Democracy Report

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By Rowland Brown

THE 2015/16 NATIONAL BUDGET: **MAXING OUT THE CREDIT CARD?**

The Namibian

Introduction

On the 31st of March 2015, the new Minister of Finance, Calle Schlettwein, announced the budget for the 2015/16 – 2017/18 financial years. The Minister announced four key priorities for his Ministry and the Government for the budget (MTEF) period, along with key interventions required to achieve these priorities as follows:

1. Inclusive growth:

- diversifying and industrialising the economy through targeted budgetary allocations to the priority economic sectors with high economic growth and job creation potential;
- continuous development of functional and technical skills through increased access to tertiary education and vocational training;
- developing and supporting domestic and regional value chains in the areas of comparative and competitive advantage;
- crowding-in much needed investment through private sector and SME support programmes as well as harnessing Public Private Partnerships (PPPs);
- enhancing greater access to development finance through the operations of domestic Development Finance Institutions and tailor-made commercial credit offerings; and
- leveraging PPPs for infrastructure development and public service delivery.

2. Poverty reduction:

- strengthening social safety nets in coverage and quantum as the first line of defence against poverty for the vulnerable members of our society;
- supporting the creation of decent jobs and self-employment opportunities in the private sector;
- implementing policies that promote local access to, and ownership of resources, and nurturing the capacity to exploit the resources profitably;
- developing social security networks that are sustainable and meaningful; and
- designing and implementing redistributive tax policies that are pro-poor and pro-growth.

3. Wealth creation:

- empowering Namibians in a manner that creates sustainable and broad-based wealth creation;
- promoting affordable and sustainable access to finance and

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means of production, while maintaining responsible lending;
- developing facilities to support SME access to finance and mentorship programmes;
- increasing the share of local ownership and value share in the value chains across various industrial and service-oriented activities;
- encouraging wealth accumulation and prudent management; and
- expanding the provision of basic amenities to all Namibians.

4. Service delivery, accountability and value for money:
- improve service delivery by strengthening internal efficiency of the public service sector through performance measures and accountability;
- continuous skills development; and
- reform of public enterprises to ensure affordable, competitive, reliable and sustainable service delivery.

While the stated priorities and focuses are, largely, commendable, the expenditure priority over the budget period appears, in many instances, to be somewhat divergent from that stated. However, it should be noted that the new Minister had been in office for about 10 days before the budget speech, and thus may not have had sufficient time, or resources, to make material change to the expenditure focus.

The budget has undoubtedly improved over the past few years. However much remains to be done in order to ensure it delivers the developmental reform of which it is undoubtedly capable. With expenditure of approximately 40 percent of GDP and as the largest single employer in the country (by an order of magnitude) the Government can certainly drive the country's development forward, however this can only be achieved if a structured, focused and dynamic taxation and expenditure framework is followed. Moreover, identification of priorities is not the focus of the budget, but rather of the various long and short term development plans, while the budget should, ideally, be the means of funding or facilitating in the implementation of these plans.

This paper attempts to review the budget in a more in-depth manner than that pursued by other analysts and institutions in Namibia. It looks first at revenue, then the current expenditure focus and ultimately the budget balance. Conclusions and recommendations are then drawn from this analysis. The purpose of the paper is to provide greater insight into the budget, but also provide constructive suggestions as to further improvement therein.

Macroeconomic environment

The macroeconomic environment in Namibia remains positive, with growth running at or above long-term averages for the past five years. The same, however, cannot be said of our southern neighbour. A notable decoupling of the Namibian and South African economies has been witnessed since 2009. Following the global recession, the Namibian economy rapidly rebounded. However, South Africa's economy continued to languish, growing at below trend rates ever since. The structural nature of this low-and-slow growth means that South Africa is unlikely to recover dramatically in the short term, and may well remain on a low-growth trajectory for much of the next half decade, and potentially, beyond. In Namibia, however, well timed counter-cyclical monetary and fiscal policies ensured a return to growth and economic stability in the country, despite persistent global headwinds.

Historically low interest rates, expansive Government stimulus and the unprecedented levels of foreign direct investment into Namibia have driven this growth, with a key focus on construction in the short term, moving toward increased mining production and logistics, particularly, longer term. Moreover, increased wages from Government and the private sector, reduced personal income tax, cheap credit supply through low interest rates and increasing employment have dramatically increased local household disposable income over the past two years. The outcome of increased household disposable income is clear to be seen in the local economy. Retail activity is booming, as witnessed by strong growth in credit demand, vehicles sales and footfall at local malls, not to mention strong demand increases for housing, and municipal services.

This strong growth, however, is not without risks. The speed and vigour of the expansion in the economy has led to a number of macroeconomic imbalances, which if left unchecked may destabilise the future growth prospects of the country to some degree. While numerable in nature, the key issues at present are: increasing demand side inflation; increased government debt; declining international reserve levels; and rapidly increasing household debt.

Over the past few years, headline inflation has remained low, falling dramatically over recent months as global oil prices collapsed. However, pockets of high inflation remain, particularly in the demand side space. As most consumer goods in Namibia are imported and sold at market rates, these items prices tend to be driven by global factors and the local exchange rate. On the other hand, many of the local services prices are determined by domestic demand and supply, and as demand increases, so do prices. This is particularly notable in the housing market, municipal utilities, electricity, schooling and transport costs, many of which are leading overall inflation in the country. This inflation is, however, at present hidden by falling global food and fuel prices, but is a classic sign of an overheating economy.

Because of the expansive budget run by Government over the past five years, the country's debt-to-GDP ratio has increased markedly, from around 16% of GDP in 2010, to approximately 26% of GDP in 2014. Further to this, continued deficits in the current budget mean that this is expected to increase further over the next three years, approaching 35% of GDP by 2017. While deficits are not a problem per se, persistent or structural deficits, as well as sizable deficits, can be. In this regard, the Government is starting to push the boundaries of sustainable debt levels for the Namibian economy. This is particularly due to the fact that the local economy is highly concentrated in a handful of sectors and companies, and partially due to the rate of increase in local Government debt levels.

The level of international reserves is generally of little concern to the lay person. However, it is arguably the single most important macroeconomic indicator for the small open economy that is Namibia. Not only are these reserves critical for maintaining the fixed currency arrangement with the Rand, but are also illustrative of the general state of the local economy. Over the past two years, the country's reserve position declined notably (particularly in hard currency terms), indicating that the country was importing and shipping out more capital than it was exporting and attracting. The vast majority of this imbalance derived from merchandise trade, where a major deficit has developed. In this regard, the country has been importing all manner of goods, with the most prevalent being construction and mining equipment, vehicles, fuel and other consumer goods. Construction and mining imports are generally viewed fairly favourably, in that they add to the country's productive capacity in the long-term, and will usually result in export growth over time. However, many of the consumer goods, particularly vehicles, fuel and consumer electronics, produce little long-term gain for the country, while requiring foreign currency earnings to acquire.

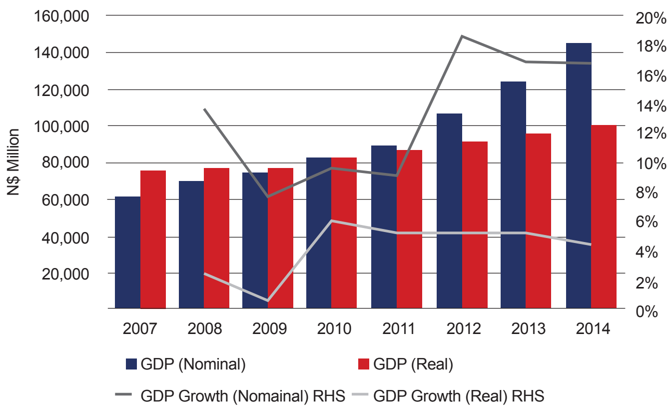
Household debt is the final notable imbalance starting to develop in the local economy. While not yet critical, household debt has increased extensively through the bottom of the interest rate cycle. As interest rates normalise, a process currently underway, the household debt repayment burden will increase, which may put pressure on some of the marginal borrowers. As such, we can expect to start to see increased defaulting on loans and repayment duress. This will be further exacerbated if unemployment increases, although it should be noted that this is not likely in the immediate future. Similarly unlikely is that the level of increase of non-performing loans will be dramatic or disastrous, provided interest rates continue to normalise through the coming months.

However, due to high demand and slow supply of housing, house price inflation and by extension, rental inflation, have also been dramatic. House prices double every 4 to 5 years, while anecdotal evidence suggests that rental inflation is upward of 10% per year. The inflation in house prices seen over the past decade has been hugely positive for home owners and the banking sector. However, should prices exceed fair value, a risk of overvaluation of banking and household sector asset values may be seen, which may cause financial sector instability.

In most economies, these imbalances would be addressed through the tightening of monetary (and at times fiscal) policy. However, in this regard, Namibia is somewhat hampered by the fixed exchange rate regime it shares with South Africa, Lesotho and Swaziland. Due to this, Namibia is unable to implement completely independent monetary policy and is required to remain fairly close to the rates seen in the common monetary area in order to ensure that unstable capital flows between the countries do not occur. As such, despite the clear need for tighter monetary policy in the country, interest rate increases have been fairly slow. Nevertheless, the Bank of Namibia is in an interest rate hiking cycle, having increased rates by 75 basis points, in the form of three 25 basis point hikes, over the past 12 months.

Despite the aforementioned imbalances, the Namibian economy continues to perform well, and is expected to continue to do so through 2015 and beyond. Moreover, while imbalances are developing, they are not yet major. From an economic stability perspective, however, the time has no doubt arrived for more reticence from the fiscus as current expenditure patterns are unstable if pursued for extended periods of time. Moreover, the strong, above trend, growth seen in the local economy signifies that the time for counter-cyclical policy is behind us, and that the previously counter-cyclical policy is no longer such, but heavily pro-cyclical. The process of interest normalisation too needs to continue. Thereafter, Namibia is likely to remain on a strong footing and on a higher developmental base, as the construction activities of the past few years morph into productive activity, substituting out the fiscal and monetary stimulus and driving Namibia forward.

Chart 1: Namibia GDP



Revenue

Table 1: Revenue (N$ Million)

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
2008 Budget	22,640							
2009 Budget	21,147	22,688						
2010 Budget	22,536	20,940	26,214					
2011 Budget	22,699	28,012	31,875	37,154				
2012 Budget	23,244	26,853	35,420	35,257	39,672			
2013 Budget		29,922	37,108	40,141	42,950	45,630		
2014 Budget			37,987	40,141	52,473	58,698	66,074	
2015 Budget					52,473	58,442	63,050	69,181

Source: Ministry of Finance

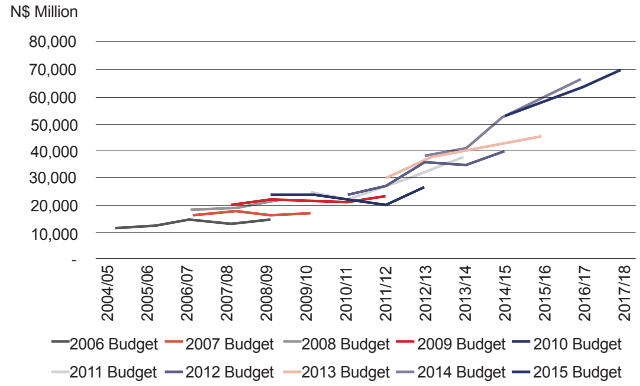
In the current budget, revenue is forecast to increase by 11.4 percent when compared to the forecast level for 2014/15. However, this is a slight downward revision, of 0.4 percent, when compared to the previous forecast for the current, FY15/16, year. As it stands, total revenue for the current financial year is expected to be N$58.4 billion.

However, in 2014/15, revenue was estimated to have expanded by 30.7% when compared to the preceding year. This number is almost undoubtedly over stated, however, and it is believed that the final figure for FY14/15 will be somewhat more moderate. As such, the actual rate of growth, should the current forecast be realised, will be higher in 2015/16 than forecast, due to the weakening of the base year.

The forecast revenue growth slowdown can, at least in part, be attributed to a decline in expected SACU revenues, a key source of funding for the local Government. Nevertheless, this slowdown is viewed as a positive based on the fact that historic forecasts are believed to be unrealistic, and conducted without consideration for the impact on trade from the fragile global and lacklustre South African economies.

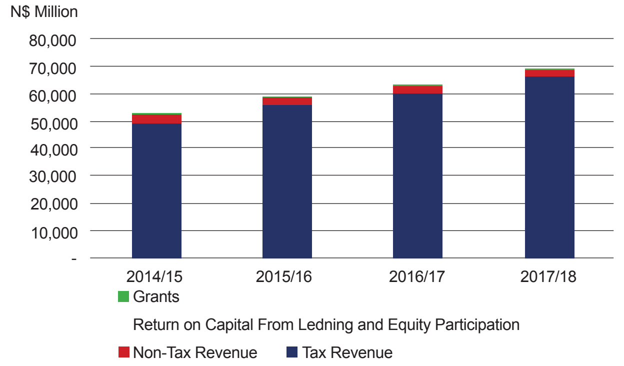
In the outer MTEF years, current forecasts see growth slowing further, to 7.9% and 9.7% for FY16/17 and FY17/18, respectively. This implies revenue of N$63.1 billion in FY16/17 and N$69.2 billion in FY17/18. As always, these forecasts are erratic, and likely to be revised up going forward.

Chart 2: Revenue



From a revenue breakdown perspective, the vast majority of revenue is derived from taxes, which, in 2015/16, make up 96 percent of total revenue, a ratio that remains fairly constant through the MTEF period. Non-tax revenue represents the vast majority of the remainder, with return on lending and equity participation, as well as grants, making up less than 0.1% of total revenue each.

Chart 3: Revenue Breakdown



Source: Ministry of Finance

The current budget is expansive in every sense of the word and in just about every aspect of the budget. From a revenue and expenditure point of view, the current budget shows dramatic increases, coming off an already high base as a result of a strong and on-going counter-cyclical budget introduced in 2011.

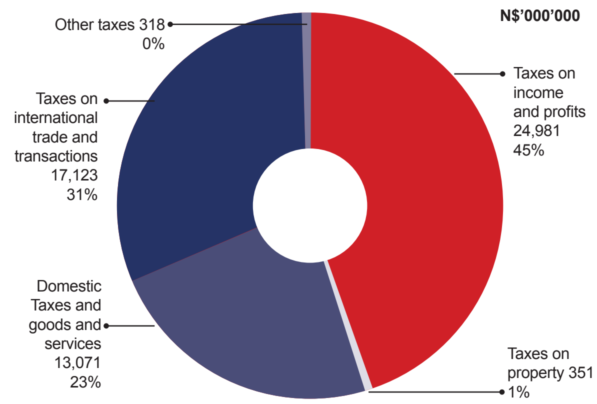
It should be noted that while the previous expansionary and counter-cyclical fiscal policy has undoubtedly helped Namibia through tough prevailing headwinds stemming from advanced economies, given the developments in the local and global economies and the sizable increases in Government expenditure in 2014/15, what was a counter-cyclical fiscal policy is quick becoming pro-cyclical.

Tax revenue:

Between 2014/15 and 2015/16, tax revenue is expected to expand by 13.7 percent, above the rate of growth of total revenue, meaning it gains a larger share of total revenue over the period, a trend that is expected to continue over the MTEF.

Tax revenue can be broken down into five categories namely, taxes on income and profits, domestic taxes on goods and services, taxes on international trade and transactions, taxes on property and other taxes. The three former categories make up 99 percent of total tax revenue, with taxes on property and other taxes making up the remaining 1 percent.

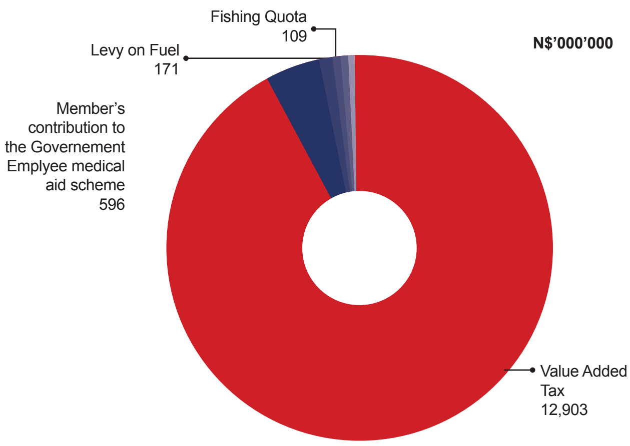
Chart 4: Tax revenue breakdown (N$ Million)



Source: Ministry of Finance

Domestic taxes on goods and services are primarily made up of VAT receipts, which have been growing at double digit rates for a number of years, testifying to the strength of the local economy at the current point in time.

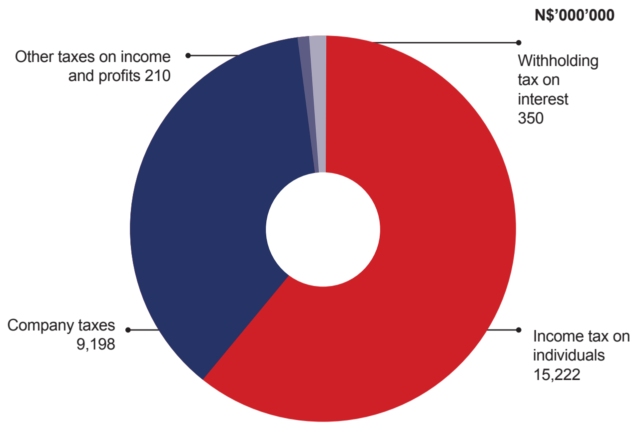
Chart 5: Tax revenue breakdown (N$ Million)



Taxes on international trade and transactions speak to SACU receipts, which as earlier mentioned, are expected to decline going forward. Taxes on income and profit, however, remain the cornerstone of government revenue, representing approximately 43 percent of total revenue.

Within the sub category of taxes on income and profit, income tax on individuals represents by far the largest single component. From this source, Government expects to raise N$15.2 billion in 2015/16. This is a major step up from the N$8.1 billion collected three years ago, and speaks to the major improvements seen in the Inland Revenue department over this period.

Chart 6: Taxes on Income and Profits (N$ Million)



The second largest component of taxes on incomes and profits is company taxes, which represent approximately 37% of the sub category. As has become the norm over recent years, the vast majority of this category is made up of non-mining company revenue, as can be expected given the relatively more numerous, sizable and profitable nature of the non-mining entities in the country vis-a-vis mining companies. Nevertheless, mining company tax revenue, with the exception of diamond mining, was eye-catchingly low in 2014/15, and projected to remain so in 2015/16. At just N$27.5 million in 2014/15 and forecast to register N$57.5 million in 2015/16, non-diamond mining companies represent just 0.4% and 0.6% of total company taxes in 2014/15 and 2015/16, respectively.

While this raises many eyebrows, at the current point in time it likely speaks to the low profitability of these companies as commodity prices languish on the back of slowing Chinese and fragile global economies. Moreover, these tax collections should be considered alongside royalties paid by the mining sector, which are generally an order of magnitude larger than the actual taxes paid. It should be noted, however, that royalties are effectively a charge levelled on companies that are exploiting a local resource, while corporate taxes are taxes on profits made in the process.

In many ways, this dependence by Government on income taxes is important, as it, in theory, binds Government to a social contract with the people, whereby legal and natural persons provide funding to the Government in return for a commitment from Government to provide certain services. In most instances, this is the relationship that breaks down when countries are hugely resource rich, forming a key component of the well documented "resource curse".

However, the relatively small tax-payer base in the country when compared to the electorate, presents a challenge, as many voters do not pay income tax. Thus, this social contract is weakened. Many tax payers thus feel that they are poorly serviced by and represented in Government, and thus that they are cornerstone tax payers, with little real voice.

Tax Developments:

Following a fleet of notable tax changes announced in the 2013/14 and 2014/15 budgets, the current budget was relatively quiet on amendments, rather following through on some prior commitments on the tax front. Nevertheless, a handful of changes are to be implemented over the coming financial year, as follows:

- Withholding tax on services rendered by non-residents to be reduced from 25 percent to 10 percent
- Non-mining corporate income tax to be reduced from 33 percent to 32 percent.
- Environmental taxes on carbon dioxide emission tax on motor vehicles, incandescent light bulbs and motor vehicle tyres to be introduced.
- The Value-Added Tax (VAT) threshold is to be increased from N$200,000 to N$500,000.
- Transfer duty on the sale of shares in companies and membership interest in close corporations owning residential property, commercial property, land and mineral licences, to be introduced.
- Taxes to be introduced to promote domestic value-addition in the primary commodity and natural resources sectors

As well as these changes, much of the current focus of the Ministry appears to be improvement of tax administration. While much progress has been made in this vein over the past three years, more remains to be done. On the Ministry's agenda at the moment appears to be: strengthening the provisions for recovery of tax debts; taking online, by 2016, tax returns and tax payments heralding the full implementation of the e-filing system; and, longer term, to work towards the establishment of an Independent Revenue Agency for Namibia.

In some ways these developments are highly positive, particularly those focusing on improved tax administration. It is believed that this will help to ensure that the tax payer base is widened, and that those currently evading tax will start to contribute their "fair share" towards Government operations. Moreover, these developments are likely to reduce the transaction cost of paying tax, which at the current point in time is fairly high due to the inefficiencies in the tax system. Caution, however, must be exercised with regards to the Independent Revenue Agency, as there exists a strong possibility that another National Statistics Agency type institution may be created, where the current function is transferred out of Government with insufficient changes to personnel and processes, yielding the same poor quality service for a higher cost.

With regards to the taxes to be introduced to promote domestic value-addition in the primary commodity and natural resources sectors, this remains highly concerning and similarly ill advised. The reason for this is that a tax of this nature acts as a disincentive to mine, rather than an incentive to add value domestically, due to the manner in which the tax burden falls. As such, there is a serious adverse risk to the country's mining sector, the proverbial "golden goose" of the local economy.

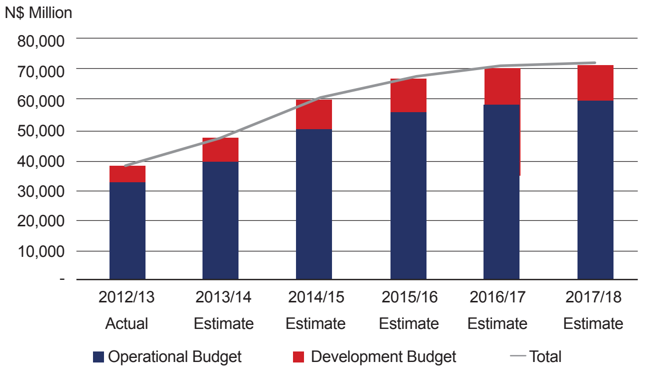
Expenditure

In the current budget year, expenditure is expected to increase by 11.6% when compared to the previous year, taking the total to N$67.1 billion. This is an increase of 4.7% when compared to the previous year's forecast for the current financial year, a well-established trend of upward revision in spending. This expenditure breaks down to 83.5% allocated to the operational budget, and 16.5% to the development budget. Thus, expenditure falls short of the targeted 20:80 split between development and operational expenditure.

Table 2: Expenditure (N$ Million)

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
2008 Budget	21,871							
2009 Budget	26,394	26,309						
2010 Budget	28,891	29,055	31,113					
2011 Budget	27,744	37,688	37,543	44,666				
2012 Budget	27,553	37,166	40,157	41,001	40,190			
2013 Budget		36,743	40,073	47,576	48,215	50,488		
2014 Budget			37,695	47,586	60,092	64,092	69,504	
2015 Budget				46,868	60,186	67,092	71,244	72,072

Chart 7: Expenditure breakdown

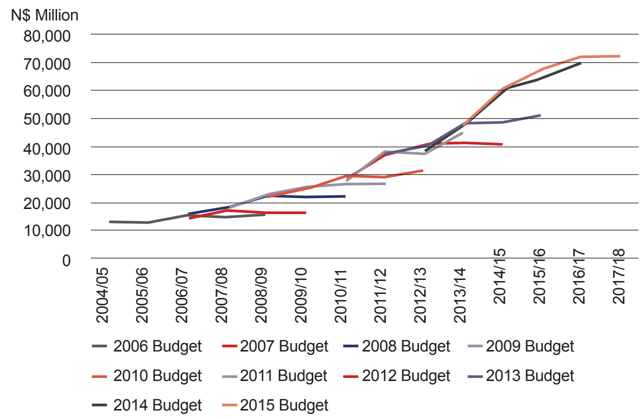


Nevertheless, despite the strong expansion in expenditure planned for 2015/16, the increase is moderate when compared to the 26.3 percent increase budgeted for in the previous financial year. While it is not believed that this volume of funds was actually spent, due to the surprise nature of the increase and the challenges relating to execution and utilisation of these unplanned for windfalls, the expansion in the expenditure envelope has increased the base from which future expenditure is planned.

Of the total N$67.1 billion to be spent in 2015/16, N$63.2 billion is non-interest expenditure, with the remainder, of just under N$4bn, being the interest costs of Government's debt.

Over the MTEF, further expenditure increases are expected. However, as per the norm, these increases are forecast to be relatively less aggressive, at 6.2 and 1.2 percent, for 2016/17 and 2017/18, respectively. Nevertheless, as has always been the case historically, the forecast expenditure growth slow-down is highly unlikely to materialise, as Government tends to budget low and then ramp up expenditure as the outer years approach.

Chart 8: Expenditure trends

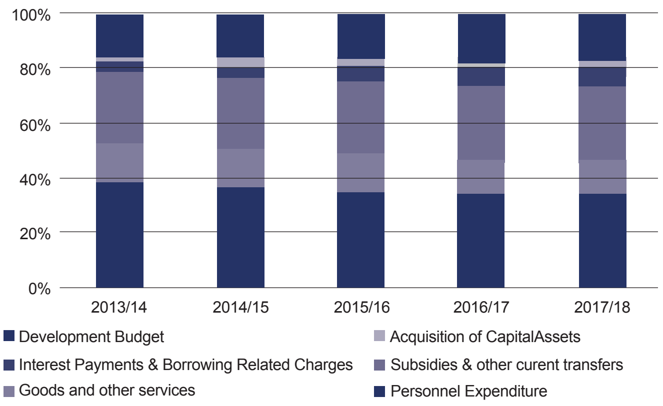


Expenditure by Sub-Division

As has been the case for a number of years, expenditure in 2015/16 will be heavily slanted towards personnel costs, with this sub-category making up 35 percent of total expenditure directly, and significantly more indirectly. This includes remuneration for Government employees, as well as contributions to pension and medical aid schemes, social security, and other direct employment benefits. At approximately 26% of expenditure, subsidies and other current transfers represent the second largest expenditure line, comprising of transfers to State Owned Enterprises (approximately N$9.7bn in 2015/16) and social grants, including old age pensions (approximately N$7.9bn in 2015/16). Thereafter comes the development budget at 16.5 percent of total expenditure as earlier mentioned. Goods and other services, made up of travel and subsistence allowances, materials and supplies, utilities, transport maintenance and similar, makes up 14 percent of expenditure, a total of N$9.3bn in the FY15/16 financial year. After almost half a decade of expansive budgets, the cost of debt has increased notably, and now makes up marginally below 6 percent of total expenditure. Moreover, this is expected to increase to close to 7.5 percent over the MTEF period, and given the unrealistic expenditure forecasts, may well end up exceeding this level.

This persistent growth in personnel costs, debt servicing and goods and other services is of great concern, as these costs fast become structural, and are extremely difficult to rein in should spending need to be constrained. As such, the parts of the budget most likely to suffer from fiscal tightening is the development budget, arguably the most important component of the budget, albeit the most discretionary.

Chart 9: Expenditure by sub division



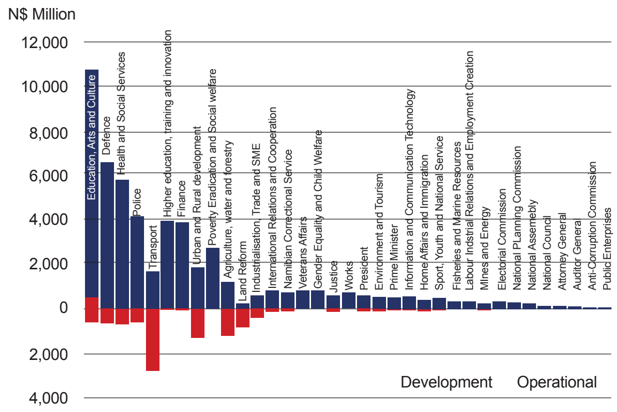
Expenditure by Vote

Following the splitting of the Ministry of Education into the ministries of Education, Arts and Culture and Higher Education, Training and Innovation, education is the largest recipient of Government funding, with the two ministries respectively receiving N$10.7bn and N$4.0bn from the operational budget, as well as N$640 and N$81 million from the development budget. Thereafter the second largest recipient of funds in the FY15/16 financial year is the Ministry of Defence, getting N$6.6bn from the operational budget, and a further N$654 million from the development budget. As such, defence spending outstrips spending on health, poverty eradication, the police and land reform.

Behind Defence, for the second year running, comes Health and Social Services, with N$5.8bn from the operational budget, and N$699 million from the development budget. Thereafter, Police, at N$4.1bn and N$648 million, respectively.

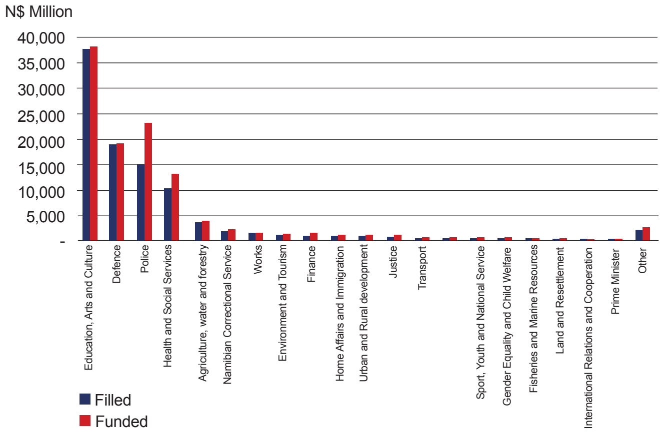
This vast Defence spending is partially justified as a job creation avenue for the large numbers of unemployed youths in the country. However, it is not used for employment alone, and there are vast and secretive expenditure lines within the development budget, which are frankly, inexcusable. Moreover, this secrecy opens the door for illicit activities, and while it cannot be concluded that such activities are taking place, the secrecy within which projects are shrouded certainly makes it possible.

Chart 10: Expenditure by vote



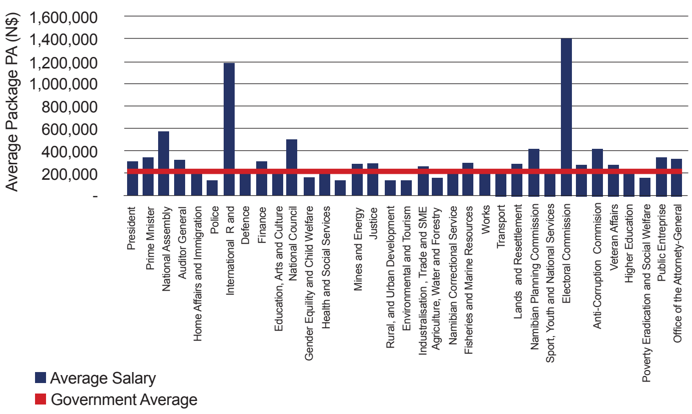
Operational allocations are largely determined by staffing in the various votes. As such, those with large staff contingents, such as Education, Defence and the Police, receive significantly greater budgetary provision than do many of the smaller, yet significantly more important ministries.

Chart 11: Staffing by vote



As employee numbers vary highly by vote, so too do average staffing costs. Notable outliers in this regard are International Relations and Cooperation, with an average staff cost of N$1.2 million per year, and the Electoral Commission, with an average staff cost of N$1.4 million per year. Employees in Rural and Urban Development have the lowest average cost, at just under N$128,000 per year. The police force is second lowest, at N$134,000 per employee per year on average. This is notably below the average staff cost in the Ministry of Defence (N$220,000 PA) and Correctional Services (N$200,000 PA), illustrating little incentive to join the police force. Average staff costs at the National Assembly and National Council are also relatively good, at approximately N$575,000 and N$500,000 per annum, respectively. These figures are calculated based on the personnel expenditure by vote divided by the number of staff positions budgeted for by vote. Votes that employ temporary staff may thus be overstated.

Chart 12: Average annual package by vote



Other notable expenditure items and commitments include:

- Allocations to cater for railway and roads rehabilitation, the expansion of the Port of Walvis Bay and the Kudu Gas-to-Power Project over the MTEF.
- N$4.93 billion over the MTEF to support the balance sheets of Nampower and Namcor for the Kudu Gas-to-Power Project. In addition, the State will provide a guarantee for the

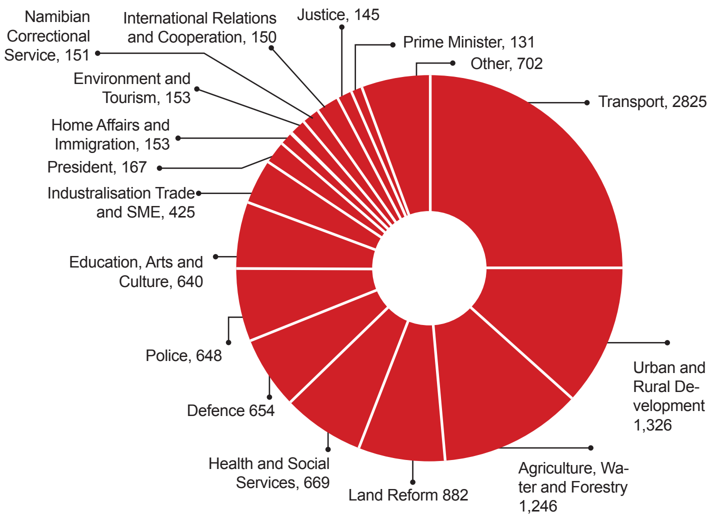
financing that will be sourced outside the budget.

- N$1.25 billion over the MTEF for Mass Housing Project. In addition, Government will issue a sovereign guarantee to the tune of N$2 billion for NHE to access funding for this vital project.
- N$3.27 billion over the MTEF for the roads projects, in addition to N$1.7 billion to be raised by the Road Fund Administration.
- N$945.84 million for railway projects, with funding outside the scope of the State Revenue Fund to the tune of N$3.79 billion over the MTEF.
- N$7.75 billion is allocated to the Agricultural Sector to cater for, among others, the Green Scheme programme and other interventions in the sector over the MTEF.
- The Old Age Pension grant was increased by N$400.00 to N$1,000.00 per month. This will further be increased annually to reach N$1,200.00 per month at the end of the MTEF period.
- Other social grants to be strengthened in coverage

Development Budget

With regards to the development budget, Transport makes up the single largest recipient of funds, receiving a total of N$2.8bn in the current year. These funds will be used, primarily, for the construction and upgrading of the local road infrastructure, and to a lesser extent, airport infrastructure. Second to this is expenditure on Urban and Rural Development, totaling N$1.3bn, which spending focuses primarily on rural sanitation, notably water and sewerage services. Finally, closing out the three largest allocations is Agriculture, Water and Forestry, which will receive N$1.2bn in the current financial year, which will be used, primarily, to support the Green Scheme and for the construction of dams and water pipelines across the country. These three votes represent close to 50% of the total development budget's allocations.

Chart 13: Development budget breakdown (N$ Million)



Some notable projects in the development budget are listed below, alongside their estimated total cost (not just over the MTEF).

- State Security Infrastructure – N$1.5 billion
- Construction of the Second Office of the Prime Minister – N$646 million
- Construction of a New Parliament Building – N$613 million
- Construction of Head Office for MHAI – N$778 million
- Upgrading of Police Stations – N$981 million
- Construction of Police Accommodation – N$851 million
- Purchasing, Constructing and Renovating of Diplomatic Premises – N$1.4 billion
- Research and Development (Defence Force) – N$6.7 billion
- Renovations of School Nationwide – N$700 million
- Extension of Existing National Council Building – N$300 million
- Construction and upgrading of Primary Health Care Clinics Nationwide – N$905 million
- Construction and upgrading of Primary Health Care Centers Nationwide – N$647 million
- Rural Electrification – N$683 million
- Upgrading and Construction of Lower Courts – N$534 million
- Various urban + rural development – township upgrading + formalisation, rural + urban sanitation
- Construction of MICT Head Office – N$290 million
- Acquisition/Construction of Offices for MoV HQ & Regional Offices – N$308 million
- Construction and Upgrading of MET Headquarters – N$274 million
- Construction of Ministry of Trade Headquarters – N$400 million
- Construction of Sites and Premises Industrial Estates – N$923 million
- Special Industrialisation Programme – N$1 billion
- External Trade Infrastructure Development – N$1.6 billion
- Product Development and Group Purchasing Project – N$400 million
- Construction of MAWF Regional Offices – N$480 million
- Green Scheme – N$3.1 billion
- National Horticulture Development Initiative – N$1.2 billion
- Construction of Large Dams, Desalination and Provision of Water to larger Settlements – 3.1 billion
- Railway Network Upgrading – N$5.3 billion
- Development of the Cape Fria- Katima Mulilo Railway Line – N$2.4 billion
- Northern Railway Line Extension – N$2.1 billion
- Various roads
- Land Purchase Project – N$2.4 billion
- Development of National Fundamental Data Sets – N$201 million
- Construction of MoNSYS Ministerial Head Quarters – N$300 million

Transfers to SOEs

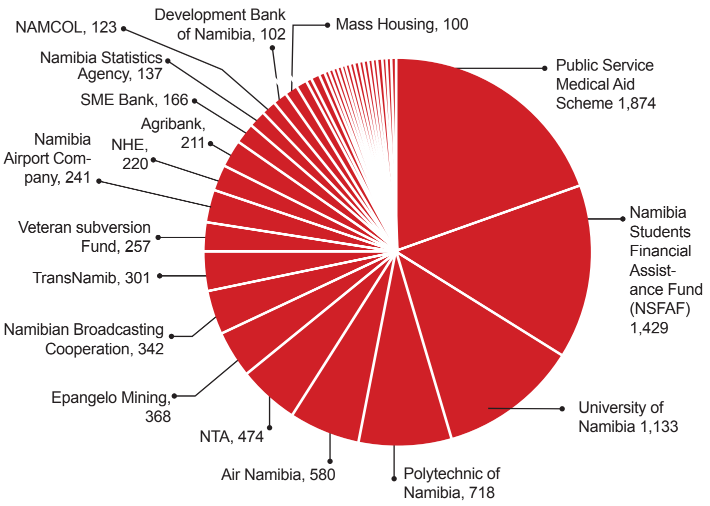
One of the larger expenditure categories in the budget is transfers to state owned enterprises. For a number of years, these transfers have been increasing as a percentage of the total budget, and in 2015/16 represent approximately 14 percent of total spending. These transfers serve various purposes, at times utilised for capital projects, but in most instances to support operational activities. The largest recipients of funding in the current budget year are the Public Service Medical Aid Scheme (N$1.9 billion), the Namibia Students Financial Assistance Fund (N$1.4 billion), the University of Namibia (N$1.1 billion), the Polythecnic of Namibia (N$718 million), Air Namibia (N$580 million), Namibia Training Authority (N$474 million), Epangelo Mining (N$368 million), the Namibian Broadcasting Corporation (N$342 million) and TransNamib (N$300 million). Further detail on the largest 20

Table 3: Transfers to SOEs

State Owned Enterprise	Stated Purpose of Funds	FY15/16 (N$ Million)	MTEF (N$ Million)
Public Service Medical Aid Scheme	Public servants Medical Aid	1,874	6,118
Nampower	For building an 800 MW Kudu Gas Power	-	4,929
Namibia Students Financial Assistance Fund	Provisions of Loans and Other Financial Assistance to Students	1,429	4,462
University of Namibia	Expansion of UNAM Oshakati	1,133	3,359
Air Namibia	Business Plan updates and pay outstanding debt.	580	1,932
Polytechnic of Namibia	Operating Costs and Capital Expenditure (Lüderitz Waterfront)	718	1,740
NTA	To equipment Improve , Upgrade Vocational Training Providers with Modern Training Facilities	474	1,573
Namibian Broadcasting Corporation	Operating Expenses, Infrastructure development (transmitter network), Completion of the DTT migration Project and upgrading of NBC studios	342	1,067
TransNamib	Maintenance of the railways and the management of the Northern Railway station.	301	946
Epangelo Mining	Improvement in Mining Output	368	818
Veteran Subvention Fund	Funding for Veterans Projects, subversion, Medical Assistance and Counselling	257	653
Namibia Airport Company	Maintain and upgrade airports aerodromes	241	589
SME Bank	To provide financial assistance and other services to Small and Medium Enterprises(SME)	166	498
Namibia Statistics Agency	To collect, analyze and disseminate Statistical data and information	137	427
NAMCOL	Constructions of Regional Offices	123	387
Agribank	Advancing Agricultural loans and training of farmers	211	321
National Youth Service	Empowering the youth through employment activities, provide training in different skills and creating a conducive environment for the youth to embark on self-employment projects.	97	304
Development Bank of Namibia	SMEs development	102	252
NHE	NONE	220	220
Mass Housing	NONE	100	200

transfers in the current budget can be seen in table 3.

Chart 14: Transfers to SOEs (N$ Million)



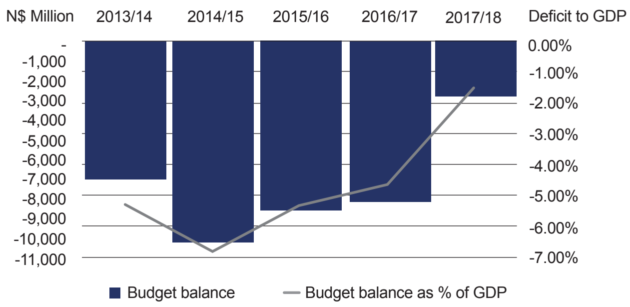
Budget Balance

The budget balance is a good single line way in which to monitor the budgeting process, as over time, the budget should be in equilibrium. In times of economic downturn, it is normal for Governments to run counter-cyclical policy which should have a stimulative effect on the economy, and generally result in fiscal deficits. Once good times have been restored, it is expected that Government will rein in spending, possibly to the point of running fiscal surpluses, to balance out the deficits of the weak years.

As of 2013/14, the actual budget deficit stood at N$7.0bn, or 5.3% of GDP, compared to the estimated figure of N$7.4bn, largely due to poor execution of the development budget during the period. According to the latest budget figures, the estimated deficit for 2014/15 has expanded from N$7.7bn to N$10.2bn, or 6.8% of GDP, on the back of an increase in the estimated operational expenditure during the period. However, given the known debt issuance figures over the period, as well as the known drawdown of cash balances at the Bank of Namibia, it is believed that this number must be erroneous, and is expected to be in the region of N$6 to N$7 billion, rather than N$10 billion.

Taking this number at face value, however, going forward, the deficit is expected to contract to N$8.641, or by 15.5%, for the 2015/16 financial year, dropping to 5.3% of estimated GDP. The decline is deficit-to-GDP is attributable to a number of factors, most notably the expected inaccuracy in 2014/15 figure, GDP growth and growing revenue collection. The budget deficit as a percentage of GDP is expected to decline over the MTEF, with the budget deficit projected to be 1.5% of GDP in 2017/18. However, given that expenditure rarely, if ever, follows the forecast path of the MTEF, this deficit is unlikely to materialise at the current low forecast levels, and is likely to be significantly larger than currently expected.

Chart 15: Budget balance and deficit



The borrowing requirement over MTEF

Although the 2015/16 budget deficit is expected to decrease to 5.3% it remains of an expansionary nature, and as expected, deficit estimates across the MTEF term have been revised upward.

Following a policy of reducing cash reserves held with the Bank of Namibia, the Government is now more reliant on debt issuance to fund the deficit than ever before. As such, the vast majority of the current deficit will be funded through debt issuance, taking the already high debt levels (relative to historic levels) even higher.

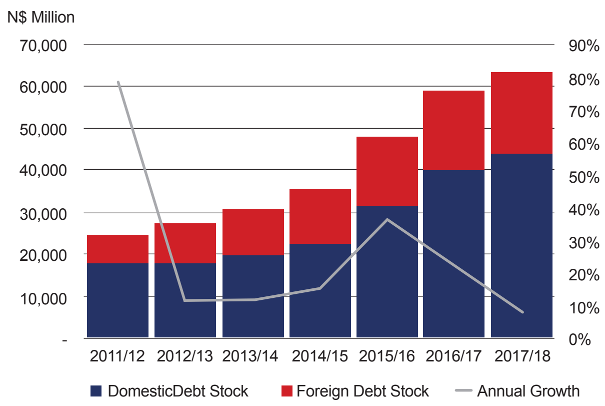
As a result of the deficit run in four of the last five years, the country's debt-to-GDP ratio has increased dramatically, and is currently forecast to double from the 2011 level, of 16 percent, by 2017/18. This increase comes about despite a major increase in GDP, emphasising the magnitude of the increase in debt over the period. Moreover, the current forecast does not capture the fact that expenditure is undoubtedly going to increase beyond current forecasts, while revenue may well remain largely unchanged. As such, there is a high probability that the debt to GDP ratio will increase beyond the current prudential limit of 35 percent (recently increased from 30 percent).

Since the introduction of the expansive budget in 2011/12, the expenditure envelope has been stretched to the maximum as rampant expenditure growth has not been matched by revenue collection growth. As such, the Ministry has been running a persistent deficit which is fast becoming structural.

The concern in this regard is that much of this expenditure increase over the past half-decade has been recurrent, which is to say that the expenditure is unlikely to result in a major structural change in the local economy, and is extremely difficult to roll back.

Through the MTEF period, debt is expected to increase by 79 percent, going from N$35.4 billion in 2014/15, to N$63.4 billion by 2017/18, starting with an increase of N$8.9bn in 2015/16, of which foreign issuance amounts to N$2.7bn. Moreover, as mentioned, this is likely to be revised up as expenditure increases in the outer years. Frankly, this trend is highly concerning and ultimately not sustainable over the long term. Moreover, the cost of ever increasing debt is becoming extensive, estimated at just under N$4 billion in 2015/16, but increasing to close to N$6 billion by the end of the MTEF. Should these deficits persist, funding costs will increase ever faster. Moreover, should this trend continue, the country may well see international rating agencies downgrading the country's foreign position, making it difficult and expensive to borrow internationally, as the country would effectively be assigned "junk" rating status on the back of a downgrade from current levels.

Chart 16: Stock of debt



Guarantees

Total Government guarantees are projected to increase to N$22.3bn over the MTEF period which is 11.3% of GDP in 2017/18, breaching the targeted level of 10%. This is highly concerning and, coupled with debt issuance, highlights the Governments continued utilisation of all possible funding sources, to their maximum, over the MTEF period. This approach of maxing out on all possible funding streams leaves little in the bank for unforeseen events. Thus, should the real sector collapse for some reason, little support can be expected from Government, as per the current situation in South Africa.

Conclusions

Credit must be given to the Ministry of Finance for the improvements in revenue collection over the past few years and, while much remains to be done, the Ministry and Government currently stand on a much stronger funding footing than was the case previously. However, while the revenue side of the budget has seen notable improvement, the expenditure side remains highly concerning.

The expenditure envelope has been stretched to the maximum over the past five years, with the debt-to-GDP ratio increasing quickly towards the prudential limit of 35 percent due to the persistent deficits over this period. The fact that these deficits are forecast to remain through the MTEF period is similarly troubling. Moreover, the fact that Government is also dramatically increasing its guarantees, means that it is, in effect, exhausting its avenues of funding. While this may not be problematic at the current point in time, it leaves the country's economy highly exposed to further negative shocks should these occur.

That said, the expenditure priority in the current budget is an improvement over that of last year, but only marginally so. Reassuringly many of the previously announced changes and improvements are being followed through. Also, while the introduction of funding support for some of the NDP4 priorities (and priority projects) is positive, the fact that it has been left so long means that there is less room in the budget to fund these projects than would have been the case had they been priorities when the debt and guarantee ratios were lower. Nevertheless, these projects and their support must be viewed as a positive, and should ultimately be prioritised over much of the other, more wasteful and recurrent, expenditure, which expenditure is unable to change the structure of the economy.

In this regard, a persistent concern is that a relatively small percentage of total expenditure is allocated to the development budget, and what is allocated is poorly utilised and very poorly focused. Not only does this section of the budget generally see the largest underutilisation of funds (poor execution rates) but the vast majority of the projects therein are not designed to structurally change the economy. A vast amount of the expenditure within the development budget appear to be projects for the construction of new offices for the ever growing civil service, a heinous waste of finite funds.

The miserly allocation of funding to housing in the budget is yet another concern, as this pitiful allocation and relatively minor pledge of support illustrates the disconnect between the political elite and the will of the people. It could be argued that housing is currently the single most important item on the agenda of the Namibian populace. However, it receives but 2.2 percent of total expenditure, and a guarantee of just under 3.0 percent of expenditure. Without serious and immediate attention from policy makers, the current housing crisis facing Namibia may well derail the country's developmental progress. However, there appears to be little priority or urgency to the political response.

The unfortunate reality is that the current and historic budgets have fallen woefully short in addressing or aligning to the key national social and economic developmental issues, and as a result has fallen woefully short of achieving its massive developmental potential. A number of the failings in terms of ultimate allocation and the developmental impact thereof must be attributed to the generally flawed budgeting process, much of which is listed below:

Broad short-fallings

The current budget, as with many that went before, suffers a number of sizable challenges, many of which are administrative in nature, rather than specific to funding allocations. Nevertheless, these administrative shortcomings certainly negatively impact upon the optimality of the budget allocation and the budget process in general, and thus do ultimately impact on funding allocations, and the optimality thereof.

Thus, in order to address the root of the problem, a number of these shortcomings are highlighted below:

"MTEF Budgeting"

The Ministry of Finance terms the budget a Medium-Term Expenditure Framework, where in reality, it is more of a single year budget, with a broad indication of minimum allocations over the following two years so as to allow for some longer term planning by Government Offices, Ministries and Agencies. However, given that the final budget figures often differ by more than 40 percent from their first estimate for a financial year, it simply cannot be said that the Ministry of Finance practices MTEF, or three year budgeting. Moreover, rather than facilitating the long-term planning of government, this annual revision of budgets rather sows uncertainty than its opposite. As such, it is of critical importance that longer-term budgeting is not only implemented, but stuck to.

The supposed three-year budgeting process contains another significant downfall, namely that budgeting focuses primarily on the upcoming financial year, rather than year two and three of the budget. As such, year two and three of the budget do not receive the scrutiny they should, despite going on to form the base from which the year two and three budgets are crafted at the point at which they become the current year's budget. As such, large numbers of improperly and inadequately appraised projects find their way into the budget through the combination of actual single year budgeting, and feigned (annual) MTEF budgeting.

Budget cycles vs development plan cycles

An additional challenge pertaining to the supposed MTEF structure of budgeting is that there is a natural disconnect between the country's development plans, which run in five-year cycles, and the MTEF's, which run in three-year cycles. As such, for at least the first two years of the three-year plans, the MTEF fails to deliver on and prioritise the issues and priorities highlighted in the said development plan. As a result, many years of the development plan are effectively lost from a budgeting point of view, and given the size of the budget relative to GDP, it is a development tool with potential second to none.

Incremental budgeting

For a number of years, the Ministry of Finance has been practising incremental budgeting, whereby new projects are tagged onto old projects and old methods of budgeting. As such, the current budget, as with many previous budgets, appears to show a significant disconnect between the development goals of the country and the funding priorities of Government. Rather than breaking down the budget and rebuilding it each year (or three years, as should be done with an MTEF) with top priorities first in line for the finite funding available, new projects, however important, are only funded if funds are available after all of the older projects and systems have been catered for. It cannot be overstated the extent of the detrimental impact that this has on the development process and the ability of Government to reach and meet development goals and targets.

Evidence and audited budgeting

Every year expenditure on goods and services, (including subsistence and travel, material and supplies, utilities, maintenance and transport) and acquisition of capital assets (furniture, vehicles and operational equipment) is sizable. However, the requirements for such increases are often not assessed by the Ministry of Finance. As such, many O/M/As sit with vast fleets of unused or misused vehicles, purchase new office equipment rather than repairing and recycling older requirement, misuse of travel and subsistence allowances and other such trespasses.

General administration

Every year, the budget suffers a number of last-minute changes, which result in documents showing innumerable and significantly different numbers for critical aspects of the budget (for example there are at least three funding shortfall numbers between the Medium-Term Expenditure Framework, Estimates of Revenue and Expenditure and the Budget Speech). As well as this, more often than not, there is a general failure by the Ministry of Finance to produce all of the budget documentation in time for the budget tabling at parliament and to produce sufficient copies of the budget for the media, analysts and public. Moreover, the Ministry fails to release all of the budget documentation on their website for an extended period after the launch of the budget, further undermining access for the public, and general budget transparency. All of these problems are completely avoidable. However, a last-minute scramble in the Ministry, rather than consistent full-year budgeting, means that every year these discrepancies arise. Moreover, this last-minute budgeting no doubt results in less than perfect allocation of funding, and thus less than optimal outcomes.

Results orientations

Finally, and most importantly, the budgeting process often appears to be more about allocating money, than assuring its optimal use. Few projects are properly reviewed and appraised as a matter of course before receiving funding, and as such the allocations are often far from ideal to assure optimal development outcomes. Thereafter, there is usually very little follow-up on the budgets to assess the success of allocation in terms of development and stated outcomes for programmes and projects. As such, few lessons are learned from failed projects, and few failing projects are salvaged.

Recommendations

Given the above, it is highly recommended that the Ministry of Finance move towards a genuine Medium-Term Expenditure Framework, which will set three year funding plans, based on well assessed projects and priorities, and then strictly adhered to such (an example of such a system can be seen in neighbouring Botswana). This process of budgeting will require that a ground-up budgeting process is set in place, and it is recommended that this ground-up budget construction is carried out every three years. Moreover, this process should be on-going, and the budget teams within the Ministry of Finance and National Planning Commission should use the three years between budgets to properly design and appraise projects best suited to achieve the country's development plans, in hand with the O/M/A's, and perform forensic autopsies on previous budgets, noting successes and failures and the reasoning behind such.

Additionally, it makes sense to change the duration of the National Development Plans from 5 years to 6 years so as to coincide with two full MTEF periods
to allow budgeting to align with development plan cycles.

Budgeting should be a full-time activity in the Ministry of Finance, and now that the 2015/16 budget has been tabled, the Ministry should start to work on some of the aforementioned issues for the 2016/17 budget. As such, the mad scramble towards the 2015 budget tabling could be avoided, expenditures could be more comprehensively appraised (for the past and future budgets) and audits could be carried out with regards to the previously mentioned expenditure categories of “Goods and Other Services” and “Acquisition of Capital Assets”.

Should the aforementioned advice be followed, a number of the issues pertaining to the actual allocation of funds would naturally fall away, and the Budget of Namibia would move towards performing the critical development role of which it is undoubtedly capable.

Notes

Notes

About the Author

Rowland Brown was born and raised in Namibia, before studying in Scotland, where he received a Masters degree in Economics at the University of Aberdeen. Upon completion of his studies, he returned to Namibia and subsequently worked in the National Planning Commission and Capricorn Investment Holdings, the Bank of Namibia and IJG Securities as an Economist. He is also the Founding Chairperson of the Economic Association of Namibia, and a regular contributor to local publications and discussions. His interests lie in the areas of Financial and Development Economics and he worked extensively on Namibia's Industrial Policy and the country's Fourth National Development Plan.

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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.

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