INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/268

BOTSWANA

September 2018

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BOTSWANA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with Botswana, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its August 31, 2018 consideration of the staff report that concluded the Article IV consultation with Botswana.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 31, 2018, following discussions that ended on June 7, 2018, with the officials of Botswana on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 16, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Botswana.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

Press Release No. 18/341
FOR IMMEDIATE RELEASE
September 5, 2018

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2018 Article IV Consultation with Botswana

On August 31, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Botswana.[1]

Sizable buffers and prudent policies have kept the economy stable despite diamond market weakness and volatility, but progress with structural reforms has been mixed. The diamond cum public sector-led development model has been showing its limitations with sluggish growth and weak job creation. In recent months, the authorities approved key legislation to improve the business environment and announced plans to proceed with privatizations, rationalize parastatals, and relax restrictions on visas and work permits.

In 2017, despite higher diamond production, real GDP growth dropped to 2.4 percent primarily because of the closure of a major copper and nickel mining company. Non-mineral growth decelerated reflecting the indirect effects of the company’s closure on electricity and transportation, coupled with a small slowdown in trade and construction. Inflation remained near the lower end of the Bank of Botswana’s objective range of 3–6 percent, with the 12-month rate at 3.1 percent in July 2018.

The fiscal position was nearly balanced, as lower mineral and non-tax revenues were offset by higher SACU receipts, and higher outlays in wages and transfers were compensated by lower spending on goods and service and bursaries. At the same time, the real effective exchange rate remained stable, the current account balance maintained a large surplus, public debt remained low, and international reserves exceeded their adequate level by a comfortable margin.

In 2018–19, it is expected that improving conditions in the diamond market and fiscal stimulus will temporarily boost economic activity. The medium-term economic outlook will depend heavily on the successful implementation of critical structural reforms.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors commended the authorities for implementing sound policies, which have contributed to macroeconomic stability, a low level of public debt, and strong buffers. Directors agreed that continued commitment to prudent policies and timely and focused implementation of structural reforms will be crucial to promote private sector growth, reduce unemployment, and diversify the economy.

Directors concurred that the fiscal policy stance is broadly appropriate. They underscored that, to maintain strong buffers, gradual and growth-friendly consolidation will be needed over the medium term. On the expenditure side, Directors encouraged efforts towards containing the growth of recurrent outlays while safeguarding capital and social spending. On the revenue side, in addition to tax administration reforms, they recommended steps to streamline VAT exemptions and reform the system of property taxation.

Directors noted that the current accommodative monetary policy stance is consistent with the output gap and subdued inflation. They agreed that the crawling peg system remains appropriate and encouraged the authorities to maintain adequate levels of international reserves. Directors also noted that the banking sector remains sound despite an increase in nonperforming loans in a few non-systemic banks, and supported the authorities' intentions to strengthen macroprudential regulations, closely monitor the risks associated with households' debt, and improve the AML/CFT framework.

Directors underscored the importance of adjusting the country's development model to boost growth potential, lower unemployment, and promote diversification. In this connection, they welcomed the authorities' commitment to accelerate the implementation of key structural reforms. Directors underscored the need to reform the public sector and its role in the economy, especially by restructuring and privatizing parastatals, undertaking a civil service reform, and strengthening the prioritization of public investment projects.

Directors stressed the need to remove distortions, (especially monopolies and regulations that raise the cost of doing business), better target social spending, improve education policies, liberalize the granting of visas and work permits, and realign educational and vocational polices to address skill mismatches. They also encouraged continued efforts to deepen financial markets and foster financial inclusion, especially by strengthening creditor rights and information on borrowers' creditworthiness, increasing the volume and frequency of issuance of government bonds, and enhancing the breadth and depth of mobile money payments.

Directors welcomed the steps recently taken to strengthen fiscal transparency and encouraged further efforts in this regard. They also called for measures to address data gaps and further improve the quality and timeliness of economic statistics.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Botswana: Selected Economic Indicators, 2014–2018

	2014	2015	2016	2017	2018
				Preliminary	Projections
	(Annual percent change, unless otherwise indicated)[1]				
National income and prices					
Real GDP	4.1	-1.7	4.3	2.4	4.6
Mineral[2]	0.5	-19.6	-3.5	-11.2	5.4
Nonmineral	4.9	1.7	5.5	4.2	4.5
Consumer prices (average)	4.4	3.1	2.8	3.3	3.8
Diamond production (millions of carats)	24.7	20.8	20.9	22.9	24.2
External sector					
Exports of goods and services, f.o.b. (% change)	7.5	-23.8	13.7	-15.6	9.5
of which: diamonds	10.4	-28.4	24.6	-19.1	9.9
Imports of goods and services, f.o.b. (% change)	-3.5	-10.0	-15.4	-11.5	15.7
Current account balance	13.2	5.6	13.7	12.3	9.5
Overall Balance	3.7	-5.4	-2.3	1.8	1.9
Terms of trade (2005=100)	165.5	195.7	174.4	155.8	159.4
Nominal effective exchange rate (2010=100)	94.8	94.9	95.1	95.4	95.5
Real effective exchange rate (2010=100)	104.3	105.2	104.8	105.0	105.1
External public debt[3]	17.2	18.4	14.3	12.9	12.4
of which: public and publicly guaranteed	4.8	5.3	4.7	4.4	4.1
Money and banking					
Monetary Base	-8.5	18.6	3.7	-13.7	11.3
Broad money (M2)	4.6	19.9	5.4	2.7	9.4
Credit to the private sector	13.7	9.0	9.0	5.3	6.7
	(Percent of GDP, unless otherwise indicated)				
Investment and savings					
Gross investment (including change in inventories)	28.2	32.6	28.6	28.1	27.5
Public	8.2	8.8	8.5	8.0	8.1
Private	20.0	23.8	20.0	20.1	19.4
Gross savings	43.5	41.2	38.8	40.3	37.0
Public	19.8	16.1	16.2	15.9	12.8
Private	23.7	25.1	22.6	24.4	24.2
Central government finances[4]					
Total revenue and grants	38.3	31.2	33.2	31.6	28.9
Total expenditure and net lending	34.7	35.8	32.5	31.5	32.6
Overall balance (deficit –)	3.7	-4.6	0.6	0.1	-3.7
Non-mineral primary balance[5]	-16.1	-18.1	-17.6	-12.9	-16.7
Total central government debt	22.6	23.2	21.3	19.4	18.9
	(Millions of U.S. dollars, unless otherwise indicated)				
Gross official reserves (end of period)	8,323	7,546	7,189	7,502	7,865
Months of imports of goods and services[6]	12.7	13.6	14.6	13.2	13.1
Months of non-diamond imports[6]	18.5	18.3	18.9	17.7	17.8
Percent of GDP	54.3	58.0	44.9	41.1	42.4

Sources: Botswana authorities and IMF staff estimates and projections.
1 Calendar year, unless otherwise indicated.
2 Projections are based on diamond production due to lack of information on the breakdown of mining value added by mineral.
3 Includes central government-guaranteed debt.
4 Year beginning April 1.
5 The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest receipts and interest payments), divided by non-mineral GDP.
6 Based on imports of goods and services for the following year.

BOTSWANA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

August 16, 2018

KEY ISSUES

Context. In recent years, sizable buffers and prudent policies have kept the economy stable despite diamond market weakness and volatility. Nevertheless, the diamond cum public sector-led development model has shown its limits with slower growth and sluggish job creation, while the implementation of structural reforms has been challenging because of limited capacity, insufficient coordination among government entities, and political constraints. The 2017 National Development Plan aims at addressing these issues, with emphasis on private sector development and economic diversification, but more focused time-bound plans with concrete reforms and revised investment priorities need to be formulated and implemented.

Economic outlook. The near-term outlook is positive considering increasing diamond exports and comfortable buffers. Medium-term prospects are also favorable assuming that key structural reforms in the areas of revenue mobilization, public financial management, financial deepening, the business environment, and education and the labor market are carried out. However, a less favorable scenario would ensue if reforms are delayed or weakly implemented.

Policies to support economic stability and improve growth prospects and equality. The projected fiscal deficit for 2018/19 is manageable given sizable savings and low debt, while the crawling peg exchange rate regime continues to serve the country well. Monetary policy is expected to remain accommodative but could be tightened if inflationary pressures develop. In the medium term, a gradual and growth-friendly fiscal consolidation based on a mix of revenue and expenditure policies and public financial management reforms is needed to maintain strong buffers, improve productivity, and reduce inequality.

Reforms to foster job creation and diversify exports. The authorities' goals to diversify the economy and create jobs require bold market-friendly measures that lower the costs of doing business, improve skills in the labor force, make the public sector more efficient, and enable competition in sectors with latent comparative advantage. In this regard, the authorities intend to liberalize visa and work permits' policies, improve the business environment, and privatize, close, or merge inefficient public enterprises. Political commitment to accelerate reforms in these and related areas and enhance accountability in government entities will be essential to attain the above goals.

Approved By
Anne-Marie Gulde-Wolf (African Department) and Nathan Porter (Strategy, Policy, and Review Department)

The discussions took place in Gaborone during May 21–June 6, 2018. The staff team comprised Mr. Gelbard (head), Ms. Ganum, and Messrs. Jardak, Maino, Torres, and Yabu. Mr. Nakunyada, Advisor to the IMF's Executive Director that represents Botswana, joined the mission. The staff met with the Minister of Finance and Economic Development, Mr. Ontefetse Kenneth Matambo; the Governor of the Bank of Botswana, Mr. Moses D Pelaelo; the Permanent Secretary of the Ministry of Finance and Economic Development, Mr. Solomon Sekwakwa; other senior officials, development partners, and representatives of the private sector and civil society. This report has been prepared with research support provided by Ms. Li and administrative support by Mr. Alsokhebr and Ms. Prado de Guzman.

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CONTEXT

Botswana is a small upper-middle income country that ranks among the best in Africa in terms of income per capita, governance, rule of law, and macroeconomic management. In recent years, the authorities have been successful in preserving economic stability amidst a challenging external environment but faced difficulties in proceeding with key structural reforms to diversify the economy and boost employment and growth, the country's top macro-critical challenges.

1. Since 2014, the economy faced a challenging external environment. The global demand for diamonds was volatile because of slower growth in China and demonetization in India. In addition, a downward trend in global demand led to a decline of rough diamond prices in real terms, lower production, and accumulation of inventories. Lastly, exports of other minerals collapsed since 2016 owing to low international prices and the closure of the largest copper-nickel mine.

2. The authorities' response contributed to a partial economic recovery. After the economic slowdown in 2015, the government adopted a countercyclical fiscal policy and the Bank of Botswana (BoB) loosened monetary policy, both of which supported non-mining economic activity.

3. The diamond cum public sector-led development model has been showing limitations. Non-mining potential growth, measured by a production function approach, has been declining because of lower capital accumulation and sluggish productivity gains (Box 1). This outcome exposed the limits of relying on the expansion of the government and the production of nontradable goods and services in a small domestic market which, together with slow progress in removing distortions and a rather unfocused development strategy, led to limited gains in terms of employment, income equality, and export diversification.

4. Macroeconomic policies have been prudent, but progress with structural reforms has been mixed. The authorities have successfully used countercyclical policies and kept debt levels and inflation low. On the structural front, progress was made with financial sector and public financial management reforms, and electricity shortages were resolved (Appendix I). However, reforms to amend tax policies, boost public sector efficiency, and improve the business environment, education outcomes, and skills in the labor force have lagged because of insufficient coordination and accountability as well as capacity and political constraints.

5. Recent legislative changes and announcements have been encouraging. In the past year, legislation was passed to improve the business environment.[1] Following mandatory retirement of President Khama, Vice-President Masisi became President in March of this year ahead of general elections to be held by October 2019. Since then, plans were announced to liberalize the meat sector, rationalize parastatals, proceed with privatizations, and relax visa restrictions and work permits, although the timing and scope of such reforms has yet to be determined.

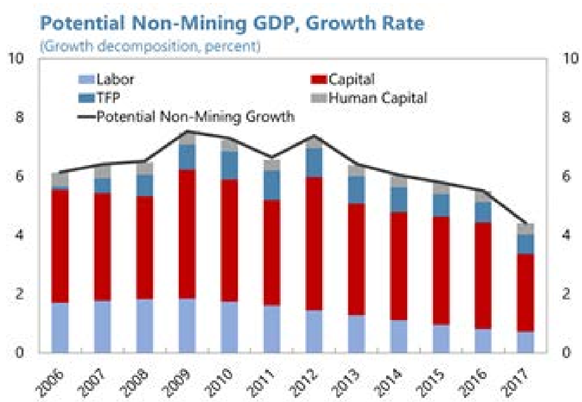
[1] The recent statutes aim at facilitating electronic business transactions (including electronic signatures), improving regulations in securities' markets, providing for the settlement of trade disputes, facilitating registration of tribal land, establishing an energy regulatory authority to regulate the energy value chain in line with best international practice, aligning customs practices to those stipulated in the Revised Kyoto Convention, and improving excise tax collection.

Box 1. Botswana: Growth, Employment, and Income Inequality

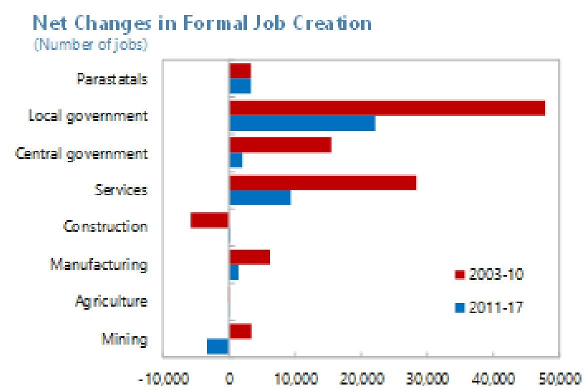
Buoyed by diamonds, the economy expanded rapidly between the early 1990s and the 2000s. Real GDP grew, on average, at a rate of about 6 percent. Diamond production and exports provided the main impetus to the economy and facilitated the expansion of the state, leading to the growth of nontradable sectors (mainly services and construction). Agriculture remained dominated by subsistence farming, and some manufacturing activities were established, although they primarily served the domestic market. As a result, the export base remained undiversified with diamonds accounting for nearly 90 percent of exports.

In recent years, non-mining GDP and employment growth decelerated. Using a Cobb-Douglas production function approach, growth potential and total factor productivity are estimated to have declined.

- Capital accumulation was temporarily boosted by fiscal stimulus in the aftermath of the global financial crisis but decelerated since then, especially with the completion of public investments in electricity. Private investment has been stable as a share of GDP mainly due to the relocation of De Beers trade activities to Botswana in 2013, but private investment outside mining was modest.
- Regarding employment, there was a decline in civil servants' recruitments after 2010, and job creation slowed in the private sector owing to high costs of doing business and the small size of the domestic market (as the production of tradable goods outside diamonds did not expand enough).



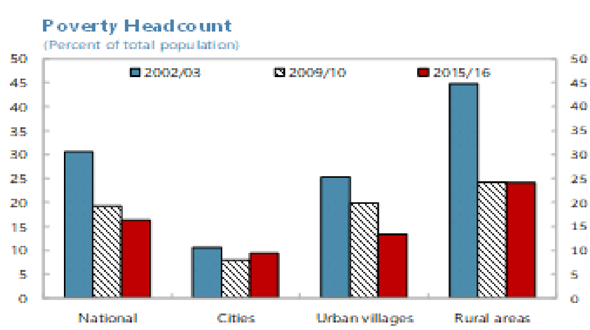
Sources: Botswana's authorities and IMF staff calculations.



Sources: Botswana household surveys and IMF staff calculations.

As a result, unemployment remained high. After declining in the 2000s because of the expansion of the public sector (hiring of civil servants, public works, agricultural programs), the unemployment rate has remained at around 18 percent and youth unemployment at 25 percent, reflecting the slow expansion of labor-intensive sectors and labor market distortions, notably skills mismatches. High reservation wages stemming from a high public-sector wage premium (estimated at nearly 60 percent) may have also contributed to sluggish job creation (IMF No. 3/297, and IMF No. 18/45).

Growth has been pro-poor, though less so recently, and income inequality has been high. Sizable social spending and public programs for farmers contributed to significant declines in poverty rates between the 1990s and the 2000s. More recently, the pace of poverty reduction slowed and was uneven across regions. Inequality has also been high (in 2009/10 the income GINI coefficient was estimated at 0.65), mostly explained by within-group differences rather aggregate determinants (e.g., geographic, employment status).



Sources: Statistics Botswana and various household surveys.

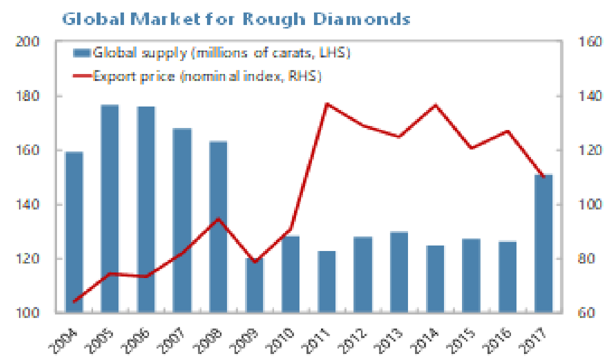
ECONOMIC DEVELOPMENTS

Despite the closure of a major copper mine and volatility and weakness in the diamond sector, macroeconomic conditions have been stable in recent years, supported by appropriate fiscal and monetary policies. Banks' profitability and liquidity declined, and nonperforming loans increased somewhat, but the banking system remains well capitalized.

6. Diamond market fundamentals improved in the past year. In 2017, higher demand from the U.S. and China led to a recovery in global production. Prices of raw diamonds remained broadly flat much of the year but started to pick up in the last quarter and in early 2018 (although they remain about 15 percent below their 2011 peak). In Botswana, while production increased, diamond exports and mineral fiscal revenue fell after a good year in 2016 (Table 1 and Box 2).[2]

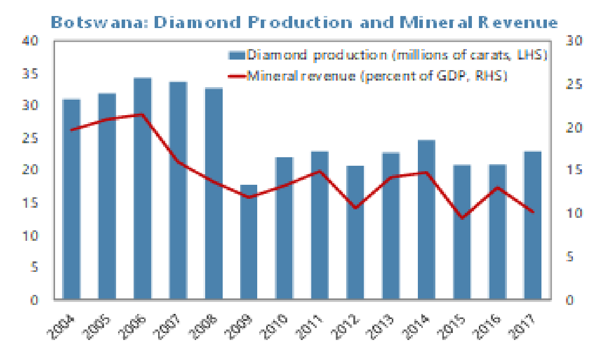
Box 2. Developments in the Diamond Market

In recent years, the global diamond market exhibited volatility and weakness. Following the global financial crisis, diamond production was curtailed which, coupled with recovering demand, led to a significant increase in prices of raw diamonds. Since then, demand has been volatile, and prices have followed a downward trend, prompted by lower demand from Gulf countries (affected by low oil prices), weak confidence (due to over-leveraging in the diamond manufacturing segment), China's economic slowdown in 2015–16, and currency reform in India.



Sources: Kimberley Process and IMF staff calculations.

Developments in Botswana were broadly in line with global trends. After 2010, diamond production fell to an average of about 22 million carats (compared to over 30 million carats in the 2000's). Despite having a positive price effect, net exports fell from over 30 percent of GDP before the global crisis to about 22 percent thereafter. Similarly, mineral revenue followed a downward trend, from over 20 percent of GDP in the early 2000's to about 12 percent in recent years.



Sources: Botswana's Authorities and IMF staff calculations.

7. In 2017, economic growth slowed while inflation remained subdued. Despite higher diamond output, real GDP growth dropped to 2.4 percent primarily because of the closure of Bamangwato Concessions Limited (BCL), a major copper-nickel mining company (Table 1 and Figure 1). Non-mineral GDP decelerated slightly reflecting the indirect effects of BCL's closure on electricity demand and transportation and a slowdown in trade and construction. In this environment, inflation

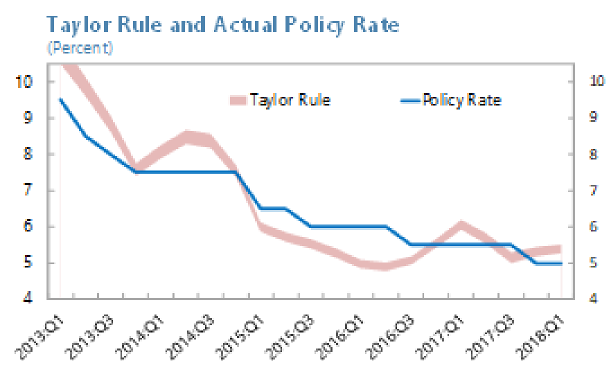
[2] The higher level of exports and revenue in 2016 were due to a partial recovery in the demand for diamonds in that year, with exports fulfilled through the liquidation of inventories that cumulated since 2014.

remained near the lower band of the BoB target range of 3–6 percent, with the 12-month rate at 3.1 percent in July 2018.

8. The external position has been broadly consistent with fundamentals and desirable policies. The pula has remained stable in real effective terms and the current account balance has been in surplus, although the surplus appears to have been overestimated.[3] The assessment that the external position is consistent with fundamentals is based on the view that, for intergenerational reasons, Botswana needs to accumulate foreign assets (Appendix II). International reserves fell from 58 percent of GDP at end-2015 to 41 percent at end-2017 but continued to exceed their adequate level by an ample margin (Table 2 and Appendix II).

9. The fiscal position has been nearly balanced and public debt remained low. Total revenue as a share of GDP declined in FY2017/18 (the fiscal year begins in April) compared to FY2016/17, as lower mineral and non-tax revenues offset higher receipts from the Southern African Customs Union (SACU) (Table 3). Current expenditure remained almost unchanged as higher wages and transfers to parastatals and local governments were compensated by lower bursaries for tertiary education and spending on goods and services. However, lower investment (partly due to under-execution) and lower electricity subsidies led to a decline in capital expenditure of about 1.7 percent of GDP.[4] Lastly, continued prudent fiscal policies kept public debt (domestic and external) low at 19 percent of GDP at the end of FY2017/18 (Appendix III).

10. Monetary policy has been accommodative. The Bank of Botswana reduced the benchmark policy rate to 5 percent in October 2017 in response to weak economic activity and low inflation. To align market interest rates with the policy stance, the BoB lifted restrictions on the issuance of central bank certificates. At the same time, an increasing demand for longer-dated assets was satisfied by expanding the range of securities usable as collateral. Nonetheless, credit growth decelerated reflecting declining demand due to weaker economic activity and risk aversion (Table 4).



Sources: Botswana's authorities and IMF staff calculations.
Note: The policy rate (the "Bank rate") is the rate at which the BoB lends to commercial banks through its discount window. The appropriateness of the rate is measured against a standard Taylor rule based on a moving average of the real interest rate.

[3] A technical assistance mission from the IMF's Statistics Department was carried out in June 2018 following a request by the authorities to review the balance of payments data in light of large errors and omissions. The key issues found were: (i) an under-coverage of dividends paid to foreign investors, profits deposited in intercompany accounts by companies in the diamond industry, and dividends received by the government; the omission of imports and exports of services by diamond companies; and (ii) an overstatement of exports of travel and construction services. These shortcomings are attributed to capacity constraints. Once adjustments are made, the current account surpluses for 2016 and 2017 could be up to 4 percent of GDP lower than currently reported (Tables 1 and 2).

[4] Electricity subsidies are currently classified as capital expenditures. Lower electricity subsidies arose because of higher tariffs, lower costly imports from South Africa after repairs in the Morupule B power station, and lower losses owing to the collapse of BCL's demand for electricity.

11. Notwithstanding some difficulties, the financial sector has remained stable and sound. The closure of BCL in 2016 and lower activity in diamond polishing led to an increase in non-performing loans in some non-systemic banks and higher provisions and write-offs, resulting in lower profitability (Figure 2). In addition, lower deposits from households and parastatals and deceleration in investment institutions' deposits led to lower liquidity in banks. Despite these difficulties, the system remained well capitalized and liquidity remained above the regulatory threshold (Table 5). In addition, the recent adoption of Pillar 2 requirements under the Basel II framework has improved the BoB's ability to assess concentration risks.

OUTLOOK AND RISKS

Botswana's medium-term economic prospects are good assuming the decisive implementation of key reforms and growth-friendly fiscal consolidation. An alternative, less benign scenario with weaker reforms and insufficient fiscal adjustment points to disappointing growth and erosion of buffers.

12. The baseline scenario envisages macroeconomic stability and higher growth. Following the one-off effect of the closure of the BCL mine, growth is expected to rebound in 2018 buoyed by higher diamond production and public spending (in the first quarter of 2018, GDP grew by 4.8 percent year on year). The monetary policy stance is expected to be accommodative and inflation remain within the BoB's target. Over time, the baseline assumes that global diamond demand will increase slowly and that, in line with recent government announcements, a set of important reforms improves public sector efficiency and the business environment, strengthening medium-term prospects (Table 1). To adjust to possible lower mineral and SACU revenue (Box 3), the baseline also assumes a fiscal consolidation based on measures to rationalize public spending and parastatals and strengthen domestic tax collection.

Box 3. Outlook for Diamond and SACU Revenues

The global diamond market started to recover but uncertainty is high. In recent months, inventories have normalized thanks to improved consumer sentiment and a recovery in retail sales, especially in the U.S., China, and India, and diamond prices started to pick up. The baseline assumes that these trends will continue and prices will increase moderately in real terms over the next 5 years but remain below their peak. This forecast hinges on developments in the global economy which, if adverse, could bring back weakness in the market and lower prices. There is also uncertainty about the evolution of consumer preferences (e.g. from younger generations) and the effects of low-cost synthetic diamonds in the medium-term.

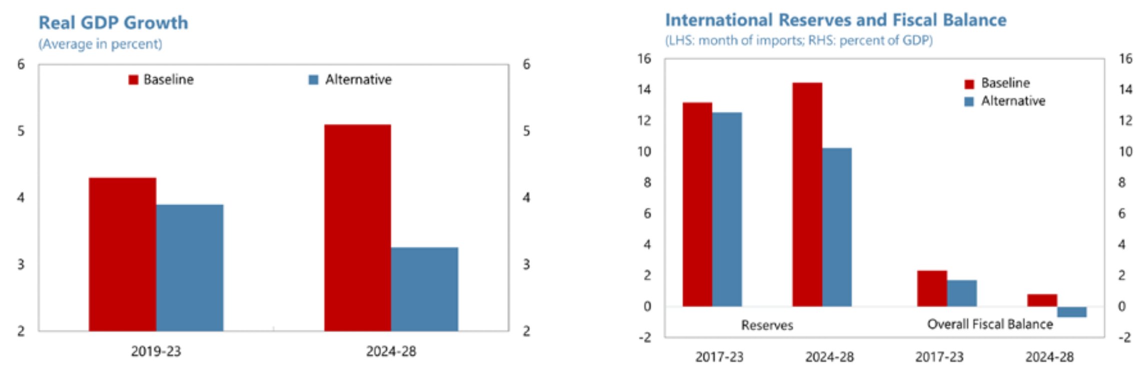
Despite higher diamond prices and production in Botswana, revenues are projected to remain subdued. Large investments are needed in diamond mines in the next five years to sustain and increase production. Assuming these investments are financed by cash flows (financing modalities have not been decided yet), the baseline projects lower taxes and dividends in the medium-term (9–10 percent of GDP compared to about 12 percent in recent years).

SACU revenues could also be constrained. Economic activity in the region is envisaged to improve, yet the recovery is not expected to be strong enough, especially in South Africa, implying that SACU transfers could decrease somewhat as a share of GDP at least until 2020.

13. The balance of risks is slightly tilted to the downside. In coming years, the main downside risks are (i) delays or weak implementation of fiscal and structural reforms and (ii) lower-than-expected diamond receipts. The outlook for the global diamond market could be affected by adverse developments in advanced economies, shifts in consumer preferences, and the emergence of synthetic diamonds; and SACU revenues could be lower in case of weaker than expected growth or adverse developments in South Africa (Appendix IV). On the upside, the global demand for diamonds and other minerals could be stronger than envisaged and a steadfast implementation of key structural reforms could lead to improved competitiveness and higher economic growth than in the baseline.[5]

14. An alternative scenario with slow pace of reform implementation would lead to a weaker economic outlook. The scenario assumes, inter-alia, no rationalization of VAT exemptions and no reform of property taxation; continued increases in current spending (especially on transfers to parastatals and subsidies); minor efficiency gains and no reprioritization of investment projects in the 11th National Development Plan (NDP11); and little progress on business environment reforms. This would result in a protracted fiscal deficit, higher debt and/or declines in government savings and foreign reserves, and slippages in terms of competitiveness and lower medium-term growth (see figure below).

Macroeconomic Projections Under Different Scenarios



Source: IMF staff calculations.

15. The authorities broadly agreed on the assessment of the outlook and risks. They are aware of the downsides of the alternative scenario and other, less benign ones, as well as of the importance of reinvigorating structural reforms to unlock growth potential. In this regard, they reaffirmed their commitment to fiscal consolidation and noted their expectation that key reforms will materialize over time alongside their goal to transition to advanced economy status.[6] With

[5] The Debt, Investment, Growth, and Natural Resources model simulation carried out in the context of the 2015 Article IV consultation showed different growth paths depending on the ambitiousness of reforms, their speed, and the extent to which the efficiency of public investment is improved. The results indicated that successful implementation of an ambitious set of structural reforms and efficiency improvements in the public sector could lead to potential GDP growth of about 6 percent per year in the medium to long-term.

[6] The authorities have a track record to revert to fiscal surplus in case of temporary deficits and NDP11, the Medium-Term Expenditure Framework, and the 2017 Article IV report on Botswana (IMF Country Report No. 17/249) already envisaged fiscal surpluses in the medium-term.

respect to growth projections, they pointed out that the recent slowdown in economic activity was also due to exogeneous factors and that GDP growth could be slightly higher than in the baseline.

POLICY DISCUSSIONS

The discussions focused on how to preserve economic stability, unlock growth potential, and create jobs. Achieving these goals will require tax and expenditure measures to ensure a gradual return to fiscal surplus, together with a prudent monetary policy and reforms to strengthen public financial management, foster financial deepening, improve the business environment, upgrade skills in the labor force, and facilitate the development of sectors with latent comparative advantage.

A. Policy Mix: Preserving Macroeconomic Stability

Sound Fiscal Policy

16. Fiscal projections for 2018/19 point to a deficit of 3–4 percent of GDP. The deficit could arise because of lower SACU revenues and higher recurrent outlays, especially in wages and other expenses, the latter largely due to the recent splitting of the ministry of education into two and higher transfers to parastatals (Table 3).[7] Overall, the fiscal position in 2018/19 is manageable given sizable buffers and a small output gap estimated at -1.7 percent at end-2017. Should the authorities decide to reduce the deficit later this year, capital expenditures should be preserved and non-priority spending curtailed. At the same time, contingency measures such as increases in excise taxes should be considered if mineral revenue collection disappoints.

17. Fiscal consolidation should be gradual to avoid a negative impact on economic activity. In the medium-term, a return to fiscal surpluses is needed to preserve buffers considering constrained diamond and SACU revenues, diamond exhaustibility (profitable production is expected to last until 2052 but production has passed its peak), and intergenerational equity considerations. Under the baseline, the budget is projected to return to fiscal balance by 2023/24 based on improvements in tax administration and spending efficiency, the maintenance of a freeze in hiring civil servants, the gradual elimination of electricity subsidies, and the prioritization of capital projects towards those with higher payoffs.

18. Domestic revenue mobilization needs to be high in the agenda. While tax administration has been gradually improving (e.g. through e-filing of returns, strengthening of the large taxpayers' unit, and implementation of a strategy to lower tax arrears), tax collection has declined (as a share of GDP) owing to the introduction of exemptions in recent years. In this regard, staff urged the authorities to include provisions in the forthcoming Tax Administration Act and VAT and income tax

[7] The fiscal data include budgetary central government units but do not include extrabudgetary funds. The projected deficit is higher compared to the 1.8 percent of GDP deficit envisaged in the FY2018/19 budget primarily because mineral revenues are likely to be lower (mainly because of investments required to sustain output in a major diamond mine). In addition, the spending projections in Table 3 include an additional 3 percent nominal increase in public sector wages adopted in April 2018 and some under-execution of capital expenditures (similar to last year), both of which were not factored in the budget.

bills to reduce the list of zero rated and exempt items while using cash transfers to mitigate the impact on low-income households. It also encouraged the authorities to increase property tax rates and proceed with plans to widen the coverage of properties.[8] Other recommendations are to repeal exemptions to passive capital income (e.g. interest, dividends), apply a single withholding income tax rate to this income and capital gains, and avoid tax concessions (if any, tax concessions should follow a well-justified cost-benefit analysis and consist of accelerated depreciation schemes or investment tax credits).

19. The authorities plan further improvements in expenditure management. The main steps are to improve forecasting capacities, strengthen the medium-term expenditure framework (MTEF), implement the new charts of accounts, appropriately classify recurrent and capital expenditures, better integrate the MTEF in the budget process, and move to performance-based budgeting.

20. Budget transparency should also be improved. This will entail the timely publication (especially online) of budget proposals, supplementary budgets, reviews, quarterly reports, and the medium-term fiscal framework (and explain deviations from the budget); and the integration of special funds into the budget approval process (alongside scrutiny on their spending).

21. The authorities expressed their commitment to fiscal discipline and broadly agreed with the above reforms. They noted their intention to gradually return to fiscal surpluses, improve tax administration, and contain recurrent spending. They agreed to improve budget transparency, noted that budget-related documents are already available on hard copies, and began preparing a cabinet memorandum to strengthen the management of special funds. However, they were hesitant to implement tax policy measures in the short term, partly because regulations were amended in 2015 after long interactions with stakeholders.

Prudent Monetary and Exchange Rate Policies

22. The monetary policy stance will likely remain accommodative but could be adjusted if inflation pressures arise. The current stance is consistent with subdued inflation and the expected closing of the output gap.[9] Looking ahead, the central bank is expected to continue monitoring liquidity conditions. Should fuel price hikes and expansionary fiscal policy push inflation towards the upper level of the objective range, the BoB remains committed to adjust the policy stance accordingly.

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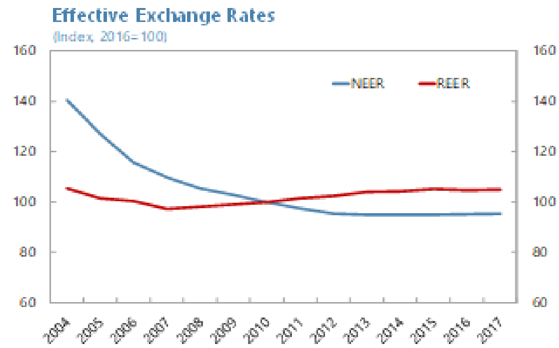
[8] There is no reliable estimate of the value of existing exemptions nor any clarity as to what exemptions may ultimately be streamlined. The baseline projections estimate that the removal of selected VAT exemptions and reform of property taxation could yield about 0.3 and 0.6 percentage points of GDP in the medium-term, respectively.

[9] The authorities have been able to combine a monetary policy akin to inflation targeting with a crawling peg exchange rate regime because of limited capital mobility.

23. The crawling peg exchange rate system remains appropriate and the balance of payments is expected to remain in surplus. During the past decade, the real effective exchange rate has remained almost unchanged (it is currently 2 percent above its 10-year average) with modest volatility, owing to sound financial policies and the exchange rate framework based on a predetermined rate of crawl and basket weights.[10] This policy is based on sound principles and continues to be appropriate. As in recent years, the external current account balance is projected to remain in surplus and support the accumulation of international reserves over time.



Sources: Bank of Botswana and IMF staff.

Preserving Financial Stability

24. While the financial system is sound, closer monitoring is warranted. The risk from higher nonperforming loans is low insofar as they only affect few non-systemic banks. However, household indebtedness has reportedly increased while data are scant, making assessments of vulnerabilities difficult. In this regard, the BoB agreed to use the 2015/16 household survey to assess indebtedness and work towards a real estate price index to monitor property market developments and, if needed, consider introducing macroprudential tools such as loan-to-value ratios.

25. A number of steps to strengthen the supervisory and regulatory framework are planned or underway. First, to set up a macroprudential function, the authorities have identified the Bank of Botswana as the entity responsible for financial stability. Second, they are finalizing revisions to the Bank of Botswana Act and the Banking Act to set up a crisis resolution framework. Third, they plan to strengthen cooperation among regulators and improve the assessments of macro-financial risks (including through consolidated supervision), implement Basel III provisions, and strengthen the anti-money laundering framework.[11] Lastly, the authorities concurred on the importance of improving the capacity of the Nonbank Financial Institutions Regulatory Authority to perform risk-based supervision and enable technological innovations.

[10] Since 2005, Botswana has maintained a crawling peg mechanism where the value of the Pula is set against a basket of currencies (the South African Rand and the SDR) representing its major trading partners. The rate of crawl is set annually aiming to compensate for the projected inflation differential between Botswana and its trading partners. In January 2018 the rate of crawl was decreased from 0.26 to -0.30, while the basket weights remained unchanged at 45 and 55 percent for the Rand and the SDR, respectively (the weights are justified by Botswana's pattern of trade where most exports go to countries whose currencies are in the SDR basket and most imports are from South Africa).

[11] In line with the recommendations of the 2017 assessment of the Eastern and Southern Africa Anti-Money Laundering Group, the authorities plan to improve AML/CFT supervision, especially by ensuring that all competent authorities understand their function and build adequate capacity and addressing deficiencies in the relevant legislation. A progress report is expected by end-2018.

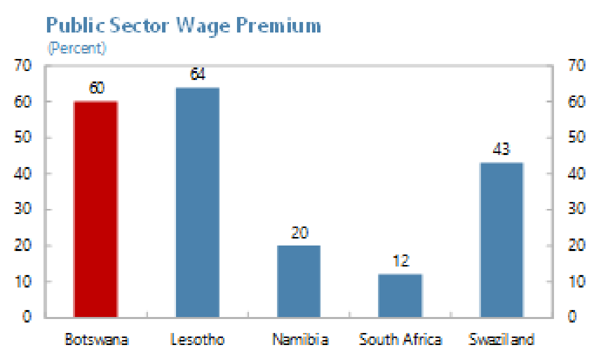
B. Public Sector Reforms to Lift Growth Potential and Increase Equity

26. Public sector reforms are needed to enable the expansion of the private sector, create jobs, diversify exports, and reduce income inequality. In an environment of constrained mineral and SACU revenues, a gradual reduction in the size of the public sector over time would allow the state to focus on providing high-quality services more efficiently. At the same time, expenditure and tax policy reforms could help reduce income inequality.

Making the Public Sector More Efficient and Effective

27. In the short term, there is a need to rationalize parastatals and privatize key enterprises. At end-2017, there were 61 parastatals, comprising 24 commercial enterprises. Many are inefficient, with overlapping mandates, unclear value-addition, and contribute to fiscal costs and contingent liabilities. The staff underscored the importance of avoiding the creation of new parastatals and supported the authorities' plans to strengthen financial oversight, improve transparency, and make public reports on meeting standards. It also noted the need to adopt a private management model for parastatals by professionalizing their boards. Lastly, the staff urged the authorities to proceed with the privatization of key enterprises, notably Air Botswana, the Botswana Meat Commission, and the National Development Bank.[12]

28. Over the medium-term, the focus should be on the cost-effectiveness and quality of public services. The expansion of the public sector in the past couple of decades has been significant, both at the levels of central and local governments and in parastatals (which together account for more than half of total formal employment). This expansion, while useful at first, has become costly in terms of efficiency and effectiveness, especially with regards to the cost and quality of services (notably health and education) and its impact on potential growth. Recently, a step was taken to freeze hiring of personnel. Looking ahead, the staff recommended to focus on the following actions:



Sources: Household surveys and IMF staff estimates.
Note: The premium is estimated from household survey data through a Mincer regression controlling for observable characteristics and reflects the percentage difference with respect to average wages in the private sector.

- Modernize service delivery and eliminate bureaucratic practices through e-government and removal of red tape;

[12] The efficiency of public enterprises is a concern. For instance, the Meat Commission and the National Development bank have accumulated large deficits in recent years and their business model is unsustainable (the bank has also been recapitalized a few times and its effect on economic development is unclear).

- Review the payroll system to align it with productivity.[13] This could also help lower the high public wage premium, which increases reservation wages and potentially hampers competitiveness.

- As the private sector develops, embark on a civil service reform that would reallocate resources and potentially reduce personnel based on a strategic staffing review.

29. Efforts to increase the value for money of public investments should continue. The authorities should revisit projects in NDP11 and formulate a new list of projects focused on those with the highest rates of return, positive externalities (e.g. IT infrastructure, transport), and those that could benefit the sectors they identified as having potential comparative advantage (e.g. tourism and beef). At the same time, recent progress on procurement and the public-private partnership framework should be consolidated with revisions to the public investment program to facilitate the planning and monitoring of projects.

Improving Equity to Prolong Growth Spells

30. Greater equality could be achieved through taxation. Property tax rates and their coverage can be increased, which could reorient investment toward more productive sectors. This, however, requires accelerating progress with land registration and improvements in valuation. The changes would improve equality and help finance increasing levels of local government spending while reducing central government transfers (in recent years, expenditures have been decentralized to enhance the provision of local services).

31. More importantly, equity can be supported by better targeting social spending and reducing subsidies. Spending on education has been somewhat successful in boosting enrollment, but it is skewed toward tertiary education and mostly benefits the wealthiest. Also, generous bursaries for tertiary levels discourage vocational training and exacerbate skills mismatches. In this context, the authorities are studying the possibility to spend more at lower levels of education and introduce fees and means-testing mechanisms for bursaries and increase cost-recovery for tertiary education. Similarly, food and old-age pension programs are helpful, but the system contains overlapping programs and beneficiaries may have access to multiple programs. This can be addressed by a generalization of the social registry,[14] means-testing (i.e. determining whether an individual/family is eligible for government assistance) or redesigning some programs,[15] and migrating from targeting individuals to targeting households (Appendix V). Lastly, the authorities plan to further reduce electricity subsidies (about 0.8 percent of GDP) by raising tariffs towards cost-recovery by 2020.

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[13] In recent years, there has been a quasi-automatic annual increase in real wages of about 3 percent not linked to productivity.

[14] The Ministry of Local Government and Rural Development has started compiling a centralized registry of beneficiaries of social assistance for four pilot regions with the support of the World Bank.

[15] For example, the payment for working on the public works' programs (named IPELEGENG) is reportedly higher than the minimum wage and could be reformed by recalibrating benefits, extending the duration and number of beneficiaries, and distributing places at the regional level using poverty criteria.

32. The authorities broadly agreed with the above reforms. They stated their intention to press ahead with reforms to improve public sector efficiency and consider ways to better target social spending. They intend to carry out a midterm review of NDP11 in 2019 at which point they agreed to review and reprioritize investment projects. They also indicated that they intend to abide by the existing moratorium forbidding the creation of new parastatals and are identifying overlaps; and agreed on the need to appoint CEOs and board members of parastatals based on professional competence. Lastly, they indicated that they expect to privatize key enterprises although they were not sure about timelines and were not optimistic about prospects for privatizing the National Development Bank.

C. Enabling an Export-Oriented and Job-Creating Private Sector

33. Job creation and economic diversification are central to Botswana's development. While macroeconomic stability and public-sector reforms are important, a set of other structural reforms will need to be decisively implemented to develop the private sector, create jobs, and diversify exports. The reforms will have to be time-bound and aimed at lowering the cost of doing business, loosening labor market rigidities and improving skills, enabling the development of sectors with latent comparative advantage, and promoting financial deepening and inclusion.

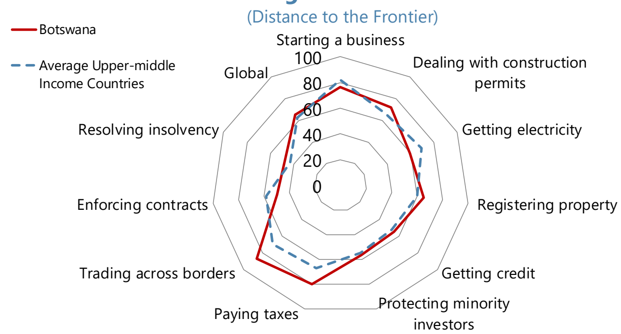
Lowering the Cost of Doing Business

34. In recent years, Botswana lost some ground as an investment destination. Despite recent improvements, including the set-up of a one-stop center for registering new businesses and legislation to allow online business registrations, the pace of reforms during the past decade has been rather slow, with the country losing 10 places in the Doing Business rankings (it now ranks 81st out of 190 countries).[16] Furthermore, Botswana ranks 153rd in the "starting a business" category and ranks lower than some upper-middle income countries in this and other categories.

35. The authorities stated their commitment to improve the business environment. They plan to update in collaboration with the World Bank their 2015 doing business roadmap, considering the delays incurred and possible changes in priorities. The staff noted that quick wins include the adoption of electronic filing for all companies, streamlined requirements for licensing, and reforms to improve creditors' rights. At the same time, a more focused list of reforms should be targeted, with clear

2018 Doing Business Indicators

(Distance to the Frontier)



Source: World Bank.

Note: Upper-middle income countries include Albania, Algeria, Argentina, Azerbaijan, Belarus, Belize, Bosnia and Herzegovina, Botswana, Brazil, Bulgaria, China, Colombia, Costa Rica, Croatia, Dominica, Dominican Republic, Ecuador, Equatorial Guinea, Fiji, Gabon, Grenada, Guyana, Iran, Islamic Rep., Iraq, Jamaica, Kazakhstan, Lebanon, Libya, Macedonia FYR, Malaysia, Maldives, Marshall Islands, Mauritius, Mexico, Montenegro, Namibia, Panama, Paraguay, Peru, Romania, Russian Federation, Samoa, Serbia, South Africa, St. Lucia, St. Vincent and the Grenadines, Suriname, Thailand, Tonga, Turkey, and Venezuela.

[16] The distance to frontier has improved but the country rank deteriorated suggesting that reforms implementation has been slow compared to other countries.

timelines and accountability and close monitoring by the High Level Consultative Committee chaired by the President.

Loosening Labor Market Rigidities and Strengthening Skills

36. The implementation of the education and training plan should improve education outcomes and skills. An important measure under the 2015–20 Education and Training Sector Strategic plan comprises the introduction in 2019 of technical and professional pathways at the senior secondary education level to align education outcomes with demanded skills. Swift implementation requires overcoming coordination problems related to the different ministries involved (technical and vocational training falls under three separate ministries), and clearer definition of responsibilities. At the same time, a public expenditure review is expected to be conducted in the coming year in collaboration with the World Bank to set the stage for subsequent reforms and improve spending efficiency.

37. In terms of labor market policies, efforts should focus on:

- Proceeding with plans to unify the graduates' registry with the jobseeker database and open it to the private sector to expose graduates to broader employment opportunities as well as signal labor market needs to education and training providers;
- Strengthening capacity for planning and policy analysis of the labor market and ensure frequent input from the private sector on education and training policies; and
- Harmonizing the approach to skills' development among concerned ministries through time-bound plans and setting up a technical and vocational training supervisory body within the relevant ministry.

38. The authorities should proceed rapidly with their intentions to overhaul visa and work permits. In recent years, overly restrictive and bureaucratic visa and work permits policies (i.e. cumbersome and lengthy processes involving manual applications, requirements to prove that domestic skills are unavailable, and frequent rejections without justification) have had detrimental effects on private investment and transfer of skills to the domestic labor force. Staff reiterated earlier recommendations to adopt transparent policies with automated and flexible risk-based requirements and timelines for granting visas and permits, monitor progress in terms of outcomes, aim at a low appeal rate, and publish data on applications, approvals and rejections. The authorities indicated that they plan to address the above issues and decide on the precise actions and timelines in the period ahead.

Implementing Market-Friendly Sectoral Reforms

39. Diversification plans appropriately focuses on sectors the authorities see as having comparative advantage. The authorities have engaged an international consulting firm to advise on the steps to develop the beef, tourism, and financial services sectors, which are perceived as having the potential to create jobs and generate export receipts. The steps will likely follow recommendations and actions envisaged in earlier studies by the World Bank, external consultants, and the BoB.[17] Staff noted that, to unlock these sectors' potential, it will be critical to remove government-induced distortions and bottlenecks while promoting greater competition and prioritizing public investments and reforms in areas with the highest payoffs and positive externalities (Appendix VI).

40. In the cattle and beef sector, for instance, reforms are needed to boost scale and productivity and facilitate entry of firms. With quota and duty-free access to the EU market and a large potential to produce high-quality beef, it is estimated that exports could easily triple from current sales of US$80 million if the market is liberalized. Key short-term actions should be to:

- Remove the Botswana Meat Commission (BMC)'s export monopoly to allow new investments and participants in the market, privatize the company, and reduce excess capacity by selling the Francistown abattoir (a facility that is underutilized and unprofitable);

- Align prices paid to high quality producers on international prices (at present, prices are preset) and allow for the exportation of live animals to raise profitability for domestic farmers and increase competition; and

- Liberalize imports of beef to serve the domestic market and consider allowing for imports of live animals to be slaughtered domestically (to use idle capacity) to either serve the domestic market or re-export to other countries in the region.

41. Tourism is also deemed to have significant potential. It is estimated that a focused and well-executed strategy could, in the medium to long-term, nearly double export receipts and employment compared to current levels of about US$700 million and 26,000 people, respectively. Such a strategy could entail:

- Producing detailed estimates of costs and benefits of exploiting different tourism regions to prioritize investments in product and geographic diversification;

- Addressing supply-related restrictions through specialized training in hospitality services and business management, improvements in air access (e.g. foster competition in domestic and regional flights), and investments in the airport infrastructure and internet connectivity in regions with clearly identified potential;

- Eliminating bureaucratic rigidities and developing a tourism-friendly environment by liberalizing restrictions for work permits and visas, adopting simplified requirements for the provision of tourism facilities and services, and promoting the dissemination of information; and

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[17] Botswana Development Policy Review: An Agenda for Competitiveness and Diversification, Report Number 73049, World Bank, September 2012; Botswana: Towards a New Economic Strategy, Harvard Business School, Michael E. Porter, 2012; and Financial Sector Development Strategy (2012–2018), Bank of Botswana, 2012.

- Considering ways to capture a larger portion of the value chain and minimize leakages, particularly by reviewing the licensing system and the lease value of land in tourist sites in future bidding rounds.

Deepening Financial Development and Fostering Inclusion

42. There is room to boost the contribution of the financial system to the economy. Despite a deepening of capital markets in the past decade, the system remains underdeveloped. Access to finance by the corporate sector is limited, and nonbank financial intermediation has yet to become a full-fledged alternative. The private sector credit-to-GDP ratio stands at 31 percent of GDP compared to 100 percent in upper middle-income countries and lending is concentrated on credit to households (60 percent of total loans). To address these issues, the staff underscored the importance of the following measures:

- Strengthen the creditor database and collateral registry for assets to improve information on borrowers' creditworthiness and support enforcement of loan contracts;
- Increase the volume and frequency of government bonds issued to develop a reliable yield curve that can be used as a price benchmark for other assets;[18]
- Improve electronic connectivity in the financial system to facilitate advanced transactions and strengthen the clearing house to facilitate trade in derivatives; and
- Adopt the Principles for Financial Market Infrastructures published by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) to ensure effective regulations to develop securities' markets.

43. In addition, developing mobile payments could foster financial inclusion. A low cap on the amount of daily mobile payments and account balances, high transaction costs, and limited options for mobile transactions discourage payments and deter inclusion. Staff advised the authorities to gradually increase this ceiling and strengthen supervision, allow inter-operability across networks and with bank accounts, promote other payment mechanisms, and foster cross-border mobile money transfers, all of which will increase efficiency and lower costs for low-income households.

44. The authorities broadly agreed with the staff recommendations on the business environment, labor market, sectoral reforms, and financial development. They attributed delays in doing business reforms to the need to change several regulations at the same time and reiterated their commitment to accelerate implementation of reforms as highlighted by the recent passage of multiple laws and President Masisi's announcements. On the issuance of additional government

[18] There is unfulfilled demand for government bonds. Government bond issuance is small at around 6 percent of GDP, compared to 18 percent in Namibia, 30 percent in Mauritius, and 40 percent in South Africa. Weak bidding at auctions suggests that demand may be suppressed by available yields as the authorities seek to contain issuance costs.

bonds, they noted that they would like to strike a balance between the cost of issuance, the goal to develop the financial market, and the risk of crowding-out financing of public enterprises.

OTHER ISSUES

45. Efforts to increase capacity in the public sector will be important in the period ahead. The authorities should continue engaging international partners and hiring qualified expertise to provide technical assistance and fill key positions in the public sector. The IMF can also contribute to build capacity in the areas of its competence. In this regard, a medium-term strategy has been prepared in consultation with the authorities which integrates surveillance priorities with technical assistance and training priorities and envisages closer engagement to ensure traction (Appendix VII).

46. Statistical data is broadly adequate for surveillance but gaps, especially in the fiscal and balance of payments accounts, need to be addressed (Informational Annex). The focus should be on: (i) the proper classification of recurrent and capital outlays and the disaggregation of transfers in the fiscal accounts; and (ii) correcting recently identified deficiencies in both the current account and financial account with a view to reducing errors and omissions in the balance of payments (a revised set of balance of payments statistics is expected to be released later this year). Lastly, it would be useful to verify if the sources and methodology to prepare GDP estimates are adequate and the type of improvements that may be needed.

STAFF APPRAISAL

47. The economy has weathered well previous weakness in the global diamond market, but potential growth has been slowing. Notwithstanding the closure of a major copper-nickel mine, non-mining growth remained relatively stable and the authorities kept the fiscal position balanced and inflation low. Yet, growth potential has decelerated mainly because of weak capital accumulation and productivity growth (related to sluggish progress with structural reforms), making it hard to reduce unemployment.

48. The authorities' macroeconomic policies are broadly appropriate. The crawling peg exchange rate regime continues to serve the country well and the current monetary policy stance is appropriate and can be tightened if inflation pressures build up. A return to fiscal surpluses is warranted given diamond exhaustibility and the need to maintain strong buffers. To avoid negative effects on growth, the pace of fiscal adjustment will need to be gradual. The composition of the fiscal adjustment matters too: the authorities should upgrade tax policies to boost revenues and improve the efficiency of the tax system (especially by streamlining exemptions) and reign in recurrent expenditure while preserving infrastructure and social spending.

49. The economic outlook is positive assuming key structural reforms are implemented. In the near-term, improving conditions in the diamond market and fiscal stimulus are expected to temporarily boost economic activity. In the medium-term, however, the main challenges will be to maintain strong buffers considering possibly constrained mining revenues as well as to improve public sector efficiency, boost non-mining growth, diversify exports, and lower unemployment, all of which will hinge on the successful implementation of critical structural reforms.

50. Although fiscal sustainability and macroeconomic stability are important, a new development model is needed. Relying entirely on minerals and the state for development has downsides as the mining sector is capital-intensive, production is finite, and related revenues are volatile. At the same time, the public sector has become too bureaucratic and is impeding productivity growth. The authorities need to shift promptly to a new model focusing on creating a leaner and more efficient public sector and implementing priority measures to unlock growth potential, create jobs, and foster a diversified export base. These goals are central to NDP11, but they now need to be crystalized on time-bound, well-prioritized plans.

51. The first aspect of the new model is to restructure the public sector and implement policies to enhance growth potential and improve equality. The focus should be on delivering low-cost, high-quality public services more efficiently and equitably, implementing a sound public investment program, and improving the tax system. To this end, the authorities should stop the proliferation of parastatals and restructure or privatize existing ones; accelerate the implementation of e-government; and formulate a civil service reform to reallocate resources and reduce bureaucracy. On public investment, they should strengthen the monitoring of public investment projects, discard those with lower potential payoff in NDP11, and prioritize projects that have higher potential and are better aligned to the new model. To improve equality, the priorities should be to redesign social programs and benefits, move towards cost-reflective electricity tariffs while protecting the most vulnerable, and extend the coverage of property taxation and raise rates.

52. A second aspect refers to market-friendly reforms to foster private sector development, diversify exports, and create jobs. In this regard, the political transition will provide a window of opportunity to once and for all move ahead with reforms to reduce red tape and the cost of doing business, eliminate government-induced distortions (especially monopolies and regulations that affect new entrants), and implement market-based solutions to allow for the expansion of the private sector, especially in areas of perceived comparative advantage. Regarding education and the labor market, the key reforms should be to swiftly liberalize the granting of visas and work permits, improve information in the labor market, and realign education and technical and vocational policies based on a close dialogue with the private sector on the needed skills.

53. A third aspect concerns policies to deepen financial markets and foster financial inclusion. A more developed financial sector will facilitate access to finance, channel savings to worthy investments, promote cross-border financial flows, and have positive effects on growth and employment. In this regard, the authorities need to increase the volume and frequency of issuance of government bonds, strengthen creditor rights and information on borrowers' creditworthiness, adopt the CPSS/IOSCO principles to support securities' markets, improve electronic connectivity and the clearing house to facilitate risk management in derivatives, and adopt the recommended measures to increase the breadth and depth of mobile money payments.

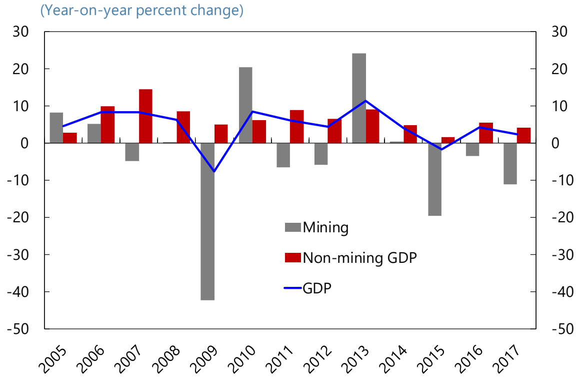
54. Lastly, implementation challenges can be overcome through leadership, transparency, accountability, and capacity building. To this end, the authorities should announce focused plans with objectives and measures involved, supported where possible with quantitative targets, timelines, responsibilities, and resolution/escalation mechanisms. At the same time, capacity can be built by engaging the appropriate expertise to facilitate training and fill positions in the public sector.

55. The staff recommends that the next Article IV consultation with Botswana be held on the standard 12-month cycle.

Figure 1. Botswana: Macroeconomic Developments

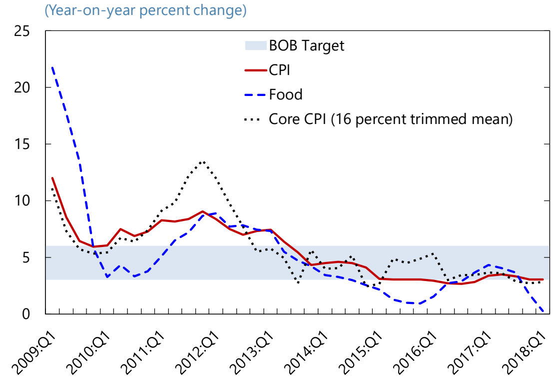
Growth has slowed down because of the collapse of copper and nickel production and sluggish structural reforms …

Real GDP Growth
(Year-on-year percent change)



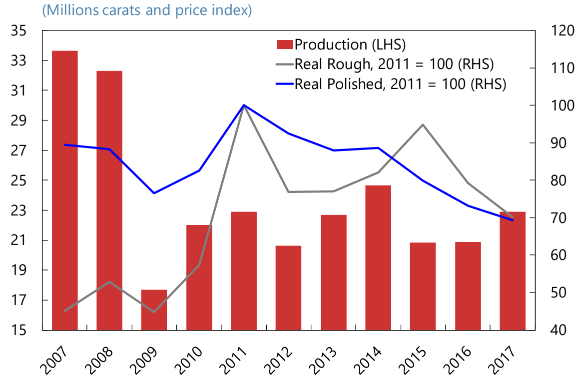
… and inflation has remained low thanks to prudent financial policies.

Consumer Price Inflation
(Year-on-year percent change)



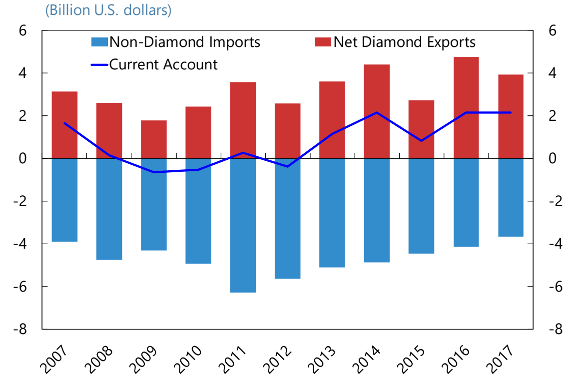
Diamond production picked up in 2016-17, but prices fell.

Diamond Production and Prices
(Millions carats and price index)



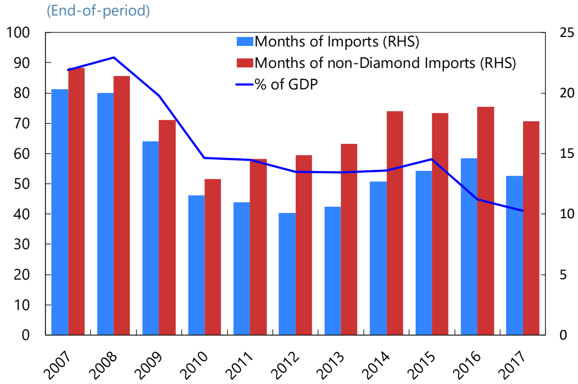
While the current account surplus has remained high.

Current Account and Diamond Trade
(Billion U.S. dollars)



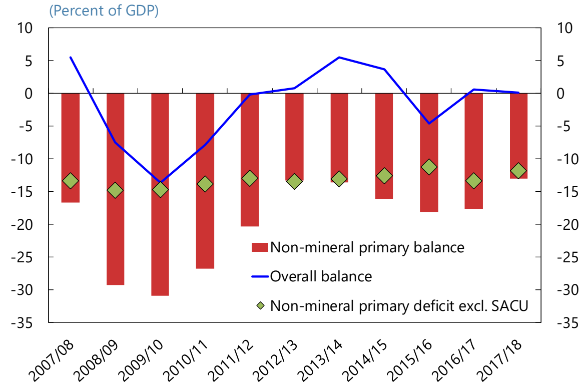
Foreign reserves, while showing a declining trend in recent years, have been well above adequacy levels.

Foreign Reserve Coverage
(End-of-period)



In the past two years, the overall fiscal position was balanced and the non-primary balance (fiscal anchor) improved somewhat.

Fiscal Balance
(Percent of GDP)

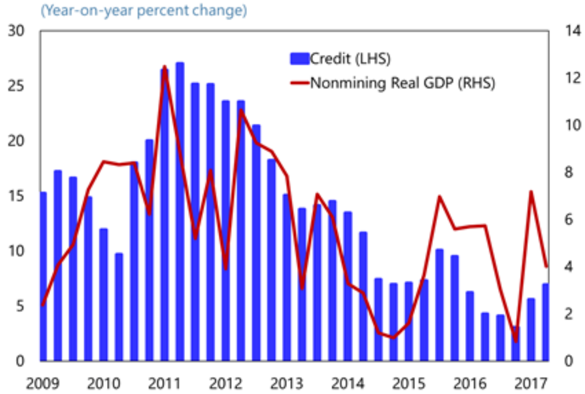


Sources: Bloomberg, Botswana's authorities and IMF staff calculations.

Figure 2. Botswana: Macro Financial Linkages

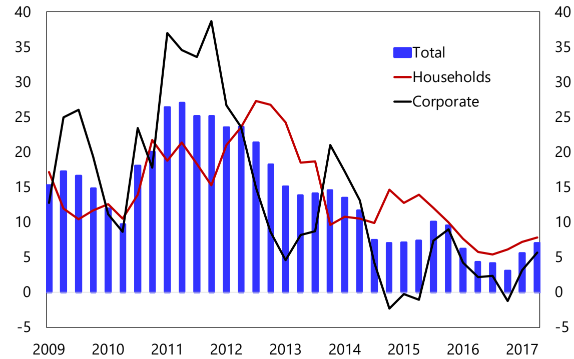
The slowdown in economic growth impacted lending behavior …

Credit and Non-mining GDP Growth
(Year-on-year percent change)



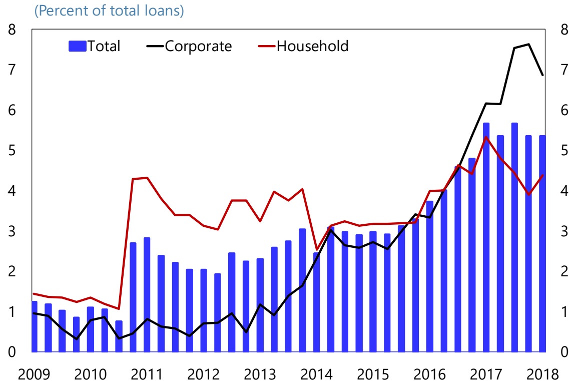
… and credit growth decelerated both for households and corporates …

Credit Growth
(Year-on-year percent change)



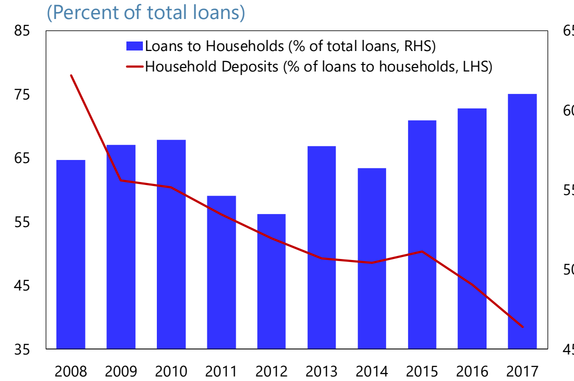
… partly due to higher NPLs …

Nonperforming Loans
(Percent of total loans)



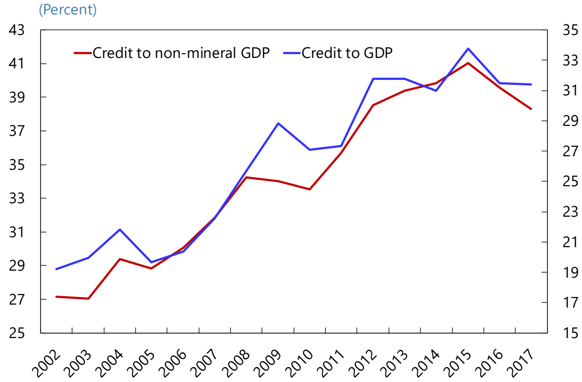
… and likely vulnerability in the households' segment.

Household Credit and Deposits
(Percent of total loans)



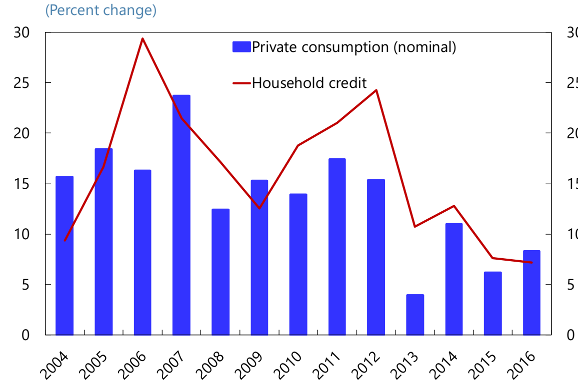
As a result, credit to GDP has been plateauing …

Credit to GDP
(Percent)



… and constraining the growth of private consumption.

Household Credit and Consumption
(Percent change)



Sources: Botswana's authorities and IMF staff calculations.

Table 1. Botswana: Selected Economic Indicators, 2014–2023

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Prel.			Projections			
	(Annual percent change, unless otherwise indicated)[1]									
National income and prices										
Real GDP	4.1	-1.7	4.3	2.4	4.6	3.6	4.0	4.1	4.2	5.5
Mineral[2]	0.5	-19.6	-3.5	-11.2	5.4	1.4	4.4	4.2	5.9	13.0
Nonmineral	4.9	1.7	5.5	4.2	4.5	3.9	4.0	4.1	4.1	4.6
GDP per capita (US dollars)	7,729	6,785	7,272	7,989	…	…	…	…	…	…
Consumer prices (average)	4.4	3.1	2.8	3.3	3.8	3.9	3.8	3.9	4.0	4.0
Diamond production (millions of carats)	24.7	20.8	20.9	22.9	24.2	24.5	25.3	25.5	25.8	28.0
Money and banking										
Monetary Base	-8.5	18.6	3.7	-13.7	11.3	9.1	8.5	9.5	9.6	9.8
Broad money (M2)	4.6	19.9	5.4	2.7	9.4	9.5	9.0	9.8	9.8	10.5
Credit to the private sector	13.7	9.0	9.0	5.3	6.7	8.2	8.2	8.4	8.4	9.1
	(Percent of GDP, unless otherwise indicated)									
Investment and savings										
Gross investment (including change in inventories)	28.2	32.6	28.6	28.1	27.5	28.9	29.7	29.7	29.7	29.8
Public	8.2	8.8	8.5	8.0	8.1	8.1	7.8	7.6	7.4	7.3
Private	20.0	23.8	20.0	20.1	19.4	20.8	21.9	22.0	22.2	22.6
Gross savings	43.5	41.2	38.8	40.3	37.0	37.7	38.2	38.9	39.5	40.2
Public	19.8	16.1	16.2	15.9	12.8	12.5	12.9	13.0	13.1	13.7
Private	23.7	25.1	22.6	24.4	24.2	25.2	25.3	25.9	26.4	26.6
Central government finances[3]										
Total revenue and grants	38.3	31.2	33.2	31.6	28.9	28.6	28.5	28.1	27.7	28.1
Total expenditure and net lending	34.7	35.8	32.5	31.5	32.6	31.7	30.8	29.9	28.9	28.2
Overall balance (deficit –)	3.7	-4.6	0.6	0.1	-3.7	-3.1	-2.2	-1.8	-1.2	0.0
Non-mineral primary balance[4]	-16.1	-18.1	-17.6	-12.9	-16.7	-16.1	-15.0	-13.6	-12.4	-11.8
Total central government debt	22.6	23.2	21.3	19.4	18.9	18.9	18.9	18.5	17.4	15.9
External sector										
Exports of goods and services, f.o.b. (% change)	7.5	-23.8	13.7	-15.6	9.5	5.2	6.9	6.0	6.3	12.9
o/w diamonds	10.4	-28.4	24.6	-19.1	9.9	5.0	6.7	3.6	3.0	10.5
Imports of goods and services, f.o.b. (% change)	-3.5	-10.0	-15.4	-11.5	15.7	5.3	8.0	4.8	5.2	12.2
Current account balance	13.2	5.6	13.7	12.3	9.5	8.8	8.5	9.2	9.8	10.4
Overall Balance	3.7	-5.4	-2.3	1.8	1.9	1.7	2.6	3.6	4.8	5.7
Nominal effective exchange rate (2010=100)	94.8	94.9	95.1	95.4	…	…	…	…	…	…
Real effective exchange rate (2010=100)	104.3	105.2	104.8	105.0	…	…	…	…	…	…
Terms of trade (2005=100)	165.5	195.7	174.4	155.8	159.4	162.9	166.1	167.9	170.1	172.9
External public debt[5]	17.2	18.4	14.3	12.9	12.4	10.8	9.5	8.5	7.6	6.7
o/w public and publicly guaranteed	4.8	5.3	4.7	4.4	4.1	3.8	3.5	3.2	3.0	2.7
	(Millions of U.S. dollars, unless otherwise indicated)									
Gross official reserves (end of period)	8,323	7,546	7,189	7,502	7,865	8,202	8,763	9,573	10,723	12,198
Months of imports of goods and services[6]	12.7	13.6	14.6	13.2	13.1	12.7	12.9	13.4	13.4	13.6
Months of non-diamond imports[6]	18.5	18.3	18.9	17.7	17.8	17.3	17.3	17.9	18.2	18.9
Percent of GDP	54.3	58.0	44.9	41.1	42.4	41.6	41.8	43.0	45.3	47.7

Sources: Botswana's authorities and IMF staff estimates and projections.

[1] Calendar year, unless otherwise indicated.

[2] Projections are based on diamond production due to lack of information on the breakdown of mining value added by mineral.

[3] Year beginning April 1.

[4] The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest receipts and interest payments), divided by non-mineral GDP.

[5] Includes central government-guaranteed debt.

[6] Based on imports of goods and services for the following year.

Table 2. Botswana: Balance of Payments, 2014–2023

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Prel.	Projections					
	(Millions of U.S. dollars, unless otherwise indicated)									
Current account balance	2,147	814	2,148	2,149	1,826	1,748	1,806	2,064	2,348	2,687
Trade balance	762	-651	1,493	930	658	671	617	643	613	666
Exports, f.o.b.	8,522	6,300	7,370	5,936	6,502	6,833	7,291	7,656	8,038	9,030
Diamonds	7,282	5,215	6,499	5,257	5,778	6,066	6,473	6,709	6,911	7,635
Other raw materials	586	466	328	98	113	125	138	221	351	560
Other	655	619	543	581	611	641	680	726	777	834
Imports, f.o.b	-7,760	-6,950	-5,876	-5,006	-5,843	-6,161	-6,673	-7,013	-7,425	-8,364
Diamonds	-2,896	-2,495	-1,736	-1,338	-1,733	-1,881	-2,071	-2,080	-2,142	-2,558
Other	-4,864	-4,455	-4,141	-3,668	-4,110	-4,281	-4,602	-4,933	-5,283	-5,806
Services	-3	20	82	122	129	155	185	302	486	632
Transportation	-265	-243	-226	-160	-178	-183	-194	-200	-203	-204
Travel	345	357	324	428	466	505	558	662	804	966
Other services	-83	-93	-16	-145	-159	-167	-179	-161	-116	-130
Income	-346	-230	-603	-580	-597	-577	-559	-540	-520	-497
Current transfers	1,735	1,675	1,176	1,677	1,637	1,499	1,563	1,660	1,769	1,886
SACU receipts	1,679	1,561	1,174	1,580	1,530	1,388	1,444	1,535	1,636	1,745
Capital and financial account	-531	-324	-583	-979	-1,464	-1,411	-1,245	-1,254	-1,198	-1,212
Direct investment	404	495	-183	68	-98	-155	-145	-128	-137	-131
Portfolio investment	-517	-988	10	-560	-594	-683	-505	-575	-521	-530
Other investment	-418	169	-409	-488	-773	-574	-596	-553	-543	-553
Assets	-503	206	-252	-378	-685	-422	-446	-439	-449	-485
Liabilities	85	-37	-158	-110	-87	-152	-150	-114	-93	-68
Net government long-term borrowing	26	25	-69	-102	-92	-172	-172	-138	-124	-103
Other net private long-term borrowing	26	-92	-38	-36	-56	-43	-43	-45	-42	-42
Short-term borrowing	33	31	28	28	30	31	33	35	36	38
Net errors and omissions	-1,019	-1,267	-1,922	-857	0	0	0	0	0	0
Overall Balance	597	-777	-357	313	363	338	561	810	1,150	1,475
	(Percent of GDP, unless otherwise indicated)									
Current account	13.2	5.6	13.7	12.3	9.5	8.8	8.5	9.2	9.8	10.4
Trade balance	4.7	-4.5	9.5	5.3	3.4	3.4	2.9	2.9	2.6	2.6
Exports of goods	52.4	43.6	47.0	34.1	34.0	34.3	34.4	34.0	33.6	35.0
Of which: diamonds	44.8	36.1	41.5	30.2	30.2	30.5	30.6	29.8	28.9	29.6
Imports of goods	47.7	48.1	37.5	28.8	30.5	31.0	31.5	31.2	31.1	32.4
Of which: diamonds	17.8	17.3	11.1	7.7	9.1	9.4	9.8	9.2	9.0	9.9
Services balance	0.0	0.1	0.5	0.7	0.7	0.8	0.9	1.3	2.0	2.4
Income and transfers balance	8.5	10.0	3.7	6.3	5.4	4.6	4.7	5.0	5.2	5.4
Financial account	-3.3	-2.2	-3.7	-5.6	-7.7	-7.1	-5.9	-5.6	-5.0	-4.7
Direct investment	2.5	3.4	-1.2	0.4	-0.5	-0.8	-0.7	-0.6	-0.6	-0.5
Portfolio investment	-3.2	-6.8	0.1	-3.2	-3.1	-3.4	-2.4	-2.6	-2.2	-2.1
Other investment	-2.6	1.2	-2.6	-2.8	-4.0	-2.9	-2.8	-2.5	-2.3	-2.1
Net errors and omissions	-6.3	-8.8	-12.3	-4.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (increase reserves +)	3.7	-5.4	-2.3	1.8	1.9	1.7	2.6	3.6	4.8	5.7
	(Annual percentage change, unless otherwise indicated)									
Export volumes	4.2	-13.8	17.3	-12.4	5.5	1.5	3.5	2.3	3.2	10.4
Import volumes	1.8	4.1	-10.3	-24.5	9.4	5.0	7.4	4.2	4.6	11.3
Terms of trade	8.7	18.3	-10.8	-10.7	2.3	2.2	1.9	1.1	1.3	1.7
End-of-year reserves (US$ millions)	8,323	7,546	7,189	7,502	7,865	8,202	8,763	9,573	10,723	12,198
Months of imports of goods and services[1]	12.7	13.6	14.6	13.2	13.1	12.7	12.9	13.4	13.4	13.6
Months of non-diamond imports[1]	18.5	18.3	18.9	17.7	17.8	17.3	17.3	17.9	18.2	18.9

Source: Bank of Botswana and IMF staff estimates.

[1] Based on imports of goods and services for the following year.

Table 3a. Botswana: Central Government Operations, 2014/15–2023/24[1]

(Billions of pula)

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
				Prel.			Projections			
				(Billions of pula, unless otherwise indicated)						
Total revenue and grants	55.9	47.4	57.4	58.2	57.5	61.6	66.5	70.9	76.2	85.2
Total revenue	55.5	47.3	57.2	57.8	57.3	61.3	66.2	70.6	75.9	84.9
Tax revenue	37.6	34.9	35.6	41.7	40.9	43.1	46.8	50.8	55.1	61.1
Income taxes	15.9	13.1	16.8	16.8	18.1	19.7	21.3	22.6	24.2	27.2
Mineral	7.5	4.5	7.2	5.6	5.8	6.2	6.7	6.7	7.0	8.1
Nonmineral	8.4	8.7	9.6	11.2	12.3	13.4	14.6	15.9	17.3	19.0
Taxes on goods and services [2]	5.7	5.5	6.6	6.6	7.4	8.2	9.0	10.4	11.4	12.7
Customs Union receipts [3]	15.7	15.8	11.8	17.9	14.8	14.7	15.9	17.2	18.7	20.4
Other	0.3	0.4	0.4	0.5	0.5	0.6	0.6	0.7	0.7	0.8
Nontax revenue	17.9	12.4	21.7	16.1	16.4	18.2	19.5	19.8	20.7	23.9
Mineral royalties and dividends	14.0	10.0	15.3	13.1	13.6	14.7	15.7	15.8	16.4	19.2
Grants	0.4	0.1	0.2	0.3	0.2	0.3	0.3	0.3	0.3	0.3
Total expenditure and net lending	50.6	54.4	56.3	57.9	65.0	68.2	71.8	75.4	79.4	85.3
Current expenditure	37.6	40.4	41.2	43.6	48.6	51.1	53.5	56.2	59.1	63.3
Wages and salaries	16.6	18.5	19.2	21.1	23.2	24.8	26.4	28.3	30.2	33.0
Interest	0.7	0.8	0.9	1.0	1.0	1.1	1.0	1.1	1.1	1.1
Other	20.3	21.0	21.1	21.6	24.5	25.3	26.0	26.9	27.8	29.2
Of which: grants and subsidies	10.6	11.3	11.3	12.2	13.3	13.7	14.0	14.4	14.8	15.3
Capital expenditure	13.1	12.8	15.2	14.2	16.4	17.2	18.1	19.1	20.2	22.0
Net lending	-0.1	1.2	-0.1	0.1	-0.1	-0.1	0.2	0.0	0.0	0.0
Primary balance (deficit -)	3.3	-7.3	-1.4	-0.4	-7.3	-7.0	-5.7	-4.9	-3.7	-0.7
Overall balance (A)	5.3	-7.0	1.1	0.2	-7.5	-6.6	-5.2	-4.5	-3.2	-0.1
Financing (B)	-4.6	7.5	2.5	1.7	7.5	6.6	5.2	4.5	3.2	0.1
Foreign (net)	-0.7	-1.2	-0.6	-1.2	-0.5	-2.0	-1.5	-1.2	-1.2	-0.9
Drawing	0.1	0.2	0.8	0.1	1.0	0.2	0.4	0.5	0.4	0.5
Amortization	-0.8	-1.4	-1.4	-1.3	-1.4	-2.1	-1.9	-1.7	-1.5	-1.3
IMF transactions (net)[4]	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Domestic (net)	-3.9	8.7	3.1	2.9	8.0	8.6	6.8	5.7	4.4	1.0
Issuance	1.9	2.1	3.8	3.5	5.0	6.0	7.0	6.0	4.0	3.0
Amortization	-1.5	-3.0	-3.7	-2.3	-4.1	-1.4	-2.6	-2.7	-2.2	-2.3
Change in cash balance (- increase)	-4.3	9.6	2.9	1.7	7.1	3.9	2.4	2.4	2.6	0.3
Discrepancy (B-A)	0.8	0.5	3.6	2.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Non-mineral primary balance [5]	-18.2	-21.8	-23.9	-19.1	-26.7	-27.9	-28.0	-27.4	-27.1	-28.0
Excluding SACU revenue	-33.9	-37.6	-35.6	-37.0	-41.5	-42.5	-43.9	-44.6	-45.8	-48.5

Sources: Ministry of Finance and Economic Development and IMF staff estimates and projections.

[1] The fiscal data include budgetary central government units but do not include extrabudgetary funds. The fiscal year begins in April.

[2] Refers to sales tax and VAT.

[3] SACU receipts consist of external trade and excises on imported goods as well as a development component derived from excise taxes.

[4] These transactions reflect Botswana's SDR allocation and contribution to the IMF's General Resource Account (GRA).

[5] The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest payments and receipts, which are roughly proxied by BoB transfers and interest).

Table 3b. Botswana: Central Government Operations, 2014/15–2023/24[1]

(Percent of GDP)

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
				Prel.			Projections			
				(Percent of GDP, unless otherwise indicated)						
Total revenue and grants	38.3	31.2	33.2	31.6	28.9	28.6	28.5	28.1	27.7	28.1
Total revenue	38.1	31.1	33.1	31.5	28.8	28.5	28.4	28.0	27.6	28.0
Tax revenue	25.8	22.9	20.6	22.7	20.5	20.0	20.1	20.1	20.0	20.2
Income taxes	10.9	8.6	9.7	9.1	9.1	9.1	9.1	8.9	8.8	9.0
Mineral	5.1	2.9	4.2	3.0	2.9	2.9	2.9	2.7	2.5	2.7
Nonmineral	5.7	5.7	5.5	6.1	6.2	6.2	6.3	6.3	6.3	6.3
Taxes on goods and services [2]	3.9	3.6	3.8	3.6	3.7	3.8	3.9	4.1	4.2	4.2
Customs Union receipts [3]	10.8	10.4	6.8	9.7	7.4	6.8	6.8	6.8	6.8	6.7
Other	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Nontax revenue	12.3	8.1	12.5	8.8	8.2	8.5	8.3	7.8	7.5	7.9
Mineral royalties and dividends	9.6	6.6	8.8	7.1	6.9	6.8	6.7	6.2	6.0	6.3
Grants	0.3	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Total expenditure and net lending	34.7	35.8	32.5	31.5	32.6	31.7	30.8	29.9	28.9	28.2
Current expenditure	25.8	26.6	23.8	23.7	24.4	23.7	23.0	22.3	21.5	20.9
Wages and salaries	11.4	12.2	11.1	11.5	11.6	11.5	11.3	11.2	11.0	10.9
Interest	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Other	13.9	13.8	12.2	11.7	12.3	11.7	11.2	10.6	10.1	9.6
Of which: grants and subsidies	7.3	7.4	6.5	6.6	6.7	6.4	6.0	5.7	5.4	5.1
Capital expenditure	9.0	8.4	8.8	7.7	8.2	8.0	7.7	7.6	7.4	7.3
Net lending	-0.1	0.8	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Primary balance (deficit -)	2.3	-4.8	-0.8	-0.2	-3.7	-3.2	-2.4	-1.9	-1.3	-0.2
Overall balance (A)	3.7	-4.6	0.6	0.1	-3.7	-3.1	-2.2	-1.8	-1.2	0.0
Financing (B)	-3.1	4.9	1.4	0.9	3.8	3.1	2.2	1.8	1.2	0.0
Foreign (net)	-0.5	-0.8	-0.3	-0.7	-0.3	-0.9	-0.7	-0.5	-0.4	-0.3
Domestic (net)	-2.7	5.7	1.8	1.6	4.0	4.0	2.9	2.3	1.6	0.3
Discrepancy (B-A)	0.5	0.3	2.1	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:										
Non-mineral primary balance [4]	-12.5	-14.3	-13.8	-10.4	-13.4	-12.9	-12.0	-10.8	-9.8	-9.3
Excluding SACU revenue	-23.2	-24.7	-20.6	-20.1	-20.9	-19.7	-18.8	-17.7	-16.6	-16.0
GDP (fiscal year; billions of pula)	145.9	152.2	173.0	183.9	199.1	215.3	233.1	252.5	275.2	302.8

Sources: Ministry of Finance and Economic Development and IMF staff estimates and projections.

[1] The fiscal data include budgetary central government units but do not include extrabudgetary funds. The fiscal year begins in April.

[2] Refers to sales tax and VAT.

[3] SACU receipts consist of external trade and excises on imported goods as well as a development component derived from excise taxes.

[4] The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest payments and receipts, which are roughly proxied by BoB transfers and interest).

Table 3c. Botswana: Central Government Operations, 2014/15–2023/24[1]

(Percent of non-mineral GDP)

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
				Prel.			Projections			
	(Percent of non-mineral GDP, unless otherwise indicated)									
Total revenue and grants	49.3	39.5	42.3	39.4	35.9	35.7	35.7	35.2	35.0	36.0
Total revenue	48.9	39.4	42.2	39.2	35.8	35.5	35.5	35.0	34.8	35.8
Tax revenue	33.2	29.0	26.2	28.3	25.5	25.0	25.1	25.2	25.3	25.8
Income taxes	14.0	10.9	12.4	11.4	11.3	11.4	11.4	11.2	11.1	11.5
Mineral	6.6	3.7	5.3	3.8	3.6	3.6	3.6	3.3	3.2	3.4
Nonmineral	7.4	7.2	7.1	7.6	7.7	7.8	7.8	7.9	7.9	8.0
Taxes on goods and services [2]	5.0	4.6	4.9	4.5	4.6	4.7	4.8	5.1	5.2	5.3
Customs Union receipts [3]	13.8	13.2	8.7	12.1	9.3	8.5	8.5	8.5	8.6	8.6
Other	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Nontax revenue	15.8	10.3	16.0	10.9	10.3	10.6	10.4	9.8	9.5	10.1
Mineral royalties and dividends	12.4	8.3	11.3	8.9	8.5	8.5	8.4	7.8	7.5	8.1
Grants	0.3	0.1	0.1	0.2	0.1	0.2	0.2	0.1	0.1	0.1
Total expenditure and net lending	44.6	45.3	41.5	39.3	40.6	39.5	38.5	37.4	36.4	36.0
Current expenditure	33.1	33.6	30.3	29.6	30.4	29.6	28.7	27.9	27.1	26.7
Wages and salaries	14.6	15.4	14.2	14.3	14.5	14.3	14.2	14.0	13.9	13.9
Interest	0.6	0.7	0.6	0.7	0.6	0.6	0.5	0.5	0.5	0.5
Other	17.9	17.5	15.5	14.6	15.3	14.6	14.0	13.3	12.8	12.3
Of which: grants and subsidies	9.3	9.4	8.3	8.3	8.3	7.9	7.5	7.1	6.8	6.5
Capital expenditure	11.5	10.6	11.2	9.6	10.3	10.0	9.7	9.5	9.3	9.3
Net lending	-0.1	1.0	0.0	0.1	0.0	0.0	0.1	0.0	0.0	0.0
Primary balance (deficit -)	2.9	-6.1	-1.0	-0.3	-4.5	-4.0	-3.0	-2.4	-1.7	-0.3
Overall balance	4.7	-5.8	0.8	0.1	-4.7	-3.8	-2.8	-2.2	-1.5	0.0
Memorandum items:										
Non-mineral primary balance [4]	-16.1	-18.1	-17.6	-12.9	-16.7	-16.1	-15.0	-13.6	-12.4	-11.8
Excluding SACU revenue	-29.9	-31.3	-26.3	-25.0	-26.0	-24.6	-23.6	-22.1	-21.0	-20.4
Non-mineral GDP (fiscal year; billions of pula)	113.5	120.1	135.7	147.6	160.0	172.7	186.4	201.5	217.9	237.0

Sources: Ministry of Finance and Economic Development and IMF staff estimates and projections.

[1] The fiscal data include budgetary central government units but do not include extrabudgetary funds. The fiscal year begins in April.

[2] Refers to sales tax and VAT.

[3] SACU receipts consist of external trade and excises on imported goods as well as a development component derived from excises.

[4] The non-mineral primary balance is computed as the difference between non-mineral revenue and expenditure (excluding interest payments and receipts, which are roughly proxied by BoB transfers and interest).

Table 4. Botswana: Monetary Survey, 2014–2023

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Prel.			Projections			
	(Billions of pula, end of period, unless otherwise indicated)									
Net foreign assets	83.3	91.0	82.2	80.9	88.6	93.4	100.9	111.3	125.8	144.9
Bank of Botswana	77.7	83.4	75.3	72.2	75.8	79.4	85.5	94.4	107.3	124.2
Assets	79.1	84.9	76.8	73.6	77.3	80.8	86.9	95.8	108.7	125.6
Liabilities	-1.4	-1.5	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Commercial banks	5.6	7.7	6.9	8.8	12.7	14.0	15.4	16.9	18.5	20.7
Assets	7.8	9.9	9.5	11.5	15.4	16.7	18.1	19.6	21.2	23.4
Liabilities	-2.2	-2.2	-2.6	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7
Net domestic assets	-31.0	-28.3	-15.4	-12.3	-13.2	-10.6	-10.3	-11.6	-16.2	-23.5
Net domestic credit	8.6	13.9	23.6	26.9	36.8	50.1	62.5	74.2	85.2	94.3
Net claims on the government	-37.0	-35.2	-29.3	-28.6	-22.4	-14.0	-6.7	-0.7	4.0	5.9
Bank of Botswana	-38.9	-37.1	-32.5	-32.9	-27.1	-22.4	-19.7	-17.3	-14.7	-13.9
Commercial banks	2.0	1.9	3.2	4.3	4.8	8.5	12.9	16.6	18.7	19.7
Claims on parastatals	1.7	1.3	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Claims on nongovernment	43.8	47.9	52.1	54.9	58.5	63.3	68.5	74.3	80.5	87.8
Claims on the private sector	45.2	49.3	53.7	56.5	60.3	65.3	70.6	76.6	83.0	90.5
Other financial institutions	-1.4	-1.3	-1.6	-1.7	-1.8	-1.9	-2.1	-2.3	-2.5	-2.7
Other items (net)	-39.5	-42.2	-39.1	-39.2	-50.0	-60.6	-72.8	-85.9	-101.4	-117.9
Monetary Base	11.8	14.0	14.5	12.5	13.9	15.2	16.5	18.1	19.8	21.8
Broad money (M2)	55.8	66.9	70.5	72.5	79.3	86.9	94.7	104.0	114.2	126.2
Money	13.2	13.7	15.9	17.3	19.0	20.8	22.7	24.9	27.3	30.2
Currency	1.7	1.7	1.8	1.9	2.3	2.7	3.1	3.6	4.2	4.9
Current deposits	11.5	12.0	14.1	15.4	16.7	18.1	19.6	21.3	23.1	25.3
Quasi-money	42.6	53.2	54.7	55.1	60.3	66.1	72.1	79.1	86.9	96.0
Memorandum items:										
Nominal GDP (bn pula)	146	146	171	180	195	211	228	247	268	296
Nominal non-mineral GDP (bn pula)	113	120	136	148	160	173	186	202	218	237
Velocity (GDP to M2)	2.6	2.2	2.4	2.5	2.5	2.4	2.4	2.4	2.3	2.3
Velocity (non-mineral GDP to M2)	2.0	1.8	1.9	2.0	2.0	2.0	2.0	1.9	1.9	1.9
Money Multiplier	4.7	4.8	4.9	5.8	5.7	5.7	5.7	5.8	5.8	5.8
Base Money (annual % change)	-8.5	18.6	3.7	-13.7	11.3	9.1	8.5	9.5	9.6	9.8
Broad Money (annual % change)	4.6	19.9	5.4	2.7	9.4	9.5	9.0	9.8	9.8	10.5
Credit to the private sector (annual % change)	13.7	9.0	9.0	5.3	6.7	8.2	8.2	8.4	8.4	9.1
Private sector credit to GDP	31.0	33.7	31.5	31.4	30.9	30.9	30.9	31.0	30.9	30.6
Private sector credit to non-mineral GDP	39.8	41.0	39.6	38.3	37.7	37.8	37.9	38.0	38.1	38.2

Sources: Bank of Botswana and IMF staff estimates and projections.

Table 5. Botswana: Financial Soundness Indicators, 2014-2017

	2014	2015	2016	Mar-17	Jun-17	Sep-17	Dec-17
	(Percent, unless otherwise indicated)						
Capital adequacy							
Capital to assets	11.3	8.5	8.4	9.0	9.4	8.7	8.8
Regulatory capital to risk-weighted assets	18.7	20.0	19.2	19.1	19.2	18.4	21.9
Regulatory tier I capital to risk-weighted assets	13.1	14.1	13.2	13.3	13.5	12.8	15.0
Nonperforming loans net of provisions to capital	10.9	9.0	13.9	15.9	17.1	15.3	13.4
Asset quality							
Large exposure to capital	232	170	148	140	90	141	90
Nonperforming loans to total gross loans	3.6	3.9	4.4	5.5	5.2	5.6	5.3
Bank provisions to nonperforming loans	48.4	54.7	57.1	...	...	...	...
Earnings and profitability							
Trading income to total income	3.4	...	...	...	...	...	...
Return on assets	2.8	2.0	2.3	1.7	1.7	1.7	1.9
Return on equity	19.5	17.5	20.2	14.6	13.5	14.6	16.3
Interest margin to gross income	47.8	57.5	61.4	63.5	63.3	62.5	61.6
Noninterest expenses to gross income	62.2	61.1	57.1	59.7	60.5	60.1	59.9
Personnel expenses to noninterest expenses	41.0	40.6	43.2	42.8	45.2	45.4	44.5
Liquidity							
Liquid assets to total assets	11.0	15.4	16.3	13.6	13.9	12.6	13.4
Liquid assets to short-term liabilities	14.1	18.5	20.0	16.7	18.8	15.4	16.4
Customer deposits to total (non-interbank) loans	113.9	119.8	121.6	117.6	118.6	119.8	117.3
Exposure to foreign exchange risk							
Net open position in foreign exchange to capital	-9.7	-59.4	...	...	...	...	...
Foreign currency-denominated loans to total loans	7.3	6.7	7.5	7.3	7.2	6.6	7.0
Foreign currency-denominated liabilities to total liabilities	13.1	13.0	14.6	14.3	15.0	15.0	13.9

Source: Bank of Botswana.

Appendix I. Track Record of Economic Policies and Reforms

Objectives	Actions/measures	Latest Developments
Maintain economic stability and strong buffers amidst volatile diamond and SACU revenue		
Macroeconomic stability and strong fiscal and external buffers	Use countercyclical policies and contain public spending as needed.	Countercyclical policies have been used to stabilize economic activity and public spending has been moderated as needed to maintain strong buffers.
Mobilize domestic revenue	Pass and implement new Tax Administration Act, strengthen the Large Taxpayers' Unit. Revisit VAT exemptions and repeal universal filling of the personal income tax, accelerate registration and evaluation of properties.	The Tax Administration Act draft has been finalized and is expected to be in force by year-end. The LTU capacities are improving in collaboration with AFRITAC South and experts from peer countries. However, no tax policy actions have been implemented thus far.
Preserve financial stability		
Set up a macroprudential policy function and strengthen supervision	Assign a clear macroprudential mandate to the BoB, establish crisis resolution framework, finalize implementation of Basel II requirements, and strengthen risk-based supervision of nonbanks.	The BoB Act has been approved by its Board. The Financial Stability Council has been created but is not yet operational. Basel II requirements have been implemented. The five large banks were asked to submit recovery plans and a methodology to define a systemic bank is being finalized.
Foster private sector growth and job creation		
Lower costs of doing business	Establish a one-stop shop to start businesses, introduce risk-based inspections to grant construction permits.	The one-stop service center has been operational since October 2017, but results on its operations are not yet available and progress in other areas has been slow.
Promote financial deepening	Broaden the creditor database to include both positive and negative credit data, strengthen the collateral framework, and implement the Making Access Possible Plan to foster financial inclusion.	Progress has been very slow. The authorities are drafting a new regulation for credit bureaus that forces them to collect both positive and negative credit information and the World Bank is assisting with the creation of the collateral registry.
Improve education outcomes and skills	Implement the education strategic plan. Relax restrictions on work permits for foreign workers. Improve coordination with the private sector.	Efforts have been made to improve coordination with the private sector, but progress in other areas has been scant.
Increase focus on enabling sectors with potential comparative advantage.	Design time-bound strategies, lower costs and remove distortions (e.g. IT connectivity), improve access to electricity and water, formulate time-bound quantitative targets and exit clauses.	Access to electricity and water improved substantially. The authorities have recently engaged international consultants to assist with strategies to develop the tourism, meat, mining, and financial sectors.
Improve efficiency of the public sector		
Improve public financial management	Continue the development of the MTEF and implement the 2014 GFSM with a clearer delineation of recurrent and capital expenditures. Strengthen public investment management. Amend the PPADA.	Progress has been slow. The authorities are benefiting from TA to enhance the quality of fiscal reports, public investment management, and the capacity of the MFED to plan and implement PFM reforms.
Enhance efficiency and financial viability of SOEs	Improve financial monitoring and evaluation of SOEs as well as their management, accelerate privatization of key commercial enterprises, review structure of electricity subsidies to set rates in line with commercial criteria, improve management of SOEs.	Progress is being made. PEEPA is strengthening its capacity to monitor parastatals. The authorities announced their intention to privatize the Botswana Meat Commission, but timelines and modalities have not been set yet. Electricity tariffs were increased by 10 percent in April 2018.

Appendix II. External Stability Assessment

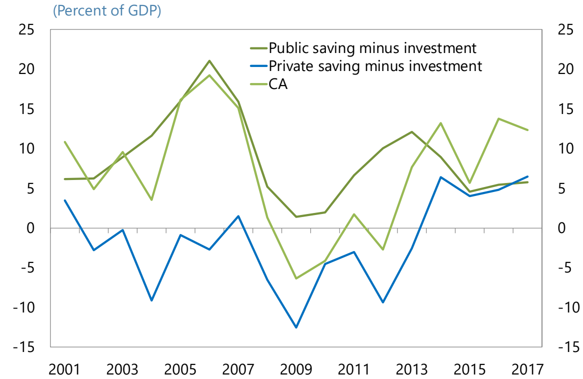
Botswana's external position is stable and consistent with fundamentals and desirable policies. The exchange rate framework, based on annual reviews to the rate of crawl and basket weights, remains appropriate. According to the IMF's metric, international reserves comfortably exceed their adequate level. Given the country's volatile foreign exchange receipts and its dependence on finite mineral resources, the authorities should maintain ample buffers.

Introduction

1. **Botswana's current account balance has recovered since 2009.** A sizable surplus of about 12 percent of GDP was estimated for 2017, somewhat lower than in 2016. While these figures are likely to be revised downward following a recent revision of the balance of payments data, the current account will nonetheless remain with a comfortable surplus.[1] The baseline scenario is conservative and envisages a gradual increase in diamond production and constant diamond prices in real terms (the forecast implies that real diamond prices would remain below their long-term average) given market risks, the emergence of synthetic diamonds, and potential changes in consumer preferences.

2. **A historical decomposition of savings and investment suggests that the external balance has been closely linked to changes in public finances.** Both the fiscal and the current account balances are expected to improve in the medium-term, supporting a further accumulation of international reserves.

Savings and Investment
(Percent of GDP)

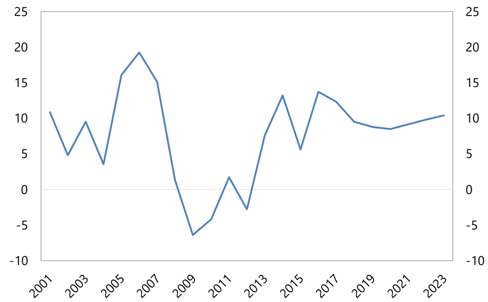


Sources: Bank of Botswana and staff estimates.

3. **The financial account has been volatile**, mostly resulting from the behavior of portfolio investment, with foreign direct investment (FDI) remaining mostly stable and positive —associated with investments in the mining sector (which on average account for about 80 percent of FDI inflows). Gross external financing requirements have gradually decreased over the past five years to about 15 percent of GDP, of which about one-fourth is short-term financing. Net foreign assets have stabilized at about 35 percent of GDP and their dynamics depend primarily on the behavior of international reserves. In the medium term, the financial account is projected to improve gradually.

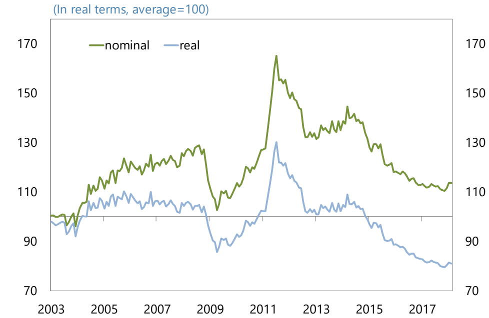
[1] A recent technical assistance mission from the IMF's Statistics Department identified some issues with the data that had led to large errors and omissions in the external sector statistics. These were: (i) the under coverage of dividends paid to foreign investors, profits deposited in intercompany accounts by companies in the diamond industry, and dividends received by the government from its share investment abroad; (ii) the omission of imports and exports of services by companies in the diamond industry; and (iii) the overstatement of exports of travel and construction services for other private entities. Preliminary estimates suggest that the current account surplus for 2016 and 2017 could be about 4–5 percentage points of GDP lower than previously estimated.

Current Account
(Percent of GDP)



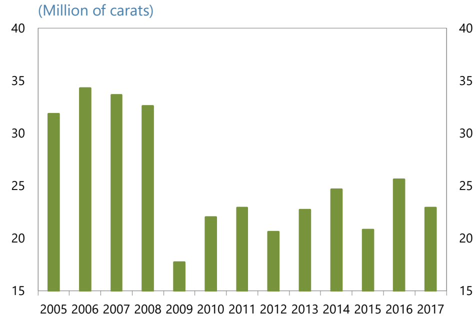
Sources: Bank of Botswana and staff estimates.

Prices of Polished Diamonds
(In real terms, average=100)



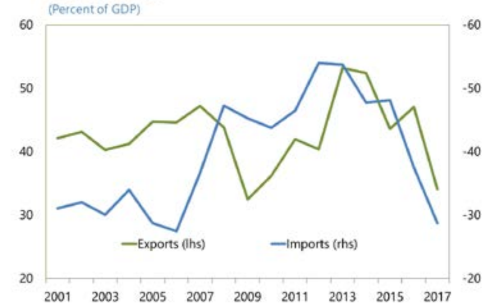
Sources: Bloomberg and staff estimates.

Diamond Export Volumes
(Million of carats)



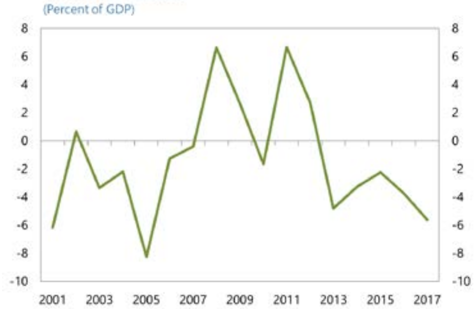
Sources: Bank of Botswana and staff estimates.

Trade Balance
(Percent of GDP)

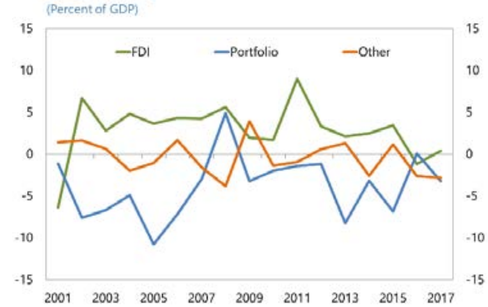


Sources: Bank of Botswana and staff estimates.

Financial Account
(Percent of GDP)

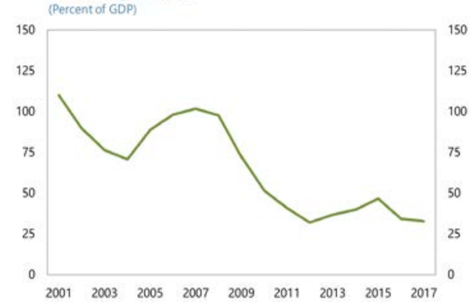


FDI, Portfolio, and Other Investment
(Percent of GDP)



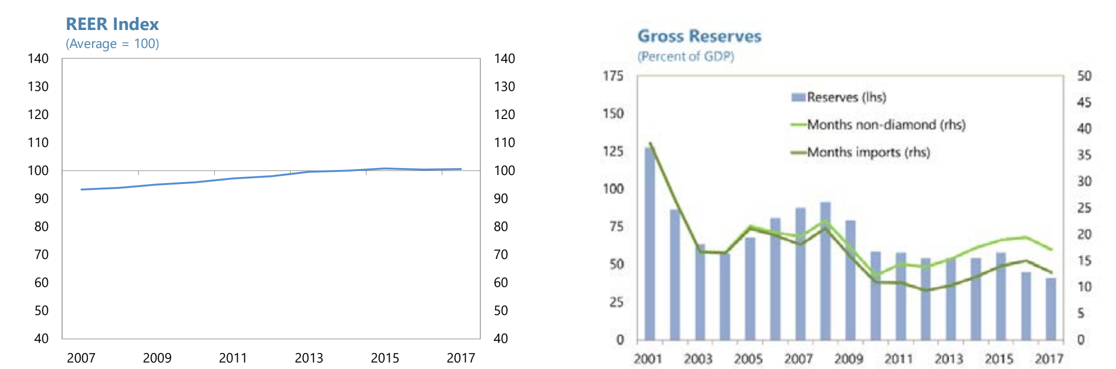
ST Debt and Amortizations
(Percent of GDP)

Net Foreign Assets
(Percent of GDP)



Sources: Bank of Botswana and staff estimates.

4. Botswana's real effective exchange rate (REER) has remained broadly stable. It appreciated marginally since 2007 and is currently about 2 percent above its 10-year average despite substantial variations in bilateral exchange rates. The relative stability of the REER can be attributed to the relatively low capital mobility combined with the BoB's policy of adjusting the nominal value of the pula in line with expected inflation differentials with major trading partners and basket weights (the basket comprises the SDR and the South African rand, with a 45 percent weigh for the latter).



Sources: Bank of Botswana and staff estimates.

5. Botswana's international reserves buffers have been declining during the past decade but remain high. At end-2017, they stood at about US$7.5 billion, equivalent to 41 percent of GDP or 13 months of imports.[2,3] Under the baseline projections, the import coverage is expected to increase gradually under the assumption that the fiscal and external balances improve over time.

Current Account and Exchange Rate Assessment

6. The assessment of Botswana's REER employs both a Permanent Income Hypothesis model to assess external sustainability as well as the regression-based External Balance Assessment (EBA)-lite models for the CA and REER.[4] The former approach assesses the current account relative to the position required to generate sufficient savings for intergenerational purposes. The latter estimations assume that both the CA and REER are endogenous variables simultaneously determined as a function of domestic and external variables including fundamentals, policy variables, cyclical conditions, and the global environment (these methodologies assess the CA

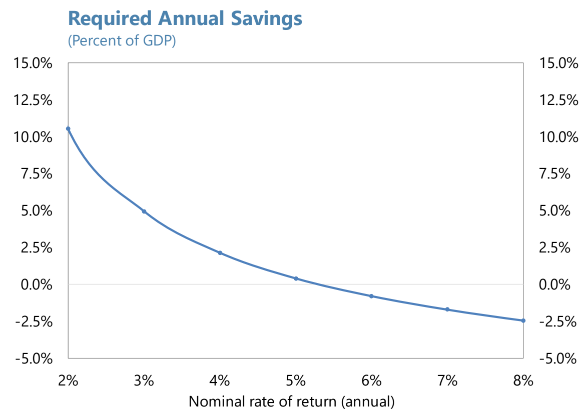
[2] The authorities concurred with the assessment that reserves exceeded their adequate level.

[3] The authorities preferred measure of reserve coverage takes the ratio to current year imports of goods and services excluding diamond imports for re-exporting purposes (which would amount to 17 months at end-2017).

[4] EBA-lite, an extension of EBA methodologies, uses annual data for 190 countries for the 1995–2016 period and incorporates fundamentals for low and middle-income countries. See further details of the EBA methodology in IMF (2013).

and REER in a multilateral-consistent manner, as each country's variables are measured relative to a weighted-average of other countries' values).[5]

7. Given Botswana's dependence on exports of an exhaustible commodity, staff's assessment relies primarily on the appropriateness of the external position for intergenerational purposes and is based on the permanent income hypothesis (PIH). Under the PIH, the external position would be considered adequate if the government is able to save enough reserves in the next thirty years, such that when diamonds are virtually exhausted, it can replace the diamond proceeds with an annuity from accumulated savings.[6] Assuming an annual (nominal) return on invested assets of 4.7 percent, the expected trajectory of foreign reserves (in the baseline scenario) would be consistent with a PIH framework.[7,8] Under this approach, the external position appears to be consistent with fundamentals and intergenerational equity.[9,10]



Source: IMF staff estimates.

[5] Since the CA and ER are measured relative to other countries, they not only reflect a country's own characteristics but also external conditions within a simultaneously determined general equilibrium system. This also implicitly recognizes that developments in a small economy would mostly influence its own CA and REER, unlike those in a large country.

[6] In other words, the exercise tries to determine whether the government would need to save more each year, such that the improvement in the current account balance would lead to an accumulation of reserves that would deliver additional foreign assets by the time diamond production ceases (this assumes that an improvement in the government's balance would improve the CA balance and the accumulation of reserves by the same amount). Given that Botswana currently receives about 10 percentage points of GDP in revenues from diamonds, the country would have to accumulate assets equivalent to 200 percent of GDP in thirty years such that at a return of about 5 percent per year proceeds from savings would be enough to replace the current level of diamond export revenues.

[7] The required annual savings would greatly vary depending on the assumed rate of return. This highlights not just the importance of regularly assessing the appropriateness of the external position but also of pursuing an adequate investment strategy to reach the desired target (in other words, if the objective is to reach a determined amount in thirty years, the investment strategy should reflect the optimal amount of risk for this long-term goal). This is important as in the past Pula Fund investments were concentrated in triple AAA bonds with a low return (about 1 percent in the past five years).

[8] In practice, the required rate of return would be about 5.5 percent, since reserves equivalent to about 20 percent of GDP would need to remain invested in short term assets as these funds would be necessary for stabilization purposes, while the rest could indeed be invested with a long-term perspective.

[9] These savings do not substitute the government's economic diversification efforts, since they do not incorporate the government's aspirations to become a high-income country which would entail much higher spending needs in infrastructure, health and education.

[10] In other words, what the results show is that if the rate of return of reserves is about 5.5 percent per year, the government would not need to have additional savings (beyond what is assumed in the baseline) such that in thirty

8. The REER EBA-lite and the CA approaches come to divergent conclusions, although they are less informative for Botswana given its commodity dependence and crawling peg regime (see table below). The regression-based methodology for the REER suggest that the REER is consistent with fundamentals and desirable policies, although the current account approach suggests a stronger external position. The REER EBA-lite approach indicates that the REER would need to depreciate by 0.6 percent to reach the fitted value of the regression. However, since the REER is very stable in Botswana due to the way the authorities use the crawling peg regime, this approach is not seen as very informative. Alternatively, the CA-EBA lite approach estimates the CA gap to be equivalent to 11.2 percent of GDP, as the fitted value of the regression is a CA surplus of 1.2 percent of GDP compared to the estimated surplus of 12.3 percent of GDP in 2017. Since the estimated elasticity of the trade balance to changes in the REER is -0.27, this methodology suggests that the REER would need to appreciate by 41 percent for the CA surplus to be reduced to the fitted value of the regression (see table below).[11] Similarly, since the sizable CA surpluses in Botswana (likely overestimated as noted in paragraph 1) are the result of large diamond sales and not of exchange rate misalignments, the CA approach is also not deemed to be very informative.[12]

Model	Observed	Norm	GAP	Overvaluation
CA	12.3%	1.2%	11.2%	-41%
ln(REER)	4.654	4.648	n.a.	0.6%

Reserve Adequacy

9. The IMF methodology to estimate reserves adequacy provides a rigorous way to assess the appropriate level of reserves. Traditional metrics of adequacy −such as months of imports, cover of short-term debt plus debt service, or percent of broad money− though attractive for their simplicity, are rather arbitrary as they only focus on one aspect of vulnerability and may provide conflicting signals. Since a balance of payments crisis can arise from various sources, the IMF's metric for market access countries employs a risk-weighted measure of diverse sources of risk.[13]

years it would have enough foreign assets to replace the diamond revenues. Thus, this means that the external position is consistent with intergenerational equity.

[11] If the current account data is adjusted as recommended by the recent technical assistance mission on external sector statistics, the estimated undervaluation under the CA approach would fall to about 25 percent.

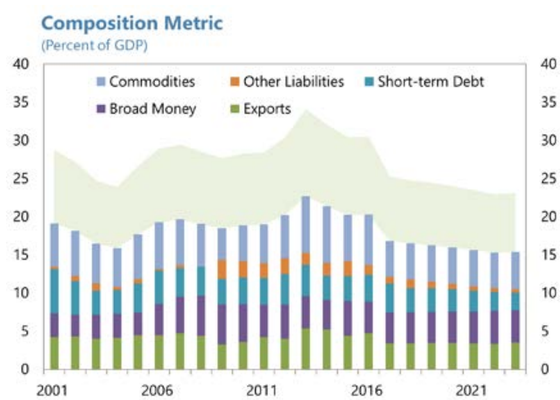
[12] About 90 percent of Botswana's exports correspond to diamonds sold at international prices. Although the exchange rate could affect the level of non-diamond imports, it has no bearing on Botswana's output or sales of diamonds which are demand determined and sensitive to economic developments in the US and China. Thus, the large current account surplus is more a structural characteristic of the economy and is weakly dependent on the exchange rate. Moreover, the non-diamond current account deficit would be about 10 percent of GDP, suggesting that the Pula could be overvalued.

[13] See further details in IMF (2011, 2013 and 2014). A separate methodology is used for non-market access countries but is not relevant for Botswana which is an upper middle-income country with little external debt and an investment grade rating.

10. The IMF's metric encompasses four specific vulnerabilities: (i) export earnings to capture potential losses from terms of trade shocks; (ii) short term debt at remaining maturity (short term debt plus debt service) to reflect rollover risk; (iii) portfolio investments plus medium and long-term debt to account for drains from non-residents' investment; and (iv) broad money as a proxy for residents' capital flight. The weights for the risks in the metric are computed as the financial outflows at the tenth percentile of the estimated annual distributions of percentage changes of each of the items discussed above during periods of exchange market pressures.[14] Separate distributions are estimated for countries with fixed exchange rates or capital controls.[15] The weights for countries with a fixed exchange rate (assumed for Botswana) are:[16]

	Short-term Debt	Other Liabilities	Broad Money	Exports
Weights	30%	20%	10%	10%

11. Botswana exhibits a comfortable reserve position. According to the IMF's metric, reserves of 12 to 18 percent of GDP would be adequate (reserves holdings of up to 150 percent of the metric are considered appropriate) compared to the most recent level of 42 percent of GDP. Using a weight of 25 percent for exports (instead of 10 percent) to reflect the country's dependence on volatile diamond receipts, the adequacy range would increase to 18–25 percent of GDP. Thus, the current level of reserves would exceed by 68 percent the upper bound of the estimated adequate range. Moreover, for the past twenty years the level of reserves has far exceeded the upper bound of the adequacy range.



12. Foreign reserves are under the control of the Bank of Botswana —with about two-thirds kept in a sovereign wealth fund (the Pula Fund) and one-third in a "liquidity" portfolio

[14] As in Eichengreen et. al. (1997), an exchange market pressure (EMP) index is constructed as the weighted average of reserve losses, exchange rate depreciation, and increases in interest rates. An episode of EMP occurs when the index deviates more than 1.5 times standard deviations from its average.

[15] Additional buffers are suggested for countries with commodity exports that exceed 50 percent of total exports. Botswana's commodity exports account for 80 percent of exports of goods and services (90 percent of goods exports). However, the IMF's methodology for commodity exporters relies on futures' prices which are unavailable for diamonds. Nonetheless, considering the decrease in exports in 2009 and 2015 due to market weakness and the fall in diamond prices, staff considers that a weight of 25 percent for exports could be appropriately used to reflect volatility in diamond prices.

[16] Botswana's pula is pegged to a basket of currencies that comprises the South Africa's rand and the SDR (with a 45 percent weight for the former). While not exactly a fixed exchange rate regime, its operational details are closer to it than to a flexible exchange rate regime. Using the weights for flexible exchange rates would, by design, yield a lower level of adequate reserves compared to the weights for fixed exchange regimes.

(used as a short-term liquidity buffer).[17] Within the Pula Fund, one-third is owned by the BoB and two-thirds by the government (kept separately in a "Government Investment Account" held at the BoB in domestic currency).

Conclusions

13. Botswana's external balance has improved since 2009 and is likely to remain in positive territory in the medium-term. The REER is consistent with fundamentals and foreign exchange reserves are adequate. Given the volatility of diamond revenues and of SACU receipts, the authorities should continue implementing prudent policies and maintaining high reserve buffers.

[17] The Liquidity Portfolio covers six months of non-diamond imports. Its most recent level is by itself adequate according to the IMF's metric.

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Appendix III. Debt Sustainability Analysis

Botswana's public debt ratios remain low and are projected to decline over the medium-term. A larger primary deficit in 2018/19 will increase financing needs in the short term but is expected to be financed mostly with buffers. In the medium-term, a gradual fiscal consolidation is envisaged, which will contribute to lower debt-to GDP-ratios. Based on a favorable economic outlook and standard stress tests, the country's level of risk of debt distress remains low.

Public Debt Sustainability

1. Botswana's public debt remains low. According to preliminary data, Botswana's gross public debt (including domestic and external guarantees) fell from 21.3 percent of GDP in FY16/17 to 19.4 percent of GDP in FY2017/18 (Table A3.1).[1] While both domestic and external public debt declined in nominal terms, the share of domestic debt in total debt rose by about 10 percentage points since 2015/16, reflecting increasing reliance on domestic financing. The fiscal year 2017/18 was also marked by a shift to longer maturities in the domestic public debt outstanding.

2. The medium-term baseline macroeconomic scenario envisages a gradual fiscal consolidation starting in FY2019/20 following a widening of the deficit in FY2018/19. The primary deficit is projected to average 2.1 percent of GDP over FY2018/23, mostly because of constrained mineral revenue. The deficit is assumed to be financed by a mix domestic debt (within the existing limit of 6 percent of GDP for bond issuance per year) and withdrawal of deposits. As a result, public debt is projected to remain stable in the next three years and begin to fall in FY2021/22, reaching 15.9 percent of GDP in 2023/24. Throughout the projection period, debt levels remain significantly lower than Botswana's legislated ceiling of 40 percent of GDP.

3. Figure A3.1 shows three alternative scenarios that also point to sustainable debt levels:

i. ***Historical values.*** The first scenario shows the behavior of public debt if the main macro variables are simulated to remain at their historical 10-year averages. In the next 3 years, the debt-to-GDP ratio would decline more rapidly than in the baseline because of the lower deficit entailed by the historical values and will increase slightly in the outer years towards 17 percent of GDP.

ii. ***Constant primary balance.*** The second scenario simulates no change in policies by holding the primary fiscal balance constant at its 2018/19 level. In this case, public debt would follow an upward trend, reaching 24.6 percent of GDP in 2023/24. Nevertheless, based on both the debt levels and gross financing needs, Botswana would continue to be classified as a lower scrutiny country.

[1] Public debt is defined as central government debt only. Botswana does not produce consolidated debt data for the overall public sector (including local governments, extra-budgetary funds, and parastatals).

iii. ***Contingent liabilities shock.*** Finally, the third scenario simulates the materialization of contingent liabilities associated with SOEs' debt. The scenario assumes that SOEs would default on 50 percent of their total debt with banks (i.e., 2.5 percent of GDP) in 2018.[2] The stress test includes a one standard-deviation shock to growth, the resulting deterioration of the primary balance (as in the standard contingent liability shock scenario in the MC DSA template) and a slight increase in interest rates. In this scenario, the debt-to-GDP ratio would rise to about 23 percent of GDP in 2020 and decline thereafter. Gross financing needs would reach 7 percent of GDP in 2019 but will be manageable given the country's large buffers.

External Debt Sustainability

4. Botswana's gross public external debt remained small at 13.8 percent of GDP at end FY2017/18 (Table A3.2). Public sector debt is mainly from multilateral organizations, primarily the International Bank for Reconstruction and Development and the African Development Bank. The external debt-to-exports ratio increased from 28.7 percent of exports of goods and services at end-FY2016 to 34.4 percent at end-FY2017, but the increase was entirely due to lower exports and is projected to be temporary. In the medium-term, improvements in the terms of trade and fiscal consolidation are projected to reduce the external debt-to-exports ratio to about 17 percent.

5. An alternative scenario, with key debt-creating variables at their historical levels, suggests that Botswana would remain a net creditor vis-à-vis the rest of the world over the medium-term. Other scenarios (e.g., exchange rate shock, interest rate shock, growth shock) also suggest that Botswana's external debt-to-GDP ratio would remain sustainable (Figure A3.2). For instance, a real depreciation, while it would initially increase the debt-to-GDP ratio, would have no impact on debt ratios in the medium-term. Only under a scenario of a non-interest current account shock the debt ratio would increase to about 24 percent of GDP, but this figure would still be below the 35 percent threshold associated with increased likelihood of a debt correction.

[2] This is based on the information collected from published financial statement for 2015/16. Most of the debt is held by Botswana Power Corporation.

Table A3.1. Botswana: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

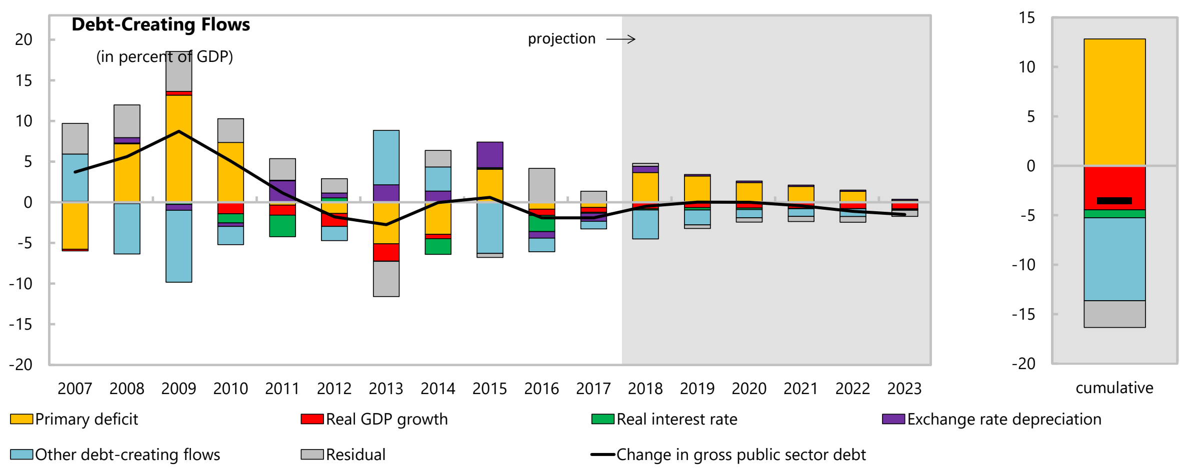
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	20.8	21.3	19.4	18.9	18.9	18.9	18.5	17.4	15.9
Public gross financing needs	4.0	2.3	1.8	6.5	4.7	4.3	3.7	2.8	1.6
Real GDP growth (in percent)	4.2	3.8	2.9	4.4	3.7	4.1	4.1	4.6	5.1
Inflation (GDP deflator, in percent)	6.1	12.0	3.1	3.5	4.4	4.0	4.0	4.1	4.6
Nominal GDP growth (in percent)	10.8	13.6	6.3	8.3	8.2	8.3	8.3	9.0	10.0
Effective interest rate (in percent) [3/]	4.4	2.5	2.7	2.8	2.8	3.2	3.8	4.2	4.4

As of May 15, 2018		
Sovereign Spreads		
Spread (bp) 2/		150
CDS (bp)		NA
Ratings	Foreign	Local
Moody's	A2	A2
S&Ps	A-	A-
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [8/]
Change in gross public sector debt	2.3	-1.91	-1.90	-0.5	0.0	0.0	-0.4	-1.1	-1.5	-3.5	
Identified debt-creating flows	0.3	-6.09	-3.27	-0.1	0.6	0.7	0.4	-0.2	-0.6	0.9	
Primary deficit	1.7	-0.8	-0.6	3.7	3.2	2.4	1.9	1.3	0.2	12.8	-0.8
Primary (noninterst) revenue and grants	36.8	32.9	31.6	28.5	28.0	27.9	27.5	27.1	27.6	166.5	
Primary (noninterest) expenditure	38.5	32.0	31.0	32.2	31.2	30.4	29.4	28.4	27.8	179.4	
Automatic debt dynamics [4/]	-0.3	-3.6	-1.7	-0.2	-0.8	-0.7	-0.6	-0.6	-0.7	-3.6	
Interest rate/growth differential [5/]	-1.3	-2.7	-0.7	-0.9	-0.9	-0.9	-0.8	-0.8	-0.9	-5.3	
Of which: real interest rate	-0.6	-2.0	-0.1	-0.2	-0.3	-0.2	-0.1	0.0	-0.1	-0.8	
Of which: real GDP growth	-0.7	-0.8	-0.6	-0.8	-0.6	-0.7	-0.7	-0.8	-0.8	-4.5	
Exchange rate depreciation [6/]	1.0	-0.8	-1.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	-1.1	-1.7	-0.9	-3.6	-1.8	-1.0	-0.9	-1.0	-0.1	-8.4	
Privatization receipts (negative)	-1.1	-1.7	-0.9	-3.6	-1.8	-1.0	-0.9	-1.0	-0.1	-8.4	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows (specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [7/]	1.9	4.2	1.4	0.4	-0.4	-0.5	-0.6	-0.7	-0.7	-2.7	



1/ Public sector is defined as central government and figures are reported in fiscal year terms.
2/ Bond Spread over U.S. Bonds.
3/ Defined as interest payments divided by debt stock at the end of previous year.
4/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
5/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.
6/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
7/ For projections, this line includes exchange rate changes during the projection period.
8/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

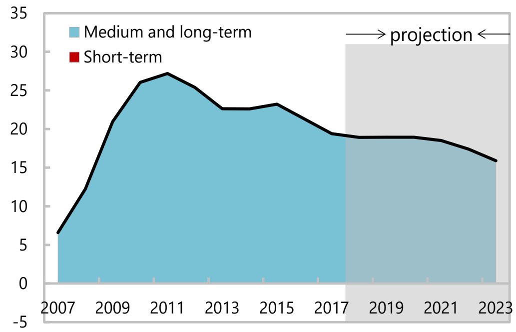
Sources: International Monetary Fund, country desk data, and staff estimates.

Figure A3.1. Botswana: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

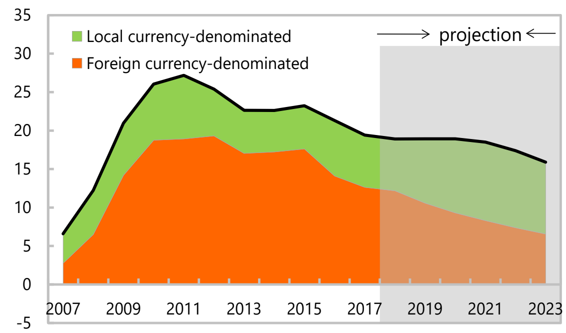
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

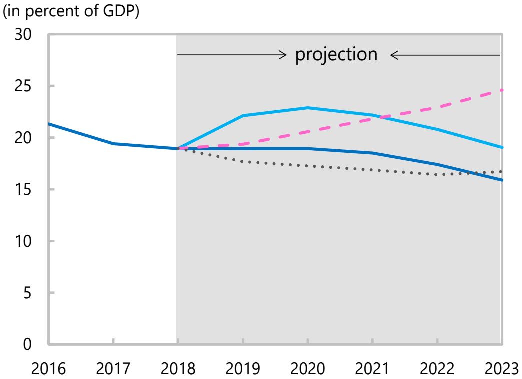


Alternative Scenarios

Baseline
Historical
Constant Primary Balance
Contingent Liability Shock

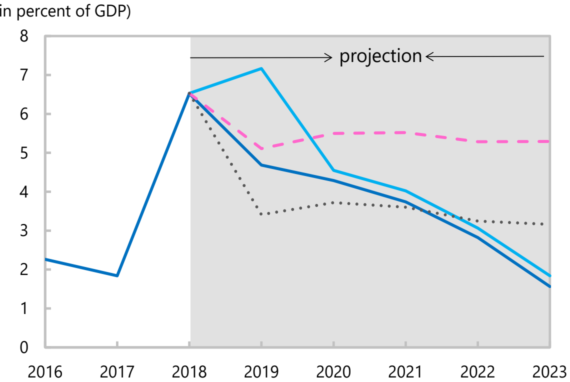
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	4.4	3.7	4.1	4.1	4.6	5.1
Inflation	3.5	4.4	4.0	4.0	4.1	4.6
Primary Balance	-3.7	-3.2	-2.4	-1.9	-1.3	-0.2
Effective interest rate	2.8	2.8	3.2	3.8	4.2	4.4
Constant Primary Balance Scenario						
Real GDP growth	4.4	3.7	4.1	4.1	4.6	5.1
Inflation	3.5	4.4	4.0	4.0	4.1	4.6
Primary Balance	-3.7	-3.7	-3.7	-3.7	-3.7	-3.7
Effective interest rate	2.8	2.8	3.2	3.9	4.3	4.6

Histocial Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	4.4	3.7	3.7	3.7	3.7	3.7
Inflation	3.5	4.4	4.0	4.0	4.1	4.6
Primary Balance	-3.7	-2.0	-2.0	-2.0	-2.0	-2.0
Effective interest rate	2.8	2.8	2.9	3.1	3.2	3.2
Contingent Liability Shock						
Real GDP growth	4.4	-0.2	0.2	4.1	4.6	5.1
Inflation	3.5	3.4	3.1	4.0	4.1	4.6
Primary Balance	-3.7	-5.6	-2.4	-1.9	-1.3	-0.2
Effective interest rate	2.8	3.0	3.4	3.9	4.3	4.5

Sources: International Monetary Fund, country desk data, and staff estimates.

Table A3.2. Botswana: External Debt Sustainability Framework, 2013–2023

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2013	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	18.4	17.6	18.5	15.1	13.8			**13.0**	**11.4**	**10.0**	**9.0**	**8.0**	**7.1**	**0.3**
Change in external debt	0.8	-0.8	0.9	-3.4	-1.4			-0.7	-1.7	-1.3	-1.1	-1.0	-0.9	
Identified external debt-creating flows (4+8+9)	-11.1	-13.7	-7.4	-14.8	-11.9			-9.7	-8.6	-8.4	-9.1	-9.7	-10.4	
Current account deficit, excluding interest payments	-8.1	-13.6	-6.1	-14.2	-12.8			-10.0	-9.2	-8.9	-9.6	-10.2	-10.7	
Deficit in balance of goods and services	1.5	-4.7	4.4	-10.1	-6.0			-4.1	-4.2	-3.8	-4.2	-4.6	-5.0	
Exports	59.4	58.5	50.2	52.7	40.0			39.8	40.3	40.5	40.4	40.5	42.3	
Imports	60.8	53.9	54.6	42.6	33.9			35.7	36.1	36.7	36.2	35.9	37.2	
Net non-debt creating capital inflows (negative)	-3.3	0.9	-0.6	0.5	0.8			0.4	0.7	0.6	0.5	0.5	0.4	
Automatic debt dynamics 1/	0.3	-1.0	-0.7	-1.2	0.1			-0.2	0.0	0.0	0.0	0.0	-0.1	
Contribution from nominal interest rate	0.4	0.4	0.4	0.4	0.5			0.4	0.4	0.4	0.4	0.4	0.3	
Contribution from real GDP growth	-2.0	-0.7	0.3	-0.7	-0.3			-0.6	-0.5	-0.4	-0.4	-0.4	-0.4	
Contribution from price and exchange rate changes 2/	1.9	-0.7	-1.4	-0.9	0.0			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	11.9	12.9	8.3	11.4	10.6			9.0	6.9	7.0	8.0	8.8	9.5	
External debt-to-exports ratio (in percent)	31.0	30.1	36.9	28.7	34.4			32.7	28.2	24.8	22.2	19.8	16.8	
Gross external financing need (in billions of US dollars) 4/	-1029.2	-1997.0	-604.8	-1949.5	-1934.6			-1586.8	-1444.1	-1514.7	-1785.4	-2080.7	-2430.5	
in percent of GDP	-6.9	-12.3	-4.2	-12.4	-11.1	10-Year	10-Year	-8.3	-7.3	-7.2	-7.9	-8.7	-9.4	
Scenario with key variables at their historical averages 5/								**13.0**	**11.8**	**11.0**	**11.2**	**12.1**	**14.0**	**-2.9**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Nominal GDP (US dollars)	14916.8	16259.5	14444.7	15663.9	17411.4			19145.6	19901.3	21174.0	22493.4	23898.1	25829.6	
Real GDP growth (in percent)	11.3	4.1	-1.7	4.3	2.4	3.9	5.1	4.6	3.6	4.0	4.1	4.2	5.5	
GDP deflator in US dollars (change in percent)	-9.6	4.0	8.6	5.1	0.3	1.7	8.8	5.1	0.3	2.3	2.0	1.9	2.4	
Nominal external interest rate (in percent)	2.4	2.6	2.5	2.6	3.4	2.8	0.9	3.4	3.5	3.7	4.1	4.4	4.7	
Growth of exports (US dollar terms, in percent)	34.3	7.5	-23.8	13.7	-15.6	4.3	22.4	9.5	5.2	6.9	6.0	6.3	12.9	
Growth of imports (US dollar terms, in percent)	2.7	-3.5	-10.0	-15.4	-11.5	4.3	14.6	15.7	5.3	8.0	4.8	5.2	12.2	
Current account balance, excluding interest payments	8.1	13.6	6.1	14.2	12.8	5.1	7.3	10.0	9.2	8.9	9.6	10.2	10.7	
Net non-debt creating capital inflows	3.3	-0.9	0.6	-0.5	-0.8	2.6	2.7	-0.4	-0.7	-0.6	-0.5	-0.5	-0.4	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

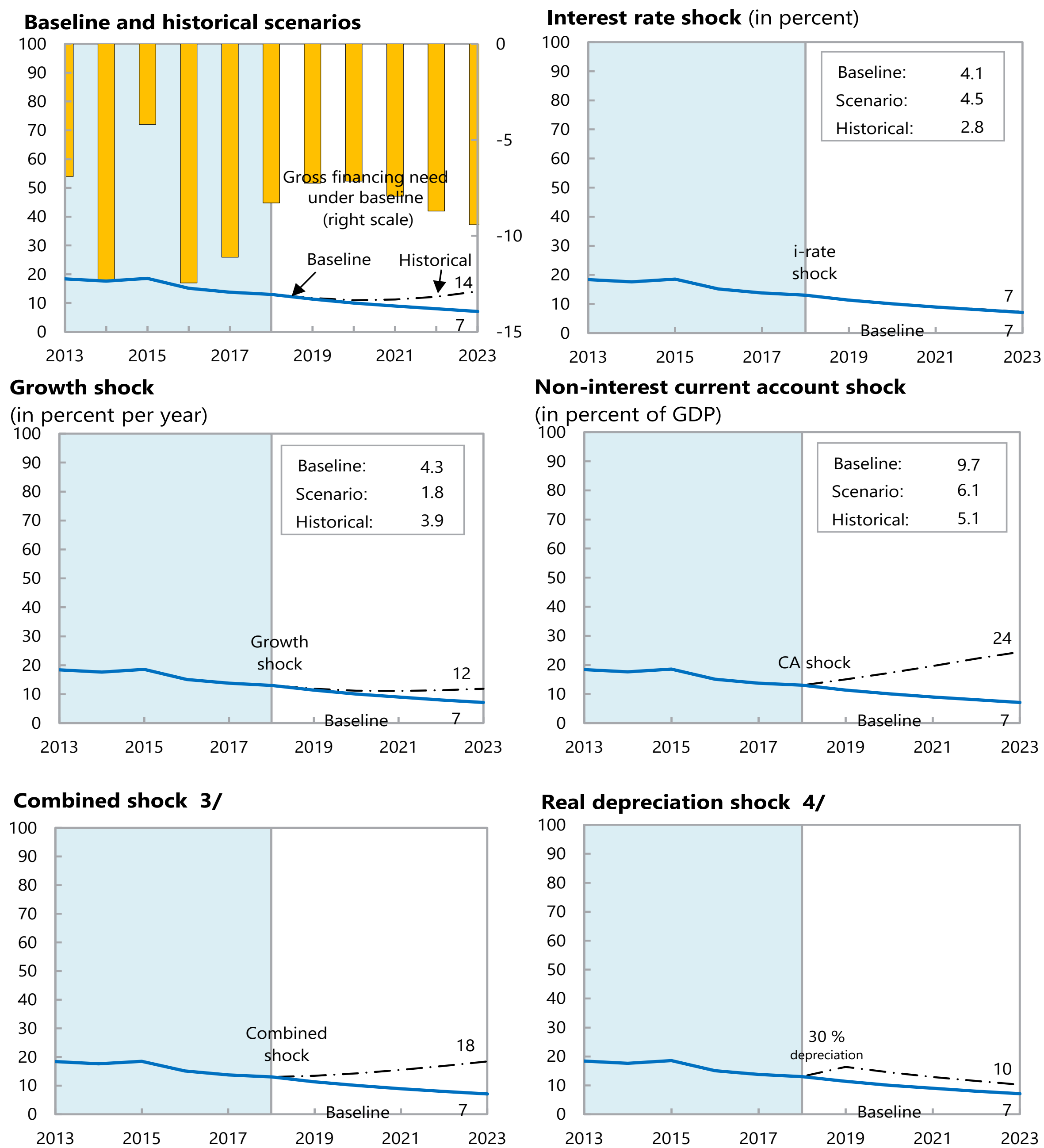
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Sources: International Monetary Fund, country desk data, and staff estimates.

Figure A3.2. Botswana: External Debt Sustainability: Bound Tests 1/ 2/



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

Appendix IV. Risk Assessment Matrix[1]

Source of risks	Likelihood / Horizon	Expected impact if realized	Possible Policy Response
Rising protectionism and retreat from multilateralism. Increased uncertainty about growth, triggered by escalating trade tensions, leads to increased financial market volatility. Effects exacerbated by changes in market sentiment and investment.	**High / ST, MT**	**High / ST, MT** Negative impact on global growth would lead to lower demand for diamonds and diamond prices.	Allow for exchange rate adjustments, use buffers to support demand, and accelerate reforms to deregulate and liberalize the business environment,
Weaker-than-expected global growth. · In the US, as capacity constraints become more binding, the risks of a slowdown increase. · In China, insufficient progress in deleveraging and rebalancing reduces growth.	**Medium / MT** **Medium / MT**	**Medium / MT** Somewhat negative impact on diamond prices and exports, as well as on growth and external and fiscal positions.	Apply countercyclical fiscal and monetary policies and accelerate reforms to mobilize revenue and promote private sector growth
Lack of medium-term fiscal adjustment in Botswana	**Medium / MT** Spending pressures could continue after the 2019 national elections, leading to protracted fiscal deficits.	**High / MT** Increases in public debt and erosion of reserve buffers would raise concerns about long-term fiscal sustainability	Advance revenue mobilization measures, reduce subsidies, improve the efficiency of public spending, speed up rationalization of parastatals and privatize money-losing enterprises.
Delays in implementing key structural reforms in Botswana.	**Medium / ST, MT** Political economy constraints or lack of focus on medium-term outcomes could lead to a sluggish pace in the implementation reforms.	**High / ST/MT** Further delays in enacting fiscal and structural reforms will result in weak economic growth, meager employment creation, and little or no economic diversification.	Exercise leadership to accelerate implementation of reforms to mobilize revenues, improve public financial management, and foster private sector growth and develop sectors with latent comparative advantage.
Protracted further decline in SACU revenues.	**High / MT** Fiscal revenues in Botswana will suffer If growth in South Africa disappoints as the latter is the main determinant of SACU pool resources.	**Medium / MT** Deterioration of fiscal and external balances.	While manageable in the short term given ample fiscal and external buffers, reforms will have to be accelerated to mobilize domestic revenue, reduce subsidies, and improve the efficiency of public spending.
Disruptions in electricity and water provision in Botswana.	**Low / MT** Performance of these sectors has improved thanks to recent reforms and investments, but implementation of plans needs to continue.	**Medium / MT** Private sector growth and diversification would be adversely affected.	Accelerate plans to increase generation capacity and efficiency in these sectors, lower cost-tariff gaps, and increase private sector involvement.
Based on the latest G-RAM (July 2018).			

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Appendix V. Fiscal Incidence and Inequality[1]

In the past two decades, Botswana has succeeded in reducing poverty, but inequality is high and preliminary evidence from the 2015–16 household survey suggests limited gains. This note evaluates the impact of redistributive fiscal policies in Botswana by estimating their incidence on household-level income inequality and poverty rates. The results suggest that fiscal policy played a significant role in alleviating poverty and inequality although there is room to enhance its impact in coming years through better targeting of spending. At the same time, revenue-enhancing measures such as removing VAT exemptions could be undertaken without aggravating poverty and inequality, and changes in property taxation could also lower inequality.

A. Poverty and Inequality in Botswana

1. **Botswana made progress in reducing poverty and inequality in the 2000s.** The poverty headcount was reduced from 30.6 percent in 2002–03 to 19.3 percent in 2009–10. Poverty reduction was particularly significant in rural areas due to government-supported agricultural incomes and public-sector employment, as well as changes in demographics, including smaller household size and a smaller number of those outside the labor force. In addition, income inequality (measured by the Gini Index) fell from 0.65 to 0.61 over same period.

2. **Despite the authorities' efforts, some vulnerabilities remain.** Many people remain marginally above the poverty line and could be at risk of falling back into poverty. At the same time, some human development indicators, particularly nutrition, lag the country's economic performance. Nearly a quarter (24.1 percent) of Botswana's population is undernourished (i.e., the intake of food is inadequate to meet dietary energy needs). Moreover, 31 percent of children under five years of age are stunted, this share is higher than in other middle-income countries.

3. **More recently, changes in poverty and inequality appear to have been more mixed and uneven across regions.** While poverty at a national level is estimated to have fallen by 3 percentage points in 2015/16[2] compared to 2009/10, it increased in cities and towns, remained stable in rural areas, and decreased in urban villages. At the same time, the consumption Gini index rose from 0.49 to 0.52 during the same period.

B. Taxation and the Social Benefit System in Botswana: An Overview

Taxation

4. **A significant share of tax revenue in Botswana comes from the Southern African Customs Union and diamonds.** In recent years, they constituted about 58 percent of tax revenue

[1] Prepared in close collaboration and with input from Dr. Wilfred Mandlebe (Botswana's Ministry of Finance and Economic Development), Jon Jellema, and Stephen D. Younger (both at CEQ; www.Commitmentoequity.org). The analysis was undertaken as part of a joint project between the CEQ and the IMF and its contents can in no way be taken to reflect the views of the European Union or the Government of Finland.

[2] Based on preliminary results from the 2015/16 Multi-Topic Household Survey.

and 13 percent of GDP. The rest comprises non-mineral income tax (26 percent of total tax revenue and 6 percent of GDP) and the Value Added Tax (VAT). The analysis covers the Value Added Tax, the fuel levy, and the personal income tax (PAYE and capital income).

5. The tax system is characterized by a low tax wedge and a relatively narrow tax base due to multiple exemptions.

- **Value Added Tax.** The VAT rate is 12 percent on standard supplies, the lowest in the SACU region. The introduction of new tax expenditures (zero-rated supplies and exemptions) in the last decade contributed to eroding the tax base and the share of VAT collection to GDP, which fell from about 6 percent in 2008/9 to about 3.5 percent in 2016/17 (Table A5.1).

Table A5.1. Botswana: Exemptions

Zero-rated supplies	Exempt supplies
Exports of goods and services;	Prescription drugs and condoms
International transport services;	Residential accommodation;
Sorghum, maize meal, millet, wheat, sugar and flour for human consumption;	Education at approved institutions;
	Public medical services;
Fertilizers for farming purposes, some pesticides and farming tractors;	Non-fee based financial services;
	Passenger transport (excluding the transportation of tourists);
Supplies to the Head of State;	
First 5,000 liters of water.	Farm implements.

- **Personal Income Tax (PIT).** Botswana's PIT is a typical global income tax that applies a schedule of progressive rates to the tax base (Table A5.2), including all types of income and capital gains. Some benefits are tax-free or exempted from the PIT such as contractual travel benefits for employees and their families, medical fund contributions and medical attention paid for by the employer, and severance pay and certain gratuities payable to citizen employees.

Table A5.2. Botswana: Progressive Taxation

Earnings (BWP)	Tax
0-36,000	BWP 0
36,001-72,000	BWP 0 + 5% over BWP 36,000
72,001 – 108,000	BWP 1,800 + 12.5% over BWP 72,000
108,001 – 144,000	BWP 6,300 + 18.75% over BWP 108,000
144,001 and over	BWP 13,050 + 25% over BWP 144,000

Social Spending and Transfers

- **Education.** While in decline compared to the 2000s, Botswana devotes about one quarter of total spending (7.5 percent of GDP) to education (6 percent excluding post-secondary bursaries and overseas training). The enrollment rate in free primary school is high, although most students, especially the poor and those living in rural areas, leave before senior secondary level and only 16.4 percent enroll in tertiary education. In 2006, 'cost-sharing' fees were introduced (P300 for junior secondary per year and P450 for senior secondary) with exemptions for the extremely poor, although compliance with payments is reportedly low.

- **Health.** Botswana spends 3.5–4 percent of GDP on health, with notable positive outcomes. This is higher than the upper middle-income countries average and could be explained by the prevalence of HIV (24 percent of the adult population), which has recently decreased thanks to free anti-retroviral medicines.

Cash and Near Cash Transfers

6. Botswana has a mix of universal and targeted social protection programs, accounting for 4–4.5 percent of GDP and fully funded by the government. These include pensions (dominated by the public fund), active labor market programs, social safety net, and sponsorships/scholarships. The analysis below covers:

- **Social assistance.** Social assistance spending amounts to about 1.5 percent of GDP. The main programs providing assistance are the orphan care program, school feeding program and other food programs, and old age pension. A public works program (the Ipelegeng) is not included in the analysis.

- **Sponsorships and scholarships for students in tertiary level**. The government grants bursaries and extend loans (which have a low repayment rate) to almost all students in tertiary education regardless of their income, at a cost of 1.3 percent of GDP in 2017/18.

Indirect Subsidies[3]

- **Electricity.** The electricity subsidy reached 1.4 percent of GDP in 2015/16.[4] However, revisions of electricity tariffs, compounded with the reduction of imports following the repair of the Morupule B power station and the closure of BCL has reduced the price gap. In addition, to electrify villages, electricity installation has also been subsidized (standard payment of BWP 5,000 to connect to the electricity grid irrespective of location), with a cost of approximately BWP262 million per annum, funded through a universal electricity levy of 5 thebe per kilowatt hour consumed. Finally, a stepped two-block tariff structure for Domestic and Small Business category customers has been maintained to lessen the impact of the tariff adjustment on low-usage households and small-scale businesses.

C. Fiscal Incidence Analysis

Concepts and Methodology.

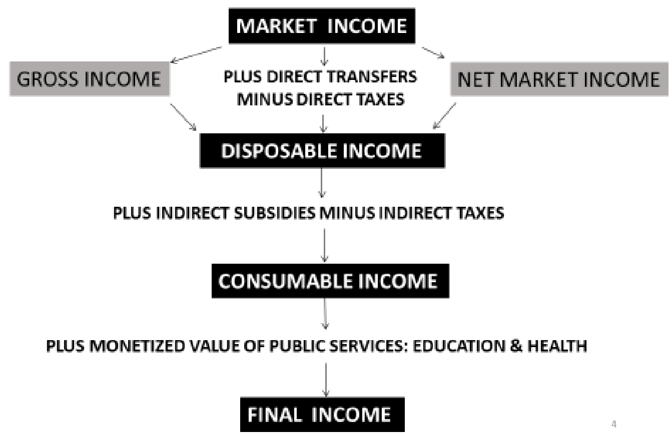
7. The CEQ assessment tool quantifies the impact of fiscal policy and its various components (e.g., taxes, social spending, subsidies) on income distribution and poverty (Lusting

[3] In addition to electricity, Botswana subsidizes water and fuel. The latter are not covered in this study.

[4] This subsidy is equally distributed between households, businesses and the public sector.

and Higgins, 2016). In the CEQ methodology, taxes and transfers are allocated to households based on patterns derived from household expenditure surveys. It requires the construction of "pre-fiscal" and "post-fiscal" incomes of households, to trace the impact of various components of the fiscal system on income and income distribution. Starting from the households' pre-fiscal (pre-tax and pre-government transfers) or market income, particular interventions (taxes paid, transfers received) are allocated to each household or individual to determine various post-fiscal income concepts (Figure A5.1).
A comparison of market income and final income gives an indication of the how redistributive the fiscal system is. The tool follows an "accounting approach"; it does not capture behavioral responses or general equilibrium effects. It is, nonetheless, a very useful tool.

Figure A5.1. CEQ Income Concepts



Source: Excerpted from Lustig and Higgins (2013)

8. **Assessments of impact on inequality and poverty.** The changes in the measures of inequality (e.g., Gini coefficient) and poverty (head count) between the pre- and post-fiscal distributions give the magnitude of the impact. For example, the extent to which the system reduces inequality is derived by tracing how inequality evolves as different transfers and taxes are added or subtracted from income. Similarly, the impact on poverty is obtained by tracing the change in poverty across income concepts. The two concepts used to describe how progressive or regressive interventions are "concentration shares", which refer to the share of total benefit received (or taxes paid) by households distributed by income decile, and "incidence", that is the benefit received (or taxes paid) by households as a share of their market income.

9. **This assessment uses the 2009/10 Botswana Core Welfare Indicators Survey (BCWIS) and follows the CEQ method described above.** The effect of redistributive fiscal policy on incomes is based on the comparison of two so-called "income concepts", one excluding (i.e., pre-fiscal) and the second including (i.e., post-fiscal) fiscal policy measures. The changes in the measures of inequality (e.g., Gini coefficient) and poverty (head count) between the pre- and post-fiscal distributions provide the magnitude of the impact. Subsidies received by households were allocated based on the data on spending from the BCWIS. Given limitations of the BCWIS data, some imputation was applied in the case of the cash transfer program. The allocation was based on the districts covered by the program and the benefit allocated to the households in those areas that met the program requirement.

10. **The analysis has some caveats.** First, it used the 2009/10 households survey, which corresponds to a year of fiscal stimulus which could amplify the fiscal incidence on poverty and inequality. If the structure of household income and expenditures or the structure of taxation and social spending have changed significantly since 2010, these results would not reflect accurately the

current situation. Second, the BCWIS underreports household consumption by 36 percent compared to the national income accounts and underreports household income tax by 42 percent compared to income tax receipts. This is a frequent problem with survey data around the world. Often, it is due to high income households not responding to the survey, but it can also be due to households underreporting their expenditures and/or incomes. Third, there are aspects of public spending and taxation that cannot be captured, including mineral revenues, corporate income tax, and spending on public goods whose beneficiaries are not identifiable.

D. Results

Overall Impact of Fiscal Policy on Poverty and Inequality

11. Overall, according to the analysis, fiscal policies in Botswana have a significant effect on poverty. Based on the national poverty line, the poverty headcount falls from about 24 percent for market income to 21 percent in the post-fiscal income and 5 percent for final income. The major gains are attributed to in-kind transfers (difference between final income and consumable income), in line with the fact that Botswana spends more than average on education and health (Table A5.3). The results also suggest that the reduction in the headcount due to taxation and social spending is generalized across regions and more pronounced in rural regions, where poverty is high.[5]

Table A5.3. Botswana: Gini, Headcount, and Poverty Gap

	Gini	Headcount	Poverty Gap
Market Income	0.639	0.239	0.100
Market Income + Pensions	0.636	0.236	0.096
Net Market Income	0.628	0.238	0.098
Gross Income	0.615	0.191	0.061
Disposable Income	0.605	0.193	0.062
Consumable Income	0.604	0.211	0.070
Final Income	0.534	0.053	0.013

Source: Authors calculations

12. Similarly, fiscal policy contributed to reduce inequality. Albeit still high at 0.53, the income Gini index declines by 10 percentage points after accounting for the fiscal policy impact. Here too, two-thirds of the gains are due to education and health transfers. Botswana compares well to countries such as Colombia and Armenia but is behind top performers such as South Africa, Brazil and Georgia (Table A5.4).

Table A5.4. Botswana: Fiscal Policy and Inequality in a Sample of Countries

		Namibia	South Africa	Brazil	Georgia	Botswana	Colombia	Russia	Armenia
Consumable Income to Market Income	Dif. in %	-0.045	-0.076	-0.053	-0.096	-0.035	-0.009	-0.028	-0.029
	Ratio in%	93	90	91	81	95	98	93	93
Final Income to Market Income	Dif. in %	-0.206	-0.176	-0.176	-0.124	-0.105	-0.066	-0.063	-0.046
	Ratio in%	68	77	77	76	84	89	84	89

Source: CEQ reports and authors calculations.

[5] Reduction in poverty headcount ranges from 6 percentage points in Gaborone to 25 percentage points in the South West.

Impact of Individual Components

13. Concentration and incidence measures of the different components are presented in (Table A5.5). It shows that except for VAT and spending on tertiary education, all components contributed to improving equity. One other important result is that social spending (in-kind and cash transfers) is a major contributor to poverty reduction.

Table A5.5. Botswana: Fiscal Incidence Table by Component[1]

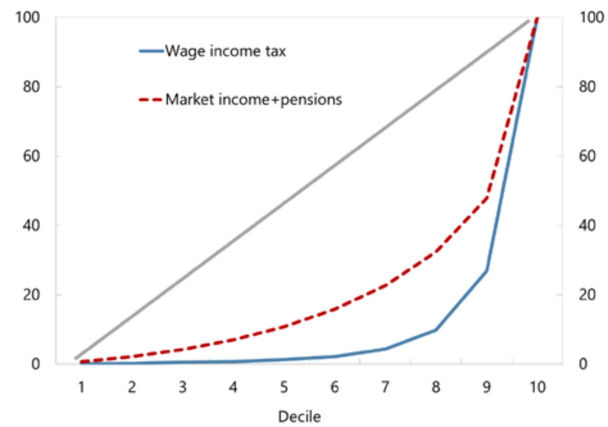
Taxes / Expenditures	Size (as a Share of Market Income plus Pensions)	Concentration Coefficient	Marginal Effect, Gini	Marginal Effect, Poverty Headcount
Direct Taxes	*0.049*	*0.844*	*0.887*	*-0.206*
Wage Income Tax	0.049	0.844	0.887	-0.206
Indirect Taxes	*0.064*	*0.623*	*-0.128*	*-2.630*
VAT	0.063	0.621	-0.138	-2.630
Fuel Levy	0.001	0.769	0.010	0.000
Pensions	*0.012*	*0.735*	*0.083*	*0.390*
Public Employee Pensions	0.012	0.744	0.010	0.034
W.W. II Veteran Pensions	0.000	0.071	0.073	0.343
Direct Transfers	*0.035*	*-0.152*	*2.158*	*4.490*
Old Age Pension	0.006	-0.112	0.423	0.723
In-kind Food Aid	0.009	-0.238	0.746	1.549
Cash Aid	0.001	-0.253	0.077	0.219
Destitute Aid	0.000	-0.275	0.023	0.066
School Allowances	0.008	-0.200	0.243	0.494
School Meals	0.011	-0.052	0.714	1.551
Indirect Subsidies				
Electricity	0.006	0.523	0.057	0.241
Education	0.222	0.049	7.020	15.382
Primary	0.048	-0.193	3.599	9.193
Secondary	0.095	-0.020	4.388	8.790
Vocational/Tertiary	0.033	0.260	0.306	0.888
University	0.045	0.294	-0.365	0.380
Health	0.033	-0.004	0.843	1.759
In-patient Care	0.025	0.006	0.356	0.610
Out-patient care, hospital	0.002	0.036	0.118	0.315
Out-patient care, facility with beds	0.005	-0.033	0.308	0.685
Out-patient care, facility w/o beds	0.001	-0.191	0.073	0.107
Headcount Poverty for Market Income + Pensions			***0.236***	
Gini Coefficient for Market Income + Pensions			***0.636***	

[1] The marginal effect is the change in the Gini or headcount that occurs when we add or subtract only that expenditure or tax from market income plus pensions, pre-fiscal income. CEQ defines these so that positive values correspond to an "improvement" in the Gini or the headcount, i.e., a reduction in those measures. They also multiply them by 100 since they tend to be small. So, a value of "+1" corresponds to one percentage point decrease in the Gini or headcount.

Personal Income Tax

14. The personal income tax is progressive.[6] Wage income tax is highly concentrated among the rich broadly; 70 percent of the tax is paid by the top decile, which receives a little more than 50 percent of pre-fiscal income (Figure A5.2). This may reflect the progressivity of the schedule, but also the higher degree of formality for higher incomes associated with a higher share of civil servants in the top deciles. The Kakwani index measuring the progressivity of the PIT compares favorably to other countries (0.21 against 0.3 in Peru, 0.28 in Mexico and 0.25 in Brazil).

Figure A5.2. Botswana : Concentration Curves
(Percent)



Source: Authors' calculations.

15. The progressive PIT reduces the Gini index but only by 0.9 percentage points. This is due to its small size, only 5 percent of pre-fiscal income, which, in turn, is related to the relatively low PIT rates, high bracket limits, and possibly tax compliance problems.

Indirect Taxes

16. The VAT is distributed just about neutral relative to pre-fiscal income. The Gini index declines by 0.1 percentage points compared to disposable income. While in general VAT is regressive, a neutral VAT is a common result in countries where basic food stuff is exempted. However, VAT increases poverty by 2.6 percentage point compared to almost no impact for direct taxes (income tax, property tax, etc.) even though they raise only about 25 percent more revenue from households. This suggests that greater reliance on direct taxes is preferable from an equality perspective. The fuel levy is paid by the high-income deciles but its size and impact on poverty and inequality are negligible.

Cash and Near Cash Transfers

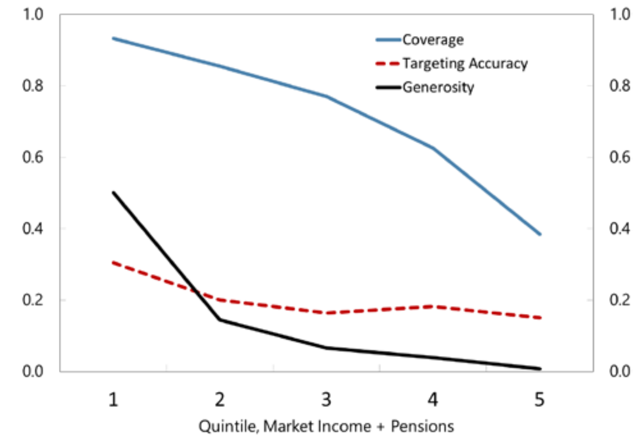
17. Direct transfers have been a major factor in helping to reduce poverty and inequality. Combined**,** the different social assistance programs contributed to reducing the poverty headcount and the GINI index, respectively, by 4.5 percentage points and 2.2 percentage points. Individually, the in-kind food program, school feeding programs and the non-contributory old age pension are the most important contributors.

18. However, despite generous spending, the targeting efficiency of direct transfers is relatively low. While the coverage is relatively good (90 percent of the lowest quintile has access to

[6] Capital income is covered by the analysis, but its size and impact are negligible.

social assistance), the targeting is not as efficient compared to other countries; about a third of the direct transfers goes to the top 40 percent of the population (Figure A5.3), while only 21 percent goes to the poorest decile compared to 85 percent in South Africa and 43 percent in average country. This may be because the largest programs (e.g., school feeding, old-age pension) are not means-tested (i.e., are not subject to an assessment of the income level). The only exception to that is the school allowance, which seems to be better targeted thanks to more equitable access to education.

Figure A5.3. Effectiveness of Direct Transfers

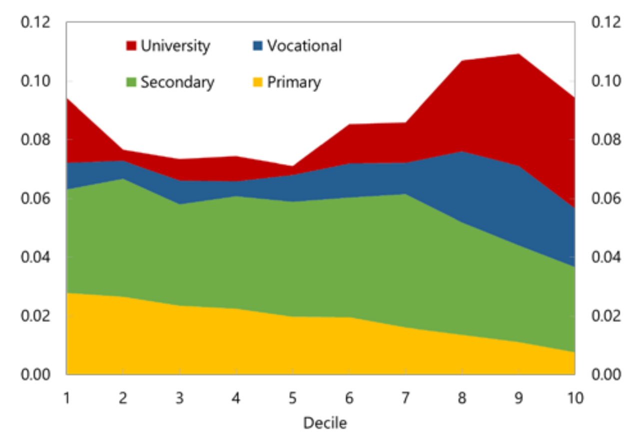


Source: Authors' calculations.

In-kind Transfers (Education and Health) and Indirect Subsidies

19. The large spending on education contributed to lower poverty and inequality in Botswana but there is scope for improvement. The concentration coefficients for primary and secondary education are quite negative (compared to other countries where they are usually closer to zero or positive), suggesting a good access to education across the income distribution. Spending on the two levels reduced the poverty headcount by 9 percentage points each. The impact on inequality is more important for primary education, possibly because of the fees in the secondary education and because primary students tend to be poorer than secondary students. On the other hand, spending on tertiary education (universities) is slightly regressive with a marginal effect on the Gini of -0.3 percentage point. This suggests that refocusing of education towards the primary level would be beneficial.

Figure A5.4 Concentration Curves of Education



Source: Authors' calculations.

20. Health spending also helped reduced poverty and inequality, though less than education expenditures.[7] It is just about equally spread across the population regardless of the type of service, suggesting that access is equitable. The only exception is for out-patient visits at facilities without beds—rural clinics and mobile clinics that naturally cater to a poorer segment of the population.

[7] The effect could be larger since health benefits are far more underreported than education.

21. Electricity subsidies are about neutral and have very little impact on poverty. Nonetheless, 56 percent of the subsidies go the top quintile as electrification has been low in rural areas. This may have changed since then as access to electricity has improved in recent years, especially in rural areas. At the same, electricity consumption in urban areas may have also increased along with changes in consumption habits.

E. Simulations Results

22. Four scenarios were simulated and contrasted to a baseline (Table A5.6).

- **Scenario 1. More progressive PIT schedule**: 2 more schedules, 30 percent bracket at BWP 216k/year and 35 percent bracket at BWP 324k/year.
- **Scenario 2. Removing some VAT exemptions:** private education and health services, sugar and fuel.
- **Scenario 3. Shifting education spending to lower levels**: primary 3970->6000 pp, secondary same, non-unit tertiary 45478 ->30000, university 100000 -> 70000.
- **Scenario 4–5. Eliminating electricity subsidies** totally for scenario 4 and only for consumption>200Kwh for scenario 5.

Table A5.6. Botswana: Scenario Analysis

	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Concentration coefficient[1]	0.706	0.611	0.031		
Change in:					
Inequality (Gini coefficient)	0.0	0.0	-1.1	0.1	0.0
Poverty (headcount)	0.0	0.2	-0.5	0.1	0.1
Poverty (gap)	0.1	0.0	-0.1	0.1	0.0
Size of the simulation[2]	3.5%	7.7%	-0.2%	36.0%	9.5%
Spending effectiveness[3]	8.0%	3.4%	n.a.	3.7%	4.5%

[1] Concentration coefficient calculated on post-fiscal income, per capita.

[2] Size of the simulation refers to the net impact on the budget as a percent of ex ante revenues/expenditures.

[3] Spending effectiveness is the increase in the absolute poverty gap (in dollars) divided by the size of the simulation.

23. The simulations show that all of the revenue enhancing measures —VAT, PIT, and electricity— have only small effects on poverty and inequality, never more than 0.2 percentage points, while generating significant additional income (7.7 percentage points for VAT, 3.5 percentage points for PIT, 36 percentage points or 9.5 percentage points for electricity depending on the scenario).[8] The last row in the table, spending effectiveness, shows the share of the overall increase in revenues that would come from the poor, which is small in each case. The very low values indicate that there is room for revenue enhancement without appreciable

[8] The impact of elimination of the subsidies is normally 100 percent; 36 percent corresponds to the share of households in total subsidies (government and private sector are also benefiting from the subsidy)

increases in poverty in Botswana should any of these tax policy measures be implemented, and that compensation of these measures through cash transfers will not be costly.[9] On the other hand, the shift in education spending to lower levels reduces both poverty and inequality by 1.1 percentage point and 0.5 percentage point, respectively, while reducing expenditures by 13 million Pula.

F. Conclusions and Policy Implications

24. Botswana fiscal policies have contributed to poverty and inequality reduction. Despite these positive effects, however, revisiting the current system with respect to both expenditures and revenues is warranted.

25. There is room to increase the efficiency of social spending. Reductions in inequality can often be generated from in-kind transfers and direct transfers, and Botswana allocates a lot of budget resources to education, health, and social assistance. Yet, there seems to be room for efficiency gains through better targeting of some social programs and shifting of education spending to lower levels. At the same time, electricity subsidies could be usefully eliminated and, if needed, replaced by cash transfers to the most vulnerable.

26. There is also room to balance equity and efficiency in tax policy. A greater reliance on direct taxes, in particular property taxation, could enhance equality while mobilizing additional revenue. At the same time, while increasing VAT rates is not warranted due to its negative impact on poverty, the results of this analysis are that broadening the tax base by streamlining VAT exemptions could provide a boost to revenue collection without a major impact on poverty and inequality.

27. More specifically, the main takeaways from this study are that:

- The PIT is progressive; adding brackets for top incomes improves revenue but has insignificant impact on inequality.[10] For greater equity, property taxation (through wider coverage and higher rates) offers more promise (and there is also a related increase in fiscal revenue). Repealing exemptions on capital gains and replacing the progressive rate by a flat proportional rate could also augment revenue without affecting inequality.

- Removing selected VAT exemptions will contribute to revenue collection with a minor impact on poverty and inequality. If needed, cash transfers could be considered to compensate the most vulnerable.

[9] For example, the removal of selected VAT exemptions will increase VAT revenue by 7.7 percentage points and increase poverty by 0.2 percentage points. To offset this negative effective, the authorities need to allocate 3.4 percentage points of the gains (i.e., the 7.7 percentage points) I the form of cash transfers to the poor. The net gains in this case in 7.7*(100-3.4) %=7.4%).

[10] The magnitude of the gains could be more important than estimated and need be updated with the 2015/16 Multi-Topic Household Survey.

- Social transfers contribute to equity and poverty reduction but could be better targeted. This could be achieved through generalizing the social registry, means-testing, and redesigning some programs to target households instead of individuals.

- Education and health are progressive and access for the poor is good, except for tertiary education which is not as progressive and contains some distortive aspects as it is heavily subsidized in detriment of vocational training. Current plans to introduce a cost-sharing formula and means-testing (i.e., fees for the wealthiest) could enhance equity and revenue. Lower bursaries to tertiary education will also help, together with focusing and devoting resources to vocational training.

- Although neutral, electricity subsidies benefit mostly the wealthiest and can be usefully eliminated, especially for large consumers, while mitigating the impact on poverty through cash transfers.

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Appendix VI. Economic Diversification

Botswana has tried to diversify its economy for many years, but results have not been up to expectations.[1] Successive national development plans have been implemented with a view towards boosting human capital and developing industries and services to employ high-skilled labor. Nevertheless, most new activities have been in the production of nontradable goods and services, with little expansion in tradables aside from mining. Although the national accounts measure of non-diamond output shows that its share of GDP has increased from 70 to about 80 percent in the past decade, this was mostly due to the expansion of trade (which includes diamond marketing activities, hotels, and restaurants). At the same time, export diversification remains limited, with diamonds accounting for about 90 percent of goods' exports.

Background

1. **Diversification remains a key goal and the authorities aim at developing sectors with perceived comparative advantage.** After a comprehensive consultation process with stakeholders including the private sector, a new approach based on a cluster-based plan was adopted as part of the 11th National Development Plan (NDP11) that commenced in 2017. The authorities also based their approach on a study prepared by an external consultant that identified beef, tourism, and financial services as strategic sectors with potential comparative advantage (Porter, 2012).

2. **This appendix assesses the constraints that have kept these sectors from reaping the intended benefits and recommends policy actions** to eliminate restrictive and costly government's interventions while leveling the playing field to achieve greater competition and private sector participation. The recommendations are based on earlier studies (e.g., World Bank, 2012).

3. **Export composition in Botswana is highly concentrated compared to similar countries**. Product diversification has not happened through the introduction of new product lines (the extensive margin) but through a more balanced mix of existing exports (intensive margin).

Cattle and Beef

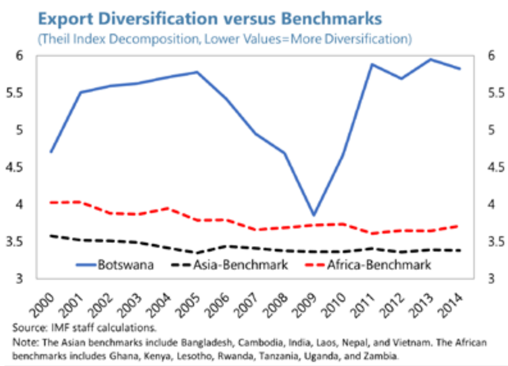
4. **The cattle and beef sector have significant potential to generate export revenue and employment.** At present, the sector accounts for just about 2 percent of GDP and 1.5 percent of exports but provides livelihood to a sizeable share of the rural population. Notably, Botswana is one of the top ten countries in the world with the highest share of cattle per person, with significant potential to produce and export high-quality (free-range, grass-fed, hormone-free) beef, and

[1] Diversification has been at the top of the economic agenda for more than two decades (World Bank, 2015). Most recent efforts include Economic Hubs, Special Economic Zones, the Economic Diversification Drive, and economic clusters. It is also a central objective of NDP11.

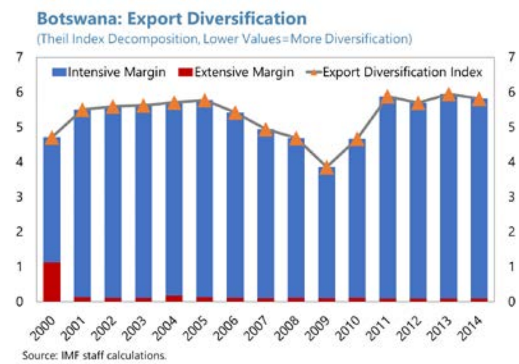
with quota and duty-free access to the EU market. IMF staff estimates that beef exports could easily triple overtime from current sales of US$80 million per year if the market were to be liberalized.[2]

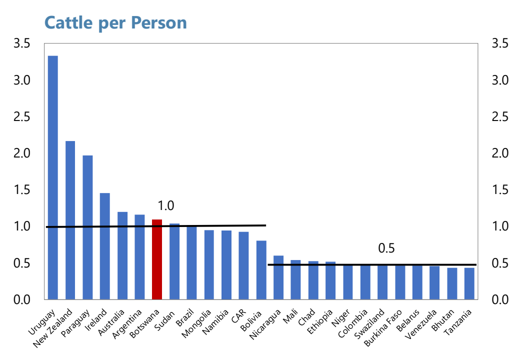
Export Diversification in Botswana

Export composition is highly concentrated compared with similar countries…

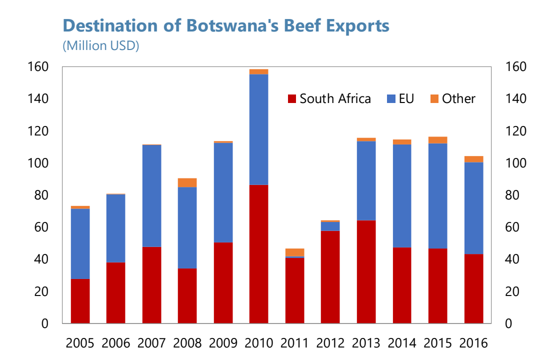


…and diversification remains low aside from temporary fluctuations in the metric.





Source: Food and Agriculture Organization of the United Nations.



Source: United Nations International Trade Statistics Database.

5. Government-induced distortions have significantly hindered the sector's development. The state-owned Botswana Meat Commission (BMC) has a monopoly on exports, pays producers below market prices, and is inefficient and unprofitable, with the government financing its losses and guaranteeing its debt. The company has three slaughterhouses that for the most part operate below 50 percent capacity, elevated production costs because it is protected from competition, and is mandated to subsidize low-quality beef producers from a region affected with foot and mouth disease (thus not suitable for EU exports). The subsidy is financed by paying below market prices to higher-quality producers, thereby discouraging production and investment. In addition, about 90 percent of the stock of cattle is held in communal farms, most of which follow traditional farming

[2] To reach this potential, the offtake rate (number of animals disposed by slaughter and sale) would need to improve to levels more consistent with commercial farming and a higher share of domestic production would need to be suitable for export to the European market (chilled) rather than sold in South Africa (frozen) or domestically consumed (domestic demand could instead be served with lower quality beef imports). For these changes to occur, bureaucratic restrictions need to be eliminated to foster private sector participation and competition in the sector.

methods with low productivity. Because BMC's price does not compensate for payment delays and additional procedures, farmers prefer to sell their cattle to local butchers.

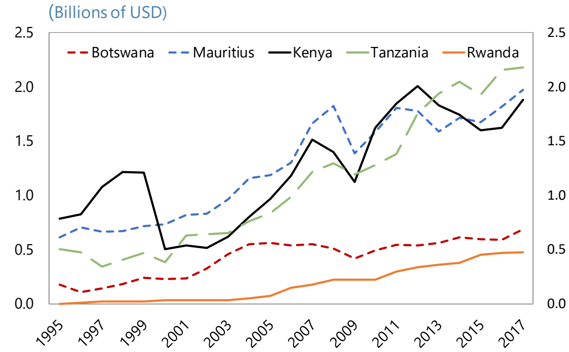
6. Swift reforms are needed to improve productivity and profitability in the sector and increase output, exports, and employment. First, BMC's export monopoly needs to be removed to allow new investments and entry to the market. Moreover, the authorities should proceed with plans to privatize BMC. Second, the current cross-subsidy between producers of cattle/beef to the EU and low-quality producers should be eliminated such that high-quality producers can receive payments which are more aligned with international prices.[3] The government might still subsidize low quality-producers (to lower the incentives for smuggling cattle from the foot and mouth disease zone), but this should be done through direct transfers from fiscal revenues. Third, the exportation of live animals should be allowed (prices for young animals are attractive in South Africa), as this would lower risks, raise profitability for domestic farmers (as weaners can be sold after 1–2 years compared to 2–3 years required to raise an animal to be slaughtered), and increase competition for BMC and other producers. Lastly, beef imports could be allowed to serve the domestic market; this could lead to a larger share of domestic production for export.

Tourism

7. The tourism sector has expanded in recent years but has a large untapped potential. Botswana's world class natural resources, coupled with its social stability and low crime rates, makes the sector internationally competitive. At present, tourism contributes about 4 percent to GDP and generates an estimated US$700 million in export earnings. However, export earnings are below those of other sub-Saharan African countries such as Kenya and Tanzania which generate over US$2 billion per year.[4] Similarly, the average number of leisure travelers to Botswana is 300,000 per year, compared to more than 900,000 for each Kenya and Tanzania each. A comprehensive and well-executed strategy for Botswana could possibly double export receipts and employment (the sector employs about 26,000 people at present). In particular, the country will need to adopt market friendly reforms to handle concessions, improve its road and communications infrastructure, and diversify its products and geographical areas for tourism.

Export Earnings, 1995-2017

(Billions of USD)



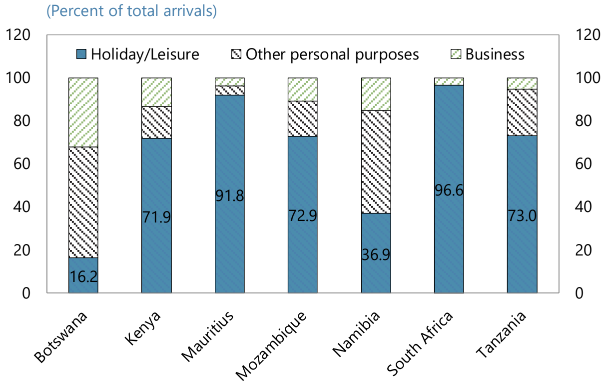
Source: World Travel and Tourism Council.

[3] The elimination of the monopoly could help if new players were not required to buy low quality beef at inflated prices.

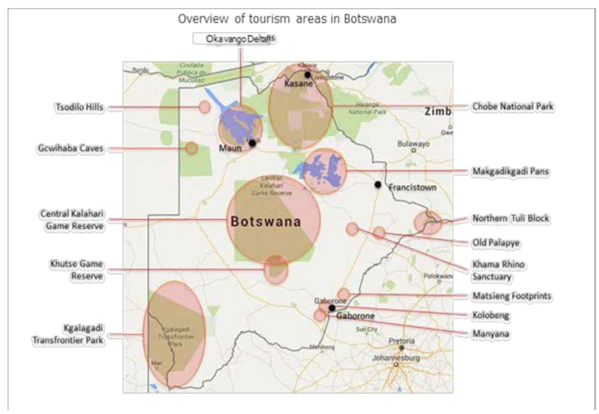
[4] This analysis relies on third party indicators which intend to provide country-level measures as consistent as possible. Nevertheless, they should be interpreted with caution due to the use of benchmarking and the limited cross-country adoption of full Tourism Satellite Accounts for estimations.

8. There is room to attract more visitors to top areas and expand on product and geographic diversification. Arrivals of tourists have been growing in recent years, yet out of 1.9 million visitors in 2016 only 16 percent were leisure travelers and most of them were from the US, UK, and Europe.[5] This is below peer countries where leisure travelers (which on average stay longer and spend more) account for over two-thirds of arrivals. So far, the sector has relied on a low volume–high value strategy that significantly limits the number of visitors, partly to protect the ecosystem. Yet this approach seems to be too rigid and broadening the focus in both existing and new areas and beyond wildlife tourism (e.g., into conference and adventure tourism) appears to offer enormous potential without compromising the environment. Producing clear estimates of costs and benefits of different tourism regions is critical. In this connection, a recent value chain study (European Union, 2015) identifies the Chobe riverfront and Okavango Delta Chobe Enclave, and Chobe National Park as areas with significant potential that could be further developed, while areas with secondary tourism potential include Tsodillo Hills, the Okavango Pan-Handle, Makgadikgadi Pans National Park, and the Central Kalahari Game Reserve.

Tourist Arrivals by Purpose, 2016
(Percent of total arrivals)



Source: United Nations World Tourism Organization.



Sources: Tourism Value Chain and analysis action plan, 2015. Government of Botswana & European Union.

9. To realize the sector's potential, supply-side limitations and bureaucratic restrictions need to be tackled. Supply-related problems (e.g., lack of skilled staff in hospitality services, and of diversified products) and challenges in obtaining tourist visas and permits were identified as critical constraints in a recent value-chain study. To unlock the sector's potential, a strategy that focuses on training, competition, the ease of regulations, and investments with positive externalities (as outlined in World Bank, 2012) is required. More specifically:

- Specialized training is needed to further build the necessary skills (e.g., business management of tourism agencies and websites, design and marketing of tours and packages, customer service);

- Bureaucratic rigidities should be replaced by a tourism-friendly environment, including by improving domestic and international road and air access and prices (e.g., fostering

[5] A large share of visitors came for business purposes (35 percent) or to visit family and friends (27 percent), mostly from Zimbabwe and South Africa.

competition in domestic and regional flights), minimizing leakages to ensure that the country captures a larger portion of the industry's value chain (for example by reviewing the licensing system for concessions and the value of leased land), and easing restrictions for work permits and visas (e.g., online visa application system, abridged booking procedures, simplified requirements for tourism facilities and services, greater information dissemination); and

- Improvements in the airport infrastructure (e.g., Maun airport) and internet connectivity will also be critical.

Financial services

10. The contribution of the financial system to the economy remains limited. Despite some deepening in the past decade, the capital market remains underdeveloped. Access to finance by the corporate sector is limited and non-bank financial intermediation has yet to become a full-fledged alternative. Despite excess liquidity in the banking system, credit to the private sector has stalled in recent years (as a share of GDP) and is low compared to peer countries (30 percent at end-2017, compared to 64 percent in Asia and 52 percent in MENA countries). Loans are concentrated on households (60 percent), which are perceived as less risky as most are civil servants. Low credit to the corporate sector stems from insufficient information on the creditworthiness of borrowers, lack of a collateral registry system to support loan contracts and financial illiteracy in segments of the population. Addressing these challenges alongside other reforms to improve the business environment would foster credit growth.

11. Given the above, improving resilience and deepening the financial system should be priorities. The initial steps to strengthening the financial sector would encompass the following areas:

- Strengthen legislation underpinning credit bureaus, set up a credit report database, and establish a collateral registry for immovable and movable assets with online access. In case of defaults, lenders should be allowed to enforce securities out of court through collateral agreements;

- Implement a macro-prudential policy function to foster the ability to analyze systemic risks including information from other regulators and undertake the necessary measures (e.g., limits on debt service-to-income ratios) covering all financial institutions, including establishing macro-prudential measures for the whole financial sector by the central bank in coordination with other regulators;

- Develop a framework and a contingency plan for responding to banking problems by revising the Bank of Botswana Act and the Banking Act, including: (i) strengthening of cross-border supervision, and (ii) accelerating the implementation of the Financial Stability Council and the Memorandum of Understanding among the BOB, the MFED, and NBFIRA regarding responsibilities for bank resolution;

- Consolidate a fragmented non-bank financial system to allow the emergence of strong financial investment companies by easing barriers between different capital market activities (securities, asset management, derivatives). Eventually, these new investment banks will develop products and lead to improved financial intermediation;

- Address the recommendations from the recent AML/CFT Mutual Evaluation carried out by the Eastern and Southern Africa Anti-Money Laundering Group; and

- Developing mobile payments could foster financial inclusion. The current cap on daily mobile payments and account balances of P4,000 is low, which, together high transaction costs, discourage payments. To improve financial inclusion, the priorities are to: (i) gradually increase this ceiling while strengthening supervision of mobile accounts; and (ii) allow inter-operability across networks and with bank accounts and other payments mechanisms, all of which would reduce cost for low-income households.

12. Over time, the authorities' goal is to create an advanced and regionally relevant financial sector. Some foundations are already there: the country has a history of political and economic stability, a well-established legal and institutional framework, and a broadly liberalized capital account. Nonetheless, making the sector internationally competitive will require removing impediments for the development of capital markets and promoting cross-border transactions. The effects would also be increased employment and possibly foreign exchange inflows. To this end, the focus should be on the following areas:

- Modernize the national payments system by implementing the new Oversight Policy Framework and addressing gaps in the prudential and supervisory framework of non-bank financial institutions;

- Improve infrastructure and connectivity. This includes increasing access and speed of electronic communications. Attention should be placed on allowing real time data from markets to be disseminated timely, having technical systems that allow orders to be electronically routed to/from overseas markets, building up network of correspondent banks and overseas branches and developing the ability to clear and settle trades carried out on foreign markets (and giving foreign firms the ability to clear and settle trades executed locally);

- Adopt the Principles for Financial Market Infrastructures published by CPSS-IOSCO; and

- Strengthen the clearing house to facilitate risk management in derivatives, net offsetting positions, and collect collateral in the event of default.

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World Bank. 2012. “Botswana Development Policy Review: An Agenda for Competitiveness and Diversification”, Report Number 73049-BW.

World Bank. 2015. Botswana - Systematic Country Diagnostic.

Appendix VII. Summary of Capacity Development Strategy (FY2018–21)

Background

1. **In recent years, Botswana experienced relatively strong rates of economic growth thanks to its diamond endowment and sound economic policies, contributing to sizable fiscal and foreign exchange savings.** However, given the volatility and exhaustibility of diamond revenues, there has been an increasing awareness of the necessity to diversify fiscal revenues and rationalize expenditures to leave space for savings in the sovereign wealth fund and/or investments in infrastructure. Apart from keeping macroeconomic stability and fiscal sustainability, the main challenges are to diversify the economy and lower unemployment and inequality through a greater role for the private sector, a well-designed set of fiscal policies, and appropriate structural reforms and sectoral strategies. This requires an enabling environment through improvements in public financial management, the public infrastructure, the business climate, and skills in the labor force. In addition, the financial sector could facilitate economic growth and inclusion through strong supervision, a macro-prudential framework, technological improvements, and measures to foster access to finance including through mobile payments.

Capacity Development Assessment

2. **Cooperation between the Fund and Botswana on technical assistance (TA) and training has been strong and covered a wide range of areas**, namely monetary policy and operations, financial supervision and regulation, central bank operations, public financial management, domestic revenue mobilization, expenditure management, and macroeconomic statistics. The authorities attach significant value to Fund TA, have showed ownership of the reform process in many areas, and have followed up on TA recommendations, albeit with delays. Results in most areas have been positive, especially on financial sector and monetary reforms. Implementation of recommendations in the areas of taxation and national accounts and fiscal statistics has been more mixed, with a slow pace owing to capacity constraints, insufficient coordination among key agencies, and at times political economy constraints. Looking ahead, IMF functional departments are expected to assess capacity constraints and calibrate the timing and scope of recommendations to address those constraints. At the same time, there is a need for strong involvement by the authorities in the areas of TA to be covered and the provision of human and financial resources to support it. The Fund stands ready to assist the authorities in this endeavor, especially through increased emphasis on training as well as invitations to participate in workshops and conferences.

Capacity Development Priorities

3. **The TA priorities listed below are consistent with the country's macroeconomic priorities.** The Fund has already delivered some assistance on the items below and further assistance is expected to be forthcoming. Other priorities identified above are beyond the Fund's expertise and are handled separately by the authorities with other experts and providers.

Priorities	Objectives
Revenue Mobilization	Strengthening the large taxpayers' unit and implement the new tax administration law. Assist on VAT and Excise tax gap analysis and possibly tax frontier analysis Review tax expenditures Support design and implementation of income tax reform
Expenditure Management	Follow-up on PIMA recommendations Consolidate progress on the medium-term fiscal framework (MTFF) Enhance risk assessment and monitoring of contingent liabilities from parastatals (including State-Owned Enterprises) Update the PPP legal framework and the authorities' capacity to manage associated risks Enhance fiscal reporting and accounting and implement the new chart of accounts
Financial Stability and Supervision	Develop stress-testing capacity Implement risk-based supervision for nonbanks Develop macroprudential framework Strengthen financial stability assessment and reporting Reinforce crisis preparedness (particularly, the resolution framework) Implement BASEL III Strengthen reserves management and monetary policy implementation
Monetary Policy Operations	Modernize liquidity management Develop the FPAS Enhance monetary policy communication Update the National Payments Law
Compilation and Dissemination of Statistics	Improve the quality of fiscal statistics (especially the classification of current and capital expenditures and public debt statistics). Complete the migration to GFSM 2014 and extend the coverage to general government Enhance the compilation of national accounts and migrate to 2008 SNA Compile a producer price index and assist in the implementation of further improvements to the consumer price index Expand coverage of monetary and financial statistics to include other financial corporations (e.g. pension funds and insurance corporations) Improve the coverage and accuracy of External Sector Statistics and the compilation of quarterly BOP and IIP data

Authorities' Views

4. **The authorities largely agreed with the priorities enumerated above and are appreciative of Fund support.** They intend to cooperate actively with the Fund regarding requests, terms of reference for TA activities, participation in training, more involvement in prioritizing activities and their timing, deploying the necessary human resources to ensure traction, and monitoring the implementation of recommendations. From the areas listed above, the authorities are not yet sure they will need or request assistance from the Fund on tax policy. In the other areas, they plan to continue engaging AFRITAC South and IMF's functional departments in the period ahead.

INTERNATIONAL MONETARY FUND

BOTSWANA

August 16, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | The African Department in Consultation with the Statistics Department

CONTENTS

RELATIONS WITH THE FUND

As of June 30, 2018

Membership Status: Joined July 24, 1968; Article VIII

General resources account	SDR (million)	Percent of Quota
Quota	197.20	100.0
Fund holdings of currency	169.44	85.92
Reserve position in Fund	27.77	14.08

SDR Department	SDR (million)	Percent of Quota
Net cumulative allocation	57.43	100.0
Holdings	58.70	102.22

Outstanding Purchases and Loans	None
Financial Arrangements	None
Project Obligations to Fund	None
Implementation of HIPC Initiative	Not Applicable
Implementation of Multilateral Debt Relief Initiative	Not Applicable
Implementation of Catastrophe Containment and Relief	Not Applicable

Exchange Rate Arrangement

The exchange rate of the Botswana Pula is a crawling peg arrangement against a basket of currencies comprising the SRD and the South African Rand. As of June 29, 2018, the exchange rate of the U.S. dollar to the Pula was US$1= P10.39, and that of the South African rand to the Pula was R1=P0.76.

As of November 17, 1995, Botswana accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement. The country maintains an exchange rate system free of restrictions in the making of transfers and payments of current account transactions.

Article IV consultation

Botswana is on a standard 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on July 28, 2017.

IMF Technical Assistance and Workshops: May 2017-June 2018

Department	Dates	Purpose
Fiscal Affairs Department	May 17	AFRITAC South: Regional Harmonization
	May-Jun 17	AFRITAC South: Establishment of industry based segments & capacity
	May 17	AFRITAC South: The Development of State-Owned Enterprise Performance Monitoring System
	May-Jun 17	AFRITAC South: Prepare a fiscal risks statements as part of the Budget Options Paper
	Jun 17	AFRITAC South: Develop a risk management framework and provide guidance on its implementation
	Jul 17	AFRITAC South: Strengthening the Risk Management Program
	Jul 17	AFRITAC South: Prepare a fiscal risks statements as part of the Budget Options Paper
	Oct 17	AFRITAC South: Participation in the STA/AFRITAC South mission on Chart of Accounts
	Oct 17	AFRITAC South: GFS/PFM TA on Unified budget and accounting classification mission
	Nov 17	AFRITAC South: Assist Botswana Unified Revenue Service (BURS) in improving VAT compliance
	Dec 17	AFRITAC South: Compliance Risk Management Program (CRM) Follow up Mission
	Dec 17	AFRITAC South: Joint BURS CRM Tax & Customs
	Dec 17	AFRITAC South: CRM Follow up Mission
	Dec 17	AFRITAC South: Joint BURS CRM Tax & Customs
	Jan 18	AFRITAC South: FAD joint Customs and Tax strategy setting mission
	Mar 18	AFRITAC South: PFM Skills Audit
	May 18	AFRITAC South: Regional SEM on strengthening the Adm. & Excises (Offsite)
	Jun 18	AFRITAC South Regional PFM Advisor
Legal Department	Jun 17	Fiscal Law: Follow-up Mission--Income Tax, VAT and Tax Procedures (with AFRITAC South)
	Oct 17	Fiscal Law (Follow Up Mission - Tax Administration, VAT and Income Taxation)
	Nov 17	Regional Workshop on Legal Aspects of the National Payment System
	Apr 17	Financial Markets Law: Payments Regulations (Work at Home)
Monetary and Capital Markets Department	May 17	Macroprudential Policy
	Jun 17	Effective Macroprudential Framework set-up
	Jun 17	AFRITAC South: National Payment System Development
	Jun 17	Macroprudential Policy and Financial Stability
	Jul 2017	AFRITAC South: Liquidity Management
	Jul-Aug 17	Insurance Supervision
	Aug 17	Systemic Risk and Financial Stability
	Aug 17	Liquidity Management (joint with AFRITAC South)
	Aug 17	AFRITAC South: Liquidity Management
	Aug 17	AFRITAC South: Central Bank Communication
	Jan 18	Macroprudential Policy and Financial Stability
	Mar 18	AFRITAC South: Implementation of Pillar 2
Statistics Department	Oct 17	Government Finance Statistics (EDDI2)
	Nov 17	Monetary Data Reporting (EDDI2)
	Apr 18	AFRITAC South: Consumer Prices/Producer Price
	Jun 18	Balance of Payments Statistics

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General. Data provision has some shortcomings in national accounts, fiscal, monetary, and external sector statistics, but is broadly adequate for surveillance.
National Accounts: In October 2012, Statistics Botswana (SB) updated the base year of GDP to 2006 and, in 2015, revised the national accounts to include new mines. Areas for further improvements include the coverage of national accounts surveys and the estimation of GDP deflators. TA is provided by the African Development Bank.
Price Statistics. The monthly consumer price index (CPI) is available on a timely manner on the SB's website. The index is comprehensive and provides breakdowns between urban and rural price data and between prices of tradable and non-tradable goods and services. A re-based CPI was first published in October 2016 with an index reference period of September 2016. The weights are derived from the 2009/10 Botswana Core Welfare Indicator Survey. A Multi-Topic Household Survey was conducted during 2015-16. The Survey will support the upcoming re-basing of the CPI expected in early 2019. Compilation challenges include the eventual inclusion of owner-occupied housing costs in the CPI. The development of producer prices is being assisted by AFRITAC South but progress has been slow.
Government Finance Statistics (GFS). The Ministry of Finance and Economic Development compiles cash-based quarterly and annual budgetary central government data following the *Government Finance Statistics Manual 2014*. No balance sheet data or expenditure by classification of functions of government are compiled, and no data are compiled for extrabudgetary institutions, consolidated central government, or consolidated general government. Data quality improvements for the budgetary central government require a breakdown of transfers expense to distinguish grants, subsidies, social benefits, and other expense; and between current and capital outlays in the development budget. The authorities are working on improving data quality and coverage with the development of a revised chart of accounts; they are also expected to broaden the scope of GFS to include local governments and extrabudgetary units.
Monetary and Financial Statistics (MFS). The Bank of Botswana (BoB) compiles MFS data using standardized report forms consistent with the *Monetary and Financial Statistics Manual*. The data currently covers the accounts of the central bank and other depository corporations. The BoB is seeking to expand the coverage of MFS to include the operations of other financial corporations such as pension funds, insurance companies, and non-money market funds.
Financial Sector Surveillance. The BoB compiles and reports to STA quarterly data on financial soundness indicators, which include 12 core and 11 encouraged indicators for deposit-takers.
External Sector Statistics. Annual balance of payments (BOP) data with a quarterly breakdown is published in the Botswana Financial Statistics and the BoB's Annual Report in an aggregated

format. Preliminary balance of payments data is disseminated within two months of the end of the reporting period, while revised (final) data becomes available after nine months. The BoB also compiles and disseminates the annual international investment position (IIP), with quarterly IIP data produced for internal use only.

The concepts, structure, and definitions of the BOP and IIP statistics follow the fifth *Balance of Payments Statistics Manual* (BPM5). Source data are broadly adequate, but the International Transaction Reporting System (ITRS) data—as opposed to alternative annual balance of payments survey on financial account items—is unreliable. Data compilation, estimation, and adjustments mostly employ sound techniques, but the methods used for estimating missing data (for example, unrecorded trade), f.o.b. /c.i.f. adjustment factors to import values, and flows from stock data are inadequate. Following the relocation to Botswana of De Beers' London sale operations in 2012, the challenges associated with the valuation of exported diamonds have been eliminated.

The main causes for large errors and omissions are the under coverage of imports and exports of services, as well as dividends paid by companies in the diamond industry; under coverage of investment abroad, both in equity capital and debt securities, of some public and private entities; and under coverage of Botswana's contribution to Southern African Customs Union (SACU) pool.

II. Data Standards and Quality

Botswana has implemented the recommendations of the Enhanced General Data Dissemination System (e-GDDS). It disseminates fourteen of the fifteen data categories defined in Table 1 on its National Summary Data Page (NSDP). Periodicity and timeliness of data dissemination on the NSDP are largely in accordance with Botswana's metadata—albeit with some shortcomings, especially for the timeliness of central government gross debt. Botswana should continue building capacity to disseminate data on general government operations and external debt. Areas for improvement include timeliness and periodicity of central government gross debt and BOP data. Its data ROSC was published on March 27, 2007.

III. Reporting to the IMF's Statistics Department

The BoB reports monetary data for publication in *International Financial Statistics* using *Standardized Report Forms* and quarterly FSIs for deposit-takers and real estate markets. Annual balance of payments and IIP data are reported to STA. The Ministry of Finance reports cash-based budgetary central government data on an annual basis to the IMF's *Government Finance Statistics Yearbook*.

Table 1. Botswana: Table of Common Indicators Required for Surveillance

(As of June 30, 2018)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange rates	Jun/2018	7/1/2018	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[2]	Jun/2018	7/12/2018	M	M	M
Reserve/base money	Jun/2018	7/12/2018	M	M	M
Broad money	Apr/2018	6/12/2018	M	M	M
Central bank balance sheet	Apr/2018	6/12/2018	M	M	M
Consolidated balance sheet of the banking system	May/2018	7/12/2018	M	M	M
Interest rates[3]	May/2018	6/13/2018	M	M	M
Consumer price index	May/2018	6/14/2018	M	M	M
Revenue, expenditure, balance, and composition of financing[4]—general government[5]	NA	NA			
Revenue, expenditure, balance, and composition of financing[4]—budgetary central government	Feb 2018	May 2018	A/Q/M	Q	Q
Stocks of central government and central government-guaranteed debt[6]	2017Q4	May 2018	Q	Q	Q
External current account balance	2017	6/15/2018	A/Q	A	A
Exports and imports of goods	Dec/2017	Jun 2018	M	M	M
GDP/GNP	2018Q1	June 2018	A/Q	A/Q	A/Q
Gross external debt	2017Q4	June 2018	A/Q	A	A

[1] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I), and not available (NA).

[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[3] Both market-based and officially determined, including discount, money market, treasury bill, notes, and bond rates.

[4] Foreign, domestic banks, and domestic nonbank financing.

[5] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[6] Including currency and maturity composition.

Statement by Mr. Maxwell Mkwezalamba, Mr.Abdulqafar Abdullahi, and Mr. Willie Nakunyada on Botswana
August 31, 2018

A. Introduction

1. **Our Botswana authorities appreciate the constructive dialogue with staff during the recent Article IV mission, and broadly concur with key policy recommendations.** The authorities' steadfast commitment to implementing prudent macroeconomic policies has helped establish a track record of strong growth. Reflecting sustained macroeconomic stability and sound governance practices, Botswana remains one of Africa's success stories. This notwithstanding, the country remains vulnerable to commodity price shocks. Against this background, the authorities are making determined efforts to promote economic diversification and private sector development, while creating a conducive environment for employment opportunities and reducing income inequalities, consistent with the Eleventh National Development Plan (NDP11). In parallel, the new administration remains committed to the accelerated implementation of structural reforms. In this context, despite the current political transitional phase, work is underway to concretize key steps and timelines.

B. Recent Economic Developments and Outlook

2. **Economic activity is projected to rebound from 2.4 percent in 2017 to 4.6 percent in 2018.** The recovery in economic activity was largely underpinned by a cyclical recovery in diamond demand and production, and growth in non-mining production, which benefitted from countercyclical fiscal policy and accommodative monetary policy measures. Looking ahead, growth is expected to slightly moderate on the back of the slower rate of capital accumulation in both the mining and non-mining sectors. That said, the successful execution of planned public investment projects, as well as reforms to improve the business climate and attract foreign capital, are expected to support sustained growth in the near to medium-term. Further, firming diamond demand from the US, China, and India, as well as improved power supply, are expected to strengthen growth prospects.

[1] The NDP is a medium-term plan towards the implementation of the country's second Vision 2036. The NDP 11 runs from April 2017 to March 2023.

3. **Inflationary pressures remain contained by subdued aggregate demand attributed to a modest growth in household incomes and moderate increases in credit growth, as well as stabilization of imported inflation.** Consequently, inflation has stabilized close to the lower end of the medium-term objective range of 3–6 percent since 2017. The Bank of Botswana (BoB), however, stands ready to make appropriate monetary policy adjustments should inflationary pressures materialize. Meanwhile, public debt remains sustainably low at 19 percent of GDP, while current account surpluses are expected to persist into the medium-term, mainly driven by rising diamond exports. As a result, the country is projected to maintain ample foreign exchange reserve buffers.

C. Fiscal Policy

4. **The authorities remain determined to improve domestic revenue mobilization through intensified efforts to diversify fiscal revenue sources and broaden the tax base.** Specifically, efforts by the Botswana Unified Revenue Service (BURS) to improve tax administration and strengthen capacity in the Large Tax Payers Unit are expected to generate additional revenue gains. Further, the adoption of a Debt Management Strategy for tax arrears by BURS is expected to bear positive results. Moreover, the authorities have drafted the VAT and Income Tax Bills, as well as the Transfer Pricing Regulation Bill. Parliamentary approval for these Bills is expected in the current FY2018/19. Ultimately, the authorities aim to achieve a balanced budget and eventually return to surpluses within the period of the NDP11.

5. **Prudent management of expenditures by strict adherence to the fiscal rules as outlined in the NDP11 remains central to the authorities' efforts to control spending**. In this context, the authorities have prioritized investment and social expenditures, and aligned budgetary allocations with the implementation capacity of line ministries. At the same time, the authorities are working on the modalities to better target social transfer programs, eliminate overlaps, and improve equity.

6. **To rationalize expenditures, the authorities are making sustained efforts to implement Public Financial Management (PFM) reforms, with special focus on strengthening the Medium-Term Expenditure Framework (MTEF) and implementing the new chart of accounts**. In this regard, work on the integration of the special funds to improve governance and mitigate potential losses has progressed, with the bulk of the special accounts already migrated to the BoB. Progress has also been made in strengthening project planning, appraisal, and monitoring, consistent with the findings of the recent Public Investment Management Assessment (PIMA). Going forward, further technical assistance from the IMF and the World Bank is expected to help overcome attendant capacity shortfalls that have slowed the pace of PFM reforms.

D. Financial Sector Policies

7. **The financial sector remains profitable, liquid, and compliant with regulatory and prudential requirements**. This notwithstanding, loss of employment attributed to the

closure of the Bamangwato Concessions Limited (BCL) nickel and copper mine in the last quarter of 2016 and the expected restructuring of parastatals have elevated credit risks. Despite the resultant deterioration of non-performing loans (NPLs) from 4.9 percent in 2016 to 5.3 percent in 2017, the banking sector remains adequately capitalized. Looking ahead, the authorities are optimistic that the on-going work to finalize the new regulation guiding information gathering by credit bureaus would help banks strengthen credit assessments and improve asset quality.

8. **The authorities remain committed to preserving the integrity and the credibility of the financial sector**. To this end, the Financial Intelligence Agency (FIA) is advancing efforts to strengthen institutional capacity and address shortfalls in the anti-money laundering and combating the financing of terrorism (AML/CFT) framework, in line with the recommendations of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG)[2]. In addition, the authorities have made strides in implementing relevant aspects of Basel III, particularly with respect to the treatment of capital. At the same time, they have established the Financial Stability Council (FSC)[3] to improve information sharing and strengthen coordination of efforts to supervise both banks and non-bank financial institutions (NBFIs). Furthermore, the authorities are finalizing reviews of the BoB Act to strengthen central bank governance, and the Banking Act to support modernization, including development of a crisis resolution framework. In parallel, leveraging Fund TA, the Non-Bank Financial Institutions Regulatory Authority (NBFIRA) is expected to intensify current efforts to adopt a risk-based supervisory approach.

9. **The authorities acknowledge the need to deepen financial markets to help reverse portfolio investment outflows and promote interbank market activity.** That said, the volume and frequency of bond issuances remain conditioned on government's financing requirements and the need to preserve debt sustainability. In addition, the authorities are carefully balancing the key objectives of increasing levels of market activity for government securities, with the need to mitigate potential crowding-out effects.

E. Structural Reforms

10. **The accelerated implementation of structural reforms ranks highly in the authorities' efforts to promote economic diversification, create employment, and raise the country's growth potential.** In the context of the Economic Diversification Drive (EDD), they intend to establish hubs, clusters, and economic zones to support diversification in prioritized sectors, including beef, tourism, financial services, mining, and diamond beneficiation. The cluster development initiative is expected to transform Small and Micro-Sized Enterprises into new engines of growth. Further, the authorities recognize the potential of the tourism sector in contributing to economic diversification and job creation. They have, therefore, adopted a strategy to preserve lucrative high-value low-volume tourist sites in the

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[2] The Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) is an intergovernmental organization that is a Financial Action Task Force (FATF) Style Regional Body (FSRB).

[3] The Financial Stability Council comprises the Ministry of Finance and Economic Development (MFED), the Bank of Botswana (BoB), the Non-Bank Financial Institutions Regulatory Authority (NBFIRA), and the Financial Intelligence Agency (FIA).

Okavango Delta and Chobe region, while ensuring environmental sustainability to retain World Heritage Status. That said, they are also pressing ahead with efforts to extend tourism products to other regions, notably areas surrounding the diamond mining fields, the broader Kalahari, and numerous agri-tourism sites.

11. **The authorities are prioritizing privatization and commercialization of loss-making parastatals.** In this regard, the Public Enterprises Evaluation and Privatization Agency (PEEPA)[4], has already identified public sector entities with scope for privatization and commercialization, as well as those with potential for merging. Government has also taken a bold decision to privatize the Botswana Meat Commission (BMC) and deregulate the beef sector to allow private sector participation. In parallel, a dedicated Public Private Partnership (PPP) unit was established within the Ministry of Finance and Economic Development (MFED) to promote private sector participation in key development projects. Relatedly, the regulatory framework for PPPs has been finalized and broadened to cover parastatals and local authorities. To date, 16 PPP projects have been identified, and feasibility studies have been completed for 10 projects and assessed to proceed to the next phase.

12. **To bridge existing skills mismatches, the Human Resources Development Council (HRDC) is facilitating engagement between industry and education and training providers.** Against this background, internships, industrial attachment, and management trainee programs are gathering momentum to improve education outcomes in line with industrial requirements. In tandem, education providers are making efforts to adjust their curricula to offer courses that empower graduates with skills required by industry. The authorities have also committed to change the immigration laws and relax visa requirements to allow importation of specialized skills that are essential to improve productivity and catalyze knowledge transfer.

13. **Strengthening the business environment remains important among the country's policy priorities**. Towards this end, the authorities are undertaking several regulatory reforms aimed at improving the ease of doing business. In this regard, they have adopted additional reforms under the Doing Business Reforms Roadmap, including improving electronic filing and payment of taxes, and establishing an online customs management system and the One Stop Centre (OSC) at the Botswana Investment and Trade Centre (BITC) in 2017. The OSC will reduce the turn-round time in registering new businesses. In addition, a Regulatory Impact Assessment Strategy was adopted in 2017 to reduce the administrative burden and improve investor confidence.

F. Conclusion

14. Our Botswana authorities remain committed to accelerating implementation of economic reforms to unleash the country's growth potential. Towards this end, they continue to sustain the implementation of prudent macroeconomic policies and sound governance practices, which have supported inclusive growth and narrowed income inequalities. The renewed commitment by the new administration to decisively implement bold measures is

[4] The Public Enterprises Evaluation and Privatization Agency (PEEPA) was established to play an oversight role on parastatals.

expected to provide strong impetus to the economic reform agenda and aid the country’s efforts to graduate from upper middle to high income status. In this context, they look forward to continued Fund engagement and further technical assistance to help advance their reform agenda.