BIDPA Briefing

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Budget Briefing 2006/7

Overview

This edition of the BIDPA Briefing discusses the 2006/07 budget speech. It attempts to establish whether the Budget Speech is growth promoting, which is a requirement for achieving the Budget theme. While we conclude that the Budget is indeed growth promoting, we also note that there is still need for further reform for the budget to fully deliver on its potential.

The Budget

The total proposed budget for expenditure and net lending in 2006/07 is P22.4 billion. The expenditure, including an 8% across the board salary hike, will be financed through revenue forecast at P24.14 billion, of which 47.0% is mineral revenues. This shows Botswana's continued reliance on mineral revenues. Other major sources of revenue are customs and excise (22 percent), non-mineral taxes (12 percent) and the Value Added Tax (9 percent). The budget, after taking into account the salary increase and changes in taxes, forecasts a surplus of P922.5 million. However, the surplus could easily swing around due to the uncertainties inherent in mineral revenues, which are subject to unexpected changes in both mineral prices and demand conditions.

The Theme

The theme for the 2006 Budget Speech, “Building an Innovative Economy for the 21st Century”, is directed at helping to achieve one of the major ambitions set out in Vision 2016, which is to ensure that Botswana is a “prosperous, productive and innovative nation”, which can be achieved through continued growth of the economy. Thus, in this Briefing, we attempt to establish the extent to which the Budget Speech helps achieve economic growth. This is done through attempting to answer the twin questions of whether the Budget Speech is growth promoting and providing an environment under which the private sector can grow.

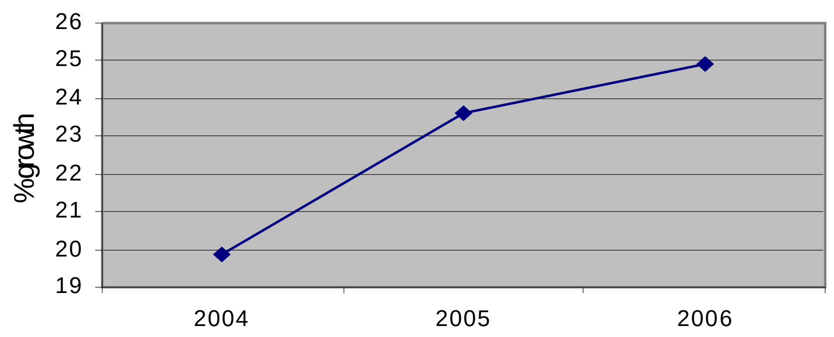
Is the Budget growth promoting?

To have an understanding of whether the budget is growth promoting or not, we look at expenditure patterns of development expenditure, as this is the budget variable that stimulates real economic activity. It essentially represents government's investment as opposed to recurrent expenditure, which is a consumption variable. In addition, we look at how such expenditure is likely to affect growth variables such as investment in physical capital, investment in human capital and investment in social capital. We also touch on tax announcements and discuss how they are likely to affect growth.

Expenditure Growth Patterns

The 2006/07 budget is expansionary. It is around 8.0% more than the 2005/2006 budget of P20.58 billion, and 38% more than the budget of about P16.2 billion at the beginning of the Ninth National Development Plan (NDP 9) in 2003/04. It also marks the beginning of the implementation of the Mid-Term Review recommendation that development expenditure be increased from 25 percent of total expenditure to 30 percent by the end of the Plan period in order to implement more projects and enhance economic growth.

Chart 1: Growth Patterns in Development Expenditure, 2004 - 2006



Thus, this year's development budget has been increased from 20.0% of total expenditure in 2004/5 to about 25.6% in 2006/7. This shows government's determination to boost the economy and put it in a growth path.

Budget Allocations

Budget allocations pay testimony to government's intentions to grow the economy.

Allocations over the past ten years show government's shift in priorities from investment in the country's human capital to protecting and sustaining it. Allocations also show government's continued investment in physical capital over the last ten years.

Investment in Human Capital

Except for 1997, when the Ministry of Minerals, Energy and Water Affairs got the highest budgetary allocation on account of a special project, the North South Water Carrier, the Ministry of Local Government got the largest share of government's budget between 1998 and 2002. The largest share for this Ministry went to construction of primary schools in all these years. A sizeable share also went to training of the country's human capital. This underlined government's desire to develop the country's human capital stock. However, when the threat of HIV/AIDS was realized in the early 2000s, government priorities changed towards protecting human capital from extermination by HIV/AIDS. It is, therefore, not surprising that the Ministry of State President (under which the National Aids Coordinating Agency falls) got the largest share from 2003 to the current budget year. Thus, indicates government's objective of ensuring that previous investment on human capital is not lost to the economy. Thus, this years' budget seeks to ensure that previous investment on human capital continues to contribute to the growth of the economy into the foreseeable future.

Investment in Physical Capital

In the last ten years, other ministries that have predominately been in the top four in terms of government allocations include the Ministry of Works, Transport and Communications (MWTC) and the Ministry of Minerals, Energy and Water Affairs (MMEWA). These two Ministries are largely charged with the responsibility of providing the economy with

Continued overleaf

the necessary infrastructure. In the last ten years, the MWTC's budget has been channelled towards, among others, the development of the country's road network and rural telecommunications. For example, the bulk (29.0%) of MWTC's budget for this year is taken by Bitumen, and Trunk roads, secondary roads (18.9%) and Government infrastructure improvements (13.9%). Other infrastructure projects claiming this year's MWTC's budget include bridge construction (11.7%) and Air transport infrastructure (11.5%). These account for 85.0% of the proposed development expenditure for the MWTC. On the other hand, the MMEWA has, in addition to mining, largely focused on the provision of power and water. Out of a total proposed budget of P622 million, 87.0% has been distributed among three major infrastructure projects, namely, Major Villages Water Supply and Development at P282 M, Water Planning and Development at P159.0M and Renewable Power Development at P100.7M. These are seen as infrastructural developments that are needed for the growth of any economy.

Table 1: Real Development Expenditure Patterns (P billion): 1997 - 2005						
Nov 1996 = 100		Order of real development expenditure allocations				
Year	Real Expenditure	Year-on-year growth (%)	1st	2nd	3rd	4th
1997	2.41	0	MMEWA	MLG	MWTC	MOE
1998	2.85	18.0	MLG	MOE	MWTC	OP
1999	3.26	14.4	MLG	MWTC	MOE	OP
2000	2.75	-15.65	MLG	OP	MWTC	MOE
2001	3.47	26.13	MLG	MWTC	OP	MMEWA
2002	3.62	4.39	MLG	OP	MWTC	MMEWA
2003	2.76	-23.74	OP	MLG	MWTC	MMEWA
2004	2.14	-22.43	OP	MLG	MWTC	MMEWA
2005	2.67	24.86	OP	MLG	MOH	MWTC
2006	2.75	3.08	OP	MLG	MWTC	MMEWA
Source: Budget Speeches – 1997 – 2006						

Where:

MMEWA – Ministry of Minerals, Energy and Water Affairs

MLG – Ministry of Local Government

OP – Office of the President

MWTC – Ministry of Works, Transport and Communications

MOH – Ministry of Health

MOE – Ministry of Education

Incomes Policy

It was reported that the Revised National Policy on Incomes, Employment, Prices and Profits of 2005, which provides for, among others, extension of minimum wages to agricultural and domestic sectors will be discussed in Parliament during the current sitting. This policy comes at a time when innovative policies are required to reinvigorate the agricultural sector, as the sector's contribution to gross domestic product has declined substantially in the last two decades. While increasing wages in the agricultural sector may have negative consequences, such as reducing employment levels in the sector, it is also expected to have advantages that are expected to outweigh the consequences. The extension of the minimum wage to the agricultural sector will not only lead to improvements in productivity within the sector, it will also attract better quality labour into the sector, which will, in turn, improve agricultural output. From a social justice perspective, workers within the agricultural sector for many years have expressed dissatisfaction at Government's reluctance to introduce an agricultural minimum wage, as in other sectors.

Does it provide an environment under which the private sector can grow?

Reforms

The budget reports that the Government continues to undertake reforms with a view to creating a conducive business environment, including the revision of the Industrial Development Act, to, among other things, simplify licensing procedures for manufacturing industries. The Companies' Act has also been reviewed with a view of simplifying registration of companies. Furthermore, Parliament approved the Competition Policy, whose main objective is to prevent and redress any anticompetitive practices and conduct by firms; encourage competition and the efficient use of resources; promote investment; broaden choices and stabilize prices. A new Foreign Direct Investment Strategy, whose key objective is to enhance foreign direct investment inflows into the country is also expected to be finalized in March 2006.

While the Budget Speech (save for the announcement that the Government Employees' Motor Vehicle Advance Scheme (GEMVAS)) is surprisingly silent on the Privatisation programme, Government through the accompanying Annual Economic Report acknowledged privatisation as a reform strategy aimed at strengthening the role of the private sector in the economy.

The budget further reported on several macroeconomic indicators that portray Botswana as private sector friendly, such as being the most competitive country in Africa, the freest economy in Africa, and notes that Botswana has continued to score extremely well in sovereign credit ratings by Moody's and Standard and Poor's since 2001. This therefore, calls on the private sector to take advantage of the conducive environment so far created and help the economy grow. This is more so that for many years, private sector activity has been mainly a function of government spending, an unsustainable situation that should be discouraged. The private sector should recognise that Government's responsibility is to create an enabling environment for the private sector to lead the country's economic activity, not to have the Government as the leader of economic activity.

Still need for further reforms

Despite strides made in providing a conducive environment for private sector activity, there are still concerns as regards regulatory and microeconomic bottlenecks that undermine efforts to promote economic diversification and growth of the private sector. Results of a survey among companies in Botswana aimed at understanding the costs and constraints imposed on private businesses by regulations, administrative procedures and other obstacles is summarised below:

Table 2: Top 10 obstacles identified by companies as major obstacles to doing business in Botswana

1	2	3	4	5	6	7	8	9	10
Availability of trained manpower	Crime, theft & disorder	Labour productivity	Cost of premises	Cost of finance (e.g interest rates)	Cost of telecoms	Access to land	Cost of electricity	AIDS and related diseases	**Access to finance**
69.1%	67.1%	62.8%	62.3%	59.9%	58.0%	56.0%	46.9%	45.4%	44.4%

Source: FIAS/BIDPA, Further Improving the Regulatory and Procedural Framework for encouraging Private Investment.

69.1% of the companies identified the availability of trained and skilled staff as the major obstacle to the growth and operation of companies in Botswana. Crime, theft and disorder were also identified as a major obstacle, followed by low labour productivity with 67.1% and 62.8%, respectively. 62% of the companies felt that the cost of premises was a major obstacle, while 60%, 58%, 56% and 46.95 of the companies felt that the major obstacles were cost of financing, cost of telecommunications, access to land and cost of electricity respectively. 45.4% said HIV/AIDS and related diseases and 44.4% said access to financing were major obstacles.

The existence of these administrative bottlenecks presents a challenge. This calls for a concerted effort by government to address the bottlenecks.

Regulation, Competition and Privatisation

As noted elsewhere, apart from a mention of privatising the Government Employees Motor Vehicle Scheme (GEMVAS), the budget speech is silent on the country's privatisation programme, which is quiet surprising, given that the Privatisation Master Plan, which is expected to pave way for the implementation of the country's privatisation programme was approved in early 2005. This is cause for concern, as it puts in question government's political will to implement the privatisation programme. This may seriously affect investor confidence on the entire privatisation programme.

Furthermore, the Budget Speech is silent on regulation of privatised entities. Experience elsewhere shows that privatisation better achieves its desired impact when the regulatory framework and competition are in place before privatisation. Any country that fails to follow this sequence runs the risk of transforming public monopolies into private monopolies, which is detrimental to consumers and the country as a whole. Suffice to say, there is no justification for Botswana to take this risk particularly that the country undertakes privatisation at the tail-end of the programme, with wealth of country experience from which Botswana can learn from.

The passing of a Competition Policy in August 2005 by Parliament is commendable. But if the time it has taken Government to implement the Privatisation Policy is anything to go by; chances of the Competition Policy being implemented in the next three years are very remote, which raises two key questions:

(a) In the absence of a regulatory framework in most sectors, how will Government ensure that privatised entities, some of which are monopoly companies like the Botswana Power Corporation, Water Utilities Corporation and Botswana Railways, do not charge exorbitant profits since there are no effective and independent regulatory frameworks in place to regulate their activities?

(b) In the absence of a Competition Authority, how will anti-competitive practices, such as price rigging, resale price maintenance, price collusion and exclusive dealing, which are likely to increase after privatisation, be handled?

It is imperative that the implementation of the Competition Policy be speeded up and a proper regulatory mechanism is put in place to ensure that privatisation achieves its objectives.

It is, however, reassuring that the privatisation agency recognises this and has undertaken an infrastructural sectors' regulatory study. Recommendations of the study should, therefore, be implemented without delay.

Fiscal Legislation

The budget came up with a number of amendments to both the Income Tax and Value Added Tax.

Income Tax: The simplification of the tax system by adopting a single company tax rate and a withholding tax on dividends as a final charge is a welcome development as this is expected to attract foreign investors into the country, thereby enhancing private sector development. However, it is questionable whether this will achieve any tangible results, as noted above; there still remains an assortment of hassles and impediments that serve to ward off FDI. Not many foreign investors would want to put their money at risk in a country where serious bottlenecks exist in areas such as access to land, poor labour productivity and excessive cost of utilities.

The proposed increase in taxable income from P25, 000 to P30, 000 and the further adjustment of the tax bracket such that the maximum tax bracket becomes applicable above P120, 000 instead of P100, 000 is also a welcome development as it partially compensates for the 16.1% increase in the cost of living during 2004 and 2005.

Unfortunately, the tax changes did nothing for those earning less than the old P25, 000 tax threshold, which serves to widen the gap between the better off and the worse off. Thus, Government should have increased their salaries by more than 8% to compensate them for not benefiting from the increase in taxable income which only accrued to those who earned P25, 000 at the time of the adjustment.

Value Added Tax: The zero-rating of additional basic foodstuffs, such as millet grain, millet meal and wheat grain is also welcome, as it is expected to benefit the poor. This is because the poor spend a high proportion of their income on food, and local studies have shown that cereals are the most consumed foods in the country.

The shortcoming arising, however, is that zero rating will not do much for people who have no income. It also has to be noted that such tax concessions serve to erode the tax base, and with it the ability of government to provide targeted assistance to the poor and the malnourished. Another shortcoming is that quite a few non-poor beneficiaries will unjustifiably benefit from the tax concessions. For example, there seems no justification for zero-rating of the agricultural inputs such as some pesticides, fertilizers and farming tractors. If the argument is that they produce food for the poor, what about pharmaceutical companies that produce medicine for the poor, building materials companies that produce input for the provision of shelter, a basic commodity that the poor need so badly? Doesn't this constitute compromising the spirit of ensuring a level playing field and directing the scarce national resources to their most productive uses? Or does that only matter when we speak of "Agriculture"?

It is, also surprising that the budget has, without any strong reason, allowed those who combine farming with other businesses to continue to claim farming losses against other income, which in essence represents a non agricultural activity tax refund to a tax payer simply because he claims to have lost on his farming business. This should be stopped as it represents a significant drain on revenue from tax payers engaged in farming and other businesses.

Budget Implementation

Botswana has suffered project implementation problems for some time now. Table 3 shows that for the past five years, the Government has not been able to fully spend its budget allocations. This has normally been blamed on "capacity constraints". While Government has consistently expressed renewed determination to address capacity problems, the successive budget speeches have decried implementation problems, suggesting that even now government has not made significant inroads into solving the problem of capacity constraints. It is, therefore, imperative that authorities ensure that this budget is implemented fully for it to achieve the intended objectives. It has to be noted; however, that project implementation does not lie with Government alone, but also calls on the private sector to deliver. In particular, local companies should endeavor to, not only complete their assignments on time, but also to produce quality output, as this would go a long way in helping to achieve the budget's objective.

Conclusion

Table 3: Budget Forecast and Expenditure Patterns, 2001/02 – 2005/06

Year	Budget Forecast (P billion)	Actual (P billion)	% under-spending
2001/02	14.08	13.67	2.91
2002/03	17.03	15.71	7.70
2003/04	20.58	16.26	20.99
2004/05	18.72	17.38	7.15
2005/06	20.58	20.1*	2.33
Source: Various Budgets			*Estimate

The 2006/07 budget has many characteristics of a growth promoting budget. First, it is expansionary, hence is expected to put the economy on a growth path. Second, it highlights strides made in providing a conducive environment for the private sector to operate. It, therefore, challenges the private sector to take advantage of the conducive environment. However, there are still administrative bottlenecks that the government has to work on to further improve the business environment. These include, among others, provision of appropriate manpower and improvement in productivity levels.

While privatisation is expected to help develop the private sector, the basics for a successful privatisation programme, such as sound regulatory framework and a competitive environment, are not yet in place. It is advisable to have these in place before major transactions are undertaken, lest public monopolies are transformed into private monopolies, all to the detriment of consumers and the country as a whole.

The VAT zero-rating of additional basic foodstuffs is a welcome development as this will be good for the poor in the country. However, in doing so, care should be taken as this also represents loss of income to Government. Alternative sources of income should be sort.

The proposed increase in the threshold for taxable income from P25,000 to P30,000 and the further adjustment of the tax brackets, such that the maximum tax bracket becomes applicable above P120,000, instead of P100,000, is also welcome development as it partially compensates for the 16.1% increase in the cost of living during 2004 and 2005. Unfortunately, zero rating will not do much for people who have no income.

In addition, there seems no justification to continue to allow offsets of farming losses against other income, as this represents significant revenue losses caused by the need to make refunds to those claiming farming losses against other income.

Finally, unless implementation capacity problems are dealt with, the budget will not stimulate the growth of the economy, as the lack of implementation takes away the mechanism with which the budget is expected to boost the economy.

Table 4: Consolidated Cash Flow Presentation of the Budget (Pula Millions)	2001/02 Actual	2002/03 Actual	2003/04 Actual	2004/05 Actual	2005/06 Rev est.	2006/07 Estimates
Revenue and Grants	**12,708.9**	**14,318.3**	**16,197.3**	**17,956.6**	**21,697.3**	**24,144.0**
Revenue	12,649.7	14,233.9	16,135.9	17,609.0	21,477.3	23,780.9
Tax Revenue	6,042.5	7,472.5	8,361.6	10,072.3	11,508.5	13,944.0
Mineral Tax	2,455.5	2,715.7	2,378.1	2,508.7	3,259.0	3,416.6
Customs Pool	1,732.9	1,568.9	2,245.5	3,226.5	3,495.7	5,299.6
Non Mineral Income Tax	1,247.9	1,839.5	2,078.7	2,082.2	2,689.7	2,920.4
Export Duties	0.1	0.3	0.2	0.2	0.1	0.2
Taxes and Property	16.3	18.4	11.6	13.1	18.2	36.0
Taxes on Motor Vehicles	51.1	55.0	62.3	105.1	74.9	124.1
Business and Professional Licenses	15.7	18.5	9.1	17.2	21.6	15.7
Sales Tax/VAT	519.7	1,254.6	1,573.2	2,116.2	1,937.3	2,118.4
Airport Tax	3.3	1.7	2.9	3.0	12.0	13.0
Non Tax Revenue	**6,607.2**	**6,761.4**	**7,774.3**	**7,536.7**	**9,968.8**	**9,836.8**
Mineral Royalties and Dividends	4,540.3	4,786.9	5,784.8	6,173.1	7,630.3	7,972.1
Interest of which	189.1	226.8	208.4	-97.2	75.3	36.2
PDSF	136.9	179.1	165.4	-127.6	36.1	2.0
RSF	0.1	-0.2	0.0	0.0	0.0	0.0
Other	52.1	47.9	43.0	30.3	39.2	34.2
Other Property Income of which	1,170.2	1,063.9	969.3	432.8	557.9	703.6
BoB revenue	1,142.2	1,028.9	755.0	388.1	420.0	550.0
Fees, Charges and Sundry	601.1	605.1	733.1	890.6	1,314.2	1085.6
Sale of Property	106.6	78.7	78.8	137.5	391.1	39.2
Grants	**59.2**	**84.4**	**61.4**	**347.6**	**220.0**	**363.2**
Recurrent	0.0	0.8	0.3	0.0	0.0	0.0
Development	59.2	83.6	61.1	347.6	220.0	363.2
Expenditure and Net Lending	**13,670.9**	**15,710.1**	**16.275.6**	**17,382.6**	**20,122.2**	**23,221.5**
Recurrent	**9,934.9**	**11,581.1**	**12,934.8**	**13,765.4**	**15,796.1**	**17,233.5**
Personal emoluments	3,446.5	3,946.5	4,141.9	5,129.0	5,436.0	5,998.0
Other Charges	6,394.2	7,553.4	8,600.2	8,321.5	10,055.2	10,957.9
Public Debt Interest	94.1	81.1	192.7	314.9	304.9	277.6
FAP Grants	**150.0**	**10.0**	**0.0**	**0.0**	**0.0**	**0.0**
Development Expenditure	**3,698.2**	**4,200.2**	**4,256.4**	**3,910.1**	**4,450.2**	**6,035.2**
Repayments of Loans of which	**-112.9**	**-121.2**	**-915.6**	**-292.9**	**-124.0**	**-47.2**
PDSF	-69.9	-76.3	-877.8	-257.4	-84.6	-5.1
RSF	-0.6	-0.6	0.0	0.0	0.0	0.0
Other	-42.5	-44.4	-37.7	-35.5	-39.5	-42.1
Overall Surplus/Deficit	**-962.0**	**-1391.8**	**-78.3**	**574.0**	**1,575.0**	**922.5**
Financing	**962.0**	**1391.8**	**78.3**	**574.0**	**1,575.0**	**922.5**
External Loans	60.1	23.5	61.6	23.0	97.0	145.0
Internal Loans	0.0	461.1	1,954.9	0.0	0.0	0.0
less Amortisations	-225.5	-231.0	-174.3	-166.8	-992.9	-192.4
IMF transactions	-18.3	-42.5	0.0	0.0	0.0	0.0
Pension Liability Service Fund	-1,834.8	-5,328.9	-3,703.7	-1,591.7	0.0	0.0
Other Financing	267.7	-761.3	-2012.5	-494.5	-10.0	-10.0
Change in Cash Balances	2,714.6	7,732.6	3,952.4	1,656.1	-659.2	-989.9

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