Economic Association of Namibia

PO Box 6148
Windhoek, Namibia
M +264 81 155 9775
F: +264 88 622 267
E: info@ean.org.na
W: www.ean.org.na

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Mid-year Budget Review – Fiscal consolidation on course despite economic headwinds

The Minister of Finance presented the fourth Mid-year Budget Review on 24 October 2018. The review serves two purposes, namely to propose internal re-allocation of approved funds and to provide some first hints about the next Medium-term Expenditure Framework. It is not a proposal for the allocation of additional funds.

Herewith a few highlights.

- **Revenue**
  - Mid-year revenue outturn amounted to 51% of projected revenue for the Financial Year 2018/19 despite declining SACU transfers, a drop in VAT and increasing tax arrears.
  - Tax arrears still amount to NAD3 billion despite a tax amnesty that was offered.
- **Expenditure:** Initial teething challenges with the new Public Procurement Act resulted in delays in the implementation of planned programmes and projects. Hence, the so-called execution rate for development expenditure stood at 27%. This resulted in underspending of the development budget amounting to NAD1.79 billion that is being reallocated to various ministries.
- **Deficit**
  - The budget deficit as a percentage of GDP increased in the last FY 2017/18 from a projected 3.6% to finally 5.0% owing to increased expenditure in order to settle outstanding invoices.
  - Deficit has been continuously reduced from 8.1% in FY2015/16 to 4.4% in the current FY 2018/19 and is projected to remain at 4.4% in the FY2019/20.
  - The deficit is expected to average 3.6% in the next Medium-term Expenditure Framework.
- **Debt**
  - Total public debt as a percentage of GDP was slightly below the projection of 42.1% at 40.4% in FY 2017/18.
  - Public debt is expected to peak at 48.7%.
  - The cost of debt servicing stood at 8.9% of revenue and hence remained below the threshold of 10%.
- **Economic growth**: Government projects the economy to contract for the second consecutive year, but at a lower rate than in 2017. After contractions of 0.2% in the first and second quarter 2018, the economy is expected to contract by 0.2% for the whole of 2018. This would be the first time that for Namibia that economic growth contracts in two consecutive years. Growth is expected to pick

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up in 2019 to 0.9%, which will still result in a decline of per-capita income since population growth exceeds economic growth.

- **Proposed measures** to improve the fiscal balance include:
    - Alternative forms of financing such as Public Private Partnerships
    - Reforms of Public Enterprises
    - Partial listing of state assets
    - Curbing growth of the public wage bill by limiting salary increments to inflation
    - Proposed tax amendments including phasing out of ineffective tax incentives
    - Increased threshold of tax-deductible pension and annuity contributions.

A few comments:

Despite continuous economic headwinds that impact on revenue collection, Government stayed on course to rein in the fiscal deficit and total public debt. According to the Bank of Namibia, private sector activities expanded, while the contraction in public sector activities resulted in an overall contraction of the economy. The private sector expansion has helped stabilising Government's income from income tax revenue.

While there are a number of factors that are beyond our control, there are others that we can influence and that we have to address more forcefully. The Minister of Finance made repeatedly reference to the need to improve our competitiveness. The recently released Global Competitiveness Report and the Doing Business Report both clearly indicate that there is room for improvement. Although becoming the most competitive economy in Africa has been a national priority since some time, very little has actually happened and consequently, Namibia is losing ground. Decisive action has to be taken to address issues that have been on the table since years. Improving the business and investment climate can attract domestic and foreign direct investment, create jobs and income for the employed in terms of salaries and for Government in terms of taxes.

In order to reduce or even eliminate over-pricing for large infrastructure projects, Government could consider contracting experts from the region that thoroughly review tender specifications and assist in the evaluation of tenders.

A clear prioritisation of expenditure needs to include an evaluation of the Ministry of Defence's contributions to the economic and social development. The Ministry received the fifth highest reallocation in the Mid-Year Budget Review and 2.5 times more than the Ministry of Safety and Security.

There are additional measures Government could consider in consolidating the budget. They will not only cut expenditure or increase revenue, but also address issues such as inequality:

The cost of the Public Sector Employee Medical Aid Scheme amounts to about NAD2.5 billion this year, while contributions from public employees amount to some NAD378 million resulting in a subsidy of NAD2.2 billion. Moving over time to a cost-recovery percentage contribution instead of the current flat rate that burdens low-income earners more than the better off would provide additional funds in the short term of at least NAD1.5 billion for vital programmes.

A number of basic food items are zero-rated for Value Added Tax in order to protect low income earners and the poor. A review of the food items included is necessary, since the zero rating most likely benefits better-off households more than the intended beneficiaries that often do not have access or cannot afford these food items.

Government could consider to raise the tax threshold and reduce the tax rate for the lowest income brackets and to adjust these tax brackets for inflation (fiscal drag), while ensuring that these measures remain tax neutral for the highest income brackets. In addition, withholding taxes on interests earned on the Basic Bank Account could be abolished, since this bank account caters for persons earning less than NAD 2,000 per month. Both measures would bring some relief for low-income earners.

The reform of Public Enterprises should include a review of the fees for non-executive directors that are, according to media reports, often several times the monthly salary of, for instance, a teacher.

It is necessary to thoroughly review the structure of the public sector that consists of more than 600 entities including Offices, Ministries, Agencies, Public Enterprises, Traditional Authorities, Councils, Appeal Committees, Boards, etc. There is most likely room to streamline the structure and reduce the financial burden. Natural attrition alone will not address these structural issues.

Finally, strengthening regional cooperation and align responses to the current economic challenges could result in synergies and stimulate regional and domestic economic growth.