T K Alweendo: Prospects for growth and employment in Namibia

Annual speech by Mr T K Alweendo, Governor of the Bank of Namibia, held in Windhoek on 15 November 2000.

* * *

1. Introduction

This year's subject matter is growth and employment or unemployment, depending whether you are an optimist or a pessimist. Some of you may be surprised by the choice of a topic. It is true that "Prospects for growth and employment" can be regarded as a topic that does not fall within the primary responsibilities of the central bank.

Conventional wisdom strongly suggests that monetary policy in itself can do little to generate growth and employment. This may sound surprising as it is within the domain of the central bank to influence the quantity and price of money in the society. The problem, however, is to do so without creating inflation, which in the longer run will harm growth. Although this question of a possible trade-off between inflation and growth has been debated for a long time, the compromise seems to be that monetary policy is most conducive to high employment and growth when price stability is maintained. Available evidence from both developed and developing countries does not support the view that monetary policy can accelerate growth and reduce unemployment at the cost of a higher inflation rate.

Why should this topic of growth and employment then be of concern to the central bank? The simple answer is that growth and employment prospects are the single most important issues on any economic policy agenda.

The objective of this speech is limited to taking stock of what we know today and indicating what in our view should be the main elements in future strategies. We have to acknowledge that empirical evidence strongly suggests that there is not a clearly identifiable single set of variables that either promotes or inhibits growth. My main contribution will be to support current efforts to stimulate economic growth; to reiterate the need for the main stakeholders to fulfil their respective roles; and to emphasise that we all have to work together.

The ultimate objective of economic policy in any society is to ensure a satisfactory level of the citizens' welfare and to improve it over time. Opportunity to work is a fundamental basis for private welfare and the lack thereof may often lead to personal and social ills. Economic growth and employment should therefore, in the case of Namibia, be closely linked to poverty reduction. Poverty is not only an assault on human dignity and deprivation of material good, but also often associated with lack of security and access to basic services including health, education and sanitation. In addition, poverty may have several economic consequences and be in itself an impediment to growth.

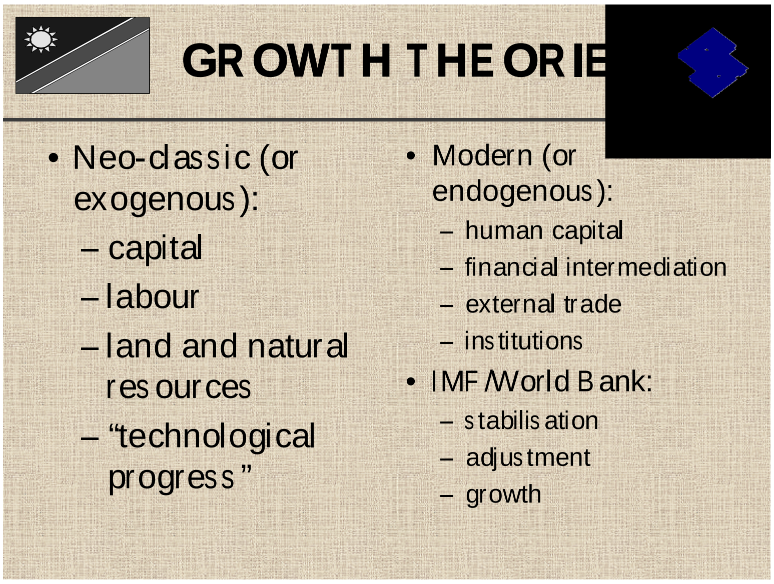
2. A review of conventional growth strategies

Let me first review some of the theories related to economic growth. Development economists have over the years established several theories in an attempt to explain dispersion in output growth among countries that have similar resource endowments. Theories explaining such growth patterns have been classified into two main groups: neo-classical or exogenous growth theories and modern or endogenous theories.

The earliest exogenous theories attributed output growth to increases in factor inputs such as capital, labour, land and natural resources and a residual called "technological progress". The endowment of human and natural resources, size, and geographical location, no doubt, are very important elements in the growth process. These theories received a lot of attention in the earlier growth literature. However, technological progress has in more recent discourse been identified as a fundamental determinant of economic growth.

Chart

Growth theories

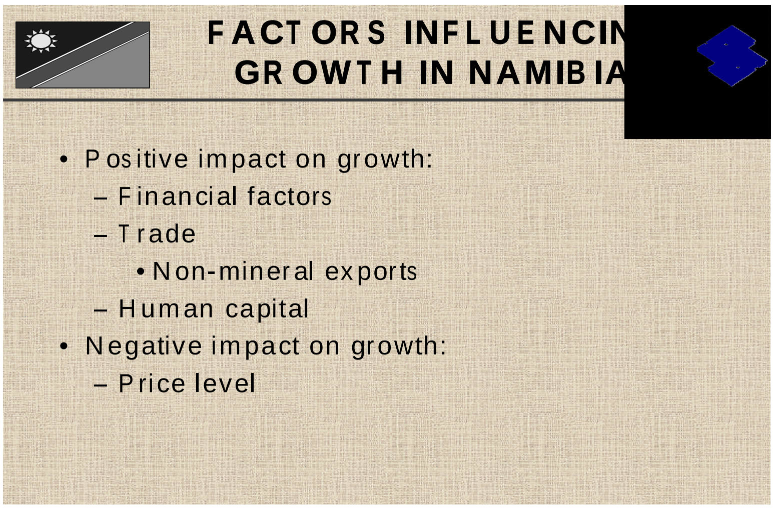


Endogenous growth theories, on the other hand, have emphasised the role of improvements in human capital, financial intermediation, external trade and institutions as very crucial complementary factors in economic development.

Most recently, in the wake of the poor growth performance of developing countries, the IMF and the World Bank have developed some stabilisation cum growth models to stimulate the economic performance of developing countries. They take into consideration the interaction among stabilisation, adjustment and growth. Critics have focused on the long-run relevance of these models for economic growth. However, evidence is beginning to emerge to support the existence of a long-run relationship between price stability and economic growth giving credibility to the Fund-World Bank efforts. Policymakers in many developing countries are beginning to appreciate the importance of policies that are targeted at reducing the price level, with a view of stimulating economic growth and development. These experiences offer important lessons for Namibia.

Chart

Factors influencing growth in Namibia



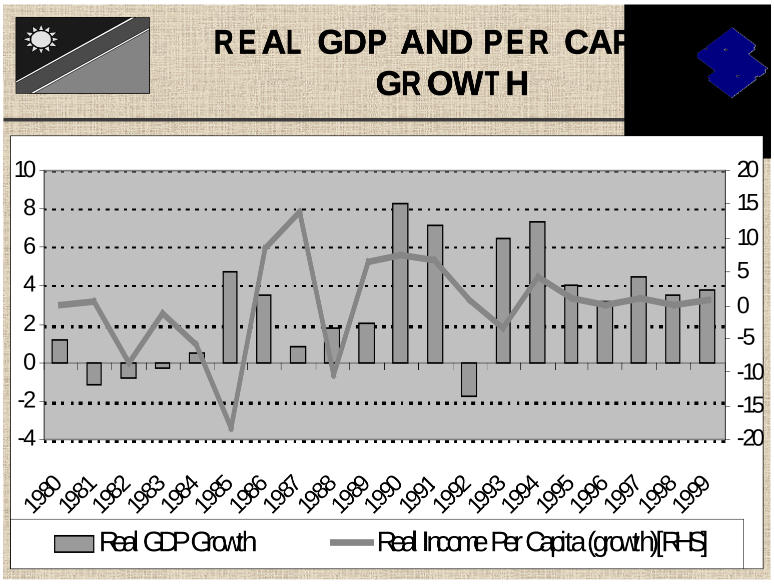
In a recent study, the Research Department at BON tested the relevance of some of these factors to the growth process in Namibia. Using a simple model based on quarterly data for the period 1990-99, our empirical results attest to the significant impact of financial factors proxied by the level of financial depth and real credit to the private sector on the growth of output. Both exports and the real exchange rate representing the trade factor, also turned out to be positively related to the real GDP. This study revealed that when exports were decomposed into two components, minerals and non-minerals, the positive contribution of the non-minerals component was quite astounding. Another thing that struck us was the impact of the human capital factor, proxied in our model by the primary school enrolment ratio on real GDP growth. The result turned out to be strongly correlated to real GDP growth, demonstrating the effect of human capital development on the growth process in Namibia. As expected, the price level, though significant, turned out negatively related to GDP growth.

3. Growth and employment trends in Namibia

In reviewing recent trends in Namibia, we find that real GDP growth for the period 1980-99 averaged approximately 2.7%. For the period 1980-89, average GDP growth was about 1.3% compared to the 4.2% recorded for 1990-99. However, real GDP growth slowed down to 3.8% for the years 1995-99.[1]

Chart

Real GDP and per capita growth (1980-99)



The performance of per capita real income was more striking. After relatively large fluctuations in the pre-independence period, real GDP per capita recorded an average growth of about 1.9% between 1990-99. Thus both real income and per capita real income have shown consistent declines since the period after independence. It is this fall in general living standards that represents our challenge.

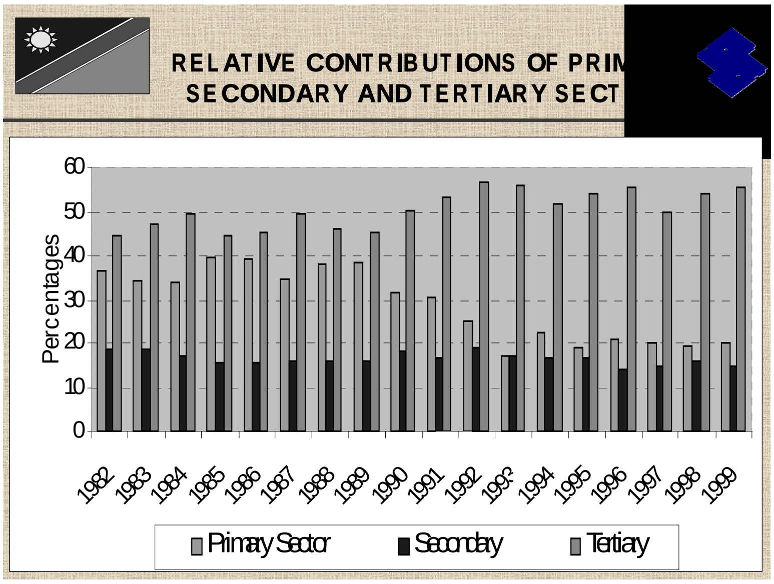
The Namibian economic performance since 1994 has not been sufficient for providing jobs for a labour force that grew by more than 3% annually. We have also registered a decline in total factor productivity. This last factor is very worrisome since it implies that for every unit of capital invested in the economy, less and less output is received in return. This is being held accountable for the flow of savings outside the economy where returns are higher. The combination of a declining productivity and outflow of savings keep growth below the potential for the nation.

[1] These growth rates are based on revised national account figures for 1993-99, which will be publicised shortly.

In relation to the First National Development Plan (NDP1) period, growth fell below the target rate of 5%, which was considered reasonable to significantly address the problems of income inequalities, poverty and unemployment in the country. Unfortunately, no major strides were made in this regard as economic growth remained weak and hence unemployment surged during this period.

Chart

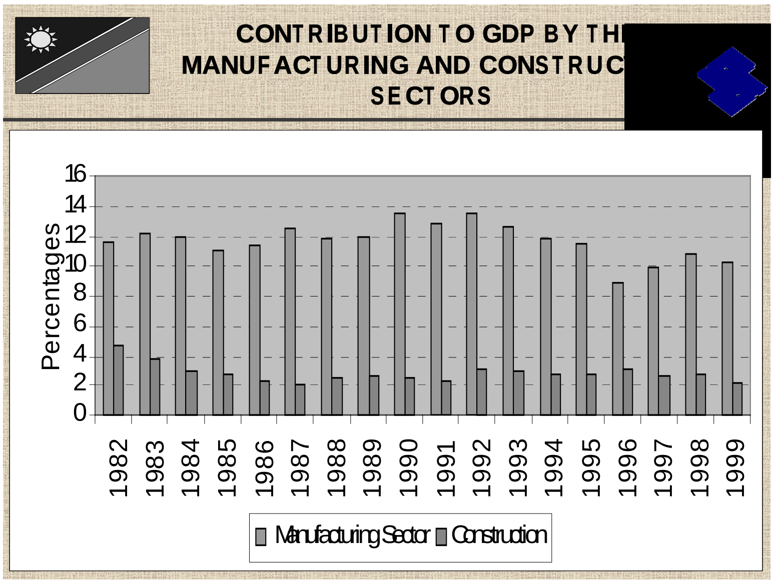
Relative contribution of primary, secondary and tertiary sectors



Looking more closely at growth on a sectoral basis, ***primary industries***, consisting of agriculture, fisheries and mining, performed rather sluggishly during the period. In particular, the share of mining to GDP declined by 5 percentage points over the period due mainly to a secular decline in commodity prices. The main commodity that has continued to dominate mining is diamond and its fortunes and misfortunes directly translate into growth or stagnation in the economy.

Chart

Contribution to GDP by the manufacturing and construction sectors



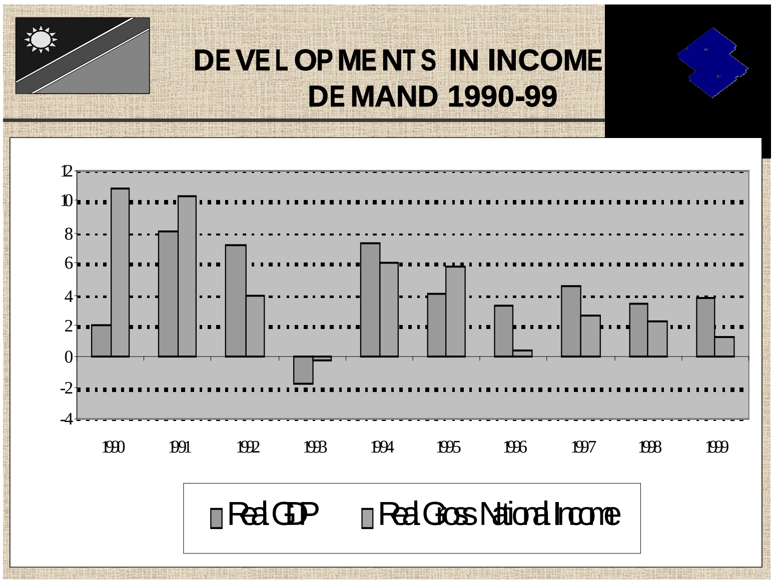
Manufacturing and construction are the two main sectors that have contributed steadily to output growth in the ***secondary sector***, particularly in the last decade. Manufacturing has continued to maintain a slow but consistent growth trend in the economy, with a contribution to GDP of about 10%

in 1999. The performance of construction has shown a rather irregular pattern since 1983. In the most recent years, construction has been sluggish, due mainly to high interest rates following the global financial crisis that engulfed most economies from 1997.

The dominant sub-sector in the ***tertiary sector*** is general government. The activity of this sub-sector is followed by wholesale and retail, transport and communication, hotels and restaurants and community, social and personal services, in that order. The ratio of general government to GDP, of some 22% over the last five years, is quite substantial. This has given vent to the fears in certain quarters that this expansion might not be in the long-run interest of the economy, particularly if it crowds out private sector role.

Chart

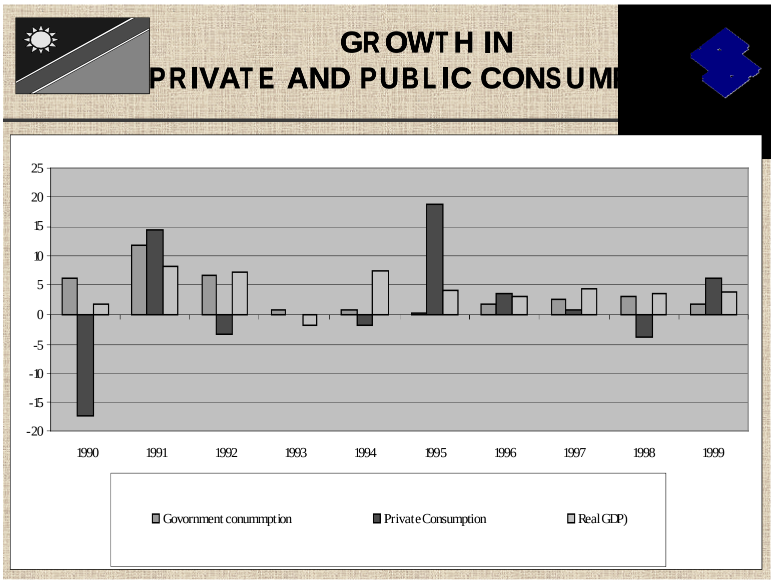
Development in income and demand 1990-99



The trends in income and demand developments have not been encouraging either. Gross National Income lagged behind GDP for a greater part of the 1990's reflecting a decline in the country's terms of trade.

Chart

Private and public consumption



The incomes of households followed the developments in Gross National Income, as the share of wage income remained relatively stable. Private consumption suffered for a greater part of the 1990's under the weight of falling real incomes and rising real interest rates. On the other hand government consumption represented a disproportionate share of GDP. It has been observed that among developing countries, the share of government consumption in GDP, which is currently put at about 30%, is the highest.

Unemployment trends

The labour market in Namibia is characterised by an excess supply of unskilled labour and, at the same time, a lack of skilled labour. Available data suggest that the unemployment rate rose from 33% in 1994 to 35% in 1997. Lack of data precludes us from making sufficient observations on the unemployment trends in the economy since then, but whatever little evidence there is, points to the fact that the unemployment situation has worsened. Government remains the main employer of labour. This has resulted in a burgeoning public sector wage bill. Although available statistics show that sectors such as finance and transport are making necessary efforts, the overall situation remains difficult and requires a structural policy thrust.

4. Factors that impacted on growth and development

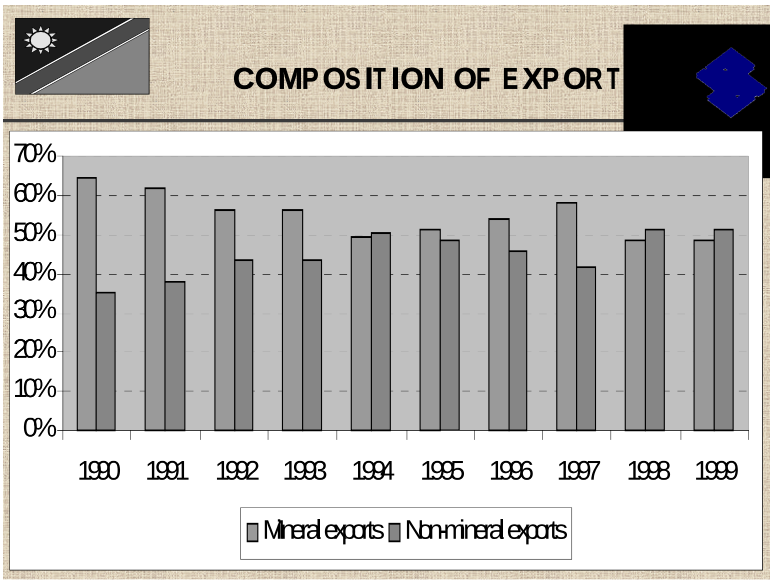
In attempting to reduce the reliance of the economy on primary exports, the government objective has been to promote sustainable economic growth through a strategy of diversification since independence. The promotion of manufacturing activities, development of the agricultural sector, the fishing industry and tourism have been identified as having the most potential to provide impetus for the diversification strategy under the First National Development Plan.

The government introduced specific measures targeted at promoting growth, development and job creation. These measures included the enactment of the Foreign Direct Investment Act 1990, which provides generous tax breaks and other concessions to investors and the export processing zones (EPZ). A further measure is the disproportionate allocation of national expenditure to education and health.

As we all know, Namibia is blessed with a significant supply of natural resources, such as diamonds, uranium, zinc and natural gas. Unfortunately these natural resources, particularly diamonds and uranium, have been susceptible to exogenous influences in the form of demand or price shocks.

Chart

Composition of exports

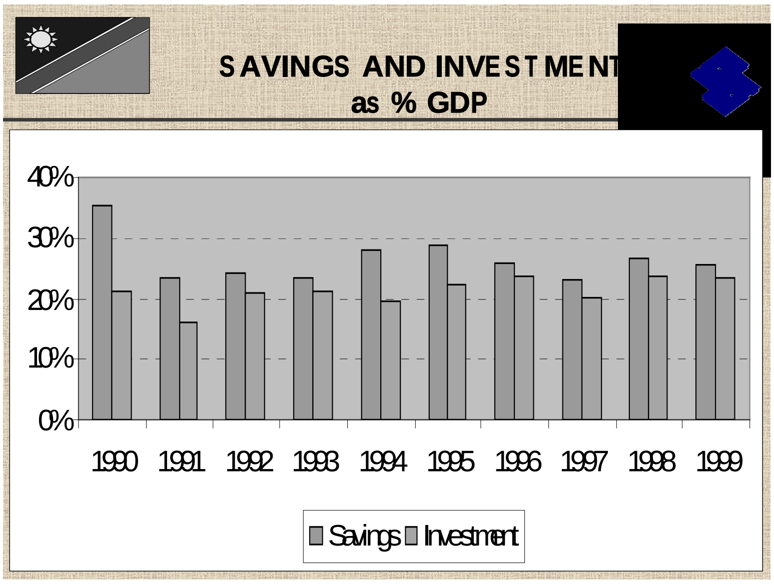


The share of minerals in total export declined from about 65% of total exports in 1990 to about 50% in 1994. Following an increase in subsequent years, the share fell to 49% in 1999.

Apart from demand and price shocks, Namibia is also susceptible to other natural shocks, which influence growth. Recurrent drought spells, for example, caused agricultural output to decline by over 40% in the last three months of 1995. As nearly 70% of Namibians derive their livelihood directly and indirectly from the land, these droughts have caused declines in agricultural exports and farmers' incomes.

Chart

Saving and investment



Let me now turn to savings. As the saying goes: "To have more tomorrow you have to have less today." To provide funds for investment at the national level there needs to be a healthy level of savings. For a greater part of the period after independence, investment has lagged behind savings. At an annual average of about 25% of GDP for the period 1991-99, the savings rate ranks among the highest in Sub-Sahara Africa. Given the savings-investment gap, Namibia has witnessed a constant outflow of capital and a matching current account surplus for a greater part of the period under consideration. Gross fixed capital formation as a percentage of GDP hovered around 21% for the period.

Both private and public investment has been on the decline, though this has been more pronounced for private investment. Two important factors that have contributed to the decline in private investment are the slowdown in government investment and the high interest rates that emerged after the financial crisis in the middle to late 1990s. The increasing savings-investment gap has remained a source of concern for policymakers particularly in the face of high domestic unemployment.

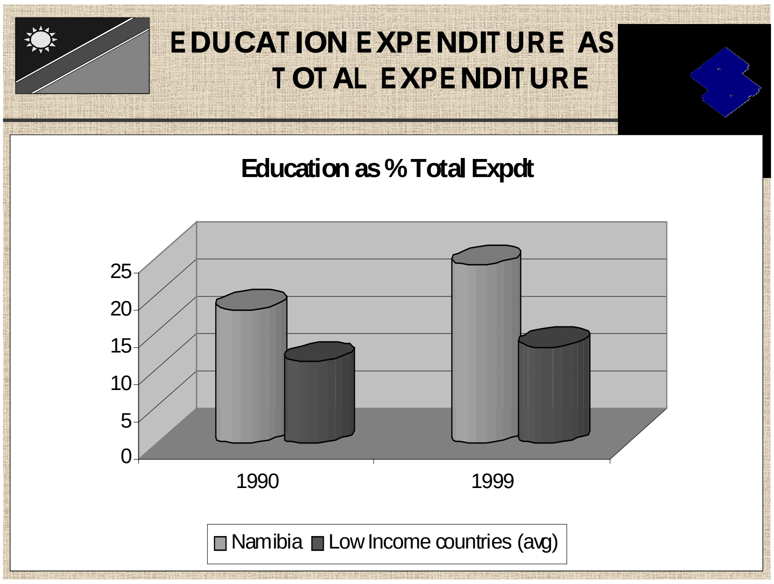
Technological progress, as mentioned earlier, enhances growth, as it makes it possible to produce more with the same quantity of resources. This boosts the potential level of output of the economy. The unprecedented growth experienced in the United States in the last couple of years is said to have been spearheaded by technology related sectors. It is important to note, however, that the pace of technological change is likely to depend on the quality and relevance of education that a country provides to its citizens.

Education has been identified as one of the priority sectors and a lot of resources have been allocated to this sector since independence. The budgetary allocation to the two Ministries of Education has increased from about 18% of total expenditure in 1990 to about 24% in 1999. This is quite a substantial amount bearing in mind that low-income countries spend on average 13% of their national budget on education.

Despite the sizeable budgetary allocation to the education sector, a consensus seems to emerge that suggests that the output from our education system is not commensurate with the input. Our schools dropout and repetition rates are the highest compared to other similar countries, such as Zimbabwe, Mauritius and Botswana. For example, the rate of grade repetition in Namibia is as high as 25% compared to an average of about 5% for these countries.

Chart

Share of total public expenditure on education, 1990 and 1999



What should also be of concern is that a breakdown of the total education budget into type of expenditure reveals worrying trends. The personnel costs of the primary education budget accounts for about 88% whilst personnel costs of the secondary education accounts for about 73% of total secondary budget during 1999/2000.

If we accept the argument that human capital is essential for economic growth, then there could be a case for re-evaluating the type and quality of education we are providing. This is necessary, not only to ensure consistency with the long-term development needs of the country, but also to increase social returns on our investment in education from the current low levels, as reflected in the high level of unemployment, especially among our youth.

5. Main elements in future strategy

Looking now into the future, the question is what Namibia can do to bring the economy on a path of sustainable and healthy growth. As I have already emphasised the point, investments in physical and human capital must continue.

However, it is far from obvious that high initial investments and savings are sufficient ***preconditions*** for growth. The relatively high saving ratio in Namibia has not been transformed into high investment and growth. As mentioned, one important explanation has been low and declining factor productivity in the economy. Public investment will remain important, but investment opportunities must also be made available to the private sector.

Although our present knowledge strongly indicates that investment is probably ***the factor*** closest correlated with growth, it is crucial to identify ***other relevant factors*** that will trigger investment and growth in Namibia. Advances in production efficiencies and technology are such important factors, but so is the complicated interplay between economic and political factors.

Let me start with sound macroeconomic policies. Sound macroeconomic policies basically mean a sustainable fiscal balance and a supportive monetary policy.

The pressure on the public finances has been growing in recent years and the budget deficit has been edging up and public debt has increased as a result. Among the new challenges that will affect the budget, is the reduced SACU receipts over the next few years. As our fiscal policymakers are aware, bold measures are needed to make sure public finances are put on a sustainable path over the medium term. These will include reduced expenditure on recurrent expenditures, especially on personnel costs, and a broadening of the tax base. This should not increase the general tax burden, but rather contribute towards its reduction. The announced review of the tax system and the introduction of a medium term budgetary framework will undoubtedly contribute to a more efficient tax system and strengthened expenditure control.

Turning briefly to monetary policy, we believe that the peg of the Namibia dollar to the rand and our membership in the Common Monetary Area (CMA) have contributed to securing broad financial stability. Our objective is to expand the role of the CMA in the direction of a true regional monetary union. Recent initiatives have strengthened the role of the smaller members in information exchange and in providing input into the monetary policy making process in the CMA.

Also within the domain of the central bank is our payment system reform project, which is aimed at establishing an automated payments system that is able to link up with regional and global systems. This would facilitate foreign trade and make monetary policy and supervision more effective. The bank is also committed to the steady liberalisation of exchange controls within the CMA. We hope this initiative will contribute towards attracting foreign portfolio investments and foreign direct investment.

My impression is that the government is eager to support general growth-oriented policies. We are also blessed with a high degree of political stability and our basic institutional structures are broadly up to good standards. However, it is important to recognise that there are severe limitations on what authorities alone can do to promote sustainable growth. We must recognise that it is individuals, firms and markets that are the most important factors for generating economic growth. Namibia needs individuals with knowledge and ideas to create new concepts and innovations and entrepreneurs that can convert these ideas into successful businesses. Physical, legal and financial infrastructure must support and facilitate this conversion.

But that is not enough. Also social attitudes that encourage creativity and reasonable risk-taking by new and established enterprises must be built. Recent development strategies are emphasising the role of "social capital", meaning the networks and relationships in social interactions that both encourage trust and mutual support in a society - be it schools, health institutions, rural villages and towns that will eventually filter through to a national level. These are factors that economists may have some difficulties to relate to and to analyse, but I believe that they nevertheless are important in the whole process.

The role of government

Development and growth policies contain many elements, but a statement in WB's Comprehensive Development Framework can serve as a summary:

"Structural elements (which) include honest, competent governments committed to the fight against corruption; strong property and personal rights laws supported by an efficient and honest legal and judicial system; a well-supervised financial system that promotes transparency; and a strong social safety net."

Namibia has in most of these areas come a far way, but there will always be room for improvements. It should be an achievable goal for Namibia to reach international standards in all these areas.

Although it is difficult both theoretically and empirically to establish a clear relationship between growth and income inequality, this is a problem that must be addressed within a comprehensive growth strategy. If we have a situation in which significant low-income groups are unable to acquire skills necessary to participate in economic activities, the society suffers a substantial loss in human capital. The Chairman of the US Federal Reserve Board, Alan Greenspan, recently stated that: *"Societies cannot thrive when significant segments perceive its functioning as unjust"*. He was referring to the changes new technology is bringing about in the US. This statement has more relevance for characterising our post-apartheid economy.

Economic empowerment of those previously disadvantaged must be addressed in a fair and transparent manner in order to build a foundation for prosperity and growth. The same is true with gender equalities. We can come some way with public disclosure, incentives and moral suasion, but in my opinion it is not likely that these measures will yield sufficient results in a reasonable length of time. A suggestion I would like to make is that we should come up with a privatisation strategy that not only addresses how to deal with potential problems that privatisation may cause in the short run, but also to address the empowerment of previously marginalised groups within our society. The potential for growth of such an initiative is large, but the process must be transparent, open and fair.

Our future growth strategy must also address the HIV/AIDS problem. This is not only a problem in relation to human suffering, but will also have a macroeconomic dimension in terms of reduced productivity and availability of productive human capital, skill shortages, and reduced saving and investment. It is estimated that annual real GDP growth may be reduced by more than 1 ½ percentage point; other estimates that are even more pessimistic. Again, this is not only the sole responsibility of the government, but the private sector, in particularly employers at all levels, must also contribute.

The role of the private sector

The private sector has to be recognised as a key stakeholder in the development and growth process, as private investment plays a pivotal role for future growth. The views of the private sector have to be heard and taken into account by policymakers.

On the other hand, we must also expect the private sector to be fully committed to the long-term development of the country. There are many ways this commitment can be displayed. Disclosure of corporate social investment in such areas as on affirmative actions, marginalised community empowerment and general skills development could perhaps be used as one indicator of this commitment.

It is sometimes argued that the wage structure in Namibia does not reflect the low level of productivity of the unskilled labour force and that uncompetitive wages have contributed to the unemployment problem. In fact, sketchy evidence indicates that unit labour cost in Namibia may be higher than in many other countries in the region, with the exception of South Africa. We must appeal to the labour unions that they should not only be concerned with the interest of their employed members, but also take macroeconomic considerations into account in their wage negotiations. Problems associated with wage inflexibility, strained labour relations and regulations on hiring and firing may have a bearing on our competitiveness and growth potential.

The role of the financial sector

The function of financial intermediation is also central in the growth process. It is therefore important to improve the functioning of money and capital markets in Namibia. The growth process would be facilitated if financial instruments and prices would be available over a sufficiently wide spectrum of maturities to satisfy the market players with regard to saving preferences and financing needs.

In this connection, the efforts made by the Bank of Namibia and the Ministry of Finance to develop more efficient markets for government securities are important. Such markets are not only important for an effective management of public debt, but well functioning markets for government securities will also provide a basis for raising funds through the issuance of securities by the parastatals and private sector. The creation of a broader market for securities would channel investable funds by local institutional investors into productive investments in the Namibian economy. This should contribute to lower interest rates, as one would expect that the interest rate premiums in relation to comparable South African government bonds should narrow over time.

I would also like to believe that in the future we should be more active in investigating and addressing perceived “market failures”. In this connection, we have to consider structural policies that can address the limited competition in a large part of the financial sector. The authorities and representatives from the sector should investigate joint actions for decentralising geographically financial services.

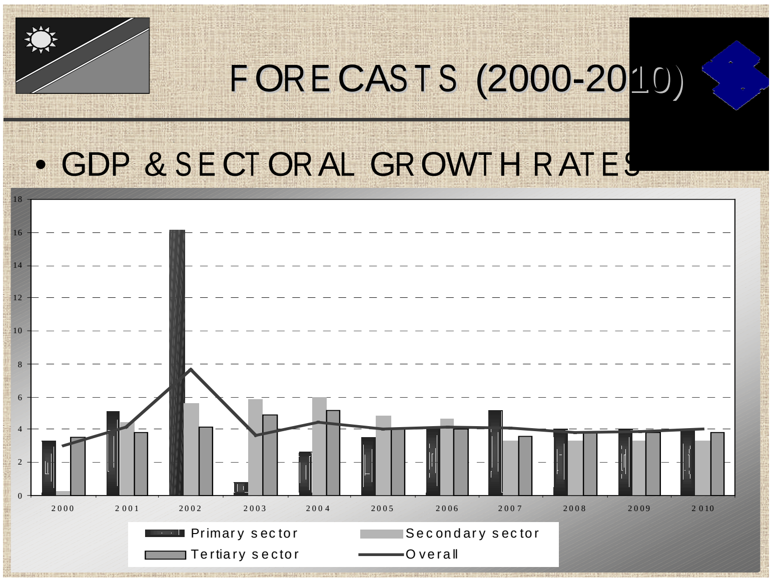
We must also recognise the fact that the traditional financial institutions and markets cannot be expected to cater for all financing needs, particularly by smaller and inexperienced future investors. The role of the financial parastatals will therefore continue to be an important alternative.

6. Prospects for the economy

I will now share with you an effort we have made to forecast economic performance based on available information and broadly on present policies.

Chart

Projected growth in GDP 2000-10

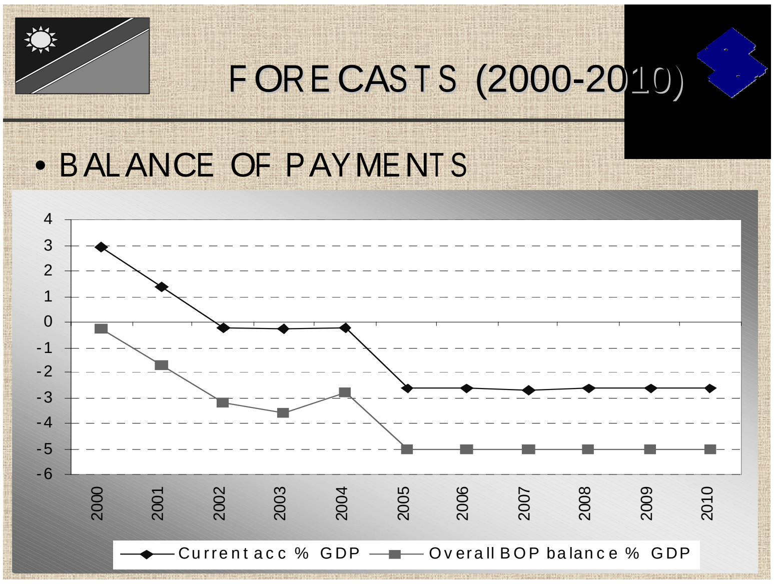


Unfortunately, the near-term prospects for economic growth are not very bright, as GDP growth for the present year will not be significantly different from last year’s rate of about 3%. Despite the present gloom, however, the recovery in the growth of the economy in the medium term will be that of a balanced, diversified growth as both the mining and non-mining sectors are expanding. Economic prospects for the next five years are particularly positive as GDP is projected to grow on average at a rate slightly below 5% per year between 2001 and 2005. For the ensuing five years beyond 2005, growth is expected to fall to an average of around 4%.

The balance of trade deficit is forecast to deteriorate during the first half of the decade as the terms of trade will continue to deteriorate. This is further compounded by the envisaged reduction in SACU revenue. Consequently, the current account of the balance of payments will become negative for the first time since data were recorded. The current account deficit, together with persistent capital outflows, yield a balance of payment shortfall for the large part of the forecasting period, implying that the internal reserves of the country will be falling. At the end of 1999, the level of reserves was equal to an import coverage of 8.3 weeks. It should be the authorities’ objective over the next ten years to increase this coverage.

Chart

Balance of payments projections 2000-10

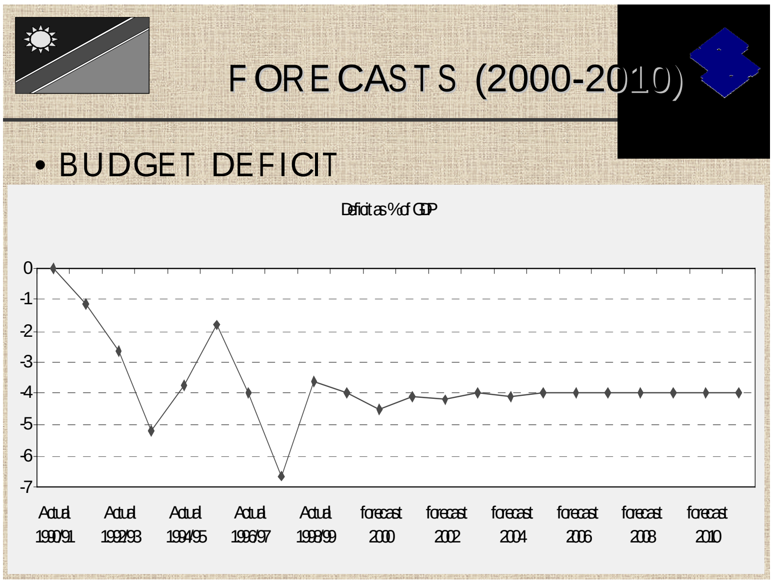


Public finance

Public finance projections are based on the assumption that the budget deficit for the next ten years remains at a level of not more than 4% in relation to GDP. Revenue from mining is expected to rise in the first half of the decade, but this positive trend is likely to be offset by the declining SACU receipts. Although the magnitude of the fall is still being investigated, preliminary evidence suggests that revenue from this source could shrink by as much as 15% over the next ten years. Government expenditure is forecast to remain stable at the level witnessed during the past two years.

Chart

Budget deficit forecast growth 2000-10

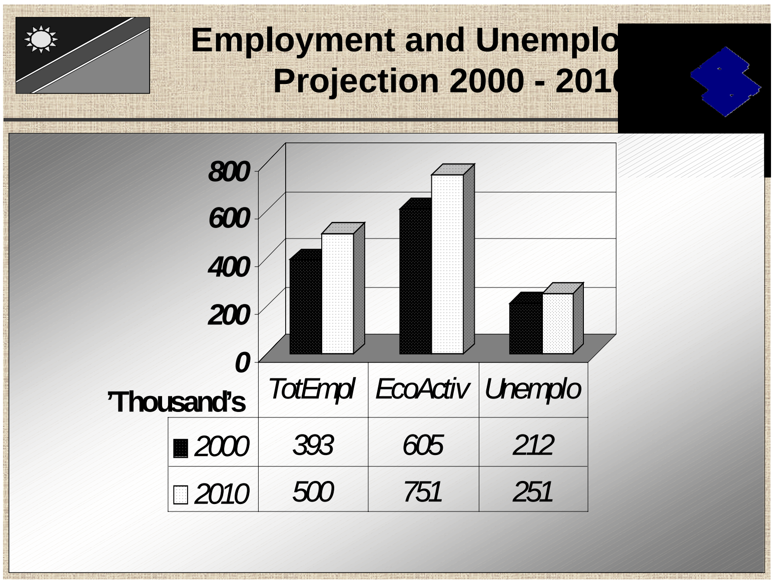


The consequence is a budget deficit continuing at the present level and an upward trend in the overall debt position of government. Although the ratio of debt as a proportion of GDP should still be within manageable limits during the next ten years, the pace of its expansion will raise some concerns.

The lack of continuous employment figures makes projections on employment a very difficult task. From the labour surveys in 1991 and 1997 one can, however, deduce some general conclusions. During this period, productivity increased substantially in the primary sector while the increase was quite modest in the non-primary sector. Assuming unchanged productivity growth rates in both the primary and non-primary sectors, total employment has been projected to grow by 2.7% on average to a level of about 500,000 people at the end of the tenth year period. Using the past average growth in the economically active population of 2.4% gives rise to a figure of 751,000 people that will be economically active at the end of the tenth year. Thus, the result is only a marginal reduction in the rate of unemployment and underemployment from 35 to about 33% at the end of year 2010.

Chart

Estimated employment and unemployment in 2010



7. Conclusion

Although these employment projections should be treated with caution due to the fact that the they are based on limited data, and also that the impact of HIV/AIDS could significantly alter the picture, the message is clear: notwithstanding the improved prospects in economic growth during the next ten years, employment outlook remains gloomy. A continuation of present policies is therefore not enough.

The government must continue its effort to expand the development potential of the economy through pursuance of sound macroeconomic policies. We have in this connection touched on a number of important challenges, such as improved efficiency in public spending, particularly in the education sector, broadened tax base and tax structure review, including the EPZ arrangement. A comprehensive privatisation strategy must also be established.

I hope that this presentation has shown that it is not the lack of ideas and good proposals which have hampered growth in our economy. Notwithstanding some misfortunes and limitations in the factors promoting growth, I also feel that our ability and willingness to act has been part of the problem. As a nation and individuals we have been too slow when it comes to implementation. Let us all, individuals and institutions, take personal responsibilities and accept the challenge to promote economic growth, lest we will continue to be marginalised economically. It is only when we all work together as a nation that our country can take up its rightful economic position alongside other nations. We are now starting a new century and we should therefore work hard in order to make a difference.