FOR AGENDA

SM/88/240

CONTAINS CONFIDENTIAL
INFORMATION

October 28, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Botswana - Staff Report for the 1988 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1988 Article IV consultation with Botswana, which is tentatively scheduled for discussion on Friday, November 18, 1988. A draft decision appears on page 25.

Ms. Dillon (ext. 8313) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

BOTSWANA

Staff Report for the 1988 Article IV Consultation

Prepared by the Staff Representatives for the 1988 Article IV Consultation with Botswana

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by A.D. Ouattara and A. Basu

October 27, 1988

I. Introduction

The 1988 Article IV consultation discussions with Botswana were held in Gaborone during August 13-27, 1988. 1/ The Botswana representatives included Mr. H.C.L. Hermans, Governor of the Bank of Botswana; Mr. B. Gaolathe, Permanent Secretary of the Ministry of Finance and Development Planning; and other senior officials and representatives of the private sector. The staff representatives were Ms. K.B. Dillon (head), Mr. T. Morrison, Mr. P. Young (all AFR), Ms. T. van der Willigen (EP-AFR), and Ms. N. Khattak (secretary-ETR).

In concluding the last Article IV consultation with Botswana on May 6, 1987, Executive Directors commended the authorities for Botswana's continued strong economic and financial performance that was related to the sharp growth of diamond exports and sound economic management. It was noted that the key issue facing the authorities over the medium term was how to use the large resources generated by the diamond sector in order to diversify the economy. Given the favorable outlook for Botswana's economy and the liberal trade and exchange system, the authorities were encouraged to accept the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement, and it was also observed that Botswana might be a good candidate for the bicyclic consultation procedure. To date, Botswana has not made use of Fund resources and continues to avail itself of the transitional arrangements under Article XIV. Summaries of Botswana's relations with the Fund and the World Bank Group are presented in Appendices V and VI.

1/ A notification of delay in concluding the Article IV consultation with Botswana was issued on June 2, 1988 (EBD/88/147).

II. Background to the Discussions

1. Economic developments through 1986

During the twenty years after independence in 1966, real economic growth in Botswana averaged 13 percent per year and real GDP per capita increased fivefold. This impressive performance was attributable in large part to the growth of the mining sector, particularly diamond mining, and sound economic policies. Following real economic growth of about 10 percent per year during the 1970s, the opening of the Jwaneng diamond mine in 1982 was primarily responsible for an acceleration of growth to 16 percent per year from 1981 to 1986 (Table 1). 1/ During this five-year period to 1986, mining's contribution to GDP increased from 16 percent to 44 percent. The next two largest sectors, trade and hotels and general government, each grew at about 10 percent in real terms during the same period, accounting for more than two thirds of the growth of nonmining GDP. The contributions of agriculture and manufacturing to GDP had diminished considerably by 1986 under the impact of a prolonged drought that roughly coincided with this five-year period. Reductions in the country's cattle herd and declines in crop production caused agriculture to contract by more than 7 percent per year and to account for only 3 percent of GDP in 1986. Manufacturing, which is dominated by the beef industry and thus was also adversely affected by the drought, grew at an annual rate of only 1 percent in real terms.

Formal sector employment rose by 6 percent per year from 1982 to 1986, compared with growth of nonmining GDP of almost 9 percent. Only in 1986 did employment growth, at about 10 percent, exceed nonmining GDP growth. Even in 1986, however, the total number of formal sector jobs created, at 11,000, fell far short of the increase in the labor force, estimated at 21,000.

Aggregate expenditure grew at a rate far less than GDP in the 1980s primarily reflecting the Government's cautious spending policy. As a result, aggregate expenditure as a share of GDP fell from 136 percent in 1981 to 84 percent in 1985. The counterpart was a very large shift in net exports of goods and nonfactor services from a deficit of P 289 million (36 percent of GDP) in 1981 to a surplus of P 344 million (16 percent of GDP) in 1985. 2/ The current account of the balance of payments moved from a deficit of 6 percent of GDP in 1982 to a surplus of 13 percent of GDP in 1986 (Table 2). Total exports almost doubled in SDR terms between 1982 and 1986, reaching SDR 732 million in the latter year, but exports other than diamonds declined somewhat in SDR terms over the same period. Beef exports fell as a result of the drought and copper/nickel exports stagnated under the influence of a depressed world

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1/ National account years begin July 1.

2/ National accounts data by expenditure category are available only through 1985.

Table 1. Botswana: Selected Economic and Financial Indicators, 1982-88

	1982	1983	1984	1985	1986	1987 Prov.	1988 Proj.
	(Annual percent change, unless otherwise indicated)						
National income and prices							
GDP at constant prices 1/	24.0	20.0	8.1	14.0	14.7	40.6 2/	-18.9
GDP deflator 1/	6.8	3.4	18.0	15.9	9.2	11.4	14.9
Cost of living index (annual average)	11.3	10.4	8.6	8.1	9.9	9.8	8.0
External sector (in SDRs)							
Exports, f.o.b.	23.0	42.5	11.3	7.4	2.1	69.9	-19.0
Imports, f.o.b.	-9.6	8.8	-0.3	-15.3	7.4	25.7	16.3
Nominal effective exchange rate (depreciation -, year on year)	-8.9	2.4	7.8	-9.2	1.5	6.3	...
Real effective exchange rate (depreciation -, year on year)	-8.0	0.9	3.0	-13.2	-1.9	2.5	...
Government budget 3/							
Total revenue and grants	22.0	43.0	42.6	41.2	36.5	14.8	27.4
Of which: Customs Union	(9.6)	(37.2)	(-0.6)	(-4.2)	(28.9)	(21.7)	(24.4)
mineral revenue	(29.1)	(95.0)	(94.3)	(54.4)	(45.4)	(22.4)	(29.9)
Total expenditure and net lending	22.0	11.0	33.6	17.0	40.2	22.7	33.9
	(Annual change as percent of beginning period money stock)						
Money and quasi-money	4.5	31.1	13.7	47.5	14.3	65.8	22.9
Net foreign assets 4/	28.5	56.8	59.9	126.7	117.1	157.5	72.6
Domestic credit	-14.6	-20.0	-38.9	-69.4	-115.5	-90.9	-49.7
Government	-16.4	-32.1	-58.6	-74.5	-118.6	-92.9	-52.7
Private sector	1.8	12.1	19.8	5.2	3.2	2.0	3.0
Other items, net 4/	-9.3	-5.5	-7.3	-9.9	12.6	-0.8	--
	(In percent)						
Interest rates (end-year)							
Bank of Botswana lending rate	12.0	10.5	9.0	9.0	9.0	8.5	7.0
Commercial banks							
Prime lending rate	14.5	13.0	11.5	11.5	11.0	10.0	7.5
Savings deposit rate	11.0	9.5	8.0	8.0	7.5	7.5	5.5
	(In percent of GDP)						
Central government budget (deficit -) 3/							
Excluding grants	-6.9	4.4	9.5	18.1	18.1	11.0	13.5
Including grants	-2.1	9.4	12.0	20.1	20.7	13.0	15.8
Domestic bank financing	-4.3	-9.6	-14.1	-20.8	-23.7	-14.6	17.6
Foreign financing	6.0	1.6	2.2	0.6	2.8	1.7	1.8
External current account balance (deficit -)	-6.0	0.2	0.9	13.0	13.1	27.3	13.5
External debt 5/	24.1	23.1	29.2	39.1	29.1	21.5	29.2
Debt service ratio (in percent of exports of goods and non-factor services) 5/	2.5	7.7	7.7	5.7	4.7	3.2	2.7
	(In millions of SDRs, unless otherwise indicated)						
Overall balance of payments (deficit -)	50.0	117.6	125.0	259.2	258.6	438.8	198.4
Gross official reserves (months of imports, f.o.b.)	6.0	7.9	10.1	17.6	22.5	25.9	25.4

Sources: Data provided by the Botswana authorities; and staff estimates.

1/ Year beginning July 1.
2/ A very large valuation adjustment, reflecting the profit on the diamond stockpile sale, is included in 1987/88 GDP at constant prices, as only the cost of production of the stockpiled diamonds had been recorded in GDP in the year they were mined.
3/ Year beginning April 1.
4/ Excluding the effect of foreign asset valuation adjustments.
5/ Medium- and long-term, public and publicly guaranteed debt, disbursed and outstanding.

Table 2. Botswana: Summary Balance of Payments, 1982-87

(In millions of SDRs)

	1982	1983	1984	1985	1986	1987
Current account	-49.4	1.5	9.6	129.9	147.3	509.5
Trade balance	-108.8	23.5	92.8	230.3	209.6	586.9
Exports of goods, f.o.b.	420.5	599.4	667.1	716.7	732.1	1,243.7
Of which: diamonds	(215.7)	(395.8)	(467.4)	(549.2)	(547.3)	(1,057.2)
Imports of goods, f.o.b.	-529.3	-575.9	-574.3	-486.4	-522.5	-656.8
Nonfactor services	-35.2	-49.1	-50.8	-42.2	-33.2	-39.6
Debit	-128.7	-154.7	-156.3	-117.3	-119.1	-137.7
Credit	93.5	105.7	105.5	75.1	85.9	98.1
Factor incomes	-11.8	-89.9	-132.5	-146.5	-125.1	-160.7
Interest receipts	30.5	33.5	49.4	58.3	70.8	92.1
Interest payments	-79.0	-102.7	-101.4	-92.8	-86.8	-80.1
Dividends and profits (net)	20.3	-44.1	-105.0	-126.1	-124.4	-188.4
Labor remittances (net)	16.4	23.4	24.6	14.1	15.3	15.7
Transfers	106.3	117.1	100.1	88.2	96.1	123.0
Official transfers (net)	106.5	117.5	107.3	91.3	98.3	124.4
Southern African Customs Union	...	45.9	48.1	44.3	47.4	60.7
Other	...	71.6	59.2	47.0	50.9	63.7
Private transfers (net)	-0.2	-0.4	-7.2	-3.1	-2.2	-1.4
Capital account	87.2	89.9	109.3	123.5	94.6	-62.5
Long-term capital (net)	90.7	66.6	115.5	96.4	93.3	-70.9
Of which: direct private investment 1/	(19.2)	(23.5)	(61.5)	(51.4)	(60.7)	(-96.8)
Government	(36.9)	(16.7)	(17.4)	(-7.0)	(7.8)	(12.4)
parastatals	(5.1)	(9.6)	(42.3)	(39.0)	(12.9)	(14.3)
Short-term capital (net)	-3.5	23.2	-6.1	27.1	1.2	8.5
Errors and omissions (net)	12.3	26.2	6.1	5.7	16.7	-8.3
Overall balance	50.1	117.6	125.0	259.2	258.6	438.8
Change in reserves	47.9	112.5	103.7	233.2	266.1	438.5
Valuation adjustment	-2.2	-5.1	-21.3	-26.0	7.5	-0.3
Memorandum items:						
Current account/GDP (percent)	-6.0	0.2	0.9	13.0	13.1	27.3
Net official reserves (millions of SDRs)	265.5	378.0	481.7	714.9	980.9	1,418.9
Months of imports	6.0	7.9	10.1	17.6	22.5	25.9
Debt service ratio (of exports of goods and nonfactor services)	2.5	7.7	7.7	5.7	4.7	3.2
Conversion factor (SDR/pula)	0.8866	0.8533	0.7581	0.5177	0.4570	0.4606

Sources: Data provided by the Bank of Botswana; and staff estimates.

1/ Includes accrued but unpaid interest by the copper-nickel company, BCL, that has been capitalized as a result of debt reschedulings.

market. Textile exports, mostly to Zimbabwe, rose strongly in real terms but declined in SDR terms owing to exchange rate movements. Imports did not increase at all over this period in SDR terms, despite volume growth of about 6 percent per year, as the rand (in which most of Botswana's imports are denominated) depreciated substantially with respect to the SDR. Overall, exchange rate movements produced a favorable terms of trade effect for Botswana, most of whose exports are denominated in U.S. dollars.

Foreign exchange reserves increased more than fivefold in SDR terms between 1982 and 1986, reaching the equivalent of 23 months' imports at end-1986. During the same period, the import-weighted real effective exchange rate depreciated by an average of about 3 percent per year (Chart 1). 1/ The South African rand has a weight of about 80 percent in this index, and a nominal appreciation of the pula against the rand of about 3.5 percent per year over this period was more than offset by a measured rate of inflation in Botswana about 6 percent below that of South Africa. 2/

The main channel through which diamond exports provided the impetus for growth of the rest of the economy was the government budget whose overall position shifted from a deficit equivalent to 2 percent of GDP in FY 1982 to a surplus of 21 percent of GDP in FY 1986. Government revenues, reflecting increased receipts from diamonds as well as rising transfers of central bank profits from its mounting foreign exchange reserves, rose from 36 percent of GDP in FY 1982 (April-March) to 57 percent in FY 1986 (Table 3 and Chart 2). The Government's mineral revenues, partly reflecting the depreciation of the pula against the U.S. dollar in which diamond exports are denominated, increased eightfold over this period, reaching 32 percent of GDP in FY 1986. 3/ Government current spending increased roughly in line with GDP from FY 1982 to FY 1986, while government capital spending rose by 4 percentage points relative to GDP.

The Government, either through spending the increased revenues at its disposal or sterilizing them in the form of deposits at the central bank, has largely determined the pace of money creation in recent

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1/ *In the case of Botswana,* the import-weighted index is a better measure of competitiveness than the trade-weighted indexes. Exports are dominated by diamonds and beef, two commodities for which the markets are far from perfectly competitive. Import weights capture not only the competitiveness of the import-substitute sector, but also the competitiveness of potential export industries.

2/ Appendix III summarizes the interlinkages between the economies of Botswana and South Africa.

3/ Production costs represent less than 20 percent of diamond export value, and the profit from diamond sales is split approximately two thirds to the Government of Botswana and one third to De Beers, its investment partner in the diamond mining company Debswana.

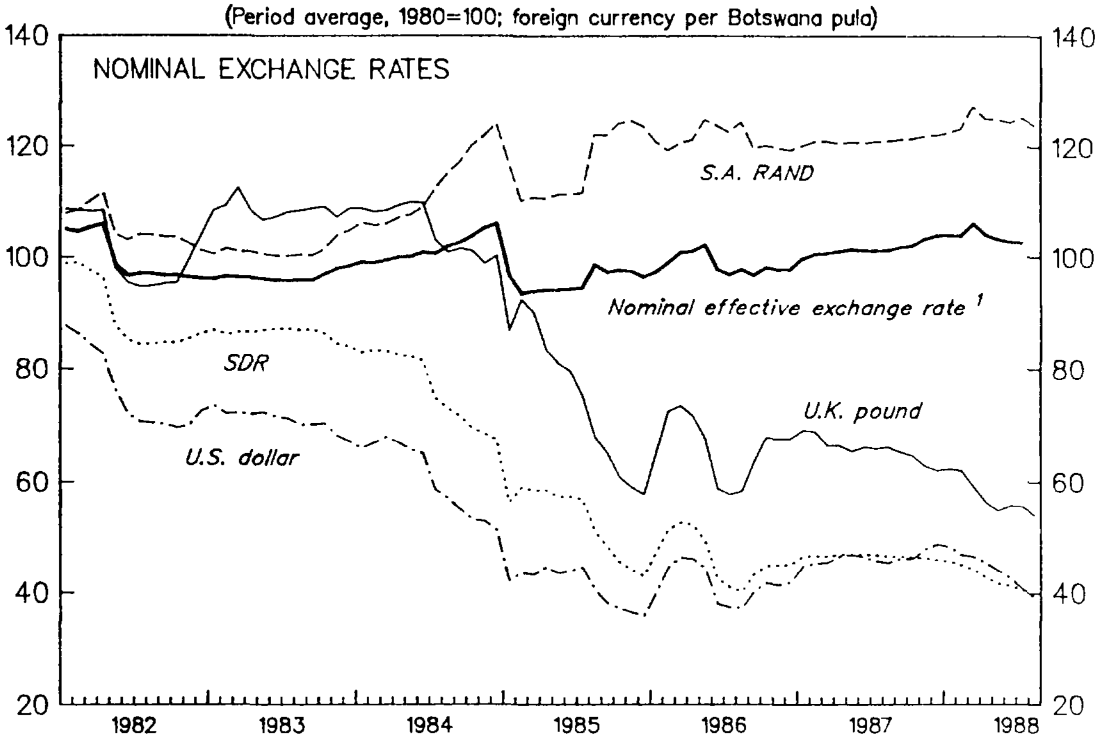
Table 3. Botswana: Summary of Overall Fiscal Operations of the Central Government, 1983/84-1988/89

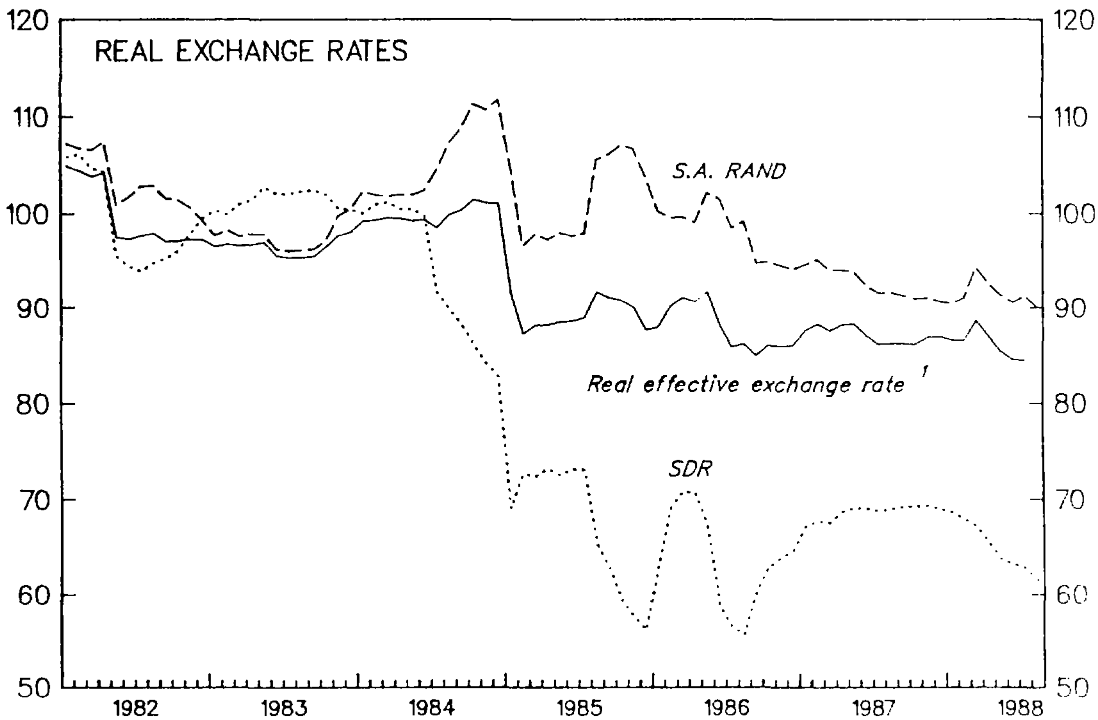
	1983/84	1984/85	1985/86	1986/87 1/	1987/88		1988/89	
					Budget	Expected Outturn	Budget	Staff Proj.
				(In millions of pula)				
Total revenue and grants	563.1	802.9	1,133.4	1,547.5	1,428.0	1,776.9	1,777.0	2,263.0
Total revenue	514.9	763.4	1,092.3	1,479.9	1,377.3	1,693.5	1,734.8	2,176.5
Tax revenue	308.5	420.6	485.5	765.0	780.1	99.2	1,066.9	1,154.1
Of which: Customs Union receipts	(156.8)	(155.8)	(149.2)	(192.3)	(237.0)	(234.1)	(291.3)	(291.3)
mineral tax receipts	(61.5)	(168.4)	(231.5)	(433.1)	(413.8)	(612.4)	(615.3)	(671.9)
Nontax revenue	206.4	342.8	606.8	714.9	597.2	694.3	667.9	1,022.5
Of which: mineral income receipts	(132.3)	(208.1)	(349.8)	(411.8)	(401.1)	(422.1)	(382.0)	(671.9)
Grants	48.2	39.5	41.1	67.6	50.7	83.4	42.2	86.5
Total expenditure and net lending	460.1	614.7	719.1	1,008.2	1,098.1	1,237.3	1,496.9	1,656.7
Current expenditure	272.7	344.6	432.3	581.2	632.7	658.6	785.1	806.9
Wages and salaries	(109.2)	(143.6)	(171.9)	(216.3)	(235.9)	(264.3)	(311.9)	(333.8)
Interest	(13.1)	(19.2)	(26.5)	(36.6)	(41.5)	(38.3)	(42.8)	(42.8)
Other	(150.4)	(181.8)	(233.9)	(328.3)	(355.3)	(356.0)	(430.3)	(430.3)
Capital expenditure	140.7	209.7	247.4	405.2	400.0	527.5	600.0	(767.8)
Net lending	46.8	60.4	39.4	21.8	65.4	51.2	111.8	82.0
Overall surplus or deficit (-)	102.9	188.2	414.2	539.3	329.9	539.6	280.2	606.3
Financing	-102.9	-188.2	-414.2	-539.3	-329.9	-539.6	-280.1	-606.3
Foreign (net)	20.0	33.8	13.2	73.1	46.3	70.2	50.0	68.1
Drawing	(34.3)	(58.7)	(57.7)	(98.9)	(78.0)	(98.5)	(84.5)	(102.6)
Amortization	(-14.3)	(-24.9)	(-44.5)	(-25.8)	(-31.7)	(-28.3)	(-34.5)	(-34.5)
Domestic	-122.9	-222.0	-427.4	-612.4	-376.2	-609.8	-330.1	-674.4
Bank	(-109.1)	(-203.7)	(-435.3)	(-595.2)	(-367.7)	(-557.4)	(-323.1)	(-674.4)
Nonbank	(-3.8)	(-0.7)	(1.0)	(7.1)	(-8.5)	(-3.6)	(-7.0)	(--)
Other 2/	(-10.0)	(-17.6)	(6.9)	(-24.3)	(--)	(-48.8)	(--)	(--)
				(In percent of GDP)				
Memorandum items:								
Overall surplus	9.4	12.0	20.1	20.7	7.9	13.0	7.3	15.8
Total revenue	41.6	48.6	53.0	56.7	33.1	40.7	45.2	56.7
Mineral revenue (tax and nontax)	15.6	24.0	28.2	32.4	19.6	24.9	26.0	35.0
Customs revenue	12.7	9.9	7.2	7.4	5.7	5.6	7.6	7.6
Current expenditure	22.0	21.9	21.0	22.3	15.2	15.8	20.4	21.0
Capital expenditure	11.4	13.3	12.0	15.5	9.6	12.7	15.6	20.0

Sources: Republic of Botswana, Financial Statements, Tables, and Estimates of Consolidated and Development Fund Revenues, various years; data provided by the Botswana authorities; and staff estimates.

1/ Includes the accounting procedures adopted for Central Transport Organization in 1986/87 only.
2/ Mainly float and unpresented checks.

CHART 1
BOTSWANA
EXCHANGE RATE MOVEMENTS, JAN. 1982–AUG. 1988
(Period average, 1980=100; foreign currency per Botswana pula)





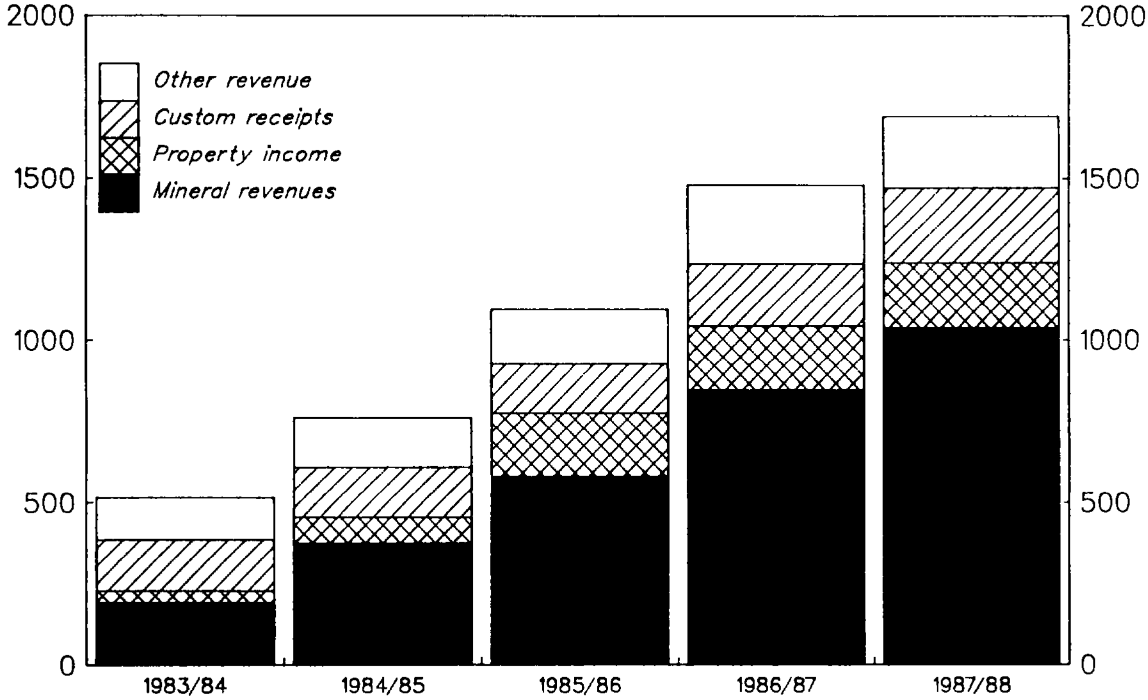
Sources: IMF Information System; and staff estimates.
[1] Import weighted.

CHART 2

BOTSWANA

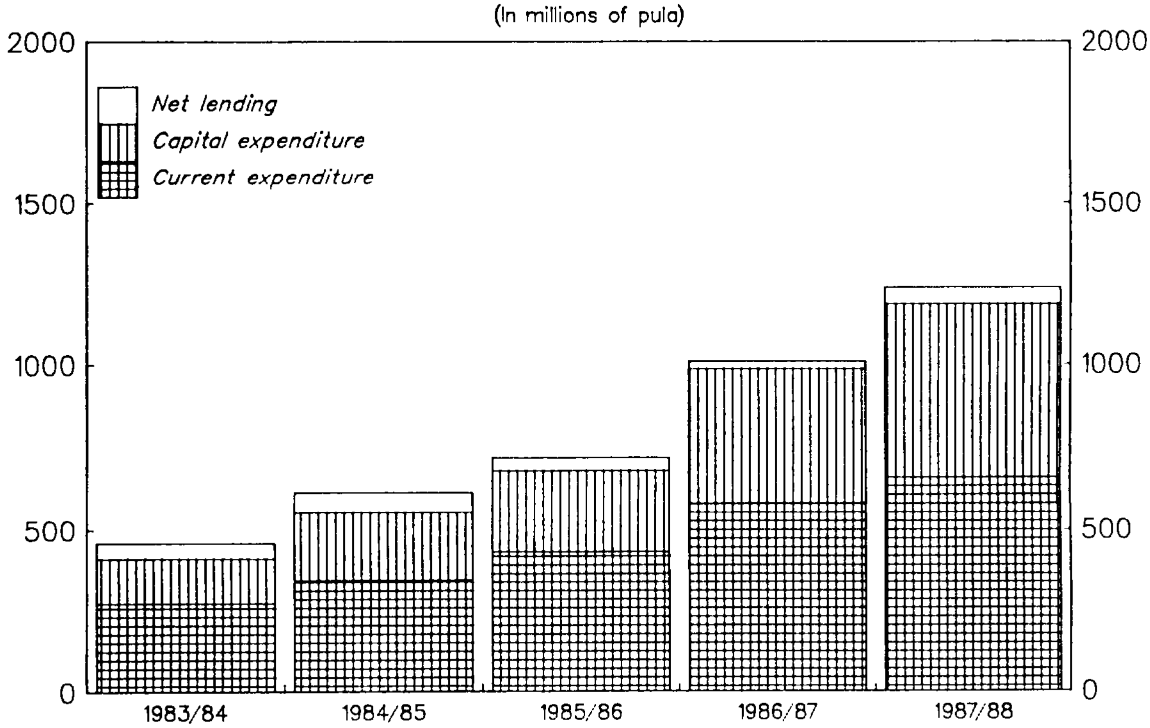
CENTRAL GOVERNMENT REVENUES, 1983/84–1987/88

(In millions of pula)



CENTRAL GOVERNMENT EXPENDITURE, 1983/84–1987/88

(In millions of pula)



Sources: Republic of Botswana, *Financial Statements, Tables, and Estimates of Consolidated and Development Fund Revenues.*

years. Almost two thirds of the increase in net foreign assets of the banking system from 1982 to 1986 was effectively sterilized in the form of larger government deposits in the central bank (Table 4). Broad money grew at an average annual rate of 22 percent during this period, approximately in line with nominal GDP growth. By 1986, net foreign assets were equivalent to more than three times the money supply and more than ten times the level of credit to the private sector. Credit to the private sector, starting from a very low base, rose by 16 percent per year from 1982 to 1986 (Chart 3). Nongovernment deposits at the central bank (held mostly by Debswana) increased from only P 8.5 million at the end of 1984 to an average of more than P 200 million during 1986.

The average rate of increase in Botswana's cost of living index between 1982 and 1986 was about 9 percent, compared with an annual increase of about 15 percent in the South African consumer price index. While Botswana's actual rate of inflation over this period was probably below South Africa's partly as a result of the appreciation of the pula against the rand, the two countries' indices differ substantially in concept and composition.

2. Developments in 1987

Jwaneng had opened during a slump in the world diamond market and during 1983-85 Botswana produced more diamonds than it was able to export, resulting in a large stock buildup. In July 1987, Debswana sold its entire diamond stockpile to De Beers in exchange for a 5 percent shareholding in De Beers (and two seats on the Board) and a cash payment. The total value of the sale, after taking into account a retroactive application of price increases of 10 percent in October 1987 and 13.5 percent in April 1988 as per the stockpile sale agreement, is estimated at approximately P 1 billion, equivalent to more than one third of the previous year's GDP. The sheer size of this transaction, its breakdown between share purchase and cash payment, and its lagged effects greatly complicate analysis of economic and financial developments in 1987. Since the diamonds had been recorded in the national accounts at the cost of production in the year in which they were stockpiled, the difference between the amount of the stockpile sale and the cost of production enters GDP as value added in 1987 and the accounts show an estimated increase in real GDP of about 40 percent. Excluding the effect of the stockpile sale, real growth is estimated to have been about 8 percent. Nonmining GDP is estimated to have grown by 9 percent in real terms, led by the recovery of agriculture, which benefited from favorable weather after the prolonged drought.

Primarily as a result of the stockpile sale, diamond exports almost doubled in 1987 to SDR 1,057 million, and total exports increased by 70 percent to SDR 1,244 million. Imports, which had remained fairly constant in SDR terms during the previous five years, rose by 26 percent to SDR 657 million, and the current account surplus reached SDR 510 million, or 27 percent of GDP. Excluding the stockpile sale, exports rose by only 8 percent in SDR terms and the current account surplus declined

Table 4. Botswana: Monetary Survey, 1982-88

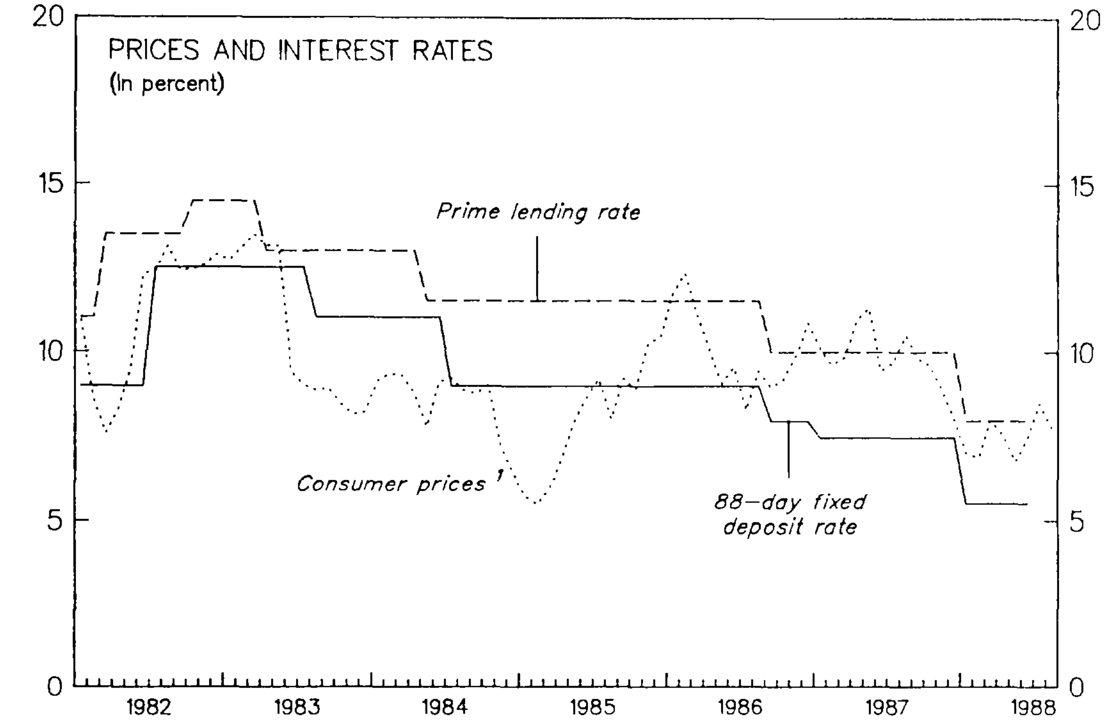
(In millions of pula; end of period)

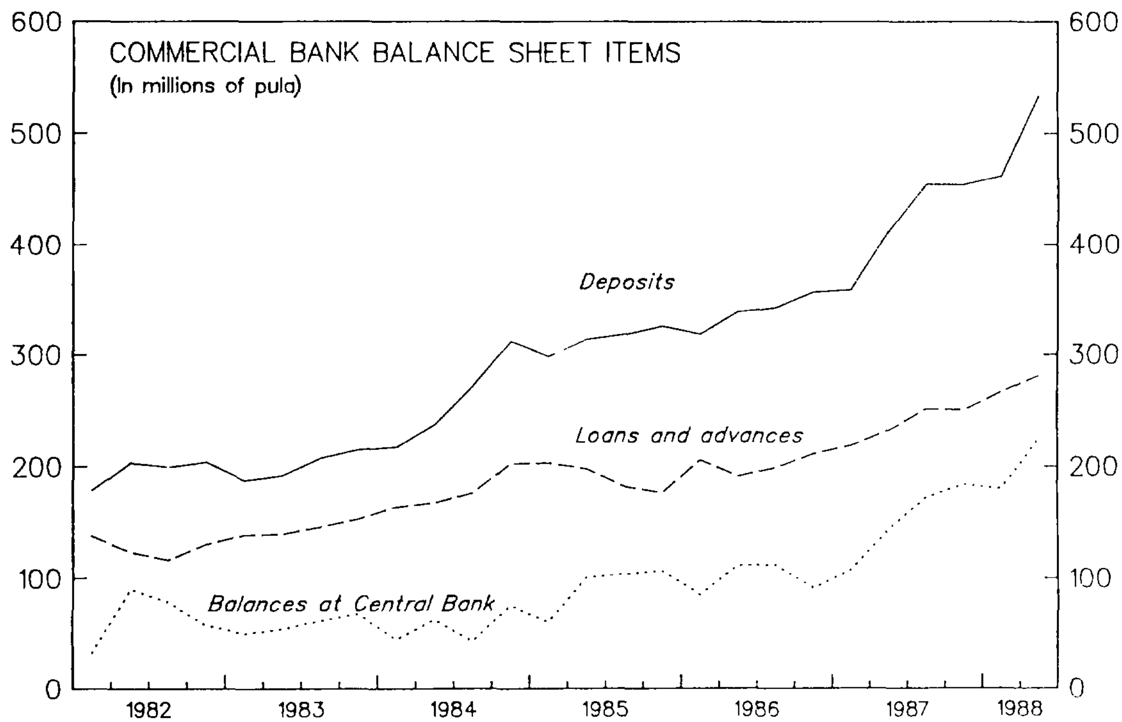
	1982	1983	1984	1985	1986				1987				1988	
					March	June	Sept.	Dec.	March	June	Sept.	Dec.	March	June
Foreign assets (net)	307.6	452.1	750.7	1,605.9	1,505.4	2,046.5	2,014.2	2,206.8	2,250.1	2,409.5	2,901.4	3,160.0	3,377.3	3,712.9
Bank of Botswana	310.8	457.3	736.7	1,644.5	1,484.8	2,037.8	2,017.5	2,200.5	2,252.3	2,407.7	2,911.7	3,151.6	3,369.4	3,689.0
Commercial banks	-3.2	-5.2	14.0	-38.6	20.6	8.7	-3.3	6.3	-2.2	1.8	-10.3	8.4	7.9	23.9
Domestic credit	53.3	5.8	-115.0	-360.2	-624.4	-695.1	-842.8	-962.2	-1,193.6	-1,221.0	-1,465.2	-1,504.0	-1,713.4	-1,686.7
Claims on Government (net)	-95.3	-171.4	-353.6	-617.1	-873.1	-936.3	-1,088.5	-1,235.6	-1,468.3	-1,503.4	-1,758.3	-1,789.3	-2,025.7	-1,995.8
Bank of Botswana	-94.9	-171.1	-353.6	-616.8	-872.8	-935.6	-1,087.7	-1,235.3	-1,468.0	-1,503.2	-1,758.1	-1,789.1	-2,022.4	-1,992.9
Commercial banks	-0.4	-0.3	—	-0.3	-0.3	-0.7	-0.8	-0.3	-0.3	-0.2	-0.2	-0.2	-3.3	-2.9
Claims on private sector 1/	148.6	177.2	238.6	256.9	248.7	241.2	245.7	273.4	274.7	282.4	293.1	285.3	312.3	309.1
Money plus quasi-money	237.0	310.8	353.5	521.4	555.6	645.8	554.6	596.0	659.5	720.9	904.7	988.0	1,027.2	1,186.6
Money	126.2	195.4	170.1	361.0	383.1	486.7	423.4	454.6	516.1	574.9	754.4	840.2	860.6	1,000.7
Currency	29.0	30.2	35.2	43.4	51.4	51.8	57.1	58.8	64.5	66.2	73.6	68.6	79.8	86.1
Demand deposits 2/	97.2	165.2	134.9	317.6	331.7	434.9	366.3	395.8	451.6	508.7	680.8	771.6	780.8	914.6
Quasi-money	110.8	115.4	183.4	160.4	172.5	159.1	131.2	141.4	143.4	146.0	150.3	147.8	166.6	185.9
Other items (net)	123.9	147.0	282.1	724.3	325.3	706.3	616.8	648.6	397.1	467.5	531.6	668.1	636.8	839.7
Memorandum item:														
Valuation adjustment (flow)	(29.4)	(10.0)	(112.4)	(407.3)				(-9.9)				(14.7)		

Source: Data provided by the Bank of Botswana.

1/ Including parastatals and local governments.
2/ Demand deposits are calculated as total current and call deposits less nonresident deposits and less 50 percent of interbranch balances at the end of the period.

CHART 3
BOTSWANA
INTEREST RATES, PRICES AND MONETARY DEVELOPMENTS





Source: Bank of Botswana.
[1] Percent change from the corresponding period in the previous year.

from the equivalent of 13 percent of GDP in 1986 to less than 8 percent of GDP in 1987. Contributing to this decline in the underlying current account surplus was a partial reversal of the previous favorable terms of trade effect as the U.S. dollar depreciated against the SDR, while the rand remained fairly constant against the SDR.

Net long-term capital flows were negative in 1987, reflecting Debswana's large purchase of De Beers shares. Nevertheless, the overall balance of payments rose to a surplus of SDR 434 million, compared with SDR 259 million in 1986. Official foreign reserves reached SDR 1.4 billion at the end of 1987, equivalent to 26 months of imports and only slightly smaller than projected GDP for 1988. Government and government-guaranteed external debt, about two thirds of which is owed by the Government and the remainder by parastatals, reached US$515 million and the debt service ratio was 3 percent.

The impact of the stockpile sale on government revenues fell both in FY 1987 and FY 1988 because of the timing of the company tax payments. In FY 1987 mineral revenues were 22 percent higher, and total revenues and grants were 15 percent higher, than in FY 1986. 1/ Total expenditure and net lending increased by 23 percent, reflecting mostly an acceleration of capital expenditures, particularly in the area of serviced land and housing, as project implementation capacity improved. Current expenditure rose by 13 percent, almost totally owing to a 22 percent increase in wages and salaries, which is explained by a 10 percent increase in wage rates on average, a 4 percent wage drift factor, and an expansion of employment by about 7 percent.

In nominal terms the FY 1987 budget surplus was equal to that of the previous year, the first time in five years that the surplus did not rise. As a percent of GDP the surplus declined from about 20 percent in FY 1986 to 13 percent in FY 1987. (Excluding the impact of the stockpile sale, the FY 1987 surplus was 9 percent of GDP.) Combined with net foreign financing only slightly down in nominal terms from the previous year, the FY 1987 budget surplus resulted in a further buildup of government deposits with the banking system equivalent to 15 percent of GDP.

While the consolidated surplus of nonfinancial public enterprises (after subsidies) had more than tripled between 1982/83 and 1986/87, reaching 2.7 percent of GDP in the latter year, it fell somewhat to 1.6 percent of GDP (adjusted for the stockpile sale) in 1987/88. As a consequence of their generally sound financial position, subsidies to the nonfinancial public enterprises were insignificant until 1986/87. In 1986/87 the Botswana Agricultural Marketing Board (BAMB) received a subsidy of P 5 million from the Government, and in 1987/88 the Botswana

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1/ Government budget revenues arose only from the cash component of the stockpile sale, and not from the retained earnings used by Debswana to purchase De Beers shares.

Housing Corporation (BHC) received a transfer of P 3.1 million. While the transfer to BAMB appears to have been a unique occurrence related to one transaction, transfers to the BHC have the potential for growing ever larger (see Section III.4).

The broad money supply rose by 66 percent in 1987, but most of this increase is accounted for by Debswana's deposits in the Bank of Botswana, which rose by about P 250 million. Excluding these deposits, the money supply grew by 24 percent in 1987. Debswana's deposits in the central bank reached more than P 500 million by June 1988 but were reduced by more than half in July when Debswana made a large tax payment to the Government. This resulted in an 18 percent decline in the money supply to a level 2 percent below the beginning 1988 money stock.

Credit to the private sector grew by only 4 percent in 1987, but by 8 percent excluding credit to the the mining sector, which has been dominated in recent years by the repayment of domestic loans by the debt-ridden copper-nickel company (BCL) as BCL has switched to external sources of finance in the context of rescheduling packages. In the first half of 1988, private sector credit (excluding the mining sector) grew by 14 percent, possibly owing in part to measures taken in January 1988 to encourage domestic credit expansion (see Section III.5 below).

The increase in the cost of living remained in 1987 at the previous year's rate of slightly less than 10 percent, but declined to 7.4 percent in the year to June 1988, primarily as a result of the abolition of secondary school fees in January 1988.

The pula appreciated by about 2 percent against the rand during 1987, but moved in line with the rand over the first half of 1988, as the rand depreciated sharply against the SDR. In real effective terms, the pula appreciated by about 1 percent in 1987 but depreciated by 3 percent during the first six months of this year. As of June 1988, the pula had depreciated in real effective terms by about 15 percent since 1982.

Following the trend of liberalization of recent years, exchange controls were further liberalized in early 1988 by the passage of a wide range of measures. These measures are discussed in Section III.5 below. Botswana's system of exchange controls is one of the most liberal on the African continent.

III. Report on the Discussions

The key issue facing the Government of Botswana is how to use most effectively the very large resources presently available to it from diamond exports in order to promote a broad-based development of the economy. At the time of the mission the authorities had just completed a Mid-Term Review of the Sixth National Development Plan (NDP6), 1985-91, and that document provided a useful basis for the consultation discussions. The staff's medium-term projections, based largely on the outlook and policies as outlined in the review of NDP6 and elaborated in the discussions with the authorities, are set out in Section IV and Appendix II of the present report.

1. Policy considerations, constraints, and objectives

The economy of Botswana is at an important juncture. The large increase in diamond export earnings over recent years has fueled a rapid expansion in government revenues and spending, in nonmining GDP, and in employment. Botswana's diamond mines are, however, now operating at capacity and no further sharp increases in world diamond prices are anticipated. The midterm review of NDP6 took place therefore in the context of a projected marked slowdown in the growth of both export receipts and government revenues.

In Botswana's situation, with foreign reserves equal to 25 months' imports and the fiscal surplus for FY 1988 forecast at 16 percent of GDP, there are naturally strong pressures for a rapid increase in government spending. Nevertheless, the authorities emphasized their awareness of the need to husband those resources carefully, given both the medium-term outlook and the country's vulnerability to developments in the diamond market, to drought, and to the political and security situation in the region. They considered a reserve cushion of 9 to 12 months' imports to be a reasonable long-term objective and that a substantially higher level was warranted at present in view of the need to finance rising expenditures as revenues slowed through the mid-1990s. The policy of the Government with respect to international reserves was to invest these resources in relatively safe financial instruments. Approximately half of these reserves were invested in treasury bills and securities and the remainder in balances at foreign banks.

The authorities envisioned that, with diamond revenues slowing, the private sector must and should assume the leading role in generating growth and employment over the longer run. Given the small size of Botswana's economy, that growth would have to be primarily export led. The authorities recognized, however, that the transition away from an economy dependent on diamonds would be neither rapid nor easy. Despite Botswana's strong financial position, there are important constraints to development. Most of the population of 1.1 million is rural, poor, and dependent on the cattle economy. A severe shortage of skilled and semiskilled labor is perhaps the most important constraint, limiting both the pace of private sector development and the Government's own implementation capacity. There are also important bottlenecks in the provision of physical infrastructure, particularly serviced land for commercial, industrial, and residential development. Moreover, private savings rates are low and the financial system is not well equipped to intermediate funds for long-term investment.

Barring important new discoveries, the only major development envisioned in the minerals sector is the Sua Pan Soda Ash Project, which will have some government equity but is to be financed primarily by foreign private investment. When operating at full capacity, Sua Pan will generate export revenues equal to about 5 percent of diamond receipts. While the ongoing agricultural development, particularly Pandamatenga in the rain-fed lands of the north, will provide an important source of income and reduce food import requirements, it was considered unlikely that Botswana (three fourths of whose land area is desert) could economically produce an exportable surplus of grains. Future export development would, therefore, have to come primarily from processing and manufacturing industries. The success of Botswana's infant textile industry in expanding exports bodes well for such development, but this must be seen in the context of an economy where manufacturing activity, other than beef processing, currently accounts for less than 4 percent of GDP.

2. Employment and manpower policies

While the shortage of skilled manpower was viewed as one of the major constraints to development, rapid population growth combined with rural/urban migration had led to rising unemployment and underemployment among unskilled labor. The unemployment rate is estimated to exceed 25 percent. The authorities, therefore, attached great importance to increasing the supply and effective use of skilled labor, while expanding employment opportunities more generally.

The Botswana representatives stressed the complementarity between skilled and unskilled labor and noted that central government hiring was particularly skill-intensive. They were concerned that the Government's "crowding out" of the private sector in the market for skilled labor might constrain private sector growth and, thereby, result in a lower rate of total employment expansion than would otherwise have been possible. The Government had, therefore, established a guideline that the central and local governments should not absorb more than one third of university graduates each. The Government was also attaching priority to the expansion of vocational education, apprenticeship programs, and university training in areas of greatest skill shortage, as well as to improved manpower budgeting within the Government. In the meantime, there would be a continued need to import skilled labor in order to ease this constraint.

3. Prices, wages, and the exchange rate

The authorities envisioned that export-oriented manufacturing and the expansion of agriculture would need to play a key role in providing employment opportunities. The staff agreed with this assessment and emphasized that such a strategy would require a wages and incomes policy formulated with a view both to external competitiveness and to ensuring that urban/rural income relationships reflected labor productivity in the two sectors. Wage restraint in the central and local governments, which together accounted for 40 percent of formal sector employment, would be essential. The escalation since 1986 in the rates of increases in government salaries, in recorded average earnings, and in minimum wages was therefore a cause for concern in terms of the ability of the authorities to maintain price stability and competitiveness.

Given the openness of Botswana's economy, movements in prices for tradable goods were unlikely to diverge substantially from those in Botswana's main trading partner. Botswana could, however, deny itself markets by allowing costs of production to rise above those of its current or potential competitors. Electricity and water charges were necessarily and appropriately high by regional standards, underscoring the need to monitor carefully developments in wage and land use costs.

In Botswana, unlike many other countries that had experienced a sharp increase in mineral revenues, the authorities had followed an exchange rate policy that had resulted in a real effective depreciation of the pula. Although the authorities' exchange rate policy was to adjust the pula in line with movements in a basket composed of the rand and the SDR, with variable weights, in practice the pula had followed fairly closely the general downward movement of the rand. It would be important that the authorities give due consideration to competitiveness not only vis-à-vis Botswana's major trading partner, but also with respect to other potential markets for manufactured exports from Botswana. The staff encouraged the authorities in their efforts to develop more accurate measures of competitiveness, such as a wholesale price index and various cost indices.

4. The FY 1988 budget and government expenditure and revenue policies

The resources available to the Government and the economy had turned out to be much higher than had been projected when the development plan for 1985-91 had been drawn up. Furthermore, as a result of the cumulative 25 percent increase in diamond prices over the past year, Government revenues were now expected to remain well above plan projections. The midterm review of NDP6 focused on the implications of this more favorable outlook for government expenditure and revenue policies over the remainder of this, and the beginning of the next, plan period. The present fiscal year ends April 30, 1989, and is covered by the FY 1988 budget discussed below.

a. The FY 1988 budget

The FY 1988 budget was announced on February 22, 1988. The original budget estimates projected a decline in the overall budget surplus to 7 percent of GDP (from 13 percent of GDP the year before). However, a number of events have overtaken the original projections, and during the discussions the authorities agreed that the outturn was likely to be substantially better than initially expected. On the revenue side, mineral revenues are likely to be more than one third higher than the budget estimate, mainly on account of the 13.5 percent

U.S. dollar price increase for diamonds announced in April 1988 and applied retroactively to the sale of the diamond stock, as well as a further depreciation of the pula against the U.S. dollar not anticipated in the budget forecasts (Table 3). On the expenditure side, the authorities published a supplement to the budget in July 1988, which allocates a further P 224 million (6 percent of GDP) to capital expenditure and P 5 million to current expenditure. According to staff projections, the net result is that the overall budget surplus will be about 16 percent of GDP, slightly higher than the year before.

b. Expenditure policies

In response to higher revenues the Government had already in FY 1986 and FY 1987 raised spending, particularly development spending, substantially above planned levels. In the context of the budget for FY 1988 and of the midterm review of NDP6, the Government has now opted for a strategy that would entail a sharp further acceleration in government development spending over the next few years, with the intention that such spending would decline in real terms over the first half of the 1990s as private sector investment picks up momentum and becomes the engine of growth for the economy. In considering projects to be undertaken under this accelerated program, the authorities said they intend to attach priority to those that reduce or overcome bottlenecks impeding the development of the nongovernment and nonmineral sectors and have little or no continuing recurrent costs. The first major initiative, which is already under way, is an accelerated program for the development of serviced land for industrial, commercial, and residential construction. A second major initiative will be government construction of infrastructure, to be charged on the basis of full economic cost, for the Sua Pan Soda Ash Project. Projects in areas such as water resources, transport, and agricultural land development have been identified or are under consideration.

The staff was in broad agreement with the authorities' strategy and welcomed in particular the intention to emphasize projects that would be self-liquidating, or at least self-supporting, while overcoming bottlenecks that impede private sector development. Botswana had the financial resources to afford an investment program at the level envisioned; indeed, the staff's projections indicated that, even with this accelerated program, foreign exchange reserves would still cover about two years' imports in 1992. There was, however, concern as to whether a program of the magnitude envisioned, particularly when taken in conjunction with the total investment requirements of Sua Pan, was consistent with the absorptive capacity of the economy and the implementation capacity of the public service. While investment in infrastructure could complement future private sector investment in productive activities, it might at the same time create new bottlenecks or even crowd out private sector activity over the near term by competing for skilled manpower and other scarce domestic resources, thereby rendering it less likely that the private sector would be able to assume its envisioned role as the prime engine for growth. The program's heavy emphasis on construction projects was also a concern, as a construction boom, not only in Botswana but in the southern African region generally, was already leading to shortages and a sharp upward movement in construction costs.

The authorities were also concerned about a possible crowding out of the private sector and said they intended to monitor developments carefully. The envisioned level of investment would most likely require greater reliance on imported skilled labor. They noted that pressures on the construction sector were not expected to abate, as the Lesotho Highlands Water Project would make major demands on regional construction capacity during the first half of the 1990s. This argued against deferring investments.

While agreeing that the development of serviced land was a priority area, the staff urged the authorities to reconsider the parallel program under which housing construction by the BHC was to increase from 1,200 units in 1986/87 to 2,800 units per year from 1989/90. In contrast to the Government's general policy of full cost pricing of services, BHC rental housing was heavily subsidized, with tenants paying only about one fourth of the economic rent. Housing built by BHC for local authority management was even more heavily subsidized and the cost was borne by the Government through local authority deficit grants which had risen sharply in recent years.

The authorities said that most tenants in subsidized housing, many of whom were civil servants, could not afford to pay economic rents on the units they occupied. It had recently been decided to raise local authority rents over time to BHC levels and to raise BHC rents by 15 percent a year. Construction costs, however, were currently rising by more than 20 percent per year. The staff stressed that Botswana should not, given the medium-term resource outlook and the need for productive investment, try to extend more generally the heavily subsidized housing that was now available to a few. Given the apparent political constraints that kept the BHC from building housing to a standard that people could afford and charging economic rents, the staff considered that the Government could best contribute to an adequate housing supply by directing its own resources to a rapid expansion of serviced land for housing, and leaving housing construction to the private sector.

c. Revenue policies

Mineral revenues, customs union receipts, and transfers of central bank profits from its foreign reserve holdings together account for more than 85 percent of government revenue. The Botswana authorities have for some time been concerned about the heavy dependence of government revenues on diamond sales and on external sector developments more generally. At the request of the authorities, a 1985 FAD technical assistance mission had addressed this problem and recommended the introduction of a broad based sales tax and certain other revenue diversification measures.

At the present juncture, however, the authorities are faced with competing considerations. On the one hand, they still see a need to broaden the revenue base in view of both the expected slowdown in mineral receipts and the ever present possibility of a major contraction in the diamond market. At the same time, given the present large government surpluses, they see no need to raise taxes. They have therefore decided to introduce the general sales tax only gradually, beginning by imposing in the current fiscal year a 10 percent tax on specified luxury goods. In order to encourage private sector savings, the Government also intends to introduce during the current fiscal year legislation that will substantially increase tax deductions allowed for employee and employer contributions to approved pension plans.

The staff representatives agreed with the authorities that it was neither necessary nor desirable to raise the domestic tax burden significantly at the present time. Indeed, it was appropriate for government revenues to decline gradually relative to GDP as nonmining activities began to account for a growing proportion of domestic production. Nevertheless, the authorities would need to prepare a plan for revenue diversification and put the necessary instrumentation in place so that nonmineral revenues could be raised gradually over time or, if circumstances required, more rapidly.

5. Monetary policy and financial development

Botswana has a relatively undeveloped and very liquid financial system dominated by a few large actors. Deposit rates have generally been negative in real terms and would have been lower in the absence of minimum rates set by the Bank of Botswana. In this situation the three commercial banks increasingly refused to take deposits in interest-bearing accounts. The Bank of Botswana stepped in to absorb deposits from Debswana and the parastatals and by June 1987, i.e., before the diamond stockpile sale, such deposits with the central bank accounted for 40 percent of total nongovernment deposits with the banking system. Nevertheless, fewer than half of commercial bank deposits were interest bearing, and bank loans were equal to only 60 percent of deposits.

Institutional factors have contributed importantly to bank liquidity. Parastatals and foreign-owned firms account for a large part of economic activity, but commercial bank borrowing by parastatals has been discouraged de facto by government policies, while bank borrowing by foreign-controlled firms has been restricted de jure. The Government lends its own funds, or onlends foreign funds, to parastatals at rates that are generally set about 1 percentage point below the prime rate. At the end of FY 1987 funds lent or onlent by the Government to parastatals were almost twice total commercial bank credit outstanding. In addition, when parastatals borrow abroad directly the

Government provides guarantees that limit the parastatals' maximum exchange risk over the life of the loan, on both principal and interest, to 8 1/4 percent and charges no premium for this cover. Despite their liquid position, the three commercial banks, all wholly or predominantly foreign owned, were quite profitable as a result of above average spreads and, most importantly, large revenues from fees on foreign exchange and other transactions, which were set by agreement among the banks.

Against this background, the Bank of Botswana has taken a number of measures to encourage increased lending by, and competition among, the banks and to let interest rates move downward while seeking to provide a minimum return to smaller depositors. In early 1987 the cartel agreement on charges was abolished; each bank now sets, subject to central bank approval, its own schedule of charges which must be publicly displayed. In January 1988 the central bank lowered minimum deposit rates from a range of 7.25 to 8.5 percent to a range of 5.0 to 6.5 percent and abolished the interest rate ceiling on loans, but set a maximum prime rate of 8.5 percent. In addition, each bank was required to post a limit, which could not be less than P 50,000 (raised to P 250,000 in July 1988), up to which it would accept savings or time deposits from any one depositor and to accept amounts above that limit at the bank's call rate. In March 1988 the Bank of Botswana liberalized the restrictions on borrowing by foreign-controlled firms by raising the tranche not subject to restriction from P 100,000 to P 250,000 and by providing that the 3:1 debt/equity rule for borrowing above that amount could be waived if it was determined that this would contribute significantly to employment creation. 1/

The staff welcomed these steps to encourage competition among the banks and to move toward deregulation of interest rates. They considered appropriate in Botswana's circumstances, and given the need to promote private savings over the longer run, the decision to protect somewhat the smaller depositor. The measures appeared already to be having the desired effects. Bank fees and commissions had been reduced, the prime lending rate had come down in stages to 7.5 percent, and there had been a definite pickup in the growth of household deposits, time deposits, and credit to the private sector. The staff considered, however, that there was a need to examine government policies regarding below-prime financing of parastatals and the provision of exchange rate guarantees. Not only was it likely that these policies were distorting parastatal funding and pricing decisions, but also greater parastatal recourse to the domestic financial system might facilitate the development of that system and help push deposit rates up to more remunerative levels. The authorities responded that low lending rates to parastatals compensated them somewhat for undercapitalization and that foreign borrowing by parastatals always required the approval of,

1/ Prior to October 1986 local borrowing by foreign-controlled firms had to be matched 1:1 by foreign funds.

and was often undertaken at the direction of, the Government, which considered that parastatals should not be penalized because they borrowed abroad rather than at the government lending rates. The staff acknowledged these points but doubted that a policy of trying to offset one distortion with another could lead to an appropriate or transparent set of relative costs and prices.

The authorities noted that the U.S. Agency for International Development had recently signed agreements to provide up to US$1.5 million to guarantee 50 percent of the interest and principal on bank loans to small enterprises in Botswana, which should help overcome their problem in obtaining credit because they lack collateral. The Bank of Botswana also considered that action was necessary to facilitate longer-term lending by banks and was considering various options for rediscounting or refinancing facilities. The staff agreed with the authorities that it would be better to have banks undertake such lending at their own risk than to establish a government institution for long-term lending, but cautioned that care would need to be taken to ensure that such a facility did not weaken central bank control over money creation or become a vehicle for interest rate subsidies.

6. Exchange control and regulatory environment

The Botswana authorities said that they considered a liberal foreign exchange regime to be an important element in creating a healthy business climate. In March 1988 they had liberalized substantially further Botswana's already quite open payments system. The share of their portfolios that pension and life insurance funds could place offshore was raised from 25 percent to 50 percent. Direct investment abroad by the corporate sector is now also to be permitted when it is considered to result in benefits to Botswana. For a wide range of transactions, the limits up to which the commercial banks may authorize transfers without reference to the Bank of Botswana were increased substantially. 1/

The staff welcomed this important liberalization and urged the authorities to consider making foreign exchange freely available for all bona fide current transactions and accepting the obligations of Article VIII, Sections 2, 3, and 4, which would be seen as underscoring and reconfirming Botswana's commitment to an open system for the making of payments and transfers for current international transactions. The authorities said that it was their intention to maintain a very open

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1/ Examples of the new delegated limits include an annual basic travel allowance of P 10,000 (US$5,550) per adult, business travel allowances of P 500 per day up to P 30,000 per person per year, an overseas study allowance of P 3,000 per month, emigration allowance of P 150,000 for permanent residents, and no limits for bona fide medical expenses. For further information on these measures, see the accompanying report on Recent Economic Developments.

system but, in view of uncertainties related to regional security and external developments, they wanted to be able to adapt to changing circumstances the restrictions currently maintained by Botswana under the transitional arrangements of Article XIV.

The Government's exchange rate guarantee scheme for parastatals that borrow directly abroad limits the exchange risk that can be incurred by a parastatal over the life of a loan to a maximum of 8 1/4 percent. This compares with an increase over the five years to June 1988 of 70 percent in the number of pula per U.S. dollar and of 90 percent in the number of pula per pound sterling at the official exchange rates. The Government had therefore incurred significant liabilities to cover the exchange losses on such loans as they matured, and the scheme was considered to have given rise to a multiple currency practice. The authorities said that they saw merit in protecting parastatals at least partially from exchange rate losses (see Section III.5 above). They acknowledged, however, that the present scheme, for which no premium is charged, had been predicated on a more stable exchange rate environment. While a re-examination of the scheme might therefore be called for, they had at present no plans to revise or terminate the scheme.

The staff noted that while Botswana's liberal trade and payments system should and was playing an important role in attracting foreign investment, the way in which other types of regulations were being implemented was apparently a major disincentive to investors. In the mission's discussions with both public and private sector managers, the difficulty in obtaining licenses and permits--including work permits for skilled labor--was frequently cited as one of the main obstacles to new foreign investment and to the expansion of productive activity more generally. This had had an important cost to Botswana in terms of lost employment and output, and the authorities needed to simplify, speed up, and coordinate the various required procedures.

IV. The Outlook for 1988 and the Medium Term

Assuming policies consistent with the authorities' present stance and stated intentions, and taking into account likely developments in export earnings, the staff has prepared a medium-term projection that incorporates the major acceleration of public sector investment envisioned in the Mid-Term Review of NDP6 as well as an investment schedule for the Sua Pan Soda Ash Project that would have production coming on stream by 1991. The assumptions underlying, and the conclusions from, the staff's scenario are detailed in Appendix II, and the main results are summarized in Table 5. In Table 5 and in the following discussion, the average of the two calendar, fiscal, or national accounts years prior to the year of the stockpile sale is taken as the point of reference.

Table 5. Botswana: Summary of Medium-Term Projections, 1988/89-1991/92

(In percent of GDP, unless otherwise indicated)

	1985/86-1986/87 Average	1988/89 (FY 1988)	1989/90 (FY 1989)	1990/91 (FY 1990)	1991/92 (FY 1991)	
Real sector 1/						
Gross national savings/GNP	38.8	38.3	38.1	37.5	35.6	
Gross domestic investment/GNP	26.5	32.3	37.0	40.8	39.4	
Real GDP growth	14.3	-18.9	2.7	2.2	4.9	
Real nonmining GDP growth	8.6	6.8	4.7	3.3	4.8	
Cost of living (percent change)	9.9	11.0	12.0	13.0	14.0	
GDP deflator (percent change)	12.9	14.9	11.0	13.1	13.0	
Central Government 2/						
Budget surplus/deficit (-)	20.4	15.8	8.8	7.2	4.0	
Total revenues and grants	57.2	58.9	51.9	55.2	54.7	
Total revenues	54.9	56.7	49.9	53.4	53.2	
Of which: mineral revenues	(30.3)	(35.0)	(26.1)	(25.7)	(24.6)	
Current expenditure	21.6	21.0	22.6	24.7	25.8	
Capital expenditure and net lending	15.1	22.1	20.5	23.3	25.0	
	1985-86 Average	1988	1989	1990	1991	1992
External sector 3/						
Current account	13.0	13.5	5.9	1.7	--	2.4
Export volume (percent change)	4.4	-26.5	0.3	0.4	0.5	0.5
Import volume (percent change)	4.1	16.0	10.1	8.7	6.5	-0.4
Net official reserves (in months of imports)	20.1	25.4	24.3	23.8	23.1	23.5

Sources: Data provided by the Botswana authorities; and Appendix II, Tables I-IV.

1/ National accounts year, July-June.
2/ Fiscal year, April-March.
3/ Calendar year.

Government investment is projected to rise to 21 percent of GNP in FY 1988 and remain at about the level throughout the projection period, while private investment--reflecting almost entirely the foreign-financed investment associated with Sua Pan--will be sharply higher from 1989/90 onward. As a result, total investment will rise from about 26 percent of GNP in the base period to 32 percent of GNP in 1988/89 and peak at 41 percent of GNP in 1990/91. Given the very high import component of investment in Botswana (particularly in the case of Sua Pan where not only capital equipment and materials, but also an important part of the labor, will need to be imported), this large increase in investment is expected to have little short-run impact on the economy and real GDP growth is projected to decelerate sharply before turning upward again in 1991/92 when Sua Pan begins to come on stream.

Reflecting lagged receipts from the stockpile sale, government mineral revenues will rise to a record 35 percent of GDP this year and the overall government surplus is projected at 16 percent of GDP despite the sharp rise in investment spending. From FY 1989 onward mineral revenues will decline steadily relative to GDP, but during the projection period this is offset by rising customs union receipts and transfers of central bank profits, and in FY 1991 total government revenues will be only slightly lower relative to GDP than they were in the base period. Government current spending is projected to rise at about the same pace as total revenues from FY 1989 through FY 1991 and government savings will remain at about 27 percent of GDP. However, with capital expenditure and net lending rising, the overall budget surplus will decline from 9 percent of GDP in FY 1989 to 4 percent of GDP in FY 1991.

Export receipts in SDRs are projected to increase at a compound annual rate of only about 3 percent over the four years through 1992, compared with 16 percent over the four years through 1986. Capital goods imports are expected to rise very rapidly, reaching a peak in 1991 fully 60 percent above the 1987 level in real terms. Reflecting primarily these developments, the external current account position is projected to drop from a surplus of 13 1/2 percent of GDP in 1988 to balance in 1991 before returning to a surplus of 2 1/2 percent of GDP in 1992 with the completion of Sua Pan. Nevertheless, given the large foreign investment in Sua Pan, substantial balance of payments surpluses are projected throughout the period and by the end of 1992 foreign exchange reserves would still be equal to about two years' imports.

The foregoing scenario assumes no recession in the diamond market and no disruptions in trade or investment emanating from regional developments. The staff produced an alternative scenario under which diamond sales quotas are cut by 40 percent from 1989 onward (similar to what occurred in the early 1980s), showing the extent to which Botswana would have to reduce its planned investment program. In this case, as discussed in Appendix II, if planned investment were not reduced the current account of the balance of payments would turn rapidly to a deficit of about 20 percent of GDP and the Government would run deficits rising from 3 percent of GDP in FY 1989 to 11 percent of GDP in FY 1992. Reserves would still be equal to almost one year's imports by 1992, but would be declining rapidly.

V. Staff Appraisal

In the two decades since independence Botswana's economy has registered a most impressive performance. Although rapidly rising diamond exports were the main factor contributing to a fivefold increase in real per capita GDP over that period, sound economic policies also played a crucial role and the authorities are to be commended for establishing and maintaining the open economy and stable macroeconomic environment that have contributed to this performance. Most importantly, the authorities have sought to ensure that the rapidly increasing resources available to the Government and to the nation were invested in economically sound projects and at a pace consistent with the aborptive capacity of the economy.

Botswana's economy is, however, at an important juncture. The diamond sector is now producing at capacity and, barring important new discoveries, the growth of both export receipts and government revenues from the mineral sector is expected to slow sharply. While government spending has provided the main impetus to growth of nonmining GDP over recent years, the authorities consider that over the medium term it must and should be the private sector that provides the engine of growth for the economy. Given Botswana's small population and limited agricultural potential, such growth will have to be export led and manufacturing based.

While the outlook is for a slowdown in government revenues, the authorities are entering this period of transition with a much higher current and projected level of resources at their disposal than had been anticipated earlier. The Government of Botswana has recently completed a Mid-Term Review of the Sixth National Development Plan, 1985-91, and has decided to undertake over the next few years an accelerated public sector investment program intended to eliminate bottlenecks and provide the infrastructure considered necessary to facilitate private sector investment, which, in turn, is expected to pick up momentum as public sector investment spending declines over the first half of the 1990s.

The staff is in broad agreement with the authorities' strategy and considers that Botswana has the financial resources to afford an investment program of this magnitude. There is, however, concern that this program, combined with the requirements of the Sua Pan Soda Ash Project might crowd out other private sector investments over the next few years in terms of access to skilled manpower, serviced land and buildings, transportation facilities and other inputs that, at least in the short run, are in limited supply. The authorities will need to monitor the situation carefully, facilitating increased use of imported skilled labor where shortages appear likely and stretching the

Government's investment program out over time if necessary. It will also be important for the authorities to proceed promptly to streamline and coordinate the various permit and licensing procedures.

The success of the authorities' medium-term strategy will depend crucially on establishing and maintaining a competitive cost structure. In Botswana's situation this will require incomes and wage policies that take into account the high cost of utilities and transportation. A low direct and indirect tax burden on domestic nonmining activities will also help Botswana's competitive position, which points to the need to restrain Government's recurrent expenditure and to reduce government investment spending as planned in the early 1990s. Finally, the authorities will need to be prepared to use the exchange rate flexibly to maintain competitiveness not only with respect to Botswana's major trading partner, but also vis-à-vis other potentially important markets.

Plans to increase substantially the production of new rental units by the Botswana Housing Corporation should be reconsidered. The need for productive investment and expanding employment opportunities in Botswana is too great to permit substantial resources to be diverted to subsidizing housing that is built to a standard that would otherwise be beyond the means of present and prospective tenants.

The monetary policy measures introduced by the Bank of Botswana in January of this year were an innovative response to an unusual set of circumstances, and these measures appear to be achieving the desired objectives of increasing household financial savings, stimulating the extension of credit to the nonmining private sector, and lengthening the maturity structure of deposits. The staff shares the authorities' concern that a complete deregulation of interest rates, by itself and in the present environment, could have an undesirable effect on household savings behavior and, in that context, welcomes the substantially increased latitude for domestic borrowing by foreign-controlled firms and foreign investment by local pension funds, insurance companies, and corporations. However, practices concerning parastatal financing, including the rates charged on government lending and onlending and the provision of exchange rate guarantees on foreign borrowing, need to be reappraised. More market-related policies not only would provide a better basis for investment and funding decisions but also might help ensure a reasonable rate of return to domestic savers and thus facilitate the development of the financial system.

The authorities have recently introduced measures that liberalized substantially Botswana's already quite open exchange and payments system. That system is free of restrictions on the making of payments and transfers for current international transactions except for relatively high limits that apply to private and business travel and certain types of remittances and transfers abroad which are maintained in accordance with the transitional arrangements of Article XIV, Section 2. Also, the exchange rate guarantees provided by the

Government on external borrowing by parastatals give rise to a multiple currency practice subject to approval under Article VIII, Sections 2(a) and 3; approval of this multiple currency practice is not recommended, as the Government has no plan for its elimination.

In consideration of the authorities' request, it is recommended that the next Article IV consultation with Botswana be held on the standard 12-month cycle.

VI. Proposed Decision

1. The Fund takes this decision relating to Botswana's exchange measures subject to Article VIII, Sections 2(a) and 3, in concluding the 1988 Article XIV consultation with Botswana and in the light of the 1988 Article IV consultation with Botswana conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Botswana continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions except for the relatively liberal limits on tourist and business travel and remittances abroad that are maintained by Botswana in accordance with transitional arrangements under Article XIV, Section 2, and the multiple currency practice arising from the foreign exchange risk sharing scheme applicable to borrowing by parastatal organizations, which is subject to Fund approval under Article VIII, Sections 2(a) and 3. The Fund encourages Botswana to remove this multiple currency practice as soon as possible.

BOTSWANA - Basic Data

Area, population, and GDP per capita

Area	581,370 square kilometers
Population: Total (1986 estimate)	1,131,700
Growth rate	3.4 percent
GDP per capita (1986 estimate)	SDR 997

	1983/84	1984/85	1985/86 Prel.	1986/87 Prel.	1987/88 Prel.
National accounts (July-June)	(In millions of pula)				
GDP at current market prices	1,302.1	1,660.7	2,193.5	2,747.4	4,304.7
GDP at constant (1979/80) market prices	1,120.5	1,211.5	1,380.6	1,583.9	2,227.1

	1983	1984	1985	1986	1987	1988 June
Prices	(Percentage change from preceding year)					
National cost of living index	10.4	8.6	8.1	9.9	9.8	7.4

	1983/84	1984/85	1985/86	1986/87	1987/1988 Expected outturn
Central government finance (April-March)	(In millions of pula)				
Total revenue and grants	563.1	802.9	1,133.4	1,547.5	1,776.9
Of which: Customs Union	(156.8)	(155.8)	(149.2)	(192.3)	(234.1)
mineral revenue	(193.8)	(376.5)	(581.3)	(844.9)	(1,034.5)
Total expenditure and net lending	460.1	614.7	719.1	1,008.2	1,237.3
Of which: current expenditure	(272.7)	(344.6)	(432.3)	(581.2)	(658.6)
capital expenditure	(140.7)	(209.7)	(247.4)	(405.2)	(527.5)
Overall surplus or deficit (-)	102.9	188.2	414.2	539.3	539.6
External financing (net)	20.0	33.8	13.2	73.1	70.2
Domestic financing (net)	-122.9	-222.0	-427.4	-612.4	-609.8

BOTSWANA - Basic Data (concluded)

	1983	1984	1985	1986	1987
Money and credit (end-year)	(In millions of pula)				
Foreign assets (net)	452.2	750.6	1,605.9	2,206.8	3,160.0
Domestic credit	5.8	-115.0	-360.2	-962.2	-1,504.0
Claims on Government (net)	(-171.4)	(-353.6)	(-617.1)	(-1,235.6)	(-1,789.3)
Claims on private sector	(177.2)	(238.6)	(256.9)	(273.4)	(285.3)
Money and quasi-money	310.8	353.5	521.4	596.0	988.0
Money	(195.4)	(170.1)	(361.0)	(454.6)	(840.2)
Quasi-money	(115.4)	(183.4)	(160.4)	(141.4)	(147.8)
Balance of payments 1/	(In millions of SDRs)				
Exports, f.o.b.	599	667	717	732	1,244
Of which: diamonds	(396)	(467)	(549)	(547)	(1,057)
Imports, f.o.b.	-576	-574	-486	-523	-657
Trade balance	23	93	230	210	587
Services and incomes (net)	-139	-183	-189	-158	-200
Transfers (net)	117	100	88	96	123
Current account balance	2	10	130	147	510
Private long-term capital	24	61	51	61	-97
Official capital	43	54	45	33	26
Short-term capital and errors and omissions	49	--	33	18	--
Overall balance	118	125	259	259	439
Gross official foreign reserves (end-year)					
Total	378	482	715	980	1,419
In number of months of imports, f.o.b.	7.9	10.1	17.6	22.5	25.9
External debt					
Debt service as percent of exports of goods and nonfactor services	7.7	7.7	5.7	4.7	3.2

1/ Actual data for 1983-86 and estimates for 1987.

Botswana: Medium-Term Projections

I. Main Assumptions by Sector

Before the results of the medium-term analysis are discussed, the main assumptions for each of the four sectors analyzed are detailed below.

a. Real sector

1. Sectoral projections for real GDP are the same as those of the midterm review of NDP6 (July 8, 1988), with the exception of the minerals sector, which is linked to the staff's projections for exports of diamonds, copper/nickel matte, and soda ash (see below).

2. Since investment and net exports are projected independently (see below), total consumption (together with imports of consumer goods) is the residual. 1/ Within the total, first government consumption is determined based on developments in the budget (see below), and then private consumption is estimated as the residual.

3. Total gross fixed capital formation, exclusive of investment associated with the Sua Pan Soda Ash Project (SPSAP), is assumed to be constrained by the shortage of skilled manpower. Government gross fixed capital formation is linked to the budget, with private gross fixed capital formation the residual. Stocks are assumed to increase in 1988/89 and the following year, reflecting a rebuilding of the cattle herd, after which stocks increase at a more moderate pace.

4. With respect to the SPSAP, it is assumed that investment associated with this project is outside the skilled manpower constraint since a large part of the necessary manpower will have to be imported. While initial projections called for implementation beginning in FY 1988/89, progress appears to be somewhat slower, and in the medium-term projections the schedule has been delayed by one year. Therefore, imports and other external flows associated with this project do not appear until 1989 and investment and government capital expenditure until 1989/90. Total value of the project is estimated at P 1,000 million, to be implemented in slightly more than two years.

5. For assumptions regarding net exports of goods and services, see external sector below.

1/ It should be stressed that this does not imply a conceptual interpretation of consumption as a residual. Rather, after the projections for the other variables have been made, the implication for consumption is checked. If this does not appear reasonable, then the assumptions on which all the other projections are based are reexamined, until a reasonable path obtains.

6. The cost of living index is assumed to move in line with developments in South Africa. With respect to the GDP deflator, it is assumed that consumption, investment, and import prices will generally rise in unison, while export prices are taken from the assumptions regarding the latter outlined below.

b. External sector

1. Exchange rate assumptions are as follows: US$/SDR - constant in nominal terms; Rand/SDR - constant in real terms; Pula/Rand - constant in nominal terms (all from mid-1988).

2. Export projections are made by commodity as follows:

(i) Diamonds - unit values (in U.S. dollars) in line with GDP deflator of industrial countries (from latest WEO projections); volume - no volume increases after 1988.

(ii) Beef - unit values (in U.S. dollars) from latest WEO projections (percent changes), volume from Botswana Meat Corporation projections (decline in 1988; 8 percent growth on average from 1989 onwards).

(iii) Copper/nickel matte - unit values based on weighted average of latest WEO projections for copper and nickel, volume - no growth.

(iv) Soda ash - exports beginning in 1991.

(v) Other - Assumed to increase by 5 percent annually in real terms reflecting deliberate diversification policies.

3. Imports are projected by category - (i) consumer/intermediate goods, and (ii) capital goods. The latter is related to gross fixed capital formation, while the former is related to consumption.

4. Within the services and incomes account, it is assumed that 22 percent of diamond receipts will be remitted abroad as dividends--somewhat higher in 1988, reflecting the 1987 stockpile sale.

5. Official transfers are projected by subcategory. The largest is Southern African Customs Union (SACU) transfers, which are estimated as accrued claims on SACU in the current year minus duties payable at the "all duty" rate. (There is also an entry in the capital account under long-term capital to government, other, equal to payments received from SACU in the current year minus amounts accrued in the current year.) Other official transfers are generally assumed to be constant in nominal pula terms, i.e., declining in real terms.

6. In the past, interest payments by BCL were imputed, with a corresponding entry in direct private investment for capitalization of interest. With the increase in copper and nickel prices, the company

has attained an operating profit and is currently able to make all interest payments. Thus, beginning in 1988, the entry for BCL under direct investment has been eliminated.

7. Long-term capital disbursements to Government are assumed to be a constant proportion of capital expenditure, with the exception of 1988, which is based on data provided by the authorities. Amortization payments are based solely on data provided by the authorities (in effect assuming a minimum five-year grace period on any external loans).

8. Long-term disbursements to parastatals are determined as follows: Total parastatal financing needs are assumed to be a constant proportion of government capital expenditure. Within this total, the share accounted for by net lending from the Government is assumed to increase by 10 percent per annum, with a corresponding decline in the share financed externally. Amortization payments are based solely on data provided by the authorities.

9. Long-term capital to other sectors is almost entirely related to the SPSAP.

c. Central Government

1. Mineral revenues are assumed to be a constant proportion of diamond export receipts from 1989/90 onward. Because of the diamond stockpile sale in FY 1987/88, 1988/89 could not be estimated in this fashion (a significant portion of revenues normally due in 1987/88 will only be received in 1988/89). Instead, the budget estimate for mineral revenues was adjusted by factors that were known to have occurred since the budget estimates were published. These factors include a 13.5 percent U.S. dollar price increase for diamonds, effective April 1988, and some further depreciation of the pula/U.S. dollar exchange rate (budget estimates assume a constant exchange rate). In addition, staff projections include a continued depreciation of the pula throughout 1988/89 (and beyond).

2. SACU receipts are linked to imports with a two-year lag.

3. Other property income is estimated as 95 percent of Bank of Botswana profits plus 10 percent of the Revaluation Account at the Bank of Botswana. Bank of Botswana profits are determined by the stock of foreign exchange reserves and the level of the interest rate (assumed to move in line with WEO projections of the Eurodollar rate). The value of the revaluation account is determined based on balance of payments developments and changes in the exchange rate.

4. Grants are assumed to be a constant proportion of non-SACU official transfers.

5. Wages and salaries are assumed to rise each year in line with the inflation rate minus 1 percentage point, a 3 percent wage drift factor, and an increase in manpower of 7 percent.

6. Other current expenditure is based on an estimated time trend and a fixed coefficient relationship between recurrent costs and capital expenditure.

7. Capital expenditure projections are based on those of the midterm review, augmented by elements of the SPSAP which were not included in the latter (mainly the railway spur) for which information is now available.

8. External financing is directly from the balance of payments (weighted average of calendar year data). Domestic financing (in the case of Botswana, a buildup of deposits with the banking system) is a residual based on all of the above.

d. Financial sector

1. Changes in net foreign assets are from the balance of payments.

2. Changes in credit to Government (net) are from the budget. The stock of credit to the rest of the economy is assumed to rise at the same rate as nonmining GDP.

3. Given that other items (net) is assumed to be zero, the change in the money supply is initially estimated as a residual. Several iterations of the model were necessary to obtain a money supply path that appeared consistent with estimated money demand.

II. The Baseline Scenario

Based on the above set of assumptions, the following baseline scenario was estimated as the most likely path for the economy to follow over the next five years. In order to highlight the vulnerability of the economy to exogenous shocks, particularly in the mining sector, an alternative scenario was estimated. This is described in Section III.

a. Real sector

Real GDP is projected to decline in 1988/89 (Table I). However, this is purely a result of the accounting convention adopted for the treatment of the diamond stockpile sale. Abstracting from that factor, real GDP is projected to increase by 5.4 percent in 1988/89. Beyond 1988/89, real GDP growth slows, relative to the historical average, for the first two years, then accelerates somewhat in 1991/92 when soda ash production begins. Gross national savings, which rose sharply to a peak of over 50 percent of GNP in the year of the stockpile sale, declines to a more normal historical level of 36-38 percent in the following years.

Gross domestic investment increases in 1988/89, reflecting an acceleration of public investment, which rises by 6 percentage points of GNP in 1988/89 (1 percentage point relative to GNP adjusted for the stockpile sale). After this the constraint on skilled manpower begins to bind, and real gross fixed capital formation, exclusive of Sua Pan, rises only at the rate of growth of the skilled labor force (approximately 6 percent per annum). Gross domestic investment reaches a peak of 41 percent of GNP in 1990/91, when the soda ash project is almost completed, then begins to decline as a share of GNP. The resource balance deteriorates substantially over the medium term, from an average of 12 percent of GNP during 1985/86-1986/87 to minus 3 percent of GNP in 1990/91.

b. External sector

The deterioration of the resource balance reflects increased capital imports associated with rising investment and increased consumer imports associated with higher incomes, along with a slowdown in the rate of growth of exports to less than 0.5 percent per annum in real terms during the medium term (Table II). In addition, no further beneficial terms of trade effect is projected for the medium term. The trade balance surplus declines to a low of 0.4 percent of GDP in 1991, but then begins to recover as imports associated with the SPSAP taper off (capital goods imports are projected to decline by 9 percent that year). The current account declines even more steeply, turning negative in 1991. Contributing to this is a decline, relative to GDP, of net transfers and net inflows from services and incomes.

Reflecting the assumptions outlined above, net long-term capital inflows reach a peak of SDR 138 million in 1990 (about three fourths of which is inflows associated with the SPSAP). The overall balance is projected to remain in surplus throughout the five-year period. Net official reserves, in terms of months of import cover, are projected to decline from a peak level of 26 months in 1988 to about two years' cover in 1992.

c. Central Government

Total government revenues are likely to hover around 50 to 53 percent through 1991/92 (Table III). Mineral revenue is projected to decline from a peak of 35 percent of GDP in 1988/89 to 25 percent of GDP by 1991/92, with most of the decline in 1989/90, reflecting the impact of the diamond stockpile sale on revenues in 1988/89. Customs revenues, which are received with a two-year lag, are likely to increase as a share of GDP during this period, as a result of the increased imports cited above. Property income will also continue to rise as a share of GDP, albeit somewhat more slowly than customs revenue, as increasing foreign exchange reserves and a projected depreciation of the pula raise transfers from the Bank of Botswana. As a share of total revenues, these three major sources will decline only marginally from 1989/90 onward. Grants are projected to decline in real terms, in line with a projected decline of non-SACU official transfers.

With respect to expenditure items, current expenditure is projected to increase gradually from 21 percent of GDP in 1988/89 to 26 percent of GDP in 1991/92, reflecting the assumptions listed above regarding wages and salaries and other current expenditure. Capital expenditure as a share of GDP remains fairly high at around 20-22 percent, reflecting the implementation of several large capital projects including serviced land and the SPSAP. The increase in net lending in the budget projections reflects the stated intention of the Government to encourage parastatals to shift from foreign to domestic sources of finance, including the Public Debt Service Fund.

Overall, the faster growth of total expenditure and net lending relative to total revenues and grants results in a steadily declining surplus, which, by 1991/92, is projected to fall to 4 percent of GDP (in comparison with 21 percent in 1985/86 and 1986/87). Own savings, however, remain fairly stable toward the end of the period, reflecting an assumption that the authorities will continue to be able to contain the growth of current expenditures.

d. Financial sector

The financial projections indicate a path for money supply growth over the next few years consistent with what one might expect given the large increase in Debswana's deposits after the stockpile sale. The financial projections indicate that the money supply will decline in nominal terms during 1988/89, as Debswana reduces its deposits (Table IV). Real money demand in the rest of the economy is expected to continue to rise in line with real growth in nonmining GDP and changes in expected inflation. Money growth then turns positive in 1989/90, albeit at a slow rate, as the adjustment period to the excess money supply extends beyond one year. The rate of growth of money continues to accelerate throughout the remainder of the period.

III. An Alternative Scenario

In order to highlight the vulnerability of the Botswana economy to exogenous shocks, an alternative scenario is presented. In this scenario diamond exports (and production) are assumed to be curtailed by 40 percent in volume terms beginning in 1989, and then to remain at the reduced output level for the remainder of the period. This is a conceivable scenario in that sales by the Central Selling Organization (the marketing arm of De Beers) fell by 46 percent in one year (1981) when the diamond market was in a deep depression and output had to be sharply reduced.

The analysis indicates that, in the event of a negative shock to the diamond market, the authorities' present plans for capital expenditure could not be fully implemented. However, for purposes of illustration, the numerical analysis is presented to show what would happen to foreign exchange reserves and government deposits if no adjustment were carried out. This clearly indicates the unsustainability of the scenario and that, in fact, adjustment would be absolutely necessary. Table V shows several key variables. All assumptions of the baseline scenario remain unchanged with the exception of diamond export and production volumes, and the lowering of nonmining GDP somewhat in response to lower incomes. Real GDP growth would be negative in 1990/91, reflecting the reduced output of the mining sector. Gross national savings would be at less than half their level in the base case and the resource balance would become negative two years earlier and be in deficit by as much as 28 percent of GDP by 1991/92.

The current account of the balance of payments would also deteriorate rapidly, turning to a deficit of 11 percent of GDP in 1989 and continuing to worsen for a further two years, to as much as 23 percent of GDP. Imports would decline somewhat relative to the base case reflecting the impact of lower GDP on consumption, but exports, of course, would decline much more, with a substantial negative impact on the current account. (Imports of capital goods remain unchanged relative to the base since it has been assumed that investment is not altered.) Net official reserves would decline steadily from their peak of 26 months of imports at end-1987 to less than 11 months of import cover by 1992.

The overall budgetary position is severely affected by the above developments. Lower diamond exports and lower foreign exchange reserves imply much lower mineral revenues and property income from the Bank of Botswana. With unadjusted expenditure, the overall budget rapidly shifts into deficit by 1989/90 and the deficit increases thereafter to as much as 12 percent of GDP by 1991/92.

Table I. Botswana: Medium-Term Projections
Baseline Scenario—Real Sector Projections, 1987/88-1991/92 (July-June)

	1987/88 Est.	1988/89	1989/90	1990/91	1991/92
			(In millions of pula)		
Gross national product	3,899.0	3,702.7	4,295.1	4,990.2	5,951.2
Net factor income from abroad	-405.7	-308.7	-277.5	-292.4	-309.6
Gross domestic product	4,304.7	4,011.4	4,572.5	5,282.6	6,260.8
Consumption	2,224.2	2,645.6	3,075.5	3,590.8	4,360.4
Government consumption	(805.3)	(992.0)	(1,230.7)	(1,548.5)	(1,909.8)
Private consumption	(1,418.9)	(1,653.6)	(1,844.8)	(2,042.3)	(2,450.6)
Investment	871.7	1,196.7	1,588.5	2,037.8	2,346.3
Gross fixed capital formation	890.4	1,162.3	1,555.2	2,032.8	2,340.7
Government	(587.6)	(779.6)	(874.7)	(1,119.4)	(1,293.5)
Private	(302.9)	(382.7)	(680.4)	(913.4)	(1,047.2)
Change in stocks	-18.8	34.5	33.3	5.0	5.6
Net exports of goods	1,208.8	169.0	-91.5	-346.0	-445.9
Exports of goods	(3,067.5)	(2,582.7)	(2,851.8)	(3,292.5)	(3,839.1)
Imports, f.o.b.	(-1,426.0)	(-1,896.7)	(-2,380.0)	(-2,924.7)	(-3,520.8)
Nonfactor services (net)	(-432.7)	(-517.0)	(-563.2)	-713.9	-764.2
Memorandum items:			(In percent of GNP, unless otherwise indicated)		
Gross national savings 1/	50.7	38.3	38.1	37.5	35.6
Private savings	19.8	—	6.3	5.4	5.5
Public savings 2/	30.8	38.3	31.7	32.1	30.1
Gross domestic investment	22.4	32.3	37.0	40.8	39.4
Private investment 3/	7.3	11.3	16.6	18.4	17.7
Public investment	15.1	21.1	20.4	22.4	21.7
Resource balance (= -foreign savings)	28.3	6.0	1.1	-3.3	-3.9
Real GDP growth	40.6	-18.9	2.7	2.2	4.9
Real nonmining GDP growth	9.0	6.8	4.7	3.3	4.8
GDP deflator (percent change)	11.4	14.9	11.0	13.1	13.0
Cost of living (percent change)	8.0	11.0	12.0	13.0	14.0

Source: Staff estimates.

1/ Including unrequited transfers.
2/ Including grants.
3/ Assumes all stocks are held privately.

Table II. Botswana: Medium-Term Projections
Baseline Scenario—External Sector Projections, 1987-1992

	1987 Est.	1988	1989	1990	1991	1992
			(In millions of SDRs)			
Current account	509.5	199.9	92.3	27.3	-0.7	45.1
Exports, f.o.b.	1,243.7	1,007.3	968.8	1,007.0	1,069.6	1,140.8
Of which: diamonds	(1,060.8)	(740.2)	(764.6)	(789.1)	(814.3)	(840.4)
Imports, f.o.b.	-656.8	-763.7	-865.7	-968.8	-1,062.2	-1,088.5
Nonfactor services (net)	-39.6	-38.1	-54.0	-62.5	-69.9	-69.6
Investment income (net)	-160.7	-140.5	-97.7	-94.9	-90.0	-88.6
Interest (net)	(12.0)	(38.6)	(59.8)	(70.2)	(82.6)	(91.4)
Other (net)	(-172.7)	(-179.1)	(-157.5)	(-165.0)	(-172.6)	(-180.0)
Transfers (net)	123.0	134.9	140.8	146.6	151.8	151.1
Official	124.4	136.2	142.0	147.9	153.0	152.2
Of which: South African Customs Union	(53.9)	(72.0)	(82.7)	(92.5)	(101.5)	(104.0)
Private	-1.4	-1.3	-1.2	-1.3	-1.2	-1.2
Long-term capital (net)	-70.9	-15.6	46.4	137.8	123.4	38.9
Direct private investment (net)	-96.8	6.0	31.6	44.6	36.3	10.7
Long-term capital to Government (net) 1/	12.4	-36.3	-29.1	27.0	38.7	28.4
Long-term capital to parastatals (net)	14.3	15.2	11.4	9.4	5.5	-0.1
Other (net)	-0.9	-0.5	32.5	56.8	42.9	—
Short-term capital (net)	8.5	14.0	—	—	—	—
Errors and omissions	-8.3	—	—	—	—	—
Overall surplus/deficit	438.8	198.4	138.7	165.1	122.8	84.1
		(In percent of GDP, unless otherwise indicated)				
Memorandum items:						
Current account	27.3	13.5	5.9	1.7	—	2.4
Trade balance	31.5	16.5	6.6	2.3	0.4	2.8
Imports	35.5	51.7	55.5	59.4	61.0	58.2
Net official reserves (SDR million)	1,418.9	1,617.2	1,756.0	1,921.1	2,043.8	2,127.9
Net official reserves (months of imports)	25.9	25.4	24.3	23.8	23.1	23.5
Import volume (percent change)	7.8	16.0	10.1	8.7	6.5	-0.4
Consumer/intermediate goods	6.8	19.8	7.1	3.1	5.6	6.9
Capital goods	9.1	10.8	14.4	16.5	7.7	-9.1
Export volume (percent change)	67.4	-26.5	0.3	0.4	0.5	0.5
Debt service ratio 2/	3.3	2.7	4.1	4.0	3.8	3.6
Conversion factor (SDR/pula)	0.4606	0.4026	0.3637	0.3313	0.3017	0.2760

Source: Staff estimates.

1/ Includes entry for imputed payments into, less receipts from, the customs union.
2/ In percent of exports of goods and nonfactor services.

Table III. Botswana: Medium-Term Projections
Baseline Scenario—Central Government Projections, 1987/88-1991/92 (April-March)

	1987/88 Est.	1988/89	1989/90	1990/91	1991/92
			(In millions of pula)		
Revenue and grants	1,776.9	2,263.0	2,299.4	2,816.2	3,293.5
Total revenue	1,693.5	2,176.5	2,210.8	2,725.5	3,200.7
Customs revenue	(234.1)	(291.3)	(397.4)	(607.4)	(734.7)
Mineral revenue	(1,034.5)	(1,343.0)	(1,155.7)	(1,309.6)	(1,482.1)
Property income	(202.2)	(256.3)	(325.6)	(420.6)	(527.3)
Other	(222.7)	(285.1)	(332.1)	(388.0)	(456.7)
Grants	83.4	86.5	88.6	90.7	92.8
Total expenditure and net lending	1,237.3	1,656.7	1,911.3	2,450.6	3,055.4
Current expenditure	658.6	806.9	1,000.7	1,260.0	1,554.2
Wages and salaries	(264.3)	(333.8)	(403.2)	(491.4)	(604.3
Interest	(38.3)	(42.8)	(52.7)	(67.2)	(83.2)
Other	(356.0)	(430.3)	(544.8)	(701.4)	(866.8)
Capital expenditure	527.5	767.8	814.8	1,054.4	1,314.4
Net lending	51.2	82.0	95.7	136.2	186.8
Overall surplus	539.6	606.3	388.1	365.6	238.1
Financing	-539.6	-606.3	-388.1	-365.6	-238.1
Foreign (net)	70.2	68.1	73.7	109.7	123.5
Domestic (net)	-609.8	-674.4	-461.8	-475.3	-361.5
			(In percent of GDP)		
Memorandum items:					
Overall surplus	13.0	15.8	8.8	7.2	4.0
Revenue and grants	42.7	58.9	51.9	55.2	54.7
Revenue	40.7	56.7	49.9	53.4	53.2
Mineral revenue	24.9	35.0	26.1	25.7	24.6
Customs revenue	5.6	7.6	9.0	11.9	12.2
Property income	4.9	6.7	7.3	8.2	8.8
Other revenue	5.4	7.4	7.5	7.6	7.6
Expenditure and net lending	29.7	43.1	43.1	48.0	50.8
Current expenditure	15.8	21.0	22.6	24.7	25.8
Capital expenditure	12.7	20.0	18.4	20.7	21.8
Net lending	1.2	2.1	2.2	2.7	3.1
Own savings	24.9	35.7	27.3	28.7	27.4

Source: Staff estimates.

Table IV. Botswana: Medium-Term Projections
Baseline Scenario--Financial Sector Projections, 1987/88-1991/92 (April-March)

	1987/88 Est.	1988/89	1989/90	1990/91	1991/92
	(In millions of pula)				
Changes in:					
Net foreign assets of banking system	1,112.6	464.9	410.7	475.5	381.4
Net official assets	1,102.5	464.9	410.7	475.5	381.4
Commercial bank assets (net)	10.1	--	--	--	--
Domestic credit	-519.8	-617.6	-383.4	-385.3	-271.9
Government (net)	-557.4	-674.4	-461.8	-475.3	-361.5
Rest of economy	37.6	56.9	78.4	90.0	89.6
Money and quasi-money	367.7	-152.7	27.3	90.2	109.4
Other items (net)	225.0	--	--	--	--
Memorandum items:	(In percent of M3 at beginning of period)				
Changes in:					
Money and quasi-money	55.8	-14.9	3.1	10.0	11.0
Net foreign assets	168.7	45.3	47.0	52.7	38.4
Domestic credit	-78.8	-60.1	-43.0	-42.7	-27.4
Government	-84.5	-65.7	-52.8	-52.7	-36.4
Private	5.7	5.5	9.0	10.0	9.0
Other items (net)	-34.1	--	--	--	--

Source: Staff estimates.

Note: Figures in this table are exclusive of valuation adjustments.

Table V. Botswana: Medium-Term Projections, 1987/88-1991/92
Alternative Scenario

	1987/88	1988/89	1989/90	1990/91	1991/92
	(In percent of GDP, unless otherwise indicated)				
Real sector					
Gross national savings/GNP	50.7	35.9	24.8	23.0	21.6
Gross domestic investment/GNP	22.4	36.5	45.0	50.3	49.5
Resource balance/GNP	28.3	-0.6	-20.2	-27.3	-27.9
Real GDP growth	40.6	-29.3	-6.2	2.6	4.9
Real nonmining GDP growth	9.0	-1.9	5.7	3.3	4.8
External sector 1/					
Current account	14.5	-11.3	-20.0	-22.6	-19.7
Export volume (percent change)	-26.5	-33.0	0.6	0.7	0.8
Net official reserves 1/ (in months of imports)	25.4	21.5	17.3	13.7	10.7
Central Government					
Budget surplus/deficit (-)	13.8	17.0	-3.2	-6.3	-11.3
Mineral revenues	24.9	38.9	19.2	19.3	18.5

Source: Staff estimates.

1/ Calendar year beginning in January of indicated fiscal or national account year, i.e., 1987/88 corresponds to 1988.

Botswana: Interlinkages with South Africa

Botswana's economy remains very much intertwined with that of South Africa. Geographically, the southeastern flank borders on South Africa, while the entire western portion of the country borders on Namibia. The closest ports to Gaborone, the capital of Botswana, are Maputo and Walvis Bay. However, on account of recent disturbances in Mozambique and Namibia, these two ports are not viable alternatives to Capetown.

Transportation is a vital aspect of the interlinkages between the two countries. Botswana would experience severe economic difficulties if the South African border were closed for an extended period of time. Over three fourths of merchandise imports are either directly from, or pass through, South Africa. While this proportion exhibited a declining trend from 1983 to 1985, in recent years it has been rising, reaching 78.9 percent in 1987, the highest proportion since 1983. A much smaller proportion of exports passes through the customs union, and this proportion has declined consistently since 1984, falling from 9.2 percent that year to 3.8 percent in 1987 (Table I).

Botswana's major export commodity is diamonds, accounting for over three fourths of total exports. In July 1987, Debswana (the diamond mining company owned jointly by the Botswana Government and De Beers of South Africa), sold its entire diamond stockpile to De Beers in return for an unspecified cash payment as well as 20 million shares and two seats on the Board of De Beers--further increasing the ties between the two countries.

A further indication of the trade links with South Africa is the number of tourists and businessmen arriving annually. As a proportion of the total number of international arrivals, the share of South African visitors has been about 28 percent for the last three years.

The number of Batswana workers in South African mines was increasing through 1986, but then declined by about 900 (out of 21,000) in 1987. In relation to total paid employment in Botswana, the number of miners has fallen from 18.6 percent in 1983 to 14.2 percent in 1987, and the value of their remittances has declined from 0.9 percent of exports of goods and nonfactor services (0.7 percent of GDP) to 0.2 percent of exports of goods and nonfactor services (0.1 percent of GDP) over the same period.

Customs union receipts continue to be an important source of government revenue, although as a share of total revenues they fell by almost two thirds, from 31 percent in 1983/84 to 13 percent in 1986/87 (still the third largest single source of revenue). This proportion is estimated to have risen to 14 percent in 1987/88.

There are also financial interlinkages between South Africa and Botswana. Since 1984, deposit rates on 31-day accounts in Botswana have moved much closer to those in South Africa--the differential has narrowed from 1,070 basis points in 1984 to only 40 basis points in 1987. Similarly, the differential between prime lending rates has narrowed from 1,350 basis points to 250 basis points over the same period. The exchange rate of the pula is also closely linked to that of the rand and, thus, given the large share of imports from South Africa, the rates of inflation in the two countries, at least over the longer term, tend to move closely together.

In conclusion, the quantitative indicators presented in Table I and other, more qualitative factors, such as the joint ownership of business enterprises and the transportation difficulties outlined above, reinforce the impression that although the degree of interlinkage between Botswana and South Africa may not be increasing, it remains high.

Table I. Botswana: Interlinkages with South Africa, 1983-87

(In percent, unless otherwise indicated)

	1983	1984	1985	1986	1987
Change in exchange rate (rand/pula, December to December)	3.4	20.6	-3.6	-2.5	2.5
Price indices (December to December)					
Cost of living index in Botswana	8.3	6.5	10.4	10.8	8.1
Consumer price index in South Africa	10.9	13.3	18.5	18.0	14.7
Wholesale price index in South Africa	7.9	11.4	21.5	16.4	11.3
Interest rates					
Deposit rates 1/					
Botswana	10.5	8.5	8.5	7.3	7.3
South Africa	13.9	19.2	13.4	8.8	7.7
Lending rates 2/					
Botswana	13.0	11.5	11.5	10.0	10.0
South Africa	20.0	25.0	16.5	13.5	12.5
Direction of trade					
Share of merchandise exports that passes through customs union 3/	8.4	9.2	5.6	5.3	3.8
Share of merchandise imports that passes through customs union 3/	83.1	78.1	74.3	77.7	78.9
South African visitors 4/ 5/ (percent of total)	25.6	29.4	28.5	28.2	28.1
Employment in South African mines 4/					
Total number	18,691	18,916	20,128	20,994	20,112
Percent of paid employees	18.6	17.2	17.2	16.1	14.2
Remittances (in thousands of rands)	7,660	6,863	6,515	6,108	5,572
Percent of exports (goods and nonfactor services)	0.9	0.6	0.4	0.3	0.2
Percent of GDP	0.7	0.4	0.3	0.2	0.1
Receipts from SACU (percent of government revenue) 6/	30.5	20.4	13.7	13.0	13.8

Sources: IMF, International Financial Statistics; various government publications (see below); and staff estimates.

1/ Bank of Botswana, Bulletin. 31-day time deposit rates, end of period.
2/ Bank of Botswana, Bulletin. Prime lending rates, end of period.
3/ Southern African Customs Union. Includes Botswana, Lesotho, Swaziland, and South Africa.
4/ Botswana Central Statistics Office, Statistical Bulletin.
5/ Includes visitors from Namibia.
6/ Botswana, Financial Statements, Tables and Estimates of Consolidated and Development Fund Revenues. Fiscal year beginning April 1 of calendar year shown.

Botswana--Statistical Issues

1. Outstanding statistical issues

a. Real sector

None.

b. Government finance

The presentation for Botswana in the 1987 GFS Yearbook includes data in the derivation and statistical tables for the budgetary central government through FY 1985. Data for FY 1986 for budgetary central government were received recently and will be published in the 1988 GFS Yearbook.

Data for extrabudgetary units and for local governments have never been received. However, the correspondent has indicated that efforts are being made to standardize the reporting of the annual accounts by different local authorities; they expect the work on a preliminary questionnaire on local government accounts to start later this year. Annual data in IFS correspond to data published in 1987 GFS Yearbook.

c. Monetary accounts

The basic data necessary for the compilation of a banking survey are available, and the Bureau will shortly propose to the authorities the procedures for reporting such data.

d. Interest rates

The coverage of IFS data will shortly be expanded to include an interbank deposit rate and a long-term rate on mortgage loans by the Botswana Building Society.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Botswana in the October 1988 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Bank of Botswana, which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in October 1988 IFS
Real Sector	- National Accounts	1986 1/
	- Prices	July 1988
	- Production	Q4 1986
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	February 1988
	- Financing	February 1988
	- Debt	1986 (provisional)
Monetary Accounts	- Monetary Authorities	May 1988
	- Deposit Money Banks	May 1988
	- Other Financial Institutions	n.a.
Interest Rates	- Discount Rate	March 1988
	- Bank Lending/ Deposit Rate	March 1988
	- Money Market Rate	n.a.
	- Government Bond Yield	n.a.
External Sector	- Merchandise Trade:	
	Values	December 1987
	Prices	n.a.
	- Balance of Payments	1987
	- International Reserves	July 1988
	- Exchange Rates	August 1988

3. Technical assistance missions in statistics (1985-present)

Subject	Staff Member	Date
General Economic Data	C.A. Patel	November 1985
Money and Banking	S. Quin	February 1985

1/ National Accounts reported through 1986; the GDP series (line 99B) is published thorough 1987.

Botswana - Relations with the Fund
(As of September 30, 1988)

I. Membership status

(a) Date of membership: July 24, 1968
(b) Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 22.1 million

	Amount (In millions of SDRs)	Percent of quota
(b) Total Fund holdings of Botswana pula	8.0	36.2
(c) Use of Fund credit	--	--
(d) Reserve position in the Fund	14.1	63.9

III. Current stand-by or extended arrangement and special facilities

Botswana has not made use of Fund resources to date.

IV. SDR Department	Amount (In millions of SDRs)	Percent of quota
(a) Net cumulative allocation	4.4	100.0
(b) Holdings	16.4	376.0
V. Trust Fund loans outstanding	--	--
VI. Overdue obligations to the Fund	--	--

B. Nonfinancial Relations

VII. Exchange rate arrangement

The exchange rate of the Botswana pula is determined on the basis of a basket consisting of the SDR and the South African rand. The intervention currency is the U.S. dollar. The representative rate on September 30, 1988 was P 1 = US$0.5008.

Botswana - Relations with the Fund (concluded)
(As of September 30, 1988)

VIII. Last Article IV consultation and consultation cycle

The 1987 Article IV consultation discussions took place in Gaborone during January 29-February 13, 1987. The Executive Board discussed the reports (SM/86/65 and SM/86/79) on May 6, 1987. The following decision was taken:

1. The Fund takes this decision in concluding the 1987 Article XIV consultation with Botswana, and in the light of the 1987 Article IV consultation with Botswana conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Botswana continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions except for relatively liberal limits which apply to private and business travel and remittances abroad that are maintained in accordance with Article XIV, Section 2. The Fund encourages Botswana to remove these remaining restrictions as soon as possible.

Botswana is on the standard 12-month cycle for Article IV consultation.

IX. Technical assistance

There are three experts recruited by the Central Banking Department, who are currently serving at the Bank of Botswana as (i) Director of Bank Supervision, (ii) Advisor for Foreign Exchange and Exchange Control Operations, and (iii) Advisor for Foreign Exchange Portfolio. In March 1985, Botswana received a joint CBD-LEG mission that reviewed and redrafted both the Central Bank Act and the Financial Institutions Act. An advisory mission from the Central Banking Department visited Gaborone during May 5-18, 1985 to examine, and to suggest measures that might be taken to manage, the excess liquidity in the banking system. The mission also analyzed the adequacy and effectiveness of monetary policy instruments available to the Bank of Botswana and suggested ways to increase the effectiveness of these instruments in regulating excess liquidity. A mission from the Fiscal Affairs Department visited Gaborone for three and a half weeks beginning September 3, 1985, to provide technical assistance to help the authorities identify areas in which the revenue base could be expanded.

BOTSWANA - Financial Relations with the World Bank Group

(As of July 31, 1988)

	(Millions of U.S. dollars)		
	Disbursed	Undisbursed	Total
Fully disbursed loans and credits	174.0	--	174.0 1/
Effective loans	15.5	52.1	67.6
Education	10.6	15.4	26.0
Development finance	2.5	9.8	12.3
Health and population	1.4	9.6	11.0
Land management/livestock	1.1	9.6	10.7
Technical assistance	--	7.6	7.6
Total	189.5	52.1	241.6
Repayments and adjustment for exchange rate changes	17.5		
Total borrower's obligation	172.1		

Source: The World Bank.

1/ Less cancellations.

Botswana - Social and Demographic Indicators

Area

581,370 sq. km.

Population (1986 estimates)

1.132 million
Rate of growth: 3.4 percent per annum

Density (1986 estimate)

2.5 persons per sq. km. of agricultural land

GDP per capita (1986)

SDR 997

Population characteristics

Life expectancy at birth: 57 years (1983)
Infant mortality: 71 per thousand (1985)
Child death rate: 11 per thousand (1986)

Health

Population per physician: 7,400 (1981)
Population per nursing person: ...

Income distribution (1975)

Percentage of private income received by:
- highest 10 percent of economically active population: 42
- lowest 20 percent of economically active population: 2

Access to safe water

Percentage of population:
urban: 98 (1984)
rural: ...

Access to electricity

Percentage of households:
total: 27 (1984)
rural: ...

Nutrition (1985)

Daily calorie supply per capita: 2,159 kcal
Daily protein intake per capita: 67 grams

Education

Primary school enrollment: 99 percent (1983)
Adult literacy rate: ...

Labor force

Total: 368,000 (1984)
Female percentage: 36 (1985)

Sources: Republic of Botswana, National Development Plan, 1985-91; and World Bank, Social Indicators of Development, 1987.