Namibia: Selected Issues Paper

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NAMIBIA

Selected Issues

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I. SOUTHERN AFRICAN CUSTOMS UNION REVENUE SURGE AND FISCAL RESPONSE IN BOTSWANA, LESOTHO, NAMIBIA, AND SWAZILAND[1]

A. Introduction

1.   **The Southern African Customs Union (SACU), the oldest customs union in the world, comprises Botswana, Lesotho, Namibia, and Swaziland (known as the BLNS countries) and South Africa.** The increase in annual average SACU revenue collected by BLNS countries from about 12.7 percent of GDP in the early 2000s to 20.7 percent in 2008 has had major macroeconomic and fiscal implications. The revenue surge depended primarily on economic growth in South Africa, which accounts for more than 60 percent of intraregional trade, and a change in the revenue-sharing formula that increased the share of the smaller countries.

2.   **While the magnitude of the increase represents the main challenge to fiscal policy in the BLNS, an additional issue is its unpredictability, which in most recent years has resulted in substantial ex post revenue adjustment or "windfall" revenue.** The inability to predict the amount of the revenue has complicated fiscal policy and encouraged an implicit assumption that SACU revenue will continue to be high. This has contributed to a substantial increase in government consumption and a procyclical fiscal policy.

3.   **The surge in revenue has raised questions about how the BLNS countries manage fiscal policy.** The objective of this paper is to analyze how policy has responded to the positive SACU revenue shock. In what follows, Section II discusses the background and structure of SACU. Section III examines the fiscal responses of the BLNS countries to the SACU revenue surge. Section IV discusses useful international experience while Section V discusses a framework for fiscal response in the countries. Section VI concludes the study.

B. The SACU Area: Background and Institutional Arrangement

4.   **Although the SACU countries are geographically close, their economies differ markedly, and there are large disparities in population, land mass, size of the economy, relative economic well being, and sectoral composition of economic activities.** South Africa, the dominant economic force, accounts for over 90 percent of regional GDP. All the BLNS countries except Lesotho report

SACU Countries: Main Indicators

Country	Population (Millions)	GDP ($ Billions)	GDP per Capita $	Average Growth Rate (1990-2008)
Botswana	1.7	12.4	7,322.8	5.5
Lesotho	2.5	1.6	663.5	3.8
Namibia	2.0	8.4	4,130.0	4.7
South Africa	48.7	277.6	5,701.0	2.8
Swaziland	1.0	2.8	2,777.6	2.7

Sources: Country authorities; and staff estimates.

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[1] Prepared by Iyabo Masha and Kangni Kpodar

high enough per capita income to warrant classification as middle-income countries. However, in most of the countries income distribution is highly skewed. Economic growth in the region as a whole has accelerated since apartheid ended in South Africa in 1994.

5.   **The BLNS countries are highly open (Table 1), and most of the imports are supplied by South Africa firms.** Because the SACU is a free trade area, these imports are free from tariffs and virtually all other trade barriers, as well as transaction costs for currency conversion, which comes with membership of the Common Monetary Area (CMA), a currency union with South Africa to which all belong except for Botswana. On the other hand, the bulk of exports from Botswana, Lesotho, and Namibia are destined for markets outside the SACU.

Table 1. SACU Countries: Foreign Trade Indicators, 2005–07

	SACU				
	CMA				
	Lesotho	Namibia	Swaziland	South Africa	Botswana 1/
Direction of Trade					
Exports to: 2/	(In percent of total exports)				
South Africa	17.6	23.5	45.2	n.a.	9.9
Europe	9.9	46.1	14.4	35.4	67.9
United States	68.5	2.5	3.2	11.6	1.0
Rest of the world	4.0	27.9	37.2	53.0	21.2
Imports from: 2/	(In percent of total imports)				
South Africa	78.2	82.4	92.9	n.a.	83.5
Europe	2.3	5.9	0.1	34.7	6.0
United States	0.8	1.5	0.4	7.6	1.2
Rest of the world	18.7	10.3	6.6	57.7	9.3
Trade to GDP ratios 3/	(In percent)				
Total exports	52.7	40.3	76.9	31.5	48.5
Total imports	102.5	41.3	87.2	34.6	35.4
Main export commodities	Garments	Diamonds and other minerals	Sugar and drink concentrates	Gold, iron ore, platinum, and other minerals	Diamonds
As a share of total exports (percent)	70	56	59	33	78

Sources: National authorities; and IMF staff estimates.

1/ Botswana is not a member of the CMA.

2/ Excludes re-exports. Trade with South Africa is the total with the CMA based on SACU data.

3/ 2004–05 average.

6.   **The SACU[2] has evolved from the initial 1910 Customs Union Arrangement via new agreements in 1969 and 2002.** Under the 1910 arrangement, all member states applied South African import duty rates to imports from other countries. South Africa administered the common customs revenue pool and distributed it among members on the basis of fixed (not trade-related) shares, which gave it more than 90 percent of the revenue. The 1969 agreement distributed customs union revenue using a formula that calculates revenue shares for each BLNS country with South Africa's share being what remains. The formula allocates customs and excise duties according to each country's share of total extra- and intra-SACU imports and excisable goods consumed within the customs union. The formula also contains a provision that enhances each BLNS country's revenue receipts by 42 percent. Revenues are distributed with a lag of two years. An important addition was made in 1977, when a "stabilized revenue rate" was introduced that promised to the BLNS countries as a group minimum receipts equal to 17 percent of the total value of SACU imports and excisable value. Because the guarantee is binding, it moderated the uncertainty about receipts; it also resulted in higher SACU receipts than would have been otherwise.

7.   **The 2002 Agreement sought to** (i) facilitate cross-border movement of goods between the member states; (ii) create effective, transparent, and democratic institutions that ensure equitable benefits to member states; (iii) promote fair competition in the common customs area; (iv) substantially increase investment opportunities in the common customs area; (v) enhance the economic development, diversification, industrialization, and competitiveness of member states; (vi) promote the integration of member states into the global economy through enhanced trade and investment; (vii) facilitate the equitable sharing of revenue arising from customs and excise duties levied by member states; and (viii) facilitate the development of common policies and strategies. The agreement introduces a new institutional structure, a new system of managing and sharing the common revenue pool, and a dispute settlement mechanism; it cites the need for common policies for industrial development, agriculture, competition policy, and unfair practice.

8.   **The revenue-sharing formula of the 2002 agreement, for a given financial year, is**

$$R_i = C * \frac{A_i}{A} + (0.85) * E * \frac{GDP_i}{GDP} + (20) * (0.15) * E * \left[1 - \frac{(Y_i / Y) - 1}{10} \right]$$
(1)

where:

R_i =   revenue share of SACU country i
i =   Botswana, Lesotho, Namibia, South Africa, or Swaziland

[2] This discussion is based on Wang, Masha, Shirono, and Harris (2007).

C	$=$	all customs duties actually collected on goods imported into SACU, less the cost of financing the Secretariat, the Tariff Board, and the Tribunal, less customs duties rebated or refunded
A_i	$=$	c.i.f. value at the border of imports of SACU country i from all other SACU members, less re-exports
A	$=$	total c.i.f. value at the border of intra-SACU imports, less re-exports
E	$=$	all excise duties actually collected on goods produced in the SACU area, less the cost of financing the Secretariat, the Tariff Board, and the Tribunal, less excise duties rebated or refunded
GDP_i	$=$	gross domestic product of SACU country i
GDP	$=$	total gross domestic product of SACU members
Y_i	$=$	gross domestic product per capita of SACU country i
Y	$=$	average gross domestic product per capita of all SACU members.

The new formula thus has three parts:

- The **customs component** ($C*(A_i/A)$), in which all customs duties collected in all member countries are distributed to each country in proportion to its share of intra-SACU imports. On the basis of 1998/99 trade, South Africa would have contributed about 80 percent to the customs component and its share of the customs pool would have been 20 percent.

- The **excise component** ($E*(GDP_i/GDP)$), set initially at 85 percent of total excise duties collected in all member countries, is to be distributed to each country in proportion to its share of SACU GDP. In 1998 South African GDP represented about 93 percent of SACU total GDP, and its share of this component would have been about 79 percent.

- The **development component** ($20*(0.15)*E*(1-((Y_i/Y)-1)/10)$), set initially at 15 percent of all excise duties collected in all member countries, is distributed inversely to GDP per capita: the smaller a country's GDP per capita, the larger its share of the development pool.

9.   **Thus the BLNS countries would largely derive their SACU revenues from the customs component, and South Africa would get most of its from the excise component, and the development component would augment the receipts of the less developed members.** The 2002 agreement is also more democratic than the 1969 agreement. All member countries now take part in managing the customs union and have a voice in setting new tariffs, which were previously set by South Africa's Board on Tariffs and Trade.

Figure 1. SACU: Distribution of the Common Revenue Pool in 2006/07
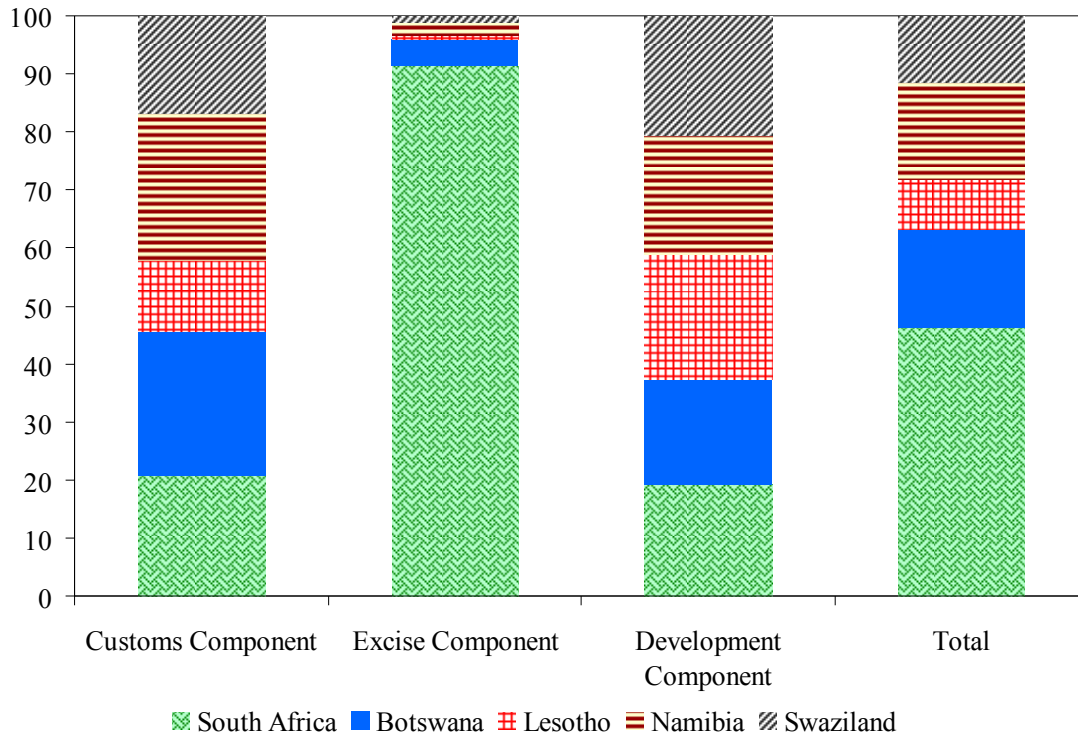
Sources: Country authorities; and Fund staff estimates.

10.   **Though the revenue accruing to the BLNS countries partly reflects domestic economic conditions–e.g. import consumption and domestic demand—but there is also a transfer payment linked to the development component of the revenue pool**. The fiscal transfer element of SACU receipts is however, not unique among regional trade areas, though the mode of administration differs. Unlike the SACU, the EU structural funds are used to finance projects based on common policies agreed by the members. New member countries are the largest recipients. The allocation is done at the central level and is considered as a best practice in a well developed federal-like system.

Figure 2. Net Regional Transfers as a Share of Government Revenue
in Selected Regional Agreements, 2006[1]

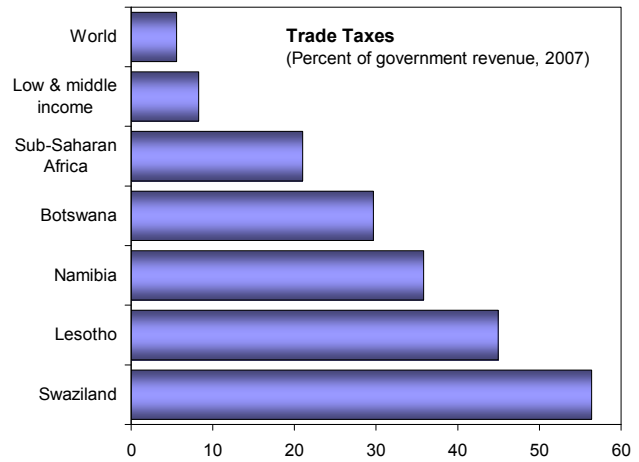**EU: Ten Largest Recipients**
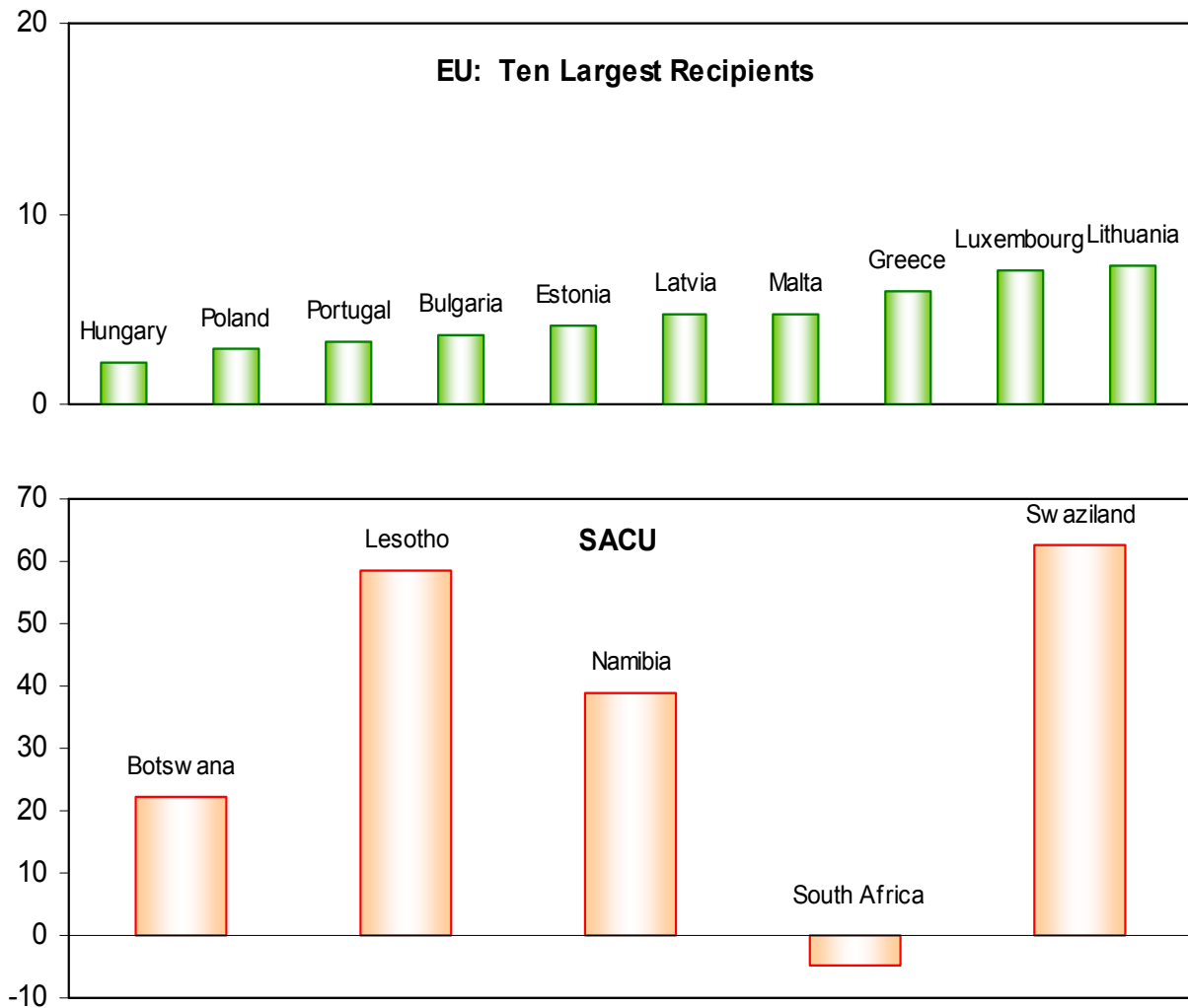
SACU

Sources: European Union Budget 2007, Financial Report; and IMF.

1/ For EU countries, net transfers are equal to national contribution minus EU financing received by the member country. For SACU countries, net transfers represent net contribution to the common revenue pool.

C.   Recent Fiscal Trends in the BLNS

11.   **The reliance on trade taxes in BLNS countries is the highest in the world.** In 2007, trade taxes as a share of total revenue in all SACU exceeded the average for Sub-Saharan African and lower middle income countries, as well as the world average. In Swaziland, the most reliant, SACU receipts amount to over 50 percent of total revenue in 2007/08. Though Botswana[3] has a relatively lower ratio of trade taxes to government revenues mainly because of high revenue from mining, its ratio is nevertheless higher than the sub-Saharan African average. Domestic revenue effort has not been as strong as it should be in the countries, except Botswana, where mining revenue are a major source of revenue. In the other countries, the share of non-SACU revenue has not kept pace with the growth of SACU revenue, and in 2008, non-SACU revenue to GDP ratio is generally lower than in the past.

12.   **Since the mid 2000s, SACU receipts have increased by, on the average, around 8 percentage points of GDP.** The main driver of the increase is the higher level of economic activity in South Africa, resulting in an enlarged customs revenue pool. In addition, the introduction of a fiscal transfer element from 2005, which benefited less developed member countries relative to the more developed ones, also contributed to the increase in the share of the smaller members of the union. Apart from the size of the SACU receipts relative to other revenue, a major issue in its intermediation is the ex post adjustment, due to the distribution agreement which stipulates adjustment payments after the actual intra-SACU trade data become available (Section II). Backward revision to prior distributions means that surprise revenue of the order of 5–8 percent of GDP in some instances; are announced in the middle of the budget year, complicating the stance of fiscal policy.

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[3] Due to Botswana's different economic structure and higher dependence on nonrenewable mineral resource, while the trend focuses on BLNS countries, the discussion and conclusions may not be strictly applicable.

Figure 3. BLNS: SACU and Non-SACU Revenue as a Share of GDP, 1994–2008

Botswana

Lesotho

Namibia

Swaziland
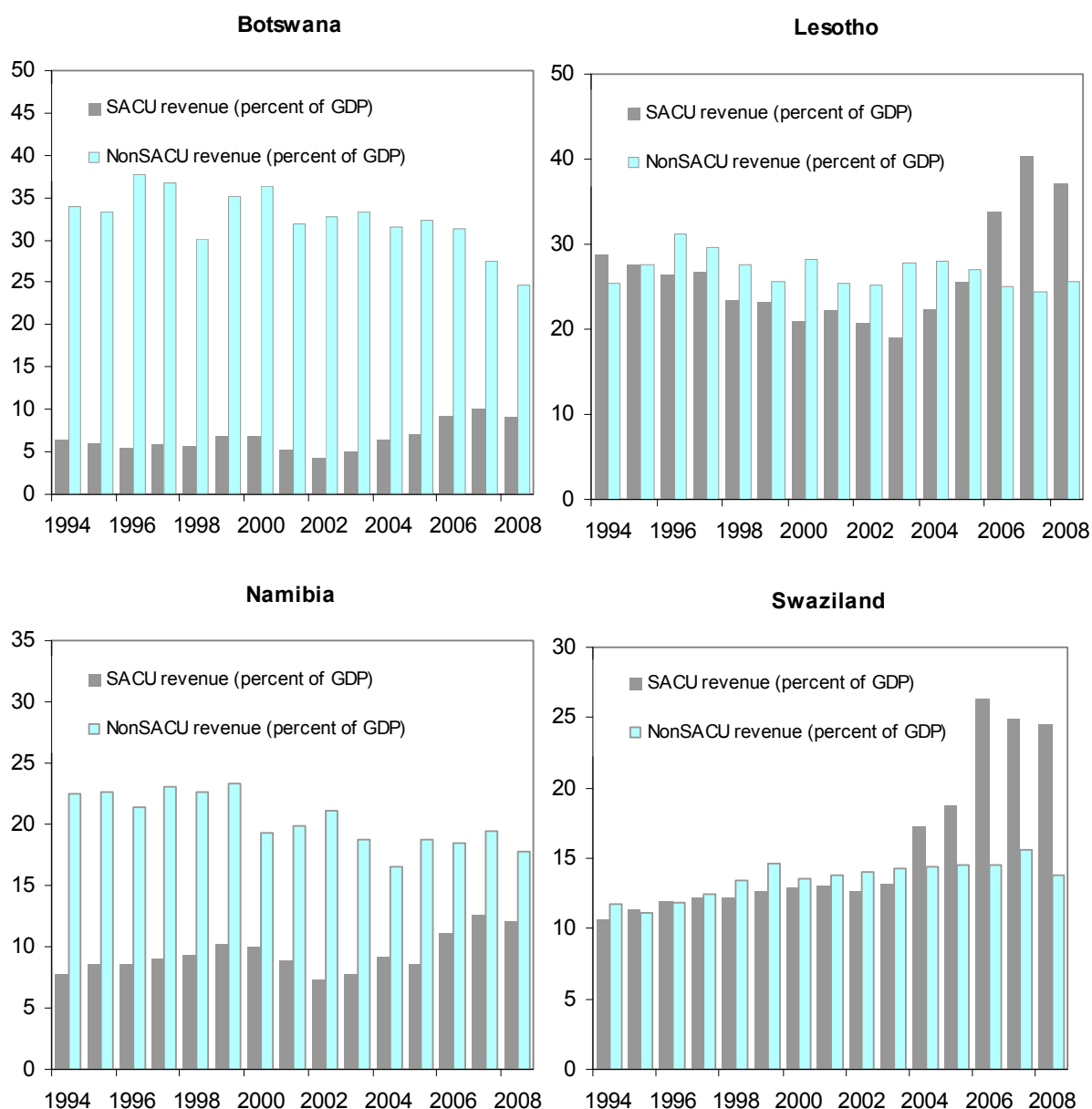
Sources: National authorities, and IMF staff estimates.

13.   **During the same period, the fiscal stance changed considerably in the countries.**
The most important change started from around 2004/05, the period coinciding with high
SACU receipts. While Lesotho reports a substantial increase in expenditure, in other
countries with less noticeable increases, there have been changes in the composition of
expenditure with most of the increase benefiting current expenditure. In Lesotho, from 2005
to 2008, spending increased by about 9 percentage points of GDP. In Namibia, the increase
in expenditure was 3 percentage points during the same period, with current expenditure,
especially wages, growing at a much faster rate than other categories. In Botswana the

increase in spending was only 0.7 percent, while in Swaziland expenditure grew by about 3.4 percentage points of GDP. Most of these increases took place in the past three years, as the initial "surprise" element of SACU revenue adjustment gave way to expectations of permanently higher intake.

Figure 4. BLNS: SACU Revenue and Government Expenditure, 1994–2008
(In percent of GDP)
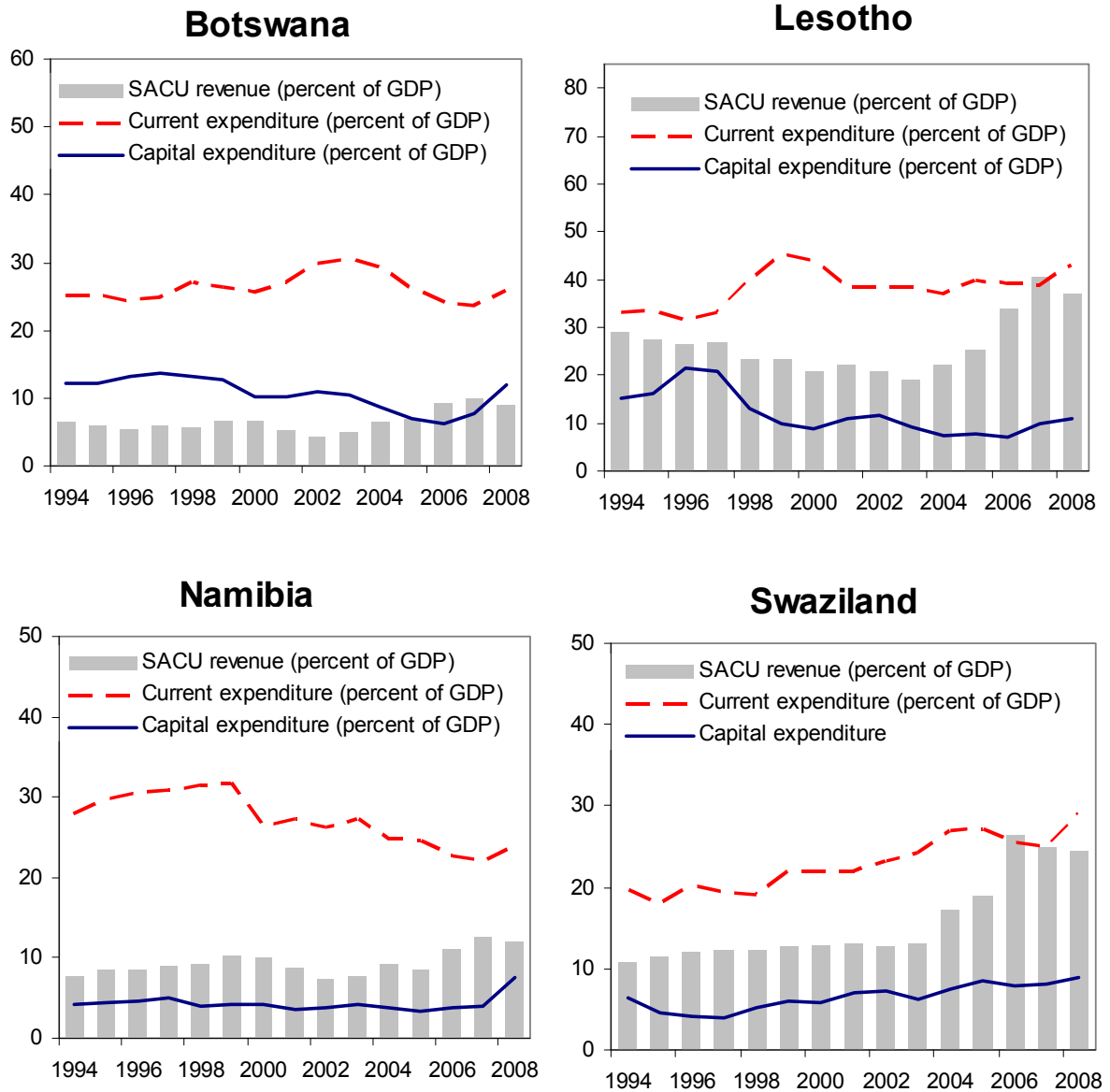
Sources: National authorities, and IMF staff estimates.

14.   **Despite the procyclical stance of fiscal policy during the period, SACU countries have, however, been able to strengthen their overall fiscal position.** Between 2000 and 2008, the average overall fiscal balance improved by between 1.3 (Namibia) to 17 (Lesotho)
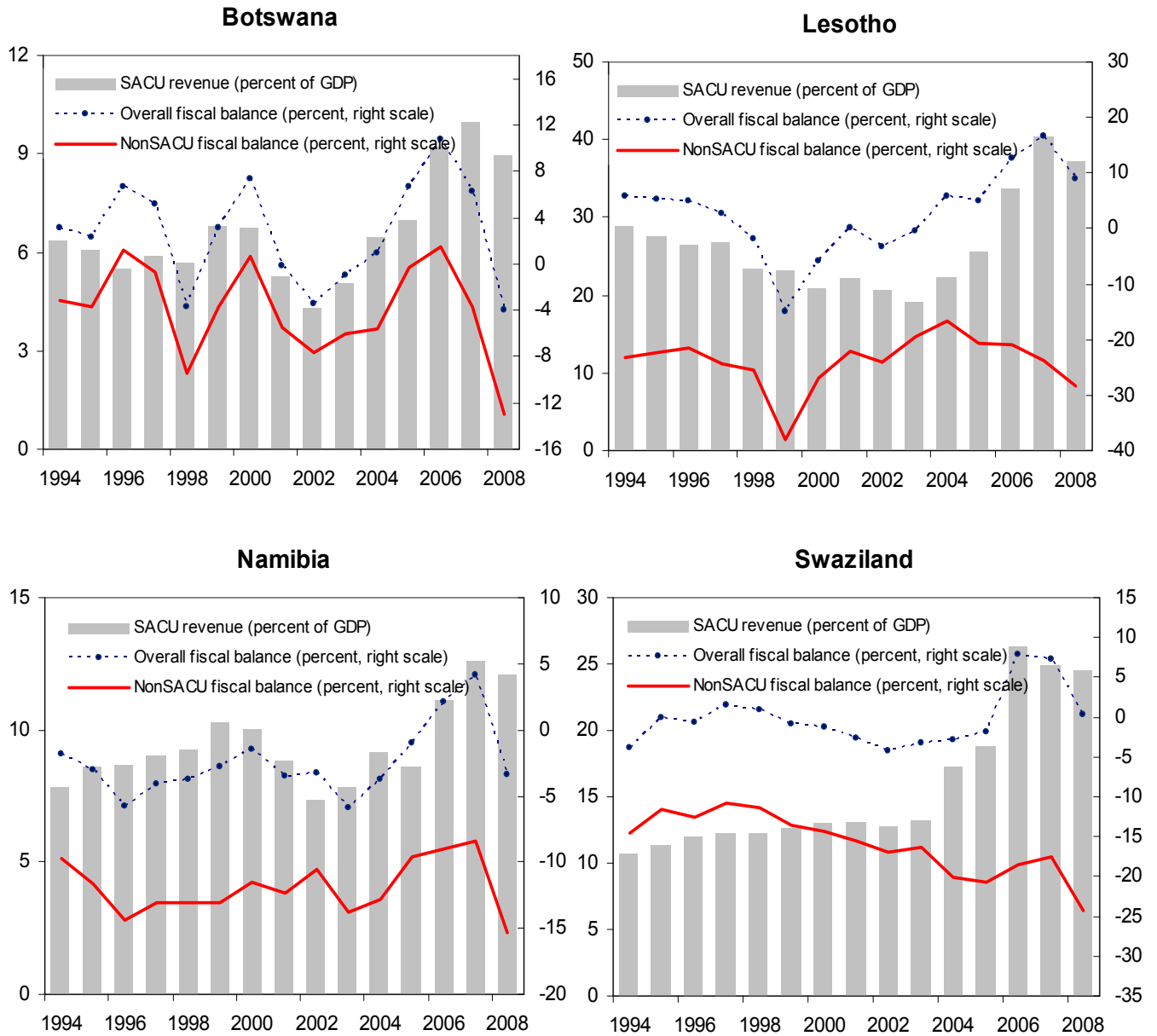
percentage points of GDP. In these two countries the windfall revenue was used to pay off high interest debt, or to lower the debt stock generally.

15.   **The overall balance, however, does not provide a realistic assessment of the fiscal stance.** A measure of structural balance, the non-SACU balance, which is based on revenue generated only from non-SACU sources indicates that none of the countries ran a surplus in their fiscal operations during the period, except Botswana for a brief period. The non-SACU balance appears to have deteriorated more strongly between 2004 and 2008, the period coinciding with the surge in SACU revenue. Therefore, increasing SACU revenue seems to have contributed to even wider deterioration in the fiscal accounts. As an indication of the importance of domestic revenue effort, the trend in the non-SACU balance implies that higher SACU revenue engendered lower domestic revenue efforts.

16.   **In light of these trends, especially the sensitivity of the fiscal stance to SACU revenue, the BLNS countries face important challenges in the design of a consistent fiscal framework.** The challenges include anchoring fiscal policy on a sustainable debt path; maintaining macroeconomic stability; moderating the impact of volatility through a consumption path that does not overheat the economy in good times, and focuses on offsetting negative shocks in times of downturn. In addition, there is need to improve the institutional framework to support improved revenue administration, expenditure management; and more efficient public finance management. In addressing similar issues, countries have found it useful to adopt rules based fiscal frameworks, which provide the scope to not only address issues of sustainable debt, but also limit procyclicality during upswings or revenue booms. These are examined in the next section.

Figure 5. BLNS: SACU and Non-SACU Fiscal Balance, 1994–2008

(In percent of GDP)

Botswana

Lesotho

Namibia

Swaziland

Legend (each panel):
- SACU revenue (percent of GDP)
- Overall fiscal balance (percent, right scale)
- NonSACU fiscal balance (percent, right scale)

Sources: National authorities, and IMF staff estimates.

Box 1. Has Government Consumption been Procyclical in BLNS Countries?

A primary consideration in the design of fiscal policy is the cyclicality of government spending, defined in terms of how spending moves with the output gap. Fiscal policy should ideally be countercyclical, with spending declining as the economy expands (the output gap is narrowing or is zero), and increasing with downturns (the output gap is widening). Because estimating the output gap precisely is difficult in developing countries, the focus here, following much of the literature, is on the comovement between government consumption and output. A simple regression is carried out to test the procyclicality of government consumption in the BLNS countries:

$$\Delta \log(G)_t = \alpha + \beta \Delta \log(Y_t) + \gamma \log(G)_{t-1} + \delta T_t + \varepsilon_t \qquad (2)$$

Where log (G) is defined as the log of real government consumption, Δ is defined as the change in the variable, t is time, Y is real GDP, T is a time trend, and ε is an error term. In the equation, when β is positive, the fiscal stance is pro cyclical, with values in excess of 1 implying more than proportionate response of consumption expenditure to output fluctuations. When β is negative, this implies counter cyclical policy. The lagged level of government expenditure captures a lagged adjustment mechanism, and is expected to be negative if expenditure reverts to mean. The focus on consumption expenditure, and not capital expenditure allows for a better analysis of fiscal stance, considering that a large portion of capital expenditure decisions are influenced by external financing, and tend to include a large share of imports.

In line with Kaminsky and others (2004), government consumption is expressed in logs rather than scaled to GDP in order to avoid the influence of the cyclical behavior of output on the expenditure output ratio. Under this specification therefore, a pro-cyclical fiscal policy involves higher government consumption in good times and lower government consumption in bad times. Ordinary least squares estimates were undertaken for each country using annual data for 1986–2007.

The results indicate that real government consumption in the SACU countries is strongly pro-cyclical, with β values above unity in Swaziland, but least cyclical in Namibia. In addition, the lagged value of government expenditure took on the expected negative sign,

Cyclicality Coefficients for Government Consumption

	Period	Δ log (Yt)	log(G)t-1	B-G test
Botswana	1986 - 2007	0.76 (0.23) ***	-0.19 (.15)	0.002
Lesotho	1986 - 2007	0.68 (0.25) ***	-.18 (0.09)*	0.37
Namibia	1986 - 2007	0.30 (0.16) ***	-0.34 (0.15)**	0.69
Swaziland	1986 - 2007	1.14 (0.21) ***	-0.17 (0.13)	0.53

*, **, *** indicates statistical significance at 10, 5, and 1 percent levels, respectively.
B-G test is the Breusch Godfrey serial correlation LM test.
Standard errors in parenthesis.

while the trend coefficient (not reported) was not significant. The estimation provides similar results for the SACU countries as a recent staff study, Akitoby et al (2006), which using a different methodology; found that expenditure on goods and service was especially pro-cyclical in Swaziland, that current expenditure was significant in Namibia, and none of the spending categories was significant in Lesotho. There is therefore scope to implement fiscal policy that would limit procyclicality during upswings or revenue booms.

D. International Experience with Fiscal Frameworks

17.   **The adoption of rules based fiscal frameworks is common.** Though, these rules vary, they are often in the form of restrictions on expenditures, borrowing, deficits, and the overall debt level. In recent times, the establishment of sovereign and/or stabilization funds, especially in mineral endowed countries, to complement fiscal rules has accelerated. These allow for adjustments from the revenue side. In general, frameworks tend to be based on one or a combination of the following:[4]

Balanced budget or deficit rules

- Balance between overall revenue and expenditure, or a limit on government deficit as a proportion of GDP—for example, Canada, Italy, Germany, and Spain.

- Balance between structural (or cyclically adjusted) revenue and expenditure; or a limit on the structural balance as a proportion of GDP—for example, Switzerland and Chile.

- Balance between current revenue and current expenditure so that borrowing is permitted only to finance capital expenditure—for example, India and the United Kingdom.

Borrowing rules

- Prohibition of domestic government borrowing—for example, Indonesia.

- Prohibition or limit on central bank borrowing—for example, EU, Argentina, Chile, Peru, Hungary, and the CFA Zone.

Debt or reserve rules

- Limit on the stock of gross (or the net) debt as a proportion of GDP.

- A target stock of reserves of extra budgetary contingency funds (social security) as a proportion of annual benefit payments.

Constant Price Rule

- For budgetary purpose, a reference export price is applied to a commodity, regardless of actual market price. A stream of revenues based on the reference export price is contributed to the general revenue pool. If export prices exceed the reference price,

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[4] See Kopits and Symansky (1998).

the surplus is put in a stabilization fund or savings fund. Accumulated balances in the fund are available to sustain spending in the event of a shortfall in export prices and/or revenues. Such funds usually have stringent operational rules. While stabilization funds aim to reduce the impact of volatile revenue, savings funds seek to create a store of wealth for future generations. Some countries have a combined stabilization/savings funds.

Permanent income rule

- In this relatively new framework, fiscal rules are designed around a country's estimated permanent income from nonrenewable resources, on the assumption that the resources are exhaustible.

18.   **The results of the implementation of rules based fiscal frameworks have been mixed, according to recent staff studies.** In countries that have successfully implemented rules based systems, usually have a highly effective government and well-developed institutions that gives credibility to the system. Where these are lacking, such systems have had limited successes. In resource-rich countries with stabilization funds, implementing quantitative fiscal rules has proved challenging mainly due to the characteristics of oil revenue and political economy factors (Ossowski et al., 2008).

19.   **The SACU countries operate medium-term fiscal frameworks, which allow for a broader view of fiscal policy and stance than is possible in year to year budget cycles.** Botswana operates a medium-term national development plan closely linked to the budget process, which specifies that nonmineral revenue should cover noninvestment current expenditure (education and health are treated as investment). Except for a brief period in the early 2000s, the adherence to the rule has produced for prudent fiscal policies. Namibia's fiscal policy is anchored on a debt-to-GDP ratio of 25 percent of GDP or less. If adhered to, it could provide the ceiling for sustainable debt. Swaziland operates a Medium-Term Resource Framework that targets a fiscal deficit of below 2 percent of GDP. Lesotho's objective to run primary surpluses, has, in recent times, been largely met, though there are no hard rules. While the BLNS countries could benefit from introducing rules based systems, commitment to fiscal discipline in a supportive institutional environment needs to be strong for rules to be effective.

E.   A Framework for Fiscal Response for BLNS Countries

20.   **Volatile SACU revenue pose challenges for fiscal policy in the BLNS.** The impact of the volatility of the revenue on the fiscal stance largely reflects the narrow revenue base, and undiversified nature of the economy. BLNS countries need a medium-term fiscal framework that systematically addresses the issues of long-run sustainability, short-run volatility, and the institutional framework, building on three pillars:

- **Fiscal sustainability:** To anchor fiscal policy on a sustainable path, the framework could be based on a numerical anchor.

- **Stabilization and fiscal smoothing**: Fiscal policy should aim to counteract the volatility in revenue receipts, while preserving fiscal discipline. Once cyclically adjusted revenue streams have been forecast, expenditure policies need to consider the absorptive capacity of the economy to minimize the risk of overheating and inflation during upswings, and inadequate stimulus during downturn. Fiscal policy should therefore aim to stabilize the economic cycle by requiring unanticipated or above trend revenue to be saved to provide a cushion in periods of poor economic performance so that expenditure can be smoothed without causing abrupt adjustments, tolerating a recession or a high fiscal cost.

- **Public finance management:** A sound revenue administration and public expenditure management is crucial for sustainable fiscal policy; the effectiveness of institutions and government determines the extent to which resources are effectively and efficiently deployed to achieve policy objectives.

These issues are examined in turn.

21.   **Fiscal anchor**: A numerical anchor could ensure that fiscal policy is consistent with achieving a sustainable debt path, where sustainability requires that fiscal operations result in a deficit that stabilizes the debt to GDP ratio.[5] During an economic downturn, when real income growth is likely to be below potential, (as is currently the case), a counter cyclical fiscal policy could mean that fluctuations above the target could be tolerated. However, fiscal policy should aim at a level of deficit that stabilizes the debt to GDP ratio in the medium-term.

Public Debt and Fiscal Anchors in the BLNS, 2008

	Total Debt (In percent of GDP)	Fiscal Anchor
Botswana	5.0	1. Ceiling of 40 percent on expenditure
		2. Achieve a surplus in the noninvestment balance 1/
Lesotho	52.4	None
Namibia	24.8	25 percent of GDP public debt stock target.
Swaziland	21.4	None

Sources: Country authorities; and Fund Staff estimates.

1/ Defined by the authorities as the difference between non-mineral revenues and current spending excluding expenditure on health and education, which the authorities regard as investment in human capital.

22.   **In the BLNS countries, Namibia has a debt anchor, Botswana which has low levels of public debt, uses expenditure anchors to keep its fiscal stance prudent fiscal prudent. Swaziland and Lesotho have no anchors.** In Namibia, the government has chosen to anchor fiscal policy on a debt to GDP ratio of 25 percent or less. While the target was loosely based on comparator country analysis, it is consistent with research indicating that on

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[5] In resource rich countries, sustainability may not imply a stable debt to GDP ratio. See Clausen (2008), for an application to Botswana.

average the sustainable level of public debt for emerging market economies is about 25 percent of GDP; and it does not breech the threshold for debt intolerance derived in a recent staff study.[6] The anchor has in the past served Namibia well allowing for fiscal consolidation and providing the discipline required to reduce the public debt, from around 34 percent of GDP in 2004/05 to about 24 percent in 2007/08. However, there are risks to achieving the target over the medium term; and future deviation could set the debt level on an unsustainable path. In addition, the presence of contingent liabilities such as publicly guaranteed debts, and possible surprise calls of guarantees could result in an overshooting of the target, even if central government fiscal stance is prudent. The numerical anchor could therefore benefit, in line with best practice, from the inclusion of publicly guaranteed debt, and a widening of the coverage to net debt,.

23.   **In Botswana, thanks to the anchors public debt levels are low; the authorities have kept expenditure below 40 percent of GDP; and have run a balanced budget in the noninvestment fiscal operations except in two years.** Though the anchors have also, in general, served the country well, they may not reveal the structural fiscal stance. As noted in a recent staff study, overall balances could improve due to higher mineral revenues and then be misinterpreted as "fiscal consolidation" or "fiscal adjustment."[7] Nevertheless, given low public debt, debt sustainability is not an issue for Botswana.

24.   **In the design of sustainable fiscal policy, authorities in Lesotho and Swaziland might weigh the merits of a formal anchor that is based on public debt, relative to the current informal objectives on which fiscal policy is based.** If a fiscal anchor is chosen, the coverage of the public debt anchor should include publicly guaranteed debt net of government deposits. Such an anchor, if institutionalized, could help ease the pressure to spend during periods of high revenue.

25.   **Stabilization and smoothing:** Smoothing revenue sources requires the development of a mechanism that sets a reasonable and simple benchmark for a "normal" trend in revenue, and provides information on the feasible bounds for the deviation of the budget balance around its long run sustainable path. The benchmark revenue level should be set taking into consideration the trend in the volatile revenue category. If in any year, actual revenue is higher than the benchmark, the government should save the surplus. . In years of poor revenue performance, government could draw on the surplus accumulated to bring revenues to a stable path, and keep consumption smooth.

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[6] *World Economic Outlook* (October 2003), Chapter 3; and *Public Debt Threshold for Kenya* in Kenya: Selected Issues (2008).
[7] Clausen (2008). In this regard, the study recommended that a fiscal rule for Botswana be based on a permanent income hypothesis.

26.   **In determining which revenue subcategory would need to be cyclically adjusted to arrive at the benchmark total revenue, the key consideration for BLNS countries except Botswana is SACU revenue.** Though both mineral and SACU receipts are potentially volatile for Namibia, in reality, the main concern is the volatility in SACU revenues, which in 2008 was about 10 percentage points of GDP more than mineral revenue receipts, and more closely correlated with government expenditures. Mineral receipts do not appear to influence government spending decisions as much as SACU revenue does, and a recent staff study concluded that mineral revenues are important but not essential to government spending.[8] For Lesotho and Swaziland, SACU revenue is the most volatile component, but for Botswana, mineral revenue, as well as its nonrenewable nature, would have to be taken into consideration.

27.   **Medium-term risks to the SACU revenue pool could provide the basis for estimating benchmark SACU revenues.** One important source of risk is the planned transformation of Southern African Development Community into a customs union as well as the planned Economic Partnership Agreement between countries in the region and the EU. The former would result in an enlarged membership and smaller pie, while the latter could mean a lowering of revenue from trade. Moreover the current global financial turmoil could slow down import demand in South Africa, impacting on the revenue pool significantly, and a prolonged downturn could worsen the outlook. Assuming that the combined impact of these risks results in a decline in SACU revenues to the pre-surge historical trend, countries' SACU receipts could be lower by 20–30 percent.[9] In the case of Namibia, a benchmark SACU revenue set at around the ten year historical average would be 9.7 percent of GDP, compared with around 12 percent of GDP in 2008/09.

28.   **Developing a cyclically adjusted SACU revenue forecast is, however, not enough to address the procyclicality bias of government expenditure, expenditure also has to adjust.** While aggregate expenditure could be limited by the combined outcome from adopting a cyclically adjusted revenue, and a fiscal anchor, additional scope for achieving a less procyclical expenditure path exists in the reallocation of expenditure away from those that increase future expenditure obligations.

29.   **Public finance management:** Strong institutional and laws are critical achieving fiscal policy objectives, including ensuring high quality of expenditure and fiscal accountability. On this score, Namibia and Botswana are strong performers by regional standards. A ranking of government effectiveness, and quality of institutions puts both

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[8] Namibia: Selected Issues Paper (2007) Management of Nonrenewable Natural Resources.
[9] For Botswana, while a cyclically adjusted or benchmark SACU revenue is desirable, due to the dominance of mineral production and export in revenue; it may not be the main consideration. For Swaziland, a 2008 staff study found that the benchmark SACU revenue is 14 percent of GDP, compared with SACU revenue receipts of 28 percent of GDP in the same year. See Swaziland Selected Issues 2008.

among the top half of performers in their
income category. They are, therefore, in a
position to provide the appropriate context
for credible fiscal policy implementation.
Namibia has a transparent legal and
administrative framework for the budget,
information on the Medium Term
Expenditure Framework is available to the
public, government procurement is subject

International Governance Indicators, 2008			
(Percentile Rankings, 100 = strongest)			
	Government Effectiveness	Regulatory Quality	Control of Corruption
Sub-Saharan Africa	26.8	27.8	30.7
Lower-middle income countries	37.2	36.9	37.4
Lesotho	39.8	24.8	54.6
Namibia	62.1	54.4	62.8
Swaziland	25.6	26.2	41.5
Upper-middle income countries	62.1	61.5	60.9
Botswana	73.0	65.0	79.7
Namibia (1996)	73.0	46.8	78.2

Source: World Bank, Governance Indicators 2008.

to internal and external audit, and the government is implementing a system to provide
information on budget execution, the *Annual Accountability Report*. However, public finance
management could be strengthened in revenue administration, especially the development of
non-SACU revenue sources and domestic revenue generation. The use of a non-SACU fiscal
balance could provide useful information on progress in this regard. In addition, stronger
expenditure consolidation need to be achieved through reforming the state owned enterprises,
and improving the budgeting procedure. Lesotho is making progress in overall fiscal
management, and has achieved relatively higher domestic and non-SACU revenue than
others. Expenditure policy has also been largely prudent, but the institutional framework
could be strengthened. Swaziland still has significant challenges as described in a 2006
public expenditure review[10] which concluded that the country suffers from systemic
weaknesses in most critical stages of the budget process. To address these weaknesses, the
authorities have begun to strengthen fiscal institutions, and are in the process of establishing
a revenue authority.

30.   **Implementation of the fiscal framework could form part of the authorities'
medium-term plans.** In the immediate term it is assumed that it will take time to adjust to a
sustainable debt level. Furthermore, it will take time to accumulate substantial savings to use
for fiscal smoothening, and significant adjustment would be required in expenditure and
revenue policies. Upon reaching the sustainable debt path, the next priority would be to start
accumulating savings to accommodate possible large swings in revenue, within the context
of the framework.

F. Conclusion

31.   **Considering the challenges faced by the smaller SACU countries, there is need to
address the procyclical stance of fiscal policy by implementing a comprehensive
framework that focuses on debt sustainability through a fiscal anchor; macroeconomic
stability and fiscal smoothening; and improvements in public finance management.**
Choosing an appropriate anchor for debt levels, and formulating a with a revenue
smoothening framework that takes account of the volatility of SACU revenue could help to

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[10] The World Bank Swaziland Public Expenditure Review 2006.

secure fiscal sustainability and promote macroeconomic stability. In addition overall public finance management, including revenue administration and expenditure management as well as institutional development could play critical roles in enhancing the achievement of fiscal policy objectives. Using the non-SACU balance to gauge policy should help policy makers focus on improving domestic tax collection, and further diversification of the revenue base. While countries like Namibia and Botswana are in good stride to implement the reforms required, for other SACU countries, the challenge could be considerable.

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