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Addressing the Plight of Poor Households by Zero-Rating VAT on Basic Commodities in Namibia

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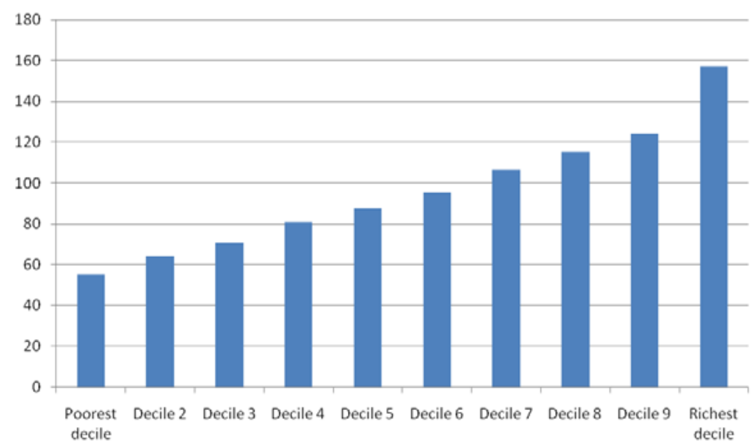
Though it is classified as an upper middle-income country and has an estimated annual gross national income (GNI) per capita of US$4,210, Namibia still faces the twin problems of relatively high levels of poverty and high income inequality. Difficult economic times began in 2008 as real economic growth dropped to 4.3 per cent from a high of 12 per cent in 2004, while cost-of-living inflation rose to a high of 10.4 per cent from a low of 2.3 per cent in 2003. The rate of unemployment (broad definition) grew to 51.2 per cent. Thus many poor households faced a rising cost of living without reliable sources of income. Their already dire situation was exacerbated by inauspicious climatic and soil conditions, which severely limit the role of subsistence farming as a viable source of livelihood in the country.

In an effort to address these problems, and specifically to reduce the regressive effects of the tax system and mitigate the impact of the rising cost of living, in 2008 the government decided to zero-rate value added tax (VAT) on fresh and dried beans, cooking oil, bread, cake and bread flour, processed animal fat. Already zero-rated in 2000 were *mahangu* (pearl millet flour), maize and maize meal, water, electricity, refuse removal and sewerage disposal.

An *ex-ante* analysis of the effects of this initiative reveals that, contrary to expectation, those with higher incomes are more likely to benefit from it than poorer households (see figure).

There are two possible explanations for this. First, VAT zero-rating did not specifically target the commodities consumed by a large proportion of poor households, but rather those (such as electricity and processed animal fat) that are consumed by only a small proportion (less than 40 per cent) of the poor, as data from a recent field survey shows. Second, in introducing this measure it may have been necessary to consider the methods whereby various households acquired the commodities, since poor households obtain significant quantities of the VAT zero-rated commodities (36.2 per cent of *mahangu* meal, 30 per cent of beans and 24.5 per cent of processed animal fat) from their own sources, while they mostly use formal markets to acquire maize meal, sunflower cooking oil, bread, and bread and cake flour. This is sharp contrast to high-income households, which depend almost entirely on the formal markets, where VAT is imposed, for these commodities.

Annual VAT Burden Lifted by Income Decile (N$ million)



The survey also reveals that some commodities that most of the poor consume in large quantities and acquire in formal markets—such as fish, meat, vegetables, other carbohydrates, beverages, fruits and detergents—were not included in the list of zero-rated commodities. VAT zero-rating of basic commodities, if it is well targeted, has great potential to benefit poor households. But the government might also have to consider expanding social transfers to poor households and targeting them better so as to compliment this policy initiative. Such transfers include the old-age pension, disability pension, war veterans subvention, child maintenance grant, special maintenance grant, foster care grant and place of safety allowance. To ensure the sustainability of the social transfers, however, increasingly they could take the form of targeted subsidisation of agricultural inputs to enable poor households to produce more basic food commodities, so that they can become self-sufficient in the supply of these commodities and thus build their resilience to recover from the current and other crises.

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