REPUBLIC OF BOTSWANA

2011/12 BUDGET STRATEGY PAPER

Ministry of Finance and Development Planning

November 2010

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A. Introduction

1. Each year the Minister of Finance and Development Planning tables the budget to the National Assembly. The budget is presented through the delivery of the Budget Speech, usually in February preceding the start of the next financial year.

2. The Minister indicates how Government plans to raise revenue and spend taxpayers money, including honouring its debt obligations and contingent liabilities. Questions like by how much will taxes be increased, and how much is allocated for the implementation of major policies, or which sectors get how much are provided in the Budget Speech.

3. For the 2011/12 budget, the Ministry of Finance and Development Planning (MFDP) has developed a Budget Strategy Paper.

B. Purpose

4. This Budget Strategy Paper (BSP) will guide the preparation of the 2011/12 budget. This is an important component of the Government's approach for improving the preparation of the national budget and the management of public finances. This document will be made available to key stakeholders, as a way to enhance transparency and accountability. The BSP will also guide the discussions with stakeholders on the key priorities and issues to be considered for the 2011/12 budget. It will also be posted on the web-page dedicated to the budget consultations. This process is expected to give Government an important outside view on issues that affect Batswana. It is our view that the BSP will enable stakeholders to understand the broader macro-fiscal context and the Government's strategy for achieving sustainable, efficient and effective public spending.

C. Economic Performance and Outlook

5. The preparation of the budget is guided by overall economic performance and outlook in both the domestic economy and globally.

Economic Performance

6. From a growth rate of 3.1 percent in 2008, the economy contracted by 3.7 percent in 2009 due mainly to the impact of the global recession. Much of the decline is attributed to the dramatic reduction in diamond production and exports, which necessitated the closure of some diamond mines for nearly four (4) months during 2009. The mining sector reduced production in line with reduced demand as a result of the global financial and economic crisis. The mining sector has started to improve following a steady revival of overseas demand for rough diamonds, and it is expected that this trend will continue until full recovery in 2012/13. It is worth noting that the non-mining sectors remained resilient during the crisis, registering an estimated robust growth rate of nine (9) percent in 2009.

7. As total mining production declined, so did exports and consequently the current account in the balance of payments deteriorated. Total revenues and foreign exchange reserves declined as lower levels of trade and commodity prices affected exports and both mineral and customs revenues. Total revenues and grants fell by 8.8 percent from P30.455 billion in 2008/09 to P27.782 billion during the 2009/10 financial year. Total revenue in 2010/11 is projected to be below the 2007/08 level.

8. Government eased both fiscal and monetary policies to cushion the impact of the contraction of the mining sector and other sectors during the crisis period. Government expenditure was retained at high levels to complete projects which had already been started and to maintain economic activity at the prevailing level. With

declining revenues, Government budget was in deficit for the 2008/09(P4.696 billion) and 2009/10 (P9.466 billion) financial years. The 2010/11 budget balance is projected to be a deficit of P12.12 billion.

9. The economy has started to respond positively to recovery in the advanced economies as evidenced by increased demand which led to a recovery in diamond sales. A positive GDP growth of 4.1 percent was registered in the first quarter of 2010, with the major contributor being mining at 9.1 percent. Other sectors which performed well during the quarter are agriculture (7.3 percent) and trade, hotels and restaurants (6.6 percent).

10. In order to enhance private sector investment, it may be recalled that the Bank rate which was 15 percent at the end of December 2008 was reduced to 10 percent in December 2009. This was done in the context of a positive inflation outlook as well as to lower the cost of capital for the benefit of the private sector. Inflation decreased from a peak of 15.1 percent in August 2008 to reach 5.8 percent in December 2009.

11. Although the Bank of Botswana aims to keep the annual inflation rate within its medium-term objective range of 3 - 6 percent, the recent VAT increase from 10 percent to 12 percent and electricity tariff increase by 30 percent (in April) pushed inflation upwards. In March 2010, inflation rate stood at 6 percent. Consequent to the increase in electricity tariffs and VAT in April 2010, inflation rose by 1.1 percent to reach 7.1 percent. This trend continued until June 2010 when the rate was 7.7 percent. However, inflation has since gone down to reach 7.2 percent in October 2010.

12. The banking sector has come through the recession reasonably strong. While initially bank deposits declined, they have since recovered. Loans and advances

have also resumed growth in the third quarter of 2009. However, arrears on banksô loans and advances, especially to persons have been accelerating.

13. The Pula basket is made up of the SDR and the South African rand. The crawl is designed to maintain a stable rate of the Pula against the basket on a daily basis, with only gradual adjustment of the rate. However, volatility of the rand against the major currencies of the world, which make up the SDR, has created volatility of the Pula against both the rand and the SDR. In real terms, the Pula weakened by 2.2 percent against the rand and strengthened by 7.7 percent against the SDR over the twelve months period ending June 30, 2010. Against the SDR individual constituent currencies, the Pula recorded appreciations of 18.2 percent against the euro, 11.7 percent against the British pound, 2.4 percent against the US dollar whilst it depreciated by 3.5 percent against the Japanese yen. The rand/pula exchange rate has been below 1.10 for much of 2010. The subsequent rise of the rand on world markets has reduced the Rand/Pula exchange rate to about R1.06/Pula at the end of August 2010.

Outlook and Risks

14. The economic outlook for 2010 is favourable, with the recovery of the mining sector. Investment in the power and water sectors is also expected to boost growth. The economy is forecast to grow at 7.9 percent in 2010. The private sector real GDP in 2010 is likely to grow at about the same rate as it did in the second half of 2009, while Government sector real GDP is projected to be about the same as in 2009, due to Governmentôs recurrent budget which is maintained at previous levels. Government is committed to undertake effective public finance reform with greater emphasis placed on prioritising spending and delivering results in order to achieve a balanced budget by 2012/13.

15. At the global level, steady recovery in recent months could be interrupted by the recent turbulence in financial markets, which reflect a drop in consumer confidence on fiscal sustainability and future prospects. There are concerns over the fiscal position and competitiveness of some vulnerable countries in the euro area. Of critical importance is the likelihood of a double-dip recession in advanced economies as it would lead to further challenges for the mining sector in Botswana. Developments in the Southern African Customs Union (SACU) area are also important in determining the revenues that Botswana will receive from the revenue pool through the revenue-sharing arrangement.

D. Fiscal Strategy and Budget Priorities

16. The strategic thrust of development policy for NDP 10, as has been the case with past plans, is to accelerate diversification of the economy. The need to achieve this objective has become even more critical in view of the global economic crisis and the envisaged decline in diamond and SACU revenues. The basic strategy for NDP 10 also places emphasis on creating a conducive environment for the private sector so that it plays a major role in driving economic development. This entails putting more emphasis on maintenance of productive infrastructure, providing infrastructure needs for the private sector as an engine for economic growth, and continuing investment in appropriate skills for the domestic job market (particularly the private sector). Emphasis is also placed on leveraging additional support for the service export, compared to merchandise export in view of the associated high transport costs of the latter.

17. The budget strategy, given financial constraints, is to allow the recurrent budget to sustain access and quality of public services and to address the large recurrent needs of the recently completed development projects. Going forward, this implies a combination of fiscal and monetary policy initiatives which include limiting

government domestic and foreign borrowing at 40 percent of GDP (20 percent internal and 20 percent external), to avoid being caught in a debt trap.

18. In the long run in the light of lower expected revenues and achieving more efficient spending, MFDP is embarking on public financial management reforms. These reforms include revamping the planning and budgeting system to meet the demands of the changing environment. As part of these reforms, the budget will be guided by this document, 2011/12 Budget Strategy Paper. In addition, there will be efforts to continually enhance consultation to include stakeholder workshops before and/or during the actual budget preparation. We will also make efforts to provide 1-3 year fiscal projections to guide the budget. This is necessary to determine the path of total spending that is consistent with the medium and long term objectives of fiscal sustainability.

Restoring Fiscal Balance

19. In view of the limited resources at our disposal, Government's strategy must focus on our core objectives. To achieve our ambition of resuming high growth with those limited funds, the Development Budget must shrink as ongoing projects are completed, and we must select only high return projects with the remaining funds. The Recurrent Budget must ensure that essential services are delivered, while scaling back the non-essential services. The Recurrent Budget must also ensure that existing infrastructure is adequately maintained and operated.

20. The budget for 2010/11 lay the foundation for achieving a balanced budget in 2012/13. This is a good start to the required adjustment to reduce public spending as mineral revenues decline and at the same time increase the scope for more private sector participation. This also implies that we should increase the value for money of public spending. Beyond 2012/13, Government strategy is to continue to bring down expenditures, limiting the role of government in the economy to essential

services only which cannot be provided by the private sector and identifying additional revenue sources. Due to the limited options to raise additional revenue without harming private sector growth, an emphasis on adjusting expenditure downwards is necessary and unavoidable, especially in light of the current high public expenditure levels and huge budget deficits (2008/09, 2009/10, and 2010/11 financial years).

Improving Service Delivery - Doing More with Less

21. As it is inevitable to reduce public spending significantly, while at the same time addressing the major development challenges and improving service delivery, the only option is to do more with less. This is to ensure that Government continues to meet the obligations of providing basic services to the citizenry, more especially the poor and other vulnerable groups. In order to achieve this, it is critical to adopt means of achieving higher returns and more objectives using the same or fewer resources. In this regard, Ministries should clearly spell out how the methodology being adopted to implement any project or programme is the best alternative. By extension, the results from any projects/programme/initiative/sector should clearly justify the level of funding allocated for such.

22. Some of the questions that need to be answered are; how can we improve the quality of education whilst we also address the issue of access? How can we improve the provision of water in the rural areas at least effective cost? How can we ensure the health of Batswana is improved over time? Is this particular project the best way to achieve the intended results? Can we afford to use the same instruments or methodologies to get better results? If we implement this project/programme/initiative today, what do we postpone? Is there a better time to start than now? If we start these necessary reforms now, we will make the adjustment more bearable than if we wait for a few more years.

E. Implications for the 2011/12 Public Expenditure and Indicative Budget Ceilings

23. It is critical to note that maintaining the total expenditure at current levels would be unsustainable. In view of the revenue situation, the laid out strategy for the 2011/12 budget and beyond; the expenditure should focus on prioritised value adding expenses and improved means of revenue collection.

24. The 2010/11 recurrent budget estimates form the basis for working out the financial ceilings for 2011/12. Any growth in recurrent expenditure should be critical, well-thought out and justified. The development budget should as a first priority be allocated to complete ongoing projects. Where priorities have changed, it should be clearly indicated as to which other projects would be forfeited or suspended. The different sectors should identify optimisation opportunities for on-going projects; identify areas of overlap and duplication, identify linkages in planning/budgeting and implementation between Ministries and Departments in order to improve coordination. Consequently, new spending decisions will need to be financed through expenditure re-prioritisation.

F. The Budget Cycle

25. The budget cycle starts as early as July/August of each year. Key milestones in the budget preparation cycle include updating of GDP, revenue and expenditure forecasts by MFDP, and Project Review exercise led by MFDP, usually in September/October. Ministries submit their bids to MFDP before the Project Review, mainly covering how much would be required to complete ongoing projects and for the day-to-day running of Ministries and Departments, including maintenance of infrastructure. The outcome of the Project Review exercise forms the basis of the Estimates Committee meetings in October/November. After the Estimates Committee approves draft estimates, MFDP then prepares the budget estimates for Cabinet consideration and approval, usually in December. Another important

milestone is the call to all Ministries to submit issues for the Budget Speech, the preparation of which starts in November. The Budget Speech is also approved by Cabinet, usually about a week before the Minister tables the budget estimates to Parliament.

26. The preparations for the 2011/12 budget have already started with the Ministry of Finance and Development Planning revising the GDP, revenue and expenditure forecasts for the next 3 years. Currently MFDP is considering bids from Ministries in preparation for the Project Review exercise.

G. Conclusion

27. The Budget Strategy is meant to guide the budget preparation and the final decisions for the 2011/12 budget. The BSP will also be used as a basis for the pre-budget discussions with stakeholders.