REPUBLIC OF BOTSWANA

BUDGET STRATEGY PAPER

2014/15

MINISTRY OF FINANCE AND DEVELOPMENT PLANNING

November 2013

Table of Contents

INTRODUCTION

1. This Budget Strategy Paper seeks to increase consultation process by providing more information to the policy makers and public for purpose of influencing the major policy issues in the annual budget. Its task is also to strengthen fiscal transparency and accountability among policy agents to ensure long term government finances. This means that selected policy issues should go through thorough vetting and agreed process for them to make it in the annual budget. At the same time, there must be practice of fiscal discipline at both budget formulation and execution stage. This therefore call for participatory approach from implementing agencies

2. In face of global economic uncertainty, the need to create more buffer remains important to the Government of Botswana. This more reason why Government remains committed to continue with a modest surplus budget for the financial year 2015/16. That fiscal path is consistent with the need to balance the budget over medium term and to maintain macroeconomic stability over the plan period. Through this paper, we are updating the public on the fiscal developments and guide policy choices and options for inclusion in the annual budget.

3. To the extent possible, however, Government's mandate is to improve the business climate for the private sector through the annual budgeting process. Through this strategy paper, MFDP seeks to implement national priorities that are coming from a wide and thorough consultation process. It therefore remains the only available mechanism to share with the public beforehand the intents of the budget and facilitate discussions from different stakeholders for purpose of influencing the outcome of annual budget.

4. Its preparation came at point when there are two important events in Botswana. One obvious is that the country is preparing for the general election while other is that the paper will guide last annual budget of NDP 10. Similarly, government is about to start a long and tedious of formulating NDP 11.As was the case in the previous budgets, we need to continue asking ourselves to what extent have the Vision 2016 aspirations and MDG been achieved and what remains to be done as we approach target years.

5. The paper will also cover the brief review of the global and domestic economic performance and outlook, and outline Government economic and fiscal strategies. Proposed budget priorities for 2015/16 will follow thereafter in the next section before the implications of the economic outlook and budget priorities on the resource allocation in the 2015/16 budget are discussed. The last section gives the summary conclusion of the whole paper.

ECONOMIC PERFORMANCE AND OUTLOOK

6. The weak economic recovery in the global economy, especially in major economies of USA and the euro area, continues to weigh down on the domestic economy, which, in turn, has implication on the resource availability for the next budget.

Global Economic Review and Outlook

7. An assessment of the global economy by the International Monetary Fund as contained in their World Economic Outlook of July 2013 noted that global prospects remain `subdued', with world output growth forecast to remain at 3.1 percent in 2013 and reach 3.8 percent in 2014, compared to 3.1 percent in 2012. The report further notes that economic activities in the global economy have substantially slowed down, mainly as a result of weak domestic demand and lower growth in emerging market economies and a longer recession in the euro area.

8. The global economic outlook remains weak, as growth in major advanced economies was projected to be around 1.2 percent in 2013, same level as in 2012, but expected to increase slightly to 2.1 percent in 2014. In emerging markets and developing economies, growth is expected to evolve at a moderate pace to reach 5.5 percent in 2014, from 5.0 percent in 2013. Economic activities in the sub-Saharan Africa region are also forecast to remain weak, as resource-rich countries, such as Botswana, continues to face weak external demand. Overall, the continued weak global economy outlook was expected to affect many commodity exporting countries such as Botswana through lower commodity prices.

Domestic Economic Review and Outlook

9. Domestic economic performance continued to be undermined by weak recovery in the global economy. In real terms, economic growth decreased from 6.1 percent in 2011 to 4.2 percent in 2012, due to a decline in performance of the mining sector. Mining sector growth was -7.0 percent in 2012, reflecting the fall in diamond production by 4.9 percent during that year, as compared to an increase of 4.0 percent in the previous year. Despite the decline in the relative share of the mining sector to GDP from 24.7 percent in 2011 to 20.0 percent in 2011, the mining sector remains the mainstay of the economy.

10. The latest data from Statistics Botswana indicate that the economy recorded a real GDP growth rate of 7.4 percent during the second quarter of 2013 compared to 3.3 percent in same quarter of 2012, mainly due to the increase in mining sector performance by 15.6 percent. Over the same period, the non-mining sector registered a positive growth rate. Among the sectors that registered strong performance include the Social and Personal Services, Finance and Business Services, Trade, Hotels and Restaurants, and General Government, which grew by 6.2 percent, 7.7 percent, 4.9 percent and 6.8 percent, respectively. Positive growth by the non-mining sector is encouraging, as it reflects its potential to foster economic growth in line with Government's economic diversification initiatives.

11. Domestic economic outlook remains positive, with the economy projected to grow by 4.4 percent in 2013, and a further 4.9 percent in 2014, underpinned by the non-mining sector. With expected resolution of the electricity problems and provided that the Morupule B Power Plant is completed and become fully operational this year, this is expected to spur growth in non-mining sectors. Furthermore, the relocation of Diamond Trading Centre from London to Gaborone by end of the year should contribute positively to the economic prospects, despite the weak external diamond demand at global level. On the downside, the Agriculture sector, which contributes to rural livelihoods, is projected to slow down due recurring droughts.

Government Budgets

- **2012/13 Revised Budget**:

12. The preliminary budget actuals for 2012/13 points to a positive budgetary outcome, with a budget surplus as a percentage of GDP of 1.8 percent, mainly due to improved revenue performance. Total revenue and grants increased by 11 percent from P38.5 billion in 2011/12 to P42.7 billion in 2012/13 with all the two major sources, i.e. tax revenue, and non-tax revenue recording increases. A significant increase was recorded in tax revenue, reflecting large adjustment payments of over P5.8 billion from SACU. Similarly, VAT collection increased as a result of BURS's efforts to expand the tax base through strengthening tax collections. These increases helped offset the sharp slowdown in mineral revenue growth during the period. Over the same period, total expenditure and net lending grew by 5.3 percent in 2012/13, mainly due to an increase of 44.7 percent in other charges, while development budget under spent by 17 percent.

- **2013/14 Budget Estimates:**

13. Although the approved budget for 2013/14 envisages a surplus budget, this will not be achieved should revenue not over perform. In part, additional expenditure will arise from the need to finance agricultural subsidies (P223.5 million) and Botswana Power Corporation (P1.1 Billion) cash injections. Total revenue and grants are estimated to grow marginally by 2.5 percent in 2013/14, compared 11 percent in 2012/13. Marginal or no growth is expected among major revenue items during the year, with customs revenue estimated to decline by 3.9 percent. On the other hand, total expenditure and net lending is estimated at P44.9 billion in 2013/14, representing a growth of 10 percent over the previous year. Growth in total expenditure is attributed to significant increase of the Development Expenditure of 47.8 percent over the period. This will result in an overall deficit of P1.07 billion for 2013/14.

- **2014/15 Budget Forecasts:**

14. Based on the preliminary macroeconomic forecasts, the 2014/15 budget points to a positive budget, with a surplus projected. Estimates indicate that total revenue and grants will increase marginally by 2.9 percent, from P43.8 billion in 2013/14 to P46.06 billion in 2014/15, due to expected improvement in both tax and non-tax revenues, in particular non-mineral income tax and VAT. Revenue from the custom union is estimated to decline slightly from P13.8 billion in 2013/14 to P13 billion in 2014/15 based on South African Treasury Forecasts. It should be noted that projections do not assume any adjustment (over/under collections) for SACU. On the expenditure side, spending is estimated to reach P43 billion with recurrent expenditure amounting to P33.9 billion and development expenditure at P9.13 billion. The increase in the overall spending will be driven largely by Personal Emoluments due to teachers salaries adjustment as well as annual incremental creep.

Public Debt Situation

15. For the financial year 2012/13, the total outstanding debt stock amounted to P20.7 billion compared to P21.3 billion recorded in 2011/12. The reduction has been realised on internal debt which stood at P6.36 billion in the revised 2012/13 estimates compared to the P7.5 billion in 2011/12. External debt increased slightly to P15.5 billion in the revised figures compared to P14.2 billion in 2011/12. The increase in external debt was mainly driven by the drawing down of bilateral and multilateral loans to finance infrastructure projects.

16. Total debt is estimated to slightly increase to P20.8 billion (which is 19 percent of GDP) in 2013/14, with external debt increasing slightly to P14.5 billion while domestic debt decreases to P6.4 billion. It is a plausible fact that statutory debt limit to 40 percent of GDP, allocated at 20 percent of GDP equally between domestic and external debt has helped the country to keep debt at manageable level. However, current events where Botswana finds it necessary to borrow, requires that the country builds capacity to adequately assess and monitor debt levels to ensure sustainability now and in the near future. One way of doing it is to take advantage of the annual debt sustainability analysis, undertaken by the International Monetary Fund by taking an active part in such an activity.

Monetary Policy and Inflation

17. The average national inflation rate decreased from 8.5 percent in 2011 to 7.5 percent in 2012. In the first quarter of 2013, inflation remained constant at 7.5 percent, but declined to reach 5 percent in September 2013, which is within the Bank of Botswana (BoB) objective range of 3 – 6 percent. The decline in inflation in 2012 can be attributed mainly to the easing of international oil and food prices as reflected in the 2013 World Bank's commodity price data report, particularly Beverages and most Food items. Despite bringing inflation down within the Bank's inflation objective range in June 2013, containing inflation have over the years remained a challenge due to risks outside the Bank's control such as administered prices, government levies and imported inflation.

18. This year, Bank of Botswana has taken a more accommodative move, reducing the bank rate from 9.5 percent implemented since December 2010 to 9.0 percent in April 2013 and further to 8.0 percent in August 2013. This reduction is expected to stimulate borrowing (especially mortgages), and private sector investment necessary to enhance economic growth.

Balance of Payments and Foreign Reserves

19. Estimates of the overall balance of payments for 2012 show a deficit of P862 million following a substantial surplus of P3.43 billion in 2011. The balance on merchandise trade recorded a deficit of P14.7 billion in 2012, up from the revised deficit of P5.1 billion in 2011.Total exports increased by 4.1 percent from P44.0 billion in 2011 to P45.8 billion in 2012, compared to an increase of 23 percent in imports from P49.0 billion 2011 to P60.1 billion in 2012. The decline in exports of diamonds by 15.1 percent, from P33.7 billion to P28.6 billion as a result of lower volumes and falling prices negatively affected total exports, leading to a deterioration of the current account. The current account balance recorded an overall deficit of P5.15 billion in 2012 from a modest deficit of P0.38 billion recorded in 2011.

20. Total exports in the first six months of 2013 were valued at P31.4 billion, indicating a significant improvement compared to P20.1 billion recorded in the same months in 2012. Imports on the other hand were valued at P34 billion over the same months indicating a 29.7 percent growth when compared to P26.2 billion in the same months in 2012. During these months, the economy recorded a trade deficit of P2.59 billion.

21. As at December 2012, foreign reserves stood at P59.3 billion (equivalent to 13 months of import cover), a decrease of 1.7 percent from P60.3 billion recorded in December 2011. The total value of Government's share (Government Investment Account) from the total fund was P18.4 billion in 2012 down from P22.1 billion in 2011. Latest data shows that foreign reserves increased by 16.4 percent to reach P69 billion in July 2013 of which Government Investment Account was P27.1 billion.

Exchange Rate Movements

22. The rate of the crawl continues to be based on the differential between Bank of Botswana's inflation objective and inflation of trading partner countries. In real terms the Pula strengthened by 8.7 percent and 12.9 percent against the rand and Japanese yen, respectively, but weakened against other Special Drawing Rights countries, in the 12 months to July 2013.The Pula depreciated by 16.5 percent against the euro, 9.8 percent against the US dollar and 6.8 percent against the British pound. In 2012 significant changes were made in the Pula basket of currencies, with the rate of the crawl revised downwards, and the weight of the rand in the basket reduced while those of the US dollar and other SDR currencies were increased.

GOVERNMENT ECONOMIC AND FISCAL STRATEGIES

23. Government, through successive major policy documents such as the national development plans and budget speeches, has clearly articulated its economic and fiscal strategies. The main objective of these strategies is to promote the development of the private sector by creating an enabling business environment. Hence, the preparation of the current Budget Strategy Paper was guided by the same strategies.

Economic Strategy

24. To promote the development of private sector activities, Government will continue to pursue its economic strategy, whose main elements include maintaining macroeconomic stability; investing in high return projects; and undertaking structural reforms aimed at promoting efficiency in different sectors of the economy.

25. The element of maintaining macroeconomic stability requires coordination of fiscal and monetary policies, striving for appropriate policy mix, and maintaining policy consistency, which are all essential for creating predictable environment for private sector operators to make decisions on investments. Equally important to the promotion of private sector development is the availability and supply of reliable water, power, transport, and communications. To this end, Government will continue to pursue a strategic approach to investment in these sectors, focusing on high return projects, with a view to supporting growth in the economy.

26. Improving productivity and the country's competitiveness remains an important objective, as the country strives to attract foreign direct investment and support the development of the private sector. To achieve this objective, Government will continue to undertake public sector reforms, with a view to remove structural bottlenecks by updating legal frameworks and promote efficiency across the economy.

However, going forward, such reforms will have to be extended beyond the public sector to cover other equally important areas such as the financial, and labour markets.

Fiscal Strategy

27. Achieving fiscal sustainability in the medium to long term remains one of Government's objectives to create a conducive environment for private sector development in the country. To achieve this, Government will continue to implement the fiscal strategy focusing on two areas (i) enhancing the revenue base, and (ii) restraining overall expenditure and focusing attention on quality investment portfolios.

Expanding the Revenue Base

28. Total revenues as a percentage of GDP averaged 38 percent in 2012/13 and 36 percent in 2013/14. Given the uncertainties in the global environment and envisaged declining mining and SACU revenues, which together are currently accounting for over 50 percent of total revenue and grants, it is imperative that the upcoming budgets look at alternative ways of expanding the country's revenue base. To this end, Government will continue to strengthen the capacity of BURS to assess and collect tax from all eligible taxpayers. Furthermore, the tax system will be streamlined to eliminate opportunities for tax avoidance such as tax expenditures. Specific measures in this regard will be considered as part of the 2014/15 budget speech. In addition, service providers especially Local Authorities and others have to explore and broaden other revenue collection measures including intensifying implementation of the cost recovery policy.

Managing Expenditure for Results

29. Achieving fiscal sustainability will also require judicious expenditure management. In this regard, Government's strategy is to maintain a balanced budget in the medium term by keeping total government spending as a share of GDP below 30 percent. Adopting this policy stance means that growth of both recurrent and development spending budget should substantially be reduced. On the recurrent budget, this can only be done through cutting back on wastage. For example, damaging traffic and street lights, power and telecommunication copper cable theft, poaching of wild animals and burning veldts are constraining government efforts to increase government expenditure for new investments and expanding economic development. It is also necessary that Government should use its mineral revenue mainly for investment purpose, rather than financing recurrent operations.

30. Similarly, there is need to improve further on implementation of development programmes and projects. Emphasis should be put on efficiency and effectiveness of development initiatives with the public clearly seeing results as opposed to seeking for more explanations and accountability on the use of the limited public resources. Other measures worth addressing are to fast track privatising and merging of earmarked public enterprises as well as outsourcing duties which can better be performed by the private sector. Government should then regulate and facilitate a conducive environment where competition and productivity are main impetus of business operations and survival.

PROPOSED BUDGET PRIORITIES FOR 2014/15

31. The 2014/15 budget priorities will depend on the revenue outlook as determined by the global and domestic economic situation. Allocation of expected revenues between recurrent and development budgets will continue to be guided by the normal budgeting principle, where the recurrent budget has the first call on available resources. On the recurrent side, issues of right sizing the civil service, outsourcing non-core activities, and merging and privatisation of some parastatals will be intensified.

32. To this end, the proposed budget priorities for 2014/15 focus more on the development budget and aim to address some of the challenges identified in the MTR of NDP 10, as well as to address some of the country's long term goals as contained in Vision 2016 and other policy documents. Specifically, Government will focus on the following priorities in 2014/15: i) completion of on-going projects and maintenance of existing infrastructure; ii) accelerating poverty eradication programme; iii) investing in projects that promote economic growth and iv) improving public service delivery. Implementation capacity and monitoring and evaluation will thus be key in the prioritisation process.

Completing of On-going Projects and Maintenance of Existing Infrastructure

33. Due to the financial constraints, Government will give priority to completion of on-going projects, adequate maintenance of existing infrastructure, and investment in a few new projects which are deemed critical in unlocking development initiatives and promoting economic growth. Such projects should go through a rigorous cost benefit analysis to ascertain their true value to economic development. This approach sets a tradeoff between unlocking of new investment projects with high potential for driving economic growth such as, roads, rail, energy, telecommunications and water supply and upgrading of existing investment projects. The alternatives for Government resonate on achieving high economic growth through increased productivity and competitiveness.

Accelerating Poverty Eradication Programme

34. Efforts to eradicate abject poverty will continue, with the intensification of monitoring and evaluation to achieve desired results. In this regard, Government will continue to provide resources for social welfare programmes such as destitution allowances, school feeding programmes and other programmes aimed at the vulnerable groups of society. In addition, the Ipelegeng program will continue as it provides a temporary relief to the unemployed. Similarly, the recent streamlining of the Integrated Support Programme for Arable Agriculture (ISPAAD) is an effort to improve on the efficacy of some poverty eradication programmes. The level of support under the ISPAAD has been streamlined and improved significantly. Under the new guidelines, for example, subsistence farmers are going to enjoy 100 percent subsidies on fertilizers, soil testing hybrid seeds and herbicides, provided they adopt modern ploughing methods (row planting and harrowing). Furthermore, some form of assistance has been extended to emerging and large scale commercial farmers who are expected to benefit in the coming ploughing seasons.

35. However, despite Government's commitment to the goal of poverty eradication, it is important that poverty eradication programmes be scrutinized with a view to reducing dependency syndrome. Furthermore, Government remains concerned about the long term sustainability of funding of social programmes. Therefore, in addition to graduating people from poverty eradicating programmes, Government will be working with other stakeholders to mobilize resources to fund these programs. Already, the private sector and individual citizens have shown their willingness to assist those less fortunate by responding positively to the President's Housing Appeal. This is an indication of the willingness by various stakeholders to assist Government in tackling some of the developmental challenges facing the country. To this end, Government will continue to explore meaningful ways of engaging other stakeholders in an effort to eradicate abject poverty in the country.

Improved public service delivery

36. Given the significant role of the public sector in the economy, improved public service will continue to be a priority for Government. In this regard, Government, through the Directorate of Public Service Management has taken a bold step towards reforming its institutional operations by introducing the use of e-service. In the next two financial years, the use of e-Government and online applications for permits and licenses will have to be increased for enhancing public service delivery as well as increase accessibility of public information to the majority of citizens. It is therefore important for Ministries and Departments to take a comprehensive review of their current services with a view to provide some of them online. This programme when fully implemented should essentially lead to cost saving for government, investors and the consumers of these services; as well as increased productivity and enhanced quality management of both human and capital resources.

RESOURCE ALLOCATION FOR 2014/15

37. The macroeconomic projections are showing that Mineral Revenue, Non Mineral Income Tax, Customs and Excise revenue and Value Added Tax (VAT) are likely to increase for the financial year 2014/15. Mineral revenue is assumed to grow in line with forecast mining GDP which is projected to grow by 8.7 percent. The Non Mineral Income Tax is assumed to grow in line with forecasts of non-mineral GDP while VAT applies forecast of Non-Mineral Non-Manufacturing GDP growth rate.

38. For the financial year 2014/15, the targeted budget surplus as agreed by Cabinet on 7th December, 2012 was P2, 749 million. However, the surplus is now estimated at P2, 079 million, mainly due to the need to finance additional requirements and priority areas. Assuming that the Development Budget ceiling of P9, 129 million is fully spent, that allows a total recurrent budget ceiling of P33, 179 million for FY2014/15. On the contrary, if the development spending continues to be about 15 percent less than budgeted, as observed in the previous financial years, the surplus is likely to be up this coming financial year. Overall the budget for 2014/15 will be driven by the Government economic and fiscal strategies, budget priorities and the indicative budget ceilings for financial year 2014/15.

SUMMARY CONCLUSIONS

39. With only two (2) years remaining before concluding of NDP 10 implementation, the core policy option going forward is to optimise public resources allocation by ensuring that funds are only provided for implementing national priorities. Against this background, the remaining non-core activities should be outsourced to the private sector. Government effort should therefore be directed towards addressing shortcomings currently inhibiting growth of private sector investment and local industry development. Necessarily, continuation of maintaining macroeconomic stability environment through exercising government expenditure restraints and supportive monetary and exchange rate policies remain critical conditions to engineer entrepreneurship spirit in the economy. However, a balance must be made between choosing economic development initiatives and sustaining social programmes so as to retain economic growth as well as social stability and coherence.