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econsult ECONOMIC REVIEW

first quarter january - march 2014

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COMMENTARY

GDP growth increases in 2013, but non-mining growth falls sharply

The first quarter of the year is always an eventful one with regard to economic data, with the Budget in early February and the release of full-year GDP data for the previous year in March. In both cases, Q1 of the 2014 results was positive. GDP data for 2013 showed that overall economic growth came in at 5.9%, well ahead of earlier forecasts, which were closer to 5%. This was largely driven by the out performance of the diamond-mining sector, where production rose to 23.1million carats, up 12.2% on the previous year. However, of more relevance to most people is probably the sharp slowdown in the growth rate of the non-mining private sector, which fell to 4.7% in 2013 from 8.1% in the previous year.

The fiscal revenue and expenditure figures presented in the 2014 Budget were also quite positive, showing a broadly balanced budget expectation in the 2013/2014 financial year. For the 2014/15 year that has just started, a small budget surplus – in the region of 1% of GDP – is projected, although this will probably disappear with the inclusion of the impact of a public sector pay increase. New information has also been published along with the budget, in the form of the government's Net Financial Asset position (included in the "Budget in Brief") – the first balance sheet measure to be made available. As we had highlighted in an earlier issue of this Review, the government's net financial position (assets less debt) has deteriorated significantly in recent years.

While this new data is welcome, in other respects the quality of budget data is questionable. Estimates of revenue for 2013/14 were not updated between the 2013 and 2014 Budgets, apparently due to problems in the Government Accounting and Budgeting System, which casts a doubt in the reliability of the overall 2013/14 budget figures. There are also some odd classifications: poverty relief spending on Ipelegeng and subventions to loss-making parastatals are both classed as development spending, but neither meet the economic definition of investment that the development spending classification is meant to represent. The result is that the economic development spending is overstated in the budget. And as we discuss later in this report, the increasingly widespread use of levies and special funds means that there is an increasing amount of off-budget revenue and spending, which lacks transparency and accountability.

There were also positive developments on the foreign trade front. A surplus was reported on the balance of trade (exports less imports) in 2013, for the first time since 2007. This was mainly driven by increased exports, with sharp increases in exports of meat, copper-nickel, and rough and polished diamonds, which more than compensated for the poor performance of exports of textiles and vehicle parts.

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COMMENTARY

One of the major developments of the quarter was the announcement that the Governments of Botswana and Namibia had signed an agreement regarding the development of the Trans-Kalahari Railway (TKR). The plan is that the TKR will run from the Mmamabula coalfields in eastern Botswana, across the Kalahari into Namibia, through to a new port development at Walvis Bay, and would be primarily (or even exclusively) intended for the export of coal from Botswana. The signing of the inter-government agreement has generated a great deal of enthusiasm, not least amongst the holders of coal prospecting licences, on the basis that this is the key to unlocking the potential of Botswana's very large coal deposits.

Certainly the TKR, if it is ever built, would transform Botswana's coal prospects. However it is not entirely clear exactly what the two governments have decided, as – somewhat oddly - neither Botswana nor Namibia is willing to make the text of the agreement public. Nevertheless, it seems that some basic principles have been agreed. The two governments will establish a joint project office; will finance a detailed feasibility study of the project to finalise costs and route alignment; and the TKR concession will be offered to the private sector on a Design-Build-Own-Operate-Transfer basis.

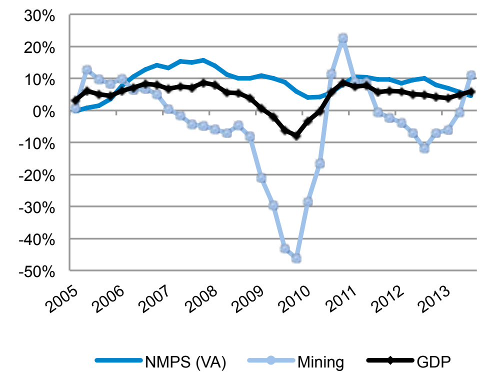
However, at this stage it is far from a certainty that the TKR will be built. Much depends on the results of the feasibility study, and this in turn depends on the long-term prospects for global trade in seaborne steam coal, and the use of coal for electricity generation in India and China. Furthermore, the project is very large – with a capital cost in the region of US$12-15 billion – and very marginal in economic and financial terms.

It will only proceed if the private sector is convinced enough of its viability to finance it – its size means it is beyond the capacity of the two governments to finance alone, even if they wanted to – and getting large coal projects financed in an environment of rising concern about global warming and carbon dioxide emissions from fossil fuels is increasingly difficult. In the meantime, South Africa is proposing to extend its heavy haul coal rail network through to Botswana, and this may offer a lower cost, more feasible, incremental solution to develop Botswana's coal exports.

Looking forward to the rest of 2014, we see overall GDP growth coming in at around 5%, slightly lower than in 2013 as the recovery in diamond production is expected to slow down. Furthermore, the problems resulting from water and electricity shortages early in 2014 will undoubtedly have a negative impact on growth. This impact is likely to be felt not just in the short term, but in the longer-term as it undermines confidence in the ability of the country to provide essential economic infrastructure and services to investors.

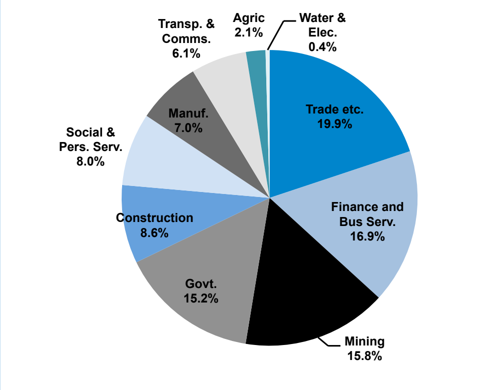
KEY ECONOMIC VARIABLES

Annual GDP Growth



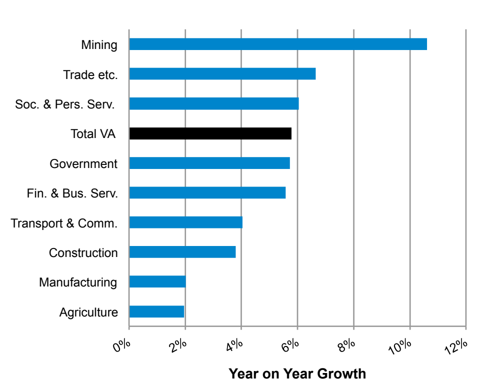
The recovery of the mining sector has boosted the economy to reach a 5.9% growth rate during 2013, an increase from the 4.3% growth realised during 2012. However, the non-mining private sector (NMPS) growth slowed down from a rate of 8.1% in 2012 to only 4.7% in 2013.

GDP (VA) Shares, 2013



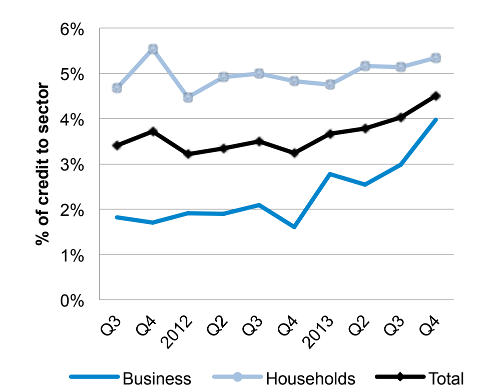
Despite the mining sector's rapid growth during 2013, it is only the third largest economic sector (after trade & tourism and finance & business services), when measured in constant prices. However, mining remains the largest sector in current prices; providing 24.5% of output (value added). Agriculture and water & electricity remain the smallest sectors of the economy, despite the continued efforts to boost them.

Sectoral Growth



Mining was the fastest growing economic sector during 2013, ahead of trade, social & personal services and government. However, most sectors (excluding mining, government and trade) experienced slower growth in 2013 than in 2012. The finance and business services, social and personal services and construction sectors grew by 5.6%, 6.0% and 3.8%, respectively, during 2013 compared to 11.0%, 12.2% and 14.4% in 2012. The water and electricity sector, excluded from the chart, continued to provide negative value added. This is attributable to the high cost of producing electricity through diesel power.

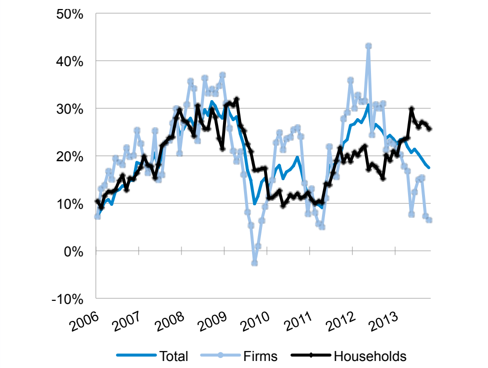
Arrears on Bank Lending



Total arrears on bank lending, as a percentage of credit outstanding, increased from 4.0% in Q3 2013 to 4.5% in Q4 2013. The biggest increase was in arrears on lending to firms, which rose from 3.0% to 4.0% between the two quarters, while arrears on lending to households increased marginally from 5.1% 5.3%.

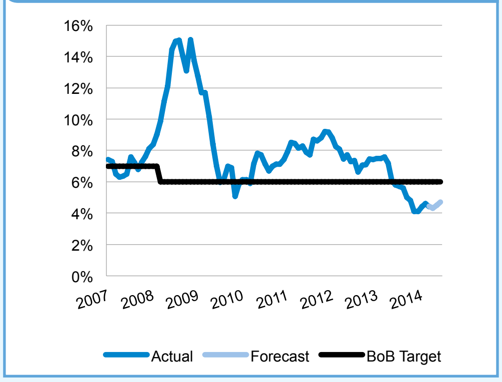
KEY ECONOMIC VARIABLES

Annual Credit Growth



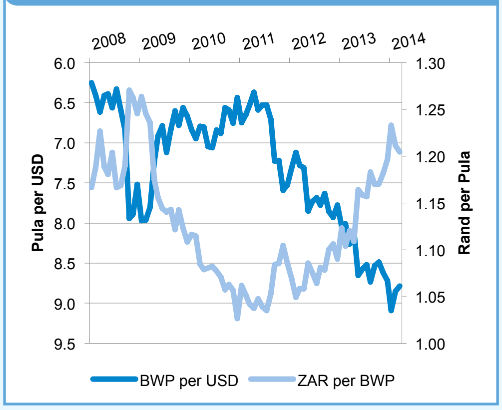
Perhaps reflecting the banks' efforts to secure their loan books, annual bank credit growth stood at 15.4% in January 2014, down from 22.5% and 18.2% in January 2013 and September 2013, respectively. However, annual growth rate of credit to households remained relatively high at 23.8% in January. Conversely, growth of credit to firms fell sharply from 21.4% in January 2013 to 3.9% in January 2014.

Inflation & Forecast



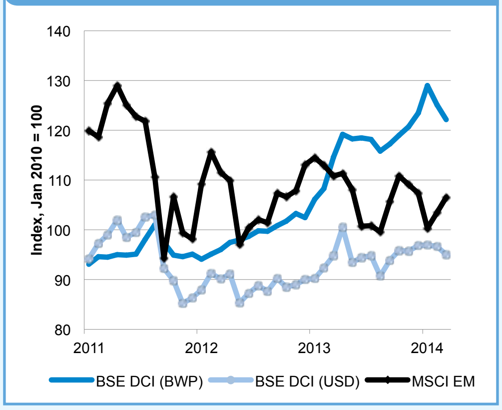
The alcoholic beverages, tobacco and narcotics group index has dragged inflation up during Q1 2014. This is due to the increase in the alcohol levy, in late December, and the introduction of a tobacco-specific "sin tax". Consequently, headline annual inflation slightly increased from 4.1% at the end Q4 2014 to 4.4% in March. We expect inflation to continue to rise in the short term, settling around 5.0% in the second half of 2014.

Exchange Rates



Owing to South Africa's chronic balance of payments deficit, as well as risk aversion towards emerging markets, the South African Rand (ZAR) remained weak against the US dollar (USD) during Q1 2014. As such the Pula has appreciated by 0.7% against the South African Rand (ZAR) while depreciating by 0.8% against the US dollar (USD) during the quarter.

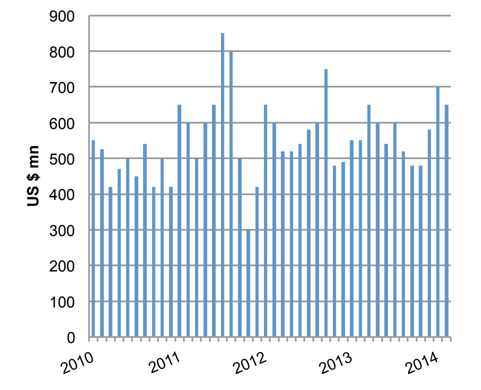
Stock Markets



The first quarter of 2014 saw the BSE DCI losing in both USD and Pula terms, by 1.9% and 1.1%, respectively. The DCI was dragged down by the bad performance of the banks, particularly Barclays and FNB, which lost 30% and 7%, respectively. Consequently, the BSE DCI was outperformed by its peers as the MSCI EM Index (which is reported in USD terms) lost 0.8% during the quarter.

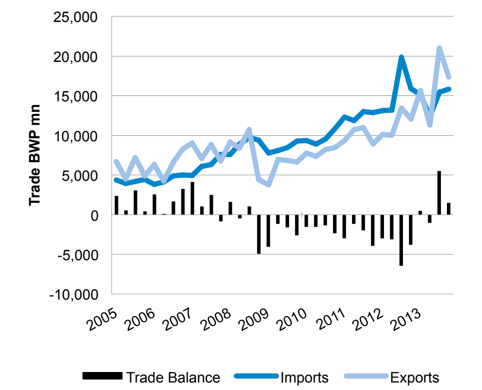
KEY ECONOMIC VARIABLES

DTC Sales



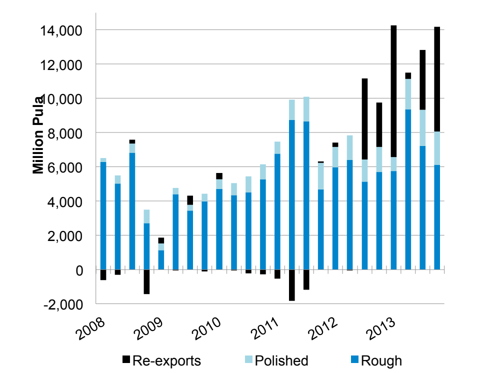
During the first quarter, there were two diamond sights, in January and February, valued at an estimated total of USD1350mn, an improvement from the USD1100mn in the first quarter of 2013. It is estimated that prices of rough diamonds increased by an average of 5% and 2.5% for the January and February sights, respectively. This indicates that the market for rough diamonds continues to recover.

Trade



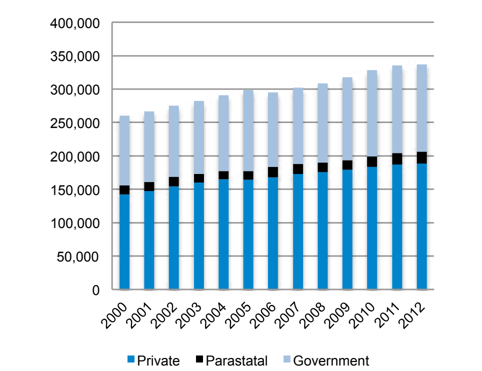
The international trade position somewhat deteriorated between Q3 and Q4 2013, as the trade surplus decreased from P5.5bn to P1.5bn. However, during 2013 as a whole Botswana experienced a trade surplus of P6.5bn - the first annual trade surplus since 2007.

Diamond Exports



Diamond exports grew from P12.8bn in Q3 2014 to P14.2bn in Q4 2013. This is largely attributable to the 75.5% increase in re-exports between the two quarters, as exports of both Botswana-sourced rough and polished diamonds fell. During 2013, the total value of diamond exports stood at P52.8bn, a 46.0% increase from the P36.1bn worth of diamond exports in 2012.

Formal Employment



Data on formal sector employment for 2012 has finally been released. The results are disappointing, with the rate of job creation having slowed to a crawl. Between June 2011 and September 2012, the total number of formal sector jobs increased by only 1,889, or 0.6%. Private sector job creation was particularly disappointing, with only 563 new jobs over this 15 month period. This may reflect the impact of tightened immigration regulations, which caused some foreign-owned firms to close down.

Sources: Statistics Botswana, Bank of Botswana, Rappaport Diamond Report, MCSI, Econsult

NEWS HIGHLIGHTS

7th January	Sefalana spreads wings into Namibian Market (Mmegi)	In line with its regionally focused growth strategy, Sefalana Holdings is set to expand into the Namibian market by acquiring 12 stores.
8th January	African Copper slides to a P35mn loss (Mmegi)	African Copper made a loss of US$4.1mn (P35mn) in the half year ended September 2013. This is an improvement from a US$9.0mn loss incurred in the corresponding period in 2012.
9th January	Energy boost for Botswana (Botswana Gazette)	Botswana Power Corporation and APR Energy have extended their existing contract for a 70 megawatt diesel power module for a further 12 months
10th January	BPC expects demand to peak at 680MW (Mmegi)	The country's electricity demand is expected to peak at 680MW in the winter of this year, from a high of 600MW recorded last year.
14th January	Discovery cuts 85 jobs at Botswana copper mine (Mining Weekly)	Discovery Metals announced a restructuring of its Boseto copper project, which would result in the lay-off of some 15% (85) of the 516 strong workforce.
15th January	Zambezi Agro-Commercial project starts to take shape (Mmegi)	The government has identified a consultant to conduct a feasibility study for the proposed multi-billion pula Zambezi Integrated Agro-Commercial Development Project.
15th January	Karowe Mine to generate P1.4bn in 2014 (Mmegi)	Owing to the expected sales of exceptional diamonds from the Karowe Mine, Lucara Diamonds has forecast revenue of up to US$160mn (P1.4bn) from the sale of 400,000 to 420,000 carats in 2014.
16th January	Boseto production recovers q-on-q (Mining Weekly)	Discovery Metals reported a 5% quarter-on-quarter increase in concentrate production at its Boseto copper mine during the quarter ended December 2013.
20th January	BITC surpasses FDI target (Mmegi)	During its first year of operation, the Botswana Investment and Trade Centre (BITC) is reported to have attracted P698.97mn in Foreign Direct Investment, exceeding its target of P600mn by 16.4 percent.
24th January	Commercial banks to use study against tariff moratorium (Mmegi)	The Bankers' Association of Botswana is set to use the results of a soon-to-start comparative study on bank charges to challenge the 2 year moratorium on tariffs imposed by Bank of Botswana.
26th January	BoFiNet signs multimillion contract with BTCL (Sunday Standard)	Botswana Fibre Network (BoFiNet) has signed a 5 year deal, valued over P300mn, to provide Botswana Telecommunications Corporation Limited (BTCL) with internet capacity to London and other destinations through the West Africa Cable System (WACS) and East Africa Sea System (EASSY).
26th January	BPOPF new strategy targets P100 bn asset base in three years (Sunday Standard)	The Botswana Public Officer's Pension Fund (BPOPF) launched a 3 year investment strategy with a focus on expanding its asset base to P100bn.

NEWS HIGHLIGHTS

29th January	Micro-lenders battle with compliance (Mmegi)	Micro-lenders are facing difficulties complying with new industry regulations. The Non-Bank Financial Institutions Regulatory Authority (NBFIRA), stated that as of the 7th January 2014, only 52 micro-lenders have been licensed out of 214 applications received.
29th January 2nd February	Retail expansion anchors Sefalana profit growth (Mmegi)	Continued expansion of its retail store network and widening of its product range has contributed to further revenue and profit growth for Sefalana Holding. In its unaudited financial results for the six months ended October 31, 2013, the group's revenue was up two percent to P1.18bn, while its profit before tax rose 46% to P63.6mn.
6th February	BITC roots for resuscitation of manufacturing sector (Sunday Standard)	The Botswana Investment and Trade Centre (BITC) stated that there is need for a revival of and a heavy reinvestment by the private sector in the country's manufacturing sector.
12th February	Morupule B shut down (Mmegi)	Power consumers experienced waves of sporadic electricity outages after the Morupule B power plant was completely shut down. The power station developed faults on the two operational units, forcing BPC to solely rely on supply from imports and the two peaking power diesel plants.
12th February	BOCRA to audit billing platform (Mmegi)	The Ministry of Transport and Communications has stated that an audit will be conducted in all telecommunications operators' billing platforms during this year, to ensure that charging is done as per the approved tariffs.
16th February	Barclays targets turnaround after tough year (Mmegi)	Barclays Bank of Botswana plans to redouble its efforts to shift its retail portfolio into secured assets, grow corporate and business loans and limit wholesale deposits,as part of a strategy to turn the bank's fortunes around.
23th February	Choppies mulls secondary listing on JSE (Sunday Standard)	The Choppies Group confirmed that it is working on a secondary listing on the Johannesburg Stock Exchange (JSE). The secondary listing is likely to have liquidity benefits and enable Choppies to raise capital for expansion.
24th February	Trade Ministry introduces performance-based subsidy for textile sector (Sunday Standard)	The Ministry of Trade and Industry has introduced a performance based incentive programme as an employment subsidy for the textile and clothing sector.
26th February	Kimberley concludes Mantle acquisition, moves to reopen Botswana mine (Mining Weekly)	After its 100% acquisition of Mantle Diamonds, Kimberley Diamonds plans to bring the Lerala diamond mine back into production later this year.
26th February	Sightholders 'Pleasantly Surprised' by Smooth Transition to Botswana (IDEX Online News)	Neo Moroka, De Beers' Resident Director in Gaborone, said that De Beers Sightholders have been "pleasantly surprised" by the smooth transition of Sights to Botswana.
2nd March	FNBB banks on innovation to counter moratorium (Mmegi)	First National Bank of Botswana (FNBB) is to look to innovation to counter the impact of the moratorium that was imposed by Bank of Botswana on fee increases. Announcing their results in Gaborone FNBB CEO, Lorato Boakgomo-Ntakhwana, said FNBB has a diversified portfolio, and they would be more innovative in their non-interest income portfolio to cushion the impact of the moratorium.

NEWS HIGHLIGHTS

2nd March	Consumer demand to decelerate in 2014 – RMB research (Sunday Standard)	The latest edition of Rand Merchant Bank (RMB)'s Global Markets Research report for Sub-Saharan Africa, which covers macroeconomic developments and implications for Botswana, expects consumer demand to decelerate this year. RMB projects that the slowdown will be driven primarily by the tightening of credit standards.
3rd March	African Energy shortlisted to bid for Botswana 300 MW Greenfield project (Sunday Standard)	African Energy, the coal exploration company, indicated that it is among the companies short listed to submit bids for Botswana's 300MW greenfield energy project.
6th March	Textile sector hinges on new blueprint (Mmegi)	Manufacturers in the country's troubled textile sector are pinning their hopes on legislative approval of a raft of incentives, including tax holidays and statutory procurement quotas, contained in a new blueprint.
7th March	Regional body annoyed by the tobacco levy (Mmegi)	The 30% tobacco levy imposed by the Botswana government on February 14 has stirred some discontent at the Tobacco Institute of Southern Africa (TISA). The levy is criticised for imposing a larger burden on importers than local manufacturers, which is said to be in contravention of the SACU agreement.
10th March	Botswana, Namibia lead Africa in Mining Attractiveness Survey (Rapaport)	Botswana is ranked 25th in the world and 1st in Africa on the Fraser Institute's Policy Perception Index (PPI) for mining. The Fraser Institute compiled data to rank 112 jurisdictions, based on policy attractiveness, government uncertainty, environmental regulations, legal system, taxation, infrastructure, trade barriers, labour, geological databases and security to establish the PPI.
11th March	More citizen retail investors on BSE than non-citizens (Sunday Standard)	The Deputy CEO of the Botswana Stock Exchange, Thapelo Tsheole, indicated that the retail participation of citizens on the local bourse was at 8.7% of total value of trading while that of foreigners was only 2.2% of total trading in 2013.
12th March	Bears hit banking shares on BSE (Mmegi)	Share prices of the country's three largest banks continued to fall as investors anticipate their profitability to deteriorate in 2014. This is informed by the prevailing low interest rates and the recently announced 2 year moratorium on commercial banks' charges.
14th March	Power tariffs to go up next month (Mmegi) Low power tariffs deter investment (Mmegi)	The Minister of Minerals, Energy and Water Resources, Kitso Mokaila, announced that electricity tariffs will be adjusted upwards by 10% in April. The Southern African Power Pool (SAPP)stated that sub-cost utility tariff levels in the region are not favourable for new project development.
18th March	Gem Diamond's $96m Botswana mine on track for H2 production (Mining Weekly)	Gem Diamonds is gearing up for commercial production from its Ghaghoo mine. The mine is on track for commercial production during the second half of 2014.
19th March	Third ETF set for BSE debut (Mmegi)	The Botswana Stock Exchange is expected to soon consider a listing application from Absa Capital for the launch of a Platinum Exchange Traded Fund (ETF) that will give local investors the opportunity to invest indirectly in physical platinum.

NEWS HIGHLIGHTS

19th March	Discovery brings new partner into Botswana nickel project (Mining Weekly)	Discovery Metals signed a new joint venture (JV) deal over its Dikoloti nickel project with Japan Oil, Gas and Metals National Corporation (Jogmec). The JV also allows Botswana's BCL Limited to earn a 51% stake in the project.
20th March	Trans-Kalahari Railway Line agreement signed and sealed (Namib Times)	The bilateral agreement between Namibia and Botswana for the construction of the Trans-Kalahari Railway (TKR) Project was signed on the 20th of March in Namibia. The proposed TKR will link Botswana's Mmamabula coalfields with Walvis Bay Port in Namibia. The estimated capital expenditure for the project amounts to approximately N$100 billion and the construction work is expected to stretch over the 2014-2019 period. The process of obtaining financing from the private sector in order to secure the development has already commenced.
21st March	BMC revives Zimbabwe cattle export deal (Mmegi)	The live cattle export deal between Zimbabwe's Cold Storage Company (CSC) and BMC is expected to resume soon.
21st March	Households change consumption patterns (Mmegi)	Botswana's largest retailer, Choppies, says it has observed a shift in households' consumption patterns due to the prevailing pressure on personal incomes with consumers cutting down on spending, particularly luxurious commodities.
24th March	Shumba Coal's secondary listing in Mauritius Stock exchange approved (Sunday Standard)	Shumba Coal confirmed that the Stock Exchange of Mauritius has granted approval for its secondary listing.
24th March	Aussie junior upbeat about coal prospects as Trans-Kalahari rail deal is signed (Mining Weekly)	The share price of coal junior Walkabout Resources spiked by 12.5% following the signing of the Trans-Kalahari railway line bilateral development agreement, between the governments of Botswana and Namibia.
26th March	Botswana Diamonds completes initial Orapa fieldwork (Mining Weekly)	Botswana Diamonds and its joint venture partner Alrosa have completed the initial planned field works for their 2.9 km^2 PL117 licence area in Orapa, Botswana.
28th March	Power tariffs to nearly double by 2018 (Mmegi)	The price of electricity is expected to rise by at least 87 percent by 2018/19, should government adhere to the Botswana Power Corporation's blueprint for cost-reflective tariffs.

MACROECONOMIC DATA

Key Economic Data

	unit	2011	2012	2013	2013 Q2	2013 Q3	2013 Q4	2014 Q1
Annual Economic Growth								
GDP	%	*6.2*	*4.3*	5.9	4.9	5.9	5.9	..
Mining	%	-2.3	-7.0	10.6	*-0.5*	11.0	10.6	..
Non-mining private sector	%	*9.8*	*8.1*	4.7	*5.8*	*4.7*	4.7	..
GDP current prices	P mn	104,573	*110,763*	124,223	*32,531*	*31,688*	31,678	..
GDP 2006 prices	P mn	*70,663*	*73,671*	78,016	*19,408*	*19,470*	20,167	..
Money & Prices								
Inflation	%	9.2	7.4	4.1	5.8	5.0	4.1	4.4
Prime lending rate	%	11.0	11.0	9.0	10.0	9.5	9.0	9.0
BoBC 14-day	%	4.5	4.6	3.1	3.5	3.2	3.1	3.1
Trade & Balance of Payments								
Exports - total goods	P mn	*39,992*	*45,599*	65,250	*11,319*	20,981	17,312	..
Exports - diamonds	P mn	*30,248*	*36,143*	52,768	*11,498*	*12,825*	14,170	..
Imports - total goods	P mn	*49,978*	*61,968*	58,758	*12,332*	*15,467*	15,809	..
Balance of visible trade	P mn	*-9,987*	*-16,369*	6,493	*-1,013*	*5,514*	1,502	..
Balance of payments	P mn	3,430	-862	..	*2,772*	114	..	..
Foreign Exchange								
Exchange rate BWP per USD	end	7.524	7.776	8.718	8.576	8.532	8.718	8.787
Exchange rate ZAR per BWP	end	1.086	1.090	1.196	1.159	1.170	1.196	1.204
FX reserves	$ mn	8,082	7,628	..	7,647	7,842	..	..
FX reserves	P mn	60,271	59,317	..	65,362	67,024	..	..
Financial Sector								
Deposits in banks	P mn	43,505	47,216	48,512	48,941	48,458	48,512	..
Bank credit	P mn	27,968	34,555	39,763	37,409	38,544	39,763	..
BSE index		6,970.9	7,510.2	9,053.4	8,688.5	8594.9	9053.4	8955.9
Business Indicators								
Diamond production *(a)*	'000 cts	*22,903*	20,619	23,134	*6,462*	5,541	6,475	..
Copper production	tonnes	22,319	26,736	41,753	11,776	10,999	9,760	..
Nickel production	tonnes	15,675	17,942	22,848	6,358	6,000	5,287	..
Business confidence index		54%	47%	45%	..	45%	..	..
No. of companies formed		11,788	16,561	14,190	2,773	4,071	3,942	..
Crude oil (Brent)	$/bar	108.09	110.80	109.95	102.49	109.45	109.95	105.95
Employment (formal)								
Government		130,196	131,033	..	..	..	..	..
Parastatals		16,992	17,484	..	..	..	..	..
Private sector		187,986	188,531	..	..	..	..	..
Total		335,174	337,045	..	..	..	..	..

Govt Budget		2012/13	2013/14 Revised	2014/15 Budget
Revenues	P mn	41,658	45,426	50,183
Spending	P mn	40,736	45,039	48,857
Balance	P mn	922	386	1,326
Public debt & guarantees	P mn	29,585	30,922	32,574
Govt deposits at BoB	P mn	20,611	..	..
GDP	P mn	112,732	127,227	136,140
Revenues	%GDP	37.0%	35.7%	..
Spending	%GDP	36.1%	35.4%	..
Balance	%GDP	0.8%	0.3%	..
Public debt & guarantees	%GDP	26.2%	24.3%	..
Govt deposits at BoB	%GDP	18.3%	..	..

Sources: Bank of Botswana; MFDP; Statistics Botswana; Department of Mines; Registrar of Companies; Econsult

Notes: (a) 2013 figures include production from Boteti Diamond and Debswana

(b) Numbers in Italics reflect revisions from the previous review

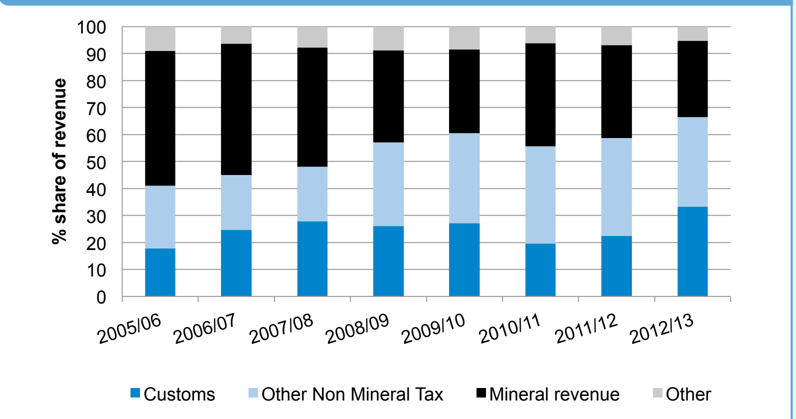
One Levy too many: An overview of the exiting levies

It is no secret that Botswana's mineral revenues are gradually declining, and as such there is need to find ways of raising additional revenues to finance government expenditures. Over the years, the importance of non-mineral tax revenues in the overall revenue mix has been rising, e.g. from 23% of total revenues in 2005/06, to 33% in 2012/13. However, the contribution of non-mining taxes to government revenues is still under-performing by some standards, and there is a need to further develop the tax system in Botswana.

The IMF, in its Article IV Reports, has encouraged Botswana to increase its efficiency in tax collection and use. They have recommended that '…broadening the tax base should be an integral pillar of a balanced medium term fiscal consolidation processes.' The proposed measures in this regard include an increase in the effective tax rates on income and value added taxes, through a judicious rationalization of the large tax expenditures and improvements in tax administration. Tax compliance should also be improved by reducing tax evasion and eliminating loopholes in the tax system. Botswana also has quite large and discretionary tax expenditures which need to be streamlined to contribute effectively to the national budget.

One development that has become apparent in recent years is the use of off-budget special funds and levies. As at 2013, there were 37 special funds in existence[1], 9 of which are financed through levies that the govern-

FIGURE 1: Government Revenue Streams

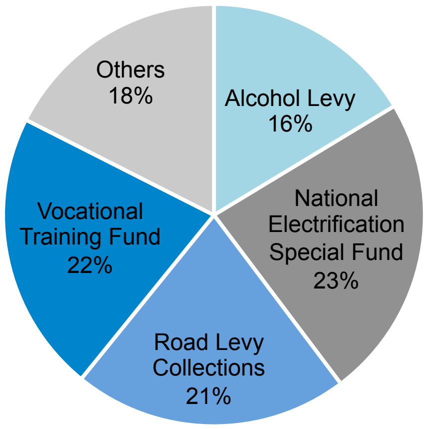


Source: MFDP, Econsult Botswana

[1] As recorded in the Annual Statement of Accounts for the Financial Year Ended 31 March 2013

ment imposes on different activities. Such levies are a form of hidden tax. During the fiscal year 2012/13, the different levies generated over P995 million in revenue, with the largest contributors being the National Electrification levy (P232 mn), the Vocational training levy[2] (VTF) (P215 mn), the road collections levy (P210 mn) and lastly the Alcohol levy (P162 mn).

FIGURE 2: Breakdown of Levy Income



Source: MFDP, BOTA, Econsult Botswana

The levies have a mixture of uses and mandates; some are intended to be permanent while others may expire once their specific objective has been achieved:

- The National Electrification Special Fund was created in 2011/12 to help electrify rural Botswana. The biggest consumers of electricity were taxed to subsidise the connection fees for people in rural areas. The impacts are noticeable, with 67% of Botswana connected to the grid as at the end 2012; the goal is to have 80% of Botswana connected to the grid by 2016.

- The Vocational Training Levy, a turnover-related tax, was created in 2008 to finance the provision of relevant training of the workforce, as an effort towards increasing their efficiency. Unfortunately this levy has not been used as envisioned; in the first year the claim rate was just 7.5% of the total fund. There has, however, been some improvement with the claim rate in the fiscal year 2012/13 up to approximately 50%. Nevertheless, over half a billion pula remains in the fund as at fiscal year end.

- The Road collections levy is a tax on fuel aimed at providing finance for the maintenance of roads.

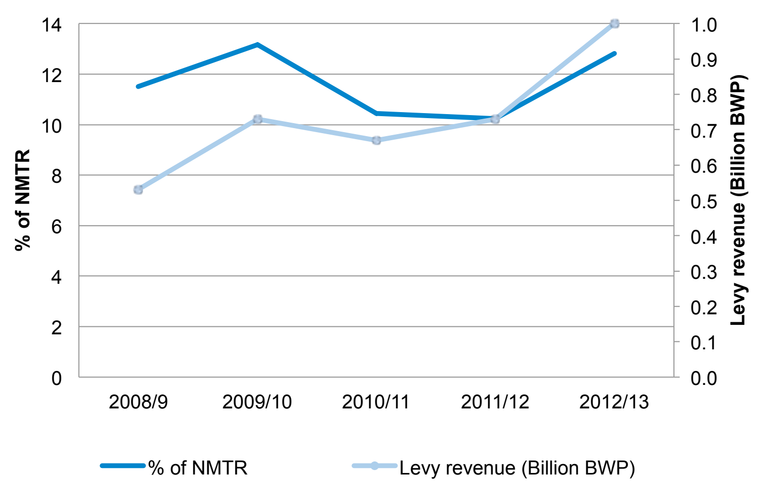
- The Alcohol levy was introduced in 2009 to try and reduce alcohol abuse by raising prices and financing appropriate activities. However, the use of the fund has changed over the years, from paying for rehabilitation services for addicts, to financing youth owned businesses, to contributing a share to the general revenues (the Consolidated Fund). The fund remained with around P230 million at the end of 2012/13.

The amount raised by these and other levies has been steadily rising over the years as illustrated below, and are equivalent to 10-12% of Non-Mining Tax Revenue (NMTR). To put things into perspective, the value of the funds raised by these levies in 2012/13 – and which did not go through the budget - was similar to the value of the entire expenditure budget for food and social welfare programmes in that year, or the cost of ten Junior Secondary schools[3] in 2008/9.

[2] The VTF is not recorded in the Annual Statement of Accounts, this information is available in the BOTA Annual Reports
[3] The Estimated cost of a Junior Secondary school in 2009 was P84m according to PPADB

SPECIAL FEATURE

FIGURE 3: Total Levy Revenue



Source: MFDP, BOTA, Econsult Botswana

Such "hidden" taxes are generally frowned upon from a public finance perspective. Since the levies do not go through the normal budgetary process and parliamentary (legislative) scrutiny, they compromise tax efficiency and transparency. For instance, it is not always clear how the levies are utilized. Unlike normal budgetary items, expenditures do not have to be approved by Parliament. Some stakeholders argue that the funds collected from the levies are utilized without fully involving those who contribute, such as the private sector, and as a result, channels of accountability have become blurred. The lax tax system and lack of transparency also provides an opportunity for exploitation; for example, retailers have applied a plastic 'levy' before it was legislated and have consequently collected revenue which is now lost to government.

Apart from the lack of transparency in expenditure related to these funds, there is a concern from the business community that there are too many levies, making it costly to do business in Botswana. For instance, the effective tax burden on individuals and non-mining firms, taking into account these levies is 12.8% higher than implied by income and profits taxes alone.

Keeping the levies and associated expenditures "off-budget" also distorts public finance figures, as both tax revenue and public spending are understated in the budget.

The logic of some of the levies is also questionable. For instance, while it may be a valid social objective for government to choose to subsidise rural electrification, this should be financed from general tax revenues, having compared the merits of this spending against other demands on the public purse. Financing rural electrification through a tax on industrial users and urban households is inappropriate, and further undermines the competitiveness of businesses in Botswana.

In general, such ring-fenced "special funds" are considered to be inefficient from a public finance perspective, especially when the expenditures benefit a different group from those who contributed the revenue. Best practice in public finance is that taxation and expenditure decisions are separated, and that both should go through the budget rather than being handled through off-budget processes.

In conclusion, there is undoubtedly a need to broaden the tax base, as has been made clear by the Ministry of Finance and Development Planning, the IMF, the World Bank and other commentators. However, it is not evident that a plethora of taxes disguised as levies is the appropriate way to do this. At a minimum, the existing levies should be brought into the budget so that both the revenue raised and the expenditures made are subject to normal public finance accountability.

Government Payroll Spending

In recent years, Government has stated that it would attempt to restrain public spending by, inter alia, holding back public sector wages and employment. Since the global financial crisis in 2008-9, public sector pay rises have been minimal, which was one of the reasons for the public service strike in 2011. There have also been restrictions on the expansion of public sector employment. The idea was to prevent the government wage bill from growing unsustainably.

Data from Statistics Botswana on formal sector employment show that in fact government almost achieved its objective of capping the size of the civil service. Over the period from 2009 to 2012, total employment in central and local government increased from 126,492 to 131,033, an increase of only 3.6%. This was assisted by changes such as those resulting from the water sector reforms, whereby many employees from the Department of Water Affairs were transferred out of government to the Water Utilities Corporation.

TABLE 1: Government spending on personal emoluments - nominal

	2009/10a	2010/11a	2011/12a	2012/13a	*2013/14r*	*2014/15e*
Spending (P mn)	9 251.6	11 899.0	12 940.7	14 547.7	*15 128.4*	*15 7489.0*
Growth (%)	6.3%	28.6%	8.8%	12.4%	*4.0%*	*4.1%*
% total govt spending	23.4%	31.0%	33.5%	36.1%	*33.6%*	*32.2%*
% of GDP	12.1%	12.3%	12.1%	12.9%	*11.9%*	*11.6%*

a = actual; r = revised budget; e = budget estimate. Includes central and local government, but not parastatals or Ipelegeng.

How effective has this been in practice? Over the four financial years from 2009/10 to 2012/13, total government spending on personal emoluments (i.e. salaries and allowances) rose from P9.25 billion to P14.55 billion, an increase of 57%. Even in real terms, after allowing for inflation, spending increased by 26% over this period.

So it appears that the intention of containing spending on salaries was not achieved. Why was this? Did government employment keep on growing, notwithstanding the restrictions on recruitment, or did salaries and allowances keep rising, notwithstanding the lack of formal pay awards?

So, with government employment growing very slowly, most of the increase in spending on salaries was due to higher average earnings, despite the supposed “wage freeze”. The average “personal emoluments” paid to public sector employees rose from P6,094 per month in 2009/10 to P9,253 per month in 2012/13, an increase of 52%.

What could have been driving this? Contributory factors include the various small adjustments that have been made to public service salary scales; the substantial pay increase that most government employees received as a result of the new Public Service Act prior to the 2011 strike; and annual increments due to "notching", as individual employees move up their salary scale. Other possible causes include salary increases as staff are moved from permanent and pensionable to contract terms of employment, more overtime, or more generous salary-related allowances.

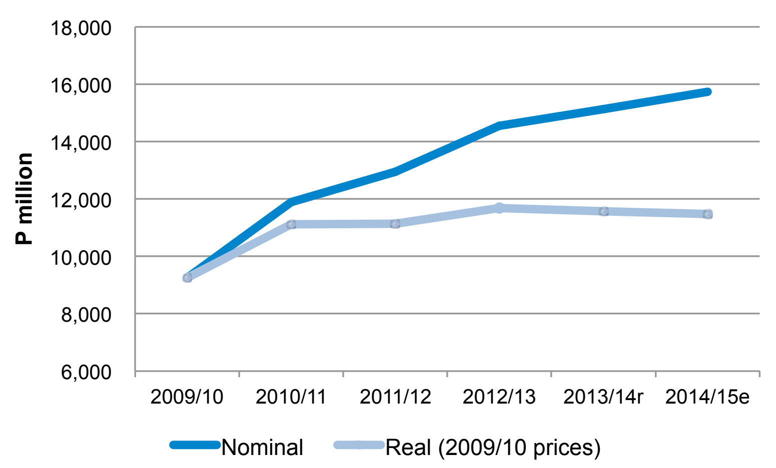
Concerns about the level of spending on the government wage bill have been driven by an ever-increasing share of government spending and GDP devoted to salaries. This is unsustainable. Once government's pension contributions are taken into account, nearly 15% of GDP was devoted to public sector salary costs in 2012/13, compared to a norm for a middle income country of less than 10% of GDP (in Mauritius it is 6%). And the share of overall government spending devoted to salaries and allowances has continued to increase.

Looking forward, budget estimates and forecasts for 2013/14 and 2014/15 indicate that the rate of growth of salary spending should decline. However, this may not be a reliable indicator, as actual salary expenditure typically comes in above the original budget forecasts – on average by 7.5% over the past five years. For instance, the estimates included in the 2014/15 Budget do not include any allowance for the current round of public service salary negotiations, and hence will almost certainly be exceeded.

Overall, therefore, the economic activity generated by aggregate spending on public sector salaries has not been adversely affected by public sector wage restraint. This may explain why sectors of the economy such as wholesale and retail trade have continued to experience sustained growth.

Unfortunately, government has managed to annoy its workforce and the public sector unions, leading to poor labour relations and reduced productivity, without achieving the objective of saving money. A rethink is clearly needed on how to achieve a longer-term objective of downsizing the government salary bill.

FIGURE 4: Spending on salaries



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