LESSONS FROM BOTSWANA'S EXPERIENCE IN TRANSFORMING RESOURCE WEALTH INTO SUSTAINABLE DEVELOPMENT

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Botswana's economic record

- A well-known "success story"
  - Rapid economic growth
  - Transformation from low-income to upper-middle-income economy over 30 years
  - 2nd highest GDP per capita in mainland SSA
- Driven by mining, specifically diamonds
  - Largest diamond producer in the world
  - Very large, low cost deposits
  - Hence very profitable and high "rents"

An economy driven by mining

Macroeconomic Indicator	Value (average 2003-2012)
% of GDP	25%
% of merch. export revenues	86%
% of government revenues	41%

- Mining is the largest contributor to GDP, exports & govt revenues
- Botswana has generally – in the view of many – avoided the "resource curse"

Key Aspects of Natural Resource Management

- Public finance
  - Revenue mobilisation
  - Expenditure
  - Asset accumulation
- Macroeconomic policy – avoiding Dutch Disease

Public Finance

Principles of engagement

- Key principles:
  - Mineral production not nationalised (instead, use JVs)
  - Taxation of minerals should appropriate rents while leaving investor with commercial return
  - Invest mineral revenues (from sale of an asset) in accumulation of other assets – economic, human, social, financial
  - Develop downstream processing, but only when economically viable
- How implemented
  - Negotiate hard with mining companies
  - Use "leverage points" e.g. when agreements come up for renewal
  - Pay for high level technical expertise where necessary (legal, technical) to boost negotiating position
- Main diamond mining co (Debswana) is 50-50 JV between govt and De Beers
  - Revenues are earned from tax, royalties & dividends

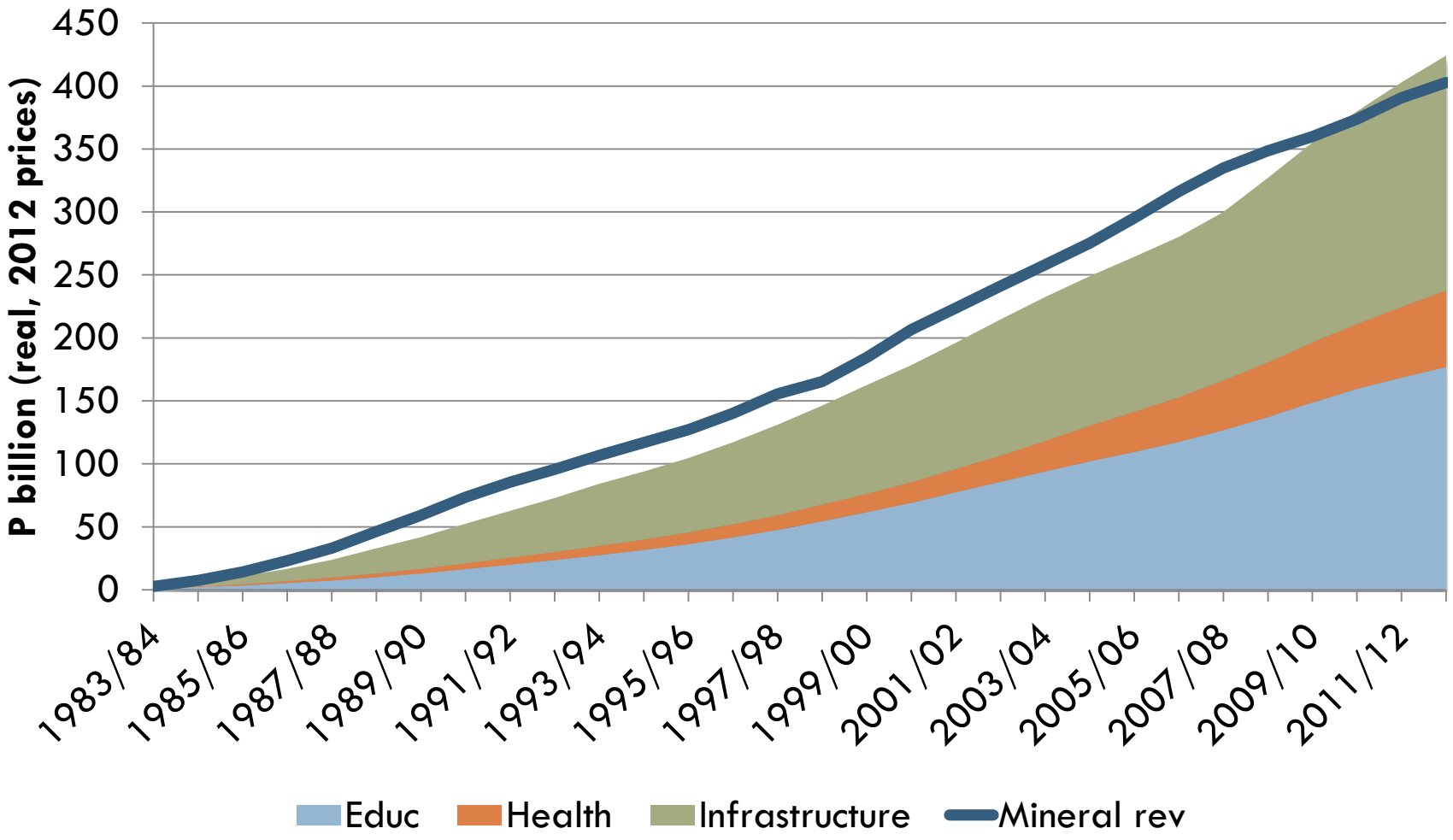
Sources of Mineral Revenue

- Profits tax:
  - Variable rate income tax
  - Formula laid down in Income Tax Act
  - Non-negotiable
  - Rate of tax (in range 22% - 55%) increases with profitability of mine
- Royalties
  - Laid down in Mines & Minerals Act
  - Non-negotiable
  - Prescribed rates
    - Coal & base metals (3%)
    - Gold (5%)
    - Diamonds (10%)
- Other taxes
  - Mainly withholding tax on dividends
- Dividends (if shares held)
  - Under M&MA, GRB can acquire up to 15% of shares in any mining project
  - A one-off option, exercisable at time of granting mining licence
  - Paid for on a pro-rata basis (i.e. not free carry)
  - Entitlement to:
    - Dividends
    - 2 board seats
    - Share of future capex liability

Mineral Revenues & Public Spending

- Over 30 years to 2012, total GRB mineral revenues were approx. US$55bn (at 2012 prices)
  - Equivalent to 20% of real GDP
  - Equivalent to 62% of mining value added
  - Estimated at more than 90% of mineral rents
- Spending split between
  - Physical capital (infrastructure)
  - Human capital (education, skills, health)
  - Financial assets
- Mineral revenues <u>not</u> used to finance recurrent spending (except health and education)

Accumulated mineral revenues and public investment



Mineral Revenues and Public Investment Spending, 1983/4 – 2012/13 (Real, 2012 prices)

Category	P billion
Mineral revenues	403
Total public investment spending (physical and human capital)	424
o/w Education spending	177
Health spending	61
Other development (investment) spending	187
Recurrent budget surplus (excluding health & education)	75
Memo: Govt net financial assets (December 2012)	*20*

Policy Framework: Rules Combined with Flexibility

- Statutory
  - National development plans (NDPs) - 6 years, with mid-term review
  - Annual budgets
  - Finance & Audit Act (limits off-budget spending)
  - Statutory limits on public debt
  - Parliamentary approval needed for all spending projects and government borrowing
- Non-statutory principles/rules
  - Mineral revenues must be invested or saved ("Sustainable Budget Index")

Flexibility can be useful – but also has weaknesses

- Requires very good processes for selecting, implementing and managing public sector investment projects
  - Difficult to maintain when there is a soft (i.e. non-statutory) budget constraint
  - Dependent upon competent and honest executive
  - Otherwise vulnerable to abuse and/or inefficiencies
- No clear rules / allocation framework for allocation of investment spend across major categories (human vs physical vs financial assets)
- No clear policy on saving through financial assets – only accumulated as residuals (excess revenues after all spending needs met)

Management and Accumulation of Financial Assets

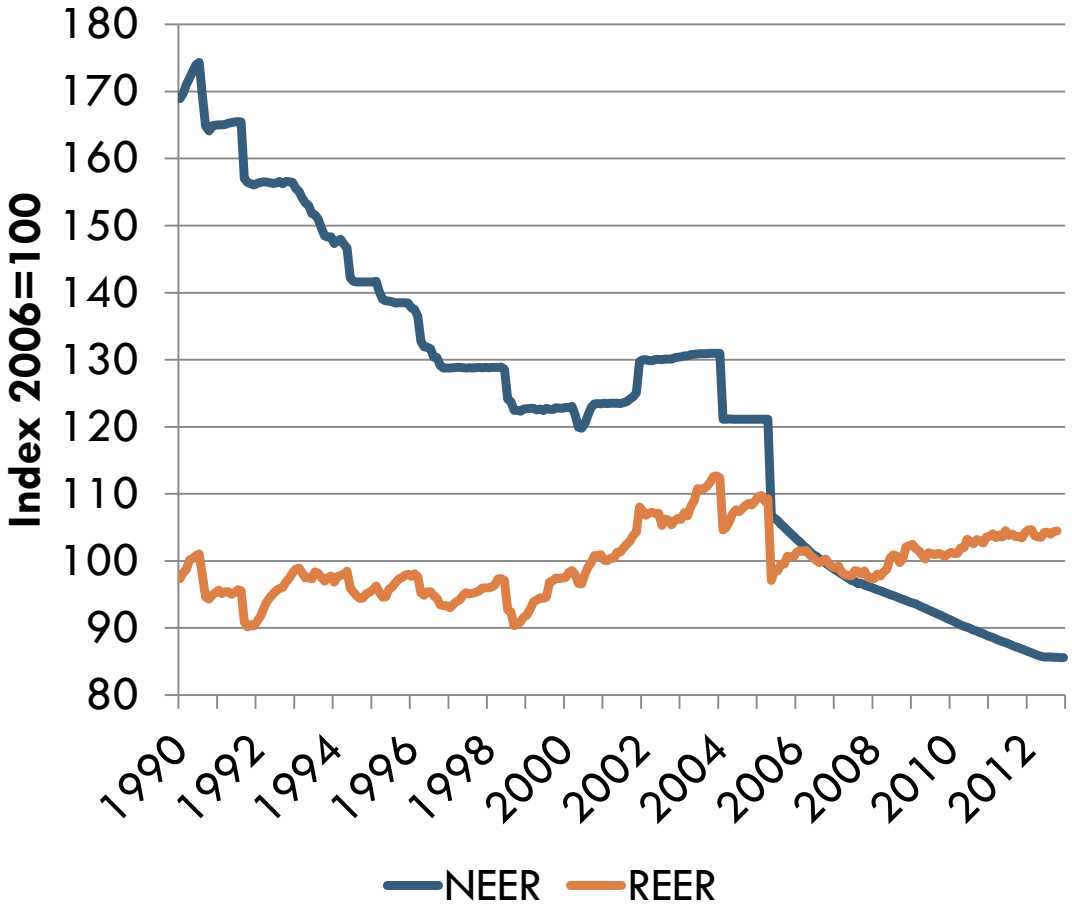
- Management
  - GRB financial assets held on central bank balance sheet
  - Held with long-term portion of FX reserves (Pula Fund)
  - Invested offshore and managed for long-term returns (equity/bonds)
  - Mixture of in-house and contracted managers
- Accumulation
  - Financial assets accumulation relatively small – only around 5% of mineral revenues saved
  - No explicit provision for financial saving from mineral revenues – accumulated from residuals not formal allocations
  - No rules for payments into and drawdowns from GRB mineral funds – hence can be depleted quickly
  - Lack of clarity over whether funds are accumulated for budget stabilisation, to provide income, or as a "fund for future generations"

Dutch Disease?

Macroeconomic Policy

- Fiscal policy:
  - Run budget surpluses
  - Keep spending growth within absorptive capacity of the economy (to avoid driving up non-tradeables prices)
- Exchange rate policy
  - Managed peg (to a basket)
  - Keep currency undervalued (relative to BoP eqn)
  - Accumulate offshore assets

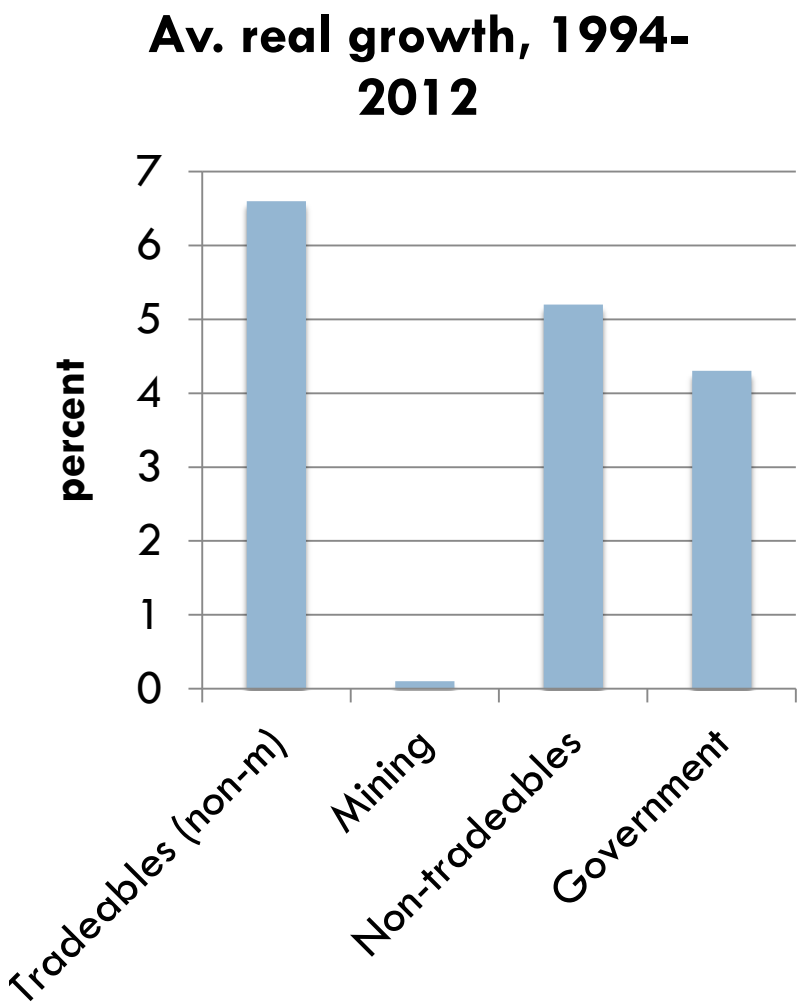
Nominal and real effective exchange rates, 1990-2012



- Steady depreciation of NEER
- Moderately stable REER
- Complex job managing inflation, liquidity & interest rates in a pegged exchange rate environment

Has Dutch Disease been avoided?

- Yes, in terms of REER stability
- Non-mining tradeables sector (agric., mfg., tourism etc.) has had buoyant growth
- But economy very reliant on non-tradeables & government
- Concern about uncompetitive labour costs – driven by mining/government sectors
- High unemployment and insufficient job creation
- Regional and international competitiveness of non-mining tradeables still an issue



Conclusion

- Botswana has been successful in managing many of the challenges of mineral-led growth:
  - Dealing with mining companies
  - Tax policy
  - Spending and investment
  - Balanced macroeconomic policy
- Many lessons for others to follow, although some aspects of policy framework need modernisation
- Key challenge now of moving to post-mineral era – requiring fundamental – and hence difficult - policy changes