BOTSWANA SOCIETY PUBLIC FORUM SERIES

Whither the Botswana Economy? Trends and Choices for the Coming Decades

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Introduction

Ladies and Gentlemen, Distinguished Guests, Friends and Colleagues, Good Evening

A month or two back, the Botswana Society approached me with a request to kick-off a new public forum series with a presentation on what the Botswana economy might look like in 2030, given national policies and in the context of regional and international developments. This was quite a challenge. Of course, as an economist, one is often called upon to make forecasts, but these usually only cover a period of 12 months or so ahead. Further than that and it just becomes a guessing game or crystal ball gazing. About the only thing that one can be sure of when projecting years or decades into the future, is that the projection will be wrong. On reflection, however, I decided that this would be an interesting challenge, not so much because of the difficulties of making meaningful projections, but more because in many respects Botswana is at a turning point. This turning point poses difficult choices, and the decisions and choices made now and in the coming years will influence the future of the country for decades to come. So I decided to approach the task from the perspective of these choices, and to consider possible future paths for the economy, and the country, depending on how these choices are addressed. As you will hear, the road ahead may well be a tough one, perhaps less comfortable – and certainly different - than the one that we have travelled over the past decades. But I do not want to suggest that the future is particularly gloomy; rather, that by building on the successes and policy choices that we have exercised in the past, and applying them to a new situation, we can create a future that will be exciting, dynamic and successful, and preserves Botswana's reputation as a country that makes well thought out, evidence-based, and analytically sound decisions in an uncertain environment, and builds the institutions to support the implementation of those decisions.

Where Are We Now?

Let us start by mapping out the current economic situation and recalling, briefly, how we got to where we are. As is well known, over the past four decades, Botswana has experienced a long period of rapid economic growth with generally rising incomes and living standards. During this time the country has built up an enviable reputation with regard to governance, economic policy making, and political stability. This growth has been largely based on the

exploitation of minerals, notably diamonds, as Botswana achieved the status of the largest diamond producer, by value, in the world.

Not all mineral producing countries have done as well for themselves as Botswana has. The agreement with De Beers for the distribution of diamond revenues has been quite favourable, enabling the country to retain the lion's share of diamond revenues and apply them to development challenges. Through the application of astute negotiating skills and the judicious leverage of well-founded negotiating positions, the country has managed to secure revenue distribution formula that retains 81% of diamond profits for the Government, leaving just 19% for De Beers. Through these revenues, the government provides the main link between the diamond industry and the economy and population at large. The result has been widespread investment in infrastructure and the dramatic enhancement of physical, social, economic and human resources. It has also accumulated substantial financial resources. One result has been a very large government, which is now the second largest sector of the economy after mining, and employing about 40% of the formally employed labour force.

While there is much to be proud of, one should not pretend that everything about this experience has been positive. Despite government channelling diamond resources into public sector employment, the overall unemployment rate in Botswana – not well measured, but probably around 25-30% of the labour force – remains very high. Poverty has been declining – although again the data are poor – but is also high for a country classified as "middle income" in global terms. And income distribution is very unequal, with the richest 20% of households earning around 70% of total household income. Whatever policies we follow in the future must address not just growth issues, but equity and employment creation as well.

Where are we going?

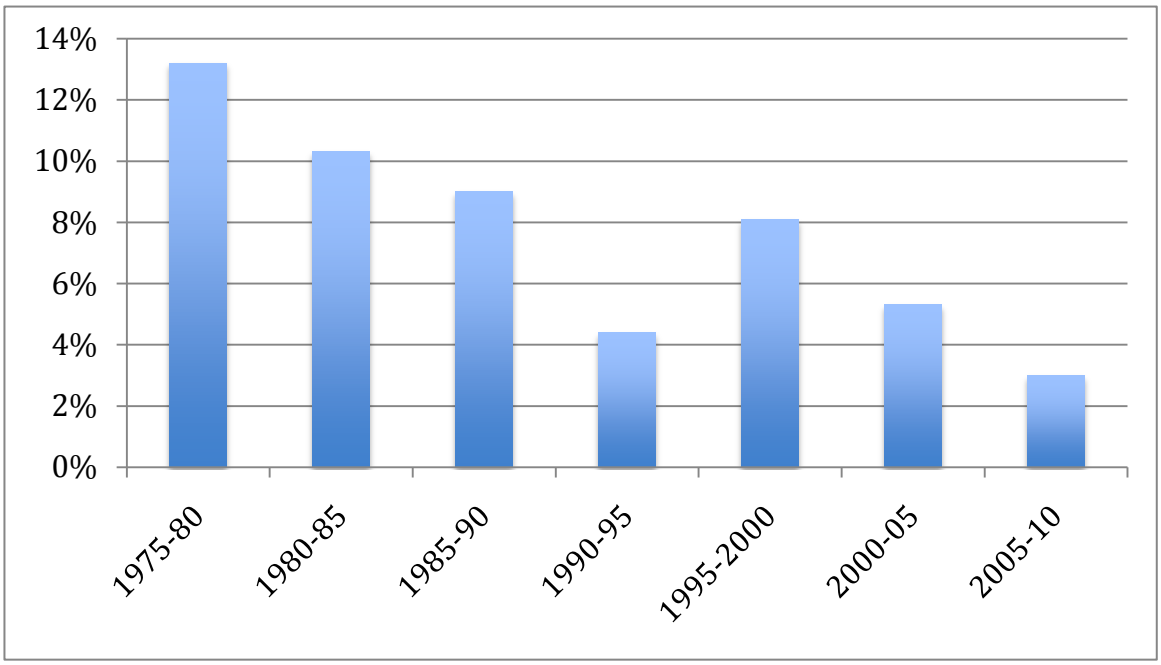
Botswana's future is likely to be very different to the past. In fact, the present is already different to the past. Over the past two to three years, Botswana has been buffeted by the harsh winds of the global economy; the global financial crisis, followed by a global economic crisis, has affected the country in many ways. Our diamond exports were badly affected, as were government revenues; we have large budget deficits and balance of payment deficits; foreign exchange reserves and government savings are falling, and for the first time we have been borrowing and building up foreign debt.

But it is not the impact of the global financial and economic crisis that I am particularly going to talk about. In some ways the impact was a foretaste of things to come. When the diamond industry had to shut down completely for several months in 2008-9, it gave a foretaste of what life might be like in 2030, or thereabouts, when the big and rich diamond deposits at Jwaneng, Orapa and Letlhakane are finally exhausted, or nearly so. Clearly, unless things change a great deal, life will be very uncomfortable – without diamonds, the economy cannot generate anything like enough income to maintain the living standards to which Botswana and Batswana have become accustomed.

But the problems that need to be addressed are not the result of the global crisis – nor will they disappear as the world economy recovers. Our growth rate has been declining over a

long period of time – the era when Botswana was one of the fastest growing economies in the world is long over.

Figure 1: Economic Growth, 5-year averages

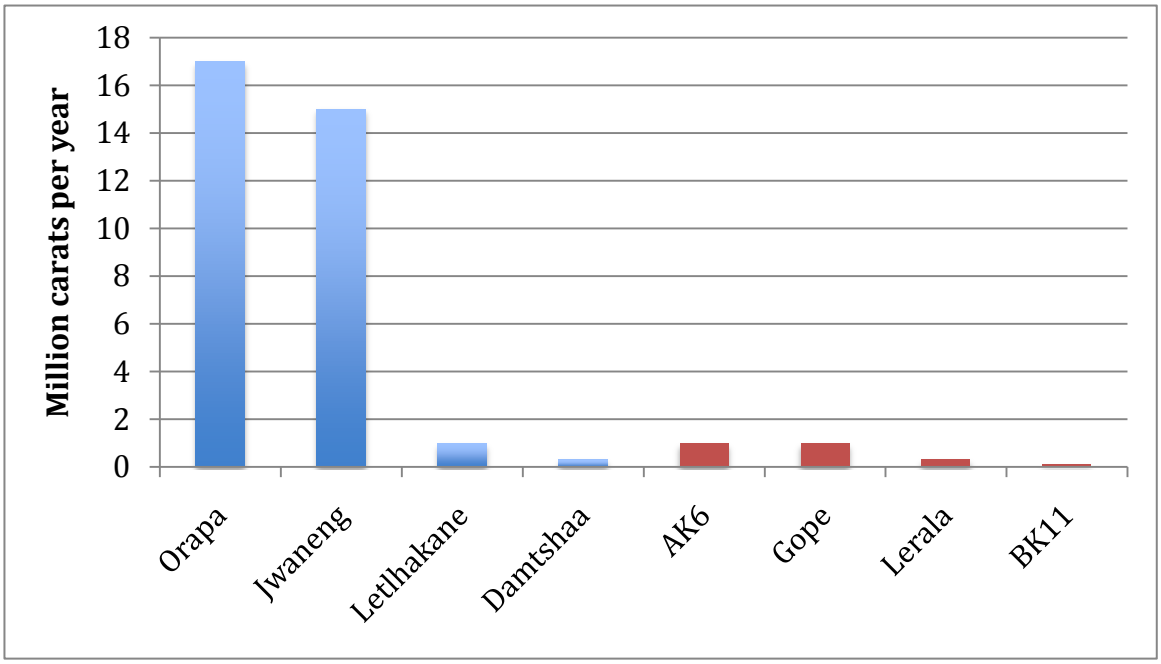


Source: Econsult, based on data from the CSO

The point is that diamonds have been the basis for Botswana's economy, growth and living standards for the past 40 years or so, but will do so less and less into the future. On current estimates, the main diamond deposits will be largely exhausted between 2025 and 2030. Production may be sustained for a while longer by going underground, but this will involve much higher production costs and much lower production levels, and will not be the industry that we have come to know and love, financially.

There may of course be new diamond discoveries between now and that future date. Prospecting is proceeding apace, and who knows what will be found. But the likelihood is that future discoveries will be relatively small. There have been no discoveries of diamond deposits comparable to the size of Jwaneng anywhere in the world since Jwaneng was found. Within Botswana, the AK6 mine, which is due to start production later this year, has total reserves estimated at around 12 million carats, and will produce 1 million carats a year. Debswana, when in full production, can produce 34 million carats a year. So for AK6, annual production will be equivalent to only 3% of Debswana's production. So it is hardly a replacement. Gope in the CKGR, due to open in 2012, is of a similar size. In fact one of the largest known diamond deposits in Botswana is the Jwaneng waste dump, which has similar reserves to AK6 and Gope. The Lerala mine, in the Tuli Block, and Firestone's BK11 mine, near Orapa, both have capacity much below this size. We may be lucky, and strike another massive pipe of the size of Jwaneng or Orapa. But we have to plan on the basis of what we know, which is that diamond production, as we know it, will come to an end within less than a generation. This situation, which we have to face head on, is not the result of the global crisis. In fact diamond production had peaked even before the crisis, and the diamond sector has not been driving growth for some time.

Figure 2: Diamond Mines, Annual Production Capacity



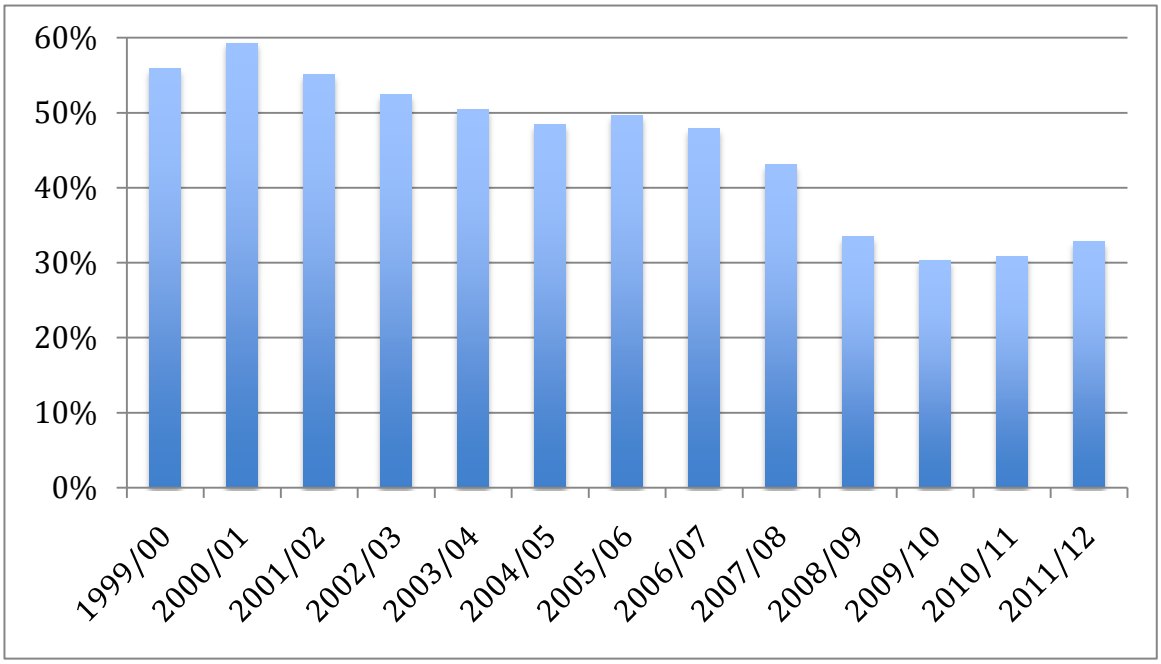
Source: Diamond company websites

This has a number of implications, none of which will be particularly new to you, but which bear repeating. First, we have to identify new sources of economic growth – the long sought-after "diversification" of the economy. Second, government has to get smaller. What is sometimes not understood is that this has to happen <u>even if diversification is successful</u>. Let me illustrate why.

Smaller Government

A large part of government revenues are derived from the diamond industry, but these revenues have been declining for many years, in terms of their overall contribution.

Figure 3: Mineral Revenues as share of Total Government Revenues



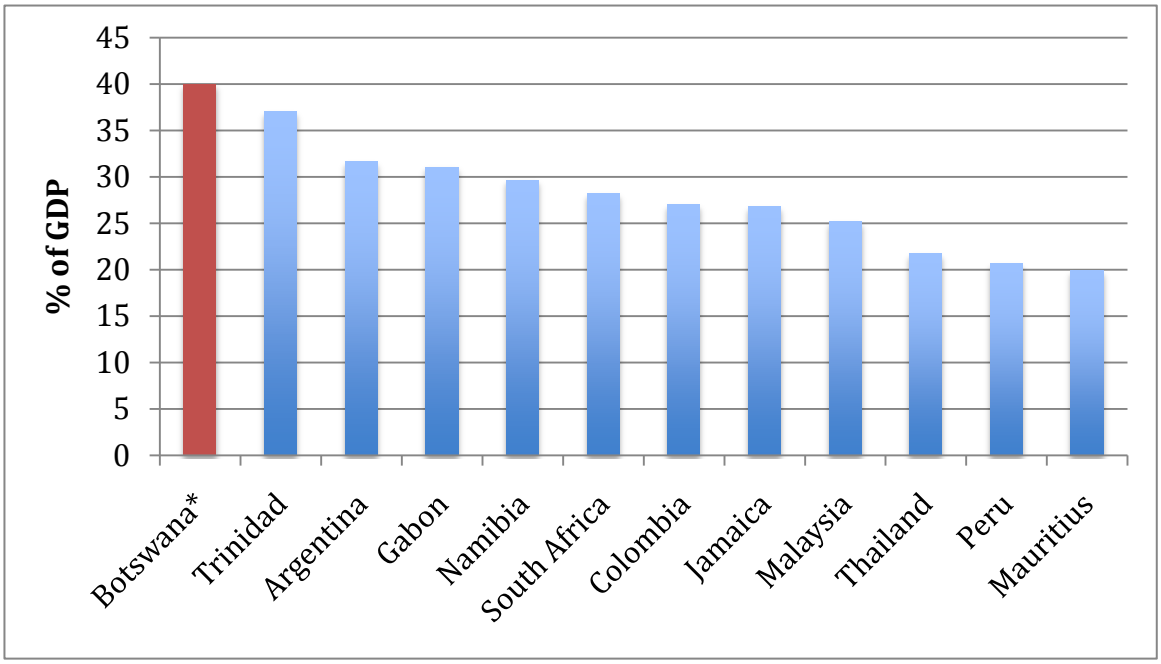
Source: Econsult, based on data from Ministry of Finance and Development Planning

The diamond mining industry, in Botswana, has three very special characteristics. First, it is very large. Second, it is very profitable, and third, it is taxed at a very high rate. Now, as diamonds run out, we might be lucky enough to establish a new industry that becomes equally as large – coal for instance, as we have very large coal deposits – although turning them into a marketable commodity on a large scale has its own challenges. But it is virtually certain that government will earn nothing like the revenues from coal that it will earn from diamonds, because something that makes 80% profit that is in turn taxed at 80% will be replaced by something that makes 30% profit and is taxed, if we are lucky, at 30% - in which case government revenues would fall from 64% of the value of the output to 9%. The implications for government revenues, as a proportion of GDP, are clear – and massive.

Government will therefore have to get smaller, relative to the size of the economy, but how much smaller? The "fiscal rule" set out in NDP9 said that government spending should, on average not exceed 40% of GDP. Even that was ambitious, as government revenues have generally been below 40% GDP since the late 1990s. With the expansion of government during the crisis, spending reached 45% of GDP in 2009/10.

But what about a more typical middle-income country, that does not have a particularly profitable mineral resource? Government revenues might typically be around 25-30% of GDP, although in one of our comparable SADC neighbours – Mauritius – it is as low as 20% of GDP.

Figure 4: Government Revenues as % of GDP - Selected Middle Income Countries



Source: Econsult; IMF

Even if we move to the upper end of this range, it means that government spending has to shrink from 40% to 30% of GDP – in other words government has to shrink by around one quarter, relative to the size of the economy, from its present position. This has many implications:

- government has to become more efficient, achieving "more with less";
- government spending available for development projects will be much reduced, so we really have to focus on choosing projects that have maximum impact – hopefully achieving an economic payback for the money invested;
- government will no longer be able to lead the economy through its spending and procurement policies, by injecting aggregate demand, but will have to lead the economy through appropriate policies and the environment it creates;
- the government salary bill is too large – at around 11-12% of GDP – and it has to be trimmed to be sustainable; which ultimately means a reduction in the ability of government to act as "employer of last resort";
- government will have to make use of privatisation, contracting out and PPPs to help improve efficiency and stimulate the private sector;
- ultimately, however, government just does too much, and will have to look for savings simply by deciding to close down low priority/low payback areas of activity – I am sure we can all think of things that government does that could disappear without the country being any worse off;
- we also have to wean the private sector off of its dependence on government – public procurement may be easy business at present, but does not encourage efficiency or long-term sustainability.

A recent Public Expenditure Review carried out by the World Bank gave extensive recommendations for reforms to the government budgeting system that would deal with many of these issues. But some of the changes are radical: giving up some of the fundamental – but outdated – tenets of the national Development Planning system, for instance. But at least a very clear roadmap exists that can be followed to chart a course through these difficult changes.

Diversification – New Activities

Equally important as the question of the size of government is the question of what are the economic activities that will take the place of diamonds when the latter run out or run down? Without such new activities, to be sure, living standards in Botswana will drop sharply. It is not my intention tonight to go into detail about the type of economic activities that may thrive in Botswana in future, although I will make some general comments. What is more important, I believe, is to identify the conditions that will encourage the emergence of sustainable new economic activities, and how one goes about creating an environment where such new activities can flourish.

The most important question to address is, what will be the source of demand for goods and services produced in Botswana? Who will provide the market? Over the past forty years the main sources of demand have been foreign purchasers of our diamonds, and the Botswana government. Other sources, such as domestic non-government consumers and foreign consumers of goods and services other than diamonds, have been less important. But as the traditional sources fade, these other sources will become more important. In a small economy, there is a limit to how far domestic consumers can provide the engine for growth. Suppliers of goods and services who wish to grow, and who focus on the domestic market, will soon find that they reach the limit of market size, at which point growth will slow. Yes, there is scope to reduce imports and to produce some such goods and services domestically, but once this is done, then what? In a small market, there is limited potential to achieve economies of scale, and too often domestic production is simply too small to be carried out efficiently. In the long run, sustained growth depends on the ability to produce for external markets, i.e., to export. The potential for growth that is opened up by successful export sales is virtually unlimited.

This should be an obvious lesson for Botswana – our whole growth success has been export-led. Exports have underpinned rising living standards. On one level, the challenge is simple: replace diamond exports with exports of other goods and services. But on another level, it is not so easy. Diamonds in Botswana are an exceptional commodity: with very large and rich deposits and low production costs, and control over the world's largest diamond deposits, we didn't have to worry too much about being competitive – nature made us competitive. There are a few other examples in the country with similar characteristics etc. – there is only one Okavango Delta for instance – but these are few and far between. Even other minerals are not like diamonds, with often low grade deposits that are expensive to mine or transport.

For virtually all other goods and services, competitiveness is the key to export success. That means we <u>do</u> have to worry about being competitive, and ensure that our costs of production do not make us uncompetitive in export markets.

This, then is the first of the key choices that we face. As the end of the diamond mining era approaches, are we going to turn inwards, or are we going to face outwards, and embrace the opportunities offered by globalisation? Are we going to focus on protectionism – shielding ourselves from international competition – or are going to pursue a future whereby we can take on, and beat, that international competition on the regional and global stage? Are going to take a "closed borders" or an "open borders" approach?

While I present this as a choice, to my mind the answer is obvious. The lessons of historical experience make the decision an easy one, at least in principle. I think it is fair to say that there is no example of a country that has grown sustainably over a long period without that growth being export-led. It is sometimes thought that large countries have the luxury of a choice between inward and outward looking approaches, given the size of their domestic markets. But this is a false choice. Even China and India, the largest countries in the world by population, have realised that an export-led approach is essential, and have boomed since they made the switch.

What can we Export?

Some of you may be thinking, well, what on earth can we export, besides diamonds? I will not try and predict the specific industries that Botswana should be promoting – unlike the "picking winners" approach that is popular in some quarters. But I will try and give some pointers at least as to the appropriate direction.

The traditional development route sees countries starting off by exporting what are termed primary commodities (agricultural and mineral products), then moving on to exporting manufactured goods, and finally exporting services.

Figure 5: Conventional Export Development

Botswana has done well in exporting primary commodities – diamonds and other minerals - but has struggled to move into exports of manufactured goods. Despite several decades of policy support and incentives for the manufacturing sector, there have been no great successes, and many of the manufacturing activities that have been established have not been sustainable; what we have is just a few niche exporters – whose success, incidentally, would have been very difficult to predict. Commodity exports – not just diamonds but also copper, nickel, gold and soda ash – continue to dominate our export pattern. Does that mean we are stuck in a commodity trap? And if we are, is that necessarily a bad thing?

Conventional thinking is that yes, this would be a problem. The reason for this is that, in economic terms, a this would make a country vulnerable to adverse terms of trade movements – essentially a long-term trend of falling prices of primary commodities, so that an exporter dependent upon such commodities would find their purchasing power – the amount of manufactured goods that could be imported for a given volume of commodity

exports – continuously falling. So, the answer is to move from producing “low value” commodities to “high value” manufactured goods, in order to become richer.

But this “received wisdom” may not be the case any more. In fact, some fundamental changes in the global economy have, I believe, fundamentally changed this old equation. What is sometimes referred to as the “supercycle” – a period of sustained high global growth – is pushing up commodity prices. Here it is necessary look beyond short-term developments. Prior to the global financial and economic crisis, commodity prices were booming. The crisis, however, brought commodity prices crashing down. Did this mark the end of the commodity boom? Not at all. Oil prices are now at two-year highs. Since the crisis, copper prices have reached their highest ever level. And even diamond prices are at record levels. The global crisis is now seen as a short interruption to the long upward march of commodity prices, in a reversal of historical trends. Prices are being driven upwards by the dramatic growth of China, India and other Emerging Markets, which shows no sign of coming to an end.

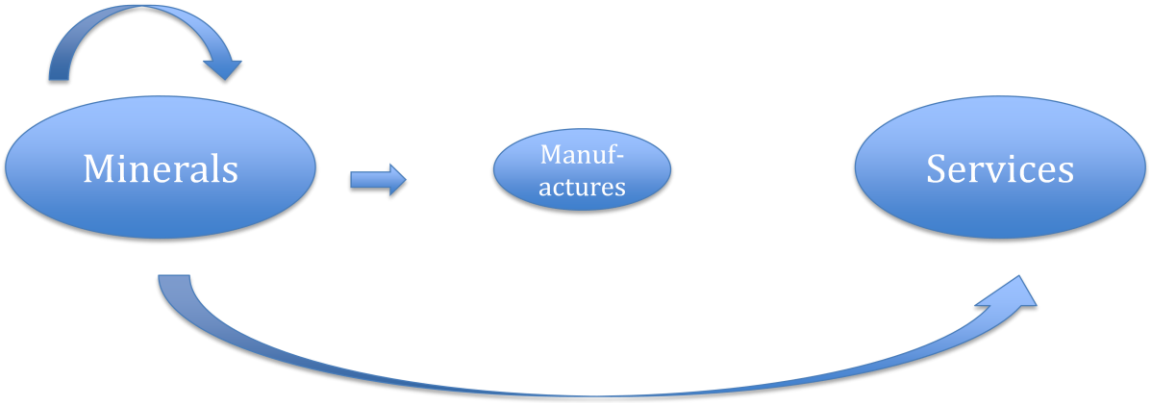
The other side of this equation is that China, India and others have been flooding the world with cheap manufactured goods. The prices of many manufactured items have been falling – electronics and computers being the extreme, but not the only, example.

So what has happened to the terms of trade? In a reversal of the old equation, it now pays to be a commodity exporter, selling in to a rising market. Exporters of manufactured goods have to be competitive with China, India and other low-cost Asian producers. It seems likely that the price of commodities will continue to rise relative to those of manufactures, so concentrating on exporting (expensive) commodities and importing (cheap) manufactures may be a viable route to higher incomes.

Both experience and global developments suggest that it will be difficult for Botswana to be a successful manufacturing exporter on a significant scale. Globally, the scale of China and India, and their low labour costs, make them very difficult to compete with in manufacturing. Eventually, of course, wages in those countries will rise – indeed this is beginning to happen already, and some manufacturing is moving to lower cost Asian producers such as Vietnam and Bangladesh. Africa may eventually benefit from some of this migration, but this will mainly be coastal nations with low labour costs – and Botswana does not qualify on either count.

So what does that mean? First, accept that there may be advantages in being a commodity producer in a world where commodities are becoming increasingly valuable. So maximise the scope for the exploitation of resources, through encouraging exploration and ensuring a suitable mining governance regime. Fortunately, this is an area where Botswana is already well-positioned. We have a very good reputation globally as a mining jurisdiction, characterised by transparency and the rule of law. We also have extensive mineral deposits – coal, copper, nickel, silver, gold, uranium, and no doubt more waiting to be discovered.

Figure 6: Alternative Export Development



A second conclusion is that instead of trying to move from commodities into exports of manufactured goods, why not leapfrog the manufacturing export stage and move straight into services? Botswana has had some successes in this already, with tourism an increasingly important export product. There is also more general potential in exporting services, supported by global developments. Historically, many services were seen as things that had to be produced locally, and were not easily traded across borders. This is now changing very fast, and trade in services makes up an increasing proportion of world trade. The main reason for this is the ability to trade services over the internet. This is potentially very important for Botswana. While a landlocked location, far from the coast can lead to very high transport costs for exports of manufactured items – and imports of the materials and components that are needed as inputs – the same does not apply to services. All that is needed is ample, cheap bandwidth, which can be provided by appropriate policy and investment. There are many opportunities in business services, back-office processing, call centres etc. – collectively falling under the Business Process Outsourcing or BPO umbrella – where I believe Botswana could compete internationally. It will not be easy, as the BPO sector is very competitive internationally, but I believe there is more scope for developing these activities as exports than there is for manufacturing. In part this is because of the constraints imposed by transport costs for manufactured goods. I also believe that the skills and interests of our population are much more suited to services work than manufacturing, and that it is easier and cheaper for government to create a conducive environment for services than it is for manufacturing.

Unfortunately our policy framework is still stuck in the old way of thinking. The National Export Strategy, for instance, is actually a National Manufacturing Export Strategy. It almost completely ignores mineral and services exports, and as a result does not consider what supporting infrastructure and policies would be needed to promote export potential in those sectors. The seven NES "priority" sectors are all manufacturing activities, including old favourites such as textiles and garments, which have demonstrated, over a long period of time, that they are fundamentally uncompetitive in global terms, and cannot survive without subsidies or other special treatment. This is not to say there is no scope for manufacturing exports – some niche producers will survive. There may be scope for minerals beneficiation, but we need to focus on how this can be done competitively, rather than automatically assuming that we can beneficiate our minerals because they are mined here, regardless of how competitive we are. We also need to design our incentive structures appropriately: for

instance, it probably makes no sense to favour manufacturing with tax concessions, when there is more long-term potential in other sectors.

Key Choices: Inward or Outward? Competitive or Protectionist?

While the decision to promote export-led growth may be easy in principle, it is more difficult in practice. It takes a long time and a lot of appropriate micro-economic decisions to build a competitive export-led economy, as well as an appropriate macroeconomic framework. It is the cumulative impact of a lot of small decisions that will ultimately determine whether or not an outward looking strategy will be successful. Some of these decisions are seemingly unconnected to competitiveness or exports, but they are relevant because they affect the costs of doing business. And costs are central to an export-focused approach because they fundamentally affect competitiveness, while they are much less of an issue with an inward looking approach, because the whole basis of the latter is to avoid competition, to be protected, rather than to compete and succeed. This is really the key distinction between the two approaches: an outward looking approach embraces competition, and uses it to become efficient, and stimulate growth. An inward looking approach seeks to avoid competition, through protection, but thereby limits growth opportunities.

Let me give some examples of decisions – and these are purely examples, and not a comprehensive review - that can be driven by an inward looking or an outward looking approach, and the outcomes of which will affect our export competitiveness and ability to achieve economic diversification and growth in the post-diamond age.

Attitudes towards FDI

Attitudes towards foreign direct investment may sometimes seem to be confused. In principle, Botswana welcomes foreign investment, and has institutions such as BEDIA and IFSC whose mandate includes attracting FDI. But we then have a whole range of policies or actions that deter FDI. These include immigration policy, reservation policy, and the increasing emphasis on citizen empowerment – which as currently structured inevitably means protection from competition, whether that competition is provided by imports or foreign investors in the country. An inward looking approach focuses on the domestic market, which is of course very limited in size, and says that FDI is not really welcome, because that means a smaller share for existing firms. An outward looking approach says, FDI is welcome, because foreign firms can help us to penetrate new export markets – where the growth potential is almost unlimited – will raise standards and productivity, and provide opportunities for locally-owned firms through sub-contracting.

Business Regulation

Another area that is not specifically about markets but affects the cost of doing business is regulation. Most governments introduce a variety of regulations affecting business. Sometimes these regulations reflect legitimate public interest objectives – such as regulations restricting pollution. But often, regulations are not in the broader public interest. This may be because regulations are introduced following lobbying by particular groups of vested interests, and were designed to protect those narrow interests not the broader public interest. Or it may be because governments intend to introduce regulations in the public interest, but, being governments, do not understand very well how business works, and the regulations have negative impacts on business that were not anticipated. Or it may

simply be that no attempt was ever made to evaluate both the costs and benefits of regulations before they were introduced, with policy makers only focusing on the purported benefits and ignoring the costs.

It is my assessment that business in Botswana is being increasingly hampered by unnecessary regulations that increase the costs of doing business in Botswana, and discourage investment and innovation, especially by small enterprises. There is a plethora of regulations, ranging from business licensing, environmental impact assessments, land zoning and change of use, that discourage businesses and increase costs. Why is that it is impossible to get a licence for a business operated from home, when we are trying to encourage entrepreneurship and self-employment? Why can't a farmer get a licence to offer overnight accommodation in chalets on his or her farm, when we see tourism as an engine of growth and wish to encourage the rural economy? In both cases, the immediate answer is that "the rules don't allow it", but the deeper answer is that we have pointless, anti-business regulations that are designed and implemented in a way that reflects little or no understanding of the needs of the economy, especially one that is trying to nourish an entrepreneurial culture and stimulate economic diversification.

The choice facing us is then, are we going to adopt meaningful deregulation, undertake a review of existing regulations and abolish all that do not meet a clear public interest benefit test? Are we going to say any proposed new regulations must go through an assessment that identifies potential costs for business as well as benefits to the public, and only proceed if the benefits clearly outweigh the costs? Or are we going to proceed down a road that involves increased regulation, higher costs for business, and even lower competitiveness?

Air travel

A clear example of unnecessary regulations that raise costs for business, discourage diversification and work against the national interest are the rules relating to air travel. In principle, we have adopted a policy of "open skies" that entails a liberal approach to allowing foreign airlines to fly to and from Botswana. But the practice is anything but the case. Certain routes – such as Maun-Johannesburg – are closed to foreign carriers, even if allowing them in would introduce competition, more flights, and better service and lower fares that would benefit the tourism industry and help to create employment. Similarly, we do not allow so-called "fifth-freedom" rights, which would allow third country carriers to fly routes to and from Botswana. For instance, we would not allow South African Airways to fly from Johannesburg to Gaborone, pick up passengers, and fly on to Luanda, Angola, even though this would provide an additional route to and from Botswana. The reason is that all SADC routes are protected and reserved for Air Botswana, even if Air Botswana doesn't fly that route!

When we are trying to improve air transport links into and out of Botswana to support tourism and other sectors of the economy, this type of thinking is totally counter-productive. We have to accept that we do not have sufficient traffic volumes on many sectors to make dedicated flights to Botswana viable to foreign airlines. But if we can encourage those foreign airlines to serve Botswana as "add-ons" to other routes, then that is a great start. If it works, maybe we can then justify dedicated routes. But at the moment we are denying that option.

The experience of other countries is universally that full liberalisation of air transport is beneficial, leading to lower fares, improved services, and the creation of new jobs, especially in the tourism industry. But is not just tourism. At the Diamond Beneficiation Pitso a couple of weeks back, when we were discussing the constraints to establishing downstream diamond industries in Botswana one of the main problems is the lack of quality air connections. What we need is a broad network of reliable, cheap and efficient air connections. Let's make it clear that all foreign airlines are welcome, and not hold back the country's development by failing to think beyond Air Botswana.

Immigration

A fourth area where policy is badly failing to support the needs of a globally competitive, globally attractive and world-class economy is immigration. In the past, Botswana has been reasonably open to foreign investors and workers. But the doors now seem to be closing, and firms are struggling to recruit the necessary skills, and potential investors are being discouraged or turned away. But the immigration system needs to be consistent with the needs of an economy that is integrating into the global economy, which includes integrating with the global labour market. Globalisation of the labour market means that labour is internationally mobile. An ideal immigration system should be simple, transparent, objective and efficient – but our current immigration system meets none of these criteria. The immigration system should also recognise that investors do not necessarily come with large amounts of money or will create large numbers of jobs, but may produce goods or services that will diversify the economy and increase exports. This is especially the case if we are to promote investment in services rather than manufacturing – services firms do not generally require large amounts of capital investment. Criteria should therefore be flexible in accommodating entrepreneurs and investors.

The immigration system for employees should welcome with open arms those with skills that the economy needs, rather than admitting them grudgingly and with the objective of pushing them out as quickly as possible. The fear that expatriates will take jobs away from Batswana is unfounded; it is not as if there are a fixed number of jobs to be distributed between citizens and expatriates. The economy is dynamic; the more it grows, the more jobs there will be. Expatriates create far more jobs than they take, and this should be reflected in our immigration policy. Again, this is an area where we face a key choice: will our immigration system support our integration into the global economy and foster the export-focused firms that the economy needs, or will it be based on turning inwards, cutting ourselves off from the supply of global skills, entrepreneurship and innovation that the economy needs to grow and prosper. An ideal, business-friendly immigration system does not have to let everybody in, but when an economy needs skills, entrepreneurs and investors, it should make it very clear that those with skills and the ability to establish businesses here are more than welcome.

Let me not give the impression, however, that these measures would only benefit foreigners. The ultimate challenge is to make sure that citizen-owned firms become exporters. And this is indeed a challenge: a World Bank survey of Botswana firms in 2006 made it clear that citizen-owned firms are smaller, more dependent on government, and export less than foreign owned firms. But the reforms that I believe are necessary will help citizen-owned firms to grow and thrive as much as foreign owned firms. A policy of helping citizen-owned firms sell more to government is fine in the short-run, but what happens as –

inevitably – government spending is cut back? The real challenge is not to sell to government, but to become efficient and sell in competitive, export markets. With this challenge in mind, the policy shortcomings that I have mentioned affect citizen-owned firms as much as foreign ones: how does it help a citizen-owned firm not to have access to the markets that FDI can bring; to be burdened by regulations that raise costs; not to have access to efficient international air travel; or be unable to recruit the necessary skills?

There are many other areas where the nature of decisions made are crucial, such as the type of infrastructure we invest in: is this concentrated in rural areas, where it may have a social function but limited economic payback; or urban infrastructure, where the economic needs and returns are greatest. We must also avoid burdening firms that are trying to compete with unnecessary costs, such as the electricity levy, which is essentially an additional tax on electricity consumers to finance a social programme. Trade policies are also important. While trade in goods is reasonably liberal, with our membership of the SACU, trade in services is highly restricted, which is not supportive of developing exports in this area. We also have a tendency to use non-tariff barriers to restrict trade – unfairly – even when in principle free trade exists.

As you can gather, an appropriate outward-looking approach would require some radical changes to the way in which things are being done and have been done in the country over the past forty years. This is true – "business as usual" is not an option. And we need to be prepared to make these radical changes. This may be difficult. Botswana has been lauded internationally for the many good things that have been done in the country, for the high quality of economic policymaking, We have a good credit rating, and high scores on many international rankings relating to governance. But this should not make us resistant to change – just because things have worked in the past does not mean that the same things will work in the future, in a very different global economic environment, and with a different domestic resource base. And change can be scary, requiring people to move out of their comfort zones. But this does not mean that change can or should be avoided. Much better to embrace the need for change and try and do so on your own terms, rather than wait until others dictate the terms.

Many of our policies are not well focused on an outward-looking export-focused approach. For instance, the Economic Diversification Drive, or EDD, is driven primarily by import substitution thinking than export promotion thinking. The EDD may bring some short-term benefits but does not address the long-term changes that the economy needs. Privatisation policy seems to me much more driven by preventing FDI and hanging on to a slice of a fixed cake, rather than encouraging FDI and growing the cake.

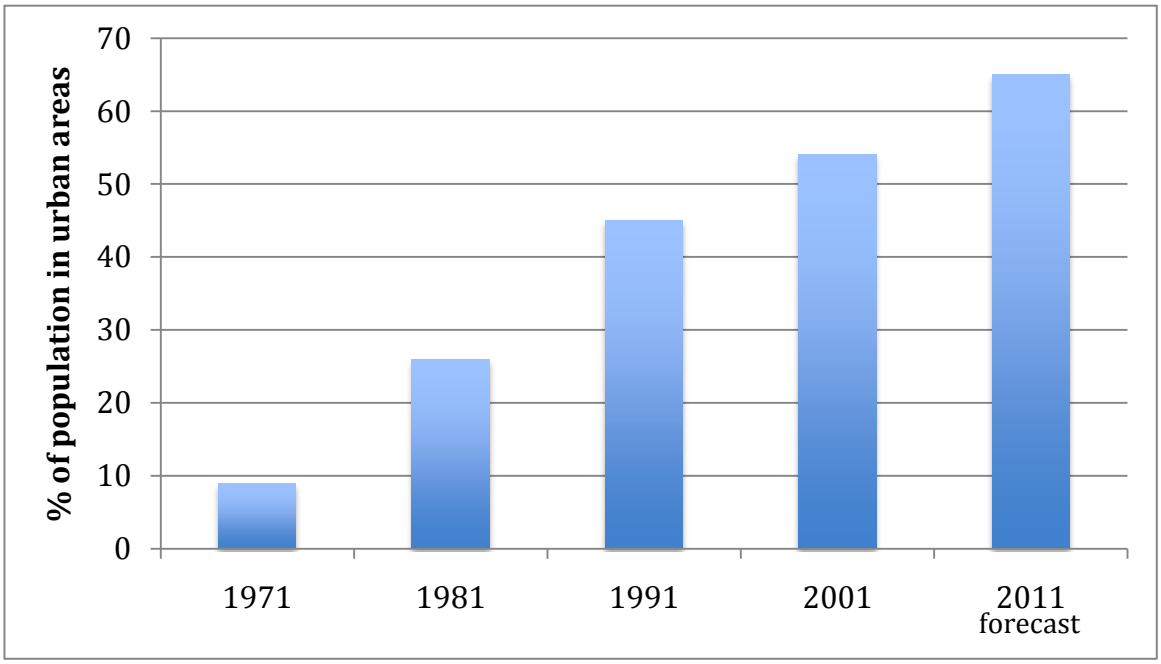
We also have to look at the overall incentive structure that the whole network of policies creates. Do these incentives favour import-substitution or exports? Because we won't succeed in developing exports if firms are not faced with appropriate incentives to do so. And too many of our incentives face the wrong way. Manufacturing, which has limited export potential, gets tax concessions, but sectors with more export potential do not – wrong incentive for investors. The local preference scheme raises the profitability of producing for the local market vis a vis producing for export – again, an inappropriate incentive. The frequent border closures for agricultural products, along with other non-tariff barriers, also promote selling to the domestic market rather than exports. All of these incentives create an anti-export bias, which is not appropriate for the country's needs.

The issues that I have outlined are only a small selection of some of the choices that need to be made, an indication of how these choices should be assessed if we want to have a successful outward-oriented strategy. There are many more. Many of the necessary action items are laid out in the Botswana Excellence Strategy, prepared by the Botswana Economic Advisory Council, and officially adopted as a strategy by the Government. In practice, however, only fragments of it have been adopted, and many actions directly conflict with the strategy.

Not just economic choices: other policies also matter.

We also need radical change, or at least openness to radical thinking, in other areas. For instance, take urbanisation. This is conventionally seen as a bad thing, and as a result, lots of money is spent on keeping people in rural areas. Policy focuses on limiting, or at least slowing down, rural-urban migration. But there is no evidence that this is effective. Rural-urban migration has continued – I anticipate that the 2011 census soon to be carried out will show that approximately two-thirds of Batswana live in urban areas, compared to only 9% in 1971.

Figure 7: Urbanisation



Source: National Development Plans, various years

There is a view that "most Batswana are dependent upon agriculture, or cattle", but this is simply not the case any more. Most Batswana are not dependent upon agriculture, at least not as a primary source of income or livelihoods, and policy that is based on this misconception will not work. Focusing investment in infrastructure in rural areas is a high-risk strategy: Even under the most favourable circumstances it is unlikely to be economically productive. There is a real danger that we will end up with a lot of unused or under-used expensive rural infrastructure – already there are rural primary schools that are half-empty because there are simply not enough children in the locality to use them. We have very expensive rural roads that are hardly used.

The policy seems to be based on the presumption that people will still stay in the rural areas if there is electricity and telephones and internet, and will even start businesses there. We are essentially taking a bet that all of the very expensive investment in rural infrastructure will pay off and generate self-sustaining growth before the money runs out – but this is a high risk and high stakes bet. We need to acknowledge that rural areas have a limited natural economic base and limited economic potential, and are being kept going by heavy government subsidies that are becoming increasingly unaffordable and untenable.

There is an alternative, which is to recognise that people migrate for a reason - because the opportunities are in urban areas, and living standards are better. Urban areas are more exciting. No country has "developed" without urbanisation. Cities are more efficient – it is much cheaper to provide schools, roads, power, water and telecoms in urban areas than rural areas. It would be better to recognise that when migration slows down and the population distribution settles into an equilibrium, Botswana will probably have a population that is, say, 90% urban and 10% rural – much like more developed countries. Think of the genuine, competitive economic base of the rural areas – cattle farming and tourism. What proportion of the population will these activities support? There is scope for more commercialised arable agriculture in some areas, but this will mainly be on the periphery of urban areas.

Besides agriculture, tourism, and mining, other economic activities have a choice of where they locate, and there is no reason why they have to be in rural areas. We might have an idealistic vision of rural villages wired with broadband hosting booming internet start up companies, but experience suggests the people do not choose to live in the rural areas – look at the extreme unpopularity of rural postings amongst teachers and government officials – and much prefer towns, and have done in all countries throughout history. So our alternative choice is to plan for efficient urbanisation, ensuring that sufficient infrastructure and roads are provided, that cities are allowed to expand into surrounding agricultural land, and that sufficient land is available cheaply for housing of different standards.

Concluding Comments

As I said earlier in my presentation, the key challenges facing Botswana over the next two decades are how to diversify the economy and develop sources of sustainable growth as large scale diamond production runs down, and how to reduce the size of government, making it smaller and more efficient, and reducing our dependence on government at the same time. Addressing these challenges requires us to take an outward-looking, export-focused approach that welcomes competition and globalisation, concentrates on reducing costs and boosting competitiveness, and is determined to succeed on the international stage. The alternative, of an inward-looking, import-substituting, protectionist approach that seeks to avoid competition, discourage FDI and cut the country off from the forces of globalisation, is a dead end.

Our policy framework must reflect this, and requires three fundamental components to be in place. First, there must be an agreed national strategy and approach, that is well understood and endorsed at all levels. Second, we must not be wedded to the past – just because certain approaches and policies have worked over the past few decades does not mean they will work over the next few decades – the world is changing, and Botswana is

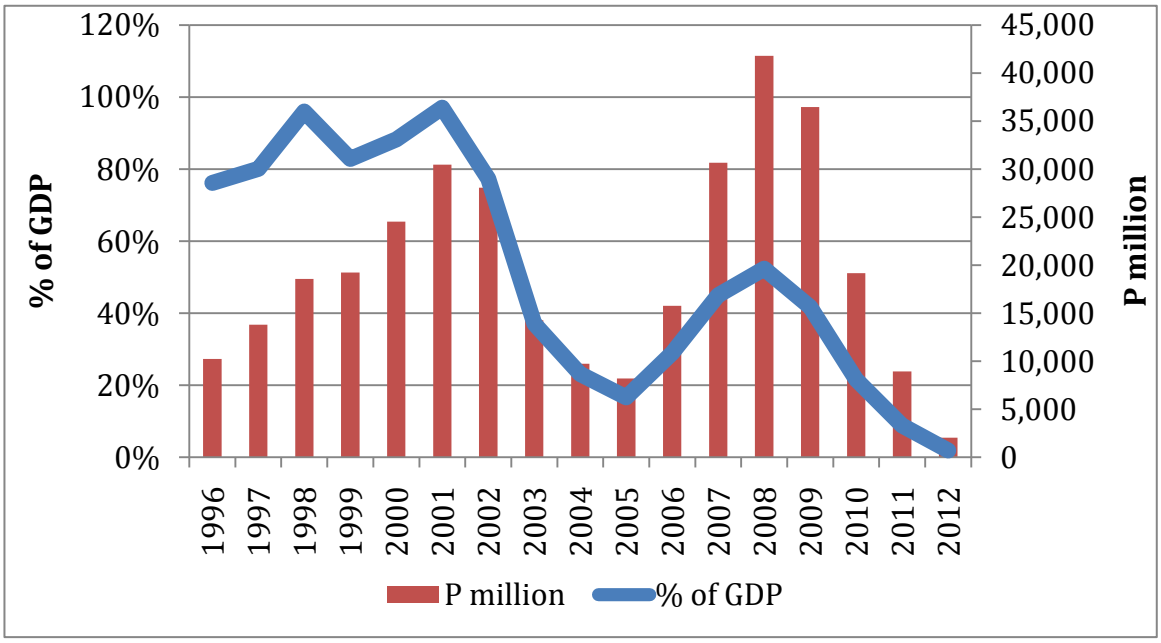
changing. Furthermore the pace of change is quickening, and we have to move with appropriate speed. Third, we need our policy choices to be based on rational analysis of the available options, and to be evidence-based. The process is simple, at least in principle: establish the policy issue; collect the data and evidence; do the analysis; weigh up the costs and benefits; and reach a rationally based, sound conclusion, which will yield the best outcome for the country and economy as a whole. Consider whether there are better, cheaper alternative ways of achieving the same objectives. Once a policy is decided, implement effectively. After some time, carry out an evaluation review. If circumstances have changed, or if the policy has not worked as intended, then change or discontinue the policy.

Evidence-based policy making used to be one of Botswana's strengths, but the skill seems to have withered. Policies are decided and implemented without the necessary analysis and assessment of costs and benefits, and are not necessarily in the national interest. We need to return to an era where policies are based on evidence and rational analysis.

The choices that I have outlined may appear difficult, and certainly, in many cases there are short-term costs while the benefits are longer- term. But putting off these key decisions, or taking inappropriate decisions, will not help the economy, or the population of the country in the long-term, once we can no longer "eat" diamonds.

The speed with which circumstances can change also needs to be appreciated. Most people have a vision that the Government is rich, with plenty of money in the bank. But this is outdated, and only a few years of budget deficits have quickly eroded the positive financial balances that government once enjoyed – there is still money in the bank, but this is almost entirely offset by the debts that we have taken on.

Figure 8: Government Net Financial Assets



Source: Econsult, based on data from Bank of Botswana, MFDP, CSO

Note: NFA = government balances at BoB less public debt. All figures as at March. 2011, 2012 figures are estimates based on Govt budget and debt data.

The global crisis that has caused such economic difficulty for Botswana in recent years – but is not, as I have said, the fundamental cause of the problems that need to be addressed – in fact provides an opportunity to improve the efficiency of public spending, speed up regulatory reform, and generally move the economy in a direction that will help to achieve long-term sustainability. We should not draw the wrong conclusions: although the disruptions to the global economy in recent years have caused difficulties for Botswana, we should recall that our prosperity over a longer period has been largely driven by our integration into the global economy. We should not turn our back on export-led growth, but focus on the new export commodities that can replace diamonds.

One thing we should not do is use the respite provided by the recovery in the global economy to relax and slacken off from the reform agenda. But if we do postpone, our room for manoeuvre will get more limited; as India's former Prime Minister, the great reformer Mr P V Narasimha Rao once said, "decisions are easy when there are no options left". Let's not get to that stage. Botswana has huge potential, and is still in a relatively comfortable position – so the starting point for change is in many respects a good one. We have opportunities to become a much more diversified exporter of minerals and mineral products, and a world class exporter of services, building on our natural resources and human capital. Although time is running out, it is not yet too late to make the right decisions. But the wrong decisions could cost us dearly if we end up going off in the wrong direction.

Thank you.

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