Statement For the 2005/2006 Budget

Presented by
Honourable Saara Kuugongelwa-Amadhila
Minister of Finance

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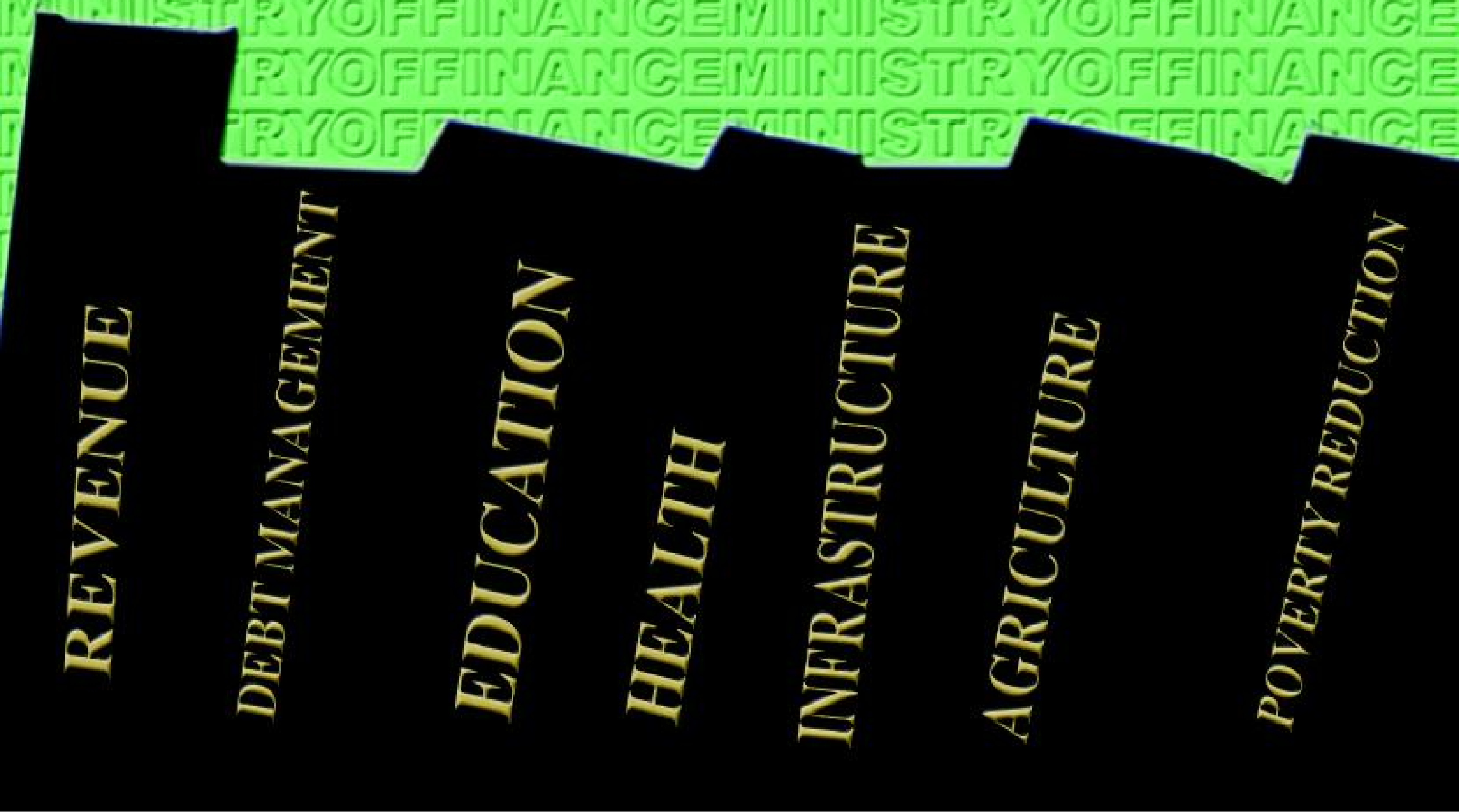

Opening Remarks

Honourable Speaker, Honourable Members of Parliament

1. I rise in this Honourable House this afternoon in fulfillment of the statutory provision that required me to present to this August House estimates of income and expenditures for the account of the state for the year ending 31^{st} March 2006 and the medium term expenditure framework for 2005/2006 to 2007/2008 for approval.

2. Honourable Speaker, this is the first budget to be presented to the 4^{th} legislative term. Namibia witnessed major political events during 2004, namely the National Assembly and the Regional Councils elections as well as the smooth transfer of power from our Founding Father, Dr. Sam Nujoma, to the current president, H.E. Comrade Hifikepunye Pohamba. This is a remarkable achievement for our democratic system and our country. I wish to, therefore, congratulate Namibia for this achievement. Sincere congratulations also go to His Excellency Comrade Hifikepunye Pohamba for receiving the honour of becoming the second President of our Republic. In the same vein I wish to express my profound gratitude to Comrade Sam Shafiishuna Nujoma, our founding President and father of the Namibian revolution for his selfless service to Namibia and its people. Namibia shall remain forever indebted to him for the selfless sacrifices that he has made for this country.

3. In my budget statement a year ago, I explained the hard choices to be made and the reform of the budget process from input based to allocations based on what we get for the value of our money and moving from how much each Ministry should get to the benefits that will accrue to our citizens.

4. My speech will first set out the fiscal and economic background of the budget. I will then set out expenditure decisions in the budget using programme budgeting and the medium term plans. I will then lastly set the fiscal consequences of those decisions and how we intend to further improve financial management.

Fiscal Policy as a tool for Economic Management

Honourable Speaker, Honourable Members

5. Fiscal Policy is an important tool for Economic Management. It is a known fact that there exists a mutual dependence between fiscal policy and economic performance. Tax revenue, which is the main pillar of Government revenue sources, is directly linked to economic performance, it moves in line with economic performance.

6. In contrast to Government revenue, which moves in line with economic activity, expenditure depends directly on the discretionary policy of Government. For the past years, a major share of Government expenditure has been current expenditure, of which personnel expenditure was the main component. However, strict expenditure control measures, which Government had put in place have greatly contributed to expenditure not increasing significantly since 2003/04.

<u>Objectives of Namibia's Fiscal Policy</u>

7. Within this mutual dependence of economic activity and fiscal policy, the Government pursues to achieve fiscal objectives through its revenue and expenditure policies. The National Development Plans (1 and 2) outline the fiscal policy of the Government. The objectives of fiscal policy are to foster growth and human development and at the same time to ensure long-term fiscal sustainability.

Honourable Speaker, Honourable Members

8. Our Fiscal Policy has been successful. Namibia has enjoyed stable economic growth since independence. In the past 15 years, we have at least partly addressed the disparities in social and economic development that we inherited and we are continuing to do so. Improving educational attainment, health services and providing basic housing and infrastructure were our priorities. It is a well-known fact that a healthy and educated people are the backbone of economic development. Therefore, the investment undertaken for the past 15 years will improve the well being of all our citizens and result in more economic activity. Throughout these years, our spending was geared towards the attainment of our national development objectives as outlined in the National Development Plan and we will continue to do that.

9. We have managed to address these needs while maintaining fiscal sustainability. Even though our debt level seems to be high, it is still manageable and sustainable compared to international benchmarks. The current public debt stock is the result of what Government has experienced in the past 15 years in addressing the disparities and covering priority areas in Education, Health, Housing and Infrastructure, among others.

10. The role of fiscal policy in promoting development can be seen through its effects on growth, and, more broadly, through its impact on social development. Over the medium term, the Government will ensure a sound public finances management, resulting in a minimal gap between revenue and expenditure. This means that the Government meets its key priorities while avoiding an unsustainable burden of public debt. For that, strict fiscal discipline will be required to produce sustainable levels of expenditure, which will require Ministries to spend within their ceilings.

Economic outlook: Global, Regional and Domestic

Honourable Speaker, Honourable Members

11. Namibia is integrated into the global economy through trade links and capital flows. This integration brings opportunities but is also a source of potential risks. The prospects for the global economy in general, and for Namibia's trading partners in particular, are an important determinant for the demand for Namibia's export products and thus for economic growth.

12. World output is estimated to have grown by a strong 5.1 percent in 2004, and the prospects for 2005 are promising. However, growth in this year will be hampered by the high oil prices due to high demand for energy, as well as by a weak US dollar. Altogether, these lead to a world output growth projection of 4.3 percent in 2005

Regional Economy

13. Economic growth in Africa is estimated to have reached 5.1 percent in 2004, albeit with considerable variations across the continent. Growth was generally supported by improved macroeconomic stability, a general rise in global commodity prices, and the large expansion in oil production. These favourable conditions are expected to prevail in 2005, leading to an average GDP growth of 5.0 percent.

14. Neighbouring South Africa is the largest economy in Africa. Buoyant domestic demand is expected to drive the economy, which is expected to expand by 4.0 percent in 2005. Most of Namibia's other neighbouring countries are also expected to witness a strong GDP growth in 2005 and 2006.

15. The growth prospects for Namibia's main trading partners in 2005 will have a positive impact on the domestic economy. Demand for export products such as minerals, fish and beef is expected to be strong, given the economic growth in the various destination markets in the US, Europe and Asia. The stable macroeconomic conditions in the neighbouring countries will contribute to a favourable business climate in the region.

Namibian Economy

16. In the period between 2001 and 2003, the Namibian economy enjoyed a stable macroeconomic environment, which has led to an average expansion of real GDP by 2.9 percent per year. The estimates indicate a strong increase in real GDP growth to 4.4 percent in 2004, receiving a major boost from a surge in mining activities.

17. A stable monetary environment was also conducive to the solid economic growth. Inflation slowed down from 11.4 percent in 2002 to 7.2 percent in 2003, and this downward trend continued as inflation reached an average of 3.9 percent in 2004.

18. Interest rates also declined significantly with average prime lending rates dropping from 15.6 percent in January 2003 to 10.7 percent at the end of 2004. Bank rates followed a similar trend falling from 12.8 percent to 7.5 percent over the same period. This positive trend enhances business expansion and our private sector is called upon to make full use of the opportunities created by these positive developments.

19. The prospects for the domestic economy over the MTEF period are promising. The economy as a whole is expected to record an average growth rate of above 4 percent between 2005 and 2007. The sectors driving the growth are mainly agriculture, mining, post and telecommunications, tourism, trade and manufacturing. In addition, a positive world economic outlook, especially for Namibia's major trading partners, will support growth, as trade links strengthen and new opportunities emerge.

20. Primary industries remain the stronghold of the Namibian economy in terms of both production of export products and employment creation. These industries are expected to grow on average by about 3 percent during the period 2005 – 2007.

21. Recent years have seen an expansion of secondary industries into activities such as textile and apparel production, mineral refinery and diamond cutting. Over the medium term, these industries are expected to grow on average by more than 5 percent per year.

22. Tertiary industries play an important role in the Namibian economy, and their contribution to GDP remains the highest at more than 50 percent. On average, tertiary industries are expected to grow by 4 percent for 2005 – 2007.

23. The review of the Namibian economy and the outlook for the upcoming years sketch the environment in which fiscal policy operates. The economic conditions in the various sectors of the economy affect revenue collection, and public spending on the other hand influences economic activities in other sectors.

External Sector Development

24. Namibia’s external sector situation continues to be unfavourable because of high levels of imports compared to exports and high capital outflows. Although Namibia has been experiencing a positive current account balance, this is mainly as a result of receipts from the SACU pool. This dependency on SACU receipts is, however, unsustainable especially in view of the SACU trade liberalisation. The Free Trade Agreements that we are currently pursuing through

SACU will also reduce the size of the Common Revenue pool and with that our share from the pool. This in turn increases the risk of current account deficits. Namibia must therefore become more aggressive in promoting its exports in order to compensate for these envisaged losses.

25. The high capital outflows are mainly in the form of pension funds, life insurance asset and Unit Trusts. In 2004, these outflows amounted to N$3,7 billion compared to N$3.2 billion in 2003. These outflows, deprive the country of the much needed funds for investments and in effect retard the national efforts to expand the economy. It is therefore imperative that this situation is reversed in order to utilize these national savings towards local investments.

<u>Exchange Rate Development</u>

26. The Namibia Dollar continued to appreciate against major international currencies especially the US Dollar, reaching levels of N$5.9 per US Dollar at the beginning of 2005. Recently, it has been hovering around N$6 per US Dollar and this situation is expected to persist for a while.

<u>Financial Sector Development</u>

27. The Banking sector in Namibia is dominated by Commercial banks whose lending is mainly on short and medium term basis. This creates a gap in long term funding that is required for large private investments that could expand the economy and create employment opportunities. Coupled with the gap in private development financing is the persistent problem of restricted access to finance for SME's due to the undue risk averseness of commercial banks.

28. Some positive developments have been observed where some banks and other financial institutions have established special funds to finance strategic investments and SME's. These developments are however, new and are yet to have an impact and they are also relatively small in size.

29. It is worrisome that banks remain excessively stringent in their security requirements thus creating undue hardships for SME's who seek to access financing. In addition, some financial institutions seem to target only Government with these funds, and where private projects are funded, full exposure risk is passed on to Government through requirements for state guarantees so that banks enjoy handsome profits while sharing no risk. Surely no serious investor can expect to have no risk. And our financial institutions are required to revisit this practice which in no doubt retards national efforts to expand the economy. I am in no way advocating that prudential requirements be thrown out the window. What I am saying is that actions that create artificial barriers for investors are definitely not supportive of national development efforts and are therefore unwelcome.

30. I must also express my concern with the high fees levied by our banks for services rendered. These have crippling effects on the banking customers and especially small and medium enterprises and the sector is called upon to ensure that their fees structures are fair and are supportive of business expansion.

Micro-financing

31. The micro finance area has experienced some new initiatives which could fill a crucial gap in credit financing. These entail credit schemes for micro and small projects which are currently not catered for by existing private banking institutions. These schemes will play a critical role in promoting income generating activities especially amongst women and the youth who are hardest hit by poverty and unemployment.

32. The Usury Act has been in operation since 1968 and has not been aligned to cater for new developments. As a result, persons who borrow money are not always adequately protected against unscrupulous operators out to make quick profits. To properly legislate for these needs, the Usury Act is in the process of review. Other pieces of legislation that are up for amendments are the Stock

Exchange Act, the Unit Trust Control Act and the Namibia Financial Institutions Supervisory Authority Act.

Development Bank of Namibia

33. The Development Bank of Namibia was launched in April 2004 to address the gap in development financing and to spear head Government's economic empowerment policy.

34. In its first year of operation, the emphasis was on establishing an entity that is based on best practice to ensure that the DBN remains at all times a viable development finance institution.

35. The Bank has developed a number of key policies to provide guidelines and a framework within which it operates. These include DBN Board Rules, Lending Policy, Risk management framework policies, Investment Policy, Procurement Policy as well as Human Capital Policy and Regulations.

36. SDF of DBN to support SMEs' and Economic Empowerment: The Special Development Fund (SDF) Rules were approved on 1 November 2004, setting the stage for the entity's operationalisation. The SDF will play a significant role in boosting SME's capacity to contribute to job creation.

37. In the first five months since the Bank's launch in April 2004, it has received 187 requests for funding from SMEs. On average, DBN receives 40 requests from SME clients per month.

38. By the end of April 2005, DBN has appraised close to 50 applications for finance. The total project cost of these projects amounts to N$1.4 billion of which 58% (N$605 million) is requested from DBN. The average loan size requested is N$13 million.

39. We are encouraged by the expressed interest from international and local financial institutions to pursue cooperation with the bank. We will continue to encourage the translation of such interest into practical activities to support local investment and strengthen the capital and technical capacity of the bank.

40. Under this MTEF N$200 million is earmarked for the capitalization of the Bank and its SDF. A further boost to the Banks capital base is expected from the transfer of the assets of the Development Fund of Namibia whose cash balances amount to some N$120 million.

<u>Agricultural Bank of Namibia</u>

41. The new Board of Directors for Agribank was appointed in October 2004 and a new CEO took office in February this year. Among the priority issues receiving the attention of the Board and the Government are, the Agribank's agricultural valuation formula of commercial farmland and the Government guarantee to AAL beneficiaries.

42. The principles of productivity, sustainability and affordability need to be applied appropriately and vigorously when approving Affirmative Action loans in order to prevent over-financing of farms. Appropriate recommendations in this regard are being finalized for the approval of Cabinet.

43. **Domestic assets requirements and Capital flight**. A large portion of Namibian savings under management by Unit Trusts industries, pension funds and insurance companies is invested in South Africa and elsewhere abroad. In view of the significant size of these funds, Cabinet decided that:

- Legislation be introduced to subject Unit Trust Management Companies to domestic assets requirement and to withdraw the tax-free status of returns on unit trust.
- The percentage of investment in dual listed companies that qualifies as domestic investment be reduced to 10 percent over five years and
- A 5 percent minimum investment in unlisted Namibian companies be prescribed to all institutional investors with immediate effect

44. Mechanisms are currently being worked on for the implementation of these measures. A taskforce has been established to facilitate for the input of the public especially the financial sector into this process. So far, some interesting proposals have been advanced.

45. It is important to note that these measures do not in anyway seek to eliminate dual listing on our stock exchange. To the contrary, the government remains committed to the cooperation of stock exchanges in SADC as part of regional integration and to accelerate regional growth.

46. However, Namibia can only partake in the regional growth, if it can increase investment levels locally which will require that the country deploys more of its savings into local investments rather than promote the narrow interest of a few individuals at the expense of the national interest.

<u>Financial charter</u>

47. Reforming the economy is by no means an easy undertaking, but a task that we should face with courage and determination. In my view, the necessary reforms could include the following: Enhancing the skills level, promoting labour-absorbing export sectors, improving access to finance through the consolidation of our property system, establishing new financing vehicles such as venture capital industry and by increasing the local ownership of our financial sector.

48. Against this background, I would like to repeat my call in the previous budget speech that encouraged the financial sector in Namibia to prepare a financial sector charter. We still believe the country needs such a charter. At the same time, I would also like to discourage the financial sector from converting their loans to other forms of lending such as preference shares with the view to avoid paying tax. This practice has been observed in the recent past in some of the financial institutions and we think it is not in the best interest of the country.

Anti-money laundering

49. The Ministry of Finance, in consultations with various national stakeholders, in particular the Bank of Namibia and the national task force on anti-money laundering has stepped up its efforts aimed at ensuring that Namibia speedily enacts appropriate legislations and creates capacity to combat money laundering. The Namibian Government views money laundering and organized crime as destabilising threats that must be defeated.

50. A number of laws relevant to the fight against money laundering have been enacted or are in the process of being enacted. In particular, the Prevention of Organized Crime Act, 2004 and the Anti-Corruption Act, 2003 have been promulgated, while the Financial Intelligence Bill, the Drugs Control Bill and the Combating of Terrorist Financing Bill are being processed with a view to have them speedily promulgated during this year.

51. However, the effective combating of money laundering and other related crimes such as terrorist financing presupposes the existence of appropriate laws. The wide consultative process that went into the above laws or bills provides for legislation that matches international standards. The biggest national challenge is for us to create national capacities in the law enforcement to ensure effective apprehension and prosecution of perpetrators of the criminal acts.

Parastatal Reforms

52. A State Owned Enterprises Bill has been drafted to regulate the management of the parastatals in an effective manner. The Bill will be tabled before Parliament during the course of 2005/06 financial year. Records show that for the past years, contributions from parastatals to the Treasury were not satisfactory. In order to address this unfavourable situation, the formulation of a Dividend Policy will require priority attention.

53. The reform efforts at Air Namibia are generating positive results. For this year, the company managed to reduce its operational loss significantly and the current initiatives of cost savings measures, introducing additional routes and rearranging current ones and the forging of strategic alliances hold great potential to further improve the performance of the airline company. It is, therefore, expected that the budgetary transfers to the airline company will reduce over the years and gradually phase out. The importance of Air Namibia for the tourism industry and by extension the overall economy cannot be over emphasized. Government therefore remains committed to support the reform process at this important national institution.

Southern Africa Customs Union

54. The new democratized SACU Agreement establishing a Customs Union with common external tariffs between Botswana, Lesotho, Namibia, South Africa and Swaziland came into force on the 15th July 2004.

55. An important difference between this Agreement and the previous Agreement is that it provides for joint exercise of responsibility over decisions affecting tariff setting, Common Revenue Pool and overall direction of the organization. The institutions of the new SACU include an independent SACU Secretariat, the Tariff Board, an adhoc Tribunal and the National Bodies. The National Bodies will be established by each Member State to coordinate SACU matters and to receive requests from the private sector on tariff changes. The creation of these institutions is part of continued efforts towards a more cohesive regional market. The new Agreement also provides for deeper economic integration through the development of common policies on industrial, investment and agriculture and competition policies as well as harmonization of policies on unfair trade practices. The integration process should continue in tandem with a further liberalization of SACU's external trade.

56. As reported in last years budget, Namibia's receipts from the SACU pool for 2005/2006 show a significant reduction compared to the previous years, following the introduction of the new revenue sharing formula.

57. However, the experienced reduction in the Revenue Share is in part offset by adjustments still due under the 1969 SACU Agreement. It is important to note that the FTA agreements currently being negotiated and the EU/RSA TDCA will have an eroding effect on the pool and thus on our revenue receipts.

58. Adjustments for the Financial Year 2002/2003 that are due for payment this year amount to N$883 million. Further adjustments for

2003/2004 financial years would become due in the 2006/2007 Financial year.

59. The SACU Free Trade and Preferential Trade Agreements that SACU is negotiating with third parties are progressing well. The SACU/Mercosur Preferential Trade Agreement has been concluded and signed in December 2004 making preferential access to the South American Markets possible. The negotiations for a Preferential Trade Agreement between SACU and the European Free Trade Area (EFTA) are progressing well and the signing of the agreement is envisaged for later this year.

60. Free Trade Agreement negotiations between SACU and the United States slowed down during the past year but have now been revitalized and the next Round of Negotiations is scheduled for May/June 2005.

61. In spite of the risks that I have refered to with regard to reduced revenue flows, the benefits to our economy from free trade agreement deals are very tangible. Apart from the fact that open markets accelerate capital inflow, the transfer of technology and skills, in essence these free trade agreements would have long-term benefits to our local firms and industries. The challenge that remains to our local businesses is to use their ability to ride on these new opportunities which the free trade agreements offer. I call upon our businesses community to take advantage of these new arrangements by penetrating those new distant markets. However, we need to remind ourselves that in order for our business to compete successfully we need to improve our production capabilities. This requires businesses to have access to new technologies as well as to have knowledge input drawn from research and development practices in order to improve product specifications and designs. I also wish to take this opportunity to call upon the Business Community to seek a dialogue with the Government that would allow that their needs are well accommodated in the negotiations of these free trade agreements so that at the end of the day any concluded free trade agreement shall reflect and respond to their needs and situations.

Policy Issues for the Budget

Expanding Economic Production

62. Increased attention is paid in the MTEF to the productive sectors and economic infrastructures which create employment opportunities and would immediately enhance economic growth.

63. The Green Scheme is one of the most important developments in agriculture and about N$300 million will be allocated to this programme during the MTEF period of which the larger part will be funded from external sources.

64. Aquaculture is another recent initiative aimed at diversifying activities in the fishing sector, and improving income generation and job opportunities. This programme can now be funded through Agribank following recent amendments to expand the definition of agricultural related activities.

65. The waterfronts projects are another initiative promoted by Government with the purpose to develop infrastructure which will induce economic activities and create job opportunities where growth is slow but potential is high. Under the MTEF, projects will be implemented in Katima Mulilo, Henties Bay and Luderitz Bay.

66. Other infrastructural projects under the MTEF include the upgrading of Walvis Bay Airport which will promote the export of our products especially fish, beef and grapes. Similarly, the Aus-Luderitz and Northern Railway projects will create the necessary linkage with regional and international markets.

67. The Kamanjab-Opuwo, Rundu-Siko-Nkurenkuru projects are the manifestation of the commitments of SWAPO Government to extend infrastructure into rural areas and open up those areas for development.

68. The Land Reform Programme will receive a boost through the implementation of the land tax. Additional funds have been made available under the MTEF to the Affirmative Action Loan Scheme and the Farm Labourers Housing Scheme.

Poverty Reduction

69. The key to reducing poverty is increasing employment and provision of skills. By expanding production, opportunities for jobs will be created and this will reduce poverty.

70. Similarly, the continuing priority afforded to education and the expansion of vocational training should enable more people to find work. In this area, the target remains to improve educational outputs and produce graduates that become job creators for themselves and others, rather than job seekers.

71. Lack of adequate shelter is another manifestation of poverty. The Government will continue with its successful "Build Together" Programme. The programme for low income groups implemented through NHE will also continue.

HIV/AIDS

72. The scourge of HIV/AIDS affects every sector of our society. Additional resources were made available last year through a special appropriation so that Anti-Retroviral programmes can be rolled out nation wide.

73. As a responsible employer, Government is keeping its commitment to ensure that Namibians infected by this dreadful disease have access to available treatment, so that they can continue to have a productive life.

Orphans and other Vulnerable Children

74. Currently, the government provides support to over 28 187 thousand orphans and vulnerable children through the Government social grants. The number of orphans and other vulnerable children (OVCs) covered by maintenance and foster care grants is being increased by over 70 percent. This will be complemented by a national census of OVCs to facilitate better planning and service delivery.

75. The additional resources are complemented by substantial inputs from a number of development partners. The Government is seeking to ensure that those funds are used according to its policies and practices, rather than inefficient alternative administrative arrangements.

Good Governance and Economic Empowerment

76. Corruption reduces social and economic development by diverting resources that could otherwise be used more effectively. Funds have been provided to launch the Anti-Corruption Commission that will work with the existing agencies (police, ombudsman, auditors etc) to help stamp out corruption.

77. The Government is committed to reducing inequality and empowering its previously disadvantaged citizens. To that end, it will continue with measures designed to facilitate better access to finance and financial services for entrepreneurs and to ensure that they have the advice they need. Government tendering procedures are being revised with a view to further improve the participation by SME's.

Efficiency and Effectiveness

78. However, improving results does not necessarily require increase in public expenditure. Alongside the additional monies that have been made available, there is a need to ensure that the nation's resources are spent wisely and that programmes continue to represent value for money. As H.E. the President has observed, improving effectiveness and efficiency are vital in the Public Service.

Medium Term Expenditure Framework

79. In 1996, Cabinet determined upon a radical path of reform for the Budget process. It wanted to move the current practice of Budget decision making towards the results being achieved, rather than organisational units and expenditure items. In 2001, the publication of the first Medium Term Expenditure Framework (MTEF), including the Performance and Effectiveness Management Programme (PEMP) frameworks, was highlighted by a major endorsement from the Founding President, declaring it "a crucial component in the development of our nation".

80. The MTEF is the key budget document that sets out Government's expenditure plans for the next three financial years. The projected revenue, the Government's fiscal stance and its debt management policies together determine the overall expenditure limits for the coming three years. Within these expenditure limits, resource allocations to Ministries and their respective programmes are then determined by expenditure policies and priorities. Each of the Ministries produces a Medium Term Plan (MTP) setting out the total resources allocated to each programme, the main activities to be undertaken and how those will help meet the Government's objectives. The MTEF provides the basis for greater transparency and accountability by demonstrating what the Government seeks to achieve and how.

81. The first MTEF, covering the period of 2001/02 – 2003/04, was introduced in 2001/02 with the aim of improving budget planning. At that time Government set itself strict fiscal targets. They foresee that the average deficit as share of GDP should not exceed 3 percent, that the debt ratio should not exceed 25 percent and expenditure should not exceed 30 percent of GDP.

82. Indicators from the first MTEF shows that government could not achieve the targets set for the deficit and debt as ratio to GDP. On average, deficit and debt stood at 4.8 percent and 27 percent, respectively. This came as a result of the additional expenditure in the first years of the MTEF and the effect of the exchange rates in the last year that affected the revenue outturn. Furthermore, the high expenditure on personnel and the narrow expansion in nominal GDP also had an effect.

83. With regard to the current MTEF, the challenge with these reforms is that they require the rethinking of the planning and budgeting process. Moving from input needs to impact on outcomes requires a complete change of mindset through all levels of Government. A big challenge within this MTEF is the move from line item to programme budgeting, which requires programmes, activities as well as ceilings to be fixed for a period of three years.

84. The main pieces necessary to make the transition to fully-fledged Programme Budgeting are now in place. Within that, ceilings for individual Ministries are set on the basis of Medium Term Plans setting out proposals for changes in programme expenditure. Those changes have to be justified in terms of expected outcomes.

85. The Government's overall expenditure policies, as set out in the MTEF, together with the priorities and programmes described in the MTP, also provide a basis upon which Development Partners can support the Government' objectives using the State Revenue Fund.

Fiscal Outturn for 2004/05 Financial Year

86. As earlier reported, the exchange rate developments had a negative influence on the fiscal situation. As a result of this, the budget deficit for 2003/2004 increased from 4% in the budget to 7.5% in spite of a decrease in expenditures. For 2004/2005, the appreciation of the Namibia Dollar persisted. In spite of that, the projected deficit shows a significant reduction down to 2.4%. This is mainly as a result of improved revenue collection and stricter expenditure control. However, this estimated deficit is still above the 1.6% provided for in the main Budget. This is due to the continued strength of the

Namibian Dollar and the increase in statutory expenditure to finance the deficit.

87. The Additional Appropriation of N$ 65 million to cover additional expenses for Medical Aid has also contributed to the increase. Total debt stock is projected to be N$11.9 billion for 2004/05 financial year.

88. The level of foreign guarantees as a percentage of GDP is on a downward trend. They have fallen from 7.1 to 6.3 percent during the years 2002/03 and 2003/04, and are estimated to record a further drop to 3.1 percent in 2004/05 financial year. This sharp decrease is mainly due to the full repayment of a loan for Air Namibia Boeing 747 Combi following the disposal of the Boeing late last year.

Honourable Speaker, Honourable Members of Parliament

89. I will now turn to the proposals of the 2005/06 to 2007/08 Medium Term Expenditure Framework.

90. The fiscal outlook for the 2005/06 to 2007/08 period points to a favourable fiscal development in that revenue estimates are projected to increase as compared to previous financial years. This increase is attributed to policy interventions that are to be implemented for the medium term. I will outline these later on. Expenditure in the medium term framework is projected to grow at a lower rate than revenue, reflecting the Government policy aimed to restrain public expenditure growth. This policy will also assist in containing the budget balance and public debt. However, the funding of priorities will not be compromised. Instead, Government expenditure will be restructured by shifting funds away from less important areas to priority issues.

91. Revenue over the next three years is estimated to total N$ 39.2 billion. The largest share of this will come from Tax Revenue. While SACU receipts, as a portion of total tax receipts, will decline from 34 percent in the past three years to 33 percent in the upcoming MTEF period, we expect significant increases in the proceeds from the income tax.

92. In the forthcoming years, total revenue collections from own sources are projected to be as follows:

- N$ 12.2 billion in 2005/06
- N$ 13.3 billion in 2006/07
- N$ 13.4 billion in 2007/08

93. In addition to that, for the next three years, a total amount of N$ 807 million in the form of grants is expected to come from our Development Partners. Of this amount, N$ 329 million will be channelled inside State Revenue Fund in a form of budgetary support and the rest will be outside State Revenue Fund. Votes to benefit from donor funds include Education, Health, Agriculture, Decentralization, Rural Roads, Tourism, Forestry, Finance and planning

94. Total expenditure for the next three years will amount to N$ 38.8 billion, and will be distributed over the next years as follows:

- In 2005/06 : N$ 12.8 billion
- In 2006/07 : N$ 13.0 billion
- In 2007/08 : N$ 13.0 billion

95. Honourable Speaker, Honourable Members of Parliament, in order to resource the recently created Office of the Minister for Presidential Affairs, I issued a special authorisation to the amount of N$1.2 million. This was issued in terms of Section 9 (1)(b)(ii) of the State Finance Act. In order to give effect to Section 9 (2), this amount forms part of the resources allocated to Vote 01 in the Appropriation Bill.

96. The funds allocated to the development budget total N$ 4.4 billion over the next three years, which is equivalent to 11.5 percent of total expenditure. This is N$1.3 billion more than what was allocated in the previous MTEF. In addition, N$841 million will be sourced from external loans over the MTEF period to finance capital programmes.

This is a demonstration of our emphasis towards strengthening resource allocation to development programmes.

97. The statutory expenditure is estimated to total N$ 3.5 billion, which is equivalent to 9 percent of total expenditure. This level of expenditure is, however, based on debt and deficit as proposed in the MTEF. Based on the MTEF projections, the proportion that goes to statutory expenditure will decrease from 3.1 percent at the end of 2004/2005 to 2.3 percent at the end of this MTEF period. This means that we can free up resources from debt servicing to financing development programmes.

98. In terms of the distribution by sectors, the largest share of total expenditure is foreseen for the social sectors, followed by the administrative sector. In detail, the sectors decomposition of expenditure over the next three years is:

- Social Sectors (32.4 percent)
- Administrative Sectors (21.0 percent)
- Public Safety sectors (16.3 percent)
- Economic Sectors (7 percent)
- Infrastructure sectors (3.0 percent)

99. The fiscal outturn for the next three years is expected to bring us closer to our fiscal targets. In particular, revenue is expected to exceed expenditure over the next three years. On average – we are expecting to have a budget surplus of 1 percent of GDP per year. While this financial year is expected to produce a deficit of 1.2 percent, expenditure restraint in the following financial years and an improved revenue outlook is expected to produce a budget surplus of 1.2 percent of GDP in 2006/2007 and 0.8 percent in 2007/2008.

100. Taking into account the above, the debt stock for Government in the three years to come is projected to be as follows:

At the end of 2005/06: 32.8 percent of GDP

At the end of 2006/07: 30.2 percent of GDP

At the end of 2007/08: 27.6 percent of GDP

Policies to achieve the fiscal targets

101. Within the fiscal stance outlined above, Government can free up additional resources through improvements in revenue collection, expenditure control measures and debt management.

102. The following revenue policies will be implemented during the medium term.

Tax Collection

103. The Ministry of Finance has initiated a series of forensic tax audits nationwide. Through these audits, the following will be achieved.

- Improved revenue collection;
- Improved compliance with tax legislation;
- Exposing possible irregularities for remedial action; and
- Strengthening of tax administration.

104. This initiative is being implemented through a public/private partnership programme between the Ministry of Finance and the private audit fraternity. The public is invited to forward information about any tax irregularities to the Ministry of Finance in order to help Government to collect what is due to it.

105. In order to further strengthen the Ministry's capacity to administer tax laws, a formal academic training programme has been introduced at UNAM to enhance the qualification of the tax administrators. The Ministry's' capacity building efforts will receive a further boost from the European Union through the Public Finance Management Programme.

106. Ring-fencing - According to the Income Tax Act, taxpayers can offset losses on farming and other activities against their salary income, resulting in refunds of PAYE to the taxpayer. This legislation has created room for abuses, and consequently lead to losses of revenue. Amendments will be introduced to the Income Tax Act to prohibit the offsetting of losses from certain activities against salary income. For now, these activities include rental of residential accommodations and rental of vehicles, among others.

107. Withholding tax on interest - Taxpayers are currently not declaring to the Receiver of Revenue the interest they derive from investments with financial institutions. In order to implement a withholding of tax by financial institutions on interest earned, the legislation will be amended. This measure will reduce the current practice of tax evasion in this field.

108. VAT refunds - It has also been noticed that abuse is currently taking place through claiming VAT refunds. Anti-abuse measures will be implemented through legislative amendments, in order to discourage taxpayers from claiming excessive refunds.

109. Luxury VAT Rate - A VAT rate of 30 percent was charged on luxury items until recently. This policy was changed in 2002, when the special Value Added Tax Rate for luxury items was abolished and a uniform VAT rate of 15 percent was introduced. This has resulted in a loss of revenue to the State and re-introducing a special VAT rate for luxury goods is envisaged.

110. Environmental tax has become common a feature in many tax systems worldwide. Principally, environmental taxes have two objectives, namely to introduce disincentives for activities that are harmful to the environment and secondly they generate revenue. An environmental tax will be introduced along these principles.

111. Unit Trusts have enjoyed an exemption from income tax for a number of years. In order to level the playing field, it is now considered necessary to subject it to tax. Consultations are ongoing with the industry to work out the required modalities and detail.

112. Transfer pricing, and thin capitalisation legislation has been passed by Parliament recently. When duly administered from this fiscal year on wards it would appropriately attack these artificial tax evasions.

113. Another component of income is non-tax revenue that is estimated to total N$2.8 billion over the MTEF. We have identify an urgent need to strengthen collection of non-tax revenue. The ministry of Finance will implement training for Financial Advisors in Ministries to improve the collection of Non Tax Revenue.

<u>Excise Duties</u>

Honourable Speaker, Honourable Members,

114. This year brings us to the second year of the phasing in of agreed tax burdens, as provided for in the new SACU Agreement. These increases are to the benefit of the SACU Revenue pool, and will be shared out to Member States in accordance with the agreed

Revenue Sharing Formula. The following nominal percentage increases in excise duties will therefore apply:

- Malt beer …………………………… 9.5%
- Traditional African beer ……………….. 0.0%
- Unfortified wine ………………….......... 20.0%
- Fortified wine …………………………… 13.0%
- Sparkling wine …………………………. 20.0%
- Ciders & alcoholic fruit beverages…… 9.4%
- Spirits …………………………………... 10.0%
- Cigarettes ……………………………… 11.5%
- Cigarette tobacco …………………........ 7.5%
- Pipe tobacco ………………………….. 11.6%
- Cigars …………………………………. 14.9%

Expenditure policies

115. The Ministry of Finance will embark upon various measures to curb overspending and unauthorized expenditure by Ministries. The following measures will help to achieve this aim:

- The requirement of keeping up to date commitment registers by all O/A/Ms will be strictly enforced.

- Measures will be put in place to ensure the proper functioning of financial controls in all Ministries. These will include: Clearance of Suspense Accounts, Balancing of Trade Accounts and Timeous closing of Accounts.
- The first steps to introduce proper financial control systems at Regional Council have been taken through a public/private partnership programme. These efforts must be further consolidated to ensure full compliance to the State Finance Act.
- A programme to clear the backlog in Government audit reports has been worked out by the Office of the Auditor General and additional resources have been allocated under MTEF to enable the Office to bring audited financial statements of Government up to date. We therefore foresee that we shall return to an integrated audit report for central Government soon.

116. The expenditure for the Public Service Medical Aid Scheme is likely to rise sharply if the current risk exposure is not addressed as a matter of urgency. As a starting point, the whole benefit structure will be reviewed. In addition, immediate steps are taken which include:

- Regular auditing of claims by medical service providers and providers of pharmaceutical products (medicines) coupled with prompt prosecution in the event of detected irregularities.

- Introduction of ceilings for some benefits.
- The commissioning of an actuarial impact analysis to determine the impact that HIV will have on the existing benefit structure.
- The commissioning of an actuarial prevalence analysis to determine PSEMAS' HIV prevalence rate.

Debt policies

117. The approval of the Sovereign Debt Management Strategy (SDMS) by Cabinet in 2005 represented a major step in Government's efforts to improve debt management. The overall objective of the SDMS is to ensure that the public debt remains affordable and sustainable.

118. For the management of the public debt portfolio, the Government foresees a set of Namibia specific benchmarks which identify risks and provide guidance for borrowing activities. Government's debt consists largely of domestic securities such as Treasury Bills and Government Bonds. Being aware of the roll over risks associated with short-term debt, Government has, over the past years, successfully decreased the share of debt that matures within 12 months. While at the beginning of the 2004/2005 financial year, the share of total debt maturing within 12 months stood at 59 percent, this ratio was brought down to 53 percent at the beginning of this financial year.

119. The successful redemption of GC05 bond on April 15th has further decreased the share of short-term liabilities to less than 44 percent. Moreover, the smooth redemption of the GC05 bond shows our responsible and foresighted approach to debt management. This success will boost investors' confidence in Government securities.

120. The new Debt management policy also provides the framework for a stricter handling of Government guarantees. Furthermore, a levy on loans and guarantees issued will be charged, thus encouraging responsible and efficient use of Government loans and guarantees.

121. Within its debt management operations, Government is committed to minimising the cost of borrowing.

Concluding Remarks

122. Honourable Speaker, Honourable Members of this August House, in my concluding remarks, I would like to reiterate that a prudent fiscal position, comprising of low budget deficits and low levels of public debt, promotes economic growth which is essential for reducing poverty and improving social outcomes.

123. I wish to thank the Honourable Members of Cabinet for their support and understanding during the Budget Development process. It is clear that the going would be tough, but I am confident that as a people centred Government, we have succeeded to allocate our resources, limited as they may be, for the development and benefit of all our people. I appeal for your solid support.

124. It is of course easy to forget the nameless faces who give momentum to the tasks we perform. I want to recognise the hard work of the officials of my Ministry and our colleagues at the National Planning Commission and indeed all Ministries officials who made it possible for me to finalise this Budget. I thank them for their hard work.

125. Lastly, but by no means the least, I wish to express my sincere appreciations to His Excellency the President for his support and for the trust he has shown in me.

126. It is now my pleasure to table the Appropriation Bill for 2005/06 and the MTEF for financial years 2006/07 to 2007/08 before this August House for its consideration and approval.

I Thank You.