

Domestic Revenue Mobilisation in the Context of Regional Integration: The Case of Namibia

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Executive Summary

Globalisation poses both significant opportunities and challenges to low income countries. Two of the major ones are the continuing liberalisation of trade and the concomitant formation of regional trade blocs. While trade liberalisation promises welfare gains and fiscal gains in the longer term because of increased economic activities, it will imply a fiscal squeeze in the short term, as low income countries are generally highly dependent on taxes imposed on trade. The longer term growth prospects will enable Governments to raise more domestic revenues. However, in the short term Governments will need to increase taxes from existing or new sources to compensate for losses in taxes on international trade and/or re-think the extent of the provision of government services. Namibia is seen as a good example for a case study since it is committed to trade liberalisation and currently receives a significant share of its income from taxes on trade.

Namibia's economy is dominated by the primary and tertiary sectors. The mining, mainly off-shore diamond mining, sector accounts for about 50% of the primary sector's contribution to GDP, while Government contributes the largest share to the tertiary sector. Manufacturing activities are mainly based on processing agricultural products and account for about 10% of GDP. The economic structure is reflected in Namibia's trade patterns. Transport equipment, machinery and other equipment, and chemicals dominate the imports while minerals and processed fish are the main export items. The import and export ratio over GDP stood at 52% and 44% respectively in 2003 indicating high openness to trade.

Since Namibia was ruled by South Africa until it gained independence in 1990, it was a de facto member of SACU – the oldest existing customs union. After her independence, Namibia became a de jure member and joined other regional and international organisations, most noticeably SADC and WTO as a founding member. Furthermore, it is a member of the Cross Border Initiative and was member of COMESA until its withdrawal in 2003. All these organisations are committed to enhancing trade. Namibia's main trading partners are South Africa, Angola and the EU. Differences exist however concerning the import and export dependency. About 80% of all imported goods are sourced from or through South Africa and 8% directly from EU countries. Exports in 2003 were to similar shares destined for the EU, South Africa and Angola. The dominance of the EU has dropped compared to 2002, which can mainly be explained by the appreciation of the South African rand - to which the Namibia dollar is pegged - against major currencies.

Since the EU is the major source for imports into SACU, the Trade, Development and Cooperation Agreement (TDCA) between South Africa and the EU will have the strongest impact of all free trade arrangements on customs revenue and the economies. Customs duties account for about 37% of SACU's common revenue pool that is distributed among the SACU member countries according to a new revenue sharing formula. Income from the SACU pool has contributed about 30% to Namibia's total revenue. Due to the TDCA, it is estimated that customs duties will decline by between 31% and 51%, depending on whether or not sensitive products

are included. This could translate in revenue losses for SACU's common revenue pool of between 12% and 19%. Adding to this decline are the possible impacts of trade diversion and of the new revenue sharing formula.

It can not be expected that the effects of trade creation will outweigh revenue losses from tariff rate reductions. This would only apply to cases of initially high tariff rates and high import elasticity. Both do not apply to Namibia. SACU's trade weighted import tariff stood at 6.1%, which is low in regional comparison. Moreover, import elasticity for developing countries is generally estimated at about 0% to 3%.

In general, Namibian businesses do not expect major challenges from trade liberalisation. As briefly described, manufacturing activities are mainly based on agricultural products and these are usually excluded from trade liberalisation. Secondly, manufacturing companies have established premium and niche markets, domestically and abroad, where they expect to be less affected by trade liberalisation. Benefits could arise from access to cheaper inputs from abroad but also from SACU producers that have to compete with tariff-free imports. However, some of the equipment used by manufacturing, mining and fishing companies as well as some inputs for the agricultural sector are already exempt from custom duties. Reduced costs can be expected from the service sector, in particular the information and communication technology sector that is rapidly gaining relevance for all businesses. However, more research is necessary for a more robust impact assessment by analysing the input structure of industries in detail and the role customs duties play.

Therefore, revenue losses from trade liberalisation are a certainty for Namibia. Since these will be incurred over a period of time, there is sufficient time to implement fiscal adjustments. They can target both the expenditure and revenue side. Though there is room for improving the efficiency of public services, this does not necessarily result in lower spending, since better qualified and skilled personnel can only be attracted through a competitive remuneration. Hence, the overall outcome of efficiency gains on expenditure is uncertain.

On the other hand, several options exist to increase revenue. Primarily, the effectiveness and efficiency of revenue collection can be increased through investment in human resource development and in appropriate equipment. Auditing of companies is rare. This carries a high probability of non-compliance with tax laws since the risk of disclosure is relatively low. In addition to capacity building, a relaxation of certain public sector procedures could be considered to attract highly qualified staff that is necessary to improve the efficiency and effectiveness. Furthermore, simplifying tax laws, especially reviewing tax incentives and exemptions, will not only increase the transparency of tax collection and thus enhance compliance, but will also free human resources dealing with applications and approvals and calculating tax payments. These employees could be used more effectively for other tasks.

Though experiences from other countries in the region with granting a greater degree of autonomy to a revenue authority were quite promising, this was usually

confined to the initial phase and not sustainable. Therefore, it is suggested that Namibia first explores the above mentioned options of increasing revenues before embarking on a broader reform of the tax administration.

Besides increasing revenue due to efficiency and effectiveness gains, the introduction of an estate duty and donation tax could be considered that are easy to collect and can contribute to a redistribution of wealth. Furthermore, since interests earned are taxable but hardly declared, a withholding tax could be introduced that is collected by the financial institution. Introducing these taxes will have less distortionary impacts on the economy than raising direct and indirect tax rates that are currently comparable to neighbouring countries. Increasing these rates above the rates of neighbouring countries could lead to increased tax evasion in the short term and to relocations of business activities in the medium term.

It appears that the main challenge for Namibia from trade liberalisation lies in fiscal adjustments rather than in substantially increased competition for Namibian businesses that poses a threat to Namibian businesses on the domestic and foreign markets. Options exist on the revenue side for adjustments that do not increase distortionary impacts of taxation.

Distributional impacts of trade liberalisation depend on the consumption patterns of households. Three household categories are identified according to the food ratio of overall consumption. Severely poor households, who spend 80% or more of total – cash and in-kind – expenditure on food, spend less than 5% on products, of which prices can be affected by trade liberalisation. This share is considerably higher for poor households – who spend between 60% and 80% on foodstuff – and affluent households that we have defined as households that spend 25% and less on food products. These households spend about 13% and 15% on products that can be affected by tariff rate reductions. Available data does not allow for a more detailed analysis of specific product items, the share of domestically produced products to imported products, and the detailed tariff rates, that apply to these products. Thus it is not possible to determine with confidence the extent to which poor and affluent households will benefit from lower or abolished customs duties. Furthermore, it is not clear to which extent tariff rate reductions will trickle through to the final consumer. Depending on the degree of competition, a certain share of the price reduction will be absorbed along the whole chain from the importer to the retail outlet. What can be said is, that severely poor households tend to benefit considerably less than other household categories since they consume by definition mainly foodstuff, often own produce, that is generally excluded from tariff rate reductions or is already zero rated.

Distributional impacts of fiscal adjustments depend on concrete measures. There are options to increase revenue that will affect mainly the richer households and to identify areas to cut expenditure that will not have a detrimental affect on the main development objectives of which the reduction of poverty and income inequality are two. Since tariff reductions are implemented over a longer period, there is enough time to design pro-poor fiscal adjustments.

The poor could benefit from a shift in the demand towards unskilled labour. However, relatively high wage levels combined with a rigid formal labour market while prices for capital goods could decline would initially suggest that a shift towards unskilled labour - or labour at all - is less likely. However, this area would warrant further research as the broader area of winning and losing industries under the current tariff regime. Only then research questions of efficiency gains and resource reallocation could be adequately addressed.

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List of abbreviations

BIDPA	Botswana Institute for Development Policy Analysis
BLNS	Botswana, Lesotho, Namibia, Swaziland
BoN	Bank of Namibia
CBI	Cross Border Initiative
COMESA	Common Market for Eastern and Southern Africa
DRC	Democratic Republic of Congo
EU	European Union
GDP	Gross Domestic Product
GSP	Generalised System of Preferences
HS	Harmonised Commodity Description and Coding System
IDS	Institute of Development Studies
NEPRU	Namibian Economic Policy Research Unit
N\$	Namibia Dollar
RSA	Republic of South Africa
SACU	Southern African Customs Union
SADC	Southern African Development Community
SAM	Social Accounting Matrix
TDCA	Trade, Development and Co-operation Agreement
USA	United States of America
VAT	Value Added Tax
WTO	World Trade Organisation

1. Background

Globalisation poses both significant opportunities and challenges to low income countries. In this context, the quality of their macroeconomic policies is likely to make the difference between catching up with high-income countries and marginalisation. The quality of policies in turn is dependent on the quality of the underlying institutions.

Major challenges are the continuing liberalisation of trade and the concomitant formation of regional trade blocs. While trade liberalisation promises welfare gains and fiscal gains in the longer term because of increased economic activities, it will imply a fiscal squeeze in the short term, as low-income countries are generally highly dependent on taxes imposed on trade. The longer-term growth prospects will enable governments to raise more domestic revenues. However, in the short term governments will need to raise new sources of tax revenue or enhance tax collection to compensate for losses in taxes on trade or re-think the provision of government services. This problem explains in part the hesitance of many countries to undertake trade liberalisation and the limitations to their sustainability. Arguably, the IMF and World Bank have until now in almost all cases pressed trade liberalisation upon low-income countries as part of structural adjustment programmes.

While the process of global trade liberalisation is continuing, the importance of regional trade blocs is increasing. Low-income countries are threatened by increasing trade barriers because of this process. This is one reason why they also scramble to form and be part of regional trade blocs. However, the success of trade integration among low-income countries is limited. One reason for this is the negative impact on tax incomes.

A key reason for the limits to success in balancing trade liberalisation and domestic revenue mobilisation is the lack of knowledge to form a sound basis for policy change. Policy makers need to know the quantitative impacts of trade liberalisation in general and regional trade integration in particular. Secondly, they need to have a basis to formulate a policy of compensating falling revenues with new other sources and better tax collection. This study aims to fill part of this gap by examining the case of Namibia.

Namibia is a good case study to analyse these challenges, since customs revenue constitutes a significant part of its tax income. However, Namibia has committed itself to a process of trade liberalisation in the framework of the WTO. Government has not yet identified a strategy to fill the impending gap in revenues resulting from this process.

The paper is structured as follows. After a brief outline of the research issues and the methodology used, Namibia's integration into the world economy is reviewed. Specific attention is paid to her import and export structure and the challenges and opportunities Namibian businesses could face in the light of ongoing and future trade liberalisation. The following chapter analyses the possible impacts on revenue and

examines alternative revenue sources to level out revenue losses. Finally, some conclusions are drawn.

2. Research questions and methodology

Regional integration is a broad issue containing various aspects. The paper focuses on just one of these, namely on trade liberalisation. Other aspects of regional integration, such as financial integration, security integration, political integration, and institutional integration are hence not part of this study. Furthermore, this research report focuses on trade liberalisation in the sense of removal or at least reduction of tariff rates but does not include the broad topic of non-tariff trade barriers. This narrow focus is justified since reducing or abolishing custom tariffs will have a direct impact on state revenue, while other regional integration schemes might not affect Government income.

The paper intends to evaluate the direct fiscal impacts Namibia will face as a consequence of recently concluded trade agreements and the negotiations of additional agreements. Secondly, it tries to analyse direct and indirect effects of these agreements on the Namibian economy. Relevant general literature on the impact of trade liberalisation as well as specific literature on Namibia has been reviewed. Interviews with stakeholders of major businesses have been conducted to get a sense of how they view trade liberalisation and how it would affect their businesses.

For a quantitative impact analysis, the use of the Namibian Social Accounting Matrix (SAM) was proposed. However, technical problems prevented its use. Additionally, comprehensive data on customs duties actually paid on products imported from outside the Southern African Customs Union (SACU) is not available in Namibia. Only data for goods directly imported to Namibia from outside SACU is collected. However, Namibia sources most of its imports through South Africa, that is also part of SACU, and hence customs duties are collected there. No information exists about the custom duties carried by these imports. Furthermore, goods imported from South Africa are recorded as imports from there irrespective whether they are produced there or imported from elsewhere and exported to Namibia. Hence, Government income in the SAM could not be split into various tax categories as intended. Rather, monetary transfers from SACU's common revenue pool – a pool that collects all customs and excise duties from SACU member countries - appear as a lump sum from Rest of the World to Government. That currently limits its use for a detailed trade analysis.

Therefore, the following analysis follows a qualitative approach in answering the research questions.

3. Namibia's economic structure and its trade regime

3.1. Import and export structure

Namibia's economy continues relying on the primary and tertiary sectors. The mining sector accounted for about 50% of the primary sector's contribution to GDP (on average 20%). Fisheries contributed slightly more than agriculture, the shares of which declined from 6.9% in 1995 to 4.6% in 2003. Government accounts for about 22% of GDP. The second most important contributor to the tertiary sector and steadily growing in importance is wholesale and retail trade (9.8%). The manufacturing sector has contributed on average about 10% to GDP. It is mainly dominated by other food production and beverages followed by fish processing. Other manufacturing accounted for just 2.7% with no clear up- or downward trend over the years. This indicates the manufacturing sectors dependence on the processing of agricultural products. Covered by these aggregate figures is, however, an increasing diversification of the sector. New products such as pasta and long-life milk are produced sheltered initially by the infant industry protection. Diamonds are cut and polished in the country following the changes to the Diamond Act. Moreover, a textile industry has been established recently, the contribution of which is not yet included in the National Accounts.

Because of the small Namibian market, businesses have to be export oriented to exploit economies of scale. In addition, since they are small in international comparison, they are dependent on a trading environment conducive to entering new markets. Their relatively low capital base prevents them from investing in foreign markets before they have established their brands there, which would be supported by low trade barriers. Once a sizable market is established, a larger engagement in the form of investment can be considered. For large international concerns on the other hand it is relatively easier to penetrate markets that are protected by high trade barriers through direct investment because the financial risk involved is relatively lower for them than for small companies. Hence, low trade barriers are in particular vital for small export-oriented companies.

The low manufacturing base in Namibia is reflected in its openness to trade, since it exports its commodities and it imports what it does not produce. The export ratio over GDP stands at 44% and the import ratio at 52%. The kinds of goods exported and imported underline this picture. Transport equipment (20%), machinery and equipment (16%), and chemicals (13%) are the main import items.

On the other hand, minerals (44%) and processed fish (25%) dominate the export of goods. The main trading partners are South Africa and the EU. About 80% (2003) of all imports are sourced from or through South Africa compared to less than 8% from the EU. The actual share of imported items from the EU and other countries outside SACU might in fact be higher, since they enter SACU through South Africa. The relevance of Namibia's export destinations differs from its import dependency. Previously, the largest share went to the EU, mainly because of diamonds that are sold

through the De Beer's subsidiary in London, and because of preferential access to the EU market of Namibian meat, fish and grapes. The share of the value of exports to the EU dropped drastically from 48% (2002) of total exports to 30% (2003), which is obviously attributed to the substantial appreciation of the South African rand – and hence Namibia dollar – against major currencies such as the US dollar and Euro. The value of exports to South Africa and the rest of SADC increased subsequently, accounting for 32% and 25% respectively. Namibia's northern neighbour Angola is by far the dominating export destination in SADC excluding SACU. Almost 99% of all exports to SADC outside SACU are destined for Angola. However, exports to Angola do not necessarily originate from Namibia but do include products from South Africa and other countries as well. On the other hand, SADC excluding SACU accounts for only 0.9% of all Namibian imports of which 37% are sourced from Angola and 54% from Zimbabwe. Namibia's trade patterns with the rest of SADC mirror the general trade imbalances between SACU and SADC. SADC is an export market for SACU products but to a much lesser extent a source for imports. This is not caused by high trade barriers within the region but by the economic structure. Most countries produce similar but not complimentary products.

On a general level, other regions are currently less relevant to Namibia as trading partners. However, the aggregated picture covers significant product-specific differences. While the USA absorbed about 3% of all Namibian exports in 2002 and 2003, almost all textiles are exported to the USA under the preferences provided by AGOA. Large investments into the textile industry have only been attracted because of Namibia's inclusion in AGOA. The relevance of the USA as an export market is expected to increase further once the free trade agreement between SACU and the USA is concluded. Good prospects exist for the export of beef and beer to this market, which would lessen the export dependence on South Africa (beef, beer) and the EU (beef).

Trade liberalisation can result in trade creation and trade diversion both leading to changes in trade patterns. This, however, is highly dependent on information about potential suppliers and customers in other than the established markets. Information comes with a cost. The lack of information and the lack of access to information will slow down the changes in trading patterns.

3.2. Namibia's trade framework

Until independence in 1990, Namibia was ruled by South Africa, which treated it quasi as a fifth province. Consequently, Namibia was strongly integrated in the South African economy and as such part of the oldest existing custom union – SACU – that was initiated by South Africa. This has changed since 1990 and Namibia became a member of various other regional organisations. It is a member country of the Common Monetary Area together with all SACU countries except Botswana. The membership entails that the South African Rand is a legal tender in these countries.

While Namibia's trade regime was highly protectionist under South African rule, it has liberalised since then. Its membership of various regional and international organisations committed to freer trade is evidence of this commitment. However, some of these organisation overlap, which results in administrative inefficiencies.

Apart from being a member of SACU together with the economic powerhouse of Africa, South Africa, Namibia is part of the Southern African Development Community (SADC). Until its withdrawal in 2003, Namibia was also a member of the Common Market for Eastern and Southern Africa (COMESA). Nine member countries of COMESA launched a Free Trade Agreement in 2000 but since individual SACU member countries can not grant trade preferences to other groups of countries and since not all SACU member countries are part of COMESA, Namibia had to withdraw from this grouping.

Furthermore, Namibia participates in the Cross Border Initiative (CBI) that includes among others seven SADC countries and is sponsored by the African Development Bank, the European Union, International Monetary Fund and the World Bank (Hartzenberg, 2001). CBI aims at integrating the markets to increase investment by reducing trade barriers. In addition, Namibia signed a bilateral trade agreement with Zimbabwe and through its membership it is part of the trade agreement between SACU and Zambia.

Besides its participation in these regional groupings, Namibia has been a founding member of the World Trade Organisation (WTO) and ratified the protocol in 1995. Under the WTO, Namibia is committed to the process of trade liberalisation. All SADC countries are signatories to the WTO agreement.

While Namibia's membership in these organisations underlines its commitment to trade liberalisation, it also puts strain on its scarce human resources that are needed to attend to the obligations under and meetings of these organisations. In addition, being part of overlapping regional organisations also results in conflicting policy goals and more specifically in confusion about the application of tariff rates under each of these schemes. The eventual withdrawal from COMESA is just one example of the drawbacks of participation in too many of these groupings and in groupings with conflicting objectives.

3.3. Trade agreements

3.3.1. SACU and the new revenue sharing formula

Since South Africa's emergence as a major economic and political player in Africa and the world after the first general elections in 1994, South Africa and SACU have started negotiating trade agreements with individual countries and economic groupings. Parallel to these negotiations were negotiations held between SACU countries to reform the customs union that was strongly dominated by South Africa's industrial development interests. This process started in the mid 1990s and lead finally to the

implementation of the new SACU agreement in July 2004. Two main areas of change that are of interest here are the new revenue sharing formula and a more democratic process of decision making, in particular concerning the Common External Tariff.

The main feature of the new revenue sharing formula is that South Africa no longer receives the residual share of the revenue pool. According to the revenue sharing formula in the 1969 agreement, Botswana, Lesotho, Namibia, and Swaziland (BLNS) received a maximum of 20% and a minimum of 17% of the value of their own total imports plus excisable production in their country irrespective of the actual amount available in the revenue pool (BoN, 2003, p.28). The share for the BLNS was regarded as a compensation for the lack of fiscal and policy discretion and the price raising effect of protection, from which the South African economy benefited most.

Customs revenues are now shared according to each member countries' share in intra-SACU trade, which takes cognisance of the land-locked status of three member countries – Botswana, Lesotho, and Swaziland – and of the fact that South Africa is the main gate for imports and exports to and from the Southern African region. All customs duties and surcharges collected minus the pro rata administrative costs are subject to this sharing formula. Botswana as one of the wealthiest member countries and since it is landlocked and has to import and export through either South Africa or Namibia is going to benefit from this formula due to its high share of intra-SACU trade. Namibia, on the other hand, has direct access to other markets through its two harbours and is hence less dependent on imports and exports through South African ports. That reduces its share in intra-SACU trade. With new infrastructure projects completed, such as the Trans-Kalahari Highway from Walvis Bay through Botswana to South Africa's industrial hub, the Gauteng province, imports by and exports from South Africa and Botswana through Namibia are picking up and adding to Namibia's share of intra-SACU trade. The overall impact on Namibia's intra-SACU share – and eventually on its revenue share from the common revenue pool - depends on whether the Namibian ports attract more trade for the domestic or the SACU market. The common revenue pool also implies that large investment projects that necessitate considerable amounts of imports, such as the potential development of Namibia's offshore Kudu Gas Field, will benefit all SACU member countries due to an increasing amount of import duties paid, and not only the country where the investment takes place.

The second and third leg of the revenue pool refers to the sharing of excise duties. 85% of excise duties are shared according to each member state's share of SACU's total Gross Domestic Product (GDP). South Africa as the dominating economy will receive the lion's share of this component, about 90%, followed by Botswana (5%), and Namibia (3%). The remaining 15% of excise duties form a development component that is distributed in reverse correlation to the members' GDP per capita (NEPRU Policy Brief 1). Despite large per capita income inequalities between SACU countries, the redistribution effect is rather modest (BoN, 2003, p.35). Botswana is expected to receive the smallest part – about 18% - and Lesotho the largest – almost 22%. The shares of the remaining countries are spread within this range.

Schade and Kalili (*ibid.*) argued in a preliminary evaluation of the proposed formula that Namibia will receive a higher share of customs duties. In a more recent report, the BoN expects that this will be offset by declining revenue from the excise duty component, since the revenue pool has moved from being dominated by customs duties to an excise dominated revenue pool (BoN, 2003). While excise duties accounted for almost 70% of the revenue pool in 1980, the share declined sharply to 40% during the decade but has since picked up again and stood at 63% in 2001. The process of trade liberalisation in the region will further support this trend.

The Bank of Namibia thus concluded that Namibia stands to lose the most from this new formula (*ibid.*). However, this will not materialise before the financial year 2006/07 because of the lagged effect of SACU payments. According to the old revenue-sharing formula, SACU transfers are based on revenues collected two years earlier, while the new formula is based on current revenue. The new agreement entitles the BLNS to the residual revenues for the past two years that will increase their income from the SACU pool. The pinch will be felt there after.

This decline is irrespective of declining income from taxes on international trade owed to trade liberalisation.

3.3.2. The TDCA between the EU and South Africa

After the demise of apartheid rule in South Africa in 1994, the Government sought to join the EU partnership agreement with the African, Caribbean and Pacific countries – the then Lomé Convention. Since the application was rejected on the grounds of South Africa's advanced economy, it entered into talks about a free trade agreement with the EU, which was finally concluded in 2000. Though the Trade, Development and Co-operation Agreement was negotiated between South Africa and the EU it is *de facto* an agreement between SACU and EU because of South Africa's membership in SACU and its common external customs tariff. The three year protracted negotiations stirred some controversy within SACU since the BLNS countries did not feel well informed and included in the negotiations although it will affect their economies and customs revenue.

EU tariffs on South African products will be phased out over a period of 10 years for 95% of the current value of South African exports to the EU. South Africa on the other hand will eliminate tariffs for 86% of the current value of EU products over a 12-year period. These concessions by both parties will lower the average duty rate from 2.7% to 1.5% by the EU and from 10% to 4.3% by South Africa (Iyambo *et al.*, 2002). Obviously, South African products entering the EU carry currently a much lower tax burden than vice versa. The tariff rate for most of South Africa's exports is even zero. Most of the imports from the EU are also subject to low or zero tariff rates. Only about 40% carry a high tax burden of more than 40% (*ibid.*). The agreement excludes liberalising tariff rates within this period for certain sensitive products, mainly agricultural products but also some industrial products such as motorcar components. The already low tax rates are indicative of the kind of goods exchanged. Most trade is

of the 'inter-industry' type rather the 'intra-industry' type as is the case between developed industrial countries with similar endowments and technology (Lewis, 1999).

3.3.3. The Cotonou Convention

All BLNS countries are part of the Cotonou Convention that covers among others non-reciprocal preferential access of products from ACP countries to the EU market. This is in particular important for Namibia's meat and grape exports that are granted certain quotas. The quota of 800 tons of seedless table grapes for duty free access has contributed to the establishment of a rapidly growing grape industry with production increasing from about 240t at independence to an expected output of 13,500t in 2004. The quota is split into two allocations, each one of 400 tons for December and January of each year respectively (Hoffmann, 2004). Other table grape exports attract an import duty of about 8% generating an income for the EU that equals 20% of its aid allocation to Namibia under the 8th European Development Fund for the period 2003 to 2007 (ibid.).

The current non-reciprocal preferences will be replaced from 2008 onwards by Regional Economic Partnership Agreements with reciprocal preferences that are negotiated between individual countries or groups of countries and the EU. The negotiations started at the end of 2002 and Namibia is part of a group of SADC countries that are in talks with the EU. The TDCA between the EU and South Africa is probably a good example for what these future agreements will look like. Since Namibia will be affected by the tariff rate reductions under the TDCA it is not likely that the new partnership agreements with the EU will have a significant impact on the tariff structure and eventually on Namibia's customs revenues.

3.3.4. The SADC Trade Protocol

Eleven of fourteen SADC member countries signed a Trade Protocol in 1996 to establish a Free Trade Area within eight years of the commencement of the implementation process, which was in September 2000. The transition period for least developed countries was extended to fifteen years. Within these periods, trade shall be liberalised for all non-sensitive products. They account for about 85% of total SADC trade. Full liberalisation is envisaged within four years there after. Trade within SADC is so far rather limited. Intra-SADC trade accounted for only 1.2% of total SADC exports and SACU accounted for only 15.5% of intra-regional imports (Hartzenberg, 2001). This is mainly because non-SACU SADC countries are exporters of mineral and agricultural commodities and thus competing within the same range of products. They rarely produce complementary products. Hence, their major markets are beyond the SADC region.

SADC tariff rates are on average between 12% and 14% (ibid.). However, there are considerable differences between countries. SACU and some other countries have low tariff rates, while other countries protect their markets.

Since SACU has already the lowest tariff rates within SADC and because it does not import huge volumes from SADC, the SADC FTA is not likely to have a major impact on SACU customs revenue.

3.3.5. Further trade commitments

As mentioned, all SACU and SADC member countries are signatories to the WTO. As such, they are committed to reducing trade barriers. Again, Namibia's situation differs from that of other developing countries. SACU, because of South Africa's development status, is treated as a developed country. It is therefore committed to a speedier tariff rate reduction than developing countries, while potential markets in other developing countries will open only slowly.

Finally, Namibia is included in the African Growth and Opportunity Act that grants unilateral non-reciprocal preferential access to the USA market. This has attracted investment in the previously almost non-existing textile industry.

3.4. Current trade negotiations

The era of non-reciprocal trade preferences is slowly coming to an end. Economic partnership agreements with the EU are one step into a new trading environment. Namibia with other SADC member countries¹ has started negotiations with the EU. In addition, trade negotiations between SACU and other countries and blocs are under way. Currently the customs union is engaged in trade talks with the USA, the European Free Trade Association, MERCOSUR, India and China. Since trade with these markets is not very pronounced any agreement reached will offer opportunities to exploit new, and partly fast growing, markets rather than resulting in custom revenue losses. If Namibian companies succeed in exploiting these new opportunities and subsequently expand their production it could result in higher Government revenue from company taxes.

3.5. Trade tariff rates

For members of SACU, the SACU common external tariff applies to all products imported from outside the customs union. The main objective of the common external tariff has been to support South Africa's import substitution policy, which was designed by the Board of Tariffs and Trade within the Department of Trade and Industry in South Africa. Interests of the other SACU member countries rarely played a role in deciding the tariff rates. Additionally, "South Africa has not hesitated to erect tariff barriers against neighbouring countries when their exports are seen to threaten South Africa's interest, even against countries within SACU (...)" (Jenkins *et al.*, 1995:35).

¹ The other countries of this grouping are: Angola, Botswana, Lesotho, Mozambique, Tanzania, and Swaziland. The remaining SADC countries have formed a group with countries from East Africa.

Furthermore, South Africa applied quantitative restrictions and formula duties to protect her industries. Thus, trade barriers were designed to shelter South African industries which do not necessarily correspond with the needs and interests of industries in the smaller BLNS countries. This is, however, expected to change with the new SACU agreement in place and the establishment of a SACU Tariff Board. Moreover, the new agreement stipulates the design of a common industrial policy and a common competition policy. Both policies could bring about a more balanced industrial development in the whole of SACU.

Since the beginning of the 1990s, South Africa entered into liberalising trade. Quantitative restrictions and formula duties were converted into *ad valorem* tariffs and subsequently tariffs were reduced. Compared to SADC countries, SACU's average tariff rates are now low. 3,206 of the 12,126 tariff lines are zero rated (Hansohm *et al.* 2002). The significance of zero-rated tariff lines becomes more evident when analysing them according to their contribution to the total value of imports. 37% of the tariff lines that account for 80% of the total value of imports from outside SADC and the EU are not subject to customs duties. The share is considerably higher for imports sourced within SADC – 61% (*ibid.*).

Primary consumer goods such as food carry very low or no customs duties; while textiles and garments are subject to relatively high tariff rates (some 27%). The spread of rates ranging from 0% to 52% is indicative for a selective protection rather than a general protection of domestic textile production. Primary intermediate goods and capital goods are rarely targeted by tariff rates. The simple average tariff rate based on all imports stands at 8.3%, while the trade weighted average is even lower – 6.1% (Hansohm *et al.*, 2002) (see also Table A1). However, the selectivity created a tariff structure with large levels of tariff differences between and within sectors.

4. Revenue mobilisation

Three areas are available to Government to respond to revenue losses from one source: cut expenditure, increase the budget deficit and/or increase revenue from other sources. After a brief evaluation of possible revenue losses arising from free trade agreements, the options of adjusting expenditure and the deficits will be considered before options for increasing revenue are explored.

4.1. Expenditure and revenue patterns

Expenditure

Namibia reveals relatively high expenditure as a ratio over GDP when compared internationally (Hansohm *et al.*, 1999). Currently the ratio stands at 34% while Government aims at reducing it to 30%. High expenditure was necessitated by the pre-independence distortionary apartheid policies. Priority spending areas are education and health, both seen as vital to uplift the standard of living of the population.

Though declining over the years, basic education continues to receive the main share of the budget – about 19%². An additional 4% is spent on higher education, training and employment creation. Public spending on education amounts to about 8% of GDP. The second priority area is health, and in particular primary health care. It has received around 14% of public expenditure over the years. Both priorities are not only meant to increase the productivity of the work force and hence spur economic growth but are also regarded as pro-poor policies. New classrooms and clinics have been built primarily in rural areas where the poor live. It is expected that investment in education and health will equip the poor with the necessary means to successfully find employment or become self-employed, thus contributing to one of Government's four national development objectives, namely poverty reduction.

Two other ministries gained importance in terms of resource allocation, namely the Ministry of Finance – even when statutory expenditure is excluded – and the Ministry of Defence. The latter absorbs the fourth largest chunk of the budget – 8.6%. The increase over time has been attributed to Namibia's involvement in the conflict in the Democratic Republic of Congo (DRC), the secessionist movement in Namibia's north-eastern region, Caprivi, and the civil war in Namibia's northern neighbour Angola that spilled over into the border areas with Angola. After the withdrawal from the DRC and after the other two conflicts have been resolved, the military continues absorbing the same share of the budget. Expectations about a peace dividend have not been fulfilled, which can - at least in part - be explained by the ongoing establishment of an air and maritime wing.

The main expenditure items are personnel costs (42%), subsidies and other current transfers³ (18%) and goods and services (15%). About 12% is used for capital expenditure, while allocations to statutory expenditure are steadily increasing accounting for an estimated 9.3% in the 2004/05 financial year – more than the allocation for the police (5.9%) for instance. Statutory expenditure includes interest payments for government debts and is hence a reflection of the level of total debts though influenced by interest rate fluctuations. Furthermore, loan guarantees by the state to mainly parastatals and some private companies have added to statutory payments since some of the beneficiaries of these guarantees defaulted on their loan repayment (Table A6).

The most convenient item for cuts in expenditure is in general capital expenditure or social spending. However, reducing capital expenditure can affect economic growth negatively if necessary infrastructure projects are targeted. Cuts in social expenditure could contradict Government's development objective of poverty reduction. A

² During the 2003/04 Financial Year the Ministry of Finance was allocated 22% - compared to 18% of the Ministry of Basic Education - to cover rising statutory expenditure.

³ This item includes among others the payment of social, non-contributory, pensions, contributions to the medical aid scheme, and payments to private health facilities and schools.

considerable share of households in particular in rural areas relies on social pensions as a major source of income.

Savings on statutory expenditure can not be expected since interest rates are on a very low level and further cuts are not anticipated. On the contrary, interest rates are more likely to rise in the medium term. Hence, only a reduction in public debts will result in lower statutory payments.

Across the board cuts in the wage bill are not feasible, since it would lead to the departure of well qualified and experienced employees for which the demand exceeds the supply. A cut in the workforce could be possible, but would result in conflicts with trade unions of which some are affiliated to the ruling party. Furthermore, socio-economic considerations will make this option unlikely since retrenchments will add to the already high level of unemployment (about 34.5%). As a recently conducted Public Expenditure Tracking Survey for the health and education sectors revealed, efficiency gains are possible in both sectors. Furthermore, possible leakages could be prevented if the auditing and control capacity within the public service is increased. Though increased efficiency can contribute to a reduction in the size of the public service in the medium term, savings on personnel costs do not necessarily go hand-in-hand with it, since salaries need to stay attractive for qualified personnel.

With declining revenue on the horizon, a more detailed review of the public sector would be needed to identify areas, where spending can be reduced without jeopardising Government development objectives. On the other hand, increasing costs for the health sector can be expected for the coming years caused by the HIV/AIDS pandemic. Thus, the overall extent to which savings can be achieved to level out losses in revenue is not clear.

Deficit

The budget deficit fluctuated between 0.2% and 6.6% since independence in 1990 with an average of 3.4%. This is slightly above the fiscal target Government aims to achieve – 3%. Though accepting a higher than 3% budget deficit would be theoretically possible to offset a decline in revenue, it is hardly an option for Namibia or necessary. Firstly, increasing statutory expenditure is already indicative for the cost of serving increasing debts. Further increases could result in cuts of other expenditure, which would negatively affect the reduction of poverty if social spending is targeted. In addition, total Government debt account already for 32% of GDP, far above the fiscal target of 25%. A further increase in the ratio would not only dent Government's reputation but could lead to crowding out private investment needed to achieve the ambitious goal of an annual 7% growth rate until 2030. Finally, there is ample time for fiscal adjustments to the changing trade environment with regard to expenditure and/or revenue without the necessity to increase the deficit.

Revenue

Namibia's tax burden exceeds that of countries with lower, comparable or higher per capita income (Hansohm *et al.*, 1999) accounting for 29% of GDP in the 2004/05 financial year. Direct taxation gained importance over the years – its share of total revenue increasing from 26% in 1997/98 to 39% in 2003/04 (Table A7). The drop in 2004/05 is owed to two factors: Firstly, the strong appreciation of the South African Rand to which the Namibian Dollar is pegged lead to a substantial decline in company taxes. Secondly, Namibia received an above average amount from the SACU revenue pool during the financial year 2004/05.

Direct taxation is characterised by a small tax base. Some 261,000 individuals are subject to paying income tax. These individuals are either self employed or employed in the formal sector. Revenue from income tax on individuals increased steadily over the years from 15% in 1997/98 to an expected 21% in 2004/05 as has income from company taxes until 2003/04 – 9.8% to 16%. Income tax on individuals is a progressive tax that exempts the first N\$24,000 earned per annum from taxation and applies progressive tax rates thereafter, thereby benefiting low-income earners. Direct taxation is based on voluntary tax compliance with limited control by tax authorities.

The share of indirect taxes declined from 60% to 51% over the period 1997/98 to 2003/04. Income from taxes on international trade has dominated indirect taxation accounting for on average 31% of total revenue. Domestic taxes on goods and services consisted mainly of General Sales Tax and Additional Sales Levy that were replaced in November 2000 by Value Added Tax (VAT). VAT proved immediately to be a more efficient form of taxation than General Sales Taxes. It contributed on average 2.7 percentage points more to Government coffers than the sales taxes (Table A7). The absolute amount of VAT collected in the year of implementation exceeded the collection from sales taxes in the year before by almost 40%. Since VAT is generally seen as being a regressive tax affecting the poor and low income earners relatively strongly because they spend a higher share of their income on consumption, staple foodstuff such as millet and maize is exempted lessening the tax burden on the poor.

4.2. Impact on revenue

Free Trade Agreements affect revenue in various ways. Most obvious is the decline in revenue from customs duties. In addition, revenue from Value-Added Tax and from tax on company profits will be affected. These impacts are discussed below in more details.

4.2.1. Revenue from taxes on international trade

Theoretically, trade liberalisation could be self-financing in the case of initially high tariff rates and high import elasticity. It is estimated that import elasticity in excess of 20% is required (Devarajan *et al.*, 1999). In this case, tariff reduction would result in

substantial increases in imports, which could outstrip the losses of customs revenue. However, Devarajan *et al.* state, that import elasticities in developing countries range between 0% and 3%, hence “nowhere near the point at which tariff reform can become self-financing” (*ibid.*, p.33). Namibia is no exception to this and secondly as described above, tariff rates are not at such a high average level that could trigger considerable increases in import volume. Thus, losses from taxes on international trade are a certainty for Namibia.

As outlined above, Namibia through SACU is involved in a number of - in part overlapping – free trade agreements with a broad variety of countries and economic blocs. Because of her current trade patterns, the most significant impact on Government revenue can be expected from the TDCA between the EU and South Africa or rather SACU⁴. Trade with other regions is rather limited now and so would be the direct impacts of tariff reductions on Government revenue.

Various studies have been conducted estimating the impact of the TDCA on SACU's common revenue pool and the revenue for member countries. All studies designed scenarios whereby tariffs are reduced once off rather than in stages as is agreed upon. Thus, SACU will not face an immediate loss of custom revenue but a decline over several years. A study conducted by the Bank of Namibia (Iyambo *et al.*, 2002) and the study by the Institute of Development Studies (IDS) and the Botswana Institute for Development Policy Analysis (BIDPA) came to similar conclusions concerning the expected loss of revenue. Excluding tariff cuts for protocol products, the SACU revenue pool would lose between 31% (IDS and BIDPA, 1998) and 35% (BoN, 2003) of its custom revenue based on the 1997 income. Taking into account that customs revenue constituted only 37% of the total common revenue pool – the remaining is made up of excise duties - this would translate into a decline of the pool by about 12% to 13%. Namibia, accordingly, would incur losses of about N\$480 million based on the expected income from international taxes in the current financial year, bearing in mind that this year's receipts from SACU are exceptionally high.

The studies however differ when protocol items are included in tariff reductions. IDS and BIDPA calculated losses amounting to 51% of the customs component of the common revenue pool (IDS and BIDPA, 1998), compared to 32% as calculated by the Bank of Namibia (BoN, 2003). The BoN explains this considerable discrepancy with possibly incomplete information available at the time the IDS/BIDPA study was conducted while the bank's estimation is based on the final agreement (*ibid.*). Using current figures, a decline by 51% would imply a reduction of the revenue pool by almost 19% or a loss of income for Namibia of about N\$794 million. It can be reasonably assumed that actual losses are lower, because the 51% loss is at the high

⁴ The BLNS countries are not part of the TDCA but except Namibia have given their concurrence to the TDCA implying that they apply the preferential tariff rates to EU imports. But even Namibia actually grants the preferential rates since it is almost impossible to control at the border posts with South Africa the origin of the shipments. It is expected that Namibia will concur in due course.

end and the current income from SACU is above average. However, the figures are useful to demonstrate the range of potential losses.

Adding to these reductions in revenue could be the losses incurred because of trade diversion. Lowering or abolishing trade tariffs for selected countries or a group of countries could result in the import demand shifting from low cost producers not benefiting from the tariff reduction to producers that actually produce at higher costs, but whose products are no longer subject to tariff rates. The demand shift from products that are subject to customs duties to products that are not, leads to a decline in customs revenue. In addition, welfare gains are less compared to the case of universal tariff reductions. The extent of trade diversion depends on the elasticity of importers to substitute regional products for extra-regional products. The larger the elasticity of substitution of importers the larger the losses in revenue from extra-regional imports the tax office will incur (Leape, 2000). Evans has undertaken some estimates, but these figures are regarded as “at best illustrative of the direction and the order magnitude of the effects” because of his methodology and the incompleteness of data (ibid. p.63). Though trade diversion is a reality Lewis *et al.* concluded in their study of various free trade configurations within Southern Africa that all are net trade creating (for more details see Lewis *et al.* 2003).

Furthermore, SACU commitments within the WTO framework and the SADC Trade Protocol will result in further drops of customs duties – unless the value of trade increases to such an extent that tariff rate reductions are levelled out. In any case, possible revenue losses are less pronounced because of the relatively low level of trade taking place with other than SACU and EU countries. The decline in revenue for Namibia resulting from the SADC FTA is estimated at less than 1% (Leape, 2000).

And finally, the decline in customs revenue will add to less income from the common revenue pool due to the new revenue sharing formula. Impacts of the new formula are expected from 2006/07 onwards. During 2004 and 2005, Namibia can expect residual entitlements that amount to 536m and 576m (BoN 2003) offsetting negative impacts of the new formula.

On the other hand, if tariff reductions are phased-in gradually, revenue can actually increase in the initial period, if trade creation outweighs both, trade diversion and the extent of tariff cuts (Leape, 2000). Furthermore, trade liberalisation opens foreign markets and provides new export opportunities for domestic producers. This in turn can have positive impacts on economic growth and company profits, subsequently increasing revenue from direct and indirect taxes. Whether and to what extent this materialises depends on the competitiveness of domestic companies and their capability to reap fruits from such opportunities. These possible fiscal benefits from trade liberalisation are less certain than the losses the receiver of revenue will incur.

4.2.2. Revenue from Value-Added Tax

In addition, lower prices of imported products combined with increased competition in the domestic market result in a lower base on which VAT is charged and could lead to a loss of revenue from this source as well. However, this has to be qualified on two grounds. Firstly, tariff reductions do not necessarily result in lower prices on the domestic market. The extent to which lower import prices are passed on to the purchaser or consumer depends on the degree of competition. Strong competition will force suppliers to adjust prices to stay competitive. If these market forces are weak or missing, cost reductions are, at best, only partially passed on. Secondly, if lower costs result in lower prices, the impact on revenues derived from VAT depends on the response of the consumer. If consumers continue spending the same share of their income on consumption, Government income from VAT will not be affected. This will only be the case if consumers keep to the same quantity of goods purchased but now at a lower price. On the other hand, if trade liberalisation leads to economic growth, then additional income from VAT can be expected dependent on the level of growth and its distribution. If the beneficiaries are mainly found among low-income earners and the poor, additional income will most likely be followed by additional consumption and hence growing income from VAT. If the wealthier part of society benefits mainly from economic growth, then the additional income might result in additional savings leaving revenue from VAT almost unchanged. There is no clear indication yet as to who benefited from economic growth in Namibia. The unemployment rate remained almost unchanged between 1997 and 2001 indicating that growth was not predominantly labour-intensive, which would have benefited the poor. More insight is expected once data from the second Household Income and Expenditure Survey is available; it covered a twelve-month period during 2003/04.

4.2.3. Revenue from taxes on company profits

The prime objective of SACU's common external tariff was not to encourage industrial developments in the BLNS countries and protect their industries but to support South Africa's import substitution policy. Hence, the tariff rates were not necessarily in the best interest of the BLNS countries and the actual level of industry protection in these countries was most likely lower than the protection of South Africa's industries. Subsequently, the increase in direct competition will affect BLNS industries less than South African industries. In addition, BLNS industries could benefit from cheaper inputs. The section below examines these both aspects in more details.

To gain some insight into what companies feel about trade liberalisation, interviews with selected companies and stakeholders were conducted (see list of persons consulted attached). As described above, Namibia's manufacturing base is rather low and most companies are involved in producing goods based on agricultural raw material. Since agricultural products and derivatives are usually classified as sensitive products (or protocol products) and are thus excluded from tariff rate reductions; these companies do not expect to face stronger competition on the domestic market. In addition, non-tariff trade barriers, such as sanitary and phyto-sanitary measures, could

be imposed to protect Namibian companies if imported agricultural products do not correspond with Namibian regulations⁵. Furthermore, Namibian producers have established themselves often in premium and niche markets abroad and do not expect to face stiffer competition if these markets open up to competitors from other countries. Other businesses are involved in manufacturing activities that have low levels of entry barriers, which on the one hand reduce export opportunities but on the other hand make the market less attractive for foreign producers. Producers of bulky, low cost products are sheltered against stronger competition from outside since high transport costs compared to the value of the product act as a barrier. However, there might be manufacturers who will face stronger competition in the local market. These are especially companies that source inputs from abroad, but due to their production capacity, can not order bulk quantities which results in relatively high input costs. They would need to increase the productivity in order to compete successfully with imported products. It appears that this situation applies only to few Namibian companies. Therefore, most of the companies interviewed do not expect significant affects from trade liberalisation on the level of competition in domestic or foreign markets and hence on their profits. One would therefore not expect a substantial impact on revenue received from company taxes.

However, this analysis excludes the impacts of trade liberalisation on the costs of inputs used in the production process. It is often argued that trade liberalisation reduces input costs for companies because of lower tariff rates applied on imported inputs and because of subsequent price pressure on locally produced inputs. The extent to which this can happen depends on the source of inputs, the tariff rates and the share for which the input accounts in the production process.

Most products are imported from or through South Africa. Goods produced in South Africa are not subject to tariff rates because of the customs union. However, trade liberalisation will affect prices of these goods, if inputs for the production of these goods are sourced from outside the customs union and are subject to import duties. In addition, even in the case of products wholly produced in South Africa, trade liberalisation will result in lower prices if the South African industry is sheltered by tariff rates and competitors from elsewhere produce at lower costs. Abolishing customs tariffs would result in price pressure on the South African producer that has to reduce prices in order to stay competitive. The extent to which Namibian producers will benefit depends on the production cost differential between the producers and on the degree of competition. The same applies to inputs sourced from Namibian producers. Lowering or even abolishing tariff rates will result in a decline in the prices of goods sourced from outside the customs union, unless monopolistic or oligopolistic markets prevent (at least in part) price changes.

Some industries in Namibia benefit from zero-rated inputs, in particular capital goods, or can reclaim customs duties paid on certain machinery and equipment. Capital

⁵ In the case of meat for instance access to the Namibian market can be denied if hormones and antibiotics are used, which is quite common in the EU and USA.

goods, such as excavators, trucks and bulldozers for the mining industry or vessels and factory ships for the fishing industry are usually zero-rated⁶. Inputs to the agricultural sector such as seeds, fertilisers and pesticides are also zero-rated, while agricultural tractors carry a relatively high duty burden varying between 12.5% and 36% depending on the region of origin. The TDCA does not exclude tractors from trade liberalisation as is otherwise the case with the automobile industry, so that price reductions can be expected. Costs in the service industry are also expected to decline. Information and communication technology especially plays an increasingly crucial role in the economy. Lower costs for equipment would trickle down to all other industries and reduce their input costs.

Company interviews could not shed much more light on the extent to which this could benefit Namibian producers. Companies usually order from South African suppliers or their forwarding agent does the customs clearance, so they are not always aware of the cost impact of custom duties.

Lower input costs will increase the competitiveness of companies and thus opens new or sustains existing markets and improves the profitability. Depending on which factors are more pronounced – increased competition resulting in price pressure or increased productivity because of lower input costs – Government revenue will loose or benefit.

The firm level interviews suggest that trade liberalisation is not expected to have a major impact on the level of competition on the domestic market and on markets relevant for Namibian exporters. However, more research into the input structure of companies and the price raising impact of tariff rates on these inputs is needed to assess the impacts of trade liberalisation on the cost structure of companies more accurately.

4.3. Sources for additional revenue

4.3.1. Additional tax sources

In theory, trade liberalisation increases investment and consumer demand and thus economic growth, which would result in growing profits and income. Depending on the distribution of these income gains, revenue from income and profit taxes could be expected to rise as well. Thus, politicians would not need to bother too much about falling customs revenue. However, “the debate on trade liberalisation and growth is still open. Neither theory nor empirical evidence provide a clear-cut answer” (Chauvin and Gaulier, 2002:21). In addition, even if trade liberalisation leads to additional economic growth not every country within an economic grouping necessarily benefits to the same extent from it. For instance, within SACU South Africa could benefit from the

⁶ There are exemptions from this general rule. For instance smaller trucks not exceeding a gross vehicle mass of 25 tonnes are subject to import duties. These are usually used in the construction industry rather than in the mining industry.

polarisation effect that attracts new investment to regions where similar industries already exist. This trend, on the other hand, can be countered by the need of companies to become competitive against imports, which could result in the re-location of industries to regions with lower input costs. Hence, neither can economic growth be taken for granted nor that it will be distributed equally between all countries participating in a free trade agreement.

Furthermore, trade liberalisation can result in resource reallocation from well-protected to less protected sectors and thus to more efficient sectors. This would increase overall economic efficiency, stimulate economic growth and benefit Government coffers through additional revenue.

In general, the SACU external tariff structure was not designed to develop Namibia's industry. However, as in most other parts of the world, the agricultural sector has received and will continue to receive particular protection. Agricultural products are classified as sensitive products and are thus exempt from trade liberalisation at least during the initial phase. Talks might resume on liberalising trade in these products once tariff rates for all other products are phased out within the agreed period. The degree of protection of other industries is less obvious and so are potential efficiency gains. Clearly, more research is needed to adequately address this area and assess possible positive impacts on economic growth and in turn on Government income.

Since these effects are less clear, options to adjust expenditure and to increase revenue need to be explored since ignoring possible revenue shortfalls could lead to negative impacts on the macro-economic framework – for instance on inflation. This does not necessarily imply raising tax rates and/or introducing new taxes, which could have distortionary impacts on the economy. Declining revenue would be a blessing in disguise if government uses the pressure on its finances to review its tax system in totality and identifies areas where revenue can be increased and distortionary impacts of taxation can be lessened or eliminated.

Increasing current tax rates could be seen as an option but would require some detailed analysis. Income tax on individuals in Namibia is already considerably higher than in Botswana but comparable to South Africa, while tax on profits from non-diamond companies is higher than in both countries (BoN, 2002). Offsetting the fiscal impacts of trade liberalisation would require increasing direct taxes 3.4% (Leape, 2000). However, such an increase could not only result in distortions in saving, investment and employment decisions, but contribute to tax evasion and eventually result in less revenue being collected. The latter is more likely within a relatively weak tax administration. Therefore, a preferred option to offset losses from customs revenue could be increasing consumption tax. Because of its broader base, the risk of market distortion would be lower. Again, Namibia's VAT rate (15%) is already higher than in South Africa (14%) and Botswana (10%). Raising it by 4.7 percentage points (Leape, 2000), which would be necessary to cover the expected revenue shortfall, could not only lead to declining demand, which could result in leaving revenue from VAT at its current level, but moreover would affect in particular the poor and low-income earner because of its regressive nature. It would subsequently affect Government's

development objective of reducing poverty negatively, unless it is accompanied by additional social transfers and by an increase in the income tax threshold to offset price increases. Since this in turn results in increasing expenditure and less revenue from taxes on income the actual increase in the VAT rate would need to be larger than 4.7 percentage points, which can have serious impacts on demand. Furthermore, Namibia's VAT rate would be more than double the VAT rate in Botswana and substantially higher than in South Africa which provides incentives for smuggling. Introducing a higher VAT rate for items defined as luxury to target the wealthier population is also not recommended, because of its additional administrative burden and incentive for tax evasion⁷. In addition, it would contradict the common wisdom that tax laws should be simple. Hence, increasing taxes on income or consumption are not an option to offset losses from customs revenue.

Instead of increasing the tax burden on salaried employees, broadening the tax base of direct taxation promises better results. This includes broadening the range of individuals and companies that are paying taxes as well as the range of income taxable (Leape, 2000). As in other countries in the region, micro-, small- and medium-sized businesses and the so-called informal sector play an important role in terms of contribution to GDP and to employment. Because of a lack of records, its size is difficult to measure and it is rarely taxed. However, some of these businesses need licenses to operate legally such as transport operators (taxis in town and long-distance operators), bars and restaurants to name a few. Revenue authorities can tap into this information to include it in the tax system. To enforce tax compliance by these businesses the specific nature should be taken into account. These entrepreneurs have the necessary skills to run their business, but they usually lack administrative skills, sometimes because of illiteracy and/or innumeracy. Therefore, record keeping is poor and the ability and willingness to fill in complicated tax forms is low. New forms of taxation have to be found that take account of the capacity in this sector. Taxation has to be simple and transparent and should encourage entrepreneurs rather than discourage them from operating legally. South Africa has therefore introduced a lower tax rate on company income for small- and medium-sized enterprises. Still, it would imply keeping records of business activities to fill in tax forms.

Another option would be to introduce presumptive taxes (Leape, 2000). Three types of presumptive taxes have emerged so far: Standard assessments, estimated assessments and presumptive minimum taxes. Other African countries employ these various types of assessment. They all have their drawbacks. Standard assessments (lump-sums) do not conform to tax equity and raise too little money. Estimated assessments are more data-intensive since certain indicators are used for the assessment as are presumptive minimum taxes (ibid.). Because of these shortcomings, closer cooperation between the licensing department and tax department could bring better results. Two options are possible: rejecting the renewal

⁷ Initially, VAT consisted of three tax rates: 0% for basic foodstuff such as maize and millet, 30% for specified 'luxury' items and 15% for all remaining goods. The 30% tax rate was abolished after two years, in October 2002.

of licenses to applicants who have not paid their taxes or using the licensing fee as a form of direct tax itself. The latter form however, carries the same weaknesses as the standard assessment, since it does not distinguish between the size and turnover of businesses. If license fees are low to attract micro and small enterprises to register, the additional revenue would be low, if they are high to generate income they can scare these businesses away and push them into the informal sector. Thus, an exchange of information between the licensing and tax department to follow up on tax payment could be considered as a relatively low cost option to broaden the tax base.

The other possibility stated is including other forms of income in taxation. Currently wage and salary earners have to declare their income at the end of the financial year and render the forms to the receiver of revenue. The income includes passive income such as interest earned. However, since the revenue authority relies on voluntary compliance and has not the capacity for extensive audits it can be assumed that interest received is often not declared. The introduction of a withholding tax would address this issue (Namibian Tax Consortium, 2002). Financial institutions holding deposits would be required to withhold a certain percentage of the interest earned. This share should not be too high since it could discourage savings or result in distortions in the investment portfolio if certain forms of gains from capital are taxed while others are not. The introduction of a withholding tax would enforce the compliance with existing tax laws. It is estimated that a withholding tax could generate about N\$140m.

Namibia is characterised by stark contrasts in wealth and poverty reflected in the Gini coefficient of 0.71⁸. Though spending patterns are usually a more efficient way than taxation to address income discrepancies and poverty there are exceptions to this general rule. A tax targeting the transfer of wealth in the form of an estate duty and a donation tax would contribute to redistributing some of the wealth that has been accumulated in the hands of a few (Namibian Tax Consortium, 2002). The advantage of this kind of tax is that it is easy to collect since transfers of estates are registered with the Master's Office. The office can provide the necessary information to the revenue office to issue a tax invoice. Due to a lack of information from the Master's Office the potential amount of funds sourced from an estate duty and donation tax could not be estimated.

4.3.2. Strengthening tax collection

Though there are options to enlarging the tax base, other possibilities can be explored as well, such as the simplification of the tax system. A range of tax exemptions and tax incentives exists, noticeable in the form of the Export Processing Zone scheme and the Special Incentives for Manufacturers and Exporters scheme. Generally, tax incentives

⁸ This is the official figure based on the Household Income and Expenditure Survey 1993/94 (NHIES). But there are indications that this figure is too high. Results of the just recently completed NHIES 2003/04 will be available towards the end of 2005 and could shed some light on the actual income distribution.

play only a minor role in attracting investment. Investors consider peace and economic and political stability first before they consider any incentives offered (Namibian Tax Consortium, 2002). Benefits from tax incentives only materialise once a profit is made, which is rarely the case in the first couple of years of operation. In the case of foreign investors, Namibia might cede revenue to the country of origin of the investor, where the profit is taxed. Thus, tax incentives do not even benefit the investor but the treasurer of the country of origin. Therefore, incentives of this kind tend not to benefit the target group. On the other hand, tax incentives open loopholes that can be exploited by businesses, such as renaming or transferring companies at the end of the tax holiday period in order to qualify for another tax exemption (*ibid.*). Abolishing tax incentives would level the playing field between businesses instead of discriminating against some for the advantage of others. It would also reduce the administrative burden and free human resources needed to enforce the compliance with tax laws. Finally, it could add to government revenue that could then be used – if possible – to reduce tax levels overall to support economic growth or to channel direct financial support to specific industries for a limited period. Reviewing tax incentives in Namibia would also be in line with the SADC initiative to avoid harmful tax competition and hence to limit the extent of tax incentives. A SADC database is being compiled to increase the transparency of tax incentives and disclosing it to the public.

Another area that bears the potential of substantial revenue gains is the efficiency and effectiveness of revenue collection. It starts with human resource development within the customs and excise department. Customs officials need to be trained to classify and value products correctly in order to apply the correct tariff rates and calculate the duty amount. It furthermore implies that information about changes in tariff rates, exemptions and rebates are immediately updated and communicated to all border posts that are often located in remote areas with limited infrastructure (Namibian Tax Consortium, 2002). Fully computerised customs offices will not only enhance the exchange of information and speed up the process of customs procedures but also improve auditing and control functions. The speedy exchange of information is even more important as Namibia is involved in parallel ongoing free trade agreements that are at different stages of liberalisation. Subsequently, tariff rates are constantly changing and different rates apply to the same product depending on its country of origin. The variety of tariff rates creates incentives for false declaration that can only be countered by well-trained, motivated customs officials with access to the latest customs tariff information.

In general, complicated and non-transparent tax and customs procedures result in discretionary power of tax collectors and can lead to corruption. This is especially true for tax exemptions and import duties. The latter is complicated by highly varying duty rates based on product specification and country of origin. Several measures could be introduced to limit the risk of bribery and corruption. Firstly, easily understandable tax laws and rules empower the tax payer and reduces the power of tax administrators. Hence, a transparent and simple tax system will not only limit corruption but will enhance tax compliance. Secondly, tax officials should be paid competitive salaries, not only to reduce the risk of corruption but also to attract and retain skilled and

experienced personnel. Thirdly, strict and efficient control mechanisms as well as effective sanctions - such as the dismissal of staff - need to be put in place.

Furthermore, the audit capacity of the Ministry of Finance is currently quite limited. This includes both, human resources and equipment. A lack of skilled personnel as well as computers exists and subsequently the authority has no experience in the area of computerised audits. Only few companies are audited every year and large corporations have apparently never been audited (Namibian Tax Consortium, 2002). If companies are aware of the limited human resources of the tax authority, it will increase the probability of non-compliance since the risk of disclosure is very low. This will be further supported if tax rates are high and tax rules are complicated. Hence, there is a strong need to increase the auditing capacity to strengthen the tax compliance. It will not only increase revenue but also level the playing field between tax law-abiding companies and those who try to evade paying taxes.

Moreover, experience from other countries has underlined the positive impact a semi- or full autonomous status of the revenue collection authority has on revenue collection. The rationale for a separate revenue authority is limiting political interference by the Ministry of Finance and freeing the revenue administration from the constraints of the public service system (Fjeldstad *et al.*, 2004:13). In principle, this would enable the authority to offer attractive remuneration packages to recruit, retain and promote skilled and experienced staff. On the other hand, it would make it easier to dismiss employees who do not live up to expectations. Furthermore, it is believed that a separate institution could strengthen the focus on revenue collection and integrated tax operations, since it is a single task agency (*ibid.*).

The establishment of a semi-autonomous revenue authority in Uganda in 1991 led to a doubling in real terms of revenues collected during the first half of the 1990s (BoN, 2002). Similarly, South Africa created the South African Revenue Services as an autonomous agency within the public service (Leape, 2000). It is funded by a certain percentage of collected revenue and, though accountable to the Minister of Finance, is flexible in managing its own resources. Within the first nine months, it achieved its revenue targets for the year (*ibid.* BoN, 2002). Mozambique (from 1997 to 2003) and more recently Angola, have taken a different approach. The countries employed the services of a private company based in Great Britain to manage the customs services. Again, the result was a substantially higher amount of revenue collected. All these examples illustrate that with the right incentives and a higher degree of flexibility – crucial especially in personnel matters - the efficiency and effectiveness of customs authorities can be improved markedly. However, these initial gains were often followed by a stagnant tax over GDP ratio, indicating that autonomy is a facilitating condition for an improved outcome but does not assure this outcome. This points at other challenges that could be neglected if the focus is merely on short-term revenue targets.

Fjeldstad and Rakner have identified the following two areas as hindrances for a sustainable success of autonomous revenue authorities: limits of autonomy and patterns of fiscal corruption (Fjeldstad and Rakner, 2003:17). To enforce tax legislation the legal power to coerce and the political legitimacy to actually use such power is

required. If this is not the case, it can not be expected that the performance will improve. In addition, a semi-autonomous authority offering attractive salary packages can become the target of political interference and of rent seekers, which subsequently undermines the degree of autonomy. Inflated expectations set by the Ministry in charge are a further factor that can undermine the credibility of the authority if these targets cannot be met. The lesson from existing semi-autonomous revenue authorities has also taught us that corruption does not disappear with a greater degree of autonomy or privatisation. It has to go hand-in-hand with other measures, as indicated above, such as a simple tax system and sufficient control of tax officials.

The experiences from other African countries indicate that there is no blueprint for improved efficiency, but measures taken depend on the specific circumstances. One lesson learnt is, however, that reforming the tax structure should precede reforming the tax administration. A first step has been taken in Namibia through the tax review that was conducted in 2001. Various options of simplifying the tax system and raising additional revenue through new taxes have been put to government. Some of the recommendations have, meanwhile, been implemented while others are expected to be implemented in the near future. The procedures indicate that tax reform takes time. It is therefore recommended that the outcome of these reforms are awaited and analysed first before embarking on a broad-based reform of the tax administration.

However, in the meantime certain steps could already be considered. There is an urgent need to recruit skilled and experienced auditors to enforce tax law compliance. To increase the flexibility in offering competitive remuneration and career structures, certain public service rules for the receiver of revenue could be relaxed. In addition, capacity building of staff within the receiver of revenue directorate is necessary, whether or not the option of an autonomous authority will be pursued at a later stage. It cannot be expected and is also not advisable that all positions in an independent authority could be filled with skills from outside the current structure. Strong capacity building programmes within the ministry are therefore needed and will contribute to increased efficiency and effectiveness.

Overall, granting autonomy is not a straight-forward exercise and not a solution for all shortcomings of the current set-up.

5. Distributional impacts of trade liberalisation

In countries with high incidences of poverty and a skewed income distribution the impacts of policies and policy changes on poverty and the distribution of wealth needs attention. In the case of trade policy changes two aspects warrant closer examination: the benefits of lower or abolished tariff rates for different income segments of the population and fiscal impacts of trade liberalisation on different income segments.

5.1. Possible impacts of tariff rate reductions

In Namibia, the classification of poor households is based on their expenditure patterns. Households spending 80% and more of their expenditure on food products are classified as severely poor while households spending 60% and more are classified as poor. Poor households accounted for 38% of all households while severely poor households accounted for 9%. In addition to these two household categories, we have selected a category of affluent households that we have defined as households that spend 25% or less on foodstuff. These categories and the following analysis are based on the National Household Income and Expenditure Survey 1993/94 (NHIES⁹). Since the income data collected during the survey is not reliable, we have used expenditure to categorise households into poor and affluent households.

Affluent households spend a large chunk of their expenditure on services including income tax (Table A8). Income tax is the largest expenditure item closely followed by the repayment of loans and credits. Expenditure items that amount to some 50% of total expenditure consist of services (42%) and goods (9.8%), but do not include any food items. The consumption basket of the poor and severely poor is less diversified than the one of the affluent – containing 301 (severely poor) and 347 (poor) products as compared to 383 of the richer households. The severely poor spend more than a quarter on the staples – Mahangu (millet) and maize. Both products account for 18% of consumption expenditure of the poor. Dominant in both categories' consumption basket are also fresh milk, sugar and beef. Most of the consumption of the poor and severely poor is own or locally produced. However, Namibia is not self-sufficient in cereals except for Mahangu and therefore about 35%¹⁰ of total consumption of the staples is imported in the form of maize. Wheat is grown only under irrigation in Namibia and covers between 15% and 20% of total consumption. It can be reasonably assumed that beef and goat meat consumed by the poor is own or local production. Though Namibia is net exporter of meat, smaller quantities are imported from South Africa by supermarket chains whose head office is based there. However, residents of larger towns with cash and access to supermarkets consume this meat. Sugar is exclusively imported and not – yet – produced in Namibia. Almost all major expenditure items of the affluent households are imported – motor vehicles, petrol, parts and accessories and radio and TV equipment.

Though it is relatively straightforward to identify the locally produced and imported goods, it is not as straightforward to assess the benefits from trade liberalisation. Two factors mainly influence the benefits, namely the customs duties levied on the items and their inclusion in current trade agreements. The trade agreement that influences SACU most is the TDCA between South Africa and the EU. However, certain products

⁹ The NHIES data has to be treated with some caution, since the sample was relatively small and not all data was collected accurately. However, there is no other data source available. Data from the NHIES 2003/04 will only be available during the second quarter of 2005.

¹⁰ The imported share fluctuates substantially because of highly variable rainfalls in Namibia.

are identified as sensitive products and so far excluded from tariff rate reductions, namely wheat, maize, dairy products, meat and motor vehicles and parts thereof. They are part of the Reserved List that is currently under review within the Mid-term Review of the TDCA, but no changes to this list are expected.

The wheat and maize industries in SACU are highly protected though at varying degrees. In Namibia, millers have first to buy the Namibian wheat and maize output before import permits are granted. The prices are based on the South African Future Exchange price for maize to which the inflation rate and the transport differential is added. There is no static tariff rate set for maize imports. The rate is flexible and dependent on the import parity price that is mainly determined by the price set at the Chicago Stock Exchange. If the import parity price falls below a certain price per ton, customs duties apply as calculated through a complex formula. If the import parity price moves above this price level, no custom duties are applied. In Namibia, the millet (Mahangu) price is based on the maize price and hence influenced by prices on the international market. Since the industry is protected by set prices rather than high import duties, and since maize and wheat are excluded from the TDCA, though not from the SADC Free Trade Agreement, no price relief can be expected for poor households. Poor households in rural areas are usually self-sufficient in the staples, so any price changes for maize and thus Mahangu would be a mere arithmetic exercise to add monetary values to their in-kind consumption. However, prices could act as incentives to sell surplus production on the market though traditional values inhibit a stronger market orientation of farmers in the north central regions so far.

Most of the other food products that are imported and account for a relatively large share of consumption of the poor carry a 0% customs duty, such as sugar, rice, tea, and coffee. 10% custom duty is levied on cooking oil imported from outside SACU and trade liberalisation could result in lower prices if prices of the South African industry are currently higher than world market prices. The non-food items that account for a larger proportion of total expenditure of the poor and severely poor households are laundry soap and toilet articles. Soap carries a 20% levy if imported from outside SADC otherwise 13%, while the custom duties for washing powder are 15% if imported from outside SADC otherwise no customs duties apply. Cigarettes are heavily taxed – 36% - and account for roughly 1% and 0.4% of the expenditure of poor and severely poor households respectively. It is expected that tariff rate reductions will have a positive impact on the prices. However, this could be offset by increased excise duties that are levied on tobacco and alcohol products and are always an easy prey for tax increases.

The picture is slightly different for affluent households. They spend about 4% on motor vehicles, that carry one of the highest tariff rates – 36%. However, this industry is also protected and falls under the Reserved List. Other items that feature more prominently on their shopping list are included in the agreement such as radio and TV equipment, toilet articles, clothing, lounge suits etc. Tariff rates for these items range between 12.5% and 25% and price changes are likely, in particular for products imported from outside SACU that can in turn put pressure on domestically produced goods. While poor households spend a similar share on clothing as affluent households, severely poor households have few funds to purchase clothing.

The comparison of these three household categories supports some obvious facts namely that more affluent households spend a large proportion of their expenditure on services followed by imported goods. Severely poor households at the other end of the spectrum spend their income mainly on own and locally produced foodstuff. Within the group of items that account for 90% of total expenditure, products that could be affected by tariff rate reductions add up to less than 5% of total expenditure for severely poor households. The same category of items accounts for 13% of total expenditure for poor households and for 15% of affluent households. Though the qualification of the data source holds, we can conclude that poor and affluent households will benefit substantially more from trade liberalisation than severely poor households will. Furthermore, there is also evidence that richer households reap larger benefits than poor households do, though a much more detailed analysis would be necessary to quantify the impacts. The broad expenditure categories do not allow for a straightforward classification in terms of tariff categories. In addition, tariff rates for products on a six or eight-digit HS level can vary significantly so that an analysis on a more aggregate level provides only a rough indication of the tax burden certain products carry.

5.2. Possible impacts of revenue and expenditure adjustments

However, the impacts of trade liberalisation on households are not confined to price changes. It can be taken for granted that trade liberalisation results in declining revenue for Government. Government can respond to this challenge in two ways or a combination of them, namely by adjusting expenditure or revenue.

Targeted tax increases or introduction of new taxes focusing on assets and income of rich households as described above can raise revenue without hurting the poor. Strengthening tax compliance is also expected to affect rich households more than poor, who often do not have taxable income or whose income does not exceed the tax threshold for the payment of income taxes. Even if Government succeeds in including businesses from the informal sector in the formal economy and hence in the tax collection system, it is not expected that the employees will be directly affected since their income is usually lower than the income threshold.

On the other hand, increasing indirect taxes such as VAT would have negative impacts on the poor who spend a larger share of their income on consumption rather than savings. They would be the more affected the more they are involved in the cash economy. So far, a considerable proportion of subsistence farmers' expenditure is spent on own production (in-kind), while the urban poor need to purchase food for their survival (cash).

Thus, revenue adjustments do not necessarily need to impact on the poor. Options exist to raise revenue through tax policies that target affluent citizens. However, it needs to be seen to which extent these measures can offset losses from declining revenue. Most likely, adjustments on the expenditure side are also needed.

In principle, there are a number of options to cut expenditure starting with a public sector reform. The objective of such a reform would be to create a leaner, more efficient public sector. Though more research would be needed to analyse the impacts of a public sector reform on employment it can be assumed that to increase efficiency better qualified personnel and less unskilled and semi-skilled employees would be needed. Unless the public sector reform induces sufficient employment-creating growth, it can be expected that low-income earners and the poor have to bear more of the consequences than better qualified and therefore better-off households¹¹. However, because of the feared social implications, the discussion about a public sector reform has not received renewed impetus in Namibia, although it was addressed in budget statements a few years back.

Since independence, Government has emphasised social expenditure in particular in the areas of education, health and social grants to uplift the previously disadvantaged groups of society. Cuts in education and health, if resulting in lower levels of service delivery, would be detrimental to Government policies, since it would particularly affect the poor and their chances of exploiting opportunities on the labour market or business opportunities. Better-off households can usually afford making use of private service providers and would thus have access to quality services, although at higher costs. Hence, across-the-board expenditure cuts are not a solution to address declining revenue. There is a need for clear prioritisation of resource allocation focusing on achieving the main development objectives as outlined in the national development plans. These objectives, of which the reduction of poverty and of income inequality are two, should guide Government in adjusting expenditure.

5.3. Possible shifts in the demand for labour

The poor would benefit if the demand for unskilled labour increases as a result of a resource reallocation. Since little work has been done on this issue and since data is sketchy, this section raises research questions rather than pretends to provide final conclusions.

Namibia's economy is characterised by a formal and informal sector and so is the labour market. There is a high degree of unionisation in the formal sector that increases the bargaining power of the employees. Secondly, wages are relatively high in the mining sector, especially diamond mining sector. Thirdly, minimum wages have been agreed upon for construction and agricultural workers. It is often argued that these factors contribute to relatively high wage levels compared to neighbouring countries except Botswana and South Africa. Indications from the recently established textile and garment industry suggest that wages for unskilled Namibian workers are

¹¹ The paper does not attempt to exhaust the various facets of a public sector reform but tries to highlight a few aspects of expenditure adjustments.

higher than for unskilled or semi-skilled Asian workers, who have been imported. However, nation-wide comparative data is not yet available¹².

The situation in the informal sector is quite different. Wages are based on supply and demand and are thus considerably lower than in the formal sector. In addition, workers do not benefit from social security benefits, such as maternity leave, sick leave and death benefits, thus reducing the costs of labour further.

Although the elimination of customs duties could result in lower inflation and hence in lower inflation caused salary adjustments, the extent to which this might happen depends on the specific circumstances in each industry. On the other hand, trade liberalisation should lead to declining prices for imported products and currently protected domestic products. The extent of the trend in prices for labour and capital will determine whether the demand shifts towards labour, particularly unskilled labour which would benefit the poor, or towards capital.

Relatively high levels of wages and salaries in the formal sector combined with a rigid labour market would suggest that a reallocation towards unskilled labour is less likely. However, more research would be needed to analyse whether the current tariff structure benefits labour or capital-intensive industries in Namibia and whether the elimination of import tariffs would favour one production factor at the expense of the other.

6. Conclusions

The benefits Namibian industries can reap from trade liberalisation depend to a large extent on the tariff rates currently applied on inputs into the production process and the extent to which they result in trade diversion protecting SACU and in particular South African suppliers. Currently sheltered industries could face stiffer competition and would be forced to reduce costs and prices to stay competitive. But a number of imported inputs for the agricultural, mining and fishing sectors are zero-rated, while some manufacturing companies can reclaim import duties paid on equipment and machinery and do not pay import duties for most raw materials imported. On the other hand, industries could benefit from export opportunities arising from the reduction of trade tariff barriers. The interviews carried out suggest that most Namibian industries will not be substantially affected by trade liberalisation. However, it also became apparent that more thorough research into the input structure of industries and the price raising effects of customs duties is necessary.

Though no major impact on revenue derived from company profits is expected, other revenue lines will be affected. Revenue losses from taxes on international trade are a certainty for Namibia, mainly caused by the TDCA between South Africa and the EU,

¹² The Ministry of Labour has conducted a Wage Survey, but the report has not yet been released and it is also not a fully representative survey.

who is the main trading partner of SACU. Other free trade agreements already in place, such as the SADC trade protocol, or those currently being negotiated will add to the trend of declining revenue though to a much lesser extent. Adding to the effects on revenue of reduced or eliminated tariff rates is the change in SACU's revenue sharing formula that is expected to leave Namibia with less income. Hence, fiscal adjustments are necessary. Since it is neither an option to accept a higher budget deficit because of its possible negative impact on macro-economic stability, nor necessary because of the long transition periods for tariff rate reductions, the focus should be on expenditure and revenue adjustments.

Additional revenue can be collected through simplifying the tax system, mainly in the area of tax exemptions and incentives, through introducing a few well-targeted new taxes, and through increased efficiency and effectiveness in tax collection. The introduction of two additional taxes could be considered that are easy to collect and could contribute to the redistribution of wealth, namely an estate duty and a donation tax targeting the transfer of wealth. In addition, a withholding tax on interests earned could be introduced, since interests although taxable are often not declared in the income tax forms. Options to increase tax rates are limited. The tax base of direct taxes is rather small and high tax rates can result in increased tax evasion and distortionary impacts on the economy. Furthermore, tax rates are comparable to rates in neighbouring countries. Increasing VAT is also not really an option since it is already higher than in South Africa and Botswana and because it would affect the poor disproportionately. However, compensating the poor through higher transfers could level out the regressive nature of VAT.

Finally, though examples from other countries in the region have shown that a semi-autonomous revenue authority can yield some substantial revenue benefits, this was often limited to the initial period. Tax practitioners have therefore become more cautious about creating autonomous bodies without addressing other imminent issues. Instead, reforming the tax structure first, increasing the internal capacity of the receiver of revenue – in particular in the area of auditing and control - and relaxing some public service regulations to attract highly qualified staff is expected to improve the efficiency and effectiveness of the current authority. These measures combined can raise revenue without having distortionary impacts on the economy, which could be the case with higher rates of direct and indirect taxes.

Because of the high share taxes on international trade contribute to Government income, it cannot be expected that the proposed new taxes – estate duty, donation tax and withholding tax on interests earned – can replace declining income from customs duties fully. However, since customs duties are gradually imposed, but the introduction of new taxes will be felt to its full extent immediately, the new taxes can offset reductions in tariff rates in the beginning. That provides Government with sufficient time to adjust expenditure and focus on increased efficiency of the revenue collection authority.

Savings on the expenditure side could be possible in the medium term but the outcome is uncertain. Downsizing the public sector could be an option, but its social implications

need to be assessed first and mitigation policies put in place, since the unemployment rate is calculated at about 34%. Secondly, a public sector reform would need to investigate the options for attracting qualified personnel to the sector to deliver high quality and efficient public services. This will cost money and off set at least some of the savings resulting from a reduced staff compliment. In addition, declining revenue can support reprioritising Government objectives and focusing on expenditure vital to achieving the main national development objectives.

The impact of tariff rate reductions on income distribution in Namibia is not as clear cut. Benefits for the consumer will only materialise if competition forces the wholesale and retail sector to make price adjustments. Otherwise, price benefits will be absorbed along the chain from the producer or importer to wholesalers and retail traders. Furthermore, even if price advantages are forwarded to consumers there might be differences in the extent to which this happens between categories of goods. Hence, different categories of consumers will benefit to different degrees. Moreover, severely poor households spend less than 5% of total expenditure on products whose prices could be affected through trade liberalisation. Poor and affluent households spend about 13% and 15% respectively on these products. Though the difference appears small, the data does not necessarily suggest that both categories would benefit to more or less the same extent. A much more detailed analysis than is currently possible, because of the availability of data, would be needed to draw conclusions with confidence. The analysis would need to focus among others on the specific, detailed items consumed by various categories of households, their import shares, domestic prices in comparison to world market prices and import elasticities.

In addition, if income losses of Government results in cuts in expenditure, the impact on income distribution depends on the sectors that are affected by these cuts and the segment of the population that benefits mainly from these sectors. For instance, a freeze in non-contributory social pensions or other state grants will have negative impacts on the poor. However, the Government could also opt for targeted cuts that will mainly affect wealthier beneficiaries of Government expenditure, if this is politically feasible.

Though more research would be necessary to analyse how expenditure cuts would affect the poor, general experience is that vocal groups suffer less than groups of society that do not have a strong voice – and these are usually the poor. Unless Government takes a strong pro-poor stand, it is likely that the poor could carry a higher burden of expenditure cuts.

Finally, more research is also needed to establish whether the poor could benefit from a shift towards the demand for unskilled labour. Relatively high wage levels combined with rigid labour markets, while prices for capital goods decline would initially suggest that a shift towards unskilled labour is less likely.

Persons consulted

Namibian Breweries Limited	Mr E. Enders	30 Sep 2004
Namibian Manufacturers Association	Mr. H. Fourie	4 Oct. 2004
Bio Dynamics	Mr. N. Viljoen	5 Oct. 2004
Namib Mills	Mr K. van Graan	5 Oct. 2004
Meatco	Mr W. Roux	6 Oct. 2004
Barloworld Plascon Namibia	Mr N. du Plessis	6 Oct. 2004
Ministry of Finance	Mr J. le Roux	7 Oct. 2004
Capricorn Sweets	Mrs Kessler	7 Oct. 2004
Agricultural Trade Forum	Mr J. Hoffmann	25 Oct 2004
Springer Schokoladenfabrik	Mr Joubert	03 Nov 2004
Neo Paint	Mr H. Niedermeier	12 Nov 2004
Nampower	Mr J. Praetorius	27 Jan 2005
Ongopolo Mining and Processing (Pty) Ltd	Mr Mouton	28 Jan 2005
Barloworld Equipment	Mrs A. Briel	28 Jan 2005
Namibia Investment Centre	Ms. B. April	28 Jan 2005
Logical Networks (Pty) Ltd	Mr M. Matswetu	04 Feb 2005

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Appendix

Table A1 Comparison of simple average tariff rates, in %

	Tanzania	Zambia	Zimbabwe	Malawi	SACU
All	24.4	7.2	26.1	20.5	8.3
Consumer Goods, Primary	0.0	10.9	18.2	20.2	6.4
Consumer Goods, Manufactured	28.2	10.7	31.6	30.9	14.0
Intermediate Goods, Prim.	28.0	5.8	22.3	13.8	2.5
Intermediate Goods, Manufactured	24.9	5.5	23.5	15.7	7.1
Capital Goods	16.3	5.3	21.0	15.2	6.2
Textiles and Garments	23.3	11.0	37.3	35.5	13.0
Agriculture	35.1	0.0	0.0	0.0	0.0
Passenger Motor Cars	16.8	5.9	35.9	34.3	34.9
Petroleum and Power	13.6	5.4	16.3	7.9	3.5
Other	14.5	8.0	0.0	24.5	17.3

Table A2 Comparison of trade weighted average tariff rates, in %

	Tanzania	Zambia	Zimbabwe	Malawi	SACU
All	21.5	13.6	23.6	14.5	6.1
Consumer Goods, Primary	0.0	10.3	3.3	3.5	1.1
Consumer Goods, Manufactured	22.3	15.4	56.5	17.2	11.1
Intermediate Goods, Primary	25.6	6.4	9.6	1.8	2.2
Intermediate Goods, Manufactured	23.8	10.0	17.7	11.6	5.7
Capital Goods	17.9	10.8	20.8	13.8	1.6
Textiles and Garments	32.2	23.5	31.9	32.3	27.4
Petroleum and Power	6.6	5.0	6.0	18.0	0.0
Other	7.9	15.1	0.0	11.9	37.4

Table A3 Value of imports and exports by region in N\$ CIF value

Region	IMPORTS 2002	EXPORTS 2002	IMPORTS 2003	EXPORTS 2003
South Africa	10,507,684,102	3,396,828,809	8,531,992,449	3,057,375,918
SACU excluding RSA	20,279,348	64,273,274	16,234,881	75,641,998
SADC excluding SACU	94,331,124	1,977,289,010	90,072,982	2,446,629,152
Rest of Africa	282,816,085	225,731,976	95,867,885	384,710,202
EU	1,381,187,142	6,456,342,164	810,490,875	2,887,390,564
USA	272,546,673	421,222,355	105,830,457	261,657,435
Rest of the World	987,431,510	780,834,859	802,890,845	528,405,052
Other	40,052,302	37,330,152	156,989,713	60,594,832
Grand Total	13,586,328,286	13,359,852,599	10,610,370,087	9,702,405,153

Source: Central Bureau of Statistics, unpublished data

Table A4 Share of imports and exports by region

Region	IMPORTS 2002(P)	EXPORTS 2002(P)	IMPORTS 2003(P)	EXPORTS 2003(P)
South Africa	77.34%	25.43%	80.41%	31.51%
SACU excluding RSA	0.15%	0.48%	0.15%	0.78%
SADC excluding SACU	0.69%	14.80%	0.85%	25.22%
Rest of Africa	2.08%	1.69%	0.90%	3.97%
EU	10.17%	48.33%	7.64%	29.76%
USA	2.01%	3.15%	1.00%	2.70%
Rest of the World	7.27%	5.84%	7.57%	5.45%
Other	0.29%	0.28%	1.48%	0.62%

Source: Own calculation based on Table A3.

Table A5 Expenditure by selected votes in %, 1997/98 to 2004/05

	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Police	3.68%	4.52%	6.36%	6.30%	5.36%	5.91%	5.64%	5.93%
Foreign Affairs	1.94%	1.84%	1.92%	3.43%	3.17%	3.04%	1.88%	1.74%
Defence	7.22%	6.52%	7.21%	7.30%	7.29%	7.94%	7.18%	8.57%
Finance	9.95%	12.48%	14.09%	15.83%	19.93%	18.57%	21.99%	18.66%
Basic Education, Culture and Sport	23.21%	21.63%	20.67%	20.33%	20.14%	20.02%	18.33%	18.90%
Health and Social Services	14.50%	13.50%	14.15%	15.14%	13.75%	13.49%	13.55%	13.46%
Agriculture, Water and Rural Development	6.52%	5.97%	5.57%	5.44%	5.01%	4.56%	4.27%	4.35%
Transport	7.19%	5.20%	5.98%	2.65%	2.10%	2.42%	2.03%	4.36%
Higher Education Training. & Employment creation	3.78%	3.87%	3.71%	4.01%	4.20%	4.05%	4.17%	4.41%

Source: Own calculation based on Republic of Namibia, various years.

Table A6 Expenditure by item in %, 1997/98 to 2004/05

	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Personnel Expenditure	45.86%	46.00%	46.64%	44.04%	43.76%	43.73%	41.91%	41.78%
Goods and Services	21.35%	20.07%	18.33%	18.60%	18.59%	16.98%	17.08%	15.05%
Subsidies and Other Current Transfers	12.61%	15.05%	15.19%	16.51%	17.01%	15.87%	18.24%	17.88%
Acquisition of Capital Assets	12.38%	11.12%	11.61%	12.34%	11.73%	10.62%	9.66%	11.50%
Capital Transfers	1.51%	0.24%	0.43%	0.36%	0.45%	0.80%	0.80%	1.64%
Total Lending and Equity Participation	2.64%	1.01%	1.41%	1.80%	1.81%	4.95%	4.28%	2.88%
Total Current	79.82%	81.12%	80.16%	79.15%	79.36%	76.58%	77.23%	74.72%
Total Capital	16.54%	12.37%	13.46%	14.50%	14.00%	16.37%	14.74%	16.02%
Total Current and Capital	96.36%	93.49%	93.61%	93.66%	93.36%	92.95%	91.97%	90.74%
Total Statutory	3.64%	6.51%	6.39%	6.34%	6.64%	7.05%	8.03%	9.26%

Source: Own calculation based on Republic of Namibia, various years.

Table A7 Revenue structure in %, 1997/98 to 2004/05

	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Tax Revenue	87.38%	88.12%	89.94%	90.23%	89.31%	89.07%	91.46%	90.07%
Taxes on income and profits	26.27%	29.24%	28.59%	30.89%	33.65%	36.50%	39.00%	29.47%
Income Tax on Individuals	15.20%	16.35%	16.74%	18.28%	19.43%	20.57%	21.59%	21.12%
Company Taxes	9.81%	11.59%	10.93%	11.38%	13.28%	14.67%	16.17%	7.94%
Diamond mining companies	1.92%	3.27%	2.88%	2.41%	5.41%	7.92%	10.39%	0.43%
Other mining companies	1.15%	1.00%	1.73%	0.85%	0.63%	1.28%	1.34%	0.12%
Non-mining companies	6.73%	7.32%	6.33%	8.13%	7.24%	5.48%	4.43%	7.38%
Taxes on property	0.96%	0.64%	0.53%	0.65%	0.51%	0.69%	0.81%	0.77%
Domestic taxes on goods and services	29.25%	28.04%	27.97%	20.64%	24.48%	24.74%	23.75%	24.34%
VAT					22.22%	22.17%	21.18%	22.12%
GST	13.66%	14.49%	12.95%	13.34%		0.00%	0.03%	0.00%
ASL	5.96%	5.80%	5.66%	4.94%		0.02%	0.01%	0.00%
Taxes on international trade and transactions	30.09%	29.56%	32.23%	37.43%	30.10%	26.45%	27.19%	34.76%
Customs and Excise	30.09%	29.56%	32.23%	37.43%	30.10%	26.45%	27.19%	34.76%
Non - Tax Revenue	10.24%	10.66%	8.48%	8.49%	8.44%	9.42%	8.35%	8.96%
Dividends and Profit Share form Bank of Namibia	1.25%	0.82%	0.43%	0.91%	0.64%	0.54%	0.02%	0.00%
Diamond Royalties	3.39%	4.09%	2.95%	3.12%	3.35%	4.47%	4.03%	4.13%
Return of Capital from Lending and Equity Participation	1.15%	0.47%	0.41%	0.24%	0.20%	0.28%	0.19%	0.30%
Total Revenue from own Sources	98.77%	99.25%	98.82%	98.96%	97.95%	98.77%	100.00%	99.33%
External Grants	1.23%	0.75%	0.10%	0.07%	0.75%	0.00%	0.00%	0.67%
Loan Proceeds Earmarked for On-Lending	0.00%	0.00%	1.08%	0.98%	1.30%	1.23%	0.00%	0.00%

Source: Own calculation based on Republic of Namibia, various years.

Table A8 Expenditure patterns for three categories of household

Food ratio <=25%			Food ratio >=60%, but <80%			Food ratio >= 80%		
Item	Share	Accumulated share	Item	Share	Accumulated share	Item	Share	Accumulated share
Income tax/salary deductions	12.69%	12.69%	Maize meal/grain	9.08%	9.08%	Mahangu meal/grain	13.65%	13.65%
Repayment of Loans and Credits	12.57%	25.26%	Mahangu meal/grain	8.90%	17.98%	Maize meal/grain	11.86%	25.51%
Gifts/Remittances given away	4.27%	29.53%	Beef	4.87%	22.85%	Fresh milk	10.46%	35.96%
Motor vehicles	4.11%	33.64%	Sugar	4.63%	27.48%	Beef	7.54%	43.51%
Petrol/Diesel	3.84%	37.48%	Gifts/Remittances given away	4.57%	32.05%	Sugar	5.05%	48.56%
Rent of dwelling	3.15%	40.63%	Fresh milk	3.63%	35.68%	Goat meat	2.83%	51.39%
Payment domestic workers	2.79%	43.43%	Toilet articles	2.51%	38.19%	Bread	2.11%	53.50%
Fees for life/pension insurances	2.36%	45.79%	Bread	2.37%	40.56%	Beer/Ales/Ciders	1.76%	55.26%
Parts and accessories	1.85%	47.64%	Beer/Ales/Ciders	1.93%	42.50%	Local home-brewed/Tombo	1.61%	56.86%
Fees for other insurances	1.72%	49.36%	Chicken	1.87%	44.37%	Chicken	1.59%	58.45%
Electricity charges	1.64%	51.00%	Laundry soap	1.83%	46.19%	Gifts/Remittances given away	1.54%	60.00%
Telecommunication charges	1.62%	52.62%	Goat meat	1.62%	47.81%	Mutton	1.46%	61.45%
Radio/TV/Cassette-, Record-and CD-players	1.56%	54.18%	Water/Mineral water/Soft drinks	1.52%	49.33%	Coffee	1.37%	62.82%
Building materials	1.43%	55.60%	Mutton	1.48%	50.81%	Spinach/Ombindi	1.35%	64.17%
Cattle	1.27%	56.88%	Cooking oil	1.39%	52.20%	Laundry soap	1.28%	65.45%
Animal care	1.27%	58.14%	Bread/Cake flour	1.38%	53.58%	Toilet articles	1.27%	66.72%
Service and repair charges	1.25%	59.39%	Everyday Life Travelling Fares	1.27%	54.85%	Fresh fish	1.14%	67.86%
Water/Sewerage/Garbage charges	1.19%	60.58%	Firewood	1.27%	56.12%	Cooking oil	1.10%	68.96%
Fees for medical and health services	1.12%	61.70%	Fresh fish	1.10%	57.22%	Bread/Cake flour	1.10%	70.06%
Toilet articles	1.09%	62.79%	Petrol/Diesel	1.00%	58.21%	Water melons	1.06%	71.12%
Maize meal/grain	0.89%	63.68%	Local home-brewed/Tombo	0.98%	59.20%	Plate of food/Sit down meal	1.06%	72.18%
Beef	0.84%	64.52%	Cigarettes	0.92%	60.11%	Beans	1.01%	73.19%
Everyday Life Travelling Fares	0.76%	65.28%	Women's footwear	0.82%	60.93%	Water/Mineral water/Soft drinks	0.89%	74.08%

Dresses	0.75%	66.04%
Sugar	0.72%	66.75%
Refrigerators/Deep freezers	0.66%	67.42%
Mutton	0.62%	68.04%
Men's footwear	0.62%	68.67%
Lounge suites	0.62%	69.28%
Jeans and Trousers	0.61%	69.90%
Bread	0.60%	70.50%
Fresh milk	0.59%	71.09%
Beds and mattresses	0.58%	71.67%
Fees for secondary school	0.56%	72.23%
Medicine	0.56%	72.79%
Goats/Sheep	0.53%	73.33%
Washing/Drying machines	0.50%	73.83%
Fees for primary school	0.50%	74.33%
Membership fees/Contributions	0.48%	74.82%
Saving deposited	0.46%	75.27%
Cigarettes	0.45%	75.72%
Water/Mineral water/Soft drinks	0.45%	76.17%
Fees for tertiary/higher education	0.44%	76.61%
Holiday Travelling Fares / Package tours	0.44%	77.06%
Water tanks/Reservoir	0.44%	77.50%
Holiday/Resort rents	0.44%	77.94%
Take-away food	0.43%	78.37%
Suits	0.42%	78.79%
Women's footwear	0.42%	79.21%
Chemicals for gardening/pool	0.40%	79.61%

Plate of food/Sit down meal	0.82%	61.75%
Potatoes	0.80%	62.55%
Income tax/salary deductions	0.74%	63.29%
Rice	0.72%	64.02%
Coffee	0.70%	64.72%
Tea	0.68%	65.40%
Repayment of Loans and Credits	0.68%	66.08%
Beans	0.67%	66.75%
Dresses	0.66%	67.41%
Spinach/Ombindi	0.64%	68.05%
Bottled/Tinned fish	0.62%	68.68%
Men's footwear	0.62%	69.30%
Sweets	0.60%	69.89%
Sausages	0.59%	70.48%
Pipe tobacco	0.57%	71.04%
Ground nuts	0.57%	71.61%
Fees for medical and health services	0.54%	72.15%
Pumpkins and Squashes	0.51%	72.66%
Clotted/Cultured milk	0.49%	73.15%
Combined groceries	0.47%	73.63%
Take-away food	0.47%	74.10%
Offal(meat waste)	0.43%	74.53%
Poultry	0.41%	74.94%
Butter	0.40%	75.34%
Magau/Omaheau/Oshikundu/ Samp	0.40%	75.74%
Water melons	0.40%	76.14%
Macaroni/Spaghetti/Noodles	0.40%	76.53%

Firewood	0.87%	74.95%
Pumpkins and Squashes	0.78%	75.73%
Magau/Omaheau/Oshikundu/ Samp	0.75%	76.48%
Rice	0.73%	77.20%
Sorghum meal/grain	0.69%	77.89%
Tea	0.69%	78.58%
Ground nuts	0.68%	79.27%
Combined groceries	0.65%	79.92%
Potatoes	0.65%	80.57%
Clotted/Cultured milk	0.61%	81.18%
Bottled/Tinned fish	0.54%	81.71%
Game	0.50%	82.21%
Take-away food	0.46%	82.67%
Dried vegetables	0.44%	83.11%
Sweets	0.44%	83.55%
Pipe tobacco	0.44%	84.00%
Oombe	0.44%	84.44%
Local home distilled drinks	0.43%	84.87%
Cooking Fats	0.42%	85.29%
Frozen fish	0.42%	85.71%
Wines	0.42%	86.13%
Pork	0.42%	86.55%
Offal(meat waste)	0.40%	86.95%
Sausages	0.38%	87.33%
Cigarettes	0.36%	87.68%
Everyday Life Travelling Fares	0.35%	88.04%
Macaroni/Spaghetti/Noodles	0.29%	88.33%

Chicken	0.40%	80.01%
Beer/Ales/Ciders	0.40%	80.41%
Laundry soap	0.40%	80.80%
Disability equipment	0.38%	81.19%
Bicycles	0.38%	81.57%
Loan and Credits given away	0.37%	81.94%
Maintenance of house	0.35%	82.29%
Funeral fees	0.35%	82.64%
Tools for gardening/pool/Outd pestic	0.35%	82.99%
Children's footwear	0.35%	83.34%

Batteries	0.40%	76.93%
Cooking Fats	0.40%	77.32%
Powdered soup	0.39%	77.72%
Wines	0.38%	78.10%
Game	0.38%	78.47%
Payment domestic workers	0.37%	78.84%
Frozen fish	0.37%	79.21%
Peanuts/Other snack nuts	0.37%	79.58%
Goats/Sheep	0.35%	79.93%
Dried vegetables	0.35%	80.28%

Mealie/Corn-cob	0.29%	88.62%
Powdered soup	0.29%	88.92%
Butter	0.28%	89.20%
Tomatoes	0.27%	89.47%
Fees for medical and health services	0.25%	89.72%
Onion	0.25%	89.97%
Apples	0.24%	90.20%
Batteries	0.23%	90.44%
Eggs	0.23%	90.66%
Lighters/Matches	0.21%	90.88%

Source: Own calculation based on data from the National Household Income and Expenditure Survey 1993/94.