Institute for Public Policy Research

14 Nachtigal Street PO Box 86058 Eros Windhoek Namibia Tel: +264 61 240514/5 Fax: +264 61 240516 info@ippr.org.na www.ippr.org.na

IPPR Opinion No. 17, May 2005

National Budget 2005/06: The Continuity Candidate's Budget

Robin Sherbourne

In the first budget of the new government, Finance Minister Saara Kuugongelwa-Amadhila deserves credit for trying to rein in public spending and borrowing after the budget deficit threatened to run out of control in 2003/04. Optimistically she forecasts a budget surplus by next year but there is little to suggest she will achieve that by squeezing spending which remains stubbornly stuck at 35% of GDP. No one can accuse the Minister of economic populism. This budget contains cuts in spending on combating crime, primary education and health care and no increase in the social pension – government programmes that directly touch the lives of the majority. Allocations to higher education and vocational training remain virtually unchanged despite the new Prime Minister's wish to create a "knowledge economy". Instead defence once again comes out the big winner. Namibia now spends more of its budget on security than on health.

It is said that the secret of being a successful minister of finance is to leave at the right time. It seems to have been good timing on the part of Nangolo Mbumba to leave his post as Namibia's Minister of Finance in a year when the budget deficit rocketed to an unprecedented 7.5% of Gross Domestic Product (GDP) in 2003/04. His successor Saara Kuugongelwa-Amadhila has been left to pick up the pieces. Those who thought she might not have the bottle to make her mark have to recognise that she has already gone down as the first minister of finance to abandon the practice of doling out cash half way through the financial year when she took the bold step of cancelling the traditional additional round of spending last December. It looks as if she intends to carry on reining in spending and debt. Spending is set to rise by just a third of a percent this year.

A weighty budget

This year's budget was accompanied by even thicker documentation than last year. The Medium Term Expenditure Framework (MTEF) document continues to grow by the year. For outsiders it is hard to say what difference the MTEF is making to the budget process or budget outcomes. In her speech the Minister found plenty of time to talk about Namibia's financial sector, lambaste the private sector, and wave the threat of new taxes about, but spent virtually no time at all explaining to the public why spending allocations are the way they are and how the MTEF has achieved this.

In the past the IPPR has expressed scepticism about the fiscal targets introduced by the previous minister of finance in 2001. Missing fiscal targets is regularly explained away to everyone's satisfaction by the Minister of Finance so it is hard to believe line ministers will not present similarly plausible reasons why they failed to achieve particular outcomes, even if they can be and are in fact measured. Despite this scepticism, it is worth taking a look at the overall fiscal stance presented in the MTEF for clues on the future direction of fiscal policy.

This is now the fifth successive year that the Minister of Finance has presented a three-year perspective on revenue, spending and the deficit, which is called the Medium Term Expenditure Framework or MTEF. Table 1 presents an updated version of the comparison of these five three-year perspectives presented in last year's IPPR opinion piece. It includes actual out-turns for 2001/02, 2002/03, 2003/04 as well as revised budget estimates for 2004/05 in the shaded boxes. The following points are worth noting:

- Actual revenues look to be higher than revenues forecast in the MTEFs with the exception of 2003/04, which looks like turning out to be the year with the poorest revenue performance since independence.

- Actual expenditures again look to be higher than expenditures forecast in the MTEFs.

- Actual budget deficits look to be higher than forecast for 2001/02, lower than forecast for 2002/03, far higher than forecast for 2003/04 and higher for the latest MTEF for 2004/05.

- The latest four MTEFs (2002/03-2005/06) have all forecast declining revenue, expenditure and deficit but there is no sign that this is taking place. In spite of introducing a spending target of 30% of GDP in November 2001 spending remains at or above 35% of GDP.

Table 1: Medium Term Expenditure Framework Projections 2001/02-2007/08 in % of GDP

	01/02	***02/03***	***03/04***	***04/05***	***05/06***	***06/07***	***07/08***
MTEF 2001/02							
Revenue	31.3%	31.0%	31.4%				
Expenditure	34.9%	33.9%	34.3%				
Deficit	3.6%	2.9%	2.9%				
MTEF 2002/03							
Revenue		30.1%	28.1%	26.5%			
Expenditure		34.5%	31.1%	29.0%			
Deficit		4.4%	3.0%	2.5%			
MTEF 2003/04							
Revenue			30.4%	28.3%	26.7%		
Expenditure			33.4%	31.6%	29.7%		
Deficit			3.0%	3.3%	3.0%		
MTEF 2004/05							
Revenue				32.3%	28.3%	27.3%	
Expenditure				33.8%	29.6%	28.3%	
Deficit				1.6%	1.4%	1.0%	
MTEF 2005/06							
Revenue					31.7%	31.6%	28.6%
Expenditure					32.9%	30.4%	27.7%
Deficit					1.2%	(1.2%)	(0.8%)
Revenue	31.8%	33.3%	29.6%	33.2%			
Expenditure	36.0%	35.9%	37.1%	35.6%			
Deficit	4.2%	2.6%	7.5%	2.4%			

Source: MTEF documents 2001/02-2005/06, Ministry of Finance
Note: Shaded areas denote latest available estimates as opposed to MTEF projections

The budget deficits for the next three financial years announced by Minister Kuugongelwa-Amadhila are the lowest forecast deficits since the MTEF began. Indeed, the Minister is now forecasting budget surpluses, albeit only from next year onwards. In doing this, the Minister has set herself even more demanding targets than her predecessor. Setting targets is a useful exercise if a serious attempt is made to meet them. If not, all that happens is that credibility is lost. While it can reasonably be claimed that the Ministry has less than perfect control over revenues, it is not unreasonable to argue that, in theory at least, it has far more control over expenditure. Because the deficit is the difference between revenue and expenditure and revenue is uncertain, the Ministry can again reasonably claim that the deficit is also harder to forecast with any degree of accuracy. However, the very clear pattern emerging is that, while the Minister and her predecessor have consistently presented a picture of declining expenditure as a proportion of GDP, spending shows no sign of falling and remains stubbornly at or above the 35% of GDP mark, in other words 5% above the target. Given this record, it is hard to believe public spending will fall by more than 5% of GDP between the 2004/05 and 2006/07 financial years, especially if revenues hold up. These forecasts become rather less believable when it is remembered that government's own target is 30%, raising the question as to why government is targeting lower spending in the MTEF.

Table 2 shows how government measures up to the fiscal targets it set itself during 2001. It shows the latest available estimates for each target at the end of 2003/04. The stock of public debt excludes government loan guarantees, which, according to the Minister, has already declined to 6.8% of GDP in 2004/05 from a high of 11.8% of GDP in 2001/02.

Table 2: Government's fiscal targets as % of GDP

	Target	***Latest estimate (2004/05)***
Public expenditure	30%	35.6%
Budget deficit	3%	2.4%
Stock of public debt*	25%	33.5%

*excludes government loan guarantees estimated at 6.8% of GDP in MTEF 2005/06-2007/08

Revenue highlights…

For some years now ministers of finance have talked about the need to improve revenue collection, tax compliance and tax administration and this budget is no different. In her speech, the Minister talked rather vaguely about tax "ring-fencing" mentioning in particular that taxpayers were offsetting losses from farming against salary income but stopped short of promising to end this practice. She promised to introduce withholding tax on interest from investments, stop abuse of VAT refunds, reintroduce the luxury 30% VAT rat on luxury items (which was abolished only in 2002), introduce "environmental taxes", get rid of the tax exemption on unit trusts, tackle transfer pricing and focus on raising non-tax revenue. She also raised excise duties on alcoholic drinks and tobacco. As in the past, the threat to introduce "environmental taxes" without giving any idea of what these might be is only likely to cause uncertainty and raise questions among business and investors. There appears to be little evidence from the revenue estimates presented that their introduction is imminent.

The following paragraphs examine revenue highlights contained in the main budget document. Worryingly, the budget document contains serious mistakes in the increase/decrease columns which compare this year's estimates with last year's.

In stark contrast to last year's budget in which individual income tax receipts were estimated to fall in an environment of relatively robust GDP growth, this year the Minister is forecasting an astonishing increase in revenue approaching 25%. However, it is certainly open to question how realistic this is and once again raises doubt about the ministry's ability to accurately forecast revenue.

While corporate tax revenue from the mining sector is set to come in under last year's rather poor performance, non-mining corporate tax revenue is estimated at N$1,062 million. Just five years ago non-mining corporate tax revenue totalled less than half of this figure at N$464.9 million which seems to suggest an astonishing increase in tax collections has taken place. Equally encouraging for government is that Non-Resident Shareholders Tax is set to more than double this year from N$36 million to N$87.9 million.

Receipts from the Southern African Customs Union (SACU) revenue pool are forecast to drop steeply from N$4.2 billion to N$3.7 billion. While the MTEF suggests SACU revenues are set to rise again next year, the following year (2007/08) sees another steep fall.

Out of the 50 or so parastatal companies that now exist, six provide just under N$33 million in dividend revenue this year. It is, however, questionable to what extent state-owned monopolies should be required to raise revenue for central government in this way. Namibia Post and Telecommunications is expected to generate N$15 million for the fiscus in 2005/06.

Diamond royalties are expected to fall by more than half this year from N$500 million to N$242 million. This is surprising since diamond production from Namdeb is expected to increase significantly, diamond prices are rising and the exchange rate is not expected to deviate dramatically from its value over the last financial year.

Government claims that it is revenue constrained so it is not surprising that, at first sight, the Minister has made an effort to raise more revenue from administrative fees and charges which rises from N$372.3 million to N$397.9 million. However, much of this can be put down to a mysterious "miscellaneous" revenue item under Vote 08 Defence of N$121.8 million. There appears to be no revenue stream under Vote 15 Mines and Energy where government is known to have required non-diamond mining companies to pay a 4% or 5% turnover tax from 1 December 2004. The Minister made no mention of this major tax change in her speech. Nor does additional revenue appear under Vote 25 Lands and Resettlement where the Minister announced the land tax would raise further resources for land reform. Park entrance fees under Vote 18 Environment and Tourism is estimated at N$15 million compared to last year's N$18 million which represented a quantum leap on the previous year's N$2.4 million. The sale of government houses under Vote 23 Works appears to have been put on hold with no revenue expected this year compared to the N$72 million in 2004/05.

The European Union (EU) and the Swedish International Development Agency (SIDA) expect to put a total of N$153.2 million through this year's budget to support education, public finance management, rural water and rural roads.

All in all total revenue is expected to rise by just 2% with tax revenues rising by over 4% and non-tax revenues falling by 25%. Clearly, more could be done to raise revenue by concentrating on non-tax revenue.

Expenditure highlights by vote…

The following paragraphs highlight what we believe to be the issues of greatest importance in each of the expenditure votes contained in the budget document. Following the inauguration of the new government on 21 March 2005 several ministries and votes were reorganised so care must be taken comparing this year's with last year's budget. Furthermore, an even larger MTEF document was presented with this year's budget. However, it is hard to know how the numbers presented in the MTEF document should be regarded since they differ with those presented in the main budget document. Certainly some of the new information, such as a selection of parastatal financial statements, is a welcome addition to the budget information presented even if it is slightly half-hearted and not explained. In other ways the MTEF confuses rather than clarifies. For instance, the Special Field Force, surely a major expenditure programme, is not mentioned in any of the programmes that fall under Vote 06.

Vote 01 Office of the President

For some years now, the largest single item of expenditure under Vote 01 has been the new state house under Main Division 02. This year is no different. The MTEF document states that the building is the number one priority under a programme called "Protection and defence of the constitution" putting expenditure at N$90 million while the budget document puts the same figure at N$100 million.

A new Main Division 03 Office of the Founding President has been created and receives N$5.7 million. This compares with N$2.5 million for the new Anti-Corruption Commission (Vote 02 Main Division 02) and N$4.6 million for the Office of the Ombudsman (Vote 16 Main Division 06)

Nowhere in the MTEF document is national intelligence mentioned as a priority yet spending on intelligence is set to rise from N$56.2 million this year to N$93.0 million by 2007/08, almost half the total spending on the entire vote. The budget document puts spending on the National Intelligence Security Agency this year at an almost unchanged N$46.2 million.

The President's Economic Advisory Council moves to Vote 01 and receives N$0.9 million including the now traditional amount for furniture although it is expected to be slimmed down to "four wise men".

Vote 02 Office of the Prime Minister

Main Division 02 has been renamed and is now called Governance of State-Owned Enterprises, Anti-Corruption and Disaster Management. It includes N$8.8 million for the Central Governance Agency, N$2.5 million for the Anti-Corruption Commission and N$150,000 for the National Emergency Disaster Fund so hopefully any disasters this year will be small ones. The Office of the Deputy Prime Minister mysteriously disappears.

Vote 03 National Assembly

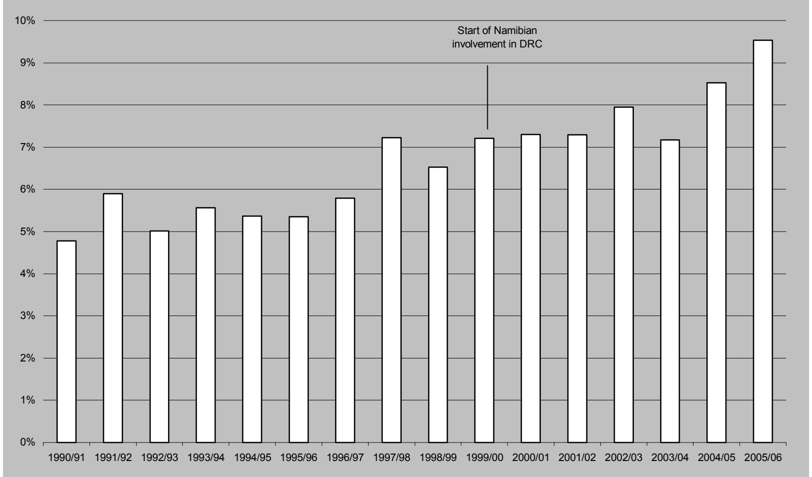
Assistance to political parties again falls slightly from N$15.9 million to N$15.4 million. Library and Computer Services (Main Division 03) receives a healthy increase in its allocation.

Vote 06 Police

The allocation to Main Division 02 Combating of Crime is cut from N$361.6 million to N$328.5 million, mainly because last year saw a large allocation for the purchase of vehicles. However, the longer-term outlook is bleak with spending set to fall to N$297.7 million by 2007/08. The spending on the Special Field Force (SFF) increases from N$267.4 million to N$279.9 million this year while VIP Security increases from N$34.6 million to N$38.6 million. A total of 1,078 police constables are employed guarding VIPs compared to 2,288 who are out combatting crime while a further 5,580 are employed in the SFF. Main Division 07 Control of Road Traffic has been discontinued under Vote 06.

Vote 08 Defence

Chart 1: Defence Affairs and Services
by functional/economic classification as a % of total spending



Source: Budget documents 1991/92-2005/06

Yet again Vote 08 has come away as the big winner in this year's budget. In total Vote 08 received N$132.6 million more this year. The army (Main Division 04) gets the lion's share of this increase, receiving N$167.7 million for "construction, renovation and improvement". As Chart 1 demonstrates, the ever greater emphasis on defence spending is one of the few clear expenditure trends since independence. The proportion of public spending devoted to defence, excluding national intelligence and the SFF has doubled since independence and now takes up 9.5% of total spending. If national intelligence and the SFF are included this rises to 12%.

Vote 09 Finance

A much higher N$64.6 million under Main Division 07 is allocated for pensions to members of the National Assembly this year compared to N$16 million last year. The contingency provision of N$150 million under

Main Division 10 is maintained into 2005/06. Air Namibia receives a further N$116 million as “equity participation” under Main Division 12 while the Development Bank of Namibia receives a further N$91.5 million. The Minister states that “reform efforts at Air Namibia are generating positive results” but the financial statement presented in the MTEF shows operating losses actually rose to N$163.1 million in 2004. Statutory payments made under Main Division 14 fall slightly from N$1,176 million to N$1,147 million partly due to a fall in the payment of loan guarantees.

Vote 10 Education

The new unified Ministry of Education brings together parts of the previous Ministry of Basic Education, Sport and Culture and the Ministry of Higher Education, Training and Employment Creation and this has given rise to the reorganisation of main divisions under this vote. Yet again spending on primary education falls, this time from N$1,203 million to N$1,132 million while spending on secondary education rises from N$502.9 million to N$552.6 million thanks mainly to a N$55 million injection of donor funds for classrooms under “construction, renovation and improvement”. Unam and the Polytechnic receive approximately what they received in 2004/05 with the former continuing to receive more than twice what the latter receives. Vocational Training under Main Division 10 remains almost unchanged with N$550,000 continuing to be allocated to training for Ramatex. It looks as if education’s days as the favoured sector is numbered. The MTEF foresees nominal spending remaining pretty much constant over the next three years.

Vote 12 Gender Equality and Child Welfare

The total allocation to maintenance grants and foster parent allowances under Main Division 06 rises dramatically from N$53.3 million to N$89.7 million.

Vote 13 Health, Social Services and Rehabilitation

The allocation to primary health care under Main Division 05 falls slightly from N$19.2 million to N$18.6 million. Spending on the social pension rises from N$462.5 million to N$474.1 million although the monthly value of the pension remains at N$300 a month.

Vote 14 Labour and Social Welfare

There appears to be some confusion since social pensions are now included under Vote 14 in Main Division 06 Social Assistance as well as under Vote 13. In the former a total of N$455.1 million is allocated to social pensions and N$14.0 million to war veterans compared to N$474.1 million and N$15.4 million respectively under Vote 13.

Vote 18 Environment and Tourism

The Namibia Tourism Board (NTB) is allocated N$21.3 million under Main Division 05, an increase on last year’s allocation despite the introduction of the tourism levy, which was to be the NTB’s main source of income.

Vote 19 Trade and Industry

Industrial incentives stay at N$2.5 million and training reimbursements for Export Processing Zones (EPZs) rise marginally to N$2.6 million.

Vote 20 Agriculture, Water and Forestry

Forestry moves from Vote 18 to Vote 20. While the amount allocated to Affirmative Action Loan (AAL) Scheme interest rate subsidies is almost halved from N$26.2 million to N$15.4 million, an additional N$37.5 million is allocated to arrears on AALs under Main Division 07. The Namibian ostrich industry receives a hefty N$11.8 million compared to N$6.3 million last year.

Vote 25 Lands and Resettlement

This year a further N$50 million is allocated for land purchases under the National Resettlement Policy. Budgeted amounts will be paid into the Land Acquisition and Development Fund where they will remain if unspent at the end of the financial year. The budget document shows that in 2003/04 only N$3.9 million was actually spent out of the budgeted N$50 million. The Minister once again promised that the land tax would start to be collected this year which should add to the resources available for purchasing land for redistribution.

Vote 29 Information and Broadcasting

NBC sees its subsidy slashed from N$81.7 million to N$59.3 million while Nampa and New Era also see their subsidies reduced but not eliminated despite supposed commercialisation. A total of N$53 million is allocated to the Film and Video Development Fund compared to N$10.3 million last year.

The continuity candidate’s budget

As far as the broad fiscal framework is concerned, this year’s budget follows in the footsteps of the Minister’s last budget and her statement to parliament on 1 December when she cancelled additional rounds of spending for the 2004/05 financial year. Her overall strategy seems to be to try to restrain spending and squeeze more tax revenue out of the economy without resorting to headline grabbing rises in income or personal tax rates in order to balance the budget. However, the reason for pursuing this course of action appears to be an ongoing fear that revenues are set to decline as a proportion of GDP (mainly because of falls in SACU receipts) rendering current levels of spending unsustainable. The medium-term view is that revenues are set to decline to well under 30% of GDP. The strategy does not seem to be founded on the view that government is taking far too big a tax take from the economy and that this is hampering growth. While it could be argued that the outcome is the same, the belief that underlies the strategy will make a difference. If spending is to be cut simply because revenues are lacking, spending is unlikely to fall from 35% of GDP if current levels of revenue are sustained. In short, government will continue to spend provided the money is available. This is in fact what has occurred since 2001/02.

For some years, the IPPR has stressed that the real challenge to the Minister is on the spending side of the budget, getting more effective public services for the vast amounts of money spent. Spending seems stubbornly stuck at above 35% of GDP despite government’s stated intention to bring it down to 30%. In her speech, the Minister talked about restructuring spending but there is precious little evidence of this happening. So far the much mentioned Performance and Effectiveness Management Programme (PEMP) appears to have made little difference to allocations. Instead, there are plenty of examples of past trends continuing, especially of spending on what can only be regarded as economically unproductive activities while programmes that directly help to improve the majority of people’s lives receive less. If this continues the massive resources taken out of the economy by government will continue to be spent in ways that will not lead to long-term growth.