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National Budget 2002/03: We've been here before

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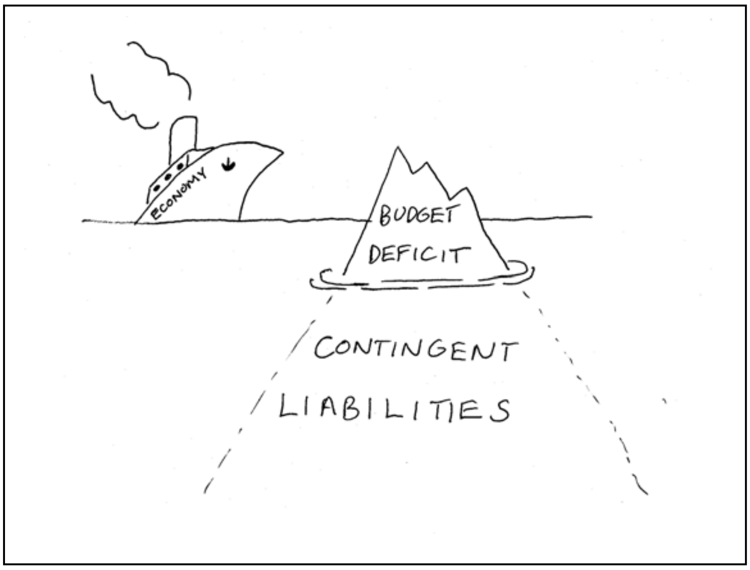
Finance Minister Nangolo Mbumba presented the national budget to the National Assembly on Wednesday 3 April 2002. The budget contained few new tax or expenditure proposals but the Minister did reaffirm the commitment made in November to reduce public spending to 30% of Gross Domestic Product. Although his revenue and expenditure proposals suggest he is making some attempt to meet this target, we are sceptical this target can be achieved within the next three years without a significant departure from past budgeting practices, notably accommodating additional budgets.

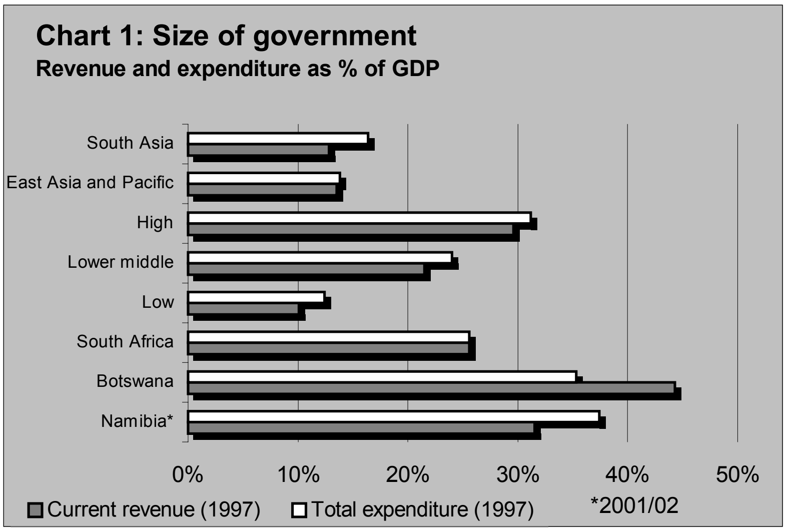


The national budget is a vitally important fixture in Namibia's economic calendar. It gives the Minister of Finance the opportunity to explain the Government's revenue and expenditure policies, together known as *fiscal policy*, to Parliament and the people. The Government has far more freedom of independent action on fiscal policy than it does on either monetary policy and the setting of interest rates, or trade policy and the setting of trade taxes and restrictions. The budget, therefore, offers Government greater scope to address Namibian priorities without first having to compromise with monetary or trade policy partners.

The introduction of a spending target is a positive step…

This year's budget was unusual in that it was the first time a Namibian Minister of Finance announced a target for the level of public expenditure. In last year's budget speech the Minister announced targets for both the budget deficit (3%) and the level of public debt (25%) as a percentage of Gross Domestic Produce (GDP), a common measure for the size of the economy.

For some time the IPPR has been arguing that these targets need to be complemented by an expenditure target (see IPPR Opinion No.1). Simply stated, the budget deficit is the difference between revenue and expenditure. A deficit target, therefore, can be met at differing levels of revenue and expenditure. Although the budget deficit is widely regarded as an important measure of macroeconomic management (a smaller deficit being generally associated with more efficient government and a lower risk of inflationary financing of the public sector), the levels of revenue and expenditure have at least as great an impact on economic performance. Revenue is raised through the tax system which changes the prices faced by households and businesses in the economy, changing their economic behaviour. Generally speaking, the greater the revenue raised from the economy, the greater this change in behaviour will be.



Last November Cabinet formally adopted a public expenditure target of 30% of GDP which the Minister confirmed in his budget speech, albeit qualified at "around 30%". Chart 1 shows that, on the Minister's own measure, government in Namibia is very large compared to international averages for regions and income groups. We welcome the introduction of an expenditure target as a matter of principle. The question is rather, is it the right target and can it be met?

…but will it be met?

Chart 1 suggests that even at 30% of GDP, government in Namibia will be larger than all the categories included with the exception of high-income countries. Namibia is entering a phase during which it has relatively little room to manoeuvre on revenue. Receipts from SACU will be under pressure as trade liberalisation reduces tariffs and the size of the common revenue pool. VAT will be difficult to increase without hitting the poor. Corporate tax is already at the higher end of the international spectrum. The rise in the corporate tax rate presented in the 1998/99 budget was quickly reversed. Meanwhile corporate tax is anyway being eaten away by special tax incentives of one sort or another. Although there may be more scope for increasing revenues from income tax on individuals, in the absence of significant windfalls arising from discoveries of commercially exploitable oil and gas deposits, revenue growth is likely to be limited over the coming years. This scenario provides a sound rationale for the Minister's expenditure target of 30%. The Minister, however, did not make such a case for his target in the budget speech.

The latest figures suggest Government spending will have to fall by a massive 8% of GDP if the target is to be met. Is this realistic? On one occasion in the past when the Minister publicly expressed concern about the level of public spending this concern was dispelled by substantial revisions upwards to GDP estimates by the Central Bureau of Statistics. This stroke of luck is unlikely to be repeated in the near future although two large projects have the potential to raise GDP considerably. Initial estimates suggested that the Skorpion zinc mine alone had the potential to raise Namibia's GDP by about 4%. Skorpion is due to come on stream at the beginning of 2003. The Ramatex textile factory too has the potential to boost GDP. Provided Government spending grows more slowly than GDP, its size in relation to GDP will fall.

The Minister's own estimates presented in the Medium-Term Expenditure Framework annexed to the budget speech, suggests he intends to allow spending to grow but at a far lower rate than GDP as shown in Table 1. Forecast revenue and expenditure growth are very low for the next two financial years.

Table 1: MTEF projections

	2002/03	*2003/04*	*2004/05*
Nominal revenue growth	7.2%	5.8%	5.5%
Nominal expenditure growth	10.3%	2.0%	4.7%
Nominal GDP growth	13.4%	13.1%	12.1%
Expenditure/GDP	34.5%	31.1%	29.0%

This year's budget strongly suggests that the Minister of Finance is serious in his intention to cut the size of government in proportion to the economy. The nominal rises in revenue and expenditure estimates presented in the 2002/03 budget are low by historical standards. Compared to last year's main budget, revenue estimates rise 7.2% from N$8.775 billion to N$9.406 billion and expenditure estimates rise by 10.3% from N$9.782 billion to N$10.786 billion. Compared to last year's additional budget, revenue and expenditure rise by 4.4% and 2.8% respectively. Charts 2 and 3 show that these are low nominal increases by historical standards.

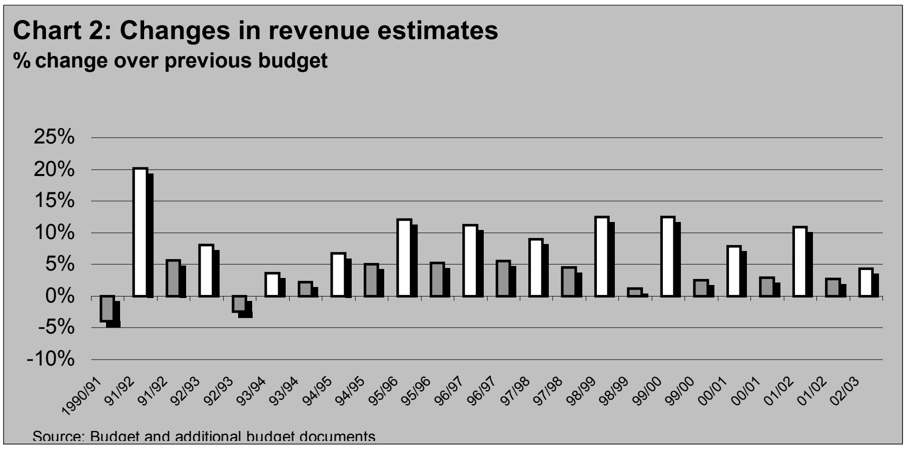


Chart 2: Changes in revenue estimates
% change over previous budget

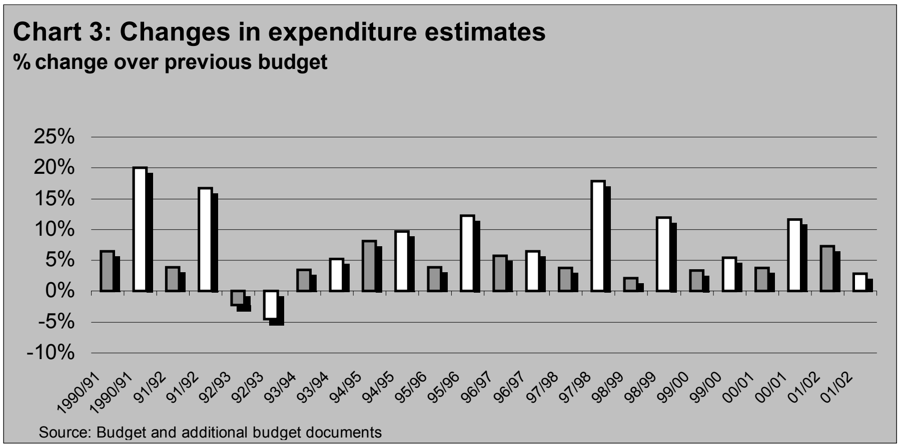


Chart 3: Changes in expenditure estimates
% change over previous budget

However, it is likely that these estimates will be subject to substantial revisions come the additional budget towards the end of the calendar year. Chart 2 shows that revenue estimates have been revised upwards in every single additional budget since 1992/93. Although the most significant increases in revenue estimates take place during the main budget (the light bars in the chart), increases in revenue estimates contained in additional budgets have been as high as 5.5% in nominal terms although in recent years increases in estimates appear to have declined. Chart 3 shows a similar picture for expenditure. Increases in nominal expenditure estimates have taken place between every main and additional budget since the main budget of 1993/94. There appears to be no downward trend and the second highest nominal revision to expenditure estimates (7.3%) took place only recently in 2001/02. Unless something extraordinary takes place and GDP rises faster than anyone is predicting, the Minister will have to wean spending ministries off the habit of an accommodating additional budget if his target is to be met by 2004/05.

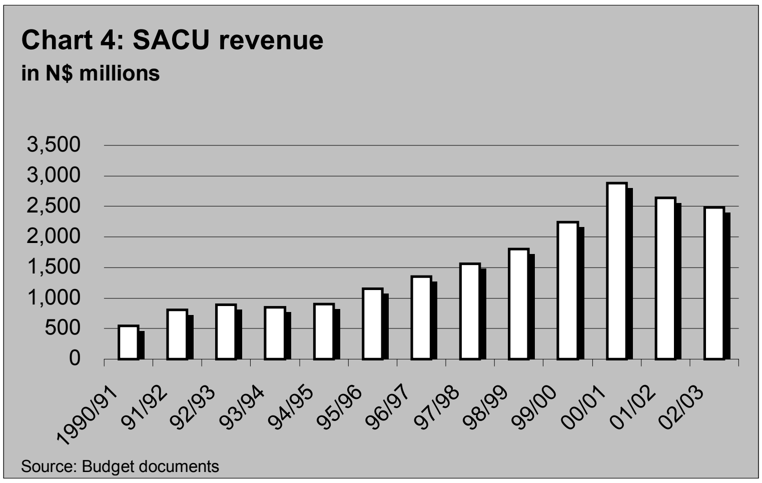
In view of past practices, we believe the Minister's target is unrealistic. Failure to meet the target will damage his credibility still further after last year's additional budget which spectacularly missed the deficit target of 3% set just months before. We believe it would have been better to set a 30% target within 5 years which would have allowed him to raise spending by 10% a year provided nominal GDP growth was 13% a year. This would have had the advantage of allowing him to raise public sector wages with inflation and bought him time in deciding on a more targeted programme of cuts.

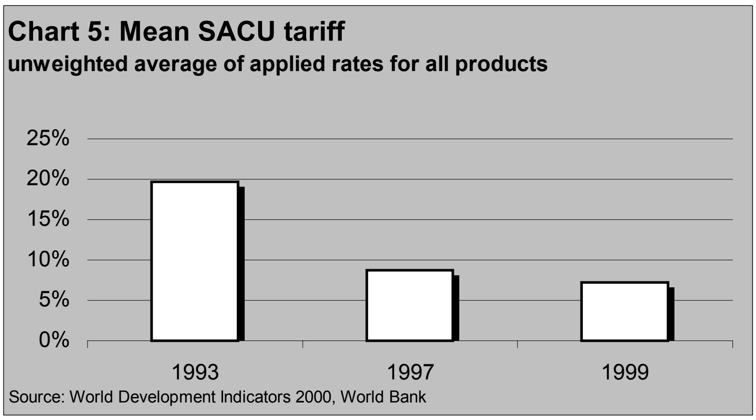
Growth in revenue estimates is limited…

Several features on the revenue side of the budget are worthy of note. First, in several passages of the budget speech the Minister stressed his view that the efficiency of revenue collection has increased. In the absence of more detailed information it is impossible to fully assess the validity of this statement. There appear to be no clear trends apparent in the ratio of individual income tax, diamond mining, other mining, and non-mining corporate tax revenues to GDP since 1990/91. Tax rates and tax bands have changed over time. Improvements in tax collection efficiency do not appear so great that they have outweighed reductions in rates.

Second, the Minister announced that VAT has generated "about 25% more revenue" than the previous system of General Sales Tax and Additional Sales Levy. The estimated amount of VAT collected in 2001/02 (N$1.900 billion) is only 7.6% greater than the combined amount of GST and ASL actually collected in 2000/01 (N$1.766 billion). No estimate for VAT is included in the budget for 2000/01 even though VAT was introduced in November 2000.

…and SACU revenues have fallen for the second year in succession.





Third, as shown in Chart 4, main budget estimates of SACU revenue have fallen for the second year in succession after more than a decade of regular increases with the single exception of 1993/94. The Minister put this down to the tariff liberalisation measures implemented under the SADC Trade Protocol and the EU-SA Trade and Development Agreement. Chart 5 shows that the average SACU tariff has indeed declined dramatically since the early 1990s to the extent where it is now low by international standards. Although such tariff reductions look set to continue downwards reducing the size of the revenue pool, the unofficial view from the Ministry of Finance is that the new revenue-sharing formula will go some way towards compensating for this reduction.

The Minister wisely held back from tax changes until the comprehensive tax review is complete.

Finally, the Minister held back from announcing tax changes preferring instead to wait until the results of the comprehensive Tax Review Project are finalised by the end of September. He did, however, hint that the tax review is likely to result in substantial changes to taxation in Namibia and that he intended to make significant changes to the system of VAT later this year. These latter changes include the abolition of the 30% tax category. Under the circumstances, holding back from tax measures at this stage seems to be the sensible thing to do although he made no mention of the one tax that is due to be launched ahead of the review – the Land Tax. Neither does the budget document appear to contain estimates of revenues collected by the tax. The questions remain, will the Land Tax generate more revenue than it costs to administer and will this revenue supplement the resources available for land redistribution to any significant extent?

On the expenditure side, pensions have been raised in real terms back to where they were in 1990…

Moving to the expenditure side of the budget, a number of features are worth highlighting. As promised by the Minister of Health and Social Services last month, the social pension has been increased from N$200 a month to N$250. Although the increase is welcome, we believe it is just sufficient to restore the buying power of the pension in 1990 when it stood at N$90 a month. This means that pensioners have not become better off in real terms since 1990. In his speech the Minister appeared to recognise that the buying power of the pension should at least remain constant stating that provision had been made in the Medium Term Expenditure Framework to allow pensions to increase in line with inflation. Unfortunately, this falls a little short of a cast-iron commitment to index-link the pension (in other words to raise it in line with inflation) and leaves Government with room to manoeuvre. No mention was made of the idea floated by NEPRU last year to target the pension on the poorest through means testing.

…while in the end the Air Namibia bride had to be given away at a price…

Government has had to bite the bullet on Air Namibia. A new privatised Air Namibia will come into being on 1 June 2002 in which Government will have a 25% stake. Government has taken over all debts of the existing company which, according to press reports, amounts to some N$1.4 billion. The N$250 million allocated in this year's budget is presumably the first of many payments required to meet this obligation. To our knowledge the full scope of Air Namibia's financial position has not been made public. We hope the lessons from this sorry saga have now been learnt. In our view these are that the Government should not get involved in trying to run a complex commercial business that operates in a competitive international environment.

The saga of Air Namibia also raises the important issue of *contingent government liabilities* - that is, fiscal obligations that depend on the occurrence of particular events. These obligations are not budgeted and accounted for, nor are they considered in conventional fiscal analysis. They have, however, resulted in serious fiscal instability for many governments around the world. The March 1999 edition of the IMF's publication *Finance and Development* presents a lay person's account of the issue which the Ministry of Finance would do well to note. The Government of Namibia guarantees a wide range of loans to parastatals and other organisations. We would like to see the

Ministry of Finance develop a clear policy on government guarantees and in future fully disclose all contingent liabilities in an accompanying document to the budget.

…and the baling out of other parastatals continues…

For the third year in succession, TransNamib receives N$43 million from the Ministry of Finance while the Development Fund receives N$11 million. Neither receives a mention in the budget speech. On a more positive note, Namwater no longer receives a subsidy under Vote 20 Main Division 02 in line with the commitment given in its annual report for 1998/99 which stated that the start-up subsidy provided by the Government would be phased out over a 5 year period. Namwater has received a total of N$125 million in budgeted transfers from central government since 1996/97.

Government has allocated N$125 million to the new Development Bank which promoters of the new institution hoped would be capitalised at an initial N$600 million. This contribution falls some way short of the N$350 million which had been expected from Government (IPPR Interview No 5).

Some critical public services receive a lower allocation than last year…

This year's main budget allocates less in nominal terms to a number of critical public services. Primary and secondary education in particular have suffered. Indeed, of the 11 Main Divisions in Vote 10 (the Ministry of Basic Education, Culture and Sport), all receive less than in 2001/02 with the exception of Main Division 01 (the Office of the Minister) and Main Division 09 (Planning, Research and Development). Development spending in primary and secondary education have borne the brunt of the cuts. The 2002/03 budget continues the trend apparent since Independence whereby secondary education has received a smaller share of education spending every single year. Budgeted spending on secondary education has fallen from 31% of total education spending in 1990/91 to just 19% in 2002/03.

While the Ministry of Basic Education' budget has been cut, the Ministry of Higher Education has seen its budget modestly increase. Both UNAM and the Polytechnic receive small nominal increases in funds (3.8% each) while the Colleges of Education receive no increase at all. The Windhoek Vocational Training Centre receives an increase of 4.5% while the resources devoted to the Vocational Training Fund has been cut by one third. An allocation of N$500,000 for training is made to Ramatex.

Of the 9 Main Divisions in Vote 13 (the Ministry of Health and Social Services), Main Division 05 (Primary Health Care Services) has been singled out for a cut. It appears this division is a victim of the moratorium place on the purchase of new vehicles.

…while certain security expenditures continue to receive more.

Security spending as a whole has also been cut in this year's budget. However, the National Intelligence Security Agency, the Special Field Force, the Signal Unit and VIP Security increased their allocations. The allocation to Vote 06 Main Division 02, Combating of Crime, was cut. Table 2 shows the allocations for different security activities in this year's budget. It is interesting to note that Government plans to spend more on the Special Field Force and the NISA than it does on Combating of Crime. The allocation to Administration is more than one fifth and to VIP Security almost one fifth of the allocation to the Combating of Crime. The budget document shows that the Special Field Force employs 4,750 constables compared to 1,679 ordinary police constables employed under the Combating of Crime. We find it hard to believe that these allocations reflect the demand for the individual public services on the ground.

Table 2: Breakdown of budgeted security expenditure

Activity	***Vote Main Division***	***Allocation***
Ministry of Defence	Vote 08	N$857.0m
Police	Vote 06	N$637.6m
Administration	Main Division 01	N$58.9m
Combatting of Crime	Main Division 02	N$255.1m
Training	Main Division 03	N$6.5m
Special Field Force	Main Division 04	N$232.1m
Traffic	Main Division 05	N$10.6m
Signal Unit	Main Division 06	N$24.5m
VIP Security	Main Division 07	N$49.8m
National Intelligence Security Agency	Vote 01 Main Division 02	N$41.2m

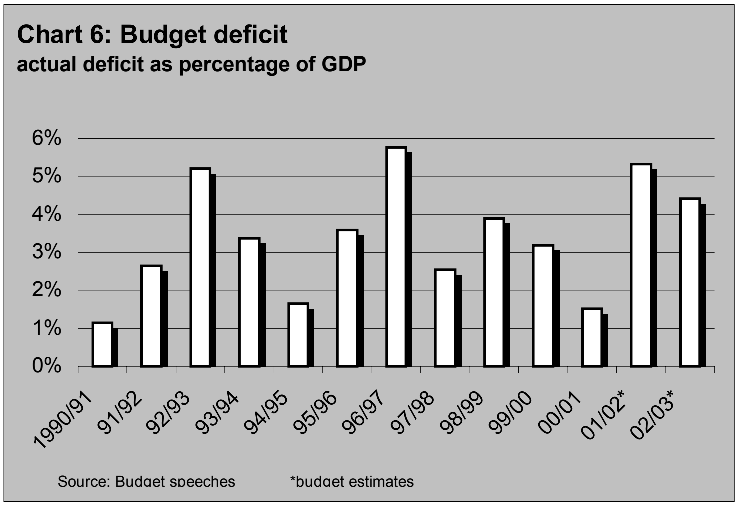
Budgeting practices will have to improve if targets are to be met.

The Minister has stressed the importance of the Medium Term Expenditure Framework but it is not exactly clear what value it has. Last year's budget for the first time presented expenditure proposals for three years (2001/02-2003/04) rather than a single year. We commented at the time that these proposals suggested no radical reallocation of resources were on the cards, at least as far as operational expenditure was concerned. This year's presentation suggests much the same. It is worth comparing the ceilings for operational expenditure in 2002/03 presented in this budget with the ceilings for 2002/03 presented in the Medium Term Expenditure Framework in the last budget. Because last year's estimates for 2002/03 are only given in 2001/02 prices it is not possible to compare allocations in money terms. It is, however, possible to compare expenditures by vote as a proportion of total spending. It has never been explained whether these are not supposed to change dramatically from one year to the next. There is little difference between last year's proposal for this year and this year's proposal. Is this a good thing?

We would venture that the value of a three-year rolling budget is to prepare spending ministries for a reordering of spending priorities in the coming years. The present framework differs little from the traditional incremental budgeting approach and suggests that all votes are going to have to share the pain of reaching the 30% expenditure target. Perhaps this will all change when the long-awaited Performance and Effectiveness Management Programme (PEMP) data becomes available. However, for the time being the Minister's approach of freezing vehicle purchases and expenditure on goods and services across the board is reminiscent of past practices. While this approach has political advantages, it is likely to be economically inefficient. We believe a much more targeted approach will be required if the expenditure target is to be met without seriously compromising the quality of critical public services – law and order, defence, education and health. This will involve the Ministry of Finance developing the capacity to identify wasteful expenditures and challenge spending ministries to reduce them during the budget hearings. That means the Ministry has to have a detailed knowledge of what spending ministries are up to.

This time last year the Minister forecast average growth of 4.8% for the years 2001-2003. Nominal GDP for 2001was estimated at N$27.1 billion and real GDP growth was expected to be 4.8%. The latest estimates presented by the Minister put nominal GDP in 2001 at N$26.7 and real GDP growth at a mere 1.6%. This suggests the Minister's forecasts leave much room for improvement.

Much attention is focussed on the budget deficit and rightly so. The Minister proposes to bring down the deficit from an estimated 5.3% of GDP in 2001/02 to 4.4% of GDP in 2002/03. The high estimated deficit in 2001/02 came about as a result of "special circumstances" addressed in the additional budget through additional spending. This threw the Minister off course from his original 3.6% estimate.



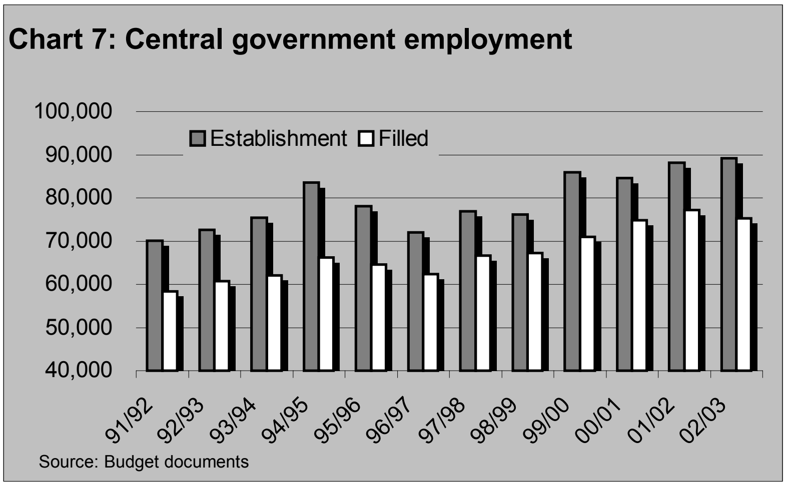
However, as far as the deficit is concerned, things often turn out better than expected due to higher than expected revenues and underspending on the development budget. The year 2000/01 is a good example. The original estimate for the budget deficit was 3.6%. This was revised to 3.5% of GDP in the additional budget of 2000/01. It now turns out the actual budget deficit was 1.5% of GDP. As shown in Chart 6, between 1997/98 and 2000/01 the average budget deficit has been approximately 2.8% of GDP, well within the Government's own target of 3%. The imprecise nature of the budgeting process means that such "good news" often comes about by accident and this prevents Government from taking the credit.

The budget speech would not be complete without an appeal to ministries not to overspend. Minister Mbumba appears to be making some progress as far as overspending is concerned. Table 3 below shows unauthorised spending from the Auditor General's reports. It shows that unauthorised spending by vote, by main division and by sub-division have all declined as a percentage of overall spending since he became Minister of Finance. There is still much to be done but some progress is being made.

Table 3: Unauthorised expenditure

N$m	*90/91*	*91/92*	*92/93*	*93/94*	*94/95*	*95/96*	*96/97*	*97/98*	*98/99*
by vote	7.1	13.5	46.9	54.9	16.1	141.1	192.9	139.6	158.6
As % of auth. expenditure	0.3%	0.4%	1.4%	1.6%	0.4%	3.2%	3.7%	2.4%	2.5%
by main division				83.4	46.5	188.9	244.4	177.2	184.8
As % of auth. expenditure				2.5%	1.2%	4.3%	4.7%	3.1%	2.9%
by subdivision				191.0	122.4	325.9	355.9	300.7	263.2
As % of auth. expenditure				5.6%	3.2%	7.4%	6.8%	5.2%	4.1%
Total authorised expenditure	2404.6	2999.3	3423.1	3381.0	3847.5	4384.1	5207.1	5754.7	6435.8

Following last year's improvements to public sector remuneration which required an allocation of N$365 million in the main budget, this year sees only N$20 million allocated for improvements to the remuneration structure. It is also worth highlighting that this year's budget suggests total central government employment has fallen for the first time since 1996/97. Chart 7 shows how the number of posts on the government establishment and the number of posts actually filled have changed since Independence. The number of posts filled has risen from under 60,000 in 1990/91 to just over 75,000 in this budget year while the number on the establishment has risen from 70,000 to just under 90,000. It should be remembered that these figures do not include employees of parastatals which no longer appear on central government's payroll. The number of parastatals has mushroomed since Independence.



Finally, two changes to the budget document are worth noting. The first relates to the previous year's revenue and expenditure estimates which have traditionally been provided for comparison in an accompanying column to the latest year's estimates. Whereas in previous documents, these estimates have referred to the previous year's main budget, they now refer to the previous year's additional budget. In other words, the budget document now incorporates the latest information (the latest estimates of revenue and expenditure). We regard this as an improvement. The second relates to the table presenting a summary of staffing by votes (page 18 of the budget document). For the past few years this table has been broken down by sex following a commitment made by the Minister in a budget speech. This year no such breakdown is presented.

We'll know by November if he's serious.

In conclusion, this year's budget is interesting because the Minister of Finance appears to be taking expenditure restraint seriously. However, given the now well-established patterns of revenue and expenditure discussed above, we are sceptical that this attempt will last beyond this year's additional budget, especially since this budget leaves little room for emergencies and "special circumstances". Furthermore, cutting expenditure without discriminating between productive and unproductive expenditures could damage the long-term health of the economy if it means crucial public services are underprovided.

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