags are raised around the inconsistencies in the estimations around VAT and personal income tax. It is unlikely, for example, that households will be paying more personal income tax but purchasing fewer VATable items in the retail outlets across the country. With estimated downward forecasts in VAT revenue and upward estimates in income tax revenue, it indicates that an inverse relationship between these two variables exists. This indicates that Namibian consumers have a large marginal propensity to save, and with current household indebtedness hovering around 100% of disposable incomes, this assumption is unlikely to be correct. The major concern in this regard is that personal income tax forecasts have been increased to offset reductions in SACU and VAT. This cannot be justified by the changes in personal income tax rates and bands, as it is estimated that these changes will have a small net-negative impact on tax receipts. As such, this revenue line may well undershoot when compared to the forecasts, leaving a larger than forecast budget deficit, ceteris paribus.

With regards to the proposed taxes to increase revenue, there are a few important considerations. A number of the tax

changes are nothing new, such as the sin tax and fuel levies, which have been increased for a number of years. However there are other more troubling proposals in the pipeline: the dividends tax may have a negative effect on corporations, and come at a time when the investment landscape is already shrouded in uncertainty. As such, this tax, if not carefully implemented, could further disincentivise investment going forward. While large businesses are likely to find ways to manage this new tax burden effectively, small investors and small businesses are likely to be hardest hit. Given that an estimated 80% of the world's jobs are today created by small businesses, this is particularly negative for the employment outlook in the country if not very carefully implemented.

Expenditure

Graph 7: Expenditure (N$ Million)

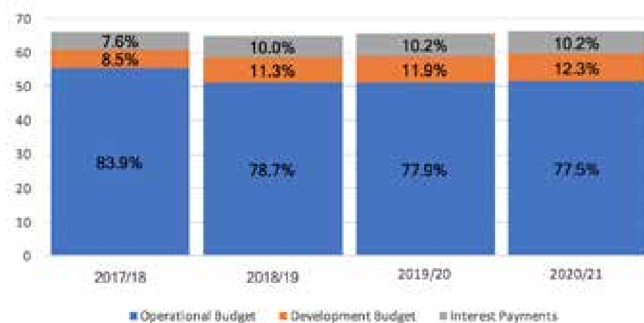


Following the large and highly concerning upward expenditure revisions in the 2017 mid-term budget, the current budget sees very little change with regards to the overall expenditure ceiling. The upward revision in the ceiling, at N$500 million, represents less than 1% of the N$65 billion to be spent over the FY2018/19 year.

Forced expenditure cuts have ensured that government expenditure as a percent of GDP in FY2017/18 fell to 38.4%, from over 44% previously, and it is set to continue this decline over the midterm. This will be achieved by curtailing expenditure growth, and an improved GDP growth outlook.

Expenditure Breakdown

Graph 8: Expenditure Breakdown (N$ Billion)

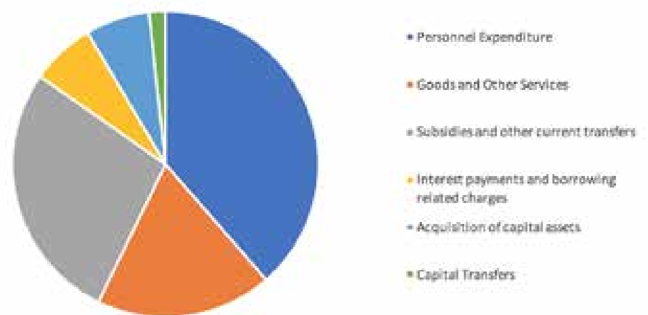


The budget remains heavily weighted to operational expenditure, with the development budget way below its non-interest expenditure target of 20% of total spending. As such, allocations to the operational budget remain the most significant portion of total allocations, with 78.7% of total allocations going towards these recurrent activities. The current development budget allocation only amounts to 11.3% of expenditure, half of what is envisioned. That said, a fair amount of funding for infrastructure has been moved off the balance sheet with the introduction of an infrastructure fund and initiatives to encourage private investment into public service infrastructure. This has been done with the issuance of government guarantees, and if used efficiently and not abused, this initiative could be an effective measure to reignite growth and development.

Interest costs have escalated to approximately 10% of total expenditure. However, this is expected to level out at the 10.2% level as growth in interest payments is expected to increase by 16% in the current fiscal year before declining further up until in FY2020/21. This is strange as the implied interest rate on total debt increases from 6.9% in 2017/18 to 8.2% in 2018/19 after which it declines linearly to 7.0%, which seems unlikely.

Expenditure breakdown by main items

Graph 9: Expenditure By Economic Classification



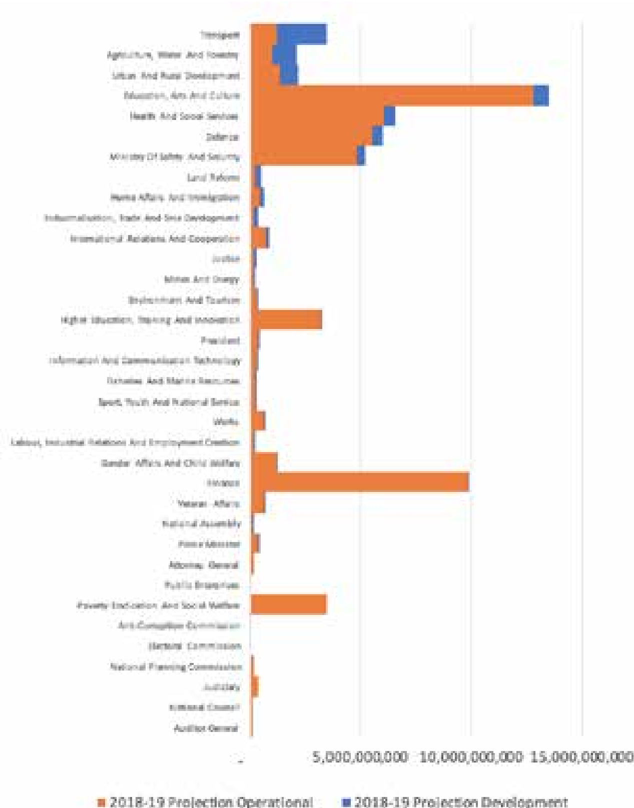
When broken down by main items, personnel expenditure still makes up the lion's share of total expenditure, varying from 45% to 46.5% over the MTEF period. The second largest main item is subsidies and other current transfers, at between 24.5% and 23.0%. Both of these expenditure lines can be considered recurrent in nature and thus extremely difficult to reduce, as has been witnessed over recent years.

Expenditure by vote

As is the norm with the Namibian budget – the majority of expenditure has been allocated to education and health. For the FY2018/19, education has received 26% of total expenditure. The implication here is that Namibia has one of the highest allocations of expenditure to GDP in the world, at approximately 9%, nearly double the world average of 5%. Basic education receives a substantial allocation amounting to N$13.5 billion,

up N$500 million since the previous financial period, while higher education will receive N$3.2 billion. Transfers will also be made to educational institutions including the University of Namibia (UNAM) which will receive a transfer of N$960 million and the Namibia University of Science and Technology (NUST) receiving N$600 million. The Namibia Students Financial Assistance Fund (NSFAF) will receive N$1.45 billion. When comparing expenditure to the number of learners, it is observed that the country currently spends N$18,668 per learner per year. This amount is four times higher than the world average, however the return for this spend, in terms of quality, continues to plague the country, therefore raising concerns around the efficiency of this expenditure. This sentiment was shared by the Minister of Finance as he indicated that increased spending has not yielded the desired improvements in educational outcomes.

Graph 10: Vote Allocation



After education, the MoF received the second largest allocation, amounting to 15.3% of total expenditure (N$9.8 billion) for the period under consideration. This increase in allocation is due in part because of the ministry absorbing key SOE transfers, such as PSEMAS.

The third largest allocation was to Ministry of Health and Social Services (MoHSS), at N$6.5 billion. However, despite the large allocation, MoHSS received cuts in its budget of N$520 million, when compared to the previous year.

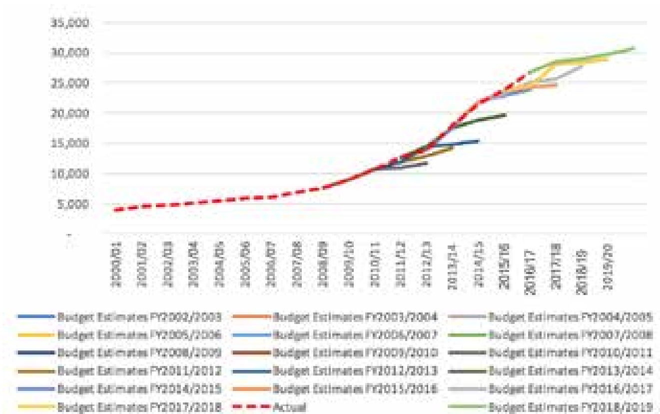
Finally, the fourth largest allocation was to Defence. This allocation, 9.3% of total expenditure, has been constantly scrutinised by the public as defence amounts to 3.3% of GDP in 2018/19. Due to this, Namibia ranks as one of the highest defence expenditures when compared to GDP in the world, and this expenditure continues unabated despite large reductions in overall expenditure, shortages of funds for health, education and housing and in absolute ignorance of the public outcry from the tax-payers of the country.

The development budget is increasing by 12.4% in 2018/19, from N$6.5 billion to N$7.3 billion. According to the Minister, non-core expenditure has been reduced and a moratorium on capital projects such as construction of office blocks has been implemented. This is intended to free up resources for reallocation to more productive uses.

The Ministry of Transport will receive about 30.5% or N$2.2 billion of this allocation, which is allocated as follows: N$1.2 billion to roads, N$539 million for rail and N$403 million for airport infrastructure. The Ministry of Agriculture will receive N$1.1 billion or 15.6% of the total development budget, of which N$779 million will go to water infrastructure development. The largest winner in this budget is the Ministry of Urbanisation and Rural Development, which will receive N$319 million more than the previous financial year. The emphasis of this ministry has, however, shifted more to the provision of sanitation, serviced urban land and bulk services for water, sewage and electricity.

Personnel expenditure

Graph 11: Personnel Expenditure (Millions)

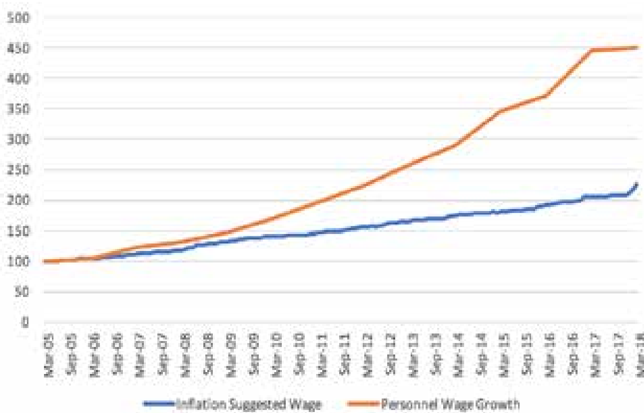


Personnel expenditure remains the largest expenditure line in the national budget, and remains concerning with its constant upward revisions in allocation. In the current budget, the allocation amounts to N$29 billion. This civil service wage bill, as compared to GDP, is the 5th highest in the world, and in the current financial year represents 45% of total expenditure.

There are two main methods with regards to addressing the wage bill, as stated by the Minister of Finance. Firstly, the government will strive to increase incremental wages at a lower than the inflation rate over the midterm period. This is represented by the low personnel expenditure growth rate which amounts to 1.45% during the current period and 3% for both the FY2019/20 and FY2020/21.

The second attempt to contain wage bill growth is the freezing of public-sector recruitment, and only filling critical positions if they become vacant. In this regard, a concern is raised as to the ability of government to stick to both of these promises, as social pressure to create jobs is unlikely to be dismissed entirely, while below inflation wage adjustments are unlikely to be popular within the single-largest unionised employee group in the country. If achieved, this will be the first time since before FY2004/05 (when our data begins) that wage growth will be below inflation. Prior to the current financial year, wages consistently grew at rates above inflation, which has now come to be expected by civil service employees.

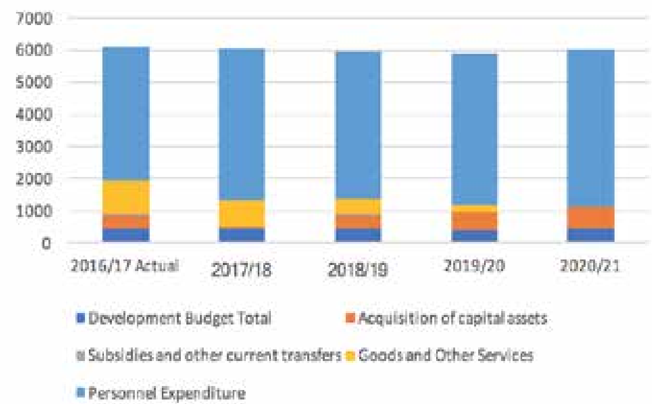
Graph 12: Civil Service Wages vs Inflation (Index (Mar 2005 : 100)



When looking at the Defence expenditure breakdown, the majority of expenditure is distributed to personnel. Of the total allocation of nearly N$6 billion in 2018/19, N$4.6 billion goes directly to salaries and wages for the defence force. This is, however, a drop of N$200 million when compared to the previous year.

As a result, Defence is a large employer, particularly for young Namibians. However, questions have to be asked as to the effectiveness of this defence expenditure in terms of job creation -i.e. is this the most efficient way to create jobs -, as well as the return on such expenditure – i.e. are the defence employees providing services to the country commensurate with their salaries?

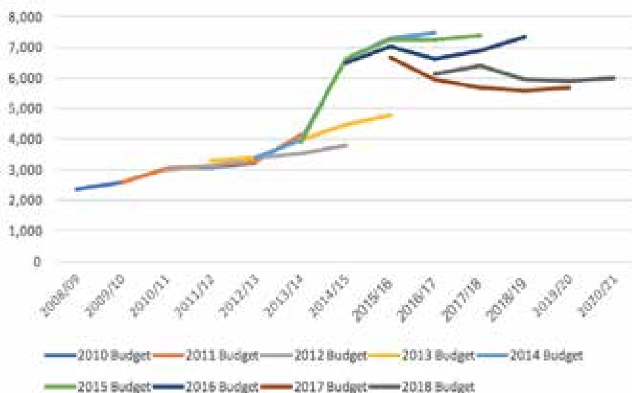
Graph 14: Defence Spending Breakdown (Millions)



Defence expenditure

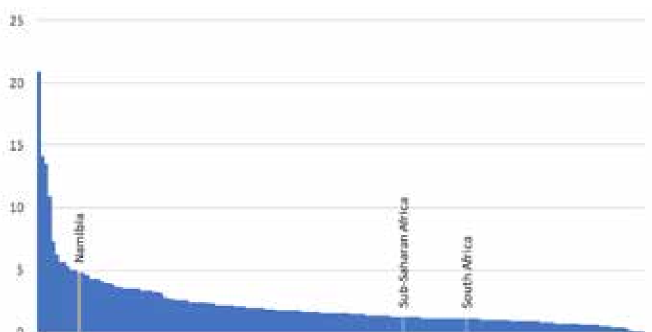
Defence expenditure has seen upward revision since the last budget announcement, illustrating fiscal slippage of non-core expenditure. The Ministry of Defence (MoD) received 9.3% of total expenditure, the 4th highest allocation, once again illustrating the questionable expenditure priorities of the government. This expenditure reaffirms Namibia's position as a colossal Defence spender, as compared to GDP, when compared to much of the rest of the world. At 3.3% of GDP in 2018/19, Namibia will feature as the 12th largest spender in the world on Defence as a percent of GDP.

Graph 13: Defence Spending (N$ Million)



Another continuously controversial issue for the MoD is developmental allocation for 'Research and Development', which received an estimated allotment of N$263 million in FY2017/18, despite the challenging economic times experienced nationwide. This amount will continue over the medium term with estimated expenditure of N$227 million in FY2018/19. According to the Minister of Finance, these allocations are towards upgrading of the equipment of the local Defence force, and are contractual obligations to which the Nation has committed. In total, this equipment upgrade, broadly considered to be arms purchases from China, is to cost the Namibian people over N$6.6 billion; however, the transparency around this expenditure is non-existent, and, therefore, large leakages and corruption are highly plausible.

Graph 15: Defence Spending as a % of GDP (Percent of GDP)



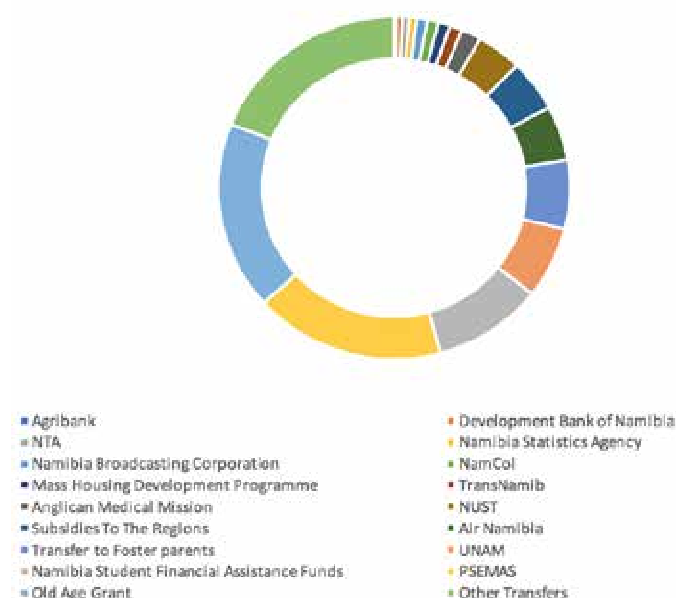
SOEs

The transfers to SOEs have continued to receive public scrutiny due to companies' poor efficiencies and reliance on tax dollars to maintain operations. This is of great concern due to continued lack of full disclosure of SOEs financials. To the government's credit, however, it is making concerted efforts to address these problems. In this regard, the government, through the Minister of Public Enterprises, has expressed the desire to make SOEs less dependent on transfers and is endeavouring to ensure that these entities become financially independent.

In the current MTEF, transfers to SOEs have been reduced once again to little over N$4 billion (down from over N$6 billion in the previous financial year), with large transfers still being seen to educational institutions and transport institutions particularly. In this regard, Air Namibia and TransNamib were two of the largest commercial recipients of funds, being allotted amounts of N$740 million and N$171 million, respectively. The mandate for these two enterprises is to create net economic benefits for the country; however, as comprehensive cost-benefit analyses for these companies do not exist, the effectiveness of these spends, as well as alternative options, need to be explored. A recent report on AirNamibia by Oxford Economics Research on these topics is currently available, but several of the assumptions made have been questioned by both the private and public sector, and the financials of the airline, which receives annual funding from treasury and thus the tax-payer, remain a closely-guarded secret.

In addition to the above, health and social transfers received large transfers from government, with PSMEAS (the state operated Medical Aid Fund) being a recipient of N$2.5 billion. This amount was only second to the old age grant offer of N$2.55 billion.

Graph 16: Significant Government Transfers 2018/19

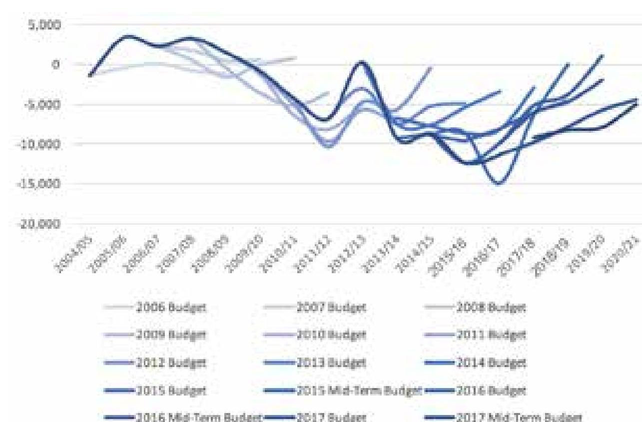


Deficit

Following a budget deficit of N$11.4 billion in 2016/17, the 2017/18 deficit is expected to come in at N$9.2 billion. As a result, it does now appear that the fiscal corner has been turned, with the deficit as a percentage of GDP reducing in two consecutive years. From 8.2% of GDP in 2015/16, the deficit for the 2017/18 year is to be 5.5% of GDP. These figures remain largely in-line with the 2017 mid-term budget, illustrating a stabilising situation.

	FY2017/18	FY2018/19	FY2019/20	FY2020/21
2017 Budget: Deficit % of GDP	5.71	4.24	2.86	2.01
2018 Budget: Deficit % of GDP	5.71	4.5	4.0	2.3

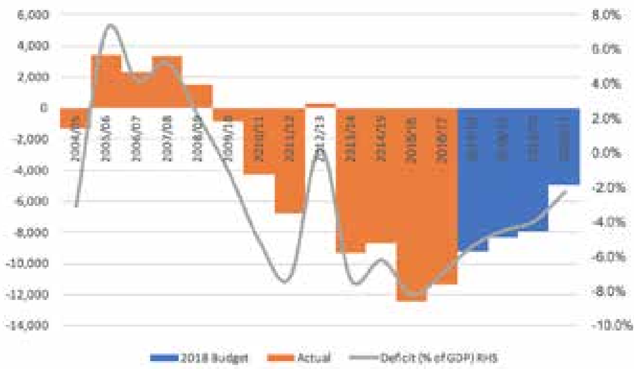
Graph 17: Budget Deficit (N$ Million)



Going forward, the deficit forecast for 2018/19 has been revised down since the mid-term budget of 2017, from 4.2% to 4.5% of GDP, indicating further fiscal slippage. A more sizable downward revision can be seen in 2019/20 from 2.9% to 4.0% of GDP, and a smaller downward revision again in 2020/21 from 2.1 to 2.3% of GDP.

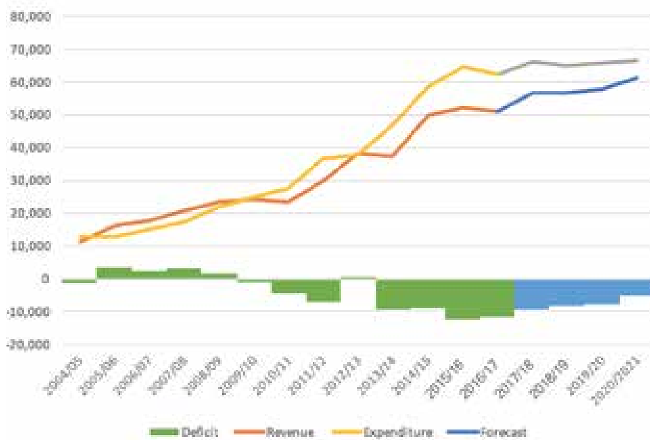
However, the forecasts for the outer years show both reasonably low GDP growth and reasonably conservative revenue growth, both being positive for an improved deficit outturn. However, current and future year expenditure forecasts appear somewhat optimistic, particularly pertaining to transfers to state owned enterprises and personnel costs. As a result, on a net basis we believe the deficit forecasts are slightly, but not excessively, optimistic.

Graph 18: Deficit (N$ Million)



Current estimates indicate that the deficit will contract by an amount of N$936 million, driven mainly on the back of consolidating expenditure, as revenue expectations have been revised downwards.

Graph 19: Revenue, Expenditure and Deficit (N$ Million)

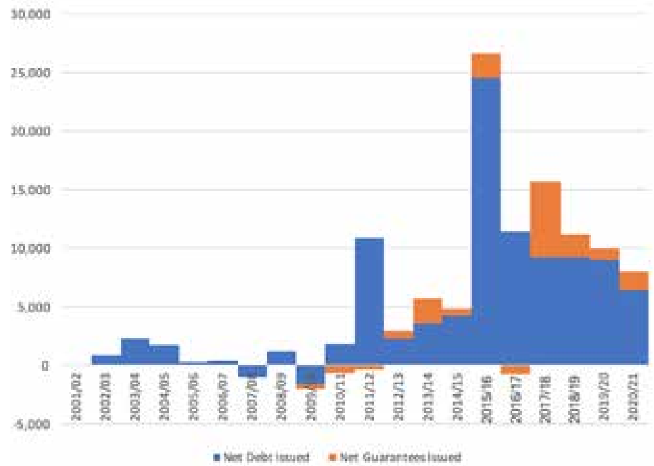


Guarantees

A large component of the more positive domestic outlook revolves around an increase in capital spending in the country, in part due to initiatives by Government to fund infrastructure development off-balance sheet via public-private partnerships and Government guarantees. As a result, the combination of debt and contingent liabilities will expand notably more rapidly than debt alone over coming years. Total guarantees are expected to almost triple between 2016/17 and 2020/21, peaking at around 8% of GDP in 2018/19.

When contingent liabilities and debt are viewed together, the implied liability (and contingent) increase in the 2017/18 financial year is the second largest such incurrence of liabilities in the country's independent history. At over N$15 billion, the only year where greater contingent and direct liabilities have been incurred by the state was 2015/16, when the total exceeded N$25 billion. Going forward, the net total debt and contingent liabilities issued per year are forecast to slowly decline, but will remain at approximately N$10 billion for the forecast period, despite the Ministry of Finance's lower forecast in 2020/21.

Graph 20: Net Debt and Guarantees Issued (N$ Million)

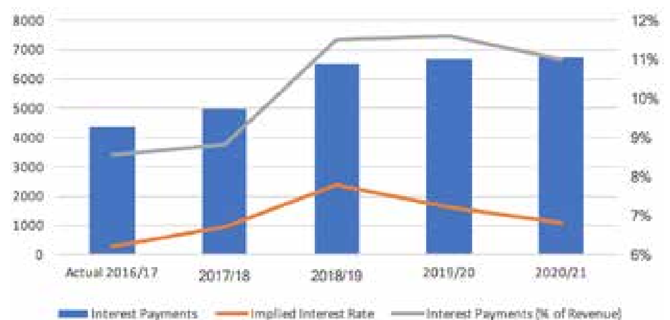


Debt servicing

The Debt stock is anticipated to grow over the midterm period and this will congruently have a direct effect on the cost of servicing this debt. This is evident with the increase in interest payments expected over the period. Interest payments are expected to grow by 15.6% to N$5.7 billion FY2018/17 (up from N$5 billion for the previous period). These payments have breached the 3% of GDP barrier and are forecasted to remain above this level throughout the forecast period.

Moreover interest payments now make a significant proportion of revenue collected by the government. Interest payments as a percent of revenue are expected to breach the 11% threshold during the forecast period. This amount will continue to grow, reaching a peak in the 2019/20, but is forecast to decline thereafter. This is peculiar, as the country has experienced rating downgrades to "junk" status, and the debt stock continues to rise, making it unlikely that debt servicing costs will come down relative to revenue over the forecast period.

Graph 21: Interest Payments (N$ '000 000)

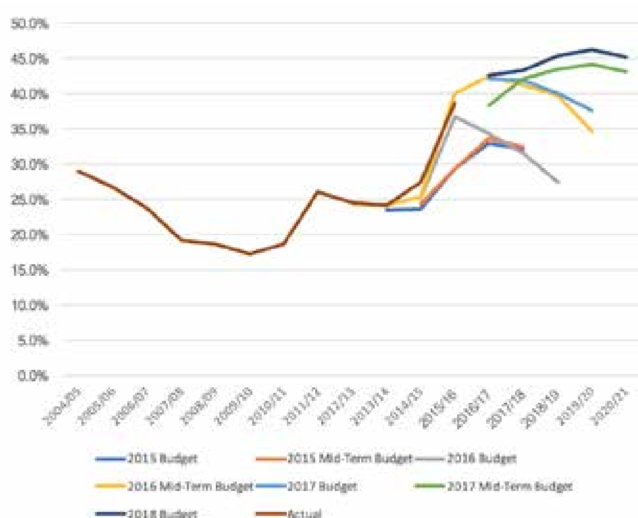


Debt

As a result of the forecast larger deficits in 2018/19, 2019/20 and 2020/21, the debt stock is expected to continue to expand, totalling just under N$100 billion by 2020/2021. This represents a close to N$85 billion increase in the public debt stock over a 10-year period, or growth of 617%.

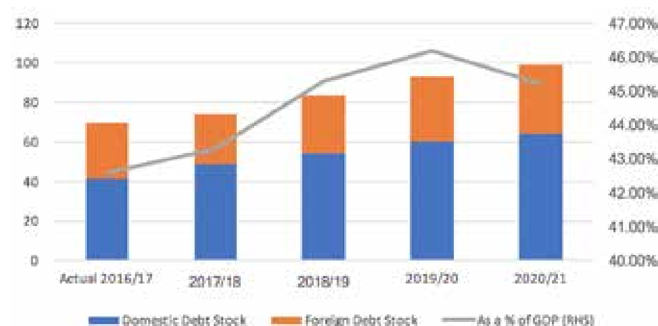
Nevertheless, the trajectory for the debt stock going forward is somewhat more positive and is likely to expand by little more than nominal GDP growth over the next three years. As a result, the debt-to-GDP ratio is starting to stabilise at approximately 45% of GDP. This is a marginal increase from the level forecasted by the Ministry of Finance for 2017/18 of 43.3% (our forecast is slightly lower at 42% due to rand strength reducing the shock of unhedged (principle of) hard currency debt). According to the Ministry of Finance calculations, the debt-to-GDP ratio will peak in 2019/20 at 46.2%, before reducing slightly in 2020/21. We view this reduction as ambitious and unlikely, but expect the debt-to-GDP ratio to stabilise below 50% of GDP, provided no policy measures are introduced that reduce GDP.

Graph 22: Debt to GDP (%)



Breakdown

Graph 23: Total Debt (Billions)



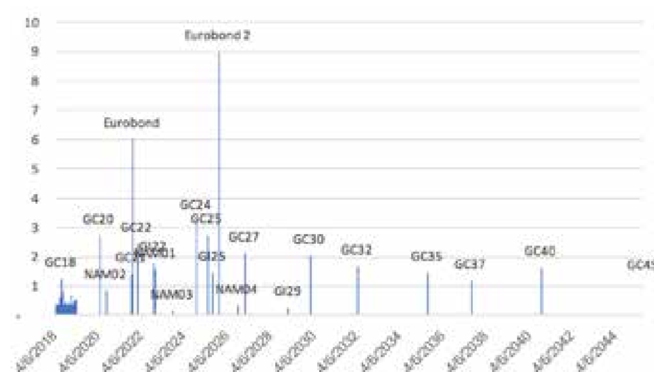
The forecast breakdown of domestic to foreign debt continues to favour domestic debt, which is set to remain at approximately 65% of total debt over the forecast period. However, this remains well below the fiscal target of 80%. Over the next three years, Government plans to issue a total of N$9 billion worth of debt in foreign markets or from foreign sources and N$15.7 billion domestically.

Maturity profile

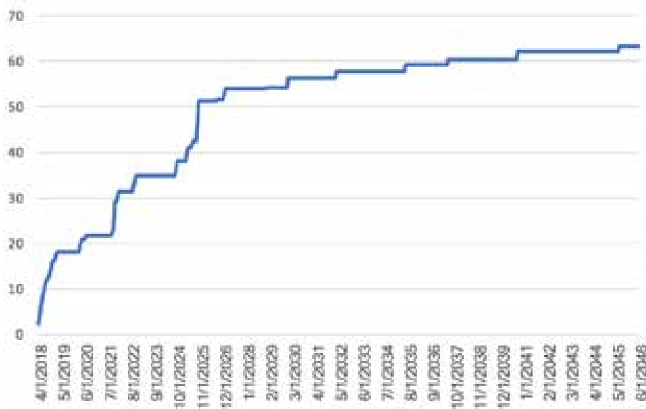
As a result of huge debt issuance in prior periods, the debt position has drastically changed with a huge amount of debt maturing in the next three years. With several of the debt benchmark indicators broken, questions around debt sustainability need to be raised. A majority of debt maturing in upcoming years is in the form of treasury bills; however, around 2021, large volumes of debt will start to mature, including the first U$500 million Eurobond.

It is imperative that the debt maturity profile is addressed going forward, as it both introduces cash-flow related default risks, and potentially puts pressure on the local currency peg if not addressed. Thus, it is evident that there is a need to roll this debt over into future periods. Doing so may, however, prove to be challenging for two reasons. Firstly, demand for longer dated debt instruments is low, due to the large growth in the debt stock over recent years and the perceived credit risk on longer duration debt. Secondly, a lack of demand for longer dated instruments suggests that pricing is incorrect to attract demand, meaning that spreads over benchmarks will likely need to increase in order for buyers to be enticed into taking the additional credit risk on longer dated instruments. This may prove expensive for the country, and would certainly ensure that the debt servicing cost profile would be incorrected in outer forecast years.

Graph 24: Debt Maturity (Billions)



Graph 26: Namibia's Debt Maturity Profile (Billions)



Conclusions and Recommendations

All in all, the budget has been positively received by the public and the restrictions on expenditure in several areas indicate the government's attempts to consolidate its expenditure and to balance the budget in a manner that will ensure the economy does not fall into an austerity cycle in the short to medium term. However, the government remains on an expenditure tightrope, with too much and too little expenditure both likely to cause major long-term economic damage in the country.

Further to this, the government cash-flow position remains highly precarious, and with deficit funding options fast running out, any revenue surprises will put the fiscus into a tail-spin due to limited fiscal buffers. Most concerning in this regard is SACU receipts, which are likely to underwhelm in 2019. Added to this the major potential for expenditure overshoots, and the possibility of another cash-flow crisis in late 2018 or late 2019 remains probable.

On a more positive note, however, while it remains evident that improved expenditure priorities and effectiveness could still be achieved, there are signs that expenditure is now, slowly, being better aligned to national priorities, and that the same amount of money is being spent somewhat more efficiently.

That said, there remain numerous opportunities to further increase the effectiveness of expenditure, especially when it comes to access to housing, access to quality education and access to other basic services. With regard to education specifically, it is high-time that Namibia moves away from the obsessive focus on coverage as a metric for measuring educational success, and focus on quality. With the 7th highest level of youth unemployment in the world, and few jobs being created in both public and private sector, the quality of local education must come under scrutiny, not just as an issue around economic opportunity, but also as a key reason behind the perpetuation of inequality in the country.

Proposed taxes for increased revenue

The proposed tax increases, particularly the dividend tax, are unlikely to derive net-positive outcomes for the country and come at an inopportune time, when the investment and business climate in the country is far from positive. As such, these taxes should be reconsidered. Moreover, it is important to note that Namibia does not have revenue issues, and indeed collects abnormally high revenue relative to GDP. Focus on improving the finances of government should thus be directed at expenditure, rather than revenue.

Personnel expenditure

Personnel expenditure remains of huge concern for Namibia, and is an issue that is borne of high youth-unemployment levels amongst other factors. In this regard, government has used both the historic surplus-debt capacity as well as windfall incomes and underspending (savings) on core service infrastructure to act as an employer of last resort for the expensive-yet-poorly-functional Namibian public education system. That this is an unsustainable situation has been made clear in many historic versions of this IPPR budget review paper.

Going forward, efforts have to be introduced to reduce the wage-bill as a percent of GDP and total revenue, but this must be done in a manner that does not disrupt peace and stability in the country. As a result, efforts are needed to ensure that, (1) The civil service becomes more efficient and helps to grow the economy; (2) The requisite incentives for investment and growth are introduced and fostered to ensure that the economy grows out of the current challenges; (3) Hiring in the civil service is kept to a minimum, and net-hiring is negative, focused on quality and skill particularly; and (4) That wage adjustments are kept at levels below total expenditure and GDP growth, and ideally below inflation.

Debt stock

The growth in the debt-stock seen over recent years has been unsustainable and sources of funding for the deficit have hit a point whereby large deficits will only be able to be funded by unsustainable means going forward. This is to say that most local pension funds and similar investors are already over-exposed to Government, and further increases in these exposures are likely to cause long-term fiscal issues for the country. Furthermore, the AfDB funding received by Government in 2017 and 2018, while positive in the short term, is unlikely to be continuously granted going forward. Similarly, the large increases in government guarantees can be used as a temporary get out of jail free card, but will not solve the country's long term structural issues.

As such, the focus on fiscal consolidation is of critical importance for the country's macroeconomic future. This is to say that every effort should be exerted to ensure no further fiscal slippage is seen in the country, and that sustainable funding models are maintained. Critical in this regard is that should revenue fall for any reason, expenditure will once again have to be rapidly adjusted. Should this not happen, further downgrades to the country's rating can be expected, and ultimately a debt-trap-situation may loom for the country.

Notes

Notes

Notes

About the Authors

Rowland Brown holds a Master's degree in Economics from the University of Aberdeen, Scotland. He has worked as an economist for the National Planning Commission, Capricorn Investment Holdings, the Bank of Namibia and IJG Securities. He is the Founding Chairperson of the Economic Association of Namibia and a Co-Founder of Cirrus Capital. He is a regular contributor to local publications and discussions. He undertakes budget analysis and business climate assessments for the IPPR.

Cheryl Emvula is a final year student at the University of Cape Town enrolled in a Bachelor of Commerce specializing in Economics and Finance, and is expected to graduate in 2018. In 2017, he worked as a research assistant at the United Nations, where he was commissioned to investigate Namibia's socio-economic climate. Shortly thereafter, he joined the Cirrus Capital team as an intern to further develop his understanding of the Namibian economic climate with a focus on financial economics.

About Democracy Report

Democracy Report is a project of the IPPR which analyses and disseminates information relating to the legislative agenda of Namibia's Parliament. The project aims to promote public participation in debates concerning the work of Parliament by publishing regular analyses of legislation and other issues before the National Assembly and the National Council. Democracy Report is funded by the Embassy of Finland.

About IPPR

The Institute for Public Policy Research (IPPR) is a not-for-profit organisation with a mission to deliver independent, analytical, critical yet constructive research on social, political and economic issues that affect development in Namibia. The IPPR was established in the belief that development is best promoted through free and critical debate informed by quality research.

© IPPR 2018

Incorporated Association Not for Gain Registration Number 21/2000/468
Directors: M M C Koep, D Motinga, M Humavindu, N Nghipondoka-Robiati, J Ellis, G Hopwood

PO Box 6566, Ausspannplatz, Windhoek, Namibia · Tel: +264 61 240514/5 Fax +264 61 240516
info@ippr.org.na · www.ippr.org.na