Botswana

key figures

• Land area, thousands of km^2	582
• Population, thousands (2001)	1 554
• GDP per capita, \$ (2001)	3 726
• Life expectancy (2000-2005)	36.1
• Illiteracy rate (2001)	22.0

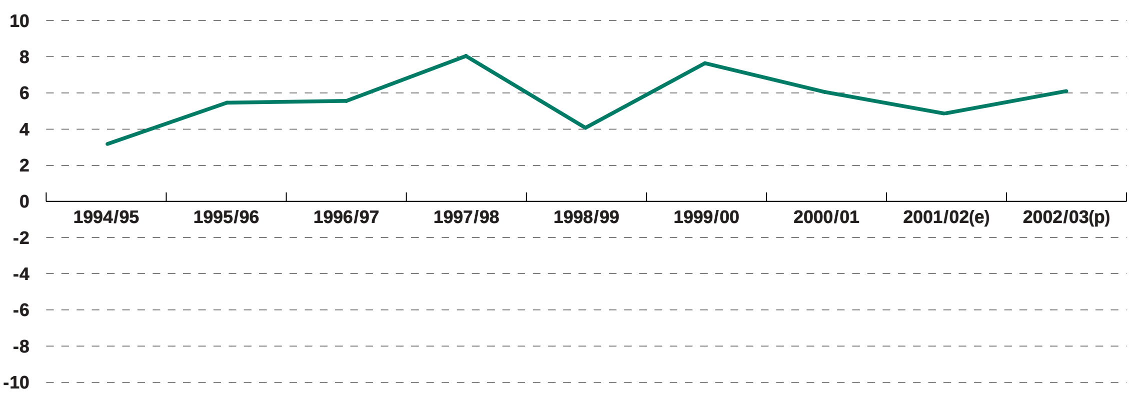
Botswana

Botswana has gained a reputation for its remarkable economic growth and prudent macroeconomic management. Over the past 35 years, the country has been transformed from one of the least-developed countries, with 90 per cent of the population subsisting in drought-prone agriculture and a per capita income of about $360, to a middle-income country with 50 per cent of the labour force employed in formal sector activities. Though a small economy with abundant diamond resources, the country's good governance has enabled the resources to be put to growth enhancing and development uses. The country continues to put in place reforms and measures to strengthen the economy, as well as to diversify it away from its dependence on diamonds. Economic growth has been strong over the past few decades with real GDP growth recording 9.2 per cent in 2000/01. The economy is estimated to have grown at a slower rate, 5.1 per cent in 2001/02, and a growth rate of 6.1 per cent is expected for 2002/03, mainly due to the fact that diamond production is expected to reach a plateau.

Moreover, economic growth will be affected by the effect of the HIV/AIDS pandemic. Indeed, the country suffers from the highest rate of HIV infection in the world, with an adult prevalence rate estimated at 38.8 per cent. Furthermore, because of inadequate job opportunities, the incidence of poverty is still high and the country's income distribution is highly skewed. The education system, considered one of the best in Africa, is still not empowering citizens to access jobs in a highly competitive labour market. An important step in addressing these problems was the government's first drafting of the Botswana Poverty Reduction Strategy (BPRS), embarked in October 2001. The BPRS identifies several policy issues which aim to create the enabling environment for a sustained attack on poverty, such as enhancing capability, adopting an integrated policy approach to HIV/AIDS, and strengthening the leadership capacity of key public institutions at all levels.

Growth in Botswana will be affected by the levelling off of diamond production and the impact of HIV/Aids

Figure 1 - Real GDP Growth

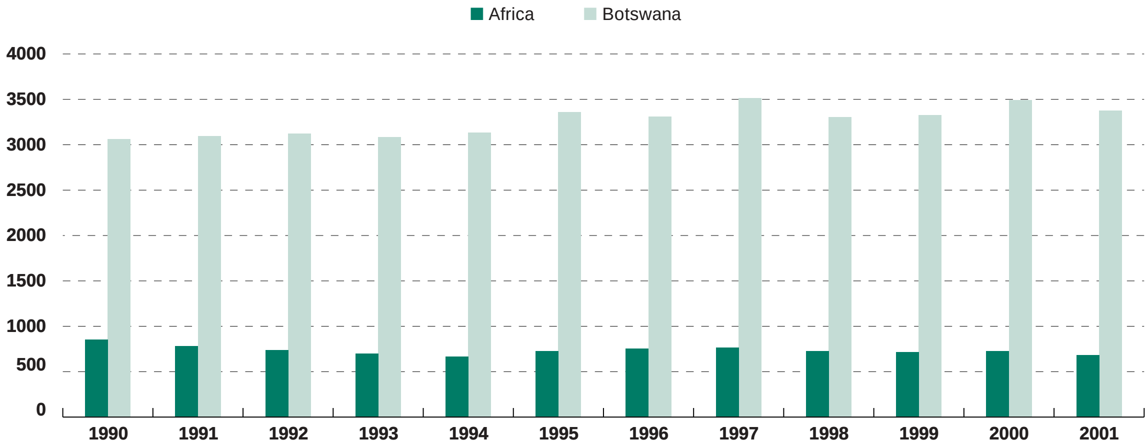


Source: Authors' estimates and predictions based on Central Statistics Office data.

Recent Economic Developments

Botswana registered a growth rate of 9.1 per cent in 2000/01. This was the result of an exceptionally strong performance in the mining sector, which grew by 19.6 per cent, basically reflecting the expansion of the Orapa diamond mine, commenced in 2000, which doubled its output. The real GDP growth rate is expected to be around 5.1 per cent during 2001/02 and 6.1 per cent in 2002/03 mainly due to a lower growth

Figure 2 - GDP Per Capita in Botswana and in Africa (current $)



Source: Authors' estimates based on IMF data.

rate of diamond output. This indicates that, despite some progress made in the diversification of the economy so far, there is still a need to push the diversification process further.

Mineral exploitation, mainly of diamonds, but also copper-nickel, soda ash, coal, a small amount of gold and other minerals, represents the country's economic base, accounting for 37 per cent of GDP in 2000/01[1]. The mining output is dominated by diamond production which contributes to 94 per cent of the total mining share in GDP. Debswana, an equal joint partnership between the international mining conglomerate, De Beers, and the Botswana Government, operates the country's diamond mines. Botswana's diamond industry endeavours to operate at capacity and to sell all its output, plus or minus small changes in stock for inventory control purposes. However, all diamond output is marketed exclusively by De Beers' London Based Diamond Trading Company (DTC), which regulates the supply to the market. Indeed, depending upon international market conditions, the DTC may impose quotas on sales, buying only a certain proportion of each producer's rated capacity. The remainder, if produced, is stockpiled and sold to the DTC when the market recovers sufficiently.

Botswana is the second largest volume producer in the world after Australia, and is the largest in terms of output value. Thus, it is especially prone to business cycles that lead to large swings in the demand for luxury goods. Botswana is also subject to swings in psychological factors that affect consumer confidence, such as the September 11 attacks.

The high value/weight ratio in the diamond output does not give Botswana an inherent competitive advantage in related downstream industries such as diamond cutting and polishing. Given the low transport costs relative to diamond value and the agreement to market all mine production through the DTC, local polishers do not even source rough diamonds from Botswana. The local diamond cutting and polishing activities have not achieved much financial success, as local workers have not attained internationally competitive productivity levels.

Major investment in treatment capacity combined with the additional production capacity, as well as the opening in October 2002 of the BK pipes at Damtshaa near Orapa, have brought the potential output slightly beyond 26 million carats. However, all the major known diamond pipes are now developed about as much as the

1. Despite the peak in mining production registered in 2000/01, the share of mining value added to GDP is on a decreasing trend. It varied between 39.2 per cent in 1989/90 to 33.4 per cent in 1999/00.

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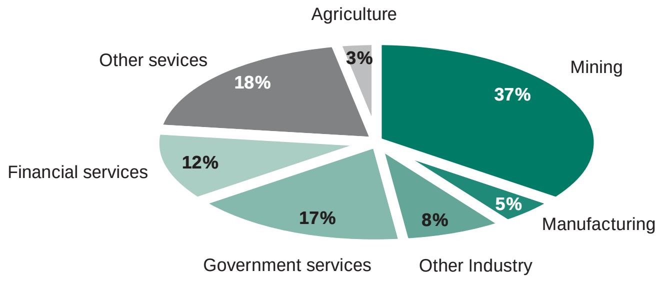
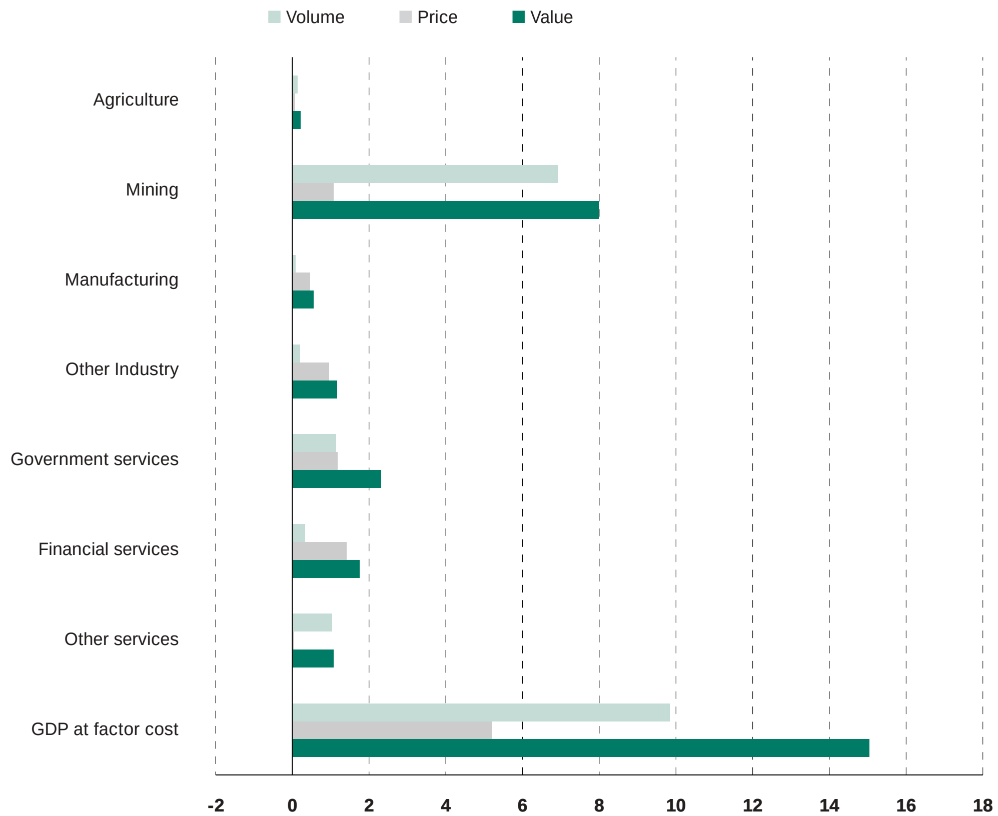
Figure 3 - . GDP by Sector in 2000/01



Source: Authors' estimates based on Central Statistics Office data.

Figure 4 - Sectoral Contribution to GDP Growth, 2000/01



Source: Authors' estimates and predictions based on Central Statistics Office data.

authorities think they can be, and only smaller diamond pipes are likely to be developed in the future. Indeed, Debswana expects a tapering off and slight decrease in diamond production over the next ten years.

Copper and nickel output declined, in real terms, in 2000/01 while soda ash output increased sharply to almost double the 1999/2000 output. Moreover, in 2003, a new gold mine, operated by the Australian company, Gallery Gold, will be opened. Total exploitable gold reserves are estimated to be around 1 million ounces. However, it is unlikely that mining will register the same record growth in 2002/03 as it did for 2000/01.

In 2000/01, the non-mining sector's contribution to GDP declined from 66.7 per cent to around 65 per

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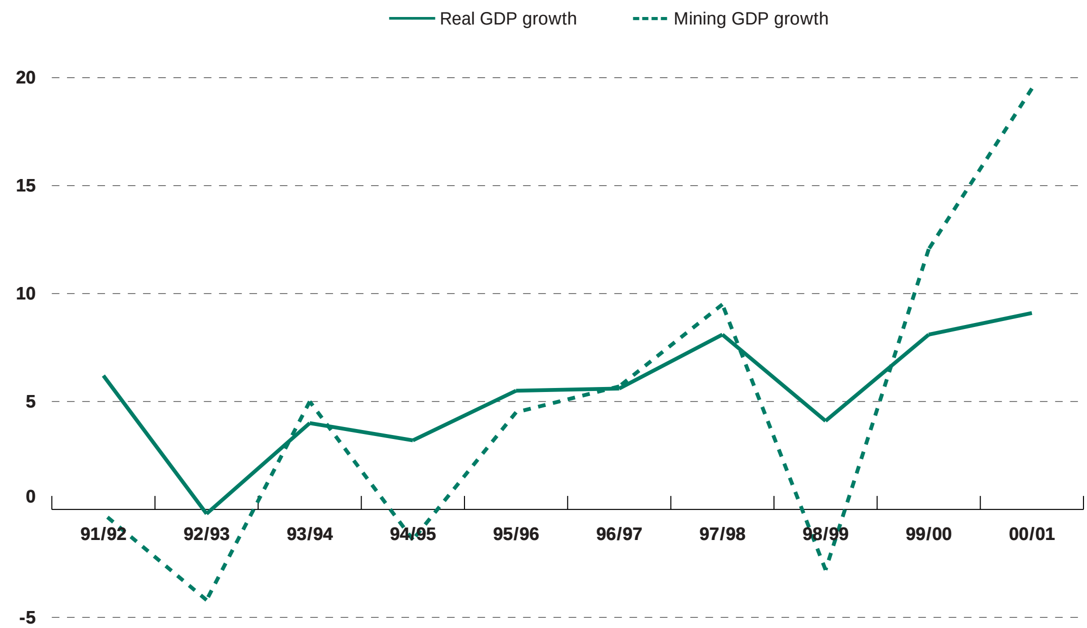
Figure 5 - Trends in Growth Rates of Total and Mining GDP



Source: Based on Bank of Botswana data.

cent. The real growth in non-mining output fell from 5.7 per cent recorded in 1999/2000 to 4 per cent during 2000/01 (the slowest in the last six years). The slower growth of the non-mining sectors was mainly attributed to the poor performance of manufacturing and construction which fell to 1.6 per cent from 3.5 per cent and 2.4 per cent respectively in 1999/2000. Poor manufacturing performance reflected a slowdown in export orders of textiles and the impact of the closure of the country's main automobile assembly plant in early 2001, following the liquidation of the Motor Company of Botswana Hyundai Assembly Plant. The slowdown in construction was due in large part to government curtailing some of the excessive growth allowed in the run-up to the 1999 elections.

Despite the last few years' disappointing performances, the government considers the development of non-mining sectors as a crucial step towards diversifying exports away from mining and to promoting employment. In fact, although diamond mining is the main contributor to wealth, it is not labour intensive and accounts for about 3 per cent of total employment in the formal sector. Manufacturing accounts for only about 5 per cent of GDP, but employs about 10 per cent of those in the formal sector. In manufacturing itself, attention is increasingly directed towards the development of the textile industry on account of the fact that Botswana has qualified for the African Growth and Opportunity Act (AGOA) which allows textiles duty free access to the US market. While some companies are beginning to export under AGOA, the government is providing further incentives to the manufacturing industry through a concessionary company tax rate of 15 per cent.

Although partially reversed in 2000/01, the agricultural sector has experienced a pattern of negative growth, leading to a sharp decline of its share in GDP. In 2000/01, agriculture accounted for less than 3 per cent of GDP, a fall-off from its levels of about 5 per cent in the early 1990s. The sector suffers from major problems such as recurrent droughts, poor soils, lack of skills in the labour force, relatively low levels of investment – especially in irrigation – agricultural infrastructure and marketing, and the resistance of traditional farmers to adopting new, improved agricultural techniques. Such obstacles have hampered

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the ability of the sector to meet the national objectives of food security, alleviation of rural poverty and increase in agricultural output and productivity.

However, while the sector is currently of relatively minor significance to the macroeconomic structure of the country, its national significance stems from the fact that 50 per cent of the total population live in rural areas, and a significant proportion of those rural dwellers still depend on agriculture for a substantial portion of their incomes and livelihoods. The agriculture sector accounts for 20 per cent of total employment (formal and informal) generated within the country.

In view of the low crop yields experienced as a result of poor rainfall, 2000/01 was declared a drought year by the government which issued free seeds to communal farmers. These types of subsidies together with other agricultural development programmes have, however, failed to improve agricultural output and productivity. Consequently, in April 2002, the Parliament approved the National Master Plan for Arable Agricultural and Diary Development (NAMPAADD) which is expected to promote major transformations in traditional farming methods with a view to increasing productivity and reducing uncertainties associated with the local weather conditions. It also aims at providing viable business opportunities for the agricultural sector, moving agriculture from subsistence to a commercial activity.

Livestock, particularly cattle, is the backbone of agriculture, accounting for about 80 per cent of agricultural output. Though the sub-sector is largely underdeveloped and characterised by extensive systems in communal areas, it produces beef that remains a major foreign exchange earner after diamonds. Although the cattle herd declined by about 12 per cent following the outbreak of Cattle Lung Disease in 1996, the numbers have increased markedly in the last three years. In 2001, farmers sold 170 000 cattle to the Botswana Meat Commission, the highest number sold to the abattoir since the early 1990s.

In line with the poor performance of non-mining activities, bank, insurance and business sector growth fell for the third consecutive year and, in 2000/01, real output rose by only 2.9 per cent (compared to 4.3 per cent in 1999/2000). Furthermore, the tourism sector, which hinges upon Botswana's extensive wildlife resources and benefits from "high value - low volume" visitors, experienced a negative growth rate in 2001 due to the political crisis in neighbouring Zimbabwe and the aftershock of the September 11 attacks on the United States.

In contrast to the service slowdown, the transport and communications sector grew by 5 per cent, almost double the growth rate of the previous year, driven by the rapid rise in air transport. Such growth resulted from a decline in operating costs following improvements in passenger handling, introduction of new routes and improved marketing. Moreover, telecommunications have seen significant growth in 2000/01, with the total number of mobile phone subscribers growing from 195 000 in December 2000 to about 315 000 in

Table 1 - Demand Composition (percentage of GDP)

	1994/95	1998/99	1999/00	2000/01	2001/02(e)	2002/03 (p)
Gross capital formation	**25.8**	**36.8**	**24.6**	**21.3**	**24.2**	**24.5**
Public	8.4	16.8	8.0	6.8	8.0	9.1
Private	17.3	20.0	16.6	14.5	16.2	15.5
Consumption	**63.7**	**62.8**	**56.0**	**57.2**	**61.7**	**60.2**
Public	28.9	30.6	27.4	29.5	32.5	32.2
Private	34.7	32.2	28.6	27.7	29.2	27.9
External sector	**10.6**	**0.4**	**19.4**	**21.5**	**14.2**	**15.3**
Exports	49.6	46.7	55.9	52.5	49.5	49.5
Imports	-38.9	-46.3	-36.5	-31.0	-35.3	-34.2

Source: Authors' estimates and predictions based on Central Statistics Office data.

December 2001, an increase of 61 per cent. Another market showing great improvement is the internet, where preliminary estimates indicate that there were more than 33 000 users in 2001, compared to 10 000 in 1999.

The strong economic growth performance in Botswana is clearly derived from strong export performance that has enabled increased consumption (private and public) in recent years. Government spending is estimated to increase in 2002/03, mainly on account of the increased import of food and the budgeted rise in social expenditures. Government investments, which declined in 1999/2000 and 2000/01 due to underspending in the government development budget, are estimated to have grown since 2001/02, reflecting the new impetus that the government has given to pro-growth measures. Although strongly supported by the government, private sector investment is projected to decrease, hampered by a severe shortage of skilled labour and the narrow economic base.

Macroeconomic Policy

Fiscal and Monetary Policy

Botswana's fiscal policy follows the directions outlined by the National Development Plans, the latest of which, the Eighth National Development Plan (NDP 8), runs from April 1997 to March 2003. Although development spending is quite a high proportion of GDP, the government has pursued prudent macroeconomic policies that have allowed budget surpluses in all but two years since 1982/83. Budget revenues stem heavily from mineral taxes, royalties and dividends, which have been the main determinant of budget surpluses over past years.

The budget surplus as a percentage of GDP increased even further in 2000/01, thanks to an improvement in total revenue benefiting from the better than expected out-turn of mineral revenues. At the same time, total expenditure, including net lending, was 3 per cent below forecast, due to underspending on the development budget, which, in turn, reflected implementation capacity constraints. For the fiscal year 2001/02, the budget surplus is estimated to have decreased to 0.2 per cent of GDP (despite a projected deficit of 0.2 per cent of GDP), mainly on account of lower mineral revenue and increased development expenditures. The lower mineral revenue in 2001/02 is partly the result of De Beers imposition of quota restrictions on diamond sales since the second half of 2001 and a fall in the international price of diamonds. For the year 2002/03, the government forecasts a 38 per cent rise in development spending in order to allow ministries to complete as much of the NDP 8 Development Programme as possible. Although it is unlikely that all the planned development projects will be carried out during the period under consideration, upward pressures on spending will come from the

Table 2 - Public Finances[a] (percentage of GDP)

	1994/95	1998/99	1999/00	2000/01	2001/02(e)	2002/03(p)
Total revenue and grants[b]	**36.5**	**35.7**	**43.6**	**44.9**	**41.6**	**40.7**
Tax revenue	29.6	26.2	36.2	38.4	36.0	35.3
Total expenditure and net lending[b]	**34.9**	**42.1**	**38.0**	**36.7**	**41.4**	**43.0**
Current expenditure	24.5	29.1	26.1	27.0	29.8	29.5
Excluding interest	*23.9*	*28.7*	*25.8*	*26.8*	*29.5*	*29.3*
Wages and salaries	9.0	10.0	8.8	8.7	9.2	8.8
Interest on public debt	0.7	0.4	0.3	0.3	0.3	0.3
Capital expenditure	11.2	13.6	12.6	10.0	11.8	13.4
Primary balance	**2.3**	**-6.0**	**5.9**	**8.5**	**0.5**	**-2.0**
Overall balance	**1.6**	**-6.4**	**5.6**	**8.2**	**0.2**	**-2.3**

a: Fiscal year begins 1 July.
b: Only major items are reported.
Source: Authors' estimates and predictions based on Ministry of Finance and Development Planning data.

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regional shortage of staple food that will make purchase of grain more expensive and from the increase in the wage bill (to compensate for rising inflation). Nevertheless, the deficit is now projected to be around 2.3 per cent of GDP, below the projected 4.5 per cent of GDP as a result of the introduction of a valued added tax (VAT) in July 2002, accompanied by an improvement in the tax collection system that will allow for an increase in government revenue. It should also be noted that the introduction of VAT and the improvement of the tax collection system will allow a diversification away from diamond taxes, royalties and dividends as main sources of government revenues.

Botswana experienced a credit boom in 1998, reflecting the strong demand conditions in the economy, when broad money (M2) expanded by over 30 per cent in the year. Since then, the monetary policy objective of the Bank of Botswana (BOB) has been to dampen inflationary pressures in the economy by stricter control of the growth of monetary aggregates. The growth of money supply subsequently slowed in response to the BOB open-market operations involving sales of BOB Certificates (BOBCs), repurchase agreement transactions and commercial banks' utilisation of the secured lending facility. At the end of 2001, the value of outstanding BOBCs had increased by 39 per cent, as compared to the start of the year. The effectiveness of open-market operations was improved further by a move from monthly to weekly auctions and shortening in maturities (91 days). The more frequent auctions allowed for a greater flexibility in the Bank's liquidity absorption and enhanced liquidity management for banks.

The upward trend of inflation recorded since 1998 was reversed in 2001, when the average rate of inflation stood at 6.6 per cent, compared to 8.5 per cent in 2000. The decline in inflation was due to a range of factors including lower international oil prices, and lower inflation in South Africa with which Botswana has close trading ties (around 74 per cent of imports come from South Africa). As emerged from the February 2002 Monetary Policy Statement, the inflation objective of the Bank of Botswana ranges from 4 to 6 per cent. This is not a formal target but represents the range of inflation necessary to achieve general stability in the real effective exchange rate. In order to achieve this inflation objective, monetary policy has been focused on the control of an intermediate target: the growth rate of credit to the private sector, for which a target range of 12.5–14.5 per cent has been set. During the first six months of 2002, inflation had been stable fluctuating around the upper level of the set target range. The average inflation for 2001/2002 was 6 per cent. However, inflation had started to increase in the second half of the year following the introduction of VAT in July 2002, rising to 10.1 per cent in September from the June level of 5.9 per cent. Although the Bank of Botswana tightened monetary policy in October and November 2002 (by raising its bank rate by 100 basis points[2] to 15.25 per cent), average inflation for 2002/03 is estimated to rise above target (to about 7.1 per cent) as a result also of food price increases, owing to grain shortages in the region, and higher South African inflation that will result in a rise of imported inflation.

The exchange rate of the Botswana pula is pegged to a currency basket comprised of the South African rand and the SDR. The pegged system has helped the pula to be generally stable in effective terms. However, in 2001, the pula appreciated in nominal terms by 21.8 per cent against the rand and depreciated by 20.1 per cent against the SDR, as the rand depreciated sharply against the major international currencies. In line with the emphasis put on the control of domestic inflation in 2001, the authorities did not devalue the pula in response to the significant fall experienced by the rand. Despite concerns about competitiveness, the Bank of Botswana is unlikely to adjust the exchange-rate basket in 2003.

External Developments

Traditionally, Botswana's trade agreements have been governed mostly by the Southern African Customs Union (SACU), the oldest customs union in Africa, which provides for the free movement of goods and the

2. In two 50 basis points steps.

right of transit between South Africa and its smaller BLNS neighbours (Botswana, Lesotho, Namibia and Swaziland). However, since January 2000, Botswana has been part of the European Union-South Africa Trade Agreement (EU-SA FTA) and, since September 2000, of the South African Development Community Free Trade Agreement (SADC FTA). Moreover, Botswana qualifies for duty free and quota free exports into the United States under the provisions of the Africa Growth and Opportunity Act (AGOA I)[3], based on raw materials sourced in Africa or from the United States. In August 2002, a new Act, which provides for an expansion of the benefits created by AGOA I, was signed into law. The Act, known as AGOA II, reclassifies Botswana as "lesser developed beneficiary" and therefore textile products manufactured in Botswana become eligible for duty-free access to the US markets regardless of the country of origin of the fabric or yarn used in their manufacture.

In spite of Botswana's strong import demand, stronger export performance attributable to the performance of the diamond industry has generated current account surpluses year after year. Consequently, Botswana has developed a strong external position over the last 20 years.

Despite the very large surplus in 2000/01, the current account balance declined in 2001/02, owing to the slight fall in diamond exports. Since the third quarter of 2001, sales of diamonds have been badly affected by the global economic slowdown, especially in the United States, which account for more than half of global diamond jewellery sales. During the second half of 2001, formal diamond quotas were imposed by the Diamond Trading Company. Moreover, nickel and copper exports were affected by falls in US dollar prices. However, beef exports rose by 54 per cent owing to the increased demand in Europe, following the outbreak of foot and mouth disease in Britain, a higher number of cattle slaughtered, and the depreciation of the pula against international currencies. Exports of Soda Ash to South Africa also showed an increase of 12 per cent. On the import side, there has been a moderate growth in metal and metal products, as well as vehicles and vehicle parts. Foreign exchange reserves rose by 21.5 per cent in pula terms, representing 39 months of import cover of goods and services. However, this increase in the pula value of reserves was mainly due to the depreciation of the local currency against major international currencies. In US dollar terms, the reserves declined during 2001, mainly due to poor returns in the major international financial markets and were equivalent to $5.9 billion, compared to $6.3 billion at the end of 2000.

Exports are projected to increase in 2002/03 as diamond sales are expected to recover and, although of minor significance, exports of garments are forecast to increase benefiting from the AGOA II. Imports will also rise, reflecting the strong government spending.

The Government of Botswana continues to avoid contracting any new debt from commercial creditors. According to World Bank figures, the total government guaranteed external debt stock amounted to $850 million at end-2001, representing 14.4 per cent

Table 3 - Current Account (percentage of GDP)

	1994/95	1998/99	1999/00	2000/01	2001/02(e)	2002/03 (p)
Trade Balance	10.3	-0.1	18.9	21.0	13.5	15.0
Export of goods (f.o.b.)	43.6	39.8	49.7	46.9	42.9	43.5
Import of goods (f.o.b.)	-33.3	-39.8	-30.8	-25.9	-29.4	-28.5
Services	0.3	0.5	0.5	0.5		
Factor Income	-2.8	-1.6	-5.5	-5.4		
Current Transfers	-3.7	-0.1	-0.2	-0.3		
Current account balance	**4.1**	**-1.4**	**13.7**	**15.8**		

Source: Authors' estimates and predictions based on Central Statistics Office data.

3. Signed into law in May 2000.

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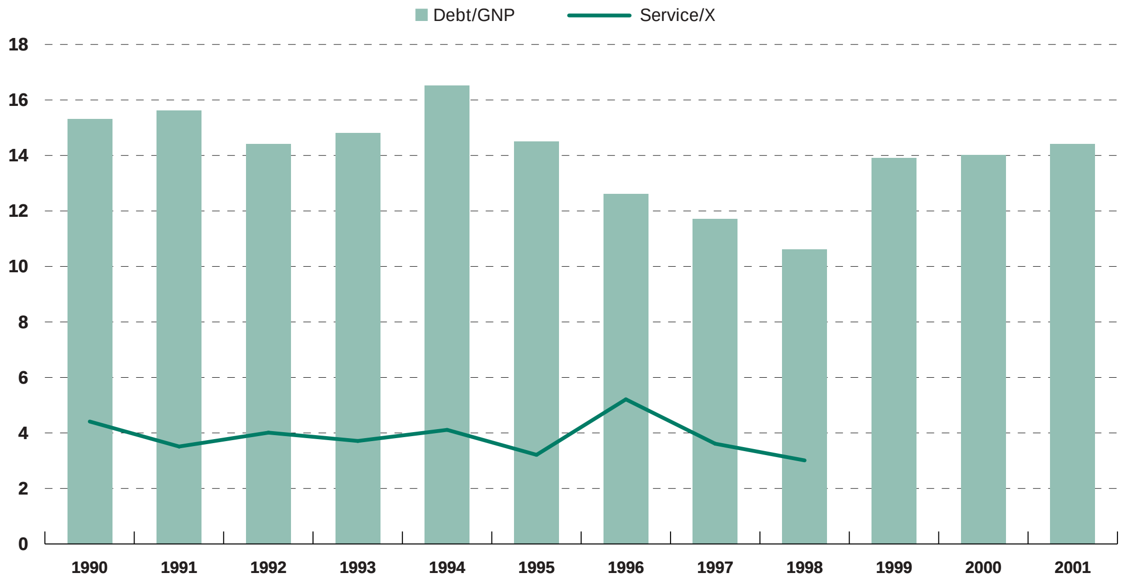
Figure 6 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports of goods and services)



Source: World Bank.

of GNP. The country's debt stock is composed of 63 per cent multilateral debt and 32 per cent bilateral debt, with the remaining 5 per cent owed to private creditors. As a result of the low level of debt and the sizeable foreign exchange reserves, Botswana is among the very few developing countries which have not implemented the IMF/World Bank structural adjustment programme. However, although the government is unlikely to borrow much at commercial rates, there are signs that its favourable sovereign credit ratings of A2 and single A awarded in March 2001 (and renewed in 2002) by Moody's and Standard and Poor's, respectively, may encourage some exploratory forays into international money markets. The ratings, which are by far the most favourable awarded to any country in Africa, have been requested by the government in order to provide a benchmark to the market, generate a good credit history, and enable parastatals and private investors to borrow funds from abroad at more favourable terms.

Structural Issues

In the framework of the Eighth National Development Plan (NDP 8), the government is pursuing the objectives of diversifying the economy and increasing employment opportunities. A mid-term review of the NDP 8, carried out in 2000, provided the priorities contained in NDP 9 (which will guide the economic policy formulation and implementation from April 2003 until March 2009). More specifically, it identified several areas of intervention, amongst which: the battle against HIV/AIDS, reducing unemployment and poverty, increasing public sector reform, accelerating economic diversification, improving government expenditure control and fostering greater citizen economic empowerment.

The country's political and economic stability, the absence of any exchange controls, the low cost of local labour and the favourable tax policy which puts a cap of 25 per cent for the corporate tax rate, make Botswana highly attractive for investors. Established by an Act of Parliament in 1997, the Botswana Export Development and Investment Authority (BEDIA) aims at promoting investment opportunities in Botswana as well as finding an export market for locally-manufactured goods in order to reach the goals of diversification away from diamonds and beef. Through its one-stop-service-centre, BEDIA offers services to

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investors to help with acquiring land, factory shells, work and residence permits, travel visas, grants and any other regulatory authorisation.

In tandem with policies to encourage foreign direct investment, the government is promoting increased participation of local entrepreneurs in the market. Among the sectors that are currently being promoted, textiles and garments are seen as the most promising, especially in consideration of benefits deriving from the above-mentioned AGOA II. In the past, the government initiated several policies and programmes aimed at promoting citizen economic empowerment that, in fact, did not produce the desired results. One such programme was the Financial Assistance Policy (FAP), which, in the later years of its implementation, recorded high failure rates among the businesses assisted, as well as widespread abuse of the scheme by some beneficiaries. FAP was terminated in 2001. In order to overcome the weaknesses and the difficulties encountered under FAP and other programmes, the government launched the Citizen Entrepreneurial Development Agency (CEDA) in 2001, which is mandated to provide assistance to Batswana wishing to go into business or to expand an existing business, through entrepreneurial and management skill training, monitoring and mentoring, provision of finance and sharing of risk. The financial assistance provided by CEDA is in the form of loans at subsidised interest rates, as opposed to outright grants, as were provided under FAP. The success of CEDA will mainly depend on its capacity to avoid supporting and subsidising non-viable businesses.

Notwithstanding the government's efforts to attract FDI in order to promote private sector development and the diversification of the economy away from mining, foreign investment inflow has exhibited a decreasing trend (from $100 million in 1997 to $57 million in 2001). Botswana has lost its prominent position among the SADC region as the main recipient of FDI, as other SADC countries have started to open up to FDI, mainly through privatisation, which, as we will see later, Botswana has yet to seriously embark upon. Such low performance with respect to FDI can also be attributable to an inadequate supply of skilled labour, the high cost of utilities and the limited domestic market. Moreover, FDI in manufacturing and services constitutes only about 2 per cent of the total stock of FDI inflow. According to the Bank of Botswana, 79 per cent of foreign direct investment continues to be in mining, followed by wholesale and retail trade and finance, which account for 8 per cent and 6 per cent of direct investment stock, respectively. The dominant source of FDI is South Africa accounting for 61 per cent, followed by the European Union countries accounting for 36 per cent, and the USA, accounting for 1 per cent.

Privatisation is still in its infancy in Botswana. In the third quarter of 2001, the Public Enterprises Evaluation and Privatisation Agency (PEEPA) was established, with the mandate of monitoring state-owned enterprises' (SOEs) performance and advising government on the privatisation process. PEEPA operates under the general policy guidance of the Ministry of Finance and Development Planning.

The privatisation programme in Botswana is a broad development policy, which goes beyond simply restructuring enterprises. The policy aims at contributing to the objective of economic diversification and empowerment of the local private sector. Unlike many other sub-Saharan African countries, privatisation in Botswana has not been adopted as a solution to financial, economic or political crisis, but has been designed in order to improve efficiency in the delivery of services and to create further growth opportunities for the private sector. Moreover, unlike the experience of many other countries, such as Zambia and Tanzania, where the government is selling most of the SOEs, privatisation in Botswana will be carried out on a selective, case-by-case basis.

PEEPA is currently carrying out a diagnostic study of the main SOEs in order to evaluate their performance and investigate the potential gains from privatisation. Based on the outcome of the study, PEEPA will then develop a Privatisation Master Plan, which will provide the basis for policy implementation, and outline the specific methods and appropriate measures to be adopted in the privatisation process. In order to ensure

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citizen empowerment, the government will assist Batswana to acquire shares in privatised enterprises, through, for instance, the use of pension funds to buy shares for the benefit of members, or special access to shares by management and employees. However, when the objective is to attract technology and management expertise, the privatisation process will be open to participation from regional or even international global buyers. It is expected that most of the privatisation of SOEs will go through the stock market.

Air Botswana is the first SOE that has been earmarked for privatisation. The airline undertook a profound restructuring and downsizing process in 1995, which finally enabled the company to record a profit after many years of making losses. Following this restructuring, the privatisation of Air Botswana has been seen as an opportunity for expanding the market, bringing in expertise and accessing technology. The privatisation of Air Botswana was due to take place in 2001; but it has been delayed owing to a deterioration in industry specific and international economic conditions.

The main difficulty faced by PEEPA is the lack of statutory authority giving it powers to drive privatisation. This enables public enterprises and certain government departments to ignore requests and initiatives made by PEEPA to kick-start the process. The other difficulty is the absence of an effective regulatory framework to protect consumers from any monopolistic tendencies of some of the utilities or which spells out the environment in which private sector entities are required to compete.

The financial system of Botswana is characterised by relatively sound and profitable institutions and infrastructure of a high standard, with good telecommunications facilities and institutional support mechanisms. Botswana has a well-developed banking sector, comprising Barclays, Standard Chartered, Standard Bank Investment Corporation (Stanbic), First National Bank and Bank of Baroda (established in March 2001), as well as two investment–merchant banks and a number of development financial institutions. A major development during 2001 was the completion of a Strategic Framework on the National Payments System by the Bank of Botswana, in consultation with commercial banks.

Botswana is also developing an International Financial Services Centre (IFSC), launched in March 2000, which should act as an efficient intermediation process for investment funds from South Africa and the rest of the world into other parts of Africa. Although the success of the project can only be determined in the long run, the authorities are optimistic since, during 2001, ten projects became operational. Furthermore, the outlook for the future is positive as some banks are relocating from Johannesburg as a result of the enhanced reputation of Botswana associated with its high sovereign credit rating. The first tax contributions from IFSC projects have been received as the first group of projects have completed their first year of operation.

Other recent financial sector reforms include the restructuring of the Botswana Development Corporation (BDC). Being involved in all sectors of the economy except mining, the state-owned development finance institution provides loans to private corporations, takes equity participation and provides business, industrial and residential premises at commercial rates. It is also used to provide guarantees for normal bank loans. BDC adopted a divestment policy in 1995, where, consistent with national policies, domestic investors were strongly favoured over foreigners. Moreover, BDC has shifted from being a typical development financial institution towards being a more commercially-oriented financial institution, which evaluates and participates in investments based on their commercial viability. BDC's policy reforms, the processes of divesting investments and the introduction of a new system of flexible interest rates make it a solid institution which can provide greater support for citizen economic participation. BDC posted good results in 2001, with a 28.7 per cent growth in its profits compared to 2000. During 2001, the Corporation's total investment portfolio was spread over three core sectors of operation; namely, property development and management (50 per cent), industry and agribusiness (39 per cent) and services (11 per cent).

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The Botswana Stock Exchange (BSE) started operations in 1995, taking over the operations of the Botswana Share Market, which had been set up in 1989. Early reforms which impacted on the Stock Exchange included the amendment of Botswana's exchange control regulations to permit dual listing of shares; that is, shares of approved companies could be dual listed on the BSE and other international stock markets. At the end of 2001, there were 16 companies listed on the Exchange, with a total market capitalisation of P8.91 billion ($1.31 billion).The domestic companies index (DCI) rose by 69 per cent that year. The BSE recorded substantial gains owing to the expected boost to demand caused by the establishment in April 2001 of a Funded Contributory Pension Scheme for the public service, 30 per cent of the assets of which must be invested locally. More significant gains were predicted for 2002 but they failed to materialise as the DCI lost ground from March through December.

Social and Political Developments

Botswana is a politically stable country holding elections every five years. The Government of Botswana adheres to democratic principles. The country's institutions work effectively to provide checks and balances on both the executive and legislative arms of the government. Consequently, there is a fairly predictable and stable economic policy environment for the private sector. Botswana is doing relatively well in terms of having a low incidence of corruption. According to the Transparency International Corruption Perception Index of 2002, Botswana was ranked as the 24th least corrupt country in the world, and the least corrupt on the African continent.

In spite of its remarkable economic performance, and several social welfare/safety net initiatives, Botswana still suffers from widespread poverty, resulting mainly from the weak economic base in rural areas, lack of sufficient human capabilities, unequal access to resources socio-cultural problems (including unequal gender relations) and a high unemployment rate, estimated at more than 15 per cent of the labour force in 2001. The government has tried to use decentralisation as an instrument for enhancing rural development performance. However, the need to have a coherent national development planning process and to ensure accountability and control, along with the lack of local (district and lower level) capabilities, hamper the attainment of decentralisation. The advent of HIV/AIDS further threatens Botswana's development challenges. Indeed, HIV/AIDS represents both a cause and a consequence of poverty, unemployment and inequality, and invariably draws resources away from other priority areas. A number of other causes of poverty can be cited, including:

- land-related issues: for instance, there is a lack of security of tenure and access to complementary resources, such as credit for productive land use;
- drought and the resultant high risk for investment in farming.

Available statistics indicate that 47 per cent of the population was living on incomes below the official poverty datum line in 1993/94[4]. Though the percentage had declined from the 59 per cent registered in 1985/86, the decline in this rate is slow in relation to the impressive economic growth rates attained by the country. The 1993/94 Household Income and Expenditures Survey reported a Gini coefficient of 0.537 and that the top 20 per cent of households earned 59 per cent of income. UNDP extrapolations based on the household income and expenditure surveys of 1985/86 and 1993/94 indicate that in 2001 the proportion of population living below the poverty datum line had fallen to 36.7 per cent. The distribution of income and the incidence of poverty are characterised by gender disparities and are related to the urban-rural distribution of the population. Geographically, poverty is highest in rural areas, with 55 per cent of the rural population living below the poverty line in 1993/94 compared with

4. The National Poverty Datum Line (PDL) used in Botswana in 1993/94 (P101 per person per month in June 1994 prices) translates to about $37.2 per month at the 1994 $/pula exchange rate. The Botswana PDL is therefore a little higher than the "$1 a day per person" used by multilateral organisations.

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46 per cent in urban villages and 29 per cent in urban areas. Poverty also varies significantly by region. The central and northeast districts have the largest number of poor people, but poverty rates are especially severe in the western districts of Ghanzi and Kgalagadi, where the climate and soils are most poorly suited for arable agriculture.

The government has embarked on a concrete effort to rid Botswana of poverty by the year 2016 as stated in the National Strategic Vision. The medium-term goal is to reduce the incidence of poverty by 2007 to a rate of less than 23 per cent. In pursuit of these goals, the first draft Botswana Poverty Reduction Strategy (BPRS) was prepared in October 2001. The poverty reduction strategy adopts a multidimensional concept of poverty that includes income poverty, capacity poverty and participation poverty. It identifies and recommends 16 programmes that should be implemented over a ten-year period aimed at enhancing the accessibility of the poor to social investment and strengthening the capacity of local government institutions to facilitate poverty reduction.

The health system in Botswana provides free or nearly free primary health care for all. By the early 1990s, about 85 per cent of the rural population had access to a health facility within a distance of 15 km. However, in the last decade, HIV/AIDS has offset much of the country's impressive health progress, and has led to a higher incidence of related diseases, such as respiratory diseases (including tuberculosis) and gastro-intestinal infections.

Botswana suffers from the highest rates of HIV/AIDS prevalence in the world. Botswana's historic labour migration to South Africa, the tradition of shuttling between village homesteads, land areas and cattle posts across seasons, and more recently urban areas, give Botswana one of the most mobile populations in the world. This constant population mobility makes the distinction between a rural and urban area, at least in terms of disease patterns, less pronounced in Botswana. Along with being a transit route for the shipments of cargo north from South Africa, and south from other southern African states to South Africa and the rest of the world, these factors explain in part the high rate of HIV/AIDS infection and the narrow gap between the rural and urban infection rates in Botswana[5].

HIV infection rates are very high, at 39 per cent for the 15-49 year age group. It is estimated that 35.5 per cent of all HIV infections among females occur between the ages of 15 and 19. For males of the same group, the figure is estimated at 14 per cent. Moreover, the HIV prevalence rate for all age groups has increased gradually and, by 2001, had reached at least twice the rate it was in 1992. According to the UNDP Human Development Report 2002, life expectancy in Botswana has fallen from 67 years in 1996 to 40.3 years in 2000. As a result, the country is expected to lose a lot of its skilled and experienced labour over the next two decades, which will significantly reduce productivity and, consequently, the rate of economic growth. The Botswana Institute for Development Policy Analysis (BIDPA) study in 2000 on the macroeconomic impact of HIV/AIDS predicted that, over the period 1996-2021, the annual growth rate of GDP could be as much as 2.5 percentage points less than it would have been in the absence of the epidemic.

As a result, in 2021, the economy is projected to be 31 per cent smaller than it would have been without HIV/AIDS. In 2000, the government declared HIV/AIDS to be a national emergency and initiated a number of additional major steps to address the epidemic. The National Aids Co-ordination Agency (NACA) was established at the end of 2000, with the mandate to co-ordinate the multi-sectoral response to Aids by the Ministry of Health, the Ministry of Finance and Development Planning and donor agencies. The areas of intervention include prevention strategies, and provision of voluntary counselling and testing centres throughout the country. At present, many initiatives are co-ordinated by NACA. Among them, Botswana

5. The public service system of transferring officers from duty station to duty station, and thus separating spouses, is another contributory factor.

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has been the first county in Africa to launch a national Prevention of Mother to Child Transmission Programme (PMTCT) that provides counselling and free HIV testing to pregnant women, and offers them the option to enrol in the programme and receive treatment. Moreover, in October 2001, the government launched an anti-retroviral (ARV) treatment programme, which should allow the free provision of anti-retroviral drugs through the public health service.

In early 2002, 250 sufferers were receiving ARV drugs from a health centre in Gaborone; and, by the beginning of 2003, 19 000 sufferers are expected to be receiving state-funded treatment. So far, it is difficult to gauge the impact of this policy since too few people have access to treatment, considering that more than 280 000 are estimated to be affected by the disease. The 2002/03 budget provides $50 million (about 1 per cent of GDP) for HIV spending, of which $4.5 million is for anti-retroviral treatments. The private sector is also supporting the government's efforts in cushioning the impact of the HIV/AIDS pandemic by providing anti-retroviral drugs to their employees. Debswana, the diamond producer, has become a model among companies in the fight against HIV/AIDS. The company records that every level of the organisation, including its diamond-cutting business and its headquarters in Gaborone, is affected by AIDS (e.g. 18.8 per cent of its highest paid workers testing positive). The company runs two hospitals for its 6 196 workers and pays 90 per cent of the cost of anti-retroviral treatment for its employees who are not covered by a medical insurance plan. Indeed, Debswana will also pay for the same treatment for a wife or husband of an employee.

Although the educational system in Botswana is considered to be among the best in Africa, the system is not empowering all people to access jobs in a highly competitive labour market, which is a major contributor factor to unemployment and widespread poverty. In particular, despite a substantial achievement in terms of gross primary and secondary school enrolment (the ratios are 116 and 89 per cent respectively) the quality of teaching is low owing to the high number of untrained teachers. The situation is exacerbated by the high prevalence of HIV/AIDS which has devastating effects on the supply and quality of teaching. HIV/AIDS also has an impact on the number of dropouts from secondary schools which are increasingly linked to HIV related diseases for pregnant girls. However, in the 2002 budget, education accounts for the largest share of government expenditure, nearly a quarter of the total budget (23 per cent). This reflects the government's intention to invest heavily in education as a way of increasing skills development to improve productivity and create more jobs, as stated in the national Strategic Vision 2016. Following the recommendation of the Revised National Policy on Education of 1994, the goals and contents of the secondary school programme have been revised to emphasise pre-vocational preparation. In this context, the government launched the Botswana Technical Education Programme in 2000, with the aim of enhancing technical training in the country. Moreover, the University of Botswana continues to be expanded and now caters for many more students than before (the number of university students in 2002 was over 11 000 compared to 3 600 ten years before). In addition, a substantial number of students who cannot be catered for in local institutions are being sent abroad for education and training.

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