

Overview

In this issue of the BIDPA briefing, we note that the newly introduced VAT, imposed on property transactions and building materials, and the long standing Transfer Duty appear less supportive of the National Housing Policy, and the Vision 2016 in the quest to achieve affordable housing for all. VAT will have an inflationary impact on the purchase price of houses. A review of the performance of non-mining sectors shows that although there are signs that diversification may be taking off, the government still needs to rigorously implement policies and strategies aimed at improving the performance of those sectors whose growth is expected to play the leading role in achieving sustainable economic diversification. Also in this issue, we note that although inflation in Botswana remained below South Africa core inflation for the current quarter, it is estimated that the introduction of VAT may result in a one off 3 - 5% increase in the consumer price index. This may result in a similar rise in the inflation rate for July 2002.

Value Added Tax and Home Ownership

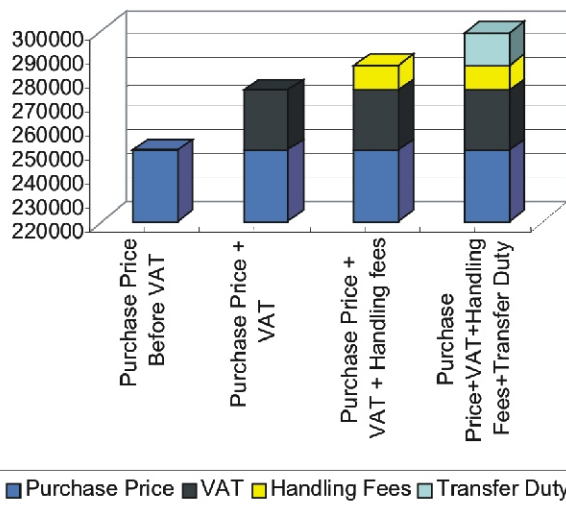
On July 1, 2002, the Government introduced the Value Added Tax (VAT) at a uniform rate of 10%, applied to a wide range of goods and services, with few exemptions. VAT is expected to broaden the revenue base of the government, and help diversify government revenues away from its heavy reliance on diamond revenues. However, VAT will impact differently on various Government programmes and policies. For this BIDPA Briefing, the focus is on the possible impact of VAT on home ownership.

Government Policy has over the years put "affordable housing for all" as a top priority. This is captured in the National Housing Policy for Botswana and the Vision 2016. To promote home ownership, the Government has established institutions such as the Botswana Housing Corporation (BHC) and the Botswana Building Society (BBS). In the past, the role of government in the housing sector has been that of providing finance, as well as being a direct producer of housing units and landlord. The current policy framework has now changed the role of government from provision of homes to facilitation of home building and ownership. The new policy framework also promotes housing as an instrument for citizen economic empowerment. Thus, the policy envisages the role of the private sector as a financier of home ownership to increase.

The newly introduced VAT, imposed on property transactions and building materials, and the long standing Transfer Duty appear less supportive of the National Housing Policy and the Vision 2016 in the quest to achieve affordable housing for all.

VAT will have an inflationary impact on the purchase price of houses. For example, a house priced at P250,000 before the introduction of VAT will now cost P275,000. Additional fees in the form of the loan administration fee at 0.75% of the loan plus VAT, the insurance fee at 1.6% of the loan and the loan replacement value at 0.125% of the loan increases the purchase price to about P285,000.

Graph 1: Effect of VAT and Other Charges on Purchase Price



The final price of the house will be even higher because of the 5% Transfer Duty levied on the VAT inclusive purchase price or value (whichever is higher) upon the transfer of immovable property. In our example, the combined effect of VAT, loan administration fees and the Transfer Duty would increase the purchase price to P296,000. This represents a 18.3% increase over the original price of P250,000.

Recognising that raising a deposit to buy a house is difficult for many Batswana, BHC developed two mortgage schemes that did not require an up front payment of a deposit. These are the Tenant Purchase Scheme (TPS) and the Step Ownership Scheme (SOS). Because of the non-deposit payment nature of the schemes, the two mortgage schemes account for approximately 80% of BHC's sales. According to the VAT Act, the tax is to be levied when "an invoice for the supply is issued by the supplier, or any payment for the supply is received, whichever comes first". This means that BHC will be required to account for VAT up front when the first installment is received. This not only increases the purchase price of the house, but also re-introduces the very

deposit that Batswana find difficult to raise. This may discourage Batswana from acquiring property, and compromise the objectives of the National Policy on Housing.

Rented residential accommodation is classified as an exempt supply under the VAT Act. While this may, to some extent, relieve tenants of the full VAT burden, it will, in the long run, lead to increases in rentals. As a result of its exempt

status, property developers would not be able to recover any input tax incurred in constructing or maintaining rented accommodation. This increases the cost of providing rented accommodation. Seeking to recover additional cost incurred in paying input tax, property developers may increase their rentals, thus defeating the initial intentions of exempting residential accommodation, as this will make accommodation less affordable to many.

The initial intentions of the Transfer Duty were good, as a form of citizen economic empowerment is practiced in the collection of the duty. Citizens are not charged duty on the first P20,000 of the purchase price or value. When this Act came into force in the 1970s, a high cost BHC house was priced at less than P20,000. This effectively exempted Batswana willing to purchase BHC houses from paying the duty. Due to the rise in property prices over the years, the P20,000 threshold no longer adequately serves its intended purpose of making properties affordable to Batswana.

Despite the VAT shortcomings, there is room for Government to make provisions

that will continue to promote home ownership.

- Building materials and property transactions may be zero-rated, as this provides for a refund of all VAT paid on inputs used to build houses and in the manufacturing of building materials.
- Alternatively, because many Batswana do not have the means to raise up-front VAT payments, let alone down payments required by lending institutions, a provision should be made to allow for VAT on residential fixed property to be paid in installments over the period of the mortgage.
- Government may wish to consider classifying residential accommodation as a zero rated supply, as under this classification, "all VAT paid on inputs used to make the supply is fully refundable", hence no need for property developers to pass on the input tax burden to the tenants.
- Government may also wish to review the Transfer Duty Act. Such review should aim at increasing the threshold high enough to ensure that many within the middle income bracket are exempted from paying the Transfer Duty.

Performance of Non-mining Sectors: A review

The mining sector has dominated the economy since the early 1970s, accounting for more than 30% of total GDP per annum over the past 20 years. Growth of the economy and its development has been dominated by the performance of the mining sector. As a result, the economy is highly un-diversified, making it vulnerable to external shocks, such as a downturn in the diamond market, or a global recession.

Economic diversification is, therefore, one of Botswana's top priorities and one of the major goals for NDP 8, hence the plan's theme of "sustainable economic diversification". This means that other sectors, besides the mining sector, are to play a greater role in the growth of the economy. Sectors, such as tourism, manufacturing and financial services, are expected to lead the long term growth of the economy. Also, a more diversified economy is more likely to create more income generating opportunities.

The government has over the years implemented a number of development policy initiatives and programmes aimed at enhancing the performance of non-mining sectors. These include the Financial Assistance Policy (FAP), the Small, Medium and Micro Enterprises (SMME) Policy and the newly formed Citizen Entrepreneurial Development Agency (CEDA). Institutions, such as the Botswana Export Development and Investment Authority (BEDIA) and the Botswana Development Corporation (BDC), have also been established to make Botswana a favoured investment destination. Other

incentives, in the form of tax incentives, have also been offered to promote investment in these sectors.

A review of the performance of these sectors in terms of their contribution to GDP, employment and revenue is summarized below, mainly to give an overview of how the non-mining sectors have responded to the above mentioned government initiatives.

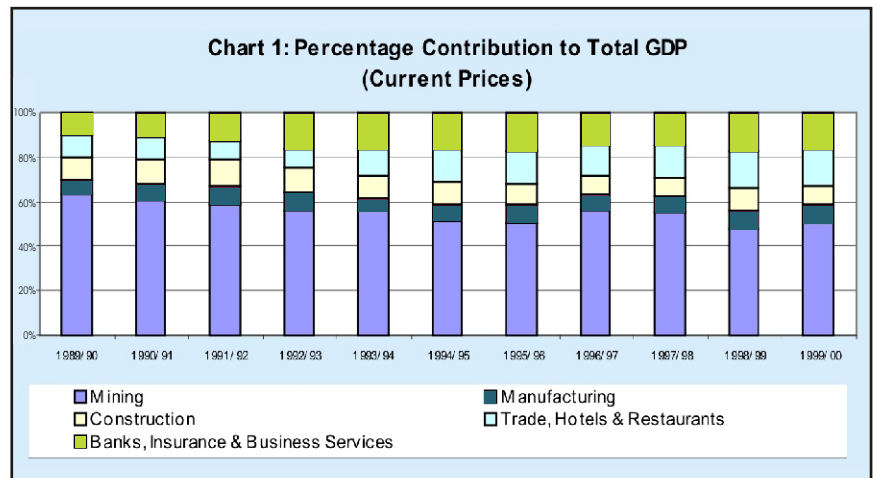
Contribution to GDP

The non-mining sectors' contribution to GDP has been steadily increasing since 1990 (Chart 1). On the other hand, the mining sector's contribution to GDP has

1994 and 1998, that is an increase of more than 40%. Such an increase in tourist arrivals is indicative of the potential that this sector has. A more concerted effort, with emphasis on citizen economic empowerment, is required to exploit and harness the potential of this sector.

Export performance

Sustainable growth of GDP requires the economy to expand non-traditional exports; that is, exports of goods other than beef products, diamonds and copper-nickel. This is presently more urgent than ever, as there is no significant growth expected in diamond production after completion of the Orapa expansion project in 2000.



been declining from more than 40% in 1988/89 to 33% in 1999/00.

During this period, the combined contribution to GDP by the trade, hotels and restaurants, manufacturing and business services sectors increased from about 6% to about 11%.

The manufacturing sector's contribution to GDP has averaged 6% over this period, which is an improvement over the 2-3% recorded in the early 1980's. The construction sector's contribution to GDP has remained almost steady over the same period.

An analysis of the tourism industry shows that the total number of visitors on holiday increased from 112,501 to 205,146 between

The growth in textile exports (Table 1), which started in the early 1990's, reached a peak in 1998 at P303 million, after which

Table 1: Exports (P Million)

	Meat, Diamonds & Copper-Nickel	Textiles	Soda Ash	Vehicles & Parts	Other Goods	Total Exports
1989	3466.0	79.8	180.6	3742.6
1990	2990.2	111.7	196.8	3319.1
1991	3361.2	123.0	22.0	..	213.4	3738.0
1992	3294.5	76.5	43.4	..	239.7	3675.0
1993	3719.8	95.0	50.4	91.0	293.7	4270.9
1994	4148.3	177.4	36.8	300.6	261.3	4965.0
1995	4491.3	146.3	21.8	957.1	286.2	5941.5
1996	6373.0	194.3	69.1	1144.4	322.6	8133.4
1997	8382.0	248.4	109.8	1182.7	433.6	10390.7
1998	6774.9	302.6	98.5	965.7	518.6	8696.9
1999	10487.3	248.5	107.0	666.8	692.0	12227.5
2000(P)	12477.3	243.7	98.1	270.4	700.1	13834.7

exports declined by 18% and 5% in 1999 and 2000, respectively. In aggregate terms, textile exports were P244 million in 2000.

The decline in textile exports was mainly due to the closure of textile and manufacturing firms that had taken advantage of Government incentives and established in Botswana. However in 2000/01, there was some improvement in foreign investment in the garment

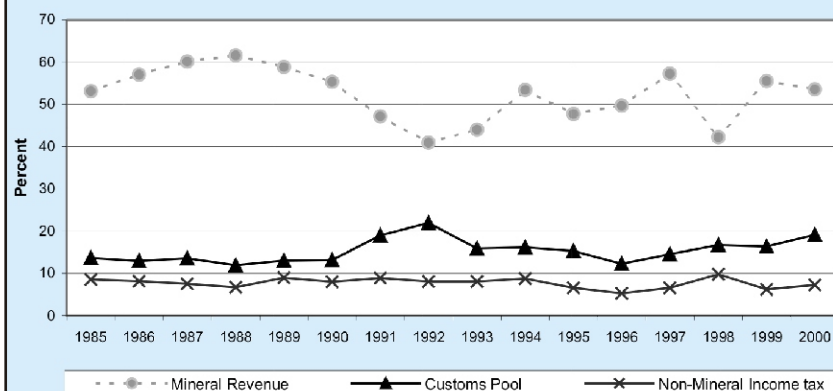
manufacturing sector as investors from countries, such as Mauritius, China and Sri Lanka, established firms in Botswana. This was mainly to take advantage of market opportunities offered under the African Growth and Opportunity Act (AGOA) and the European Union, as well as in the SADC region.

Exports of vehicles and parts also exhibited a much more pronounced declining trend. This was due to the operational problems of Motor Company of Botswana, which finally closed down at the beginning of 2000. Exports of other goods show a steady increase since 1989.

Contribution to revenue

In terms of contribution to total revenue (Chart 2), it can be noted that revenue from the customs pool has been increasing, steadily. Non-mineral income tax, has also

Chart 2: Contribution to Total Revenue

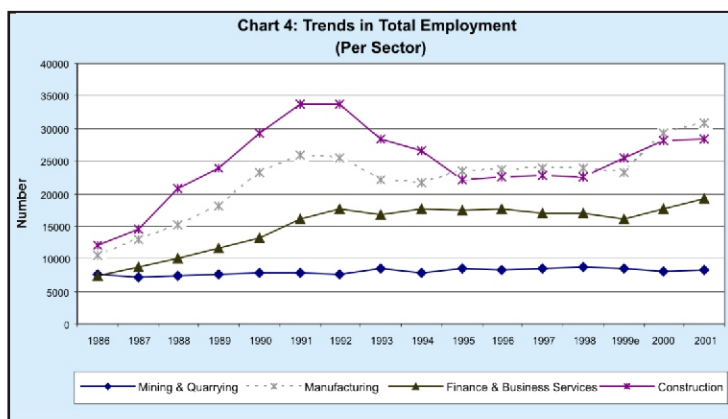


maintained almost constant growth rates. It is hoped that with the introduction of the VAT, non-mineral income tax will show some improvement. This will have a positive effect on the economy's revenue sources and will contribute, albeit modestly, towards reducing the economy's vulnerability to fluctuations in diamond revenues.

Employment

Employment grew significantly over the period 1990 - 2001. Much of this growth was accounted for by increased employment in the non-mining sectors.

Formal sector employment grew on average by 3% per annum between September 1990 and September 2001. The role of the private sector has become a lot more prominent in recent years. Between 1997 and 2001, the private sector registered an average growth employment rate of 6% per annum while employment growth in government averaged 3% per annum.

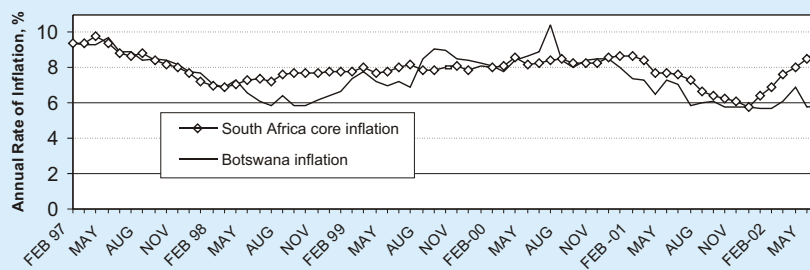


construction sectors exhibited increasing trends. Employment in the mining sector was rather stagnant, indicating the importance of other sectors in creating employment. A significant increase of more than 5% per annum on average was recorded for employment in the manufacturing sector between 1997 and 2001, while finance and business services employment growth averaged 2% per annum. Growth in employment in the construction sector averaged 4% per annum over the same period.

Although there is still a lot to be done in terms of boosting the performance of non-mining sectors, there is no doubt that government initiatives aimed at diversifying the economy may be beginning to bear fruit, as shown by the increasing contribution of the non-mining sectors to GDP, the constant growth rates in non-mineral income tax and the increases in non-mining private sector employment. This, therefore, supports calls for the government to rigorously implement policies and strategies aimed at improving the performance of non-mining sectors, whose growth is expected to help achieve

This is in contrast to the early 1980's scenario, where the government accounted for most of the increase in employment, and

Chart 5: Botswana Inflation, and South African Core Inflation 1997 - 2002



private sector employment was either stagnant or falling.

Between 1990 and 2001, total employment within the manufacturing, finance and business services and

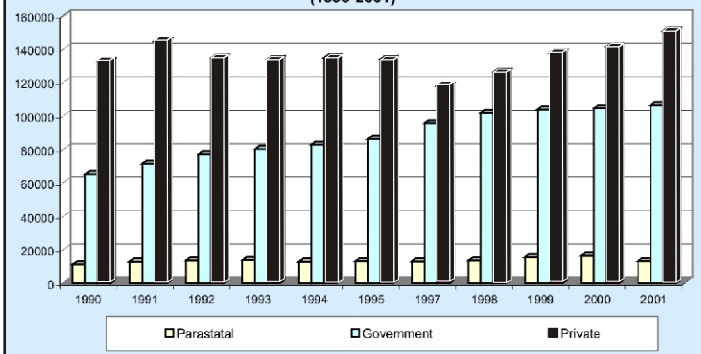
economic diversification and minimise the potential adverse effects of relying on one source of growth.

Inflation Rate

The annual inflation rate for June 2002, at 5.9%, was up by a 0.1 percentage point compared to the May 2002 rate of 5.8%.

The increase in inflation can be attributed to an increase in three group indices; fuel and power index, which rose by 1.3% compared to May 2002, largely due to an increase in

Chart 3: Total Employment by Sector (1990-2001)



electricity tariffs which were increased by 5% effective 1st June 2002; the household operations index, which increased by 1% due to a 2.1% increase in the domestic services section; and the health and personal care index which increased by 1.5%, mainly due to 2.2% increase in the health section.

Inflation in Botswana remained below South African core inflation for the current quarter. As a result, producers in Botswana who compete with imports from South

Africa, or those who export to the South African market, who have had their competitiveness adversely affected by real exchange rate movements, are now becoming more competitive.

Inflation outlook

The introduction of 10% VAT is expected to increase the inflation rate. However, it is difficult to determine the extent of the price increase. Some goods and services were

previously subjected to sales tax. Prices of these goods and services are not expected to increase, unless producers take an unfair advantage of the introduction of VAT to hike prices. It is estimated that the 10% VAT will partially be absorbed by products that were subjected to sales tax before the introduction of VAT, resulting in a one off 3 - 5% increase in the consumer price index. This may result in a similar rise in the inflation rate for July 2002.

ECONOMIC FACTS AND FORECASTS

(end of period)	Quarterly								2002	
	2000				2001				Q1	Q2
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
Interest rates (%)										
BOBC (3 month)	12.43	12.49	12.49	12.71	12.67	12.89	12.82	12.22	12.23	12.21
Prime	15.25	15.25	15.25	15.75	15.75	15.75	15.75	15.75	15.75	15.75
Inflation (%)	7.8	8.9	8.2	8.7	7.5	7.1	6.1	5.8	6.1	5.9
Rand-Pula	1.354	1.330	1.385	1.411	1.426	1.429	1.500	1.709	1.676	1.662
US\$-Pula	0.206	0.195	0.190	0.187	0.177	0.174	0.167	0.145	0.148	0.162
BSE index	1471	1435	1475	1454	1733	2037	2214	2455	2633	2540
Annual										
	1994	1995	1996	1997	1998	1999	2000	2001	2002	
Growth (%)										
GDP (real) <i>d</i>		4.0	3.2	5.5	5.6	8.1	4.1	8.1	9.1 <i>p</i>	4.9 <i>f</i>
Non-mineral GDP (real) <i>d</i>		5.8	6.1	5.5	7.3	7.8	6.2	3.9	6.5 <i>p</i>	6.5 <i>f</i>
Exports (nominal) <i>b</i>		20.6	19.0	23.1	39.7	-15.4	41.2	11.0	-1.0 <i>e</i>	6.0 <i>f</i>
Imports (nominal) <i>b</i>		3.9	21.5	9.6	44.0	19.3	3.4	4.4	3.6 <i>e</i>	14.0 <i>f</i>
Govt. spending (nominal) <i>c</i>		-4.6	21.5	17.3	21.6	22.4	15.0	6.6	20.9 <i>p</i>	26.8 <i>f</i>
Govt. revenues (nominal) <i>c</i>		-16.6	22.2	35.3	12.0	-7.2	55.8	18.0	-5.4 <i>p</i>	8.8 <i>f</i>
Formal employment <i>s</i>		1.3	1.2	2.2	-4.5	6.1	6.4	2.1	4.0	5.0 <i>f</i>
Unemployment rate <i>a</i>		21.3	21.5	20.9	20.4	19.8	17.8	15.8	15.6 <i>e</i>	15.2 <i>f</i>
Domestic (bank) credit <i>b</i>		18.2	-3.7	1.1	5.6	56.1	41.3	17.7	14.0 <i>e</i>	14.0 <i>f</i>
Interest rates (%)										
BOBC (3 month) <i>a</i>		11.90	11.95	12.23	11.40	10.66	11.98	12.71	12.22	12.15 <i>f</i>
Prime <i>a</i>		14.00	14.50	14.50	14.00	14.00	14.81	15.75	15.75	15.75 <i>f</i>
Inflation (average, %) <i>a</i>		10.6	10.5	10.1	8.9	6.5	7.8	8.5	6.5	7.0 <i>f</i>
Rand-Pula <i>a</i>		1.305	1.294	1.284	1.278	1.318	1.329	1.411	1.709	1.664 <i>f</i>
US\$-Pula <i>a</i>		0.368	0.354	0.274	0.263	0.224	0.216	0.187	0.145	0.153 <i>f</i>
BSE index <i>a</i>		313	333	352	709	947	1399	1454	2455	2798 <i>f</i>
Balance of Payments (Pm)										
Exports (diamonds) <i>b</i>		3,727	3,994	5,272	7,675	6,004	9,603	11,748	11,471 <i>e</i>	12,076 <i>f</i>
Exports (other goods) <i>b</i>		1,305	1,995	2,100	2,620	2,704	2,690	1,902	2,048 <i>p</i>	2,257 <i>f</i>
Imports (goods, cif) <i>b</i>		3,663	4,451	4,879	7,026	8,380	8,664	9,047	9,370 <i>p</i>	10,677 <i>f</i>
Current account balance <i>b</i>		568	831	1,644	2,634	860	2,859	2,782	2,558 <i>p</i>	2,885 <i>f</i>
Foreign Reserves										
Pula m <i>a</i>		11,961	13,249	19,076	21,619	26,485	28,852	33,880	41,182 <i>p</i>	40,422 <i>f</i>
US\$ m <i>a</i>		4,402	4,695	5,234	5,675	5,941	6,229	6,317	5,897 <i>p</i>	6,202 <i>f</i>
Govt. spending (Pm) <i>c</i>		4,277	5,195	6,092	7,406	9,065	10,428	11,113	13,433	17,030 <i>f</i>
Govt. revenue (Pm) <i>c</i>		4,472	5,464	7,395	8,281	7,681	11,963	14,115	13,347	15,411 <i>f</i>
Budget surplus/(deficit) (Pm) <i>c</i>		196	270	1,302	875	-1,385	1,536	3,002	-85	-1,619 <i>f</i>
Govt. balances at BOB <i>a</i>		6,705	6,460	7,204	15,364	19,212	20,199	24,740	31,802 <i>e</i>	21,080 <i>f</i>

Notes: *a* end of period; *b* calendar year; *c* financial year (starts March); *d* statistical year (starts July)

e BIDPA estimate; *f* BIDPA forecast; *p* preliminary data; *s* year to September

Details of assumptions underlying the forecasts can be obtained from BIDPA.

Sources: CSO, Bank of Botswana, MFDPA, BIDPA

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