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Botswana’s 2006 budget

The Minister of Finance and Development Planning, Baledzi Gaolathe, delivered the 2006 budget to the Botswana National Assembly on 6 February. The theme of the budget was “Building an Innovative Economy for the 21st Century“.

Recent macroeconomic developments

The minister reviewed Botswana’s economic performance over the 2004/05 fiscal year (which runs from April to March) in regional and international contexts. A central focus of the speech was the ninth National Development Plan or HDP 9, which runs from 2003/04 to 2008/09. The budget proposals are based on the Mid-Term Review of the NDP 9 of December 2005.

Botswana’s macroeconomic indicators reflected several positive developments. The economy grew by 8.3%, significantly above the 3.4% achieved in the previous year, which is largely due to the strong performance of the diamond mining sector. Output in this sector grew by 18.2% in 2004/05 compared to 0.2% in the previous year. The non-mining sector grew by a more sluggish 1.9% in 2004/05, and below the rate of 5.6% achieved in the previous period. Most industries in non-mining sectors grew by less than 3%, but the transport sector (5.6% growth), finance and business sectors (4.1%), general government (3.6%) and water and electricity (3.3%) were above this trend. A real GDP growth rate of more than 6% is envisaged in NDP 9.

Inflation was higher at an average of 8.6% in 2005 against 7% in 2004. The minister blamed the transitory effects of the new crawling band exchange rate mechanism (introduced in May 2005) and high administered price increases, mainly fuel and telecommunications. Price pressures emanating from the high international crude oil price can be expected to be more permanent than the once-off impact of the new exchange rate mechanism.

Employment growth of 2.8% was below expectations as well as the previous rate of 3.1%, but above the population growth rate of 2.4%. Employment growth was recorded largely in the informal sector.

The external sector was affected by volatile exchange rates. The government is particularly concerned about the negative impact on Botswana’s international competitiveness caused by an overvalued real exchange rate, which has emerged since 2000. To combat this, the new crawling band system was introduced in May 2005 to reverse the pula’s real appreciation. This is based on the view, stated in the minister’s concluding remarks that “No nation has prospered with an overvalued currency”.

The balance of payments is expected to show a record surplus of P6.5 billion in 2005 as exports (up 31%) rose more than imports (up 17%). Exports were buoyed by higher volumes for diamonds, copper/nickel, soda ash, beef and textiles, as well as strong commodity prices (diamond prices rose by 19% in US dollar terms) and favourable exchange rate movements.

Botswana’s international sovereign credit ratings by Standard and Poors’ and Moody’s are investment grade with a stable outlook and are still the highest in Africa.

Foreign exchange reserves were up by almost 9% y/y in US dollar terms to US$6.2 billion at year end, equivalent to about 27 months of imports of goods and services.

The minister also reviewed the financial affairs of the government’s 12 public enterprises and concluded that their performances were satisfactory. Sectoral developments and policy issues were also reviewed.

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2004/05 budget performance

The 2004/05 budget showed a surplus of P574 million, even though a large deficit was projected in the revised estimates. Revenue surprised on the upside as diamond prices rose by a fifth and expenditure was lower than planned.

Revised budget estimates for 2005/06

The revised budget figures for 2005/06 show a significantly larger budget surplus of P1.58 billion compared to a balanced budget figure of P112 million. The increased surplus emanates from higher estimated diamond output and prices, and a weaker currency. Expenditure on development is expected to fall by P332 million as a result of capacity constraints.

Budget proposals for 2006/07

The main budget proposals are set out below. Although mineral revenue is expected to grow by about 5%, a final payment by the Southern African Customs Union (under the old agreement) to the fiscus will result in customs and excise recording the largest percentage increase.

	Pula billion	% of budget
Revenue and grants	**24.14**	
- Mineral revenue	11.39	47.2%
- Customs and excise	5.30	22.0%
- Non-mineral income taxes	2.92	12.1%
- Value added tax	2.12	8.8%
- Other revenue	2.41	10.0%
Expenditure	**22.64**	
- Recurrent	16.84	74.4%
- Development	5.80	25.6%
Surplus	**1.50**	

Several changes in fiscal legislation were announced. Company tax will be simplified and a single company tax will be adopted. Personal income tax rates were lightened and the tax-free threshold increased to P30 000 from P25 000, whereas the maximum personal tax rate will kick in at P120 000 rather than P100 000. Changes were made to withholding tax and residents will now also be subject to a 10% withholding tax on interest received from certain sources if it exceeds P1 000 per quarter.

Capital markets will also be affected by new legislation, which is intended to clarify tax implications on the disposal of shares and debentures. Changes proposed should increase trading volumes on the Botswana Stock Exchange. Additional VAT exemptions were also announced as well as other changes in various categories.

The overall purpose of the changes is a streamlining rather than a radical overhaul of the tax system. The government is in the “enviable” position of having a fiscal surplus; there are capacity constraints and implementation bottlenecks on the expenditure side, rather than a revenue shortfall. This gives the government the freedom and opportunity to focus expenditure to create the required capacity and eliminate constraints.

Conclusion

The minister said that growth-enhancing strategies will be focused on the allocation of expenditure on projects with high social returns, the elimination of administrative obstacles to investment, maintaining a competitive exchange rate and improving productivity. Also, the government’s adherence to fiscal prudence will ensure sustainability, which could be interpreted to mean that government activities will not crowd out private sector initiatives. This is enshrined in the so-called Fiscal Rule, which stipulates that total government expenditure must not exceed 40% of GDP. There is a further aim that development expenditure should rise to 30% of total expenditure, from the current 25%, thus reducing recurrent expenditure.

Botswana enjoys a stable macroeconomic environment and its financial architecture is well developed in a regional context. Confidence in the country's financial system and currency was recently affirmed when the African Development Bank issued a pula-denominated bond of P300 million (one-year maturity) and the European Investment Bank one of P500 million (five-year maturity) at the end of 2005.

Economic diversification is essential for Botswana's future economic growth – and the government is acutely aware of this imperative. Significantly, productivity growth is part of the government's long-term economic growth plan. This is evident from the Bank of Botswana's *Annual Report 2004,* which contains an analysis of the importance of productivity growth for long-term economic growth and elevating the standard of living for the countries' citizens. In his budget speech the minister also underscored the importance of productivity as a driver of growth.

The slow pace of diversification and high HIV/Aids infection rates are the two main constraints on the country's future economic development.

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