

Fiscal Policy and Growth

- Boosting Employment and Competitiveness in Namibia -

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## 1. Twenty Years of Independent Namibian Fiscal Policy

The Namibian economy suffers from the highest income inequality in the world. This is due to the legacies of colonization and apartheid, which made education, labour, resources and capital exclusive to the white minority of the population. On average 2% of the richest households earn N\$ 300,000 per year, while the poorest 25% only have N\$ 3,000.<sup>1</sup> Even though Namibia recently ascended from a lower to an upper middle income country, 55.8% of the population live below the poverty line, trying to survive on less than US\$ 2 per day.<sup>2</sup> Since Independence the economy experienced only slow growth, wage increases stagnated and unemployment increased up to 52.1% in 2010.<sup>3</sup>

Namibian fiscal authorities tried to solve these problems by implementing supply side policies, expecting that the attraction of investments would finally lead to growth. Fiscal policy makers gave tax concessions to manufacturing corporations and tried to strictly keep the budget in balance. In addition, 51% of Namibian state revenues accrue from regressive indirect taxes like the Value Added Taxes (VAT) and import taxes. They seem favourable, because corporations can pass the costs on to the consumer and investment decisions are not being influenced. However, indirect taxes affect the poorest in the country most and inhibit stimulation of their demand. Unfortunately, only 48% of Namibian tax revenues accrue from progressive direct taxes, which are for instance income, profit and property taxes. Even though supply side fiscal policies have not been very successful in attracting large scale investments, Namibian fiscal authorities still focus on the same measures, without discussing alternatives.

Accordingly, this paper assesses the question, whether Namibian policy makers should keep on relying on supply side fiscal policy to raise growth, or whether redistributive fiscal policy would lead to the development of an internal market via higher disposable income of the poor. I argue that the current supply side orientation of the Namibian fiscal policy did not and will not lead to growth, but that a new demand side approach must be implemented to solve Namibia's economic problems. In the first section of this paper, I will define growth and competitiveness and then outline the various economic theories on how fiscal policy can influence growth. While neoclassical theorists would recommend to consolidate the budget and to abolish most taxes, endogenous growth theorists suggest increasing VAT and decreasing other taxes, which distort economic development. Keynesians however, recommend to raise expenditures and to collect more revenues from progressive taxes. The theory section is followed by the main part of this paper. It consists of 3 sections, in which I show the past and current Namibian fiscal policy measures and add demand side alternatives to them. I subdivided this section into budget consolidation, expenditures and revenues. Here, I demonstrate how the focus on a balanced budget lead to low expenditures in the past. Then, I recommend that the

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<sup>1</sup> Republic of Namibia (2008: 28)

<sup>2</sup> Hansohm/ Venditto/ Ashipala (1999: 1-7)

<sup>3</sup> The World Bank (2007: 249)

expenditure composition must be enhanced and how a high amount of funds could be channelled from the defence to the industry and social sector. I also explain how this triggered growth and competitiveness. Finally, I show how redistributive tax policy would increase the income of the poorest in the country and how this could lead to demand and growth. Namibian fiscal authorities should now launch higher taxes on property and mining corporations. I conclude with the plea for Namibian fiscal authorities to quit focusing on fiscal consolidation.

## 2. Theories on Fiscal Policy, Growth and Competitiveness

Economic theory on fiscal policy is split into two major paradigmatic streams, the Keynesian and the neoclassical theory. Keynesian theory is also referred to as demand side theory, because it advises economic policy to support consumption, which would then lead to higher investments and therefore to growth. Neoclassical theory, on the other hand, is called supply side theory, because it suggests improving the investment conditions for producers, which would then increase employment. A synthesis of these two theories was established with the endogenous growth theory, which however is focusing on the supply side as well. All three theories assess in how far fiscal policy can trigger growth, competitiveness and development. But neoclassical and Keynesian theory fight over the effectiveness of the specific fiscal policy options to achieve this. Neoclassical theory bases upon the notion that a market mechanism always brings the economy into equilibrium again. For this reason government intervention can only worsen the development of the business cycle. On the contrary, Keynesians try to prove that the economy is not always in equilibrium and that the government needs to intervene into the market to enhance growth and employment. Endogenous growth theory is closer to Keynesian theory, in so far as it claims that the government should intervene in the market. But it is closer to neoclassical theory in so far as it suggests intervening to support production and not consumption.

### 2.1 What is long-run growth?

Economists define growth as the increase in technical know-how, progress in technical production facilities and the accumulation of productive resources. While technical know-how refers to the efficiency of processing resources domestically, technical progress can be achieved by innovation in the economy itself or by importing innovations from abroad, mostly by foreign direct investment (FDI). Productive resources mean intangible assets such as human capital.<sup>4</sup> Therefore, when assessing the impact of fiscal policy on growth, these three variables must be evaluated.

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<sup>4</sup> Tanzi/ Zee (1997: 180)

## 2.2 What is competitiveness and in how far is it linked to fiscal policy?

Competitiveness is the ability of domestic industries to produce at lower costs and deliver goods and services on higher quality than other industries in the global market. The more integrated an economy is into world markets, the more products have to compete with products of other countries. Since the costs and quality of production are determined by the fiscal policy of a country, these policies have to adopt market oriented strategies to help the domestic corporations being competitive. Supply side theories state that one of the most important factors in this regard is the costs structure, which is highly determined by domestic taxes. In case the taxes for corporations are too high, corporations might outsource their production to another country or hesitate to further invest in this country.<sup>5</sup> FDI triggers growth by bringing skills, technology and capital with them.<sup>6</sup> However, FDI inflows are not only triggered by tax concessions, but also by infrastructure, worker skills, labour costs, the level of technology in the industry, the development of the financial and banking sector and the size of the domestic market.<sup>7</sup> Therefore, Keynesians suggest that tax concessions overall will not lead to competitiveness, but that the industry must be strengthened by higher demand and investment in infrastructure and education.

## 2.3 Neoclassical theory and the plea for non-intervention

In general, neoclassical theory bases its policy suggestions on the notion that the market is regulating itself by market mechanisms. It produces optimal levels of welfare, production and growth, while state intervention can disturb the optimal equilibriums. An intervention by the government should only be adopted when the market produces negative externalities, for instance environmental damage.<sup>8</sup> For this reason, neoclassical theory also proposes a non-interventional form of fiscal policy, in which the expenditures and the revenue collection are minimized. The consolidation of the budget is the key factor for achieving growth.

The most important impact of a deficit on investments is the so called *crowding out* factor. The neoclassical thesis is that government borrowing on domestic financial markets leads to higher demand for credit and thereby to higher interests of credit. Hence, neoclassical theory argues that private investments decreased if the government operated with a budget deficit. Consequently, the consolidation of the budget leads to lower interest rates and higher investments, which lead to growth.<sup>9</sup>

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<sup>5</sup> Hein/ Truger (2000: 38)

<sup>6</sup> Gropp/ Kostial (2000: 12-13)

<sup>7</sup> OECD (2010: 48)

<sup>8</sup> Kaldor (1971: 313)

<sup>9</sup> Hermes/ Censink (2001: 2)

The second factor is the investor's anticipation about the future strategy of the government. A high deficit entails the risk that the government might induce inflating monetary policy to reduce its debt. Investments might be inhibited, because of the lowered expected returns.<sup>10</sup>

In addition to that, investors and consumers facing a high government deficit, expect taxes to increase in the future. Higher taxes mean lower incomes for consumer and corporations, therefore the consumption and investments would decrease.<sup>11</sup>

Neoclassical theory also gives suggestions how the consolidation of the deficit should be achieved. Since an increase in revenues by higher taxation inhibits investments, a balanced budget should be accomplished by lower government spending, only.<sup>12</sup> Tax policy itself is supposed to be incremental and it should not intervene in the distribution of incomes. Plus, low corporation taxation lead to higher investment flows into the economy and thereby to growth and competitiveness.

In conclusion, neoclassical theory proposes that the reduction of government spending is the best fiscal policy strategy to achieve growth, because crowding out is prevented. In addition, consumption and investments increase, because investors and consumers expect a beneficial economic future. Since non-intervention is the best policy to attain growth, tax revenues should not be collected to influence the business cycle. Investments can also be attracted by disburdening corporations from taxes. Lower taxes lead to higher competitiveness in the global markets.

#### 2.4 Endogenous growth theory and non-distortionary taxes

In contrast to neoclassical theory, endogenous growth theory states that not every form of government spending worsens economic development, but that there are certain expenditures that can influence the business cycle in a positive manner. However, revenues should not be collected through direct taxation - corporate or income taxes - but only through the indirect VAT.

Endogenous growth theory points out that not every form of government expenditure leads to crowding out of investments. There are expenditures, like education and infrastructure that might even enhance the investment possibilities for corporations and thereby lead to growth and competitiveness.

While non-distortionary taxes do not influence investment decisions, distortionary taxes do. Endogenous growth theory lists labour taxes, social security duties and corporate taxes among distortionary taxes, because they increase the production costs for corporations. While labour taxes increase the wages, social security duties increase the real wage and corporate taxes add on the overall production costs for corporations. Therefore, distortionary taxes also decrease the return on investments and thereby limit investing.<sup>13</sup> There is basically only one tax that fits into the category of

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<sup>10</sup> McDermott/ Wescott (1996: 2)

<sup>11</sup> McDermott/ Wescott (1996: 2)

<sup>12</sup> Kaldor (1971: 313)

<sup>13</sup> Hermes/ Censink (2001: 4)

non-distortionary taxes and that is the VAT, because it can totally be rolled over to the consumer and the company does not have to bare additional costs. The lower the costs for corporations, endogenous growth theory claims, the higher the production and investments and the higher competitiveness of the industry in the global market.

In sum, endogenous growth theory is as well as neoclassical theory suggesting that fiscal policy should support the supply side of the economy by collecting revenues from immobile factors, such as labour and not from the corporations or the investors.

## 2.5 Keynesian theory and state intervention

Keynesian theory opposes neoclassical theory in the state intervention question. In contrast to neoclassical theorists, Keynesians state that the market can fall into long-term disequilibrium. In this case the government can induce countercyclical demand stimulation by either monetary or fiscal policy. Fiscal policy can be used to trigger consumption and investments during a recession by raising government expenditures, as well as by lowering the tax burden on consumers. The reduction of the budget itself can lead to a recession.

According to Keynesian theory demand can be stimulated by increasing government expenditure in education, infrastructure, communication systems and in other public sector investments. Thereby consumption, private investments and growth can be triggered. The higher the transfers to the poor, the higher the growth effect, due to their larger propensity to consume. The poorest of the country use the biggest share of their income for consumption.

The reduction of the government deficit ó supported by neoclassical theory - entails the risk of inducing a recession. If wages of the public sector and transfers to the population are lowered, consumption and investments decrease. This in turn unleashes unemployment and could lead to a recession.<sup>14</sup>

Tax revenues are a key factor in Keynesian economic policy, because the state needs the resources for countercyclical demand policy. For this reason, tax concessions for corporations are not favourable for the market.<sup>15</sup> Keynesian theory distinguishes direct from indirect taxes. In contrast to the endogenous growth theory, Keynesians rate direct taxes, like corporate income, personal income or property taxes, as more favourable than indirect taxes, like VAT. They are progressive, meaning that the higher the income, the bigger the proportional share individuals or corporations have to pay to the treasury. Indirect taxes on the other hand are regressive. VAT affects the poorest in the country most, because they spend the biggest share of their income on consumption and are therefore charged most. Therefore, Keynesians suggest that tax policy should base on direct taxes. Demand increases if

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<sup>14</sup> McDermott/ Wescott 1996: 2

<sup>15</sup> Kaldor (1971: 313)

the income of the poorest is less burdened and the internal market can develop, thereby investments and competitiveness increase.

In conclusion, Keynesians would rather suggest increasing government expenditures to enhance growth. This should mainly be financed by direct taxes, leading to growth.

Neoclassical Theory	Endogenous Growth Theory	Keynesian Theory
<ul style="list-style-type: none"><li>- Growth can be raised by consolidation of the budget</li><li>- Balanced budget should be accomplished by reducing expenditure</li><li>- Revenue collection should be neglected</li><li>- Tax concessions are important to attract investments</li></ul>	<ul style="list-style-type: none"><li>- Certain expenditures lead to growth</li><li>- Revenues can also be increased by tax increases</li><li>- The indirect Value Added Tax (VAT) is superior to direct taxes because it is non-distortionary</li></ul>	<ul style="list-style-type: none"><li>- Growth can be increased by countercyclical demand policy (increased expenditures)</li><li>- Revenue collection is key for demand policy</li><li>- A reduction of the deficit can lead to recessions</li><li>- Direct taxes are superior to indirect taxes in triggering domestic demand</li></ul>

### 3. Budget Consolidation and Growth in Namibia

The Namibian budget, unlike in other developing countries, has never faced excessive debt after Independence. Both governments put attention to a more or less balanced budget for preserving financial market confidence. In 2001 the government introduced a fiscal target called Medium Term Expenditure Framework (MTEF), which confirms and secures the conservative Namibian budget policy. Then in the years 2005 to 2008 the Minister of Finance Saara Kuugongelwa-Amadhila even managed to generate a budget surplus.

The MTEF, which was introduced in 2001, allows for a budget deficit of 3% of GDP, as well as a public debt of 25% of GDP. However, in 2011 public debt threshold was extended to 30%. This form of debt restriction is usually enforced on debtor countries by the IMF and the World Bank, but the Namibian government imposed it on itself. The fiscal target is designed to give investors the

confidence that the Namibian debt cannot increase rapidly and that government cannot fall into a debt trap as others did.<sup>16</sup>

The Namibian expenditures have been kept low since Independence. In 2003 Saara Kuugongelwa-Amadhila was assigned new Minister of Finance. She tried to limit government expenditures and achieved a steady decrease during the years of 2004 to 2007. In addition, revenues could be increased steadily from the year 2003 on. Then, in 2005/2006 Kuugongelwa-Amadhila managed to obtain a budget surplus. This surplus was outstandingly increased in 2006/2007 as shown in table 1 and 2. Table 2 shows the budget balance in the first years of Kuugongelwa-Amadhila's tenure, without the years of the global financial crisis, which caused lower revenues and higher expenditures by an external shock to the Namibian economy.

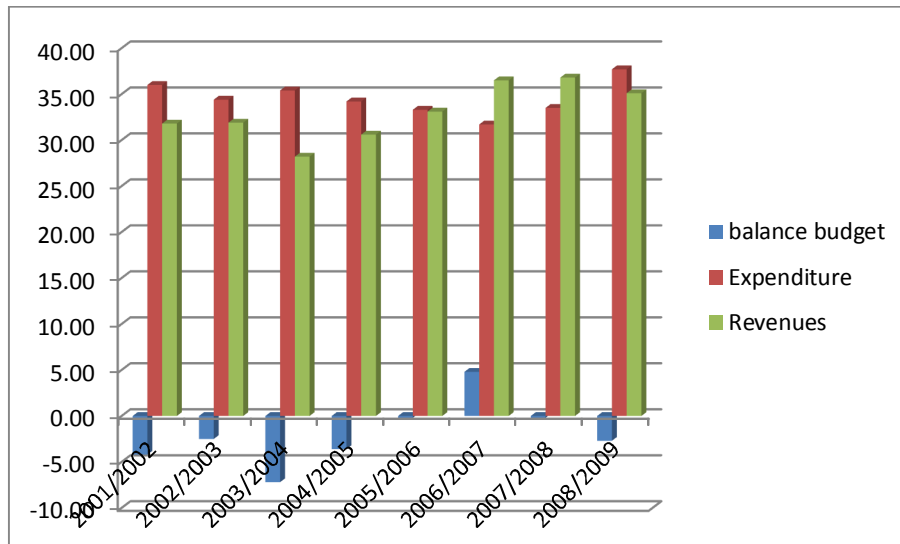


Table 1: Budget balance as percentage GDP 2001/2002 to 2008/2009.<sup>17</sup>

<sup>16</sup> Sherbourne (2009: 27)

<sup>17</sup> Source: Sherbourne (2009: 24)

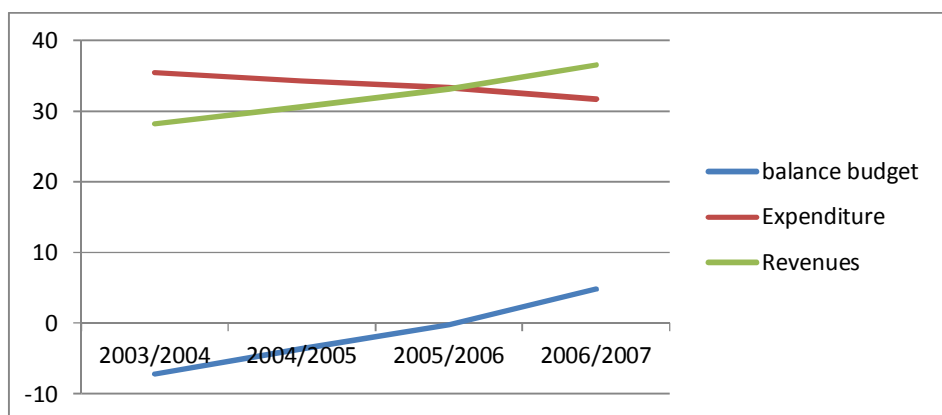


Table 2: Budget balance as percentage GDP 2003/2004 ó 2006/2007.<sup>18</sup>

In line with neoclassical theory Namibian fiscal authorities have focused on the budget consolidation in their policies. Supply side economics state that a balanced budget would lead to financial market confidence. This confidence is important to attract investments to the Namibian economy, as well as incite borrowers to finance the Namibian debt by buying treasury bills and government bonds. Neoclassical theory claims that investors fear a lower return on investments if debt is excessive, because the government might induce inflation or higher taxes to finance the debt. Plus, corporations would also fear higher interest rates if the debt increases and might therefore hesitate to invest further in Namibia (see chapter 2 neoclassical theory). Obviously, the Namibian government does follow supply side instructions. The consolidation of the budget is a key feature of Namibian fiscal policy. Since Saara Kuugongelwa-Amadhila did not only decrease the expenditures ó as proposed by neoclassical theory - but also increased revenues, she followed a policy mix of neoclassical and endogenous theory suggestions. However, if we look at the development of FDI and growth over the past years, there is no evidence that a balanced budget improved the economic development, as shown in table 3 and 4. Since 1990 the investments rather decreased than increased. And during the period of full consolidation of the budget in 2005 to 2007 we find the lowest rates of FDI. Besides of a low increase in FDI, Namibia is far from achieving the growth target of 7% it has set itself with Vision 2030. Even though growth had a peak in 2004, it fell immediately again in 2005, meaning that it was not sustainable and can therefore not be due to conservative fiscal policy.

<sup>18</sup> Ibid.

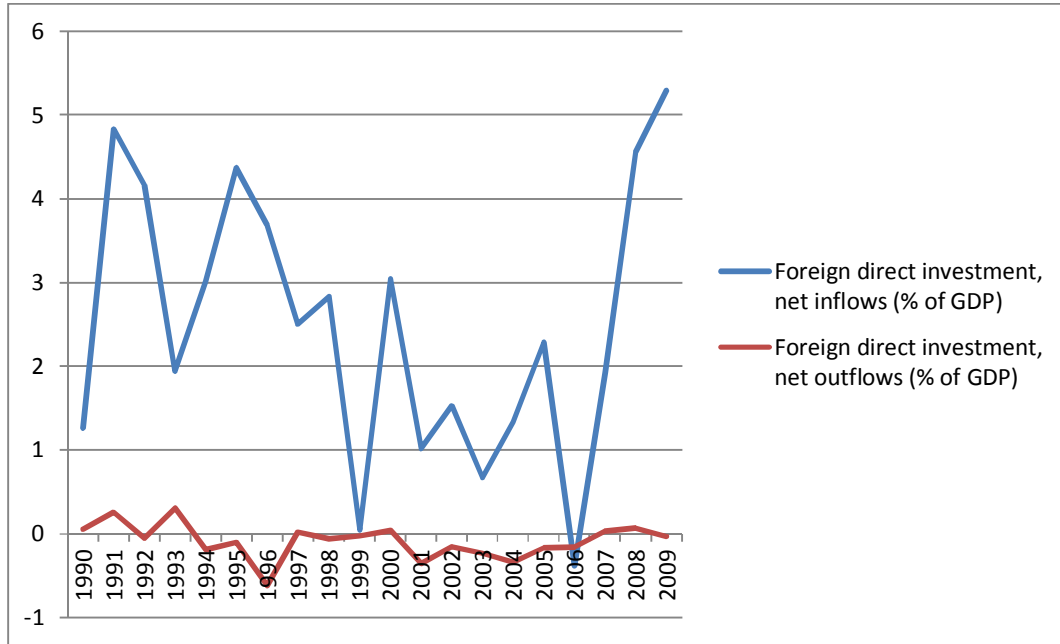


Table 3: Foreign direct investment in- and outflows Namibia 1990-2009.<sup>19</sup>

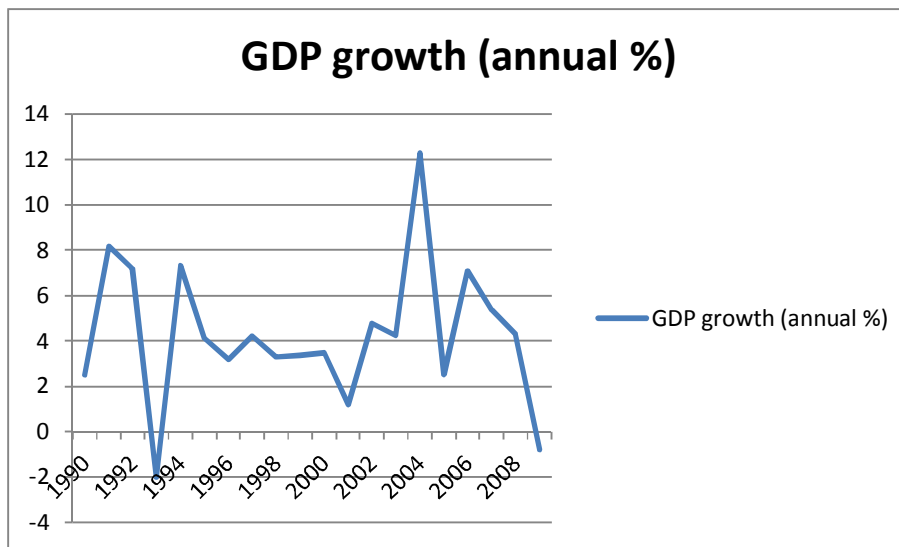


Table 4: GDP growth at domestic prices at constant local currency.<sup>20</sup>

<sup>19</sup> Source: World Bank <http://databank.worldbank.org/ddp/home.do?Step=3&id=4>

<sup>20</sup> Source: World Bank Databank <http://databank.worldbank.org/ddp/home.do?Step=3&id=4>

For this reasons, Namibian policy makers should dare to implement alternative policies. Keynesians recommend attracting investments by a good infrastructural environment, education of the workforce, as well as demand of the internal market. The internal market is important because corporations want to invest in economies in which consumers buy their goods. It can develop with countercyclical demand policy. Therefore, Namibian fiscal authorities should increase revenues and expenditures to stimulate demand. This lead to higher production and consumption and this in turn will increase the revenues again.<sup>21</sup> Growth and competitiveness can be composed of increased production by technological progress and enhanced human capital. If expenditures are cut for infrastructure and education, the growth prospects are even diminished.

In conclusion, while conservative supply side fiscal policy in Namibia might create financial market confidence, expansive demand side policy will more likely lead to growth. Keynesian fiscal policy would lead to investments in the long run, because expenditure in education, infrastructure and internal demand would trigger consumption, which would lead to growth and competitiveness. Fortunately, Saara Kuugongelwa-Amadhila broadened the debt target from 25 to 30% and increased the expenditures in the 2011/12-2013/14 MTEF. Her aim is to lower unemployment in Namibia. This is an important step towards creating an internal market.

#### 4. Expenditures and Growth in Namibia

Even though the Minister of Finance tried to decrease the expenditures between 2003 and 2006, she fortunately increased the government spending during and after the Financial Crisis. However, the distribution of expenditures could be enhanced. Some of the funds for the defence sector could be channelled to education, the social and the industry sectors.

As noted in the previous section, the Namibian expenditures have been decreased during the years of 2003 to 2007 before the Financial Crisis hit the Namibian economy. During the crisis the expenditures were increased, due to less production and higher unemployment. But instead of lowering the expenditures again afterwards, the minister even increased them for the year 2011/2012. She plans to create 104.000 jobs within the coming 3 years.<sup>22</sup>

When assessing the expenditure shares distributed to the votes, we see that the highest share of expenditure was channelled to education in the last three years. This field of expenditure is also increasing faster than any other area. The second highest receiver of funds is the defence sector, followed by health and social services. Very little funds got to labour and social services, gender equality and child welfare, as well as trade industry and agriculture. We can see from table 3, that there has not been a change in the trend of these policies. All expenditures increase over the years by a similar proportion.

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<sup>21</sup> Interview with John Ernest Odada

<sup>22</sup> Ministry of Finance (2011: 7)

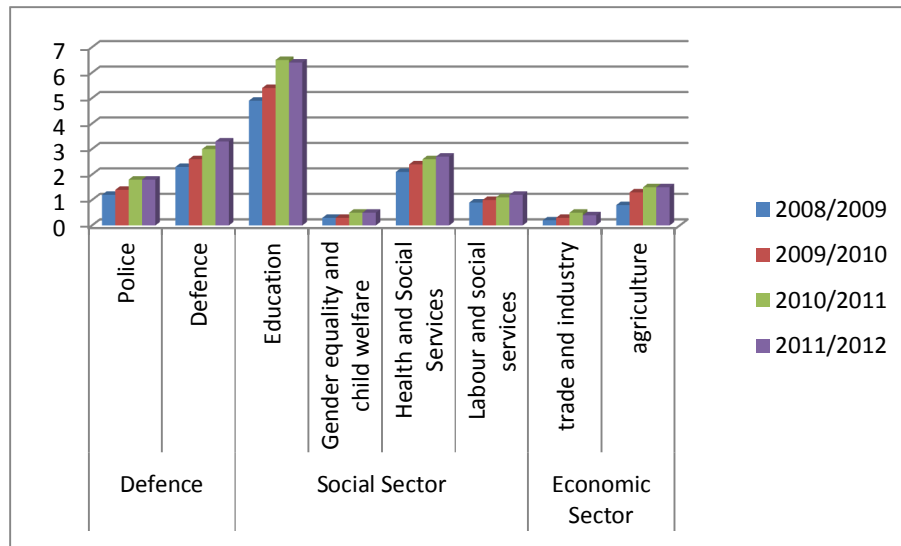


Table 5: Expenditures by vote 2008/2009-2011/2012 in N\$ billions.<sup>23</sup>

Even though the Namibian fiscal policy is very much supply side oriented when it comes to the consolidation of the budget, this does not seem to be true for expenditure policy. Neoclassical theory would recommend lower expenditures. But Saara Kuugongelwa-Amadhila even increased them over the last three years and is planning to further increase them in the future. However, the composition of expenditures could be adjusted. The OECD suggests that the government should invest even more in education, water, electricity and telecommunication to further attract investments.<sup>24</sup> In addition, the government investments in trade, industry and agriculture are marginal. More investments in the industry sector would certainly lead to competitiveness and private investments from abroad. Plus, higher expenditures in social security would lead to higher demand. Transfers to the lowest income groups increase their productivity and ability to work.<sup>25</sup> On top of this, social expenditures allow small entrepreneurs and worker to engage in risky actions, because they are saved by a social safety net. Thereby, innovations and creativity increase. Finally, imperfections of the financial markets are reduced by social expenditures.<sup>26</sup> All these factors would lead to growth and competitiveness of the Namibian economy.

In conclusion, increasing expenditures was the right decision. But the composition of the expenditures could be adjusted. Defence is a large receiver, which is not necessary for growth.

<sup>23</sup> Source: Ministry of Finance: Estimated revenues and expenditures and MTEF 2011/2014

<sup>24</sup> Chipeta/ Schade (2007: 151)

<sup>25</sup> Ashoff (1988: 258)

<sup>26</sup> Tanzi/ Zee (1997: 189)

Therefore, some of the funds could be channelled to education and social security. Plus, subsidies for certain industries would lead to competitiveness and growth.

## 5. Namibian Tax Revenues Under Global Market Pressures

The Namibian state revenues have increased excessively over the past 20 years. While the tax revenue in 1990 made up around only one N\$ billion, the revenues in 2011 will probably account for around N\$ 26 billion. The biggest share of these revenues is made up of the customs revenues collected and distributed by the Southern African Customs Union (SACU). Unfortunately, these revenues decreased last years and will further decrease in the future. Namibian policy makers now have to find new ways of revenue collection. Until now the Namibian fiscal policy authorities tried to fill this gap, by increasing personal income taxes and taxes on goods and services to similar shares. An alternative would be to increase the property taxes and the corporation taxes for the mining industry.

### 5.1 How do Namibian policy makers cope with the drop in SACU revenues?

SACU collects the customs for Namibia, Botswana, Swaziland, Lesotho and South Africa and channels the funds on basis of a formula to the countries again. In Namibia these revenues constitute a substantial share of the budget. However, in the last years the revenues decreased radically, because of lower trade activity in the union. In 2008/2009 around 40% of Namibian tax revenues were collected by SACU as customs, in 2011/2012 it will only be 27.3%.<sup>27</sup> Plus, they will decrease even further due to the 2010 extension of the customs union to all SADC countries. Before the extension Namibia had gained the customs from Non-SACU countries of the SADC, which now are members of the customs union and therefore do not pay customs to SACU countries anymore. In addition to the current decreases in revenues, a report of the Australian Centre for International Economics recommends a new revenue-sharing formula which would decrease the customs and excise revenues ever more for Namibia, Swaziland, Botswana, but increase them for South Africa. If the union would follow the report's advice Botswana, Namibia and Swaziland would lose an amount of 2% of GDP every year.<sup>28</sup> Table 5 shows how the revenues dropped over the last years.

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<sup>27</sup> Source:Ministry of Finance: Final MTEF 2011/12 by Ministry of Finance

<sup>28</sup> Duddy, Jo-Mare (2011: 1-2)

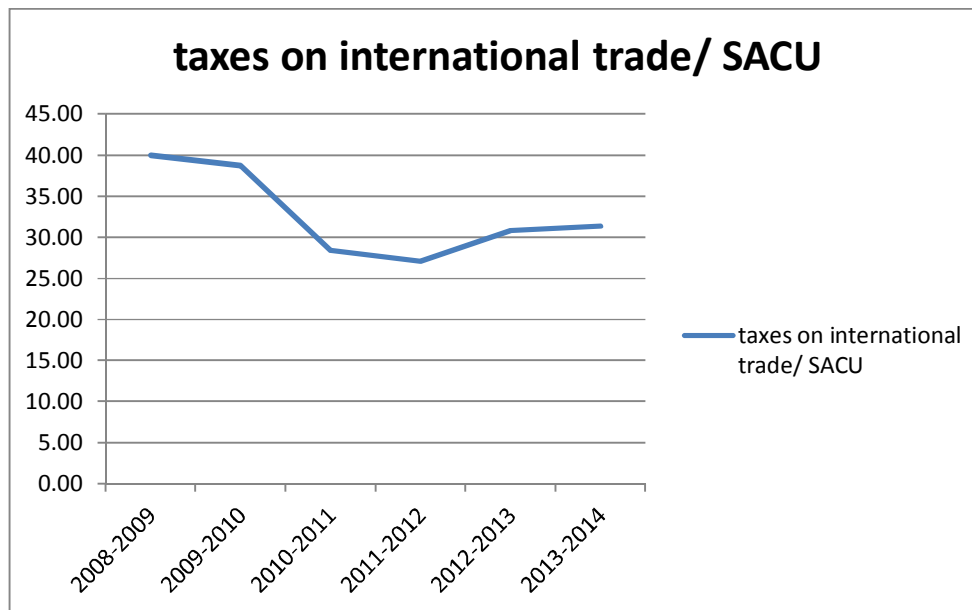


Table 5: SACU customs revenues as share of total tax revenues 2008-2014.<sup>29</sup>

The decreases in custom revenues have to be replaced by higher taxes or other revenues. While in 2008/2009 revenues from income tax accounted for 20% of tax revenues, VAT made up for 18% and company taxes had a 15% share of tax revenues, in 2011/12 the composition had already changed significantly due to the lower SACU revenues. The personal income tax share of the budget increased by 4.8 percentage points, the share of VAT was raised by 4 percentage points. However, the share of company taxes only increased by 2.5 percentage points and property tax revenues were kept stable, as shown in table 6.<sup>30</sup>

Namibian fiscal policy is restrained by the lower incomes from SACU. Instead of cutting expenditures ó as neoclassical theory would propose ó Namibian policy makers increased expenditures and filled the gap by increasing the state revenues. This kind of policy overall is in line with Keynesian suggestions. However, the composition of the increased revenues might have had a negative influence on the demand stimulation. Since VAT, which affects the poorest in the country most, was increased by the same amount as the progressive personal income tax revenues. Plus, company tax revenues have increased only little and property taxes not at all. Demand would have increased by higher amounts, if the revenue composition would have been more redistributive.

To conclude, the problem of lower SACU revenues was not solved by lower expenditures, but

<sup>29</sup> Source: Ministry of Finance: Estimated Revenue and Expenditure 2010/2011

<sup>30</sup> Source: Ministry of Finance: Estimated Revenue and Expenditure 2010/2011

higher revenue collection. This might have increased demand and growth. However, the internal market would gain more, if instead of increasing VAT, property taxes and corporate taxes for mining would be increased, as explained in the following sections.

## 5.2 Does the composition of Namibian tax system favour growth?

The Namibian tax revenues are composed half of indirect tax revenues and half of direct tax revenues. Indirect taxes are VAT and SACU customs and direct taxes are personal income taxes, corporate taxes and property taxes. Even though supply side economics would recommend to even increase the non-distortionary VAT and decrease all other taxes, I argue that the Namibian system already collects too much of the poor's income by a high VAT. For an increase of growth, a reform of the tax system is needed, which decreases VAT and increases at least the property tax.

Personal income tax revenues account for around 24% of tax revenues and are therefore an important source for the budget. Their share of overall taxation increased by 4.8 percentage points over the last 3 years, as shown in table 6. The tax itself is structured fairly progressive. A person who earns less than N\$ 40.000 does not have to pay taxes. Individuals with an income of N\$ 40.000 to 80.000 have to pay 27% taxes on the amount exceeding 40.000. Those who earn in between N\$ 80.000 and 200.000 have to pay the amount of N\$, 10.800 plus 32% on the amount exceeding N\$ 80.000. An income of N\$ 200.000 to 750.000 is taxed by the amount of N\$49.200, plus 34% on the amount exceeding N\$200.000. Finally, all income above N\$750.000 is taxed by N\$ 236.000 amount plus 37% on the income.<sup>31</sup>

The value added tax also is an important revenue source for the Namibian treasury. It accounts for around 22% of the overall revenues. Its share increased over the last 3 years by 4 percentage points. Even though there actually is only one rate of 15%, which is levied on goods and services, there also is a zero rate for exports, international transport, land, staple food, petrol and diesel, livestock.<sup>32</sup>

While VAT and personal income taxes constitute a significant share of the revenue, taxes on property and withholding taxes on interests are very tiny.<sup>33</sup> The corporate income taxes will separately be examined in the following section.

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<sup>31</sup> Pkf (2010: N3)

<sup>32</sup> Pkf (2010: N1)

<sup>33</sup> Source: Ministry of Finance: Estimated revenues and expenditures 2011/2012

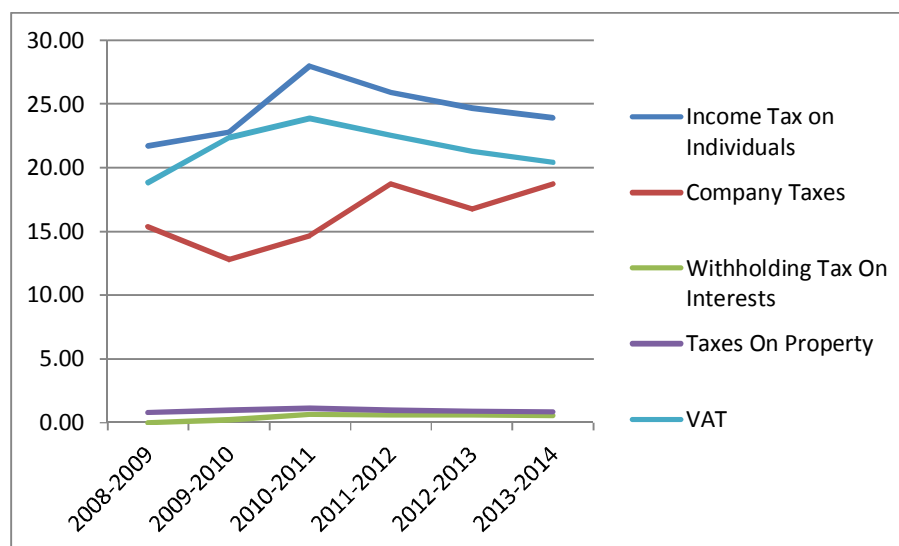


Table 6: Revenues as share of total tax revenues 2008-2014.<sup>34</sup>

The Namibian tax system is constructed of a more or less equal share of VAT and personal income taxes, a lower share of company taxes and no taxation of property. This again shows the supply side orientation of the previous and the current government. As endogenous growth theory would suggest a high share of state income accrues from VAT. Endogenous growth theory would also dissuade from high income taxes, because it lessens the incentive to save and therefore to accumulate capital.<sup>35</sup> However, the Namibian tax structure suppresses demand and the development of the internal market. Most of the Namibian revenues stem from indirect taxes, as shown in tables 7 and 8. While 51% of Namibian revenues are accrued by indirect taxes, only 48% of revenues are collected by indirect taxes. This is problematic, because indirect taxes affect the poor most. A higher share of direct, progressive taxes would lead to a more equal income distribution and thereby to consumption.<sup>36</sup> The Namibian government decided to implement a zero VAT rate on basic food. This will definitely favour growth and development. Another concept of redistributive tax policy would be to impose a tax on luxury goods.<sup>37</sup> Plus, since property tax is almost non-existent its rate should be increased. The taxation potential is high in countries with high inequality in distribution of income and wealth.<sup>38</sup> Since Namibia is the country with the highest Gini-coefficient in the world, the taxation potential is very high.

In sum, for increasing growth rates, Namibian fiscal authorities should increase the progressive personal income tax, rather than increasing VAT. But even more importantly, property tax

<sup>34</sup> Source: Estimated Revenue and Expenditure 2010/2011 by Ministry of Finance

<sup>35</sup> Tanzi/ Zee (1997: 185)

<sup>36</sup> Kaldor (1971: 324)

<sup>37</sup> Ashoff (1988: 259)

<sup>38</sup> Kaldor (1971: 316)

should be raised. Thereby the poor in the country would have higher incomes, which will lead to growth, because they spend most of these incomes again. Lower taxes for those who have the highest propensity to consume will lead to demand and growth. Also competitiveness will increase, because the industry sector will gain from the demand.

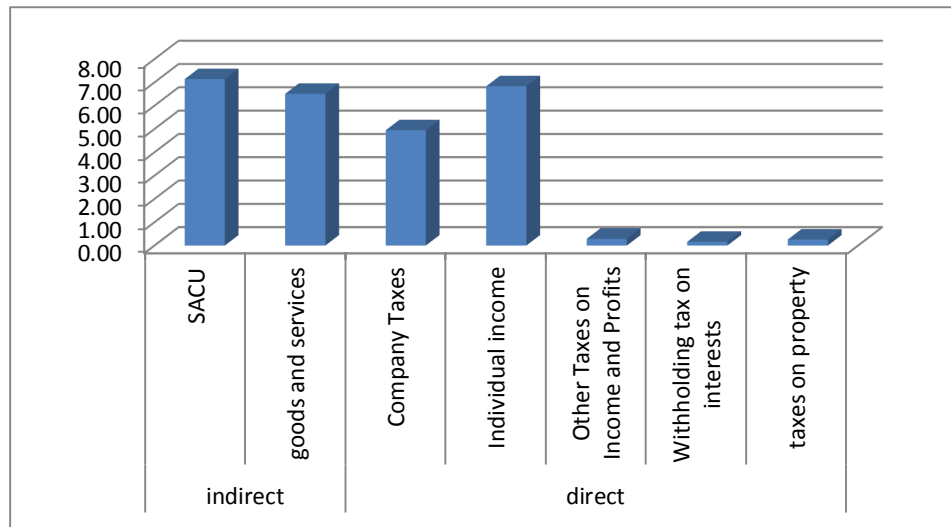


Table 7: Direct and indirect tax revenues 2011/12.<sup>39</sup>

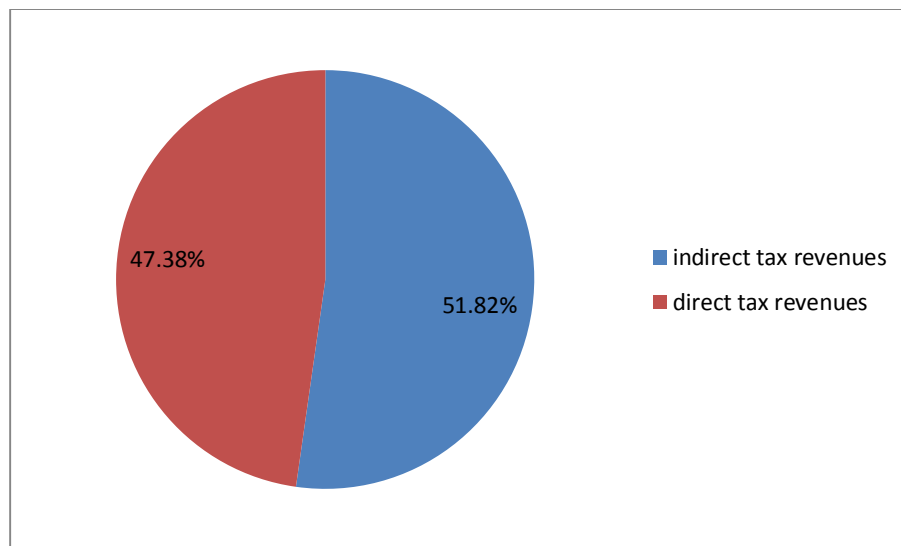


Table 8: Direct and indirect taxes as shares of total taxation 2011/12.<sup>40</sup>

<sup>39</sup> Source: Ministry of Finance: Estimated Revenue and Expenditure 2010/2011

<sup>40</sup> Source: Ministry of Finance: Estimated Revenue and Expenditure 2010/2011

### 5.3 Company taxes in Namibia ó Are tax concessions necessary for growth?

Namibia is a highly liberalised country, which stands under strong tax competition. Company taxes in Namibia have overall been lowered over the years. Plus, for attracting manufacturing corporations to the country companies gained special incentives, for instance in EPZs. However, redistributive tax policy is still possible.

The corporate income tax rate in Namibia is 35%. Its revenue share of total revenues increased from 2008 to 2010 from 15% to 19%. The biggest share is paid by the non-mining sector, while the diamond mining and other mining companies are contributing least to the revenues, as shown by table 9. Tax revenues from diamond mining even decreased from 2008 to 2010, while revenues from the non-mining sector increased slightly.<sup>41</sup> Shareholder taxes and withholding taxes on interest taxes are minimal. Plus, to improve the conditions for manufacturing firms, the Namibian government introduced a 50% tax deduction for the first 5 years in 2003, which is then phased out over 10 years.<sup>42</sup> On top of this exporters of manufacturing get an 80% CIT allowance on export income.<sup>43</sup>

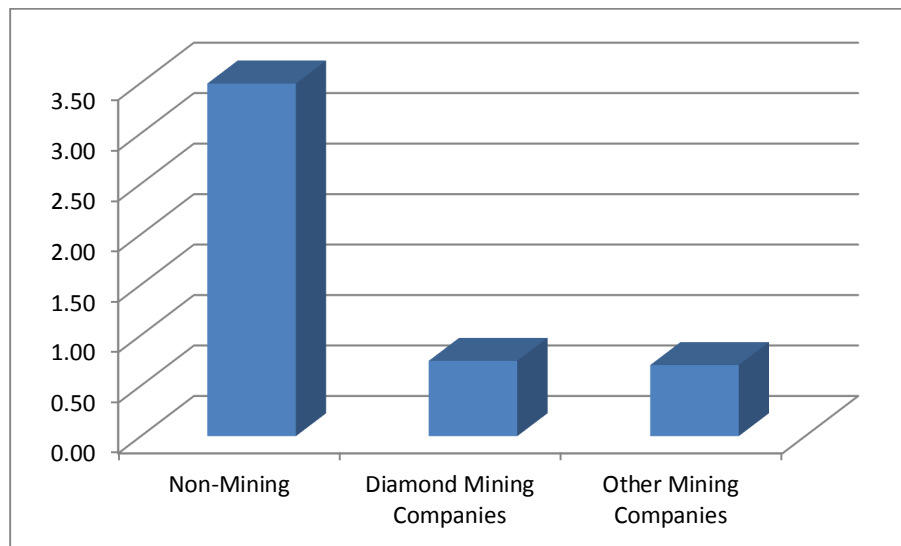


Table 9: Company tax composition 2011/12

<sup>41</sup> Ministry of Finance (2010: 14)

<sup>42</sup> Sherbourne (2009: 28)

<sup>43</sup> Southern Africa Global Competitiveness Hub (2006: 46)

In the year 2000 the Namibian government introduced Export Processing Zones (EPZ), which attract manufacturing firms to the Namibian market. Manufacturing companies operating in EPZs are exempt from VAT and CIT.<sup>44</sup>

Namibia has followed the neoclassical advice to implement tax concessions to corporations. Since the Namibian economy is highly liberalised and integrated into SACU markets,<sup>45</sup> it has to compete with all the products from this region. Especially products from South African are highly competitive and it is therefore difficult for Namibian products to gain a market share. Therefore tax incentives seem to become ever more important for Namibia to make corporations more competitive and to attract corporations to operate or invest in Namibia. In addition, Namibia cannot use the exchange rate mechanism to balance the low competitiveness ó e.g. devalue the currency to lower the prices of domestic exports<sup>46</sup> - because it does not have sovereign monetary policy under the Common Monetary Area (CMA).<sup>47</sup> However, even though Namibia finds itself under extreme tax competition pressure, redistributive tax policy would still increase growth. For instance more revenues could be collected from the mining sector. Due to their dependence on Namibian resources mining corporations would not leave due to higher taxes. In addition, EPZ policy needed to be enhanced, since a study by the National Planning Commission showed that only 32 of 116 EPZ companies were operating.<sup>48</sup>

In conclusion, Namibia has followed a supply side tax policy when it comes to corporate taxes. Not only was the corporate income tax lowered over the years, but also manufacturing corporations gained specific incentives to operate in the country. Since FDI did not increase by these policies, redistributive policies should be implemented. New revenues could be collected from the mining sector for instance.

## 6. Concluding Remarks

Namibian supply side orientation in fiscal policy did neither lead to investments nor growth. Even though fiscal authorities always tried to keep the budget balanced and even introduced a fiscal target in 2001, this did not lead to higher investments via financial market confidence as neoclassical theory had predicted. Even during the years in which Saara Kuugongelwa-Amadhila achieved a surplus of the budget, neither investments nor growth increased. After the Minister of Finance cut expenditures during the years 2003 and 2007, she needed to increase them during the Financial Crisis. After the crisis she further increased them within the MTEF 2011/2014 to create jobs. This approach overall is good to increase demand. However, more funds should be channelled from the defence to

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<sup>44</sup> Ibid.

<sup>45</sup> OECD (2010: 58)

<sup>46</sup> Wagschal (1999:223)

<sup>47</sup> Chipeta/ Schade (2007: 46)

<sup>48</sup> Sherbourne (2009: 194-5)

social, education and industry sector. These areas mostly determine the growth rate, demand and employment. They enhance productivity and thereby competitiveness. Plus, if the poorest in the country have a little more income, they spent most of this income on consumption and thereby boost growth. This will also make Namibia more attractive to investors, which want to serve the domestic market. Moreover, the competitiveness of the Namibian industry would increase by higher subsidies and higher demand from the domestic market. The Minister of Finance will also have to find a solution to the fading SACU revenues in the coming years. Right now this gap is filled by higher VAT and personal income tax. I would suggest instead to increase property taxes, which are more or less non-existent at the time, and to increase the corporate taxes for mining. The mining industry is dependent on the Namibian resources and will therefore stay in the country even if taxes are increased. With increased revenues from these two areas, taxes on consumption could be lowered, which again increased the consumption. A zero VAT rate on staple foods is a good step. However, the demand for manufactured goods must be increased by lower VAT as well. Thereby, industrialisation and competitiveness will be triggered.

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