

A Review of the Association between Performance-Based Budgeting and Debt Sustainability in Namibia

¹Tafirenyika Sunde and ²Isaac Randa

¹Polytechnic of Namibia,
School of Economics and Finance, Department of Economics.

²Polytechnic of Namibia,
Graduate School of Business.

Corresponding Author: Tafirenyika Sunde

Abstract

Public debt escalation for developing countries is not a new phenomenon. However, if the debt level rises above the Gross Domestic Product of the economy, sustaining it in the long run can become an issue. In this review, we examine the concept of performance-based budgeting in general and also in the context of Namibia's medium term expenditure framework (MTEF) which was introduced in 2001. We also discuss debt sustainability issues as well as some of the approaches used to determine it. In addition, we discuss Namibia's macroeconomic performance, budget deficit and debt sustainability. Various variables are analysed using tables of figures and diagrams and we conclude that Namibia's debt is still sustainable according to the yardsticks used by the IMF and the World Bank. The article is significant in that it contributes to macroeconomic literature on performance based budgeting and debt sustainability; an area that has received insignificant attention from economic researchers in Namibia. The review recommends that the government of Namibia should use its existing fiscal space to borrow funds from both the domestic and international markets (depending on which market is cheaper) to grow its economy and therefore create jobs for the jobless Namibians.

Keywords: deficit, public debt, performance based budgeting, economic indicators, gross domestic product, sustainability, Namibia

INTRODUCTION

The main purpose of the current article is to try and establish the relationship between performance-based budgeting and debt sustainability in Namibia. The article, therefore, contributes to macroeconomic literature on performance based budgeting and debt sustainability in Namibia. This is an area that has received very little attention from researchers in Namibia.

The functions of government can be categorised as follows: (i) provision of public goods; (ii) redistribution of income; (iii) provision of social safety nets; and (iv) the stabilisation of the economy (Mahendra, 2006). To perform these functions governments need financial resources. This is why governments table budgets at the beginning of each fiscal year in which they outline their expenditure outlays and justifications; and also the revenue levels and sources.

When government expenditure is equal to the government revenue for a particular fiscal year, the government is said to be running a balanced budget. In other words the government's fiscal policy is neutral, that is, its influence on the economy is neither expansionary nor contractionary. Contrary to what the classical economists believed, a balanced

budget may not necessarily be good. A balanced budget may imply that the debt levels are stable and therefore provides some level of expenditure discipline (Anipa et al., 1999). Nevertheless, a balanced budget may, in fact, be restrictive in some ways that may result in a depression. This is particularly factual for developing countries in their early stages of development as government plays a major role in influencing economic growth and investment (Mahendra, 2006). In the same vein, a budget surplus is also generally regarded as restrictive on the economy and may lead to inflation. A budget surplus implies that money budgeted for has not been utilised and this limits the potential growth and expansion of the economy.

In the case of the budget deficit, it can either have a restrictive or a positive effect on the economy depending on how the instruments of budgetary policy are applied. The instruments in question include government expenditure, taxation, borrowing and debt repayment. If budget deficits are prolonged they cost the economy heavily and they also end up being directly linked to government debt. In such a situation policy makers often debate the necessary fiscal adjustment (which is defined as a change in the primary deficit above a given threshold). Further the conventional macroeconomic policy focusing on

inflation targeting and zero budget deficits has not been successful in many cases. Keynesian economics contends that governments can achieve desired levels of national output using reasonable budget deficits to absorb the excess private savings over investments. From functional finance perspective, the idea of balanced budget is not acceptable on the grounds that such a budget is generally not compatible with the achievement of high levels of aggregate demand (Mahmood & Rauf, 2012). This implies that budget deficit and public debt should be considered simultaneously by government as the two are intertwined.

Government budget deficit and debt reduction is an issue if the two have risen beyond sustainable limits. The sustainability issue has received a lot of attention from economists and policy makers in the recent years. This is mainly due to the failures to service debts experienced by some developing countries and of late by developed countries (mainly associated with the current global economic crisis). The concept of debt sustainability has the following three vital elements; (i) availability of adequate resources for government to execute its functions; (ii) implications on other macroeconomic variables and economic growth; and, (iii) affordability of proposed expenditures.

In the light of the above, the goal of the policy makers should be to ensure that debt and its costs should be in line with sustainable economic and fiscal fundamentals.

The purpose of this review is therefore twofold:

- i.) to determine theoretically the effect of the medium term expenditure framework (MTEF) implemented in 2001 on the evolution of public debt in Namibia, and,
- ii.) to evaluate the long run sustainability of the public debt in Namibia

In the second section, we briefly explain the rationale for performance based budgeting in developing countries. In the third section we define public debt and its sustainability. In the fourth section we explore the macroeconomic measures and debt performance of Namibia. In section five we attempt to link performance based budgeting to economic growth and debt performance and sustainability. The last section has the conclusion and recommendations.

The Rationale For Performance Based Budgeting

Performance-based budgeting is being implemented in emerging and developing economies for various reasons within the context of new public management (NPM) reforms. The emphasis of the NPM reforms is to incorporate citizens' participation in decision making and governance and also increase public accountability. The origin of performance-based

budgeting dates back to 1961 when the US Government first implemented the planning-programming-budgeting systems (PPBSs). Since then several other forms of budgeting have been implemented in different countries ranging from programme based budgeting, zero based-budgeting, output based-budgeting and recently the new performance based budgeting (Diamond, 2003). The new forms of budgeting include, integrated medium term expenditure frameworks (MTEF), output-purchase budgeting, public service agreements (PSA) and programme performance ratings systems (Robinson and Last, 2009). These different forms of budgeting are attempts to implement the principles of managing which lead to better results in the public sector.

The idea for performance based budgeting is to develop and integrate performance information into budgets. Therefore instead of the specific line-item classification often found in traditional budgeting systems, performance based budgets classify expenditures by broad areas of responsibility with built-in flexibility for managers. The primary focus of performance based budgeting particularly in the public sector is the need to facilitate increased strategic allocation and efficiency in the use of scarce public resources. In its rudimentary form, performance based budgeting ensures that when formulating the government budget, key decision makers, systematically take into account the desired results to be achieved by expenditure (Robinson and Last, 2009). As a result, emerging developing economies are compelled to implement a form of performance based budgeting for various reasons including financial compliance, aggregate fiscal discipline and the allocation of resources in accordance with strategic imperatives (Mahmood & Rauf, 2012). These imperatives translate into three key objectives which define effective public expenditure management system, namely, fiscal discipline, policy priorities and improved quality of services delivery and alignment of resources allocation to strategy.

In Namibia performance based budgeting in the form of programme-based budgets was implemented incorporating the MTEF in 2001. It was used a central tool for public budget planning and management to enhance national planning certainty and transparency of the budgetary processes and outcomes (Shafuda et al., 2004). The MTEF in Namibia is supported by medium term plans (MTP) and performance and effectiveness management programme (PEMP) frameworks forming a set of performance measures that are integrated as part of a three-year rolling budget. In a number of developing countries, the issue of perennial public sector under-performance is connected to poor budgeting outcomes deriving from inappropriate links between

public policy, planning and budgeting. This is the reason why we want to establish the relationship between performance-based budgeting and debt sustainability in Namibia.

The justification for MTEF in developing countries as a tool of public expenditure and financial management reform (PEFM) is its ability to link short term macroeconomic stabilisation imperatives with medium and longer term demands on the national budget. It provides a framework which contributes to improved public policy making and planning which enhances efficiency and effectiveness of service delivery. However, in some other developing countries MTEFs approach was developed to address the inherent weaknesses in PEFM systems (Holmes, 1998). These include weaknesses in resource allocation and accountability spanning all the three dimensions of public financial management (budget formulation, execution and reporting).

The process for developing a fully-fledged MTEF involves a top down (Ministry of Finance and Cabinet) and bottom up (line ministry) approach of matching limited resources with unlimited needs. More specifically, this involves defining the availability of resources (both government and external) over the medium term (usually three to five years), through the development of a fiscal framework which divides the resources between line ministries on the basis of government priorities. This, therefore, requires line ministries to provide indications of their funding requirements; and this helps to direct scarce fiscal resources to high priority activities according of the different ministries. For example, Dorotinsky (2007), contends that the main components of an effective MTEF include a medium term fiscal framework, a medium term budget framework and a programme based budget which focuses on activities' costing.

Public Debt and its Sustainability

Financing development is a key concern for developing countries in an environment of dwindling resources often leading to government deficits. Developing countries are often faced with a choice over the financing of the budget deficit and these are: printing money, using accumulated exchange reserves, sale of public assets and soliciting for grants to support government budget.

Public debt is created when governments resort to borrowing from the financial institutions locally and offshore through the sale of government bonds and treasury bills. Public debt financing if the economy is operating below its potential level was advanced by the Keynesians as a tool to restore the economy to its full employment potential. However, excessive public debt financing has the potential to precipitate macroeconomic instability characterised by high

inflation, exchange crises, external debt crises, and high real interest rates (Fischer, 1989). It is, therefore, not surprising that much effort is placed in the assessment of public debt sustainability. According to Daseking (2002) debt sustainability is a situation in which a borrower is expected to continue servicing debts without resorting to an unrealistically large future adjustment to income and expenditure. This definition implies that debt becomes unsustainable when it accumulates at a faster rate than the borrower's capacity to service it. Thus, in the context of a government, sustainability of public debt is premised on the accumulated government debt outstanding. This has implications on governments' solvency and liquidity.

Debt solvency is achieved when future primary surpluses are large enough to pay back the debt (Wyplosz, 2007, 2011). Therefore, the concept of debt sustainability rests on the concept of debt solvency. He further argued that solvency alone may not be a sufficient condition to render a stock of debt sustainable; there is need for the existence of a reasonable level of liquidity. In the light of the IMF definition, debt sustainability cannot be realised in the absence of effective solvency and liquidity conditions. However, according to Collignon (2010) governments face a present value borrowing constraint, implying governments must inter-temporally balance their budgets by setting the current market value of public debt equal to the discounted sum of expected future fiscal surplus. This condition implies that the growth rate of the economy must be higher than the interest rate otherwise debt stock will explode and the ensuing fiscal policy is unsustainable. Hence, public debt sustainability is the ability of government to service its borrowings without resorting to debt rescheduling, accumulation of debt servicing arrears or summary default.

The two definitions of public debt sustainability provide the primary point of reference for public debt sustainability assessments. Whereas, the resources gap approaches including primary balance, tax, and net worth are linked to the solvency criteria requiring that the primary surplus relative to GDP remain consistent over time, the econometric approaches are based on the assumption that fiscal sustainability exists when government policies satisfy the present value inter-temporal budget constraint. In this review, the resources gap approach is used to evaluate Namibia's public debt sustainability. The next section examines the macroeconomic performance and debt in Namibia since 1990.

NAMIBIA'S ECONOMIC PERFORMANCE AND DEBT LEVEL

Economic Performance

Namibia's economic and fiscal performance has been a subject of debate of late and this is mainly due to

the high unemployment rate of 51% that was reported in 2010. The Namibian economy is failing to create new jobs to absorb a sizable chunk of its labour force. Apart from the growth rate of 10.34% in 2004 all the other years' growth performance has been disappointing. The growth for 2001 was negative mainly because of the drought that affected Namibia and other Southern African countries. The negative growth rate for 2009 was a result of the effects of the global economic crisis. Economic analysts have argued that for Namibia to be able to create enough jobs it has to consistently grow at an annual rate above 6% per annum for a number of years. The

statistics also show that investment as a percentage of GDP is smaller than public debt as a percentage of GDP and this is not good for the economy as it shows that the economy is gradually overburdening the future generations. Comparing the export growth rate with the import growth rate also shows that imports are growing at a faster rate than exports for all the years considered. This is also not good for the economy because the economy may end up using more foreign exchange than it is generating which leads to further external indebtedness of the economy.

Table 1: Economic Indicators

Year	Real GDP Growth Rate	Investments as (%) GDP	Inflation (%)	Export Growth Rate (%)	Import Growth Rate (%)	Public Debt % of GDP
2000	1.042	11.089	9.268	-0.84	44.55	21
2001	-0.939	11.973	9.266	-2.67	47.67	23.8
2002	2.822	13.863	11.28	16.24	48.08	23.4
2003	2.426	20.062	7.152	8.85	52.47	26.4
2004	10.349	15.689	4.147	5.38	42.08	29
2005	0.723	16.218	2.261	-0.83	40.31	26.4
2006	5.12	18.431	5.053	15.35	41.56	24.3
2007	3.406	16.145	6.728	6.39	52.04	18.8
2008	2.336	14.678	10.35	8.14	60.07	18.3
2009	-2.545	15.662	8.782	-14	60.16	15.5
2010	2.908	14.944	4.47	-42.3	37.82	16.6

Source: World Bank Statistics (2012)

Budget Deficit and Deficit Financing

Low growth rates of the economy have implications on public debt via their effects on government revenue. The low growth rates combined with the rising government expenditure and poor financial management only lead to an increase in budget deficits and hence government debt. From the year 1990 to 2007, Namibia's government expenditure is greater than government revenue; and from 2007 to 2010 government revenue is greater than government expenditure. In 2011 and 2012 government expenditure is greater than government revenue again.

Deficits are usually financed by either raising taxes or borrowing. In Namibia raising taxes under the current scenario is not an option because both the income and corporate taxes are already very high when compared to other countries in the Southern African region. In fact, Namibia and Zimbabwe are the only countries with very high income and corporate taxes. This automatically makes them unattractive destinations for Foreign Direct Investment. This means that the option available to Namibia is borrowing which results in the creation of public debt. The debt levels for Namibia are still considered manageable because debt as a percentage of GDP is still generally below

40% which is considered the cut-off point by the World Bank and IMF (See Table 2). However, if the rising debt levels are not checked by a growing economy this can result in a number of problems.

Table 2: Deficit, Debt, and Interest payments (2000-2010)

Year	Deficit/Surplus as % of GDP	Debt as a % of GDP	Interest Payments as % of GDP
2000	-3.9	21.0	1.48
2001	-0.5	23.8	1.49
2002	-3.7	23.4	0.27
2003	-2.2	26.4	2.27
2004	-6.3	29.0	0.84
2005	-3.0	26.4	2.34
2006	-0.1	24.3	0.08
2007	+4.1	18.8	0.87
2008	+0.7	18.3	0.12
2009	+5.8	15.5	0.82
2010	+8.3	16.6	0.08

Source: World Bank Statistics (2012)

Sustainability Indicators

The government of Namibia debt is created mainly through borrowing from the domestic sources. Namibia has not borrowed much from the

international multilateral organisations like the International Monetary Fund and the World Bank, but from the domestic economy. The obvious benefit of this is that resources do not flow out of the country. The other benefit is that the exchange rate risk is also minimised. However, since the Namibian dollar is pegged to the South African rand the exchange rate risk is not much of a concern. The only problem of government borrowing from the domestic market is that government crowds out private sector investors who may not be able to borrow at high interest rates. Another factor to take into consideration is that Namibia's financial services sector is not competitive and very deep. So crowding out the private sector compromises the growth of the economy. The behaviour of interest rates appears not to be related to the budget deficits and debt in Namibia. The potentially high interest rates that result from government crowding out the private sector may imply a higher return on capital in the local economy and this may help attract additional foreign capital. An additional problem of borrowing domestically is that lenders in the local market are not as strict as the external lenders and this can be a recipe for faster growth in domestic borrowings and hence debt.

The indicators of the sustainability of public debt are the interest rate and the rate of growth of the economy. Data in Table 2 and Figure 1 below show that interest rates are higher than the rate of growth of GDP. This implies that the debt to GDP ratio will rise in future. The debt to GDP for Namibia is still sustainable because it is still below the limit of 40%. The inflation rate can also be very important when discussing debt sustainability; so we include it in the diagram below.

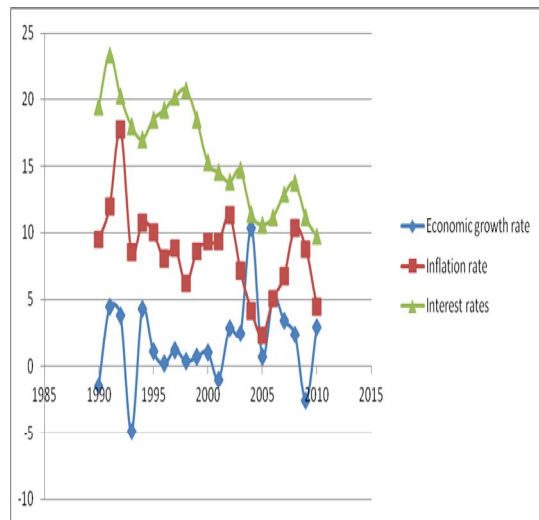


Figure 1: Debt sustainability indicators

Source: World Bank Statistics (2012)

Table 2 shows that the government debt and deficit levels appear to be manageable. They show that Namibia still has some fiscal space to use to try and improve the livelihoods of the Namibians and create new jobs. It is possible for Namibia to increase its local borrowing and offshore borrowings. The table shows that from the year 2000 to 2006 government expenditure was greater than government revenue (government budget deficit); and from the year 2007 to the year 2010 government expenditure was less than government revenue (government budget surplus). Debt as percentage of GDP also shows an increasing trend from 2000 to 2004 after which it takes on a consistently downward trend. Interest payments as a percentage of GDP range between 0.08 and 2.34 for the entire period from 2000 to 2010. Most countries have debt service as percentage of GDP figures which are higher than the ones shown above. However, a country like Nigeria has debt-GDP ratio and fiscal deficits-GDP ratios which are smaller than those for Namibia (see Obi and Nurudeen, 2009).

Performance Based Budgeting, Debts and Economic Growth in Namibia

Appendix 1 has figures for debt, government revenue and government expenditure as percentages of GDP. The figures do not show big changes after the implementation of performance based budgets in 2001. After 2001, government revenue remained more or less the same up to 2006 after which it started falling. Government expenditure ranged between 19.3% and 24.5% for the entire period after the implementation of performance based budgets. However, these figures are lower than those for the period before the implementation of performance based budgets. The debt percentage to GDP for the same period increased from 23.8% in 2001 to 29% in 2004. From 2005 up to 2010 debt as a percentage of GDP fell consistently until it reached 16.6% in 2010. The fall in debt as a percentage of GDP can be attributed to the implementation of the performance based budgets in Namibia. The implementation of MTEF under the performance based budgets has helped Namibia not to become heavily indebted. The fall in debt after the implementation of MTEF has also led to the systematic fall in interest rates (the cost of borrowing). However, the avoidance of high budget deficits in the presence of other macroeconomic challenges like high unemployment is not a good idea. In the presence high unemployment government is supposed to use the borrowed resources to create jobs and grow the economy. The average growth rate for the Namibian economy in the last 20 years is about 4.3% which is lower than the required 6% which is argued to have the potential to create adequate jobs and therefore reduce the unemployment rate.

CONCLUSION

In this review we discuss the concept of performance based budgeting in general and also in the context of Namibia's medium term expenditure framework (MTEF) which was introduced in 2001. We also discuss debt sustainability issues as well as some of the approaches that are used to determine it. The review also discusses the macroeconomic performance, budget deficit and debt sustainability in Namibia. After analysing various variables by using tables of figures and diagrams we conclude that Namibia's debt is still sustainable according to the yardsticks used by the IMF and the World Bank. This implies that Namibia still have the fiscal space to implement an expansionary fiscal policy. We, thus, recommend that the government of Namibia should use its fiscal space to borrow some more funds from both the domestic and international markets (depending on which market is cheaper) to grow the economy and, therefore, create more jobs for the jobless 51 percent of the labour force. It is not wise to put more emphasis on a balanced budget, small fiscal deficits and hence debt when the unemployment rate and poverty are wreaking havoc in the country. The findings of this review may be made more credible by invoking econometrics techniques to formally determine the relationship between performance-based budgeting and debt sustainability. This may be regarded as the main weakness that plagues this article.

REFERENCES

- Anipa, S., Kaluma, F. & Muggeridge, E., 1999. Best Practices on Public Expenditure Reforms, The MTEF in Malawi and Ghana. In Good Practice in Public Expenditure Management. Oxford, 1999. Oxford Policy Management Review.
- Collignon, S., 2010. Fiscal Policy Rules and the Sustainability of Public Debt in Europe. www.recoproject.eu: Recon Online Working Paper Series, ISSN 1504-6907.
- Daseking, C., 2002. Debt: How Much Is Too Much? Finance and Development, A quarterly magazine of the IMF, December. pp.1 - 6.
- Diamond, J., 2003. From Program to Performance Budgeting: The Challenge for Emerging Market Economies. Washington, DC: International Monetary Fund, Fiscal Affairs Department WP/03/169.
- Dorotinsky, B., 2007. MTEF's: Concept and Lessons. Washington D.C: International Monetary Fund.
- Fischer, S., 1989. The Economics of the Government Budget Constraint. Development Economics - The World Bank, Washington DC, pp.19-20.

Holmes, M., 1998. Public Expenditure Management Handbook. Washington, DC: World Bank.

Mahendra, R., March 2006. Assessing the sustainability of Fiji's public debt: a cointegration analysis approach. In Economic Association of Fiji., March 2006. RBF Quarterly Review.

Mahmood, T. & Rauf, S.A., 2012. Public debt sustainability: evidence from a developing country. Pakistan Economic and Social Review, 50(1), pp.23-40.

Obi, B. & Nurudeen, A., 2009. Do interest fiscal deficits raise interest rates in Nigeria? A vector autoregression approach. Journal of Applied Quantitative Methods, 4(3), pp.306-16.

Robinson M., D.L., 2009. A Basic Model of Performance-Based Budgeting. Washington, DC: International Monetary Fund Fiscal Affairs Department.

Shafuda, E.C.C.a.B.F., 2004. Public Finance Reforms - Successful Fiscal Policy Through Medium Term Planning. In Budget Reforms. Pretoria (SA), 2004. Collaborative Africa Budget Reform Initiative (CABRI).

Wyplosz, C., 2007. Debt Sustainability Assessment: The IMF Approach and Alternatives. Geneva: Graduate Institute of International Studies.

Wyplosz, C., 2011. Debt sustainability assessment: mission impossible. Review of Economics and Institutions, Vol.2(3) ISSN 2038-1379.

APPENDIX 1

Year	Debt as a % of GDP	Interest payments as a % of GDP	Lending rate	Govt revenue as a % of GDP	Govt Expenditure as a % of GDP
1990	8.3	0.5013	19.33	31.34353	30.61996
1991	6.8	1.484	23.36	37.34089	33.49317
1992	9.2	2.2738	20.21	35.28234	35.43803
1993	12.7	1.5432	18.02	32.67899	31.58461
1994	12.1	1.484	17.05	31.27046	28.27574
1995	15.3	0.4227	18.51	31.70707	30.21407
1996	17.1	2.693	19.16	30.7208	30.31777
1997	15.3	2.3377	20.18	33.38129	30.20715
1998	18.7	2.693	20.72	32.4376	29.56517
1999	24.3	0.0847	18.48	34.73651	30.30362
2000	21	1.484	15.28	30.10166	23.5023
2001	23.8	1.484	14.53	29.15211	22.82626
2002	23.4	0.2702	13.84	29.45171	21.48744
2003	26.4	2.2738	14.7	26.01845	22.20405
2004	29	0.8387	11.39	26.38554	20.36833
2005	26.4	2.3364	10.61	28.21801	19.28449
2006	24.3	0.0817	11.18	32.42101	19.4936
2007	18	0.8387	12.88	29.23724	20.67299
2008	18.3	0.1176	13.74	31.4000	20.48378
2009	15.5	0.0817	11.12	30.0000	24.35486
2010	16.6	0.0847	9.72	27.8000	22.12038
2011	26.5	1.4000	9.75	29.1000	40.30000
2012	25.0	2.1000	9.25	30.4000	39.20000

Source: World Bank Statistics, Bank of Namibia Statistics (2012).