Public Debt and Public Investment

By Emmet Kiberd

The Sustainable Development Goals (SDGs) are a comprehensive and ambitious set of targets designed to support sustainable economic and social transformation between now and 2030. In Namibia, there have been, over the years, many ambitious sets of development targets, including the recent *Harambee Prosperity Plan*. In such situations, one of the most important roles for an economist is to ask the question, "How will we pay for this?" Additionally, the economist must look beyond the immediate future and ask, "Can we afford this in a sustainable way?"

SDG 8 (*Decent work and economic growth*) seeks to promote inclusive and sustainable economic growth, and public debt levels play a crucial role in this: while a swift rise in public debt can stimulate an economy in the short-term, this is quite different to the lasting, structural changes required for meaningful and sustainable economic development. Furthermore, other SDGs rely on fiscal stability to finance investment in areas such as agriculture, education, renewable energy, water and sanitation.

The earlier questions are relevant to the current situation in Namibia. Namibia's public debt has risen substantially in the past five years, from approximately 17% of Gross Domestic Product (GDP) in March 2011 to 40.1% of GDP by March 2016. Public debt exceeds the government's current target of 35% of GDP. With the government finding it increasingly difficult to borrow on the domestic market, it is becoming clear that public debt has reached the upper limit of sustainability.

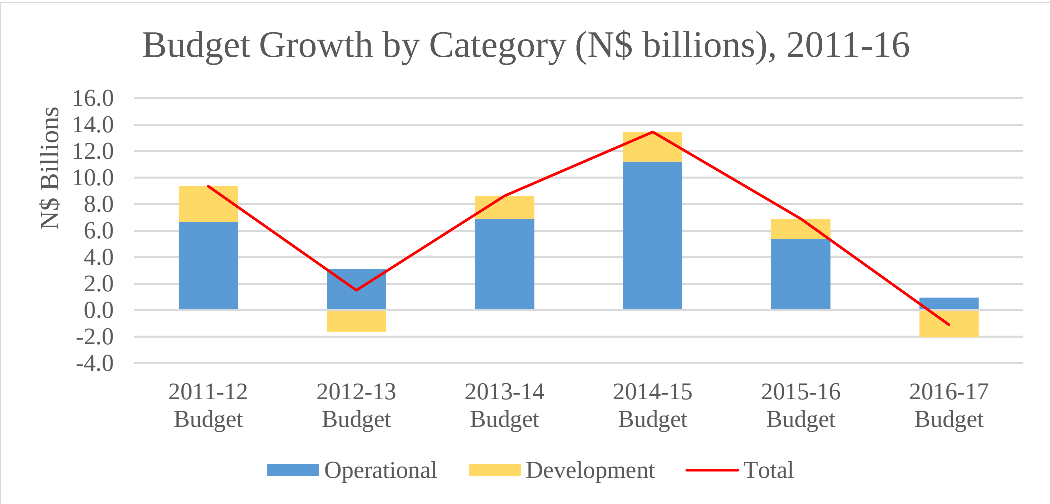
It is often assumed that a developing economy should be unconcerned with running a persistent budget deficit, i.e. spending more than it receives from revenue, year after year. This argument points to the considerable investments in infrastructure still needed in a country like Namibia. It states that, in theory, we can borrow money to quickly develop this infrastructure, thereby improving the growth potential of the economy, and repay those debts from the increased tax revenues yielded by this healthy economic growth.

In reality, many governments run large deficits to finance consumptive public expenditure, such as civil service wages, social grants and operational transfers to parastatals, as opposed to funding economically friendly infrastructure investment. This is less likely to be sustainable in the long term, as this type of expenditure tends to yield less improvement in economic growth, and therefore impacts adversely on the government's ability to service and repay public debt.

There are other dynamics that tend to encourage public borrowing. In many countries, political forces create a strong incentive for deficits and debt levels to stay persistently high. Although many politicians might publicly disagree with the notion, a politician's top priority when taking decisions in government is to remain in power via re-election. This gives them an incentive to satisfy the immediate demands of their voters before the next election, often at the expense of fiscal sustainability several years later. Empirical analysis suggests[i] that such political deficit cycles are more likely to occur in new democracies, i.e. countries that have gained their independence relatively recently. This may be because voters are less experienced in judging the sustainability of a prospective government's fiscal strategy, or because voters in new democracies tend to have less information with which to assess fiscal sustainability at election time.

Small economies are also by nature, price takers in the global financial markets, meaning that their cost of borrowing can be influenced by developments in the world's major economic powers. Therefore, external economic forces, such as low global interest rates and favourable exchange rates, can foster temporary conditions in which accumulating large foreign-currency debts is a much more attractive proposition.

Specifically, in the last eight years, interest rates have been kept at historically low levels in the United States and Europe, resulting in investors from these countries investing more heavily in developing economies in search of higher returns. This abundance of new funds has allowed many African governments to borrow internationally for the first time, with countries such as Ghana, Zambia and Angola borrowing large amounts in US dollars (US$) on the international markets. Namibia has followed this trend, having borrowed a total of US$1.25 billion from international investors via two Eurobonds, issued in 2011 and 2015 respectively.



Source: Estimates of Revenue and Expenditure, Ministry of Finance

But in terms of how pro-growth this borrowing has been, Namibia's record in recent years is mixed. During the past five years, as public debt rose relative to the size of the economy, most of the increase in public expenditure was in the operational parts of the budget, such as civil service wages, other overheads including supplies and travel allowances, and transfers to state-owned enterprises.

For example, in the 2014/15 financial year, when the budget increased by N$13.5 billion (or 28.8%), the operational budget increased by N$11.2 billion (28.4%), whereas the development (capital investment) of the budget increased by N$2.2 billion (30.6%).

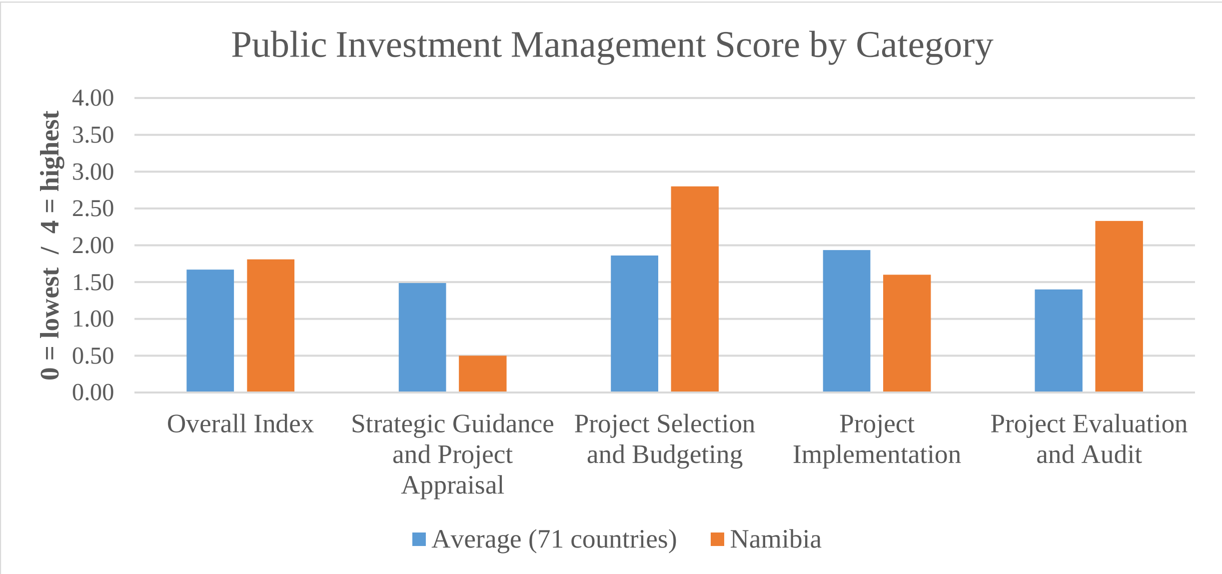
Historically, the development portion of the budget has always been less than the operational, so that although it increased by more in percentage terms in some of the recent years than the operational portion, most of the increase in absolute terms went to the operational budget. However, it should be noted that there has been recent large-scale public investment in sectors that are likely to boost economic growth, including port and road infrastructure.

Another consideration, is the quality and composition of the expenditure financed through new debt. In the right circumstances, operational expenditure can have a pro-growth effect, for example via hiring more teachers whilst concurrently improving educational standards and outcomes. The composition of development expenditure has varied from the very productive (e.g. expanding the container terminal at Walvis Bay port) to the less productive (e.g. constructing new office buildings for purely administrative or regulatory public institutions).

Through improving the effectiveness of public capital expenditure, a government can enhance economic performance using the same finite resources. The *Harambee Prosperity Plan* envisages large-scale public investment in energy and water supply, roads, land servicing, housing and Information and Communication Technology (ICT) infrastructure. If, as the plan envisages, this is to be done while also reducing public debt to 30% of GDP by March 2020, a change of approach will be needed. For this to happen, the Namibian government will need to reduce expenditure growth without seriously compromising GDP growth, an unenviable task that will necessitate getting a much better ‘bang for our buck’ from public investment.

In a 2014 research paper for the World Bank, Cavalcanti, Marrero and Le examine the impact of debt-financed public investment on African economies (Ghana, Tanzania, Zambia and Ethiopia) that have recently borrowed from the international bond markets. Their model highlights that improvements in public investment management can enable debt to be better translated into productive public capital. This in turn implies that better public investment management makes it easier to maintain debt sustainability while borrowing to invest.

The same paper references the Public Investment Management Index, which was compiled for 71 developing countries by the World Bank in 2010, to highlight areas in which such improvements in public investment management are needed.



Source: World Bank – Actionable Governance Indicators Data Portal

Of the countries surveyed, Namibia scores relatively well on project selection and budgeting, and project evaluation and audit. Conversely, Namibia scores below average for project implementation, and in strategic guidance and project appraisal with a score of 0.50 out of 4.00 in the latter (relative to an average of 1.49).

Among the areas in which Namibia is deficient, the Public Investment Management Index highlights:

- A lack of broad strategic guidance for public investment decisions, and a lack of sector strategies with cost estimates;
- Insufficient medium-term planning and budgeting for public investment; and
- Very limited or non-existent parliamentary scrutiny of projects prior to their receiving funding.

Taking these findings collectively, it appears that there are opportunities for efficiency gains in Namibian public investment activities, and that these are likely to improve the sustainability of Namibia's public debt portfolio. Effective project appraisal, prioritisation within the budget, medium-term planning and efficient project implementation would allow Namibia to accelerate economic development without compromising the macroeconomic stability that has long been one of the country's great strengths. Ensuring sustainable levels of public debt will not only contribute to achieving SDG8, but will lay a foundation for progress in many other SDG areas.

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[i] Brender, Adi and Allan Drazen (2005) "Political budget cycles in new versus established democracies." Journal of Monetary Economics, Elsevier, 52(7), 1271-1295.