



**A Critical Analysis of Namibia
FY2013/14 National Budget**

Introduction

“Resource distribution among programs is perhaps the least technical part of the budget process. With the exception of investment projects, spending decisions are rarely based on technical principles or on detailed work to determine the population’s preference. The allocation of funds results from a series of forces that converge at different points of the decision-making process, with an arbitrator who ruled according to an imperfect perception of present and future political realities”.

- Romeo E. Petrei

Norm

The budget should be a financial mirror of society's economic and social choices. In order to perform the roles assigned to it by its people, the state needs, among other things, to: (i) collect resources from the economy, in sufficient and appropriate manner; and (ii) allocate and use those resources responsively, efficiently and effectively.

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Glance

- Size of the budget is N\$47.6.2 billion against N\$37.7 billion last year or some 26.3% increase
- Against a this total outlay, the budget forecasts total revenue at N\$40.1 billion, leaving a fiscal deficit of N\$7.4 billion which is 6.4% of the gross domestic product (GDP). It will be met through Cash Reserves of N\$4.0 billion, net external financing of N\$678 million, domestic borrowing of N\$3.4 billion.
- Coming to the Revenue side, realistically speaking, though unfortunately, the taxes to be collected are heavily skewed towards SACU N\$14.7 billion.

Key Themes

- **“Growing the economy Optimizing Development Outcomes”**
 - *with tax cuts and salary increases!*
- **“Gradual withdrawal of significant fiscal expansion”**
- **“Doing more with less”:**
- **“Fiscal Sustainability”:**



2

Macro Assumptions

Macroeconomics Assumptions

How much more can policy aggression be?

GDP Growth & Inflation

- The macro picture does not give compelling reason for the fiscal expansion. GDP growth is above trend, inflation is below trend, interest rates are lowest.
- All in all the macroeconomic assumptions are realistic. The growth prospects gives a reassuring view of the future of Namibia's public finances than last year's budget with nominal spending capped over the coming three years, progressively smaller deficits and lower overall debt.



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Fiscal Stance

A fiscal stimulus or is it?

On the look of things, the budget is pleasing to the general public as it contains handouts in the form of income tax rate cuts for individuals and corporates, while spending (both consumption and investment) is increased. In this sense the budget expands (increases) domestic demand. However, whether or the budget will stimulate job creation is a different question all together.

The ideal fiscal weapon against downturns is the so-called “built-in fiscal stabilizers” given their endogenous reaction to cyclical weakness, and since they seem to meet the “t-t-t-test”. They kick in when needed (are “timely”), primarily support those affected by the downturn (e.g., through the operation of unemployment benefits—hence are “targeted”), and fade away when recovery sets in (are “temporary”). However Namibia’s fiscal system does not have these “built-in fiscal stabilizers”. Against this, discretionary measures to support demand is the only choice. However discretionary measures are known to come too late in the cycle, and at times may not be really targeted well enough to have the desired effects, and could boost Government debt to worryingly high levels if they are not taken back in better times. In this respect, we assess the likely impact of the discretionary measures contained in the FY13/14 national budget.

How appropriate is the fiscal stance?

- Fiscal policy is instrumental in nature. As a central instrument of policy, it must pursue all three overall economic policy goals. Financial stability which calls, among other things, for fiscal discipline; economic growth and equity which are pursued partly through allocation of public money to the various sectors; and, most obviously, all three goals require efficient and effective use of resources in practice. Hence, the three goals of overall policy translate into three key objectives of good public expenditure management: fiscal discipline (expenditure control); allocation of resources consistent with policy priorities (“strategic” allocation); and good operational management. In turn, good operational management calls for both efficiency (minimizing cost per unit of output) and effectiveness (achieving the outcome for which the output is intended)

Consumption Spending

Among the discretionary measures taken by the Government, increasing consumption spending is probably the least appropriate for a pro-cyclical fiscal stimulus to demand.

Government consumption consists of compensation to civil servants and purchases of goods and services. Hiring more civil servants or raising wages for existing ones would boost current Government spending and may have positive multiplier effects in the short-term. However, these measures could hardly be reversed in an downturn if done in an upturn.

Alternatively, purchases of goods and services could be increased temporarily. But assuming that spending on these items reflects private demand for Government services

provided by civil servants, there would be no direct economic benefit from an increase in purchases (though indirect effects may be positive as suppliers to the Government would benefit).

“Development Expenditures”

- Moreover, apart from follow-up costs for the future maintenance of capital, it would raise Government spending only temporarily. There are, however, two drawbacks associated with this measure: firstly, with hindsight, the share of Government fixed investment in GDP is rather modest, averaging around 3.4% of GDP from 2000 to 2007. Hence, it is unclear whether enough sensible projects can be found quickly to fill a spending package in the amount of several percent of GDP, although quite frankly the FY09/10 national budget indicates this is not really a problem. Secondly, and perhaps more serious is the fact that it often takes a long time for planned infrastructure investment spending to be disbursed. Both points suggest that investment is best suited for a follow-up measure to an earlier alternative fiscal impulse rather than as the jump-starter.

Transfers to state owned enterprises

- *Transfers to state owned enterprises* remains high, albeit they are discretionary and can be (at least theoretically speaking) reversed. Nonetheless, for the purpose of inducing demand, transfers to our cash-strapped state owned enterprises would be very effective as they are unlikely to save any Government transfer. However, while transfers to distressed businesses would be spent and hence could boost demand, the price of such action could be the preservation of unviable economic structures. Hence, Government transfers to companies in difficulties ought to be given on the grounds of facilitating structural adjustment rather than on supporting aggregate demand.

Tax Cuts for Individuals

- The range of measures that were chosen on the tax side which include a cut in personal income taxes, corporate taxes, and transfer duties are all equally interesting. Our views on the efficacy of these measures as tools for counter-cyclical fiscal policy are as follows.
- Income tax cuts are broadly equivalent to the transfers to households. In much the same way as transfers, permanent or temporary income tax cuts would raise demand for pay cheque-to-pay cheque households. By contrast, either form of cut would be neutral for wealthy households who save in anticipation of higher taxes or lower spending in the future. When households are not credit-constrained, a permanent tax cut may raise demand but temporary cuts would probably have little effect. From this, it follows that temporary income tax cuts targeted at credit-constrained household are probably the most effective counter-cyclical direct tax changes. For the proposed income tax cuts, we tend to believe they would favour the pay cheque-to-pay cheque households, and unlike the 09/10 tax cuts, the current proposals are significant to make a difference on demand growth.

Non-Mining Corporate Tax Cuts

- **The Cut in Corporate tax rate by 1.0%** for this year and the next perhaps constitute the biggest tax concession in the budget, representing a positive move albeit perhaps too small especially when viewed on a comparative basis (compared to neighbours). In our view, a cut in company taxes would raise profits, but without recovery around the corner (as it is driven by exogenous factors), this would probably induce an increase in retained earnings rather than investment and employment, and hence may fail to exert employment effects anticipated.

How do we know the stimulus will work?

- Theoretically speaking, the multiplier effect from Government spending would be larger than the tax multiplier, simply because some of the tax cuts could be saved especially the cut in corporate tax rate, and hence would not spin the spending wheel as anticipated. This leaves Government transfers to households and state owned enterprises together with the increase in Government consumption spending. However, although these discretionary measures are of a recurring nature, and hence are not entirely in line with responsible budgeting. In fact, given the uncertainty surrounding the future of receipts from the SACU pool, we foresee these measures creating a budgetary dilemma.
- To the extent citizens understand the dynamics of the economy, an increase in the Government's budget deficit caused by discretionary measures, could give rise to concerns about future tax increases (Government spending is perceived to be permanent) to bring deficits down again, and hence induce an increase in private sector savings.

The timing and sustainability of fiscal policy measures may not be clearly thought through.

- Ideally, fiscal policy support for domestic demand should be implemented in a timely way, phased out as soon as self-sustaining growth has been restored, and reversed when the economy is on its way to overheating. The phasing out of a fiscal stimulus would most likely pose a serious dilemma. Our view is that the debt overhang is still a big risk factor for sustainable global growth. If this takes several years, fiscal policy may swing between concerns about demand growth and the explosion of public debt. To prevent the Government debt-to-GDP ratio increasing without increasing the inflation rate, the Government will either hope that GDP growth will be above potential (to close the cyclical deficit), or introduce a negative fiscal impulse (to close the structural deficit), something we believe is politically difficult to do. The risk is that fiscal policy is torn between stimulating demand and maintaining Government solvency. This has been Japan's dilemma since 1991. The not very successful efforts to stimulate demand eventually boosted debt to 171% of GDP by 2007 from 64.1% in 1991.

Some concluding thoughts

- The 2013/14 budget is favorable for the working class, as it delivers for the both salary increases and tax cuts. This by itself is a good thing but it also bad when judged from the lenses of equity. Except for the youth who might benefit through the education and youth credit schemes, the budget overs little for the vulnerable, at least in relative terms. Appropriately, it has not been termed “pro-poor”.
- Viewed with macroeconomics lenses, the fiscal stance is “pro-cyclical” as opposed to “counter-cyclical”. As such it is bad for fiscal stability as it exhibits lack of fiscal discipline (expenditure control) and consequently compromises the country’s fiscal stance. Lack of commitment to fiscal consolidation and
- Stimulus to due tax stimulus can be withdrawn in future, at least in theory! Although not targeted at stimulating domestic production and hence may not be the best option for job creation.

Questions and Discussions