

# **BUDGET SPEECH 2010 ECONOMIC OUTLOOK**

**Presentation to Debswana Jwaneng Mine**

**24 February 2010**

**Bogolo Kenewendo**

**[bogolo@econsult.co.bw](mailto:bogolo@econsult.co.bw)**

**3900575**

**72586591**

**[www.econsult.co.bw](http://www.econsult.co.bw)**

**Econsult Botswana Pty LTD**

The 2010 Budget Speech presented on February 8<sup>th</sup> had the theme “Transforming Our Economy After the Crisis: 2010 and Beyond”. After last year’s “crisis management” budget, which was aimed at stabilising the economy in the depths of the global crisis, the 2010 Budget took a more medium term perspective; hence the theme of economic transformation.

The introduction to the budget contained many interesting comments, including:

- Diversification; the global crises has proven that it is indeed time to move away from the dependence on the mining sector and hence the need to seek new opportunities for growth.
- With a sharp decline in govt revenue primarily because of the fall in mining revenues, govt has to search for new avenues for revenue generation such as non-mining taxes.
- In the past govt has spent money on projects without prioritizing because there was no need, we had the revenue to sustain all projects now; govt has to undertake programs/ project prioritizing and undertake those projects that have current and future benefits.
- There is a need to reduce debt, carefully use reserves and cut down on expenditure, in-order to have sustainable public finance.

All of the above are the effects of what happened in the Botswana economy in 2009. Let’s take a look;

- Mining sector has been doing very well all through the years, having the most output in 2006, and 2009 saw a slump in mining output (Mines closed).
- Non mining sector gradual growth over the years and accelerated in 08 attributed to govt spending and some diversification
- The export sector saw 32% anti-growth (negative) while the domestic economy grew by apx 9% in 2009
- 

## BUDGET

The budget has a medium term perspective as mentioned above, all of the afore mentioned points could be an indicator of dramatic change. However, such change cannot be introduced overnight, and only over the next 2-3 years will it become apparent whether such dramatic change – notably in the public sector – will in fact be undertaken.

Botswana has been spoilt in that it has been enjoying surpluses and now faced with big deficits, the immediate challenge becomes the balancing act between maintaining spending in order to support the economy, and reducing the deficit in order to move towards fiscal sustainability. As

apparent, we have had a substantial decline in revenues and a sharp increase in govt expenditure trying to stimulate the economy.

Like other countries, Botswana's 2009 Budget entailed a substantial deficit; in order provide a source of aggregate demand to compensate for the weakness of the global economy – Botswana's own fiscal stimulus package, driven by a substantial increase in government spending. This represented short-term, crisis management and it was inevitable that in 2010, there had to be some withdrawal of economic stimulus, and the some shifting of the balance away from increased spending towards a decreased deficit. Certainly, another deficit of the order of 15% of GDP would not be sustainable. What we are seeing is continued pressure on government revenues, with little support from either economic recovery or the impact of higher taxes; a modest cut in spending; and a small reduction in the deficit, which remains very large.

The rule of thumb is that 3% of GDP is sustainable deficit; this is also backed up by the fact that one of the main criteria for monetary union convergence is between 3-5%, for example in SADC is a deficit of 3% of GDP.

To take a look at why exactly we have a deficit, we know that generally govt revenues have declined and that mining has had a lot to do with that; closer look, all revenues have declined except non-mining taxes.

The problem is the continued decline in revenues as a share of GDP, down to 27%, the lowest for 35 years; even in 2009/10, revenues amounted to 31% of GDP. This is driven by a combination of higher GDP (as growth recovers), and further declines in the two main revenue sources, minerals and SACU.

- Mineral revenues are lower, despite global recovery,
- SACU revenues are lower due to reduced trade volumes and a shift in the pattern of imports into South Africa away from high tariff items (such as motor vehicles).
- Mineral revenues may recover somewhat from current lows of around 7% of GDP, but, relative to the size of the economy, are unlikely to get back to where they were in the 1980s and 1990s (20-30% of GDP). SACU revenues experienced an exceptional rise in recent years, and we are now seeing a decline due to both the slowdown in world trade (and imports into South Africa) and a reversion to more normal levels.
- Interest on reserves has become insignificant

The key point, therefore, is that Botswana has a fiscal revenue problem not just because of the recession, but because of adverse medium-term revenue trends. As the economy diversifies away from the highly-taxed (and highly profitable diamond sector) towards other less highly-taxed (and less profitable) activities, the average tax take will inevitably decline. It is therefore necessary to cut spending as seen in the 2010/11 budget, though very modest. This however still leaves spending at 40% of GDP (unsustainable levels).

The cumulative budget deficits in the three years from 2008/09 to 2010/11, amount to P30.3 billion. This can be usefully compared to government's accumulated financial resources. In March 2008, at the start of this three-year period, government's total financial assets (savings at BoB less public debt) amounted to P42 billion. Three years of deficits have therefore already consumed over 70% of government's net financial assets – illustrating how quickly years of savings can be dissipated. Given that there will almost certainly be further deficits beyond 2010/11, government is likely to quickly become a net debtor. This in turn has led to a credit rating downgrade (A to A-), given that the current investment grade rating was based to a large extent on government's position as a substantial net creditor.

What did the Budget do for the business and investment climate? Several measures can be identified that worsened the business climate, including:

- the increase in the corporate tax rate;
- the squeeze on consumer spending (increase in VAT, no public sector pay rise);
- reduced government spending;
- the surcharge on electricity consumption;

While the first three of these measures were largely unavoidable given the fiscal crisis, the final measure seems unjustified and counterproductive, given the already high costs of doing business in Botswana.

Nevertheless there were some positive dimensions to the Budget for the business climate:

- The commitment to medium-term budget sustainability
- The commitment to direct government spending towards projects that yield positive returns
- The prospect for capital market development given domestic borrowing needs;
- The establishment of a unit to develop public-private partnerships
- Investments in economic infrastructure and human capital (BIUST, roads, power, water etc.)

## IN CONCLUSION

2010 will be a better year than 2009, overall GDP growth is likely to bounce back as sectors recover. What will still remain a challenge is much of the unnecessary govt infrastructure and the whole principle of infrastructural development has to change in terms of budget constraints and cost effectiveness. There is also a fundamental problem in that government is too big. Just as parastatals are being rationalised to remove overlaps and duplication, government needs the same process. Government has been happy to add to the activities it undertakes, but has not been willing to cut back on others. Many government activities are no longer necessary or justified. This is at the core of the budget sustainability problem – and hence the longer-term challenge of reducing the size of the government workforce remains. And it is necessary for all of the good intentions

laid out by the Minister at the beginning of the speech to be translated into concrete actions, and quickly.

