DEMOCRACY REPORT
May 2017

Special Briefing Report No.19

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THE NATIONAL BUDGET 2017-18: PRIORITISING PERSONNEL

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The Namibian

Summary

Following the sharp downturn in the economy that we saw from mid-2015 to the end of 2016, some slight macroeconomic improvement can now be seen. It appears unlikely that the next 18 months will see negative adjustments of a magnitude comparable to that of the past 18 months.

Broadly speaking, the current budget captures this macroeconomic climate and shows major improvements over those that came before. Administratively, the process appears to have run far more smoothly than in many previous years. The full suite of budget documents was promptly made available to the public within minutes of the commencement of the budget speech in parliament. Within these documents, the administrative errors that were a common sight in previous budgets have been much reduced, and for the most part, numbers balance and make sense.

With regards to the allocation of funds, further improvement has been seen with targeted cuts being introduced to reduce more wasteful expenditure while preserving critical expenditure lines as much as possible. The Defence budget has been cut, many non-key infrastructure projects have been halted, and others completely removed from the budget. The proposed new parliament has been dropped from the development budget all together, as has the proposed N$1 billion-plus new Prime Minister's Office. In addition, the largest allocations ever have been made to maintenance and renovation of current assets, including schools, hospitals and other government buildings.

While not detracting in the slightest from improvements made in the current budget, there remain a number of areas in which further improvement is possible. Concerns still exist around the development budget, around forecast credibility, and, most importantly, around the deficit and the debt stock. This report further elaborates on these, and other issues, while recognising that notable progress has been made to date.

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

Macroeconomic backdrop

The global economy remains on a knife-edge, with downward revisions to growth expectations becoming the norm rather than the exception. Global growth is expected have to slowed to 3.1 percent in 2016, and is only expected to see marginal recovery in 2017. Many advanced economies are struggling to regain their pre-global crisis growth and employment rates, while several emerging economies have seen major and painful short-term adjustment over the past two years. The US economy remains relatively robust, with employment levels and growth slowly returning to long-term trend levels. Europe remains fragile, with uncertainty much increased due to the recent vote by Britain to leave the European Union. Although the market reaction to the Brexit shock was reassuringly orderly, the ultimate impact remains very unclear, as the fate of institutional and trade arrangements between the United Kingdom and the European Union is uncertain.

Between 2009 and 2015, Namibia posted some of its strongest-ever growth, with consecutive rates of between 5.1 and 6.3 percent, compounding each year over the six-year period. As such, the economy grew from a N$77.9 billion economy to a N$108.3 billion economy in real terms. This abnormally strong growth was driven by three key factors. Firstly, Namibia has been through a prolonged period of historically low interest rates, which drove unprecedented uptake of credit by the private sector; secondly, major fiscal expansion from 2011 until early 2016, drove money into the pockets of the public, as well as major civil works programmes; and finally, unprecedented levels of foreign direct investment into the country, driven by the consecutive construction of three foreign funded mines. These factors resulted in a consumption and construction boom, which saw a major expansion in the local economy.

However, subsequently, the macroeconomic environment in Namibia has started to deteriorate, as a combination of factors has come together to dampen growth and drive imbalances within the local economy. The unwinding of historically low interest rates, less foreign investment into the economy, a weaker external environment – particularly in Angola and South Africa, weakening commodity prices, regional drought and a high base all had a negative impact on the economy directly in the second half of 2015 and through 2016.

Government finances

The result of the general external and domestic slowdown has been wide-ranging. However one of the most notable implications has been a contraction in Government revenue receipts. Due to the low government revenue, deeper than expected expenditure cuts were announced in the 2016/17 budget so as to ensure that the debt stock does not continue to expand at an unsustainable rate. Following several years of large budget deficits, the country's debt to GDP ratio is now well beyond the target 35% threshold, having surpassed 42%. Thus, given the options available to the Ministry, these expenditure cuts were undoubtedly the right call.

Unfortunately, cuts of this magnitude continue to have a negative impact on the local economy, and 2016/17 and 2017/18 are likely to prove challenging years for Namibia. It should be noted that these challenging years come after six particularly good growth years, which caused a major rebasing in the size of the local economy. However, the current cuts, combined with the various other macroeconomic challenges faced by the country, mean that a contraction was very likely for 2016, while 2017 growth will hinge on hopes for no further exogenous shocks and the performance of the uranium industry, in particular.

Inflation

Inflation saw a sizable upswing in 2016 when compared to 2015, and 2017 figures look to continue the trend of strong price increases. While 2015 saw average inflation of 3.4%, 2016 averaged 6.7% and the first two months of 2017 averaged 8.0%. For over a year now, Namibian inflation has outstripped that of South Africa. However, inflation expectations remain high in both countries. These expectations are largely driven by currency weakness and the pass though effect of higher Import prices. The effect of higher food inflation due to the drought has also had a negative effect. Our expectations of Namibian inflation for 2017 is for an average of 7.8% before slowing slightly to 6.4% in 2018. The main reason for relatively high level is the continual increases seen in administered prices, sustained increases in rentals and housing, and the continuing pass-through effect of high food import prices.

Interest Rates

Interest rate increases slowed through the second half of 2016, following increases in the first half of the year after the rand weakness caused by the Minister of Finance rotation in South Africa at the back end of 2015. The repo rate now stands at 7.00% in both Namibia and South Africa.

With South Africa being downgraded to junk status, our expectation is that rates will be increased in South Africa and that Namibia will be forced to follow. However, should this be averted, it appears likely that rates will be kept on hold to support growth in the South African economy, provided inflation remains within the SARB target band over the medium term. Despite the dovish leaning of the SARB in recent meetings, it appears unlikely that rates will be cut in South Africa any time soon, particularly given the expectation of higher interest rates in the US towards the end of 2016 and into 2017.

In Namibia, interest rates are expected to broadly follow South Africa since, despite the clear need for higher rates in Namibia, the low and slow growth environment means the central bank is likely to try to keep rates as supportive as possible for as long as possible.

Balance of payments

Over recent years, the Namibian balance of payments has come under extreme pressure, largely on account of sizable merchandise trade imbalances. Trade deficits of over N$25 billion have been seen for the last three calendar years, with an almost N$40 billion deficit seen in 2015, and an almost N$30 billion deficit seen in 2016. These deficits have been partially

funded by foreign direct investment inflows, particularly into the mining sector, but have also required extraordinary government and central bank intervention in 2015 and 2016. The former came in the form of large-scale foreign debt issuance in 2015, while the latter takes the form of asset swap agreements undertaken by the Bank of Namibia with NamPower and the Government Institutions Pension Fund.

Investment Environment

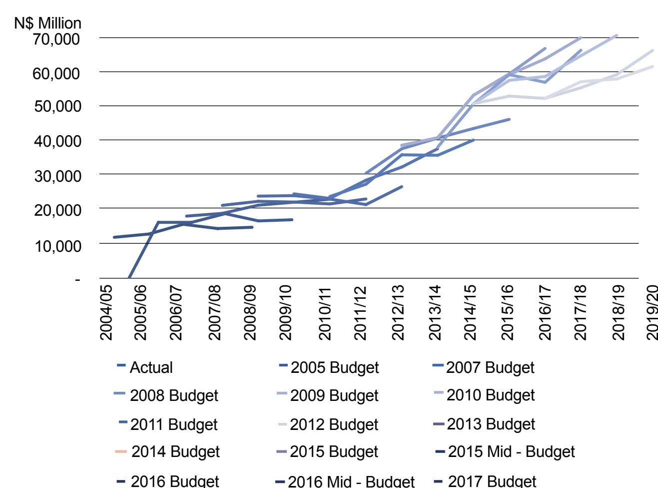
The past 12 months has seen a notable deterioration in the investment environment in Namibia, largely due to the reduced external and domestic demand for goods and services produced in Namibia, as well as the increasing unreliability of payments to service providers for Government and State Owned Enterprises. Added to this, a number of pernicious pieces of legislation have come to the fore, which act as major disincentives for investment into the country's economy. The most notable amongst these include the New Equitable Economic Empowerment Bill and the Investment Promotion Act, both of which contain anti-business clauses which have led to a loss in investor confidence in the country. Both pieces of legislation have been discussed in various international reports and publications, and entities such as the Fraser Institute have already downgraded Namibia's attractiveness as an investment destination as a result.

Revenue

The revenue outturn for the 2015/16 financial year was, as cautioned, far lower than the number presented in the budget of 2016. Despite this budget being presented a little over a month before the end of the financial year, the revenue outturn was overestimated by over N$4.5 billion, resulting in an outturn some 8.0% lower than forecast.

The reason that this is relevant for this report is twofold. Firstly, this is the first comprehensive budget review conducted since the 2016 final numbers have been released and thus the overstatement should not go unrecognised; and secondly, the far lower than expected base has meant that subsequent forecasts have too been excessively ambitious .

Chart 1: Revenue



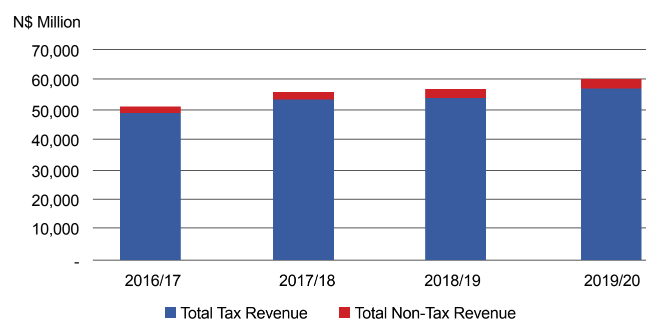
As a result of a lower than forecast revenue outturn for 2015/16 and weaker than forecast growth in revenue (an expected contraction) between 2015/16 and 2016/17 of -1.4%, the expectation for revenue for 2016/17 has been revised down by N$6.3bn, or some 10.9% as compared to a year ago. Due to the base set in 2015/16 and the now more conservative forecasts, this downward revision is carried forward across the MTEF, with a downward revision of revenue for 2017/18 of N$7.5bn (11.7%), and N$12.6bn (-18.1%) for 2018/19.

As a result, over the three years from 2016/17 to 2018/19, the total revenue collection expected now stands at N$165.1bn, compared to N$191.6bn expected for the same period, just one year ago.

Total Revenue (N$ Million)	2015/16	2016/17	2017/18	2018/19	2019/20
2016 Budget	56,765	57,845	63,915	69,816	
2016 Mid-Term Budget	52,230	51,511	54,595	58,445	65,465
2017 Budget		51,512	56,425	57,192	60,795
Change 2016 to Mid Term	(4,535)	(6,334)	(9,320)	(11,371)	
%	-8%	-11%	-15%	-16%	
Change Mid Term to 2017		1	1,830	(1,253)	(4,670)
%		0%	3%	-2%	-7%
Change 2016 to 2017		(6,333)	(7,490)		
%		-11%	-12%	-18%	

For the current financial year (2017/18), the revenue take is expected at N$56.bn, up N$4.9bn on the estimated take of 2016/17. The main reason for this rise is the increase in SACU receipts, following the nearly N$3bn repayment that was made in 2016/17 due to over payment in the 2015 SACU year.

Chart 2: Revenue Breakdown



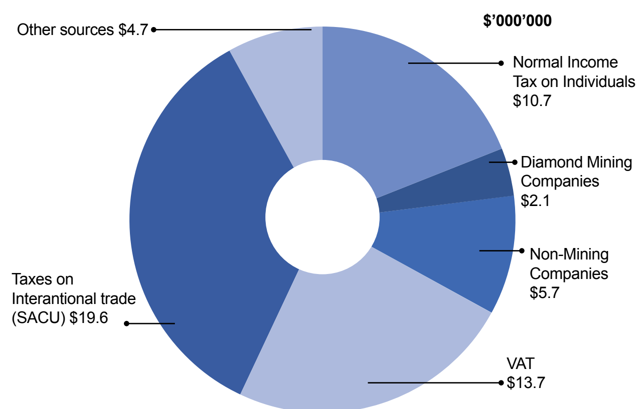
As is usually the case, the vast majority of own-source revenue (excluding grants of N$163 million) collected is to be from taxes. In the 2017/18 financial year, approximately 95% (N$53.4bn) of revenue is from tax sources, while the remainder (N$2.7bn) is from non-tax sources. In this regard and more

generally, the breakdown of revenue receipts has remained broadly the same over the past decade, in that the contribution from the main revenue lines to total revenue, have remained fairly constant. This remains true for the current budget, where contributions, as a percent of total revenue, for the main line, remain fairly stable.

On the tax-revenue front, SACU payments represent 36.7% of the total, with VAT and income tax on individuals representing a further 25.7% and 20.1% respectively. Non-mining company taxes make up 10.6% of tax revenue and diamond mining companies 3.9%, with the remaining 3.0% of tax revenue made up of other sources including:

- Diamond Mining Companies
- Other Mining Companies
- Non-Resident Shareholders Tax
- Tax on Royalty
- Annual Levy on Gambling Income
- Withholding tax on companies & individuals
- Withholding Tax on Unit Trusts
- Withholding Tax on services
- Taxes on property
- Levy on Fuel
- Other on goods and services
- Environmental levies and Carbon Emission taxes

Chart 3: Revenue Breakdown

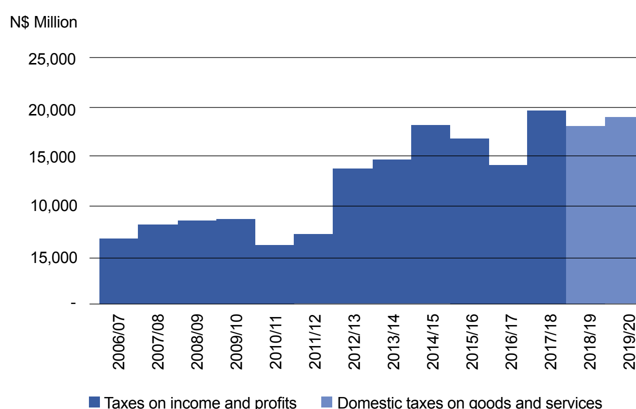


On the non-tax side of revenue, the N$2.7 billion is mainly made up of dividends and profit shares (N$745 million), diamond royalties (N$976 million) and administrative fees (N$811 million), as well as a number of smaller lines, including:

- Interest Receipts for Loans Extended
- Interest on Investments
- Interest on State Account Balances with BON
- Other Mineral Royalties
- Fines and Forfeitures
- Fishing Quota Levies
- Gambling Licenses

The main factor behind the revenue recovery in 2017/18 relative to 2016/17 has been the recovery in SACU revenues. While 2016/17 saw a repayment (netted off from current year receipts) of N$3 billion to SACU for overpayment in the previous year, 2017/18 promises to be a bumper year, with receipts of N$19.6 billion to be received. Even excluding the repayment to SACU in 2016/17, this receipt is far larger than any yet received by Namibia, and comes at an opportune time, as fiscal revenues remain under pressure. Due to the repayment and subsequent "normalisation", SACU revenue it to grow by N$5.5 billion in 2017/18, or some 39.2%, when compared to the preceding year. On a normalised basis, removing the once-off repayment, SACU revenue will grow 14.8%, or by some N$2.5 billion.

Chart 4: SACU



Assessment

Broadly speaking, the current revenue forecasts for revenue appear reasonable.

The magnitude of the SACU payment, however, may turn out to be excessively large when compared to what has been predicted going forward.

How it plays out is likely to be highly dependent on the value of the South African Rand through the year. Given the heightened political risk environment, this remains unpredictable.

Expenditure

The final figures for 2015/16 show slightly lower expenditure than the figures tabled in the budget last year, with the outturn being N$1.7 billion less than the figure budgeted for in February 2016.

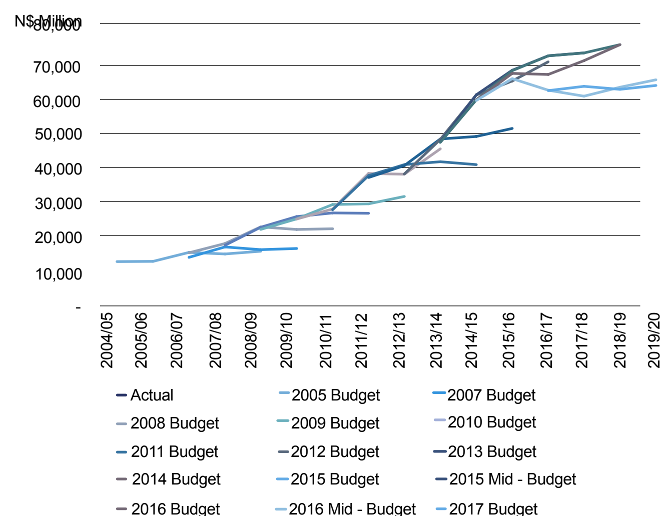
For the 2016/17 financial year, despite the major downward revisions in revenue, much of the focus on the actions of government were in fact aimed at the expenditure side of the budget. Despite the large cuts exhibited across many newspapers, these cuts were, in fact, smaller than the reduction in revenue seen by the fiscus. While the forecast for revenue fell by some N$6.3 billion between the 2016 and 2017 budgets for the 2016/17 financial year, expenditure cuts totalled just N$4.5 billion. These expenditure cuts were introduced in order to maintain a manageable fiscal deficit, however did not match the magnitude of the revenue slowdown. In total, between 2015/16 and 2016/17, revenue fell by N$3.1 billion, some 4.9%, to total N$61.5 billion.

From both a revenue and expenditure perspective, some minor respite can be expected in 2017/18, when compared to 2016/17. In total, the Government plans to spend N$62.5bn, during the financial year, up approximately N$1.0 billion on 2016/17 expenditure, some 1.7% expenditure growth.

For the remainder of the MTEF period, expenditure is forecast to remain within similar levels to that of 2017/18. However, this is, for the most part, the norm when it comes to budgeting in Namibia, and these forecasts for the outer-years of the budget lack any credibility.

	2015/16	2016/17	2017/18	2018/19	2019/20
2016 Budget	66,345	65,996	69,858	74,418	
2016 Mid-Term Budget	64,638	61,496	59,854	62,292	64,425
2017 Budget		61,496	62,541	61,861	62,720
Change 2016 to Mid Term	(1,707)	(4,500)	(10,004)	(11,371)	(12,126)
%	-2.6%	-6.8%	-14.3%	-16.3%	
Change Mid Term to 2017		-	2,687	(431)	(1,705)
%		0.0%	4.5%	-0.7%	-2.6%
Change 2016 to 2017			(4,500)	(7,317)	(12,557)
%		-11%	-6.8%	-10.5%	-16.9%

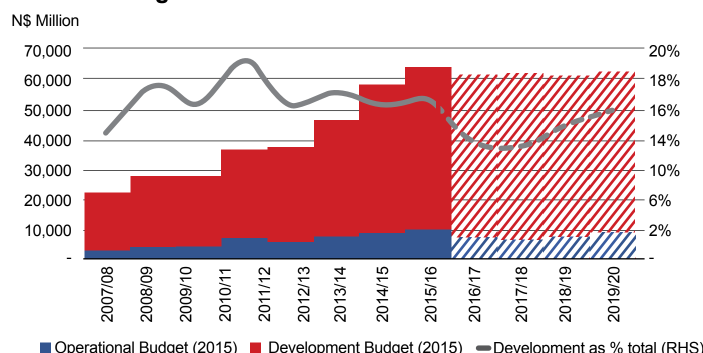
Chart 5: Expenditure



Development vs. Operational Expenditure

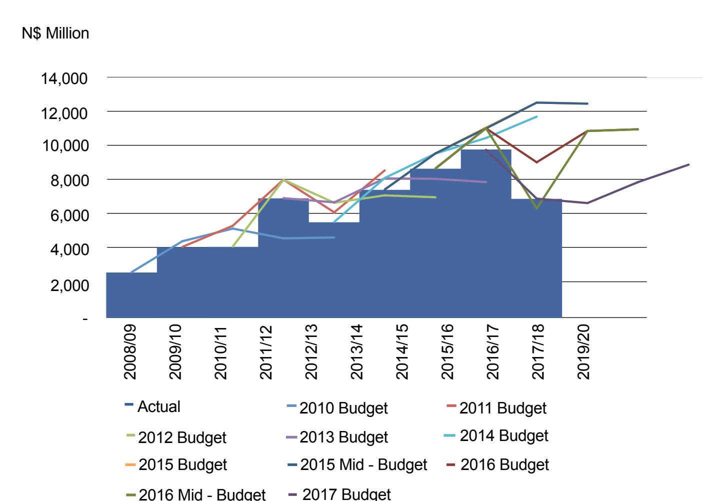
The target breakdown of development expenditure to operational expenditure is 20:80. However, this target ratio has not been reached in over a decade. In the previous financial year, the reported development expenditure, relative to total expenditure was 11.3%, while the expectation for the current financial year is 10.7% - approximately half of the normal target. The reason for this relatively low level of development expenditure is that through the process of implementing expenditure cuts, larger cuts were made to the development budget than the operational budget, as it is easier to stop capital projects than reduce operational or on-going expenditure such as wages and salaries. Moreover, the increases that we have seen in some recurrent expenditure lines in the current budget, such as that of personnel costs, ensure that the operations budget remains relatively large when compared to the development budget.

Chart 6: Budget Breakdown



This situation does not come as a surprise, and has been repeatedly warned against in previous budget analyses by the IPPR. In this regard, caution has been advised with regards to the major increases in operational, recurrent, expenditure through the boom years, due to the challenge with regards to rolling back such expenditure when the economy experiences a downturn. Thus, while the current situation is clearly undesirable, it was foreseeable and avoidable.

Chart 7: Development Budget



Despite this, the low value spend on development activity is not per se, a bad thing. The reason for this is simply that the measure of assessing "development expenditure" relative to total expenditure is somewhat blunt, and mislays the fact that not all expenditure is created equal. In this regard, much of the so-called "development" expenditure over recent years has fallen far short of the mark of achieving any meaningful development. This is best illustrated by the fact that while the country's capital city is unable to provide reasonable guarantees of water supply to major producers and employers, there has

existed more than ample funding for the construction of large numbers of ivory-tower type office buildings by Government. This is perhaps not a new development, but certainly gained a great deal of traction since the introduction of the TIPEEG programme in 2011.

In this regard, many billions worth of lavish head and regional offices have been or are being constructed, while fiscal deficits have been run. That this expenditure is unproductive in the long term, and increases debt levels for little to no return, no doubt can exist. The end result is such that we now sit with a vast stock of Government property assets that yield little return, and thus are unable to fund themselves or the debt that was taken out for their construction (directly or indirectly). Because of this concentration of wasteful projects seen over the past half-decade, and the fact that many of these projects are now being stopped or similar projects not started, this slowdown in development expenditure is not of particular long-term concern, however will result in increased pressure on the construction industry, and will likely feedback into lower revenues and employment numbers going forward.

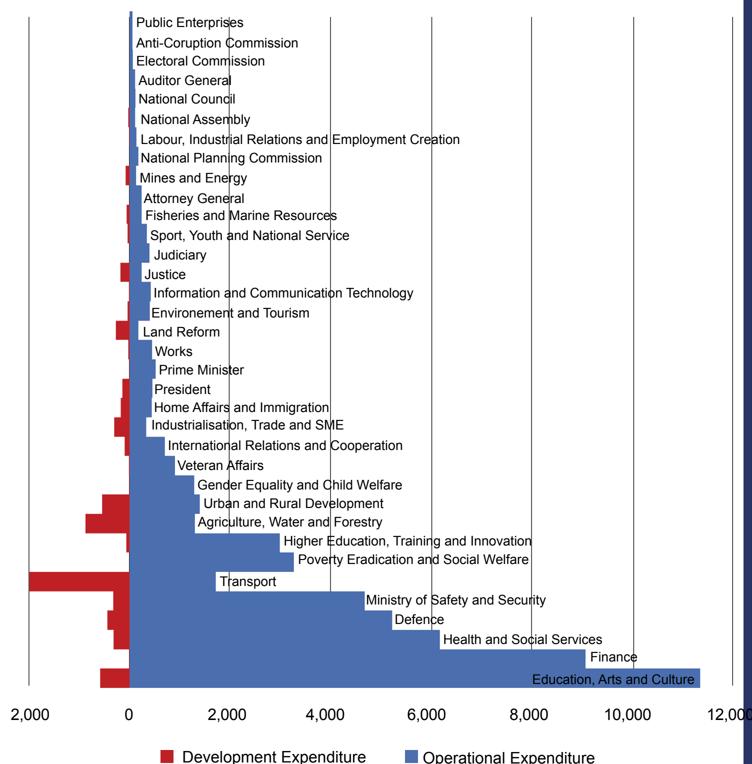
This said, there remains a desperate need to refocus development expenditure on genuine development initiatives, including the provision of critical economic and social infrastructure such as water, road, rail housing and sanitation, amongst others. A possible positive in this regard is that this flushing out of many development budget projects may open up space for higher impact projects, should we see a revenue recovery in future.

Breakdown by vote

As has become the norm, the vote of Education, Art and Culture (N$12.0bn) received the largest total allocation of funds in the current budget, followed by the Ministry of Finance at N$9.1bn (largely due to transfers to SOEs and interest payments), followed by Health and Social Services at N$6.5bn. Collectively, these three votes receive 44.1% of total expenditure for 2017/17.

The next largest funding recipients are Defence and the Ministry of Safety and Security, receiving N$5.7bn and N$5.0bn respectively.

Chart 8: Expenditure by Vote



Main items

For the 2017/18 financial year, personnel expenditure and subsidies and other current transfers (pensions, grants, transfers to SOEs and transfers to regional and local government) make up some 71.6% of total expenditure, with goods and other services (mainly materials and supplies and utilities) make up a further 10.5%. Thereafter, dramatic increases in interest costs increase this category to 8% of total expenditure, approximately the same percentage as the acquisition of capital assets.

Between 2016/17 and 2017/18, growth of 14.9% is expected for personnel expenditure, while interest costs are forecast to grow by 29.1%. The small expenditure line of lending and equity participation is expected to grow by 3%. All the other main item lines are to contract, most notably the acquisition of capital assets and goods and other services.

	2015-16	2016-17	2017-18	2018-19	2019-20
	Actual	Revised	Budget	Projection	Projection
Personnel Expenditure	24,000	24,443	28,095	28,402	28,906
Goods and Other Services	9,085	8,291	6,546	6,362	6,663
Subsidies and other current transfers	17,834	17,334	16,691	14,790	15,038
Interest payments and borrowing related charges	3,130	3,875	5,001	4,264	3,131
Acquisition of capital assets	9,083	6,297	5,035	6,085	6,623
Capital Transfers	1,923	1,230	1,146	1,931	2,332
Lending and Equity Participation	22	26	27	28	28
GRAND TOTAL	65,076	61,496	62,541	61,862	62,721
Percent of Total					
Personnel Expenditure	36.9%	39.7%	44.9%	45.9%	46.1%
Goods and Other Services	14.0%	13.5%	10.5%	10.3%	10.6%

Subsidies and other current transfers	27.4%	28.2%	26.7%	23.9%	24.0%
Interest payments and borrowing related charges	4.8%	6.3%	8.0%	6.9%	5.0%
Acquisition of capital assets	14.0%	10.2%	8.1%	9.8%	10.6%
Capital Transfers	3.0%	2.0%	1.8%	3.1%	3.7%
Lending and Equity Participation	0.0%	0.0%	0.0%	0.0%	0.0%
GRAND TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%
Year on Year Growth					
Personnel Expenditure		1.8%	14.9%	1.1%	1.8%
Goods and Other Services		-8.7%	-21.0%	-2.8%	4.7%
Subsidies aznd other current transfers		-2.8%	-3.7%	-11.4%	1.7%
Interest payments and borrowing related charges		23.8%	29.1%	-14.7%	-26.6%
Acquisition of capital assets		-30.7%	-20.0%	20.9%	8.8%
Capital Transfers		-36.0%	-6.8%	68.6%	20.7%
Lending and Equity Participation		20.3%	3.0%	3.0%	3.0%
GRAND TOTAL		-5.5%	1.7%	-1.1%	1.4%

Personnel expenditure

The continued expansion in personnel expenditure is highly concerning and each year this line represents an ever-larger percentage of total expenditure. This has become particularly apparent in the most recent budget, where the majority of expenditure lines have been cut, while strong growth has been seen in the line of personnel expenditure. Added to this is the fact that employing large numbers of people is expensive, with more than 50% of the budget being used for employment, material, supplies, utilities and similar, not to mention office buildings and the somewhat opaque nature of transfers to State Owned Enterprises, much of which appears to go to operational activities, such as wages and salaries.

According to a number of statements by officials, we currently have a hiring freeze in Government - however, the budget documentation suggests that some 113 positions were filled in 2016/17 and, more importantly, that a further 11,088 positions are to be filled in 2017/18. Whether this is correct or not is currently unclear, and it appears more likely that current staffing numbers and/or budgeted staffing numbers are not correct – a potentially worrying issue.

Due to political pressure, the Government has repeatedly reiterated its intention to not make civil servants redundant. While understandable from a political perspective, this focus, coupled with the fact we already have an exceptionally bloated civil service, is likely to create major issues for Namibia in the long term. The reason for this is simply that there are a number of additional financial demands on Government, which if not serviced, will result in revenue collapse and ultimately an inability of government to either pay salaries or conduct other affairs.

This is illustrated by the fact that the civil service continues to mop up the vast majority of the budget, directly and indirectly, while critical service infrastructure (such as water), required for productive industries to create wealth, jobs and ultimately pay tax, becomes ever more undersupplied.

The commonly repeated claim from officials is that public sector employment is critical as a solution to Namibia's high unemployment levels. However, creating employment directly, through government, is exceptionally inefficient, and the unit cost is far higher than would be the case if Government finances were used to create an investment environment for businesses, to provide support to new businesses, and to create a conducive tax environment. Moreover, there is a cynical argument to be made to support the idea that increasing the number of government employees, due to the bureaucracy this creates, actually produces a disincentive for private sector to create jobs due to the increased time, costs, and processes required to do so.

Public Sector Employment

	Established	Filled	Funded	Jobs to be created
President	383	299	379	80
Prime Minister	453	309	430	121
National Assembly	179	158	172	14
Auditor General	298	183	234	51
Home Affairs and Immigration	1,461	1,069	1,071	2
Ministry of Safety and Security	45,593	17,467	26,297	8,830
International Relations and Cooperation	361	345	352	7

Defence	33,144	22,629	22,629	-
Finance	1,483	1,751	1,773	22
Education, Arts and Culture	40,127	38,017	38,339	322
National Council	134	114	126	12
Gender Equality and Child Welfare	774	534	511	-23
Health and Social Services	17,699	16,149	17,668	1,519
Labour, Industrial Relations and Employment Creation	699	630	699	69
Mines and Energy	340	257	302	45
Justice	625	325	325	-
Urban and Rural Development	1,183	1,054	1,134	80
Environment and Tourism	1,769	1,216	1,216	-
Industrialisation, Trade and SME Development	201	174	240	66
Agriculture, Water and Forestry	3,974	3,240	3,461	221
Judiciary	892	671	748	77
Fisheries and Marine Resources	554	486	487	1
Works	1,993	1,426	1,438	12
Transport	1,419	1,030	1,059	29
Land Reform	757	551	551	-
National Planning Commission	142	124	127	3
Sport, Youth and National Service	719	601	720	209
Electoral Commission	44	44	45	1
Information and Communication Technology	276	220	276	56
Anti-Corruption Commission	99	82	82	-
Veteran Affairs	163	131	163	32
Higher Education, Training and Innovation	114	143	143	-
Poverty Eradication and Social Welfare	154	146	161	15
Public Enterprises	50	42	52	10
Attorney General	301	190	301	111
	158,557	111,807	123,711	11,994

One of the major reasons behind the expansion that we have seen in the civil service wage bill was the civil service salary regrading between 2012/13 and 2014/15. The aim of this activity was to align civil service wages to those of the private sector in order to attract and retain skills. However, because of the large size of the civil service and the magnitude of the adjustment, over the three-year period from the end of 2011/12 to the end of 2014/15, the civil service wage bill expanded by 83.4%. In the three-year period thereafter, the wage bill is expected to expand by a further 27.8%. The end result being that in total, the civil service wage bill has doubled in the five years to 2016/17.

At the time, this was masked by abnormally high “windfall” revenue collection, largely as a result of the construction boom the country was experiencing. However, despite this windfall growth, revenue still only expanded by 72% over the period that the wage bill doubled, meaning that wages and salaries increased as a percentage of total revenue, and now sits at approximately 50%.

Chart 9: Average Salary

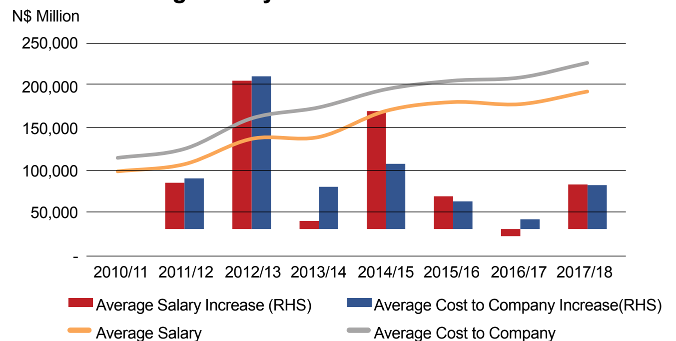
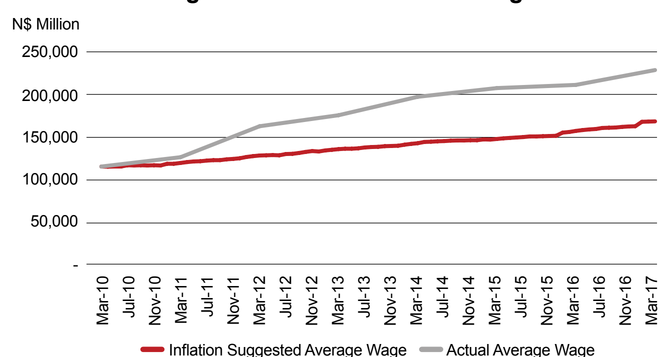


Chart 10: Average Namibian Government Wage vs Inflation

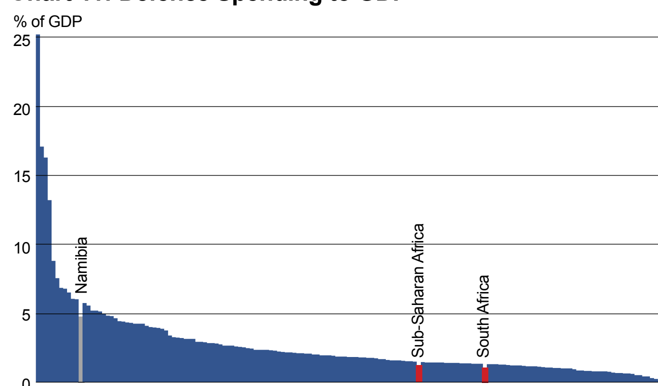


Defence spending

Between Defence and the Ministry of Safety and Security expenditure, the total allocation of N$10.7bn can be seen as around a billion shy of the allocation to Education, Arts and Culture. This is extremely concerning from a prioritisation perspective, particularly due to the fact that Namibia is currently peaceful and stable.

As a result of the large allocations to Defence, Namibia has the 12th highest defence spending relative to GDP in the world. While some defence spending is likely to be justifiable, the magnitude of such that we see in the current budget is certainly not.

Chart 11: Defence Spending to GDP

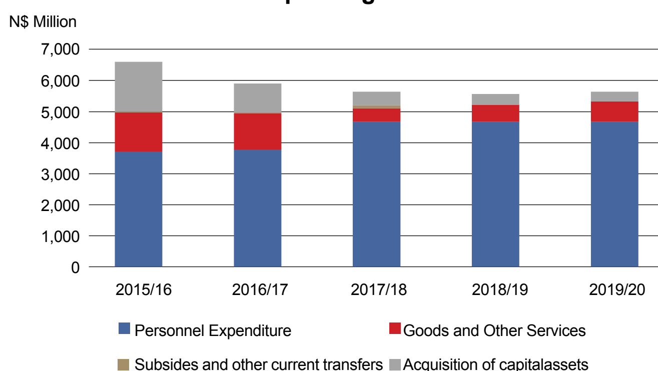


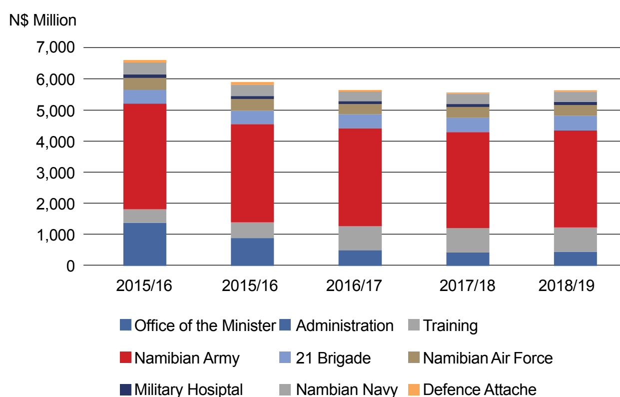
The bulk of the defence spend is allocated to personnel costs, which make up N$4.7 billion of the N$5.7 billion allocated to the vote. When broken down by main division, the Namibian Army is the largest recipient of funds, receiving N$3.2 billion of the total N$5.7 billion allocation to the vote.

While this defence spending is undoubtedly predominantly a job-creation strategy, particularly for the creation of jobs for young Namibians, serious questions exist around the strategy with regards to its efficiency. In essence, the Government 's strategy of creating jobs directly, rather than creating an environment for the business sector to create jobs, is sub-optimal.

While the bulk of the defence spend in Namibia is utilised to create employment opportunities for Namibian youth, the Defence Ministry is also one of the largest recipients of development budget funds. These funds are utilised for the construction and renovation of military bases around the country, but also for the second largest project in the development budget – a project shrouded in secrecy called "Research and Development". In total, this project is worth N$6.7 billion. Even in current trying times, this project receives the third largest development budget allocation in the current (2017/18) year of N$263 million.

Chart 12A&B: Defence Spending Breakdown





The positive in the current budget is that defence spending has been cut fairly aggressively for the most part, meaning that the defence spending to GDP ratio is forecast to improve going forward, from the 4.8% of GDP in 2015, to under 3% of GDP by 2019.

Chart 13: Military expenditure (% of GDP)

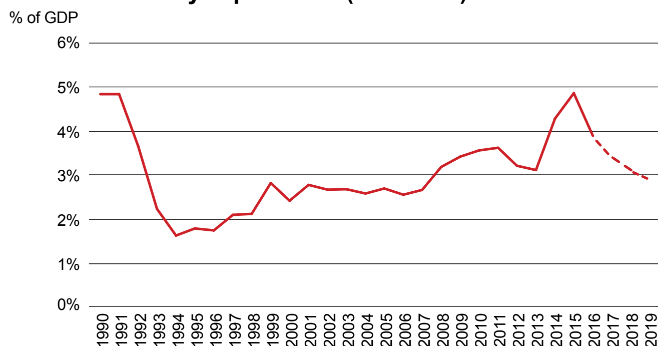
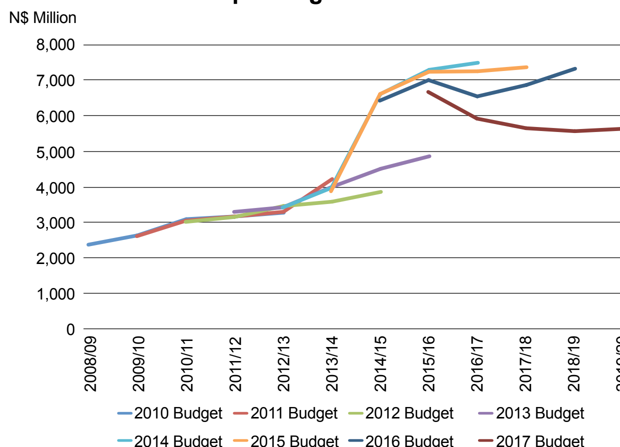


Chart 14: Defence Spending



SOEs

Transfers to state owned enterprises remains a contentious issue in Namibia as many of these entities have failed to deliver basic financial reports (required by law in most instances) to the providers of these funds, the taxpayers. Moreover, there exists major issues around the transparency and detail of the transfers made from central government to the SOEs, and a simple comparison of the detail given for N$1 million spent within government vs transferred to an SOE is startling. For billion dollar transfers, the budget documents contain little more than one-line commentaries on the planned use of funds, often saying only "operational expenses" or something similar. Many of the SOEs fail to report back on the actual use, resulting in a highly undesirable lack of accountability in the use of public funds.

That said, improvements in the recent budget and on-going efforts by the new Ministry of Public Enterprises to provide oversight should be recognised. In this regard, the current SOE transfers focus extensively on the provision of funds to educational institutions. Moreover, although not contained in the budget, both the Minister of Finance and Minister of Public Enterprises have publicly expressed their desire to reduce SOE transfers and move towards a situation where SOEs that can stand on their own become financially independent of Government. These are positive steps.

Chart 15A: Transfers to SOEs: 2017/18

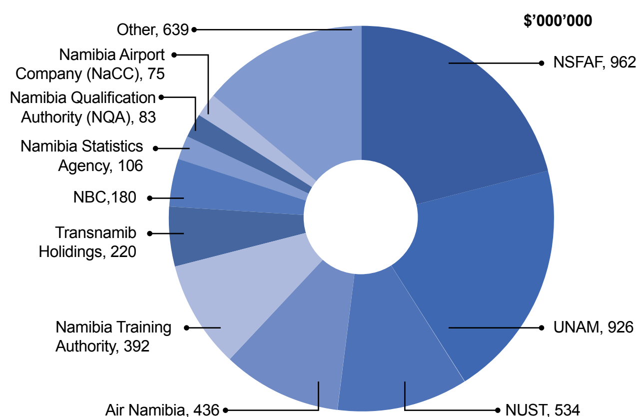
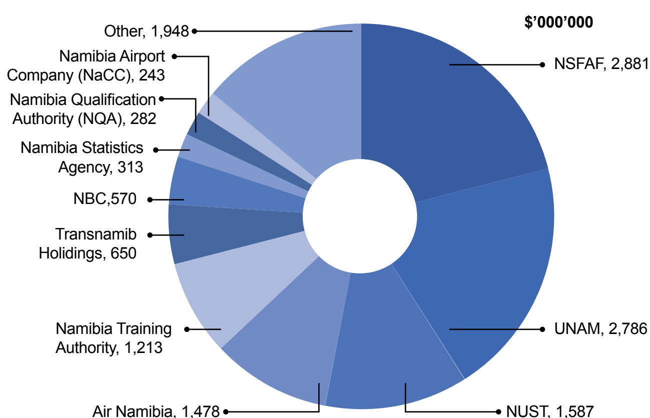


Chart 15B: Transfers to SOEs: MTEF

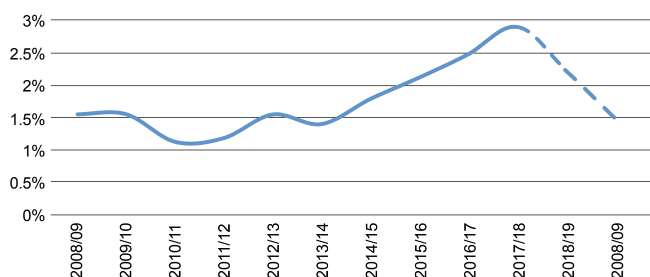


Within the SOEs, two specific concerns revolve around the transfers to Air Namibia and to TransNamib. While transfers to the former may indeed be economically justifiable, as it is feasible that the broad economic benefits of supporting the airline outweigh the fiscal cost of doing so - to our knowledge no such research has yet been conducted. Commissioning such research should be a priority before further such funds are allocated to the airline. TransNamib, for various reasons, has become a black hole into which taxpayer funds are continuously poured. While it may not be possible to run such an entity at a profit, it should be possible to provide a better service and a lower taxpayer cost through improved management.

Debt servicing

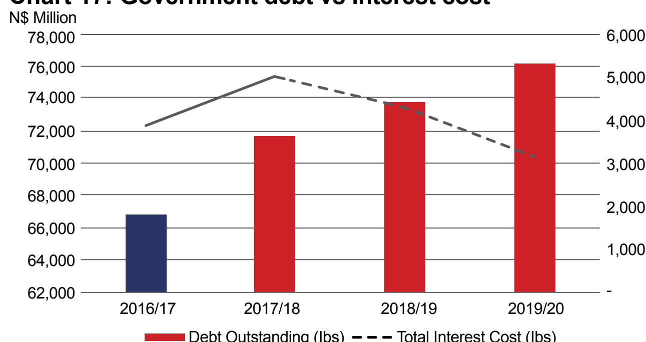
The debt servicing cost of Government has expanded dramatically over the past three years as first the debt stock grew aggressively and then the cost of borrowing started to increase as a result of both local (as illustrated by the spread over the benchmark), regional (as illustrated by the weakening of the South Africa yield curve) and international factors (largely driven by US interest rate moves). The end result has been a major increase in Namibia's cost of borrowing, relative to GDP.

Chart 16: Debt Servicing to GDP



Going forward, the Ministry of Finance forecasts for the cost of debt are peculiar, in that despite the increases in the debt stock that are forecast over coming years, the cost of borrowing is forecast to decrease. This is highly implausible, as not only will the continued growth in the debt stock increase the total cost of borrowing (even in the highly unlikely event that the marginal cost of borrowing declines), but there is also a heightened risk of a rating downgrade, which will increase borrowing costs, plus large increases in the volume of debt over the next 24 months, which will be rolled at a far higher marginal cost than was the case when it was issued, driving up the debt servicing cost even further.

Chart 17: Government debt vs Interest cost



Development budget

The development budget remains, in many instances, troubling. The reasons for this are manifold, but generally boil down to the prioritisation of expenditure and price. In this regard, there are a number of peculiar, and often extremely expensive projects in the budget, which have little to no long-term impact on the economy. The examples of this are extensive, ranging from office buildings, to tarring rural roads, to secretive defence projects. In this regard, the allocations in the development budget for the current year are listed below.

Largest allocations for 2017/18

Vote	Project	Project Description	Budget (2017/18) - N$ Million	Total Project Cost - N$ Million
Transport	24/03/9 - Railway Network Upgrading	Walvis Bay to Kransberg railway line development	651	6,423
Agriculture	20/11/5 - Construction of Large Dams, Desalination and Provision of Water to larger Settlements	Neckartal Dam construction	415	3,197
Defence	08/04/4 - Research and Development	Research and Development (classified Information)	263	6,658
Lands and Resettlement	25/05/2 - Land Purchase Sub-Programme	Acquisition of 45,714.2 hectares of farmland.	200	3,007
Home affairs	05/03/21 - Construction of Head Office for the Ministry of Home Affairs and Immigration	Construction of Head Office for the Ministry of Home Affairs and Immigration	167	564
Transport	24/02/102 - Rehabilitation of the TR 1/16: Windhoek -Okahandja Road (67km)	Construction of Dual Carriageway between Windhoek and Okahandja	150	3,462
Agriculture	20/06/2 - Green Scheme	Complete the construction at Uvhungu-Vhungu dairy section and expand Aussenkher (ORIP) grape irrigation	101	3,500

As well as these projects there are a further 580 projects in the current development budget, of which 424 receive funding in the current year.

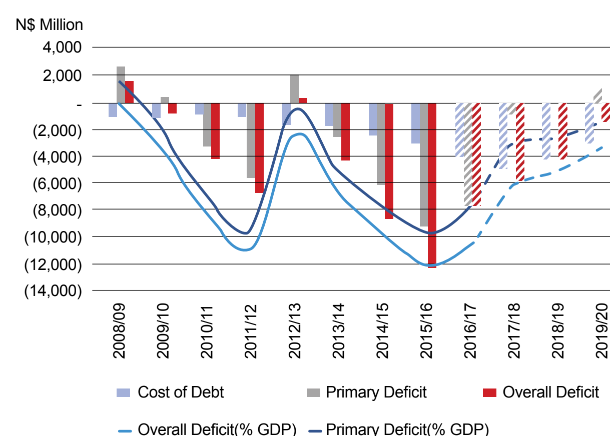
Deficit

As per the 2017/18 MTEF, it is projected that Namibia will be on path of fiscal consolidation in the new fiscal year, with a reduction in the primary deficit projected to contract to N$917 million in 2017/18 from N$7.736 billion in 2016/17. This will be the smallest primary deficit government has run since the primary surplus it ran in 2012/13.

The contraction in the primary deficit is mainly a function of expenditure increasing by 1.6% due to broad base cuts across all major expenditure lines, except personnel expenditure, while SACU revenues will see a N$5.5 billion increase which will see revenue increasing 9.5% in 2017/18 financial year.

As a percentage of GDP, the primary deficit is projected to improve from 4.9% to 0.5%, while the overall deficit from 7.3% to 3.5%. The overall budget balance will not consolidate as much with the cost of debt that is projected to increase by N$1.1 billion to N$5.0 billion.

Chart 18: Deficit

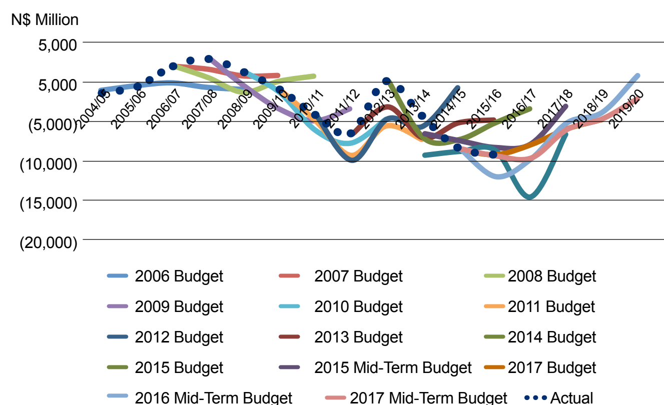


Signs of fiscal consolidation are welcome considering the growth in public debt witnessed over the last two fiscal years and the deterioration in the country's foreign reserve position. It is our opinion that it is critical for Namibia that Government moves towards running a positive primary balance in order to allow for the economy to digest the growth spurt witnessed from 2010 to 2015, to rebase in an orderly fashion and for government to see a stabilisation in its debt position. Moreover, a primary budget surplus is critical for the safe guarding of Namibia's external position.

The latest MTEF forecasts further fiscal consolidation in the outer years of the budget with Government projected to run a balanced primary budget by the next fiscal year (2018/19) and a primary surplus by 2019/20.

The concern however is that Government has a reputation for projecting fiscal consolidation in the outer years of an MTEF while constantly failing to deliver on these projections as is indicated in the chart below. It must however be noted that the current projected path of consolidation is less aggressive than the previous MTEF projection, but that the commitment to consolidation appears more credible than those of the past.

Chart 19: Deficit Forecasts



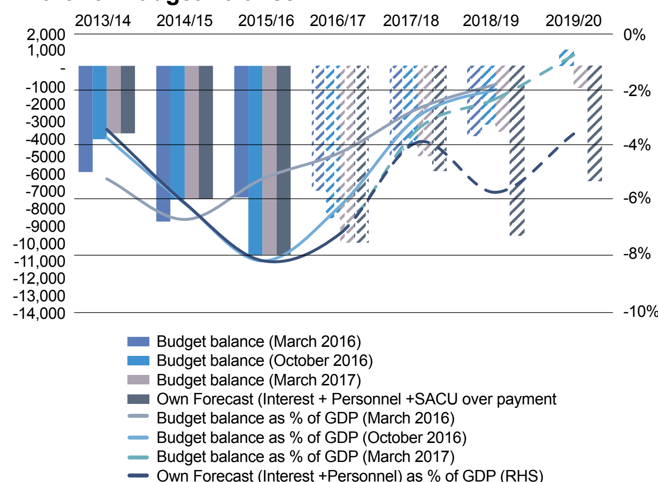
As is discussed previously in this report, while the current year's projections seem reasonably achievable, we question government's ability to deliver on fiscal consolidation in the outer years given three factors:

i. Personnel expenditure – it is our opinion that the current projections of 1.1% and 1.7% increases in 2018/19 and 2019/20, respectively are very low and that increases more align with inflation over the periods are more realistic forecasts.

ii. Interest cost – The interest cost in the outer years are forecast to decrease while government debt stock is forecasted to increase (in line with the shortfalls) and interest rates are under pressure to increase. In our adjusted deficit numbers, we have assumed interest rates to remain constant on top of the growing debt base.

iii. SACU revenues – SACU revenue is projected to increase significantly this year to N$19.6 billion from N$14.1 billion previously. In our view there exists a strong probability that Government may see a SACU repayment in the current MTEF outer years as was the case in 2016/17 which will put pressure on the budget balance.

Chart 20: Budget Balance



Incorporating these adjustments in to the deficit numbers, it is our estimation that the actual budget deficit in 2018/19 will be closer to N$11.2 billion or 5.8% of GDP versus the MTEF projection of N$4.3 billion or 2.3% of GDP.

Debt Stock

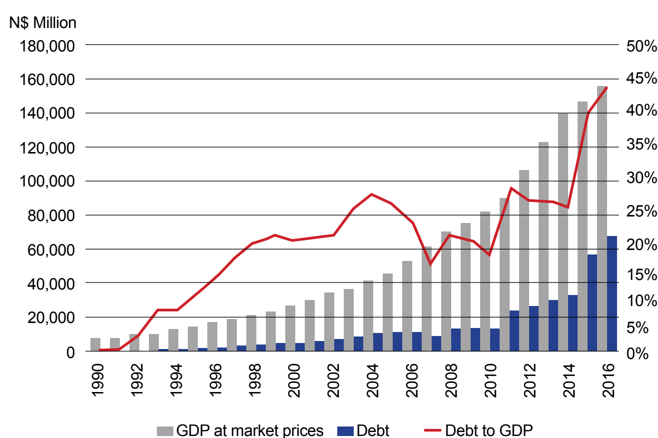
Over the past two years Government saw a significant pick-up in its debt stock, with outstanding debt more than doubling from N$32.7 billion in 2014 to N$67.4 billion in 2016. As a result, the debt to GDP ratio had increased to 43% by end of 2016, surpassing the Government's self-imposed threshold of 35% and is fast approaching ratings agencies' threshold of 45%.

Over the last year, it proved very challenging year for Government to fund their budget deficit, with the bid to cover ratios at Government bond auctions deteriorating to one of the lowest levels ever seen. This was largely due to the market becoming saturated on the back of Government's strong issuance over the past two years, and the stickiness of the yield curve, which appears reluctant to reprice.

Given the consolidation in the budget in the current fiscal year the debt stock is not expected to increase as aggressively as previously with only a 7.4% increase projected. The sustainability of the debt position does however get questioned over the outer years of the MTEF given the ambitious deficit forecasts.

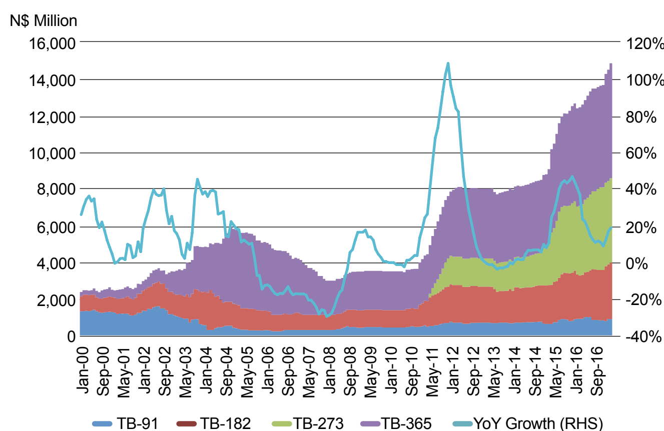
According to the MTEF the current budget deficit will be 60% funded through foreign debt issuance and 40% placed domestically. This funding strategy will increase the foreign debt component to 39.8% of total debt and essentially further expose Government to the volatility of the Namibian Dollar/Rand and effectively exposing Namibia to the fragile South African political situation. The recent South African cabinet reshuffle saw Namibia's foreign debt exposure increasing by N$1 billion overnight and N$1.6 billion over the subsequent week.

Chart 21: Public Debt to GDP



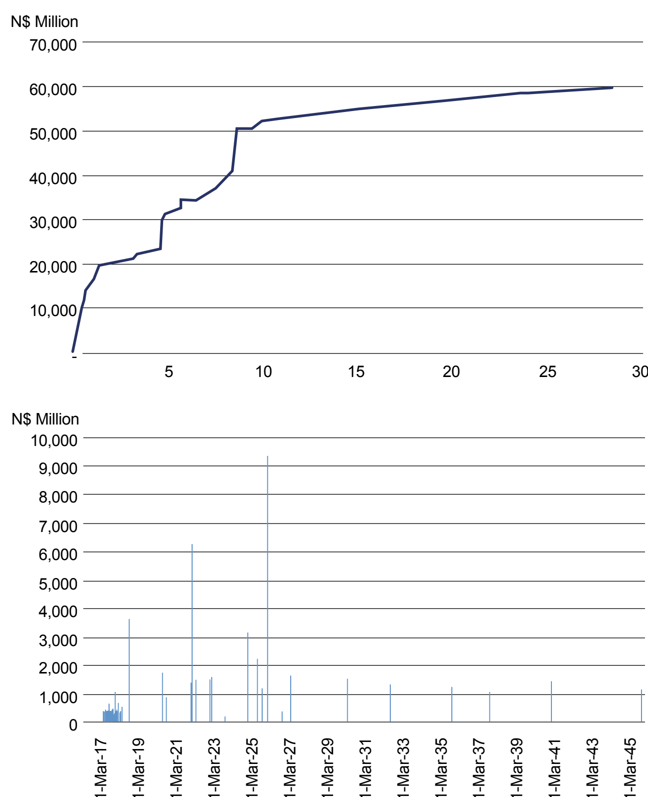
Due to the general lack of interest in Government bonds, Government was silently forced to issue more Treasury Bills in order to fund the deficit. As a result, we saw the amount of Treasury Bills outstanding ballooning to N$14.9 billion by February 2017, from less than N$4 billion in 2010 and increasing more than 100% in 2011 alone. Over the 7-year period from end 2010 to end 2017, the Treasury Bills stock has seen growth of 23.7% per year on a compounded annual growth rate basis, fast outstripping the economy's nominal growth rate. As it stands Treasury Bills represent 37% of domestic debt outstanding and equates to 9.2% of GDP.

Chart 22: T3 Stock and Growth



The next two years may prove challenging for Government to fund their budget deficit from the domestic market, mainly due to the maturity profile of the debt stock outstanding with approximately N$19.3 billion in Government debt maturing within the next 15 months. For this reason, we believe Government's focus will need to shift focus from "funding the deficit" to "rolling debt".

Chart 23: Maturity Profile



Conclusions and recommendations

Broadly speaking, and despite further room for improvement, the current budget shows major advances over those that came before. Administratively, the process appears to have run far more smoothly than in many previous years, and the full suite of budget documents was promptly made available to the public within minutes of the commencement of the budget speech in parliament. Within these documents, the administrative errors that were common in previous budgets have been much reduced and, for the most part, numbers balance and make sense.

With regards to the allocation of funds, further great improvement has been seen with targeted cuts being introduced to reduce more wasteful expenditure while preserving critical expenditure lines as much as possible. The Defence budget has been cut, many non-key infrastructure projects have been halted, and others completely removed from the budget. The proposed new parliament has now been dropped from the development budget all together, as has the proposed N$1 billion-plus new Prime Minister's Office. In addition, the largest allocations ever have been made to maintenance and renovation of current assets, including schools, hospitals and other government buildings.

While not detracting in the slightest from improvements made in the current budget, there remain a number of areas in which further improvement is possible. These include, but are not limited to:

Transparency in transfers to SOEs

As earlier mentioned, many sizable transfers to SOEs are entered into the budget as one-liners in which virtually no detail as to fund use is provided. As many SOEs also fail to produce annual reports and annual financial statements that are available to the public, these transfers go largely unscrutinised. From a transparency perspective, this is concerning, as the basic check-and-balance around the use of public funds (being public scrutiny) is undermined.

In order to address this issue, two things are required. Firstly, transfers to SOEs need to be subjected to the same level of detailed reporting as transfers within government, with the full detail of the planned use being publicised alongside the transfer. Secondly, the on-going efforts to ensure that adequate financial reporting from all SOEs needs to continue and these reports need to be made available to the public for scrutiny.

Development budget

The development budget remains concerning in a number of areas. Firstly, the allocations to this budget have been much reduced due to the expenditure cuts and the relative ease with which capital projects can be cut vis-à-vis operational expenditure. However, this is not, per se, a bad thing, as many of the projects that have been cut were large, low impact projects.

Nevertheless, Namibia remains with large infrastructure investment requirements, many of which are currently not being

addressed due to funding constraints. At the same, time, huge allocations are seen to remaining low-impact projects, peculiar and secretive defence projects and hugely over-priced large and small projects. According to the Ministry of Finance, many of the projects not catered for within the budget are to be conducted through public-private partnerships, however this model will only work for small numbers of projects, and public goods (such as railway lines) will most likely have to be provided for by government, or at least with government guarantees. In this regard, better prioritization of the use of public funds remains required, however the unlocking of alternative funding options and complimentary solutions, is unquestionably a positive step forward.

When assessing the capital budget, one cannot help but question the vast number of projects therein, both with regards to the reason for their prioritisation and their cost. Small police stations in low population areas of the country that cost the best part of N$100 million, for example, exhibit a peculiar sense of priority when upward of 30% of the country still lacks basic housing. The examples of such peculiar prioritisation are many. Huge savings could be made by reassessing development budget projects, their costs, and then reallocating funds to genuine priorities.

Finally, the removal of wasteful projects from the development budget is a positive move forward. However, a number of concerns remain as to whether this will still be the case should we see a revenue recovery going forward. In this regard, projects such as the new parliament building, new Prime Minister's office and similar, that have now been removed, should remain out of future budgets.

Concerns around debt stock

The growth in the debt stock seen over the past two years has been startling, and predictably, costly. The debt servicing cost of Government has expanded dramatically, as first the debt stock grew aggressively, whereafter the cost of borrowing started to increase as a result of both local (as illustrated by the spread over the benchmark), regional (as illustrated by the weakening of the South Africa yield curve) and international factors (largely driven by US interest rate moves). The end result has been a major increase in Namibia's cost of borrowing, relative to GDP.

Going forward, the Ministry of Finance forecasts for the cost of debt are peculiar, in that despite the increases in the debt stock that is forecast over coming years, the cost of borrowing is forecast to reduce. This is highly implausible, as not only will the continued growth in the debt stock increase the total cost of borrowing (even in the highly unlikely event that the marginal cost of borrowing declines), but there is also a heightened risk of a rating downgrade, which will increase borrowing costs, plus large increases in the volume of debt to roll over the next 24 months, which will be rolled at a far higher marginal cost than was the case when it was issued, driving up the debt servicing cost even further.
As such, action is needed now, in order to ensure that the country's debt stock remains manageable, and that a default is avoided over the next 10 years or more.

There remains a need to make use of relative rand strength to hedge the currency risk on the hard currency debt stock of the country, particularly in light of the heightened downgrade risk and the likelihood that current bonds will be extremely expensive should they need to be rolled into junk rated instruments.

The major net-issuance of treasury bills needs to be stopped immediately as the stock of treasury bills has grown to such an extent that there is an ever-increasing risk of a debt trap for the country. Because of the discount on the treasury bills stock that we see presently, the stock increases by approximately 10% per year simply to maintain neutral cash-flow for government. If not addressed, a few weak growth years could see the treasury bills stock growing out of control relative to GDP.

The "lumpy" nature of the maturity profile of the government debt stock needs to be addressed, and the hot-spots around 2020-2022 and 2024-2027 need to be smoothed out. It is worth the government paying up to achieve this, otherwise if buffers are not rebuilt before 2021 and 2026, there is a risk of major cash-flow issues for government.

Finally, the path of fiscal consolidation which is currently forecast must be achieved. If it is not, there is all but zero chance of Namibia maintaining an investment grade rating. Given many of the peculiarities in the current budget, including wage bill growth forecasts, and debt-servicing costs, maintaining this path will be challenging.

Forecast creditability and confidence

Over the past few years, the forecasts of the Ministry of Finance with regards to the budget figures were largely inaccurate. Many examples of this exist, from growth to the deficit. We believe that much progress has now been made by the Ministry to address this issue, but more need to be done.

A number of examples of peculiar forecasts still exist within the current budget, whereby the likes of personnel cost increases are unlikely to be achieved, and interest costs are almost certainly inaccurate. As has happened many times before, this will filter through to the budget bottom line, resulting in a larger than intended budget deficit, and stronger than forecast debt stock. This trend has been on-going for many years now.

This situation is completely unacceptable for investors who commit to long-term funding for the Namibian government based on government forecasts, and is likely to be one of the reasons that demand for government debt has dried up so dramatically. As such, there is a need to a. improve forecasts, and b. rebuild credibility with investors by sticking to forecasts. This is not, per se, hard to achieve. However, a change in mentality and intent is required from the Ministry of Finance to improve accuracy (even when this makes figures look worse) and to consult with investors on a regular basis.
Finally, it should be noticed that the response of the Ministry to issues such as the rating outlook downgrade and the bal-

looning debt stock, has been exceptionally positive. The approach of taking ownership of the issues and committing to address them (and then attempting to do so) has built a great deal of confidence and trust. This needs to continue, and it would be very beneficial if other key policy makers pursued the same approach.

Contractionary feedback

At present, the Ministry of Finance is forecasting negligible growth in revenue excluding SACU. However, there remains a risk of negative feedback from budget cuts implemented in October 2016, resulting in lower than expected revenue. This is likely to be from the construction sector particularly, where margins are under enormous pressure, and jobs are being actively shed. This will feed back into personal income tax collections as well as corporate tax collections.

However, while we caution about this issue, we do not have the detailed information that the Ministry has with regards to individual revenue lines by sector, and thus cannot quantify the feedback. Thus, we simply state this point as a potential area for observation.

Macroeconomic foresight and reaction

The Ministry of Finance has made a number of positive steps forward with regards to macro-foresight, partially through movements within the Ministry team, and partly through the involvement of private sector parties. In this regard, the Ministry must be commended.

However, there remains a need to improve macro-foresight capacity within the Ministry, particularly with regards to key issues such as the currency peg, international ratings, growth and other macro forecasts, and the debt stock situation and forecasts. This can either be achieved through bringing in the right external support, or by developing internal capacity further. It should be noted that if nothing is done to improve the foresight capacity within the Ministry, we believe it will become extremely costly to Namibia, and the Namibian taxpayers.

Appendix 1: Large Projects: Development

Budget

Vote	Project	Total Project Cost (N$ Million)
Education	Establishment of Hostels at Schools Nationwide	9,000
Defence	Research and Development	6,658
Transport	Railway Network Upgrading	5,457
Transport	Keetmanshoop via Aroab to Klein Menasse Border Post 6 km)	5,000
Transport	Rehabilitation of the TR 1/16: Windhoek -Okahandja Road (67km)	3,310
Rural/Urban Development	Implementation of the Master Plan for Oshakati Town	3,290
Lands	Land Purchase Sub-Programme	3,007
Agriculture	De-bushing in Commercial and Communal areas	2,975
Agriculture	Construction of Large Dams, Desalination and Provision of Water to larger Settlements	2,758
Transport	Upgrading the TR 1/4: Windhoek - Rehoboth road to a dual carriage ways (84 km)	2,715
Transport	Upgrading the TR9/1: Windhoek-Hosea Kutako road to a dual carriage (44km)	2,700
Agriculture	Green Scheme	2,442
Rural/Urban Development	Construction of Services Infrastructure in Outapi Extension 8	1,967
Transport	Northern Railway Line Extension	1,771
Mines	Seismology and Ground Geophysics (SGG)	1,515
International Cooperation	Purchasing, Constructing and Renovating of Diplomatic Premises Abroad	1,478
Agriculture	Horticulture support programme	1,432
Higher Education	Upgrading and renovation of Rundu Vocational Training Centre	1,432
Education	Basic Education Facilities Upgrading	1,400
Transport	Maintenance of paved and unpaved roads	1,299
President	State Security Infrastructure	1,262
Transport	Upgrading of MR91 Gobabis - Aminius & MR 40 Aminius - Aranos (245Km) to bitumen standard	1,241
Education	Construction of Teachers Houses	1,141
Higher Education	Construction of Eenhana Vocational Training Centre	1,114
Agriculture	National Horticulture Development Initiative (Horticulture Production, Processing and Marketing)	1,100
Trade	Construction of Sites and Premises Industrial Estates	1,096
Police	Construction and Renovation of Official Accommodation	1,037
Transport	Upgrading of the MR 44: Swakopmund -Walvis Bay Road (44 km)	1,015
Education	Renovations of School Nation Wide	1,000
Agriculture	Bulk Water Supply	1,000
Agriculture	Integrated Forest Resource Management	992
Police	Upgrading of Police Stations	981
Agriculture	Rural Water Supply Coverage (Rural Secondary Pipeline Construction)	981
Higher Education	Construction of the National Science Technology and Innovation Valley in Windhoek	949
Transport	Construction of Swakopmund - Henties Bay - Kamanjab Link (412KM).	944
Transport	Development of the Cape Fria- Katima Mulilo Railway Line	900
Rural/Urban Development	Upgrading and development of Informal Settlements & Low Income Townships in Windhoek	842
Transport	Construction and Tarring of the road from Opuwo to Epupa	806
Transport	Upgrading and Rehabilitation of Aus-Luderitz Railway Line	801
Defence	Upgrading of Leopards Valley Military Base	801
Health	Construction and upgrading of Primary Health Care Clinics Nationwide	738
Transport	Construction of a new Area Control Tower for the Windhoek FIR	728
Rural/Urban Development	Construction of Services Infrastructure in Katima Mulilo	719
Mines	Rural Electrification	707
Transport	Rehabilitation of the Keetmanshoop - Mariental road (386km)	696
Transport	Construction and Tarring of the road from Opuwo to Sesfontein	643

Defence	Rehabilitation of old bases countrywide	615
Rural/Urban Development	Construction of Services Infrastructure in Nkurenkuru Phase 2	604
Education	Building and Maintenance	600
Agriculture	Construction of Veterinary Clinics, Offices and Accommodation	597
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About the Author

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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. The project 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 into social, political and economic issues that affect development in Namibia. The IPPR was established in the belief that free and critical debate informed by quality research promotes development.

Incorporated Association Not for Gain Registration Number 21/2000/468
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