

Market insight – Botswana Budget 2003/04 – tightening the belt and hope for the best

4 February 2003

Global economic hardship slows Botswana's growth and government revenue

Botswana's economic growth is highly dependent on developments in the diamond market which in turn is vulnerable to global economic conditions. The subdued global economic performance in recent years together with increased volatility and uncertainty has resulted in a slowdown in Botswana's economic growth performance. The fact that diamond output has reached a plateau after the completion of the Orapa project has also impacted on growth.

The less favourable conditions experienced in Botswana's diamond industry had negative consequences for government finances. Rising expenditure pressures, while revenues remained flat, resulted in a budget deficit for the first time in 1998/99 after 16 years of surpluses.

Adding to the diamond industry's woes are various negative shocks or events that have compounded the impact of the slowdown in diamond mining activity on the economy as a whole. Of note is the recurrence of foot and mouth disease in some parts of the country which negatively impacted on the beef industry. Also, the regional food crisis has contributed to higher interest rates to control inflation. Overriding all these is the fight against HIV/Aids which is threatening economic and socio-economic stability.

It is against this background that the Minister of Finance Baledzi Gaolathe delivered his budget speech yesterday. The budget can be seen as a combination of significant belt tightening and holding thumbs that the estimated revenue will materialize.

This scenario will also present itself in successive budgets as the economy is expected to perform below historical levels in the medium-term. The economy grew by a mere 2.3% (above initial estimates) in 2001/02 compared to the revised 8.4% recorded in 2000/01. Growth in 2003/04 and 2004/05 is expected to be in the region of 5%, which compared to historical growth rates, is below average.

Outcome of budget 2001/02

A fall in mineral revenue and the appreciation of the pula against the US dollar resulted in total revenue and grants in 2001/02 coming in below expectations while expenditure was inflated to above estimated levels due to the 20% civil servant salary increases awarded in 2000 and the leave encashment policy introduced in September 2001.

The result has been an actual budget deficit for the year 2001/2002 of P964 million (3% of GDP), compared to a deficit of P85 million (0.3% of GDP) anticipated in the revised budget estimates.

Revised budget estimates for 2002/03

The pressure on government finances continued in 2002/03 which resulted in revenue shortfalls due to suppressed diamond market conditions. The revised total revenues and grants for 2002/2003 are now estimated at P14.43 billion against the original budget estimates of P15.42 billion.

Estimates for total expenditure and net lending have been reduced to P16.64 billion compared to the original budget estimate of P17.03 billion.

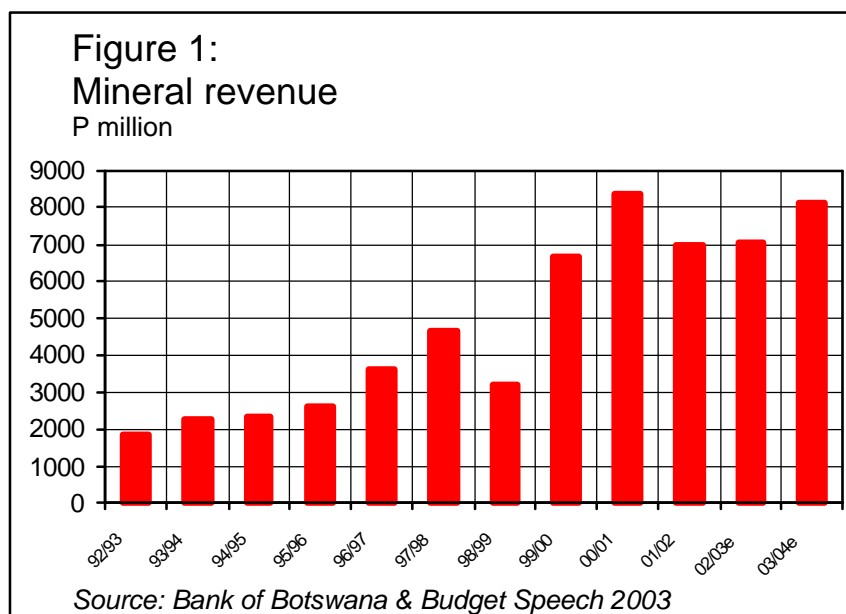
Despite this belt tightening the expected budget outcome for 2002/2003 is a larger deficit of P2.22 billion (6% of GDP) compared to the original estimated budget deficit of P1.62 billion (4.5% of GDP).

2003/04 Budget proposals – a balanced budget and no public service salary increases

Revenue and grants

Total revenues and grants for 2003/2004 are forecast at P17.54 billion, an increase of P3.11 billion, or 22% over the 2002/2003 revised budget estimate. The increase in revenue is expected from a 16% increase in mineral revenue to P8.14 billion on the back of an expected increase in diamond output and higher prices.

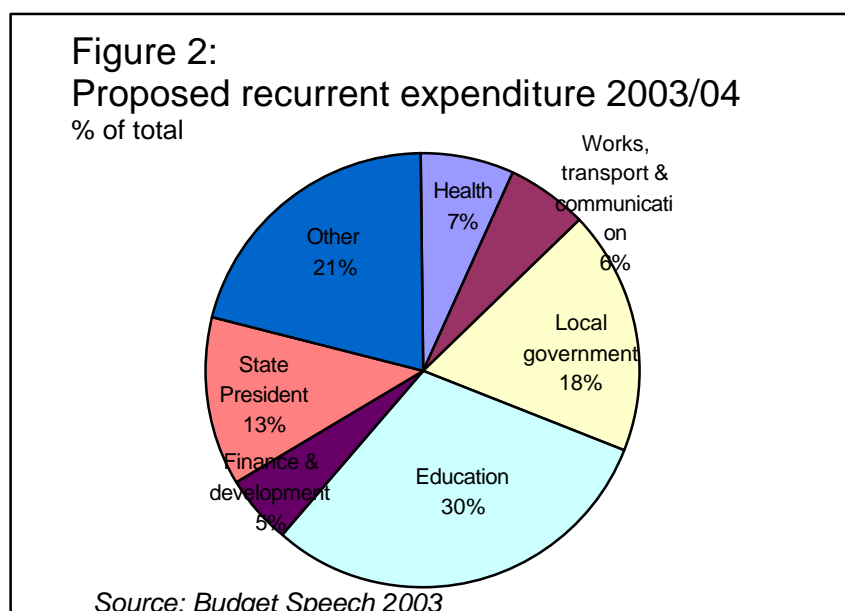
Non-mineral income taxes are forecast at P2.53 billion, which is a 12% increase on 2002/2003 revised levels. VAT revenue is expected to increase by 79% in 2003/04 to P2.31 billion reflecting the first full year of operation of VAT. A general improvement in the collection of revenue is also expected to contribute to these higher forecasts.



The other main revenue category, customs and excise, is expected to grow by P563 million which represents a 36% increase on 2002/2003 levels. The main reason for this improvement is an expected increase in Botswana's imports and some depreciation of the Pula against the Rand.

Expenditure and net lending

Total expenditure and net lending for 2003/04 is forecast at P17.33 billion (4.1% above the revised P16.64 billion for 2002/03) of which P13.32 billion (77% of total) is earmarked for recurrent expenditure. Personal emoluments (salaries and wages) are estimated to grow by a mere 6% which is in line with the government's 4% to 6% inflation target range.



A total P4.4 billion is proposed for the development budget in 2003/04 against the P4.5 billion in 2002/03. The reason for this marginal decrease is the demand for recurrent expenditure and government's intention to finalise outstanding NDP8 projects before embarking on new ones.

Of the P4.4 billion development budget, P4.3 billion is earmarked for normal development projects; P107.7 million for implementation of the development programme of parastatals and autonomous organisations; and P47.7 million is for completion of drought-related activities carried over from the preceding year.

The largest single share of P802 million (18.1%) of the total development budget has been allocated to the Ministry of State President which will channel P415 million to the Botswana Defence Force (ongoing projects on housing and replacement of equipment), P183 million to the HIV/AIDS Programme and P145 million towards new police facilities.

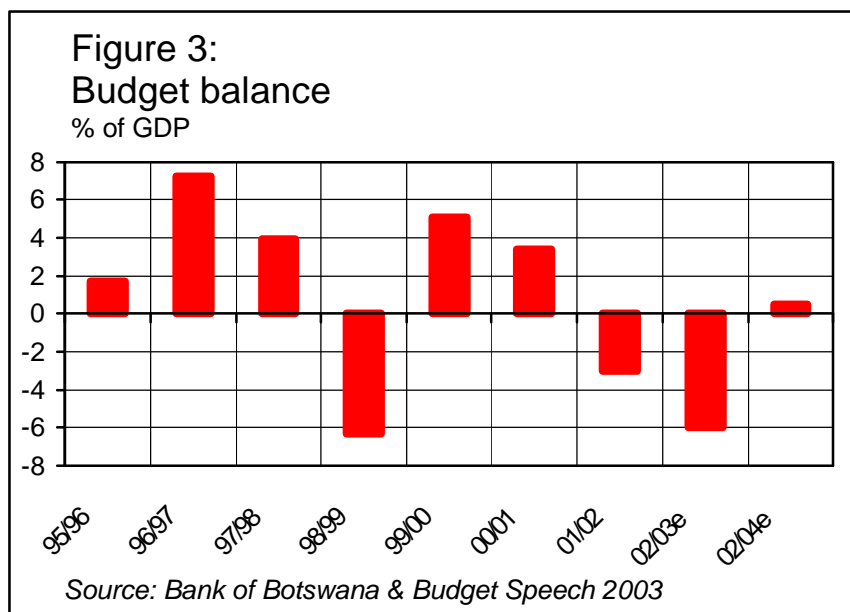
The Ministry of Local Government will receive P730 million (16%) of which 60% will be used to finance two major projects. The village water supply and sewerage project will get P227 million and the primary schools project P208 million. The rest of the P730 million will go to other projects, notably local authorities infrastructure maintenance (P60 million), labour intensive public works (P41 million), primary health facilities (29 million), computerisation (P27 million), village infrastructure (P25 million) and rural administration centres (P23 million).

Of the P548 million that has been allocated to the Ministry of Works and Transport more than 74% will finance bitumen and trunk roads improvements and the construction of additional secondary roads.

The rest of the development budget has been allocated to the remaining ministries.

Overall balance

The outcome of the 2003/2004 budget proposal will be a balanced budget (including a small contingency surplus of P206 million) with total revenues and grants of P17.54 billion and total expenditures and net lending of P17.33 billion.



Conclusion

Successive budgets have highlighted the government's and economy's reliance on minerals (especially diamonds) for revenue and growth. Mineral revenue has proved to be rather volatile. In addition, other traditional sources of revenue have been declining. The introduction of VAT in July 2002 has improved the outlook for government revenue but from a sustainability point of view economic diversification is crucial. Only by recording higher levels of growth through diversifying the economic

base will the government's current level of expenditure be sustainable. Efforts to diversify the economy continue in NDP9, which was presented to the National Assembly in November last year.

The proposals for budget 2003/04, while positive, are exposed to a great degree of uncertainty. On the revenue side it is not clear, taking account of events in the past few years, that mineral revenue will meet government's expectations given the increased uncertainty and volatility inherent to the global economy. Pressure to increase expenditure above estimates may come from various sources, the most likely being the country's drought relief programme that may require more resources than anticipated. Government's decision not to award any public service salary adjustments in 2003/04 opens the possibility that this decision may be reversed due to pressure from stakeholders.

The proposed balanced budget is therefore under threat. To realise a balanced budget mineral revenues below anticipated levels would have to be countered by expenditure cuts or increased revenue from other sources. In this regard the minister has alluded to the fact that a broadening of the tax base or higher taxation rates cannot be ruled out. While expectations of an increase in the VAT rate in the run-up to the budget speech have not been met, it is possible that this may occur during the lifetime of budget 2003/04.

Despite concerns that estimates of a balanced budget may be optimistic, if realized it should go a long way in restoring confidence in Botswana's fiscal strength and government's ability to manage its resources effectively and prudently.

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