Namibian Mid-Term Budget Review 2017/18 – 2019/20

Analysis of the Namibian Mid-Year Budget Review that was tabled in the National Assembly on 2 November 2017
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“...measures to improve the productive capacity of the economy as well as economic diversification are critical for Namibia to bolster resilience.”

Minister of Finance, Mid-Year Budget Review, November 2017
Background

Introduction

The Minister’s mid-year policy stance is focused on achieving three mutually reinforcing objectives of:

- entrench fiscal sustainability through a balanced fiscal consolidation program;
- providing fiscal policy support to the fledgling economic growth; and
- contributing to the achievement of socio-economic objectives set out in the Harambee Prosperity Plan and Vision 2030.

The focus on achieving fiscal consolidation while supporting growth and achieving long-term socio-economic objectives is a fine balancing act.

The projected budget deficit for 2017/18 has been revised by N$4.04bn to N$9.4bn, increasing the budget deficit as a percentage of GDP from 3.6% to 5.3%. The increase is attributed to outstanding invoices emanating from 2016/17, amounting to N$2.2bn and an additional N$2.4bn in allocation to various offices, ministries and agency of which N$1.6bn is earmarked for education.

Following two contractionary mid-term budgets and one contractionary annual budget, this is the first expansionary budget since early 2016, which is testimony to the Minister’s “support to fledgling economic growth”.

Consideration of the growing debt to GDP ratio and the recent Moody’s downgrade, this expansionary budget raises concerns as to the credibility of Government’s fiscal consolidation agenda, and as a result, fiscal sustainability over the long-term.

“.....trade balance has improved and Current Account deficit has narrowed from 14.1 percent of GDP in 2016 to an estimated 5.8 percent of GDP by September 2017”

Minister of Finance, Mid-Year Budget Review, November 2017
In the mid-term budget speech, the Minister announced an increase in revenue expectations for the current, 2017/18 financial year of approximately N$300 million, however noted the expectation for reduced revenues, relative to previous forecasts, in the 2018/19 (N$575 million reduction) and 2019/20 (N$1015 million reduction) financial years.
Revenue outturn – 2015/2016 and 2016/2017

Some contributing factors to the changes in the revenue breakdown in 2015/2016 and 2016/2017, are:

- Increase in individual taxes was primarily driven by increases in salaries at rates above inflation.
- The decrease in company taxes is mainly due to a decrease in commodity prices. However, there has been an 11% increase in taxes collected from non-mining companies.
- Increases in withholding tax on interest can be attributed to the fact that only two months’ worth of collections took place in 2015/2016, in comparison to the full 12 months in 2016/17 – due to the withholding tax on interest becoming effective on the 31st December 2015.
- The 44% increase in other taxes on income and profits, including NRST, tax on royalties and the annual levy on gambling income, is attributable to the introduction of a 10% royalty on rental payments on foreign assets, as well as an increase in dividends declared to foreign shareholders.
- The Minister announced a significant downward adjustment on VAT of 12.9% for the year. The performance in VAT receipts is evidence of the weakness in the overall economy.
- The shortfall on VAT is, however, offset by better than expected individual income tax, improved fuel levies collections and the introduction of export and environmental levies.
- The decrease in SACU revenue is mostly related to a repayment of receipts of previous years.

Revenue forecasts – 2016/2017 and 2017/2018

Some contributing factors to the changes in the revenue breakdown in 2016/2017 and 2017/2018, are:

- The increase in individual taxes is expected to be driven by increases in salaries at rates above inflation, however this may be tempered by lower employment levels in the country.
- Company taxes are expected to increase in nominal terms, but contract in real terms, largely due to adverse economic conditions.
- Strong increases in diamond taxes are likely to be driven by increased diamond output, however this may be tempered by recent capex outlays.
- SACU revenues will increase in 2017/18 when compared to the prior year, largely due to base effects following the previous year’s N$3.5 billion SACU repayment.
“Revenue collection is expected to be in line with budget expectations, with a moderate over performance of about N$300 million expected due to ongoing Tax Arrear Recovery Incentive Program and the elasticity of some revenue streams.”

Minister of Finance, Mid-Year Budget Review, November 2017
Expenditure

Overall, expenditure has been adjusted upward by just over N$4 billion in the current financial year, from N$62.5 billion to N$66.5 billion, an increase of 6.5%. Internal savings of approximately N$600 million were realized and reallocated, meaning that the additional expenditure plus reallocation totals approximately N$4.6 billion. Of this, N$2.4 billion has been allocated towards the additional budget, and the remaining N$2.2 billion has been utilized to settle outstanding invoices from the previous financial year. The social sector takes 48% of the revised allocation, while 21% goes to public safety, 14% to the economic sector, and 8% each to the administrative and infrastructure sectors.

According to the speech, the operational budget execution rate stood at 51% in the first six months of the fiscal year, however the execution rate of the development budget was significantly lower, at 34%. The ratio of operational to development expenditure is illustrative of government’s priorities and fiscal consolidation comes at the expense of the developmental projects.

In February the development budget for 2017/18 was revised down from N$10.9bn to N$6.7bn. Despite this reduction, execution remains low, thus funds being deployed to capital projects have seen a sharp reduction when compared to previous years.
Downward revisions in non-essential spending items amount to N$121 million and N$365 million in the operational and development budgets, respectively, meaning that 75% of the internal savings come from the development budget. The development budget saw a net decrease of 5%, whereas the operational budget saw a net increase of 9%. Whereas reallocation and additional allocations were made to the operational budget, no additional allocations were made to the development budget.

Budgets of seven Votes were not revised, namely the National Assembly, Auditor General, National Planning Commission, Anti-Corruption Commission, Veterans Affairs, Public Enterprises, and the Attorney General’s Office. Significant changes were made to the operations budgets of the Ministry of Basic Education, receiving the lion’s share of the additional budget, at N$1.1 billion, while the Ministry of Higher Education receives the second largest adjustment, amounting to N$800 million. The Ministry of Urban and Rural Development gains an additional N$480 million, and the Ministry of Health and Social Services an extra N$450 million. In all, these four ministries receive an upward adjustment of N$2.8 billion, or 60% of the amendments.

“This spending trajectory provides for about N$5.4 billion additional spending to the current MTEF ceilings as means of implementation of the proposed intervention measures.”

Minister of Finance, Mid-Year Budget Review, November 2017
The development budget saw no upward revisions, and several infrastructure budgets were reduced in the pursuit of internal savings. These amount to N$365 million in total. The greatest savings came from the Ministry of Basic Education, as the Ministry’s development budget was cut by N$88.5 million. This was mainly composed of the reduction of the budget for the construction and renovation of several schools.

The second biggest savings were realised from the Ministry of Industrialisation, Trade and SME Development, totalling N$69 million of its allocated development budget.

Not far behind this is the Transport vote, which saw internal savings of N$50 million from its allotted development budget. These savings are directly from the proposed upgrades and rehabilitation of the Mpacha and Eros airports.
Tax

The Minister emphasised that tax policies should contribute to economic growth through revenue generation capacity and efficiencies. As such the Ministry will implement further reforms in both tax policy and administration. Such reforms will also include measures to protect the tax base. No increases in tax rates are anticipated at this point.

Tax base protection measures will include the abolishing of certain VAT and income tax exemptions. These measures were mentioned by the Minister in his March 2017 budget speech as well. It remains to be seen which specific exemptions will be abolished and what the impact of the proposed changes will be on revenue collection.

While not mentioned in the March 2017 Budget Speech, the Minister re-introduced the topic of an amendment to the Transfer Duty Act in the midterm speech. We suspect that this amendment will see the sale of shares and membership interest in close corporations that own immovable property become subject to transfer duty. This amendment has been on the cards since 2005 and has been mentioned occasionally since then. We see major practical difficulties with the proposal, particularly if it takes the same format as initially proposed. One such challenge, for example, would be the valuation of share sale transactions where immovable property makes up only a part of the transaction. The draft amendment bill did take into account an exemption for sales on the stock exchange and we would expect the exemption to remain in the final bill.

As previously announced, the Minister confirmed that the presumptive tax proposal for the informal sector will be introduced in the next session of parliament while the Namibia Revenue Agency will be established in a phased transitional approach. The Namibia Revenue Agency Bill was passed at the end of October, and, in collaboration with stakeholders, the Ministry intends for the Agency to become operational during 2018.

The tax arrear recovery programme will continue until 31 March 2018 and is expected to continue to enhance the recovery of outstanding taxes.

The renegotiation of double tax agreements would also be considered to achieve mutually-beneficial outcomes for Namibia and to leverage from regional and international tax cooperation to enhance technical capacity. This approach is welcomed to ensure that Namibia obtains its fair share of taxes where international transactions are concerned.

Interestingly, the Minister did not make any mention of the wealth tax and capital gains tax that were previously proposed. Counter to expectations he also did not comment on the status of the integrated revenue system.

From our standpoint, we believe that in order to improve efficiency, tax administration and increase revenue collection, the Ministry would do well to focus on technical training and consider the wider domestic and investment environment when amendments are proposed and developed.
“As the economic recovery takes shape, it is not my intention to increase general tax rates. But we intend to bring all potential taxpayers in the tax net and achieve full compliance. This is to allow for economic agents to produce and invest, while creating incentive to work and promoting equity and fairness of the tax system.”

Minister of Finance, Mid-Year Budget Review, November 2017
Deficit, Debt and Funding

Sovereign Ratings Assessments:

The Minister referred to the recent credit rating downgrade by Moody's, again stating his disappointment in the agency’s "lacked of substantive assessment of domestic developments and consultation".

The Minister reinforced their focus on addressing the weaknesses listed by Moody's through public finance rebalancing and addressing the developmental needs in the real sector.

The Ministry is establishing a plan to focus on pro-growth fiscal consolidation, reducing public debt, strengthening institutional capacity and fast-tracking implementation of the announced structural reform measures to support higher and inclusive growth.

Public enterprises:

The Minister emphasised the objective for Public Entities (specifically commercial Public Entities) to achieve self-sustainability as opposed to being "a perpetual drain on scarce public resources".

Capital markets:

Under budget priorities, the Minister stated that the Development Bank of Namibia will establish and operate an infrastructure fund, initially of approximately N$2.5bn. This infrastructure fund will be seed funded by utilizing N$2bn of the N$4bn African Development Bank infrastructure loan expected in 2018/19.

The Minister mentioned the intent to “partially” list select state assets in order to raise capital.

Further capital market developments are expected through the establishment of the SME Financing Strategy, specifically by establishing a Venture Capital Fund, Credit Guarantee Scheme and a Training and Mentorship Program.
Deficit

As a result of the increases in fiscal expenditure, with largely unchanged revenue, the FY17/18 year will see a notably larger budget deficit than previously projected. The deficit expectation for the year in the March budget was N$6.1 billion, or 3.6% of GDP. However, the current budget deficit has been revised to N$9.4 billion, or 5.3% of GDP. GDP has also been revised, following the release of better than expected figures by the Namibia Statistics Agency for the 2016 calendar year.

Across the MTEF, expenditure has been revised up in every year, while revenue has been revised down in every year except the current (2017/18) fiscal year. As a result, the budget deficit has widened across every MTEF year, representing noteworthy fiscal slippage. While the Minister has suggested that fiscal consolidation will continue, the rate of consolidation is slower than previously planned. On the basis of the historic and current fiscal slippage, there are grounds on which to question whether the path of fiscal consolidation in future years will in fact materialize.

The deficit forecast for 2018/19 has been revised lower, from -2.4% to -4.2%. Similarly, the deficit for 2019/20 has been revised lower, from -1% to -2.9%.
As a result, the budget deficits remain through the MTEF period, and Government remains dependent on currently elusive growth to improve debt metrics. However, the tightrope being walked by Government means that public expenditure is unlikely to be a key driver of such growth going forward. Similarly, high levels of household debt, and sticky imports, mean that private consumption and net-exports are also going to yield lean pickings when it comes to the growth outlook. As a result, the only noteworthy source of growth that the economy can look to is investment. Current policy proposals, coupled with impending downgrades and investment uncertainty, may continue to overshadow the investment environment, and thus the possibility of growth from this source remains tenuous.

It has become clear, that despite the best-efforts of the fiscus to date, reaction to the revenue downturn was perhaps too little, too late, and it could now take a number of years to regain fiscal stability.
Guarantees:

As well as running large, and larger than previously forecast, deficits, major increases in Government contingent liabilities have been seen, in the form of guarantees, over the past 12 months. From N$5.6 billion in 2016/17, guaranteed have increased to just under N$13.0 billion. The N$7.4 billion increase in contingent liabilities appears to be part of an effort to shift liabilities off the balance sheet of Government through guarantees, as well as an effort from Government to encourage SOE investment into infrastructure development. This “off balance sheet” expenditure, backed by Government guarantees, represents the tapping of one of the few remaining sources of funds for Government related activities. In a single year, these guarantees have increased by over 130%, admittedly from a low base. As a result, the ratio to GDP has jumped by 118%, from 3.4% to 7.4%.
Due to the persistent budget deficits over the next three years, debt levels are to continue to rise. The major fiscal slippage seen in the current budget, however, means that the debt levels of the country will rise faster than previously expected. Thus, over the next three years, debt levels are expected to expand by N$19.8 billion, from N$67.8 billion, to N$87.6 billion. This is an upward revision of 16.5%, or N$12.4 billion over the March budget expectations.

The increase in the debt stock will be driven by both domestic and foreign debt increases. The domestic debt component, however, is approximately double that of the foreign debt component. The domestic debt issuance is, in effect, taking advantage of the cash generated by the current debt portfolio in Namibia, as well as the increases in local asset requirements for pension fund and life insurance companies. This will result in increased concentration of pension fund risk in Government assets.

When read in conjunction with the increases in contingent liabilities, it appears that local contractual saving pools are becoming increasingly exposed to, and concentrated in, assets associated with the revenue streams of Government, and are to either a direct or indirect degree, exposed to Government risk.
The bulk of the foreign debt increases expected over the next three years is linked to AfDB funding, and currency depreciation on US Dollar debt. The benefit of the former is that it is ZAR denominated, meaning that the currency risk is mitigated to a large degree.
**Cost of debt**

The weakening of the fiscal metrics, expansion in the debt stock and the concerns around forecast credibility, mean that the cost of Namibia’s sovereign debt is set to increase. This is due to both the volume of debt issued by the country, and the rate at which the said debt is issued. Further, the recent downgrade of the country to “junk” status by Moody’s, the impending downgrade of South Africa (to which most Namibian debt is benchmarked), and the possibility of a Fitch downgrade of Namibia, mean this situation may well be exacerbated further over coming months.

Moreover, the concentration of debt on the short-end of the Government yield curve, and the fact that such debt has to be rolled in the near future, or on an on-going basis in the case of treasury bills, means that not only will marginal debt costs increase, but average debt costs will not be far behind.

**Ratings**

The fiscal slippage seen in the mid-term budget is as predicted by local analyst and noted by Moody’s in their recent report where Namibia was downgrade to “junk” status. This slippage, combined with a languishing economy, is likely to drive further rating pressure on the country, first by Fitch in their upcoming review, thereafter by Moody’s in 2018. Following this mid-term budget, the probability that Fitch will follow Moody’s with a downgrade of the country is viewed to have increased.

Furthermore, the weakening fiscal metrics and questions around the credibility of fiscal consolidation efforts and promises, see the probability of regaining the rating without major fiscal reform, slide ever further from reach.
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