



Overview

As 1998 drew to a close, the Botswana economy finally felt the impact of the global economic slowdown, with a sharp drop in diamond exports in the fourth quarter of the year. However, this has so far had little impact outside of the mining sector, with sustained growth continuing throughout most of the domestic economy. A key question is, therefore, what impact will current export problems have on the rest of the economy, and what should the appropriate policy response be? In particular, will reduced export earnings and government revenues have any impact on the 1999 Budget, due in February?

On the international front, there is more stability in world markets than there was three months ago; most world stock markets have staged a recovery since September, although there is concern that the US market in particular is still overvalued relative to economic fundamentals. Exchange rates also appear to have stabilised, at least for the time being. There is a general consensus that 1999 will be a year of slow economic growth globally, with some countries in recession. Recent IMF forecasts suggest world economic growth of 2.2% in 1999, the same as 1998, but well below the historical average of 4%. Of particular concern to Botswana and other developing countries is the forecast for a sharply reduced growth rate for world trade, and a continuation of declining prices and weak demand for commodities.

Diamond Exports

1998 was an extremely bad year for the world diamond industry, with rough diamond sales through De Beers' Central Selling Organisation down 28% to \$3.35bn, the lowest annual sales total since 1987. The main reason for this was a collapse in demand for diamonds from Asia, especially Japan. One consequence of reduced sales has been a build up of inventories throughout the supply chain, with stockpiling by producers such as Debswana, by retailers of diamond jewellery, and by the CSO itself. Although Botswana's diamond exports held up reasonably well during the first three quarters of the year, preliminary estimates for the fourth quarter indicate that exports of diamonds were extremely bad, less than US\$150m, compared with an average of US\$500m a quarter during 1997. This would mean that 1998 diamond exports were some 30% down in US dollar terms compared to 1997, and more than 20% down in pula terms.

At the same time as Botswana's diamond exports have fallen sharply, imports have continued to grow strongly, up by an estimated 30% this year, driven by expenditure on major items such as vehicles and construction materials. With imports running at about P800m a month, export earnings were probably covering little more than half of this amount in the fourth quarter, leading to a deficit on the current account of the balance of payments and a decline in the foreign exchange reserves.

The fall in diamond exports is likely to lead to a deficit on the government budget and on the current account of the balance of payments, but will, however, have little short term impact on the real economy. The flexibility provided by the accumulated foreign exchange reserves and government balances means that there is no immediate pressure on the balance of payments, nor will the government have any problems financing its deficit. Assuming that diamond production continues at the same rate, and that surplus diamonds are stockpiled, there will be no impact on employment. Nor will there be any immediate effect on real GDP, which measures

Domestic Economy

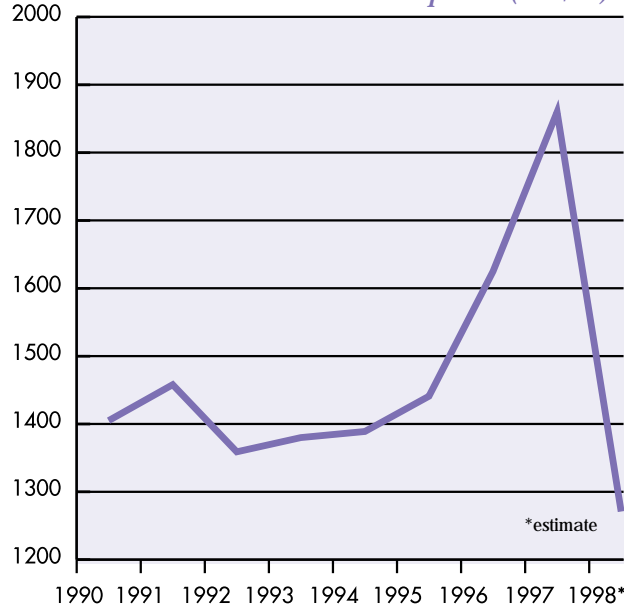
Despite the disappointing export performance, the domestic economy continued to boom, driven mainly by government and consumer spending. The rapid expansion of bank credit that was highlighted in the last issue of the BIDPA Briefing continues, with bank lending increasing by

45% in the 12 months to October 1998. Although part of this is accounted for by a major loan to the WUC North-South Water Carrier project, other lending to businesses increased by 35% and that to households by 45%. Such growth is of course unsustainable and provides an ominous reminder of the boom-bust cycle experienced in the late 1980s and the early 1990s.

Inflation continues to be low by historical standards, but some signs of inflationary pressures are emerging. Consumer price inflation rose for the second consecutive month, to reach 6.4% in December, and could be pushed

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Botswana's Diamond Exports (US\$m)



*estimate

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up further by a sharp rise in South African inflation to 9.4%. Botswana's wholesale price inflation also rose in the fourth quarter, from 5.2% to 5.9%, indicating future rises in consumer prices. Figures on employment, although somewhat out of date, also indicate healthy economic growth: between March and October 1997, formal sector employment rose by 3.6%, which would have helped to bring about a small reduction in unemployment.

Outlook

To be able to withstand the loss of 25% of its major export without any serious immediate economic consequences is

testimony to Botswana's relatively healthy economic situation and record of good economic management. However, this should not induce a sense of complacency. As the chart shows, the reduction in diamond exports is much larger than it was in 1992, the last time there was a downturn in the international diamond industry. Furthermore, current prospects are for a similarly bad year in 1999, with diamond sales projected at the same level as 1998. No recovery is likely unless the Japanese economy moves out of recession more quickly than expected, while any slowdown in US economic growth could make 1999 even worse than 1998, given that the US accounts for around 40%

of the world diamond market. While there is no immediate crisis, it must be acknowledged that Botswana's real income, measured in terms of the international buying power of what we produce, has been sharply reduced in 1998. And dependence upon the cushion of accumulated financial surpluses could soon turn into a liability: as the foreign reserves and government savings are drawn down, revenues fall even faster, given that income from the reserves (which would be reduced) makes up a significant proportion of overall revenues. If there is no sign of a recovery within the next 12 months, then some serious belt-tightening measures will be necessary.

The 1999 Budget

The 1999 Budget, scheduled for February 8th, is likely to be dominated by news of the first budget deficit in sixteen years. This is a major event in economic terms, and marks a sharp turnaround in the country's public finances, which have been very healthy for many years. The move into deficit is due to two major reasons: the sharp drop in mineral revenues because of the crisis facing the diamond sector, and the excessively rapid rate of increase in government spending in recent years.

BIDPA forecasts indicate that the budget deficit during the current (1998/99) financial year will be approximately P1 billion. The turnaround in the budget situation is illustrated by the contrast with the previous year's (1997/98) budget, which recorded a surplus of over P1.1 billion, and with the original forecast of a P200m surplus for the current year. This forecast is substantially higher than the deficit we were forecasting only 3 months ago (P500m), due to the very poor diamond performance in the last three months of the year.

The main change in the budget figures is on the revenue side: we estimate total government revenues at P8.3 billion, some P800m below the budget figure, due to a 25% fall in mineral revenues. At the same time, total government spending is likely to rise by around 25%. A sharp rise in spending was included in the 1998 Budget, due partly to the rapid implementation of NDP 8 projects, but this has been compounded by this year's public sector pay rise, which will have added nearly P500m to spending during 1998/99.

Although the deficit is worrying, and at nearly 5% of GDP is relatively high by international standards (and incidentally is higher than South Africa's troublesome budget deficit), it does not in itself cause an immediate problem. The past sixteen years

of budget surpluses have enabled the government to build up substantial savings. The P1 billion deficit is no larger than the previous year's surplus, and can easily be met from government deposits at the Bank of Botswana, which in October were P19 billion.

However, the rate of growth of government spending is a cause for concern, for other reasons. Government spending has been increasing at over 20% a year since 1994, or 12% a year in real terms, while the non-mining economy is growing at around 7% a year. This means that government spending is increasing considerably faster than total GDP; this is likely to cause inflation, and means that the public sector is increasing its share of the economy, contrary to the government's long-term objectives. Indeed, public expenditure has increased from 34% of GDP in 1994/5 to an estimated 41% of GDP in 1998/99.

The last time that government spending increased too fast, in the late 1980s, an enormous amount of damage was done. The cost of development projects was badly affected, their quality went down, and there was a property boom and subsequent collapse of property prices. It would seem, therefore, that the government should be careful in the 1999 Budget to slow down the rate of increase of public spending. This does not mean that public spending should be cut, which would probably cause too much of an economic shock. However, rate of growth of spending should be below the economic growth rate, which would reduce the share of public spending in GDP. This may be difficult, as there will be political pressure to increase government spending even more, because of the upcoming election, but government should not ignore the economic harm that could result from a further rapid increase in spending.

The 1998 National Business Conference

This year's National Business Conference, held in Francistown over two days at the end of October, marks a turning point in the series of conferences – previously the BOCCIM Private Sector conferences – going back to 1988. In contrast to some earlier years, which have been marked by acrimonious exchanges, relations between the senior government and private sector representatives who make up most of the participants were good. And this year the list of resolutions produced at the close of the conference refer to action by both government and the private sector, instead of being simply a list of demands placed before government.

The theme of the 1998 Conference – which was officially opened by President Festus Mogae – was “Globalisation and Competitiveness: Botswana Towards 2016”. The aim was to examine how the objectives of Vision 2016 could be met in the context of the changing global economic environment, where globalisation is leading to greater international competition and greater integration of economies internationally, recognising that Botswana's continued economic prosperity depends on carving out a successful role in the regional and international economy.

The attempt to link the needs of economic and social development in Botswana – as expressed in the Vision – with broader global trends led to some interesting debates and exchanges, characterised by both agreement and contradiction. The broad parameters of globalisation were set out in the keynote address by Mr Nico Czipionka, a leading South African economic commentator. He noted that globalisation was an unstoppable trend, but one that offered opportunities if addressed in good time with sensible strategies. For Botswana, globalisation offered the potential to be successful in the international economy by concentrating on the development of specialised niche industries in manufacturing and services such as tourism, although the potential of an international financial services centre was doubtful. Success would not be easy to achieve: if Botswana was to prosper it would have to make some hard choices, change some attitudes, and be realistic about strengths and weaknesses. As for Vision 2016,

while it was a valuable starting point, good at laying out the issues and presenting a general framework for progress, it was still “too dreamlike”, and would require a detailed, well focused and appropriately sequenced action plan. He said that one of the consequences of globalisation is that links to multinational companies are absolutely essential, and Botswana needed to be much more aggressive in attracting foreign investment, through, for instance, making work permits much more freely available to foreign investors and skilled workers.

While there was general appreciation of the benefits of foreign investment, several participants were concerned that many investors who had come to Botswana in the past were not genuine, and simply exploited the country's financial benefits without making any long-term contribution to development. There was a lot of support for the idea of “screening” investors to ensure that only genuine ones were supported, but not much appreciation of the fact that such an approach could end up deterring investors in general.

The tension between the promotion of international competitiveness and openness on the one hand, and strengthening locally-owned businesses on the other, was apparent in the topic of “Empowerment and Competitiveness”. It was evident that this is an important issue, and there is a strong feeling that Botswana have not participated fully enough in Botswana's economic development successes, due to a mixture of neglect by government, negative attitudes and a lack of mutual support amongst players in the economy. In response, it was pointed out that most of the economic and social policies adopted and implemented over the past thirty years were in fact aimed at empowering Botswana, and that in many cases the opportunities available were simply not taken up. Looking to the future, there is a lot of expectation that the policies that will result from the Task Forces on Small, Medium and Micro Enterprises (SMMEs) and Privatisation will help to promote local businesses. Empowerment will remain high on the agenda in the future, but also has the potential to clash with the imperatives of globalisation and competitiveness. It was apparent that, all too often, calls to support

empowerment become appeals for additional subsidies and discrimination against foreign investors, neither of which are likely to help the economy become more competitive. It was agreed that a seminar should be held on citizen empowerment sometime in 1999, to give the topic time for more thorough discussion.

Other presentations showed that in general the policy environment is being improved and updated in directions that should help Botswana firms to compete, and to meet Botswana's international obligations, although some areas for improvement remain. The Minister of Commerce and Industry, Mr George Kgoroba, began by outlining the policy initiatives currently being developed by his ministry, including the new Industrial Policy, Policy on SMMEs, and Competition Policy. Other achievements of MCI include the establishment of BEDIA and the Botswana Bureau of Standards (BOBS), as well as the new Copyright Act. This was followed by a presentation outlining the findings of the 1998 Africa Competitiveness Report for Botswana. This report rated Botswana quite highly, as the third most competitive of the 23 African countries reviewed, but also pointed out that there were a number of characteristics where Botswana scored badly. Some of the weaknesses that still need to be resolved from a competitiveness perspective include: ensuring the effective implementation of new policies on privatisation, competition, education and small enterprises; improving the speed of government decision-making; reviewing employment regulations for both the public and private sectors; and improving the ability of management to innovate and improve productivity.

Many of the improvements in the policy environment can be attributed to the debates and decisions made at previous conferences, which have led to a series of recommendations on policy and institutional reforms. The record on implementation of resolutions of previous conferences is quite impressive: the establishment of the Botswana National Productivity Centre (BNPC), the High Level Consultative Council (HLCC), BOBS and BEDIA; the reduction of corporate and personal income tax rates; exchange control liberalisation;

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establishment of the Privatisation Task Force; reform of the Local Preference Scheme, and production of the Long Term Vision for Botswana (Vision 2016). The good relations that prevailed between the government and private sector representatives are partly due to this record, which has dealt with some of the more serious policy deficiencies identified in the past. It also reflects a change of attitudes, with more mutual respect, between participants.

However, some points were apparent that might be relevant to the future role of these conferences. First, while relations between government and

big business are now good, those between government and the small/medium business sector are less good, although the new SMME policy might help. Second, past resolutions have mostly been quite specific, usually calling on government to undertake particular policy reforms. Now, the outstanding requirements relate more to policy implementation rather than formulation, and to changes of attitudes. Third, resolutions refer to action by the private sector as well as by government. This is important, as it reflects the maturing of the economy in general and the private sector in particular. As a result, however,

many of the 1998 resolutions are much "looser" than in the past. This raises important questions that will need to be answered if these conferences are to be useful and relevant, such as how will the implementation (or not) of such resolutions be monitored, and who is accountable for actions which are the general responsibility of the private sector?

A full record of the proceedings of the 1998 National Business Conference will be available from BOCCIM (Botswana Confederation of Commerce, Industry and Manpower) in due course. The conference was organised by BIDPA on behalf of BOCCIM.

Economic Facts and Forecasts

Quarterly (end of period)		1997	1998				1999
		Q4	Q1	Q2	Q3	Q4	Q1
Interest rates (%)							
BOBC (3 month)		11.40	10.26	10.21	10.46	10.66	11.00
Prime		14.00	13.31	13.25	14.00	14.00	14.50
Inflation (%)		7.8	6.9	6.1	5.9	6.4	6.6
Rand-Pula		1.28	1.29	1.36	1.30	1.32	1.32
Pula-US\$		3.81	3.90	4.33	4.48	4.46	4.50
BSE index		708	811	949	954	947	-
Annual							
		1994	1995	1996	1997	1998	1999
Growth (%)							
GDP (real)	d	3.1	7.0	6.9	5.7e	4.0e	-
Non-mineral GDP (real)	d	5.5	5.6	7.5	8.5e	6.0e	-
Exports (nominal)	b	18.4	19.7	40.7	27.8	-12.0e	8.0f
Imports (nominal)	b	2.7	20.4	8.2	43.9	9.0e	13.0f
Govt. spending (nominal)	c	-4.6	21.5	17.3	21.3	26.0e	11.0f
Govt. revenues (nominal)	c	-16.5	22.2	35.3	17.1	-5.0e	8.0f
Domestic (bank) credit	b	18.2	-3.7	1.2	5.6	45.0e	25.0f
Interest rates (%)							
BOBC (3 month)	a	11.9	12.0	12.2	11.4	10.7	11.0f
Prime	a	14.0	14.5	14.5	14.0	14.0	14.5f
Inflation (average, %)		10.6	10.5	10.1	8.9	6.5	6.5f
Rand-Pula	a	1.30	1.29	1.28	1.28	1.32	1.35f
Pula-US\$	a	2.72	2.82	3.64	3.81	4.46	4.90f
BSE index	a	313	333	352	709	947	-
Balance of Payments (Pm)							
Exports (diamonds)	b	3727	3994	5272	7654	6000e	6500f
Exports (other goods)	b	1304	1994	2100	2454	3000e	3200f
Imports (goods)	b	4406	5305	5740	8263	10800e	12100f
Current account balance	b	642	937	2108	3059	-400e	-700f
Foreign Reserves							
Pula m	a	11961	13249	19076	21619	24900e	25400f
US\$ m	a	4402	4695	5234	5675	5600e	5400f
Govt. spending (Pm)	c	4277	5195	6092	7389	9300e	10300f
Govt. revenue (Pm)	c	4473	5464	7395	8659	8300e	8800f
Budget surplus/(deficit) (Pm)	c	196	269	1303	1270	-1000e	-1400f
Govt. balances at BOB	a	6705	6460	7204	15634	18000e	17400f

Notes: a = end of period; b = calendar year; c = financial year (starts March); d = statistical year (starts July) e = BIDPA estimate; f = BIDPA forecast.
Details of assumptions underlying the forecasts can be obtained from BIDPA. Sources: CSO, Bank of Botswana, BIDPA.

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