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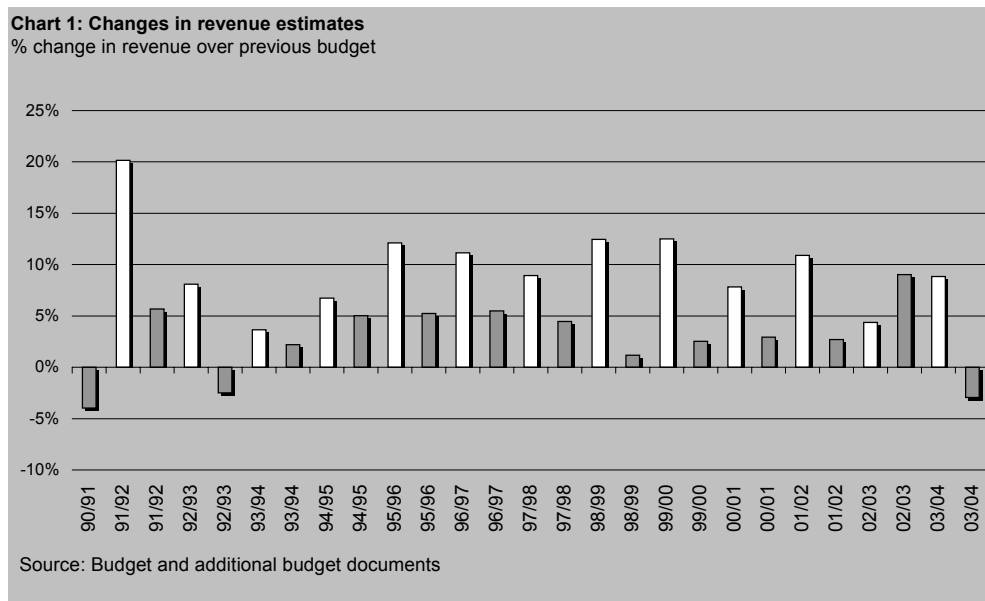
## Additional Budget 2003/04: We had it coming

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The 2003/04 additional budget was a baptism of fire for the new Minister of Finance, Sarah Kuugongelwa-Amadhila and her team. For the first time in years, total revenue had to be revised downwards. With the economy growing more slowly than expected and an almost unchanged level of spending, the estimated budget deficit rose from 3% to 4% of GDP. Under these difficult conditions, total spending was limited to just below the level presented in the main budget. However, within this same ceiling, significant suspensions were combined with equally significant additional appropriations calling into question yet again the quality of the budget process. This budget underlines the need to improve revenue forecasts and develop mechanisms to cope with windfall revenues, especially from diamonds.

How long can a small open economy dependent on a single commodity keep going without experiencing a fiscal shock? We have highlighted in previous papers (see IPPR Briefing Paper No. 20) that the diamond industry makes up 10% of Namibia's entire economy and last year accounted for some 15% of Government revenues. This year's additional budget demonstrates the danger this degree of dependency poses to fiscal policy and therefore macroeconomic stability.

### Revenues down for the first time in over ten years...



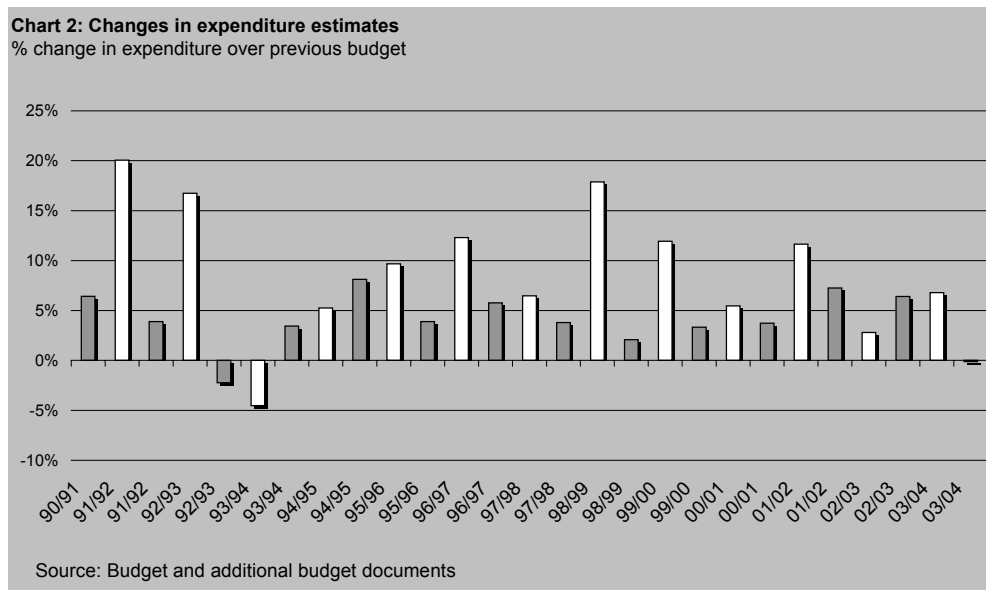
As previous IPPR opinion pieces have testified, Namibia's additional budget has traditionally consisted of the Minister of Finance magically conjuring up more revenue than was expected at the start of the financial year. This permits the Minister to undertake a popular round of additional spending while not straying too far from the path of fiscal righteousness, thus keeping everyone

happy – spending ministries and those who worry about fiscal discipline. This year was different. The new Minister of Finance, Sarah Kuugongelwa-Amadhila, announced a gross reduction of N\$1.2 billion in revenue out of an initial estimate of just over N\$11 billion. The main reason for this dramatic fall was the decline in revenue from diamond and non-diamond mining company taxes as well as the associated non-

resident shareholders tax. These revenue estimates fell by N\$940 million, N\$130 million and N\$95 million respectively.

Luckily, the Ministry's traditionally conservative estimates for other important revenue sources helped offset this gross reduction in revenue. These included personal income tax (revised up by N\$295 million), non-mining corporate tax (up by N\$275 million) and value added tax (up by N\$185 million). Furthermore, a total of N\$55.9 million in grants were received from some of Namibia's development cooperating partners. The net effect of these revisions was that total revenue was revised down by "only" N\$328 million or about 1% of revised GDP. As Chart 1 shows, this is the first time since the additional budget of 1992/93 that total revenue has been revised downwards in either a main budget or an additional budget.

With revenue down and growth lower than expected (GDP growth in 2003 is now expected to be a modest 2.9% compared to the original estimate of 4.2%), the Minister was faced with the choice of either cutting spending, increasing borrowing or some combination of the two. She opted to maintain total spending at the original level and raise the budget deficit from 3% to 4% taking Government away from its stated target of 3%. Although the Minister chose the less painful option of borrowing rather than cutting, Chart 2 shows how unusual it is that spending remained constant after an additional budget.



### Diamonds are forever but not for always...

The fall in revenue estimates highlights the particularly problematic nature of mining revenues. The key issue here is to what extent revenues from a wasting asset (that is to say a non-renewable resource such as diamonds) can be considered recurrent revenue, especially when it is subject to massive swings due to the exchange rate and other factors. Just because diamond revenues are high one year does not mean they will be high the following year. Predicting exchange rates is well nigh impossible (who predicted the crash in the exchange rate at the end of 2002 and the strengthening that followed?). There is a good case for treating revenues from diamonds differently to other revenues and identifying windfalls as precisely that. The trouble is Government has become so dependent on diamond revenues it can barely finance current expenditure without them.

### Aren't shareholders supposed to know more?

What is particularly worrying is that the Ministry of Finance can get the profitability of a company of which it is a 50% shareholder so totally wrong. Taxes from diamond mining companies were revised down from N\$1.16 billion to just N\$220 million. Mysteriously, dividends from Namdeb (which is related to profitability) and diamond royalties remained unchanged at N\$25 million and N\$450 million respectively. It is hard to imagine De Beers making such inaccurate forecasts. There seems to be a problem of information flow



between Namdeb and the Ministry of Finance. One way around this may be to require Namdeb to publish and justify quarterly earnings and profits forecasts in a similar way to De Beers as a whole.

### The mystery of the corporate tax take deepens even further...

For some time now, the IPPR has been pointing out that the Ministry's revenue projections, especially for company taxes, have been regularly subject to massive revisions between main and additional budgets. Especially mysterious has been the poor performance of non-mining company tax revenue. The *IJG* Business Climate Monitor for March 2003 already examined how strangely non-mining corporate tax has behaved during the past eight years as shown in Table 1. This is the first time since 1999/2000 that this revenue item has been revised up rather than down. Worryingly, during the same period, actual revenues have generally been lower than revised estimates. It is easy to accept that precise forecasts are difficult to make but somewhat harder to understand that they can be out by some 55%. The latest estimate of N\$770 million brings revenue back to the levels of the late 1990s.

**Table 1: Non-mining company tax revenue**

N\$ million	96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04
Main budget	318	350	447	440	625	635	515	495
Revised budget	360	345	573	440	590	500	460	770
Actual revenue	282	406	540	359	426	465	n/a	n/a
Total revenue	4,676	5,690	6,186	7,272	8,343	9,098	10,256	10,836
As % of total revenue	6.0%	7.1%	8.7%	4.9%	5.1%	5.1%	4.5%	7.1%
FY GDP	15,447	17,263	19,263	21,510	24,806	28,158	32,116	35,084
As % of GDP	1.8%	2.3%	2.8%	1.7%	1.7%	1.7%	1.4%	2.2%

Sources: Main and additional budget documents 1996/97-2003/04, Budget speeches 1996/97-2003/04

### Grants from the EU, SIDA, NORAD and the Netherlands helped...

A total of N\$55.9 million was received by the Government in grants. Table 2 shows the breakdown of these grants. While the EU, SIDA and NORAD received mention in the budget speech, the poor old Netherlands did not.

**Table 2: External grants**

<i>External Grants</i>	<i>Amount</i>	<i>Purpose</i>
EU/SIDA	N\$13,809,400	Education sector - recurrent activities
EU/SIDA	N\$14,790,600	Education sector - development projects
NORAD	N\$1,239,757	Energy sector
Royal Netherlands Government	N\$26,087,000	Basic education – development projects
Total	N\$55,926,757	

Source: Additional Budget document 2003/04

### Suspensions hit almost everyone...

Turning to the expenditure side of the budget, it is interesting to note that, although total spending remained almost unchanged at N\$12.2 billion, there were significant reallocations within this ceiling. For the first time the budget document contains a comprehensive list of suspensions by budget code. Cabinet clearly endorsed the view that tough measures were required to deal with the shortfall in revenue. The Minister made no attempt to describe or justify these suspensions. The only votes to escape suspensions were the



Office of the President (Vote 01), Civic Affairs (Vote 5), Higher Education (Vote 27) and the Electoral Commission (Vote 28).

Suspensions totalling N\$707 million were made from voted funds plus a further N\$110 million from statutory provisions. However, this includes an amount of N\$303 million originally allocated to the Ministry of Finance for the improvement of remuneration structure across Government. This was suspended then reallocated leaving net suspensions at N\$514.3 million as stated in the budget speech. Hardest hit appear to be Police (Vote 06) which saw a suspension of N\$52 million from the VIP Security Division (Vote 06 Main Division 07). In previous publications, the IPPR has highlighted the fact that more police constables are now employed protecting VIPs than combating crime in the entire country. It is not known if this latest suspension represents a change of policy.

**Table 3: Summary of additional expenditures and suspensions by vote (N\$'000)**

<b>Vote (abbreviated name)</b>	<b>Additional appropriation</b>	<b>Suspensions</b>	<b>Statutory</b>	<b>Revised estimates 2003/04</b>	<b>% of total spending</b>
01 President	5,176	0		156,946	1.3%
02 Prime Minister	52,421	3,527		109,066	0.9%
03 National Assembly	0	1,723		52,763	0.4%
04 Auditor General	792	202		15,310	0.1%
05 Civic Affairs	8,142	0		93,331	0.8%
06 Police	131,935	73,102		749,563	6.1%
07 Foreign Affairs	2,983	7,707		225,238	1.8%
08 Defence	119,547	5,247		993,757	8.1%
09 Finance	8,674	456,643	110,329	2,136,690	17.5%
10 Basic Education	203,060	14,720		2,434,855	19.9%
11 National Council	0	1,209		26,083	0.2%
12 Women's Affairs	5,243	5,606		109,679	0.9%
13 Health	49,276	34,163		1,676,462	13.7%
14 Labour	0	10,010		46,188	0.4%
15 Mines	3,036	3,221		94,228	0.8%
16 Justice	3,465	4,335		117,118	1.0%
17 Regional Government	2,930	14,817		436,601	3.6%
18 Environment	9,663	5,269		153,727	1.3%
19 Trade and Industry	1,796	597		109,628	0.9%
20 Agriculture	7,906	23,736		507,388	4.1%
21 Prisons	2,113	4,778		139,881	1.1%
22 Fisheries	2,658	3,100		119,240	1.0%
23 Works	0	8,303		301,827	2.5%
24 Transport	141,621	2,484		388,030	3.2%
25 Lands	1,600	5,276		153,023	1.2%
26 National Planning	0	9,243		58,354	0.5%
27 Higher Education	36,784	0		547,545	4.5%
28 Electoral Commission	0	0		51,192	0.4%
29 Attorney General	3,176	1,873		56,392	0.5%
30 Information	827	6,346		183,842	1.5%
<b>Total</b>	<b>804,824</b>	<b>707,237</b>	<b>110,329</b>	<b>12,243,947</b>	<b>100.0%</b>

Source: Additional Budget document 2003/04

Finance (Vote 09) saw suspensions totalling N\$456.6 million including N\$125 million that had been earmarked to capitalise the new Development Bank of Namibia (DBN). Although a CEO for the new



institution has now been appointed, it looks as though further capitalisation (N\$125 million was allocated in 2002/03) will be delayed until the next financial year. This was probably a sensible move under the circumstances since the DBN is not yet operational. The Ministry is at pains to stress the suspension should not be seen as a weakening of Government's commitment to the new institution but it does explain why the Minister made such a point of encouraging private asset managers to step in and help fund the DBN. Agriculture (Vote 20) was also hard hit. The Cabinet resolution calling for additional spending on agriculture of N\$1 billion looks even less realistic now than it did when it was first made public just over a year ago.

### Salaries come first...

At the same time, additional spending on remuneration totalled N\$474.9 million out of total additional spending of N\$804.8 million. This includes the N\$303 million originally budgeted for salary improvements. According to the Minister, the net additional commitment to remuneration was N\$83.9 million. UNAM, which seems to lead a charmed life, received a hefty additional N\$31.1 million for salary increases. Government appears to have very deliberately chosen salaries before other expenditure items. This is due to the agreement made earlier in the year to award an 8% salary increase across the board.

### ... still leaving room for significant additional spending.

**Table 4: Additional expenditures (excluding remuneration for central government)**

Vote 01 President	N\$2.550	Administration (National Intelligence Security Agency)
Vote 02 Prime Minister	N\$50.000	Cabinet Office (National Emergency Disaster Fund)
Vote 04 Auditor General	N\$0.250 N\$0.200	Administration (rental) Auditing (private audit firms)
Vote 08 Defence	N\$21.000 N\$13.525 N\$1.500	Administration Army Army (operational equipment)
Vote 09 Finance	N\$3.344	Public debt (foreign interest payments)
Vote 10 Basic Education	N\$7.352 N\$27.897 N\$3.264 N\$2.838 N\$7.616	Education Standards Primary Education (construction) Library and Information Adult Education Planning
Vote 13 Health	N\$6.351	Regional health (Mission hospitals)
Vote 15 Mines and Energy	N\$1.240	Energy (NORAD grant)
Vote 16 Justice	N\$0.300	Legal Support (Turnhalle renovations)
Vote 18 Environment and Tourism	N\$0.092 N\$0.658 N\$0.044 N\$0.740	Administration Parks Scientific Services Forestry
Vote 19 Trade and Industry	N\$0.800	Industrial Development
Vote 22 Fisheries*	N\$1.000	(insurance for new vessel)
Vote 24 Transport	N\$40.000 N\$75.295 N\$26.326	Transport Infrastructure Railway Infrastructure Civil Aviation
Vote 27 Higher Education	N\$0.150 N\$31.064 N\$5.570	Higher Education Higher Education (UNAM salaries) Vocational Training
Total	N\$330.966	

\*cannot be found in budget document



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If they are supposed to exist at all, additional budgets are used to firm up revenue and spending estimates later in the year as more information becomes available on the state of the economy. This year's additional budget sees yet again a significant level of additional appropriations, not just on remuneration but on a range of other items. The level of suspensions combined with this level of additional appropriations suggests the quality of the budget process leaves much to be desired. Table 4 highlights all additional appropriations that are not related to remuneration in central government. It seems remarkable that the N\$141.6 million allocated to Transport (Vote 24) was not provided for in the main budget. We could not find the additional N\$1 million for Fisheries (Vote 22) mentioned by the Minister in the budget document.

### **No money for parastatals...**

In another break with the past, the additional budget proposed no new transfers to parastatal companies. It is reassuring to learn that Air Namibia is receiving "priority attention" but in the absence of any more detailed information, it is impossible for outside observers to assess whether this marks a turning point in terms of subsidies or whether it is simply a lull in the relentless pouring of money into certain companies that, for some reason, cannot be allowed to go broke.

### **A crisis budget...**

This latest additional budget was clearly a result of crisis management due to significant and unexpected revenue shortfalls. Under such circumstances it was perhaps too much to expect the new Minister of Finance to stamp her mark on it. However, it is perhaps significant that no explicit mention was made of the fiscal targets the previous Minister had struggled so hard to achieve. Although it was lamented that the 3% deficit target would not be achieved, no mention was made of the debt or expenditure target. No figures were provided on the implications for the debt target (25% of GDP) which had already been exceeded at the time of the main budget. The Minister kept quiet on the whole issue of debt guarantees.

### **... in which the poor come last.**

Given the need to deal with the revenue shortfall, the new Minister had little scope for improving the impact of the budget on poverty and inequality. There were some measures to show these important objectives had not entirely been forgotten (N\$10 million to the new orphans fund, N\$50 million for drought relief). Interestingly, a total of N\$34.2 million was suspended from Health (Vote 13) because the sum required to deal with the backlog of pensioners on the waiting list had been overestimated in the main budget. This backlog is now apparently dealt with. However, there is little sign that the budget is being shaped to deliver a more ambitious range of welfare grants which several studies show are the most effective way of alleviating poverty.

### **Will the lessons be learnt?**

This additional budget raises two key issues. The first is the need for the Ministry of Finance to improve its revenue forecasting on important items of revenue, especially corporate tax. The second issue is how Government should deal with windfalls that are by their nature unlikely to be repeated. It is a deeply ingrained human characteristic that change only takes place following a crisis. The Ministry of Finance and Government generally have shown that they can respond to a significant revenue shock without losing total control of the budget deficit. This is positive and adds to Government's credibility in economic management. However, if history is not to repeat itself and important public spending programmes are to take place within a predictable fiscal framework, considerably more effort must be placed on improving revenue forecasts. We had it coming but it need not happen again.

