BIDPA Briefing

Sponsored by Bifm

ISBN 1560-5817

2005/06 Budget Briefing

Introduction

The theme for the 2005 Budget Speech, "Meeting the Millennium Development Goals and Vision 2016 through a Self-Reliant Approach to Development", marked a reversion to themes that were emphasised in Botswana's earlier development periods, when Batswana were encouraged to do more for themselves, rather than depending upon government initiatives and handouts. The call for greater self-reliance reflected the growing awareness that not only were the Government's existing and prospective resources already stretched to the limit, but also that the dependency syndrome that had evolved over the past decade or so was becoming increasingly unsustainable. The Honourable Minister of Finance and Development Planning, while recognising that Government still has major roles to play in the economy, called upon all sections of society to take greater individual responsibility for their economic and social development. In addition, the Budget Speech theme served to signal to both the local and international community that while Botswana was committed to achieving the goals of the Millennium Declaration and its own Vision 2016, it was also committed to pursuing sound and sustainable financial management.

The 2005/06 Budget that the Minister presented on 7 February 2005 was fashioned against the numerous challenges that were facing the nation, including, inter alia:

- the HIV/AIDS pandemic,
- the slower growth in GDP,
- the high and rising rate of unemployment, heavily concentrated amongst an increasingly educated youth,
- the inadequate progress in diversifying the economy,
- the high incidence of poverty, especially amongst the rural population,
- the over-valued exchange rate[1], which was eroding the competitiveness of domestic producers,
- international fluctuations in exchange rates and mineral prices, which were making sound financial planning and budgeting difficult, and contributing to emerging large budget deficits.

In the face of those challenges, the Honourable Minister of Finance and Development Planning presented a basically balanced budget, expressing the commitment the Government has to living within its means, at least over a medium term horizon. The previous year's budget estimates had also presented a basically balanced budget (a small surplus of P69 million was forecast); but, the revised estimates for 2004/05 now heralded a P1.4 billion deficit, mainly due to revenue shortfalls from minerals (P357m) and non-mineral income tax (P486m) and higher than expected development expenditures (+P717m).

Government Revenues and Grants

The budget estimates for 2005/06 foresee Government revenues and grants rising to P20.57 billion, an 18.9 percent increase over the P17.29 billion now expected for 2004/05. The P3.28 billion increase in revenues projected for 2005/06 is more than accounted for by the increases coming from higher mineral taxes (P711m), additional mineral royalties and dividends (P1702m), increased non-mineral income taxes (P532m) and greater fees, charges and sundry (P423m). There are some other revenue items, such as SACU revenues, VAT and Bank of Botswana revenues, which are forecast to decrease in 2005/06. While the increase in mineral revenues may be explained in part by the new mining agreement with De Beers, under which new 25 year mining leases for all four of Botswana's current diamond mines were awarded to Botswana's long-standing diamond mining partner, as well as by several diamond price increases that were announced during 2004 and modest increases in production expected during 2005, the large 25.7 percent increase in non-mineral income taxes is more questionable, especially given the slow growth being recorded in the non-mining sectors of the economy, and the even slower growth rates predicted for 2004/05 and 2005/06 by the Honourable Minister. With no increases in tax rates expected in 2005/06, improved tax administration by the Botswana Unified Revenue Service faces a serious challenge. Other major sources of Government revenues, e.g., SACU revenues and Bank of Botswana earnings on the invested international reserves, are not expected to add much, if anything, to total revenues and grants.

This leads into the question of how have Botswana's revenue sources really been performing over the past few decades, as a prelude to what might be expected in the future? Over the period from September 1973/74 to September 2004/05, prices (as reflected in the national cost of living index) rose at an average annual rate of 10.63%. Adjusting the nominal levels of revenues and grants by the cost of living index allows the calculation of constant price figures for the major sources of funds that the Government received over the 33 year period for which comparable data are available from the Cash Flow Presentation of the Budget. The figures for the major categories of revenues and grants in constant 2004 prices for selected years are shown in Table 1.

For 2005/06, mineral revenues (from tax, royalties and dividends) are expected to constitute 48.3% of total revenues and grants, SACU revenues 16.6%, non-mineral income tax 12.6% and VAT 10.2%. The other revenues and grants would contribute 13.8% to the total.

From 1973/74 to 2005/06, total revenues and grants, in real terms, grew at an average annual rate of 9.8%. However, real growth has slowed over the past decade to 5.9% p.a. Over the period from 1973 to 2005, real mineral revenues increased twenty fold, averaging an annual increase of 14.5%. However, over the past decade from 1995/95 to 2005/06, growth has slowed to 6.1% p.a. Indeed, excluding the 2005/06 estimate, which may have been boosted by the negotiations for the new mining leases, the real rate of growth of mineral revenues from 1990/91 to 2004/05 has been a modest 0.4%[2]. With only modest increases in diamond production expected over the next decade, after which operations will need to go underground, resulting in less production and higher costs, future real revenue increases from the diamond sector are likely to be quite modest. Other mineral sector revenues to Government, however optimistic one might be, will be small compared to the diamond revenues.

SACU revenues have maintained a strong real growth of over 6% p.a. from 1973/74 up to the budget estimate for 2005/06; although the growth in real terms from 2004/05 to 2005/06 is expected to be negative. With trade liberalisation between SACU and other regional groups (e.g., EU, Mercosur, SADC, USA, etc.), as well as WTO agreed tariff reductions, this revenue source should not be expected to contribute much, if anything, to increased Government revenues in the years ahead. With economic diversification and improved upstream and downstream linkages in the economy, SACU revenues should grow less rapidly than Non-Mining GDP. Non-mineral income tax has registered strong real growth, both over the longer period from 1973 (9.1% p.a.), as well as from 1995/96 to 2005/06 (13.2% p.a.; although as noted above, the figure for 2005/06 may be somewhat over-optimistic). However, non-mineral income tax should not be expected to grow much faster than Non-Mining GDP, since the most highly profitable business ventures have already established themselves here, yielding the highest sources of company income tax. Other investments that might be undertaken in Botswana, while profitable, are likely to be less profitable than those that have already occurred; and thus, they are likely to yield lower taxes per unit of GDP than the already established enterprises. In economics jargon, the newer investments are likely to development

Table 1: Cash Flow Presentation of Budget Revenues (in Constant 2004 Prices)

						Real Rates of Growth	
	1973/74	1995/96	2004/05	2005/06	2005/06	1973/74-	1995/96-
			Revised	Estimates	Share	2005/06	2005/06
Revenue (Pula Million)	957	10,812	17,094	19,194	98.9%	9.8%	5.9%
Mineral Tax, Royalties & Dividends	122	5,163	7,713	9,364	48.3%	14.5%	6.1%
Customs Pool	480	1,652	3,292	3,214	16.6%	6.1%	6.9%
Non-Mineral Income Tax	149	711	2,068	2,453	12.6%	9.1%	13.2%
Sales Tax/VAT (l)	0	437	2,000	1,981	10.2%		16.3%
Other Taxes	37	45	119	117	0.6%	3.7%	9.9%
Interest	45	461	165	71	0.4%	1.4%	-17.1%
Other Property Income of which	20	2,119	476	435	2.2%	10.1%	-14.6%
BOB revenue	0	2,093	434	396	2.0%		-15.3%
Fees, Charges and Sundry	103	197	929	1,275	6.6%	8.2%	20.5%
Sale of Property	0	26	333	283	1.5%		26.7%
Grants	144	74	200	208	1.1%	1.2%	10.9%
Total Revenue and Grants	1,100	10,886	17,294	19,402	100.0%	9.4%	5.9%

Source: Financial Statements, Tables and Estimates of the Consolidated and Development Fund Revenues, Ministry of Finance and Development Planning. A 6% rate of inflation is assumed for 2005.

be moving down the marginal efficiency of investment curve, yielding lower taxable incomes.

VAT, which took over from the Sales Tax, has grown rapidly (16.3% p.a.) in real terms over the past decade. But, in future, such growth should be more in line with the real growth of the economy, now estimated at about 4%-5% p.a. Other property income, mainly revenues from the Bank of Botswana, peaked in real terms in 1996, and have decreased substantially (15.3% p.a.) since then. Future revenues from the Bank of Botswana, mainly based on the earnings on the Government Investment Account, will continue to be modest. Fees, charges and sundry revenues have grown about 8.2% p.a. in real terms since 1973, and more rapidly at 20.5% p.a. since 1995, reflecting success in improving cost-recovery measures. As emphasised by the Honourable Minister, this is an area where Government hopes to make substantial progress in the coming years. There has also been substantial real growth in revenues from the sale of Government property[3] averaging 26.7% p.a. over the period from 1995/96 to 2005/06. However, the budget for 2005/06 estimates a real decrease in such revenues.

Recurrent and Development Expenditures and Net Lending[4]

The 2005/06 Budget provides for Expenditures and Net Lending to increase from an expected P18.7 billion in 2004/05 to P20.5 billion in 2005/06, an increase of 9.3%. Recurrent expenditures are estimated to increase by 7.5%, from P14.6 billion to P15.7 billion, while Development expenditures are forecast to grow by 12.3%, from P4.3 billion to P4.9 billion. Net lending is estimated to continue to be negative, as repayment of PDSF/RSF loans is forecast at P124 million; and no new PDSF loans are expected. Recurrent expenditures are expected to constitute 77% of total Expenditure and Net Lending; and of that, Personal Emoluments are forecast to comprise 27%, Other Charges 49% and Public Debt Interest, 2%. Development Expenditure is estimated to amount to 24% of total Expenditure and Net Lending, while the Net Lending will subtract about 1% from the total.

The breakdown of the budget into the expenditure components of the Recurrent Budget, Development Budget, PDSF/RSF Loans, Repayment of PDSF/RSF Loans and FAP Grants has been changing over the past two decades, with a greater share going to the Recurrent Budget, and smaller shares going to the Development Budget, PDSF/RSF Loans and FAP Grants (which was terminated in the 2003/04 budget).

Adjusting the Government expenditure figures for changes in the price level that have occurred provides some measure of how much has been channelled through the budget to the different categories of expenditure. In constant 2004 prices, over the period from 1983/84 to 2004/05, the average annual real rate of growth of Recurrent Expenditures was 10.3%, while that of Development Expenditures was 7.4%. The real growth rate from 1983/84 to 1995/96 was especially high for both Recurrent Expenditures and Development Expenditures, at 11.4% p.a. and 10.8% p.a., respectively. The rates of growth of both these major categories of expenditure slowed in the subsequent periods from 1995/96 to 2000/01 and 2000/01 to 2004/05, with Recurrent Expenditures growth going from 8.8% p.a. in the former period to 7.0% in the latter period, while Development Expenditures recorded 3.0% p.a. and 0.9% growth rates in the two respective periods.

Table 3: Cumulative Total Expenditure and Net Lending
(Pula million, Constant 2004 Prices)

In real 2004 constant price terms, Total Expenditure and

	1983/84 to 2004/05	1983/84 to 1994/95	1995/96 to 2000/01	2001/02 to 2004/05
Recurrent	159,042	51,689	41,979	65,374
Development	77,230	33,225	21,497	22,508
PDSF/RSF Loans	9,577	8,782	578	218
Less Repay-ments	-5,510	-1,976	-1,736	-1,798
FAP Grants	1,712	642	773	297
Total	242,050	92,361	63,090	86,599
Shares of Total				
Recurrent	65.7%	56.0%	66.5%	75.5%
Development	31.9%	36.0%	34.1%	26.0%
PDSF/RSF Loans	4.0%	9.5%	0.9%	0.3%
Less Repay-ments	-2.3%	-2.1%	-2.8%	-2.1%
FAP Grants	0.7%	0.7%	1.2%	0.3%

Net Lending over the period from 1983/84 to 2004/05 amounted to P242 billion (see Table 3), of which Recurrent Expenditures were P159.0 billion (65.7%), Development Expenditures were P77.2 billion (31.9%), Net Lending was P4.1 billion (1.7%) and FAP Grants were P1.7 billion (0.7%). The share of Recurrent Expenditures in Total Expenditure and Net Lending has risen steadily from 56.0% over the period from 1983/84 to 1994/95, to 66.5% for the period 1995/96 to 2000/01, to 75.5% for the period from 2001/02 to 2004/05.

In contrast, the shares of the other components of Expenditure and Net Lending have trended downwards, with that of Development Expenditure falling from 36.0% of the total over the period from 1983/84 to 1994/95, to 34.1% for the period from 1995/96 to 2000/01, to 26.0% for the period from 2001/02 to 2004/05. The share of Net Lending has also declined, from 7.4% of Total Expenditure and Net Lending for 1983/84 to 1994/95, to -1.9% and -1.8% for the latter two periods, reflecting the ending of new PDSF lending and the repayment of previous loans outstanding. Similarly, the share of FAP fell as that programme was eventually wound down in 2001.

Table 2: Government Expenditure and Net Lending, Selected Years

Pula Million, Constant 2004 Prices
(percent of total expenditure and net lending in brackets)

	1983/84	1990/91	1995/96	2000/01	2004/05	2005/06
COLI (Sept. 2004 = 100)	14.4	27.5	50.2	75.1	100.0	106.0
Recurrent	1,877.3 (58.8)	5,142.7 (48.1)	6,848.6 (66.2)	11,158.8 (72.7)	14,624.7 (78.1)	14,830.2 (76.9)
Development	976.1 (30.6)	3,957.3 (37.0)	3,331.0 (32.2)	4,172.5 (27.2)	4,326.7 (23.1)	4,583.0 (23.8)
PDSF/RSF Loans	365.7 (11.5)	1,648.8 (151.4)	226.0 (2.2)	171.3 (1.1)	0.0 (0.0)	0.0 (0.0)
Less Repayments	-40.9 (-1.3)	-145.9 (-1.4)	-200.2 (-1.9)	-306.1 (-2.0)	-232.0 (-1.2)	-117.0 (-0.6)
FAP Grants	14.3 (0.4)	79.9 (0.7)	143.4 (1.4)	159.7 (1.0)	0.0 (0.0)	0.0 (0.0)
Total Expenditures and Net Lending	3,192.4	10,682.9	10,348.7	15,356.3	18,719.3	19,296.2

Source: Financial Statements, Tables and Estimates of the Consolidated and Development Fund Revenues 2005/06

The changing shares of Recurrent and Development Expenditures reflect and signal the attempt by Government to maintain a prudent fiscal policy stance. With the slowdown in the growth of Government revenues, sound and sustainable fiscal policy requires that Government slow down the rate of growth of its expenditures. Curtailing the rate of growth of total Government expenditures, while maintaining and operating the existing government facilities, means that Government must slowdown the rate at which new government facilities are brought on stream. It is Development Expenditures which bring forth new government facilities, which have Recurrent Budget implications if they are to be operated satisfactorily. Thus, by reducing the share of Development Expenditures in Total Expenditure and Net Lending, Government is trying to slow down the rate of growth of both Recurrent Expenditures and Total Expenditures; hopefully to rates of growth that are consistent with the expected long-term rate of growth of Government revenues, especially the rate of growth of recurring revenues that do not derive out of the sale of assets (e.g., the non-replenishable diamonds).

The real Recurrent Budget implications of Development Expenditure can be estimated easily from the change in Recurrent Expenditures between two periods and the total cumulative amount of Development Expenditure that occurred from the initial period to the year just before the end of the period. For the period from 1983/84 to 2004/05, every Pula of Development Expenditure brought forth an additional P0.165 of Recurrent Expenditure. Even over the more recent period from 2001/02 to 2004/05, the Recurrent Budget implications of Development Expenditure amounted to P0.191 per Pula of Development Expenditure. Using that Recurrent Budget implication estimate, and assuming that Government's recurring revenues will grow 5 percent per annum, in line with the expected growth of the non-mineral economy, the ratio of the Development Budget to the Recurrent Budget that would yield growth in Recurrent Expenditures consistent with the growth in recurring revenues is estimated to be 0.262. That is, the Development Budget should not be allowed to get to be much over one-fourth as big as the Recurrent Budget, if the Recurrent Budget is not to grow much faster than the expected recurrent revenues.

The share of the Development Budget in Total Recurrent plus Development Expenditures that would be consistent with 5% per annum recurring revenue growth would thus be 0.207[5]. Over the period from 2001/02 to 2004/05, the share of Development Expenditure in Total Recurrent and Development Expenditures was 0.256. Even for the 2005/06 budget, the share of Development Expenditure in Total Recurrent and Development Expenditure is 0.236. This is still somewhat above the ratio needed for budget consistency and sustainability; but, it is clearly a move in the right direction towards slowing down the rate of growth of Government expenditures to sustainable levels.

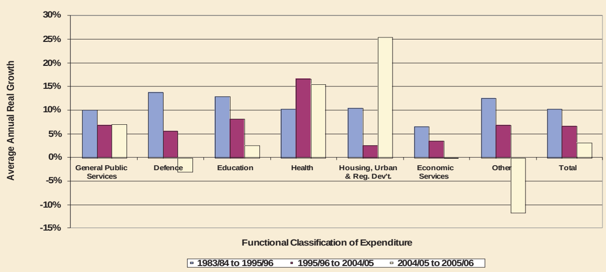
Functional Expenditure Categories

Chart 1 shows the real rates of growth of Government expenditure on various functional budget categories for selected periods from 1983/84 to 2005/06. Growth in Total Expenditure and Net Lending measured in 2004 prices is shown to slow down from 10.3% p.a. for the period from 1983/84 to 1995/96, to 6.8% p.a. for the period from 1995/96 to 2004/05, to 3.1% for the budget estimated for 2005/06 (assuming a 6% rate of inflation in 2005). But, behind those aggregated figures were some notable differences in the growth rates for different functional areas of the budget.

In real terms, growth of expenditure on General Public Services has generally been in line with growth of total expenditures; although the budget estimate for 2005/06 shows substantially higher growth (7.2%) than that for the total. In contrast, growth of real expenditure on Defence has been exhibiting a downward trend over the two periods from 1983/84 to 2004/05, and will be negative in 2005/06. Education, which recorded the second highest growth rate from 1983/84 to 1995/96, has also been exhibiting a downward trend in recent years, with the budget for 2005/06 projecting real growth of just 2.6%.

As would be expected, the rate of real growth of expenditure on Health has been amongst the highest of all the categories, and has been rising over the past decade, increasing from 10.4% p.a. for the period from 1983/84 to 1995/96 to 16.63% p.a. for the period

Chart 1: Real Rates of Growth of Government Expenditure 1983/84 to 2005/06



1995/96 to 2004/05; and remaining quite high, at 15.6%, in the budget for 2005/06. Housing, Urban and Regional Development, which grew modestly at 2.5% p.a. over the period from 1995/96 to 2004/05, is set to grow 25.5% in the budget for 2005/06, with large recurrent budget increases provided for Housing, Local and Regional Development and Urban Infrastructure. The expenditure category for Economic Services, which covers Agriculture, Forestry and Fishing, Mining, Electricity and Water Supply, Roads, Air Transport, Rail Transport, Post and Telecommunications, Other Transport and Promotion of Commerce and Industry, has exhibited a declining growth trend since 1983/84, with the period to 1995/96 registering real growth of 6.5% p.a., and that from 1995/96 to 2004/05 recording 3.5% p.a. For 2005/06, the budget holds real expenditure constant. The declining share of expenditure and net lending going to Economic Services may reflect that most of the high priority investments in developing Botswana's economic infrastructure have now taken place, and that greater priority should be directed at the other functional categories of public expenditure. However, given the ongoing concerns about the need for economic diversification and more rapid growth in productive and sustainable jobs and income, it is reasonable to question whether there should be such a marked decline in priority attached to this functional category of expenditure.

The Other functional category of expenditure, comprising budget items such as Food and Social Welfare Programmes, Other Community & Social Services and Unallocated Expenditure (e.g., Public Debt Interest, Revenue Support Grants to local authorities and FAP Grants), has also shown slower real rates of growth over the past two decades, with real growth decreasing from 12.6% p.a. over the period from 1983/84 to 1995/96 to 6.9% p.a. from 1995/96 to 2004/05. The budget for 2005/06 estimates a further real decrease in this category of expenditure of 11.7%.

The changing budget shares over the past two decades give some indications of the changes in priorities that have occurred as Government has responded to new challenges, e.g., HIV/AIDS, and adopted new initiatives (or terminated old ones as in the case of PDSF lending and FAP grants). General Public Services[6], measured in 2004 constant prices, has recorded a growing share of Total Expenditure and Net Lending, rising from 17.1% for the period 1983/84 to 1994/95, to 19.2% for the period 1995/96 to 2004/05, and 19.7% in the budget for 2005/06. The share of Defence in total expenditure has declined from 9.7% over the period 1983/84 to 1994/95, to 8.7% from 1995/96 to 2004/05, and further to 7.6% in the 2005/06 budget. Education, on the other hand, has been a big winner in the budget allocations, with its share of total real expenditures rising from 17.3% for the period 1983/84 to 1994/95, to 24.2% for the period 1995/96 to 2004/05, and to 25.0% in the budget for 2005/06.

The fight against HIV/AIDS and other diseases is reflected in what happened to the share of Health in the budget allocations. Health's share has grown rapidly, from 4.6% for the period from 1983/84 to 1994/95, to 6.8% for the period from 1995/96 to 2004/05. The 2005/06 budget allocates 12.2% of Total Expenditure and Net Lending to Health. The share of the budget going to Housing, Urban and Regional Development decreased from 10.7% for the period 1983/84 to 1994/95 to 6.0% over the period from 1995/96 to 2004/05. It is expected to increase slightly to 6.6% in the new budget year. Because of the modest increases in real expenditure by Government on Economic Services, that category of expenditure has recorded the largest drops in budget shares, falling from 28.1% of Total Expenditure and Net Lending for the period 1983/84 to 1994/95, to 19.1% for the period 1995/96 to 2004/05, and to 16.1% for the 2005/06 fiscal year. The share of total expenditure going to the Other functional category recorded an increase to 16.1% during the period from 1995/96 to 2004/05, compared to 12.5% for the period from 1983/84 to 1994/95. However, the budget for 2005/06 sees that share dropping back to 12.9%.

Critical Issues for Fiscal Policy

The Honourable Minister of Finance and Development Planning identified a number of critical issues that needed to be addressed if Botswana were to be successful in achieving the Millennium Development Goals and Vision 2016 through a Self-Reliant Approach to Development. Some of these issues directly impact upon the Government budget, and its ability to fund development projects and the provision of public goods and services. Others have their main impacts on the private sector and its ability to supply the goods and services needed to raise standards of living of Batswana profitably on a sustained basis. For both the public and private sectors, raising the real productivity of Batswana workers, managers and entrepreneurs remains the crucial challenge if the real standard of living and quality of life of Batswana is to continue to rise. Without real productivity increases, any increases in consumption that Batswana get to enjoy in the short term cannot be sustained into the longer term. Without productivity improvements, short term gains for some Batswana can only come at the expense of the welfare of other Batswana, either in the present or in the future. It is for that reason that Government must always press for efficiency, for value for money, for cost-effectiveness and for living within its means, lest it ends up reducing the welfare of Batswana in the aggregate.

From the Government side, given the limited resources, greater cost-recovery on the basis of ability to pay becomes an increasingly important issue, not only because it helps to put the public finances on a sounder footing, but also because it is efficient and socially just.

In a similar manner, the Honourable Minister stressed the need to improve tax compliance, not only because it is socially just, but also because without it, Government credibility and its ability to maintain a sound and sustainable fiscal policy is undermined. Those who clamour for Government to turn a blind eye to non-compliance or to grant unlimited tax amnesties to those who knowingly fail to comply with the tax laws are sadly misguided as regards the foundations of good governance and how important such good governance is to the business environment in which they operate.

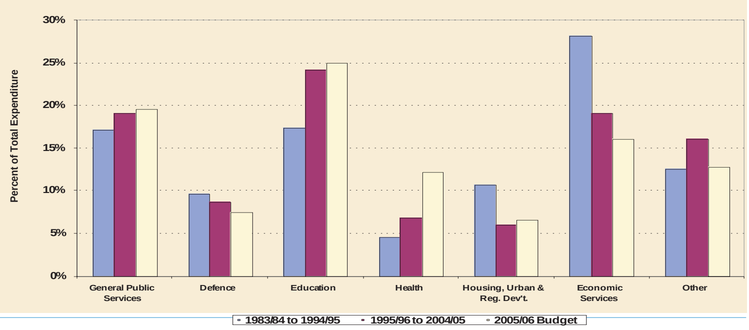
Another critical issue is the need to maintain Botswana's capital stock efficiently. The Honourable Minister noted that there is a backlog of maintenance of public facilities that needed to be cleared; something many observers have already commented upon. Government must give priority to maintaining the existing infrastructure, and completing on-going projects, before it embarks on developing new ones.

The Honourable Minister of Finance and Development Planning had some prescient words to say about avoiding the debt trap, something many other developing countries, especially in Africa, fell into. Botswana should only borrow for projects that can yield a high enough return to first be able to service the debt and then provide some net benefits that can be enjoyed by Batswana in the future. Far too often, that simple rule of finance has been lost on the recipients of Government-sponsored credit schemes.

One of the more important reasons that Botswana's economy is slowing down, and thus jeopardising attainment of the Millennium Development Goals and Vision 2016, is that the investment occurring in Botswana is not as productive as it should be. Low productivity investments, investments with low or negative real rates of return, result in small or even negative increases in real incomes for Batswana. Government, therefore, must do a better job in picking projects that have high positive real rates of return. Projects which cannot demonstrate a solid real net benefit to Botswana should be scrapped; and the resources allocated to them re-allocated to projects which can demonstrate good positive real rates of return. Even refraining from spending money on low productivity projects in Botswana, and leaving that money invested in a diversified portfolio of international reserves earning real positive returns in other countries, will make Batswana better off in the long run, since then in the future Botswana will have more money (more real purchasing power) to invest in productive projects in Botswana when they can be identified.

The BIDPA Briefing on the Budget is not the venue to try to specify the low productivity projects that should be avoided (or terminated). The slowing down of the economy is a clear indication that high productivity projects are not being identified and invested in. In addition to looking at Government building projects, where cost over-runs, delays and output under-runs have undoubtedly reduced whatever real returns might have been estimated or "guestimated" for them, two other areas where hard looks are overdue involve: (1) Government sponsorship of human resources

Chart 2: Changing Budget Shares 1993/84 to 2005/06



programmes where the outputs end up unemployed or eventually under-employed in jobs unrelated to the previous Government-funded education and training; and (2) Government incentive programmes, such as CEDA and BEDIA, where the funds spent appear to be associated with only small increases in employment and real incomes for Batswana.

CEDA, like FAP and the Selebi-Phikwe Regional Development Programme in earlier years, is just another one of the more prominent examples of dozens of incentives schemes Botswana has introduced over the past three decades, as diamond revenues provided an easy pool of resources into which development practitioners could dip. The critical issue that now arises, given the more stringent budget constraints facing Botswana, is how productive really are such incentives? Of course, some will argue that other countries have incentives, and, so too, should Botswana. But, it is not good enough any more to say that other countries use incentives, since every incentive has a cost, a trade-off that entails a tax on someone else in Botswana. That tax, whatever it is, reduces the attractiveness of investing in Botswana; it reduces the profitability of some activity in Botswana; it discourages some activity and some job opportunity in Botswana; it has a deadweight loss to Botswana; it creates a wedge of inefficiency in Botswana. There is no free lunch in giving incentives; other Batswana have to pay for them. It may have been relatively easy in the past, using the revenues to Government from diamonds to pay for them. But, even then, many people in Botswana have had to pay income taxes, sales taxes and VAT that could have been much lower if the inefficient incentives had been foregone. For example, the P700 million spent on CEDA represents about a third of the amount raised through non-mineral income tax. If CEDA had not been introduced, such income taxes on individuals and companies could have been reduced by a third, thus making Botswana a much more attractive location for both investment and employment.

The above issue also relates to the clarion calls for Government to do something to get industries to process locally more of the natural resources produced and/or exploited in Botswana, or to provide greater up-stream and down-stream linkages to the basic natural resources Botswana has. Government and several of its parastatals have indeed been doing that for thirty plus years. The various mining agreements have included provisions to develop such linkages; BDC has been seeking technical partners to process BMC's leather to further stages, including final consumer products. Diamond polishing factories have been established in Molepolole and Serowe, supported by Government incentives. Government has investigated and commissioned studies to identify opportunities where value to natural resources could be added in Botswana, where Botswana had a real comparative advantage or where a competitive advantage exists or could reasonably be expected to be developed.

A number of local enterprises, some of which have been supported through Government incentive schemes, do directly supply goods and services to the mines. However, quite a number of those efforts have not been successful, resulting in successive losses that either required Government subsidies to overcome or resulted in the termination of the venture. The recurring losses registered by the diamond polishing factories, despite substantial FAP and Government support, highlight the challenge Botswana faces in having Government target industries in its drive to diversify the economy. The Selebi-Phikwe Regional Development Programme, the Motor Company of Botswana (which assembled Hyundai vehicles) and the Haltek Textile operations provide other telling examples of how Government incentive programmes may not result in sustained development.

Government is often criticised for not doing enough to promote economic diversification and industrial development. Yet, if one carefully looks at the record of Government initiatives and interventions (they can be found in the 9 National Development Plans), Botswana has promoted development and diversification in virtually every sector of the economy, with programmes dating back to the earliest National Development Plans. Dozens of programmes to promote and diversify agriculture (development projects for cattle, smallstock, Arable Lands Development Programme, special support for borehole maintenance, rice, poultry, fishing, horticulture, beekeeping, veld products, forestry, etc.); other programmes to promote and diversify manufacturing and mining (Financial Assistance Policy [FAP], Selebi-Phikwe Regional Development Programme, Local Preference Scheme, Local Procurement Programme); special projects targeting SMEs (Batswana Enterprises Development Unit [BEDU], Small Borrowers' Fund, Tswelelo, Small Scale FAP, SMME Credit Guarantee Scheme); special development finance institutions to facilitate credit and finance to Batswana enterprises (NDB, BDC, Botswana Co-operative Bank, Botswana Building Society, Financial Services Company, Citizen Entrepreneur Mortgage Assistance Equity Fund, Citizen Entrepreneurial Development Agency [CEDA]); special business advisory and mentoring programmes for Batswana entrepreneurial development (BEDU, Rural Industries Promotion Company, Rural Industries Innovation Centre, Rural Industrial Officers, Business Advisory Service, Integrated Field Services, Small Business Promotion Agency, Enterprise Botswana, CEDA); special programmes to help citizen contractors and construction firms; incentives and subsidies for various transport modes; special programmes to assist citizen retailers; special programmes to develop citizen entrepreneurs that can supply basic goods to Government; support for tourism and wildlife development; Government support and funding for vocational education and training programmes, as well as special tax relief for training; special support for NGOs; assistance to co-operatives; technology development (Botswana Technology Centre, Botswana Renewable Energy Technology Project); trade interventions to protect local industries (KBL, KSI, SAB); special regulations to reserve activities and markets to Batswana; etc.

The point to perhaps stress here is that every P5-P10 million that Botswana loses trying to convert diamonds into jewellery or produce leather shoes or produce whatever, when the country does not possess a comparative advantage in that activity, is another school Botswana cannot build, is another clinic that won't be built and operated to serve sick Batswana, is another 10-20 km of roads to remote villages that won't be built for some time to come, is another 100 Batswana students that won't be able to go for tertiary education or training. Every regulation that leads to, and preserves, inefficient production and resource allocation makes productive investment in Botswana less attractive, reducing the opportunities for Batswana to have truly productive employment opportunities that can be internationally competitive and sustainable. Quite a bit of those kinds of costs for low productivity interventions have already been incurred in the past; and now they are coming home to roost. Botswana can ill-afford to continue to incur such costs in the future. It is time to weed out the low productivity Government incentives, initiatives and interventions.

---

[1]The issue of exchange rate policy is beyond the scope of this Budget Briefing. Suffice it to say that correcting the over-valued exchange rate runs the risk of creating macroeconomic instability, something the authorities would always want to avoid. It would, of course, be preferable to remedy the over-valued exchange rate through significant productivity improvements that would enable prices and costs in Botswana to rise less rapidly than those in trading partner and competitor countries. Unfortunately, that has not been happening for Botswana; although the Minister continues to call for such productivity improvements.
[2]In constant 2004 prices, real mineral revenues in 1990/91 amounted to P7,280 million. By 2004/05, they had grown to P7,713 million, an average increase of 0.41% p.a.
3 For example, sales of shares in Anglo-American Corporation, sales-leases of state land and sales of boarded vehicles.
[4]The Recurrent Budget covers the continuing administration and service costs of government. Specific projects (e.g., capital expenditure) are financed from the Development Budget, which generally covers any addition to the stock of government assets. Net Lending refers to loans (less repayments) made by Government to parastatals and local authorities, mainly from the Public Debt Service Fund, but also from the Revenue Stabilisation Fund and, in the case of local authorities, the Development Fund.
[5]For sustainable budgeting, the rate of growth of recurrent budget expenditures must be no greater than the rate of growth of recurring revenues (5% p.a.). By definition, the rate of growth of recurrent expenditures equals the ratio of the development budget to the recurrent budget times the recurrent budget implications of development expenditures (0.191). Thus, it follows that the target ratio of the development budget to the recurrent budget should equal (or be no greater than) the rate of growth of recurring revenues divided by the recurrent budget implications of development expenditure; i.e., 0.262 = (0.05/0.191) (QED). The target share of the development budget in the total of the recurrent budget plus the development budget thus is the target ratio of the development budget to the recurrent budget divided by one plus the target ratio of the development budget to the recurrent budget; 0.207 = (0.262/1.262).
[6]This covers expenditure on the Legislature, Foreign Affairs, Financial Administration, Government Construction, Services and Buildings, Government Transport Services, Immigration, Courts and Legal Administration, Police, Prisons, etc.

This edition of BIDPA Briefing was written by Jay Salkin
(e-mail: jsalkin@bidpa.bw).
Published by BIDPA, Private Bag Br29, Gaborone, Botswana

Tel: (+267) 3971750 Fax: (+267)3971748. Website: http://www.bidpa.bw

BIDPA's Briefing is sponsored by bifm, Botswana's largest manager of pension and insurance fund assets with over P4 billion under management. Bifm encourages greater public understanding and awareness of Botswana business and economic issues and is therefore delighted to support BIDPA's Briefing, providing independent analysis and economic forecasts to business and policy makers throughout Botswana. The views expressed in this edition of BIDPA's Briefing are those of BIDPA and are not necessarily those of bifm.