



Botswana Institute for Development Policy Analysis

THE RECENT FINANCIAL CRISIS:

*Some Reflections on its Likely Financial and
Economic Effects on Botswana*

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Recent Financial Crisis : Some Reflections
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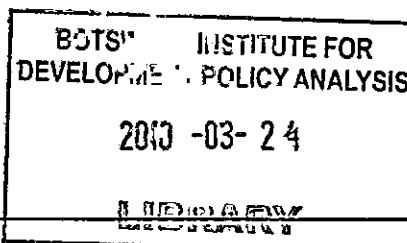
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THE GLOBAL PICTURE

1. INTRODUCTION

As events are still unfolding, it is difficult to write a complete story about the subject. As we speak: the stock market continues to decline, a number of companies are bankrupted and collapsing, many banks all over the world are in some trouble, and the job layoffs in each company and in each country is changing by the day. Worst yet, many believe, the worst is yet to come, as witnessed by the recent number of job losses in the US and Europe. This brief note is, therefore, only a snap-shot of the story to date and only a selected aspect of this complex, ever-changing and far-reaching aspect of the unfolding story.

I don't know how much justice I will do to this complex issue. Hence the objective of this note is rather limited. Specifically, the intention here is not to fully dissect a rather complex and yet unfolding economic phenomenon, but rather to highlight, if possible, some of the implications to the Botswana economy using the limited data available. Accordingly, Part I explores the factors commonly cited as culprits for the crisis, its effect on the global financial and economic performance. And finally Part one concludes by highlighting the likely core economic factors that might have contributed to the crisis. Having laid the global context, Part II then deals with the likely impact(s) of the crisis on the Botswana economy. After a brief description of the preliminary evidence, it will outline the approaches that have to be followed towards designing and implementing policies that might help mitigate the effects of the crisis¹. Before going to details, let me briefly review how we get there and the state of affairs in both the financial and economic sectors as a background to the detail that follows.

1.1 In the Financial Sector:

The world economy has changed dramatically since September 2008. What began as a downturn in the US housing sector is now a global crisis, spreading to both rich and poor economies; Many believe this may go down in history as 'the worst crisis since the Great Depression of the 1930s'.

The housing bubble in both the US and some European countries has been noticeable for some time. This boom was taken at its face value as a sign of healthy economic performance despite some notable warning signs in some quarters, particularly in the way credit is priced and allocated. Added to this were the market environment which had roots in the deregulation undertaken under President R. Reagan in the US and Prime Minister M. Thatcher in the UK in the 1980s. This environment coupled with the financial innovations that have been taking place in the global market led to a financial sector that is neither controllable with the traditional means of monetary policies nor immune to price risk and assess profitability. In short, among some of the commonly cited explanations as factors that contributed to the financial crisis include:

¹In this note, if and when no specific resource(s) is provide, all the ideas that are either quoted or paraphrased are attributed to WIKIPEDIA ENCYCLOPEDIA and other incorporated internet sources by anonymous contributors.

THE RECENT FINANCIAL CRISIS:

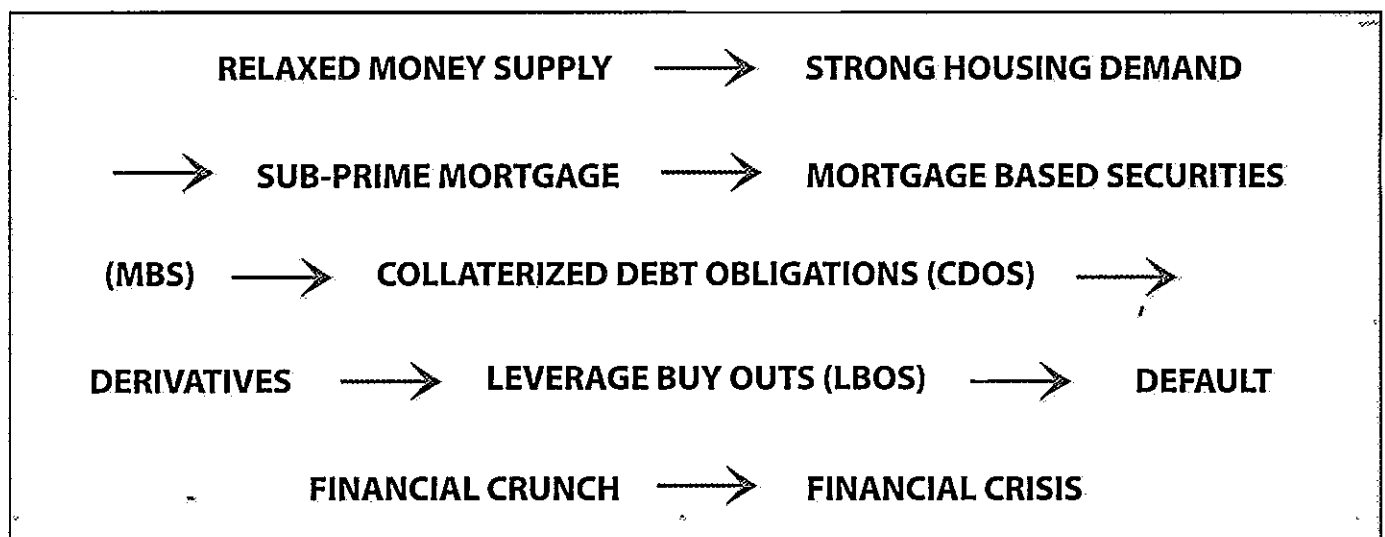
lack of regulation in the financial markets (particularly derivatives related to the mortgage backed securities (MBS);

- a) Excess money supply in the system; partly fuelled by unprecedented financial innovations;
- b) overheating of the world economy (due to economic boom in China, India...);
- c) Commodity price increase;
- d) Irresponsible financial management;
- e) Excess saving in China, Japan, Germany and the Middle East; and
- g) Greed supported by right-leaning political environment.

These factors, triggered by the nationalization of the ' Fannie Mae and Freddie Mac on September 8, bankruptcy of the Lehman Brothers, and the bailout of A.I.G (the largest insurance company in the world) led to the chain reactions worldwide and resulted in the financial meltdown across many countries. This chain of events shook the confidence of the financial market beginning mid-September which was already simmering to burst any time by the collapse of the housing market in the US. Once such huge companies reached the brink of collapse, the crisis spread across the international financial markets like a wild fire.

Therefore, as the following chart shows, the Collapse seems to have developed as follows:

Box 1: Sequence of Events that likely led to the Crisis



Clearly the initial core culprit for the crisis is the sub-prime lending in the US which Gylfson (2008, P. 2)² defined as “selling mortgage loans to people with no jobs, no income, no money to put down, and no means of paying back”. In effect due to the way the housing market has been operating the market economy got drunk in which the hangover is unfolding. A prime example of this madness is found in one investor (a certain B. Madoff in which he allegedly skimmed \$50 billion from customers using a Ponzi type of game!). Ultimately, as A. Shah (October 5, 2008) noted, “The extent of the problem has been so severe that some of the world’s largest financial institutions have collapsed. The government of wealthiest nations in the world have resorted to extensive bail-out and rescue packages for the remaining large banks and financial institutions”.

‘Cutting to the chase’, as they say, let me just summarize it as follows: Ignoring what happened to specific companies and individuals, it has affected the financial markets of national economies across the world, albeit at different degrees. In short, it seems it is much more difficult to find an unaffected country in Europe, Asia and Latin America than the converse. To name a few, among the countries whose stock markets have either been partially or mostly collapsed, needed BOP support abroad, or faced a serious financial meltdown include: in the **Americas**: *Argentina, Brazil, Chile, Canada, Mexico, the US*. In Asian-Pacific: *Australia, China, Hong Kong, Japan, Malaysia, Newzealand, Singapore, South Korea And India*.

And in **Europe**: *Austria, Belarus, Belgium, Denmark, Estonia, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Netherlands, Norway, Poland, Portugal, Russia, Spain, Sweden, Switzerland, UK and Ukraine*. And even in the **Middle East**, (particularly **Saudi Arabia**) haven’t been immune from the crisis, albeit with less severity than that of Europe, mainly because they were some of the lenders. Therefore, as the Guardian reported, the Bank of England noted that, “market mayhem has left the world’s financial institutions nursing losses of \$2.8 trillion”. For instance, ‘between the first half of 2007 and end of 2008, between 25 to 50% of the value of assets on the world stock exchanges has been wiped out’. More ominously, since March 2008, major investment banks and major integrated global banks and other financial institutions have been threatened with collapse. ‘Citibank, the US’ biggest bank, got \$27 billion injection from foreign sovereign funds. UBS, the world’s fifth biggest bank, got \$ 37 billion capital injection from similar sources’.

1.2. The Real Economy

And what has been the economic impact so far? Since what is happening globally is clear, let me just highlight the following general points:

- The Global economy is in major downturn in which most countries are officially in recession;
- Particularly, the US, Europe, Japan and many industrialized countries are hard hit;

²T. Gylfason (2008), “What’s going on? ten lessons from The Financial crisis” (January) The Second Annual Meeting of the African Policy Institutes Forum, 4-5 December 2008, Libreville, Gabon.

- But even the relatively strong emerging economies (like that of China and India) will contract by some percentage points. For instance, China and the Middle Eastern oil exporting countries are revising their growth prospects downwards for 2009.
- Worst yet, the poor countries which many believe will be spared from the collapse of their financial sector (thanks to lack of global integration) their economies are likely to be affected via various channels like investment, trade and tourism.

Accordingly, the economic slowdown and recession have resulted in massive employment layoffs in different countries across the globe, again at different degree of severity. To just highlight some figures, as a sample of the increase in unemployment:

- The ILO initially forecast that 'unemployment was expected to increase by 20 million in 2009, but in its recent estimates it stated³ "as many as 51 million jobs worldwide could be lost this year because of the global economic crisis. The UN agency says that would push up the world's unemployment rate to 7.1% by the end of 2009, compared with 6.0% in 2008 and 5.7% in 2007".
- The number of jobs lost in the US in 2008 was 2.6 million, in November 2008 alone 533,000 jobs were lost and still continuing in 2009; Consequently, the unemployment rate jumped to 7.2% (a 16 years high) by the end of 2008. More recent estimates put the figure around 10%.
- The high unemployment figures do not include the recent layoffs (in Caterpillar -20,000, Home Depot - 7,000, Microsoft and other firms such as ING and Philips);
- This number will swell if and when the layoffs by auto manufacturing companies materializes, estimated to be about 3 million in the US alone.
- Even in China the number of factories that are closing and the increase in unemployment due to the decrease in exports is huge.

1.3. Any Theory as a Guide?

Not many economists predicted the magnitude of the crisis; most economists predicted this will be an easy recession and recovery will start by July-August of 2008. Clearly, many economists missed the cause, the scope and the duration of the crisis. This might be partly due to lack of a comprehensive theory that explains the anatomy of financial crises.

³International Labour Organization (ILO), BBC (28 January 2009).

For brevity, the scanty theories of financial crisis that we have might be grouped into three interrelated categories⁴: (a) World Systems Theory, (b) Minisky's theory and (c) Coordination Games based theories.

- a. *The World Systems Theorists* (Andre Gunder and Immanuel Wallerstein, for instance), and the *Minisky Theories* essentially (with some variation in details) argue that 'financial fragility is a typical feature of any capitalist economy' as it moves through the business cycles'. In particular, firms change their attitude towards risk as they go through the various stages of the business cycle from 'hedge finance' (conservative risk) to 'speculative finance' (moderate risk) and finally to Ponzi financing as their confidence increases with an economic boom. These theories essentially emphasize that the free market system is 'impregnated' with internal instability.
- b. *Coordination Games* related theories, on the other hand, are the modern theories which use mathematical models that emphasise that financial crisis result from 'feedbacks which are explained as herd mentality, contagion, self-fulfilling prophecies (as in Dornbusch, Krugman and Fieldestein for the exchange rate speculative attacks)'. Their defining feature is that they are caused by some actual or perceived disequilibrium and an overreaction to this disequilibrium by economic agents.

2. WHAT HAS BEEN THE POLICY RESPONSE SO FAR AND WILL IT WORK?

2.1 The Policy Response

World leaders initially met in Beijing to address the issue (an interesting choice of venue to fix the market system); After few exchange of ideas to work cooperatively, they decided to make the next meeting in the US and then to get together in three months time. France and the UK seem to be taking an aggressive stand at a global level to remedy the financial structure by either re-organizing the World Bank and the IMF or coming up with a new (Bretton Woods II ?) or some financial architecture. The so called G20 countries met and declared their intentions to do something about it.

But at a specific country level, most of the major economies have been engaged in some bailout of one sort or another. As Highfill⁵ (2008, p.1) noted¹ "The government responses are perhaps the best signal of the scale of the crisis – the September \$700 billion bailout packages in the U.S.; the October packages, 50 billion pounds in the U.K., 500 billion Euros in Germany, 360 billion Euros in France; and November's four trillion Yuan package in China " are among the notable ones governments released to bailout their respective markets. This of course does not include the many bailout packages by much smaller countries and the nationalization measures taken by some countries like Iceland, among others.

⁴wikipedia.org/wiki/financialcrisis

⁵Highfill, J (2008), "The Economic Crisis of December 2008: The Global Economy Journal, Weighs In", 8(4), P. 1-5.

In short, the U.S. Federal Reserve, China, Japan and the European Central Bank (ECB) alone have now infused close to \$7 trillion worth of financial help to markets. However, the deflation in all markets is so severe that those infusions pale compared to the \$25 trillion wiped out from world markets in the last year. In another front, by October 30, the International Monetary Fund offered as much as USD 100 billion in a new kind of loan to countries that are battered by the financial crisis, making available new cash to help ease the world credit crisis.

In the US, the new administration is proposing \$825 billion stimulus package (in addition to the \$700 billion financial bailout). If the congress approved, this will be a massive stimulus package. It appears that the stimulus package is considered so vital, it has become the preoccupation of the new administration. In short, it seems, anything could fly in the US public and the Congress as long as it is couched in terms of helping the financial crisis.

2.2. Will the Bailout Policy Work?

On the whole, the jury is still out but the consensus and the economic events since the announcements of the bailouts seem to be:

- (a) That the bailout and the stimulus package are necessary for the simple reason that "the cost of not doing is higher than doing so".
- (b) that it may help, at least in the short-run, by boosting confidence in both the financial markets and the business community;
- (c) but not likely in the long-run.
- (d) but some argue the cost of incurring such a huge debt is a burden for generations to come while that it will work at all is questionable. Therefore, while most agree that it has to be done, its efficacy in limiting the damage on the economy and its impact on debt are of some concern for some people. To sample a few view points:

Stiglitz believes, "The very assumption that the rescue plan has to help is suspect. After all, the IMF and the US treasury bail-outs for Wall Street 10 years ago in Korea, Thailand, Indonesia, Brazil, Russia and Argentina didn't work for those countries although it did enable Wall Street to get back most of its money. The taxpayers in these other poor countries picked up the tab for the financial markets' mistakes'.

Stiglitz continues, "The bailout is seen as a bailout for the culprits while the ordinary person would be left to pay for their folly. (This assumes) that you throw enough money at Wall Street, and some of it will trickle down to the rest of the economy. It's like a patient suffering from giving a massive blood transfusion while there is internal bleeding; it doesn't do anything about the basic source of the haemorrhaging, the foreclosure problem " (Stiglitz, 2008).

R. Lucas, on the other hand, believes that "The immediate focus should be on addressing the recession. And the Fed seems to be doing its job". R. Lucas. The market 'guru' supporting a bail-out!

In short, many believe that it's a total unmitigated disaster. The only question is "when will all the layoffs appear everywhere?". If we go back to the last great world depression in the 1930's, all the layoffs started in earnest about a year after the financial crashes. By 1933, the US had over 25% unemployment, and stocks had fallen 90%.

So these are some of the views on the world economic situation. So far we have seen the financial and economic impacts of the crisis, but what explanations do economists give as fundamental causes for this?

3. WHAT FUNDAMENTAL FACTORS CAUSED THE ECONOMIC IMBALANCES?

At a diagnosis level, whether it is viewed as a temporary market correction or a system disintegration of the market system, depends on the school of thought you subscribe to. But interestingly, Minsky's Post-Keynesian predictions seems to be sensible in this case when he stated some 30 odd years ago that: "Stability is paradoxically destabilizing... good times encourage experimentation and excessive risk-taking, ending up with a bang".

Be that as it may, the current crisis is attributed to have been caused by three imbalances:

a. Current Account Imbalances:

'A decade ago, the Asian financial crisis of 1997 was caused by the gaping current account deficits of emerging countries mostly financed by private capital inflows that gushed out as quickly as they pushed in. Today, the export surplus and excess savings in other parts of the world – most notably the Asian countries – support the consumption habits of the US household and government'.

In 2006, US public debt (excluding government's intra-governmental debt of another \$3.8 trillion) 'stood at \$5 trillion of which \$2.2 trillion (44%) was held by foreigners. Foreign central banks with huge reserves owned 64% of this \$2.2 trillion. The country holding the most US public debt was Japan (\$612 billion), followed by China (\$420 billion). This does not include the private debt of households in the US totaling \$12.8 trillion (\$9.7 trillion in housing loans and \$2.4 trillion in credit card loans)'.

'Corporate debt was \$9 trillion and financial sector debt was \$14.2 trillion (Hodges, 2007). According to the same report, foreign investors accounted for 46% of US treasury bonds, 27% of corporate bonds, and 14% of government agency bonds. In 2007 the US CA deficit of \$790 billion was 93% financed by the combined CA surpluses of China and Japan, Germany and Saudi Arabia (Economist 2007e)'.

b. The second imbalance is 'Wealth and Income Imbalance'

The so called 'saving glut' or less consumption in the emerging economies while the converse is true in the developed countries is also cited as a contributing factor. (But) Why? One view is, it may be 'because there aren't many profitable investment opportunities or the bond markets are not well developed';

But it may also be due to skewed income distribution. Hence 'income and wealth inequality in these countries has worsened. For instance recent studies in China have shown that income inequality as measured by the Gini coefficient rose from 0.310 to 0.415 (equivalent to that of the US in 1999) between 1985 and 2001 and it is likely to increase due to the bias against the rural area. The inequality is also evident from the disproportionate share of income - most of it going to capital rather than labor - according to WB estimate the share of China's GDP to labor fell from 53% in 1998 to 41% in 2005'.

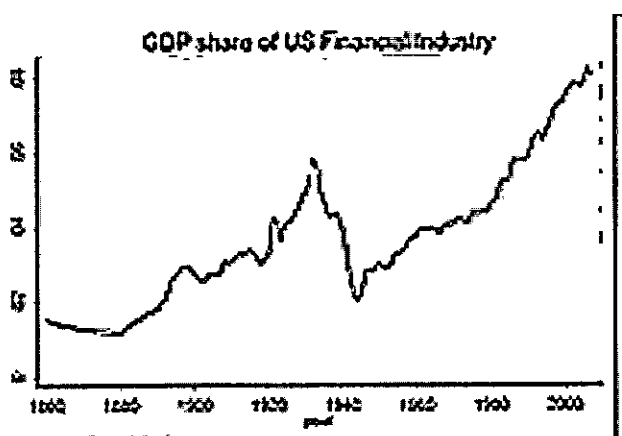
The excess wealth must be re-invested. Therefore, the billions and trillions of excess income of rich individuals, institutions, and sovereign states has no option but to chase for higher yields. Financial institutions and innovations exist to meet these demands, hence, in the midst of today's credit crunch, there is excess liquidity in the financial system looking for profitable investment opportunities. For example, sovereign states with an estimated \$3-\$4 trillion of funds are desperately seeking higher yield.

c. Imbalance between Finance and The Real Economy

This is the most serious of the imbalances that have taken place. The volume of financial investment has dwarfed the value of productive investment worldwide as various indicators show;

'The ratio of global financial assets to annual world output used to be about equal (109% in 1980), but by 2005, it was three times larger (316%). And in terms of value, global financial assets were \$140 trillion while total world GDP stood at \$48 trillion in 2006 (1:3)'.

GDP Share of US Financial Sector (1860-2008)



Another indicator is the fact that the basic composition of the financial sector has dramatically changed:

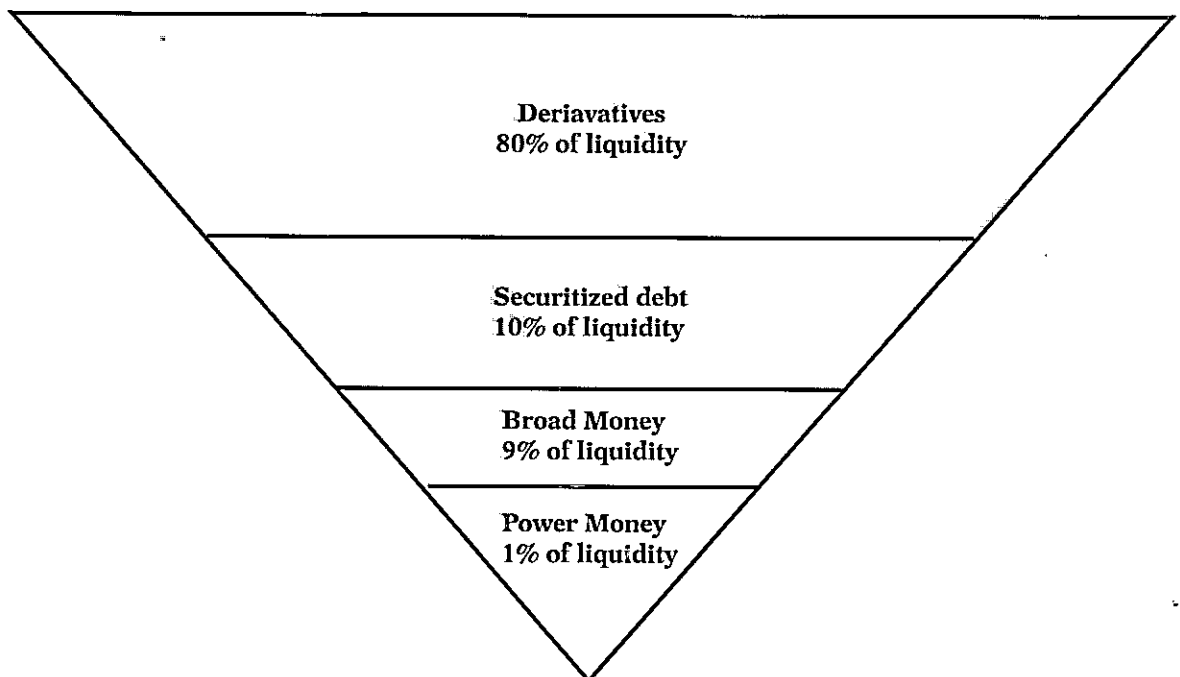
‘Turnover in traditional exchange markets (spot, forward and swaps) increased to an unprecedented level of \$3.2 trillion a day, while activity in the over-the-counter derivatives markets reached \$2.1 trillion per day. This is compared to the volume of world trade which stood at \$12 trillion per day’.

- ‘The traditional idea of M1, M2 and M3 as the core liquidity is no longer valid, given the financial innovations that have resulted in an explosion of other forms of liquidity, like derivatives, that have truly escalated leverage’.

According to a recent study high powered money (M1 and M2) constituted only 1% of the global liquidity pyramid while broad money and securitized debt constituted 9% and 10%, respectively. Derivatives constituted 80% of the global liquidity

The global liquidity market is estimated at \$607 trillion or 12.5 times global GDP. Given this scenario, central banks have little control over the global liquidity market. It seems the basic relationship that is supposed to exist between the amount of money in the economy and size of productive assets is disturbed and worst yet it has become beyond the ability of central bankers to establish that balance in the advent of the current financial innovations.

Figure 1 Global Liquidity Market \$607 Trillion



In Sum, therefore, both the financial meltdown and the economic downturn, albeit big, suggest that it is a reaction to the excesses observed in the market rather than a collapse of the system. This is just like a drunk person who may negatively affect his health (and at times could endanger himself) but after while s/he shakes off the hangover and becomes the good self.

WHAT ARE THE LIKELY IMPACTS ON BOTSWANA? AND AFRICA?

4. IS BOTSWANA LIKELY TO 'DUCK' THE FINANCIAL BLOW AS SOME AFRICAN COUNTRIES SEEM TO DO?

There are different views regarding the likely effects of the crisis on Africa in general, never the less, there seems to be a consensus on the following points:

First, because of Africa's generally weak financial integration with the rest of the global economic system, it is believed that the financial sectors of many African countries (except slightly that of South Africa and few countries) will not be directly affected by the unfolding crisis.

Second, the economic effects that are likely to follow (if and when they do) are going to be severe because of the vulnerability of African economies to even minor external shocks and their dependence on the rest of the world for vital economic support;

Third, the channel through which the shock(s) transmit to African economies is not mainly through the credit crunch and lack of liquidity as observed in advanced and emerging economies but through the recession that follows this crisis.

As the World Bank Chief Economist for Africa S. Devarajan noted: the way the crisis would have an adverse impact on African economies as recession in developed economies spread will be indirect, which include:

First, a slowdown in private capital flows which will negatively affect economies that had been relying on these flows to finance much-needed investment, particularly infrastructure investment. "Already Ghana and Kenya have postponed sovereign bond issues worth about \$800 million," he said.

Second, commodity prices are falling which favors importers at the expense of exporters. UNCTAD adds "Commodity-dependent economies are exposed to considerable external shocks stemming from price booms and busts in international commodity markets". Countries like Botswana are vulnerable for such booms and busts.

Third, tourist revenues are likely to substantially decline as recession in developed countries deepens, as these countries tend to be the biggest source of such flows.

The wealthier ones (Middle Income Countries – MICs - like Botswana and South Africa) who do have some exposure to the rest of the world, of course, may face some

problems of financial crunch as well in addition to the secondary or recession related economic effects.

Consequently, as is the case for the developed countries, the World Bank has downgraded the growth prospects of Africa from 7.9% to -0.1% for 2008 and from 6.9% to -1.1% for 2009 (see Table below).

World Economic Outlook projections (IMF - the last two years are revised values)

World	2006	2007	2008	2009	2008	2009
USA	5.1	5.0	3.9	3.9	-0.2	-0.9
Euro area	2.8	2.0	1.6	0.1	0.3	-0.7
UK	2.8	2.6	1.3	0.2	-0.4	-0.1
Brazil	2.8	3.0	1.0	-0.1	-0.8	-1.8
Russia	3.8	5.4	5.2	3.5	0.3	-0.5
China	7.4	8.1	7.0	5.5	-0.7	-1.8
India	11.6	11.9	9.7	9.3	-	-0.5
Sub-Saharan Africa	9.8	9.3	7.9	6.9	-0.1	-1.1
Middle East	6.6	6.9	6.1	6.3	-0.5	-0.5
ASEAN-5	5.7	5.9	6.4	5.9	0.2	-0.1
World trade volume*	5.7	6.3	5.5	4.9	-0.1	-1.0
APF/MRDE	9.3	7.2	4.9	4.1	-1.2	-1.9

On the bright side its relatively healthy foreign reserve position (about USD 8 to 9 billion or 65 to 70 billion Pula) and a decline in oil prices have probably mitigated and give some optimism despite the gloomy picture;

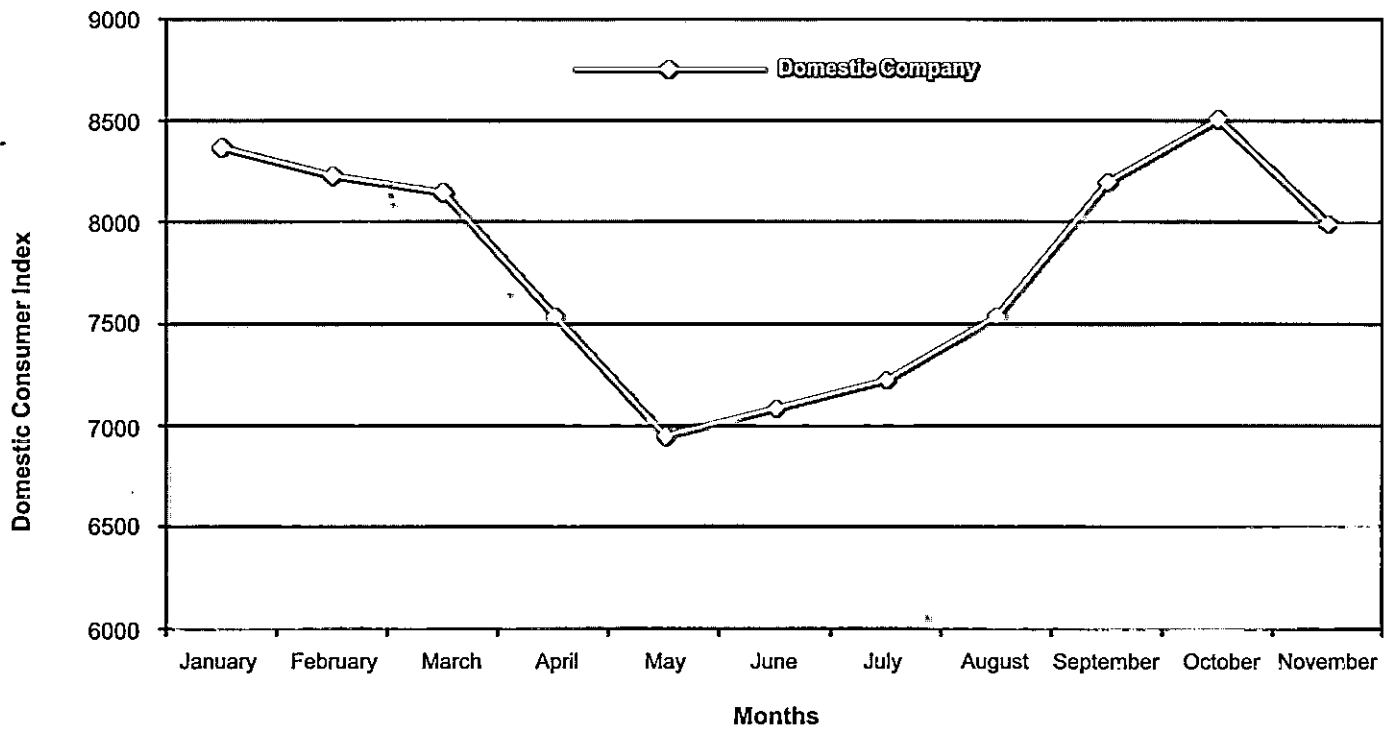
Otherwise, as is the case in many export dependent economies, the preliminary evidence suggests that both the real sector and to some extent the financial sector are somewhat negatively affected by the crisis;

4.1. What does the Preliminary Evidence Say?

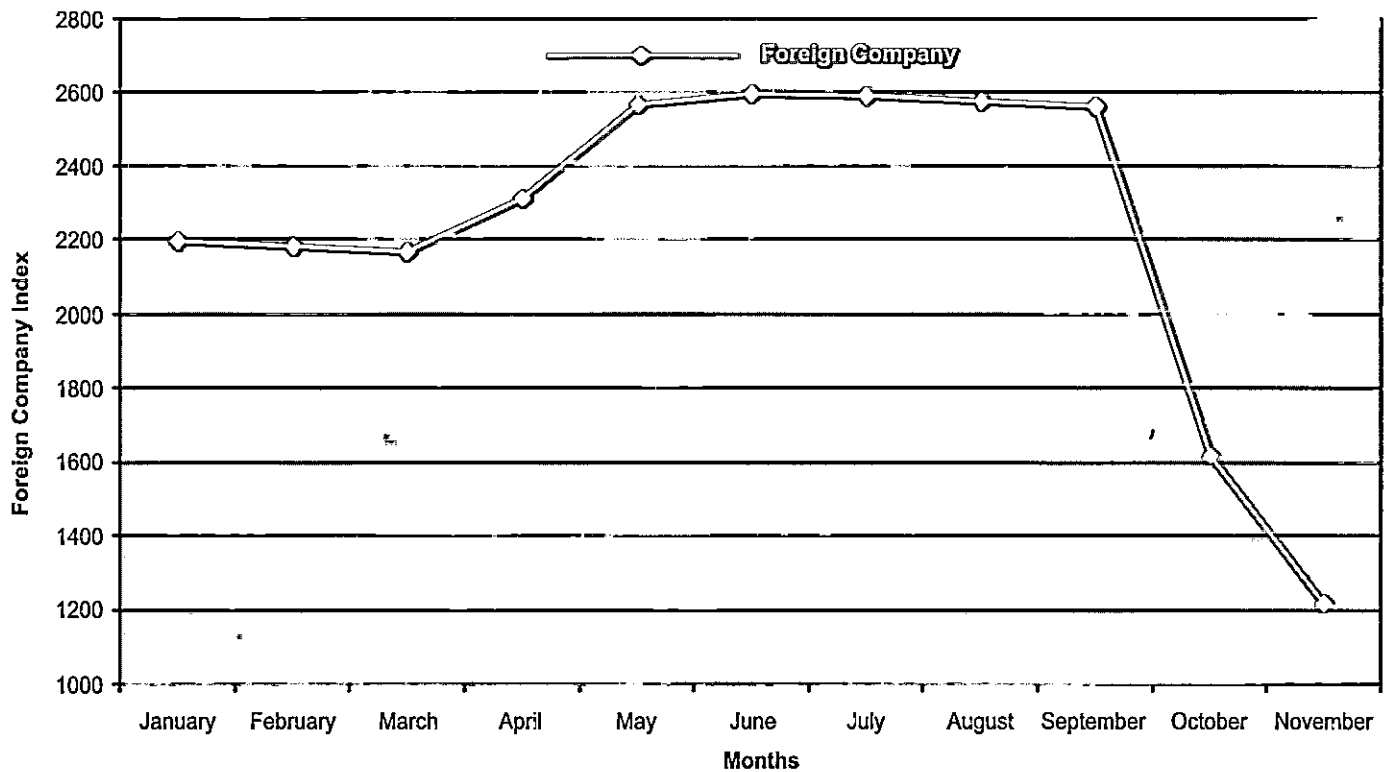
The Picture in the Financial Sector

As the following graphs show, the stock markets of both domestic and foreign firms show a decline since September 2008. In particular, the index for foreign firms has noticeably declined since September as was the case in the industrial countries. Understandably, the index for domestic firms started to decline slightly late and with a smaller margin than that of foreign firms.

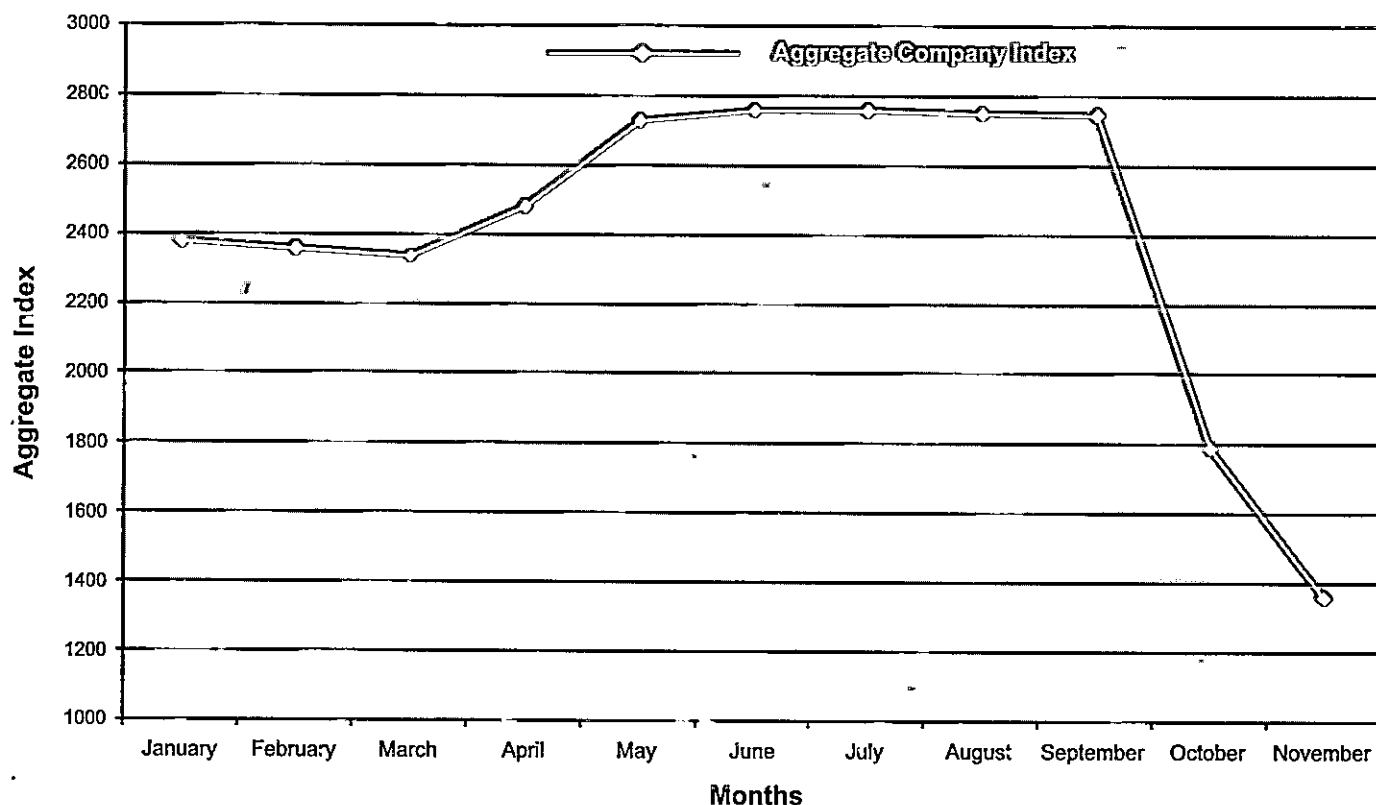
Domestic Company Index, 2008



Foreign Company Index, 2008



Aggregate Company Index, 2008

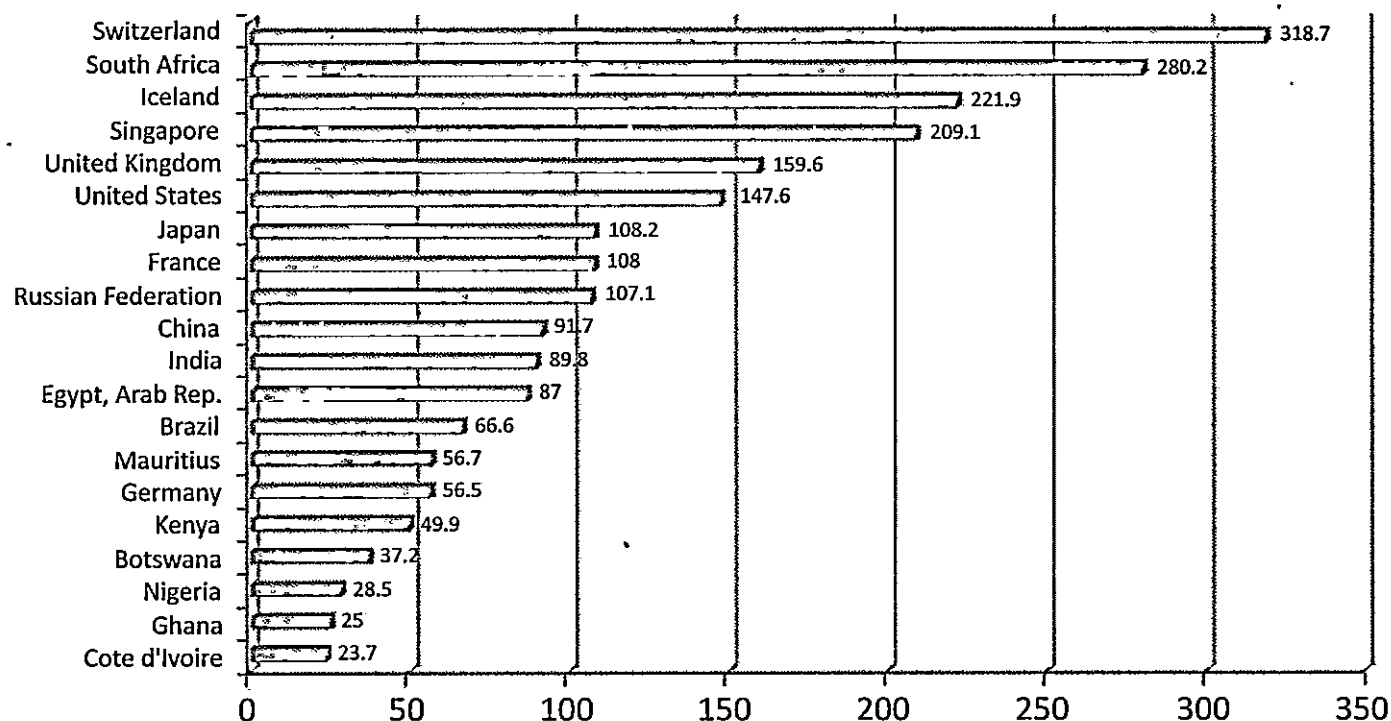


But let's put it all in context. While there have been a downward movement in the financial sector in recent months, Botswana's overall financial structure looks healthy compared to other countries. Let us examine some indicators for both few selected countries and Botswana as data permits.

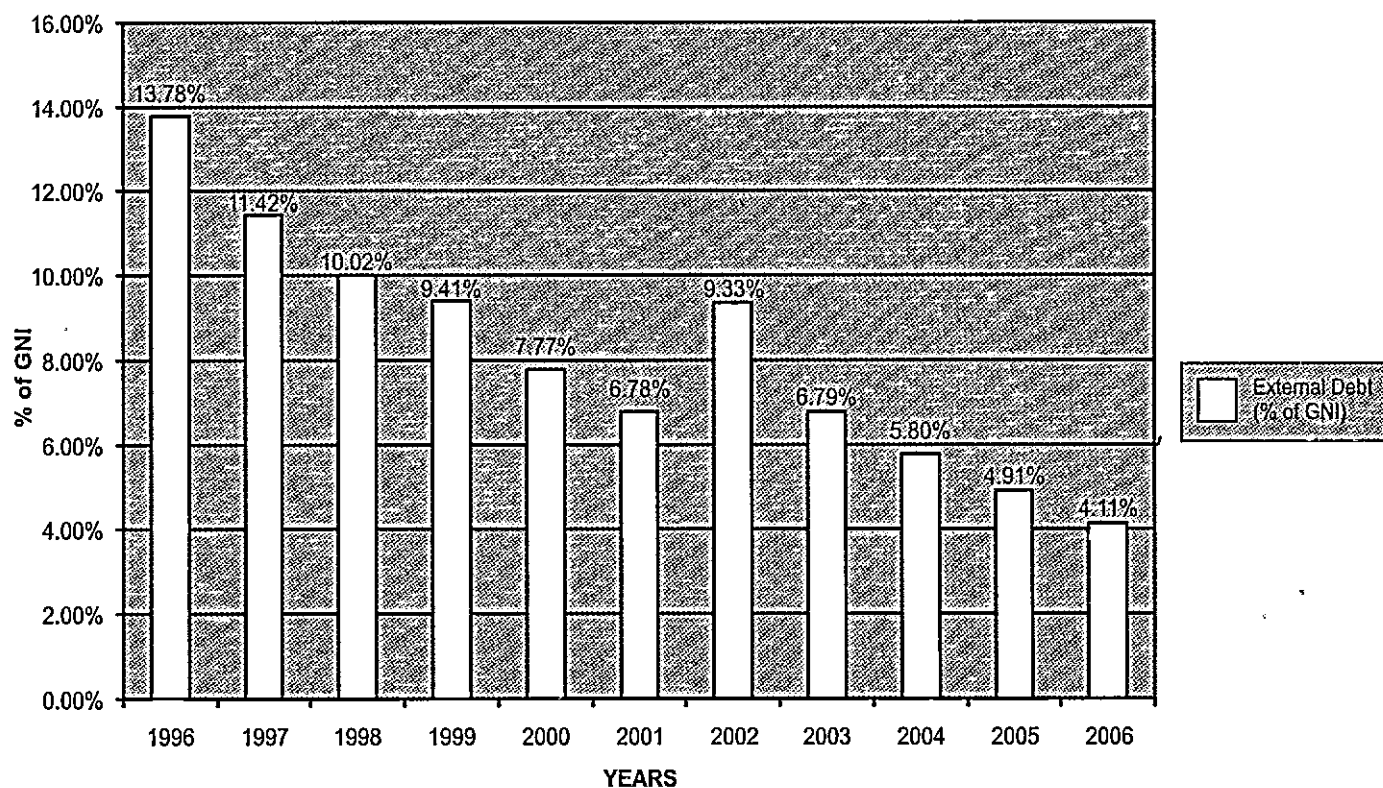
If we choose (i) market capitalization of listed companies (ii) External debt, (iii) Bank assets, (iv) Central Bank foreign exchange reserves, and (v) current account balance of these countries as a ratio of GDP (as a scalar), Botswana's position is relatively healthy. As could be seen in the following graphs, in all the cases, Botswana's position is not comparable to the countries that are hard hit like Iceland, for instance. Note that we only used data up to 2006.

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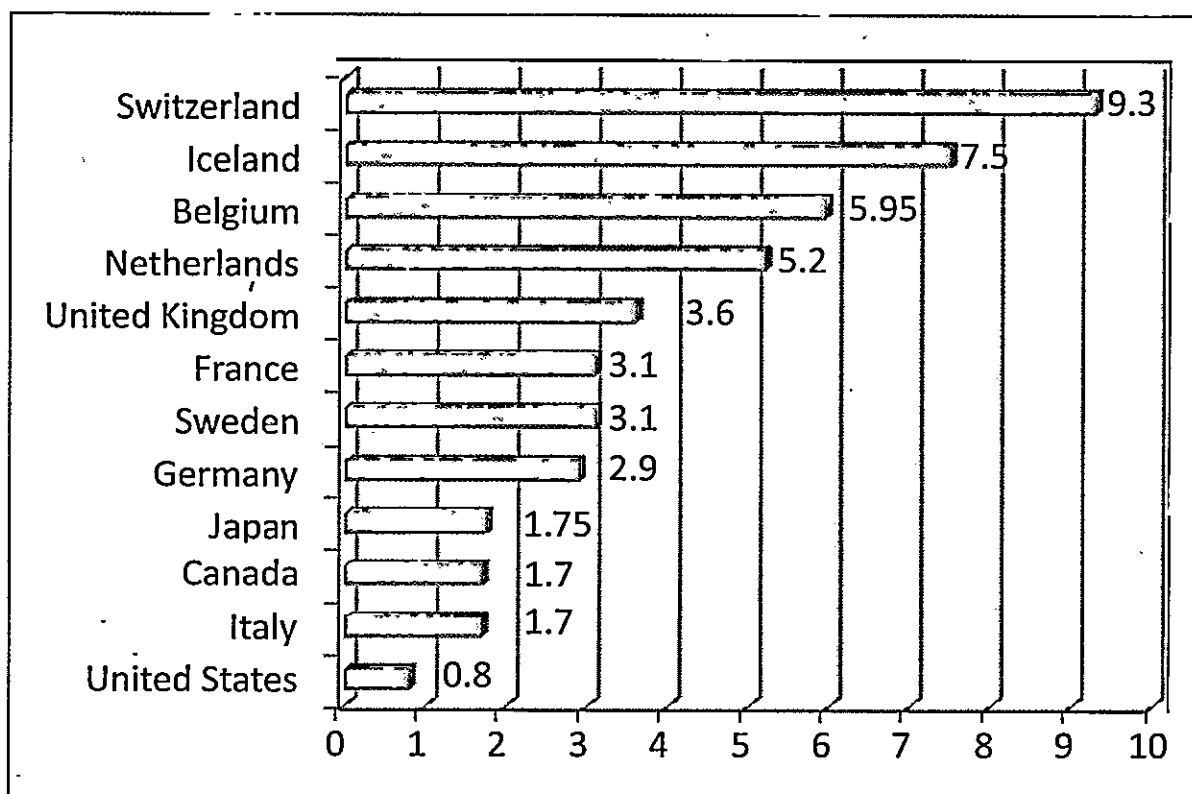
Market capitalization of listed companies 2006 (% of GDP)



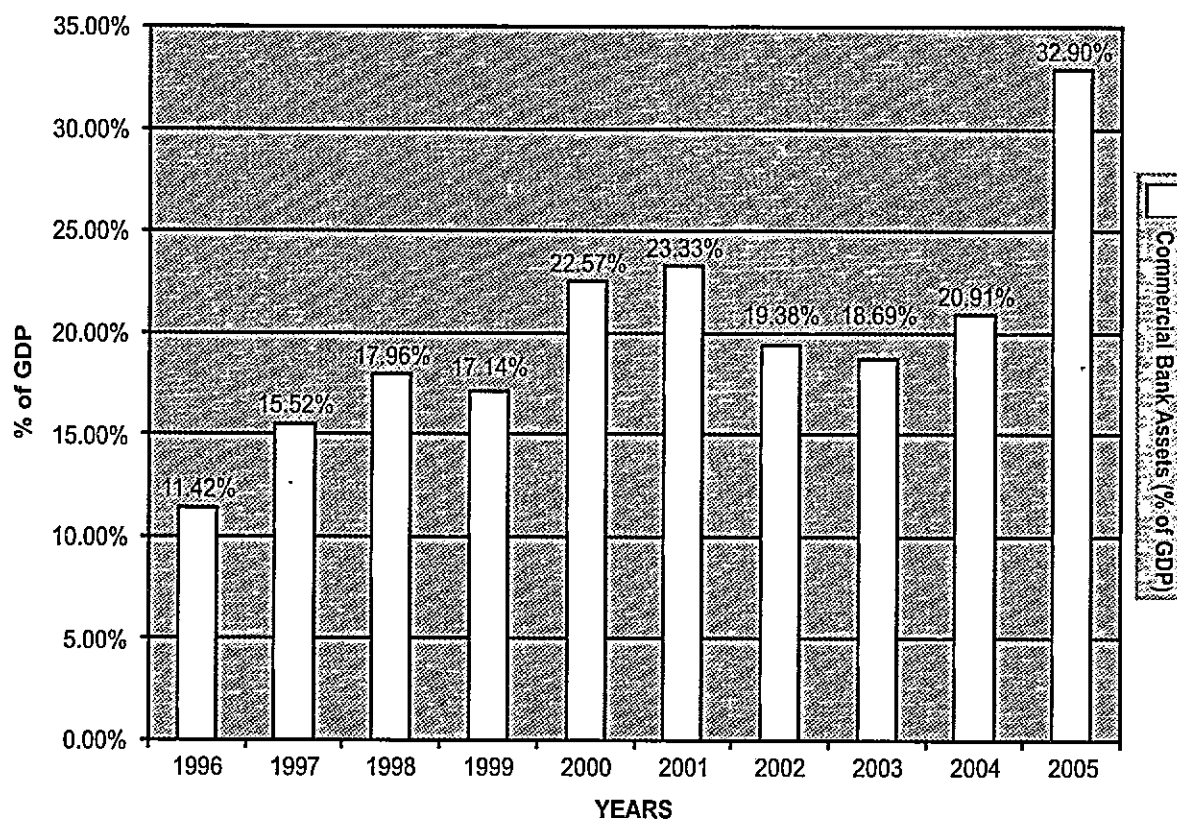
Botswana: External Debt (%GNI)



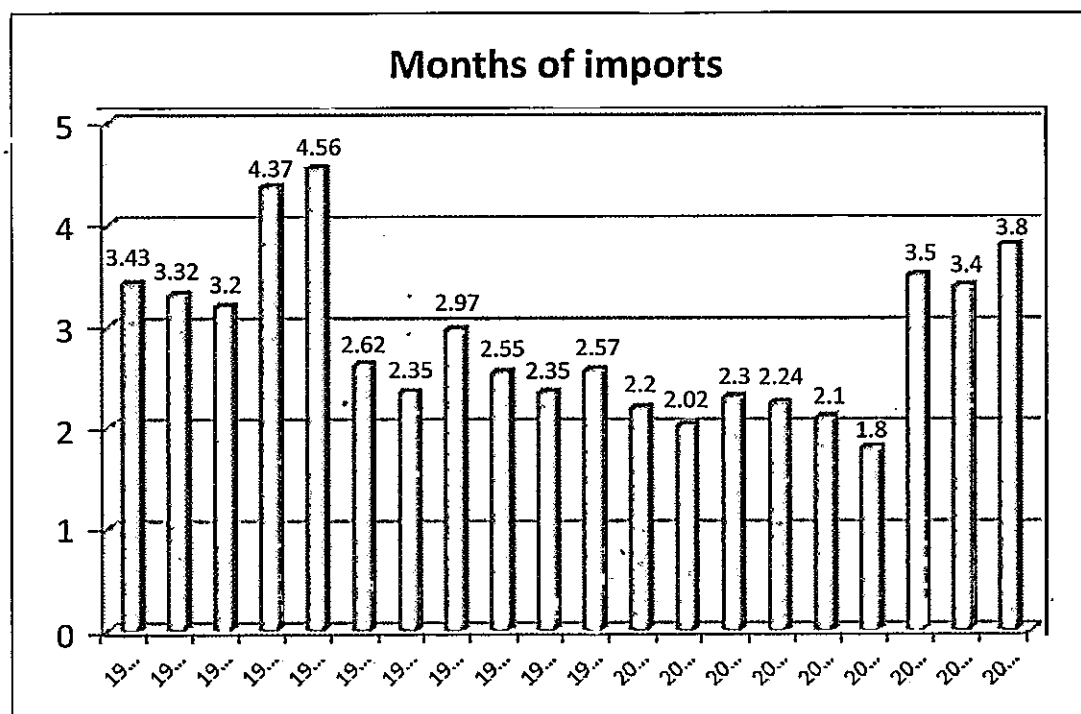
Selected Countries: Ratio of Bank Assets to GDP 2007



Botswana: Commercial Bank Assets (% GDP)

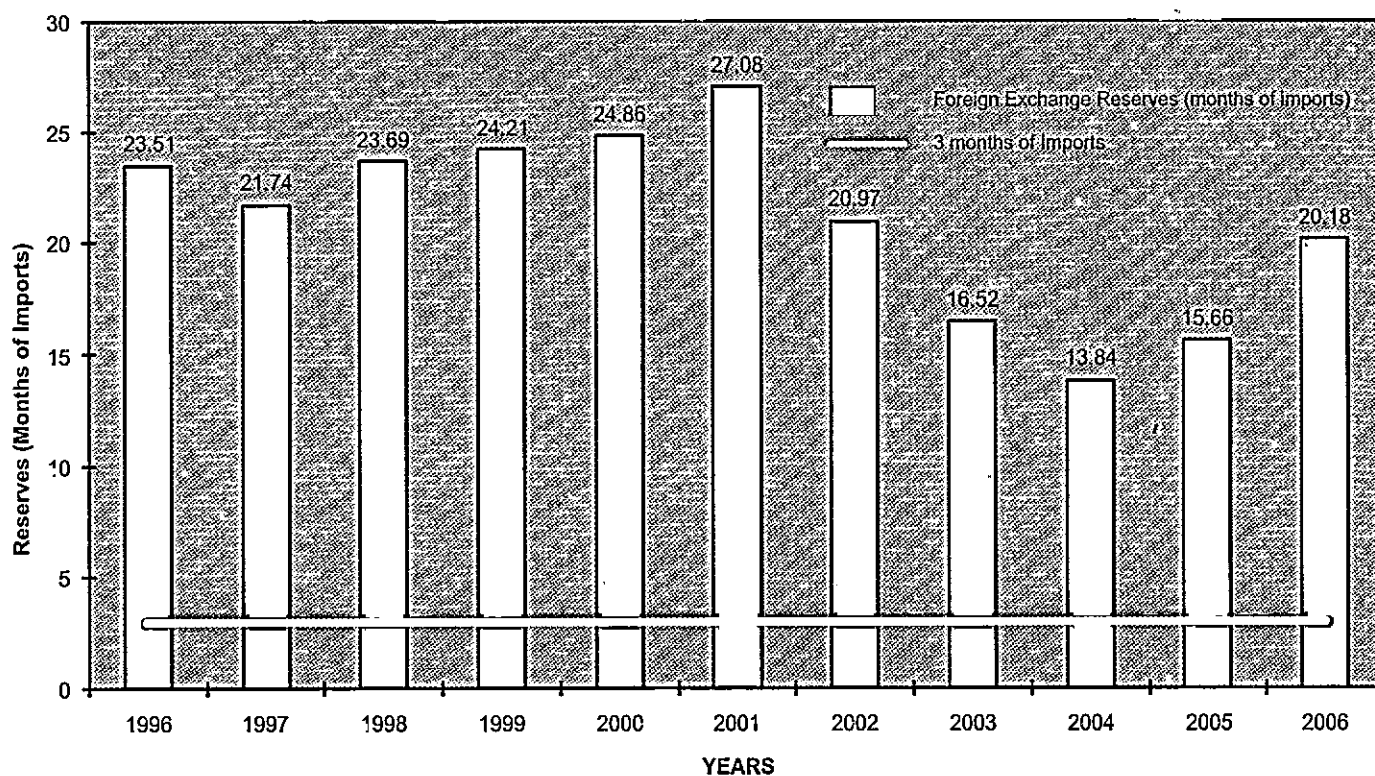


Iceland: Central bank foreign exchange reserves 1989-2008

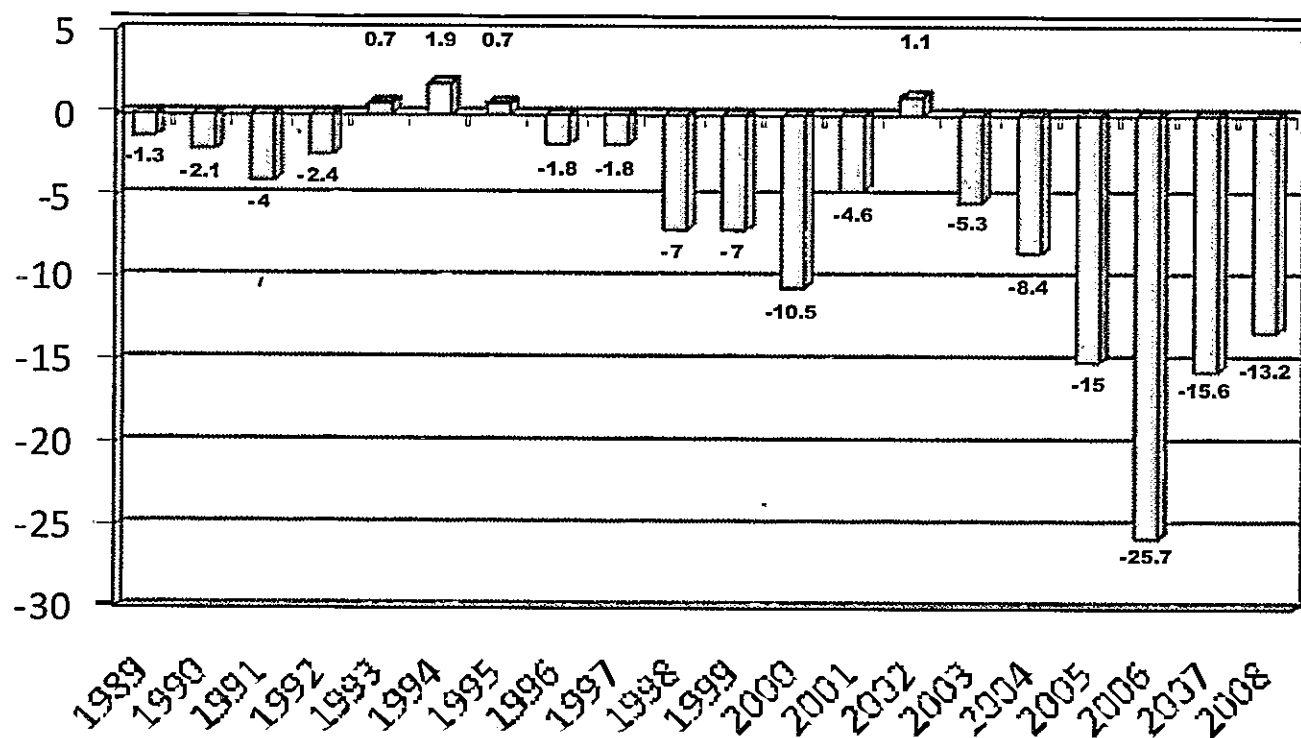


Source Gylfson (2008)

Botswana: Foreign Exchange Reserves (months of imports)

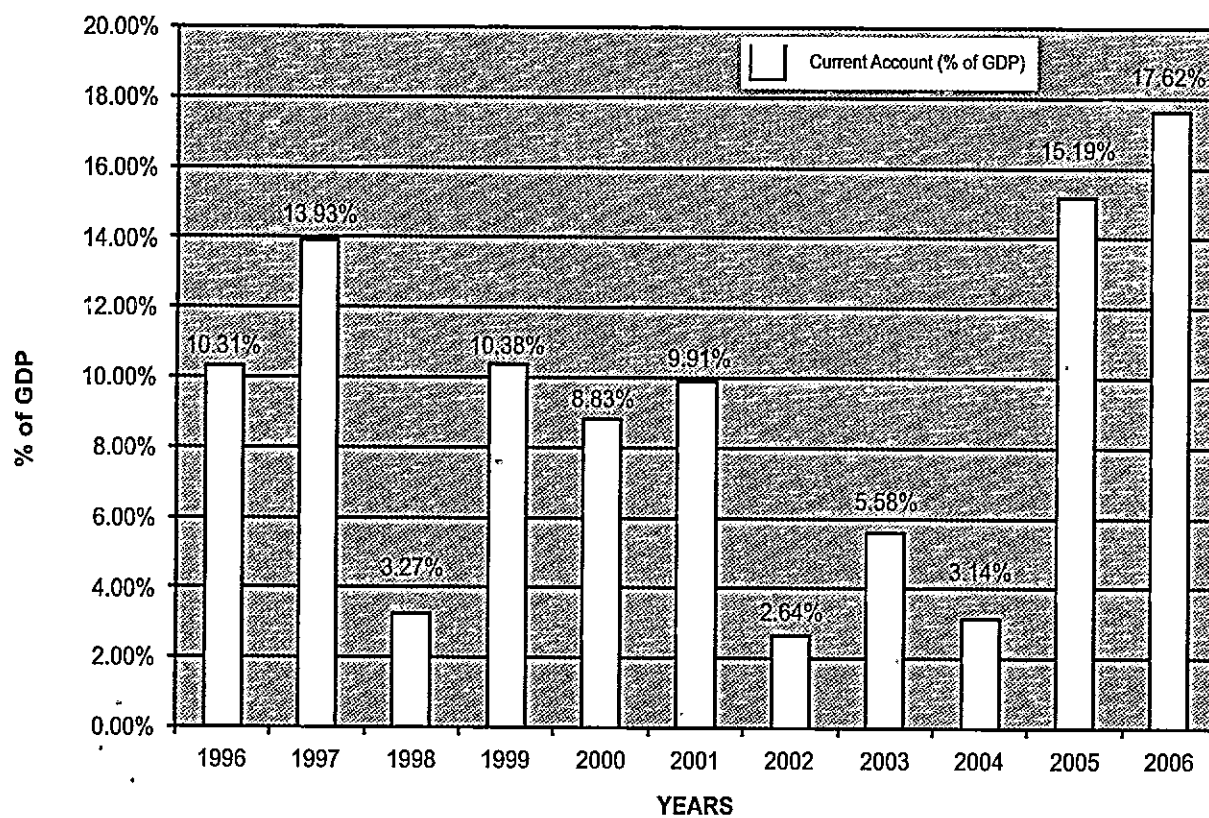


Iceland: Current account 1989-2008 (% of GDP)



Source Gylfson (2008)

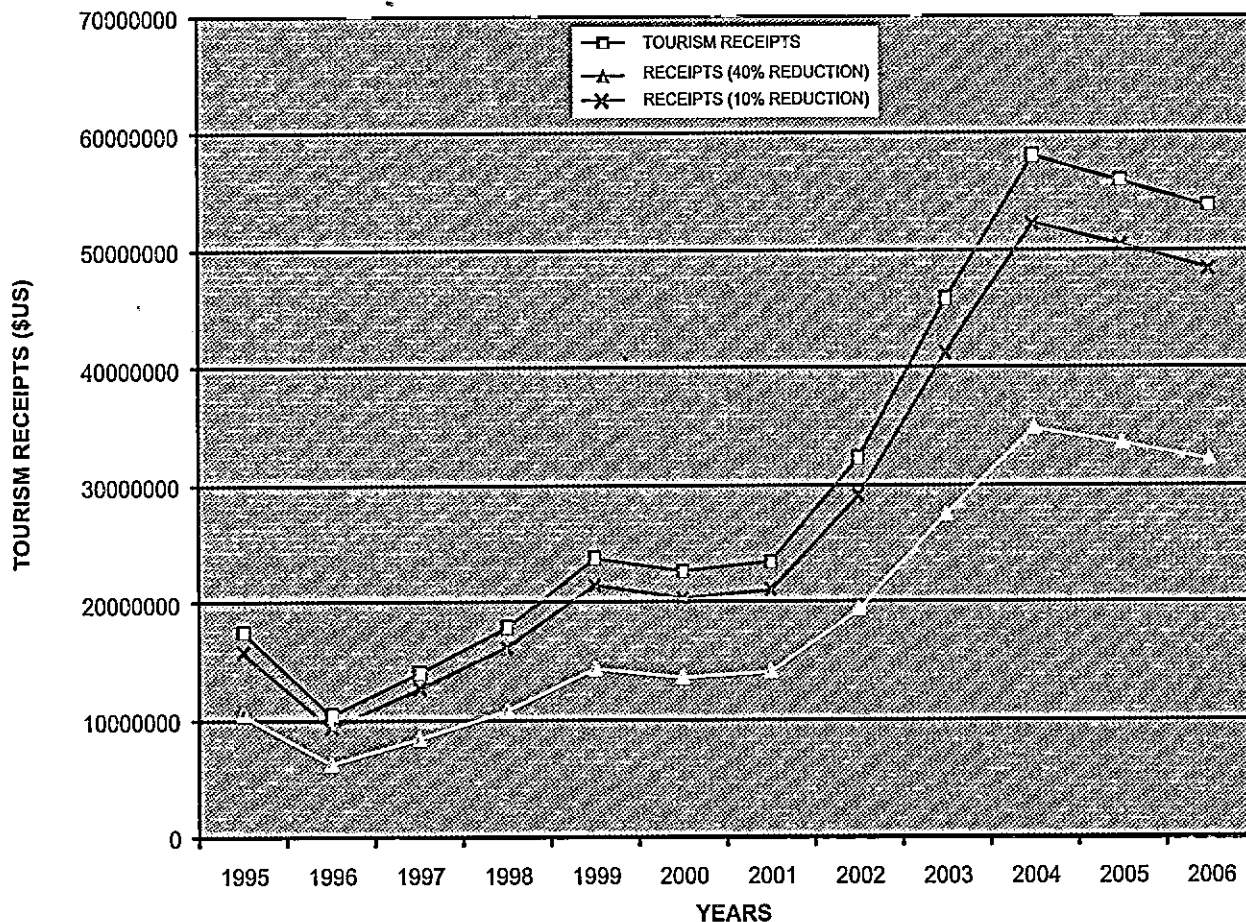
Botswana: Current Account (% GDP)



THE RECENT FINANCIAL CRISIS:

Further, no data is readily available, but in all likelihood it is expected that there will be some decline in tourist revenue. Assuming, a best case scenario of only about 10% and a worst case scenario of about 40% reduction in tourist revenue, as could be seen from the following graphs, the contribution of the sector to GDP would appreciably decline.

Tourism Receipts (Current \$US)

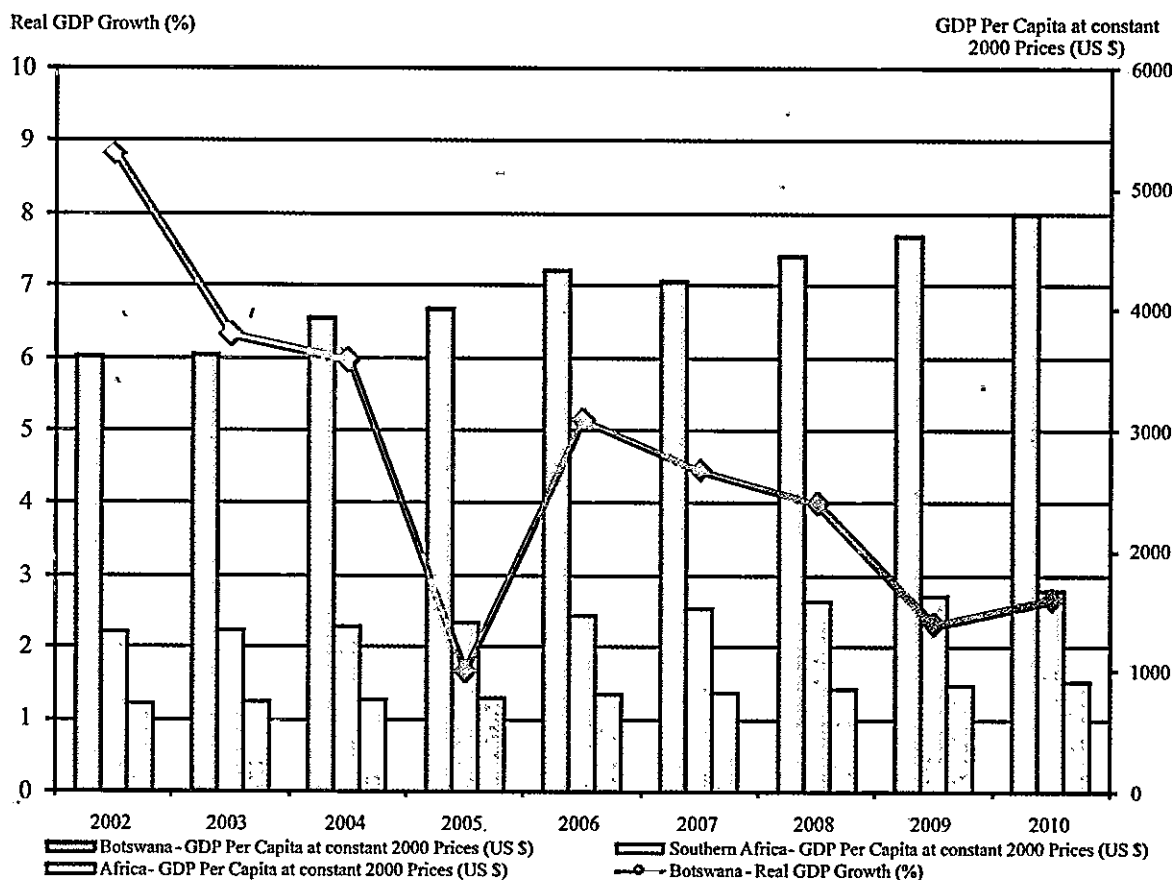


Other collaborative evidence also suggest a similar decline on the overall performance of the economy. For instance, the Minister⁶ of Finance noted "The impact of the recent financial crisis will be substantial with serious implications for the economy. The main risk to our economy from the crisis is on mineral exports, in particular diamond sales, which started to fall significantly in November 2008..(and) there has been a sharp decline in commodity prices in the past three months for other minerals like copper-nickel and gold. As a result.. there will be a slowdown in economic growth."

Consequently, the Minister noted that "the expected substantial reduction in mineral revenue due to the global financial crisis is a cause for serious concern, given that such revenues have accounted for about 35-50% of the total government revenues over the past five years."

⁶Source: local news papers.

Projected GDP growth Rates (%)



Demand Composition

	Share of GDP		Growth %, Real			Contribution to Real Growth		
	2000	2007	2008(e)	2009(p)	2010(p)	2008(e)	2009(p)	2010(p)
Gross Capital Formation	31.8	26.9	12.1	9.1	7.2	3.3	2.7	2.3
Public	12.0	7.5	12.5	11.0	9.0	1.0	0.9	0.8
Private	19.8	19.4	12.0	8.4	6.5	2.4	1.8	1.5
Total Consumption	56.2	60.5	3.2	4.4	4.2	1.8	2.6	2.5
Public	25.4	20.2	7.8	7.3	7.4	1.5	1.5	1.6
Private	30.8	40.3	0.8	2.8	2.4	0.3	1.1	0.9
External Demand	12.1	12.6				-1.2	-3.1	-2.4
Exports	53.3	49.5	1.7	-1.5	-0.9	0.9	-0.8	-0.4
Imports	-41.2	-36.9	5.4	6.0	4.9	-2.1	-2.3	-2.0
Real GDP Growth						4.0	2.1	2.3

Further, as the following graphs shows, preliminary forecasts by the African Development Bank (AfDB) for Botswana's overall economy (as measured by its GDP), also suggests that its growth will decline from an estimated rate of 4% for 2008 to 2.1% in 2009 and 2.3% for 2010.

On the whole, therefore, it is premature to precisely know (in quantitative terms) the extent to which the global financial crisis will affect the Botswana economy. The preliminary evidence (documented above which by and large is based on only few months recent data and educated guesses), however, seems to suggest that the economy is unlikely to 'fully duck' the blow or even escape with only a small scratch.

The Important question is then, what policy options should one put in place to mitigate if and when a full-fledged 'blow' hits the economy? Or more specifically, what policies, at what level of sectoral detail and in what sequence should policies be designed and implemented to mitigate such effects?

But fully addressing such questions requires identifying what data sets or information and what policy instruments are available for use before embarking on such an exercise.

5. ELEMENTS OF DESIGNING A COHERENT POLICY

5.1. Pre-requisites

Before attempting to design any policy there are few issues that have to be addressed from the outset. These include:

1. Assembling timely, accurate and encompassing data sets on all the variables of interest, particularly those related to crisis prone sectors;
2. Based on historical data, assessing the multiplier effects and inter-sectoral interactions (ranging from simple elasticities to multi-sector linkages) to evaluate any actual and/or potential impacts of the global recession on the economy;
3. The designed policy must satisfy two essential objectives: relevance in mitigating any possible current crises and promoting long-term growth;
4. Once the raw data is assembled and the sectoral forward and backward linkages are established, a thorough assessment of the policy instruments among a menu of choices has to be identified;
5. A detailed assessment of the basic attributes of the economy and its reaction to various policy shocks, particularly emanating from the hard hit partner countries, has to be examined;
6. The criteria that should be used to select from a catalogue of policy options include: ease of implementation (as measured by procedural and access criteria), relevance to desired impact(s), and possible growth and equity considerations;

7. The policies that should be designed must be coherent, reinforcing each other and anchored on the essential characteristics of the Botswana economy;
8. All policy framework(s) must be designed to address a plausible range of scenarios and a time frame that distinguishes between the short-, medium- and long-term performance of the economy;
9. Special attention must be given to the sequencing and size of the shocks and possible policies to be implemented so that they will have the desired effects;
10. In short, before designing and implementing policy, the following relevant (in terms of the impact of the global financial crisis) and similar questions have to be considered by relevant bodies:
 - a) How much and where are Botswana's pension, foreign reserves, and private stocks invested abroad? And what is the state of those investment firms abroad? How likely are they to be affected?
 - b) What is the likelihood of the employment layoffs by firms who have subsidiaries in Botswana to affect branches here, if any?
 - c) Exactly by how much are Botswana's exports likely to decrease (both in volume and price) due to the global recession?
 - d) By how much is the tourism industry to be affected due to the recession? What about FDI flows?
 - e) How will these affect the foreign reserve position of the country both in the short- and medium-run to withstand the storm without serious deterioration? How long and in what scenario is BOP surplus to be maintained? And more importantly,
 - f) What is the consensus about the time frame of the global crisis? And how likely is Botswana to withstand the 'storm' in that time frame?
 - g) Are there opportunities that could be exploited during the crisis that wouldn't otherwise exist? At what risk?

The answer to these and similar core questions will determine both the extent of the economic effect of the recession and pave the way for a coherent, sound and effective policy response by policy makers. It is then, and only then, could one attempt to implement appropriate policies to fend off the adverse effects of the crises and its follow up – economic recession.

5.2. Some Pitfalls of policy making

As a pre-caution, it is important to note that the temptation to mimic or copy industrial countries' stimulus packages must be avoided because the transmission mechanisms of both economies are likely to be different from each other. For instance, unlike in the developed economies with a significant share of the economy (2/3 rd in the US) dependent on consumer demand, a stimulus in Botswana → more demand for imports probably with less effect on domestic production → BOP deficit → Depreciation of the currency → (given inelastic demand for exports) less export revenue (due to so called J-curve effect) → deficit financing → possible inflation due to a price-pass through and/or demand pull inflation → ultimately may depress domestic production rather than boost it and hence the stimulus may end up boosting domestic demand and not domestic production with all the implications for inflation and BOP position. Clearly not the intended outcomes!

5.3. What are some of the policy instruments that should be considered?

As noted above, the specific policy choice should only be considered once the above points are ascertained; but in general, given the Botswana economy, the following general guidelines could be suggested, as rules of thumb to initiate discussion.

- fiscal policy will be preferred to monetary policy; in particular fiscal policy that is geared to inducing some incentives, cut some fat on the expenditure side and targeted equity enhancing measures will go a long way to both decrease expenditure, create incentives and address some equity concerns;
- In general, with regard to equity consideration alone, incomes policy is superior to tax policy;
- The focus of policy should be to smooth the transition rather than jump start economic activity, as the latter is mainly determined exogenously.

Therefore, all what has been said above suggest that, even though the direct effect of the recent financial crisis will be limited, its indirect economic impacts due to the recession abroad is unmistakably serious. What we don't know for sure is the exact magnitude on each sector and its overall effect and the time frame of those impacts.

Finally it is important to re-emphasize two points: (a) the need for a timely, accurate and sector specific data to examine the depth, scope and transmission mechanisms of the possible effects of the crisis on the Botswana economy. And (b) the focus of any policy must be to search the best way possible to manage the transition rather than jump-start the economy, as is the case in other countries.

