

The recent economic reforms in Botswana: A critical assessment

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Abstract

This paper critically evaluates the economic reforms that have been adopted in Botswana since 2008. The year 2008 is significant for two (2) main reasons; it was the year when: (i) a new president, Lt. General Seretse Khama Ian Khama, was inaugurated, and (ii) a global financial economic recession was declared. Our analysis reveals that most of the recently introduced economic policies were uncoordinated and lacked the intensity to bolster economic activity and mitigate the economic slowdown. Furthermore, the policies give mixed signals as to their intended outcome. For instance, one would have expected that the money raised from the alcohol levy would be used to support anti-alcohol campaigns and rehabilitate abusers rather than be diverted to other projects.

Keywords: economic reforms, tax reforms, recession, economic policies, uncoordinated, economic slowdown.

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Introduction

The aim of this paper is to assess the recent economic reforms in order to understand the rationale behind their adoption in 2008. The year 2008 is important for Botswana because it is the year that the country underwent some major transitions; the most notable were the change in presidency and the beginning of a global economic recession. As one would expect, the new presidency brought with it new innovations in all sectors of the economy, among which was the imposition of the alcohol levy.

To achieve its objective, the paper is organized as follows: the current section introduces the paper. The next section outlines some of the policies that have been improved by the Government under the new presidency. The third, and last section then discusses the poverty reduction policies inherited from the previous Government which are also intended to create employment for low income groups. The already existing, *temporary* labour intensive public works programme under the previous Government known as *Namola Leuba* (drought relief), was replaced with a permanent one, known as *Ipelegeng* (be self-reliant). In an economic recession, such programmes have advantages and disadvantages.

The advantage of such programmes is that they target low income groups, and most of the income earned from such programmes is likely to be spent on goods and services, therefore stimulating economic activity. On the other hand, the programmes may not be good for the economy because Government spending on such programmes as a permanent rather than a temporary measure may not be sustainable in the long term. As such, it is also necessary to interrogate how the Government spent limited financial resources in the face of an economic recession, and examine the rationale for maintaining certain projects which were planned and budgeted for. This is because pursuing such projects may lead to more economic activity and mitigate the effects of the economic downturn. The section also addresses the tax reforms which are sub-divided into taxes and levies, as well as changes to the VAT and corporate tax rates and the implications for both tax payers and the economy. The discussion of tax reforms also includes the electricity and alcohol levies, and their possible effects on stimulating the much needed economic growth.

Economic reforms

This section examines major policies that have been introduced or revamped since 2008. It starts off by focusing on those policies that deal with the pivotal issues of unemployment and poverty. Secondly, Government spending decisions in the wake of a recessionary period are examined. Finally, the section assesses the recent tax reforms, starting with changes to the existing tax rates and concluding with a discussion of the levies that have recently been introduced.

Unemployment and poverty

In an effort to create employment and alleviate poverty among low-income Botswana, the Government introduced a labour intensive public works programme called *Ipelegeng* in July 2008. This replaced the old *Namola Leuba* or drought relief programme. *Namola Leuba* was a famine relief programme that was meant to assist low income Botswana in years when there was shortage of rainfall (see Malema, this volume). In the years when rainfall fell below the required level, the President would declare a drought year and introduce projects that would employ the affected Botswana.

While *Namola Leuba* was temporary, *Ipelegeng* is permanent. In addition, *Ipelegeng* is meant to provide extra income to the poor and the unemployed by having 40,000 of the affected group of people engaged at a time. One of the justifications for continuing with the programme, even during a recession, is that it is one of the stimulus tools that the Government intended to use to mitigate the adverse effects of the economic downturn. Indeed, literature on public economy (Feldstein, 2009; Graves, 2010) argues that increases in Government spending can stimulate economic activity and take an economy out of a recession. But, to be potent, the spending should be large, rapid and targeted at expanding aggregate activity and employment (Feldstein, 2009). A programme like *Ipelegeng*, that began in 2008 and continues to spend at a higher level today, is not likely to be as effective as a counter-recessionary instrument in the way as that which spends a large amount of money in one instant. In this regard, the Government, under the new presidency, should have, at least, continued with *Namola Leuba* until the economy had recovered from the effects of the recession. *Ipelegeng* perpetuates what Siphambe (2003) termed as a 'dependency syndrome' among Botswana as it provides neither training nor education to harness relevant skills that may reduce unemployment.

The other problem with *Ipelegeng* is that there hasn't been any evaluation to determine whether it is achieving its intended objective of reducing unemployment and/or alleviating poverty. On a positive note though, the use of *Ipelegeng* as a stimulus tool may not be such a bad idea. Literature suggests that for a stimulus to work, it has to be handled in such a manner that it is spent on goods and services (Harvey, 2009). By targeting low income earners, *Ipelegeng* guarantees that the money will be spent on goods and services. A rational middle income earner may invest or save it, in anticipation of bad times, rather than spend all of it on purchasing goods and services. Indeed, in bad times, people would rather settle debts with or save the extra income rather than spend all of it.

Government spending

To mitigate the adverse effects of the global economic recession on the Botswana economy, in 2008 the Government decided to continue with the budgeted for projects inherited from the previous Government in order to stimulate economic activity. Some of these projects included the Morupule 'B' Power Station expansion, the expansion of the Sir Seretse Khama, Maun and Francistown airports, and major dam projects. The decision to continue with the projects was a move in the right direction as it came at a time when the economy needed a boost in terms of increases in Government spending. But a relevant question is whether this action took into account the view that public goods are not the same. For example, Graves (2010) argues that not all public goods are equal stimulus tools: while some qualify to be used as part of a stimulus package, others do not. One group of public goods that does not qualify as a stimulus package is one whose production is of no use. 'Not useful' public goods are bridges on roads which go to nowhere or those that are rarely used, and airports that are under-utilized. (Any expansions also have to take into account the general trend that people reduce expenditure during a recession. Although these types of goods may provide the much needed employment, they may also waste the already scarce financial resources. Another example of 'not so useful' goods is the introduction of a security agent like the Directorate of Intelligence and Security (DIS) during a recession. Having the DIS may reduce the (private) demand for security services, installation of electric fences, security walls etc. and contradicts the Government's efforts to stimulate economic activity. The argument here is that during a recession, the Government must always produce public goods that

complement private goods (and are ‘useful’). By so doing, much more income will be generated, partly because individuals have the incentive to generate more income for the goods that they have been yearning for all along. Also, as the provision of public goods increases, so does the demand for complementary private goods. For example, building highways and a new road or improving an existing one will stimulate a demand for cars, and building a dam would stimulate the demand for seeds as rural people may want to start gardening projects. In the case of Botswana, the expansion of the Morupule B Power Station is likely to stimulate the demand for electrical goods, although this might be more relevant for the urban than it is for the rural populations. In these instances, the need to generate income is greater than if the public and the private goods were unrelated. The Keynesian multiplier effect will therefore be very high in this case than if the goods were ‘useless’.

Tax reforms

Taxes

Since its introduction in April 2002, Value-Added Tax (VAT) has been maintained at 10% until April 2010 when the Government increased it by 2% to 12%. The increase came at a time when the economy was recovering from the global economic recession. According to public sector economic theories, during economic recessions, the Government can either increase its spending or cut taxes in order to stimulate economic activity. The rationale behind the increase in VAT is therefore unclear, especially when the economy had not fully recovered. The VAT increase has been among the major factors (besides Government levies) that the Bank of Botswana, during its 2011 Monetary Policy Statement attributed to inflation exceeding the targeted range of 3-6 percent. The argument for the 2% VAT increase may be that the Government wanted to increase its tax revenue, but in a recessionary period increasing tax should be the last thing on the Government’s list of considerations. The focus should be on increasing individuals’ disposable income, so that they may purchase more goods and services. An increase in taxes necessarily contracts disposable income and, as a result, depresses the economy. The VAT registration threshold was increased from P250, 000 to P500, 000 in July 2011. The change might bolster the Government’s efforts to encourage small businesses as they no longer have to maintain elaborate and costly accounts and self-reporting. Having to maintain complex reports was not desirable as it may have been uneconomical, especially for small businesses. However, the increase in the threshold

may have unintended effects as most small businesses may opt not to register. This would mean that they would not be able to improve accountability and record keeping. Record keeping is important in the sense that owners are able to assess if their enterprises are doing well or not and/or detect failure on time and find ways to avoid losses, increased costs and/or possible closure.

Finally, a two-tier Corporate tax system was replaced with a Corporate tax rate of 22% and a Dividend Withholding Tax of 7.5%. This means that companies will now be effectively taxed at 27.85% instead of about 32.5%. For example, under the two tier system, a company that makes P100 profit pays P32.50 in taxes: at the primary stage it pays 15% of P100. Finally, at the *secondary stage*, the company deducts 10% of P75 (i.e. P7.50) as the Dividend Withholding Tax. Under the new system the company will pay P27.85 in taxes; 22% of P100 (i.e. P22) as Corporate tax and 7.5% of P78 (i.e. P5.85) as Dividend Withholding Tax. The new Corporate tax system is easier to administer and is likely to increase compliance by companies and, as a result, more revenue will be collected.

The current Government has decided to continue with the agriculture reforms that were initiated by the previous Government to alleviate poverty. VAT has been amended such that farm implements (ploughs, planters and harvesters) are exempt. This is a good initiative that will ensure a reduction in the cost of production for farmers and therefore reduce the country's reliance on imported food. The proposed tax changes may have come at a good time when the economy needs a reduction in taxes. Indeed, a good tax policy has the potential for contributing to ending an economic recession or mitigating its effects.

Levies

This sub-section outlines some of the recently imposed levies on electricity and alcohol. But, before discussing the levies, one needs to appreciate what a levy is and how it differs from other forms of tax, such as VAT. A levy is a form of excise tax. An excise tax is a tax levied on the sale or production for sale of specific goods. Unlike customs duty, which is imposed on imports (border tax), an excise tax is imposed on domestic goods. Excise tax is sometimes referred to as an indirect tax. It is 'indirect' because it is demanded from an economic agent in expectation that somebody else will pay the tax. In other words, the incidence of the tax does not necessarily fall on the economic agent who

bears the burden of the tax. Examples of other indirect taxes include VAT, excise duty, import and export duties. Usually excise taxes are imposed together with other indirect taxes such as VAT/sales tax.

Excise tax is commonly used as a political as well as a financial tool. Some of the motivation for imposing such a tax may include public safety, health and morals, environmental safety and national security. One of the early proponents of excise on alcohol duty is Adam Smith, who argued that the tax was justified in England because it was the country's policy to suppress the consumption of 'spirituous liquors' because of their perceived danger to health and encouragement of immorality in people (Smith, 1776). In contrast, Samuel Johnson described the tax as nothing but a 'hateful tax' meant only to punish individuals.

Electricity Levy

This is a 5 thebe/kilowatt-hour levy collected to help fund the Rural Electrification Programme by ensuring that new electricity connections to households are affordable through a National Electricity Connection standard cost of P5, 000. It is an additional cost or *tax* on electricity users. Therefore, imposing such a tax will hike the cost of production, leading to an increase in prices, and cost-push inflation. The Bank of Botswana reported an increase in inflation from 5.8% in December 2009 to 7.4% in December 2010 due to, among other factors, the introduction of this levy. Besides, this is an unnecessary cost that is used to finance social programmes.

One of the sectors that the Government wants to support in order to diversify the economy away from the mining sector is the manufacturing sector. The importance of the sector is further emphasized by the latest policy dubbed the 'Economic Diversification Drive (EDD),' which was introduced in April 2010. The policy was intended to support growth and development in both the manufacturing and services sector of Botswana. It was hoped that more job opportunities would be created by such a programme. However, the electricity levy and tariff increases are likely to make the manufacturing sector uncompetitive due to an escalation in the cost of production. This means that attempts to have an export-led growth are stifled.

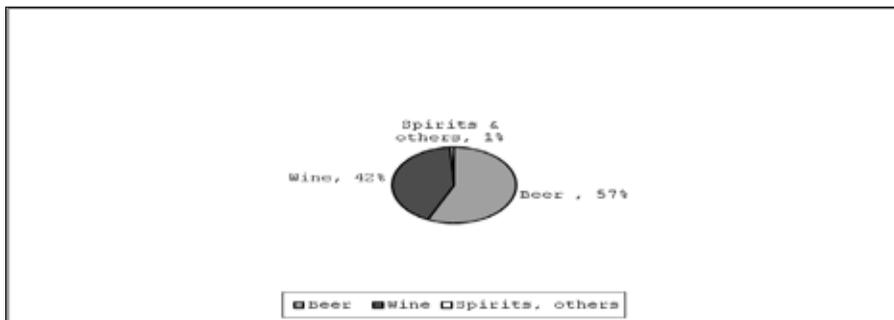
The electricity levy may also be pre-mature given the current shortage of electricity supply to those who are already connected. Furthermore, the electricity levy is also used to finance the Rural Electrification Collective Scheme aimed at ensuring more connections

by availing easy payment terms. Jefferis (2011) argues that investment focused on rural areas is a ‘high risk strategy’ in the sense that the economy may end up with under-utilized expensive rural infrastructure. It is likely that even with electricity, telephones and internet, people will still migrate to urban areas because rural areas have little potential and they rely heavily on Government subsidies.

Alcohol Levy

The levy was initially set at 30% when it was first introduced in November 2008. The levy is a good initiative and it is not a new concept as other countries such as Australia and the UK have such a levy. While the levy is uniform in the case of Botswana, in most countries that have an alcohol levy, it is not. The non-uniformity takes into account the different drinking patterns according to the type of alcoholic beverage, as depicted in Figure 1. Indeed, the potency and the negative social effects differ according to the type of alcohol. The general and non-discriminatory imposition of an alcohol levy by the Government is counter-productive. According to Sechaba Holdings, some of the possible effects of such an intervention measure include the large scale switching in customers’ drinking habits, shifting from low alcohol content products to higher alcohol content products, relatively cheaper imported products and a potentially harmful migration from *Chibuku* to other informally produced brews of a shady quality.

Figure 1: Recorded adult (15+) alcohol consumption by type of alcoholic beverage (in % of pure alcohol), 2005



Notes: Beer includes malt beers. Wine includes wine made from grapes. Spirits includes all distilled beverages. Others include one or several other alcoholic beverages, such as fermented beverages made from sorghum, maize, millet, rice or fruit wine, fortified wine etc.

Source: World Health Organisation (2011).

Drinking patterns in Botswana do not seem to have changed significantly as a result of the introduction of the levy. The levy was reported to have had reduced overall alcohol consumption in litre from 7 million in the third quarter of 2008 to 4 million in the first quarter of 2009, but the decrease wasn't for long because consumption increased to 6.2 million in the fourth quarter of 2009. To investigate the issue further, two consulting firms, Deloitte and Touche and Probe Market Intelligence, were assigned the task of determining the effectiveness of the levy on excessive alcohol consumption. The results of the study revealed that drinking habits are not significantly different from before the introduction of the levy.

In terms of the uses of revenue raised from such a levy, the common practice is to use the revenue for compensating social costs associated with the product/services being taxed. For instance, revenues from tobacco tax might be used on anti-smoking campaigns while revenues from alcohol are commonly used on anti-alcohol campaigns. This is not happening in Botswana. According to a recent news article by *Africa Review*, May 1st 2012 issue, only a small proportion of the money raised from the alcohol levy has been used for the originally proposed anti-alcohol campaign. Instead the money has been diverted to projects that have nothing to do with anti-alcohol campaigns. According to the news article cited above, approximately US\$3.9 million has been used to purchase supplies from the Central Medical Stores (CMS) and some of the money has been used to prepare for the national football team's participation in the African Cup of Nations (AFCON) football tournament. Even where the money has been allocated to the proposed anti-alcohol projects, the projects have been slow to take-off. For instance, of the US\$3.9 million approved for the Department of Secondary Schools' alcohol abuse campaign since 2009, only US\$30,532 had been used as of March 2012. This is a disappointing outcome as one would have expected the revenue collected from the alcohol levy to be used to help those who have an alcohol (abuse) problem rather than for other Government projects as is happening now.

It seems the Government introduced the levy as a way of raising extra cash for other projects and/or to punish those who drink rather than find out why people are abusing alcohol in the first place and what can be done to help those affected. Research such as that of Gujadhur (2000) attributes the abuse of alcohol in Botswana to lack of entertainment facilities. The Government acknowledges the problem and has since introduced initiatives such as the 'Constituency Sports

Tournament.’ If the levy was introduced in good faith then the collected revenue should be used to provide entertainment facilities and provide support and rehabilitation for the affected. The Government should not take alcohol abuse lightly: alcohol abuse is a complex problem and requires complex solutions. Drinking tends to have *primary* outcomes (poor health, contracting STD, even HIV, and assaults) that bring about *secondary* outcomes (job losses and dropping out of school).

Conclusion

The objective of the paper was to assess the economic reforms introduced in 2008 to determine their rationale and possible impact on the economy of Botswana. The assessment was not an easy one for two main reasons: firstly, the change of power in Botswana coincided with the year when a global economic recession was declared. Secondly, the period of analysis may be too short to come up with meaningful conclusions, i.e. it may be too soon to judge the impact of any new policies. The fact that the current Government came into power at a time when the global recession was declared makes it difficult to determine whether the regime would have adopted different economic policies if it wasn't faced with an economic downturn. One thing is clear though: the fiscal stimulus (in terms of its size and speed) adopted to deal with the economic recession was not used in a concerted and synchronized manner in order to boost economic activity. This shortcoming is serious because the fiscal stimulus will not/did not yield the desired outcomes. While the policies introduced are well intended, it is difficult to pinpoint the rationale behind them. For instance, the imposition of an alcohol levy, while it is a standard practice in other economies, begs the question of why it was imposed in Botswana. This is because it was ill-timed—conventionally, during a recessionary period a Government either cuts taxes or increases spending. This is because levies (alcohol, electricity etc.) do not only contract economic growth, but they also lead to increased inflation.

Another pertinent question is whether the alcohol levy was intended to alter people's drinking habits (and related behaviour) or to raise money for its 'stimulus packages', such as *Ipelegeng* or whether it was some kind of punishment. If the levy was imposed in good faith, then the Government should be providing support for those who are alcohol dependent. Therefore, the revenue generated from the levy should be used to provide, among other things, entertainment facilities for young and vulnerable people and rehabilitation centres for those

who are addicted to alcohol. It has been documented that most people drink as a result of limited/lack of recreational and social opportunities as well as poverty and unemployment. Therefore, for abusers, alcohol is an economical source of pleasure and entertainment to spend one's money on. Moreover, from an economic point of view, studies suggest that communities engaged in significant and self-determined projects are not likely to abuse alcohol. A potential solution is to rehabilitate the ex-abuser and provide entertainment and relaxation that does not include alcohol, and create opportunities for (self-) employment. A simple increase in the price of alcohol products is not enough motivation for behaviour change.

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