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# BIDPA Briefing

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## Overview

Current indicators, such as bank credit and electricity consumption, suggest that there has not yet been the slowdown in GDP growth that can be expected, if the growth of government spending is cut right back as announced in the February 2000 budget. The annual rate of inflation rose to 7.5% in June, from a temporary low of 6.4% in March, but may fall back again if oil prices continue to decline. Inflation remains below core inflation in South Africa. Employment continued to grow at around 6% in the year to September 1999, with private sector employment growing faster than government employment. The draft Mid-Term Review of NDP8, being debated in Parliament at the time of writing, acknowledges the unwanted side-effects of overspending in the first half of the Plan period. It proposes postponing most of the projects in the Plan which have not yet been started. The preferred scenario would select about a quarter (by value) of the projects not yet started. The additional cost would be financed by additional government revenue (mainly cost recovery measures), in order to avoid budget deficits and a fall in the foreign exchange reserves. However, the proposed additional revenue would come mainly from user fees on basic education and health services. There is therefore a risk that the additional spending will be implemented, while the revenue measures will not.

## Economic Developments

*Is growth slowing down?*

In previous BIDPA Briefings, it was noted that the current boom has depended to a large extent on the high rate of increase in government spending. The continuation of the boom also largely depends, therefore, on whether or not the government increases its spending at a much lower rate, as announced in the February 2000 Budget Speech. So far, there is not much more than anecdotal evidence for the current year, and that is rather mixed. However, there has been a close correlation in the past between the growth of GDP on the one hand, and consumption of electricity on the other hand. In the first quarter of this calendar year, non-mining electricity consumption grew by 12%, and in the second quarter it grew even faster, by 17%. There has been a small reduction in the rate of growth of bank lending, but it remains high, at about 40%. This suggests that there has not yet been a slowdown in the economy. A further indication of future growth is contained in the macroeconomic strategy of the Mid-Term Review of NDP8, which is discussed below.

*Employment growth*

Employment statistics for September 1999 indicate that their rate of growth has been maintained. Total formal sector employment increased at an annual rate of 5.8% in the year to September 1999, compared with 6.1% in the previous year, and 5.4% in the year to March 1998. Moreover, the recent rate of increase in employment in the private sector is now faster than in government. This is in contrast to the first half of the 1990s, when the government accounted for all of the increase in employment, and private sector employment was either stagnant or falling. It also reverses the relative rates of growth of private and public sector employment in the year to September 1998, when government employment was growing faster (Table 1).

Table 1

Annual growth in employment

| | Sept 1998 | Sept 1999 |
|---|---|---|
| Private sector | + 5.8% | + 7.7% |
| Government | + 8.4% | + 3.2% |
| Total | + 6.1% | + 5.8% |

If account is taken of the fact that employment in the parastatal sector has fallen slightly (from 13,600 to 13,300), and that employment in mining is stagnant at 8,700, then employment in the rest of the private sector is growing even faster than the 7.7% shown in Table 1, at more than 9%. This means that the rate of growth of employment has finally caught up with the growth of non-mining GDP. It lagged behind during the early years of the current boom. This was probably because some employers hoarded labour during the preceding recession. Whatever the reason, it was very disappointing, particularly as the creation of jobs is the most crucial way of reducing poverty. It is therefore excellent news that employment is currently growing as fast as it is. The fact that growth is faster in the private sector is also good news, because rapid growth in government employment would not be sustainable.

Unfortunately, more than half (63%) of the increase in private sector employment, in the 18 months to September 1999, was in construction. This sector is particularly vulnerable to a downturn in government spending. Most other sectors are also vulnerable, although perhaps to a lesser extent. Government spending is budgeted to rise by less than the rate of inflation in the

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current fiscal year (after rising at more than 20% a year for several years). It is also disappointing that manufacturing employment rose by only 700 (2.9%) in the 18 months to September 1999; this is less than the number of jobs lost later, when the Hyundai assembly plant closed in early 2000.

*Inflation*

Inflation was running at about 7% at an annual rate at the end of 1999. It then fell slightly, to a temporary low of 6.4% in March. Since then it has risen by more than a percentage point, to 7.5% in June. A large part of the increase can be attributed to higher fuel costs: the index for fuel and power rose by 7.4% in the last three months, and the transport index (which has a much larger weight in the all items index) rose by 6%, compared with the 2.4% quarterly rise overall. On the other hand, food, which has the heaviest weight in the index (26% compared with 20% for transport), rose by only 1.8% in the last three months.

It is possible that this increase in the rate of inflation will not persist, because oil prices have been falling in recent weeks. Meanwhile, the rate of inflation in Botswana remains below the core rate of inflation in South Africa as shown in Chart 1 (the core rate excludes the cost of South African mortgages, which have no impact on prices in Botswana).

It is important that inflation in Botswana has remained below core inflation in South Africa, given that the nominal exchange rate has been stable. As a result, producers in Botswana who compete with imports from South Africa, or who export to the South African market, have not had their competitive position harmed by adverse movements in the real exchange rate (which is a combination of the nominal exchange rate and inflation differentials).

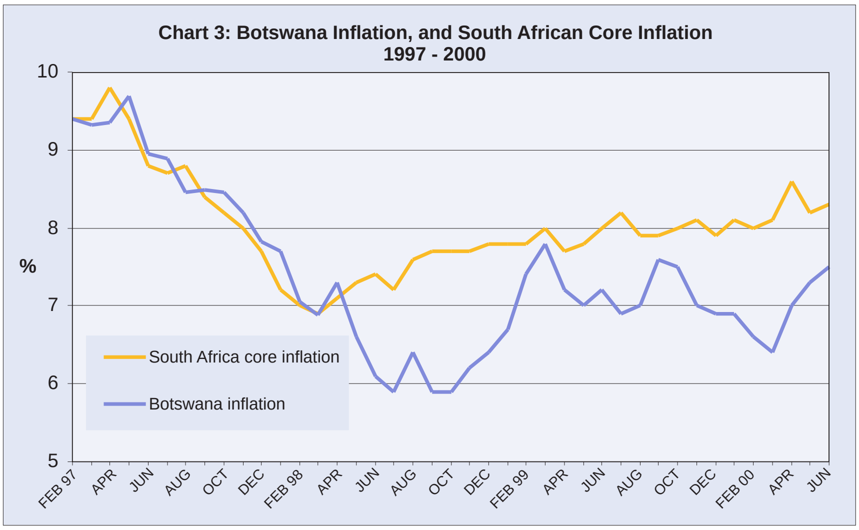


Chart 3: Botswana Inflation, and South African Core Inflation 1997 - 2000

## Mid-Term Review of NDP8

*Overspending of the development budget*

The Draft Mid-Term Review of NDP8 was being debated in parliament at the time of writing. It gets about as close as can be expected of a government document to admitting that the front-end loading of development expenditure in NDP8 was a mistake, and that this problem was made worse by substantial overspending of the front-end loading. The Review admits that this put a tremendous strain on the spending ministries. Their capacity to implement projects should grow over time, and is therefore least at the beginning of a plan period. It should also have been predictable that, having once risen, it would be difficult to cut back development spending as planned.

As a result of the overspending, cost escalation had increased the Total Estimated Cost of NDP8 projects, from P11.8 million to P16.6 billion, in current prices, by the beginning of 2000. This cost escalation means that some projects in the Plan will have to be reduced, have their design changed, or be deferred until the next Plan period. It is also acknowledged that cost escalation may have made some projects unviable, so that they will have to be appraised again to see if they should be implemented at all.

*Revised growth estimates*

The Review now expects GDP growth to be 6.5% over the Plan, compared to the original projection of 5.2%. The main reasons are better-than-expected results from the mining sector, and higher than planned government spending. However, growth in the final two years of the Plan is now expected to be little different from the growth rates originally projected. Private sector growth (excluding mining) is projected at the relatively high rate of 7.3% for the two years to July 2003 (see Table 2), which is encouraging for the growth of employment.

Table 2

Growth during NDP8: original projections compared with Mid-Term Review (original NDP8 projections in brackets)

| | 2 years to July 1999 | 2 years to July 2001 | 2 years to July 2003 | 6 years of NDP 8 |
|---|---|---|---|---|
| Mining | 2.3 (1.2) | 10.6 (8.1) | 0.4 (0.1) | 4.3 (3.0) |
| Government | 8.4 (3.4) | 5.2 (5.4) | 3.4 (5.5) | 5.7 (4.8) |
| Other | 8.0 (6.5) | 8.9 (6.6) | 7.3 (6.9) | 8.1 (6.6) |
| TOTAL | 6.2 (4.2) | 8.9 (6.8) | 4.6 (4.5) | 6.5 (5.2) |

Source: Draft Mid-Term Review of NDP8 (July 2000)

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*Revised inflation estimates*

Inflation was estimated to fall gradually, from 10.3%, at the beginning of NDP8, to 7% at the end of the Plan period. Actual price increases, together with revised projections for the remainder of the Plan, show inflation lower by between two and three percentage points through most of the Plan period, and falling from 6.2% this year to 4.7% in 2003. Lower inflation has occurred despite higher than planned government spending; it must be mainly attributable to lower inflation in South Africa.

*Choosing what to do next*

The Review says that completion of ongoing projects would cost P8.1 billion at current prices during the remaining three years of the Plan. Projects which are not yet started would cost another P8.0 billion (P9.2 billion with inflation). The Review calculates that implementing all of this would not increase GDP growth by very much (by 0.12, 0.07 and 0.31 percentage points over the next three years). The impact on employment would be higher, but probably temporary as it would depend on government spending on construction. The difference between inflation in Botswana and South Africa would be 45% higher, the budget would be pushed heavily into deficit (deficits of between P3 and P4 billion), while foreign exchange reserves and months of import cover would fall sharply. It is argued that this would be irresponsible, adding very little to the overall GDP growth rate, while creating unwanted side-effects. Perhaps worst of all, budget deficits would "signal to the rest the world that the era of sound fiscal management in Botswana is over".

The Review's preferred alternative scenario is to select some priority projects from among those which have not yet started, and to finance them with additional government revenue. Priority projects in education, training, health and sanitation have been selected, to be implemented in the final two years of the Plan at P1 billion per year.

This preferred scenario generates better results, according to the model used by the Ministry of Finance and Development Planning:

- government spending grows more slowly than GDP
- employment growth is satisfactory
- inflation is almost unchanged in comparison with existing projections
- the budget deficit is not affected
- foreign reserves and months of import cover remain the same.

The cost of the priority projects in the preferred scenario would be covered mainly by new and enhanced cost recovery measures in all possible sectors, particularly in health and education.

*Problems with the preferred scenario*

As it stands, the preferred scenario seems to be a sound compromise. It would maintain some momentum, it tries to choose those areas of government spending which "crowd in" rather than "crowd out" private sector investment, and it is fiscally responsible.

There remains a potential problem, however. Economic planners (and the IMF) like to propose *packages* of measures, which *taken together* make economic sense. There are two problems with this. Governments invariably choose those parts of a package of measures which are less unpopular politically (and less easy for the IMF to monitor). This leads to immediate implementation of "easy" policies, combined with promises to do something about the "difficult" policies. Secondly, some parts of a package can be quickly implemented, while others take longer. As a result, even if a government is serious about the more difficult policies, such as cutting government spending or raising taxation, any benefits occur long after the easy policy has been implemented.

The macroeconomic strategy proposed in the Mid-Term Review appears to be such a package of economic policies. The proposed policies make macroeconomic sense taken together. The problem is that additional development spending is politically more attractive than raising additional revenue. Sadly, therefore, it is extremely likely that the extra spending will be implemented, while there is a major risk that the additional revenue collection will not. In this particular case, moreover, the revenue-raising part of the package is spectacularly unpopular. It is difficult to imagine a more controversial revenue proposal than the imposition of fees on basic health and education services. Public criticism has indeed started already. These services have not only been provided free for many years, but people will fail to understand why fees are necessary when the government has such large financial savings. Although all tax increases are unpopular, almost any other proposal would probably be easier to implement, both administratively and politically, for example an increase in the tax on petrol (which is currently about 30% cheaper than in South Africa).

There is also a serious risk that the imposition of fees will exclude the poorest people from basic health and education. The Review makes almost no mention of means testing, which could be used to excuse the poorest people from paying fees. In any case, it is doubtful that the Government has the administrative capacity that would be needed to ensure that only those who can afford fees will have to pay.

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The Review also mentions the introduction of Value Added Tax (VAT) next year, in the expectation that that will also increase government revenue. However, it is possible that the impact on revenue will be limited over the Plan period, because of the administrative difficulty of getting it started and working efficiently. Administrative problems, in setting up a system for collecting user fees on health and education, could also lead to delays in the collecting of additional revenue. There is therefore a risk of (modest) budget deficits; but they would be well within Government's capacity to finance from accumulated savings.

## ECONOMIC FACTS AND FORECASTS

**Quarterly**

| | 1998 | | 1999 | | | | 2000 | |
|---|---|---|---|---|---|---|---|---|
| (end of period) | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 |
| Interest rates (%) | | | | | | | | |
| BOBC (3 month) | 10.46 | 10.66 | 11.55 | 11.75 | 11.68 | 12.0 | 12.45 | 12.53 |
| Prime | 14.00 | 14.00 | 14.25 | 14.75 | 14.75 | 14.75 | 15.25 | 15.25 |
| Inflation (%) | 5.9 | 6.4 | 7.2 | 7.5 | 7.6 | 6.9 | 6.4 | 7.5 |
| Rand-Pula | 1.30 | 1.32 | 1.33 | 1.30 | 1.32 | 1.33 | 1.35 | 1.33 |
| Pula-US$ | 4.48 | 4.46 | 4.67 | 4.63 | 4.55 | 4.62 | 4.85 | 5.15 |
| BSE index | 954 | 947 | 990 | 1033 | 1417 | 1399 | 1471 | 1495 |

**Annual**

| | | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|---|---|
| Growth (%) | | | | | | | | | |
| GDP (real) | *d* | 4.2 | 2.7 | 6.6 | 7.2 | 8.3 | 4.2 | 9.0 | 7.0 *f* |
| Non-mineral GDP (real) | *d* | 3.5 | 4.8 | 5.0 | 7.9 | 7.7 | 8.9 | 8.5 | 5.0 *f* |
| Exports (nominal) | *b* | 15.3 | 18.4 | 19.7 | 40.7 | 27.8 | -12.5 | 43.1 | 0 *f* |
| Imports (nominal) | *b* | 9.2 | 2.7 | 20.4 | 8.2 | 43.9 | 19.7 | 11 | 13 *f* |
| Govt. spending (nominal) | *c* | 11.8 | -4.6 | 21.5 | 17.3 | 21.6 | 22.4 | 15 *e* | 13 *f* |
| Govt. revenues (nominal) | *c* | 14.3 | -16.5 | 22.2 | 35.3 | 12.0 | -7.3 | 55 *e* | 3 *f* |
| Domestic (bank) credit | *b* | 11.8 | 18.2 | -3.7 | 1.2 | 5.6 | 56.1 | 41.3 *e* | 40 *f* |
| Interest rates (%) | | | | | | | | | |
| BOBC (3 month) | *a* | 13.5 | 11.9 | 12.0 | 12.2 | 11.4 | 10.7 | 12.5 | 12.3 *f* |
| Prime | *a* | 15.0 | 14.0 | 14.5 | 14.5 | 14.0 | 14.0 | 15.3 | 15.3 *f* |
| Inflation (average, %) | | 14.4 | 10.6 | 10.5 | 10.1 | 8.9 | 6.7 | 7.2 | 7.3 *f* |
| Rand-Pula | *a* | 1.32 | 1.30 | 1.29 | 1.28 | 1.28 | 1.32 | 1.35 | 1.36 *f* |
| Pula-US$ | *a* | 2.56 | 2.72 | 2.82 | 3.64 | 3.81 | 4.46 | 4.85 | 4.96 *f* |
| BSE index | *a* | 279 | 313 | 333 | 352 | 709 | 947 | 1471 | - |
| Balance of Payments (Pm) | | | | | | | | | |
| Exports (diamonds) | *b* | 3340 | 3727 | 3994 | 5272 | 7675 | 6405 | 9813 | 9600 *f* |
| Exports (other goods) | | 841 | 1304 | 1994 | 2100 | 2620 | 2603 | 2651 | 2900 *f* |
| Imports (goods, cif) | *b* | 4290 | 4406 | 5305 | 5743 | 8256 | 9804 | 10710 | 12400 *f* |
| Current account balance | *b* | 1220 | 642 | 937 | 2108 | 3059 | 860 | 1842 | 100 *f* |
| Foreign Reserves | | | | | | | | | |
| Pula m | *a* | 10509 | 11961 | 13249 | 19076 | 21619 | 26347 | 28852 | 29500 *f* |
| US$ m | *a* | 4097 | 4402 | 4695 | 5234 | 5675 | 5960 | 6229 | 6500 *f* |
| Govt. spending (Pm) | *c* | 4481 | 4277 | 5195 | 6092 | 7406 | 9065 | 11412 *e* | 11730 *f* |
| Govt. revenue (Pm) | *c* | 5359 | 4473 | 5464 | 7395 | 8281 | 7678 | 11922 *e* | 11777 *f* |
| Budget surplus/(deficit) (Pm) | *c* | 878 | 196 | 269 | 1303 | 875 | -1387 | 510 *e* | 47 *f* |
| Govt. balances at BOB | *a* | 5598 | 6705 | 6460 | 7204 | 15634 | 19212 | 20199 | 22097 *f* |

*Notes:* *a end of period; b calendar year; c financial year (starts April); d statistical year (starts July)*
*e BIDPA estimate; f BIDPA forecast; p preliminary data*
*Details of assumptions underlying the forecasts can be obtained from BIDPA.*

*Sources:* *CSO, Bank of Botswana, BIDPA*

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