EXPLORING ECONOMIC STRUCTURE AND DRIVERS OF ECONOMIC GROWTH IN BOTSWANA

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Abstract

This article set out to analyse the economic structure and main economic drivers in Botswana. Botswana, a country in sub-Saharan Africa, is a relatively small economy, hugely dependent on its diamond mineral wealth. Concerns have arisen in recent years that the diamond deposits will soon be depleted and the country therefore needs to embark on a diversification programme to broaden its economic base. In order to understand the Botswana economy, its economic structure and current domestic sectorial performance were evaluated, as well as its trends in imports and exports. An analysis of the data shows that, regardless of the awareness of the sensitivity to external shocks of commodity prices, as well as the obvious future depletion of diamond reserves, the Botswana economy continues to rely on diamonds, at the expense of attracting international capital flows to enhance and maintain sustainable economic growth, through investments in agriculture, manufacturing and tourism. It is therefore recommended that the Government of Botswana becomes proactive and implements recommended policies to diversify its economy, so that it can sustain or improve its economic growth by becoming a prime destination of international capital and domestic private sector investment, thereby increasing employment and trade opportunities.

Keywords: Trend Analysis, Investment, Imports, Exports, Policy, Botswana, Africa, Diversification, Economic Growth, Diamonds, FDI

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1 Introduction

Botswana is a small, landlocked country located in Sub-Saharan Africa, with a population of just over two million. Previously colonized by Britain, it gained its Independence in 1966, and was considered one of the poorest nations with a per capita gross domestic product (GDP) of only US$70 (World Bank, 2014); growing to US$6500 in 2012 (African Economic Outlook, 2012). Also, at independence, Botswana's economy was agro-based, with this sector contributing approximately 43% of the country's GDP, mainly from its cattle rearing and beef production (Malema, 2013). The country's fortunes however changed a few years thereafter upon the discovery of diamonds. Botswana experienced exceptionally high economic growth, and was reclassified as an upper-middle income country, as evidenced by the real GDP which increased at an average annual rate of 4.6% between 1994 and 2011, based on the new constant 2006 prices (World Bank, 2014). As a result of the diamond mining, focus shifted from agriculture to mining, and mining became the preponderate sector in terms of GDP contribution to the economy of Botswana. According to Siphambe (2006), agriculture shrunk from 39% of the economy in 1966 to 2% of total output by 2003; whereas mining went from 0% to a peak of 47%, before declining to 35% during the same period.

The recent global financial meltdown of 2008 exposed the vulnerability of Botswana's overdependence on its diamond mining as the backbone of its economy. The low global demand for minerals resulted in a sharp decline in commodity prices, and diamonds were not spared either. Diamonds contribute 50% of the Government's revenue, mainly through its 50:50 joint venture shareholding structure with De Beers in Debswana Diamond Company. During the crisis, jobs were shed, and in some instances, mining operations were suspended in order to preserve jobs as well as the mineral wealth while waiting for the commodity markets to recover so that decent prices can be earned from the sale of diamonds.

As a result of this dependence of the entire economy on mining, and specifically the mining of diamonds, there have been calls for the Government to encourage investment in other sectors of the economy. This call for diversification is as a result of the limited lifespan of the diamond mines. Diamonds are a natural resource which will run out in due course. Experts have estimated that the current diamond deposits in Botswana will be depleted in 2029 (Basdevant, 2008). What then will become of the country and its economy then, should the main economic driver be depleted? Does Botswana have the capacity to attract foreign investors to augment its endeavors to establish and sustain alternative economic sectors?

The primary objective of this paper is to examine the economic structure and the main economic drivers in Botswana. In order to understand the dynamics of the Botswana economy, this article will seek to undertake a comparison of FDI to trends in imports and exports, as a percentage of GDP, as these tend to substitute inward international capital. The country's investment attraction policies will also be studied with the view of understanding what structures the Government has put in place in order to diversify its economy. The remainder of this article is set out as follows: the first section gives a general overview of the economic structure of Botswana, followed by an examination of the domestic sectorial economic performance. The third section is an analysis of import and export trends in Botswana. Lessons learned from the diamond dependency syndrome, as well as recommendations on Government's investment and economic diversification policies will be considered in the fourth section. The paper ends with a concluding summary to the study.

2 Overview of the structure of the economy of Botswana

Botswana is renowned world over for its diamond production. Little was known about this small country until the discovery of diamonds. At Independence from British rule in 1966, Botswana had a predominantly agriculture-based economy, mainly cattle rearing and beef production. However, the country is semi-arid with the Kalahari Desert covering almost 70% of Botswana's land surface. As a result, the country is naturally prone to droughts, which occur every second year. The high prevalence of droughts poses a huge threat to the agricultural sector as the absence of reliable rainfall affects crop production. The rural population also depends on livestock herds, which due to overgrazing, adds to the country's woes. In drought years, many cattle die off. Due to diamond exploitation, the Botswana economy has structurally reformed from agro-based to mining based. Within the mining sector itself, the focus is on the lucrative diamond extraction than other minerals such as copper-nickel, soda ash and gold (Bank of Botswana, 2013).

The Government of Botswana (GoB) is a major player in the diamond mining sector. In order to attract foreign investment, Botswana in 1969 entered a joint venture shareholding structure with De Beers of South Africa, wherein the Government would hold 15% of the shares, while De Beers held the lion's share of 85% in Debswana, a company established to exploit diamonds in Botswana. With rising demand for diamonds, and therefore an increase in prices and hence improved profitability, the GoB in 1975 revised the Debswana shareholding structure as follows:

- The GoB received equity shares of 15% of diamond mining proceeds;
- The GoB exercised its option to purchase an additional 20% of the shares, effectively earning itself the right to have direct representative sitting on the Board of Debswana Mining Company, the Botswana-based subsidiary of De Beers Mining Company;
- The GoB was also to receive royalties equivalent to 15% of the shares.

The above arrangement effectively gave the Government a 50% equity in its diamonds sector, and this has tremendously boosted Government coffers over the years (Siphambe, 2006). According to Mahembe and Odhiambo (2013), diamond revenue accounts for at least 55% of Government income. Although the mining sector as a whole is dominant in the economy in terms of output and exports, this does not translate to much as far as employment is concerned because the sector only contributed employment of 5% (Siphambe, 2006).

As can be noted from Table 1 above, there has been a consistent improvement in the GDP per capita, ranging from the captured period of 1995 to end of 2013. The real GDP growth rate itself recovered significantly shortly after the 2008 global financial crisis from a negative 7.84% in 2009 to a positive 8.59% in 2010. In terms of imports and exports of goods and services, measured as a proportion of GDP, Botswana receives a significant amount of its income from exports of diamonds and copper-nickel, although more than 50% of this still leaves the country as payment for the importation of various products such as fuel, food and machinery. Agriculture and manufacturing contribute less than 8% apiece towards the economy, a very precarious situation which needs to be urgently remedied, because mining cannot and will not continue to sustain this economy beyond the economic lifespan of the diamond deposits. The scenario is even worse when examining the minimal contribution to GDP from net FDI inflows, yet Botswana has some lucrative investment opportunities for foreign capital, but clearly fails to capitalize on this. According to the Bank of Botswana (2013), the country's upward trend in trade continues to be buoyed by the relocation of De Beers Diamond Trading Company from London in the United Kingdom to Gaborone, the capital city of Botswana. Aggregation of rough diamonds has occurred in Botswana since July 2012, resulting in re-export trade since local production is pooled with that of De Beers' mines in Canada, Namibia and South Africa.

Besides having an open economy, Botswana is also fortunate to have a mature democracy, which creates political stability in the country; a requirement for FDI attraction to its economy. On the labor front – the Government has invested significantly in basic education by offering free primary school education. This has however not translated to a large enough supply of skilled labor, as the country continues to have to employ a substantial number of expatriates for high level positions particularly in mining. The country further faces an unemployment rate of approximately 20%, as well as the world's second highest prevalence of adult HIV/ AIDS, which results in a lower life expectancy.

Table 1. Key macroeconomic indicators in Botswana

Indicator	Measure	1995	2005	2009	2010	2011	2012	2013
GDP	US$ billions	4.730	9.931	10.107	13.747	15.365	14.537	14.785
GDP per capita	Current US$	2,988	5,294	5,178	6,980	7,734	7,255	7,315
GDP growth rate	%	7.03	4.56	(7.84)	8.59	6.18	4.31	5.83
Real interest rate	%	6.78	0.23	9.98	(6.28)	4.76	9.84	4.00
Exports of goods and services	% of GDP	50.84	52.92	35.35	35.84	45.32	43.48	55.12
Imports of goods and service	% of GDP	43.76	35.58	52.71	46.24	52.40	59.43	59.90
Net FDI inflows	% of GDP	1.49	2.81	1.27	0.99	7.11	1.01	1.28
Agriculture , value added	% of GDP	4.91	2.03	3.27	3.22	2.75	2.93	2.54
Industry, value added	% of GDP	46.47	47.63	30.83	40.14	40.04	35.33	36.92
Manufacturing, value added	% of GDP	5.64	5.50	7.36	6.58	6.34	6.43	5.68
Services, value added	% of GDP	48.62	50.33	65.90	56.64	57.21	61.74	60.54
Trade	% of GDP	94.60	88.51	88.06	82.08	97.73	102.91	115.02
Population	Millions	1.583	1.876	1.952	1.969	1.987	2.004	2.021

Source: World Bank (2014)

3 Domestic sectorial performance

According to the Bank of Botswana (2013), there was an improvement in the country's economic performance in 2013. The country's real GDP grew from 4.2% in 2012 to 5.9% in 2013, attributable to the lucrative mining sector which grew by 11%, after the 7% contraction in 2012; and despite a severe drought which led to water shortages and electricity outages. Non-mining GDP however grew by 5.1%, a deceleration from 6.2% in 2012. Continuing with its trend for decades now – mining retained its position as the local economy's largest contributor, accounting for 22.1% of total output at current market prices, compared to the 2012 level.

Table 2. GDP by sector (percentage)

Sector	2008	2012
Agriculture	2.8	2.9
Mining	29.2	21.9
Manufacturing	6.3	6.4
Water and electricity	1.0	(0.5)
Construction	5.5	7.4
Retail trade, hotels and restaurants	14.8	16.6
Transport and communication	4.9	6.2
Finance and business services	13.8	15.9
Public administration	16.1	16.4
Other services	5.7	6.8
GDP at basic prices/ factor cost	**100**	**100**

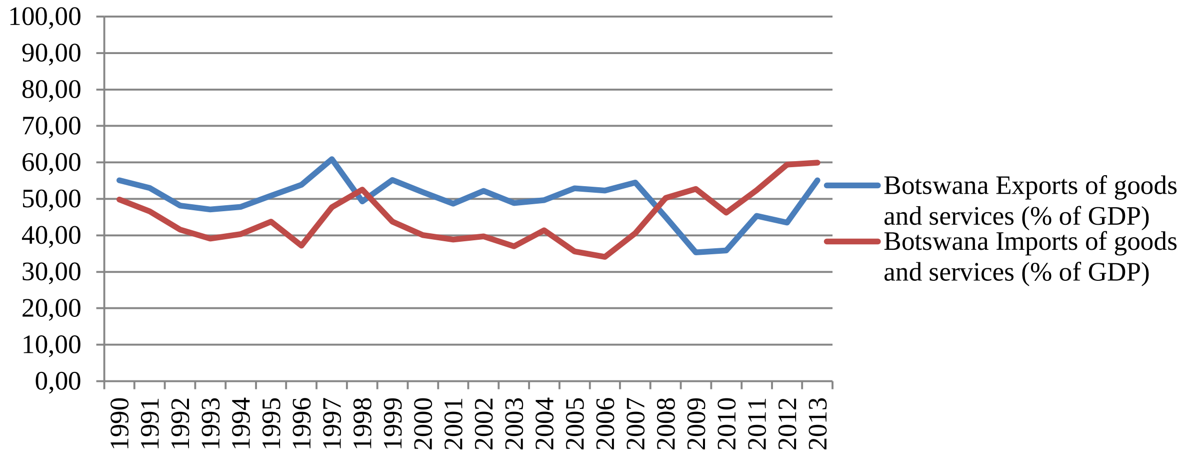
Source: African Economic Outlook (2014)

Looking at the sectorial contributions made, as presented in Table 2 above, only mining; retail trade, hotels and restaurants; and finance and business services are noteworthy of paying attention to. Diamond production in 2012 increased on the back of higher demand from the United States of America (USA) and China. There were also positive contributions made in the production of copper-nickel; although operational challenges impacted negatively on coal output (Bank of Botswana, 2013). Retail trade, hotels and restaurants benefitted primarily from a rise in retail trade activity, finance and business services was boosted by a surge in real estate dealings. Interestingly, the Government contributed over 16% towards its own GDP. This was not raised from the typical taxes and other public funds, but rather from realized diamond mining revenues. As already alluded to above, Botswana experiences perennial droughts, and the 2012/ 2013 agricultural period was affected, hence no real contribution was made by the sector. The manufacturing sector also posted disappointing results, especially in the textile sub-sector which shrunk by 59.6%.

4 Import and export trends in Botswana

Like most economies in the world, Botswana is engaged in the business of importing goods and services that it cannot produce for itself at an economic advantage, while exporting those goods and services which can earn it much needed foreign currency. Figure 1 below shows the interrelationship and trends between imports and exports. It is noted that imports and exports closely mimic each other in terms of peaks and troughs over the period 1990 to 2013. Export levels were generally higher than imports during the period under review, except from 2008 to 2013 when imports became slightly more than exports. This was due to the impact of the global financial crisis on the economy.

Figure 1. Botswana Exports vs Imports, 1990-2013



Source: Author's calculations derived from World Bank data (2014)

It can be further assessed from Tables 3 and 4 below that Botswana's total exports rose by 36% compared to a mere 2% rise in imports in 2013. Contributing to this rise in exports were diamonds, copper-nickel and beef, whose exports rose by 46%, 36% and 90%, respectively, between 2012 and 2013. Diamond exports were enhanced by larger volumes and higher prices, which came about as a result of the local currency (Pula) depreciating against the American dollar. On the other end of the spectrum, exports of vehicles, textiles and gold, which declined by 33%, 41% and 27%, respectively, during the same period (Bank of Botswana, 2013). The leading destinations of exports from Botswana in 2013 were Belgium, India and Israel, which were impacted on by the relocation of diamond sales from the UK to Botswana.

Table 3. Exports from Botswana, 2012-2013

	2012 Pula million	2013 Pula million	2012 %	2013 %	% change
Total exports	45 861	63 859			39
Of which:					
Diamonds	36 143	52 768	78.8	82.6	46.0
Copper-nickel	3 393	4 604	7.4	7.2	35.7
Beef	523	996	1.1	1.6	90.5
Soda ash	645	723	1.4	1.1	12.2
Gold	618	451	1.3	0.7	(27.1)
Textiles	613	362	1.3	0.6	(40.9)
Vehicles	989	658	2.2	1.0	(33.5)
Other goods	2 937	3 297	6.4	5.2	12.2

Source: Bank of Botswana (2013)

With regard to imports, the top four commodities imported were fuel, chemicals and rubber products, diamonds and food. Botswana does not have oil reserves, nor the capacity to generate its own electricity and hence has to source fuel from outside the country. Due to the regular droughts experienced in the country, food also has to be imported. Most of Botswana's imports are sourced from neighboring South Africa and the United Kingdom which in 2012 accounted for approximately 63% and 17% of all imports, respectively; as well as China, Israel, Namibia and Zimbabwe (African Economic Outlook, 2014).

Table 4. Imports to Botswana, 2013-2013

	2012 Pula million	2013 Pula million	2012 %	2013 %	% change
Total imports	60 633	61 823			2.0
Of which:					
Diamonds	16 512	17 655	27.2	28.6	6.9
Fuel	10 005	10 833	16.5	17.5	8.3
Food	6 125	6 377	10.1	10.3	4.1
Machinery & elec. equipment	9 091	7 535	15.0	12.2	(17.1)
Chemicals & rubber products	5 432	5 812	9.0	9.4	7.0
Metals & metal products	2 915	2 936	4.8	4.7	0.7
Textile & footwear	1 893	1 895	3.1	3.1	0.1
Vehicle/ transport equip	5 505	5 148	9.1	8.3	(6.9)
Other	4 480	4 972	7.4	8.0	11.0

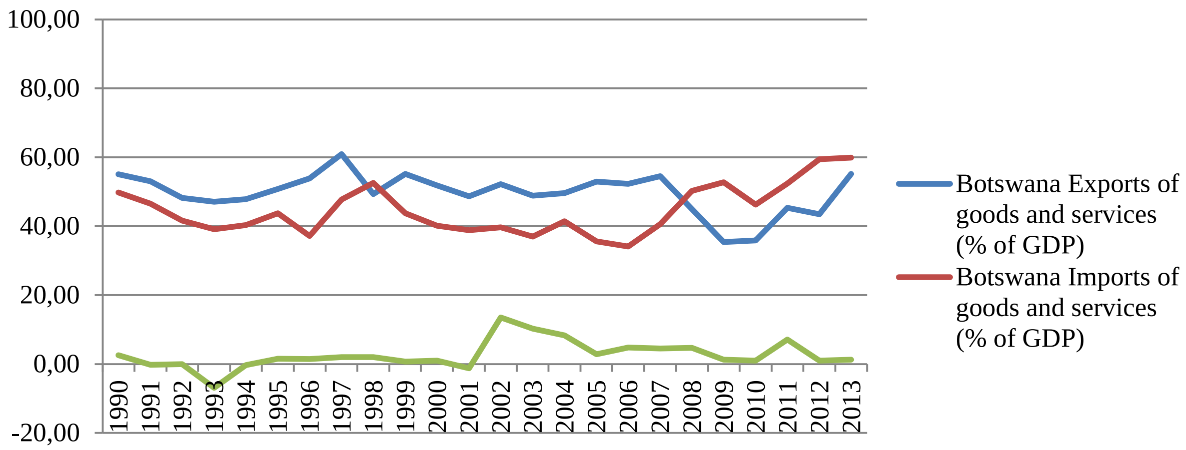
Source: Bank of Botswana (2013)

5 Conclusion: lessons learned and policy recommendations

The primary objective of this paper was to examine the economic structure and the main economic drivers in Botswana. It emerged that despite being an open economy, the country is largely dependent on a single commodity – diamonds. The problem with diamonds is that as a natural resource, the deposits will soon be all mined out, and the country will have limited or no alternatives to sustain its economy. Also, the value of diamonds fluctuates as commodity prices are subject to global external shocks. In addition to the above, despite being the biggest economic driver, the diamond mining sector actually only contributes 5% to the country's employment. In the 2012/ 2013 period, diamonds accounted for 46% of total exports, and over 55% of the Government's income through its various shareholding arrangements in Debswana.

Figure 2 below shows the concerning gap between imports, exports and FDI inflows to Botswana between 1990 and 2013. It is clear that FDI is not considered an alternative source of funding for long term projects which could free up Government income sources for use in social development agendas. The highest level of FDI received by Botswana (as a % of GDP) was 13.46% in 2002. Thereafter, the trend of FDI inflows actually declined to almost non-existent levels. Other challenges that Botswana faces is that the Government's high contribution to total output has effectively crowded out private sector investments, hence FDI is required to fill this gap. The country has also been affected by the high scourge and prevalence of adult HIV/ AIDS, hence reducing the pool of labor. In line with providing basic human rights to the affected population, those infected with the disease are able to work until such time that their illness affects productivity. The Government however tries to ensure that once infected, the disease sufferers have access to adequate health facilities.

Figure 2. Botswana Imports, Exports and FDI, 1990-2013



Source: Author's calculations derived from World Bank data (2014)

Given Botswana's mature democracy, an impressive track record of good governance and economic growth backed by sound macroeconomic and fiscal policies, the IMF (2011) advises that the country should in fact push for the diversification of its economy in sectors such as tourism, agriculture, manufacturing, trade and telecommunication. Botswana's other investment attraction factors besides the diamond mines; include vast tracts of desert sands in the Kalahari Desert and the Chobe River, both of which have the potential to bring in high tourism receipts. Also, there are several opportunities available in commercial cattle rearing and beef production. Botswana beef is exported in carcass form to neighboring countries, as well as the European Union. The Botswana Investment and Trade Centre (BITC, 2015) also lists additional investment incentives as follows:

- The country offers tax holidays and low corporate rates of tax, e.g. 15% for manufacturing firms, 22% on capital gains, 15% on foreign dividends;
- Infrastructure-wise, the railway links Botswana to Zimbabwe and South Africa; while the road network connects Botswana to South Africa, Zimbabwe, Zambia, Namibia;
- Access to markets due to regional trade membership agreements such as SADC and SACU;
- A stable and competitive exchange rate, no exchange controls, low incidence of crime, good labor relations, and a pool of labor with basic primary education.

In 2013, a reimbursable advisory services (RAS) agreement was entered into between the GoB and the World Bank, for the purposes of initiating and pursuing an economic diversification and competitiveness agenda leaning on five pillars – doing business, industrial and trade policies, infrastructure, access to finance and skills development (World Bank, 2014). However for this programme to be successful, it requires a political commitment from the Botswana Government itself. The diversification agenda can also be funded using international capital flows in the form of foreign direct investment (FDI). Attracting FDI to Botswana will enhance and encourage greater private sector development and participation, create employment and free up Government funds. According to Malema (2013), the private sector remains subdued, and still looks to Government to create jobs and other entrepreneurial opportunities. Domestic financial markets are not adequately developed as yet to be able to facilitate the raising of significant amounts of capital for long term investment and growth. The Botswana Stock Exchange is relatively small in comparison to other African stock exchanges in Kenya, Nigeria, Uganda, Zimbabwe and South Africa; with only eighteen (18) listed counters, and a mere market capitalization of US$4,588m in 2012 (World Bank, 2014). Financial market development in Botswana is not reflective of the country's GDP and economic growth rates which have resulted in it being classified a middle-income country.

In conclusion, it is recommended that the incumbent Government seizes existing opportunities offered by the World Bank and IMF, as well as take the advice rendered insofar as the promotion of economic diversification and harnessing of FDI is concerned. In this way, the economy will not halt to a complete standstill when diamond mining and production hits a plateau and declines due to depleted mineral resources. The country has been found to be the 36th freest in terms of the economic freedom score by Heritage Foundation (2015), putting it at a greater advantage than most other countries in the Sub-Saharan region. It therefore remains to be seen whether the economic diversification programmes will be pursued and implemented, and how soon.

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