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Assessing Namibia's current fiscal position

Where are we and how did we get here?

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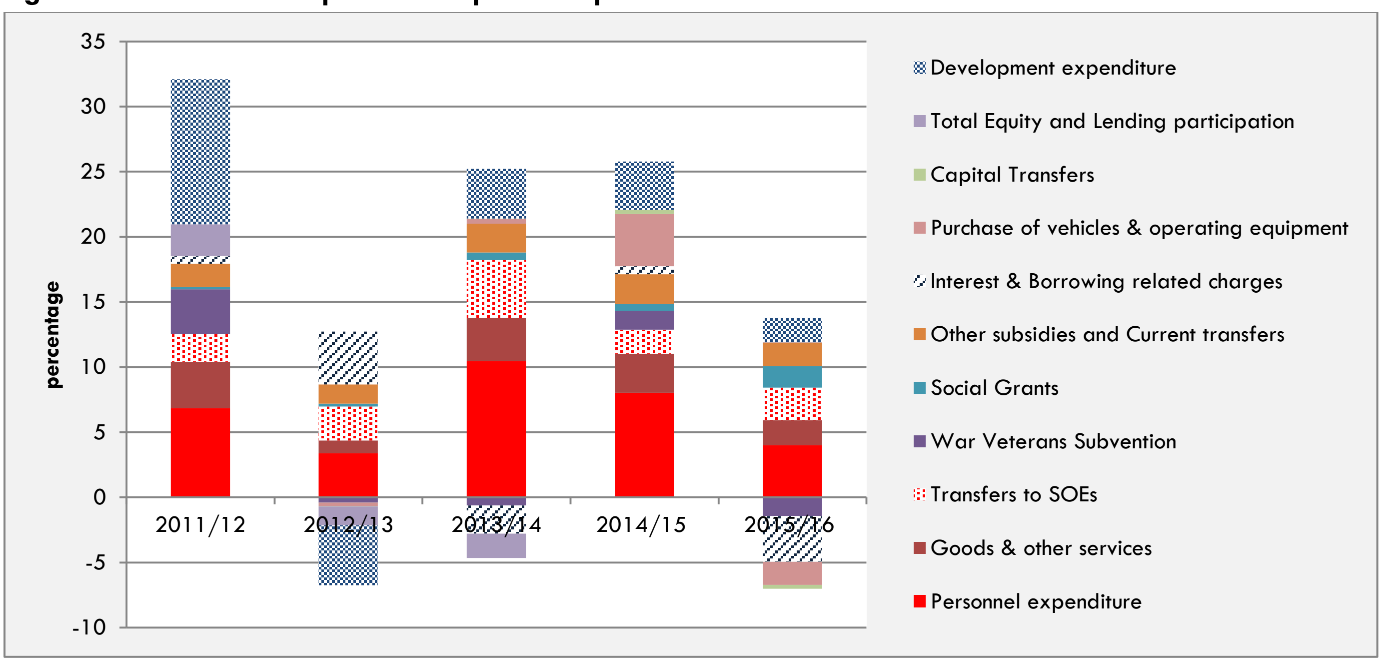
Fiscal Position: Where are we and how did we get here?

The 2008/09 global financial crisis impacted negatively on economic growth with real Gross Domestic Product (GDP) slowing down to 0.3% in 2009, the lowest recorded growth since 1993. This in turn translated into lower revenue collection with revenue growth slowing down to just about 2.4% in 2009/10 before contracting by around 2.7% in 2010/11. Fortunately, there was sufficient fiscal space to be able to use fiscal stimulus to stimulate economic growth. The budget deficit then widened in 2010/11 (-16.9%) and 2011/12, before reducing significantly in 2012/13 as a result of the windfall revenue from the Southern African Customs Union (SACU) revenue pool[1].

Thereafter, between 2013/14 and 2016/17 financial years public expenditure growth averaged 11.04% per year , surpassing growth in public revenue and nominal GDP growth which recorded average growths of 6.8% and 8.9% per year, respectively (see Table 3).

Figure 1: Growth decomposition of public expenditure



Source: Author's compilation, based on the growth decomposition methodology.

[1] Taxes on international trade and transactions accounts for about a third of the total public revenue and on average about 10 % of GDP and has thus been an important source of revenue over the years. However, fluctuations in trade cycles due to the global economic environment make it a highly volatile source of revenue.

Figure 1 clearly shows that personnel expenditure[2] has been the main driver of public expenditure growth. It is worrying that about three quarters of total domestic tax revenue is spend on personnel related expenditure which directly only benefit about 5% of the Namibian population. In addition, between 2012/13 and 2015/16, personnel expenditure increased by about N$ 10 billion, representing a growth of 72%, primarily due to the civil servants regarding and salary adjustments in 2013/14 and 2014/15. The average annual remuneration per public sector employee[3] increased from around N$134 000 in 2012/13 to over N$190 000 in 2015/16. The problem with personnel expenditure is that inflexible i.e. almost impossible to reduce.

The table below suggest that compared to its neighboring country Botswana, Namibia can do a little better in terms of public resource allocation. With relatively lower government expenditure, Botswana spends a bit more on development expenditure compared to Namibia. Botswana's expenditure on civil servants remunerations is also a bit lower and has also been more stable (not shown here) over the past six years compared to Namibia's.

Table 1: Public Expenditure: comparing Namibia and Botswana

% of GDP (Average 2011/12-2016/17)	**Total Public Expenditure**	**Development Expenditure**	**Personnel Expenditure**
Namibia	38.5	5.8	14.2
Botswana	35.4	8.6	12.1

Source: Botswana Ministry of Finance & Namibia Ministry of Finance.

Other operational expenditure items such as transfers to State Owned Enterprises, acquisition of consumables and capital assets i.e. machinery and vehicles have also somewhat contributed to expenditure growth. Moreover, there has been an increase in capital expenditure, particularly for transport infrastructure, Green Schemes expansion, and construction of large dams (Neckartal dam) as well as education and health facilities upgrading, among others. The key drivers of public expenditure are summarized in Table 4.

As a result of these fiscal developments, key fiscal aggregates have deteriorated in relation to the adopted targets. Public expenditure as % of GDP for the years 2014/15 and 2015/16 exceeded the set ceiling of 40%; the budget deficit has been above the 5% threshold since 2014/15 and public debt as % of GDP has increased to over 40% since 2015/16 (see Table 2).

The fiscal policy stance over the medium-term emphasizes fiscal consolidation and aims to re-align expenditure to revenue prospects in order to reverse the current fiscal position to what is deemed sustainable. Having painted a picture of the current fiscal position, this economic brief attempts to assess the impact of the current fiscal policy stance.

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[2] The wage bill constitutes over 85% while employer's contribution to pension and medical aid funds constitutes about 10% of personnel expenditure. On average, the wage bill accounts for about 90% of personnel expenditure growth.

[3] Part time employees included.

Fiscal consolidation: Composition, Implications and Impact

In response to the fiscal developments discussed above a fiscal consolidation programme was introduced in the 2015/16 mid-year budget review and cemented in the 2016/17 budget and mid-year budget review. The short to medium term impact of fiscal consolidation on economic growth is dependent on the composition of the fiscal adjustment[4]. Size and pace are other two important aspects of fiscal consolidation. The International Monetary Fund (IMF) country report of Namibia for 2016[5] emphasize that a combination of revenue and expenditure measures, together with some fiscal structural reforms will be required to minimize the negative impact of fiscal consolidation on economic growth. The current fiscal policy stance is considered within this scope, firstly looking at its composition, the possible implications and its simulated impact.

Composition

Fiscal consolidation was effected in the 2016/17 mid-year budget review, with budget cuts for the 2016/17 budget and revised indicative expenditure ceilings over the 2017/18 to 2019/20 Medium Term Expenditure Framework (MTEF) for both capital and recurrent expenditure, focusing on unproductive spending[6] and capital projects with low implementation rate. However, given the rigidity of most recurrent expenditure components (i.e. personnel expenditure) the reduction of expenditure is biased towards the development budget. In fact, with the 2016/17 total budget cut of N$ 4.5 billion, the development budget was cut by N$ 2.7 billion compared to N$ 1.8 billion cut for non-interest recurrent expenditure. Moreover, new development projects will only be considered when fiscal space that is consistent with the fiscal stance and adjustment path emerge[7]. The average growth in public expenditure over the MTEF is expected to slow down to just about 0.7%.

Fiscal consolidation measures that are currently under consideration seem to be more biased towards expenditure. However, some revenue enhancement and tax administration reforms have been proposed. New taxes such as the environmental taxes, export levy and increase in fuel levy have been introduced, though it appears that significant increase in domestic revenue collection can only be realized through enhanced efficiency and by strengthening the tax administration. With subdued growth, domestic revenue is projected to grow by an average of just about 3.9% over the MTEF, surpassing growth in expenditure. The SACU revenue is expected to grow by an average of 12% per year, increasing total public revenue growth to an average of 5.7% per year over the MTEF.

Furthermore, key to the fiscal consolidation is the supportive structural policy reforms aimed at reducing the over-reliance on the national budget by seeking alternative sources of financing by

[4] Burgert, M, Hruzova, M.L & Monks, A. 2016. Composition Matters: Fiscal Consolidation and Economic Growth in the Czech Republic (2010-2013). Economic Brief 012. European Commission.

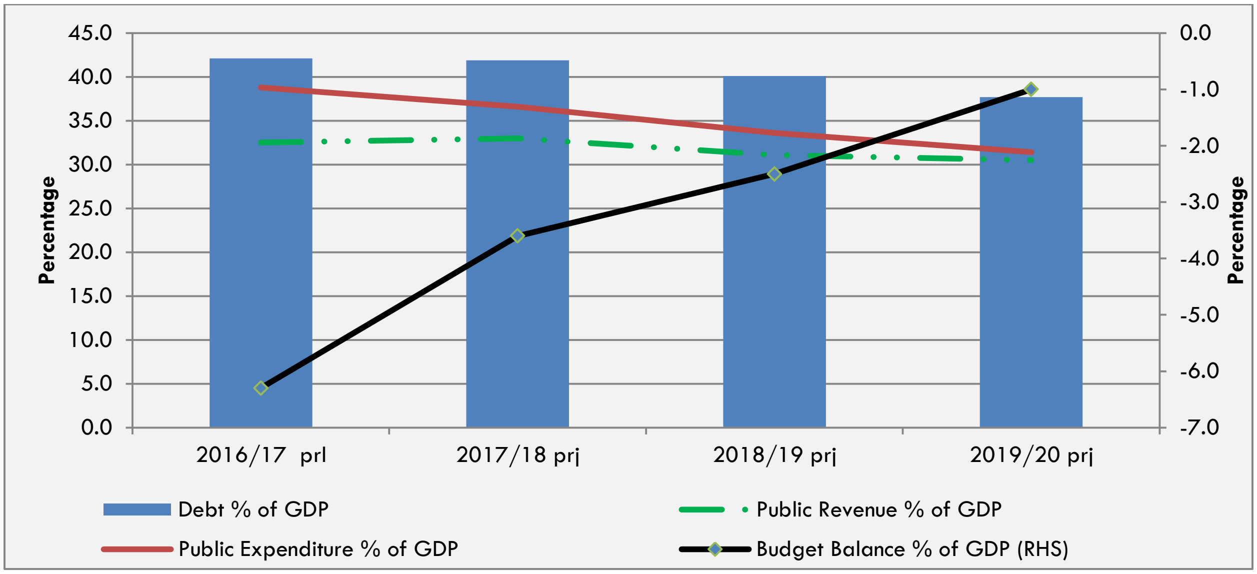
[5] International Monetary Fund. 2016. IMF Country Report No. 16/374. Washington, D.C.

[6] This include the freezing of nonessential government vacancies, expenditure cuts on travelling and subsistence, moratorium on construction of new government offices.

[7] Ministry of Finance. 2016. FY2016/17 Mid-Year Budget Review Policy Statement.

engaging the private sector through Public Private Partnerships (PPPs) and private sector investment. Projects in the housing, energy, water and railway sectors are primary targets for PPPs funding.

Figure 2: Fiscal Policy stance over the MTEF



Source: Ministry of Finance.

Overall, as depicted in Figure 2, the fiscal consolidation plan aims to place public finance on a sustainable path by reducing the budget deficit to around 3% of GDP and gradually reduce public debt to below 35% of GDP. As reflected by the composition of the fiscal consolidation, this is to be achieved mainly by enhancing public expenditure efficiency and reducing wasteful spending. Furthermore, the seemingly ease with which the development budget was cut and capital projects suspended, because of low implementation rate, would suggest structural weaknesses in terms of capital projects identification and costing.

Implications

Economic growth

The public sector has been a key driver of economic growth over the years and the expansionary fiscal policy stance post-2008/09 global crisis has sustained the relatively high level of economic growth for the period 2010 to 2015, with real GDP growth averaging over 5%. This is evident from economic growth decomposition which suggests that GDP growth over the 2010 to 2015 period can largely be attributed to the construction, wholesale and retail trade and public administration sectors[8]. Intuitively, this means that a slowdown in public spending will most likely

8 Over the 2010 to 2015 period, the construction and wholesale and retail trade sectors accounted for about 35 % of economic growth while the public administration sector accounted for 18 %. Increased public expenditure on construction and renovation partly contributed to the boom in the construction sector. The construction boom, together with the improvement in the public servants remuneration structures (which increases disposable incomes) stimulate domestic demand, translating into good growth performance of the wholesale and retail trade sector.

have a negative impact on economic growth due to reduction in public investment and domestic demand. Econometric estimation suggests that there is a significant long run relationship between GDP growth and government expenditure growth, with a 1% increase in public expenditure leading to about a 0.9% increase in GDP[9]. Furthermore, the poor economic performance in 2016[10] attributable to the mining, construction and public administration sectors, is an indication that public sector liquidity problems and fiscal consolidation stance indeed impact negatively on GDP growth, at least in the short run.

Furthermore, it is important to emphasis that revenue collection is dependent on economic growth performance. This is affirmed by evidence of a revenue-GDP nexus which suggests that there is a unidirectional relationship from GDP to public revenue, thus economic growth stimulate revenue performance. Furthermore, the revenue-spend hypothesis suggests a unidirectional relationship from public revenue to expenditure, that is good revenue performance results in an increase in public expenditure (See Table 5).

Public investment

Public investment impacts on infrastructure development and subsequently on the economy's productive capacity and growth potential. The increased public sector investment due to expansionary fiscal policy[11] and the investment from the private sector particularly in mining resulted in a construction boom over the 2010 to 2015 period. With most of the mining constructions completed and the Government adopting a fiscal consolidation stance, the construction sector is expected to contract, slowing down economic activities in other sectors and overall growth.

Public investment is expected to decline to about 4.2 % of GDP over the MTEF, reflective of the moratorium on the construction of government offices as well as freezing of capital projects whose tenders were not awarded during the 2016/17 budget review. This is amidst large investments required in infrastructure such as water, energy, housing, roads and railways, as well as education and health infrastructure. These infrastructures create a necessary environment to crowd-in the private sector, which should be the main driver of economic growth going forward.

On the projects implementation, depending on the stage of development for the ongoing projects, they are expected to become more costly, with their period of completion prolonged. This will have further cost implications while also affecting public sector operations and service delivery.

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[9] Estimated model: *log*(GDP*) = 0.9269 + 0.9133 *log* (Public Expenditure) where GDP* = combined nominal GDP contribution of the construction, wholesale and retail trade , public administration , education and health sectors.

[10] Namibia Statistics Agency. 2016. Gross Domestic Product third Quarter 2016.

[11] Public investment as % of GDP averaged 6.2 % during the period 2011/12 – 2015/16 compared to 3.9 % between 2006/7 - 2010/11.

Employment

In 2014, the public sector represented about 15 % of total employment in Namibia[12]. The average growth in public sector employees over the period 2010 to 2015 stands at 4.8 % per annum, which translate into over 4000 net new vacancies (including part-time workers) in the public sector per year favoring the education, health, police and defence sectors. Moreover, the construction industry which employs majority of the unskilled and semi-skilled largely depends on government projects and contracts. Thus, the slowdown in government construction expenditure will mean less construction activities, impacting negatively on contractors and sub-contractors, engineers, quantity surveyors, manufacturers and suppliers of building materials. According to the survey done by Construction Federation Industry[13] in December 2016, reducing labour costs is one of the strategies that companies will use to adjust their operations to the reduction in construction activities. As a result of the public sector liquidity problems experienced just before the effecting of the fiscal consolidation in the 2016/17 mid-term budget review, over 1600 employees in the construction industry were retrenched between September and December 2016. With the freezing of some capital projects following, this number might undoubtedly increase.

In addition, the freezing of what is considered nonessential government vacancies coupled with the slowdown in overall economic activities, the private sector will also most likely not be able to create sufficient employment opportunities and thus resulting in limited job opportunities not only for the unemployed masses but also for majority of university graduates[14].

Furthermore, while the government intends to protect social spending, the likely negative impact of consolidation on growth particularly on the construction sector will reduce the income and purchasing power of majority of the poor and low income earners. This can potentially increase the poverty incidence of the majority that directly and indirectly rely on construction work for survival.

Simulated impact of fiscal consolidation

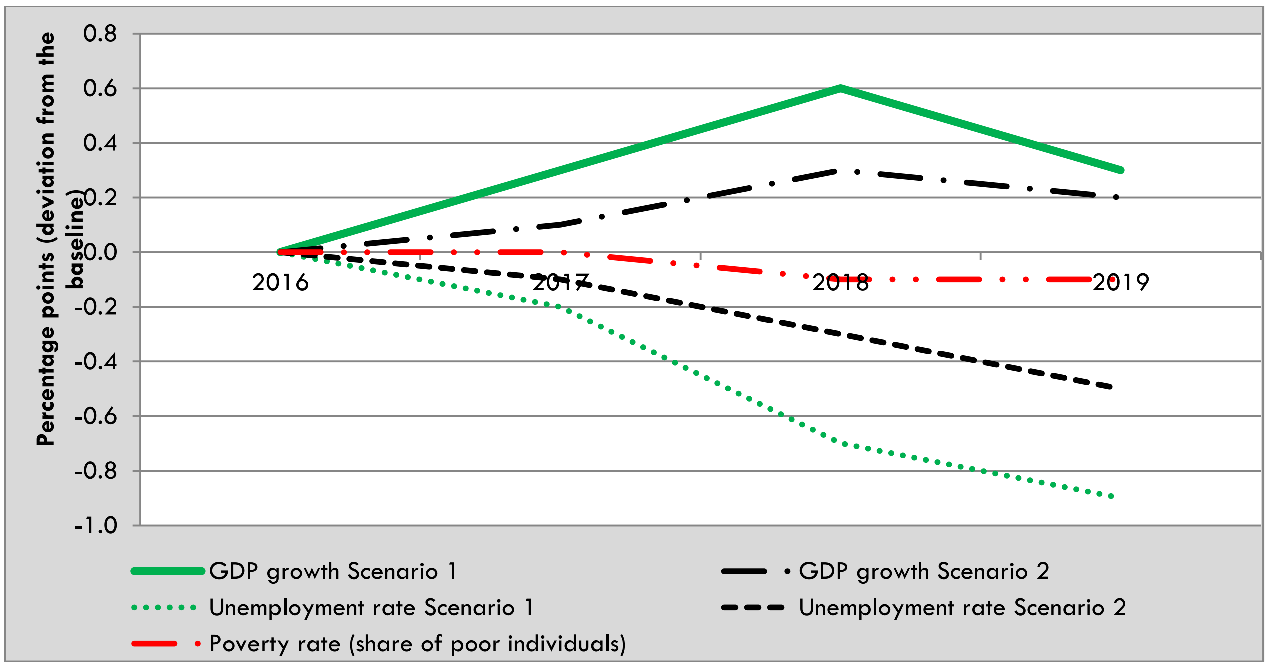
Having outlined the composition and implications of the fiscal consolidation plan, the focus now turns to its simulated impact. To this effect, by running simulations, the impact of this policy stance on the Namibian economy in the medium term is assessed using the !NAMTRIMO[15] and NODSOM[16]. The idea is to assess the impact of the fiscal consolidation plan under consideration versus two alternative scenarios where a slightly different mix of expenditure measures is used.

The baseline is as per the information contained in the 2017/18 budget that is the set expenditure ceilings, the projected revenue outlook and debt stock. Scenario 1 adjusts the current fiscal consolidation measures, specifically by adjusting the level of expenditure ceilings, increasing it by a total of N$ 7 billion over the MTEF period which is almost equivalent to the development

[12] Namibia Statistics Agency. 2015. The Namibia Labour Force Survey 2014 Report.
[13] The Construction Industry Federation of Namibia, 2016, Press Release, 09 December 2016.
[14] In 2015, the total number of UNAM, NUST and IUM graduates was 8500 while 9600 graduated from VTCs.
[15] Namibia Treasury Integrated Model.
[16] Namibia Occupational Demand and Supply Outlook Model.

budget cut for the years 2017/18 and 2018/19. It is assumed that this amount is to be allocated for productive investment spending i.e. allocated to for capital spending; N$ 1 billion for 2017/18, N$ 3 billion for 2018/19 and N$ 3 billion for 2019/20. On the other hand, Scenario 2 is similar to Scenario 1, except that the extra amount allocated is N$ 3.5 billion; N$ 0.5 billion for 2017/18, N$ 1.5 billion for 2018/19 and N$ 1.5 billion for 2019/20. For both scenarios, revenue outlook is assumed to remain as projected in the budget, thus assuming it does not react to the adjustment in expenditure. The simulated results are summarized in Figure 3 in terms of the % point deviation from the baseline scenario.

Figure 3: Simulated impact of Fiscal consolidation on selected key variables



Source: Author's calculations based on !NAMTRIMO & NODSOM.

These results reaffirm the fact that the current fiscal consolidation plan will contribute to weak growth performance, due to the impact of the reduction in public investment as well as the reduction in domestic demand on economic performance in the medium term. As emphasized earlier, the reduction in government construction expenditure will impact negatively on the construction industry and companies will be forced to lay off workers in order to reduce operating cost. This, given the employment elasticity of the construction sector will impact negatively on employment of majority of the unskilled and low income earners. The impact on poverty is also negative[17]. With the less employment opportunities for the unskilled and semi-skilled who rely on construction work, the income of the poor and low income earners will be affected negatively, thus increasing their vulnerability to poverty.

[17] It should be mentioned that due to the nature of !NAMTRIMO, this is perhaps underestimated. With changes in economic growth the model assumes movement of households between the various main source of income categories i.e. from subsistence agriculture to salaries.

Sovereign Wealth Fund (SWF)

There are a number of Sovereign Wealth Funds (SWFs) globally for which the major players are China, Middle East and Norway. Generally SWFs are important for various reasons, which include: economic stabilization, inter-generational savings accumulation, buffers against economic shocks, and wealth diversification and domestic investment among others.

SADC countries are urged to adopt some practical steps to develop Sovereign Wealth Funds (SWFs) that are financed out of mineral resources found in the region to help member states to overcome the severe constraints imposed by the volatility in international trade and fluctuations in the global economy. Countries that are moving to establish SWFs are growing as economies explore ways to substantially raise living standards, generate employment, alleviate poverty and mitigate external shocks from the globalized economy. Countries which have SWFs within the SADC region include: Botswana, Angola and Tanzania among others. Botswana established such a SWF (Pula Fund) in 1994, with funds sourced from diamond exports, and this fund cushions the country in times of economic turbulence and shocks. Zimbabwe also passed the SWF Bill in September 2013, to create SWF which will be funded from up to a quarter of mining royalties realized from trade in gold, diamonds, coal, coal-bed methane gas, nickel, chrome, platinum and other mineral that may be specified. Furthermore, Lesotho and Zambia are both contemplating establishing such funds.

The fund serves as wealth for future generations, under the SADC Industrialization Strategy and Roadmap (2015-2063) that was adopted in Harare was seen as a vehicle for poverty alleviation, a decent standard of living for all, industrialization and infrastructural development for which all these count towards regional development. In light of this, Namibia is in a better position to create such a long-term investment portfolio (SWF), with the aim of preserving part of the income from SACU revenue as well as from exports accrued to the economy from its rich natural resource endowments, especially from minerals (Uranium and Diamond) for future generations. It is worth pointing out that Namibia was intent on establishing Minerals Development fund as early as 1995; however, it did not materialise.

By creating a separate investment portfolio, it would be possible to provide more appropriate and longer-term investment considerations in the prescribed guidelines of its management. In additions to SACU revenue and surplus exports, foreign exchange reserves that are in excess of what would be expected to be spent in the medium term plan would also be transferred to that Sovereign Wealth Fund, where this capital is invested as per the set investment guidelines.

Although establishing a SWF has noted benefits to any economy, however, it has some downside risks including transparency and accountability among others which have been the main reason why most developing countries opt against setting SWFs.

Conclusions

Following windfall revenue from the SACU revenue pool in 2012/13, public expenditure growth has outpaced public revenue growth resulting in deterioration in key fiscal aggregates. The civil servants salary improvements/adjustments have played a lead role in driving public expenditure growth. It has become necessary to reverse the fiscal position to what is deemed sustainable. Fiscal consolidation has been adopted to be pursued over the medium term.

The composition of the fiscal consolidation plan is more biased towards expenditure measures and impacting more on development expenditure. It seems to reflect the inefficiencies and wasteful spending on both the operational and development expenditure in public expenditure over the years. In the short to medium term, fiscal consolidation will contribute to weak growth performance; unemployment rate is most likely to increase due to the reduction in construction activities, affecting mainly the poor and low income earners. This will further increase the vulnerability of the poor and low income earners, resulting in increased poverty incidence. Whether the likely gains of fiscal consolidation in the long term in terms of macroeconomic stability will outweigh the medium term losses could not be established here.

The following are proposed to complement the ongoing fiscal reforms;

- Mechanisms to reduce the cyclicality in SACU revenue, by introducing a Sovereign Wealth Fund (SWF) where a portion of revenue from SACU pool can be saved, particularly in years of good SACU revenue performance. This can reduce the pressure of increasing expenditure, particularly the inflexible recurrent spending, and can create fiscal space for essential spending over time. Exports from mineral resources accruing to the economy (Uranium and Diamond) could be pooled in the SWF to provide for future generations, provide economic stabilization, as well as serve as important buffers against economic shocks among others.
- Enhancing capacity for capital projects identification, scoping and costing in order to maximize the efficiency and effectiveness of the limited public resources available for investment.

Appendix

Table 2: Fiscal aggregates developments

% of GDP	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17 *prl*
Total Revenue	31.4	33.7	32.8	35.3	35.0	32.5
Domestic Tax Revenue	*21.0*	*19.2*	*18.9*	*20.3*	*21.2*	*21.8*
SACU Revenue	*7.5*	*12.2*	*11.5*	*12.8*	*11.6*	*8.9*
Total Expenditure	38.4	33.8	36.6	41.6	41.5	38.8
Wage bill	*13.3*	*12.3*	*14.0*	*15.3*	*16.1*	*15.4*
Capital Expenditure	*7.6*	*4.9*	*5.5*	*6.2*	*6.6*	*4.4*
Budget balance	-7.0	-0.1	-3.8	-6.3	-8.3	-6.3
Public Debt	26.0	24.4	24.2	25.4	42.1[18]	41.9
Interest Payments % Revenue	6.2	6.9	4.3	4.1	5.0	7.5

Source: Ministry of Finance

Table 3: Fiscal aggregates developments

Year-on-year growth	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17 *prl*
Nominal GDP	13.8	18.4	13.1	10.7	5.5	6.4
Revenue	28.0	27.0	10.3	19.1	4.6	-1.3
Domestic Tax Revenue	*19.0*	*5.4*	*6.7*	*10.8*	*5.7*	*5.9*
SACU revenue	*5.0*	*22.3*	*2.5*	*8.1*	*-1.5*	*-6.3*
Expenditure	32.9	4.1	22.6	25.8	5.4	-0.7
Wage bill	*6.9*	*3.4*	*10.5*	*8.0*	*4.0*	*0.7*
Capital Expenditure	*11.1*	*-4.6*	*3.8*	*3.7*	*1.9*	*-4.6*

Source: Ministry of Finance.

Table 4: Key drivers of public expenditure

Year	Main drivers of public expenditure (ranked in descending order)	% points[19]
2011/12	Capital expenditure (Transport infrastructure, construction of Neckartal dam, Green Schemes expansion) Personnel Expenditure (General salary increment of 10 % and improved benefits for all civil servants) Goods and other services (Materials and supplies i.e. consumables) War veterans subvention	11.1 6.9 3.6 3.4
	Total % increase in public expenditure 32.9%	
2012/13	Interest payments Personnel Expenditure (General salary increment of 8 % and improved benefits for all civil servants)	4.1 3.4
	Total % increase in public expenditure 4.1%	
2013/14	Personnel Expenditure (Civil servants re-grading and salary adjustments) Transfers to SOEs Capital expenditure (Construction of Neckartal dam, Transport infrastructure etc) Goods and other services (Materials and supplies i.e. consumables)	10.5 4.4 3.8 3.3
	Total % increase in public expenditure 22.6%	
2014/15	Personnel Expenditure (Civil servants re-grading and salary adjustments- appeal) Acquisition of capital assets (Operational equipment, Machinery, Plants and Vehicles) Capital Expenditure (Transport infrastructure, land purchase, rural water supply)	8.0 4.0 3.7
	Total % increase in public expenditure 25.8%	
2015/16	Personnel expenditure (General salary increment of between 3 and 6 % for civil servants)	4.0
	Total % increase in public expenditure 5.4%	

Source: Author's compilation, based on the growth decomposition methodology.

[18] This acceleration of the govt debt was due to the Euro bond issuance (US$750 million) in 2015.

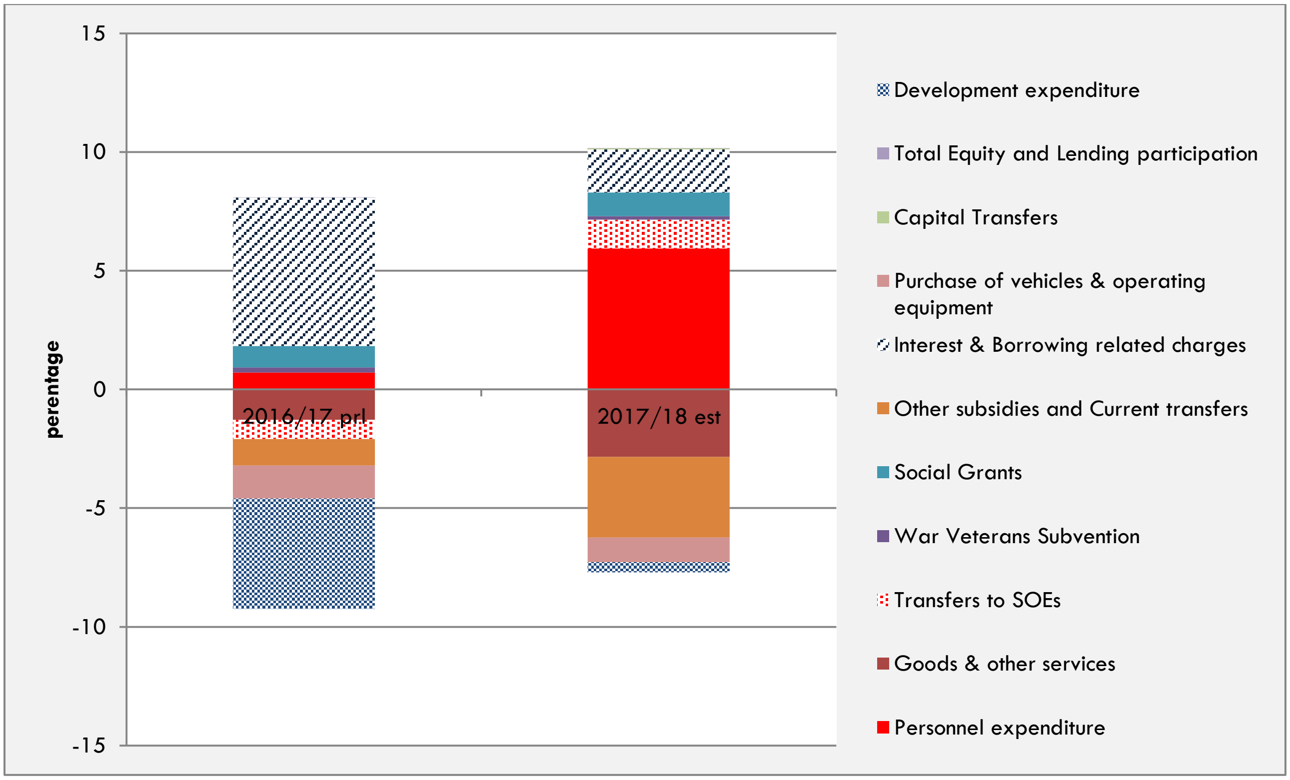
[19] Decomposition of public expenditure growth i.e. the figures represent %age points share in total %age increase in public expenditure.

Table 5 Granger Causality Test[20]

Regression	Lag	Chi-square statistics	P-value	Granger Causality
log(Expenditure) on *log*(Revenue) **Null hypothesis: Revenue does not granger cause Expenditure**	1	4.93	0.026	Yes
log(Revenue) on *log*(GDP) **Null hypothesis: GDP does not granger cause Revenue**	1	7.17	0.007	Yes

Source: Author's calculations.

Table 4: Growth decomposition of public expenditure



Source: Author's compilation, based on the growth decomposition methodology.

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